

Chapter I

Renewed International Attention on Caspian Energy Resources

1. An Explicit U.S. Commitment to Central Asia

Since around mid-1997, the oil and natural gas deposits of the Caspian Sea and Central Asia have come back into the international limelight. To be sure, the energy resources of the region commanded a significant amount of interest even earlier than that. On the eve and the immediate aftermath of the breakup of the Soviet Union, the American oil major Chevron Corporation made a big splash when it announced that it would be a major participant in a large-scale project to develop the Tengiz oil field in Kazakhstan. Then, in 1994, American oil majors began one after another to commit themselves to the development of offshore oil resources in Azerbaijan, drawing the attention of their industry rivals. Naturally, the countries of the region, which had just gained independence, were for their own part keen on developing the hydrocarbon resources of the Caspian Sea. A total of five countries have direct stakes in the development of Caspian oil and natural gas resources: Azerbaijan, Kazakhstan, Turkmenistan, Russia, and Iran. Another two countries, Uzbekistan and Georgia, can also be seen as local parties with an interest at stake. The former has territorial rights over some of the oil and gas fields that stretch from the Caspian Sea, and the latter sits in the path of some of the important proposed pipeline routes. Furthermore, neighboring countries as Turkey, Pakistan, and the Ukraine naturally have direct and indirect stakes in oil and gas development in the Caspian region. Western energy interests as well as China have also been closely watching the energy situation in the region.

Nonetheless, it is safe to say that the recent emergence of the Caspian region as one of the mostly closely watched areas of the world was due primarily to the United States' definition, in around mid-1997, of its a new doctrine toward Central Asia. This is not to say that U.S. policy toward the region had been rudderless up to that time. The U.S. had been involved in major efforts to dismantle the nuclear arsenals of some of the former Soviet republics and to prevent nuclear proliferation from

these countries. It had also pursued several goals with regard to the newly independent states of Central Asia and the Caucasus. For instance, it supported the American oil majors' involvement in the oil and gas development as a means to prevent these countries from falling back under Russian control; it supported these countries' efforts to "democratize" and to move toward market economies; it tried to hold in check Iran's attempts to extend its influence in the region. But the intensity of the American commitment to the region was fluid, or at least appeared to be somewhat undecided.

The first hint that U.S. policy toward Central Asia had begun to move toward a stronger position came in a speech delivered at John Hopkins University on July 21, 1997 by Under-secretary of State Strobe Talbot. Emphasizing that the successful implementation of various reform measures then underway in Central Asia would be an indispensable prerequisite for stabilizing the region's situation, he made it unequivocally clear that the United States, in dealing with the region – with its estimated 200 billion barrels of untapped oil reserves – was determined to help the countries of the region democratize, establish free market economies, promote cooperation within and outside the region, and assimilate themselves into the international community. In discussing means to deter Iranian expansionism, he underlined both the importance of Turkey's role, as well as the need to resume aid to Azerbaijan, and thereby hinted at a lifting of the sanctions which were then in effect against Azerbaijan as part of American efforts to support Armenia. This clear articulation of an intention to make a commitment to developing Caspian oil resources meant that the United States had reoriented its Central Asian policy, and that inside the U.S. government the oil lobby had grown more influential than the powerful Armenian lobby. Following the outbreak of the Nagorno-Karabakh dispute, Azerbaijan had placed an economic blockade against Armenia, stopping its supply of natural gas, and the United States had countered in October 1992 by passing Clause 907 of the Freedom Support Act, which stipulated that the United States would restrict its aid to Azerbaijan until the latter "takes visible

measures to terminate all its blockade actions and the exercise of other aggressive forces against Armenia.”

At the end of July 1997, however, Azerbaijani President Heidar Aliyev received a hearty welcome when he visited Washington, and received a pledge from President Clinton that he would see to it that Clause 907 be lifted and American aid to Azerbaijan resumed. This shift in American policy toward the Caucasus and Central Asia, toward giving priority to the development of the region's oil resources, suggested that U.S. human rights diplomacy in the region henceforth would be pursued more flexibly than before.

In other words, given the headway being made in the development of the region's oil and natural gas resources, under the initiative of American oil majors, the U.S. government announced its intention to make a full-fledged commitment to safeguarding Central Asian security, and a readiness to modify or revise its existing policy when necessary. The policy of developing Caspian natural resources emerged as a major restraint on, or even a crucial determinant of, American policies toward Central Asia and the Caucasus, Russia, and the Middle East. Also, it seemed that the diplomatic stances of the local governments would be significantly affected or restricted by the development of the Caspian oil and gas fields. The United States appears to have begun supporting a policy to turn Kazakhstan into a “Saudi Arabia of Central Asia,” and Turkmenistan and Azerbaijan into positions similar to that of Kuwait.

One noteworthy recent development has been a rapprochement between Uzbekistan, the largest country in Central Asia in terms of both population and influence, and the United States. In 1994, Uzbekistan surprised the international community by suddenly shifting to a policy of close cooperation with the United States, even going to the extent of endorsing U.S. containment policies toward Iran and Cuba. The motive behind the rapprochement, on the part of the United States, was its interest in nurturing Uzbekistan into a strategic outpost in Central Asia; Uzbekistan, for its part, was looking to the United States as a reliable backer to help reinforce its national security vis-a-vis Russia and to implement its energy development strategy.

Signaling a further deepening of its commitment to the region, in September 1997 the United States undertook a joint military exercise in Uzbekistan and Kazakhstan under its own leadership. The

huge scale of exercise, which involved not only Uzbekistani and Kazakhstani, but also Russian and Ukrainian forces, is shown by the fact that a greater than 500-person American air-borne unit was flown nonstop to the region from the United States, receiving three aerial refuelings on the way. The drill was seen as very important, since it had shown both the seriousness of the American commitment to the region and the fact that the major Central Asian countries were linking up their national security policies ever more closely to the United States. Russia sent just 40 soldiers to participate in the joint drill, an obvious expression of displeasure at what it saw as a manifestation of deeper American intrusion into its own sphere of influence. More joint military exercise are scheduled to be held in Uzbekistan and Kyrgyzstan in September 1998 with the participation of American forces. The drill in Kyrgyzstan is scheduled to take place in the Province of Osh, in the Fergana Basin, while the site for the drill in Uzbekistan has not been decided yet. It is reported that while the U.S. military wants to hold the drill in the Province of Tashkent, the seat of the capital, the Uzbekistani military leaders wish to hold it in the Province of Fergana. Fergana, a leading cotton production center, is reported to be the most active center of the Islamic revival movement in Central Asia, and the holding of the joint exercises could be extremely provocative toward the people there. It may be that President Islam Karimov is intent on showing off his government's power to the potential Islamic movement of Fergana.

Also noteworthy was an announcement made by the U.S. Department of Defense on February 25, 1998 of a partial reorganization of the areas covered by the nine military districts of the U.S. forces. First, the Western Slavic and Caucasian countries in the old Soviet Union (i.e., Ukraine, Belorussia, Moldova, Georgia, Armenia, and Azerbaijan) would be placed under the command of the U.S. Forces in Europe beginning on October 1, 1998. The Central Asian countries of the old Soviet Union (i.e., Kazakhstan, Uzbekistan, Turkmenistan, Tadzhikistan, and Kyrgyzstan) would be placed directly under the command of the Central area, also beginning on October 1, 1998. It is worthwhile to note that Ukraine and Belorussia will be treated separately from Russia, that Central Asia is being treated by American strategic planning as part of a single unit, together with India and other Asian countries.

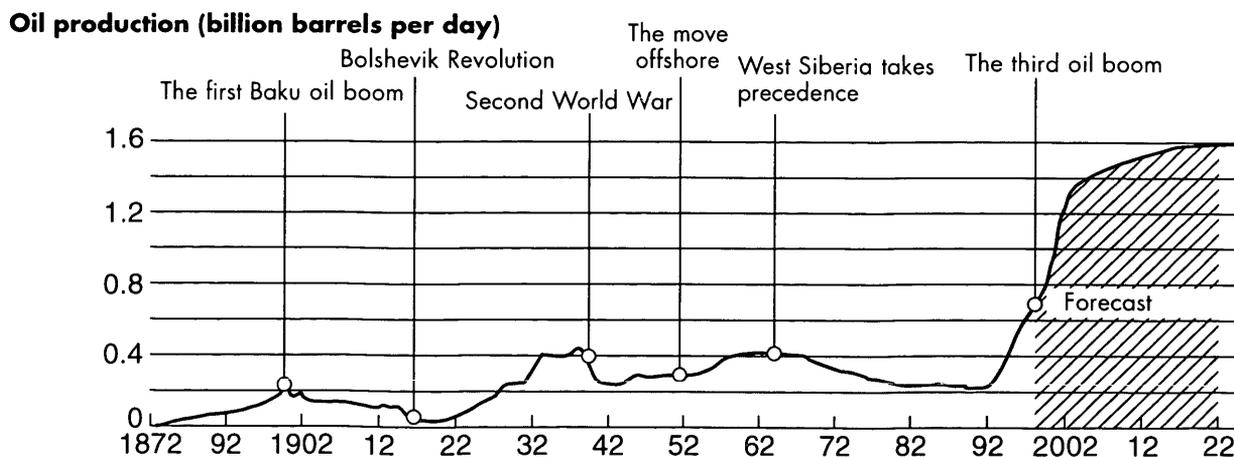
2. The History of Caspian Oil and Gas Development

The history of the development of the oil and gas resources in the vicinity of the Caspian Sea is as old as the history of the oil industry itself. The symbol of the eternally burning fire used in Zoroastrianism, the pre-Islamic Persian religion which still has believers in certain areas of Iran and in Mumbai (Bombay), India, reminds one of abundant petroleum of the Caspian region. The name of Aturpat, who ruled the region in the fourth century B.C., and who it is believed became the basis for the word "Azerbaijan," is reputed to mean "the guardian of fire." Moreover, the history of Baku, the capital of Azerbaijan, is very important in understanding the history of the development of the Russian oil industry. At the same time, Baku led the capitalist development of Russia as one of its most important and advanced centers.¹ Following the lifting of Russia's petroleum monopoly system in 1872, there was a flood of investment from Europe into the development of oil in Baku. By the mid-1880s, the amount of oil produced in Baku had soared to approximately one third of the amount produced in the United States, and by 1900 the Baku oil field was producing 240,000 barrels a day, or half the world's daily production. Three distinct layers of capitalists were involved in the development of the Azerbaijani oil industry. First there were the international oil interests such as the Nobels and Rothschild, sitting at the top and playing the leadership role, followed by Russian capitalists who occupied the second-tier positions, and under them were the indigenous Azerbaijani capitalists.² The projects be-

ing undertaken today for the development of the Caspian oil fields are reminiscent of the earlier efforts in the sense that international oil interests are once again deeply involved in the projects.

From the late nineteenth into the early twentieth century, kerosene was the major product derived from oil, and the St. Petersburg and other Russian markets were dominated by the kerosene processed by Nobel Brothers from the crude oil pumped up from the Caspian oil fields. Shipping the product over the long distances to Petersburg and other markets within Russia, however, was a laborious task. First the product was put into wooden barrels, loaded onto ships at the port of Baku, and transported some 600 kilometers across the Caspian Sea to Astrakhan, at the mouth of the Volga. At Astrakhan, the kerosene barrels were transferred to smaller boats, which sailed up the Volga, unloading the barrels at railway stations along the way for further inland transportation.³ In order to make the transportation easier, the oil tanker was developed and put into use for the first time in the Caspian Sea, in 1878. Railway lines exclusively for the transport of kerosene were also constructed. In the mid-1880s, large numbers of oil tankers began going into service in the Atlantic Ocean, bringing about a revolution in oil transportation.

Meanwhile, in opposition to the Caspian route controlled by Nobels, two rival oil producers, Bunge and Paravshkovky, conceived of constructing a railway line along the Caucasian mountains, connecting Baku with Batum on the Black Sea.⁴ They obtained the license for the construction and began the work, but ran out of funds halfway



through the project. At that point, the French plutocrat Rothschild join the project, supplying the necessary funding, and using the group's oil-related facilities inside Russia as collateral. Rothschild's investment in the Caucasus railway was motivated by his intention to ship the oil produced from the Baku oil field to European markets. The railway between Baku and Batum was completed in 1883. As this demonstrates, the construction of railways in Caucasus was closely related to the development of oil. A few years later, in 1886, Rothschild established a "Caspian Sea and Black Sea Petroleum Company," and began constructing oil storage and marketing facilities in Batum. The opening of the Caucasus railway made it possible for Russian oil to be marketed in the international market, and the vendors of Russian oil competed fiercely in the European markets for the subsequent 30 years. The Rothschilds, however, withdrew from the oil business in 1907, selling their shares to the Royal Dutch-Shell. The same year saw the completion of a pipeline between Baku and Batum, which dramatically improved the transportation of oil from Baku to the Black Sea. Shortly thereafter, however, Baku became one of the leading centers of the Russian labor and revolutionary movements, and during the political turmoils that led to the 1905 revolution, many of its oil wells were destroyed, and it suffered from a series of strikes.⁵ As a result of the political turmoils, Baku's oil production plummeted, and by 1913 its share in the world's oil production had fallen to approximately 10 percent.

Nonetheless, the Baku oil field continued to have strategic importance. After the Russian Revolution in 1917 until the beginning of 1920, the Caucasus experienced a short spell of independence from Russia, but was soon reincorporated into Russia and subsequently the Soviet Union. The production of the Baku oil field recovered gradually, and on the eve of the Second World War it was entering a second boom as a leading oil producing region of the Soviet Union. One strategic goal of Hitler's assault on the Soviet Union was to capture the oil fields of the Caucasian region (i.e., Maikop, Grozny, and Baku), since petroleum was indispensable for the conduct of the war. Nazi Germany launched an assault on the Soviet Union in June 1941. By early August it had captured Maikop, but was unable to advance further across the Caucasian mountains, and failed to capture the Baku oil field. It should be pointed out, incidentally, that the Volga-

Ural oil field, another large deposit of oil, was discovered in the Soviet Union in the early 1930s, and production there increased so rapidly that by the mid-1950s it accounted for more than 60 percent of oil production in the Union, dwarfing the status of the Baku oil field. Nonetheless, offshore oil wells in Baku went into production in the late 1940, but the Soviet Union did not have the technological expertise to fully tap the offshore resources. Meanwhile toward the end of the 1960s, thanks to the Samatrol oil fields in Tyumen' and other fields, West Siberia emerged as a major oil producing region. Since the latter half of the 1970s, however, oil production in West Siberia has stagnated, with the result that by the latter half of the 1980s, the offshore oil resources of the Caspian Sea began to loom large once again in the Soviet Union's oil development policy, and great expectations began to be pinned on the possibility of developing these resources as major oil supply bases in the years to come. The existence of oil resources under the Caspian Sea's continental shelf, in addition to the existing Baku oil field, has already been confirmed. The continental shelf which stretches from Kazakhstan to Astrakhan, which is called the northern lowland of the Caspian Sea, has drawn attention as the most promising replacement for Tyumen'.⁶

As is clear from the foregoing observations, Caucasus oil has played an important role in Russian and Soviet history. However, the breakup of the Soviet Union, and the independence of the countries of the Caucasus (i.e., Azerbaijan, Georgia, and Armenia) and of Central Asia (i.e., Kazakhstan, Turkmenistan, and Uzbekistan) resulted in a major change in the government authorities taking charge of developing the offshore oil resources of the Caspian Sea. The development of the oil resources of the Caspian region is now entering a third boom, as all these newly born countries are showing great interest in the development efforts.

3. Impacts of the Energy Resource Development in the Caspian Sea

There are two pillars to the development of the Caspian oil and gas resources: the onshore oil field of Tengiz, Kazakhstan, and the offshore oil field of Baku, Azerbaijan. The reason for the sudden emergence of the Caspian region into limelight was that the region is one of the remaining few that can

offer new concessions to international oil majors or oil importing countries. Moreover, the region is attractive because of the extremely small risk involved in oil development there. There are only a few other areas in the world that have the potential to offer new concessions to international oil interests: Iran, Iraq, the Sahara Desert area of Algeria, and a few others.

The oil and gas resources of the Caspian were not extensively developed because the Soviet Union lacked the technology and know-how necessary for offshore oil field development. Most of the oil deposits of Azerbaijan, and between 30 and 40 percent of those of Kazakhstan and Turkmenistan, are offshore. The total confirmed deposit in the Caspian region is reported to be between 15 and 29 billion barrels, a size comparable to the deposits in the United States (22 billion barrels) or that in the North Sea (17 billion barrels).⁷

Today, the prices of oil and natural gas are basically determined based on the relationship between supply and demand, and are thus increasingly taking on the characteristics of ordinary primary commodities, depriving the Organization of Petroleum Exporting Countries (OPEC) of the strong influence it once held as a supply cartel. The continuing fall of international oil prices since the end of 1997 is revealing of how the oil market stands today. Nonetheless, given the fact that large oil export revenues can have enormous economic and political impacts, and also that energy resources, with their lopsided geographical distribution, remain geopolitically and strategically important, oil, unlike other ordinary international commodities, continues to retain potentially strategic importance. Moreover, as the Asian region, including China and India, is expected to grow further economically, it is quite likely that the demand for oil in the region will increase in the medium to long term. It should also be pointed out developing oil and natural gas resources and constructing pipelines for transportation requires the investment of enormous amounts of funds for an extended period of gestation before the new facilities go into service, meaning that the development of oil and gas requires a long-term perspective, or strategic planning.

The Caspian oil resources, because of their geographical locations, have inherently profound strategic implications. First, the development of the oil and gas fields will have a major impact on the

framework of relationships between Russia and the countries in the vicinity of the Caspian Sea. The increasing economic and energy independence of the countries of the Caucasus and Central Asia, which formerly belonged to the Soviet Union, will result in a weakening of Russian power, making it difficult for Russia to reassert its hegemony over them. Second, for many of the countries in the Caucasus and Central Asia, exports of natural resources are the only promising and viable leverage available in the short-term for their development strategies. In other words, the development of oil and gas will be a critical factor in determining whether or not these countries can successfully establish national economies, move to market economies, and, in particular, rehabilitate their economies and put them onto trajectories of growth. Third, from the standpoint of the American policy of containment toward Iran and Iraq, which figures significantly in its post-Cold-War world strategy, American involvement in the development of Caspian energy resources will have the effect of "denying" Iran the chance to partake in the production of the resources or to earn transportation charges from pipelines installed in its territory. Stated differently, the development of the Caspian oil fields is interlocked with the strategic objective of halting the spread of Islamic fundamentalism from Iran to the Caspian region. It should be noted, however, that American oil majors have reportedly begun to voice reservations to their government's policy toward Iran. Fourth, the development of the Caspian oil resources is providing the gigantic U.S. oil majors with new business opportunities. Fifth, the prospect of growing oil and gas revenues and the question of whether these revenues will be put to effective use will have a significant effect on political stability and intra-regional relationships in the Caucasus and Central Asia, where there have traditionally been a number of unsettling factors including ethnic conflicts. For instance, the conflict between Azerbaijan and Armenia, as well as the secessionist movements of Abkhaz Autonomous Republic and the Ossetian Autonomous Region, both in Georgia, will be influenced by the development of Caspian oil. Also, the construction of pipelines will influence the winding down process of the civil war in Afghanistan. In sum, the Caspian oil resources have become a determining factor in intra-regional relationships in the Caucasus and Central Asia. And sixth, the region, because of its

potential impact on the supply-demand situation in the international oil market, has begun to attract the attention of the oil-importing countries of Asia, including Japan, China, and India.

4. *The Caspian Oil Fields and U.S. Sanctions against Iran*

The development of the Caspian oil resources has posed the United States the knotty question of how it should reconcile the interests of American oil companies, who want to take part in full-fledged development, and the national strategy of containing Iran.

In its October 1997 report on the hydrocarbon energy resources of the Caspian Sea, the U.S. Department of Energy summarized the problems involved in the development of these resources under the following five headings:

- (1) Legal issues concerning the territorial rights and the rights to develop natural resources in the Caspian Sea;
- (2) Regional instability;
- (3) How to develop export routes through several countries;
- (4) Problems involved in exporting oil and gas via routes that pass through the Straits of Bosphorus;
- (5) Problems related to sanctions against Iran and the development of the Iranian route.

Since the first four problems are dealt with elsewhere, we will concentrate here on the fifth problem, namely the relationship between sanctions against Iran and the development of the resources.

To begin with, the existing American policy toward Iran has greatly complicated decisions regarding the routes for transporting oil and gas from the Caspian region. Apparently, a route passing through Iran to the Persian Gulf or Indian Ocean would be economically most efficient, but this route is restricted by the American policy of containment against Iran (as well as against Iraq).

To briefly summarize the recent policy measures taken by the United States toward Iran, President Clinton issued on March 15, 1995, an administrative directive banning American firms from participation in Iranian oil development projects. At about the same time, the American oil major

Conoco shelved its contract for a large-scale oil field development project in Iran. At the end of April 1995, Clinton announced a total ban on trade with and investment in Iran. The U.S. government was prompted to take this sterner attitude by Israel as well. Concretely speaking, as the peace process in the Middle East unfolded, the confrontation between Israel and the Arabs, which had previously dictated the region's political contour, began to be replaced by a confrontation between Israel and Islamic extremists. Israel was becoming increasingly nervous about the activities of Islamic extremists such as Hamas and Hizbollah in Israel and the occupied territories, and was accusing outside forces, and in particular Iran, of being the puppet masters behind these activities. The United States rationalized its containment policy on the grounds that Iran was opposed to the ongoing peace process in the Middle East, and had the intention of developing nuclear weapons and other weapons of mass destruction. One noteworthy development in the U.S. Congress in relation to the country's diplomacy was that contrary to the long-standing assumption that the Israel lobby's natural ally in the Congress was the Democratic Party, hard-line supporters of the lobby began to emerge among Republicans, most notably Senator Alfonse M. D'Amato. The second phase of U.S. sanctions against Iran was instituted in August 1996, when President Clinton signed the Act for Reinforcing Sanctions against Iran and Libya, which stipulated that companies from third countries investing 40 million dollars or more a year into the Iranian oil and gas industry would be subject to the American sanctions. The Act is also known as the D'Amato Act because the Senator was the main initiator of the bill. The United States' intention to invoke a domestic law and impose sanctions against private firms from third countries relating to their economic activities outside the United States is considered problematic from the standpoint of international law, but the very fact that such a law was legislated reflects the political mood within the United States in support of sanctions against Iran.

It is also true, however, that U.S. policy toward Iran cannot be fully explained by the influence of the Israel lobby. In fact, the mainstay of the United States' post-Cold-War national security strategy was the assertion that "rogue states" would be dealt with properly, and its policies of containment against Iran and Iraq are of symbolic importance. It is for

this reason that the United States has been trying to prevent Iran's participation in the development of the oil field off the coast of Baku, and has been opposed to the idea of constructing pipelines through Iran. Recently, however, new developments have been in the making. For instance, the new Iranian administration of President Khatami, who took office in July 1997, has begun to seek a cautious rapprochement with the United States; and in the United States, too, calls have begun to emerge calling for a reappraisal of their country's policy toward Iran. Although there are no clear signs yet of an impending turnabout in U.S. policy toward Iran, it is necessary to keep in mind that depending on the development of relations between Washington and Teheran, the Caspian question may take a new turn.

The U.S. strategy toward Iran, however, are so deep-rooted that, even in the event of a rapprochement, the United States may stick to its strategy of denying Iran any share in the benefits resulting from the pipelines for the Caspian oil fields. Such a strategy would be in tune with the basic strategic goal of the United States in the Middle East, namely, of preventing the emergence of any regional power able to exert dominance over the Persian Gulf.

Under the preliminary deal signed on May 18, 1998, the United States hinted that it would exempt European countries from such sanctions. However, officials indicated that there would be no automatic waiver for firms investing in pipelines that run through Iran from the Caspian (*The Economist*, May 23-29, 1998).