

# The Caspian energy plateau: Geo-economic, geopolitical and legal essentials

## Abstract

*Regions that are rich in energy resources continue to be of crucial interest to our carbon-powered world. There are numerous concepts at stake, including international legal status, ownership rights, energy routes, transit corridors, state and corporate interests, environmental hazards and the overall puzzle of energy diplomacy. Additionally, the Caspian is troubled with its own specific set of complexities, encompassing its undefined legal status, territorial disputes, ethnic instabilities and its vicinity to other hot spots, such as a middle east in turmoil and the more recently-sparked conflict in Ukraine. Its geographical setting makes the Caspian of central interest for European energy security, although the supply chain from the region has traditionally been kept under Russian control. However, for the past decade or so, the EU has been becoming increasingly ambitious in planning Caspian pipelines that bypass Russian territory. The Caspian is, therefore, also at the crossroads between the grand and conflicting energy interests of Russia and western Europe.*

**Keywords:** Caspian Basin, energy security, pipelines, geopolitics, international maritime law

## Introduction

Just as the rapid melting of the polar caps has unexpectedly turned distant and dim economic possibilities into viable geo-economic and geopolitical probabilities, so it was with the unexpected and fast meltdown of Russia's historic empire and its economic ties to the Caspian Basin. The Caspian has presented itself as an open sea of opportunity literally overnight. This opportunity exists not only for the riparian states, but also for the belt of neighbouring ones, as well as other interested states overseas.

The interests of the external players range from the symbolic, or rather the rhetorical, to the geopolitical: from an antagonising political conditionality and constraint to more pragmatic trade-offs between political influence and gains in energy supply. We can identify three most important categories of interest in the Caspian. The first are the energy-related economic and political interests. These refer to the exploitation of the gas and oil resources hidden in the Caspian. The second are the non-energy related economic interests, such as the extensive fishing options and the costly and luxurious caviar of the Caspian Sea. The third is the Caspian's strategic position. Its location is not only part of numerous crossroads between Europe, Asia and the middle east, but also offers different avenues for setting future pipeline routes that are part of larger geo-strategic and geo-economic considerations (Zeinolabedin and Shirzad, 2009).

In the context of this interest-driven, conflicting mixture, we cannot neglect the power and influence of the large transnational corporations which are influencing the region's stability, equilibrium of interests and policy-making processes. In these circumstances, we are also referring to non-state players, such as organised radical Islamic groups; organised crime groups; and international and non-governmental organisations concerned with human rights, democracy building and environmental issues. Additionally, let us not disregard major consumers, such as China, India or the European Union (EU), that are driven by their own energy imperatives to improve energy security as well as to diversify their supplies, modes and forms in the long-run. Striving for energy security is, relative to demand, of utmost importance when it comes to the geopolitics of energy in the Caspian.

On the promise of these allegedly vast, and mostly untapped, oil and natural gas resources, the Caspian is witnessing a 'New Grand Game' – a struggle for dominance and influence over the region and its resources, as well as transportation routes. Notably, the Caspian Basin is a large, landlocked water plateau, without any outlets to other water systems. Moreover, the former Soviet republics of Azerbaijan, Kazakhstan and Turkmenistan have no direct access to international waters. That means that pipelines remain the principle mode of the transportation and delivery of carbonic fuels, creating yet another segment for competition and as a source of regional tension, since the three riparian states depend on their neighbours for export routes. Ultimately, due both to the unresolved legal status of the Basin, as well as the implications of its resources for energy security in the EU, numerous new pipeline constructions and expansion projects have been proposed but remain unrealised. For the EU, the most important of these was the Nabucco pipeline which, although not fully guaranteed, served as a hope for reduced energy dependence on Russia. Such a goal is currently becoming additionally more relevant due to the ongoing crisis in Ukraine and the accompanying process of alienation in general, with uncertain future results.

This article considers the geopolitical, legal and economic features of the Caspian Theatre, the complex interplays and a possible future outlook. It will reflect in detail on the interests of the involved regional and global players, as well as on the highly complex issue of the undeclared legal status of the Caspian and the consequences that this *status quo* holds for the concerned parties. In addition to that, the article emphasises the importance of the most notable current and planned pipeline projects and their impact on EU energy security. Towards the end, the text also seeks to depict the future options for pipeline diplomacy in the region, as well as the implications this will hold not just for the EU but also for the wider region of the Caspian itself.

## A profile of the Caspian Basin

### *The Caspian water plateau*

The Caspian is the world's largest enclosed body of salt water, approximately the size of Germany and the Netherlands combined. The geographical literature refers to this water plateau as a sea, or the world's largest lake, covering an area of 386 400 km<sup>2</sup> (a total length of 1 200 km from north to south; and a width ranging from a minimum of 196 km to a maximum of 435 km), with a mean depth of about 170 metres (the maximum southern depth is 1 025 metres). At present, the Caspian water line is some

twenty-eight metres below sea level (this is the median measure of the first decade of the 21<sup>st</sup> century). The total Caspian coastline measures nearly 7 000 km, being shared by five riparian (or littoral) states.

The legal status of this unique body of water is still unresolved, i.e. whether the Caspian is a sea or lake. International law delineates lakes from seas, so the Caspian should be referred to as a water plateau, or the Caspian Basin. Interestingly enough, the Caspian is both a sea and a lake. The northern portions of the Caspian display the characteristics of a freshwater lake, due to the influx from the Volga, the Ural River and other relatively smaller Russian river systems. In the southern portions, where the waters are considerably deeper but with fewer major river inflows, the salinity of the waters is evident and the Caspian appears as a sea.

### *The Inner Circle*

The so-called Inner Circle of the Caspian Basin consists of five littoral states – namely Russia, Iran, Azerbaijan, Kazakhstan and Turkmenistan – sharing the common coastline. They are of asymmetric constellation and can be divided roughly between the two traditional states of Russia and Iran; and the three states of Azerbaijan, Kazakhstan and Turkmenistan. This division also corresponds with the following characteristic: only Iran and Russia have open sea access, while the other three countries are landlocked, as the Caspian is itself a landlocked body of water.

In addition to the five littoral states and, correspondingly, five different outlooks on the Caspian, the region is home to numerous territorial disputes while maintaining absolute geopolitical importance to its respective littoral states and beyond. An additional layer of complexity is represented by the unsolved legal status, the resolution of which is drifting between an external quest for the creation of special international regimes and the existing United Nations Convention on the Law of the Sea (UNCLOS).

The dynamic of the respective littoral states displays the following three traits: dismissive; assertive; and reconciliatory. ‘Dismissive’ refers to the erosion of the efforts of the international community and external interested parties in the creation of an Antarctica-like treaty, by keeping UNCLOS referential. ‘Assertive’ refers to maximising the shares of the spoils of partition by extending the exclusive economic zone (EEZ) and the continental shelf as to divide most, if not the entire, body of water among only these five. ‘Reconciliatory’ refers to preventing any direct confrontation among the riparian states over the spoils by resolving claims without arbitration by third parties (Bajrektarevic, 2011).

### Russia

With regard to the Caspian Basin, only a negligible part of Russia’s extensive reserves appear to be located there. Therefore, Russia has adopted a strategy of involvement in the energy business of the other, better-endowed riparian states by means of joint resource development and the granting of access to the Russian oil and gas pipeline system. The main players in this field are the state-owned companies Gazprom, Rosneft and Transneft, as well as the numerous large private energy enterprises like LUKoil, Sibneft or Yukos (Crandall, 2006).

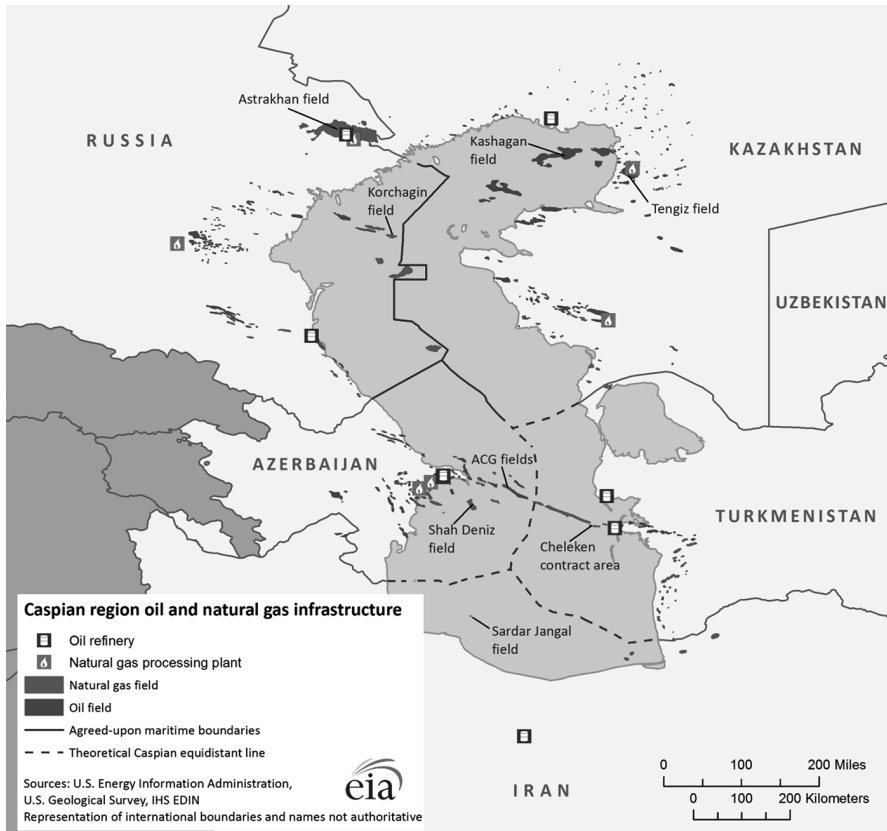
In the light of the loss of economic influence in the Caspian after the dissolution of the Soviet Union – due to the overwhelming preoccupation with preserving strategic influence in the region – Russia's views dramatically shifted in the 2000s from politico-security aspirations to goals that were largely economic. To this end, Russia turned to bi- and multilateral agreements with the other Caspian littoral countries to secure its economic interests in the Basin. With its unique policy, called *Common waters, divided bottom*, it moved closer to the Kazakhstani/Azerbaijani stance, following the principle of dividing the seabed into proportional national sectors, in line with the UNCLOS principle. At the same time, Russia maintained common management of the surface waters, preserving free navigation and common environmental standards for all the littoral states, partly following the lake principle by excluding the international community. With this division, Russia would receive eighteen and a half per cent of the Caspian seabed; Kazakhstan would gain twenty nine per cent; Azerbaijan and Turkmenistan approximately nineteen per cent; while Iran would be left with fourteen per cent.

Due to these efforts, Russia has agreed upon the division of the northern part of the Caspian with Azerbaijan and Kazakhstan, while still strongly affirming that the five-party consensus continues to be the only path to a final decision on the legal status of the Caspian (Zimnitskaya and von Geldern, 2010). This agreement presents a positive sign for the future, but it has a major downside, which is that it is completely dependent on good relations between the littoral states and, subsequently, the geopolitical realities of the Caspian.

We must also consider Iranian defiance of this solution, since it diminishes its political and economic role in the Basin, leaving it with the smallest share and the deepest waters. For now, with the successful agreement in the north, the division is illustrated in Figure 1.

Regarding intra-regional relations in general, Russian concerns about the influence of Turkey, China, the EU and the US in the Caspian Basin have increased in the recent past, due to its eagerness to regain its role as a major power. Above all, the emergence of Azerbaijan as a major ally of the west has caused dismay in Moscow. Concerning Iran, the historically adverse relationship has improved in some areas as the two powers still share a number of mutual interests in the Caspian Basin. An example of this includes opposition to growing western interference in regional affairs and the proposed construction of a trans-Caspian pipeline (Dekmeijan and Simonian, 2003).

Figure 1: The proposed and already effective division of the Caspian Basin



Source: EIA, 2013.

## Iran

Despite ranking among the world's leading oil producers, and the second largest producer of natural gas, Iran's share of the local oil and gas reserves is negligible, similar to Russia. Moreover, foreign direct investment in the energy sector has been hampered due to the continuous conflicts with the west over nuclear issues (Crandall, 2006). However, Iran's status as a regional power, as well as its unique geographic position between the Caspian Basin and the Persian Gulf, means that it remains an attractive transit country. This also grants it power and a wide range of possibilities for gaining influence as a Caspian littoral state.

Foreign policy priorities have been affected by Iran's past dominance, as well as the religious ties it has with the republics of Azerbaijan, Kazakhstan and Turkmenistan. However, these newly independent states (NIS) see Iran's potential in terms of cheap transit routes for oil and gas rather than as an Iranian advantage. Of greatest concern

is Iran's relations with Azerbaijan, hampered due to Azerbaijan's westwards co-operation on energy matters (Dekmejian and Simonian, 2003).

Additionally, we have to mention the great divide between the two countries when it comes to defining the legal status of the Caspian. Initially, following the collapse of the Soviet Union, Iran strongly asserted that Azerbaijan was, along with the other former republics of the Soviet Union, a successor to all the treaties signed between Iran and the Soviet Union. It never fully deviated from this position, but Iran was also a strong supporter of the condominium solution (i.e. common use by all the littoral states on the basis of joint ownership), along with Russia. However, when it lost Russia as an ally in this matter due to Russia's efforts to form a closer bond with neighbouring Azerbaijan, it opted for the 'lake' solution of the Caspian, which remains Iran's official position today.

Azerbaijan, on the other hand, has greatly defied all these positions and is lobbying for the Caspian to become subject to the UNCLOS treaty. This would give way to a diminished role for Iran in the Caspian, along with the realistic threat of bringing foreign military vessels into the Caspian and up to Iran's borders.

### Azerbaijan

Heavily dependent on the oil sector, the State Oil Company of the Azerbaijan Republic (SOCAR) was created to benefit from the abundance of hydrocarbon resources in the Caspian. Subsequently, foreign SOCAR partnerships have attracted considerable foreign direct investment into the region (INOGATE Oil and Gas Directory, 2003-2004). By 2010, after signing the so-called 'Contract of the Century' with thirteen leading world oil companies in 1994, an amount of eight billion dollars had already been invested in exploration and development operations in the sectors of the Caspian that, according to the UNCLOS provisions, belong to Azerbaijan. An additional one hundred billion is expected to be invested in the next twenty-five to thirty years (Zimnitskaya and von Geldern, 2010).

When it comes to the Caspian, Azerbaijan has been very vocal in defining the Caspian as a sea and, therefore, subject to international law. This stance can be easily understood when we consider that Azerbaijan would benefit greatly from this ruling. Its continuous lobbying for this solution is not difficult to perceive, given that economic stability has been a way for Azerbaijan to deter its powerful neighbours, Russia and Iran, and to sustain sovereignty as well as retain alliances (Zimnitskaya and von Geldern, 2010).

Concerning foreign policy, Azerbaijan's goal has been to maintain a balance between Russia and the west. However, most worrisome are the unresolved conflicts with Armenia over the status of Nagorno-Karabakh province and the fragile relationships, mostly due to pipeline disputes, with Turkmenistan (Dakmejian and Simonian, 2003).

### Kazakhstan

Holding the greatest share of Caspian oil in its national sector, Kazakhstan's foreign policy is heavily influenced by its dependence on Russia as a primary energy transit

route. Additionally, the growing inflow of foreign direct investment from China signals the rising importance of co-operation with the east (*Economist*, 2007).

Due to the vast energy resources in its possession, Kazakhstan's decision regarding its energy export routes is crucial for the stability of the current power game in the Caspian. The country has three options for exporting its energy reserves. The first is expanding the existing route through Russia to the Black Sea coast (EIA, 2003). The second is transporting additional oil into the western Baku-Tbilisi-Ceyhan (BTC) pipeline through the Aktau-Baku sub-sea pipeline (Marketos, 2009). The third option is to raise the importance of energy flow to the east through the Kazakhstan-China pipeline (EIA, 2003).

### Turkmenistan

Recent developments have marked a new era with respect to Turkmenistan's position in the energy game. With newly-inaugurated Chinese and Iranian pipelines and pledges to supply the Nabucco pipeline, the country has not only diversified its supply routes but has also offered central Asian countries the opportunity to lessen their dependence on Russia as a major energy supplier (BBC, 2010). Turkmenistan was also the first country in the Caucasus region to secure an energy contract which completely bypassed Russia. This was done through the Korpezhe-Kurt Kui pipeline, supplying Turkmen gas to Iranian markets.

In the aftermath of the Korpezhe-Kurt Kui project, Turkmenistan became extremely ambitious in terms of constructing new energy routes, such as the proposed east-west pipeline, the Trans-Caspian pipeline, and the Turkmenistan-Afghanistan-Pakistan-India (TAPI) pipeline (EIA, 2012).

### *The Outer Circle and other external actors*

Other players from the international community have been able to enter the Caspian game rather successfully following the collapse of the Soviet Union. The three former Soviet republics were in desperate need of technology and capital to exploit the hidden Caspian resources; outside involvement was therefore seen as crucial for developing drilling and exporting capabilities and also distancing Azerbaijan, Turkmenistan and Kazakhstan from Russia. The landlocked nature of the Caspian Basin means that it is dependent upon pipelines and shipping through neighbouring states to reach consumer markets. The upgrading of old Soviet pipelines and constructing others became pivotal for the economic stability of the region, and it also gave way to major strategic planning in terms of the routes of these new pipelines. The three post-Soviet Caspian littoral states were not very powerful in regional, let alone global, terms. Newly independent, with weak militaries, barely functioning economies, and great prospects for domestic and external conflict, they were easy targets for other interested parties looking to exploit these circumstances (Kubicek, 2013).

In regard to the transshipment of hydrocarbons to the international market, the importance of the interests of, and the state of the political environment in, countries such as Georgia, Armenia, Turkey, Uzbekistan, Afghanistan, India and Pakistan, commonly referred to as the Outer Circle, needs to be remembered.

At the beginning of the energy hype around the Caspian, Turkey felt that it could exploit its culture. This makes sense considering that Azeris, Turkmen, Kazakhs and Uzbeks are all Turkic peoples, while Turkey's status as a modern, successful state could be utilised to gain major influence in the region. Unfortunately, this perception has been far too optimistic; Turkish construction firms seem to do well in securing business in the region, but Caspian states seem to prefer Russian, American or European investors when it comes to investment and major energy projects. One important aspect for Turks is the BTC pipeline connecting Turkey to the Caspian region but, nevertheless, most of the country's energy needs are still met through pipelines coming from Russia, most notably Blue Stream (Kubicek, 2013).

However, as it always is with unpredictable strategic gaming in the Caspian, with the suspension of the Nabucco (Nabucco-West) and, recently, the South Stream Project, it has become evident that Turkey could play a much more crucial role in the future of pipeline diplomacy. For now, both the EU and Russia are entertaining themselves with the dream of a gas route through Turkey: the EU *sans* Russia, with a starting point in Azerbaijan; and Russia with a stream of gas flowing from the Russian fields, through Greece and Turkey. We have yet to witness which Southern Corridor strategy will be implemented. What is clear, though, is that Turkey has gained greatly in its starting position because of the zero-sum gaming process taking place between Russia and the EU, so its expectations of being an important (pivotal) transit country may well become a reality in the near future.

Also very important to competition in the Caspian are India and Pakistan's growing energy needs. They have both backed the proposed TAPI pipeline, although the prospects for this seem dim both at the moment and for the foreseeable future. Other than that, India has a vivacious co-operation with Iran in the field of gas supply; it has gained rights to develop two Iranian gas fields and is in the midst of discussing a pipeline route from Iran that would traverse Pakistan (Kubicek, 2013). Iran undoubtedly represents a critical area of interest for India regarding its energy security, since it provides the country with shorter supply routes without major choke-points in between. The invigorated India-Iran strategic partnership from 2003, subsequently diminished due to US meddling, would also be beneficial not just for India's energy and Iran's economic security but also for the strategic balance and security enhancement of the whole region. Both India and Iran are similarly concerned when it comes to issues like Afghanistan, Pakistan and, recently, ISIS (Kapila, 2014).

Additionally, with regard to global actors such as the United States, the European Union, China and Japan, interest in the Caspian region can be delimited not only with reference to the promotion of general political stability and access to Caspian oil and gas resources, but to an extension of the view that the Caspian states are a new potential market for western products and foreign direct investment.

The United States has managed gradually to insert itself into the region. Its initial involvement predominantly included investments made by major American corporations that gained substantial percentage shares of large-scale projects, mainly in Azerbaijan and Kazakhstan. Empowered by this, however, the US slowly became more ambitious. In accordance with its struggle to keep the vision of a unipolar world alive and relevant, they introduced a new important strategic goal for the Caspian: drawing

pipeline routes that would completely bypass Russia and therefore diminish its influence in the region. Nevertheless:

*Events have not transpired as those in Washington hoped or those in Moscow feared. (Kubicek, 2013)*

Russia's strategic influence has not dissipated and, besides Azerbaijan, the US has no other major ally among the Caspian littoral states. When it comes to strategic alliances in the countries surrounding the Caspian riparian states, it is the reverse that is true.

China has moved from a somewhat silent presence immediately following the collapse of the Soviet Union to a more active involvement in recent years. Much like in Africa or the middle east, this involvement is predominantly powered by the vast energy needs of the country. Also similar to Africa and the middle east, China has high prospects for success because it seems to be a less threatening partner than Russia or the US, not to mention the absence of historically-denoted relations.

It first managed to enter the region through the Shanghai Co-operation Organisation, which has stretched from having predominantly security-oriented goals to being an energy-concerned forum, thus effectively introducing China into the energy politics of the region. Central Asia and the Caspian Basin are also part of China's policy of the New Silk Road, stretching from China all the way to Rotterdam, in the Netherlands. The concept of a New Silk Road is, much like the ancient one, envisioned to be an economic belt, an area of economic co-operation and a vision of China for an inter-dependent economic and political community extending from the shores of the Pacific to the murky waters of western Europe (Tiezzi, 2014). At the moment, though, China is mostly present in the Kazakhstani oil sector and the Turkmeni gas sector.

Additionally, we must take into account here the collision of Chinese energy security needs and the Iranian search for new energy partners following the harshening of western sanctions due to Iran's nuclear programme. Both China and Iran have gained greatly with this enhanced co-operation: China with securing more energy supply deals; and Iran in preserving its state of economic development and stability.

### Status-related disputes

Innumerable rounds of negotiations have been held in order to determine the legal framework applicable to the Caspian Sea. Affecting both the development and ownership rights for gas deposits, the implications reach topics such as environmental protection, navigation of the waters and fishing rights.

### *Historical developments prior to 1991*

1991 not only represents a key date in world history, but also left a deep imprint on the Caspian Basin. After all, the number of riparian states increased from two to five virtually overnight following the disappearance of the Soviet Union.

The first sources addressing the legal status of the Caspian Sea date back to the 18<sup>th</sup> and 19<sup>th</sup> centuries when the first treaties between Russia and Persia were concluded, *de facto* establishing the beginning of Russian geopolitical supremacy in the Caspian

region (Raczka, 2000). With the creation of the Soviet Union, a new legal framework, the Treaty of Friendship, was negotiated in 1921 which declared all previous agreements void (Mehdiyoun, 2000). Following the 1935 Treaties of Establishment, Commerce and Navigation, the 1940 Treaty of Commerce and Navigation, and the 1957 Treaty on Border Regimes and subsequent Aerial Agreement, the initial obligations of the 1921 treaty were further reiterated, establishing consensus over matters previously not covered.

However, with the collapse of the Soviet Union, the legal validity of the existing legal framework prior to 1991 was seriously challenged and, to a great extent, regarded as obsolete since it no longer reflected the realities within the region. The Caspian Basin has become a unique multinational mixture of economic, political, energy and environmental concerns; and where the attempts at division in any way have, for now, proven not to establish a proper balance between the aerial and the utility claims of the parties in conflict (Oleson, 2013). However, following the exploitation of the resources hidden in the Caspian becoming a reality in the 2000s, the states have chosen to distance themselves from the international regime and seek other solutions under which they can divide their respective energy reserves. However, the lack of utilisation of international law inevitably means more manoeuvring space for self-interested power play (Zimnitskaya and von Geldern, 2010).

#### *Present alternative legal options and their implications*

Following the increase in the number of Caspian littoral states, calls for alternative legal options were made, most importantly either to determine the legal status of the Caspian Sea or insisting on the condominium approach.

Classifying the Caspian as a sea would bring forth the application of the 1982 UNCLOS. Following this action, the Caspian Sea would be divided into respective corridors, determining the applicable rights and obligations both for the littoral states and third parties (Janis, 2003). In line with UNCLOS, this would, in principle, divide the Caspian into three parts: firstly, there are the territorial waters, stretching twelve nautical miles from the shore; secondly, there are the 200 to 350 nautical miles of continental shelf, depending on the configuration of the continental margin; and thirdly, there are the exclusive economic zones (EEZs), extending from the edge of the territorial sea waters up to no more than 200 nautical miles into the open sea. Within this area, the coastal state has exclusive exploitation rights over all natural resources. Territorial waters grant full state sovereignty, while the EEZs grant sovereign rights to exploit resources to a certain state but do not grant sovereignty over the waters of the EEZ.

Such a division, considering that the Caspian width does not extend beyond 435 km (270 nm), would mean that different state economic zones and continental shelves would overlap, giving way to interstate bargaining. According to UNCLOS, the:

*Delimitation of the continental shelf... shall be effected by an agreement on the basis of international law... in order to achieve an equitable solution. (Aras and Croissant, 1999)*

In this process, the most powerful states in the area would have the upper hand in the bargaining. Considering that UNCLOS has been accepted and ratified, only Russia faces the complexity of having to define the status of the Don-Volga river system and the incompleteness that the UNCLOS solution offers for the Caspian.

Alternatively, the classification of the Caspian as a lake is complicated both by the absence of international convention on the issue and the lack of international practice, even if covered by customary law. The most common practice on the matter is the division of the water plateau into equal portions inside which states exercise full sovereignty. In the sovereignty sense, drawing a border on an inner water surface is similar to drawing land borders.

In comparison to the solution under the provisions of UNCLOS, the division of national sectors under this principle would grant states a greater degree of control (Dekmeijan and Simonian, 2003) and leave no room for political bargaining. This also leaves the door closed to the international community, foreign trade, a military presence and large petroleum companies.

The final option, condominium status – conjoint ownership over a territory – is usually seen as temporary in nature and used only as a last resort. This solution for the Caspian was initially urged by Russia and Iran, which was not sufficient to approve it as a final solution for the division of the Basin (Raczka, 2000). Azerbaijan, Turkmenistan and Kazakhstan have strongly advocated against this idea, given their relatively long Caspian coastal lines and heavy dependence on Caspian-produced energy.

Currently, the condominium option seems the least plausible of all the proposed solutions. Following Russia's change of heart regarding the condominium issue, due to its attempts to improve the relationship with Azerbaijan and Kazakhstan, Iran has been left without an ally. Keeping this in mind, Iran has strongly supported the lake solution because it still rewards Iran with a considerable portion of the Caspian (Oleson, 2013).

### *Present and future outlook*

In the new millennium, this already-mentioned important shift took place in the approach to the legal division of the Caspian Basin. The northern part of the seabed was *de facto* divided between Russia, Azerbaijan and Kazakhstan in 2003; however, it is unclear whether Iran and Turkmenistan will compromise on the issue. Considering the frequent border disputes between Azerbaijan and Iran in the recent past, and the absence of a *de jure* division of the Basin, the situation needs unanimous settlement in order to avoid future conflicts and to attract foreign investment.

The most publicised trans-Caspian initiatives – the twenty-third meeting of the Special Working Group on the Caspian Sea in 2008 and the Caspian Five Summit in 2010, both held in Baku – have, in contrast to expectations, failed to deliver a feasible solution. An agreement regarding security issues was signed in November 2010; however, the issue of the legal status of the Caspian was once again postponed. The 2010 Baku summit reflected the *status quo* and focused on pipeline developments in Nabucco, trans-Caspian initiatives and future revenue possibilities. The result is that the five states left the territory and resource issues unresolved (Pannier, 2010).

However, despite these failures, an agreement was reached between all five littoral states at the end of September 2014. Iran and Russia successfully lobbied to reach a unanimous agreement on the inadmissibility of a foreign military presence in the Caspian, thereby ruling out any possible future deployment of North Atlantic Treaty Organization (NATO) forces (Dettoni, 2014). This signals the aspiration of all parties involved to find common ground on the delimitation matter. An agreement on this has yet to be reached, but it seems evident now that no NATO flag will be flying above Caspian waters, which is an important geostrategic victory for Russia and Iran.

The decision comes at a fragile time for both countries in question: the civil war in Ukraine has severely damaged Russia's relations with the west; and Iran is still in the midst of very harsh sanctions due to its nuclear programme.

## EU-Caspian relations and energy security

### *Energy reserves and transportation*

Caspian energy reserves, concentrated primarily in Azerbaijan, Kazakhstan and Turkmenistan, can have a disruptive effect on the global energy market. Tables 1 and 2 show that, in 2012, the Caspian share constituted 3.4 per cent of global oil production and 20 per cent of total world gas production. However, with the increase in Azeri and Kazakh oil production and in Azeri gas production, these two will increase their importance in export markets (BP Statistical Review of World Energy, 2013).

**Table 1 – Proven Caspian oil reserves (billion barrels)**

State	At end-1999	At end-2012
Azerbaijan	1.2	8.5
Turkmenistan	0.5	1.9
Kazakhstan	25.0	31.2
Total	26.7	41.6
Total world	1085.6	1650.1
% of world reserves	2.45	2.52

Source: EIA, 2013.

**Table 2 – Proven Caspian natural gas reserves (trillion cubic metres)**

State	At end-1999	At end-2012
Azerbaijan	1.23	1.31
Turkmenistan	2.59	10
Kazakhstan	1.78	1.95
Total	5.6	13.26
Total world	148.55	201.079
% of world reserves	3.77%	6.59%

Source: OPEC, 2012.

Due to the landlocked nature of the Caspian Basin, these three states are dependent on at least one adjacent country in order to export oil and gas.

Traditionally, the infrastructure has been dominated by Russian state-owned pipeline monopolists; however, this contradicts the needs of these states, which are seeking energy independence to implement their energy deals (Goldwin and Kalicki, 2005). There are, however, important pipelines that are not controlled by Russia, most notably the Baku-Tbilisi-Ceyhan (BTC) oil pipeline and its parallel gas counterpart, the South Caucasus Pipeline (SCP), also known as Baku-Tbilisi-Erzurum (BTE).

Upon its opening, the BTC pipeline was regarded as the largest exporting pipeline in the world, spanning over 1 040 miles of terrain. The construction of the pipeline is regarded as unique in connecting the Caspian to the Mediterranean. It is of the utmost importance to remember that Europe gained access to the very heart of central Eurasia upon the completion of the BTC. This strategic economic co-operation also explains why a partnership with NATO and the EU is one of the highest priorities for these republics (Zimmitskaya and von Geldern, 2010). The westwards extension of the SCP to central Europe and the construction of a trans-Caspian oil or gas pipeline are of great interest to the west, especially the EU, in transporting Kazakh and Turkmen reserves via the BTC and the SCP.

Additionally, due to heavy reliance on the oil and gas sectors in the respective economies of the five Caspian states, prudent administration is of utmost importance. For example, stabilisation oil funds have been set up in Kazakhstan and Azerbaijan to help save profits for the proper use of the gained income. However, due to corruption, these funds have failed to achieve their goals (Crandall, 2006).

One must also bear in mind that these large construction projects often lack proper regulations and oversight. There are two ways for managing such regulations: inter-governmental agreements (IGA) between the countries directly involved; or a series of host government agreements (HGA) between the states in question and corporate-led consortia. Such agreements were originally designed to reduce the risks of investing in unstable regions and avoid the inefficiencies associated with local government corruption. Both solutions have been liable to criticism: IGAs due to the above-mentioned lack of prudent administration and corrupt governments; and HGAs because of their

tendency to take precedence over domestic legislation. HGAs are part of international investment agreements under international law and usually of an extremely volatile nature; it is standard procedure to include a clause stating that the standards agreed upon are not static but evolve over time (Amnesty International, 2003). This essentially allows oil interests to overcome standard legislative regimes on oil and gas exploitation and environmental protection issues. Additionally, host governments are not allowed to challenge the decisions made in the name of ‘evolving conditions’ due to the possible damaging ‘effects on the economic equilibrium’ of the project, therefore representing a clear danger to national sovereignty (Zimnitskaya and von Geldern, 2010).

With the intention of meeting its energy policy priorities, the EU has identified co-operation with the Caspian region as one of top goals. The general legal framework governing the political, legal and trade relationships with the Caspian states – with the exception of Iran – is the Partnership and Co-operation Agreement. With the aim of building a stronger presence in the region, the EU has initiated several collaboration platforms: the Transport Corridor Europe-Caucasus Asia in 1993; the Interstate Oil and Gas Transport to Europe (INOGATE) in 1995; the Energy Charter Treaty in 1997; and the Baku Initiative in 2004 (European Commission, 2006).

In regard to energy security, the risks of an over-dependence on Russia as a primary source of both oil and natural gas supply became especially apparent after a series of disruptions of gas deliveries to Ukraine, Belarus and the Baltic States (US Library of Congress, 2006). Moreover, significant stakes in several European energy companies have been acquired by Gazprom, so the EU’s goal of diversifying among suppliers could have been anticipated (Baran, 2007). In the EU action plan entitled *Energy Policy for Europe*, functioning markets, a diversification of sources, the geographical origin of sources and transit routes were outlined (European Commission, 2006).

In addition to the EU, the presence of other global players, such as Japan, China, the US and Turkey, also have to be taken into account. Japan’s position in the region can be seen more as a provider of development aid, but the presence of US and China signal a growing need for energy to satisfy their increasing demand.

### Case study: Nabucco pipeline

Nabucco was a natural gas pipeline project designed to connect the Caspian resources with the European market and has enjoyed full support from the EU as a means of diversify its energy supply. Stretching from Turkey to Hungary, while crossing Romania and Bulgaria, the plan initially envisioned the transportation of natural gas from Azerbaijan as well as Turkmenistan, Iran, Iraq and Egypt. Given the thirty-one billion cubic meter (bcm) maximum capacity of Nabucco, the project could potentially contribute 4.4 per cent of the total required amount of gas supply.

In the first phase of the project, Azerbaijan agreed to feed the pipeline with eight bcm of gas. The second phase planned to introduce gas from other central Asian countries, while the third phase would see the gain of steady flows of gas from Iran, Iraq and possibly Egypt (Baker and Rowley, 2009). This pipeline posed a serious strategic rivalry to Russia’s proposed South Stream Pipeline, because the two pipelines targeted the same markets and followed extremely similar routes. Three out of the five countries

envisioned to lie along the course of the Nabucco pipeline are also part of the South Stream proposal, all of which are clearly recognisable from Figure 2.

Figure 2: Planned courses of Nabucco and South Stream gas pipelines



Source: BBC, 2008.

The financing of the two projects also merits examination. The Nabucco pipeline was designed to be privately financed and, therefore, had to demonstrate its commercial value. The Russian firm, Gazprom, will never have a problem with financing in accordance with Moscow's strategic goals (Marketos, 2009). Additionally, both projects had been facing criticism for several reasons: Russia accused the Nabucco deal of being politically motivated and even alleged that the company had artificially inflated the commercial value of the project. Furthering Russia's claims, Nabucco was given official exemption from EU competition rules in 2008 (*Downstream Today*, 2011).

Aware of the EU deal, Russia began the development of the South Stream and North Stream projects, both designed to deliver gas to European markets. South Stream's initial output was projected to reach the markets in 2015 (South Stream Project, 2014). But pipeline diplomacy proved unpredictable and political bargaining halted the project, before it was pronounced dead in late 2014. The pragmatic reasons for this decision were the continuous obstructions posed by the Bulgarian government (which many believe were orchestrated and supported from Brussels). Henceforth, Russia declared its withdrawal from South Stream and immediately started focusing on Chinese markets and securing new deals with Turkey (Micalache, 2015).

Initially planned for construction in 2009, Nabucco also faced challenges both on the investment and supply side. Even though the \$7.9bn project had secured promises of \$5bn in loans from the World Bank in 2010, the European Investment Bank, the European Bank for Reconstruction and Development, RWE of Germany and OMV of Austria had already in 2009 announced their decision to postpone their investment. Furthermore, the Azeri contribution was supposed to account for approximately one-third of the pipeline's capacity, but the financing ultimately proved elusive. In order

for the pipeline to be fully viable, Nabucco was in need of additional suppliers from among the region's suppliers (*The Economist*, 2010).

However, the Nabucco pipeline received a damaging blow in 2012 when the proposed pipeline route was reduced by two-thirds, from the original 3900 miles to 1300 miles due to the substantial, and previously uncalculated, financial costs and shifting governmental support in the host countries (Natural Gas Europe, 2012). This meant that the eastern section of the pipeline was terminated, making way for the Turkey/Azerbaijani-financed Trans-Anatolian pipeline (TANAP). The remaining part was, afterwards, known as Nabucco-West. However, even this reduction could not save the project from receiving a lethal blow in June 2013, when the Azeri Shah Deniz Consortium chose the competing Trans-Adriatic Pipeline (TAP) instead (Del Sole, 2013). After the decision was made public, the chief executive of the Austrian energy company, OMV, told the media that the Nabucco pipeline was over for them, effectively ending the dream of many high-level politicians in the EU energy sector. A decade of planning had abruptly finished, with very slim chance of ever starting up again.

This course of events, and the final decision, indicate a unique set of processes taking place in the Caspian energy field. It is very hard to argue that the decision to choose TAP was not strategic and geo-political. The behind-the-scenes events taking place were largely connected to the beneficiaries of the project, as well as the strategic rapprochement between Russia and Azerbaijan.

We have to be clear that the decision to terminate Nabucco was taken in Baku, and the reasons are numerous. Firstly, the Nabucco pipeline was a joint EU venture, while Azerbaijan and Turkey had supported TAP and the important midway junction, TANAP. Secondly, the route is 500 kilometres shorter than Nabucco-West and therefore more economic. Thirdly, the TAP infrastructure primarily travels through Greece, eliminating the risk of interruptions in the supply chain realistically to one country. The result of EU austerity measures in Greece has been that the country has been forced to privatise the state-owned energy company, DEPA, and the state gas provider, DESFA, which was bought by Azerbaijani-owned SOCAR. The strategic implications of the decision behind the TAP project are now clearer than ever. Fourthly, Azerbaijan did not want to sour its relationship with Russia. Fifthly, Azerbaijan and Turkey had the goal of enhancing their role as pivotal energy suppliers for European markets (Weiss, 2013).

## Conclusion

The Caspian Basin re-emerged as a source of global attention when a new race started for access to its resources (Kleveman, 2003). This is referred to as the New Great Game by many academics, indicating the historical analogies between contemporary rivalries and the ones between imperial Russia and Britain in the 19<sup>th</sup> century (Mandelbaum, 1998). Along with the increased competition, the position of the Caspian littoral states – Kazakhstan, Azerbaijan and Turkmenistan – has dramatically shifted. Possessing influential power over their respective reserves, the three states also have to compromise with various external parties on access to energy transit routes, know-how and capital.

With regard to regional disputes, there are numerous implications. Firstly, the numerous ethnic and territorial disputes have an adverse impact on both energy supply potential and the business environment in general. Recently rated as a dangerous conflict area, the situation in the northern Caucasus region might unfold with devastating regional consequences (International Crisis Group, 2014). Moreover, the disputes over the legal status of the Basin endanger the stability of the area. Therefore, the *sui generis* legal status is the only viable approach available and needs to be capitalised on.

Finally, as identified earlier, the Caspian Basin has emerged as a key area of European interest, with a clear focus on energy supply potential. However, the EU approach could be viewed as too fragmented. Often unable to speak with a common voice on energy-related issues, the EU lags behind Russia in terms of increased co-operation initiatives. Even in the context of the effort of trying to diversify its energy supply by avoiding Russia and gaining access to the heart of the Caspian, the EU failed due to its over-inflated view of its influence in the region.

Compounding this problem further is the Caspian littoral states simultaneously striving for their own economic power and independence. They might not want to stumble from one strategic umbrella to another, but instead make a solid grounding for their own voice in the future of Caspian energy matters. When fighting for energy security, the EU will have to anticipate other emerging players in the New Great Game and remember that tapping into other energy reserves now, in contrast to the past, comes at a price.

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