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*UNLOCKING THE ASSETS: ENERGY AND THE FUTURE OF CENTRAL  
ASIA AND THE CAUCASUS*

PETROLEUM AMBASSADORS OF RUSSIA:  
STATE VERSUS CORPORATE POLICY IN THE CASPIAN REGION

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## Introduction

The collapse of the Soviet Union has opened up a vast and exciting new oil play stretching from the Caucasus to the deserts of Central Asia. Still relatively unexplored, the Caspian region may hold oil reserves as large as 140 billion barrels of oil. By the year 2015, production is forecast to reach between 2-million and 4-million barrels a day of which, at least 75% will be available for export. Almost every large oil company and many smaller ones want to participate in the development of the Caspian, which will act as an important counterbalance to Middle East dominance of world markets in the next century and could fundamentally alter traditional patterns of international oil and gas trade. Newcomers to the region will have to compete with Russian entities that, to a certain extent, regard the area as both economically and politically theirs by right. Inevitably, competition for Caspian oil resources will be played out as part of a broader struggle for control and influence over the post-Soviet space, regardless of the degree of commercial orientation of Russian and international oil and gas corporations exploring in the region. That struggle is likely to break down traditional international alliances as well as cement others.

This paper sets out to examine the changing role of Russia in the Caspian Sea, the Caucasus and Central Asia and attempts to explore the likely behavior of Russian companies acting either as agents of state policy or as purely commercial entities driven by their own thirst for profits. What seems more likely however, are actions motivated by some uneasy mix of the two. The region under study will be referred to throughout simply as the Caspian. It includes the Caucasus, especially Azerbaijan, which aspires to join the ranks of the world's major oil producers and Georgia, where hopes of building an Eurasian corridor for the transport of Caspian petroleum to world markets looks increasingly likely to materialize. In Central Asia, the paper covers resource-rich Kazakhstan, a republic the size of Australia stretching from the northeast shore of the Caspian Sea to the Chinese border and gas-rich Turkmenistan whose southern frontier skirts Iran.

## Background

Since 1991, when the Soviet Union fell apart, Russia has been adjusting economically and psychologically to the loss of an empire and to a changed relationship in a zone of influence that stretched far beyond the boundaries of the former USSR. Russia's empire tumbled down under the weight of an obsolete and abused system of central planning. In place of the old order, Moscow has begun building a market economy in which control over the country's main industries has steadily being devolved to a series of privately-owned and intensely competitive financial and industrial groups. In any economy, government and big business are intertwined, particularly when it comes to the management of strategic resources such as oil and gas. But in the case of Russia, the two are so close as to be at times indistinguishable.

The contours of power-sharing between political and commercial entities has blurred enough over the past three years to tempt analysts to believe that the handful of giant corporations and financial groups that now dominate the Russian economy are more powerful than a divided government that has had to answer to an antagonistic parliament. This spring, Russia was left without a government as President Boris Yeltsin suddenly sent the administration (led by Prime Minister Viktor Chernomyrdin), into retirement. As Yeltsin and the power-makers of Russia mulled over possible candidates to occupy the new Cabinet, the country's corporations were caught up in a frenzy of alliance making, forming even larger holdings, or looser partnerships that may or may not withstand the economic turbulence of the next few months as Russia absorbs the shock of low oil prices.

At this writing, a new government had yet to be formed. The process of selecting a new government is being influenced by a critical debate regarding how the new government, once selected, will rule. At issue is the appropriate level of state control in industry and in the economy as a whole. If the matter fails to settle quickly, the political/corporate alliances will be in limbo.

So far, only two Russian oil and gas companies-LUKoil and Gazprom-have any significant involvement in the Caspian. If they have not actually helped fashion Moscow's Caspian policy,

they have benefited enormously from government efforts to shore up influence in an area which, for two centuries, has been regarded as the Russian backyard. Gazprom likes to advertise itself as the guardian of Russian interests while LUKoil prefers to be identified as more of a huge, Western style oil corporation driven by commercial rather than political goals. Despite their different public images, both companies have much in common. In particular, they share an obsessive hunger for power, and pursue aggressively imperialist business strategies, expanding untiringly into new oil and gas provinces and bagging markets to the exclusion of all competitors. As Russia's claim to great power status has weakened during the 1990's, corporations like LUKoil and Gazprom have gained strength, natural resources, capital, and most importantly, international recognition. In some sense, they have inherited the mantle of Russian might.

It is natural for any withdrawing imperial power to try and maximize local contacts and influence to secure business opportunities in the territory from which it is departing. But Russian LUKoil and Gazprom perceive themselves as more than just well-placed asset grabbers in the Caspian. Both have a vigorous sense of national pride and entitlement to Caspian resources that underpins their commercial pursuits. So far, they have been mainly concerned with building empires and blocking the rise of rivals -a business that usually has dovetailed comfortably with Moscow's policy of shoring up control in the newly independent republics. But conflict between commercial goals and political ends will likely expand once Caspian oil projects grow, and the region begins to make a significant contribution to the Russian oil companies' corporate cash flows.

During the Soviet era, Caspian oil was a low priority mainly because there was plenty of more accessible petroleum to be tapped in Russian regions like the Volga-Urals and West Siberia. Soviet industrial planners tended to put Russian projects first, and the republics remained somewhat economically backward. When foreign companies began arriving in the Caspian, bringing the promise of unprecedented wealth to the region, Moscow was forced to start designing a new strategy for the region.

Western analysts believe that what first appeared to them as a muddled, incoherent and essentially defensive policy in the early 1990's has now given way to a more flexible approach.

Russia accepts, however reluctantly, that it will find its place alongside other foreign entities as just one more investor jostling for space and influence in the Caspian. This is not just wishful thinking. Russian academics \* have noted a softening in Moscow's Caspian policy recently which, most importantly, they attribute to the influence of Russian oil companies, particularly Lukoil. However, some die-hard politicians remain opposed to foreign projects in the Caspian. Certainly, in the early 1990's, Moscow perceived that external powers, particularly the United States and Turkey, could endanger Russia's complex security interests in the Caspian and that the area should be closed to outsiders as much as possible. Oil and gas resources and pipelines were to serve as a tool, allowing Russia to gain and maintain strategic control over the area. But eventually, Russia's industry began to accept foreign participation in Caspian petroleum developments. This international presence had its advantages for Russia's firms including added capital, technology and operational and commercial expertise.

However, favorable attitudes toward foreign participation in the Caspian only extend so far. Russia accepts such participation on the condition that it does not lead to an overbearing Western political influence in the area. Russia wants exclusive political and military influence in the region and wants to exercise its dominance via control of the region's oil and gas industries and transport. If Russia is to favor any one partner in the region it will be Iran, which must be secured from Western influence. In this context, Russia's sale of nuclear equipment or armaments to Tehran serves a dual purpose, promoting trading links at the same time as demonizing Iran in the eyes of the United States. The boundaries of the historic "great game" have been pushed south in the twentieth century oil context to embrace both Iran and Iraq, which in many ways are an even more enticing petroleum prospect than the Caspian

Moscow has attempted to retain influence over Caspian oil developments via three main policies:

1. Maximizing the role for Russian companies in the area
2. Controlling transport out of the landlocked region
3. Using the uncertain legal status of the Caspian Sea to undermine confidence in or to prevent unilateral offshore oil developments by arguing that resource projects are unacceptable in the

area unless sanctioned by all five surrounding states including Russia, Azerbaijan, Kazakhstan, Iran and Turkmenistan.

So far, this policy has been implemented fairly successfully. LUKoil, looking suspiciously like an ambassador for Moscow, has made impressive advances in the Caspian that would not have been possible without political support. The spoiling game played by Russia during negotiations for the Caspian Pipeline Consortium's export line between Kazakhstan and the Black Sea, not to mention the sporadic warnings from Moscow's Ministry of Foreign Affairs that Caspian Sea projects are all illegal, have served as uncomfortable warnings to investors in the region that nothing can happen without Russia's blessing. However, in the long term the policy is not sustainable. LUKoil will eventually want to make a commercial success out of its Caspian properties and for that, it will need both pipelines and a concrete resolution of the dispute over Caspian resource ownership. It looks as if the boundary question is going to be solved soon, thanks partly to other former Soviet Caspian states that are now more vociferously challenging Russian actions that effectively block their economic development.

## **Will LUKoil Remain Compliant?**

Certainly LUKoil's extremely aggressive upstream strategy in the Caspian in recent years would have been difficult to implement without, at the very least, tacit backing from Moscow. Nonetheless, LUKoil's President Vagit Alekperov repeatedly asserts that the company's policies in the Caspian are driven by commercial, not political ends. Commercially, what LUKoil needs most is a source of low cost production and access to a more solvent customer base than currently exists in Russia. Soon after its formation, LUKoil decided it must internationalize, and quite naturally headed for countries within Russia's traditional zone of interest. Signature of the West Qurna contract in Iraq is by far the best foreign project LUKoil has lined up so far in terms of production potential. At peak levels, West Qurna will produce 640,000-b/d, adding over 50% to LUKoil's existing 1.2-m b/d output. But before this happens, UN sanctions need to be lifted.

LUKoil's second foreign priority has been the Caspian region where, somewhat optimistically, it hopes to source between 15% and 20% of its total oil production by the year 2000. There are

sound commercial reasons for de-emphasizing Russian spending in favor of the Caspian. According to Renaissance Capital Group Research,\*\* the typical new well in West Siberia costs \$1-million to drill and yields 150-b/d of oil. By contrast, a well in the Caspian region costs \$200,000 to put into operation and will likely produce between 1,500-b/d and 5,000-b/d. LUKoil's long- term strategy plots a return to West Siberia once Caspian and Iraqi projects have generated sufficient free cash flow to allow for investment in advanced and more expensive technology. It is important to note that Lukoil is not giving up on Russia. About half of the \$7-billion the company plans in capital investment before 2000 will be devoted to projects in Azerbaijan, Kazakhstan and Turkmenistan. A significant amount of this capital will be provided by Atlantic Richfield, which has formed the LukArco joint venture with LUKoil.

Azerbaijan has so far been host to the bulk of LUKoil's Caspian operations . Politically this makes sense because LUKoil is providing a Russian counterweight to the numerous foreign companies involved in one area. Azerbaijan can also provide LUKoil, whose President Vagit Alekperov is himself half Azeri, with a bolt hole if relations with Moscow sour. So far, LUKoil's total investment in Azerbaijan amounts to \$145-million and is rising rapidly. Plans are to invest some \$90-million in 1998.

LUKoil's interests in Azerbaijan include:

- The AIOC consortium where it has a 10 % stake at the Azeri, and Chirag fields, and at deep water sections of Guneshli. This trio of deposits have combined oil reserves of 510 million tones or 3.7 billion barrels.
- The Karabakh prospect is where LUKoil holds a combined 35% stake in Caspian International Petroleum Company (CIPCO). Karabakh is located in waters bordering on AIOC 's acreage. CIPCO suffered a setback last fall when an initial well drilled on Karabakh proved dry. Plans to begin production by 2001 may now be postponed. Earlier, CIPCO envisaged installing three platforms at Karabakh, capable of producing a maximum of 7 mt/y (140,000-b/d) of oil.
- At Shakh Deniz, in the southeast Caspian, LUKoil has a 10% interest in a large foreign group led by BP. Estimated reserves are 230 million tones (1.7 billion barrels)of oil and 510 bcm of gas.

Independently of foreign companies, LUKoil has a 60% stake in Yalama field with state SOCAR holding the remaining 40%.

Onshore, Azerbaijan LUKoil is building a chain of gasoline stations. Four are already operational in Baku, and several more should be opened by the year's end. LUKoil processes gasoline for local outlets at the Aznefteyag refinery near Baku where between 4,000 tones and 5,000 tones a month (973 b/d - 1,216 b/d ) were processed there in 1997. Crude feedstock is for the time being purchased from state SOCAR.

LUKoil has also established a strong presence in Kazakhstan although on several occasions, its ambitions have been checked by the Kazakh government. LUKoil has already invested \$300-million in the republic and plans to boost spending to a total of \$740-million by the end of the century. LUKoil's LukAgip venture has a 5% stake in the 5.8-billion barrel Tengiz field. Tengiz will produce 170,000-b/d this year and will eventually peak at 820,000-b/d. Five percent in such a giant is not enough for LUKoil, and the company has made no secret of its desire to at least double its interest in one of the world's biggest oilfields. However, earlier negotiations for a slab of the Kazakh government's equity in the project ended in stalemate.

Elsewhere in Kazakhstan, LUKoil has a 50:50 joint venture with Hurricane Hydrocarbons of the US at the 343-million barrel Kumkol field in the central southern part of the republic. Kumkol's production is expected to climb to 52,000-b/d in 2000 from 12,000-b/d (600,000-tones) in 1996. LUKoil is also exploring on the Badenginskaya depression in Kyzl Ordinsk region and is awaiting government approval for a development contract at Alibek-Mola field in the Aktyubinsk area .

Off of Kazakhstan's shore, LUKoil is determined to win acreage in the Caspian Sea, but failed to break into the KazakhCaspiShelf consortium that recently concluded a production sharing contract for twelve blocks in the area.

Downstream, LUKoil failed to follow through with earlier plans to participate in the privatization of Kazakh refineries. LUKoil gasoline stations are popping up in Almaty and in the new capital



Akmola, which is still largely under construction, and where the company is making its mark with a new representative office and a hotel.

In Turkmenistan, LUKoil plans to participate in upcoming offshore tenders where it estimates reserves to exceed 250 million tones of oil.

Determined to emerge as the leading company throughout the Caspian Sea , in 1996, LUKoil persuaded Moscow to appoint it as coordinator of Russian projects in the area. Demonstrating its commitment to the offshore, LUKoil has imported a semi- submersible rig from the Persian Gulf to the Caspian for upgrading at the Krasniye Barrikadyshipyard near Astrakhan. The unit, suitable for operating in shallow waters down to 45- meters, will become operational this August. LUKoil is also developing its own river-going tanker fleet, which will be used to ship Caspian crude up the Volga to its own refineries at Volgograd and Perm.

Until recently, LUKoil had faced no Russian competitors in the Caspian Sea. However, Bank Menatep, which is consolidating a huge oil corporation around the core of its integrated YUKOS, plans to challenge LUKoil's dominance of the offshore. YUKOS made its debut in the Caspian Sea last December, competing against LUKoil in a tender for the 8,000-sq. km Severny block off the coast of Astrakhan province. According to YUKOS, LUKoil won unfairly, and it insists that it topped its rival's bid for the block where reserves are estimated to amount to some 4.2-billion barrels. Since then, YUKOS has merged with another integrated, Sibneft, to form YUKSI . With reserves exceeding 14 billion barrels, Yuksi is the world's largest privately owned company. In terms of production, it is outdone only by Exxon and Shell.

YUKSI intends to get even bigger. Yukos officials make no secret of the fact that one of the prime motives for the formation of YUKSI was to create a company with the financial and political clout to compete with Lukoil in the Caspian Sea. As a start, YUKSI will continue the battle for Severny. Another company gearing up to make its mark in the Caspian is the Central Fuel Company, a relatively new group owned by the government of Moscow. CFK started life in April of 1997 as an oil refiner based at processing facilities near the Russian capital. It has lately

burst into the upstream signings, including a series of alliances with producing regions including Kazakhstan, where it plans to play a role in offshore projects.

## **Offshore Boundaries**

Moscow's declaration earlier this year that it is prepared to abandon its somewhat contrary objections to unilateral resource development in the Caspian Sea significantly improves the investment climate for all oil companies. Since the early 1990's, the Ministry of Foreign Affairs (MID) has insisted that the Caspian Sea should be defined as a lake, and therefore managed jointly by surrounding states including Russia, Azerbaijan, Kazakhstan, Turkmenistan and Iran. MID used the "lake" definition to outlaw unilateral resource developments except in a narrow band of coastal water off each littoral state. However, Russian oil policy in the area is not being played out according to these rules. The Severny tender itself, closed to all bidders save LUKoil and YUKOS, was a blatant violation of MID's ruling.

Uncertainty over the status of the Caspian Sea has served LUKoil, as guardian of Russian interests, quite well. Foreign companies operating offshore of Azerbaijan have been willing to accept the company as a partner into their consortia partly because they believe the presence of a Russian shareholder will protect them if Moscow tries to enforce regulations banning unilateral resource developments. But Lukoil has not been able to breeze into any block it wanted. Last August, protesting vehemently, LUKoil was obliged to abandon a preliminary agreement it had signed with Azerbaijani state oil company SOCAR for the offshore Kapaz field after Turkmenistan complained that the deposit lay in its own territorial waters. And it looks as if there is more trouble ahead. Following complaints from Kazakhstan that part of the Severny block lay outside Russian waters, Lukoil has agreed that it may have to surrender part of the block. Here the sacrifice will be minimized if the Kazakh government approves a contract already negotiated by the Russian company for offshore acreage that is itself encompassed by Severny.

Just why Moscow has at this point agreed to allow the Caspian to be divided into sovereign sectors is not clear. It may be that quite simply, MID has watched AIOC bring early oil ashore

from its Azeri project, and realized that it is too late to block unilateral resource projects. Some analysts suggest that the realization that there are huge reserves in the Russian sector may have persuaded hardliners that there was some advantage to securing a part of the Caspian where there would be no obligation to share resources with outsiders. LUKoil is already well represented in the Caspian, and CFK claims to be close to signing up for its own block off of Azerbaijan. If YUKSI gets its way, it too will soon have offshore acreage. LUKoil's patience with the restrictions of the offshore boundary dispute was already wearing thin. And as commercial Russian rivals begin operating in the Caspian, it will certainly prove more and more difficult for Moscow to control the ambitions of corporate rivals.

## **Control of Pipelines**

Moscow's determination to control oil and gas transport out of the Caspian region has so far been advantageous to Russian oil companies, most of all LUKoil. Domestic firms producing oil in Russia don't want to share the country's limited export capacity with outsiders or facilitate competition for Urals blend in Mediterranean and North European markets. However, attitudes will change once output builds in the Caspian and LUKoil, or any other Russian producer in the region, come under commercial pressure to move equity crude to market quickly and efficiently, regardless of the political cost to Moscow.

Chevron's willingness to allow LUKoil to farm into its Tengizchevroil joint venture was in part driven by the perception that the presence of a Russian company would help unblock export routes out of Tengiz crude transport out of the field. LUKoil has helped Tengizchevroil establish multiple routings to market by pipeline and rail that have allowed the venture to double crude output. However, if Tengizchevroil is to be profitable in the long term, a dedicated export line out of Tengiz is needed.

After three years of often acrimonious negotiations over such a pipeline, a large group of foreign producers joined a consortium in 1996 in which Russia and Russian companies have a dominant share. Appearing once again as a facilitator, LUKoil secured a key role for itself in the Caspian Pipeline Consortium by planting one of its own executives, Vladimir Stanev, at the helm of the

new group. LUKoil is also helping manage the government's 24% stake in CPC alongside Rosneft and pipeline operator Transneft. However, even Russia's majority shareholding in CPC has not saved the group from a series of frustrating delays in obtaining approvals for the project both in Moscow and the regions.

Foreign participants frequently stress the sizable commercial benefits that will flow both to the Russian government and Russian companies involved in CPC. Over the 40-year lifespan of the project, it is estimated that Russian central and regional governments will pull in approximately \$23.3 billion worth of tax and revenues from pipeline users. The project will provide significant employment opportunities in depressed areas of Russia. By easing capacity constraints in the Russian export system, CPC will also provide an indirect investment stimulus to the domestic oil industry. However, it appears that financial incentives are not enough to outweigh political opposition to the project.

The tortuous history of the CPC has taught foreign oil producers in Kazakhstan that it is unwise to rely on a single route to market. However, Russian influence stretches beyond Russian territory. Investors considering construction of a line across the Caspian to a landfall in Azerbaijan have already collided with opposition from Moscow. Acting First Deputy Prime Minister Boris Nemtsov told at a recent meeting of the G8 that it was environmentally unsound to build a subsea Caspian line. It is not a coincidence that foreign plans to build oil pipelines east out of Kazakhstan to China have been accompanied by a thawing in Moscow's relations with Beijing.

In the Caucasus, Moscow has been given a dose of its own pipeline medicine from the independent-minded republic of Chechnya, which lies between Azerbaijan and Russia. For the first ten months of 1997, Chechnya refused to allow transport of Azerbaijani crude through its territory defying the terms of government-to-government deals signed by Moscow and Baku. Although oil from AIOC's Chirag field is now flowing through the system, political instability in Chechnya has shaken foreign confidence in the Russian route to market. Few international oil companies are enthusiastic about Moscow's plans to build a pipeline bypass to Chechnya that would run through the ethnically troubled region of Dagestan.

LUKoil's Vagit Alekperov has repeatedly stressed that the bulk of AIOC crude oil should be exported via the most economic route. And that, he says, means via Russia where pipelines are already in place. His view is shared by Boris Nemtsov, another energetic supporter of Russian routes to market. The first two cargoes of AIOC production delivered to Novorossiysk were traded by LUKoil. AIOC had postponed decision on the routing of a high capacity export line out of Azerbaijan and will make do with a combination of the existing Russian system and a new line across Georgia to the Black Sea scheduled for completion towards the end of this year. For Russia, it is crucially important to demonstrate that its pipelines can provide an uninterrupted route to world markets in the meantime.

If Russia is not selected as the route for transport of AIOC's so called "Late Oil", Moscow will likely insist that Russian investors play a key role in the construction and management of alternative systems. Pragmatically, Gazprom is already positioning to act as a guardian of Russian oil and gas transport interests both in the Caucasus and Central Asia.

## **Gazprom more statesman than ambassador**

It has always appeared that Gazprom's long term willingness to act as a protector of Russian political interests would be easier to secure than LUKoil's , not least because the company's ex-chairman, Viktor Chernomyrdin, served for most of the 1990's as Prime Minister. A company that early on dreamed up the slogan, "What is good for Gazprom is good for Russia" and whose Chairman appears on the nation's TV screens on national holidays to greet citizens obviously relishes the role of statehood as much as industrial might. After Chernomyrdin was dismissed by President Yeltsin in March, Gazprom quickly committed to engineer his political come back. The company will support Chernomyrdin's planned bid for the Presidency in the year 2000. Gazprom's commercial strategy in the Caspian has been heavily colored by politics. However, there are signs that Caspian states that earlier bowed to Gazprom's commands are beginning to find confidence to stand up to the company.

Except for a brief involvement at Kazakhstan's Karachaganak field, Gazprom has so far shown only detached interest in the Caspian upstream. Although the company appears less keen than

LUKoil to acquire properties, it likely believes that it has the clout to barge into projects when it chooses. When it comes to Caspian oil and gas transport, Gazprom's commercial and political goals dovetail neatly. Gas industries in landlocked Kazakhstan and Turkmenistan will have difficulty flourishing without access to Gazprom's pipeline network, so, to a significant extent the economies of these two republics are hostage to Russian favors.

For Gazprom, there is a distinct commercial advantage in being able to bar rival suppliers from premium European markets. Gazprom's method is to assign transit rights to Kazakhstan and Turkmenistan in exchange for hard cash and political cooperation. But when such republics begin negotiating alternative transport routes, Gazprom has shown an inclination to barge into projects or plan its own schemes with a view to controlling the flow of both oil and gas out of the Caspian regardless of routing.

It may be that Gazprom has slightly overplayed its hand. This is certainly true in Turkmenistan, which stopped exporting gas through Russia altogether in 1997 and refused the terms of a new transit accord proffered by Moscow in early 1998. Without the privilege of access to Gazprom's pipelines, there has been no incentive for Turkmenistan to comply with Russian policy on Caspian offshore boundaries.

Until recently, Turkmenistan agreed to tow Moscow's line on a variety of issues including Caspian offshore boundaries, in exchange for the usage of Gazprom's network. Political compliance was not rewarded with any particularly attractive commercial breaks. Turkmenistan was only permitted to supply markets in Ukraine and the Caucasus where buyers have a reputation for unpaid debts. Gazprom is not willing to allow competition in premium European markets and has repeatedly stressed that it will never be economically sound for Turkmenistan to transport gas over 5,000 km across Russia to Europe.

Turkmenistan began actively to rebel against Russian gas terms a year ago when it shut off supplies altogether to protest debts accumulated by Ukraine. Partners in the Turkmenrosgaz joint venture handling Turkmenistan's exports include Gazprom, state Turkmenneftegaz and ITERA, a US registered trading company, that handles a substantial proportion of Ukraine's gas imports.

President Saparmurat Niyazov visited Moscow last August and recommended to President Boris Yeltsin that Turkmenrosgaz should be reformed without ITERA. Vyakhirev did not disguise his dislike for being told what to do by a gas supplier. Turkmenrosgaz was not reformed, and until late December when a 4 bcm/ year pipeline linking Turkmenistan's southern fields with northern Iran was opened, the republic exported no gas.

It seems that Gazprom was slightly rattled when Turkmenistan finally broke its 100% dependence on Russian export routes. Although the line to Iran has limited capacity and will not earn revenue until Iran has recouped its investment in construction, Turkmenistan is determined to extend the system to Turkey, one of Gazprom's most prized expanding markets. In the new year, Vyakhirev accompanied Chernomyrdin on an official visit to Ashgabat. Caspian boundaries were on the agenda, so was a new gas transport contract. But the Russian visitors left Turkmenistan empty handed.

Gazprom wants to change the rules under which it transports Turkmen gas. Instead of allowing the republic to participate in trading, the company proposes to buy gas at the Russian border for a price that Turkmenistan does not find acceptable. Sooner or later, the two sides are likely to find a compromise. But the terms under which Gazprom allows Turkmenistan to use its pipelines are likely to be subject to frequent adjustment driven mainly by politics. Turkmenistan knows it must find an alternative route to market. But Gazprom has a habit of turning up on the doorstep each time progress is made in this direction. Gazprom muscled into the project sponsored by Delta/Unocal to build a gas trunk-line linking southern Turkmenistan with Pakistan via Afghanistan and then pulled out when foreign partners came to the conclusion that the scheme was for the time being at least not financeable.

Now it seems likely that Gazprom, which is already building a presence in southern Iran, will seek to influence the progress of Turkmenistan's pipeline to Turkey. Shell, Gazprom's new strategic partner, could facilitate this policy. The company was recently appointed by Turkmenistan to conduct a feasibility study of the Iran-Turkey system.

Gazprom also looks set to make its mark as a transporter of oil and gas in the Caucasus, although it has arrived somewhat late onto the scene. Georgia, traditionally a trading route, was the first to promote the idea of building the so-called Eurasian Transport Corridor through the Caucasus for Caspian oil and gas. The idea gained favor with foreign oil companies investing or planning to invest in Azerbaijan, and a pipeline linking Baku with the Georgian Black Sea should become operational this fall. Now Gazprom has turned up in the Caucasus with plans to build both oil and gas lines south from the Russian town of Tikhoretsk to Turkey. Gazprom has also shown interest in participating in a proposed scheme to build a line through Bulgaria to a port on the Greek coast for the export of Caspian oil. For Moscow, the obvious advantage of this scheme is that it would reduce Turkey's control over crude oil exports leaving Black Sea ports.

## **Summary**

Russia would like to maintain the political and economic dominance of the Caspian region it enjoyed during the Soviet era and even earlier in Tsarist times. This policy goal has been effected by maximizing Russian involvement in Caspian oil and gas projects and controlling export routes out of the landlocked region. An additional wild card in the Russian pack has been a dispute over the legal status of the Caspian Sea fostered by Moscow's Ministry of Foreign Affairs. This three-pronged strategy can only be effective if domestic oil and gas companies, active in the Caspian, are willing to act as agents of government policy.

So far, only two Russian companies, LUKoil and Gazprom, have had the political contacts, cash and organizational means to build any significant presence in the region. As Moscow's unofficial ambassadors in the Caspian they have enjoyed enormous commercial advantages both over domestic and foreign competitors. As they have not gone far beyond acquisition building in the area, they have not yet begun paying commercial price for their political privileges.

Both LUKoil and Gazprom like to present themselves as commercial organizations driven by the search for profits. Until Prime Minister Viktor Chernomyrdin was dismissed this March, Gazprom's willingness to act as an agent of government policy, or at least as an agent of those policies advocated by Chernomyrdin, was virtually guaranteed. But it has been more difficult to



rely on LUKoil's political loyalty as the company's Caspian projects have begun to make a contribution to corporate earnings. LUKoil's impatience with political restrictions is already evident even though profit is just entering the delicate balancing act between the company's commercial goals and the political mandates that come with privilege. If the company finds its virtual monopoly on Russian Caspian operations challenged by other domestic investors tension between LUKoil and the Kremlin will build.

Russian corporations enjoy enormous economic and political power and may therefore be able to force changes in Moscow's political policy in the Caspian. But however rapidly these companies are evolving, they are unlikely to abandon their instinctive desire to protect Russian interests altogether. Acknowledging the strong cards Russia holds in its Caspian pack, foreign oil companies are willing to form partnerships with Russian companies to facilitate oil development and transport projects. Cooperation of this sort could help promote understanding and compromises that will lead to huge commercial benefits for all investors. But for the time being, both sides are more concerned that they may just be taken for a ride.

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