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Berkeley Program in Soviet and Post-Soviet Studies
Center for Slavic and East European Studies

**The Geopolitics of Oil, Gas, and Ecology
in the Caucasus and Caspian Basin**

May 16, 1998

Conference Report



Berkeley Program in Soviet and Post-Soviet Studies
Working Paper Series

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Center for Slavic and East European Studies

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in the Caucasus and Caspian Basin**

May 16, 1998

Conference Report

Editors:

Marc Garcelon, Edward W. Walker, Alexandra Wood, Aleksandra (Sasha) Radovich

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Editors' Note: The talks presented in this conference report were compiled on the basis of oral presentations. In transcribing the talks into written form, we have sought to preserve the content of the speakers' presentations. Readers may thus note a distinct "oral style" in the essays.

*The Geopolitics of Oil, Gas, and Ecology
in the Caucasus and Caspian Basin*

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CONFERENCE PANELISTS

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David Hooson has been Professor of Geography at the University of California, Berkeley since 1966. He has served as Chairman of both the Geography Department and the Center for Slavic and East European Studies as well as the Dean of Social Sciences. Originally from Britain, he has degrees from Oxford and the London School of Economics. His publications have mostly been on the former Soviet Union and Europe as well as on the history of geographical ideas. His most recent book is *Geography and National Identity* (1994).

Robert E. Ebel is Director of Energy and National Security at the Center for Strategic and International Studies (CSIS). He works with research in progress, initiates new research, represents the Center with the media, and participates in briefings given to donors. He was project director for the recently released reports on the *U.S.-China*

Commercial Nuclear Commerce and *The Safe, Timely, and Effective Disposal of U.S. and Russian Weapons-Grade Plutonium*. In addition, he is co-Director of the Caspian Sea Oil Study Group and presently is co-directing a major study entitled *The Strategic Energy Initiative*, which is co-chaired by Senator Sam Nunn and Dr. James Schlesinger.

Previously, for the federal government, Mr. Ebel served with the Central Intelligence Agency (CIA) for 11 years and spent 7½ years with the staff of the Office of Oil and Gas in the Department of the Interior. For the Federal Energy Office, he worked in the International Energy Area. In 1974 he joined the ENSERCH Corporation. From 1974 until 1978 he served as Vice President for International Affairs, advising the Corporation and its subsidiaries on international issues relevant to day-to-day operations. He is author of *Chernobyl and its Aftermath* (CSIS, September 1994), *Energy Choices in Russia* (CSIS, October 1994) and *Energy in the Near Abroad*, released in April 1997. His previous books include *The Petroleum Industry of the Soviet Union* and *Communist Trade in Oil and Gas*.

Onnic Marashian is an Editor Emeritus and currently a consultant to Platt's Oilgram, a daily international print and electronic news and market price service published by McGraw-Hill, Inc. He was Director from 1995-96 and Editor-in-Chief from 1973-95 of Platt's Oilgram News, a print and online energy information service on the politics and economics of oil and gas worldwide. He has organized and participated in a number of international petroleum conferences in Singapore, New York, Washington, Houston, Mexico City, Vancouver, Montreal, Rome, Paris and London.

Scott Horton is partner with Patterson, Belknap, Webb & Tyler LLP, an international law firm with offices in New York and Moscow and affiliated offices in St. Petersburg, Nizhny Novgorod, Kyiv, Tbilisi, Erevan, Baku, Tashkent, Bishkek, and Almaty. He founded the firm's practice in the CIS countries and today is responsible for its work throughout the Central Asian and Transcaucasus regions. Currently, his practice includes representing Western natural resource companies in exploration and development projects, representing major philanthropies, and advising foreign sovereigns (including at various times all five of the Central Asian republics) on legal reform issues. He also represents multilateral development banks in secured finance and equity investment projects. He has represented investors in some of the largest natural resource development projects in the Caspian region. Mr. Horton is an adjunct professor at the Columbia University School of Law and the author of over 200 articles and monographs on legal developments in nations in transition, with a focus on natural resource law.

Michael Clayton is a founder and member of the governing board of the Horizonti Foundation, a non-governmental organization based in Tbilisi, Georgia, which assists American and European foundations and organizations in developing relations with Caucasian organizations, universities, and government bodies and representatives. He was the Caucasus Program Manager of the Initiative for Social Action and Revival (ISAR) from October 1993 until March of this year. Over the last four years, he has worked extensively in the Caucasus with non-governmental organizations concerned with environmental issues. Mr. Clayton received his B.A. in International Relations from Stanford University in 1992.

Igor Zevelev is Head Research Associate of the Institute of World Economy and International Relations in Moscow (IMEMO), where he received his Doctorate in Political Science in 1992. Dr. Zevelev is a member of the Russian Academy of Sciences, and is currently a Visiting Fellow at the United States Institute of Peace in Washington, DC. He has written extensively on the relation between nationalism and state disintegration in Russia in the late Soviet and post-communist periods. His publications include “Russia and the Russian Diasporas,” *Post-Soviet Affairs*, 12 (1996); “Building the State and Building the Nation in Contemporary Russia” in *Russia, Political and Economic Development*, ed. by G. Breslauer et al. (1995); and *Communist Ideology and Human Rights* (1992).

Michael Ochs received his Ph.D. in Russian history from Harvard University. Since 1987, he has been a Professional Staff Advisor at the Commission on Security and Cooperation in Europe (the Helsinki Commission) for the U.S. Congress. He specializes in the Caucasus and Central Asia, and on Russian relations with those countries. From September through December of 1995, he was co-coordinator of the OSCE/United Nations joint election observation mission in Azerbaijan.

Reserves

Oil: Proved Reserves* billion barrels/billion tons

7.0/1.0	Azerbaijan
8.0/1.1	Kazakhstan
48.6/6.7	Russian Federation
.6/.1	Uzbekistan
1.2/.2	Other Former Soviet Union
5.4/9.1	Total former Soviet Union

Possible Oil Reserves per billion barrels

6 to 14	Azerbaijan
47 to 117	Kazakhstan
1 to 1.4 billion	Turkmenistan
1 to 5.1 billion	Uzbekistan

Natural Gas: Proved Reserves* Trillion cubic meters/Trillion Cubic feet

.85/30	Azerbaijan
1.84/65	Kazakhstan
48.14/1700	Russian Federation
2.86/101	Turkmenistan
1.12/39.6	Ukraine
1.88/66.2	Uzbekistan
.02/.8	Other Former Soviet Union
56.71/2002.6	Total former Soviet Union

Special thanks for Onnic Marashian for providing much of this information. Proven reserves statistics obtained from BP Statistical Review of World Energy 1998 <<http://www.bp.com/bpstats>>. Possible reserves obtained from Manik Talwani, Andrei Belopolsky, and Dianne L. Berry, *Unlocking the Assets: Energy and the Future of Central Asia and the Caucasus* (Houston: Rice University, James A. Baker III Institute for Public Policy, April 1998).

*At end of 1997.

Production

Oil Production* thousand barrels daily/million tons

Azerbaijan	180/9.0
Kazakhstan	535/25.8
Russian Reederation	6215/306.9
Uzbekistan	240/10.2
Other Former Soviet Union	230/11.0
Total Former Soviet Union	7400/362.9

Natural Gas production* billion cubic meters/million tons

Azerbaijan	5.6/5.0
Kazakhstan	8.2/7.4
Russian Federation	531/477.9
Turkmenistan	16.1/14.5
Ukraine	16.3/14.7
Uzbekistan	45.9/41.3
Other Former Soviet Union	.3/.3
Total Former Soviet Union	623.4/561.1

Capacity

Oil Pipeline Capacity (barrels per day)

	current/at time of completion	eventual expansion
Baku-Grozny-Novorossiysk	180,000	340,000
Baku Supsa *	80,000	120,000
Tangiz Chevroil's Oil*	1,200,000	
Baku-Ceyhan	700,000	1.1 million
Turkmenistan-Afghanistan-Pakistan*		1 million
Azerbaijan-Turkmenistan-Iran**		1.4 million
Kazakhstan-Xinjang Autonomous Region**		1.4 million

Special thanks to Onnic Marashian for providing much of this information. Production statistics obtained from BP Statistical Review of World Energy 1998 <<http://www.bp.com/bpstats/>>. Capacity statistics from Onnic Marashian's paper enclosed: "Pipeline Routes and Pipeline Politics,"

* Under construction

** To be Constructed.

The Caucasus and Central Asia



Introduction

George Breslauer

Good morning, and welcome to the Berkeley Program in Soviet and Post-Soviet Studies' third annual Caucasus Conference. Three years ago, we received a grant from the Ford Foundation for a multi-year effort to develop a research and graduate training program on the Caucasus region, and our annual Caucasus conferences represent a key component of this new program. We have recently received an additional multi-year grant from the US government that will allow us to expand this program to include the Caspian littoral states of Kazakhstan and Turkmenistan as well. These grants have made today's conference possible.

The first of our conferences, held in 1996, focused on the cultural, historical and political roots of identity in the Caucasus, an important topic given the region's ethnic and religious diversity. In 1997, we broadened out from the theme of identity and culture per se, to the issues of identity politics, ethnic conflicts, and the roles that institutions can play in either fostering or muting such conflicts. We also examined the experiences of ethnic conflict and conflict management in a number of other areas, in search of comparative insights useful for assessing possible mechanisms for resolving ethnic conflicts in the post-communist Caucasus. Today, we take on a different theme: the geopolitics of oil, gas, and ecology in the Caucasus and Caspian basin.

This is a fascinating and important topic, for the anticipation of a new oil boom in the Caspian basin has captured attention around the globe. Indeed, this region today is a focus of political ambition, concern, and fear, all at the same time. The fact that the Caucasus and Caspian littoral region serves as a crossroads both between Europe and Asia, and between Russia and the Near East and South West Asia, underscores why the scramble for Caspian oil and gas has become a fulcrum of geopolitical dynamics and regional politics. The region's immense reserves of oil and gas have raised hopes that Caspian energy will fuel industries and heat residences around the world. These reserves have also sparked dreams of immense riches among diverse people, companies, and countries alike. Of course, the region's recent history as the southern tier of the former

Soviet Union renders it of continuing strategic and economic concern to Moscow. Moreover, some nationalist groups and elite figures in the Russian Federation continue to look at the region with a marked neo-imperial nostalgia. Thus the Caucasus and Caspian littoral have become a focus of US foreign policy, in part to prevent a revival of Russian dominance over the region. US policy here is not simply a function of America's strategic relationship with Russia; rather, US policy toward the region is driven by a number of factors, including an interest in consolidating regional democracies and markets, and a desire to assist Western companies in their search for profits from energy extraction. Moreover, the United States hopes to expand the base of fuel reserves to which itself, Western Europe, Japan, and others have access.

The region's mounting ecological problems, however, cast a shadow over the promise of an energy boom in the Caucasus and Caspian littoral states. Indeed, the region is ecologically threatened in ways which parallel mounting ecological problems elsewhere. The complex intersection between geopolitics, regional stability, the promise of a Caspian oil boom, and the area's threatened ecology thus warrant particular attention. In order to put these complex dynamics in historical perspective, we begin today's conference with a talk by Professor Terry Karl of Stanford, who will speak on comparative lessons of relevance to the scramble for Caspian oil, lessons drawn from other regions that have experienced oil booms.

State Building and Petro Revenues

Terry Karl

In 1975, I interviewed Juan Pablo Perez Alfonzo, the Venezuelan founder of OPEC. After discussing OPEC's approach to price setting, the minister suggested that I should consider taking up a far more interesting and less studied topic—"What oil is doing to us," as he put it. "Oil," he went on, "is the excrement of the devil." This provocative assertion prompted my investigation into the relationship between oil and politics in my recent book, *The Paradox of Plenty: Oil Booms and Petro-States*, which analyzes the impact of oil on the political economies of Venezuela, Nigeria, Mexico, Iran, Algeria, Indonesia, and Norway.

Based on my research for this book, I would expect that oil rich countries of the Caspian basin are currently experiencing a "boom mentality" in anticipation of vast hard currency earnings from oil exports. I would thus expect to find a widespread belief that oil will help overcome the trauma of the economic and political transition from Soviet socialism and bring rapid prosperity as well as the promise of national greatness. As the Shah remarked during the 1973-74 OPEC oil embargo, when oil prices were going through the roof, "The chickens of colonialism are coming home to roost." Similarly, the president of Venezuela had predicted at one point that his country's oil wealth would mean that Americans would soon be driving Venezuelan-built cars made with Venezuelan bauxite and fueled by gasoline from Venezuelan oil.

These expectations have since proved false. The record of disappointment means that, some 25 years after the 1973-74 oil price spike, there are more voices today urging caution. Of the countries I have studied, only Norway has been able to avoid some of the adverse consequences of oil wealth on its political economy. Of the remainder, the best case had been Indonesia, which looks much less of an exception today.

Starting with Adam Smith, economists have long warned that commodity-based wealth is at best a mixed blessing. Smith once wrote that the Spaniards think that gold is wealth, while Tartars think that land and agriculture are wealth—the latter, he asserted, are more correct. Economists have a name for some of the boom-bust patterns associated

with excessive reliance on income from oil and gas commodities— “the Dutch Disease,” but this is an insufficient explanation of the phenomenon.

In all the cases except Norway, economic performance has been very poor. This was true even before the dramatic decline in oil prices in 1983. Each country experienced large bottlenecks, declines in the value of agricultural and industrial output, capital flight, efficiency losses, double-digit inflation, and sudden declines in living standards. This was the pattern particularly in Mexico, Venezuela, Iran, Nigeria, and now Indonesia.

In each of the cases except Norway, we have also seen persistent political instability and conflict, as demonstrated most dramatically by the 1979 Iranian revolution and the unfolding drama in Indonesia today. The slow demise of one-party rule in Mexico and the political violence in Algeria likewise had their roots in the boom phenomenon. Even Venezuela has been struggling against the threat of a military coup, and has been considerably more vulnerable to democratic failure than its neighbors. As for Indonesia, the assumption that it is a typical victim of the “Asian flu” is incorrect. It has been hit hardest and is the most unstable politically. Again, its current economic crisis and political instability are rooted in part in the country’s excessive dependence on oil revenues.

Moreover, many cases are “capital deficient” oil exporters, not “capital surplus” exporters. The difference is the ratio of proven reserves to population. Capital surplus exporters include Saudi Arabia, Kuwait, and the United Arab Emirates, where the value of proven reserves is extraordinarily high in proportion to population. My findings thus apply most dramatically to capital deficient countries. However, oil-dependency problems, taking longer to manifest themselves, are nonetheless present in countries such as Saudi Arabia.

Why has oil had such perverse effects? The paradox is an interesting and perplexing puzzle, particularly given that all these cases began their oil booms in such different conditions. All they had in common was their large oil reserves and the fact that they all adopted what I call an “oil-led development strategy.”

One of my most important findings is that oil dependency changes the entire political economy of a country. In particular, the relative power of different groups changes. In most cases, the landlord class is weakened while new interest groups linked to

the oil business or to consumption patterns based on oil emerge. At the same time, the structure of the state changes. The state becomes what I call “a petro-state,” sometimes slowly but sometimes overnight. When oil revenues begin to flow into the national treasury, the government typically goes on a spending spree. But new barriers to sustainable economic growth appear, which end up forcing the state to cut back drastically on its spending. There is in fact only a very narrow window during which officials can make decisions enabling the state to accommodate oil wealth responsibly. If that window closes, the opportunity to make choices vanishes.

In this sense, oil over-determines outcomes. It exacerbates certain kinds of perverse behavior, particularly rent seeking—that is, the pursuit of profit over and above the level that would be possible in a competitive market. Oil is a unique commodity in that it provides enormous and rapid profits for the state at very little effort. It also is still the most important commodity for the world economy, and it creates unique opportunities for states to extract resources and accrue rents from the international system.

The extent of cooperation between and among national governments and oil companies represents an important difference between the cases I have analyzed. When there is conflict, oil prices fall. When there is cooperation, prices rise or at least don't fall below an agreed upon minimum or “floor.” In all of the cases, revenues from oil exports began at a time of rising prices. Indeed, between the late 19th century and 1973-74, oil prices for the most part rose gradually and steadily in real terms. In 1973-74, however, the price of oil rose dramatically. Since then, prices have frequently spiked. In today's era of high price volatility, there can be no certainty about oil revenues, which makes oil dependency even more dangerous. Recently, oil prices have fallen to below \$15 per barrel, which has contributed greatly to Indonesia's problems. The worst scenario is for oil revenues to begin at a time of high price volatility, which increases a country's vulnerability to sudden collapses in the oil market.

Another effect of oil on a country's political economy is the extent to which it skews interests. For example, in Russia oil is causing a dramatic restructuring of political interests around oil exports. A common problem is that businesses, like governments, can become hooked on oil-based subsidies, which lowers productivity and makes it difficult to

compete in international markets in the long run. Businesses become used to low risk activities giving high returns that result from subsidization made possible by the state's oil income. Politicians and bureaucrats also become caught up in rentier activity, often illegally, and thus a dense network of corrupt links develops between public and private sectors. Economic and political fortunes become inextricably linked, which helps explain why regimes in petro-states are so vulnerable to collapse when the economy gets in trouble.

Rent-seeking behavior in petro-states takes the form of what game theorists call a “two-level game.” In one game, the state confronts the oil companies, with each player trying to extract the maximum rent at the expense of the other. The state wants to distribute oil rents politically—in effect, extracting from the outside but distributing on the inside—while the oil companies want as high a rate of return on their investment as possible. In the second game, the state confronts new social groups, particularly the middle class, which grows in size and becomes more politically influential thanks to oil-based development. These groups then begin to make demands on the state for a share of the oil bonanza. In effect, what develops are two inter-linked rentier networks.

Formerly, the emergence of these networks usually took a long time. Today, however, they develop far more quickly. Oil revenues first began to flow into Nigeria's treasury shortly after the end of the devastating civil war over Biafra, which meant that Nigeria had an *extremely* weak state at the time. The regime immediately attempted to use its petrodollars to keep the country together, and as a result Nigeria's petro-state emerged virtually overnight. Moreover, its agricultural sector was destroyed in about five years, in part because its subsistence farmers were unorganized and lacked the political capacity to defend their interests.

One reason for the rapidity of political and economic changes wrought by oil today is that oil income begins to flow into state coffers sooner and in greater volumes than before. Traditionally, states taxed the profits and property of oil companies to the benefit of the companies. However, after the Venezuelan Hydrocarbon Act—which provided for a 50-50 split of profits—was passed, revenue sharing contracts became the norm. As a result, states are able to reap the benefits of their oil windfall more quickly. But capacity

to extract non-oil resources generally has been undermined. Rather than learning how to build efficient tax systems, they learn how to extract as much as possible and as quickly as possible from the oil companies.

Another perverse effect of oil wealth is that income distribution tends to worsen. This is particularly true where oil undercuts the rural economy. Where land reform and investment in agriculture continues, as in Indonesia, the country does better. However, what the state typically does is use its oil revenues to buy out landlords, who tend to be politically assertive and thus, potential challengers to the regime. Oil income is used to buy the land from the landlords, thereby providing them with the capital they need to move into industry, and particularly into the construction of oil-related sectors. As a result, landlords become supporters of oil-led development, which means that there is one less powerful social group to oppose the petro-state.

How, then, to explain differences in outcome between my cases? At least until recently, Indonesia was the “best” case other than Norway. The principle reason for the “Indonesia exception” was the decisive lessons that Suharto learned from the mass unrest that brought down Sukarno in 1965. Suharto understood that Indonesia needed to remain self-sufficient in rice, and that the price of rice had to be kept low and stable, which in turn meant that the country’s rice producers had to be protected. As a result, Indonesia’s agricultural sector was not starved of investment, and its economy remained more diversified than elsewhere. Indonesia was therefore less dependent on oil revenues. Nevertheless, Indonesia’s economy also had its perverse qualities, as I point out in my book, including the development of an extensive private-public rent-seeking network based around the Suharto family. This network helps explain the extent of Indonesia’s economic and political difficulties today. There has already been a much more dramatic drop in living standards in Indonesia than in the other countries that have caught the “Asian flu,” and it will be more difficult for Indonesia to recover than its neighbors. While the IMF is pressing the government to withdraw some of its oil-funded subsidies for basic commodities, including rice, the political unrest has forced it to reinstate them, but there is no longer any money in the treasury to pay for them.

Norway is the only one of the cases that handled its oil wealth relatively effectively. This was because it already had a well-developed non-oil-based economy prior to the discovery of oil and strong vested interests in protecting its traditional sectors—shipbuilding, agriculture, and fishing. It also had an effective environmental lobby and a strong state staffed by an efficient and honest civil service. In this respect, the current emphasis on the privatization of the oil industry in countries such as Azerbaijan misses the point. There are well-run state oil companies and well-run private oil companies. Far more important is an effective civil service.

Indeed, in many cases it is the private sector that pushes for a strong role for the state in the oil sector. For example, the American companies involved in the development of Venezuela's oil industry preferred to deal with the state than with a host of small landowners. They had learned from their experience in Texas that a multiplicity of small holders greatly complicates their efforts to extract oil. But the oil companies also preferred that the state be relatively weak, and they therefore tended to invest more willingly in countries with weak states that would be less likely to cause them problems.

Where you have a weak and corrupt state at the time oil is first discovered, the country is in big trouble. One of the important effects of oil is that it strengthens the position of the individuals and groups in power when the oil revenues first start to flow. If the political class is already corrupt, it becomes even more so. Only a rapid fall in oil prices can shake up the thick network of rent-seekers that develops between the state and private interests.

Another important factor is the nature of the regime. Where you have genuine competition for political office—what we normally call democracy—there is a better chance of weathering a collapse of the oil market without political upheaval. Venezuela, where there was a measure of political competition, therefore better managed, politically, the drop in oil prices in the 1980's than Nigeria, Algeria, or Indonesia.

Oil, in sum, is simply a black viscous commodity. What matters is the institutional order into which it is inserted. If a country starts with a weak and corrupt state, or a weak and unbalanced economy, these distortions will be aggravated by oil dollars, which perhaps does not bode well for the oil-rich countries of the Caspian basin.

Visualizing the Caucasus: A Geographer's Perspective

David Hooson

As Professor Karl advises, the best way to consider the possible effects of oil on any part of the world is to look at the other qualities and characteristics of the region as a whole. Being a geographer, I consider long-term and regional contexts to be critical. Maps, such as those I've displayed here for you today, represent a crucial first step in assessing the geographical context of an emerging pattern of "petro" development, for maps give us a view of a region "from the ground," so to speak. And oddly enough, the conditions on the ground are often neglected in political analyses.

The Caucasus region is not some outlandish place, really. Perhaps a place that has been forgotten until a few years ago, but not one lying at the ends of the earth. Located between the Caspian and Black Seas, this relatively small region is very central to the "world island." For many, many centuries, it's been a kind of crossroads or throughway for peoples on the move; but it's also been a sort of cul-de-sac where peoples have "washed up" after being invaded. It's a place of conquerors, refugees, and refuges. It sits between a number of distinct cultural and geographical areas. The Greeks, Romans, Mongols, Persians, and Ottoman Turks have all had their day here. Finally, after all of them, the Russians came into the picture early in the nineteenth century. The Russians spent many, many decades trying to absorb the region into their imperial space. People like Pushkin, Lermontov, and Tolstoy were all entranced by it, as were most Russians of the time. It was so different from anything Russian, so diverse, becoming a favorite place for any number of reasons. Those who had money could enjoy the region's climate. Things that were important to Russians could be grown here, such as tea and lemons.

The Caucasus was the site of the first major strike of oil in the world, leading to a majority of the world's production in the 1880s and 1890s and attracting the attention of big business. The region was quite a prize then, not only because of its beauty, variety, and resources, but because of its oil. Indeed, before the Texas discoveries, the territory of today's Azerbaijan was the largest oil producer in the world.

During the Civil War, before the consolidation of the new Soviet state, much of the region seceded and broke away from Russia, aided to a certain degree by the interests of international capital. These dynamics extended the logic of the so-called “Great Game” between British and Russian imperial interests. Indeed, with British India nearby and the Russian Bear encroaching from the north, the Caucasus in the early part of the twentieth century served as a sort of cockpit for the world’s imperial powers. It was a very unstable area from 1917 until 1921, when it was decisively incorporated into the Soviet Union.

Prior to the Soviet period, the Caucasus had been rather freely connected to the world, long functioning as a central transit point between Mediterranean Europe and Central and East Asia. Indeed, the old Silk Road passed right through it. When thinking about the Caucasus in terms of regional development, then, one must always bear in mind this long history of commercial and cultural connections.

In Soviet times, this very natural connection was sealed off. The sealing-off of the region transformed the Caucasus from a traditional hub of cultural and commercial exchange into the impenetrable southern border of the Soviet Russian empire. Contact with Turkey or Iran became very difficult.

During World War II, however, the region’s fate took another sharp turn, as the Caucasus were temporarily thrust back into the center of geostrategic machinations. Baku oil became a mainstay of the Soviet war effort, and was even piped to the Black Sea and the world beyond to aid the allied cause. Thus, once again, much depended on the region, as the Nazi invaders tried repeatedly to capture Transcaucasia and thus cut-off the USSR’s petroleum lifeline. In the end, the axis defeat ultimately depended very much on the failure of the Nazi and Japanese empires to gain access to Caucasian oil. We should remember how close the Germans got to Baku in 1942 and 1943. If Germany had won the key battle of World War II, at Stalingrad, the Nazis would have marched quickly to Baku, denying Russia the oil essential to her war machine.

After the War, the Soviets shifted their emphasis in oil extraction to the reserves of west Siberia, and the Caspian oil industry grew at a much slower pace. Once again, the USSR sealed off the area, marginalizing the region geopolitically as the southern periphery

of the Soviet empire. As in the 1920s and 1930s, the Caucasus faded from world attention.

Despite its relative isolation from the outside world in the post-war period, the standard of living in much of the Caucasus—and particularly in Georgia—was actually much higher than in urban Moscow or St. Petersburg. Thus we see a very unusual situation, in which the people of a colony lived much better than its metropolitan masters. Georgia was famous for its wine, food, and salads. The Georgians had a high quality of life, and were confident in their knowledge of this fact. This reality must be taken into account when contemplating the impact of the coming petro-dollar windfall on the region, as the conditions which allowed one of the highest regional standards of living in the Caucasus during the Soviet period were there before oil, and will remain there after oil.

Since the independence of the new republics in 1991, of course, the geostrategic situation of the region has again changed dramatically. We now see a regular flow of diplomats from the Middle East to these new states, something that would have been unthinkable in the Soviet period. Thus, in the wake of the collapse of the Soviet cordon around the region, we've witnessed a reversion of this very small geographical area to a position of centrality between surrounding states and regions. So the whole situation has changed, and leaders like Georgian President Shevardnadze and Azeri President Aliyev now operate in a wholly new set of spatial contexts. This new set of spatial contexts, of course, strongly shapes possible avenues of development from this point forward.

In assessing developmental alternatives for the region, we should bear in mind that the Caucasus is physically a very diverse region. This is a land of mountains, deserts and forests, well-loved by a number of outsiders, including the British geographer Douglas Freshfield, who was the first to climb 18,000 foot Mt. Elbrus. The Caucasus range is more majestic than the Sierras or Alps, and truly defines the region, as it forms a barrier between conquering peoples and the refugees who fled into its remote and inaccessible corners. Over time, these geographical features have thus led to a tremendous diversity of peoples and languages—more than fifty in a very small area. There are the Caucasian language-groups, which include the Chechens and Ingushetians in the northeast, the Dagestani region in the north, the Abkhaz and Circassian peoples in the northwest, and the

Georgians and Mingrelians in the south. There is also the Turkic language group that includes the Azeris and Karachay, and the Indo-European language-group, including the Armenians and Ossetians. Many of these groups live in completely different sub-regional environments. It is not only the landscapes that differ, but also the climates. The vast majority of the oil to be exploited lies basically in the Azeri desert and under the waters of the Caspian, but just to the west we find areas of heavy rainfall, swamps and sub-tropical conditions. The contrast is not unlike that between the east and west coasts of the United States.

The environment of the Armenian plateau is windswept and earthquake prone. Landslides and avalanches are common in the mountains. Armenia and Azerbaijan are both landlocked, because the Caspian Sea is, after all, an inland body of water, the largest in the world. There are great forests on the wet slopes of the west Caucasus, though these forests were excessively cut in the Soviet period. This has led to erosion and flooding above and near the coasts of the Black Sea at Abkhazia.

One can easily overlook the fact that the Caucasus is sandwiched between the Caspian Sea and the Black Sea. The Black Sea, one of the deepest and deadest seas in the world, has only a narrow corridor to the Mediterranean, the Bosphorous Straits. Many rivers drain into it, including the Danube. Over time, too much organic material has built up in the Black Sea, leading to a layer of lifeless hydrogen sulfide at the bottom. The sea's life thus is found around its edges, where the water is shallow. The fisheries of this sea used to be famous. In Byzantine times, black caviar was the food of the poor. Huge sturgeons thrived in the surrounding rivers, forming a tremendous resource for Greeks, Romans and other Mediterranean peoples. Today, due to extensive pollution and over-fishing, sturgeons are scarce, and the fishing industries of the Black Sea have plummeted catastrophically.

Social scientists display a persistent tendency to assume that at least the physical environments—the seas and mountains—don't change, but in fact they do. The water level of the Caspian Sea dropped between the mid-thirties and mid-seventies by about ten feet. Of course, this has impacted human plans around the coast. Many Soviet plans were in the works to offset this decline by diverting northern Russian rivers. Luckily, Soviet

inefficiency moved on this grandiose plan very slowly, and by the mid-seventies, for still poorly understood reasons, the sea level rose again of its own accord. Indeed, in the last 20 years, the level of the Caspian has almost regained that of the 1930s. Of course, this causes many difficulties for coastal facilities that have been built in the meantime. Oil facilities and other industrial sites built during the Soviet phase, including the town of Neftyaniye Kamni in the middle of the sea itself, have been very much affected by this rise in the sea level. Oil facilities in Kazakhstan and particularly Turkmenistan are being flooded.

The shift in the Caspian's sea level is partly a function of the discharge coming down the Volga Basin, which has been tampered with a great deal by the construction of dams and reservoirs (as well as by pollution). But there is also a good deal that's unknown about this cycle, and any development plan has to take this into account.

In short, we find in the Caucasus and the Caspian littoral a tremendous complexity of people and diversity of dynamic environments in a small area, with a variety of languages, ethnic groups and religions. People here are widely said to reach ages of 120, often ascribing this feat to the number of wives or bottles of wine in their lives. The Caucasian peoples have been developing here on their own for many centuries. For some reason, "Caucasian" is one of the boxes one can check on surveys and applications. Don't check "Caucasian" unless you are actually a Caucasian. Check "other." There is no place more ethnically diverse than the Caucasus, and therefore less susceptible to homogenous typing than this supposedly racial designation.

Without going into details, we also find enormous volatility in this region. Obvious examples of this include the Chechnya tragedy, the secession in Georgia of various ethnic groups, and the conflict over Nagorno-Karabakh. This is an ongoing problem for our poor benighted friend Eduard Shevardnadze, who has almost been killed several times in connection with the conflicts inside Georgia. Or perhaps because of the machinations of his former friends, the Russians.

Looking to the future of the region, then, we must always bear in mind the rich mixture of peoples, environments, and resources that distinguish the Caucasus. Of course, oil is one of these, and the intense commercial and strategic interest in Caucasian oil of

late has led us to consistently overlook the area's other commercially viable resources and industries. In Georgia, for instance, you have wine, a four or five thousand-year-old industry. Indeed, Georgia was the former center of wine production in the Soviet Union. In one of his most ill-advised, and frankly stupid, policy moves, Gorbachev destroyed many vineyards in the late 1980s as part of his anti-alcoholism campaign. Now the wines are coming back, and have attracted international interest. If the region can concentrate on wine, sub-tropical foods, and the assets which made it one of the great tourist areas of the Soviet Union, the region has a promising future. Just think of it, this is like California with history. If the peoples of the Caucasus can get themselves together—without developing an economic dependence on oil revenues—they can gradually rebuild the tourist sector with its beaches, mountains, and hot springs. Let's not forget that Gorbachev rose to power from Sverdlovsk, where his jurisdiction extended to the hot springs areas of the Caucasus such as Pyatigorsk and Kislovodsk. Aged Soviet leaders from Moscow would go down there very regularly to soak their bones, and this vigorous young leader often played host to them in the baths. Eventually, he was invited to Moscow. Is this an indication of environmental determinism?

You have in the Caucasus, as in California, ski resorts, hot springs, beaches, wine, good food and a colorful, remarkable history of many peoples. In any region, long-term assets and advantages such as these have to be considered. The people of the Caucasus are poised to capitalize on these resources, so long as they can step back from internecine strife and avoid being swamped by the allure of oil, as Professor Karl has warned. I was recently relieved to hear that estimates of the size of the Caspian oil deposits have recently dropped from about thirteen to six percent of the world's total reserves. I hope that these declining estimates may motivate regional leaders to avoid putting all of their eggs into the single basket of oil production, chasing the mirage of petro development. Time will tell.

The Geopolitics of Caspian and Central Asian Oil and Gas

Robert E. Ebel

Let me begin by quoting from a book I recently read:

“It will be sad to see how the magnet of oil draws great armies to the Caucasus; it will be fascinating to examine how the oil companies mobilize their forces of diplomacy to fight their battles across green tables and behind the scenes...; it should be enlightening to study how far the foreign policies of nations, in the matter of recognition, of credits, etc., are influenced by that universal lubricant and irritant—oil...”

The author is Louis Fischer, the title of the book is *Oil Imperialism*. The date of publication—1926. These words, written 72 years ago, by chance or foresight come close to capturing the sense of what is taking place today in that remote part of the world.

The multinational oil companies have returned to Baku in search of oil to meet the requirements of tomorrow. Battles are being fought over green tables and behind the scenes. Foreign policies have been adjusted so as to ensure that national interests, in part conducted through the oil companies, at all times are being served. In sum, not all that much has changed.

Within the last several years, the Caspian Sea basin of the former Soviet Union has become the focus of attention for the world oil industry. Five nations border on the Caspian Sea—Russia, Kazakhstan, Turkmenistan, Iran, and Azerbaijan. Because their national interests do not always coincide and because of the power conferred by oil, development of the Caspian cannot be separated from politics.

I would suggest that at the time of the dissolution of the Soviet Union, in December 1991, there was only passing recognition of Azerbaijan and Central Asia. Sheltered within the Soviet Union, they mattered little to the outside world. Then, the unthinkable happened. Independence was thrust upon them, suddenly and unexpectedly without a prolonged struggle. Freedom came in the guise of the Soviet collapse. And then, perhaps just as suddenly, Azerbaijan and Central Asia were strangers no more.

Why? Very simply, the scent of oil is very intoxicating. It is intoxicating to the private sector and to governments alike. Caspian and Central Asian oil—and natural

gas—have caught the attention of a broad array of nations and of entrepreneurs, for reasons which mix politics and economics. It is, in sum, the power of oil.

Just what is that power? The world oil scene has been relatively quiet since the Gulf War, which now seems like a long time ago. But I would emphasize that oil is high profile stuff, for it fuels much more than automobiles and airplanes. Oil fuels military power, national treasuries, and international politics. Because of this it is no longer a commodity to be bought and sold within the confines of traditional energy supply and demand balances. Rather, it has been transformed into a determinant of well being, of national security, and international power, both for those who possess this vital resource, and for those who do not.

The countries of Azerbaijan, Kazakhstan, and Turkmenistan face a bright future—with that future based on the export of crude oil and natural gas to foreign markets. Had Moscow taken on a policy of draining these countries dry, producing their oil and natural gas first and saving Russian oil and natural gas for later, the years ahead would be bleak indeed. But that did not happen. Indeed, virtually all the available capital earmarked for the Soviet oil industry was directed to Western Siberia, while the potential of Turkmenistan, Kazakhstan, and Azerbaijan remained largely undeveloped. The outlying republics were linked to Russian oil and gas by means of steel umbilical cords. Energy was supplied in whatever amounts were required, at heavily subsidized prices. Local energy development was not necessary.

The producing potential of the Caspian Sea basin has caught the eye of the major international oil companies for several reasons. First, nothing is quite as attractive as something that in the past was denied, but which today is available. Second, the Caspian producing potential is world-class. Third, this potential cannot be realized within an acceptable time frame without outside participation. Fourth, and perhaps most important for the foreign investor, Caspian oil will not be developed to meet domestic requirements. Domestic requirements are comparatively small and are expected to remain that way. Most of the oil to be produced will be for the export market.

Handling Risk and Enthusiasm. When oil companies search for crude oil and natural gas, they confront three completely different kinds of risk: geological, technical,

and political. Geological risk concerns the degree to which underground rock formations are such that they trap and hold crude oil or natural gas. Once oil or natural gas deposits have been located, attention shifts to technical risks. Technical risk concerns the capacity of available technology to bring these resources to the surface, at a cost which supports project viability. In contrast to geological and technical risks, political risks have nothing to do with the physical environment, and everything to do with the stability and attitude of local political players and institutions. In assessing political risks in the oil business, you can apply the following maxim: the higher the political risks, the higher the returns must be. In short, can a project yield a financial return commensurate with the perceived political risks?

If a prospective investor were to consider an exposure in the Caspian basin, how would these three risks be evaluated? Many of the crude oil and natural gas-related projects which have been offered in the Caspian Basin to the foreign investor—whether joint ventures or production-sharing arrangements—involve development where the presence of oil or gas has already been confirmed, and often where some production has already been initiated. That in effect eliminates geologic risk. Further development of these deposits had been halted because of a shortage of investment capital, or because technology available to the developer could not get the job done. Had adequate capital been available, the necessary technology could have been purchased abroad. Off-the-shelf Western oil field technology is more than adequate for the tasks at hand. Technical risk can now be eliminated, leaving just political risk to contend with.

In sum, investors in Caspian oil essentially have traded geologic and technical risk for political risk. Is this an unwise trade? Probably not. There is risk in any oil-related venture. If there were no risk, then most assuredly there would be no return on the capital invested.

Prisoners of Geography. Azerbaijan and the Central Asian states are prisoners of geography. While the end of the Cold War may have changed a number of things, it could not change the physical isolation of these countries from Western oil and natural gas markets. Russia to the north, Iran and Iraq to the south and southwest, Afghanistan to the southeast—all effectively block the way. Which means that, given limited domestic

requirements, construction of export pipelines must precede any expansion in production. At present, oil companies can reasonably expect just three pipelines for moving Caspian crude to port to be available in the near future: the Baku-Novorossiisk line, the Baku-Supsa line, and the Tengiz-Novorossiisk line. Each faces its own set of problems, and the availability of these pipelines is not necessarily a given. Prospective routes confront a variety of highly contentious issues in all directions, issues which can sometimes delay, and sometimes effectively block, pipeline construction.

For instance, delays have risen with regard to building the western route for “early oil” from the Azerbaijani International Operating Company (AIOC). This route runs from Baku to the Black Sea port of Supsa. How much importance should be attached to this delay? Not much, as it only represents a temporary delay in the availability of the western route. To this date, the delay has had no negative impact on the expansion of AIOC oil production, as the northern route to Novorossiisk will be adequate for the next several years.

The AIOC and its member-companies, however, must start maximizing revenues. That only can be accomplished by bringing on more production, earlier. The pace must be stepped up. And that of course requires additional export capacities, whatever the means.

The start of the Tengiz-Novorossiisk pipeline has largely been put off by delays in reaching agreements with the governors of the several Russian regions that the pipeline will cross. The issue of revenue splits—that is, how much will the transit oblasts receive—has never been settled. These delays could very well mean that oil will not be flowing through the Tengiz-Novorossiisk pipeline before the year 2002.

A number of commentators have recently suggested that the construction of an oil pipeline from Baku through Armenia would contribute to a satisfactory resolution of the Nagorno-Karabakh issue. This, in my opinion, is wishful thinking. I am convinced that a pipeline can follow peace, but peace cannot follow a pipeline. My conviction stems from the answer to the following question: what is the driver in pipeline route selection in this region? Because of the strategic implications of a pipeline, the answer must be politics, and not so much economics. Route selection is thus all-important from a political point of view. However, from the perspective of investors, final route selection should not reflect

last week's or last month's political developments. Pipelines, after all, are like diamonds, for pipelines are forever. Planners try to picture what the region might look like ten to fifteen years from now. Surely, the Caspian region and Central Asia will be quite different from today, but in what way is difficult to predict.

Today, much is being made of the Caspian's oil potential, perhaps too much. Given the political and bureaucratic hurdles ahead, translating this oil potential into actual production will not be an easy task. Potentials cannot and do not fill a pipeline, which means that pipeline availability must be matched with oil production capacity. One without the other is useless.

Selecting Pipeline Routes. Countries solicit the construction of pipelines across their lands for three reasons: 1) transit fees, which can be considerable over time; 2) anticipated economic stimulus to the transit regions; and 3) the political and economic leverage a pipeline confers. Transit country expectations are high, perhaps too high. These states expect too much, too soon, and thus they risk being sorely disappointed.

Like the British-Russian struggle over the region a century ago, the issue of pipeline construction in the Caucasus and Caspian littoral states today is often referred to as "The Great Game." In any game I have ever watched or participated in, there has been a winner and a loser. To date, in this great game, there have only been winners. The US policy of multiple pipelines has seen to that. But eventually, there will be losers, and will the loss be accepted quietly? Has the great game become the great gamble?

The US Position. The US position on the Caspian and Central Asia has been laid out for all to see. American policy has been designed to promote multiple pipelines; ensure the diversification of oil supply sources; support the realization of a new Trans-Eurasian trade corridor running through Georgia; encourage the building of a large-diameter pipeline from Baku to the Turkish port of Ceyhan on the Mediterranean; reinforce American sanctions against Iran by preventing Iran from serving as a transit route; and so on. But the UK, Norway, France, Italy, Germany, Japan—that is, the governments of other home countries of major international oil companies investing in the region—have been quiet. The reasons for this reluctance to enunciate explicit policies for

the region are not clear, but the issuance of policy statements by these governments comparable to those of the United States would be helpful to all concerned.

In recent months, the Clinton Administration has been pushing—perhaps too hard—for the concept of a Eurasian transport corridor. This concept minimizes oil flows through Russia and avoids Iran at all costs. The US policy emphasis on multiple pipelines also leads in the same policy direction. A key element of the Eurasian transport corridor concept is the building of pipelines westward across the Caspian Sea. But Russia objects strongly to this idea on ecological grounds, and the unresolved status of the precise location of the median line separating the Azeri and Turkmen sectors of the Caspian Sea further complicates this plan. I have difficulties with a Eurasian transport corridor, if only because of the hostile relations between Azerbaijan and Armenia, and the unsettled political conditions inside Georgia. Is the Eurasian transport corridor realistically more politically secure than other routes?

How Much Oil and Gas, and Where is it Going? As we think about the future, we must remind ourselves from time to time of the oil industry's tendency to overestimate the unknown, and to underestimate the known. The oil potential of the Caspian Sea, for example, has been placed as high as 200 billion barrels, but to put that potential to work, if the oil is there, is going to be difficult. We all have known individuals of high potential who, for whatever reason, were never able to live up to that potential. Nations are much the same way: some succeed, others fail. Nonetheless, industry places a high premium on the undiscovered resource potential of the Caspian. It is the main driver behind their commitment to the region.

The media, in its search for eye-catching headlines, has been careless in its assessment of the Caspian contribution to world oil supply. Some have even concluded that at long last a rival to the Persian Gulf has been found. This is not so. Indeed, new Caspian oil is not going to be a substitute for Persian Gulf oil. Not in terms of levels of production, not in terms of costs of production, not in terms of ease of access to world markets, and certainly not in terms of reduced political risk.

Consider the more important constraints on the development of Caspian and Central Asian oil and gas:

- ◆ the oil and gas is landlocked, with no easy access to western markets;
- ◆ ongoing delays in pipeline availability, for whatever reason;
- ◆ politically disruptive elements in host countries;
- ◆ a shortage of drilling rigs;
- ◆ a generally inadequate supporting infrastructure;
- ◆ differing opinions and agendas on the part of consortium member companies;
- ◆ US containment policy toward Iran;
- ◆ the unresolved conflicts in Nagorno-Karabakh, Chechnya and Abkhazia;
- ◆ the dependence of political stability in Georgia, Azerbaijan, Kazakhstan, and Turkmenistan on the fortunes of individual political leaders;
- ◆ pervasive corruption.

Indeed, the firm Control Risks recently named Azerbaijan as the fourth most corrupt country in the world.

I would suggest that by the year 2010, new exportable oil from the Caspian and Central Asia might represent some 3 to 4 percent of world oil supply. In very broad terms, that implies an exportable surplus of between 3 to 4 million barrels per day, presuming pipeline availability and timely and successful field development. But, I would caution, these are very big “ifs.” At the same time, I would venture that foreign investors would be very satisfied if that much exportable surplus will indeed be available twelve years from now.

The projected increment of 3 to 4 million barrels per day should be kept in perspective. Consider that Venezuela has plans to increase its oil production by a roughly comparable amount—some 3 million barrels per day—by the year 2007. Yet this increment is barely acknowledged in discussions of world oil supply, while Caspian oil is accorded star status by the media. More realistically, Caspian oil will play an important role at the margin. Most importantly, it will diversify supply sources for importers. But its overall impact on world oil markets will not prove pivotal.

In fact, further pipeline delays, continued low oil prices, and constant reminders of the region’s fragile stability all lead us to conclude that the region’s political stability (or instability) will be play a more important role on the world scene than its presumed oil contribution. Indeed, is it just the oil we are after? Certainly, regional stability, independence, prosperity, democracy, and consolidation of free market economies all should stand as western policy goals at least co-equal with the western interest in

developing a new source of oil. But in realizing these goals, do we also diminish Russian influence in the region? Of course we do, and this promises further tensions between the great powers over the region.

As the Caucasus and Central Asia grow in importance as corridors of trade, with oil leading the way, the region's newly independent states cannot afford to ignore or divorce themselves from developments elsewhere. Their artificial isolation during Soviet times is now over, hopefully never to return. Isolation is being replaced by engagement. But engagement carries certain responsibilities and certain risks. Involvement in oil also means involvement in politics, and oil and politics, as we know, can be a volatile mixture.

Azerbaijan. Azerbaijan oil production continued its slow but steady decline in 1997. But the country's future has now arrived, as early oil from the AIOC offshore fields is now making its way to foreign markets via the Baku-Novorossiisk pipeline. But that future will be slow in unfolding, and substantial oil flows should not be expected until the middle part of the next decade. Production by the Azerbaijan International Operating Company in 1998, its first full year of operation, should average about 30,000 barrels per day.

The key pipeline issue for Azerbaijan, as for other exporting countries, is pipeline availability. Of the three main pipeline routes under review, Azerbaijan, Georgia, Turkey, and the United States have all voiced support for a large diameter oil pipeline from Baku to the Turkish port of Ceyhan. A decision is to be made by October of this year, but circumstances are changing and a number of complications have arisen. For instance, difficulties have been encountered in the effort to complete a pipeline between Baku and the Black Sea port of Supsa. Much of that pipeline was to be based on the renovation of an existing pipeline. However, this old pipeline was found to be in terrible condition, and much more of the steel pipe would have to be replaced than had been originally thought, at a cost almost double than originally estimated. But if the old pipe were to be replaced, why not use larger diameter pipe, thus solving the matter of how to move the larger volume of later oil to market? The AIOC Steering Committee continues to debate the issue, but so far has failed to make a decision. Whatever the eventual outcome of this decision, the pipeline to Supsa, originally scheduled for completion in December 1998, is

going to be delayed. Which, in turn, means more oil moving northward through Russia to Novorossiisk.

Moreover, the need for a large diameter export pipeline may be premature. Consumption and/or re-export of Caspian oil by the Black Sea littoral states could well consume much of the future Caspian oil supply. Further, it is possible that a market may be found in Russia for Caspian oil, and substantial swaps with Iran may well come into play. All this aside, more oil than just those volumes from the Azerbaijan International Operating Company will be required—from other Azeri fields, from Kazakhstan, from Turkmenistan—to justify a large diameter export pipeline. And Russia, watching all this with rising interest, has volunteered that the northern route's capacity could be raised to 340,000 barrels per day and even to 600,000, thus implying that a western route is not necessary at all.

Kazakhstan. In Kazakhstan, oil production is growing on the back of the giant Tengiz oil field, which averaged 139,000 barrels per day in 1997 and has current peak production around 190,000 barrels per day. Tengiz, without western involvement, would still be standing idle. The task today is to find means to move the incremental barrel to market until the Tengiz-Novorossiisk pipeline becomes available. This pipeline unfortunately has suffered a variety of delays and the most recent evidence indicates that construction may not be completed until the fourth quarter of 2001. Considerable Tengiz oil moves across the Caspian to Baku and then by pipeline and rail to the Black Sea port of Batumi. Chevron is rehabilitating an existing Baku-Batumi pipeline, which will be able to handle 150,000 barrels per day, allowing for further expansion in Tengiz production.

A major new player—China—arrived on the scene not long ago, taking substantial equity positions in the Aktyubinsk and Uzen oil fields and agreeing to build a pipeline eastward to China and south to Iran. But China has said little and done less with respect to its involvement in Kazakhstan. It has been estimated that to move Kazakh oil to the Chinese border will cost about \$4 per barrel, and another \$4 per barrel to markets inside China. China in effect would be paying a security premium of \$5 to \$6 per barrel for Kazakh oil if this pipeline project is finalized. Is security of supply worth that much?

Kazakhstan's oil producing future may well surpass that of Azerbaijan, if the Kazakh sector of the Caspian Sea and the Karachaganak gas condensate field live up to their presumed potential. Kazakh authorities estimate that by the year 2010 Kazakhstan will be producing about 1.7 million barrels per day, most from the following three sources. First, Tengiz will provide about 440,000 barrels per day. Second, Karachaganak will produce approximately 220,000 barrels per day. And third, the Kazakh sector of the Caspian Sea will provide about 700,000 barrels per day. Domestic demand in the year 2010 is placed at just 320,000 barrels per day, meaning that exports will take the lion's share of this oil. And where will these exports be directed? Surprisingly, Kazakh officials put exports to China at 610,000 barrels per day by the year 2010.

How will Kazakh export oil be moved to market? Kazakhstan is looking at 6 pipeline options, running in all directions, north, south, east, and west. To the north, the Atyrau-Samara line must be expanded to allow for increased deliveries to the Commonwealth of Independent States (CIS) and to Eastern Europe. Indeed, authorities appear to regard this project as having the higher priority. To the west, the Caspian Pipeline Consortium (CPC) line of course is the priority line, and Kazakhstan assumes it will be handling almost 800,000 barrels per day by the year 2010. To the south and west, plans center on building a pipeline from Aktau across the Caspian to Baku, and then to Supsa in Georgia, and finally on to Ceyhan. To the east, attention is focused on a possible pipeline to China. Finally, to the south Kazakhstan has two options: through Iran, or through Afghanistan and Pakistan to the Arabian Sea. The key issue for all these pipeline projects is *financing*. Financing for the CPC line is not in question, and China will finance the pipeline to its borders. But financing for the other lines today appears questionable.

In any case, Kazakhstan today is a sizable oil exporter. Last year Kazakhstan exported an average of 330,000 barrels per day, or some 64 percent of domestic production. Of that amount, however, just 70,000 barrels per day were directed to buyers outside the CIS.

Turkmenistan. Turkmenistan is a minor oil producer, and output this year is unlikely to exceed 116,000 barrels per day. Yet Turkmenistan, sitting on world class natural gas reserves, has to be perhaps the most frustrated nation in the world today. It

has no way to move its natural gas to western markets. Russian pipelines are available, but only to markets in Ukraine, Belarus and the like, not to hard currency markets where Turkmen gas would compete with Russian gas. Unfortunately, CIS buyers do not pay their bills. Afghanistan blocks the way to the south; markets in China are almost too distant, it would appear. Iran as a transit country is problematic because of the US containment policy. The proposed Turkmenistan-Iran-Turkey gas pipeline has attracted considerable international attention, and could yet be sanctioned by the United States. Access to pipelines and export markets is essential. A stoppage of natural gas deliveries to Ukraine last year caused natural gas production in Turkmenistan to be cut roughly in half, to 17 billion cubic meters. For comparison, natural gas production in Turkmenistan in the year 1991 exceeded 81 billion cubic meters and exports were on the order of 75 billion cubic meters. The loss of export markets has been traumatic for that country's economy.

Unocal and its partners would like to transport Turkmen natural gas through Afghanistan to Pakistan and beyond to India, but the absence of a strong central authority in Afghanistan makes the securing of project financing almost impossible. Unocal appears close to abandoning this project, at least for the present.

Despite American protests, prospects for a natural gas pipeline running from Turkmenistan across Iran to Turkey and beyond to Europe continue to improve. The United States, for its part, wants to be supportive of Turkmenistan while blocking the selection of Iran as a transit route for Turkmen gas. As a result, the United States is encouraging the construction of a gas pipeline from Turkmenistan across the Caspian Sea to Baku and then onward to Turkey and Europe. Russia, as might be expected, has strongly objected to this plan on ecological grounds.

An Uncertain Future. Over the longer term, markets in Southeast Asia and the Far East will be a powerful magnet for Caspian and Central Asian oil. By then, Iran will be available as a transit country, and, it can be assumed with some certainty, Afghanistan may be available as well. The first stage of pipeline construction and oil development is now coming into view. This is a westward view. The longer term view lies eastward.

Once the crude oil and natural gas begins to flow from Azerbaijan, Kazakhstan and Turkmenistan, political risk is likely to increase. Full pipelines become very attractive targets of opportunity for any dissident, separatist, or disgruntled citizen. But perhaps more important, how will petroleum export revenues be spent? Will they be spent wisely on improving infrastructures, health, education, agriculture and the like, and creating new job opportunities? Will they be used to solidify political and economic independence? Or will the revenues be wasted through corruption, through the construction of mega-projects for public show, on heavy subsidization of consumer goods and services, on programs designed to keep the incumbents in power and, more worrisome, on an arms race? All of these temptations will be difficult to resist.

Unrealized or unrealistic expectations on the part of the population, as the oil industry develops, may pose an additional problem. The man-on-the-street does not have a long-term outlook on life. When will conditions improve, he asks? I would think that the Azeri budget, for example, will not substantially benefit from oil exports until the year 2003, at the earliest. Such a long wait will be difficult for those who do not understand market economics. Moreover, oil prices do not always go up, sometimes they decline, as they have been recently. Can a nation easily adjust its spending habits to accommodate reduced revenues? Not likely. The kinds of investment agreements that have been struck in Azerbaijan, for example, call for the bulk of the initial cash flows to be directed to the recovery of investment costs, meaning that for some time little will be available to the local economy. And this is a circumstance that can lead to political misunderstandings in Azeri society.

Such considerations force us to recognize that confrontations between host governments and western investors may emerge in the future in relation to oil. Western investors must be sensitive to the market. A soft market may cause an investor to delay or cut back oil production expansion plans. A host government, concerned only about revenue flows, may find this unacceptable. What then?

Today, corporate interests in the Caspian coincide with US national interests. That may not always be the case. American corporate interests boil down to access to oil, and thus will remain unchanged. But American national interests will be defined by the

circumstance in which the United States sets domestic and foreign policies, and the behavior of states where democratic principles are not yet firmly in place (and may not be for some time) remains unpredictable. Internal changes in states may thus generate strong shifts in US foreign policy, as we saw in the case of Iran in 1978-79. When all of these considerations are taken together, we recognize immediately that resource development can be a destabilizing as well as a stabilizing factor in a region. This sobering realization is just as crucial to the future of the Caucasus and Caspian littoral states as the actual volumes of oil and gas lying under the Caspian Sea.

***Pipeline Routes & Pipeline Politics:
The Geopolitics of Oil & Gas Exports from the Caspian Basin***

Onnic Marashian

So much has been written about the enormous wealth waiting to be discovered and developed in the Caspian Sea region, that it may be worth while to first take a good look at the actual regional resource base before we even attempt to figure out where, when, and how regional crude oil, natural gas, and gas condensate will eventually reach the markets that will use them. Estimates of the potential of the Caspian Basin vary widely. Although potential, still undiscovered reserves are put at around 200 billion barrels, this is pure speculation. Disinterested resource specialists believe that the region's oil resource base is grossly inflated by host governments and others interested in the region for commercial, geopolitical, or other reasons. Recent estimates by the Geneva-based Petro-consultants, the London-based International Institute for Security Studies, and the Houston-based James A. Baker Institute for Public Policy take a much more sober view.

Proven oil reserves are currently put at between 15 billion and 29 billion barrels. Nearly three percent of the world's total reserves—7 billion barrels—lie in Azerbaijani territory, mostly offshore. Another 14 billion barrels may possibly be discovered offshore and ultimately recovered, if international companies go ahead with their intensive drilling plans. In Kazakhstan, 20 billion barrels are proven and expected to be recoverable, with another 25 billion estimated to be potentially available in the future. In Turkmenistan, 1.7 billion are proven. Another 4 billion may be recoverable onshore and offshore, if Turkmenistan settles its offshore ownership dispute with Azerbaijan.

At any rate, the thirty or so companies already active in the region are working on the assumption that the Caspian Basin contains at least as much oil as the North Sea. As for production, under the most optimistic scenarios of settlement of all regional disputes, the output of these three Caspian oil-producing countries may peak between 2.5 million and 3.5 million barrels per day by the year 2015, thus covering nearly four percent of the anticipated world oil consumption at that time. Compare this with the present 6.1 million barrels per day production from the North Sea.

What these reserve figures indicate is that Caspian oil may eventually substitute for North Sea oil, after North Sea output begins to decline in the first quarter of the next century. Caspian oil taken together will not match the reserves of each of the major Persian Gulf producing countries. Given the size of the reserves, the possibility of the Caspian serving as a major long-term competitor and substitute for Persian Gulf oil evaporates. Nevertheless, for the economies of the three resource-rich countries, these reserves are of tremendous significance. Moreover, they are of geopolitical significance both to their neighbors and to outside players.

Major Players. The main players in the game of selecting export outlets for Caspian oil are Russia, Turkey, Iran, China, and the United States, all of which are involved in the struggle to control the flow of the oil from the region. The first four are next door neighbors and candidates for one or more export routes. The United States is involved directly and also by proxy through Turkey. For the Caspian producers, the choice of export route will not only boost their economic development, but will also give them increased geopolitical importance and the best chance to assert their independence from Russia.

For Russia, the selection process presents an opportunity to re-establish and maintain its political leverage in the southern tier of the Commonwealth of Independent States (CIS); neutralize the growing influence of the United States and competing neighbors; and maximize economic benefits through pipeline revenues. For Turkey, a favorable outcome to the route-selection process promises to meet rising domestic oil needs, diversify the supply of gas, and establish political leverage in the region. This last potential, if realized, would in turn give Turkey a way to reassert its geopolitical significance for the West. Beyond supporting American oil companies' commercial interests, the principal policy interests of the United States in the route-selection process are geostrategic. Thus the United States hopes to prevent Iran and Russia (and possibly China) from extending their influence, while enhancing Turkey's strategic and economic role in the region.

Legal Regime. In assessing how to proceed in the route-selection process, however, both investors and strategists alike must account for additional factors beyond

the uncertainty of the resource base and the competing geostrategic interests of major players. I have in mind here two problems that affect both resource development and pipeline construction: 1) the lingering legal dispute over the ownership of the undersea resources of the inland sea; and 2) the long-term impact of offshore oil and gas development and undersea pipeline construction on the Caspian ecology. Both of these factors are interconnected.

Before the Soviet Union broke up, the Caspian was considered an inland sea, and Iran and the Soviets shared its then most famous resource: caviar harvested from Caspian sturgeon. After the Soviet disintegration, two of the newly independent littoral states, Azerbaijan and Kazakhstan, claimed the Caspian should be partitioned between the five littoral states, and proceeded to give production sharing contracts for the areas they claimed. Russia, Iran, and initially Turkmenistan insisted that both the marine and mineral resources should be exploited jointly. Iran has stood its ground, but lately Kazakhstan and Russia seem to have come to a de facto acceptance of a division of the seabed. But border disputes remain. Russia and Kazakhstan, for instance, seemed on the verge of an agreement two weeks ago, but a last-minute hitch over some islands delayed an agreement. Azerbaijan has denounced the agreement because it would affirm only the principle of dividing the seabed, leaving jurisdiction over the waters themselves unresolved.

Turkmenistan and Azerbaijan are at odds over ownership of two oil fields, the Azeri and Kyapaz fields, located midway between the shores of the two countries. Turkmenistan, like Russia, has also softened its initial opposition to developing Caspian oil and gas prior to a general agreement between the five littoral states on ownership rights. The current Turkmeni position is that Turkmenistan won't try to stop western consortia from operating the disputed fields, provided it is given a share of the revenues.

The Caspian Ecosystem. While these jurisdictional disputes may not unduly delay development, a long-term issue raised by Russia and Iran concerns the threat to the Caspian's fragile ecosystem by hasty and unsupervised drilling, chemical pollution by coastal installations, damage stemming from the installation of sub-sea pipelines, and the environmental consequences of increased tanker and barge traffic. Iranian and Russian

Existing Oil Pipelines



Proposed Oil Pipelines



map provided by Onnic Marashian

marine scientists have sounded the alarm that the enclosed sea is already on the brink of an environmental disaster, a situation that may well be exacerbated by plans to construct oil and gas pipelines on the seabed. The output of Caspian caviar, pride of both Russia and Iran, is severely endangered, along with other marine life and renewable resources. According to Iran's Environmental Protection Office, caviar harvested from the sea stood at 700 tons last year, a decline of seventy percent compared to ten years ago.

The development of urban and industrial centers, construction of on-shore petroleum infrastructure, early tapping of oil and gas deposits in territorial waters, and heavy barge traffic have already caused pollution of major proportions. Pipelines on the seabed will add oil spills and other hazards such as leakage or rupture due to corrosion or accidents. Marine scientists say there now exists no mechanism for coordinating the five littoral states' economic development and anti-pollution activities to avoid major accidents.

Beyond these man-made hazards, we must take into consideration the growing impact of a steady rise in the level of the Caspian Sea. In the past five years, the Caspian's water level has risen 2.5 meters, an unexplained phenomenon that could endanger offshore oil and gas gathering lines and coastal installations alike.

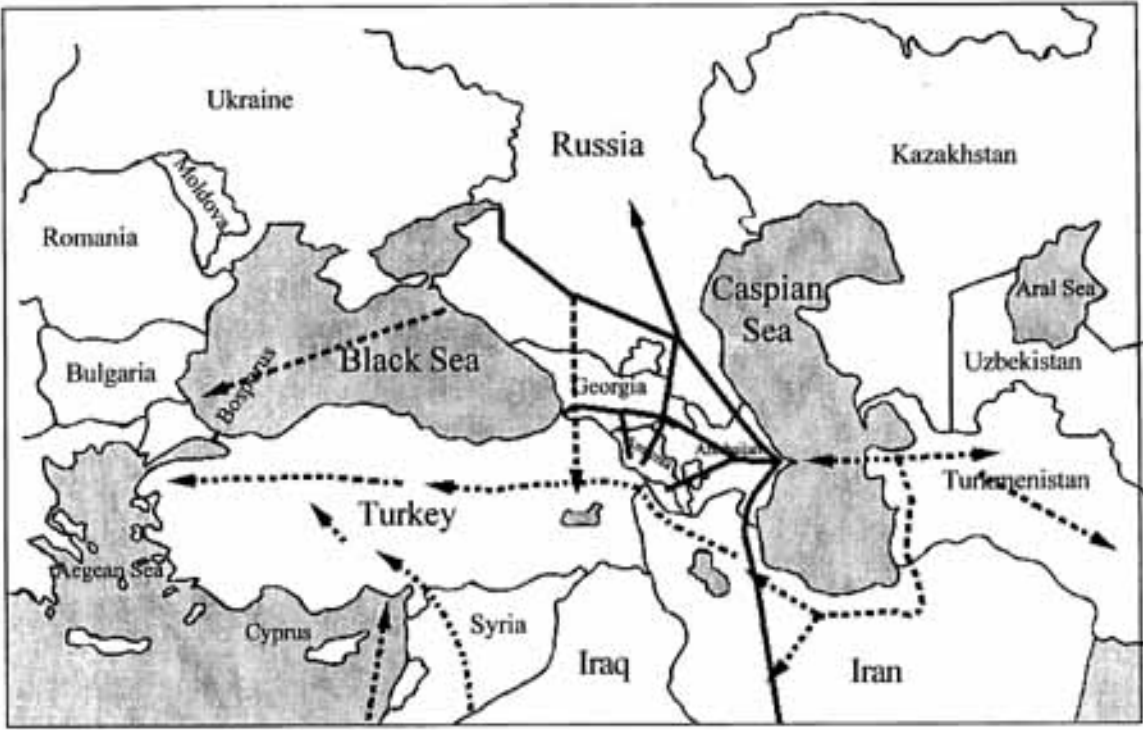
Seismologists also point to the danger of earthquakes. The Caspian seabed is an active seismic zone where earthquakes and mud volcanoes erupt occasionally. A quake of the magnitude of 9 points on the Richter scale could wreak havoc there. The design and routing of future pipelines both onshore and on the Caspian Sea floor should take these seismic factors into account. Russia and Iran have taken a common stand on this issue, arguing that marine environmental protection cannot be confined to national offshore jurisdictions and thus that the building of pipelines on the sea floor should be tackled by a compact of all littoral states. Undoubtedly, preservation of the Caspian ecosystem requires a coordinated approach to the development of regional resources and to the prevention and control of spills and other accidents.

Considerations Governing Pipeline-Route Selection. At least eleven different pipeline routes to bring Caspian oil to markets in the West, North, South, and East have been proposed in recent years. And by some accounts, there are two dozen variances on

Existing Gas Pipelines



Proposed Gas Pipelines



map provided by Onnic Marashian

these routes. Moreover, every route traverses geologically unstable and ecologically fragile areas of one sort or another. For commercial, logistical, and geostrategic reasons, many players would prefer to avoid altogether both the existing Russian pipeline network, and proposed routes crossing Russian territory. The majority of players thus favor choosing one, two, or multiples of the proposed, more southerly pipeline routes. Ideally, the optimum choice would be the one where politics and commercial interests mesh. In the final analysis, however, it remains a big question mark whether politics or economics will be the decisive factor.

Unlike the North Sea and other major producing regions, Caspian oil and gas production is landlocked and needs pipelines crossing several borders to reach world markets. For obvious reasons, companies want to ensure they have access to safe conduits to transport Caspian oil to world markets before they go ahead with huge investments to explore for oil. They realize that the transit countries with which they negotiate rights of way and tariffs not only expect to reap profits and guaranteed supplies of oil and gas, but just as importantly, they hope pipeline transit will give them strategic control of the oil flow and thus geopolitical clout.

Before the Soviet breakup, the USSR's vast centralized pipeline network was the most extensive in the world, with a design capacity of 12 million barrels per day, of which 2 million was designated for export. The breakup gave the newly independent states ownership of the lines within their borders, but eighty percent of the system remains in the Russian Federation, and is today still under the centralized control of a Russian common-carrier monopoly, Transneft. Transneft calls the shots on regional oil transport, allocates export capacity, and coordinates delivery schedules. Transneft's current monopoly position over the transport of existing Caspian oil thus helps explain the attractiveness for Azerbaijan, Kazakhstan, and Turkmenistan of routes that by-pass Russia altogether.

Let's review possible route choices one by one.

Caspian Pipeline Consortium (CPC). Even before the dissolution of the Soviet Union, Chevron had begun negotiations with Moscow to develop the giant Tengiz field, which the Soviets had discovered and were already producing. It took seven years and nearly \$1 billion by Chevron alone, later joined by Mobil, Lukoil, and Atlantic Richfield,

Oil Fields in the Caspian Region
Gas Fields in the Caspian Region



map provided by Onnic Marashian

for Chevron to finally feel at ease about its investments and the prescribed export route to Tengiz' closest terminal—Novorossiisk on the Black Sea. Current production of 160,000 barrels per day is still inhibited because the export pipeline isn't ready yet. With completion of more fieldwork, production is scheduled to go up to 240,000 barrels per day in 2000, and 600,000 barrels per day in 2010.

Chevron has been exporting most of this crude via the Transneft line to Baltic ports and barging it down the Volga-Don Canal to the Black Sea. Some oil is also moving by rail to Kazakhstan's Aqtau port on the Caspian, then by barge across to Baku, from Baku through an old pipeline to a terminal in Azerbaijan for reloading on rail cars, by rail to the Black Sea port of Batumi in Georgia, and finally at Batumi, it is loaded on tankers heading to the Mediterranean via the Bosphorus Straits.

Chevron spent more than four years winning Russian support for the transit solution it wanted all along. The Caspian Pipeline Consortium's 1,200 km, \$2 billion pipeline—half new, half refurbished—will carry crude from its Tengiz and nearby fields on the Eastern shores of the Caspian, to the Black Sea port of Novorossiisk. It will be built along the route of an older Russian network, with a partnership that includes Russia and Kazakhstan. The pipeline will be the first major oil route through Russia controlled independently of the monopoly operator Transneft. Shipments may start in three years, with supplies going through the Bosphorus Straits and to markets in the Balkans. Initial capacity of the 42-inch line is set at 560,000 barrels per day ; ultimate capacity may reach 1.5-million barrels per day .

Export Routes from Baku: 1) the 'Early' Northern Line. "Happiness is Multiple Pipelines," proclaimed bumper stickers on the cars of Western oilmen in Baku. True to that dictum, the Azerbaijan International Operating Company's (AIOC) first offshore oil for export began flowing northward a few weeks ago through an existing line that formerly carried crude south from fields in the northern Caucasus to a key refinery in Baku. Badly damaged during the Chechen fighting, the line was fixed several months ago at little cost. Its flow was reversed, but political squabbling and haggling over tariffs claimed by the Chechens delayed shipments until a few weeks ago. Oil belonging to British Petroleum, Norway's Statoil, and Japan's Itochu has been loaded onto tankers at

Novorossiisk. When AIOC increases production of the so-called “early oil,” the Baku-Novorossiisk line will be able to handle approximately 100,000 barrels per day.

2) The ‘Early’ Western Line. A second “early oil” route to the Black Sea, this one avoiding Russian soil, would run on an existing line westward from Baku, 920 km to Georgia’s Black Sea port of Supsa. Its initial capacity was to have been 100,000 barrels per day, later expandable to 200,000 barrels per day. After many months of delays, initially due in part to Russian opposition and later to financing difficulties, many assumed that AIOC would complete repairs and start exports sometime this year. It turns out that the line was so badly corroded that the entire line needs to be replaced, doubling the cost to \$600 million and delaying the start-up schedule until sometime in 1999.

In the meantime, however, efforts are being made to settle another disagreement between the three governments involved—Azerbaijan, Georgia, and Turkey—and the Western consortium partners. Since the line to Supsa will have to be replaced, why not put larger diameter pipe (42 inches, instead of the planned 22 inches) to get it ready for the anticipated longer term exports due to start, hopefully, by the year 2003? The consortium will need more pipeline throughput capacity to ship the 700,000 barrels per day that it expects eventually to produce. The question is, who will build it, own it, finance it, control it?

3) Main Export Pipeline (MEP). Indecision and confusion over “early oil” exports from Baku will pale in comparison to that expected over the choice of route for the longer-term Main Export Pipeline (MEP). The northern alternative through Chechnya, including a projected safety valve bypass through neighboring Daghestan, is being touted by Russia as the most cost-effective option. Its length would be 1,400 km and cost \$2 billion. What if Chechnya flares up again, and neighboring Daghestan is infected with the insurgency fever, too?

Among the partners, some would settle for a shorter line through Georgia, instead of a longer, more expensive route to the Mediterranean via Turkey. This alternative would run 900 km and cost \$1 billion. The oil would then be loaded on tankers en route to the Bosphorus (if the Turkish government would permit this), or be destined for Odessa, Ukraine, for transshipment to Central Europe, to Romania, or more likely to Burgas,

Bulgaria, where another cross-border pipeline would take the Caspian crude to the Mediterranean, via Greece or Albania, bypassing the Bosphorus altogether.

Still, the biggest push related to the MEP has been by the United States, Turkey, Azerbaijan, and somewhat ambivalently by Kazakhstan and Turkmenistan, for an MEP route from Baku to Turkey's Mediterranean terminal at Ceyhan, bypassing the most direct route through Armenia, crossing Georgia instead, then transiting northern and central Turkey to avoid the Kurdish-controlled insurgent areas in the southeast. This 1,730 km megaproject through Georgia and Turkey would cost \$3 billion and eventually move 700,000 barrels per day of Azeri and another 300,000 barrels per day of other Caspian oil. Turkey has been pushing hard for the line to Ceyhan, provided the financing comes from AIOC partners; otherwise, it has threatened to bring in outsiders if AIOC balks. For Turkey the stakes are very high indeed. Not only does it expect to reap the benefits of revenue from transit fees and guaranteed new supplies of discounted crude oil for its refineries, it would also have control over the traffic from the Caspian fields, thus gaining more clout and more respectability in Europe and more influence in the Central Asian and Caucasian producing countries. Besides, the Ceyhan alternative would thin out tanker traffic through the Bosphorus and minimize risks of environmental accidents in the fragile Bosphorus ecosystem.

During early discussions on the routing of this line, the possibility that it could pass through Armenia and the Republic of Nagorno-Karabakh also came up. Some companies in the consortium discussed this with the government in Yerevan. US and Turkish spokesmen made vague references to it, showing mild interest. But I don't think any serious offer of real negotiation was ever really advanced to the Armenian government. And if there were any discussions, a quid pro quo was never established. Besides, Azerbaijani officials made clear they would veto a route through Armenia even if the two countries reached a settlement over Nagorno-Karabakh.

The Clinton Administration is behind the Ceyhan option and continues to promote it at the highest levels. But the US government also says Turkey and other countries that will benefit from this pipeline must come to the table with proposals for making this route commercially attractive, including tariff and tax breaks, attractive insurance and financing

costs, and help in obtaining and guaranteeing rights of way. The downside to the Ceyhan option is that it is by far the most expensive of all the other options, northern, western, and southern, because of its length. Moreover, security risks all along the route in Georgia and Turkey would be higher, and this higher cost would have to be built into the pipeline's tariff structure.

A final decision on the MEP route was originally scheduled for October of this year, to coincide with the commissioning of the Baku-Supsa line through Georgia. Both are now almost certain to be delayed. AIOC partners are keeping all their options for the main export pipeline open, and continue to talk with the governments of Turkey and Georgia, as well as Russia and Iran. But for the United States, a pipeline network linking Turkey, Georgia, and Azerbaijan would also help cement strong economic, political, and strategic ties. Already, there have been discussions between these parties involving joint military training, exercises, arms supplies, and other forms of security arrangements.

The New Silk Road. US policy spokesmen have lately played down the idea of multiple pipelines, in favor of a single east-west Eurasian Energy Corridor. This position represents a revival of the old Silk Road, linking the republics of Central Asia across the Caspian Sea through parallel oil and gas lines from a point in Turkmenistan to Baku. From there, the oil line would link up with the Baku-Ceyhan main line directly to the Mediterranean, or to the Baku-Supsa line to the Black Sea.

A parallel gas pipeline from gas fields in Kazakhstan and Turkmenistan would also end up near Baku and continue on to Turkey, where it would compete with Russian gas. This would also free-up additional volumes to feed central Europe as well. The commercial advantages of such a costly project are debatable, but the geopolitical bonanza to Azerbaijan and Turkey should be obvious. Even if the United States invites Russian participation and assures the Russians that the Trans-Caspian route wouldn't necessarily be exclusive of alternatives through Russia, it would suit the dual US strategy of neutralizing both Russian influence and Iranian inroads in the region. For Turkey, such a route would also open the door wide to the wealth and cultures of Central Asia, and to fill the power vacuum that is still there seven years after the breakup of the Soviet Union. It would perhaps even help ward off Chinese influence from the East.

The “New Silk Road” would also be a tangible affirmation of an old dream of Pan-Turkism—a movement for union of all peoples of Turkic heritage from the Adriatic Sea to China’s Western province of Xinjiang. The idea of forging a secular commonwealth of all the Turkic races of Central Asia and the Caucasus with common linguistic ties, linked with Turkey as big brother, secular guide, and mentor, is nothing new. It has adherents in several former Soviet republics, notably in Azerbaijan and Uzbekistan. And the United States appears to be implicitly favorable to it as a bulwark against Russian, Iranian, and Chinese inroads. As one analyst put it, the new high-tech Trans-Caspian “Silk Road” has become the new religion in Washington, making Baku a “hub” for oil transport from the Caspian region and Turkey “the bridge” to the West.

The Routes South. Despite US sanctions and threats of boycotts, there is increasing talk about reviving a southern route through Iran. There are several variations. One proposal would take the oil from Baku directly to the Iranian border, connecting it to an existing Iranian network, reversing its flow, and expanding its capacity. A more advanced proposal is for a pipeline running south along the eastern shores of the Caspian to gather Kazak and Turkmen oil. Both plans would eventually deliver oil to a terminal in the Persian Gulf, or on the Arabian Sea beyond the bottleneck of the Strait of Hormuz. A third project would be to take Kazakhstan’s oil by tanker to an Iranian port, Neka, on the Caspian, which is now under expansion.

An increasing number of oil company executives believe that if the United States really wants American companies to have a leading role in tapping the region’s landlocked resources, it has to change its policy toward Iran. Excluding Iran from the pipeline game would keep them out and leave the field to European, Russian, Japanese, and Chinese interests. The southern route through Iran is seen by other Western governments, oil companies, and its neighbors as the most practical export route for Caspian oil and gas for markets in the West, as well as in South Asia and the Far East.

Despite lip service to a Turkish line, neither Kazakhstan nor Turkmenistan have ruled out Iran. Just last week, Kazakhstan’s Foreign Minister reiterated the “practical and economic” advantages of an Iranian route for Kazakhstan’s oil, and estimated that such a line would cost only \$600 million to \$800 million, whereas an oil pipeline under the

Caspian Sea to Azerbaijan would cost at least \$2.8 billion, not including the Baku-Ceyhan or the Baku-Supsa legs. Even the AIOC, where American companies' participation stands at forty percent, still keeps the option of a \$2 billion pipeline from its offshore fields to the Persian Gulf terminal of Kharg Island, arguing that there could be big differences in project costs and oil prices due to the twists and turns of international politics.

Swaps. A so-called "virtual pipeline" already exists from the Caspian states to Iran. This "virtual pipeline" consists of the possibility of arranging a swap of Central Asian crude for Iranian crude in the Gulf. So far, such swaps amount to only an on-again, off-again trickle of oil, but this trickle may well increase substantially in coming months. To compete with plans for an east-west oil pipeline, Iran announced last week construction of a 180-mile pipeline, connecting the refurbished and expanded port facilities at Neka on the Caspian to its domestic refineries in the north. International bids will be opened in June.

When completed in thirty months, this line would be able to handle 380,000 barrels per day of crude oil by tanker from Kazakhstan to Neka and by pipeline to the Tehran and Tabriz refineries, saving Iran the cost of pumping Iranian crude from its southern oil fields northward. The estimated cost of \$400 million would be considerably less than the \$2.8 billion conservatively estimated for the Trans-Caspian underwater pipeline to Baku, and \$3 billion or more for the projected Main Export Line from Baku to Turkey's Mediterranean port of Ceyhan. The swap arrangement would also be used primarily by western companies operating in Kazakhstan and Azerbaijan, delivering their oil to Iranian refineries in exchange for equivalent volumes of Iranian oil delivered at Persian Gulf terminals.

Early last year, about 70,000 tons of Kazakh crude was shipped to Iran for processing in its refineries, but this was stopped because at the time Iranian refineries could not process Kazakh crude with its high mercaptan content.

Western oil companies like the swap idea because of its simplicity and speed, and last month Mobil Oil Corp applied for a license from Washington to carry out swaps under an exception to US sanctions laws. The big question is how much will Iran have to charge the oil companies for moving their crude. Some industry estimates say Iran would have to

charge at least \$5.50 per barrel if it wants to undercut other transport routes. Others dispute that Iran's charges will be that high.

Thus the cost of such swaps would be quite a bit more than the \$2.14 per barrel that Russia is charging for "early oil" from Azerbaijan's newly producing offshore Chirag field to the port of Novorossiisk on the Black Sea, but somewhat less than the \$6-8 price Chevron is reportedly paying to move the crude from Kazakhstan's Tengiz field to Baku and on to Georgia's Black Sea port of Supsa. Iranians say, with proper pipeline and tanker transmission programs, such swaps could total 800,000 barrels per day—equal to the throughput capacity of five refineries in northern and central Iran.

Beyond such swap arrangements, however, Iran is also promoting a direct pipeline route to carry 1.6 million barrels per day to a terminal on the Arabian Sea, outside of the Persian Gulf. This oil would serve markets in South Asia, Southeast Asia, and the Far East.

Afghanistan, Pakistan, and Beyond. Also on the drawing board is a proposal by Unocal and the Saudi Arabian private company Delta Oil to build a \$2.7 billion, 1,700 km line from central Turkmenistan, south through the Taliban-held areas of Afghanistan and Pakistan to an export terminal on the Arabian Sea. With 1 million barrels per day capacity, the Central Asia Oil Pipeline would also gather oil from Kazakhstan and Russia through the Transneft network, providing a new export option for growing markets in Southeast Asia and the Far East for Russian as well as Caspian oil. The highly unstable situation in Afghanistan, however, continues to severely dampen prospects for this idea.

China and Points East. Rising demand in Asia has turned the attention of China and Japan to Central Asia and Azerbaijan. China's need for oil is growing faster than that of any other country in the world. Rather than buy Caspian oil from western companies, these two powers are out to buy oil fields and are eager to assure transportation as well. China's state oil company (CNPC) recently bought interest in Kazakhstan's second largest oil field, Uzen, south of Tengiz, and is planning a pipeline eastward to western China. Completion is set for 2005. Some oil is already being shipped to western China by rail car.

Russian producers in western Siberia have been invited to link their existing lines with the new pipeline in return for helping finance the Kazakh section of the pipeline. Since ownership of pipelines also determines export allocations, the combination of Russian, Chinese, and Kazakh financing of this ambitious project could have powerful geopolitical, as well as economic, implications.

In addition to this direct east-west line to China and beyond—and in an apparent challenge to Turkey, the United States, and the multinational investors—China has also agreed to help build a north-south link from Kazakhstan and Turkmenistan to an Iranian terminal on the Arabian Sea. As a matter of fact, one of the conditions for Kazakhstan granting a production-sharing agreement for the Uzen field and a nod for a pipeline to western China was a Chinese promise to help build a southern pipeline through Iran as well. So, at a time when the United States is trying to prevent pipeline domination by Russia or Iran, China is already providing an alternative route and working on a second one.

The Kazakh government has meanwhile served notice to US oil interests that they have until October 1998 to come up with a commercially viable alternative to the Iranian route. In case the US Administration's opposition aborts the Iranian option, which I doubt, Unocal's other southern alternative would become more viable. This line would go south through Afghanistan and on to Pakistan to a terminal on the Indian Ocean, as I have already mentioned.

Natural Gas Pipelines. Competition is also heating up to supply natural gas from Turkmenistan's enormous gasfields near the Iranian and Afghan borders to markets in Turkey and Europe. Ankara has made agreements to buy gas both from Iran and Russia. Russia would supply Turkey both from an existing route through Ukraine, Romania, and Bulgaria, which already carries 6 billion cubic meters (210 billion cf). This will compete with an 820-mile line from the northwestern Iranian city of Tabriz on to Ankara, and a third line from the Caucasus down to Armenia and on to Turkey. The ultimate export target is 30 billion cubic meters (1.05 Tcf). In order to avoid undue dependence on Russia, Turkey will continue to play the Iranian card, and possibly other cards as well.

Also last week, Bulgaria and the Russian giant gas enterprise Gazprom signed long-term contracts for the delivery and transit of Russian gas to Bulgaria, Greece, and other Balkan states, as well as Turkey. At the same time, Russia is making plans to start construction of a gas pipeline on the bed of the Black Sea, from Tuapse to Samsun, intended to serve as an outlet for Russian gas to Turkey.

But the only new gas line that has actually been built is the short one from Turkmenistan's western fields to the border of Iran. This gas is intended for consumption in Iran's northern provinces. The line will be the first leg of a mammoth trans-continental line from Turkmenistan to Turkey (and eventually Europe) through Iranian territory—3,000 km long, and with 30 billion cubic meters capacity. Royal Dutch Shell has been asked to look into this.

To keep a balance between the southern and western gas pipeline options, the Turkmen government has also asked Shell to do a feasibility study for a gas line through the Trans-Caspian corridor to Azerbaijan and Turkey. Iran would also be involved in this indirectly because Shell believes Iran must give its consent to build any pipeline on the Caspian Sea floor.

Planners would also have to take into consideration that while the long-term destination of Caspian hydrocarbons would be the Far East and South and Southeast Asia, the near term priority is Europe.

Conclusion. In conclusion, one would have to ask how many of these pipeline projects will remain pipe dreams, and how many will become realities. Those players who remain in the game will have to compete fiercely, unless a coordinated regional approach is taken not only for the transit of oil and gas, but to tackle all other problems—logistics, financing, security, environmental—that will affect the choice and operation of pipelines.

The intermingling of geopolitics and commercial dictates of the oil industry can be expected to cause further delays for many of these projects and to slow down the pace of future investment. At a time when oil prices are falling, and are expected to remain weak for some years, oil companies will have to be cautious about where they place their investment dollars, at what level, and how quickly.

International Law Ownership of the Caspian Seabed

Scott Horton

Today, I am going to talk about the legal status of the Caspian Sea, and in particular, the legal status of its subsoil oil and gas deposits. Current disputes over the legal status of Caspian resources bear directly on the political risks facing both states and energy companies who hope to exploit these resources. Political risk analysts frequently use game scenarios as a way of highlighting the significance of different kinds of risk. I'd thus like to start with the following scenario. Imagine that it is the year 2005, fourteen years after the collapse of the Soviet Union, and that 50,000 barrels of oil a day flow through a pipeline from Baku to Novorossiisk. A cut-off has been built along the coastal regions so as to bypass Chechnya, a now independent and sovereign nation which has yet to reach an agreement with Russia on tariffs for the trans-shipment of oil across Chechen territory. The newly-elected President of the Russian Federation, Boris Berezovsky, has just announced that the time has come to adjust the payment schedule on the oil sold from the depot in Novorossiisk to reflect the Russian Federation's 35 percent ownership interest in Russia's portion of the oil produced at the well-head, in line with Russian insistence that the Caspian sea is a joint-use area. However, in the view of Azerbaijan, most Western analysts, and Western oil companies, the offshore oil claimed by the Russian Federation may have come from Azerbaijani fields. Thus Berezovsky's announcement promises a bitter political and legal struggle over oil shipped through the Baku-Novorossiisk pipeline.

My scenario underscores why the question of national ownership rights preoccupies most analysts concerned with Caspian oil and gas. Indeed, the current unresolved status of these ownership rights presents a fundamental challenge to anyone investing in offshore facilities or raising capital in international markets to develop Caspian energy resources. Today, we know that most oil companies are prepared to accept the risk of proceeding, even though regional disputes over national ownership rights remain unresolved. Money is being raised, projects are going forward. These companies' risk-minimization strategy consists largely of including Russian companies in the consortia that

have been formed to develop Caspian oil and gas, as well as on occasion including Iranian companies in these consortia. Thus the companies involved view the political risks in the Caspian region as “rear-end” risks. By “rear-end” risks, I mean risks that arise down the road, after the investment in infrastructure has been made and post-production conflicts over rival claims of ownership begin to threaten investor access to contracted shares of the proceeds from the sale of oil or gas.

Ownership disputes over resources between Caspian littoral states turn on a number of complicated arguments under international public law, including the current dispute over whether the Caspian should be defined as a sea or a lake. A number of speakers today have already mentioned the importance of this dispute, though I would emphasize that the problem of contested ownership rights does not revolve strictly around this issue. The dispute over ownership of the Caspian is but one of any number of legal conflicts stemming from the collapse of the Soviet Union pertinent to the future of oil and gas production in the region. If we look at the territory of the old USSR, we see many such relevant actual and potential territorial disputes between the newly independent states, such as those raised by Russian nationalists in regard to the legal status of parts of northern and eastern Kazakhstan, or transit questions relating to the Fergana Valley. And of course, there is the Caucasus region itself, with its well-known conflicts in Nagorno-Karabakh and Chechnya, and its lesser-known conflicts over Abkhazia, South Ossetia, and Ingushetia. From the perspective of international investors in the region, however, all of these disputes pale in comparison to the question of ownership of the Caspian seabed.

On this critical issue, regional governments have aligned themselves into two major camps. The first camp argues that, according to the definitions formulated in the international Law of the Sea, the Caspian is an enclosed sea. The second camp insists that the Caspian is an international or “frontier” lake. If the first position prevails, Caspian seabed resources will be subject to the jurisdiction of all the littoral states—the states bounding the sea—following delineation of a median line. Proponents of this position expect the median line to be drawn according to the guidelines set by the 1982 Convention on the Law of the Sea. Each of the littoral states would exercise exclusive jurisdiction over the mineral resources underlying its sector. With respect to the body of the sea itself,

however, littoral states would have a more limited jurisdiction and, by general agreement, there would be some shared responsibilities, including the formulation and enforcement of fishing rights and the resolution of ecological problems confronting the Caspian as a whole.

The great majority of reserves are located in the northwestern portion of Kazakhstan, bordering the Caspian Sea, and near the Abseron (Apsheron) peninsula off of Baku. Thus it comes as no surprise that littoral states have taken positions reflecting their economic interests. For instance, Azerbaijan and Kazakhstan have been pushing for a swift delineation of a median line. Azerbaijan has been very aggressive about this, while Kazakhstan has been less so. This stance, however, faces a number of serious problems under international law, problems for which the Law of the Sea Convention clearly does not provide an answer. Article 123 and all the preparatory works of this Convention make it very clear that an explicit decision was taken in 1982 to exclude the very issues raised by disputes over ownership rights to Caspian resources. Interestingly enough, this exclusion came at the insistence of the United States, which was very concerned about “UN bureaucrats” and “Third World whirling dervishes” having any say in the laws governing our great inland bodies of water, namely the Great Lakes. Heaven forbid that such people should have a say in anything concerning Lake Michigan! That’s for us, or at most, for the United States and Canada, to decide. We wrote this into the Convention, thereby clearly segregating out bodies of water similar to the Great Lakes, such as the Caspian. Thus the argument favoring quick delineation of a median line at best uses the Convention on the Law of the Sea by analogy, insisting that it provides the modern rules for resolution of these kind of disputes.

The Russian-Iranian Approach. The alternative position has been aggressively advanced by the two countries that have the least mineral-rich territory in the area, the Russian Federation and Iran. This position boils down, basically, to an insistence that Iran and Russia together will decide ownership of the Caspian without regard to the newly independent states. Iran and the Russian Federation view the Caspian as an international lake, and insist treatment of the Caspian be derived from established custom and usage in the region. Since before 1991, the Soviet Union and Iran established this custom and

usage, the Russian-Iranian argument insists that the status of the Caspian is a matter for Iran and Russia—the legal heir of the USSR under international law—to resolve on a bilateral basis. In support of their position, both countries routinely cite three Soviet-Iranian treaties. By the way, one of these treaties, which would have established a regime of accepted usage between the two states, was never ratified by the Iranians, though both states relied on it as a practical matter. The Iranians and Russians insist these treaties imply a concept of joint use with respect to the core of the lake. As with the Azeri and Kazakh position, there are a number of very serious problems with this position under international law. Perhaps the most important of these is that the Geneva Convention on the Law of Treaties very clearly states that past Soviet-Iranian treaties are not binding on the newly emerging republics. In addition, the median line demarcation concept pushed by the Azerbaijanis and Kazakhs has, in fact, been imposed over and over again whenever international courts and arbitration tribunals have been impaneled to address this sort of question. There is a whole series of such decisions that I will talk about a little later.

Looking at the Russian perspective in greater detail, we encounter a considerable number of vehemently articulated but not always mutually compatible views about the Caspian. In particular, for the last year and a half, there has been an Energy Ministry view and a Foreign Ministry view. The Foreign Ministry view has been presented at international conferences and before the United Nations but, I suspect, since the Deputy Minister of Energy became the Minister of Energy and subsequently the Prime Minister, I wouldn't be surprised if the Ministry of Energy view becomes the official policy of the Russian Federation.

We can break down the Russian view into five basic points, articulated in a briefing memorandum submitted to the General Assembly of the United Nations in 1994 as a definitive legal expression of their position. The first point insists that the Caspian is a lake for purposes of international law, because it is landlocked, is not connected to the world's oceanographic network, and therefore, not an international body of water subject to the rights of navigation for the benefit of maritime nations. For that reason, Russia believes that the elaborate system of international maritime law which primarily focuses on providing these rights to ships visiting ports and so forth should not apply to the Caspian,

and that exclusive economic zones in the Caspian should not be demarcated by the continental-shelf approach.

Secondly, Russia insists that the Caspian is a joint-use area. Issues pertaining to all activities, particularly exploitation of subsurface mineral resources, should thus be resolved with the participation and consent of all littoral states. This is a very important position from the perspective of the Russian Foreign Ministry, because it entails the initial consent of all five littoral states to any proposed solution to the question of ownership of the subsoil resources for such a solution to become legally binding.

Third, the status of the Caspian must be resolved in a manner consistent with prior treaties between the USSR and Iran, and particularly the treaties of 1921 and 1940. The Russians thus insist that, under international law, Azerbaijan, Kazakhstan, Russia, and Turkmenistan are successors to the USSR and are bound by the treaty commitments made by the USSR. As I have already mentioned, however, this position is untenable according to four articles of the Vienna Convention on the Law of Treaties. The Russian government has slowly come to recognize this problem, and now cites the Minsk Treaty that created the Commonwealth of Independent States (CIS) as obligating signatories to the CIS treaty to observe the 1921 and 1940 Soviet-Iranian treaties on the Caspian. The Russians insist that the Minsk Treaty obliges member states to abide by the territorial delimitations between the union republics in place at the collapse of the union, and indeed, if you go look at the Minsk accord, this is correct. As many observers were quick to point out, however, the problem with the new Russian position is that the Minsk agreement only covered three republics, namely Russia, Ukraine, and Belarus. The other republics were added in the Almaty Accord, which followed the Minsk agreement. However, one of the critical distinctions between the Minsk agreement and the Almaty accord is that the latter did not include this same provision concerning the resolution of territorial issues. The reason it did not was, you may recall, that Armenia and Azerbaijan at the time were embroiled in an undeclared war over the status of Nagorno-Karabakh, and therefore territorial delimitations were taken off the table.

The fourth point made by the Russians is that prior Soviet-Iranian treaties do not form a comprehensive basis for the development of the Caspian, and that relations

between the four littoral successor states to the USSR in this area require legal clarification. Though this point conflicts with Russian insistence on the binding character of previous Soviet-Iranian treaties on Caspian littoral states, Russia again is trying to assert by a different route that all littoral states must be party to any potential resolution of the current dispute over Caspian ownership rights.

And finally, the Russian Federation decisively repudiates the notion that unilateral action by any state can resolve or form a basis for development of the Caspian Sea. This mantra is repeated by the Russian Foreign Ministry every time a new consortium agreement is announced in Azerbaijan. The unusual thing, of course, is that Russian companies are always partners in these consortia. Thus Russian energy interests are operating in the Caspian region independently of such Foreign Ministry pronouncements.

Aside from the weaknesses in the Russian-Iranian position that I have already pointed out, there are serious questions regarding Iranian and Russian claims of an established pattern of custom and usage. For instance, the custom and usage established in the Soviet period included the systematic exploitation of Caspian seabed and subsoil resources by the USSR without prior Iranian consent. And indeed, the Council of Ministers of the USSR issued a series of orders in which they delineated responsibilities between union republics with respect to that exploitation, giving specific rights to the Russian Soviet Federated Socialist Republic and Kazakhstan. Right around the time of the dissolution, a specific agreement was reached between the USSR Council of Ministers and the Azerbaijani Soviet Socialist Republic Council of Ministers concerning Azerbaijan's right to take the initiative in authorizing and supervising some forms of Caspian Sea development. The practice argument thus does not seem to hold up. Indeed, it seems to be more of an improvised afterthought of the Ministry of Foreign Affairs, cited without serious consultation with people in the oil sector.

The Azeri-Kazakh Approach. Azerbaijan's position forms the principal statement of opposition to the Russian view. First of all, Azerbaijan consistently argues that prior practice during the Soviet period regarding the development of Caspian resources form operative guidelines for such activity today, and thus that disputes between littoral states over subsoil ownership rights should not impede further development.

Azerbaijan recognizes that the arguments raised by the Russians and Iranians necessitate their involvement in the development consortia. The Azeris thus view such inclusion as addressing Iranian and Russian concerns. The Azeri government also refers to a whole series of agreements, arbitrated decisions, and court rulings on similar disputes involving the division of comparable bodies of inland water. Examples would be disputes between the United States and Canada over our own Great Lakes system (Lake Erie, Lake Huron, Lake Michigan, Lake Ontario, and Lake Superior); conflicts between Chad, Niger, Nigeria, and Cameroon over Lake Chad; disputes over Lake Geneva between France and Switzerland; and conflicts between Austria, Germany, and Switzerland over Lake Constance. In each of these cases, the median-line approach served as a basis for resolving these disputes. In the median-line approach, a line is drawn outward from the shore of littoral states, reaching a point equidistant to the shoreline. When diagramming territory, shoreline irregularities, peninsulas, islands, rocks and protrusions are given attention according to their prominence. Azerbaijan has expressed its willingness to enter into a Caspian Sea Treaty, assuming the median-line division principal be used as a baseline for any agreement. But it has rejected the view that any two littoral states can enter into an agreement that binds the remaining littoral states with respect to the Caspian Sea. The Azeri position was initially formulated in 1994 and 1995. Ironically, Azerbaijan now regrets taking this position, in part because the Azeri government has come to see the potential utility of resolving Caspian ownership disputes through the use of bilateral treaties. One of these agreements is quite aggressively being pursued between Azerbaijan and Turkmenistan. Similarly, other such agreements between Russia and Kazakhstan, and between Turkmenistan and Kazakhstan, are supposedly close to conclusion.

Kazakhstan's government takes a broadly similar stand to Azerbaijan on all these issues, though it has articulated its position in a low-key and conciliatory fashion. We can reasonably suppose that this reflects Kazakh President Nursultan Nazarbaev's close economic relationship with Russia, Kazakhstan's large Russian ethnic population, and territorial claims being asserted by some Russian nationalists against Kazakhstan. Indeed, Nazarbaev is walking a very delicate line in managing Kazakh relations with Russia, and sees no benefit in playing the pit bull in the conflict between Russia and the newly

independent states over ownership rights to Caspian resources. And why should he, when Azeri President Haydar Aliyev seems more than willing to play this role?

Turkmenistan's policy has at times been very difficult to decipher. Very early, Turkmenistan adopted a 12-mile territorial limit, and at one point, seemed to be adopting the Russian position or something close to it. However, in a series of televised presentations broadcast from Ashkhabad, President Saparmurat Niyazov has proclaimed his belief in the median-line approach. However, the Turkmeni government insists that Azerbaijan's proposed division according to this approach is incorrect, as it allots major deposits claimed by Turkmenistan to Azerbaijan.

Where do we stand today? Both the Iranian government and the Russian Foreign Ministry insist that Iran and Russia alone should delineate a large joint-use core area of the Caspian. Tehran really has no other choice, as the use of a median line would give them virtually nothing. After all, no significant seabed resources have been found in what would be the Iranian sector under this approach. The Russian Federation, on the other hand, has strongly modified its previous position (or positions), taking a much more conciliatory tone to the discussions. As articulated by Boris Nemtsov, the former and current First Deputy Prime Minister, and Sergei Kirienko, Nemtsov's former Deputy, and current Russian Prime Minister, and the former head of the refining plant in Nizhny Novgorod Oblast, the Russian Federation's interests overwhelmingly lie in the prompt development of the Caspian Sea, with the participation of Russian companies. Thus Russia's new senior government leaders clearly do not believe that Russia should block development by pushing its territorial claims. In recent negotiations between Kazakhstan and Russia, for instance, we know from newspaper reports and recent statements by the Kazakh Foreign Minister and Prime Minister that a deal is very close to being signed. At the same time, Robert Ebel earlier today informed us that parties to the negotiations have some reservations as to when we would actually see such an agreement signed.

According to public statements made by parties to the negotiations, the principals undergirding this potential Russian-Kazakh agreement entail a median-line delimitation with respect to subsoil resources, but a mixed use or joint use rule with respect to the waters themselves (beyond, of course, a certain delineation of territorial waters).

With respect to Azerbaijan and Turkmenistan, we have also heard from the Turkmen President during his recent appearances in New York and in Washington. He apparently believes a resolution of the territorial dispute with Azerbaijan is also close, although neither government is in a position to announce it now. In any case, if this Azeri-Turkmen agreement materializes, it will also apparently be based on the median-line principal.

Looking ahead, I think the most important question for all parties interested in Caspian development is whether or not we will see a treaty between all the littoral states resolving, once and for all, the question of subsoil resources. The answer is that such a treaty cannot be foreseen at this point, because Iran is clearly in a position to block it, and clearly will. Instead, we will likely see a series of bilateral agreements between the remaining four littoral states, and I'm optimistic that such a series of treaties will facilitate development of Caspian energy resources. Indeed, it now seems likely that we will soon see such agreements materialize, though it's difficult to say whether these agreements will be legal and binding or merely informal working understandings. In any event, I think they already exist on an informal level sufficient to promote development of some of the territories in question.

The Environmental Factor in Decisions about Oil in the Caucasus

Michael Clayton

As a number of speakers have already emphasized, a broad range of political and economic factors today influence the process of selecting the pipeline routes which will eventually deliver Caspian oil to the world market. Today, I will provide an overview of how environmental issues relating to the transport of oil have affected decisions related to pipeline routes in the southern Caucasus region. In so doing, I will also touch on a number of broader environmental problems facing the region.

Outline of Environmental Issues Related to the Transport of Oil in the Caucasus

Agriculture. Obviously, oil spills and pipeline construction directly impact the productivity of agricultural land located along pipeline routes. Environmentally-oriented non-governmental organizations (NGOs) can here play a critical role in ensuring that the impact on local agriculture of an oil pipeline routed through arable land is minimized. In Georgia, for instance, members of a local NGO recently traveled parts of the designated route of the Baku-Supsa pipeline to explain to villagers their rights for compensation from any damage to agricultural land caused by the transport of oil. A rail accident involving a train carrying oil from Kazakhstan to the Georgian port of Batumi subsequently resulted in a spill which damaged a corn field in this region. According to reports, the Georgian government compensated farmers for the damage. This accident and the resulting compensation underscores the importance of factoring the potential environmental impact of a pipeline on local agriculture into the pipeline-route selection process, as well as the importance of creating both NGO watch dogs to monitor the environmental impact of oil transport systems, and governmental and corporate mechanisms for correcting oil-related environmental damage.

Air Pollution. More than ninety percent of pollutants emitted into the air in Azerbaijan are connected to the oil and transport industries. In particular, Baku's oil refineries release dangerous concentrations of gases (hydrocarbons, sulfur dioxide, and nitrogen oxides) directly into the atmosphere (see Mustafaev). As with many parts of the

former Soviet Union, the current economic downturn in Azerbaijan has had a direct and positive effect on the country's air quality. However, the danger of such pollution in Azerbaijan remains especially potent, since more than seventy percent of the country's production potential and forty percent of the population are located near or in Baku along the Apsheron peninsula, the site of Azerbaijan's Soviet-era petroleum industry and of many of the on-shore oil and gas reserves exploited by the Soviet government.

Archaeology. The rich and scientifically priceless archeological record of the Caucasus must be taken into consideration in selecting pipeline routes and constructing the actual pipelines themselves. A reassuring first step in this direction has already been taken by the most active and important oil-development organization in the region, the Azerbaijani International Operating Company (AIOC), which has provided funds to archaeologists for research. Recently, an excavator digging a trench for pipes near Mtskheta in Georgia opened a well-preserved Bronze-age grave, with skeletons and artifacts intact. This incident immediately caused a public furor in the media, and the lobby of archaeologists in Georgia successfully pressed for compensation from damage to the site caused by the excavation. Again, this incident underscores the importance of voluntary associations in monitoring pipeline planning and construction if the environmental impact of such projects is to be minimized.

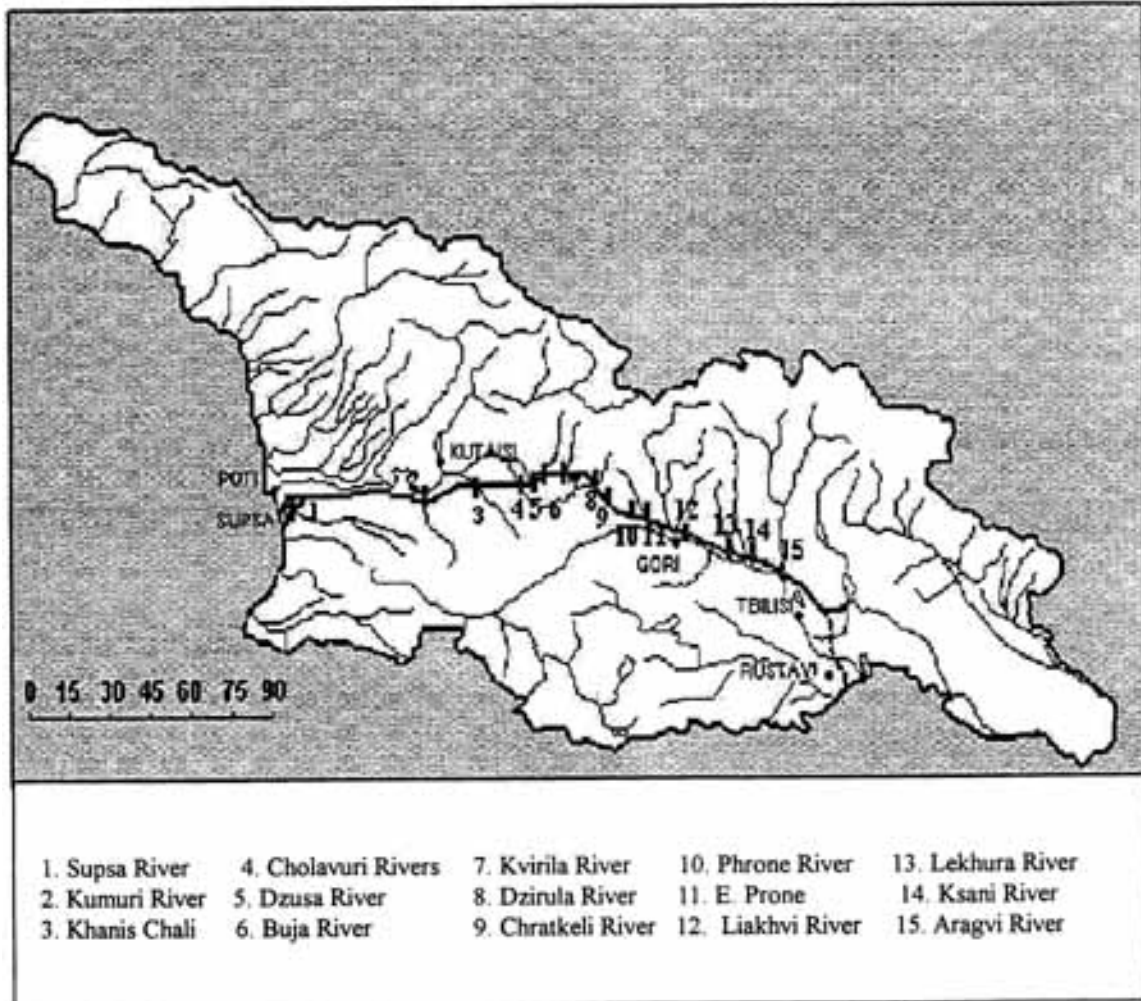
Bosporus Straits. The fate of the Bosporus Straits is undoubtedly the most widely discussed of the environmental issues related to the transport of oil through and from the Caucasus. Although differences of opinion exist on the anticipated amount of oil to be transported through the Straits (due to conflicting estimates of both the actual size of the newly discovered Caspian deposits, and of the demand for oil from countries bordering the Black Sea), most analysts expect a dramatic increase in oil-tanker traffic in the Bosporus Straits. Such an increase, in turn, will endanger both the fragile environment of the Straits and the safety of the people of Istanbul.

Environmentally, the Bosporus is the biological corridor for all marine wildlife traveling in and out of the Black Sea. The nineteen-mile channel which bisects Istanbul (population 12 million) requires large vessels to make at least twelve course changes,

including four turns of greater than 45 degrees. Annually, approximately 45,000 vessels, nearly one every twelve minutes, traverse the Straits (see “Transporting Caspian Sea Region Oil”). During the period of 1992-1995, only seven of these 45,000 vessels were 100,000 ton capacity or larger, and in all of these cases, the Straits were closed to other vehicles during their passage (see Daly). The Turkish Minister of Energy estimates that the oil-transport capacity of the Straits could be increased from its current level of 32,000,000 to 37,000,000 tons annually (Daly), a capacity far below most estimates of an additional 15-18,000,000 tons needed to accommodate oil originating from the Caspian basin. The environmental risk involved with increasing the tonnage of oil shipped through the Bosphorus becomes even more apparent when the history of oil-tanker accidents in the Straits is taken into consideration. For instance, in 1979, the tanker *Independenta* dumped 93,000 tons of oil into the Bosphorus, and in 1994, a collision between the *Cypriot Nassia* and the *Cypriot Sea Broker* caused thirty deaths, released 20,000 tons of oil into the water and onto the shoreline, and caused an oil slick which burned for five days, closing the shipping channel entirely (see “Transporting Caspian Sea Region Oil”). Along with its economic interest in re-activating the eastern Mediterranean Ceyhan terminal, Turkey has officially stated that, for environmental and safety reasons, it will not permit a substantial increase in oil tanker traffic through the Bosphorus (“Proposed Turkish Pipeline Route”). Together with Azerbaijan, Georgia, and the United States, Turkey has officially stated support for a transport network for Caspian oil which would bypass the Straits entirely. Of course, the Russians are unhappy with this position, as it would largely exclude Russia from the collection of oil-transport fees.

Oil Leaks. The operation of the currently operational Baku-Batumi pipeline is controlled from the Supervisory Control and Data Acquisition System located in Sangachal, near Baku. This system detects leaks along the length of the pipeline. It has a sensitivity to leaks greater than two percent. A supplementary monitoring system is thus needed to detect smaller leaks. The expanded carrying capacity and pressure in the line that will be caused by the addition of the Supsa-Baku leg of the pipeline will certainly increase the rate of damage to the environment from any spill, further necessitating the placement of sufficient systems of monitoring and control along the entire route.

Georgia: Rivers



map provided by Michael Clayton

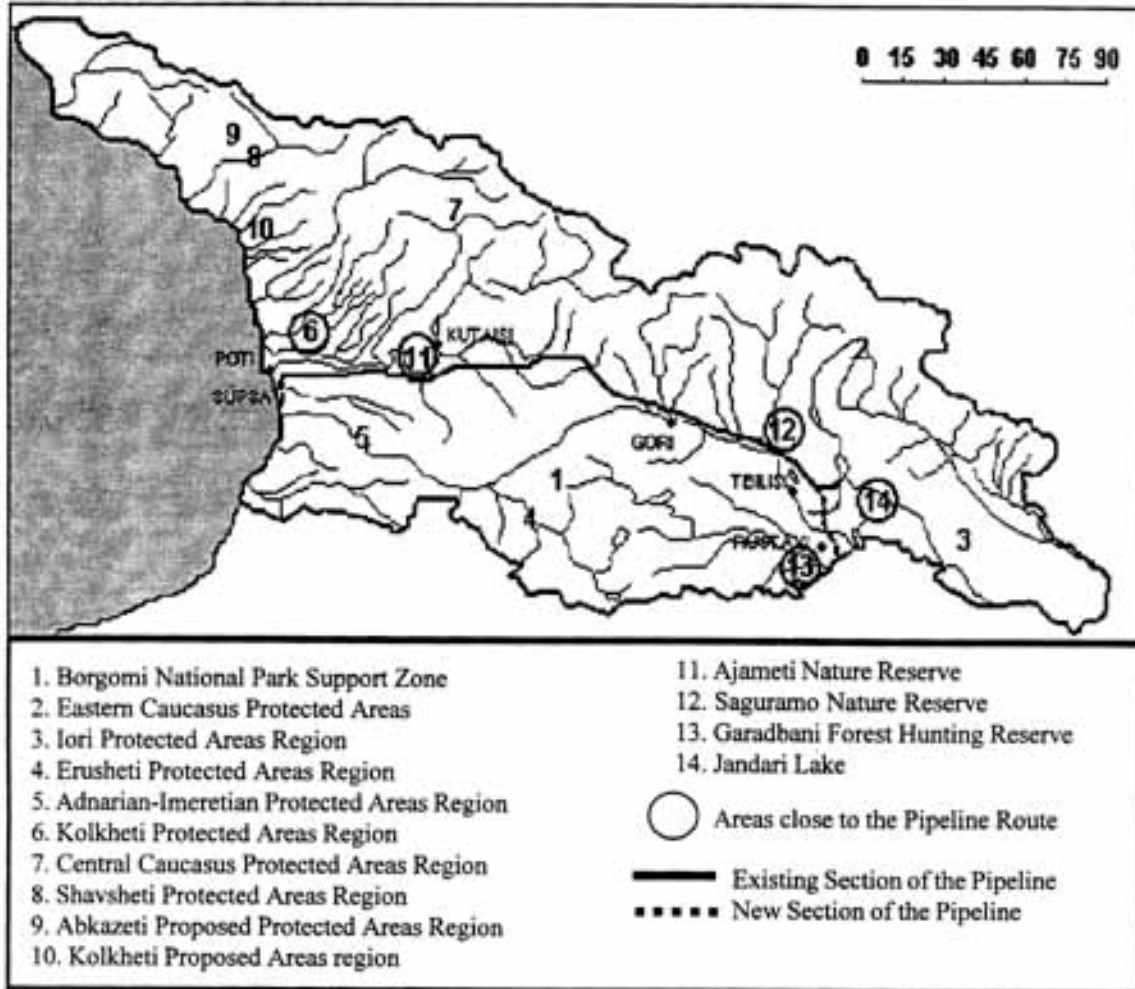
Radioactivity. High levels of radioactivity have been documented in the oil fields and the “oil lakes” of the Apsheron Peninsula, a result of past drilling, production, and processing of oil (see Djahanguiri). Effective governmental regulation of processing technology and active monitoring of the petroleum industry by local NGOs are thus essential if a repetition of this disastrous situation is to be avoided in the future.

Soil Pollution. Given the existence of such radioactive “oil lakes” near Baku, it comes as no surprise that petrochemical-related soil pollution is most severe along Azerbaijan’s Apsheron peninsula. Indeed, the long history of Soviet oil extraction has left immense stretches of land on the peninsula polluted by oil and oil products (see UNDP). Again, the importance of local regulations and NGOs in preventing a repetition of such tragedies cannot be underestimated.

Water Pollution. While environmentalists concur with recent decisions to channel the Supsa leg of the Baku-Batumi pipeline beneath waterways, the fragile network of waterways will nevertheless remain at risk from spills and leaks from the pipeline. Most water treatment plants in the region do not work, and the rivers are already highly polluted by industrial and agricultural discharge. Much of this water network feeds into rivers supplying both Tbilisi and Baku, and flows directly into either the Caspian or Black Sea. As such, river crossings must be monitored carefully and constantly, and the most sensitive sites should be specially protected.

Seismic Activity of the Region. The Caucasus is a region of heavy and on-going seismic activity and soil movement. Areas of particular seismic activity along the route of the pipeline need special engineering designs and monitoring. The utilization of the existing Baku-Supsa pipeline as the first leg of the emerging plan for a multi-pipeline energy transportation system for Caspian oil and gas would reduce substantially the risk of seismic activity affecting the pipeline network, since southern Georgia—the route of numerous plans for additional pipelines—is particularly dangerous and geomorphologically complex. However, as a number of speakers today have said, plans for building alternative routes through southern Georgia continue to play a central role in the thinking of both energy companies and governments actively engaged in developing Caspian oil and gas.

Georgia: Protected Areas



map provided by Michael Clayton

Sensitive Habitats/Endangered Species

The catastrophic financial situation of scientific research in the Caucasus has resulted in a lack of sufficient information on the current status of sensitive habitats and endangered species in the region. However, we do have a rough baseline of habitat information, on which I will rely in the following overview.

Georgia. In Georgia, environmental NGOs and the AIOC's environmental impact assessment have established the Kolkheti wetlands, the Ajameti Reserve, the Saguramo Reserve, the Gardabani Forest and Hunting Reserve, the Likhi Mountain Ridge, the Surami Pass, and the Igoeti Plains as particularly sensitive habitats. A variety of species inhabit each area, including migratory birds listed and protected under various international conventions.

1. The Kolkheti wetlands is a protected area with a complex canal and river network draining into the Black Sea and Lake Paliastomi. The Kolkheti Reserve (a strictly protected area) is located within the wetlands. A winter 1998 survey of the site identified around one hundred migratory bird species within a few days. The number of species present during migration is estimated at double this figure. Additionally, endangered and endemic plant species—including the *Diospyrus lotus*, *Quercus hartwissiana*, *Pterokarya pterokarpa*, and *Trapa colchica*—are found within the wetlands. The Supsa terminal itself is in fact located within the wetlands area.

2. Located on the Kolkheti lowland, the strictly protected Ajameti Reserve is a mixed subtropical forest exhibiting a particular extensive floral diversity, with approximately 520 species documented. Species of particular interest include the following endangered forest species: the Imeretian oak (*Quercus imertina*) and the *Zelkova* (*Zelkova carpinifolia*). The pipeline runs along the northern border of the reserve for approximately ten kilometers, and then cuts through the western end of the reserve for approximately two kilometers.

3. The Saguramo Reserve (a strictly protected area) contains a rich and unique collection of flora, including approximately 40 percent of the species present in Georgia (31 of them endemic to the Caucasus). A five-kilometer segment of the pipeline runs along the southern border of the Saguramo Reserve. In addition, a two-kilometer section

along the Reserve's southern border forms part of the four-kilometer wide pipeline corridor. In sum, the pipeline effects ten percent of the Reserve's total area.

4. The Gardabani Forest and Hunting Reserve forms part of the Eastern Caucasus protected area. The Reserve's riparian forest is critically endangered. The forest is home to several lianas (*Hedera helix*, *Celmatis vitalba*, and *Smilax excelsea*), and the only existing phytocenosis in Georgia. The region consists of a complex system of canals which receive water from the Kura (Mtkvari) River, and then feed this flow back into the river downstream. A pipeline route now currently under active consideration crosses both numerous waterways in the Reserve, and an area approximately 8-10 kilometers from the critically endangered riparian forest.

5. The Likhi Mountain Ridge and its Surami Pass (both non-protected areas) divide eastern and western Georgia. The pass is the only existing migration corridor between the Great Caucasus Range and the Caucasus Minor for species in the region. This corridor must be maintained in order to protect the species' high genetic diversity and spatial structure, as well as to prevent the extinction of isolated populations. In particular, the habitat is critical to the Caucasian bear, birds of prey, and the lynx. The habitat includes both large forests and forest fragments that are home to plants listed as endangered by international organizations and in the Georgian Red Book (such as *Castanea sativa*, *Diospiros lotus*, *Staphylea pinnata*, *Buxus colchica*, *Zelkova carpinifolia*). The Baku-Supsa pipeline crosses the Likhi Mountain Ridge.

6. The Igoeti Plains (a non-protected area) is the only habitat for a number of rare plant species, including the endangered *Paeonia*. Environmentalists argue that the risk to these species posed by the pipeline requires further research in the field and in genetic conservation and reintroduction. The AIOC has recently agreed to fund a research and conservation program at the Tbilisi Botanical Garden.

The construction and transport of oil close to or within the above mentioned sensitive areas risks habitat distraction and destruction, decline in current populations of endangered and threatened species, and damage to the infrastructure of national parks (the World Wide Fund for Nature and the World Bank have already invested millions of dollars in national park and coastal management infrastructures in these areas). The AIOC has

committed itself to financing research on rare plant species such as the Paeonia, and to establishing a permanent ornithological monitoring center. Environmentalists have acknowledged that such research will contribute to monitoring the environmental impact of pipelines during both the construction and operational phases of pipeline development.

Azerbaijan. As both the principal site of recently discovered offshore oil deposits on the Caucasian side of the Caspian Sea, and of some of the worst of Soviet-era petrochemical pollution, the varied habitats of Azerbaijan face special dangers. I have broken down at-risk Azeri habitats in the following way.

1. Floral and faunal zones at or near the planned sites of further oil extraction in the Caspian (including Azeri, Chirag and Gunashli sites) should be monitored regularly and closely. According to the United Nations Development Program, eleven species of seaweed, seventeen species of sea animals, and ten species of fish are present near the Azeri site while 42 species of seaweed, 29 species of zooplankton, 16 species of animals and 9 species of fish live near the Chirag site.

2. The Caspian basin, including the Shirvan State Reserve, the Kyzyl-Agach State Ornithological Reserve and the Apsheron State Reserve, provides critical habitat to a wide variety of species, including the Caspian seal (the world's smallest seal, endemic to the Caspian and classified as "vulnerable" by the IUCN) and the majority of the world's sturgeon. Approximately 120 species of fish inhabit the Caspian. Additionally, the shallow sea inlets, bays and estuaries of the Caspian have been recognized as habitats of international importance to ornithology, due both to their large number of bird species, and the total population of birds. The lagoon and coastal areas provide critical habitat to migrating birds from Europe, Asia, and the Middle East (including the Greater Flamingo, Bewick's Swan, the Little Bustard, pelicans, the Purple Gullinules, the Red-breasted Goose, the Pygmy Cormorant, and the Lesser White Fronted Goose).

3. The Korchay Nature Reserve, the Karayazi State Nature Reserve, and Karyazo Akstafa Protected Areas provide habitat to the endangered gazelle (*Gasella subguttroza*) and red deer (*Servus elaphus*), in addition to the Eurasian otter, wolf, and striped hyena (Mustafaev). Existing pipelines cross each of these reserves.

Finally, one should also bear in mind here that the already fragile ecosystems of the Caspian and Black Seas would be impacted by excessive discharge or spills resulting from the extraction and transport of oil.

How Environmental Issues Have Affected Decisions Related to the Pipeline

A 1996 meeting at the Academy of Sciences in Tbilisi provides the most illuminating insights into the general impact of environmental issues on the political and economic decisions shaping pipeline projects in the Caucasus today. In September of that year, the Georgian Pipeline Company (the GPC, which is the Georgian branch of the AIOC) and the AIOC itself convened an advisory board of accomplished Georgian scientists and representatives of NGOs to discuss the environmental impact of the proposed Western Route Export Pipeline (WREP). At the meeting, the GPC and AIOC representatives announced that the WREP would run to Supsa, rather than to Batumi or Poti. Immediately, scientists at the meeting questioned the environmental rationale for deciding to build a new terminal at Supsa rather than utilizing the already existing ports in Batumi or Poti. The GPC responded to this criticism by stating that the public review and advisory council had been convened in order to evaluate how best to protect the environment along the route to Supsa, not to evaluate the ecological merits of various possible ports. To all those involved in the discussion, this statement made very clear the predominance of economic and geo-political factors over environmental concerns in the pipeline selection, design, and construction process.

Given this reality, many environmentalists have nevertheless been rather surprised that, since that meeting, environmental concerns have in fact had a substantive impact on decisions about the pipeline. The most significant example is the AIOC's late 1997 decision to address the risk of oil leaks into the region's extensive network of waterways. The network of large and small rivers in Georgia supports a rich population of fish, including several endangered species of sturgeon (*Huso huso*, *Acipenser colchicus*, *Acipenser* spp) and salmon (*Salmo fario*), as well as providing both major cities with drinking water and farmers with irrigation water. As depicted on the map on page 57, the Baku-Supsa pipeline crosses ten rivers and several minor waterways in Georgia.

According to the plan originally outlined by the AIOC, the existing pipeline would be refurbished, and oil would cross most of these waterways above ground. According to local environmentalists, such exposed pipelines not only fell below international health and safety standards, but also posed particularly significant dangers to a region with a history of punctures to extant pipeline. Indeed, a previous assessment identified approximately 265 illegal taps into the old pipeline. After intense discussions, the AIOC acknowledged in 1997 this environmental and security risk, and agreed to channel the pipelines under, rather than over, waterways, at an anticipated additional cost of between \$15-30 million. The environmental value of this decision was highlighted in late 1991 by an accidental spill from an above-ground pipeline into the river Tortla near Gori, a spill caused by a construction company opening the line for de-oiling without first checking the level of internal oil. This incident followed a similar 1997 spill into the Pichora River (which flows into Paliostomi Lake, close to the Black Sea), a spill that occasioned a suit against the AIOC filed by a local branch of the Ministry of Environment. Although the Ministry later withdrew the suit, in December 1997 an NGO discovered dead, oil-stained waterfowl—including species such as the Arctic Loon (*Gavia arctica*), the Great Crested Grebe (*Podiceps cristatus*), and the Mediterranean Shearwater (*Puffinus yelkouan*)—along the coastline, and used this evidence to arouse further attention in the media to the danger of spills.

For these and similar reasons, the oil-spill issue subsequently effected economic and geo-political calculations about the route of the Main Export Pipeline (MEP). The AIOC's decision to place pipeline water crossings underground has made it technologically possible to double pumping pressure in the pipeline; this, combined with the unexpected early April 1998 determination that much of the existing pipe along the Baku-Supsa route needed to be removed anyway, led to a proposal to replace the existing corroded 24-inch pipe with a 42-inch pipe. Thus, rather than constructing an entirely new leg of the proposed Baku-Ceyhan pipeline through the largely undisturbed and valuable habitat of southern Georgia's Samtskhe-Javakheti region (which includes a network of lakes critical to abundant waterfowl breeding and migration), political and corporate leaders have proposed expanding the capacity of the Baku-Supsa pipeline and utilizing it

as the first leg of the MEP. The combination of the decision to place the pipeline underneath waterways, and the determination that the existing pipeline needed to be replaced, made the MEP route from Baku to Supsa to Ceyhan an economically feasible option. Moreover, this altered route for the MEP had certain geopolitical benefits from the Georgian and Azeri points of view, as this shift would avoid regions in southern Georgia inhabited largely by Armenians and perceived by political leaders as areas of potential manipulation and conflict. As an indirect result of these decisions to protect waterways, the governments of Georgia, Turkey, and Azerbaijan have publicly expressed their support for the inclusion of the Baku-Supsa leg within the MEP rather than the construction of an alternative route for the MEP through southern Georgia. This series of decisions shows that, while the route of the pipeline is clearly being directed by economic and political factors, environmental issues can influence the calculations in a manner favorable to ecological preservation.

Conclusion. Considering the scope and complexity of environmental issues in the region and the impact of the decision to channel the oil beneath the waterways, we can expect that environmental issues will continue to have an indirect effect on the economic and political calculations underlying decisions taken on developing oil and gas in the Caucasus. According to a Georgian activist, one of the greatest environmental benefits from the construction of the pipeline through Georgia is that both individuals and NGOs have gained experience participating in and affecting an international environmental impact assessment. As such, it is probable that, while economic and geo-political factors will continue to dominate oil-related negotiations, environmental issues will also continue to effect decisions about pipelines in the Caucasus.

Russian Foreign Policy and Strategic Interests in the Caspian Region

Igor Zevelev

The collapse of the Soviet Union led to a dramatic historical reversal of Russia's role both in Europe and Asia. While in the early 1980s, the Soviet Union had the second largest GDP in the world, Russia today ranks eleventh in terms of comparative GDPs, lagging behind France, Britain, China, Brazil, and other countries. Only a decade ago, the USSR maintained a strategic parity not only with the United States, but with all of NATO. Today, Russia's demoralized military lacks the capacity to handle the local conflict in Chechnya.

In 1991, Russia's Asian territories shrunk by twenty percent, while the Russian population in Asia decreased from 75 million to 30 million people. In addition, another 30 million people became citizens of the newly independent states in the Caucasus. In this situation, Russia's strategic task is to manage its geopolitical decline, minimize the damage, and adapt to a new, diminished international role. Russian Foreign Minister Evgeni Primakov believes that a multipolar world is a good environment for a weakened Russia, and sees Russia's primary goal as becoming an important regional power.

Paradoxically, Primakov has to confront domestic multipolarity in foreign policy decision-making. While struggling against the hegemonic ambitions of Russian nationalists, Primakov seeks to establish his Foreign Ministry as the predominant institution shaping Russia's policies towards the "near abroad." So far, this has proved difficult to accomplish. Other centers of power with their own interests and agendas continue to resist Primakov's attempts to increase the influence of the Foreign Ministry. For instance, many of Russia's wealthy financial-industrial groups claim that their own interests coincide with those of Russia itself. In other words, "what is good for Gazprom, or Lukoil, is good for Russia." Of course, such conflicts between foreign policy institutions and various special interest groups are not unique to the Russian case. In the era of globalization, non-state actors play an increasingly important role in international relations. However, the Russian case is distinguished by the extreme weakness of the state, and the correspondingly enormous political influence gained by non-state actors.

There are three groups of actors that exert influence on the formation of Russia's policies in the Caspian region. These are 1) the weakened state represented by the Foreign Ministry; 2) Russian oil and natural gas companies, especially Lukoil, Gazprom, Rosneft, and the state-owned company Transneft, which has a monopoly over export pipelines running through the territory of Russia; and 3) less influential actors, such as the fishing industry, regional leaders and semi-independent Chechnya.

The strategic importance of the Caspian region follows primarily from the abundance of natural resources in that region. Many foreign policy analysts in Russia argue that the Caspian will, in the near future, compete on the world market with Russian oil and gas deposits in Western Siberia. Currently, Russia exports 90-100 million tons of oil a year. By 2015, the Caspian states are expected to export 100-200 million tons of oil per annum to the world market. Despite the concerns of Russian politicians regarding the potential economic competition in the energy export sector posed by the Caspian states, Russian companies and financial industrial groups continue to actively participate in the development and transportation of Caspian oil reserves.

We thus see how the profit-maximization objectives of the Russia's business elite often clash with the geo-strategic considerations of Russian political establishment, which views the Caspian region as a zone of Russia's vital political interest. Since 1993, Russia has adopted a more assertive position toward the "near abroad." This policy emphasizes the importance of developing friendly ties and economic integration with the newly independent states, as well as pursuing political and military integration between Russia and some of these states, where possible. Factors that contribute to the formation of Russia's policies towards the Caspian states include: 1) economic, military, and personal ties between Russia and these former Soviet republics inherited from the Soviet period; 2) the activities of traditional regional players (Turkey, Iran) and new actors (the United States, Western oil companies) that challenge Russia's primacy in the region; 3) Russia's participation in both settling local ethnic conflicts, and in generating internal political instability in some southern newly independent states; and 4) the flow of narcotics from the region. Furthermore, in Kazakhstan the issue of a Russian diaspora constituting forty percent of the republic's total population may emerge as an important instrument of

Russia's regional influence. By contrast, in other Caspian states, Russian communities are dispersed and relatively small in number.

The development of relations with Iran and Turkey has been another important factor shaping Russia's policies toward the Caspian region. Russia is cautiously developing a tactical alliance with Iran in order to counter the increasing participation of Turkey in Central Asia and the Caucasus. The sales of high-tech missile technologies and the construction by Russia of the nuclear power plant in Buzher provide evidence of the continuing development of bilateral relations. However, this cooperation is weakened by the competition over alternative pipeline routes, Russia's fears of Islamic fundamentalism, and the negative reaction of the United States to the deepening of Russian-Iranian relations.

Several factors, however, prevent Russia from conducting a consistent and efficient policy towards the Caspian. These include institutional weakness and conflicting interests between various foreign policy institutions and actors; the deterioration of traditional instruments of influence, including the conventional armed forces; and the continuing economic crisis in Russia. Nevertheless, Russia continues to enjoy significant leverage in relations with Caspian states, due to its military presence in every country of the region with the exception of Azerbaijan; Russia's active participation in mediating the region's ethnic conflicts; the dispute over the legal status of the Caspian Sea (although Russia's attempts to use this issue have not to date been effective); Russian control of most existing export pipelines; and the strengthening of Russia's oil companies. For instance, Lukoil participates in three of the five biggest oil projects currently underway in Azerbaijan.

One of these sources of leverage, however, may soon begin to erode, as Russia's monopoly on oil transportation has been challenged by proposed alternative pipeline routes, such as the Baku-Ceyhan project, and the "East-West" project that envisions the construction of a pipeline crossing the Caspian. Although these projects are supported by the United States, which seeks to diversify the routes of oil exports, their implementation is problematic, mainly due to high costs.

The evolution of the dispute over the legal status of the Caspian Sea suggests that Russian oil companies may have increasing leverage in shaping Russian policies towards Azerbaijan and other Caspian states, further complicating the goal of consolidating policy-making toward the region under the Foreign Ministry. The Russian-Iranian treaties of 1921 and 1940 stipulated the “joint use” of the sea, forbidding any unilateral steps without consultation with the other party. Up until the collapse of the USSR, the Caspian was considered by both countries a lake, shared by Iran and Russia and inaccessible to other countries. Today, the situation is very different, with five states and multiple transnational corporations pressing their claims to the Caspian’s natural resources. In 1993-1994, the Russian Foreign Ministry insisted on a joint-use approach to the exploitation of all Caspian resources, maintaining that only a 45-mile exclusion zone extending from the shore of each littoral state would fall under the exclusive jurisdiction of one or another state. This position was supported by Iran and, initially, Turkmenistan. The alliance of Russia and Iran on this issue became possible because both countries do not have any significant oil deposits in their respective sectors of the Caspian. On the other hand, the holders of the lion’s-share of these off-shore deposits—Azerbaijan and Kazakhstan—were opposed to the joint-use principle. Russia’s insistence that any compromise solution must first obtain Iranian consent contains a veiled anti-US threat. After all, Iranian participation in all deals concerning the joint use of Caspian resources would effectively exclude large American oil companies from participating in the consortium, since American firms are prohibited under current US law from entering into any business arrangements with Iran.

Starting from 1993, Russian oil companies have advocated a new approach toward the Caspian problem. Representatives of Russia’s Lukoil company played the key role in Russia’s de-facto acceptance of the division of the Caspian sea into national sectors. In 1993, Lukoil first signed agreements with Azerbaijan and Turkmenistan. Despite the tough rhetoric of the Russian Foreign Ministry, the government could not (or did not want to) stop these business contracts. In 1996, Gazprom signed multiple agreements with Turkmenistan concerning the development of natural gas deposits, and for the upgrading of Turkmenistan’s natural gas industry. In 1998, the Russian political establishment followed private companies in accepting the legal claims of Azerbaijan and Kazakhstan to

their sectors of the Caspian. A compromise proposal sought to divide the Caspian seabed into national sectors, while leaving the water resources in joint use. In February of 1998, Russia signed multiple agreements with Kazakhstan, thus facilitating a possible rapprochement with Azerbaijan and Turkmenistan. Although the agreements between the Caspian states virtually excluded Iran, Moscow and Tehran still share some common interests, such as a desire to curb the influence of outside actors in the region, and opposition to the construction of pipelines across the Caspian seabed.

In contrast to earlier attempts to try and undermine the activities of the AIOC, Russia's most recent policies towards the Caspian states have been dominated by the desire to secure the participation of Russian companies in all Caspian projects. Despite this shift, the Russian leadership was unable to prevent a few blunders, such as the so-called "Kyapaz incident," when an agreement between Rosneft and the Azeri state oil company was reversed by the Russian government in the wake of loud protests on the part of Turkmenistan that it was the legal owner of the disputed Kyapaz field.

The selection of pipeline routes for exports of Caspian oil represents another sphere in which Russia has tried to actively exert influence in the region. In their competition to influence the selection of various pipeline-route options, Russia, Turkey, Iran, and the United States have all shown an obvious desire to increase both their geopolitical influence, and the profits to be reaped from controlling and transporting oil. Currently, all Caspian states remain highly dependent on the pipelines that run through Russian territory for transporting oil to the world market. Realizing that in the near future this monopoly will be undermined by the construction of new export pipelines, Russia is trying to use its influence to persuade the pipeline consortium to adopt routes more favorable for Russia, namely, the Baku-Novorossiisk and Tengiz-Novorossiisk routes. Thus Russia has striven both to secure a northern route for "early" oil from Azerbaijan and to prevent the construction of the proposed Baku-Ceyhan pipeline. Turkey, however, controls the Bosphorus Straits, and thus could potentially limit the amount of oil that is delivered by tankers from Russia's port of Novorossiisk. Due to this fact, and the fact that Turkey stands to gain the most from the proposed Baku-Ceyhan pipeline route, Turkey has emerged as Russia's main rival in the competition over pipeline routes.

In Russia, the external dispute on the issue of pipeline routes is mirrored internally as a conflict between various interests. On the one hand, “hard-liners” indifferent to transnational cooperation stress geopolitical interests in their drive to recapture for Russia the regional domination once enjoyed by the former Soviet Union. On the other hand, pragmatic politicians and businessmen representing the interests of the new non-state actors are attracted by the potential economic benefits Russia would gain from participating in cooperative oil projects and transporting Caspian oil through Russian territory. Thus, in 1993-94, two Russian policy lines toward the coming Caspian oil boom evolved simultaneously.

From 1995 on—and especially in 1998—the pragmatic line dominated the views of Russian politicians. On March 2, 1998, Sergei Kirienko (then the Fuel and Energy Minister) declared: “Let the economy decide Caspian pipeline routes.” Nevertheless, the victory of the pragmatic approach should not be taken for granted. A 1997 report entitled “CIS: The Beginning of the End of History,” prepared by a prominent Russian think tank, the Institute of Diaspora and Integration, concluded that de-stabilizing the political situation in the “near abroad” was more preferable for Russia than allowing the consolidation of anti-Russian newly independent states in the Caucasus and Caspian littoral. The report outlined the means by which Russia could restore its pre-eminence in the South. For instance, the report suggests, Russia could secure Armenian military superiority in its conflict with Azerbaijan, and back the secessionist aspirations of the Lezgin and Talysh (Iranian-speaking minority) minorities in Azerbaijan.

The views of Russian pragmatists do not necessarily contradict either US interests in the region, or the interests of the American companies operating in the Caspian. However, some regional conflicts of interest between Russia and the United States remain. The United States is too distant to be geopolitically dominant in this part of the world, but is too powerful not to be actively engaged. The general strategy for US involvement in the Caspian was recently outlined by Zbigniew Brzezinski in the book, *The Grand Chessboard: American Primacy and Its Geostrategic Imperatives*. These objectives include preventing the restoration of Russia’s dominance in the region, and reorganizing the system of international relations in ways that favor the emergence of many relatively

stable and moderately strong states and hamper the rise of any single dominant power in Eurasia. According to Brzezinski, if Russia controls the Caspian Sea, the role of the United States in the region will be minimal. On the other hand, if the Caspian is divided between five sovereign states, some of which would be dependent on Western investment and technology, then American geopolitical interests in the region would be maximized. Moreover, a commercial bonanza for US oil companies would thus be guaranteed.

On March 3, 1998, Ambassador Thomas Pickering, the Under-Secretary of State for political affairs, presented Washington's official view of US objectives in the region, emphasizing Washington's goal of promoting sovereignty, democracy, and prosperity in the Caspian states. During an address at the Johns Hopkins University, Deputy Secretary of State Strobe Talbott expressed a similar view, adding that in its relations with the newly independent states, the United States will press for the respect of human rights. So far, this rhetoric has not been supported by action, as the authoritarian leaders of Azerbaijan and Turkmenistan have received grand receptions in the White House.

The second US objective in the region is to foster conflict resolution. Here the interests of Russia and the United States seem to concur, because Russia has finally chosen to support and build constructive relationships with present regimes and discourage any secession attempts. Although Russia continues to resist international participation in peacekeeping operations in the former Soviet states, the United States has to date evinced little discomfort with this and, so far, has not made any attempts to restrain Russia's desire to remain the region's principal peacekeeper.

The third US objective is to support the development of an east-west transportation corridor that would bring the Caspian energy resources to the market; serve US oil companies' interests in the Caspian; and develop alternate pipeline routes outside Russia. For instance, President Bill Clinton has expressed his support for the Baku-Ceyhan route.

In conclusion, international competition over Caspian oil reserves is often compared to "the Great Game" played between Russia and Britain in Central Asia in the nineteenth century. However, some major differences exist between these two historical periods. While the Great Game involved only two major players, today there are five

independent states sharing the Caspian, and several additional outside players with conflicting geopolitical and economic goals are active in the region. Furthermore, large oil and gas companies are also involved in the region as independent (or semi-independent) actors. Finally, while in the nineteenth century, Russia was on the rise, today it is in economic and military decline.

Russia's success in adapting to this new situation largely depends on the political wisdom of the Russian political establishment. Recent developments in and around the Caspian region suggest that Russian politicians have proved capable of realistically assessing Russia's limited ability to use great-power methods in relations with the "near abroad," and have instead opted to assist Russian oil companies involved in the region. The question today is whether Russia will continue with this policy of regional moderation, or whether it will return to more assertive policies by, for example, encouraging various separatist movements in the South. In the end, the answer will depend on the type of political regime established following the elections in the year 2000, as well as on the success or failure of democratic and economic reforms in Russia in the coming years.

The Congress and United States Foreign Policy toward the Contemporary Caucasus

Michael Ochs

For good or ill, the legislative and executive branches of the United States government tend to treat the Caucasus and Central Asian region as one entity. I will frame my comments today accordingly.

In a recent article, Ian Bremmer wrote that, “less than a decade after its collapse, the Soviet Union has been eclipsed by the Caspian Basin as an American strategic priority.” Though I don’t necessarily agree with this very strong statement, it is certainly the case that both the executive and legislative branch have shown a markedly intensified level of interest in the Caucasus and the Caspian Basin. President Clinton and the National Security Advisor, Sandy Berger, have made statements about the region being one of strategic national interest for the United States. This says a lot, even if the Caspian region has not actually eclipsed the former Soviet Union as an American strategic priority. Some of the other speakers today have already made reference to US policy in the region, but I am going to try to encapsulate it on the basis of statements by high-ranking US government officials made in various fora—including congressional testimony—and then look at the foreign appropriations budgets that Congress has passed.

United States Policy Goals. The most comprehensive statement of US policy towards the Caucasus and Central Asia was made almost a year ago by Deputy Secretary of State Strobe Talbott at the Central Asia Institute of the School for Advanced International Studies (SAIS) in Washington, DC. When taken in conjunction with many other statements of policy by other government officials, his remarks can be divided into subsets of positive and negative policy goals.

Let’s start with the positive; namely, what would the United States like to see unfold in the region? To quote Talbott, “the US has a stake in the independence, prosperity, and security of all the states in the region.” He noted that if reform succeeds here, it would encourage similar progress in other parts of the newly independent states (NIS), including Russia and Ukraine. However, as he put it, “the ominous converse is also true.” That is, if reform does not succeed, the entire region—bordered by states

which are themselves for the most part undemocratic and often riven by dissension, war, and terrorism—would fall victim to similar ailments, and this would be very detrimental to US interests “in an area that contains possibly as much as 200 billions barrels of oil.”

Talbot’s citation of this figure is noteworthy. Though his remarks were made almost a year ago—some time before recent studies indicating that the amount of oil in the region might be far less than 200 billion barrels—they were nevertheless based on a State Department report. Obviously, the more oil in the Caspian basin, the more interested we are. Consequently, Talbot drew the conclusion that “conflict resolution was job one” for US foreign policy, and he pointed specifically to the US role in helping negotiate settlements to the conflicts in Nagorno-Karabakh, Abkhazia, Tajikistan, and Transdnistria.

In talking about US support for achieving the above-stated goal, Talbot broke down US policy into four categories. The first is democracy-building. Certainly administration representatives would take strong issue with previous speaker Igor Zevelev’s assessment that democracy-building is no longer very much on the agenda of US foreign policy. Under the general rubric of democracy-building, Talbot had in mind the sponsorship of programs that promote the rule of law, civil society, independent media, non-governmental organizations (NGOs), and the like. The second policy category covers initiatives designed to promote free markets, including support for privatization and legislation that would create tax and tariff structures conducive to foreign investment. The third category focuses on the sponsorship of peace and cooperation between and among the countries of the region; and the fourth, the integration of the entire region into the international community. In a word, US goals aim to support the independence, sovereignty, and prosperity of all the states in the region.

With respect to energy, it is US policy to promote energy development in the region, and to ensure US access to those energy sources. Within that general framework, the United States supports east-west corridors for the transport of energy, goods, and services, and that means support for multiple pipeline routes, which would ensure diversification of supply and prevent disruptions of supply. Specifically, the United States supports a Baku-Ceyhan pipeline, and trans-Caspian oil and gas pipelines, as has been

discussed today by other speakers. While doing all of this, it is US policy to support and promote US business opportunities, and, in dealing with all the countries of the region, to support their ability to protect their own security. This means involvement in the Partnership for Peace, support for the Central Asian Peacekeeping Battalion, support for these countries' ability to guard and maintain their own borders and customs, and to do whatever is necessary to help them prevent proliferation of weapons of mass destruction, narcotics, etc.

So much for the positive goals of US foreign policy. What is the US government against? Specifically, the US government does not accept spheres of influence in this region. As a corollary, Strobe Talbott mentioned the idea of "winners all, losers none." Talbott specifically elaborated this notion in his talk when he argued that "the Great Game" of the nineteenth century should not be allowed to repeat itself today. There need not be losers; everyone can be a winner. This at least is the stated point of view of the man who is most responsible for crafting US policy in this region.

As other speakers today have pointed out, the United States is strongly opposed to any pipelines through Iran, because it views Iran as essentially a rogue state that opposes Middle East peace efforts and is involved in terrorism. The United States is also strongly against giving Iran the opportunity to accrue revenue from oil transit fees and to gain political leverage over countries that would have to rely on Iran to transport their resources to the rest of the world.

Talbott also pointed out Russia's strategic ambivalence toward this part of the world. There are forces in Russia, he said, that would like to recreate the Soviet Union and are interested in reasserting hegemony over these regions, and then there are others who have a more modern view of Russia's national interests and its relations with these countries. Talbott stressed that the goal of US policy is to ensure that the latter view prevails in Russia. At a talk in February 1998 at the Central Asian Institute at SAIS, William Courtney, our former Ambassador to Kazakhstan and Georgia, and currently in charge of Eurasian policy at the National Security Council, explicitly said that it was also part of American foreign policy to see to it that Russia did not have a monopoly on pipeline routes. Of course, that could have been inferred from Washington's multiple

pipelines policy, but it was noteworthy as an explicit statement on the issue by a US government official.

Furthermore, the United States does not want to subsidize these pipelines. While the government supports the construction of any number of pipelines, Washington insists that they be financially self-sustaining. Finally, all executive-branch statements of American policy toward the region oppose Section 907 of the 1992 Freedom Support Act, which governs the sanctions introduced on government to government aid between the United States and Azerbaijan. I'll return to this theme later.

Let us now turn our attention to the congressional view of the Caspian region. First, however, I'd like to cite two critical assessments of US policy in the area, one by Ian Bremmer, and the second by Fred Starr, director of the Central Asia Institute at SAIS. Among the points that Bremmer made in a recent article, he noted that US policy statements and actions with respect to Russia and Russian policy indicate an uncertainty on the part of the US government as to what exactly we want from Russia in the region. Bremmer concludes that we should strive for a policy of cooperation with Russia.

In a piece published in *The National Interest* last year, Fred Starr laid out a quite different perspective. He concluded that the United States was indulging Russian sensibilities to excess in the South Caucasus and Central Asia. Starr strongly argued that the United States should drop its opposition to pipelines through Iran, because in many ways the policy deprived Central Asia and the Caucasus of the most reasonable, cost-effective option for transporting energy. I mention these two points of view not because they necessarily have influenced either executive or congressional policy, but simply to give you a frame of reference for the congressional views on some of these issues.

Congressional Views on US Foreign Policy in the Contemporary Caucasus.

Let me make a couple of general remarks about Congress. First, there is no question that as with the executive, so in the legislative branch of government, the intensification of interest in the South Caucasus has been very marked in the last few years. This is evident in the number of hearings that have been held on exercising congressional mandates for oversight and also in deciding foreign aid; a large and growing number of congressional trips to the region; and many legislative initiatives, some of which I will discuss later. To

state the obvious, Republicans currently control Congress, and we have a Democratic president. That adds a partisan element of criticism of US government policy by a Congress to what would otherwise be the normal creative tension between executive and legislative branches.

Second, a Republican Congress tends to be conservative on several levels, including the fiscal and geopolitical levels. Moreover, a certain isolationism characterizes various members of Congress. Finally, this Republican Congress displays a traditional, residual suspiciousness towards Russia, and both parties remain suspicious of Iran.

Third, Congress has generally exhibited a certain reluctance to encroach on presidential prerogatives when it comes to foreign policy making. Now this obviously doesn't apply to all members, but there is a tendency to respect the president's right to make foreign policy. Therefore, legislation pertaining to foreign policy often includes a presidential waiver. That is, the legislation will contain a provision allowing the president to waive the application of the law if the president concludes that such a waiver is in American national security interests. Let me give you an example. In 1997, legislation called the Humanitarian Aid Corridor Act was passed. This law would cut off assistance to countries that bar the transit of humanitarian aid to third countries. Mostly, it was directed at Turkey, for not allowing US humanitarian aid to go through to Armenia, but the president has consistently waived the application of this act.

All of this serves as an introduction to understanding the evolution of current thinking in Congress toward the Caucasus and Central Asia. From what I have seen on the Hill, there is relatively little congressional disagreement with the goals of US foreign policy in the region. Of course, as Senator Patrick Leahy (D-VT) said recently to Deputy Secretary Talbott in a hearing, "the way you phrase the goals of US foreign policy, it's hard to find grounds to object to them." Still, there are several instances where the congressional perspective differs from or is more strongly accented than the administration's perspective.

The first difference concerns policy toward Russia. Let me cite a few recent congressional remarks in this regard to illustrate the point. The first comes from a press conference held on April 21, 1998, by Senator Sam Brownback (R-KS), Chairman of the

Near Eastern and South Asian Affairs Subcommittee of the Senate Foreign Relations Committee; and Congressman Bob Livingston (R-LA), Chairman of the House Appropriations Committee. They had both recently returned from a trip to the Caucasus and Central Asia, not long after the second assassination attempt on Eduard Shevardnadze. Senator Brownback said: “We did not stand up at that time and say to the Russians ‘this is wrong.’ We do not support a policy of destabilization of the leadership in Georgia. A weak US policy in Central Asia and the Caucasus invites the expansionist forces in Russia and Iran and encourages them, so I think we need to put forward a much stronger policy.” Livingston agreed with Brownback. As I said, many members of Congress who are involved in foreign policy, particularly as it relates to this part of the world, tend to be suspicious of Russia and to call for a stronger and more assertive foreign policy with respect to what are perceived as Russia’s unfriendly, unhelpful goals in this part of the world.

There are other instances of this anti-Russian attitude. At a recent congressional hearing, Steve Sestanovich, the ambassador (at large) to the CIS, was testifying. Congressman Lee Hamilton (D-IN), the ranking minority member of the International Relations Committee, asked whether the US government objected to Russian bases in Armenia and Georgia. That was an awkward question for an administration official, as Armenian government officials have pointed out repeatedly that Russian bases are in Armenia with the full approval of the Armenian government. The situation is more difficult in Georgia, because the parliament has been opposed to them, but Shevardnadze has argued that the bases are necessary, at least for the present. In any case, Sestanovich answered that we cannot object, since they are in these countries with those governments’ approval and agreement. At some point later in the hearing, Congressman Doug Bereuter (R-NE) said that he was appalled that the US government did not object to the presence of Russian bases in Armenia and Georgia and that he intended to introduce a resolution expressing strong disapproval of that fact.

Furthermore, at another congressional hearing, Congressman Rohrabacher (R-CA) said that he was very unhappy with Russian policy with respect to Iran; that is, the assistance given Iran by Russia in developing nuclear capabilities. He asked Richard

Morningstar, who is in charge of all our aid policies in the former Soviet Union, to provide him with everything that we have done in the former Soviet Union since the very beginning of US aid to that region. The inference was that he intended to introduce sanctions on Russia in response to its behavior in the region. Concerned, Morningstar said, “I hope that you will take into account, when you look into this, those programs that are useful and the ones that we really need for US interests.” My point here is that while the administration acknowledges a strategic ambivalence in Russia towards the Caucasus and Central Asia, various influential members of Congress have expressed a strong sense that the US government is not being sufficiently assertive in protecting these countries from predatory Russian policies.

With respect to Iran, recall that Fred Starr suggested we drop our objection to pipelines through Iran. When it comes to Congress and Iran, if anything, the Congress is even much stronger on record than the administration has been in opposing anything having to do with improving relations with Iran, or allowing Iran to make any money off of pipelines or any other economic deals. In 1996, the Congress passed ILSA, the Iran-Libya Sanctions Act, which involved sanctions on companies that contribute capital to the development of Iran’s petroleum industry. When ILSA came up for a vote, nobody voted against it. There is no indication that the administration is the least bit interested, for the moment, in allowing any pipelines to go through Iran, and there is every indication that Congress is even more strongly opposed to any such initiative.

Congressional Policymaking on the Contemporary Caucasus. First, let’s review the players and the playgrounds: who are the people on the Hill who are influential in policymaking when it comes to this part of the world?

In the House of Representatives, of course, there’s the International Relations Committee, chaired by Ben Gilman (R-NY). The ranking member is Lee Hamilton. Gilman and Hamilton hold many oversight hearings, and these are the source of many of the congressional testimonies I cite today. Perhaps more directly relevant to some aspects of policymaking, we find next the House Appropriations Committee, and particularly its Subcommittee on Foreign Operations, Export Financing, and Related Programs. Bob Livingston chairs the full Committee and Sonny Callahan (R-AL) chairs the

Subcommittee. More recently, Doug Bereuter, the Chairman of the Subcommittee on Asia and the Pacific of the International Relations Committee, has become involved in policymaking toward the region. Bereuter is another member of Congress unhappy about Russian policy in the Caucasus and Central Asia.

We cannot fail to mention the Armenian Caucus in the House of Representatives, founded in January 1995. At present, 62 members of the House belong to this Caucus. Bear in mind that the House has 435 members, so the 62 members of the Armenian Caucus constitute about 15 percent of all Representatives, a pretty impressive number. In a letter inviting other members to join, the co-Chairmen of the Armenian Caucus, Frank Pallone (D-NJ) and John Porter (R-IL) wrote: “The Caucus is an official congressional member organization, on record with the Committee on House Oversight; as such, we are an informal organization of members who share a concern for a stronger US-Armenia relationship while better representing the over one million Americans of Armenian descent.” The Armenia Caucus, particularly the two co-chairmen, has been extremely active in promoting Armenia’s interests on the Hill. Their priorities are: 1) ensuring foreign aid to Armenia; 2) maintaining Section 907 in effect; and 3) seeing to it that Nagorno-Karabakh gets direct US government assistance. Congressman Pallone has been a vocal critic of Administrative policy with respect to the OSCE and the Minsk Group negotiations, which he considers to be weighted in favor of Azerbaijan, and an attempt to impose a pro-Azerbaijan solution on Armenia through the OSCE.

In the Senate, of course, there’s the Foreign Relations Committee, chaired by Jesse Helms (R-NC). He, I believe, has never traveled to the region. But two members of the Senate have traveled frequently to the region, and are quite influential in policymaking, namely, the Chairman of the Senate Subcommittee on Foreign Operations, Mitch McConnell (R-KY), and Sam Brownback (R-KS). Senator McConnell is directly involved in decisions about foreign aid to the region. Sam Brownback has recently introduced legislation, which I will talk about later, but these are among the most important players on the Hill when it comes to the Caucasus and Central Asia.

Though they are not congressional bodies, two American-Armenian organizations, the Armenian Assembly of America and the Armenian National Committee of America

(ANCA), deserve mention here, as they wield considerable influence on the Hill. The Armenian Assembly, which describes itself in its press releases as a “nationwide non-profit organization that promotes public understanding and awareness of Armenian issues,” is a non-partisan organization; it is not affiliated with any Armenian political parties. The ANCA, by contrast, is affiliated with the Armenian Revolutionary Federation (ARF), or Dashnaks, which is the oldest Armenian political party. There was a time when these two organizations were rather at odds, because President Ter-Petrossian in 1994 banned the ARF in Armenia. But when it comes to foreign policy and getting US aid into Armenia, they have always cooperated, and since both support the new Armenian President Kocharian, it can only be expected that their cooperation will continue, and probably intensify.

Congressional Aid Appropriations for the Caucasus and Section 907. How have all these players and views been translated into US government and congressional budgets? In fiscal year (FY) 1994, reflecting the budget decided in 1993, US aid to the NIS peaked at 2.4 billion dollars. The following year it went down to 850 million dollars (FY 1995), and in FY 1996, it dropped to 641 million dollars. In FY 1997, it went down to 625 million dollars. Focusing specifically on the 8 countries of the South Caucasus and Central Asia, between 1992-1997, US government assistance totaled over 2.2 billion dollars, with the general tendency to shift from humanitarian to developmental aid. In November 1997, before the FY 1998 foreign aid appropriations were passed, Congress allocated 250 million dollars to the South Caucasus, and 90 million to Central Asia. For FY 1999, the US government has requested 925 million dollars for the region, a substantial increase.

A few patterns in foreign aid should be mentioned. In FY 1996, reflecting a decision made in 1995 and presumably connected with congressional unhappiness about the war in Chechnya, Russia’s unhelpful policies in the Caucasus, and probably unhappiness about statements of various Russian politicians about Ukraine, there was a shift in emphasis away from Russia, and towards Ukraine, Armenia, Moldova, Georgia, and Kyrgyzstan. Enterprise funds were created for the Transcaucasus and for Central Asia, and earmarking of aid was instituted for Armenia and Georgia. In FY 1995,

Armenia received an earmark of 75 million dollars, and Georgia received 50 million dollars. In FY 1996, Armenia received 85 million dollars, and Georgia got 30 million dollars. In 1997, aid for Armenia was earmarked at 95 million dollars, and while there was no earmark for Georgia, it was expected that aid would be almost as much as the year before. In FY 1998, this current fiscal year, the earmark for Armenia slipped a bit to 87.5 million dollars and the earmark for Georgia rose to 92.5 million dollars.

All of this assistance goes to governments, NGOs, and to the private sector, with one exception; namely, the Azerbaijani government, due to Section 907 of the Freedom Support Act. After all, there can't be any drama without conflict. And if there is one issue over which the Administration and Congress have consistently been at odds, it has been Section 907.

Section 907 was introduced in 1992, as part of the Freedom Support Act. It bans government to government assistance from the United States to Azerbaijan until and unless the president can report to Congress that Azerbaijan has taken demonstrable steps to cease all aggression and end all blockades. What that means is that the US government has been unable to give any assistance, with a few exceptions, to the government of Azerbaijan, and all programs and monies that have been funded for Azerbaijan have been given to and through NGOs. That ban has been maintained in effect since 1992. The US government has always been against it; the Bush and Clinton administrations opposed it, claiming that it impedes the ability of the United States to pursue its goals in the region, and makes it difficult for Washington to be an honest broker in the negotiations over Nagorno-Karabakh. Those members of Congress who supported maintaining the ban argue that the situation that led to the imposition of sanctions in the first place—the blockade and aggressive policies of Azerbaijan—have not changed. So since 1995, we have seen an ongoing struggle in the House and Senate Foreign Appropriations Sub-Committees over Section 907.

Section 907 does not contain a presidential waiver, so the administration cannot waive it on the basis of national security interests unless, as I have mentioned, it reports to Congress that those circumstances which occasioned the imposition of the sanctions have changed. This has not happened, and in very recent congressional testimony, when

Senator McConnell asked Strobe Talbott why the administration hadn't waived the bill, Talbott responded that Azerbaijan has not done anything that would allow us to waive it; the blockades are still in effect even though there has been a cease-fire since 1994.

There have, however, been a few dilutions of Section 907. Legislation for FY 1996 eased Section 907 to allow the US government to give humanitarian aid to the government of Azerbaijan, if the US president determined that the delivery of humanitarian aid through NGOs was inadequate. Then, in discussions on the FY 1997 budget, a new element entered the debates around the foreign aid bill in the House. Congressman Porter introduced an amendment which would have provided for direct US government assistance to Nagorno-Karabakh—this had not been proposed before (to my knowledge)—which elicited a very strong reaction in Azerbaijan. Baku saw the attempt to direct US government assistance to Karabakh as an attack on Azerbaijan's territorial integrity. The State Department also opposed it for that reason. Congressman Porter and others who supported the initiative argued that it was necessary for humanitarian reasons. The House passed it that year, but when House and Senate came to conference, it was killed. Nevertheless, having already been raised on the agenda of the Committee on Foreign Operations, it was sure to emerge again, which it did last year. In 1997, Section 907 was diluted in the following ways, at the initiative of the Senate: 1) OPIC, TDA (Trade and Development Agency) and ExIm Bank operations were allowed in Azerbaijan; and 2) direct government to government assistance on democracy-building and for humanitarian purposes was made possible. At the same time, the foreign aid bill for last year allocated 12.5 million dollars for direct US government assistance to Karabakh.

So what have been the general trends in the debate around Section 907 in the last few years? First, initiatives to weaken it have generally come from the Senate, whereas the House has generally supported Section 907. Now there is in fact a bill before the House by Congressman Peter King (R-NY), which would eliminate Section 907, but I'm not aware that it has gone anywhere. So while Section 907 has been diluted in the last few years, it remains the law of the land. Moreover, the earmark for aid to Armenia has also been maintained, and in the House, pressure to provide direct aid to Karabakh has increased. Currently, debates are about to take place in the House on foreign operations,

and the Armenian Caucus, backed by the Armenian Assembly and the ANCA, is in favor of a hard earmark of 20 million dollars for Karabakh (a 7.5 million dollar increase over last year). There will also be pressure within the House to keep this aid exclusively within Nagorno-Karabakh, because the language of the legislation was carefully written; it says that the aid should go to the “victims of the conflict in Nagorno-Karabakh,” which could be interpreted to mean that since there are also Azerbaijani refugees of the conflict, it might go to Azerbaijan. Congressman Pallone and others have strongly spoken out against any such diversion of the aid and will insist it go to Karabakh directly.

Now let’s factor US government proposals for FY 1999 into the analysis. As I have mentioned, the administration has asked for 925 million dollars, and interestingly, this request does not specifically ask for or earmark aid to Karabakh. Today, four pieces of legislation of direct relevance to the administration’s regional policies and budgetary request are before Congress. I will give you a brief overview of these legislative proposals and their potential implications for US policy:

1. Congressman Sherman (D-CA), a member of the Armenian Caucus, has proposed a bill that calls for the imposition of new sanctions against Azerbaijan if it engages in armed aggression or renews hostilities against Armenia or Nagorno-Karabakh. There is no mention of Section 907 in this bill, but it simply assumes that Section 907 will remain in effect. There is a presidential waiver, on a case by case basis, and it calls on the president to ban any loans from international financial institutions to Azerbaijan if it renews aggression.
2. Frank Pallone’s bill emphasizes that the blockades and border closures, which occasioned the imposition of Section 907, remain in effect. While it calls for strengthening the independence, sovereignty, democratic government, and human rights of all the countries in the region, including help for conflict resolution, etc., the Pallone bill would supersede all previous legislation except Section 907. It would in effect call for 907’s sanctions to remain in effect and in fact, would appear to cancel the dilution of Section 907 enacted last year. While Pallone does not call directly for US aid to Karabakh, he does call for humanitarian aid and economic reconstruction assistance for victims of the

conflicts and other individuals in need throughout the South Caucasus region, including aid for Nagorno-Karabakh.

3. and 4. The Silk Road Strategy Act is actually two different but similar bills in the House and Senate, one proposed by Representative Gilman, and the other by Senator Brownback. Basically they call for a codification in law of all the policies that I have laid out before—promotion for democracy-building, conflict resolution, support for the independence and sovereignty of these countries, and making available ExIm Bank, OPIC, and TDA funds for this purpose. Also, they specify assistance for the prevention of narcotics trafficking and proliferation. What distinguishes these two bills is that Gilman would have his legislation supersede all previous legislation except Section 907, with the following exceptions: humanitarian assistance, democracy-building, prevention of narcotics trafficking, anti-crime operations, and international financial assistance. In other words, Gilman’s bill would maintain Section 907 on the books, but codify the dilutions of last year’s foreign operations appropriations bill.

Brownback’s legislation, by contrast, would supersede all previous legislation. In other words, while not specifically mentioning that Section 907 would be eliminated, that would be the practical effect of his bill. Moreover, unlike Pallone’s bill, Nagorno-Karabakh is not mentioned specifically in either the Gilman or Brownback bill. Each calls for US promotion of efforts to resolve conflicts “in Georgia, Azerbaijan, and Tadjikistan,” which presumably indicates an emphasis on the territorial integrity of these countries. They also call for aid to “countries,” as opposed to the Pallone bill, which calls for aid to individuals.

The Clinton administration is opposed to the Gilman bill because it maintains 907 in effect. It has problems with the Brownback bill, not because it objects to anything particular in the bill, but some of its language would essentially tie the administration’s hands when it came to making decisions about the administration of foreign aid.

The Armenian Caucus, the Armenian Assembly, and Armenian National Committee have come out against both the Gilman and Brownback bills, and are in favor

of the Sherman and Pallone bills. These issues are going to be key as the debates on foreign aid to the Caspian region heat up in the next six months. In the Senate, there has been a tendency over the last few years to weaken or get rid of Section 907, while the House has tried to maintain 907 and get direct US aid to Karabakh, so the debates both within and between these chambers will give us a better sense of how much backing Section 907 retains in Congress, six years after its passage, and after a period of intensified administration lobbying against it. It should be remembered, however, that this is an election year, which makes it unlikely that 907 will be further diluted, much less eliminated.

I'd like to make two more quick points, unrelated to Section 907, about remarks made recently, one by Congressman Livingston and the other by Senator McConnell. Both of them are potentially, at least, very important. At a recent hearing, McConnell said to Strobe Talbott that, "while you might not expect it of me or anyone in Congress, I am not unalterably opposed to the participation of US forces in a possible peacekeeping force in Karabakh." This is the first time I have heard any member of Congress make such a statement. Nothing may come of it, and I am not sure what other members of Congress think about this issue, but when Mitch McConnell says he is "not unalterably opposed," the administration is going to pay very close attention, because any Karabakh settlement will require a multinational peacekeeping force. And the participation of US troops, even in small numbers, would help to convince all the parties that the peace will in fact be kept, so congressional statements backing the idea could represent an important step forward in the peace process.

The other remark was made by Congressman Livingston. I said before that the US government has been consistently against the subsidization of pipelines; that is, US government policy has been that pipelines must pay for themselves. Nevertheless, Congressman Livingston, at a recent press conference held after coming back from the region and talking with the leaders of some of these countries, said a very interesting thing: "If you look at maps, you begin to realize how important it is that pipelines be in areas that benefit the freedom-seeking, democratic countries of that region, and that very likely may not be the cheapest way to go. International oil companies of their own right

may wish to go the cheapest route, and if we can't for security reasons convince them that it's the right thing for US policy and for world policy to choose a longer route, then yes, it may well be that we may have to come up with additional funds to supplement the extra cost of those pipelines." Now this could be a big deal. If the economic priority the US government has previously insisted on in choosing pipeline routes gives way to political and geostrategic considerations, then Washington might be willing to fund some of the difference between the two.

In sum, Congress has voiced few objections to the stated goals of US policy towards the Caucasus and Central Asia. Congressional criticism of the administration has focused on the allegedly inadequate implementation of those goals, especially the fostering of the NIS' independence and sovereignty. Republican members of Congress have especially criticized the Clinton Administration for failing to protect the countries of the Caucasus and Central Asia from Russian meddling and intimidation. In the absence of other substantive differences over broad policy issues, Congress and the administration have battled over US government aid to the government of Azerbaijan. In this struggle, the influential Armenian lobby and its backers on the Hill have thus far prevailed over the executive branch and efforts by the oil industry to eliminate Section 907 of the 1992 Freedom Support Act. This pattern is certainly likely to continue through 1998, an election year.

The Geopolitics of Oil, Gas, and Ecology in the Caucasus and Caspian Basin

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Turkmenistan Embassy Homepage:

<http://www.dc.infi.net/~embassy/index.html>

Contains wealth of information on Turkmenistan, from visa requirements to American companies currently doing business in Turkmenistan.

Turkmenistan Resource Page

<http://www.soros.org/turkstan.html>

Maintained by the Soros Foundations, Provides a wide variety of information about Turkmenistan: politics, culture, history, business, ecology, and more.