

**THE CASPIAN OIL AND GAS IN  
INTERNATIONAL ENERGY POLICY:  
OPPORTUNITIES FOR TURKEY**

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## **ABSTRACT**

### **THE CASPIAN OIL AND GAS IN INTERNATIONAL ENERGY POLICY: OPPORTUNITIES FOR TURKEY**

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The Caspian region hydrocarbons are important for international energy security. Producer, consumer and transit countries, albeit for different reasons, try to get a share of these new resources. The opening up of the Region has presented Turkey with a new set of opportunities. In this thesis the positions of all the countries involved are examined. Special attention is given to Turkish policies towards the region. In conclusion the geopolitical environment emerged around the hydrocarbon resources and pipelines is evaluated. It will be seen that this environment puts Turkey in a very favorable position and Turkey is now a player in the international energy game despite the fact that it has almost no hydrocarbon resources.

Keywords: Caspian Region, Energy

## ÖZ

### **HAZAR BÖLGESİ PETROL VE GAZININ ULUSLARARASI ENERJİ POLİTİKASINDAKİ YERİ VE TÜRKİYE İÇİN FIRSATLAR**

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Hazar Denizi bölgesi hidrokarbonları uluslararası enerji güvenliği açısından önem taşımaktadır. Amaçları farklı olsa da, üretici, tüketici ve transit ülkeler bu kaynaklardan pay almaya çalışmaktadır. Bölgenin açılması Türkiye'ye yani fırsatlar sunmuştur. Bu tezde konuyla ilgili ülkelerin konumları incelenmiştir. Türkiye'nin bölgeye karşı yürüttüğü politikalar özellikle değerlendirilmiştir. Sonuç olarak hidrokarbon kaynakları ve boru hatları etrafında oluşan jeopolitik ortam değerlendirilmiştir. Bu ortamın Türkiye'yi çok olumlu bir konuma getirdiği ve Türkiye'nin kendi hidrokarbon kaynakları olmamasına rağmen uluslararası enerji konusunda artık bir oyuncu olduğu görülecektir.

Anahtar Kelimeler: Hazar Bölgesi, Enerji

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## **LIST OF ABBREVIATIONS**

AIOC: Azerbaijani International Oil Company  
AzPF: Azerbaijan Popular Front  
bcm: billion cubic meter  
b/d: Barrel per day  
BTC: Baku-Tbilisi-Ceyhan  
BTE: Baku-Tbilisi-Erzurum  
CAOP: Central Asia Oil Pipeline  
CASFOR: Caspian Sea Force  
CFE: Conventional Armed Forces in Europe Treaty  
CIS: Commonwealth of the Independent States  
CNOC: Chinese National Oil Corporation  
CPC: Caspian Pipeline Consortium  
EU: European Union  
FSU: Former Soviet Union  
LNG: Liquefied Natural Gas  
NIS: Newly Independent States  
NPT: Non-Proliferation of Nuclear Weapons Treaty  
PfP: Partnership for Peace  
OECD: Organization of Economic Development and Coordination  
OPIC: Overseas Private Investment Cooperation  
PSA: Production Sharing Agreement  
SCO: Shanghai Cooperation Agreement  
SOCAR: State Oil Company of Azerbaijan  
SCP: South Caspian Pipeline  
TCP: Trans-Caspian Pipeline  
Tcm: Trillion cubic meter  
tcm: thousand cubic meter  
TCP: Trans-Caspian Pipeline  
TOE: Ton Oil Equivalent

TRACEA: Eurasian Transport Corridor

UNCLOS: United Nations Convention on the Law of the Sea

US: United States

WMD: Weapons of Mass Destruction

WTO: World Trade Organization

## **CHAPTER 1**

### **INTRODUCTION**

The opening up of the Caspian region has presented Turkey with a new set of opportunities. The region is rich in hydrocarbon resources even though speculations describing the Caspian as the “New Gulf” proved wrong. Although the region’s resources are not comparable to those of the Middle East, they are important for the purposes of energy security. Oil production from the Caspian region can provide the marginal production capacity to prevent supply shocks and accompanying price hikes that originate from other oil producing regions. However, if this marginal production capacity is to be significant, the means to transport this oil must not be under the control of a single country that could use it as a geopolitical lever. Similarly gas from the region can decrease the European Union’s overdependence on Russian gas if it could be transported to the EU without using the Russian gas pipeline network. Just as the Caspian region is presenting alternative resources, Turkey is poised to provide the alternative transport route for oil and gas. The purpose of this thesis is to show the significance of Caspian oil and gas for global energy security and how this affects Turkey’s geopolitical position.

Energy security, in another word, sustainable and environmentally friendly flow of energy, whenever and wherever is demanded, and with affordable prices, is a prerequisite for development and well being (Brenner, 2006). Industrialized nations need it to keep their positions in the global economy and to sustain their way of life. Developing countries, on the other hand, need it to close the gap between themselves and industrial nations. The things that define our way of life, earthly comforts are all made possible by energy. Electricity generated from natural gas and nuclear energy provides light, cooling, heating and operates everything we use in our daily

lives. With natural gas, we can live in apartments or suburban houses and not be affected by harsh winter conditions. Oil made it possible for pleasant suburbs to spring up outside of crowded cities.

Energy is not only essential for development and production but it also has profound effects on national economies and policies. Energy is a fundamental driver of growth and development around the world. Energy is also an economic and political “good”. Consumer countries are dependent on producers for an uninterrupted supply of energy. This is an issue with profound economic as well as strategic ramifications. Energy imports and exports may have enormous effects on balances of payments of countries. Energy prices have direct effects on inflation and exports of an economy hence its international competitive position.

Furthermore, energy, especially oil, is indispensable for military might. Winston Churchill, then First Lord of the Admiralty of Great Britain, was the first one to recognize this. His decision to convert coal fuelled warships of the Royal Navy to oil fired vessels on the eve of the First World War was criticized by many since this decision was to lead to the Royal Navy’s dependence on oil coming from Persia, instead of Welsh coal. However, the advantages of oil<sup>1</sup> surpassed the concerns over distance and insecurity of Persia, and gave a great edge to Britain in the First World War against the German Navy. Churchill had the foresight that oil would be the conduit to mastery in the twentieth century (Yergin, 1991, p.12).

Oil also played a crucial role during the Second World War. The new German war doctrine, lightening assaults of tank divisions, the *blitzkrieg*, made oil an indispensable strategic commodity. Having captured the Low Countries, France, Eastern Europe, Balkans and part of the Soviet Union, Hitler was advised that Germany could not continue without Russian oil. Hence, in 1942, the German High Command designed the “Operation Blau”. The objective was to capture the Caucasus, especially the Baku oilfields, and then to continue south to capture Iranian and Iraqi oil fields (Yergin,

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<sup>1</sup> Oil fired ships have a great advantage over coal fired ones vis-à-vis speed, supply and operation times and manpower requirements.

1991, p.336). This operation had the double objectives of supplying the German economy and war machine with much needed oil while at the same time depriving the Soviet Union of its main oil supplies thereby delivering a crippling blow at the Eastern Front. However, the Germans could only capture western parts of the Caucasus. On the North African front, the only hindrance of Rommel's advances was lack of oil. In his final push against the British, Rommel was planning to capture Egypt, and then move towards Iraq, Iran and Caucasus. However, the long supply lines from Tripoli and the Allied maritime activity to disrupt Italian supply convoys to North Africa deprived Rommel's tank divisions of most needed oil and this operation, too, ended in futility (Yergin, 1991, p.340).

Since the beginning of the 20<sup>th</sup> century, the importance of oil has made it a decisive factor in international politics. The Arab oil embargo of 1973 shows the effectiveness of oil as a weapon in international politics. Not only did the embargo cause shortages of oil, but the resulting fourfold increase in the oil prices had a serious impact on the world economy. Henry Kissinger aptly stated that this weapon "...altered the world irrevocably..." (Yergin, 1991, p. 588).

On 2 August 1990, oil was again the objective of an international conflict. Saddam Hussein's occupation of Kuwait was not only based on his desire for a more suitable outlet to the Persian Gulf, but also to capture the oil riches of this country. If he had succeeded Saddam would have been the largest oil exporter of the world with the power to control the quantity and the prices of the commodity. In other words, he would have been the sole power to wield the "oil weapon". So much was at stake that the world saw unprecedented cooperation between the US and Soviet Union and the speed with which forces to defend Saudi Arabia and repel the aggressor were amassed (Yergin, 1991, p.12).

The consumer countries' dependence on energy, i.e. oil and gas, has repercussions on their foreign and security policies. The European Union, for example, is concerned that its dependency on Russia for natural gas will

compromise its foreign policy towards Russia and make the Union prone to Russian pressure (Clingendael International Energy Program [CIEP], 2004). This was evident from Russian use of natural gas supplies as a vehicle to pressure Ukraine and Georgia to further this country's political demands. Similarly neo-con strategists in the US believe that the US accommodation of the undemocratic, repressive and fundamentalist regimes in oil producing countries is contrary to the US interest because the oil income is used to support terrorist activities against the US and its allies. Energy would probably be the only common denominator for peace, security and cooperation between industrial world and developing countries.

Due to the importance of energy, especially oil and gas, governments, instead of treating them as any other commodity to be left to businessmen, were involved in their affairs from the onset. As Nelsen cites:

Whether invited or not, governments have been involved in the petroleum industry since oil took on strategic significance in the early years of the twentieth century. It was then that government officials like E.G. Pretyman, Admiral John Arbuthnot Fisher, and First Lord of the Admiralty Winston Churchill immersed the British state in the financial dealings of companies like Burmah Oil and the Anglo- Persian Oil Company (later British Petroleum). A few years later, on the other side of the Atlantic, the Texas Railroad Commission began regulating much of North America's crude production, and by mid-century many Third World oil producers had assumed a role in the exploitation of their petroleum resources. (Nelsen, 1991, p. 8)

Not only is energy the prerequisite for economic growth and military might, it is also big business. One may even say that it is "the business" and that it is the driver of the Western Capitalist system. Symbols of capitalism, such as Henry Ford's automobile factory were made possible by oil. Five of the first ten companies in the Global Fortune 500 companies are in the energy sector. ExxonMobil, with its 340 billion \$ in revenues and 36.1 billion \$ in profits in 2005, sits at the number one place in the Global Fortune 500 list as the biggest company in the World.

The importance of energy compelled national leaders to assure cheap, clean and uninterrupted flow of energy for their countries and make this objective one of the important parameters of their policies. In fact, energy policies are so important that they are usually part of foreign and security policies.

There are two types of energy sources: primary energy sources such as the sun, wind, coal, oil, natural gas and secondary energy sources such as electricity and efficient fuels. Secondary energy is generated through a conversion process from primary energy sources. Amongst the primary energy sources hydrocarbons, primarily oil and natural gas are the most versatile and efficient. Although research is being carried out around the world for replacement sources that are equally versatile, efficient, feasible and affordable, oil and later, natural gas reigned supreme since the second half of the 19th century, and no serious contestant for the next fifty years or more seems possible.

Oil and gas have different characteristics for logistical purposes. Oil can be transported by pipeline, tankers or railcars. In fact, the first mode of transport of Baku oil was rail cars from Baku to Batumi and then by tanker steamers. It can be stored in bulk for a long time thus making strategic reserves against “oil shocks” possible. It can be stored in small quantities as well. This makes oil versatile in its usage. Cars, trucks and aircraft can carry relatively small quantities in their tanks. This versatility of its transport affects the way it is marketed. Normally, when oil is found it can be extracted and supplied to markets. Very long term contracts are not needed. It can be sold either through spot market or three to six month forward contracts. In that sense it is a strategic global commodity.

In order to prevent oil shocks, spare production capacity is important. In the face of a sudden surge in demand due to, for example, an economic boom or a disruption or interruption of supply due to, for example, terrorist activity, strikes such as seen in Venezuela in 2004, civil war or international conflict such as the Iraqi war, this spare capacity could be taken into

operation and a massive reduction in supply with a corresponding price hike can be prevented. In recent years the gap between production capacity and production is getting narrower. In 2005 only Saudi Arabia had spare capacity.

Gas, on the other hand, is more cumbersome. The main mode of its transport is through pipelines. When there is transit passage over a number of countries. Geopolitical consideration come to fore. A pipeline is a huge investment (The BTC cost 4.1 billion \$) and stability of the regions over which it traverses should be assured. Gas is difficult to store in bulk for a long time. It can be transported by tankers in liquidified form as Liquidified Natural Gas (LNG) but this requires liquidification plants at the port of exports and regasification plants at the port of imports. LNG can also be used in cars, however, its widespread use, as well as use in aircrafts has not been realized yet. The necessity that long and expensive pipelines are needed for transport of gas affects the way it is marketed. Gas is sold through very long term (20-30 year) contracts. Pipelines are only built after such contracts are signed and enough gas to fill them is assured.

World primary energy consumption, i.e. oil, gas, coal and nuclear energy, rose by 2.7 % in 2005 (BP, 2006, p.2). Since the world population, which is over 6 billion today, is expected to grow by 1.4% each year, and reach to 8 billion in 2010 and 10 billion by 2050, and the world economy is expected to grow by an average of 3.8% per year, it is expected that within the next 25 years.<sup>2</sup> Global energy consumption will increase by a total of 71%, or average 2 % per year (United States Department of Energy, Energy Information Agency [EIA], International Energy Outlook, 2006 [IEO2006]). As can be seen the rate of increase of world energy demand is higher than the rate of increase of global population, and world energy requirement in 2010 will reach 11.3 billion TOE (ton oil equivalent) and in 2020 13.4 TOE . The

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<sup>2</sup> Projections for economic growth and energy demand are taken from International Energy Outlook 2006(IEO2006) prepared by the US Department of Energy's Energy Information Administration, [www.eia.doe.gov](http://www.eia.doe.gov)



OECD countries will account 3/4 of this demand but by 2015 the energy use of non-OECD countries will be more than that of the OECD countries. In 2030 total demand of non-OECD countries will be 34% more than that of the OECD countries. As the world demand of energy is raising fast and production nears existing capacity, the world is beginning to put the issue to the front burner.

Today, the hydrocarbon based sources occupy the greatest share in the world primary energy consumption. Global oil consumption rose by 1.3% in 2005. Although this figure was lower than the strong 2004 figure of 3.6%, the share of oil will remain, at least for the near future, 38% of the total energy consumption, and thus retain its strategic significance. By the year 2010, world demand for oil is expected to reach roughly 100 million barrels per day (b/d). Most of the demand for oil will come from increased usage of this commodity in air and land transport.

Furthermore, Asia - Pacific economies, mainly China, with India and Korea, are rapidly growing hence their oil demand will continue to increase. Almost half of the projected increase in the global demand for oil in 2010 will come from East Asia, not including Indonesia and India.

Total world proven oil reserves are nearly 1,3 trillion barrels as of the beginning of the 2006. The Middle East, with its 743 billion barrels, has the largest portion of it. Saudi Arabia, with its nearly 265 billion barrels, owns the largest proven crude oil reserves in the world. Iran has 133, Iraq 115, Kuwait 98 and UAE has 98 billion barrels of reserves, respectively (EIA, 2006).

The second geographical region with the highest reserves is North America. Here Canada has the largest reserves with 179 billion barrels making the country number two in the global list. The United States is at the 11th place with its 21.4 billion barrels.

A look at the map will reveal that four of the first five biggest oil producing countries, namely Saudi Arabia, Iraq, United Arab Emirates and Kuwait lie in the Middle East.

According to BP, world oil consumption in 2005 rose by 1.3% and reached to 82,5 million b/d. The US alone, consumes roughly 25% of the world's oil production (BP, 2006).

According to the IEO2006 <sup>3</sup> reference case, world demand for oil grows from the 2003 figure of 80 million b/d to 98 million b/d in 2015 and 118 million b/d in 2030. This is an average of 1.4% growth per year or a 47% aggregate increase. Non OECD Asia, including China and India, will account for 43% the total demand over this period. However, it should be remembered that the level of demand is sensitive to the price. There are two scenarios in IEO2006 for oil prices: A low scenario of 34 \$/barrel and high scenario of 96\$/barrel. The total demand will fluctuate accordingly between 128 million b/d for low price scenario and 102 million b/d for high price one. Non-OECD Asia, i.e. China, India and others is going to be mainly responsible for this increase in demand due to the expected strong economic growth in this region. This economic growth will be crucial for long-term growth in oil markets. North America is also expected to show a sizable growth in oil demand. Oil demand in the EU, on the other hand, is expected to rise very little, only by 0.2%.

In order to meet this increase in the global demand, total oil supply in 2030 will need to increase by 38 million b/d to 118 million b/d from the 2003 level of 80 million b/d. Only 14.6 million b/d of this amount is to be provided by OPEC. The OPEC production in IEO2005 is expected to increase by 24.0 million b/d between 2002 and 2025. In IEO2006 this figure is revised down to 11.8 million b/d.

Much of the demand increase in oil, almost half of it, is expected to come from transportation sector since very little possibility of using alternative fuel exists here. Industry usage, mainly chemical and petrochemical industries, will account a further 39% of the increase.

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<sup>3</sup> Projections for oil and natural gas usage are taken from International Energy Outlook 2006(IEO2006) prepared by the US Department of Energy's Energy Information Administration, [www.eia.doe.gov](http://www.eia.doe.gov) retrieved on 4 Nov. 2006

The resources in the Middle East and South and Central Americas are organized under the OPEC cartel which in the past has freely played with the prices causing oil crises of 1970's. Saudi Arabia, being the biggest oil producer and exporter, can regulate world output and prices. The only way the power of the cartel was reduced was through the discovery of oil in the North Sea.

However, the North Sea fields are nearing to depletion. Coupled with the increasing world demand, it is important to find resources that will cover the loss of marginal production from the North Sea as well as to weaken OPEC's cartel price mechanism. Furthermore, Venezuelan production has come to a standstill after President Hugo Chavez came to power and Nigerian production has been affected by civil strife in this country.

Gas is expected to play a more and more important role in economies. The share of gas in the EU consumption, for example, is expected to increase to 29% in 2030 from its 2000 level of 20%. Most of the demand will be used for electricity generation since gas is in line with the requirements of the Kyoto Protocol.

Total World proven natural gas reserves are estimated to be approximately 180 trillion cubic meter (Tcm) as of the beginning of 2006 (BP, 2006). Undiscovered reserves of natural gas are estimated to be approximately 118 Tcm (IEO2006).<sup>4</sup>

Nearly, 75 % of the world's oil and natural gas reserves are possessed by the countries of the Middle East, Europe, Russia and Central Asia. Russia with its nearly 48 Tcm reserves is at the number one place making up 27.5% of all the reserves. It is followed by Iran with 26.74 Tcm, Qatar 26 Tcm, Saudi Arabia 6.90 Tcm and United Arab Emirates 6.04 Tcm.

Reserves in the Central Asia namely those of Turkmenistan (7.75 Tcm), Uzbekistan (1.85 Tcm) and Kazakhstan (3 Tcm) amounts to 12.6 Tcm making up 3.4 % of the world reserves.

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<sup>4</sup> World Petroleum Assessment 2000, United States Geological Survey, quoted in "International Energy Outlook 2006", US DOE Energy Information Administration

If we look at gas production figures, Russia, as expected, has the number one place with 598 bcm in 2005. Russian production is projected to increase by an average 2.4 % annually and reach 1.1 Tcm in 2030 (EIA,IEO,2006) Global natural gas consumption is expected to increase on average by 2.4 % annually from its 2005 level of 2.749 Tcm to 5.096 Tcm in 2030 (EIA, IEO2006).

Natural gas is expected to be preferred as the primary energy source due to the fact that it is more environmentally friendly, in line with the Kyoto Protocol and burns more efficiently than coal. This trend in natural gas consumption reflected in IEO2006. Gas consumption is expected to rise from the 2003 figure of 2.66 Tcm to 5.096 Tcm in 2030 which corresponds an average annual increase of 2.4%. Industrial plants and electric power plants will be the largest consumers of gas. In 2003 the shares of industrial consumption and power generation were 44% and 31 % respectively. The natural gas usage of industry is expected to grow by 2.8% and electric power generation by 2.9% between 2003 and 2030. It is expected that, by 2030 there will be more natural gas usage in industry than oil.

A concentration of oil and gas production in a few areas is a serious concern for the industrial countries especially for the US and the EU. First, these areas are usually prone to political instability and conflict. Secondly such a concentration may give an enormous economical and political leverage to the producers. If the present increase in the global demand continues as predicted by the projections and the concentration of the oil and gas production continues, the buyers market of 1984-99 will not be restored. Instead, today's seller market with high prices will continue.

As the majority of the producing countries are situated at unstable regions of the world, geopolitical realities have a serious impact on energy supply and demand as well as the energy security. This concern of the concentration of oil and gas in unstable regions was pointed out by Yergin too:

The renewed focus on energy security is driven in part by an exceedingly tight oil market and by high oil prices which have doubled

over the past three years. It is not only the shortage of oil but a perceived threat of instability in some exporting countries, threat of terrorism, a nationalist backlash, fears of a scramble for supplies, geopolitical rivalries and countries' fundamental need for energy to power their economic growth. (Yergin 2006, p. 69)

Energy security has become the main concern of the countries as a consequence of pressure and responsibilities to response the relative insufficiency of energy resources to cover the increasing demand in recent years, the troubles and uncertainties faced to finance the investments, economic and political instabilities all over the world as well as the commitments to decrease the negative environmental effects to a minimum level. The United States has put energy security a priority in its Energy Strategy paper (National Energy Policy Development Group, 2001). China is attempting to secure energy concessions from producing countries. Japan is implementing a new strategy to ensure stable oil and gas supplies. It is "revving up its diplomatic drive to strengthen relations with oil-and gas-rich countries of Central Asia amid stubbornly high oil prices." The European Union, slowest of the energy consumers to address energy security issues, has produced a "Green Paper" on this issue (Commission of European Communities [CEC], 2006).

The limited natural energy resources of the countries and increasing in consumption have made "self-sufficient energy" strategy change as "the development of international trade and more the development of regional integrations" strategy. This condition calls attention to subjects such as; energy security, mutual benefits (or "mutual dependency"), international agreements and international investments. Hence the access to and control of the energy resources, chiefly hydrocarbons, will continue to play an increasing role in the twenty-first century. Due to increasing demand of energy consuming regions, such as the EU, South East Asia, China and Japan energy relations will become an integral part of foreign and security policies. Competition to reach energy will be fiercer (CIEP, 2004).

Signs to this effect are abound. The first Gulf War was to prevent Iraq to capture Kuwaiti, and possibly Saudi, oil fields and became an even bigger oil supplier. Current developments in Iraq fundamentally affect security of supply for the EU, the US and China, and they will be one of the main determinants of the geopolitical relations and developments of the international oil and gas markets in the near future. (CIEP, 2004) The conflict between Armenia and Azerbaijan, and secessionist fights in Georgia led an increased Russian influence over the South Caucasus through where oil from the Caspian region was to be carried to world markets.

While competition to access energy is going on, consumer countries are trying to diversify the source of their energy imports and transit routes. The Caspian hydrocarbons come just at this point into the picture.

After the collapse of the Soviet Union, the Caspian region emerged as one of the largest unexploited reserves of oil and gas in the world. (Forsythe, 1999). Three littoral states, Azerbaijan, Kazakhstan and Turkmenistan, unknown to the world during the Soviet times, have become the focus of world's attention due to the fact that most of the energy deposits in the region are in these states. When these countries gained independence one by one, an "oil rush", similar to those seen in late 19<sup>th</sup> and early 20<sup>th</sup> century begun. A lot were at stake: power, influence and money. The situation is made more complicated because the number of players is high and their characters are varied. There are oil and gas corporations. Moreover there are states, newly independent and lacking experience. There are countries with historical, cultural and ethnic ties with the region. There are also the old imperial master, Russia, and the sole superpower, the United States. This complicated situation is described by Forsythe as "The demise of the Soviet Union in 1991 and the subsequent rise of the more vulnerable and less experienced newly independent states of the Caucasus and Central Asia led to an intense political and commercial competition for control over oil resources and exports" (Forstyhe, 1999).

The Caspian resources and their supply to the world markets will create a positive balancing effect on energy markets. Since the opening of the region to foreign investment, the question of how to bring production from these resources out of this landlocked region has been on the agenda. However, there should be another and equally important question: Whether oil and gas would flow to the west or east. If they flow to the east, to the energy hungry China (and also to India) who can afford to built pipelines over long distances and difficult terrain, then the EU's and US' plans to use the Caspian hydrocarbons to break OPEC cartel, to regulate oil and gas prices and diversify energy sources cannot be fulfilled.

Caspian riches will particularly have profound effects on Turkey and Russia. How the situation is resolved will determine the political and economic future of these two countries. The purpose of this thesis is to show that the new geographical environment created by the emergence of the Caspian region as an independent oil and gas supply presents Turkey with an opportunity to become a player in the twenty-first century.

Historically Turkey has been a bridge between Asia and Europe. With the discovery of the sea lanes Turkey's position in international trade lost its previous importance, leading gradual decline and eventual disintegration of the Ottoman Empire. The successor state, Turkey, found itself a position in the cold war's bi-polar world as the vanguard of the NATO. It arranged its foreign and security policies around the requirements of the western alliance and through supports and receipts from this alliance sustained its economy and development. The end of the Cold War and the disintegration of the Soviet Union changed this matrix and created a new world. The military and ideological Soviet threat to the West ceased to exist. In its place new threats and opportunities emerged. A significant part of these challenges and opportunities concern energy.

The first is the high concentration of energy sources, especially oil and gas. The existence of the OPEC oil cartel caused concern in the west for this cartel used oil as a weapon for economic and foreign policy objectives.

Second is Europe's high dependency on imported energy especially from a single source. With regard to gas Russia supplies the majority of gas to the Union 26% of EU's gas demand, and this is expected to increase to 30% of the EU's gas demand. The energy security of the EU dictates that alternative energy sources as well as transit routes outside the Russian control should be found.

Thirdly, the dissolution of the Soviet Union has opened new regions of the world, the Caspian Region, Central Asia and the Caucasus, to the United States. Great power politics require that the US should make inroads to these regions. Caspian oil and gas will be a good conduit for predominance in the region.

Fourthly with the collapse of the Soviet Union the United States emerged as the "sole superpower". The US security doctrine for the twenty-first century states that the US would not allow the emergence of a power that can challenge the US supremacy. This requires the containment of Russia. To the same end, the US should contain the new emerging economic powerhouse, China.

From the opportunity side, exploitation of energy resources will mean new business prospects for the western, mainly US energy firms.

Furthermore, the income from oil and gas will enrich Newly Independent States (NIS) in the Caspian Region, namely Azerbaijan, Kazakhstan and Turkmenistan, increases the standard of living of the people there, and provides new markets for western goods and services.

One way of containing Russia and China is to prevent them from accessing the energy resources of the Caspian Region, one of the few remaining untapped energy deposits of the world.

Therefore the exploitation as well as the transport of oil and gas from the Caspian region becomes important; and from the Western perspective, the exploitation contracts need to go to consortia under western control. Transport should be through territories outside of Russian control and oil and gas should flow towards west not east, i.e. China.



At this conjunction, the interests of the West, the US and the EU, coincide with those of Turkey. Turkish participation in exploitation contracts may help the consortia in dealing with the regional countries due to Turkish interests and relations with the Region.

Pipelines through Turkey may provide a secure access to Caspian energy while supporting the Turkish economy. In fact the first leg of this project has already been realized on July 13, 2006 with the inauguration of the Baku-Tbilisi-Ceyhan Pipeline. The political allure of the BTC project for the whole region is self-evident: The BTC pipeline could deny Iran a significant role as a Caspian energy exporter, reduce the dependence of Caspian states on Russian pipelines, and bolster fledgling regional economies; especially those of Azerbaijan, Georgia and Turkey. The combined diplomatic weight of the United States and Turkey has ultimately overcome the commercial hesitation and cost-conscious reluctance of the Western oil companies to support the 2.9 billion \$ BTC project and has turned it from "a pipeline pipedream" into a "one million barrel fact".

Being an energy hub between Central Asia, the Caspian Region and the Middle East, will help Turkey in its quest to integrate with the European Union. The developing markets in Azerbaijan, Kazakhstan, Turkmenistan and other Central Asian countries will provide new opportunities as an alternative to the EU for Turkish goods and services while making Turkey a bridge for transit trade between the east and west.

In sum, Turkey has pursued a very pro-active policy not only for building one pipeline connecting two countries but also towards the establishment of a safe energy "corridor", connecting a number of producing basins with the West, and a significant amount of resource, expertise, capital, faith and dedication has been invested for the realization of this goal. Projects that are pursued by Turkey can be characterized as news-breaking, new, unique and pioneering. Passing through multiple sovereign areas, these projects represent an ambitious goal of serving stability, peace and collaboration across the regions involved.

At this point if Turkey plays its cards right, and design its policies accordingly, it can find itself a position in the world of twenty-first century, a place stronger and more prominent than its place during the Cold War. If this is realized, Turkey can truly be a major actor in world events.

But how would Turkey achieve this objective? What kind of policies should it follow? Can nationalistic rhetoric such as the unification of the Turkish speaking world from the Adriatic to the China Sea have a place in this scheme? Can Turkey fill the vacuum created in the Caspian region after the collapse of the Soviet Union? Should Turkey fill this vacuum? Can Turkey be the “elder brother” in the region? Should Iran be challenged for the predominance in the Caspian Region and Central Asia? The answers to these questions will determine Turkey’s position in the world of twenty-first century, and looking for these answers is the objective of this thesis.

In this thesis, firstly, the Caspian region, and its position on world energy balance will be examined. The term Caspian Region in this thesis, includes the new Caspian littoral states, excluding Russia and Iran, namely, Azerbaijan, Kazakhstan, and Turkmenistan since these three are new actors in international relations and they have major hydrocarbon resources. These three countries as well as Uzbekistan, since it is an important country that lies in the “Greater Caspian Basin”, and Georgia, crucial for transporting oil and gas to markets will be examined

In the third Chapter global and regional actors who have stakes in Caspian politics, the US, Russia, the EU and Iran will be examined vis-à-vis their geopolitical positions with regard to the region.

Then Turkey, its policies towards the Region, the emerging East-West corridor with pipelines and Turkey’s strategy on this issue, are discussed.

In conclusion, it will be seen that the geography once more put Turkey in a strategic position in the twenty-first century. Despite the contrary Russian - and to a lesser extent Iranian - efforts, Turkey is fast becoming an energy hub, something its founding fathers or successive governments have not thought about. The BTC and South Caucasus pipelines, and other

projects on the table prove that Turkey's position as the transit and terminal country is established. This would bring many economical and political advantages to Turkey if it follows a logical and sustained policy to this end.

## **CHAPTER 2**

### **THE CASPIAN REGION**

The Caspian Sea is an inland sea bordered by the Transcaucasus on the west, the Russian Plateau on the North, Central Asian steppes in the east and the Iranian plateau in the south. It has no natural exit to the high seas. The region is populated by a high number of diverse ethnicities with indigenous languages.

The western part of the Caspian region, the Caucasus, had been a bone of contention amongst the Ottomans, Iran, Britain and Tsarist Russia, with Russia emerged as the prevailing force in 19<sup>th</sup> and 20<sup>th</sup> centuries. Russia also successfully colonized the Central Asia in 18<sup>th</sup> and 19<sup>th</sup> centuries hence gained control of the Caspian region and Central Asia.

After the October Revolution in 1917, Azerbaijan and Georgia had a brief period of independence. This did not last very long and the Bolsheviks occupied these countries in 1921. Afterwards the Soviet Administration tightened control over the Caucasus, the Caspian region and the Central Asia, integrating them into the Soviet Union.

The Caspian Region, namely, Azerbaijan, Kazakhstan and Turkmenistan, came to international limelight after the collapse of the Soviet Union in the year 1991. These three countries, hitherto forgotten in the Soviet Union and with little or no experience in statehood, self-governance or international politics found themselves in an international struggle for power, money and influence.

After the demise of the Soviet Union, and the emergence of new states, the region has come to attention for its rich hydrocarbon resources, for it was one of the oldest oil and gas basins of the world. The importance of the region was augmented by other factors. Firstly the Caspian basin is in the middle of some of the most geopolitically significant regions. The Caucasus

in the west suffered prolonged ethnic strife and armed conflict since the end of the Soviet Union, Iran in the south is accused of harboring terrorism, further south is the Middle East with its unstable Iraq, in the east the Newly Independent States (NIS) in Central Asia and in the north Russia, with its designs to reestablish its influence over the territories of the former Soviet Union (Sinker, 2001). Secondly the newly independent states in the region, Azerbaijan, Kazakhstan and Turkmenistan, saw these riches as their way to develop their economies, increase their standards of living and acquire their political independence from Russia.

Russia sees the resources as an opportunity and threat. If it can control the extraction and transport of the oil and gas from the region, it would gain great economic benefits, control the three NIS allowing them nominal independence and control the oil and gas supplies to global markets. If Russia fails to control the extraction and transport of oil and gas, it will not only be deprived of the financial gains of these deposits and lose control of the three NIS in the Caspian region, but also it would find competitors in its main export products, oil and gas, as well as its historical rival, the US, exerting influence just over its southern border.

Furthermore, intra-regional conflict, ethnic strife, corruption, bad governance, nepotism and a lack of political experience make the countries in the region difficult places to do business.

The legal status of the Caspian Sea is also an important issue for the development of the region's hydrocarbon resources. The legal regime of the Sea has been established by a series of treaties between Persia and Tsarist Russia after the latter's occupation of the Caucasus and Central Asia. The imbalance between the two countries was reflected in treaties establishing this regime too. For example, only Russia was allowed to maintain a naval fleet there (Sinker, 2001). During the Soviet times the situation was improved for Iran and this country acquired equal rights to maintain a fleet. The Sea was divided between Russia and Iran based on two agreements signed in 1921 and 1940. Since most of the resources lie in the northern part

of the sea, there was no question as to how the resources were to be shared although the agreements did not establish sea bed boundaries or discuss oil or gas exploration (Cordesman, 2000). When the number of the littoral states increased to five, the division of the Sea became a serious issue. First of all, the existing agreements between Russia and Iran are in force since they are not replaced or annulled yet. Furthermore, the CIS, by signing the Almaty declaration of 21 December 1991, undertook the obligations of agreements or treaties signed by the Soviet Union (Sinker, 2001). There are two views as to how the Sea should be divided. Iran and Russia insist on the “Condominium” principle, i.e. the Caspian is not in fact a sea hence is not subject to the United Nations Convention on Law of the Sea (UNCLOS). Under this principle the riches under the seabed should be equally shared by the riparian states. Azerbaijan, Kazakhstan<sup>5</sup> and Turkmenistan, on the other hand, claim that the Caspian is a “sea” as defined by the UNCLOS, and the delimitation of the maritime areas should be done accordingly. Although Turkmenistan has not always consistent in its view over the delimitation of the Caspian Sea, by enacting, in 1993, the Law on the State Border in which a territorial sea and exclusive economic zone was described in accordance with the UNCLOS, it implicitly and unilaterally delimited the Sea (Sinker, 2001).

Russia initially supported that UNCLOS was not applicable to the Caspian Sea but by signing a bilateral agreement in 1998 with Kazakhstan dividing the seabed in the north of the sea along the median line it implicitly accepted the UNCLOS view. Although the legal regime governing the Caspian Sea has not been finalized, an understanding in dividing the Sea into national sectors over which the states can exercise sovereign rights of exploitation has been reached among Russia, Azerbaijan, Kazakhstan and Turkmenistan. Iran, however, insists that coastal waters of the sea should be divided into national sectors and the middle of the sea should be under joint ownership. This situation is not trouble free. Turkmenistan and Azerbaijan

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<sup>5</sup> According to Kazakh understanding of the application of the UNCLOS, Kazakhstan should be given free access to Don –Volga and Volga-Baltic Channels and high seas.

both claim Kepez/Sardar field. Similarly there is maritime territory dispute between Azerbaijan and Iran which almost escalated to an armed conflict in 2003.

The demise of the Soviet Union had an immense impact on international politics. Not only the “Cold War” ended and the US emerged as the sole superpower, a number of new actors appeared on the map, each with different problems, sources, concerns and issues. This also affected the Caspian region. The break-up of the Soviet Union left behind an incredibly complex set of political, cultural and economic interdependencies. The centrally planned economy of the Soviet Union was based on the interdependence of member states (Kasım, 2004 Oct. 13). The aim of this planning was the prevention of a single member state achieving economic superiority. Planners in Moscow made sure that resources and consumers of these resources were kept separate. In this manner, for example, cotton from Turkmenistan would not be weaved in where it was grown but in another state. Similarly, Soviet system created ethnic pockets in states, such as the Armenian enclave of Nagorno-Karabagh in Azerbaijan or Russians in Kazakhstan, to prevent the emergence of an ethnic group as the titular nationals of a state. This would prevent the raising of an ethnic group other than Russians in preeminence in the Soviet Union. When these countries gained independence in 1991, they were left with an industry that would not be any good and with a lot of ethnic and political problems.

After the collapse of the Soviet Union, the number of the littoral states increased to five with the emergence of Azerbaijan, Turkmenistan and Kazakhstan. This immediately posed a new problem. During the Soviet time, the region and the Caspian Sea were divided between Iran and the Soviet Union, based on two agreements, the latter owning the bigger part. Now a new division had to be found. Although a final agreement has not been reached yet, an “understanding” has been reached among Azerbaijan, Russia and Kazakhstan.

Furthermore, security has always been a problem in the region especially in the Caucasus. Ethnic strife as well as territorial claims make the region a volatile geography and there is no viable dispute settlement/conflict prevention mechanism in place.

None of the new states in the Caspian region, nor any of the other NIS in Central Asia, i.e. Uzbekistan, Kyrgyzstan and Tajikistan, has been able to create sustainable political and economic development. Both the Caspian region and Central Asia are unfortunately plagued with political risks, namely, tribal identities, corruption, minority problems and border issues. This last, included not only territorial claims but also delimitation of the Caspian Sea and illegal border crossings.

The states in the region, although gained independence in almost the same time, followed different economic and political strategies. While Azerbaijan welcomed foreign investment and tried to integrate itself with the West, Kazakhstan has been more reluctant and tried to keep at least amicable relationships with Russia. Turkmenistan, on the other hand, run by an autocratic regime, has frowned upon foreign investment and tried to minimize Russian effect. It has tried to avoid foreign contact as much as possible, and turned itself into a “Hermit Kingdom”.

Altogether the Caspian region is a difficult, almost hostile environment for business and investment, especially foreign direct investment, which is indispensable for the development and transport of the hydrocarbon potential of the region. The question of internal stability is detrimental to the security of the investments. Furthermore, the lack of transparency and institutionalization could raise questions regarding validity and value of the contracts signed by foreign companies. A change of administration, even in a ministry, may result in the refusal of honoring contracts. Moreover, the riches brought by the extraction and export of oil and gas may not be distributed among the population in an equitable and just way. The difference of wealth between the ruling elite and people may drastically increase to the detriment of the latter. If these regimes become repressive to



protect the status quo, the foreign investors providing the riches seem to be supportive of these regimes by the people causing further domestic instability and hostility towards the foreigners. The differences of income may cause jealousies and strife. The latest incidence in Kazakhstan, between local labor and Turkish workers is a good example of problems that may arise from differences of income.

Caspian region, in fact the entire Central Asia, is the venue of a chess board. Three major players, the US, China and Russia, are actively involved in the region. Russia wants to keep its hegemony and influence in the region and its monopoly over the region's energy resources. China is trying to assure energy sources for its energy hungry economy and wants to decrease its dependency on Middle Eastern sources. The US is trying to thwart the actions of the first two, to prevent them from dominating the region, while making sure that the regional resources are brought to the global markets freely and the region can balance the vagaries of international energy markets. Furthermore, the US wants access and influence in the region to prevent terrorist organizations to gain a foothold there.

## **2.1 The Caspian Oil and Gas and the World Energy Base**

The accounts of early travelers included stories of “eternal fires” in Baku region as early as the sixth century BC. These and Byzantine authors’ reference of “median fires”<sup>6</sup> probably meant naturally seeping oil and gas. The first records of oil exports date back to the tenth century. Oil from hand dug wells were exported to be used as burning fuel or to anoint camels against certain skin diseases. The Caspian region became a truly oil production and exporting region with the expansion of the Russian Empire here in the 19<sup>th</sup> century. Russians were aware of the importance of oil. The

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<sup>6</sup> Fire from north western region of Persia i.e. Medina (Gökay, 2001).

Russian Czars war against Persia to capture Baku was probably the first war in history caused by oil (Gökay, 2001).

After the Russians gained control of Baku, they began to pay attention to oil. In the context of the industrialization efforts of the Czar Alexander III, the fields in Azerbaijan were developed, and in 1843 the first “well” was prepared in today’s Bibi-Eibat field (Gökay 2001). Russia, in 1898, became the first petroleum exporter in the world (Jafalian, 2003). Baku was perhaps the first oil capital of the world. Russian administration did everything to improve the extraction techniques. Transport was first through railways. The construction of the Trans-Siberian Railway allowed fuel oil to be transported to the interiors of the Russian Empire. Batumi on the Black Sea was connected to Baku by the Transcaucasian Railway in 1883 and oil began to be sent to Batumi and from there to the world by tankers making Russia an oil exporting country so that, according to Gökay, in 1901 half of the world’s oil was coming from the fields in Caucasus, particularly from about 1,900 wells in Baku (Gökay, 2001). The prospects of the region attracted foreign investors as well. The famous Nobel Brothers were in Baku in 1873 followed by the Rothschilds in 1892. Robert Nobel, having purchased a small refinery and several oil rich parcels, started its operation and expanded. He modernized refinery process and within a period of two years, became the most competent refiner in Baku The Nobels built the first oil tanker in Russia, the Zoroaster, and supplied northern Europe by sending their illuminating oil to Northern Europe by sending it by tankers over the Caspian to Astrakhan, from there by river barges through the Volga. They also partnered with Rostchids in building small tankers to carry oil over the Caspian to Astrakhan. Rostchids also built a pipeline and the Baku-Batumi railway (Gökay, 2001).

Standard Oil had a brief period of investment and operation in the independent Azerbaijan Republic during the Russian Civil War between 1918 and 1921. All this came to an end with the arrival of the Red Army and annexation of the region into the Soviet Union. The Bolsheviks confiscated

all private properties and exploration rights virtually isolating the region from the world.

During the Soviet time, oil production was accelerated, the technology was upgraded and new wells were dug. In 1940, 62 060 000 barrels of oil was produced in Baku region and 16 060 000 from the North Caucasus (as cited in Gökay, 2001).

The German threat posed to the Baku oil fields in the Second World War caused Soviet planners to shift the weight of drilling activities to the Volga Ural region causing the decline of importance of the Baku oil fields (Gökay, 2001).

Starting with late 1960s and continuing in 1970s Soviet oil production slowed down. This was mainly due to inadequate equipment and extraction techniques. This continued in 1980's for the worse. The technological revolution of the West could not be matched by the Soviet Union which also lacked funds for investment in modernization of the petroleum extraction industry (Gökay, 2001). Azerbaijan was the hardest hit oil region. Its share of Soviet oil production shrank. Most onshore oil fields around Baku were depleted and there were no funds to develop promising offshore fields. Finally, Moscow conceded it needed outside support and, in late 1980's, sought possibilities for joint development of oil fields with western firms (Spatharou, 2001).

When the region was under the Soviet rule there was scant information on the region's energy resources. This was not important at the time because even if information had been available this would have been no help to anybody since it was impossible for foreigners to invest in the Soviet territory. Although the initial oil was discovered and produced onshore, subsequent exploration revealed that rich hydrocarbon resources existed under the Caspian Sea in six separate basins.

However, the euphoria over the size of these resources proved to be unfounded. Despite their immense sizes, the hydrocarbon resources of the region vis-à-vis the global reserves are marginal. To give an example, Saudi

Arabia possesses proven reserves of 265 billion barrels of oil, corresponding to 25 % of the global reserves. The Caspian region's oil reserves, on the other hand, are estimated between 17 and 44 billion barrels comparable to those of Kuwait in the low end and the US on the high end (EIA Caspian Sea, 2005).

Natural gas prospects of the Caspian region is more significant than its oil resources. Proven reserves are estimated at 6.57 Tcm comparable to that of Saudi Arabia's 6.90 Tcm.

Due to the disagreement with Iran on the division of the resources, of the six separate basins of hydrocarbon deposits under the Caspian Sea, only those in the North could be developed.

After the demise of the Soviet Union, 'the energy hungry' western countries saw the Caspian as a possible new hydrocarbon depot to substitute mainly the North Sea. The regional countries, on the other hand, evaluated their energy resources as a one way ticket to the real freedom.

Considering that the biggest traditional supplier, the Middle East is prone to conflict – the questions about Iraq's future is the main reason behind this uncertainty – and others may not be deemed secure – conflict in West Africa, and an anti American President in Venezuela – increased the value of Caspian oil as a balancer in global markets in the eyes of western policy makers.

There is a serious problem, though, in considering the effect of the Caspian region hydrocarbons: How to bring the oil and gas to consumers. The producer countries are all landlocked and oil and gas they produce need to cross third countries, transit countries, in order to reach global markets. The efficient way to transport oil and gas over long distances is through pipelines. However, the regional pipeline system was built during the Soviet era to supply Russia and the communist Eastern Europe. Prior to 1997, the only way out for oil was the 24,000 b/d Russian pipeline extending from Kazakhstan to Russia. Gas exports were similarly dependent on Russian infrastructures. Moreover, after the independence of the three producer

countries, the pipelines inherited could not be adequately maintained. Most of them are old and could not be relied on to transport huge amounts that are expected to be produced in the region. Russian pipelines are almost in the same condition. Furthermore, Russian oil pipelines are owned by the state monopoly Transneft, and gas pipelines by Gazprom and these are unwilling to allocate quotas for Caspian region producers. When Gazprom allocates space for Turkmen gas, this is to deliver to countries such as Ukraine, and Moldova which have payment difficulties.

The three producers need alternative routes for their production. Barring Russia, the only ways are through China to the east, through Iran to the south, and through Georgia or Armenia and Turkey to the west. China is a huge energy consumer on its own right so a pipeline through China makes sense. However, the distance to be covered is long. Iranian route may seem to be feasible; however, the US sanctions against this country preclude any cooperation with Iran. Armenia, at the moment occupies almost 20% of the Azerbaijani territory displacing about 900.000 Azeris from their homes. Furthermore, it shows no inclination to solve the situation hoping that the support of its diaspora will enable it to get concessions from Turkey and Azerbaijan. This is hardly a suitable environment to lay down a pipeline. The only remaining option is a pipeline through Georgia and Turkey to the Mediterranean. And that was what happened. The inauguration of the Baku-Tbilisi-Ceyhan oil pipeline on 13 July 2006 heralded the breaking away of the Caspian producers from the Russian monopoly.

## **2.2 “Caspian Region Effect” in the Supply Security**

As mentioned above four of the five biggest oil producers are in the Middle East, a place that has always been at the top of the political agenda, and amongst the world's flash points.

For years, the Middle East was the main supplier of oil. The vast reserves of Saudi Arabia, Iraq and Iran, alongside the others, supplied the

world with much needed oil. Then came the oil embargo of 1973. This was a shocking development and showed the West, especially the United States that energy now was a geopolitical tool and the suppliers, hitherto good allies of the United States, could not be trusted upon any longer. Oil became a political weapon in the hands of Arab states like Libya.

Just at this juncture, there came the North Sea oil. When the demand was soaring in the West, and questions over the security of supply were abound, the offshore fields in the North Sea, beyond the control of the OPEC cartel, was a much welcome alternative, and of course nuclear energy played an important role to support power generation.

Starting with the 1990s, when the energy demand was once more soaring, but this time due to not only the US but also China and partly India, a new region, the Caspian, came to the rescue. Although its oil reserves, when compared with those of the Middle East, may not be significant, they are comparable to those in the North Sea and the Gulf of Mexico.

The following part of this Chapter discusses new actors with rich hydrocarbon resources in the region, namely Azerbaijan, Kazakhstan and Turkmenistan. A section on Uzbekistan, although not a riparian state, is also included because this country is in the “Greater Caspian Basin” and its policies, hydrocarbon resources and attitude affect other countries in the region. Finally, another non-riparian country, Georgia, is discussed because this country, devoid of oil and gas, is crucial in transporting oil and gas to the world markets.

## **2.3 New Actors in the Caspian Region**

### **2.3.1 Azerbaijan**

Oil production is not a new issue for Azerbaijan. At the end of the 19<sup>th</sup> century, Baku was one of the first oil production regions of the world. Rostchids and Nobels developed oil fields and exported oil to the world.

With the Revolution of 1917 and the establishment of the Soviet Union, these fields were nationalized and came under state control until Azerbaijan declared its independence on 30 August 1991 and left the Russian organized CIS in 1992.

Azerbaijan is neither a parliamentary democracy nor a real autocratic country. There is a President, head of the executive, with strong powers. Judiciary and legislative, on the other hand, have limited powers. The reason that Azerbaijan has not turned into a full fledged autocratic regime is, perhaps, Azerbaijan established the “first democratic republic in the Muslim World” (Cornell, 2005).

Azerbaijan is the most important former Soviet Republic in the region for the following reasons:

First, it has its own hydrocarbon resources. It has proven reserves of 7.3 billion barrels of oil, 0.6% of the world total, and 1.37 Tcm gas, 0.8% of the global reserves.

The oil production of the country is increasing. Having dropped to its lowest in 1995, to 67.2 million barrels, it reached to 115 million barrels in 2004. In 2005 Azerbaijan increased its production by 42.8% and reached to 164.2 million barrels.

As of end of 2005, Azerbaijan has also 7.02 Tcm of proven gas reserves. Its gas production of 4.7 bcm in 2004 increased by 13.9 % to 5.3 bcm in 2005.

Secondly, Azerbaijan is an important transport route for the Caspian region hydrocarbons to reach the world markets.

This importance of the Country, coupled with its policy seeking total independence from Russia resulted in a volatile political history since its independence in 1991. In most of the other Turkic speaking NIS the leaders in power at their independence, mostly former high ranking officials of Communist Parties, held to power. Examples are abound: Turkmenistan’s Niyazov<sup>7</sup>, Uzbekistan’s Kerimov and Kazakhstan’s Nazarbayev are still in

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<sup>7</sup> Prezident Niyazov has died after this thesis was accepted.

power, their position is stronger than ever. Kyrgyzstan's Akayev just lost its seat after a long period of tenure through a "colored revolution". Azerbaijan, on the other hand, has its fourth president since 1991. The political history is dotted with attempted coups and thrice successful coups. This is mainly due to Russian concerns over and involvement in the Republic's affair.

Only Azerbaijan among the NIS could seek a credible policy of independence from Russia. The main Russian hold over the NIS to retain authority over the 'near abroad' has been the supply of cheap energy, as a lever of political influence (Hadjian, 2001). However, this cheap, subsidized energy does not mean anything in the case of Azerbaijan since it has its own rich hydrocarbon resources. Moreover, Azerbaijan, during the Soviet times, was the center of oil field equipment manufacturing.

The first president of the country was a Soviet era oil technocrat Ayaz Muttalibov who originally rose to power in 1989 as the First Secretary of the Azerbaijani Communist Party. In the same year, first negotiations with western oil companies started. Muttalibov in this aspect was more liberal than his predecessors (Spatharou, 2001). Negotiations were slow to develop because Muttalibov was hesitant to sever ties with Moscow. He would only declare independence in the aftermath of the coup against Gorbachev in Moscow, and after all the other republics declared their independences. This hesitancy, both in political and economic sphere, strengthened the opposition the Azerbaijani Popular Front (AzPF). AzPF was following a strongly nationalistic line perceiving oil as a weapon to be used for the solution of Nagorno-Karabagh conflict. Furthermore, AzPF saw that without total control of oil and gas resources Azerbaijan would never be free of Russian control and became a truly independent state.

In order to counter accusations that he was deliberately stalling negotiations for oil concessions Muttalibov, in Spring 1991, offered two biggest offshore oilfields, Azeri and Chirag, to international bidding. Amaco of the US was selected to develop the project (Spatharou, 2001). However, this was not enough to keep him in the office. Massive military defeats at the



war in Nagorno-Karabakh and the loss of Hocalı, cause him to lose the Presidency in 1992 (Spatharou, 2001).

Muttalibov was removed from the office through the first and only true elections in the country and replaced by former dissident Ebulfeyz Elçibey's AzPF government in June 1992. Elçibey came into power on a strong anti-Armenian and Anti Russian platform and declared that he would not ratify the agreement signed by Muttalibov for joining the CIS. His rhetoric describing the 1928 Gulestan agreement between Russia and Iran dividing Azerbaijan between the two countries as the beginning of Azeri colonization was not favorably met by the Iranian authorities either (Spatharou, 2001). He followed a strongly nationalistic policy, based on using oil for economic independence, utilizing its revenues for a favorable solution in Nagorno-Karabakh conflict and making oil a cornerstone of Azerbaijan's foreign policy. To this end Elcibey actively pursued to involve western companies in the development of oil potential of his country. In March 1993 BP and Statoil got the concession to exploit Chirag field. In June 1993 the Azerbaijan oil company SOCAR announced its plans to develop Azeri, Gunesh and Chirag fields with western concerns and the imminent signing of the agreement. In line with the strong Turkish orientation of Elchibey, the Turkish oil company TPAO was also involved in the project and the pipeline to carry the oil would be Baku-Tbilisi-Ceyhan. Russia and Iran were not invited to the deal. His pro-Turkish, pro-western policy included total exclusion of Russia from Azerbaijan. Elcibey further managed to persuade Russians to remove their troops from the Azeri territory in 1993, one year ahead of schedule. However, the situation at the front in the war in Karabagh was not bright. Just before his departure for an official visit to London on 30 June 1993, a military commander, Suret Huseinov refusing to integrate his volunteer militia into the Azerbaijani Army, marched his troops to Baku. The coup ended with the flight of Elcibey to Nakhcivan (Spartharou, 2001).

Aliiev, coming to power in 1993, followed a more cautious foreign policy. Despite the fact that this former president of Nakhcevan had fostered strong

relationships with Turkey before, upon becoming the President he distanced himself and Azerbaijan from Turkey. This was mainly to pacify Russian concerns over increased Turkish involvement in the Transcaucasus. His token gestures to Russia such as imposing visa requirements for Turkish citizens should be seen in this light (Hadjian, 2001). He also tried to mend fences with Moscow and agreed to join the CIS.

Aliev was savvier in developing plans to use the country's hydrocarbon resources for national aims. He was a better businessman in dealing with foreign oil companies. When he came to power in July 1993, he cancelled the old deal signed by Elçhibey, claiming that he could get a better deal for Azerbaijan (Hadjian, 2001). Negotiations restarted and Russia was taken aboard by offering part of SOCAR's share to Russian Lukoil and on 20 September 1994 Aliev scored his biggest success with the conclusion of the 8 billion \$ agreement with the Western consortium led by British Petroleum-Statoil, for the development of the Azeri, Chirag and Guneshli offshore oilfields. The three fields to be developed are estimated to contain between 3 and 4 billion barrels of light sweet crude oil. The "Deal of the Century", represents the largest single foreign investment in the former Soviet Union. Aliev had been more anxious to score political points than to impose harsher terms on oil companies. Nonetheless, he lived up to his promise to get a better deal for Azerbaijan. The Azeri share of profits rose from 70 per cent to 80 per cent in the new agreement and the Country expected revenues to the tune of \$80 billion over the project's 30-year lifespan (Hadjian, 2001). Then came the question of transport. Here again Russia insisted on a pipeline through its territory. It proposed the upgrading of Baku-Novorossiysk or Baku-Supsa pipelines. Oil from these ports would be loaded on tankers and shipped across the Black Sea through the Turkish Straits to world markets. However, this project was objected by the US, as giving the sole control of the oil pipelines to Russia, and by Turkey, claiming that the already crowded Turkish Straits could not bear the extra burden the tankers would bring. At the end, a system of multiple pipelines was agreed upon. The Baku-

Novorossiysk and Baku-Supsa pipelines were to be used for the transport of “early oil” and the main pipeline would follow the Baku-Tbilisi-Ceyhan route to the Mediterranean.

Azerbaijan has followed a policy of strong integration with the West, with western multinationals, oil companies and institutions, such as the IMF and the World Bank.

After its independence, the foreign policy of Azerbaijan can be described as oscillating between Russia and the US (Blandy, 2006). This is out of the obvious necessity. Azerbaijan tries to use its oil card to consolidate its integrity which has been badly damaged by the Nagorno-Karabag conflict, and elevate its standard of living. Making sure that it will not re-enter Russian orbit is also Azerbaijan’s priority.

Azerbaijan has four political concerns: Conflict with Armenia, domestic political situation, nation-building and relations with Russia, and two main foreign policy threats: Russia and Iran. As Cornell said, “Azerbaijan from the outset identified Russia and Iran as two leading threats to its national independence and security.” (Cornell, 2005, p.55).

Russian domination of its politics, international relations and economy is a serious threat for Azerbaijan. This threat finds its roots in Russia’s support of Armenia in the Karabagh conflict. This is not an alleged support; in fact, Russia was overt in its actions. Weapons worth 1 billion \$ were transferred from Russia to Armenia during the Armenian assaults that resulted the occupation of Nagorno-Karabagh and six Azerbaijani provinces.

Azerbaijan’s main concern is to prevent Russian domination on its economy and foreign policy. To this end, it wants control over exploitation of its hydrocarbon reserves. However, it cannot escape from Russian interest. Russia was reluctant to let Azerbaijan have a pipeline outside of Russia to transport its oil, and used its weight to prevent it.

The independence of Azerbaijan disturbed Iran because of the latter’s perception of a security threat that an independent Azerbaijan would be a “bad example” for 20 million Azeris living in Iran. In this context the existence

of Azerbaijan is disconcerting for Iran. This, in turn, leads Azerbaijanis to mistrust Iran although an overt Iranian attempt to Azerbaijan is not expected. Iran, on top of its unease for its Azeri community, is further concerned by Azerbaijan's close relations with the US, its archenemy and Turkey, its regional competitor. The maritime dispute in delimiting the Caspian Sea is another issue to cause tension between Iran and Azerbaijan (Cornell 2005). This territorial dispute has gone so far that , in July 2001, Iran sent gunboats to chase away an Azerbaijani contracted BP survey vessel searching for oil in Alov field situated in the part of the Caspian Sea where Iran claims sovereignty (Maliki, 2001 August 17).

### **2.3.2 Kazakhstan**

Territory wise Kazakhstan is the ninth biggest country in the world. It borders two powers, China and Russia, and has ample natural resources. Its oil reserves of 39.6 billion barrels make up 3.3% of the world reserves. Oil from its Tengiz fields already finds its way through the Caspian Pipeline Consortium's (CPC) 980 mile pipeline to Russian port of Novorossiysk and from there to world markets. Similarly the northbound Atyrau-Samara pipeline brings Kazakh oil to the Russian pipeline network. Its oil production was 151 million barrels in 1995. The production has continuously increased and reached to 461.8 million barrels in 2005.

Kazakhstan has also 3.0 Tcm of gas reserves, corresponding to 1.7% of the world reserves.

Kazakhstan gained its independence in 1991 after the dissolution of the Soviet Union. Nursultan Nazarbayev, the leader of the Kazakhstan Soviet Socialist Republic, became the President of the Kazakhstan in 1992. He immediately started political and economic reforms to bring the country out of its Soviet era stagnation. Initially political reforms were promising. Democratic concepts such as division of power, elections and allowance of opposition parties were put in the Constitution. But, in practice decision making rested with the executive. Nazarbayev, through political

maneuvering and cancellation of elections upon complaint about irregularities, changes in the constitution and extension of presidential terms, held on the presidency. Freedom of press has been restricted and state structure has been strengthened. In the end, the so called political reforms were not successful and a western style democracy is still to come.

Economic reforms are a different story. Here, pragmatism reigned and there has been considerable progress. Immediately after independence the country started to privatize. Small and medium size enterprises as well as agricultural establishments have been privatized. Foreigners have also been allowed to buy those establishments. A modern financial system has been developed with banks, a stock exchange, tax laws and convertible currencies. A well managed monetary policy keeps inflation in check. It has averaged 6.8% between 2001 and 2005.

The results of these reforms have shown themselves. Foreign investors have invested about 17 billion \$ since independence. The GDP has grown steadily since 1999. Between 2002 and 2005 the average GDP growth has been 9.5%. (IMF World Economic Outlook, 2006, 2005, 2004). In 2000, Kazakhstan is the first NIS country to repay all of its debt to the IMF, seven years ahead of the schedule. The country was recognized as a “free market economy” by the US, a first among the NIS countries. In 2002, Kazakhstan received investment-grade credit rating from a major international credit rating agency, another first among the former Soviet Union countries.<sup>8</sup> In line with its desire to integrate with the global economic system, Kazakhstan, wants to be a member of the World Trade Organization (WTO) in 2007.

In the security field Kazakhstan has also cooperated with the west without being overtly in the western side. It signed the PfP with NATO but most importantly it signed the NPT (non-Proliferation of Nuclear Weapons Treaty) in 1993 and gave up 1400 plus nuclear warheads it inherited from the Soviet Union. It showed its peaceful intentions when it solved a border dispute with Uzbekistan peacefully in September 2002.

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<sup>8</sup> US State Dept. Fact Sheet Kazakhstan, [www.state.gov](http://www.state.gov) retrieved on

From the onset Kazakhstan welcomed foreign investment<sup>4</sup> Nov. 2006ts. The biggest deals have been in oil. Kazakhstan has a huge oil potential and it can play a role in world oil markets. The US, cognizant of this fact, supported American firms to develop these resources. In fact, Chevron was already negotiating with Moscow before Kazakhstan became independent to develop Tengiz fields.<sup>9</sup> Unfortunately, the country had to rely on Russian Transneft pipeline system to export this oil. However, the Caspian Pipeline Consortium (CPC) pipeline changed this. A private consortium, in which US firms also hold stakes, the CPC now carries 600,000 b/d Kazakh oil, mainly from the Tengiz field but also gas condensate from the Karachganak field.

China is also interested to purchase Kazakh oil to satisfy its growing energy demand. The China National Petroleum Corporation (CNPC) bought Petrokazakhstan for \$4.18 billion (Pala, 2006 March 17) Kazakhstan and China are cooperating to build a three part pipeline from Atrayu in north Caspian to western China. This is expected to be completed by 2011 and carry 600,000 b/d oil. Part of this pipeline is already operational. This Kazakh Chinese cooperation in oil disturbed Russia as well as the US.

Gas resources of Kazakhstan have been hitherto neglected due to lack of transport infrastructure and concentration on oil development. Gas released from oil fields have been flared up or reinjected into the ground to maintain operation pressure. Kazakh government is now trying to develop options to produce and export gas. Its gas production has already reached to 16 bcm this year (Mann, 2006 July 25).

Kazakhstan, unlike Azerbaijan, has not followed a close integration policy with the West. The country's main vulnerability is its ethnic composition. Due to the forced population movements, a legacy of the Stalin era, and continued after the dictator's death, ethnic Kazaks have been minority in Kazakhstan. This disproportion in population caused some observers voicing concerns over future of Kazakhstan's state building experience (Welt, 2006 Sept 27). In fact, Kazakh population only reached

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<sup>9</sup> As a sign of Glasnost, Kazakh officials were allowed by the Soviet authorities to sit at the table during these negotiations.

51% after the independence. This is due to the emigration of ethnic Russians. The northern part of the country is predominantly ethnic Russian. This makes the country vulnerable to ethnic unrest. A number of steps to appease Russia and ethnic Russians have been taken. The capital was moved from Almaty to Astana in 1998. By establishing the new capital in a region where ethnic Russians have a majority, the government is hoping to give a message of national unity. Furthermore President Nazarbayev, in his speech of 1 March 2006, stated “increasing integration with Russia” as his country’s first priority. (Pala, 2006 March 17).

Kazakhstan’s is cooperating with Russia and China in the Shanghai Cooperation Organization (SCO).

This multi-vectored foreign policy, cooperating with Russia on security and economic issues while welcoming American investors to develop its resources and establishing good relations with China proved successful. The standard of living of the people improved and the country prospered even to the extent that it could project economic power beyond its borders. It became the main investor in the neighboring Kyrgyzstan and a major investor in Georgia. Kazakhstan signed a joint venture agreement with Batumi Oil terminal in Georgia to facilitate the flow of Kazakh oil to the Black Sea (Welt, 2006 Sept. 27).

Kazakhstan, like the other ex-Soviet countries in the Caspian region has two main foreign policy objectives. To make sure that Russia cannot re-establish the control it lost after the dissolution of the USSR, and to assure its oil and gas exports. Kazakhstan is also a landlocked country that needs Russian pipeline system to send its oil to the markets. It is trying to find alternative routes for its oil. As mentioned above, the first alternative is the Caspian Pipeline Consortium’s (CPC) pipeline. Although this also passes through Russian territory, it is not owned by the Russian state (i.e. Transneft). The CPC is owned by a mixture of state and private entities. Furthermore Kazakhstan signed another deal to ship 51.31 million barrels of oil-to increase to 153.9 million barrels- per year to Baku by tankers, and from

there to Ceyhan on the Mediterranean via the BTC pipeline. Kazakhstan is now a truly Caspian player (Welt, 2006 Sept. 27).

China is also interested to purchase Kazakh oil. In fact China sees Kazakhstan as its main energy resource. China National Petroleum Corporation's purchase of Petrokazakhstan was already mentioned. China spent a further 700 million \$ for a pipeline to bring this oil to China. (Pala, 2006 March 17).

Recently Kazakhstan, like Turkmenistan, has been disturbed by the "color" revolutions in Ukraine, Georgia and Kyrgyzstan, and decided to strengthen relationship with Russia and China. The Shanghai Cooperation Organization could prove a suitable environment to voice these concerns.

### **2.3.3 Turkmenistan**

Turkmenistan is the remotest of the former Soviet republics in the Caspian region. This mainly desert country with an area 488,100 sq. km. and population slightly above 5 million is difficult to reach by land. The eastern shores of the Caspian Sea are less developed than the western shores (Raczka, 2005). It is a poor, underdeveloped country where the tribal connections are still strong. During the Soviet era its main produce was cotton. With 700,000 tons, it was the second largest cotton producer in the Soviet Union in 2005.<sup>10</sup> However due to some bad harvests in recent years the cotton production dropped by 50% (Central Intelligence Agency (CIA), 2006).

Despite the desert climate and drastic drop in cotton harvests, Turkmenistan has good prospects. It has rich gas and some oil reserves.

The country's gas reserves are estimated to reach 2.9 Tcm, or 1.6 % of the world gas reserves. (BP, 2006) However, since the Turkmen statistics are not transparent, these may be much higher than claimed by the country. Production reached to 58.8 bcm in 2005 making the country second largest

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<sup>10</sup> Turkmenistan fact sheet, US State Dept., [www.state.gov](http://www.state.gov), retrieved 4 Nov. 2006



gas producer after the Gasprom in the ex-Soviet Union. Oil reserves are not that spectacular. The proven reserves are estimated at 733 million barrels.

These prospects have two obstacles. First, the country has an autocratic administration almost reminiscent to the communist party rule. It “has become a Soviet style holdover from the communist era” (Shiver, 2006, p.34). The money is not convertible and the Central Bank has no authority, its only duty being printing money and extending loans to state enterprises (Sabonis-Helf, 2004). The economy is basically under state control. Privatization can only be seen in food processing, services and trade. Old Soviet practices are still seen in the form of state subsidies for public goods and services which are being increasingly difficult with the increasing population. The financial sector is controlled by the state. Although there is a *Halk Maslahati* (Council of the People) and *Majlis* (parliament), they are not permanent legislative bodies. They only convene annually or at the pleasure of the President (Sabonis-Helf, 2004). All the powers are concentrated on the President, Shaparmurad Niyazov<sup>11</sup> who got himself elected as the lifelong president in 1999. The state is cautious towards foreigners. The country began registering and monitoring all foreigners, students previously approved to study in the United States were not allowed to go. Foreign entrepreneurs are regarded with xenophobia. The country is not hospitable to foreign investment. There is no transparency, no rule of law and rampant corruption. Ministers are frequently replaced making contracts signed by them worthless. This attitude towards the foreigners and foreign investment and lack of proper business environment prevented much needed foreign investment into the country to develop infrastructure.

The second problem is the question of transport of oil and gas. Here the malady of former the Soviet Republics, i.e. the dependence on the ex-Soviet pipeline system, which is presently under the sole control of Russia, also hinders Turkmenistan. This means a virtual Russian chokehold over Turkmen oil and gas, and Russia used it as a policy instrument.

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<sup>11</sup> Prezident Niyazov has died after this thesis was accepted.

In 2003, Russia had a deal with Turkmenistan where the former agreed to buy 6 bcm gas by 2004, 6 bcm gas by 2006 and 8 bcm gas by 2009 from the latter for 44 \$ per 1000cm.(tcm), 22 \$ of this was to be paid by Russian exports to this country. (Blank, 2006 Feb. 22). Furthermore, Russia supplies this gas to “near abroad”, countries with payment difficulties such as Ukraine, Moldova and Georgia while sending its own gas to paying customers such as the EU, further harming Turkmen income. However, Turkmenistan’s dependency on Russia may have come to an end. On 5 September 2006, Turkmenistan signed a deal with Russia in Ashkabat, where the price of Turkmen gas was increased from 65 \$/1000m<sup>3</sup> to 100\$/1000m<sup>3</sup>. Through this three year agreement Russia undertakes to purchase a total of 50 billion m<sup>3</sup> gas from Turkmenistan. The fact that the agreement covers 2007-2009 only indicates that prices may increase afterwards.

Turkmenistan is trying to play China against Russia. Turkmen President Niyazov, during his visit to China in August 2006, reiterated that work is continuing on a gas pipeline from Turkmenistan to China which would carry 30 bcm/year Turkmen gas to China’s energy hungry economy and it is expected to come on line in 2009. Igor Torbakov, a freelance journalist, considers that Turkmenistan’s economic partnership in China can dramatically change Central Asia’s energy equation (Torbakov, 2006 Aug. 29). That is probably why Russia conceded to Turkmen demands to increase the price of gas by 40% from 65 \$ for 1000 cm to 100 \$. Sergei Blogov, an expert on CIS affairs, further adds that failing to reach an agreement with Turkmenistan could have led drastic consequences for Russia since without Turkmen gas Russia would be unable to fulfill its export commitments to the EU and elsewhere (Blagov, 2006 Sept. 6).

Other than Russia, the Niyazov regime considered three routes for its exports. The Transcaspian Pipeline, under the Caspian Sea to Baku and Turkey, a pipeline through Iran to Turkey and a third option via Afghanistan to Pakistan and Indian Ocean. For several years, Turkmenistan was in the

Caspian Basin Energy Initiative, which tried to develop the Trans-Caspian Gas Pipeline (TCGP), with private sector and Turkmenistan, Georgia, Azerbaijan, and Turkey under the Caspian Sea. Gas from Turkmenistan was to be exported to Turkey and beyond. However, in 2000 Turkmenistan essentially undermined the negotiations by refusing all offers by its commercial partners and making unrealistic demands for billion-dollar "pre-financing." Furthermore Iran and Russia, regional competitors of Turkey and the US objected to the project. The second one was hindered by the U.S. embargo towards Iran under the Iran-Libya Act. The third one was not considered by the investors since it was to cross the volatile Afghanistan.

One issue in gas production is Turkmenistan's attitude towards the legal status of the Caspian Sea. Turkmenbashi's position in this issue has vacillated over time. He supported Iran in the latter's view that the Caspian Sea was a lake hence should be evenly divided among the five littoral states. Other times he was leaning towards the Russian position that The Caspian Sea should be treated as a "sea" under the Law of the Sea Convention. The reason behind this vacillation is the dispute over Serder gas field in the Caspian Sea. Some said that personal rivalry between Turkmenbashi and Azerbaijan's late President Haydar Aliev has also played a role. Whatever is the reason, Turkmen position is one of the obstacles before the development of the full potential of the Caspian region. For example, the dispute over the Serder field was also behind the lack of progress in the Trans Caspian Pipeline project.

Although gas is a lifeline for Turkmenistan, it also brings all the problems of a single product economy. To alleviate this, the country need to upgrade its infrastructure, such as pipelines and refineries; and diversify into other products.

After gaining independence Turkmenistan followed a policy to obtain greatest independence in international politics through a tightrope foreign policy based on "positive neutrality". This is also accepted by the United Nations. On 13 December 1995, the United Nations General Assembly

officially proclaimed Turkmenistan's neutrality. As an example of its neutrality, it refused to be integrated into the Russian supported NIS and refused to sign the NIS Charter in 1993. Ashgabat also declined to sign the collective security agreement for the ex-Soviet republics in 1993, to participate in the intergovernmental economic committee to reintegrate the NIS economies and to sign multilateral treaty to protect the "external frontiers of the NIS", all of them being initiatives of Moscow to integrate the NIS with Russia. However, due to its landlocked status and dependence on Russian pipelines to export its main product, gas, it avoided to openly antagonize Russia. For example Niyazov accepted the Russian demand for dual nationality for ethnic Russians living in Turkmenistan.<sup>12</sup>

Turkmenbashi's iron grip on its country has one other ramification: The question of succession. There is no heir apparent to Turkmenbashi. Any minister being too prominent is immediately replaced (Sabonis-Helf, 2006). When he is no longer in the picture, a power vacuum in politics may emerge. Furthermore, since as mentioned above, the system is akin to a socialist one with state subsidies, any disturbance in the workings of the state after Turkmenbashi may interrupt these subsidies causing public unrest. This may bring the integrity of the country and hence security of the gas supplies to the West in question. In fact, Steven Blank, research professor working on national security affairs at the US Army War College thinks that Turkmenistan, after Turkmenbashi, will probably be a "failed state" (Blank, 2006, p. 54).

#### **2.3.4 Uzbekistan**

Uzbekistan is not a Caspian littoral state. However, its proximity to the region, cultural affinity with Azerbaijan, Turkmenistan and Kazakhstan as well as the shared history of the Soviet administration makes this country important for Caspian affairs.

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<sup>12</sup> However, this dual nationality was abolished later on and people are forced to select their nationality.

Uzbekistan, once the poorest state of the Soviet Union, with its 25 million inhabitants, is the most populous state in the region. Uzbeks make up the ethnic majority. Russian's (5.5%) and Tadjiks (5%) make up significant minorities. The country is situated on the famous Silk Road. Some of the best known cities of this road -Samarkand, Bukhara and Khiva- are in Uzbekistan. Tsarist Russia occupied Tashkent in 1865 and as with the other parts of the Central Asia Uzbekistan's colonization was completed by the end of the 19<sup>th</sup> century. After the establishment of the Soviet administration, Uzbekistan Soviet Socialist republic was established in 1924. During the Soviet times the country supplied cotton and natural gas to the Soviet Union. After the collapse of the Soviet Union the country declared independence on 1 September 1991 Islam Kerimov the former first Secretary of the Uzbek Communist Party becoming the first president.

Although Uzbekistan is a constitutional republic with separation of powers, it is only an illusion. All the powers are gathered in the hands of the president Kerimov, whose presidency has been extended through various elections and referendums. International observers, especially those of the OSCE, states that those elections and referendums are not satisfactory for OSCE standards. Judiciary is not independent and legislature only meets for a few days every year. There is no freedom of speech or free press and opposition is severely repressed.

Uzbek economy is mainly dependent on cotton production and exports. The country is also a major exporter of gold and it has sizable copper deposits.

According to the Oil and Gas Journal (as cited in EIA Uzbekistan, 2005) Uzbekistan's oil reserves are estimated as 594 million barrels (or 100 million tons). The country has a total of 171 oil and gas fields. Uzbek oil production has been steadily decreasing since the peak of 60.1 million barrels in 1998. The production was the lowest in 2005 with 40.3 million barrels, a sharp drop of 16.6% from the 2004 figure of 48.4 million barrels.

The prospects are better for natural gas. Uzbekistan has proven gas reserves of 1.85 Tcm, 1% of the global deposits, putting it in the third place, after Russia and Turkmenistan among the former Soviet Republics. Gas production has been steadily increasing from its 1994 figure of 45.3 bcm to 2005's 55.7 bcm corresponding to an increase of almost 23%.

The government has a strong hand in the economy. Harsh measures almost crippled trade. The restrictions on currency convertibility, despite the acceptance of the Country of the Article VIII of the IMF's Articles of Association, restriction on foreign trade, especially the closure of borders with Kazakhstan and Kyrgyzstan, have all had negative effects on the economy. The undemocratic nature of the government and its slow pace to transform the country to a market economy make it an inhospitable place for foreign investment which is desperately needed to develop the hydrocarbon reserves and other natural resources.

In order to develop its resources, Uzbekistan is trying to privatize Uzbekneftgas, the state company but an insistence on maintaining control is not desirable for foreign investors. The country is trying to have agreements with foreign companies to develop oil and gas fields especially after the drop of oil production. China is interested and in 2005 a Chinese oil company, Sinopec signed a 106 million \$ agreement to rehabilitate existing oil fields. CNPC is also expected to sign a joint venture agreement to develop oilfields in Bukhara and Khiva regions. Malaysian Petronas is interested with a 200 million \$ deal to develop Aral Sea resources.

Uzbekistan, like Turkmenistan, is doubly landlocked. It has almost no international oil pipelines. The only one in existence links Shymkent refinery in Kazakhstan to Chardzou refinery in Turkmenistan. Uzbekistan has signed a Memorandum of Understanding for the construction of the Central Asia Oil Pipeline (CAOP) connecting Turkmenistan and Uzbekistan to Pakistani ports in the Arabian Sea, through Afghanistan. However, due to the instable situation in Afghanistan, the uncertainty in the future of this country and

negative investment environment in Uzbekistan, it is very doubtful that the project would find financing.

Development of natural gas resources is better. In 2001 Uzbekneftgas signed a Production Sharing Agreement (PSA), to develop gas fields in central Uzbekistan, but the agreement was broken later on by Uzbekistan. Gasprom, ever needing new gas supplies, signed a gas supply agreement with Uzbekneftgas to purchase 9.8 bcm gas per year and also involved with upgrading existing fields. Moreover, Gasprom is planning to invest 1.2 billion \$ to develop Usyurt gas fields. Furthermore, Gazprom's announced plans to spend 1.5 billion \$ to modernize central Asian pipelines would also help to boost gas exports from Uzbekistan to Russia.

Uzbekistan joined the CIS in 1991 right after its independence. However, it refused to be integrated and left the CIS in 1998.

Uzbekistan has cooperated with the US in the "War against Terror", but the US condemnation of events in Andjican in 2005 resulted a cooling of US-Uzbek relations.

### **2.3.5 Georgia**

Georgia is not a Caspian region country. However, it is vital for the transport of the Caspian oil and gas. Since Armenia is out of the picture because of its aggression towards Azerbaijan, occupying a sizable portion of this country's territory and close relations with Russia, Georgia is the key link of the "East-West Corridor" and hence it is included in this study.

Georgia is, perhaps, the most vulnerable country in the region. It has no natural resources worth to mention, no industry. Following the overthrow of Gamsakhurdia, the first democratically elected President, the country suffered civil war. Russian pressure is present each and every minute. It is dependent on Russia for energy. Georgian-Russian disagreement on any issue results in ethnical strife in Abazia or Ajara, or alternatively interruption of supplies of gas or electricity. Georgians spent some of the coldest days of

winters without energy. However, as a Georgian diplomat states, the country can offer its geography to the world since it is strategically situated on the most critical pipeline routes.

Georgia suffered greatly from Russian attempts to make it an unstable country to transport Caspian oil and gas. Following the removal from office of Gamsakhurdia, separatist groups in Abkhazia, Ajara and South Ossetia took up arms against Tbilisi. Following a Russian brokered peace Abkhazia became a de facto Russian protectorate (Cordesman, 2000).

Georgian economy was devastated by internal troubles. In 1995 the Country's GDP fell 20% of 1990 level and inflation rate reached to a staggering 7000%. Georgia applied to the IMF for support and the hyper inflation was checked.

As mentioned above, Georgia is important for energy markets because of its geographical position. It is the gateway for the Caspian hydrocarbons. Georgia is part of the Eurasian Transport Corridor (TRACECA) bringing hydrocarbon and other resources from the Caspian region to Europe (Cordesman, 2000). The first sign of this was the transport of the so called "early oil". On 8 March 1996 an agreement was signed between Georgia and Azerbaijan to pump the early oil from Azerbaijan to the Georgian port of Supsa on the Black Sea.

The BTC is a chance for Georgia to break Russian dependency. The income and also the political support it garners from the pipeline will strengthen Georgian government against Russian interventions. Furthermore, President Saakashvili is also looking for ways to cooperate with Russia so that the latter would have a stake in Georgia's stability. In, 2004, during a visit to Moscow the Georgian President stated that if Russia wished to build a pipeline through Georgian territory, Georgia would support it. Such a pipeline joining to the BTC or running parallel to it, would reduce Russia's exclusion from the transport of Caspian oil to world markets and protect its oil exports. (Anjaparidze and Welt, 2005 March 9)



The South Caucasus pipeline running parallel to the BTC and transporting natural gas from Azeri Shah Deniz fields to the Turkish city of Erzurum is another leg to bolster Georgia's position.

## **CHAPTER 3**

### **GLOBAL AND REGIONAL PLAYERS AND THEIR CASPIAN STRATEGIES**

The resources in the Caspian Sea have come in the picture in a very opportune time. The energy security concerns of large industrial countries matches with political concerns of the countries in the Region. The countries, which have recently seceded from the former USSR, want to bolster their independence and also increase their stage of development, which have been stunted during the USSR era, to the western standards.

In light of the importance of the Caspian region in the world energy equation, it is only natural that global actors as well as regional players find it imperative to assure that the way the region is developed and integrated in the world is advantageous to them. There are three groups of states in this game: producer states, i.e. Azerbaijan, Kazakhstan and Turkmenistan transit states, i.e. Russia, Iran and Turkey; and consumer states, mainly the United States, the European Union and China. Uzbekistan and Georgia also plays important roles in the “broader Caspian region”. To further complicate the situation four of these countries, The United States, Russia, the European Union and China are global powers hence global players, Turkey and Iran are serious regional players.

Three countries in the Region are important. Azerbaijan and Kazakhstan hold most of the Caspian oil reserves. Turkmenistan, on the other hand, has vast gas reserves. Georgia is the key to transport oil and gas from the region. Uzbekistan, on the other hand, is significant for its proximity to the region. They are all “Newly Independent Countries” all emerged after the demise of the USSR. However, their progress has not been similar. They have not been players in a historical sense. Now they are players because they are producers. This characterization has been placed

upon them by way of nature. It is the only way out for them after the independence.

There are also various cooperation arrangements affecting the region. NATO set up a bilateral cooperation program for the NIS called Partnership for Peace (PfP) program<sup>13</sup>. Russia, on the other hand, set up the Commonwealth of Independent States (CIS) and Collective Security Treaty Organization (CSTO) to counter the PfP program, pull regional countries in its military sphere and reestablish its influence over the Caspian region states and Central Asia. Russia and China established the Shanghai Cooperation Organization (SCO). The membership includes Kazakhstan, Kyrgyzstan, Uzbekistan and Tajikistan while Russia and China are joint Chairs. Mongolia, India, and Iran are observers. There are considerable differences of opinion on the objectives of the SCO i.e. whether it is to be an organization for development of economic and commercial cooperation or a provider of security such as Central Asia's answer to NATO.

### **3.1 The United States**

Access to energy sources has always been of strategic importance for the US since it continued to be the number one energy consumer of the world. , As of end of 2005 its proven oil reserves amount to 26.4 billion barrels, making up 2.4% of the global reserves (BP, 2006). Its production has been declining since 2000. In 2005, the production was realized as 6.830 million b/d, (2.3 billion barrels/year), a drop of 5.5% from the previous year. Consumption, on the other hand, does not show any discernable pattern of decline. Total US consumption was 20.665 million b/d (6.9 billion barrels /year) in 2005, a slight drop of 0.2% from the 2004 figure of 20.732

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<sup>13</sup> PfP is a bilateral cooperation programme between NATO and individual countries. Partner countries choose individual activities based on their desires and capacities and sign an agreement with NATO which then extends its cooperation to partner countries to realize these objectives. Cooperation focuses in particular on defence-related work, defence reform, defence policy and planning, civil-military relations, education and training, air defence, communications and information systems, crisis management, and civil emergency planning.

million b/d. This figure was 20.033 b/d in 2003, 19.761 b/d in 2002, 19.649 b/d in 2001 and 19.701 b/d in 2001. The difference is made up by imports. The US, the biggest oil importer, imported 13.525 million b/d of oil per day, a rise of 4.9% from the previous figure of 12.898 million b/d. The import figures show a steady increase. Today the US oil imports make up 27.1% of global oil imports.

As of the end of 2005 the proven US natural gas reserves amount to 5.45 Tcm, representing 3.0% of the global reserves. Its production declined to 525.7 bcm, a drop of 2.3% from the 2004 figure of 539.4 bcm. No pattern in production, whether there is a trend of decline or increase, can be discerned. Consumption was realized as 633.5 bcm in 2005, a slight drop of 1.5 %from 2004 figure of 645.0 bcm. The difference between consumption and production was made up by imports. In 2005, the US imported 104.21 bcm natural gas by pipeline, mainly from Canada (only 0.08 bcm from Mexico) and 17.87 bcm liquefied natural gas (LNG) by tankers, mainly from Trinidad&Tobago (12.44 bcm), Algeria (2.75 bcm) and Egypt (2.05 bcm). The dependence on imports for natural gas is 19.27 %, less than that of oil, but is still sizable.

The figures above clearly show the importance of energy, especially imported oil and gas, to the US. Therefore it should not be surprising that US shows clear indication that energy has the first priority in national security. This is strongly stated by President Bush as “America is addicted to oil which is imported from unstable parts of the world”. In mid-2000 the US experienced severe oil and natural gas shortages. Oil imports rose more than 50% of the total consumption.

Despite such a dependency of imported oil, the US lacks a consensus on energy policy. The Republicans insist on more domestic production, mainly in natural preserves, while the Democrats propose more energy efficient technologies and energy conservation. At the end, the US dependency on imported oil, especially on Middle Eastern oil, continues.

The first thing President Bush focused on, when he came to power, was to take steps to assure energy security of the US. The National Energy Policy Report, presented by Vice President Cheney in May 2001 recommended that “... *the President should make energy security a priority of our trade and foreign policy.*” (National Energy Policy Development Group, 2001, p.130).

The report, in addition to chapters on politically correct issues, such as “Using Energy Wisely”, and “Protecting America’s Environment”, has a chapter titled “Strengthening Global Alliances”. Here, in this Chapter Eight, the importance the US attaches to the energy supply security and flow of oil to the US is obvious. “US national energy security depends on sufficient energy supplies to support US and global economic growth.” (National Energy Policy Development Group, 2001).

The lynchpin of the US energy strategy is its “special relationship” with Saudi Arabia. Under this understanding, the US guarantees the security and independence of the Kingdom, i.e. the Suud family; in return Saudi Arabia assures the flow of oil with moderate prices. (Barnes and Morse, 2003). This was the main drive behind the first Gulf War when the US sent an enormous amount of troops and equipment to Saudi Arabia to discourage Saddam Hussein from advancing into the Kingdom after Kuwait. However, the attitude of the US administration changed when President Bush and his neo-cons came to power. The neo-con attitude towards the Middle Eastern oil producers was that the US should not support these undemocratic, fundamentalist regimes which were suspected to support terrorist activities against the US. America should, instead of accommodating these regimes in return of assurances of flow of oil, establish its dominance in the region and bring democracy into these countries. Neo-cons point out that high oil prices and the US dependency on Middle East oil brings windfall revenues to these countries and hence the US strategy should be to diversify its sources and try to break up the OPEC cartel. However, the present implementation of this strategy, the domination of the Middle East, is becoming more and more

costly for the US in terms of lives, equipment, money and national prestige. Afghanistan has not been pacified yet and a solution in Iraq is far away. Moreover, there is no guarantee that once Iraq is “democratized” it will leave OPEC and act in line with the US interests in the oil market. At this conjecture Russia and the Caspian region comes into picture.

Although Russia is the second largest oil exporter after Saudi Arabia and increased its oil production due to increased political stability, improved legal environment, lower domestic costs and higher oil prices, it cannot be the alternative the US expects for a number of reasons.

First, Saudi oil is still the cheapest. The entire infrastructure has amortized itself. Russia cannot match Saudi costs. Furthermore, still more investments are needed for the undeveloped Eastern Siberia fields.

Secondly, a country, in order to play the role of a balancer, should have slack capacity of production so that it can increase production to stop prices going too high or reduce production to prevent them dropping too much without seriously harming its own economy. Russia does not have the slack production capacity to regulate the output, hence the prices. Saudi Arabia has that capacity.

Thirdly, Russia is not a global player in the oil and gas, It only supplies Europe. Saudi Arabia, on the other hand, supplies the Americas, China and Europe.

Finally, despite the fact that Russia was accommodating the US in Central Asia when the latter sought bases in this region for the “War on Terror”, Russia is still a serious rival. American concerns over Russian desires to establish its hegemony over the territory of the ex-Soviet Union still persist .

Here comes the question whether the Caspian region can be an alternative.

Although the US is far away from the Caspian region geographically it has always afforded importance to the region as well as the Central Asia for strategic purposes. The importance for the US of the land mass making up

Central Eurasia, i.e. the Caucasus, the Caspian basin and Central Asia was stated by Zbigniew Brezinsky, the National Security Advisor to the President of the US between 1977-1981, in his book "The Grand Chessboard" as "It is imperative that no Eurasian challenger emerges, capable of dominating Eurasia and thus also of challenging America." (Brezinsky, 1997, p. xiv). These views of the National Security Advisor of President Carter was repeated by Ariel Cohen, in the Hearing of the US House Sub-Committee on Middle East and Central Asia: "It is the US policy that no single hegemon dominates Eurasia to challenge the US." (Cohen, 2006). Hence, after the collapse of the Soviet Union, the United States, for the first time in history, had an opportunity to move into the Eurasian Heartland.

Furthermore, the region's rich hydrocarbon resources are important for the stability of the global economy. This is made clear in the report titled "Transforming Defense: National Security in the 21<sup>st</sup> Century", where it is stressed that "access to oil in the Gulf, the Caspian sea and elsewhere will likely to remain critical to global economic stability". (National Defence Panel, 1997,p. 7)

After the collapse of the Soviet Union in 1991, fourteen independent states, in addition to the Russian Federation, emerged. The US, emerging victorious from the Cold War, had to change its foreign policy orientation to an extent not seen since late 1940's. As Shiver points out, "With the end of the Cold War the US could no longer define its foreign relations in the context of a bipolar world." (Shiver, 2006, p.17). The main concerns of the US at this stage was (1) to prevent the Weapons of Mass Destruction (WMD), legacy of the Soviet era, to be transferred to other countries or terrorist groups; (2) to convert military equipment and weapon plants in the successor states, another legacy of the Soviet times, into civilian use; (3) to prevent Russia to establish a Soviet style hegemony over the successor states; and (4) benefit from the resources of the region.

The US method to gain influence in the NIS was through promoting liberalism and democracy supported by technical, military and economic cooperation (i.e. aid).

Furthermore, the US views that the economic potential of the Region should also provide new opportunities for the US corporations while energy supplies are assured with reasonable and stable prices. The U.S. wanted a share, preferably the lion's share, from the opportunities in the region. The U.S. companies saw lucrative prospects especially in energy sector. The U.S. advantage in technology and financing would allow these companies to be in the leading positions in various deals. Chevron, for example, poured about \$ 20 billion in Kazakh oil field developments. Similarly Azerbaijan benefited hugely from the American investments. These deals were actively supported by the U.S. Government through diplomatic initiatives, humanitarian and economic assistance to host countries and investment insurance through OPIC.<sup>14</sup>

Starting from the end of 1995 the US government began integrate the interests of the US oil companies, which had already started to establish themselves in the region, into the US foreign policy towards the region. In this context the US began to formulate strategies for the energy resources in the Caspian region.

After the 9/11 the U.S. policy towards the region included a strong security aspect. While the "War on Terror" began with the occupation of Afghanistan and the Taliban regime was toppled, the U.S. started to establish security cooperation with regional countries.

As mentioned above, the ownership and operation of the oil and gas fields should be in friendly countries for an energy security point of view. The access to these resources should also be in friendly hands.

This should be achieved by limiting two regional players, Russia, the old time rival, and Iran, in their efforts to assert control over the Region.

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<sup>14</sup> OPIC (Overseas Private Investment Corporation) is a U.S. Government Agency supports private sector in managing risks connected with foreign direct investment.



The United States insists on multiple pipelines from the Caspian and the Central Asia in order to ensure that no one state, let alone a competitor or hostile state, has control of oil and gas supplies from the region. To this end it tried to assure that the countries over which pipelines cross are under “friendly” governments, remote to Russian overtures. For this reason, the US is suspected to be the instigator behind the so called “color revolutions” in Georgia and Ukraine among others (Engdahl, 2006 June 10).

The United States has two other objectives.

The first one is the protection of the investments, rights and positions of the US energy companies. As mentioned above the biggest corporation in the world is ExxonMobil. There are three US oil companies (ExxonMobil, Chevron and ConocoPhillips) in the top ten companies of the Global Fortune “Top 500” list.

Secondly the US is keeping a very eye on China. The country is regarded as the superpower of the 21st century.

The traditional US way of co-opting other partners to achieve a win-win solution does not seem possible when the US is dealing with Russia in the Caspian hydrocarbons issue. Russia has no inclination to relinquish its monopolistic position as a transit country. Even the successful conclusion of the BTC has not persuaded Russians to give up their attempts to dominate the region’s energy resources. The game here is a zero-sum game. The gas from the Caspian region will not go to the US but curbing Russian influence and dominance over the NIS is important for the US. The US has no other option but to confront Russia in the Region with a coherent and sustained policy.

Although the US has succeeded to realize what can be regarded as the lynchpin of the east-west corridor with the BTC, it was not very successful with gas. The South Caucasus Pipeline (SCP) will bring the Shah Deniz gas to Turkey. However, the Trans-Caspian pipeline was not realized. The US is still working on it or a variation of the initial project, where instead of Turkmenistan, Kazakhstan will be connected with a trans-Caspian pipeline

to Baku and from there to Turkey. Turkmenistan, later on, can join to the pipeline if it so chooses.

### **3.2 Russia**

After the disintegration of the Soviet Union Russian foreign policy was in disarray. There was not a consensus on the future path to be taken. There was the problem of defining the foreign policy orientation. In the Tsarist Russia and Soviet times the foreign policy was designed taking into account of a multi ethnic state. After the demise of the Soviet Union Russia was alone for the first time in history (Kasım, 2004 Oct. 13). There were two main lines of thought. The first group, called “Atlanticists” saw the future of Russia in integration with the west, mainly in Euro-Atlantic structures, such as NATO and the EU. The country should minimize its attention to the CIS and shed the burden of the empire. The Eurasianists, on the other hand, insisted that Russian future was with the Eurasian heartland and Russia should concentrate to regain influence in the territories of the Former Soviet Union (FSU). Russia had a responsibility to ethnic Russians living in the NIS and should pay attention to their rights and interests. In that context Russia should develop policies towards the Caucasus, the Caspian region and Central Asia. At the end of the day, the Eurasianists became “victorious” and Russia began paying attention to the NIS in the territories of the FSU. In this context Russians had difficulty in accepting that there were fourteen new independent states in what had once been the territory of the Soviet Union. Russian policy-makers believed that Russian dominance in this former Soviet space should be reestablished and no outside force should be allowed to have influence there. Successive Russian administrations, including the present one, have seen the NIS in the territories of the FSU as their back garden, giving them a natural right to be involved in the regional affairs to the exclusion of other countries. The term describing these territories, the “Near Abroad”, was first coined by Russian foreign minister

Andrey Kozyrev. A good example of this is the union of Belarus with Russia (Martinsen, 2002).

The survival of NATO of its Cold War era rival the Warsaw Pact, and its transformation to expand its political and military role, enlarging its membership with countries that had been in the Communist block also worried Russia. NATO's new doctrine would allow it to intervene in unstable "peripheral areas", which, in Russian, eyes could go into FSU territory even right into the Russian territory (Jalali, 2001).

As regards the Caspian region, Russia, after a short period of disinterest following the break-up of the Soviet Union, started to pay more attention in the CIS and after 1992, tried to recover part of its former interests and influence in the region. The Russian security doctrine of 1993 included the following points for the Transcaucasus:

1. Russia must be the main intermediary between the region and the outside world.
2. No other country should be allowed to establish a presence in the region that could rival Russia's.
3. Under no circumstance should this region become a source of threat to Russia or serve to isolate it from the rest of the world.
4. A political leadership responsive to Russia must be favored in the Transcaucasian republics (as cited in Hadjian, 2001, p. 140).

In line with Moscow's above-mentioned military doctrine, Russia asked and successfully renegotiated force reduction levels in the Caucasus to the great concern of Turkey.<sup>15</sup>

Russia also created policies to confront Turkey in the Caucasus, the Caspian region and Central Asia. In this context, Russia had a number of tools in its chest. First of all Russia had great experience in these region. During the 70 years of Soviet administration Russia shaped social, intellectual and political structure. Secondly, Russia had valuable

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<sup>15</sup> The CFE treaty was negotiated during the Soviet times. Russia argued that the flank areas of Baltics and Transcaucasus became border zones of Russia hence 15% force limits in these areas which together made up half of the European Russia were illogical. Coupled with the threat of Islamic radicalism in the Caucasus, NATO conceded to the Russian demands. (Hadjian, 2001, p. 137)

connections in these regions. The political elites at the time of the independence of new states were all ex-communist party members and all but one (Kyrgyzstan) of the leaders were ex-KGB officials. Thirdly, Russia had economic connections with these regions. Soviet planners created an interdependent industrial structure. Similarly oil and gas extracted from the Caspian region could only be transported through Russian pipeline system (Kasim, 2004 Oct. 13).

The Russian involvement in the Nagorno-Karabag conflict, Georgia-Abkhazia and Georgia-Ajara conflicts, as well as Russia's priority in asserting its absolute control on breakaway Autonomous Republic of Chechnya showed that it was the dominant player in the Caucasus.

The end of the Soviet Union and emergence of NIS meant not only Russian withdrawal from these countries but also the collapse of industrial connections, economic ties, military and security infrastructure. In order to prevent the creation of a vacuum, Russia tried to set up various organizations through which it intended to dominate the territories it had to withdraw. The first one is the CIS. However, this proved a non- starter when the NIS became targets of western influence. NATO's PfP program included a number of the NIS, however for the purpose of this thesis it suffices to say Azerbaijan, Kazakhstan and Georgia signed this agreement with NATO. In order to counter NATO's PfP programs Russia set up the Collective Security Treaty Organization (CSTO).<sup>16</sup> Russia is also proposing to establish a Caspian Sea Force (CASFOR) to protect oil and gas assets. This force, which is to be dominated by Russia, would exclusively by the littoral states. Blank views the practical outcome of this proposal is that if it is realized it would put Azerbaijan, Kazakhstan and Turkmenistan as dependencies of Russia while Iran is subordinated (Blank, , 52)

Russian involvement in the region cannot be seen simply as an aspiration to re-establish the "Russian Empire", the desire to dominate the territories that, at one time, made up the USSR. It is a matter of crucial

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<sup>16</sup> Steven Blank thinks that another objective of the CSTO is to create legal and political grounds to permanently situate Russian troops in Central Asia (House p.52)

importance for the existence and well being of the Russian Federation. Russia has both economic and strategic objectives.

The demise of the USSR marked not only the end of a superpower but also the end of an economic system. It was, in a way, the acceptance of the superiority of the market economy over the centrally planned economy. The industry and infrastructure received from the Soviet Union was old, inefficient and not geared to supply the needs of a society with aspirations to integrate with the global economy of the 21st century. Russia, like all the other newly independent states of the Central Asia and the Caucasus, had no industrial products to offer to the world. The only commodities it can offer for hard currency were oil, natural gas and other mineral resources. This is still the case. Russian economy is depended on oil and natural gas exports.

Between 1993 and 1996, Russia encountered a major economic crisis. The GDP dropped drastically as the country showed four years of negative growth (-8.7%, -12.6%, -4.0% and -2.8% respectively) and high inflation rates (895.9%, 302.0%, 190.2%, and 47.8% respectively).

Although the IMF praised Russia's restructuring of its economy declared that "...continued progress toward economic normalization is in no doubt" (Fischer, 1998), on 17 August 1998 Russia announced a repayment moratorium on certain loans held by foreigners and a compulsory restructuring of domestic debt.

The salvation came in, not in the form of IMF programs, but price increases in oil and gas. In 2004, only six years after Russian moratorium, Russia's GDP grew by 7.1%.

Russia's economy is heavily dependent on oil and natural gas exports. In 2005 Russian exports reached to 243.6 billion \$ and 61 % of this i.e. 148.9 billion \$ came from exports of oil, oil products and gas. That is how Russia recovered and reached a 7.1% growth just six years after the moratorium.

Russia's proven oil reserves, as of end of 2005, totals 72.4 billion barrels with around 67 billion barrels of probable reserves. Furthermore

bearing in mind that most of Russia's vast (17,075 million sq.km.) territory has not been properly prospected, it is safe to assume that huge unfound reserves may exist. The country produced 3.5 billion barrels of oil in 2005, up by 2.7 % from 2004 (BP, 2006). Russia is expected to increase its oil output by 2.5% in 2007 (PIRN, 2006 Nov. 17). Of the Russian crude oil production, only 30% is domestically refined, over 70% is exported. (EIA). During the first half of 2005 Russia exported around 4 million b/d oil. Roughly 1.4 million b/d oil was sent through Druzhba pipeline to Belarus, Ukraine, Germany and Poland as well as other points in Central and Eastern Europe. (EIA Russia 2006)

As for natural gas, the prospects are more promising. Russia holds world's largest reserves. Its reserves of nearly 48 Tcm, making up of 27.5% of the global reserves, puts it at the first place in the world. These reserves are twice the size of that of Iran which ranks number two (BP, 2006).

Russia is also the biggest gas producer in the world. In 2005 it produced 598 bcm gas, up by 1.5% from 2004, making up 21.6% of the global production. Of this amount 151.28 bcm gas has been exported by pipeline, making Russia also the number one exporter of gas. (BP 2006, p.24,30) Traditionally the European Union is the main customer for the Russian gas. However, Russia desiring to diversify its market, is looking new contracts. Turkey is one such market. The Blue Stream pipeline provides an alternative gas supply route to Turkey.

These figures mean three things. Firstly as mentioned above, oil and gas exports are crucial to Russia. Secondly the price of oil and gas is a serious concern for Russia. A 1 \$ increase in the price of a barrel of oil for a year causes 1.8 billion \$ increase in the Russian GDP (EIA, 2006). Russia's place in oil exports is not large enough to affect the global prices. However, in gas it is a leading producer and exporter.

Therefore, it is not surprising to see that Russia regards energy strategy as the linchpin of its international policy. Russian energy strategy is described in a successive set of documents announced by various Russian

Governments. The first one, the “Concept for Energy policy Under New Economic Conditions” was approved in principle in September 1992. The last one, “Elaboration on the Main Provisions of the Energy Strategy of Russia to 2020” is approved by the Putin administration on 28 May 2005 (Fredholm, 2005)

Being cognizant of the importance of oil and gas exports in the Russian economy, the Russian administration is concerned with alternative sources of oil and gas for the world. It cannot do very much for traditional sources such as the Middle East, Venezuela and Nigeria. But it deems it crucial that it keeps control of the oil and gas sectors in the countries that once formed the USSR. How much production is realized by whom and how this production is transported to the markets are the main topics that deeply concern Russia. One can say that the most important threat to Russia after 1991 has been its loss of control of the Caspian region countries and the Caucasus. The former for their energy resources, and the latter for the transport of these resources.

The first priority of the Russian energy strategy is, obviously energy security. However, for the purpose of this Thesis, international aspects of the Russian energy strategy are more pertinent.

Having lost its military preponderance, economic means and ideological rhetoric to affect international events, Russia sees energy as the trump card in its international relations. Hence it strives to maintain and increase its energy exports, protect and expand its foreign markets; tries to exploit, where possible, energy resources of other countries, while keeping its own reserves intact for future generations; seek to attract foreign investment to develop its own resources and infrastructure; and works to assure that energy produced in the Caspian region is transported via Russia (Fredholm, 2005).

Russian oil exploration and extraction technology is relatively inferior vis-à-vis that of the West. The reason behind the declining production towards the end of the Soviet Union was this backward equipment and

production techniques. This can be seen from what Azerbaijan inherited from the Soviet Union around Baku. Russia has almost no expertise in off-shore drilling. It has difficulty in discovering new fields and estimating the potential of existing ones. It cannot get in the exploration and extraction business on its own, both in Russia and in other countries in the Caspian region. It needs western technology, i.e. cooperation with the multinationals. Russia, on the other hand, owns the transport infrastructure in the region. Hence, instead of pressurizing Caspian countries for cooperation in extracting oil and gas in their territory, the Russian strategy has been to make sure that oil and gas from these countries reach to markets via Russian controlled pipelines.

The EU is the main customer for Russian gas. It also exports oil to the EU and China. Rosneft, the Russian oil giant that supplies 70% of the Russian oil exports to China plans to increase its exports to this country to 140 million barrel in 2007. Furthermore the company announced that it would cooperate with the China National Oil Corporation (CNOC) in developing Siberian oil fields and Shakalin-1 Gas fields.

Bearing in mind the importance energy plays in Russia's international relations, it is not surprising that this sector is under the full control of the Government. The former Ministry of Energy under the Soviet rule has given birth to two state owned economic enterprises: Gazprom and Transneft. There are a number of private companies, such as LUKOil, Rosneft and YUKOS, however these always toe the Government's line.

Gazprom is world's largest gas company. It is also the third largest company with a market value of 270 billion \$, even more valuable than the famous Microsoft (246 billion \$). It supplies 8% of the Russian GDP. (Escobar 26 May 2006). It is under the control of the Russian state although it has some foreign investment which is limited by law to 20%. It is the sole exporter of Russian gas. It also re-exports gas from Turkmenistan.

Transneft has a monopoly of oil pipelines. As with the Gazprom, it is controlled by the Russian government through a controlling stake.



Although most energy companies in Russia are privately owned, the government controls the energy sector through these two companies. The Russian government has shown no desire or inclination to give up the control of these companies and pipelines. Furthermore, it intends to keep its control on new infrastructure, i.e. pipelines, as well. Some believe that the reason behind the YUKOS affair was this company's desire to build independent pipelines, especially to China.

In early 1990s just after the demise of the Soviet Union and the emergence of Russian Federation, Moscow's view of Turkey was that Turkey was still the proxy for the US and a direct competitor for influence in the Caspian region, the Caucasus and Central Asia. The Turkish involvement in NATO's Partnership for Peace program targeting the NIS, and pan-Turkist rhetoric for a Turkish world extending from Adriatic to the China Sea strengthened this perception. Turkey and Russia were also on different sides in Balkan conflicts, i.e. Bosnia and Kosovo. However, the Russian view was to change. Turkish Parliament rejected US requests for troops, bases and right of way for the Second Iraq war in 2003. Turkey also objects to any prospective US attack on Iran.

The competitive set up was illogical anyway. Despite the fact that Turkey saw the Caucasus, and the Caspian basin as its prospective area of influence in early 1990's, these countries could not offer any prospects to Turkey. Russia, on the other hand, was, and still is a lucrative market. Turkish contractors got and successfully completed a large number of significant projects and had a very good reputation there.<sup>17</sup> "Suitcase traders", Russian's flying into Istanbul with chartered planes, purchasing goods and selling them in Russia, were adding 5-7 billion \$ to Turkey's balance of power. From the Russian side, Turkey was a good customer for Russian gas.

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<sup>17</sup> When Moscow wanted a speedy repair and reconstruction of the Parliament damaged during the attempted coup against Gorbachev, they could not find constructors accepting the tight construction schedule of three months. Then the Turkish company GAMA was called in, accepted the time constraints and got the contract without a tender. The job was completed in 2.5 months.

The Turkey-Russia relations began to take a turn for the better in 2000's. Russians with their new found wealth from high oil prices, began to appear in Turkish holiday resorts. In 2005 about 1.85 million Russians spent their holidays in Turkey. Military ties have also improved and Turkey became the first NATO country purchasing Russian arms. Russia also bid for the tender for combat helicopters for Turkish Army, although the Russian design, Kamov/Erdogan, was eliminated. Furthermore, Russia scored a major coup and convinced Turkey for the Blue Stream gas pipeline. This gives Russia another outlet to Turkey to sell its gas and lays the infrastructure to possible future contracts to sell gas to Israel.

The present Russian foreign policy is not expected to change in the near future. Russia, firstly, will try to keep its position as a major oil and leading gas exporter. It will try to minimize the dependence of its oil and gas exports to third countries. Any dispute with Ukraine, Moldova or Belarus negatively affects its relations with its major customer, the EU, and, on top of it, results in loss of revenue.

Furthermore, Russia will keep trying, as it has been doing until now, to persuade/coerce the Caspian countries, to send their oil and gas exports through Russian transport networks (Russian pipelines and ports). This objective has received a serious blow with the coming on line of the Baku-Tbilisi-Ceyhan (BTC) pipeline.

Thirdly, Russia will try to integrate Central Asian and Caspian energy infrastructures with its own. This may sound a natural desire since these networks were unified in the Soviet times. In fact, Russia has already proposed a "Central Asian Energy Space". This makes economic sense and has the added value of confirming Russia's leading position in development and export of Caspian region's energy resources (Fredholm, 2005, p. 4). Notwithstanding the economic logic behind such a desire, it will obviously raise concerns in Caspian and Central Asian Countries for their economic and political independence.

As a natural result of this objective, as well as the Russian energy strategy, Russia needs to access resources of the Caspian states. As mentioned, Russia cannot produce enough gas to satisfy the EU demand. As Ariel Cohen said Russian access to Central Asian (specifically Turkmen) natural gas is the key to its domination of the European natural gas market (Cohen, 2006). Furthermore if Russia wants to deliver 80 bcm/year to China, its need to Turkmen gas will be greater.

Russia is using Turkmenistan's dependency to Gazprom pipeline network to export gas to its profit. Through deals forced on Turkmenistan, Gasprom buys cheap Turkmen gas to deliver it cheaply to its domestic consumers and to countries with payment difficulties such as Ukraine, Moldova and Georgia, hence preventing Turkmenistan profiting from gas exports. In the same time, Russia sells its own gas from fields in western Siberia to the EU, with much higher prices, giving itself a nice profit. Furthermore, this way Russia does not need to invest for development of untapped eastern Siberian fields to satisfy its gas sale contracts nor is it obliged to invest in corporate restructuring and technological improvements to keep its position in global markets.

In order to counter the US in the Caspian region and Central Asia Russia utilizes the Shanghai Cooperation Organization (SCO). The SCO was established in 1996 as a non-aligned group comprising Kazakhstan, Kyrgyzstan, and Tajikistan as well as two regional powers China and Russia. Uzbekistan became a member later on. India, Pakistan, Mongolia and Iran have become observers. The thus established Shanghai Cooperation Organization was not very prominent at first. The main security concerns behind this arrangement were to fight against terrorism, separatism (i.e. ethnic separatism) and extremism (i.e. Islamic radicalism). Five years ago, in 2001, it startled to become a significant actor in Central Asian politics. It is now concentrated on confidence building measures in the border regions, combating terrorism, increasing economic, security, diplomatic and political cooperation among its members. Now, Russia is attempting to elevate the

SCO's prominence in Asian affairs as a counterweight to western (i.e. the US) influence in the region. (House of Commons, 2005)

China especially sees this organization as a means to project influence to Central Asia and in light of its growing demand for energy, increase economic ties with this region. The SCO's objectives of combating separatism fits well with the Chinese concerns for the secessionist attitudes in its Xingjian region.

Russia, although it does not need the SCO to project its influence in the region, regards it a counterbalance against the US involvement in Central Asia, a means to combat Islamic extremism on its southern borders and a venue to control and, if needed, check China.

The NIS members to the SCO regard the Organization as a useful tool to perpetuate its authoritarian regimes and prevent dissidents from their countries finding refuge in their neighbors. The SCO, in their eyes, could also avoid potentially harmful competition between Russia and China over Central Asia.

Although the SCO does not pose an economic or military threat to the US interests in Central Asia, the fact that all the member states are autocracies is counter to American efforts to make inroads to Central Asia through promotion of democracy. From time to time, the fight against terrorism, separatism and extremism by SCO members runs counter to American slogans of democracy, free press and opposition. The Iranian attempts to be full member to the SCO as a counterweight to its American imposed isolation, is also a concern for the US. If this happens and the SCO becomes a real international security and cooperation organization comprised of authoritarian regimes, it would be a serious challenge to the US.

### 3.3 China

The growing economies of Asia, namely India and especially China, put great pressure on international oil and gas demand.

China, with 1.3 billion people, the largest population in the World, was established after the World War II by Mao Zedong as an autocratic communist state, was not successful in putting the country in the forefront of economic development.

The country received Soviet technical and economical assistance until 1960. During this time it was a net oil importer from the USSR. As a result of the rift between China and the Soviet Union, all the Russian technicians in China were expelled and relationships were downgraded. However, due to the necessity, China continued to import crude oil and oil products from the Soviet Union. This situation lasted until 1965 when rich oil fields were found in Daqing. In 1970's and 80's China was an oil exporter and carried out an export led growth policy. Petroleum was the major export item.

However, this policy could only be achieved by suppressing domestic oil demand, which coupled with the "cultural revolution" led economic policies caused the collapse of the Chinese economy.

Starting in 1978, Deng Xiaoping, coming after Mao Zedong, tried to implement principles of market economy. Hence the country's third world economy was transformed to a centrally planned market economy closed to the international system, a system similar to market economy. Collectivized agriculture has been gradually removed, prices liberated, foreign trade and direct investment allowed. State economic enterprises were given autonomy and asked to behave like private sector. The Country's membership to the WTO was a big step. With this, China made a number of commitments to liberalize trade and investment.

As a result, the Chinese economy has grown some ten folds since 1978. The GDP growth averaged 10% annually. Today, China is the second largest economy after the US.

Furthermore this economic growth is expected to continue. China's need for energy is projected to increase by 150 percent by 2020. To sustain its growth, China requires increasing amounts of oil and later on gas<sup>18</sup>. Its oil consumption grows by 7.5% per year, seven times faster than that of the U.S.

Although China managed to quadruple its GDP between 1980 and 2000 while its energy requirement was only doubled, this growth, still, resulted in a massive increase in energy demand. The increase was due to the increase in production capacity of the economy and also to the transfer of the Chinese society's mode of transport, basically from bicycles and mass transport, to private cars since these are now affordable to many due to increased levels of income. The number of private cars is now 23 million and this is expected to go up to 130 million by 2030 (Huus, 2006 May 4).

China<sup>19</sup> consumed 7.23 million b/d oil in 2005 (BP, 2005). This makes the country the second largest consumer of oil. The Energy Information Agency of the US Department of Energy estimated that China's oil consumption will reach 14.2 million b/d by 2025 (EIA China, 2006).

China produces oil from its territory. However its own reserves are small relative to its consumption. In 2005, oil production was 3.627 million b/d, and with this rate of production its reserves will only last for another couple of decades. The remainder (3.603 million b/d) was imported. It has been a net importer since 1993.

Traditionally, China would import its oil from the Middle East. Today 58 % of the imported oil comes from the Middle East and this is expected to rise to 70% in 2015. It also imports Russian oil.

However, oil imports alone could not be a solution to the thirst of the Chinese economy. Chinese leaders historical desire for self-reliance<sup>20</sup> also

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<sup>18</sup> It is expected that coal fired electricity generation will be replaced with gas fired plants over time.

<sup>19</sup> Including Hong Kong.

<sup>20</sup> Lieberthal, K., "Governing China: From Revolution to Reform", New York, 1995, pp.76-77 quoted in Swaine (1998). "Self reliance here means not self sufficiency but being in control of the situation"

contradicts with importing oil since it is felt that oil exporting countries and companies could have a choke hold on the Chinese economy hence making it subject of vagaries of international politics and trade. It seems that China has not forgotten the embargos of 1940s and 1950s and the western arms embargo imposed upon it after the Tiananmen Square event in 1989.

Keeping pace with its increased demand and desiring to have control of its energy supply, China took steps to assure its energy security and tried to get into lasting arrangements with the Middle Eastern countries. However, the Iraqi war of 2003 drastically changed Chinese expectations. Seeing that the United States was firmly establishing itself in the Middle East and trying to change the region through its Greater Middle East Project, China had to re-think its energy supply strategies and look somewhere else. While trying to find alternative suppliers, China is also looking to be actively involved in production process. It acquired interests in Kazakhstan, Venezuela, Saudi Arabia and Canada.

China has been trying to purchase a 50 % stake in Iran's Yadavran oil field. Since 1997 China invested heavily in oil- rich Sudan. Similarly it also gave a 2 billion\$ soft loan to Angola after the civil war ended in 2002. China's national oil company CNOC in its 18.5 billion \$ bid to acquire the US company Unocal, was trying to acquire this company's substantial oil and gas reserves in South East Asia.<sup>21</sup>

These efforts should not be regarded only for supply security. Chinese government, through acquisition of foreign production fields and facilities, is also trying to insulate its industry from price hikes of oil. In a serious price hike, Chinese National Oil Corporation is expected to supply the domestic economy with below market prices.

China shows that it is putting greater emphasis on the security of energy routes. This can be seen from the Chinese claims on the entire area of the South China Sea, which is important both as a source as well as oil transport route. Furthermore, China's decision to relocate military units,

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<sup>21</sup> The deal was overturned by the US Government.

hitherto situated on the Russian border to the Xincan region, another important pipeline route with rich mineral resources, should also be noted.

China is the co-chair of SCO with Russia. It has seen increased presence of the US in Central Asia and the Caspian Region as a threat. Beijing is in the same line with Moscow on “color revolutions”, both see them as US instigated selective regime changes.

### **3. 4 The European Union**

The European Union is the second energy consumer in the world. However it is not rich in energy resources, highly dependent on imported energy and will remain so. Presently it imports 50 % of its energy and this is expected to reach to 70% in the course of next 20-30 years.

Today energy imports of the EU correspond to 6% of its total imports and 1.2% of its GDP. Furthermore, its oil and gas production is maturing hence the Union will be more and more dependent on imported oil and gas (CIEP, 2004). North Sea fields are expected to be depleted in the next 25 years or so. Compared to today's 50%, two thirds of energy requirements of the Union will be imported by 2020. It is expected that in the course of the next 20 years the import dependency of the EU would reach to 90% in oil, 70% in natural gas and 100% in coal (CEC, 2006).

According to 2003 figures, 40% of the total EU energy consumption was oil followed by natural gas (24%). Natural gas consumption is growing fast due to environmental concerns since gas usage is compatible with the Kyoto Protocol.

The EU's own oil resources are limited and cannot satisfy the demand. The main reserves are in and around the North Sea. Oil reserves in this region are owned by four EU countries, the UK, Germany, the Netherlands and Denmark, and Norway. Norway holds 57% of the reserves and the UK holds 30%.



The EU produced 2.911 million b/d in 2005 while consuming 14.738 million b/d (BP 2005). The rest was imported. The main production fields in the North Sea initially held sizable reserves. In its peak year, 1998, North Sea oil production represented nearly 9% of world oil production. However, the production from these fields is expected to get into a period of decline. The EU imported 3.75 billion barrels of crude oil in 2004.

Russia is the biggest supplier of oil for the EU oil demand. It supplied nearly 26% (973.590 million barrel) of the total imports followed by Norway which supplied 20% (752.026 million barrel). Saudi Arabia supplied 12.78 % (480.068 million barrel), Libya 9.55% (358.592 million barrel), Iran 6.55% (245.982 million barrel) and Kazakhstan 3.72% 139.571 million barrel).

Like oil, Europe's main natural gas reserves are located in the North Sea. However, these fields are also regarded as mature fields although Norway managed production increases in recent years through improved maintenance and newer technologies. UK, the only other country owning fields in the region, is, on the other hand, expected to become a net gas importer in the medium term.

The EU produced 0.23 Tcm in 2005 and consumed 0.48 Tcm. The difference was covered by imports.

In face of raising oil and gas prices, scarcity of indigenous resources, dependence on few suppliers, and the interruption of gas supply from Russia in winter of 2005-2006, forced the EU, like others, to look for means to assure energy security. However, both the concept of energy supply security, and questions under this concept are different for the EU.

First, the EU does not have a competitive internal energy market yet. In another word, The internal energy market of the EU can be regarded as the aggregate of individual member states' energy markets. Furthermore a supply interruption due to uncertainty in the Middle East may hinder the development of the EU internal energy market since in such a case members will probably revert to national policies.

Secondly, and this can be regarded as a natural consequence of the first concept, the EU does not have a common external energy policy or strategy. Only the individual members have external energy strategies.

Furthermore, taking into account that the EU is dependent on imported oil and gas, and bearing in mind that only 20 % of the imported oil and gas comes from stable resources (Norway), the EU needs urgently a common and coherent external energy strategy. As stated in the Green Paper, “a coherent external policy is essential to deliver sustainable, competitive and secure energy.” (CEC, 2006, p.14).

At the moment, the EU does not enjoy, at the moment diversity of sources. Roughly half of the imported gas comes from Russia, Norway and Algeria. (CEC, 2006, p.3) As mentioned, only Norway could be regarded as a stable supplier. This lack of diversity was, in fact, shockingly come to the attention of the EU when Russia, due to its dispute with Ukraine, cut off gas supply to this country. Ukraine, coming face to face with harsh winter conditions and no energy, started to get gas from pipelines supplying Turkey and the EU. Russia, realizing this, cut off the gas supply completely causing a threat to Turkey and the EU.<sup>22</sup> That is when the EU started the energy question more seriously.

Moreover, the EU has an additional parameter to take into consideration when it develops its policies: Climate change and its CO<sub>2</sub> emission commitments under the Kyoto Protocol. Any policy to aim to boost competitiveness, or provide energy security need also be sustainable i.e. environmentally friendly, a concern not shared by China or Russia.

Leaving the issue of climate change, which is not the subject of this study, aside, the EU needs to address two issues: a unified and competitive internal energy market, and supply diversity.

An internal energy market is necessary for the EU's competitiveness. It is also useful for security of supply. Currently not only the EU legislation but

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<sup>22</sup> Since then the World Bank recommendation to Turkey, to build emergency gas storage facility and natural gas reserves are taken more seriously.

also the energy infrastructure is not conducive to such a unified market. Furthermore, it is not certain that the individual member states are prepared and willing to cede their control over domestic energy policies to the EU bureaucracy.<sup>23</sup>

The issue of diversity of supply regions and transport routes is high on the EU's energy agenda. The Union is looking for natural gas sources other than Russia. In this respect the Caspian region, with alternative transit routes is one of the targets for this diversification strategy. Independent gas pipelines from, among others, the Caspian region into Europe and Central European oil pipelines to facilitate Caspian oil supplies to Europe, are among projects mentioned in the Green paper (CEC, 2006, p.15). Trying to establish contacts for new supplies, European Commissioner for Foreign Affairs Benita Ferrero-Waldner underlined the importance of energy cooperation between the EU and Azerbaijan and stated that Azerbaijan's access to European markets "will give new impetus to the country's European integration process" (quoted in Ziyadov, 2006 Feb. 24).

While trying to diversify its energy resources, Europe is also attempting to draw Russia into being a more dependable supplier. The "Green Paper" on "A European Strategy for Sustainable, Competitive and Secure Energy" states that "A new initiative is particularly opportune with regard to Russia, the EU's most important energy supplier." (CEC, 2006, p. 15). Attempting to persuade Russia with an equal partnership, the EU points out that it is Russia's largest energy buyer. It is also proposing that the parties (i.e. the EU and Russia) should open their internal markets and infrastructures to each other and pipelines to third parties (such as the Caspian producers). This energy initiative should be integrated in the new round of EU-Russia relations due to start after the present EU-Russia Partnership and Cooperation Agreement expires in 2007 (CEC, 2006). As a basis for energy security the EU, as was recommended by the "Green Paper", attempted to bring pressure on Russia in G-8 for the ratification of the Energy Charter

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<sup>23</sup> Establishment of a European Energy Supply Observatory is proposed. This body is expected to monitor demand and supply in the union, determine possible shortfalls in infrastructures and supply.

Treaty (ECT). However, this attempt was rebuffed by the Russian President Putin, who, although allaying the fears of the EU over energy security, nevertheless refused to sign the ECT. Similarly the EU continuously demands that Russia opens its domestic market and infrastructure. Chancellor Merkel of Germany said in an EU Energy Summit in Finland, on October 20, 2006, that she wanted Russia to break down the barriers to its domestic market. (as cited by Bilefsky, 2006 Oct. 20) Putin rejected this demand saying that Russia was determined to tap into its energy potential for its own development (Binyon, 2006 Sept. 12)). Not only Putin's statements clearly rejected this demand but also his actions supported his views. Gasprom decided in October 2006 to develop the Shoktoman gas field, one of the biggest in the country, without foreign participation. (Bilefsky, 2006 Oct. 20)

This Russian behavior, not entirely pacifying EU concerns on energy security, increases the importance of the Caspian region as an alternative energy resource. However, to be a viable alternative, the oil and gas from this region need to be transported to the EU through pipelines that are not under Russian control. In fact the European Union "Green Paper" on "Towards a European Strategy for Security of Energy Supply", published in 2000, advises the EU to pay particular attention to Turkey, among others as a transit state (CEC, 2000). "The Report on Energy Supply Security and Geopolitics", prepared for the EU under contract, also describes Turkey as an important transport corridor (CIEP, 2004).

The issue of resource diversity poses not only a threat to the European economy but the also a hindrance to the EU foreign and security policy. The energy security for the EU is closely linked with the security policy of the EU. As mentioned above, the EU is dependent on imported energy, namely oil and gas, and Russian Federation is the largest supplier of gas to the Union. Fears were voiced after the gas cut off of January 2006 that the Russian Federation could use the energy card to achieve political objectives. (Dempsey 2006, Feb. 16)

The resources that can cover the expected shortfall must be outside of the control of a cartel or a single country that could choke off the supply at will. If supplies from the Caspian region can be brought to the European consumers through a safe and reliable way, this would be a relief for the EU.

As mentioned above, one of the problems is that the EU did not have a common external energy policy in the past. It is only developing such a policy in the face of growing energy dependency on Russia. The Green Paper of 2006 calls for a Strategic EU Energy Review to establish a common vision (CEC, 2006). Even now the European leaders are divided over whether to accommodate Russia or take countermeasures. This obviously plays in Putin's hand. While he is telling the EU that Russia will behave responsibly in global energy markets he refuses to sign the ECT. (Bilefsky, 2006 Oct. 20) The lack of unified vision is probably the reason why the EU has been passive in accessing the Caspian oil and gas. This vacuum was filled with companies of its major members. British flagship BP is the major contractor/shareholder of the Baku-Tbilisi-Ceyhan pipeline. Italian and French companies are involved in the development of oil fields. France is joint chair of the Minsk Group, the international body set up to solve Azeri-Armenian conflict. However, these attempts cannot be a substitute for the common vision envisaged by the "Green Paper".

### **3.5 Iran**

Iran is one of the most important countries in the Caspian region due to its pivotal position at the crossroads of the Middle East, Turkey, Central and South Asia. It occupies the strategic position between the Eurasian land mass and the high seas. During the Cold War it played an important role for the containment policy of the US against the Soviet Union acting as an effective bulwark to prevent its access to the Indian Ocean. Its rich cultural heritage coupled with being the traditional leader of the Shi'a sect allows it to wield great influence to its environment. A report prepared by the Chatham House describes the country as "one of the most significant and powerful

states in the region” who has been the “traditional master of soft power” (Chatham House, 2006, p.8).

Iran’s economy is based on oil. Oil export revenues are the main foreign income of the country, representing around 80-90 % of the total export revenues and 40-50 % of the state budget (EIA Iran 2006). According to the Oil and Gas Journal, as of beginning of the 2006 Iran has 132.5 billion barrels of proven oil reserves corresponding to 10 % of total world reserves (quoted in EIA Iran, 2006). This figure is estimated in BP’s Quantifying Energy 2006 Report as 137.5 billion b/d corresponding to 11.5% of the world resources. (BP, 2006) From its 40 producing fields, the country produced 3.94 million barrels/day in 2005 corresponding 5% of the total world production. This production was realized as 3.75 million b/d during the first half of the 2006 while its consumption increased to 1.5 million b/d. Iran currently exports 2.5 million barrels/day. Japan, China and South Korea are the first three destination for Iranian oil exports, followed by France, the Netherlands, Italy and Turkey (EIA Iran, 2006).

Iran has the second largest reserves of natural gas after Russia. BP’s Quantifying Energy 2006 Report gives Iranian natural gas reserves as 111.9 Tcm as of end of 2006 making up 14.3% of the world total (BP, 2006). Its production of 84.9 bcm in 2004 rose by 2.8% in 2005 and reached to 87.0 bcm making up 3.1% of the total world production. According to EIA Iran Report 62% of Iran’s natural gas fields have not been developed (EIA Iran, 2006). Despite these huge reserves Iran could only export 3.2 bcm gas to Turkey. US sanctions against Iran prevented the building of gas export infrastructure such as pipelines. Domestic use of natural gas is increasing and the government is investing in infrastructure to increase this usage. Iran has great potential to be a major gas exporter. According to Iran’s Oil Ministry sales gas sales from Iran’s biggest field, the South Pars field, could earn the country as much as 11 billion \$ per year over a period of 30 years (EIA Iran, 2006). It is no surprise that over 15 billion \$ has already been spent for the development of this field.

Iran has never been without rivals. First the Ottoman Turks proved to be victorious in various confrontations with Iran. The last one resulted the recapture of Baghdad by the Ottoman Sultan Murad IV. The *Kasr-i Şirin* treaty signed after this conflict finalized the borders between the two states. Starting with the 18<sup>th</sup> century Russian pressure was felt from the north. Iran lost significant territories to the Tsarist Russia in the 19<sup>th</sup> century (Jalali, 2001). During the Cold war Iran, like Turkey, was firmly in the western (US) camp. After the revolution and change of regime in 1979 and severance of ties with the West, Iran followed a more activist foreign policy.

The Iranian rhetoric of 1980's on exporting Islam abroad left its place to a more pragmatic approach towards the end of the decade. Domestic priorities became more prominent. Eight year of war with Iraq not only devastated the Iranian economy but also raised doubts on the suitability of a theologically oriented government (Hunter, 2003). The failure to reconstruct and improve economy might cause domestic unrest. Moreover, situation on the borders were becoming dangerous. In the north the Soviet Union was collapsing, the civil war in Afghanistan and the subsequent rise of the Taliban caused new security concerns in the north and east. Gulf war in the south added further to Iranian insecurity. In the west, a hostile Saddam Hussein was still in power. Moreover a democratic Turkey with Islamic population posed a bad example of the Iranian population.

Iran's security concerns became more acute in early 1990's. The end of its superpower neighbor, the Soviet Union, hardly improved Iranian security. The emergence of independent Azerbaijan was perceived as a threat in view of the large Azeri population in Iran. Moreover, Iran was afraid that it would be negatively affected by the ethnic strife in the Caucasus. Iran already had a refugee problem in its territory due to endless conflicts in Afghanistan and the repressive regime in Iraq. This problem would become more serious if the Armenian-Azerbaijani conflict escalated. Furthermore, just after the disintegration of the Soviet Union, the Russian-Iranian relations were soured due to the former's perception that Iran was poised to export fundamentalist

Islam to the Muslim populated countries on the border of Russia. Furthermore, in Turkey voices for Pan-Turkism were being held. Although Iranians were of different origin than Turks the Azeri population could be susceptible to this ideology.

Although the situation with Russia improved, Iran is still situated in the middle of a very unstable region. Iran's area of immediate concern is riddled with conflicts. The war on terror in Afghanistan; the conflict in Iraq, the instability there and the uncertainty about the future of this country; and the Arab-Israeli conflict, all cause Iranian administration to feel threats to Iran's security and stability. They feel that they are being circled by hostile forces and unstable states. The US is in Iraq, and in Afghanistan, it has bases in Turkey, Turkmenistan and the Gulf. Azeri population in the northern Iran, is a constant worry for Tehran. Especially when the example, the independent Azerbaijan, is there. Furthermore Israel is treating with preemptive strike, and the US fleet is in the Persian Gulf. As summarized by Hunter, after the collapse of the Soviet Union changes in international and regional systems triggered by unilateral and uncontested military actions of the US resulted a worsening of Iran's geopolitical situation (Hunter, 2003).

In 1990's Iranian foreign policy had two faces. When dealing with the NIS, especially those with predominantly Moslem populations, the religious orientation seen towards the Middle East and the Gulf region left its place to a more pragmatic approach based on self interest. The best example is Iranian approach towards the Tajik civil war. Although the rebels were made of Islamic forces, Iran did not support them against the Tajik government. In the absence of material or rhetorical support of the rebels Iran could play an indispensable role in bringing the civil war to an end (Hunter 2003). Keeping in mind that the NIS with Muslim populations in Central Asia and Azerbaijan had had a 70-year secular administration, Iran realized that the only result of trying to export fundamentalist Islam would not be success but isolation in the region. In light of the US embargo Iran could not afford this. Therefore, while Iran was still showing its religious face in its dealings with the Gulf



countries and the Middle East, in Central Asia and Azerbaijan it followed a more moderate policy devoid of religious motives.

Iran has always placed Russia as the corner stone of its relations with the Caspian region and Central Asia. One reason for trying to have good relations with this traditional rival was to find an alternative supplier of technology and military equipment in the face of US embargo. Iran benefits greatly from Russian technology in its nuclear program and is also a great supplier of energy to China. In 2000 Russia announced that it would resume arms sales to Iran, and expand technological cooperation with this country. This marked the end of Gore-Chernomyrdin agreement, reached in 1995, by which Russia undertook not to sell arms to Iran (Jalali, 2001).

Iran is increasing cooperation with Russia and China and has become an observer to the Shanghai Cooperation Organization although this could not be regarded as a strategic shift of Iran's priorities (Chatham House, 2006) As a result of these deepening relations, both Russia and China acts in International fora especially in the UN for a milder and more conciliatory approach towards Iran as regards to this country's nuclear program.

The war on terror conducted by the US has resulted in an unexpected benefit for Iran. It eliminated two rival regimes from its borders: Taliban in 2001 from Afghanistan and Saddam Hussein in 2003 from Iraq. As the US was not able to establish stable regimes in these countries, Iran easily filled the vacuum.

The greatest threat Iran poses to the US is its ability to further destabilize and supersede the US as the most influential power in Iraq.

Matters are complicated by the triple issues of energy security, Turkey's bid for the EU accession and Turkey-US ties. By 2010 it is expected that 19% of Turkey's natural gas supplies will be obtained from Iran and 58% from Russia. Turkey is ambitions to became energy corridor for Russian, Caspian, Iranian and Middle Eastern gas for Europe

Iran is the only Caspian state with access to the Persian Gulf and Arabian Sea. Its Kharg Island, Lavan Island, Sirri Island and Ras Baghregan

ports allow Iranian oil to be exported to the World.<sup>24</sup> This advantage, of course, should give Iran considerable leverage in transporting Caspian oil to the world. Logically Iran is the shortest route to transport oil and gas from the Caspian region and Central Asia to the world markets. However, the Iran-Libya Sanctions Act, effective since 1990, has been a great obstacle in development of transport infrastructure. This Act, punishing those who invests more than 20 Million \$ to Iran, prevented the flow of foreign investment necessary to develop oil and gas transport infrastructures. The only exception to this embargo worth noting is the Iran Turkey gas pipeline. The agreement was signed during the Islamic oriented Turkish Prime Minister Necmettin Erbakan's tenure in line with his foreign policy of developing and strengthening relations with Muslim countries. The construction and operation of the pipeline was delayed due to the effects of embargo on the US manufactured equipment.

Iran has also strong interests in the Caspian Basin. Being suffocated under the US sanctions, and worried about its own Azeri population, it does not want the United States to establish inroads into the Region. Iran, owning large energy resources, also wants the control of access routes of these products to the world markets. Furthermore, Iran does not want to lose its position in the world energy markets to the Caspian basin countries. To this end, it is providing access to Armenia, landlocked and suffering under Turkish and Azerbaijani embargo, for goods and energy. It is trying to develop relations with Turkmenistan, Kazakhstan and Uzbekistan to their oil and gas to world markets. It has already had a small scale swap agreement for Kazakh oil<sup>25</sup> and a pipeline carrying Turkmen gas to northern Iraq.

The future of Iran's foreign policy in the Caspian region depends on two issues. The first is the US attitude towards Iran. Without foreign investment Iran has neither the money nor the clout to get a share of the Caspian

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<sup>24</sup> Iran also has OPEC's largest tanker fleet comprising about 29 vessels including a number of Supertankers (Very Large Crude Carriers). (EIA Iran 2006, p.5)

<sup>25</sup> Kazakh oil is delivered to northern Iran. Iran, in return, exports its own oil of same value on behalf of Kazakhstan.

riches. President Clinton's containment policy for Iran is similarly followed by his successor, the Bush administration. There is no sign that the new president after Bush will change the US policy towards Iran. The second is the Islamic face of Iran and the reflection of this to its foreign policy. It was mentioned above that on its dealings with the Muslim countries of the Caspian region and Central Asia Iran did not push its Islamic identity but followed a secular and pragmatic policy. However, its Islamic oriented policies towards the Gulf region and the Middle East, (such as supporting the Shia population in Iraq against the US, Sunnis and Kurds) negatively affect Iran's relations with the Caspian region and Central Asia due to linkages existing between these three regions. (Hunter 2003). The solution to these problems is that Iran should convince the US and secular regimes in its north that its Islamic orientation is not a threat to them. However, the success of this strategy is largely dependent on the US perception of motives and objectives of Iran (Hunter, 2003).

## CHAPTER 4

### THE POSITION OF TURKEY

The collapse of the Soviet Union had profound effects around the world. As the cold war affected various states differently so did the fall of the Berlin Wall had different effects on each country. Turkey is, perhaps, one of the most affected countries.

The traditional Turkish foreign policy, after the establishment of the Republic of Turkey as the successor state of the Ottoman Empire had been based on the Kemalist motto “peace at home, peace in the world”. (Aras, 2000, p. 36) This was a result of two previous but unsuccessful policy concepts of the Ottoman Empire: “pan-Islamism” proposed by Abdulhamid II (Islam as the glue of the Ottoman society against nationalistic aspirations) and Enver Pasha’s pan-Turkism (reestablishing the Ottoman Empire with a view to the traditional Turkish heartland of the Caucasus and Central Asia). The former did not prevent the uprising of the Empire’s Muslim subjects, in cooperation with the “infidel” enemy, against the Caliph and the disintegration of the Ottoman Empire. The pan-Turkist foreign policy showed itself in Enver Pasha’s movement towards the east. Proposing that Ottoman territories should include the Caspian sea region and Afghanistan, and with the support of the German High Command, Enver pasha, moved the Ottoman third army against Russia. This operation unfortunately ended in disaster in *Sarıkamış*. Enver Pasha’s second move was to send his brother Nuri pasha to Azerbaijan to establish an army of Azerbaijanis and liberate the North Caucasus and Dagestan. Then, Enver pasha was planning to move the army to Turkistan and create a union of Turkish speaking peoples. Nuri pasha succeeded in reaching Gence and Baku. (Özdoğan, 1994, p.363). However when the Turks entered Baku in September 1918, the end

of the war was very near. The Ottoman Empire had to sign the Mondros cease fire in October 30, 1918. Baku was left to the British Army. (Gökay, 2001)

During the Turkish War of Independence, the Ankara Administration rejected pan-Turkism concept and sought the support of the Soviet Union. To this end Ankara did not support the "*Milli Musavvat*" party of the independent Azerbaijan and signed two agreements with the Soviet Union, first one in 1921 (Moscow and Kars), the second in 1925 (Ankara Agreement).

The principle, "peace at home, peace in the world" while keeping the Republic of Turkey away from serious armed conflict since its inception, nevertheless resulted in a passive, even "shy" (Aras, 2000, p. 37), stance in foreign policy. The state, in line with Atatürk's views saw its orientation towards the West. An Islamic oriented foreign policy was out of question since this was contrary to the secular identity of the state. Besides the "Islamic" regions were mostly colonies of western powers lacking independent state structures or economies with which links could be established. On the other hand a "pan-Turkism" oriented foreign policy was seen by Atatürk as unrealistic at the time, causing unnecessary anxiety both in the west and in Russia and Iran. Besides such a policy towards the Caucasus and Central Asia was impossible due to the fact that the "Turan", the mythological Turkish heartland consisting of the Turkish speaking regions, was under the Soviet rule and Turkey, just gained its independence after a bloody and destructive war, and aiming to elevate its standards to level of "contemporary civilization" was in no position to follow a pan-Turkish policy against the Soviet Union. Thus Ankara, between 1923 and 1939, followed a strongly western oriented but anti-imperialist and nationalist foreign policy.

After the Second World War, Turkey felt left alone with the Soviet Union in the region. Soviet Union, with a diplomatic note dated March 19, 1945 informed Turkey that it would not renew Ankara agreement of 1925. When

Turkey sought to find a common ground to renew the agreement Moscow demanded certain changes that would not be in line with national sovereignty<sup>26</sup> (Sönmezoğlu, 1994, p 85). Just at this time the US filled the vacuum created by the withdrawal of Britain from the region as the provider of security and Turkey joined the NATO on February 18, 1952. Tied to the NATO for its security, Turkey used its position as one of the two members of the Alliance who had borders with the common adversary, the Soviet Union. Thus, Turkey benefited from Western military and economic support, and carried out its existence without too much regard to what was happening in its environment and around the world. The way to the east was closed by the iron curtain. Turkey could only trade with Russia, if and when possible, and mostly in the form of barter trade.

Relationships with Iran, Turkey's other eastern neighbor and conduit to the east, have always been fragile and balanced (Narlı, 1993). During the Safavid dynasty (1486-1722) the theme of the relations between the Ottoman Empire and Iran was an intense rivalry based on sectarian differences (Aras, 2001). The Turkish Qajar dynasty coming to power in 1797 had a more positive attitude towards the Ottoman Empire and starting with 1850's and with the continuous Russian pressure on both states in the Caucasus and Caspian region, relations became closer. The Pahlavi dynasty, coming to power in 1925 after the Qajars, continued these good relations with Turkey. Reza Shah was a student of Atatürk's reforms and relationships were improved, culminating in the signing of the *Sadabad* Pact in 1937. With this agreement, the signatories<sup>27</sup> pledged good relations with each others and guaranteed that none of them would "manipulate or antagonize ethnic minorities living in other member nations in order to develop conflict between the central government and tribal powers" (Narlı, 1993). The aim of this agreement was to consolidate the territorial boundaries of the signatory states.

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<sup>26</sup> These demands included certain modifications, in favor of the USSR, on the Turkish Soviet Border and regime of the Turkish Straights. Both demands were rejected by Turkey.

<sup>27</sup> Iran, Iraq, Afghanistan and Turkey

In a bi-polar world, as the name implies, there were two global powers. The emergence of regional actors was not possible because each of the global powers, for fear of escalation of a regional conflict to a global disaster, held its allies or client states in check. That is what happened around Turkey. Firstly there was no question that Turkey could be a regional actor. It was too weak and strongly in the Western camp, its army and economy were strongly dependent on US support. Iran similarly could not use its oil wealth to become a regional actor because its oil riches, its army and the entire Iranian administration starting with the Shah were deeply connected with American interests. Besides, there was no regional “vacuum” to be a regional actor because the Caucasus and the Caspian region were under the firm control of the Soviet Union.

Two things changed this paradigm: The Islamic revolution in Iran and the collapse of the Soviet Union.

With the fall of Shah in 1979 and Ayetollah Khomeini’s coming to power, Iran severed its ties with the US. The fundamentalist regime in Tehran, after consolidating itself, followed a more active foreign policy independent of the US and based on “exporting Islamic revolution”. Suddenly Turkey was faced with another actor on its borders and had to consider policy responses. Firstly Turkey was concerned with the militancy of the regime in Tehran. Turkey and Iran hitherto in the western camp parted ways. Iran rejected the western system and embarked upon a policy to export Islamic radicalism while Turkey stayed committed to market economy and NATO. Turkey especially started to worry when Turkish Islamists, in line with the practice in Iran, seem to take action to impose their views and way of life on the society. The speeches of Khomeini,<sup>28</sup> incidents such as the

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<sup>28</sup> In Khomeini’s words “Demands for an Islamic state are now being heard in Turkey as well, partly as a result of what is happening in Iran.” (quoted in Narlı, (1993)

“Turban crisis” in March 1998<sup>29</sup> or the Iranian Ambassador’s speech in the Jerusalem day in February 1997 greatly enchanted this worry.<sup>30</sup>

The end of the Soviet Union was the second event that changed the geopolitical landscape at the east of Turkey. Turkey was suddenly faced with a completely different set of parameters causing a new set of concerns.

First, Turkey did not have a land border with Russia, the successor of the Soviet Union, any more. A completely new set of neighbors, Georgia, Armenia and Azerbaijan (Nahcivan) emerged. These countries had very little experience in statehood, and could not carry out duties expected from a state, such as internal security, border security etc. Lack of state control over common borders causes concern in Turkey. Border security that cannot stop illegal crossings, smuggling of people and goods may be a real issue. In the administrative vacuum created after the Soviet Union, places like Georgia have become transit routes for almost everything that has a market. Illegal arm sales, uranium, surplus army material are among some. Similarly the porous borders resulted a high number of illegal workers, Georgians, Azerbaijanis and even Armenians, in Turkey. (Armenians in Turkey, 2006)

Another result of the instability in neighboring countries is lack of internal control. This means hostile groups to Turkey can find refuge in these countries arising security concerns in Turkey. These groups can establish links with similar groups in Turkey and support them actively and logistically. Armenia, for example, has a Kurdish population whose connections to the PKK were proven on a number of occasions.

Third, Turkey was concerned with the Russian forces in the Caucasus. Turkey wants to nullify the centuries long Russian threat and prevent Russia to establish itself on or near its borders again.

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<sup>29</sup> When the Turkish Constitutional Court revoked a bill allowing female students in universities to wear turban, young women in Iranian style chadoors demonstrated in several major cities in Turkey. Similar demonstrations took place in Iran as a solidarity to Turkish Islamists. (Narlı, 1993)

<sup>30</sup> In February 1997 the Iranian Ambassador Baqheri speaking in the Jerusalem Day meeting, said that those who sign agreements with the United States and Israel will, sooner or later, be penalized. (Aras, 2001)



Fourth, Turkey was concerned that its importance for the West was diminished with the disappearance of the Soviet threat. This concern was proven right when Russia demanded changes in the Conventional Forces in Europe Treaty. Instead of supporting Turkey in its complaints about the quantity of Russian forces near its borders, the West preferred to reach a compromise with Russia.

The September 11 attacks on the US and the subsequent “war on terror” has changed all this. Any US operation in Afghanistan and Iraq would be extremely difficult without Turkish support. Similarly, any attempt to benefit from the riches of the Caspian region and the Central Asia would require the cooperation of either Turkey or Russia. Moreover, to reach, develop, extract and transport oil and gas from these NIS require internal stability in these countries. Here, Turkey also plays an important part as a model for a democratic country with a predominantly Moslem population.

Fifth, there is the issue of energy security. Turkey does not have oil or gas resources. For oil, only available resource is in the heavy oil area. Turkey currently imports 90 % of the consumed oil. A similar situation exists for the natural gas production. Petroleum exploration so far has not been successful. Latest UK owned British Petroleum exploratory well activity in the East Black Sea area did not produce discovery news. The National Oil Company of Turkey, Turkish Petroleum Corp., commenced in 2006, an aggressive exploration program in the deep waters of Mid-Black Sea area with Petrobras as its partner in 2006.

Turkey’s booming economy and its development is strongly tied to energy, namely oil and gas. Turkey, consumed ,1.6 billion barrels (or 650,000 b/d) of oil in 2005, a drop of 5.9% from the 2004 figure of 235 million barrels although this decrease cannot be regarded as a trend. Its production, however, is meager, 43,000 b/d. The difference is imported mainly from the Middle East and Iran. The usage of gas in Turkey is relatively new. Starting in early 1980’s Turkey decided to use natural gas instead of coal gas for heating. Gas was also seen as a suitable fuel for

industry. Turkey signed the first gas agreement with the Soviet Union in 1986. The consumption in 1987 was 0.5 bcm, in 2004 it was 22 bcm. Its gas consumption is steadily increasing while its negligible proven gas reserves of 8,5 bcm is far from satisfying its demand. The country used 27.4 bcm gas in 2005 an 24.1% increase from the 2004 figure of 22.1 bcm. The country is at the moment heavily dependent on Russian gas. Of the gas imports in 2005 17.3 bcm came from Russia.

The track record of Russia of using gas as a weapon for its foreign policy, concerns for stability in the Middle East and the US-Iranian relations, motivates Turkey, like other energy consumer countries, to diversify its energy sources and transport routes. Caspian region will be an alternative source for oil and gas and their transport routes, outside of the Russian control provides this diversification.

Finally, Turkey wants to get a share of the new economic opportunities emerged when regions such as the Caucasus, the Caspian and Central Asia were opened to foreigners after the Soviet withdrawal. When the development of the hydrocarbon resources of the Caspian region came to fore, Turkey, with its proximity to the region, is faced with new possibilities for economic cooperation. Business with the region is not a new issue for Turkey. Turkey has long standing ethnic, cultural and historical ties with the Caspian region. The Don-Volga canal project, envisioned by the great Ottoman Grand Visar Sokullu Mehmet Pasha, was to connect the Black Sea with the Caspian via a canal connecting Don and Volga rivers. This would allow Turkish navy to access to the land locked Caspian Sea and project Turkish power to the region. However the project had never materialized and with the gradual retreat of the Ottoman Empire the region was left on its own until eventually the Tsarist Russia gained control. However, business ties continued.

The business stopped abruptly when the Soviet administration established itself. The “iron curtain” severed all relationships between Turkey and the Caucasus, the Caspian region and the Central Asia. The only

contact, meager cultural exchanges such as singers were organized via Moscow.

The break up of the Soviet Union, the creation of newly independent states in its place and the opening of the Caspian riches to the world just came in a moment when Turkey was forced to reconsider its place in the world. The Soviet Union collapsed and the NIS emerged when the Ozal administration in Turkey was integrating the country to the global economy. It was both an opportune moment and also an unfortunate one. It was opportune, because the Turks were beginning to take part in global business. Turkish construction companies were the vanguard seeking and taking contracts in the Middle East and North Africa as well as Russia. In another word Turks were beginning to shake their decades long inward looking attitude and beginning to look abroad. It was also an unfortunate moment because drastic changes implemented by the Ozal administration in domestic economy kept getting the headlines, sometimes stealing them from what were happening in international arena.

Turkish policy towards the NIS with Turkic origins in general and towards the Caspian Region countries in particular can be examined in three periods.

In the first period between 1991 and 1993 Turkey was gripped with an euphoria in view of a number of emerging Turkic states after the Soviet Union. The emotions were high. The Turkish public, containing a set of strong diasporas from the Caspian region and the Caucasus demanded stronger Turkish involvement there. The Administration saw an opportunity to establish hitherto non existent cultural, economic and diplomatic ties with Azerbaijan, Turkmenistan, Kazakhstan, Kyrgyzstan and Uzbekistan and project its influence towards the Caspian Sea and Central Asia. The leaders of these countries turned to Turkey, with its NATO membership and close ties with the western institutions, as intermediary between them and the west (Sayarı, 2000). Their main concern was to bolster their newly found independence against Russia. Each head of state or high level official

coming from these states to visit Turkey were given promises of support (Aydın, 2006). Turkey, in turn, saw this position as an opportunity to act as a bridge between the west, especially the US, and the region and with the US support, to check Iranian and Russian influence there. The possibility of large untapped hydrocarbon riches there was also a great incentive. Turkey's these ambitious policies were supported by the US as well. A democratic, Muslim but secular Turkey, embracing principles of market economy, would be a great role model for the Caspian region and Central Asia against political Islam exported by Iran. Russia, on the other hand, was still discussing its policy orientation and it did not have a clear policy towards the region. This period of euphoria finished with the Turkish World Summit of Ankara organized on 30-31 October 1992. Rhetoric by Demirel on the "emergence of a Turkic World from the Adriatic to the China Sea" and his proposal for the establishment of a "Union of Turkic States" or the ambitious projects announced at the outset by the President Ozal, such as the establishment of Turkic Common Market and Turkish Investment and Development Bank caused hesitation among the invited heads of states (Aydın 2005, p.12). At the end none of these projects were accepted. Furthermore, participants refused to any reference to the Conflict in Karabagh and the recognition of Turkish Republic Of Northern Cyprus (Aydın, 2006). These were serious blows to Turkey and created quite a shock.

Second period, the period of 1993-1995, is when Turkey met with the realities of the region. The disillusion at the end of the Summit was due to the fact that Turkey had misread the situation in these countries. Having just gained their independence the Turkic NIS were not looking for an "elder brother" to guide their domestic and foreign policies. Their interests in Turkey were not due to kinship but to pragmatism. Turkey was to be a member state of the EU and this could help them to establish links with the Union. However, continuous rejection of Turkey by the EU changed this image. Moreover, with the "Eurasianist" view in Kremlin, Russia started to

get more involved in the Caucasus and the Caspian. All the NIS were wary of Russian reaction to establishment of strong ties with Turkey who was obviously in the western camp. Furthermore, Turkish economy was in no state to support the economies of these NIS nor could it supply the required investments there. Turkey could not deliver the promises made to those countries.

Elchibey's loss of power in Azerbaijan was a great loss for Turkey. His strong pro-Turkish attitude was one of the main drivers behind the acceptance of Turkish oil company, TPAO, in the "Deal of the Century". The relationships between Turkey and Azerbaijan soured when Turkey did not immediately recognize Aliev's regime and Aliev reimposed visa requirements to Turkish citizens.

In the third period starting with 1995 Turkey realized that it did not have the necessary economic power nor the political or diplomatic skills to play the role it had envisioned for itself in the region. It realized that it could not be the dominant player in spite of Russia. The policies it followed could result in economic, religious even armed conflict in the Region. Turkey needed to reevaluate its policies towards the region. In economic fields Turkey and Iran were competitors for the pipelines to transmit Caspian hydrocarbons to global markets. However, here the US embargo to Iran was decisive. Nevertheless, Turkey and Iran also found possibilities of cooperation in transporting Turkmen gas to Turkey.

In cultural concerns first gain in this period was the acceptance of Latin alphabet by Uzbekistan and Turkmenistan. Azerbaijan had accepted the Latin script in 1991. This was a good step for cultural exchanges between Turkic speaking states against the Iranian efforts to impose Arabic script.

During this period Turkey also tried to settle Russian fears that Turkish involvements would agitate Turkish speaking minorities within its borders. Moreover the fact that Russia is a much bigger market for Turkish goods and services than the Turkic speaking countries caused Turkey to improve its economic relations with these Countries. Turkey also saw that, its desire to

be a conduit for western businessmen to enter the CIS was not realistic. These businessmen would prefer to go to Central Asia and Caucasus via Moscow, instead of Istanbul, and also capture opportunities in the Russian market (Aydın, 2006).

How the issues in the Caspian Region are settled will have great significance on what kind of country Turkey will be in the twenty first century. The Region carries both opportunities and threats for Turkey.

Turkey expects sizable benefits from newly independent countries in the Region both as partnership in energy projects and as targets for Turkish industrial production. Russian dominance on the former Soviet Republics in the Region will attempt to cut off Turkey's economical opportunities with these countries. Furthermore, in such a situation Turkey will also lose its chance to solve regional conflicts, and some long standing questions, such as the Armenian issue, in favorable terms.

When Turkey is planning a move in the Caspian region it should know that Russia would be there and Russian interests should be taken into consideration. Bearing in mind the ties between Turkey and Russia in economy, energy, tourism and even military fields Turkey should design its policies towards the region so that Russia would not be alarmed.

Similarly, Iran and Turkey are rivals in the Region for the development of and access to the hydrocarbon resources. However, Iran poses no threat in this issue due to strict American embargo that would preclude any economic cooperation with this country. The American attitude was so strict on this issue that when the most feasible route was discussed to bring the Caspian region oil to the markets, the Clinton Administration refused to lift the embargo despite the strong lobbying by the oil companies for an Iranian pipeline to the Indian Ocean. Instead the US government persuaded the oil companies to build the more costly BTC pipeline.

Turkey, like the West, is worried that Iran would export Islamic fundamentalism to the Central Asia, the Caspian region and the Caucasus. However, this concern was also proven unfounded. First of all these

countries with Muslim populations had been under the Soviet Rule for 70 years. Anti-religious attitude of the Soviet administration instilled in these NIS a strong secular tradition and none of them wanted to be ruled by mullahs from Qum. Moreover, there existed a strong institutional structure against such religious fundamentalism. Russia was concerned for religious extremism among its own Muslim populations so it was keeping close attention to such movements. China with its own problems in Xingjian was equally concerned with Islamic extremism. Since most of the opposition in Central Asian NIS had strong Islamic components the autocratic leaders of these countries would keep a tight control over religious activities in their countries. Moreover, as mentioned above one of the objectives of the Shanghai Cooperation Organization was to combat extremism, i.e. religious extremism.

Furthermore, Turkey will benefit from its position as an energy transit country to the EU with its accession relations to the Union. The role of Turkey as an alternative energy corridor for the EU is also stated in the Study on the Energy Supply Security and Geopolitics prepared for the EU:

The potential for Turkey to become an important country for oil and gas transit from Russia, the Caspian Sea Region and the Persian Gulfs adds to the strategic importance of Turkey to the EU. Turkey also connects the EU with the Middle East and is an important player in the Mediterranean. Political-strategic consideration will undoubtedly play an important role in discussions about Turkey's potential EU membership.(CIEP, 2004)

Being one of the two energy corridors to the EU, will help Turkey to integrate in the EU's energy infrastructure and administration. The question of whether Turkey has a place in Europe will be weaker in the face of the fact that Turkey is transmitting a sizable proportion of the gas transmitted to the EU. At home, with the collection of the transit fees, those who advocate to sever ties with the EU will lose ground.

#### **4.1 Crucial Oil and Gas Pipelines**

The concept of pipeline is relatively new for Turkey. Apart from some short military pipelines build under the NATO auspices, the only example was the Kirkük-Yumurtalık oil pipeline. This 966 km pipeline, which began operating in 1977, is Iraq's largest oil pipeline. Since 2003 its operation has been greatly impaired due to insurgency in Iraq. It can carry up to 1.6 million b/d.

Starting with 1980's, Turkey's quest to use natural gas to satisfy its energy needs resulted building new gas pipelines. With various cities starting to use natural gas for heating, industry beginning to convert to natural gas and new gas powered power plants are being built, Turkey's gas pipeline infrastructure has developed. Turkey now has nearly 8,500 km. of domestic gas pipeline network connecting eastern and western borders of the country. In another word Turkey has already created its own "East-West Energy Corridor". Deputy Director General Bıyıkoglu of the Turkey's pipeline company BOTAŞ said "Our East-West line is capable of carrying from Iran back to the west around 22 bcm/year" (as cited in Roberts, 2004). This pipeline, around 1.000 km in length, extends from Iranian city of Tebriz to Ankara. The operation of this pipeline was interrupted by Iran in the winter of 2005-2006 due to "technical difficulties" and "cold weather". (EIA Turkey, 2006)

The collapse of the Soviet Union and the opening of the Caspian hydrocarbon resources to foreign investment brought the question of how oil and gas from the region were to be transported to the world markets. Energy security, as seen by the US and EU, dictated that no one country, especially a country such as Russia, should control all the transport routes from the Caspian Region.



## **4.2 Creation of the East-West Energy Corridor**

Turkey has realized that it has a great opportunity to be an energy corridor for Europe and the West. This strategic position has also been recognized by the EU. The Final Report on the Study of Energy Security, commissioned by the EU, states that Turkey will be an important energy corridor because of increased volumes of oil and gas transit through the country from the Persian Gulf, the Caspian basin, and Russia. (CIEP, 2004)

The first step is the BTC oil pipeline. This project, heralded by some as an engineering feat, brings Azeri oil from Azeri, Chirag and Guneshli fields to Ceyhan terminal on the Mediterranean. The BTC inaugurated on 13 July 2006, brings the riches of the Caspian with a special importance to Azerbaijan to the world markets. In late 1990s once pronounced as a pipe dream, the BTC project succeeded with a 21<sup>st</sup> Century quality pipeline, able to transport 1 million barrels of oil per day, with 10 to 30 % capacity increase potential when drag reducing agents are added.

The second step is the “Blue Stream”, bringing Russian gas to Turkey through an underwater pipeline laid at the bottom of the Black Sea. This 1000 km natural gas pipeline, almost half of it under the sea, can carry 15.82 bcm gas annually although this volume is not expected to be reached until 2010. Turkey agreed to purchase 7.92 bcm gas for 2006. This amount will increase gradually until the full capacity achieved.

The BTC and “Blue Stream” pipelines are just the beginning. Once the producers see that the BTC is a reality and the “energy corridor” is working, new opportunities emerge. In June, Kazakhstan signed a contract to send oil through the BTC. As a start 51.3 million barrels of oil per year from Kazakhstan’s Tengiz field will be shipped to Baku by tankers and from there to Ceyhan by the BTC. Eventually the total volume is to reach 154 million barrels per year eventually.

The “Baku-Tiblisi-Erzurum” (BTE) or South Caucasus Pipeline (SCP) which will lie next to the BTC, is to carry 2 bcm of Azeri gas per year, from Shah Deniz field, rising to 6.6 bcm per year at its peak to Erzurum and from

there to the Turkish national network. It is expected to be completed by the end of 2006. Through a special provision in this contract Turkey has the right to re-export this gas.

The Samsun-Ceyhan oil pipeline, which is planned to carry 1.5 million barrel Russian and Caspian oil per day is another important step in Turkey's quest to become an energy hub. Oil from Russian port of Novorossisk is to be shipped by tankers to Samsun and then by pipeline to Ceyhan, reducing load and danger on the Turkish Straits. Construction started in 2006 and the pipeline is expected to be on line by 2009. Turkish government, in order to make it more attractive to investors, has not demanded a share in the project. It is to be privately constructed and operated by a joint venture of Italian ENI and Turkish Çalık Energy. At this point the old Kirkuk-Yumurtalık pipeline must not be forgotten. This thirty year old, Iraqi oil pipeline from Kirkuk with a 1.5 million barrel per day capacity is ready, but waiting for the Iraqi side to continuously pump oil. With these projects and storage capacities in Ceyhan, Turkey will assure its supply elasticity and have strategic oil stocks in times of crisis. Furthermore for Turkey the Ceyhan terminal may bring other opportunities. As part of the energy corridor, the Iskenderun Bay in the East Mediterranean Sea and especially around the town of Ceyhan is going to be transformed. The oil and in future refined oil products can be used to establish a futures commodity exchange in the region, hereby helping both sides of the trades to hedge their risks. A further benefit can be realized with the definition of new oil essays, such as the Azeri blend or even, the Ceyhan blend. A new industry for oil and gas related equipment manufacturing may emerge around Ceyhan. This will make Ceyhan not only a terminal at the end of pipelines but, a center, an energy hub where energy related activities take place and energy business is conducted. It will be comparable to Amsterdam which is Europe's main oil import terminal. Such valuations will undoubtedly enhance the producing countries' netback.

The fact that Ceyhan was becoming an energy hub was also realized by Russia, and Moscow started to take steps to benefit from it. During the inauguration ceremony of the Blue Stream pipeline the Russian president Putin said that Russia would extend the reach of its natural gas exports by using Turkey as a hub for shipments to Southern Europe and possibly Israel. (Kramer, 2005 Nov. 18)

All these completed and committed projects will create a new supply outlet for the European Union of about 4.5 Million barrels of oil per day. This non-OPEC oil will have profound effects on the supply side, especially to offset of declining North Sea oil.

Perhaps the coup-de-grace of these projects is the proposed Trans-Caspian Pipeline project. This Project has been on the drawing board since the early 1990's. It is expected to bring Turkmen gas to Azerbaijan via pipeline under the Caspian sea . From then on gas will be pumped to the South Caucasus pipeline to Erzurum and via Turkey to Europe. To achieve this, a 700 km underwater pipeline has to be built from Turkmebashi port in Turkmenistan to Baku. Needless to say Russia is strongly against this project which will bring greater independence to Turkmenistan in its gas exports and present a serious challenge to the Russian primacy in supplying Europe with gas. Russia, managed to delay the project up to now, by pressurizing Turkmenistan and claiming that the pipeline will be environmentally hazardous, and cross over disputed territory of the Caspian Sea.

İsmail Cem, former Turkish Foreign Minister said that "The 21<sup>st</sup> century began by giving signals that a large part of the Caspian-origin energy will be processed in Turkey, consumed in Turkey and delivered to the West through Turkey" (Cem, 2002). In fact, projects to this end, to create an East-West energy corridor, bringing Caspian hydrocarbons to the West has already begun. European need to diversify gas supplies has led two important projects.

On December 23, 2003, in Ankara, Turkey and Greece through their respective pipeline companies BOTAŞ and DEPA signed an agreement for a 286 km gas pipeline connecting Turkey and Greece and also concluded a “Natural Gas Sale/Purchase Agreement”. The Turkey-Greece connector will connect Turkey from a point near Karacabey (Bursa) on the eastern shore of the Marmara Sea with Western Thrace in Greece. The objective of this pipeline which is also supported by the European Union <sup>31</sup>This 300 km pipeline, with a 17 km underwater passage, constitutes an important part of the South European Gas Ring. It is expected to transport initially 0.250 bcm/year gas which can be expanded according to the Greek demand to 0.750 bcm/year. The construction is expected to be completed at the end of 2006.

The next step for this Turkey-Greece connector will be to extend this connection under the Adriatic Sea to Italy and perhaps following to the Adriatic shore to southern Balkan countries. With the Italian extension 12 bcm/year gas, 8 bcm/year of it to Italy, and the rest for Greece, will be transported from Turkey to the EU. (Pala, 2005, p.23)

The main artery from Turkey to Europe will be the “Nabucco Project”. An international consortium consisting of Turkey’s Botaş, Austria’s OVM, Hungary’s MOL Transmission, Bulgaria’s Bulgargas and Romania’s Transgas is proposing a 3,300 km pipeline to bring Eurasian and Middle Eastern gas to Europe hence reduce the dependency on Russian gas. It is expected to carry 20-30 bcm gas per year. The importance of this project increased after the Russia-Ukraine gas dispute. Originally gas from Iran was also expected to be fed through this pipeline to the EU. However, this is not certain in the face that Iran has other options for its gas such as transporting it as LNG to China and India or to re-inject it to its oil fields to maintain pressure. Besides, the reduction of Iranian gas to Turkey in January 2006, although it was claimed to be due to “technical problems”, a claim of little

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<sup>31</sup> The EU allocated funds for the Environmental Impact and engineering studies of the project and classified it as a “priority” projects.

credibility, left lingering doubts in Europe whether Iran would follow the Russian example of using energy as a diplomatic tools.

Two other projects are also on drawing board. The first one, Iraq-Turkey natural gas pipeline project is planned to bring Iraqi gas to Turkey. From Turkey gas could be exported to the EU via Turkish pipeline system and to the US by LNG tankers. An agreement for this project was signed in 1996. However, The UN embargo against Iraq stopped this project and no work has been done. If security and stability of Iraq could be assured and this country becomes a reliable energy exporter again, this project could be revitalized.

The second project was to bring Egyptian gas to Turkey and to Europe. This project, which will further diversify gas suppliers is based on a Turkey-Egypt framework agreement signed on 17 March 2004. Feasibility studies for this pipeline which will go from Egypt-Syria and Turkey and from there to Europe are underway. This pipeline is also planned to be expanded to Arab Gas pipeline.

There is also a project negotiated between Turkish and Israeli officials to build a pipeline from Turkey to Israel. Turkish Weekly reported that this project, if realized would not only carry gas and oil to Israel but also supply this country with water. This would enable Russia as well as the Caspian region producers to sell oil and gas to Israel.

#### **4.3 The Future**

The European Union is a very important gas market. In addition to this, the Balkans, Central and Eastern European countries, once their economies are integrated with the EU, is expected to enjoy high growth rates further increasing the European gas demand. Turkey is the only country, outside Russia, to transport large amounts of gas to Balkans, Central and Eastern Europe and Western Europe. Having seen this opportunity Turkey, through its state company BOTAŞ, takes into account this demand as well as its

domestic needs, when it is negotiating gas purchase agreements. Moreover, while Turkey is taking serious steps to create its domestic gas market, it is also investing to improve and enlarge its infrastructure to transport gas abroad. Turkey is planning to extend its 8,500 km gas pipeline network to 10,000 km within two years time .(Pala, 2005, p. 21)

Furthermore, the EU, in 2020, is going to have a 300 bcm/year gas supply gap and contracts for this gas have not been negotiated yet. Turkish gas transport capacity of 37 bcm/year through Nabucco and Turkey-Greece connector can be augmented with new projects to carry more than 22 bcm/year to ranges of 100 bcm/year. Turkey will not only supply Caspian gas to EU but Middle Eastern, Iranian and Egyptian gas will also find their ways through Turkish system to the EU.

Turkey would be the alternative route, the energy hub to supply this gap. The pipeline projects, some already in place and working, the others in various stages of development will make sure that the east-west energy corridor is realized. Turkey would not only earn transit fees but will also gain from on-sale of gas it purchased. Gas contracts for Shah Deniz already include such clauses. The only objection is expected from Gasprom who naturally would not like to see a competitor in its biggest market, the EU. However, this is not certain. In 2004 when Turkey broached the subject of reselling the Russian gas to the EU, Russian officials did not object. If Russia wants to sell its gas to Israel via proposed pipeline going under the Mediterranean it might accede to Turkish requests.

This corridor, apart from the obvious financial and energy security gains for Turkey and support for its bid for the EU accession, will have another benefit. Through the pipelines not only the Caspian region but also Russia finds alternative ways to export its oil and gas. This would reduce tensions between the two countries emerged during Turkey's bid for influence in the Caucasus and Caspian region. In fact Fiona Hill and Omer Taşpinar put forward evidence that such a rapprochement is already

emerging. Since 2003 Russian President Putin and Turkish Prime Minister Erdoğan have held various meetings.

In fact, in 2005, relations between the two states were probably better than at any point over the last several centuries-given a history of imperial competition and frequent wars between the Russian and Ottoman Empires since the 18<sup>th</sup> century as well as the rivalry of the Cold War. (Hill and Taşpınar, 2006, p. 4)

The rapprochement between Turkey and Russia makes sense. Turkey imports 70% of its gas from Russia. The trade volume between the two countries was 10 billion \$ in 2004 It reached to 12.5 billion \$ in the first nine months of 2006<sup>32</sup> and is expected to reach 27 billion \$ in 2007. In 2004 1.7 million Russians visited Turkey. Russia is Turkey's second trading partner after Germany. Turkish investments in Russia totals 1.5 billion \$.<sup>33</sup> Turkish companies have received significant construction contracts in Russia. Russia also aims to invest in Turkey's energy sector and participate in tenders to supply military equipment to Turkish Army. These figures show that Turkey will not gain from a confrontation with Russia. As a matter of fact, with the BTC, the BTE , and the Samsun-Ceyhan is in progress, cooperation with Russia will greatly be in Turkey's benefit. Turkey succeeded to realize the BTC and BTE with the US support. Now, it can get into a win-win situation with Russia. Besides, if Turkey wants to improve its chances to be a real energy hub, i.e. supplying not only Europe but also others such as Israel, it should not get into competition with Russia but instead seek possibilities of cooperation with this country.

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<sup>32</sup> Foreign trade statistics are from the Undersecretariat of Foreign Trade web site, [www.dtm.gov.tr](http://www.dtm.gov.tr)

<sup>33</sup> Since capital export below 5 million \$ is free from Turkey this figure may not be accurate.

## **CHAPTER 5**

### **CONCLUSION**

With the demise of the Soviet Union, the common thinking was that the world was no longer bi-polar anymore - no more East and West – but that a new era had started with a uni-polar world - the US only. The capitalist system has proven more successful in creating wealth and raising the welfare of the masses. Western, i.e. the US military superiority is uncontested.

One item, the need for reliable, abundant and affordable energy, the source of economic prosperity and military might, could change this new order. The dependence of the US and the EU on imported energy, mainly oil and gas, is continuously rising. The traditional sources of energy, the Middle East, Venezuela, and Nigeria etc. can no longer be counted on as reliable. China and South East Asia, are emerging as new economical power centers demanding more and more energy. China is also reaching out to secure energy “at its source”. Furthermore, Russia is consolidating itself as an energy giant with its vast resources, monopoly over transport systems and strategic agreements signed with other resource rich countries and markets. Against this background the Caspian Region emerges not as a major source of oil and gas such as the Persian Gulf, but as a balancing weight for global energy security in the twenty-first century.

Firstly the availability of the Caspian region oil, oil that is outside of the OPEC cartel and in a region where the US has access, will provide a necessary balance against price hikes due to political disturbances in volatile areas of the world. Secondly, gas from the Caspian region will provide the EU with supply security, in the face of European Union’s overdependence on the Russian gas monopoly. Furthermore, as the North Sea oil provided the needed impetus to the European economy when the latter was picking up,



Caspian oil will give the needed push to the global economy when the North Sea oil production starts to decline and the Chinese and Indian demand pick up.

However, it is important that the transport routes of oil and gas do not fall under the control of a single power. Multiple pipelines, not under the control of one single country add to the supply security. Moreover, the transport routes should be through stable and safe territories.

This means that the Caspian region can only play this balancing role if transport routes outside the control of Russia can be assured. In this regard, Turkey is the only candidate. Taking advantage of its geographical position, Turkey is trying to become a safe energy corridor between east and west. In this context Turkey has embarked upon a number of projects to bring Caspian oil and gas to world markets. Although the transport of Caspian hydrocarbons is the main objective of these projects, any neighbor of Turkey, as well as the others in the surrounding regions, who wants to bring its oil and gas to the global consumers through a safe, state of the art infrastructure, will also benefit from Turkish pipelines.

Turkey's energy corridor policy offers EU a fresh supply of new oil. The natural gas supply issue, however, requires a further coordinated effort from the EU countries. A window of opportunity exists for the EU during the upcoming gas contract renewal time (2011-12) with Russia. If this opportunity is well capitalized, it will provide the EU with gas supply diversification and a price competition environment.

The natural gas pipeline carrying non-Russian gas through Turkey is becoming a reality this year with Shah Deniz Pipeline from Azerbaijan. The southern part of the EU is being connected to Turkey with an underwater pipeline crossing the Dardanelles. This will bring future re-exported gas to Greece and Italy.

The EU's alternative pipeline route policy originally took Iranian gas sources as the main supply. However for the several years and including the events of 2006 cast a dark shadow on this possibility. Rather, the European

countries should look at other alternative sources, such as Azerbaijan, Turkmenistan and Kazakhstan and the others. The “Gas giant” Turkmenistan puzzle, with its gas supply commitments to Russia, the legal status of the Caspian (lake or sea) require a lot of international work to be done.

With the completion of the BTC and South Caucasus pipelines Turkey will firmly be established as a transit country. This fact is accepted by the EU and Russia. More, independence, security and economic prosperity of the three new producers in the Caspian region, Azerbaijan, Kazakhstan and Turkmenistan, as well as the transit country Georgia, will greatly be influenced. Furthermore, when the income from the pipelines that bypass Armenia start pouring into Georgia, Armenia will hopefully, realize the price of its aggressive and uncompromising strategy seeking territorial gains. This may be a great incentive to move forward to the solution of Armenian–Azerbaijani conflict. Some observers worry that such a situation may cause further conflict if Armenia wants to hold pipelines hostage for gain or if Azerbaijan, with a military strengthened by oil and gas income, tries to regain the territory it has lost, by force. However, international investment in production of oil and gas as well as in pipelines will preclude such a course of action by Armenia or Azerbaijan.

These pipelines that traverse Turkey will be the foundation of an east-west axis, and the emergence of this axis is important. The first steps have already been taken with pipelines. The Baku-Tbilisi-Ceyhan oil pipeline was inaugurated on 13 July 2006 and the first oil was loaded. The BTC has connected Azerbaijan to the world energy markets. The Caspian Pipeline Consortium pipeline has already started to transport Kazakh oil to the West. Even though it passes through Russia, the CPC pipeline, because it is owned by a Western Consortium and is therefore outside of the Russian Transneft monopoly, connects Kazakhstan to the same markets.

A larger capacity, cross country gas pipeline from Turkey to Austria, the Nabucco project is once again at the discussion stage. This pipeline can

help the EU to diversify its the gas supply resources and potentially to create price or gas-to-gas competition. Unfortunately a free market originated, and supply-demand based price scheme does not exist in Europe. Such pricing perhaps should be based on the main alternative source, the coal.

There are also future prospects, It must be remembered that a “corridor” can work both ways. These energy connections mentioned above, will no doubt be augmented with land and rail connections, telecommunications and infrastructure etc. that will facilitate the flow of goods and services from the west to the east, creating a real East West Corridor connecting China and Central Asia to the West, in essence like a new “Silk Road”,

In different periods in the history of mankind, certain geographical locations were crucial to civilization and wealth. Countries suitably situated in these locations prospered and became prominent. This is why commerce and civilization evolved around the Mediterranean for such a long time. First Greece and then Rome, and after their demise the maritime Italian city states, Venice and Genoa and France grew rich.

Then, when the control of this area passed to the hands of the Ottomans, the world economy shifted to the Atlantic. Here, first Spain and Portugal, and then with their secure ports, Britain and the Netherlands as well as France and later the US became foci of economy and hence civilization.

Towards the end of the twentieth century the world has seen that the Pacific rim was becoming more and more prominent. While the countries around the Atlantic Ocean still had their places in the global economy, Japan and the South East Asia emerged as economic powerhouses. It is not far fetched to imagine that the twenty first century will see that the east-west axis, connecting China and Central Asia to Europe and the West, will be at least one of the centers of the global economy.

With these connections, the South Caucasus countries and those in Central Asia are becoming truly independent for the first time after their

colonization by Russia. Similarly, for the first time in history, since it lost its place in the world trade with the discovery of new sea lanes to India, Turkey is suitably situated on this new axis. Geography and a favorable international conjuncture put Turkey in a unique position. Turkey is poised to be not only an energy bridge but also an energy hub, and will have the unique position of being a major player in energy without indigenous energy sources.

If it can realize this and take the necessary steps, Turkey can really be a player in the twenty first century. More importantly standards of living that it has aspired to, can finally be attained. Turkey at this point should be well aware of its strengths and weaknesses. Experiences in early 1990's showed that playing the "elder brother" to the Turkic NIS is not the way to gain political prominence and economic gains. Turkey does not have the resources or the political or diplomatic experience for such a role. Moreover, having shed the Russian yoke after 70 years of Soviet rule none of these regional countries wants such a role from Turkey and such an attitude creates irritation among the leaders of these countries.

Plans to fill the vacuum emerged in the Caspian Region after the demise of the Soviet Union proved futile. The main reason was that in reality there was no "vacuum ". What seemed to be a vacuum was a temporary setback of Russia while it was trying to determine its policy orientation. Once the policy was agreed upon, Russia immediately focused its attention on the Caspian region and affected the events through ethnic conflicts. Armenia-Azerbaijan conflict and the situation in Georgia are good examples.

While designing policies to strengthen its position as the key to the east-west corridor, to enjoy benefit of this corridor or to join extraction and sale of oil and gas from the Caspian region, Turkey should be careful not to antagonize Russia. In fact there is no need for confronting Russia or competing with it. Geography, conjuncture and policies of the US and the EU have already put Turkey in a key position. Turkey does not need to extent more influence in the Caspian Sea. Any sign of confrontation would cost Turkey economically as lost trade with Russia, less Russian tourists and

contracts. The only image Turkey should project is the image of a good, reliable business partner with strong ties with East and West.

In this context rhetoric and postures that may challenge Russia, such as Demirel's statement of the emergence of a Turkish World extending from the Adriatic to the China Sea, or proposal for the establishment of a "Union of Turkic States", Ozal's declaration that the twenty-first century being the "Turkish Century" would lead Russia and others to believe that Turkey had expansionist projects. Needless to say such nationalistic rhetoric is detrimental to the Turkey's image in the region as a good business partner.

Despite the set backs of early 1990's Turkey managed to establish strong cultural and economic ties with the region. The BTC and other pipelines solidify this strong connection. A true east west corridor, allowing not only the flow of energy but also goods and services in both directions is not a utopia. In this matrix Turkey has a valuable place which is stronger than its position in the Cold War era. Instead of using its ties with western institutions to be a role model for the Turkic NIS, Turkey can use its strong ties with western economic interests to increase commercial and economic relations with these countries. In this way, not only are the Russian and Iranian concerns over western political influence in the Caspian region spearheaded by Turkey are alleviated, but also Turkey can keep its Russian and Iranian markets. Ankara's policies towards the Caspian region should not be tarnished with "Pan-Turkic" rhetoric. Azerbaijan and the Turkic states in Central Asia have shown that they were not interested. The grandiose schemes of Turgut Ozal, such as a Turkic Common Market and Turkic Bank for Reconstruction and Development, cannot be realized without taking into account of Russian interests. However, these connections, once established, lead stronger economic relations with the Turkic NIS.

At this point in time, when Turkey-EU relations are strained due to the Turkish perception of the latter's unjust demands, voices for a change of Turkey's directions are being heard. Certain circles are advocating for a cessation of relations with the EU and are looking for other possibilities, such

as closer relations with the Turkic states or joining the Shanghai Cooperation Organization, or closer ties with Iran and the Muslim world or Russia. First of all, cooperation with Caspian region states or those in Central Asia and the EU accession process are not mutually exclusive. In fact none of the proposed options are to the exclusion of the others. The more Turkish institutions and economy are developed, due to the EU accession process or not, the more possible it would be to increase economical, technical or political cooperation with the Turkic NIS. Similarly Turkey and Russia have been living in this region for centuries. For the first time in history their relationships, described by a considerable number of conflicts, are moving to a more cooperative sphere. This opportunity should not be ignored. The existing relationships in trade, tourism and energy should be enhanced and bolstered with new contacts.

Moreover, continuing good relations with Russia would be in line with the EU attitude towards this country. As mentioned above in the section 3.4 on the European Union, the EU is trying to draw Russia into the system as can be seen in the attempts to enshrine some principles of the ECT, the treaty Russia refuses to sign, into a new framework agreement with Russia. Russian participation in the energy projects developed by Turkey will also be beneficial for Turkey-EU relations.

The evidence, supported by views of certain authors, demonstrates that the end of Cold War has not cost Turkey its importance for the West. On the contrary, Turkey, now, is more important for a number of diverse actors and if it can adjust to the new environment, not only will it achieve a sustained economic growth but also will gain a more important and prominent place in the decades to come.

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