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TOWARDS COOPERATIVE ENERGY SECURITY IN THE SOUTH CAUCASUS

Robert M. Cutler *
(Canada)

Introduction

The South Caucasus is becoming once again a part of the Middle East as broadly conceived under the British Empire. The disappearance of the Cold War distinction between Central Asia and Southwest conditions and redefines the problem of security in the region.¹

Indeed, 'Southwest Asia' was a creation of Western strategists and never really existed as an organic unity of a cultural, economic, or any other kind. As a geopolitical unit it is disintegrating, dissolving into the broader band of countries stretching into Central Asia from the Black Sea littoral. The whole macro-region from the Caspian Sea to the Black Sea, and all their littoral states from the Balkans to Central Asia, is becoming the focus of new sets of regional international networks of interdependence. International regions are not what they used to be, nor are they, despite their increasing autonomy of great power conflict, any longer as mutually separable as they were earlier this century.

The fate of Georgia, Armenia, and Azerbaijan is inseparable from the success or failure of developing this broader region both economically and politically, and ensuring its stability. The current turmoil in the South Caucasus will be remembered with fond nostalgia if policy makers do not address wholly predictable demographic and geographic sources of forthcoming conflicts. In the crescent of Central and 'Southwest' Asia, where the median age is in the low twenties, a demographic explosion is inevitable. The population of this crescent of countries from Turkey through Kazakhstan, already over a third of a billion, is projected to double in the next quarter-century.² People will migrate to the cities--they have already started-- and there, following the economic and social pattern of Iran in the 1970s, they will become a lumpenized mass. As is

already happening in Kuwait and Saudi Arabia, an increasingly educated middle class will seek a greater voice in the political process. An average annual growth rate of 5% would be necessary in the GNP to cope with the demographic explosion, but GNP is currently declining.

I. Solutions Already Proposed And Why They Will Not Work

There are three ways to promote stability for the region in the sphere of energy security. First, it is possible to concede a Russian sphere of influence but try to enhance the Commonwealth of Independent States (CIS) as a security agent. This approach would promote integration as a specific security tool and seek to transform the CIS from a closed shop into an open system. Second, it is possible for the West to try to conclude a series of comprehensive agreements with the non-Russian CIS, on the model of the European Union's 'Europa Agreements' with the Central and Eastern European countries. Third, the West could become proactive, promoting and participating in the formation of cooperative relations between Russia and the other newly independent states in sectors where Western interests are at stake, notably energy security and economic development. The U.S. appears to be choosing the first of these possibilities. The European Union has been working on a version of the second, without obvious effects. The third requires more work, but it is more sure, more efficient, and responds better to the interests of the states in the region, including Russia.

Russian control of the means of transport of energy supplies risks turning into control of the rest of the newly independent states. Switching the taps on and off is a way to bring recalcitrant satellites to heel; payments issues are also a tool for this. Russian hegemony over CIS-space is not in keeping with the international norms to which the West proclaims its adherence. Nor, frankly, is it in the West's interest either. An unavoidable but frequently ignored fact about making the oil and gas resources in the region a strategic economic and political asset, both for the region and for the world, is that no one party alone can successfully exploit this wealth. Neither of the two ideas circulating around the third of these possibilities seems to satisfy real-world requirements.

The first of these ideas proposes the creation of an unspecified network of oil export pipelines stretching into Central Asia, to be managed by an international authority which would own and operate them.³ The practical difficulty with this is that the newly independent states of the region would not look favorably on the abnegation of territorial sovereignty that this implies. Worse yet, given the present and foreseeable configuration of Russian politics, one can only imagine what the reaction in Moscow would be to the idea of an international authority (proposed by the West) actually owning any part of the existing Russian pipeline system, or any new pipelines to be built.

The second of those two ideas advocates a spiderweb of pipelines in the South Caucasus, but is ruefully pessimistic about the feasibility of maintaining the network's physical integrity against saboteurs.⁴ This idea seems to have originated in Turkish Prime Minister Ciller's early-

1995 visit to the Center for Strategic and International Studies in Washington. (Turkey has also been trying to promote a community among Azerbaijan, Georgia, and Armenia: something like the Benelux arrangement among Belgium, the Netherlands, and Luxembourg.) More specifically, the second initiative would construct as many pipelines as feasible and distribute revenue not as a function of volume of oil produced or exported, but rather according to a predetermined pie to be divided. However, this variant offers every player the incentive to hoard, since the payoff is not a function of the amount produced or exported; it presents a classic 'free-rider' problem, except that everyone can be a free-rider.

II. The Real Requirements for Energy Security: A New Triad

Neither of the two solutions just mentioned satisfies the real requirements for energy development and cooperative security. Despite the multitude of deals with Western companies being negotiated by the newly independent states, only a few projects are operating. Threats to political stability and uncertainty about pipelines block the path to developing the strategic energy assets of Eurasia. Experience in Saudi Arabia, Alaska, and elsewhere points up three conditions that must be met for oil and gas deposits to be exploited successfully and brought to market.

The two necessary conditions are political stability and secure and cost-effective transport. However, even these are not sufficient. What is further required is a positive financial and investment climate. The first requirement is political stability. This itself requires the creation of legitimate governments in the region and the mutual clarification of their national interests. Here mutual security comes from the reciprocal accounting for the interests of one's neighbours even if one's own interests do not coincide with those. The second requirement is secure and cost-effective lines of transport. These are impossible unless they will function technically in a regular manner. That means they must not be subject to extraordinary costs such as the repair of chronic politically-motivated sabotage. Chevron had this experience in the 1980s in southern Sudan and is not about to put itself in such a difficult position again. Only on the basis of these two together is the third requirement able to be satisfied: a positive financial and investment climate entailing agreed legal regimes ('rules of the game') that dovetail with dominant international norms and are not subject to arbitrary change.

1. Political Stability Manifests Compatible National Interests

In the late 1980s, as the USSR was falling apart and before the Karabakh situation flared up, emerging industrial and technical classes in Armenia began to extend commercial contacts with Turkey. Their Turkish counterparts had responded enthusiastically to these initiatives for cooperation. Mutual antagonism seemed finally on the verge of being overcome through recognition of a shared interest in the present day. However, as the Russian military-security complex destroyed the democratic movement in Azerbaijan and forced the country's participation in the CIS, Azerbaijani domestic politics turned into a

battleground between Russian and Turkish strategic influence. Armenia, seeing Russia and Turkey competing openly for power on her doorstep as Karabakh erupted, developed a siege mentality that reflected the real economic siege to which she was then (and is still) subjected by Azerbaijani and Turkish trade embargo. Russia, complicit and possibly even a motive force in the Karabakh fiasco, profited from the combination of Armenia's isolation and Azerbaijan's political fragmentation to use Armenia as a political- military lever against Azerbaijan. Whether or not control of the Baku-to-Novorossiisk oil pipeline through Grozny was an important factor in Moscow's decision to send troops into Chechnya, massive Russian air bombardment took special care to avoid all major pipelines. However, the Chechen resistance retains sabotage as a trump card regardless of military reversals on the ground. Many other secondary and tertiary oil and gas transmission lines also pass through Grozny. Repeated sabotage of a pipeline carrying Turkmenistani natural gas to Armenia, for example, likewise demonstrates the impossibility of guaranteeing the integrity of transmission lines in the absence of political and economic stability. The Karabakh conflict currently blocks the Azerbaijani-Armenian cooperation that would be necessary for such a route. And what now blocks the pipeline's development is the domestic political situation in Armenia. The West has made it clear that Armenia can receive the pipeline if it concedes on the Karabakh issue. The Azerbaijani leadership favours the route through Armenia, because this would enable them to provide for the energy needs of the Nakhichevan enclave, which is presently dependent upon Iran. (All leading political figures in Azerbaijan, including the last three presidents who have successively deposed one another, are from Nakhichevan.) A pipeline for Azerbaijani oil constructed through Georgia would have to transit territory populated by ethnic Armenians, and Russia could easily incite another Abkhaz rebellion against Tbilisi to menace Georgia's political stability. Russia has until recently sought only to maintain the present instability and to prevent other powers from asserting themselves in the Transcaucasus. For example, Moscow at different times welcomed Turkey and Iran as intermediaries in Nagorno-Karabakh only because this favoured Russian interests. This means playing the balance in the "balance of power" rather than resolving the conflict. A lesson that the West has so far failed to learn is that it should seek political instruments enabling the non-Russian NIS to deal evenly and negotiate effectively with both Russia and the oil and gas companies.

2. Secure and Dependable Transport Manifests Cooperation

The well-known problems of Armenian-Azerbaijani relations are not the only example of how hard it is to agree on transport. The difficulties of the Caspian Pipeline Consortium also illustrate this in even higher profile. They accent the problems of agreeing on transportation arrangements, because the political stability is relatively well established. It is therefore useful to recall some details. In 1993, Russia limited exports of Kazakhstani crude oil, saying that the Tengiz field had too high a level of corrosive sulphur compounds called mercaptans. As a result of Moscow's insistence, Chevron had to build a treatment plant to extract hydrogen sulphide from the crude oil before putting it into Russia's pipeline system.

Although Chevron already had the capacity to extract nearly 100,000 tons per month, which figure was set to double by the end of 1994, exports fell to 12,000 tons per month and remains low.⁵

From the beginning Chevron wanted a direct pipeline to a port, but disputes arose over which port it should be, who should pay for construction, and how. It was agreed that the pipeline from the Tengiz field to the Black Sea would be built and managed by the Caspian Pipeline Corporation, a joint venture among Kazakhstan, Russia, and the Oman Oil Corporation. Chevron was asked to finance most of the \$1.4 billion cost because Russia and Kazakhstan have no money, yet was offered only a minority share in the pipeline. The bulk of Chevron's share was instead to go to Oman Oil, whose presence in the consortium Chevron never liked and whose financial participation would be minimal. This impasse led Chevron to slash its investment in Tengiz by 90% for 1994.⁶

In early 1995 Russia and Kazakhstan agreed to construct a short section of the Caspian pipeline, a 150-mile line from Kropotkin in the north Caucasus to a new Black Sea terminal north of Novorossiisk (to be opened in 1997). Russia announced plans to ship nine million tons per year through it to justify the link economically without the need for Tengiz oil, and Oman Oil is to seek the \$400 million financing from international banks. Yet even this arrangement fell through when Oman failed to secure international financing by October 1995, and Russia and Kazakhstan failed to meet their contractual obligations for capital contribution. How is this impasse to be explained? More than simple economic hardball is involved. Early on, Kazakhstani officials asserted that the Bush Administration was pressuring them to sign with Chevron as a condition for obtaining U.S. support for economic assistance. Kazakhstan's lack of sympathy for Chevron's protests over the pipeline to Novorossiisk becomes more understandable if this is true. However, the differences between Chevron and Kazakhstan that nearly led Nazarbaev to cancel the deal and open bidding on the Tengiz project to other western oil companies, concerned mainly social infrastructure. Out of the \$1.5 billion investment originally projected in the first three years, Chevron balked at allocating more than \$50 million for hospitals, schools, and the like. The international oil and gas conglomerates simply do not pay attention to problems of social infrastructure despite their importance for political stability, with which governments (including Western governments) must nevertheless be concerned.⁷ Nor is Russia blameless. The deal between Chevron and Kazakhstan has been effectively halted, because most realistic possibilities depend on Russia and landlocked Kazakhstan refuses to pipe it across Iran to the Persian Gulf. As a result, other possibilities for trans-Caspian transport are currently being studied, but Russia has consistently demanded both a political veto and an economic interest in any Caspian Sea project.⁸ Its disputes with Azerbaijan over offshore fields are well known. It forced its way into the Karachanagak gas project in Northwest Kazakhstan, with the result that exploration is delayed. It has done absolutely nothing to develop the Shtokmanovksoe field in the Barents Sea.⁹

3. An Investment-Friendly Financial and Legal Climate Realises Energy Security.

Above all the most significant question is how to put into effect international norms for promoting financial stabilisation with a view towards economic development. International financial institutions have been at work on this, but they focus on specific countries individually, and on specific policy issues like privatisation, price reform, and currency stabilisation. This useful approach nevertheless tends to overlook the interactive effects of relations among the NIS, particularly the transnational connections between national microeconomic and macroeconomic policies, as well as the need to coordinate these multilaterally.

Macroeconomics and microeconomics in any single given country are interconnected through the ensemble of national legal regimes that mediates between domestic exchanges and international flows. These legal structures represent nothing less than the interface between the individual country's society and national economy on the one hand, and, on the other hand, the rules of the international economic order that TNCs follow and to which they are accustomed.¹⁰ They affect the success of both microeconomic and macroeconomic reforms. For example, successful microeconomic policy on privatisation and price reform requires the establishment of effective systems for accounting law, property ownership, inheritance law, contract law, and bankruptcy law. Likewise, successful macroeconomic policy in (for example) convertibility, currency reform, or international borrowing is linked to the creation of foreign trade, banking, and insurance systems.¹¹ Western leadership has already been required to solve important payments problems. Large amounts of U.S. aid to Ukraine have been handed over directly to Russia in payment for energy supplies. This is no secret and is even encouraged by Washington for purposes of political and economic stabilisation. The U. S. has also set up and attended negotiating sessions in Turkmenistan conducted by IMF officials to settle differences over payments between Turkmenistan and Ukraine. Where the West has not been involved, a barter system has made a partial comeback: Azerbaijan and Turkmenistan have agreed that the former's energy debt to the latter will be repaid with goods. These financial instabilities affect the living standard of the populations concerned, and hence too the political stability of the governments in place. These payments issues are not ad hoc problems but recurrent structural disequilibria needing systematic attention.

III. The Unspoken Problem And How To Solve It

The coordination of foreign direct investment, macroeconomic stabilisation, and currency and financial affairs is of special significance. Some newly independent states originally hastened to adopt their own currencies. Russia forced those that did not to do so, by pushing them out of the ruble zone in the fall of 1993. Russia has reneged on its proposal for a monetary union with Belarus. With the exception of the Central Asian union among Kazakhstan, Uzbekistan, and Kyrgyzstan, currency cooperation is problematic to say the least. This difficulty complicates the macroeconomic stabilisation of the countries concerned. Western participation is needed and costs little. Energy payments and revenues account for so large a proportion of the national economies and foreign

exchange of the newly independent states, that these issues inevitably affect macroeconomic stabilisation.

1. The Unspoken Problem

Because the newly independent states are unable to finance their own modernisation and resource exploitation and do not command a monopoly of technical capability, they must tap western companies for investment and know-how. Thus Western corporations and especially western oil and gas companies--the 'economic West'--rushed into fill the entrepreneurial vacuum after the Soviet Union disintegrated. Western states--the 'political West'--supported this transfer of capital because it seemed to complement their own goal of helping these newly independent states to integrate into the world economy and democratic political culture. Even when the newly independent states have significant bargaining cards when it comes to negotiating with Western companies, they often do not have the experience to recognise them or to play them wisely. That is all well and good so far as the corporations are concerned, especially if the 'political West' offers nothing that the newly independent states could use to counterbalance against Russian demands. However, that is not in the interest either of Western governments or of their voting publics who need dependable and reasonably priced Eurasian oil and gas, because it is not in the interest of the political West for the NIS to be powerless vis-a-vis Russia.

Such a situation would strip the West of leverage vis-a-vis both Russia and the corporations, and effectively makes the West politically dependent upon Russia alone for its own energy security. The oil companies' acquiescence in the 1973 oil embargo and their response to the Iranian revolution make the 1970s a watershed for American perceptions of economic security. The unmistakable conclusion must be that the international oil and gas companies will bend in the direction of greatest economic gain unless, as in the case of the U.S. embargo on Iran, there are clear and unambiguous financial and legal penalties. The U.S.-European rift in the early 1980s, over the provision of pipeline technology to the Soviet Union, illustrates that even in that case corporations do not always behave as their governments might prefer.

The reason is that the international oil and gas corporations have grown more powerful than governments and developed divided political loyalties. They no longer follow unquestioningly the interests of the political entities called states, which nurtured them when they were nationally based and where their physical headquarters are nominally located. But the corporations are constrained by legal norms. Not only that: they will in general refuse to act in a legal vacuum of legislative uncertainty. They are therefore dependent upon states, whose political authority and autonomy their expansion has done so much to weaken over the last quarter-century. States, on the other hand, can defend their interests and those of their citizens against the corporations only through law, national and international. Not only is it the general absence of national and international legal frameworks for private ventures the most obvious obstacle, other than the threat of political instability, that stands

in the way of energy resource development.¹²

These frameworks also are the means for ensuring that the interests of states and their citizens are respected, including the need for balanced socio-economic development in the newly independent states. Creating those frameworks and making certain that they dovetail with one another and with international laws is thus the unspoken problem here.

2. How To Solve It

Cooperative energy security provides the answer. Specifically, the answer is to establish a Eurasian Oil and Gas Association (EAOGA, pronounced 'yoga') to realise the vast energy potential of the newly independent states. The oil companies have economic clout but they need an environment of investment stability, business-like ethics, and the necessary legal framework. That takes political clout, which only Western governments can offer. Even oil company executives would agree that the development of energy resources is too important to be left to them alone. The nature and variety of technical and geophysical obstacles in Central Asia has already required pooling of financial resources, transport facilities, and technical know-how. The complexity of the technical problems in the Tengiz venture has already required new forms of organisation and decision making.¹³

Outmoded political structures must likewise be either transformed or bypassed. In the early 1950s France and Germany created the European Coal and Steel Community in order to prevent yet another war in Europe. In so doing, they placed under international control the resources upon which conventional war-making depended and laid the groundwork for the European Union. A Eurasian Oil and Gas Association (EAOGA) could guarantee national and international security multilaterally; however, it would have to work differently. EAOGA should not create an international bureaucracy like UNCTAD. It should not seek to cede national authority to an international body like the Law of the Sea Treaty. Nor should EAOGA control those natural resources or their extraction and sale. Rather, it should establish the rules of the game for opening those resources up, promoting international regimes for the development of energy resources. The West can ensure that national systems of banking, finance, and legislation in the NIS dovetail with international requirements by basing EAOGA on the Energy Charter Treaty, which both the U.S. government and the international oil industry support.¹⁴

Being an association rather than a community, EAOGA could go beyond mere gov-ernmental participation. Transnational oil companies would be there. Voluntary citizen organisations from the NIS would be there, helping to promote desperately needed 'civil society' and democratisation.

IV. Conclusion Increasing energy demands by the newly industrialising countries in what used to be called the Third World enhance the importance of the search for new energy sources in the world as we move towards the early 21st century. The countries of the European Union already import half of their primary energy requirements. This figure that will reach 75% by the year 2020. ¹⁵ Developing the resources of the newly independent states and bringing them smoothly to market could stabilise global energy balances, make prices more predictable, guarantee

Western supplies, and assure the regions' balanced socio-economic development. The energy resources of the South Caucasus and Central Asia therefore present enormous potential for the West, but the potential of the unbridled economic development of transnational oil and gas projects represents an enormous challenge to the governments (and the publics that they represent) that will carry the social costs of that economic development. Moscow seems concerned that development of resources outside Russia will threaten her own share of the world market. However, the energy monopolies and ministries in Russia would probably like to participate in the development of resources outside Russia, for the purpose of economic gain. This is resisted by the approximately 400 monopolies of the military-industrial-security complex that continue to set the principal prices in the Russian "market" and still dominate its political economy.

Russia has imposed prohibitive and even punitive costs for transit rights, costs so high that it is hardly economically viable to look for the oil and take it out of the ground in the first place. The other players must choose among continuing to do for next to nothing, thus allowing Russian reintegration of the CIS to become an iron lock (as in Chechnya), and acting to make sure its own interests are reflected in the way that reintegration occurs. Western companies are concerned mainly with economic investment in the region, but Western states must be concerned with its balanced economic development and related ethnopolitical equilibrium. Energy security requires the region's balanced socio-economic development, which in turn requires harmonious relations among the states of the region. Only on this basis can real progress be possible towards satisfying the basic human needs of food, shelter, and access to medical care for the publics there: not to mention the transfer of technology, expertise, and training for which only the West can provide the vast amounts of capital and know-how necessary.

The oil and gas conglomerates are necessary for that development, but they have until now been 'free riders' profiting from the 'security goods' provided by states and international organisations. Even tax laws are no guarantee that they contribute to picking up the costs, since the oil and gas TNCs are frequently able to negotiate special treatment. TNCs create massive social costs that political institutions must cover. This has always been so, but today the situation is qualitatively different. In the newly independent states, where the apparatus of government is still implanting itself, and where political authority over society is not truly consolidated, the security problems caused by unbalanced social and economic development are not merely national but international and transnational. A transnational association of governmental, nongovernmental, and intergovernmental organisations is therefore called for. It would rally all levels of international society in order to safeguard cooperatively their own economic security and thus guarantee to the TNCs, and in concert with them, the political stability that the latter require for their development projects. Only this pragmatic coalition of the West, the international oil and gas industry, and local citizen groups as well as governments in the NIS, can push and pull newly independent states along the road to reform and a commitment to businesslike practices.

Notes:

* Dr. Robert Cutler is an analyst of international political and economic affairs from the Atlantic to Almaty, who is based in Monreal.

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4. Paul A. Goble, 'Light at the End of the Tunnel? Pipeline Politics in the Former Soviet Union', *Prism*, Vol. 1, No 23 (3 November 1995), Pt. 2, [unpaginated, electronically distributed].
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10. For technical background in a particular field, see Anand G. Chandavarkar 'Developmental Role of Central Banks: Beyond Their Regulatory and Monetary Policy Functions, Central Banks Can Foster Financial Innovation and Development', *Finance and Development*, (24 December 1987), pp. 34-37.
11. For an overall conceptual framework, see Robert M. Cutler 'International Relations Theory and Soviet Conduct Toward the Multilateral Global-Economic Institutions: GATT, IMF and the World Bank' in Deborah A. Palmieri, ed., *The USSR and the World Economy* (New York: Praeger, 1992), pp. 105-135.
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