



## CASPIAN ENERGY AND LEGAL DISPUTES: PROSPECTS FOR SETTLEMENT

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### Overview

In the past decade, the Caspian Sea has become one of the world's most promising new regions for petroleum investment and development, as well as the focus of intense international competition for access and pipeline routes. The problems of ethnic tension,

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instability, slow democratisation, and geopolitical contest in the region are of great concern to neighbouring countries, major external powers and investors. Border disputes and conflicting legal claims to offshore oilfields of the littoral nations of Azerbaijan, Iran, Kazakhstan, Russia, Turkmenistan are among serious risk factors for investors engaged in the development and export of hydrocarbons from the Caspian Sea.

Disputes over the legal status remain an omnipotent barrier for a resolution of the political and economic problems among the littoral states. The present situation, despite serious political and legal quarrels, is fortunately calm. However, the absence of conflict or visible confrontation does not mean that unexpected tensions are ruled out. On the contrary, there are causes for predictions and anxiety, which have to be detected and resolved. Whether to consider the legal status of the Caspian Sea as "closed" or "opened"<sup>2</sup> has direct implication towards the exploitation of the sea-bed or continental shelf zones under the principles of "common ownership" or "separate ownership".

This paper aims to provide an overview of the Caspian energy prospects and politics on the global scene with a particular emphasis on the legal disputes and their impact on business operations.

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<sup>2</sup> The Caspian Sea, the largest close water body in the world, divides Asia and Europe and links the Caucasus, Central Asia, Southwest Asia and Russia. It is stretched to 371,000 square km. and its depth is 1025 metres. It is about 1,200 km long from north to south and 320 km wide from west to east. There are around 50 islands in the lake with a total area of 350 square km. Due to fluctuations in the water level, which is over the past century has oscillated significantly, those figures are not constant.

It also elaborates on the investment environment, the geopolitical stakes and country positions for each key player as they relate to the legal arguments that are randomly advanced according to the perceived national interests. Turkey's position as a consumer, transit country and security provider for Caspian energy shipments in relation to other major players active in the region is also of special interest to the paper. The paper puts forth a series of ideas for reaching a settlement of the disputes in the Caspian region.

### **Caspian Energy Potential**

U.S. Energy Department estimates that the Caspian region's oil reserves comprise 200 billion barrels -- about 16 percent of the world reserves. Others refer to more modest figures. Measuring the Caspian wealth is not easy. One difficulty in reaching exact values of the oil reserves is the clashing comments and gossips over the issue. The uncertainty in measurements is not merely because of the geological obstacles, which makes measuring troublesome, but rather caused by the regional states' and the actors' benefits in it. The Caspian states have considerable interests in keeping estimates high in order to maintain their attractiveness to outside investment. While the regional political elite tries to exaggerate the potential of the region to profit from the higher share prices of the exploitation and transportation of the oil, the foreign companies engaged in the Caspian oil race manipulate the statistics through their expert groups for striking better deals.

Although it is not another Gulf or Saudi Arabia, the Caspian oil reserves can play

an important role in moderating worldwide oil prices. In the years ahead, oil production outside Organization of Petroleum Exporting Countries (OPEC) member countries will likely see its biggest growth in the region of the Caspian Sea<sup>3</sup>. There has been some talk recently about downgrading Caspian reserves because of unsatisfactory drilling results in the western Caspian<sup>4</sup>. Kazakhstan is believed to hold nearly 70 percent of the Caspian total oil reserves.

It should also be noted that, to date, there have been only three disappointing wells drilled in the Caspian, which compares with about 100 in the North Sea before the first commercial discovery were made. The IEA reserve estimates for the Caspian have been among the more conservative: proven oil reserves at between 15 - 40 billion barrels. This represents about 2 to 6 percent of world proven reserves. Because much of the region remains to be explored, it is more likely that estimates of the reserve base will increase rather than decrease. To put this in perspective, the most optimistic reserve estimates for Caspian oil still pale in comparison with those for the Middle East, which holds over 650 billion barrels or some 65 percent of the world's proven reserves, but they are nonetheless roughly comparable to those of the North Sea.

Today, the oil production of Azerbaijan, Kazakhstan, Turkmenistan and Uzbekistan combined is just less than 1 million barrels

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<sup>3</sup> 4 November 2002, RFE/RL, New York.

<sup>4</sup> "Caspian: Sea's Oil Reserves Estimate Revised Downward", Michael Lelyveld, Boston, 10 April 2002 (RFE/RL). One of the largest oil companies in the Caspian region sounded a note of reality with a new and more modest estimate of the area's oil reserves. Gian Maria Gros-Pietro, chairman of Italy's Eni oil company, said the Caspian contains 7.8 billion barrels of oil.

per day (mbd), of which about two thirds is used domestically and less than 10 percent is moved through Russia to export markets beyond the Commonwealth of Independent States. If investments in the Caspian region continue at the current pace, and if sufficient export outlets are developed, the annual oil production could reach 3.9 mbd by 2010, of which about 2.3 mbd would be available for export. Domestic consumption is also expected to grow. In a "low case" scenario, which assumes some project delays, oil production by 2010 would reach 2.8 mbd, comparable to Venezuela, of which about 1.5 mbd would be available for export. (To put this into perspective, Russia currently exports about 2 mbd.)<sup>5</sup>.

Most analysts now agree that future flows of oil from the Caspian will make only a marginal difference to world prices, perhaps ranking in importance with Britain and Norway's production from the North Sea<sup>6</sup>. However, fears of military conflict in Iraq and a waning supply of oil to the United States from Venezuela, which pushed the price of oil to around \$30 in early January 2003— up more than 30 percent from a November 2002 low<sup>7</sup>, have increased the importance of Caspian crude supply in world markets.

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<sup>5</sup> "Future Trends in Supply and Demand in the Mediterranean and Black Sea Oil Markets", presentation by Ambassador William Ramsay, Deputy Executive Director, IEA, London, 27 April 1999.

<sup>6</sup> At best the Caspian region will account for about 4 to 5 percent of world oil supply in 2010. By way of comparison, in recent years Middle East-OPEC has supplied over 40 percent, and could supply over 52 percent of world consumption by 2010.

<sup>7</sup> "Rising price of oil adds to world's woes", International Herald Tribune, 3 January 2003.

## **Caspian's Access to World Markets: Transportation Challenges**

One of the things that sets the land-locked Caspian apart from the North Sea and other important marginal suppliers is the difficulty of getting the oil and gas production to world markets. The construction of new export pipelines has become a priority. The region's energy transportation systems were originally designed and built to serve the strategic needs of the Soviet Union. All oil and gas export pipelines inherited from the Soviet period pass through Russia. Russia's pipeline operators, citing capacity constraints and various tariff problems have effectively capped exports from the region. Most routing options are currently fraught with technical, financial, legal and political difficulties. They must pass through—or take expensive detours to avoid—politically troubled areas.

Obviously, oil and gas development in the Caspian region will not be feasible without reliable long-distance transit. Local and regional markets are all affected by the economic collapse following the demise of the Soviet Union and can contribute neither sufficient demand nor ability to pay to finance the large-scale investment under consideration. Transit to markets - mainly in Western Europe, Turkey, in the future perhaps also to Eastern Europe when it prospers - is therefore the key to development. But, these transit requirements raise two issues:

- First, long-distance transit adds appreciably to the costs of production. The lower the oil prices, the more will transit requirements therefore obstruct the commercial

viability of investment. Transit facilities also require massive front-end investments. These can only then be funded if there is a commercially viable project - and if the risks appear manageable. Transit costs are not only the purely "technical" costs (construction and operation of pipelines and loading facilities), but also additional "transit fees" charged by transit countries. The fewer alternatives exist, the more can a transit country occupying a quasi-monopoly role extract transit rent from pipelines.

- Second, transit in most of the available directions is fraught with substantial political risk. The East-West corridor solution (over the Caucasus, through Georgia and under the Caspian and Black Seas) raises serious legal and environmental problems (crossing the seas and passage through the Bosphorus), insecurity problems (passage through Azerbaijan and Georgia), the passage through Russia exposes transporters to both Russian post-colonialist hegemonic policy and the Russian oil and gas transport monopolies, in addition to the Chechnya risk<sup>8</sup>.

The history of Middle East pipelines illustrates that few pipelines have survived and prospered in politically

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<sup>8</sup> Pipelines through Turkey also involve the now relatively reduced risk in Southeast Anatolia, pipelines through Afghanistan the civil war risk. All these pipeline concepts involve the risk of inter-state conflict with the well-observed lack of ability of the neighbouring states to find lasting agreement. Pipelines through Iran confront the US sanction policy, pipelines to China (a large market and a relatively risk-free transit area) are too long and therefore expensive.

volatile areas. Successful pipelines (Algeria-Tunisia-Italy; Paraguay-Brazil; Algeria-Morocco-Spain) seem to be based on a depoliticised environment, private law models and avoidance of much state involvement<sup>9</sup>. The consequence of these difficulties is usually a multiplication of political risk. Pipeline projects can, under favourable economic circumstances, accommodate, deal with and manage the political risk of individual countries - but the pipelines out of the Caspian are asked to handle multiple inter-state and intra-state risk. Only the least expensive and least risky pipeline projects will be done over the next ten years - and all with considerable delay, slowly and in parallel with equally delayed oil and gas development<sup>10</sup>.

The significance of transit has encouraged the search for stronger legal instruments to facilitate transit and bolster the legal security of pipeline and transit arrangements. The approach is right - whether there is enough strength to reinforce contracts in societies with a very weak respect for contract is another matter. The key legal instrument is the 1994 Energy Charter Treaty (ECT)<sup>11</sup>.

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<sup>9</sup> "International Good Governance and Civilised Conduct among the States of the Caspian Region: Oil&Gas as Lever for Prosperity or Conflict", Thomas Waelde, <http://www.dundee.ac.uk/cepmlp/journal/html/article4-16.html>

<sup>10</sup> What is necessary is competition between pipelines as only such competition can provide security against blackmail by transit countries (or transit operators). Similarly, such competition can pressure difficult pipeline operators (e.g. in Russia) to seek to establish themselves as respectable and reliable business partners.

<sup>11</sup> The ECT has two elements reinforcing the legal value of pipeline contracts: First, it provides for extensive protection of property and contract of foreign investors, bolstered by a direct investor-state arbitration right (Art. 10,

This multilateral treaty provides assurance beyond the usual assurance provided by bilateral agreements since it rests not only on the relationship between two countries, but the 50 members of the ECT. Currently, there are negotiations to expand Art. 7 of the ECT into a specific multilateral transit convention.

But law is not enough. Contracts can be disregarded, and legal excuses will always be found<sup>12</sup>. Procedures under the ECT's transit regime are not necessarily legally binding. Political pressure through the Energy Charter Conference procedures is likely to be slow in operating, and rests anyway on many other political considerations. The legal arrangements, therefore, are a useful and facilitative device, reinforcing the strength of other pipeline- and transit-related contracts, but they are not per se sufficient to guarantee that states will not disrupt transit, or that the relations between states or the situation within a state will not lead to a disruption.

It may be useful to enumerate some of the drivers, which will ultimately lead to transportation decisions. There is a substantial consensus on a few things that will be on the minds of those contemplating the alternatives:

- Companies—not governments—will build pipelines. If Caspian producers and transit countries do not create the conditions under which companies are encouraged to invest,

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Art. 26). Second, it includes a novel obligation of member states to comply on a provisional basis, after signature and before ratification to enable and facilitate transit, abstain from politically motivated disruption and, within capacity, provide access to pipelines.

<sup>12</sup> See Waelde, 2002.

the marginal dollar can go somewhere else.

- Multiple pipelines are in the interests of: (a) Shippers, who need export alternatives to position them to negotiate competitive transit terms; and (b) Countries which want to avoid creating single pipe vulnerabilities, either in getting their oil or gas out—or getting it in.
- There is some limit beyond which the Turkish Straits cannot handle incremental cargoes. No oil pipeline is going anywhere until enough barrels need a way out. No route is without political risk.
- No gas pipeline is going anywhere until there is bankable gas demand at the other end. Economic forecasts of gas demand are interesting, but a commercial gas supply obligation and a viable power purchase agreement are much more compelling.
- Supplier pressures for early pipeline decisions are going to increase substantially as delays in the long promised earnings from oil and gas create political tensions domestically.

### **Caspian Energy Investments**

Most petroleum companies have the choice to invest their money elsewhere. Production costs of the region may be below those of the North Sea and Russia, but they are certainly higher than those in the Middle East, where some countries are sending enticing messages about foreign participation. Furthermore, it is not enough to produce the oil. It must also get to market. Central and Western Africa, where companies have for years had access to offshore reserves,

will also be a major competitor for investment. Governments in the Caspian region that hope to attract production and transit investments must keep in mind that they are competing with other regions for investment funds.

Against this background and given the region's dubious reputation as a hotbed of political intrigue<sup>13</sup> -- not to mention its lack of pipeline infrastructure --, raising finance for oil and gas projects in the Caspian region will always be tricky. Oil price fluctuations and financial crises in emerging markets only made matters worse, prompting bankers to think twice about funding projects in Azerbaijan, Kazakhstan and Turkmenistan. And now, a string of well-advertised exploration failures has prompted many to adjust their expectations of the Caspian's potential. For all this, the region still has its fair share of oil and development projects that need to be financed. For instance, the 14 biggest projects in Azerbaijan alone will require total investment of \$45-bn and that figure does not include export pipelines<sup>14</sup>. Even if many schemes fall by the wayside, the scope for project finance is potentially huge.

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<sup>13</sup> The escalation of the conflict in the northern Caucasus region of Dagestan threatens to engulf the Caspian region in yet another violent cycle of confrontation marked by the already present flight of a large number of refugees and displaced people. Similar to the Chechen conflict of 1994-1996, the events in Dagestan and the Russian military response to the situation pose challenges to the neighbouring countries of Georgia, Armenia and Azerbaijan. The geostrategic importance of the Caucasus to Russia as its vulnerable southern flank is compounded by the presence of the sole export pipeline utilised by Azerbaijan to transport its oil exports from the Caspian Sea's offshore reserves.

<sup>14</sup> "The Boom That Is Surely Coming (Some Day)", International Petroleum Finance, March 1999, p.8.

### ***Slow Tracked Market Reform; Erosion of Caspian Potential***

Notwithstanding the international attention devoted to the Caspian, the region still appears to fall short in the following areas:

- Obtaining competitive terms for access to energy-consuming markets
- Facilitating economic recovery through commercialisation of energy sector enterprises and in regulating state enterprises and natural monopolies,
- Adhering to agreements for the non-discriminatory treatment of foreign investors,
- Installing and empowering necessary market institutions,
- Providing a reliable supply of energy to domestic consumers at competitive prices,
- Transparently managing and allocating revenue derived from investments,
- Removing regional obstacles to enhanced economic development and stability.

Failing to address these important issues on any significant scale will undermine the attractiveness of the Caspian Region in the eyes of the international investment community. Capital is finite and operates in a global market. Investors seek fair returns and aim for the line of least resistance or risk. The Caspian must conform consistently to internationally accepted norms of governance if they are to compete successfully for limited capital resources.

For the past decade, attention has focused on project-specific

arrangements, dedicated-cross border transport routes and other strategically motivated investment plans. The acute economic needs of the newly independent Caspian states have often been cited in justification of this chosen focus. The dominance of the Caspian energy exporters' traditional trading partners and their ongoing control over integrated regional energy infrastructure calls out for market-based realignment and diversification of intra-regional and export trade routes. However, such realignment demands massive capital inflows and potential investors remain to be convinced of the likelihood of enduring market reform. A decade later, several such infrastructure projects have been realised with the support of significant levels of investment committed by international players.

Nevertheless the risk of revived state interference remains. Barriers to entry and terms for access to newly installed transport systems and their operation continues to exist and in many instances market reform remains fragile. Moreover as state revenues derived from these 'first generation investments' begin to flow, the urgency for attracting further investments may ebb away. In this scenario the incentives to observe internationally accepted standards for the treatment of investments and to follow through on efforts at market reform may fall by the wayside over time. Such a negative outcome would be unfortunate since the aggregate volume and economic significance of future generations of 'merchant' investment is potentially significant and will have a direct impact on domestic growth.

When compared with current strategic commitments protected by project-

specific arrangements, new generation investments in for example, the manufacturing, equipment, services and other energy related industries depend on whether effective markets and institutions are in place.

### ***What's Next?***

Foreign investors have enjoyed a decade long 'welcome' in the Caspian region. It has been relatively straightforward to navigate in comparison with the much more complex and politicised investment climate that Russia witnessed in the 1990s. The relative attractiveness of the less complex Caspian region combined with a strategic focus on major projects may be responsible for muting demands for effective market reform in the region. As a consequence of accumulating investment flows in a weak legal and institutional context, arbitrary measures and discrimination against ventures operated or owned by foreign investors looks set to increase.

Such encroachments are difficult to demonstrate and challenge in the fragile market environment presented by the essentially project driven economies of the Caspian. Applicable commercial benchmarks are hard to come by and investors remain susceptible to the risk that incentives granted to them in the early stages of an investment relationship are clawed back over time. If commitment to market reform continues to be lukewarm, regulatory institutions will remain largely ineffective and reliance on recourse to international law does not present a cast iron solution. Foreign investors operating in the Caspian may be exposed to a 'big squeeze' over the next decade. In this scenario, investment

opportunities elsewhere will appear more attractive. The Caspian states will have forfeited or at best, delayed the realisation of their ambitions to realise economic growth by failing to establish themselves as a reliable supplier to oil and gas markets.

To mitigate these risks, focus should move beyond project specific issues that have marked the first step in Caspian oil and gas market development and look towards matters of general market reform and commercialisation. Stakeholders operating under the myriad investment arrangements that make up the Caspian investment and commercial climate, or that otherwise depend on the adequacy of related legal and institutional frameworks, should benchmark their Caspian experience against the mechanisms and frameworks that are available to them globally. An informed assessment of the economic risks and opportunities that the Caspian region offers and their comparison with developments in other markets will lead to a better understanding of what can be expected reasonably from Caspian oil and gas market development in the decade to come.

### **Geopolitical Rivalry for Caspian and Energy Security**

The growing significance of the Caspian region in international politics and economy is due to its geostrategic location and huge energy reserves. Attempts by the Caspian countries assisted by foreign actors to weaken their dependence on their Russia dominated infrastructure (and on each other) are at the heart of Caspian geopolitics. The proposed pipeline routes are intended, in the main, to

contain the influence of Russia and Iran, thus diversifying sources of energy supply and strengthening the independence of Caspian nations. However, Russia is keen to maintain its strategic interests in the Caspian region and want the bulk of the pipelines to pass through it. Similarly, Iran is interested that the pipelines pass through its own territory.

The winners in the struggle over pipeline routes expect to secure major strategic advantages. The latest crisis in Afghanistan seems to have altered the equations. The growing US military presence in the region and its involvement in Afghanistan and Iraq may help Washington establish and consolidate the bases of its influence and permanent presence in the Caspian region. Russia's co-operation with the US in the war against Afghanistan has enhanced its role and importance in the region. The liquidation of the Taliban regime in Afghanistan also helped Russia in containing the growing separatist movement in Chechnya and Dagestan. Moreover, Russia hopes, in return, the US will accede to its major role in ensuring the flow of Caspian oil and gas via the northern route guaranteed by it<sup>15</sup>. Turkey is increasingly a key actor and an ally of the US in the new Caspian (and Middle East) geopolitics of energy

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<sup>15</sup> "Pipeline Politics in the Caspian Sea Basin", Shah Alam, Researcher, IDSA, at <http://www.idsa-india.org>. In general, the US policy towards Russia is to integrate Russia into the Western- oriented market (like G-8) and security arrangements. But in relation to Central Asia and the Caucasus region, the US seeks to contain Russian influence and break the Russian monopoly through one means or the other.

In this 'New Great Game' the rivalry is not as simple and plain as it used to be in the past. There are complex factors involved with many new players. It is between Iran and Turkey, between Iran and the United States, between Russia and Turkey; and between Iran and Russia on the one hand and the United States and Turkey on the other. The multinational oil and non-oil companies are also among the new players: while the states are mainly interested in enhancing their strategic position, influence and interests, the companies have primarily economic interests in the game.

### *Caspian Energy and Security*

The Caspian developments have a significant bearing on the world's current and future energy security. But the importance of Caspian energy resources to global energy supplies and energy security should not be overstated. In comparison to the global energy resource base, Caspian oil and gas reserves represent a tiny fraction of overall supplies—one quarter of Venezuela's, one-seventh of Iraq's, and one-seventeenth of Saudi Arabia's. Even if the region reached its maximum oil production potential, its exports would account for slightly less than 3 percent of global oil consumption by 2010. Moreover, the degree to which the Caspian region's potential reserves are recovered and exported over the next 10–15 years remains uncertain<sup>16</sup>.

From the West's perspective, therefore, while the emergence of the Caspian Sea

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<sup>16</sup> "The Politics of Oil in the Caucasus and Central Asia", Rosemarie Forsythe, Adelphi Paper 300, Oxford University Press for IISS, Oxford, 1996.

region as an important source of global energy will contribute to improved energy security, Caspian supplies are unlikely to become critical to the West's security and prosperity, or a potential strategic vulnerability. Moreover, it is unlikely that the region will realise its full potential for some time (if at all), given the constraints on rapid oil development and other factors that are likely to create an oversupply of oil for the next decade, even if the demand for it is high. Consequently, it is unlikely that the world will become heavily dependent on Caspian energy. Hence, any severe interruption in the flow of Caspian oil is unlikely to cause more than a temporary dislocation in the availability of oil on the world market and a modest increase in prices.

In sum, the treatment of energy security in the Caspian, which mirrors in general the discussion in the academic literature, has become oversimplified and sloganized. Western access to Caspian oil is not strategically vital. Rather, the West has a modest stake in helping to ensure that (1) conflict in the region does not impede the flow of oil, (2) no truly hostile state has a huge monopoly over oil, (3) U.S. and Western companies have a shot at the profits from oil development, and (4) no state has a monopoly over regional pipelines. Overall, these are important, but hardly vital, interests.

### ***Turkey's elusive quest for activism in Caspian***

Turkey's playing an active role in Caspian energy politics is closely related to its new foreign policy approach that considers energy security in the region as a top national interest. Throughout the

Cold War, Turkish foreign policy was typically insular and passive. Turkey focused its energy on internal development and sought to avoid foreign tensions that could divert it from that goal<sup>17</sup>.

The activist trend in Turkish foreign policy since the Gulf War includes both a wider scope for imaginative diplomatic initiatives and a greater preparedness to use or threaten to use force. Preoccupied as it is with the Iraqi situation, Cyprus and EU accession, Ankara is far from adventurist in its foreign policy. It continues to try to use diplomacy and multilateralism, as far as possible, to promote stability and prosperity in its various regions. Most manifestations of its assertiveness are in the realm of diplomatic initiative, not the use of force. Its activism is a measured activism.

Whereas during the Cold War Turkey's foreign and security policy outlook was relatively circumscribed and naturally dominated by the country's role in the containment of Soviet power, the last decade has witnessed a sweeping enlargement of the country's external horizons. The notion that Turkey's interests and potential influence stretch from the Balkans to western China has proven quite realistic, even if some of the early assumptions about Ankara's

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<sup>17</sup> It remained neutral during almost all of World War II, joining the allied side only in the war's waning days with the outcome already decided. In joining the Gulf War coalition, Turkey broke several of its long-standing taboos. It took sides in a Middle Eastern dispute and assumed a war-like posture on its borders for the first time since a brief period of tension with Syria in 1957. It forged a strategic partnership with Israel.

role in the Turkic republics of Central Asia proved somewhat overblown.

Turkish policy interests and initiatives mirror this expanded concept of Turkey's security space. Recent examples include defending the welfare of Turkish residents in Germany, and more active diplomacy in the Caucasus. The rise of Turkish nationalism and closer attention to sovereignty questions as political forces within Turkey have led Ankara to vigorously defend its interests in recent years. The most impressive examples in this regard have included the use or the threatened use of force beyond Turkey's borders. Ankara credibly threatened to attack Russian-supplied S-300 surface-to-air missile sites if the system was deployed on Cyprus; the missiles were not deployed.

Turkey made clear its willingness to act against Syria if Damascus did not end its crossborder support for the Kurdistan Workers' Party (PKK) and expel the PKK leader, Abdullah Ocalan; Ocalan left and Syrian support for the PKK essentially ceased. In their counter-insurgency campaign against the PKK, Turkish forces have for some time engaged in extensive cross-border operations in northern Iraq and have established a de facto security zone in the region. With the important exception of the 1974 Turkish intervention in Cyprus, these assertive actions would have been difficult to imagine in previous decades and under Cold War constraints.

Notwithstanding Western opinions, and despite the fact that Turkey no longer shares a border with Russia, Ankara continues to view Russia with concern. A long tradition of Russian-Turkish

competition contributes to Turkish unease, and reinforces more modern worries about Moscow as a geo-political competitor and source of regional risk<sup>18</sup>. Two issues stand out in this regard.

- First, there is a possibility that a resurgent and more assertive Russia would find new spheres for competition with the West, outside the center of Europe, on the Balkan and Middle Eastern periphery. Competition along these lines, which could, for example, take the form of increased Russian transfers of military technology to Turkey's Middle Eastern neighbours, would directly affect Turkish security. Even more tangibly, a reinforced (and permanent) Russian military presence in the region would go against the limits on Russian forces set out in the Conventional Forces in Europe agreement. Turkish military planners fear that Turkey might be left to face such revived flank risks alone, as NATO focuses more heavily on other missions.
- Second, Turkey is exposed to spillover risks associated with instability in the Russian near abroad, along the lines of the crisis in Chechnya. Turkey worries that in the future it might confront sudden and large-scale refugee flows, arms smuggling and terrorism on its borders as a result of developments in or around Russia and the Black Sea region. Risks of this sort might also negatively affect the progress and reliability of new energy

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<sup>18</sup> "Turkey: The Changing European Security Environment and the Gulf Crisis," Sabri Sayari, *Middle East Journal*, 46, no. 1 (winter 1992) p. 11.

infrastructure projects (for example, the Blue Stream, Trans-Caspian and Baku-Ceyhan pipelines) that are important to Turkey's own energy supply and economic prosperity<sup>19</sup>.

As a matter of fact, the Turkish-Russian relationship of today is far more relaxed than it has been for decades. Mitigating security concerns has been a boom in commerce. In the 1990s, bilateral trade and Turkish investment in Russia have shot upward. The Russian Prime Minister Mikhail Kasyanov's visit to Turkey in late October 2000 has not produced much in political terms, but economically it resulted in many important compromises. These include plans for electricity purchases from Russia through Georgia, co-operation in the defence industry, co-production of some weapons<sup>20</sup>, additional natural gas purchases through existing pipelines, an increase in bilateral trade volume and the settling of Turkish contractors' debts in Russia<sup>21</sup>. Despite some troublesome points, relations between the two countries currently seem to be on the right track. Kasyanov's words, "Turkey and Russia are not rivals but partners," also demonstrate that the two countries are determined to improve relations for the sake of regional stability.

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<sup>19</sup> Quite apart from Russo-Turkish competition, Turkish security interests are therefore closely interwoven with developments across the Black Sea. The risk of friction with Moscow over regional policy has also encouraged a relatively conservative Turkish approach to developments in the Caucasus and Central Asia, where there continue to be opportunities for more active Turkish involvement.

<sup>20</sup> Turkey plans to spend some \$150 billion on weapons during the next 25 years and Russia is keen to win some of these lucrative weapons contracts.

<sup>21</sup> "Turkey and Russia Aren't Rivals but Partners", Turkish Scanner, October 2000

Several factors continue to hinder Turkish efforts to increase its role and influence in the region:

- First, Turkey's own domestic problems, in particular Kurdish separatism, the growth of Islamic influence, and economic weaknesses, diverted attention away from the region.
- Second, Turkish diplomatic energy in the Caspian region was drained by other more pressing security challenges, including threats to the south from Syria, Iraq, and Iran, instability to the north in the Balkans, and ongoing disputes to the west with Greece over Cyprus and the Aegean.
- Third, Turkey's lack of geographic proximity to Central Asian countries limited Ankara's ability to project influence there.
- Fourth, as it became abundantly clear that cash-strapped Turkey lacked capital for large-scale economic aid and investments, Central Asian countries lost much of their interest in Turkish proposals for regional economic integration.
- Fifth, Turkey's pretensions to leadership offended the sensibilities of many Central Asian leaders, especially in the face of fewer common cultural, social, or even linguistic links than many of the parties

expected.<sup>22</sup> The peoples of the south Caucasus and Central Asia have a strong sense of national pride, and—having suffered for years under the Soviet Union—were not about to become the “little brothers” of Turkey or any other outside power.

- Sixth, as many of the Central Asian countries developed their own relations with Western countries, they felt less need to rely on Turkey as an intermediary with the West.
- Seventh, Turkey’s capabilities to project military power are limited, especially beyond the south Caucasus.
- Finally, Ankara remains wary of taking actions, especially in Georgia and Azerbaijan, that might antagonise Russia, a major trading partner and significant source of energy and the only country still capable of bringing heavy military pressure to bear on Turkey.

In retrospect, Turkey’s short-term goals and expectations were unrealistic. Turkey is operating on a crowded playing field. Although Turkey has raised its profile in Azerbaijan, it has nonetheless been frustrated in its desire to improve relations with Armenia. Moreover, Ankara’s ties with Georgia, while growing, are constrained by Georgia’s continued military and economic dependence on Russia. Indeed, Russia has enjoyed some success in

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<sup>22</sup> See “Turkey in Post-Soviet Central Asia”, Gareth Winrow, Royal Institute of International Affairs, London, 1995.

thwarting a significant expansion of Turkish influence in the region, especially Kazakhstan, and Turkey has been careful to avoid challenging important Russian interests. That said, Turkish engagement in the Caspian remains substantial, and the long-term prospects are promising for increased bilateral co-operation and a steady, if unspectacular, expansion of Turkish influence. For now, Ankara has a more realistic appreciation of the difficulties it faces and has trimmed its policies and expectations to fit these realities<sup>23</sup>.

### *Iran: Chipping away at the margins*

In stark contrast to the relatively warm reception given to the Turkish engagement in the region, Iran’s forays after the collapse of the Soviet Empire were met with fear and mistrust among Caspian’s ex-communist rulers. Iran’s interests in the region revolve around Caspian oil, its concern that Azerbaijan might subvert the internal ethnic Azeri population (who sometimes call the part of Iran they live in “Southern Azerbaijan”), and the chance to use Armenia’s and Azerbaijan’s territory as

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<sup>23</sup> During his October 2000 visit to Central Asia, the Turkish President Ahmet Sezer gave signals of a change in Turkey’s approach vis-à-vis its Central Asian cousins. The traditional policy adopted by Turkey towards these republics during the term of his predecessor was one based on rhetoric of brotherhood and personal relationships. Despite Turkey’s wish to strengthen the ties with these countries, there have been few concrete results in practice. The new Central Asian strategy aims to foster more solid, institutional bases. A convergence of mutual interests will be actively pursued. President Sezer called for the institutionalisation of relations in the region and mainly focused on the issues of security, military co-operation against Islamic terrorism and efforts to implement the energy projects to transport the petroleum and natural gas resources of the region to Western markets through Turkey.

energy transit routes. Iran suggests that it can also act as a mediator in settling ethno-political conflicts.

In the early 1990s, Iranian-sponsored Islamic fundamentalism was perceived throughout the region as the most serious threat to regional peace and stability. However, since the middle of the decade, Iran has had some success in projecting a more positive image. It has kept a low profile in the region and pursued pragmatic, cautious, and moderate policies. Tehran has attempted to expand its influence by providing technical and financial assistance, supporting regional economic integration, expanding cultural links, and facilitating the efforts of Kazakhstan and Turkmenistan to develop alternative transit routes for oil and gas.

Still, several factors have circumscribed Tehran's opportunities for achieving substantial influence and presence in the near term:

- Iran's revolutionary vision, especially its anti-imperialist and anti-hegemony overtones, has some appeal among Muslims, including Sunni movements. Nonetheless, many Muslims in Central Asia have little sympathy for Iran's brand of radical Islam.
- Notwithstanding Iran's heightened interest in the Caspian region and pipeline routes, Tehran's domestic and foreign policy priorities are currently focused primarily on economic reconstruction at home, safeguarding the Iranian revolution against perceived external threats, and asserting

Iran's historical claims to regional domination in the Persian Gulf. These preoccupations will consume much of Tehran's energies for the foreseeable future.

- Because of Iran's own ethnic problems, especially unrest among its large ethnic Azeri minority, Iran's stability and territorial integrity could be undermined by the Azeri separatist movement<sup>24</sup>.
- With the exception of Turkmenistan, Iran does not border any of the Central Asian states, and this lack of proximity makes it more difficult for Iran to project its influence.
- Iran currently lacks the resources to become a major economic actor. As in the case of Turkey, Iran is not in the position to make major investments, and the abysmal performance of the Iranian economy over the past two decades is hardly a model that the Caspian states would wish to emulate. Iran is unlikely to emerge as a major market for Caspian products, and there is a far greater possibility that Iran

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<sup>24</sup> The possibility of a Southern Azerbaijan issue becoming an international problem should be taken seriously. Mostly Azeri Turks identical to those across the frontier populate Iran's north-western province bordering on Azerbaijan. There have been semi-nationalist movements in the province during past decades and some of the Iranian Azeris seek unification with Azerbaijan. Although Iran and Azerbaijan have normal relations and the Azerbaijani government discourages pan-Azeri nationalism, a heightening of this issue could still cause considerable friction some day.

and Caspian states will become trade competitors rather than partners.

- As long as Iran remains politically isolated, it will be extremely difficult to carve out a major niche for itself as a significant pipeline route. Until the fundamental character of the Iranian government changed, Caspian leaders and populations will remain highly suspicious of Iranian intentions.

In sum, for at least the next decade, Tehran will likely behave as a status quo rather than a revolutionary power because it has a strong stake in preserving regional stability to minimise the risk of ethnic separatism at home. The ruling elites in Tehran almost certainly understand that any overt, aggressive Iranian attempt to foment an Islamic uprising—or throw Iran's geopolitical weight around—would be met by strong opposition from Russia, the United States, China, and Turkey. Nevertheless, as long as Iran is excluded from the development and transport of the region's energy resources, Tehran will likely try to play the role of spoiler wherever possible.

***Russia: No longer a hegemon, but a major player***

Russia continues to see the Caspian region as vital to its security interests, and has relied on three main tools to advance these interests: integration of the CIS under Russian domination; the use of military, economic, and political leverage to subordinate the independence of the Caspian states to Russia's interests; and international

recognition of an exclusive Russian-led CIS peacekeeping role and Russia's "special powers" as guarantor of peace and stability in the region.

Russian President Vladimir Putin has pushed ahead with an aggressive policy designed to recover Moscow's regional hegemony soon after his 26 March 2000 election. The National Security Council declared the Caspian region to be one of Russia's key foreign policy interests<sup>25</sup>. Former energy minister Victor Kalyuzhny was appointed to a newly designated deputy foreign minister post, serving as special co-ordinator of Russia's Caspian policy. The creation of the post underlined a significant shift from Moscow's ad hoc and disorganised approach seen during the Yeltsin era to more efficient approach to the region.

Russian military doctrine stresses regional threats and local conflicts, the need to improve the mobility and deployability of Russia's conventional forces to deal with conflicts on Russia's periphery, the imperative of protecting Russians in the "near abroad," and the importance of preventing other countries from gaining a foothold in the region. The Russian military thinks of the Caspian as a buffer zone along its southern border and has adopted a forward defence strategy predicated on the belief that the defence of Russia's

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<sup>25</sup> The ominous implications of Russia's new policy were underlined by Andrei Urnov, Russia's ambassador at large and chief of the Foreign Ministry's Working Group on the Caspian Sea, in a May 2000 appearance on Capitol Hill. Soon after Russia had forcibly "pacified" the Northern Caucasus, Urnov told the Washington audience, "it hasn't been left unnoticed in Russia that certain outside forces are trying to weaken our positions in the Caspian Basin, to drive a wedge between us and other Caspian states."

borders starts at the Caspian border<sup>26</sup>. Russia has played hardball to maintain its pre-eminent position in the region, prevent the spread of foreign influence, muscle its way into energy development consortia, and retain exclusive control over energy pipeline routes.

Heavy-handed attempts so far included interventions on behalf of Abkhazian separatists in Georgia (which the Russians exploited to extract basing agreements from Tbilisi), military support of Armenia in its conflict with Azerbaijan (which the Russians used to leverage Baku into joining the CIS), attempts to install more pliant regimes in Azerbaijan and Georgia when these governments resisted Russian pressures for tighter CIS integration, and numerous cut-offs of oil and gas exports from Azerbaijan, Turkmenistan, and Kazakhstan.

Many post-Soviet Caspian states remain dependent on Russia for trade, energy supplies, military equipment and training, and internal stability and external security. Further, in the south Caucasus, the area of greatest concern to Moscow, the Russians have established important footholds in Armenia and Georgia: bases, installations, and security treaties. Nonetheless, given Russia's resource constraints and internal problems, as well as the growing assertiveness of the Caspian states, Moscow faces a huge and perhaps irreversible gap between its ambitious objectives and the means available to achieve them.

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<sup>26</sup> See "The Russian Military and Security Policy in the Near Abroad," John W.R. Leppingwell, *Survival*, Vol. 36, No. 3, autumn 1994, p. 77.

Simply put, Russia lacks the military and economic wherewithal, as well as the political competence and ideological legitimacy, to maintain its supremacy in the region and to prevent other states and international organisations from gaining increased influence and access. Moreover, it is by no means certain that Moscow will continue to pursue a hard-line "neo-imperialist" policy in the Caspian region given that differences have emerged within Russian decision-making circles over how Russia should define and pursue its interests there.

The Kremlin is skilfully advancing its agenda by utilising Bush administration foreign policy rhetoric with its emphasis on the anti-terrorism campaign and the right of pre-emptive action<sup>27</sup>. It has concluded strategic partnership agreements with the United States, EU members and other countries. Thus, as Zbigniew Brzezinski has observed, Russia will be too weak to reimpose its imperial domination but too powerful to be excluded. For historical, geographic, cultural, ethnic, and strategic reasons, Moscow will try to use Russia's remaining leverage to protect Russian interests in a weak, fragmented, and unstable region. The perception that Russia retains considerable leverage to influence developments in the region is reflected in the growing tendency of Caspian states to try to co-opt rather than exclude Russia from participation in key energy development projects.

### *The US in the Caspian Game*

American objectives in the Caspian have nominally included the promotion of

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<sup>27</sup> "Russia moves to reassert influence in Central Asia", *Eurasia Insight*, Igor Torbakov: 16 December 2002

democracy and free markets, regional peace and co-operation, energy diversification, and American business opportunities. In practice, however, the focus of such efforts has been on energy issues<sup>28</sup>. Accordingly, the US Administrations have hosted the leaders of the Caspian states, promoted the involvement of American firms, and encouraged specific deals for new pipelines and transportation links. Along the way, US policymakers have tended to emphasise bilateral solutions to Caspian problems.

Policymakers are also concerned by the effect of America's Caspian policy on US-Russian relations. Russia's concerns go beyond NATO enlargement—the lens through which American policy is often viewed—to include numerous instances of US intervention in Caspian politics including support for dividing the seabed, endorsement of the Baku-Ceyhan pipeline as the main export route from Azerbaijan, and calls for Azerbaijan and Turkmenistan to resolve their quarrel over the delimitation of national zones.

Although domestic political developments have shifted Russia's Caspian policy, making it more in line with American policy, US intervention is still widely resented for its perceived arrogance and marginalization of Russian concerns. And while US Administration insiders have increasingly voiced the need to include Russian firms in oil and gas transportation deals, such concessions are rendered ineffective by the absence of any larger framework for

systematically addressing Russian concerns.

An additional plank of American policy is preventing the spread of Islamic fundamentalism and terrorism in the region. In practice, this means containing Iranian influence abroad while pressing for a domestic political transformation. While seeking to bolster the Caspian states' sovereignty (and perhaps also domestic legitimacy), US policy has provided Azerbaijan, Kazakhstan, and Turkmenistan with an alternative to institutionalised collaboration with Russia. The greatest shortcoming of America's Caspian policy is lack of clear prioritisation among its stated goals.

From this perspective, the vital American interest in both the short and long haul is regional stability and democratic-political and market-economic reforms likely to further that end should be encouraged. Environmental integrity and institutionalised international co-operation to achieve it is desirable for the same reason. Diversification, as well as gaining proceeds from oil exploitation; while both significant—are distinctly secondary US national interests, long-term objectives that do not require the sacrifice of other key goals in the short term.

The United States has supported the principle that the resolution of the legal status of the Caspian Sea must be decided by the five littoral states. The concern of the US government is apparently testified in 1999, when the Special Advisor to the President and secretary of State on Caspian Basin Energy Diplomacy, ambassador Richard Morningstar, stated that: "... and we believe the sectoral boundaries are

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<sup>28</sup> "Value Tradeoffs and America's Caspian Policy: Energy, the Environment, and Sustainable Development", Douglas Blum, Providence College, May 1998

ultimately the best way to go. It is important that settlement of these issues not hold up exploration and development of the Caspian resources.”<sup>29</sup>

### ***'Militarization' of the Caspian Sea***

Since 1991, Azerbaijan, Kazakhstan, Russia, and Turkmenistan have undertaken the strengthening of their military capabilities in the Caspian region. Such steps, which would have remained unnoticed under normal circumstances, have sparked much concern after President Putin ordered the Russian military to arrange what he suggested the largest regional war games since the break-up of the Soviet Union in 1991.

The manoeuvres involved naval, ground, and air forces equipped with some of the newest weapon technologies. Putin also pledged to allocate more than \$300 million in the coming years to modernise Russia's Caspian Fleet<sup>30</sup>. The Caspian manoeuvres triggered swift reactions in Iran, with official newspapers slamming "Russia's threatening tone" against its neighbours and President Mohammed Khatami cautioning against an arms race in the region<sup>31</sup>.

There are also reports that Russia is currently deploying a new missile system on the Caspian Sea shore and recently moved several gunboats from its Baltic and Black Sea fleets to the

Caspian Fleet. The scale and purpose of the so-called "militarization" of the waterway -- or, as Russia's "Vedomosti" financial daily on 26 April 2002 phrased it, "the renunciation of the idea of demilitarizing the Caspian Sea" -- remain unclear and have given rise to much speculation.

Defence analysts argue that despite the assistance offered by the United States to Azerbaijan and Kazakhstan to build up national fleets, the military capabilities of these countries remain somehow limited. The same goes for Turkmenistan, although Ashgabat claims to have recently acquired a number of Ukrainian speedboats and is reportedly considering purchasing Russian-made gunboats in return for natural gas. Of all the Caspian littoral states, only Iran has enough military strength to match Russia.

Russia considers Iran as a potential counterweight to Turkey's influence in the South Caucasus, while Tehran sees in its co-operation with Moscow a way to offset the policy of containment imposed by Washington on the Islamic Republic. Yet, when it comes to its interests in the Caspian area -- a region it considers its backyard -- Moscow is ready to place its relations with Iran on the back burner. This goes exclusively for the Caspian. In Moscow's view, there is no point in isolating Iran completely, as the United States wants. It is just that, for Russia, it is much more important to reach an agreement on the Caspian with its neighbours than with Iran.

Azerbaijan's legal dispute with both Turkmenistan and Iran over ownership rights to several oil fields was aggravated on 23 July 2002, when an

<sup>29</sup>

[http://azerilink.homestead.com/Caspian\\_Sea.htm](http://azerilink.homestead.com/Caspian_Sea.htm)

<sup>30</sup> Prague, 10 June 2002 (RFE/RL)

<sup>31</sup> Yet, reports also say Tehran has recently deployed 38 new gunboats in the sea's southern sector, thus apparently contributing to what is commonly referred to as the "militarization" of the Caspian.

Iranian warship illegally entered Azerbaijan's territorial waters to chase an oil-exploration vessel out of a disputed area. The Iranian move drew fierce protests from the U.S., which soon afterward presented Baku with two gunboats, and Turkey. It also served as a reminder that disputes could quickly turn into hot confrontation in the region.

Turkey's special relationship with the US and accession prospect with the EU create a difficult dilemma. High-profile US pressure on the EU to create a special fast-track for Turkey at the December 2002 EU summit in Copenhagen scored some favourable points with Ankara, but cut little ice with EU members. Turkey received a 2005 date for conditional membership talks even though it had pushed for one far earlier, and even worse, while the Greek part of Cyprus was asked to join the EU, the Turkish part got left behind. The crucial question now is what path Turkey chooses to take. The US pressure for active Turkish involvement in Iraqi operation and partnership in the Caspian energy corridor may lead to greater divergence of interests with the EU<sup>32</sup>.

### **Turkey: Market, transit and security provider for Caspian energy**

The Turkish agenda has been understandably dominated in recent years by the economic crisis and Turkey's possible role in the United States-led drive for a regime change in Iraq, as well as by the domestic political upheavals that resulted in a November 2002 victory for the AKP. Consequently, there has been little serious discussion of

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<sup>32</sup> "Forget Iraq: The Real Battle Is In Turkey", Heather Wokusch, published on December 26, 2002 by CommonDreams.org

Turkish energy problems. In fact, until recently, the prevailing mood in Ankara on energy policy was unwaveringly upbeat<sup>33</sup>. Political leaders and officials pointed to Turkey's vibrant economy and projected energy needs as they focused on the important role the country was destined to play in the global energy picture.

Parallel to its own growing energy consumption, they argued, Turkey would use its geographic location and strategic influence, along with its ethnic links to the Caspian Sea region oil and gas producers, to provide the answer to the problem of transportation in the exploitation of Caspian energy resources<sup>34</sup>. Thus, as the primary facilitator in the creation of the Eurasian Energy Corridor, in close co-operation with the United States, Turkey would be transformed into an indispensable energy hub in the transportation of Caspian oil and gas to world markets. A sober assessment now seems to be in the making.

As a country with an emerging and growing economy, Turkey is facing a rising growth of its demand for energy

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<sup>33</sup> It is difficult to speak of Turkey having a co-ordinated and consistent policy on energy issues. There are too many players on the energy scene, each preferring to go its own way. Influential people and groups on this issue include the President and Prime Minister and their offices, the Energy Ministry, the Foreign Affairs Ministry, the State Planning Organisation, the state-owned Pipeline Company (BOTAS), the Turkish Petroleum Corporation (TPAO), various Turkish construction companies and finally the National Security Council. When former President Demirel asserted that Turkey should not lose time and that the next two years would be very important, he was actually complaining of this "mess of decision-making procedures".

<sup>34</sup> "Turkey's Caspian Energy Quandary", Caspian Energy Update, 13 August 2002.

by 8 percent per annum whereas the world average is 1.8 percent. Turkey's energy consumption in 1998 was 76 million tones of oil equivalent (mtoe) and is expected to reach 179 mtoe by 2010, and 319 mtoe by 2020. Turkey has been pursuing policies in order to meet its expanding energy need based on diversified, reliable and cost-effective supply sources. Former Turkish President Suleyman Demirel had warned that Turkey needed to invest \$130 billion in energy over the next 20 years<sup>35</sup>. Such huge investments cannot be realised through state funds only; international resources should be mobilised to make the necessary energy investments.

Yet, energy investments have declined since 1994, as plans to privatise the sector were raised. But the sector was pushed into chaos because the privatisation attempts began before the necessary legal and institutional infrastructure was established. Meanwhile, maintenance and renovation work on state power plants was neglected. Due to a mismatch of energy demand and supply, Turkey would face electricity shortages unless some solid short-term solutions, including power conservation, can be produced and activated.

It may well be a cliché to describe Turkey as the country where Europe ends and Asia begins, but this is particularly true in its strategic position as a bridge between energy supplies from the East and consuming markets in the West<sup>36</sup>. The country is a natural

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<sup>35</sup> "Energy policy or politics of slogans?", 15 April 2000, Turkish Daily News, "Opinion" By Professor Huseyin Bagci

<sup>36</sup> "Turkey: A New Actor in the Field of Energy?", Temel Iskit, Perceptions, I, no. 1 (March-May 1996).

transition point for hydrocarbon supplies from Russia, Iran, Iraq and, more recently, the Caspian region<sup>37</sup>. It is therefore not surprising that Turkey figures largely in some of the major pipeline projects in the region, both as a consumer and as a transit point for exports beyond its territory into Europe. Besides, as one of the biggest investors in the region and its close historical, cultural and economic ties with the countries of the region, Turkey acts not only along with its commercial interests but also feels a special responsibility for supporting these nations in their social and economic development.

Turkey's interest in the Caspian pipeline issue began as just one of the many strands of late President Turgut Ozal's broad policy of engagement with the newly emerged Turkic states. The concept of making Turkey the main export corridor for oil from Azerbaijan and perhaps Central Asia as well-by means of a pipeline linking Baku to the Turkish port of Ceyhan on the Mediterranean Sea-was first discussed at a political level by Presidents Ozal of Turkey and Elchibey of Azerbaijan in 1992. As Turkey's grander ambitions in the region began to fade and the Caspian oil boom picked up steam, the Baku-Ceyhan pipeline project increasingly became the core of Turkish policy towards the Caspian region and indeed an important priority of Turkish foreign policy overall.

The justification for the Turkish emphasis on the Baku-Ceyhan pipeline has three components<sup>38</sup>.

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<sup>37</sup> "Economic Potential Undermined", Petroleum Economist, July 1999, p.14.

<sup>38</sup> For this section, the author benefited from the views contained in "Turkey and Eurasia:

- First, Turkey has come to see the pipeline derby as a proxy for strategic competition in the region and ultimately the main determinant of Turkish political influence in the Caspian. For the Baku-Ceyhan pipeline to be built would at very least represent the symbolic fulfilment of its activist foreign policy vis-à-vis the region; at most it could create a long-term economic and political bond between Turkey and the Turkic states.
- Economic interests are the second factor driving Turkey's support for Baku-Ceyhan. The pipeline's construction would generate some business for Turkey's dynamic construction and engineering sector. Meanwhile the state budget would receive transit fees from users of the pipeline. "Access to oil supply" is sometimes cited as another reason for Turkish interest in the Baku-Ceyhan project, but this is a less important driver as Turkey has ready and secure access to Middle Eastern oil supplies.
- The third and most complex reason for Turkey's support of the Baku-Ceyhan pipeline is related to its deeply felt environmental concerns regarding the passage of oil tankers through the Turkish Straits. To pass from the Black Sea into the Aegean Sea and the Mediterranean beyond, ships must pass through two narrow straits, the Bosphorus and the Dardanelles, as well as the Sea of Marmara. Should pipelines for

Caspian oil terminate on the Black Sea rather than the Mediterranean, the number of oil tankers transiting the Straits and particularly the Bosphorus would grow significantly<sup>39</sup>. Occasional accidents have served to emphasise the ongoing environmental risks of the passage, most disastrously in 1979 when a tanker ran aground and spilled nearly 100,000 tons of oil—more than twice the volume spilled by the Exxon Valdes ten years later in Alaska.

### ***The Fundamental Importance of Gas***

While access to oil supply is not a pressing issue for Turkey, the question of access to new supplies of natural gas certainly is. The gas business differs significantly from the oil business, and access to supply is a far more vexing problem for gas than it is for oil. For the most part, sources of supply and areas of demand need to be connected directly by pipelines, since shipping gas by tanker is a technically complex and expensive process. Pipelines for gas are typically much more difficult to finance than oil pipelines, since they require credible guarantees of payment from solvent end-users.

Turkey is the fastest growing gas market in Europe, and in recent years it has had difficulty in obtaining enough gas to meet its burgeoning near-term demand. Turkish gas consumption—and therefore economic growth—already is being artificially constrained by a shortage of

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Opportunities and Risks in the Caspian Pipeline Derby", Laurent Ruseckas, Vol. 54, No. 1, p 217-236, CERA, 2000.

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<sup>39</sup> While the very largest supertankers do not attempt this passage, there is currently considerable traffic in somewhat smaller (though still large) tankers, with a capacity up to about 120,000 dead weight tons. Ten to fifteen fully loaded tankers of this size or smaller transit the Bosphorus each week.

supply. Meanwhile, several consortia have built new gas-fired power plants in order to meet Turkey's rapidly growing demand for electric power. Should gas not be available to supply these plants in the next few years, it could trigger a serious economic crisis.

Natural gas import started in 1987 from the former USSR with 500 million cubic meters and reached around 15 bcm in 2000. Dynamic economic growth, industrialisation, population growth and rapid urbanisation are the basic factors for this rapid increase in gas consumption. BOTAŞ supplies natural gas to 211 industrial plants, 59 power plants including auto-producers,

organised industrial regions and to the cities of Ankara, Istanbul, Bursa, Eskişehir and İzmit for the residential and commercial usage. Demand for natural gas in the power sector is the real driver for growth in gas consumption in Turkey due to the increase use of gas in base load power plants.

Currently Turkish natural gas demand is provided by four contracts which are in effect: two agreement with Russia for the quantities of 6 and 8 bcm per year respectively and the others in LNG form with Algeria for 4 bcm and with Nigeria for 1.2 bcm per year. The imported quantities in 1999, 2000 and 2001 are around 12 bcm, 15 bcm and 18 bcm respectively.

<b>Natural Gas Supply Contracts</b>				
Existing Contracts	Quantity (bcm/year)	Date of Signature	Duration (Years)	Status
Russia (West)	6	February, 1986	25	In operation
Algeria (LNG)	4	April, 1988	20	In operation
Nigeria (LNG)	1.2	November, 1995	20	In operation
Iran	10	August, 1996	25	Start 2003
Russia (Black Sea)	16	December, 1997	25	Start 2003
Russia (West)	8	February, 1998	23	In operation
Turkmenistan	16	May, 1999	30	Start 2002-2004
<b>Total</b>	<b>61.2</b>			

Source: Botas

Botas lowered its gas-demand estimates for 2003 by nearly 14 percent and slashed its 2004 forecast nearly 20 percent from predictions made less than three months ago<sup>40</sup>. Botas's new forecast reduced Turkey's gas demand in 2003 from 31.6 bcm to 27.8 bcm. But even the

lower number implies that gas use would grow more than 43 percent over the predicted rate of 2002. (Note that the country used only 16 bcm of gas in 2001). Energy officials have apparently been trying to make adjustments for

<sup>40</sup> Turkey: Gas-Demand Forecasts Are Bad News For Exporters, Michael Lelyveld, 17 July 2002, RFE/RL <http://www.rferl.org/nca/features/2002/07/17072002161724.asp>

unrealistically high expectations, but in the process, they are still predicting that gas use will grow many times faster than the economy.

With Turkey's political and economic future in the balance, gas issues may be far down on the list of concerns. But countries including Russia and Iran have invested large sums to build pipelines to a Turkish market that is now vastly oversupplied. In the short term, Turkey will require 8-10 bcm of additional gas, which it has amply booked from a number of suppliers. For long-term, according to Botas, the Turkish natural gas consumption is expected to reach 55 bcm by 2010 (despite analysts' warnings that the estimate is 40 percent too high) and 82 bcm by 2020. Agreements signed so far guarantee 45.2 bcm of natural gas a year, however. The shortfall will be around 10 bcm in 2010 and 38 bcm in 2020<sup>41</sup>. But, pipeline developers are unlikely to have invested on unreliable forecasts. Even with Botas's latest revisions, gas exporters have reason to be sceptical. As with earlier forecasts, the new figures still assume enormous leaps in consumption, suggesting that officials are reluctant to recognise the damage that successive crises have caused.

The options are that gas comes from Turkmenistan via Iran or across the Caspian or even north around Caspian; from Iran via Turkey<sup>42</sup>; from Russia via Bulgaria, from Russia across the Black Sea via the "Blue Stream" pipeline, from Russia via Georgia, and from Egypt by pipeline. Then there is always

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<sup>41</sup> Petroleum Economist, July 1999, p.15.

<sup>42</sup> Under a contract between the two countries, Iran is to export 3 bcm of natural gas to Turkey annually from July 2001 if the Turkish part of the pipeline is completed as planned. The volume of Iranian natural gas exports to Turkey is to reach 7-bcm from 2005 and to 10-bcm from 2007. Iran is busy laying 48-inch gas pipelines in an area of 550 km from Qazvin, in central Iran to Bazargan border with Turkey.

incremental LNG from various sources. Iran has been pumping small amounts of gas under a 1996 contract that was supposed to be worth \$20 billion over 25 years. Russia's Gazprom and Italy's ENI oil company also opened their \$2.5 billion Blue Stream pipelines across the Black Sea in January 2003. And investors in Azerbaijan are poised to approve a \$3.2 billion plan for the Shah Deniz gas field in the Caspian Sea with yet another pipeline to Turkey. All are hoping that Turkey's recovery from its last economic crisis in 2001 will get back on track.

Consequently, the two giant gas projects, Blue Stream and the Trans-Caspian gas pipeline plus the Azeri line, were racing to "get to the Turkish market first," knowing that the loser would probably be shut out for some time. The competition between these projects has become part of the strategic competition over the future of the region. With Russia identifying the Blue Stream project as a top priority, the fate of this project will surely help determine the direction of Turkish-Russian relations as well as that of the Caspian basin. Significantly, Russia has made it clear that it wants to not only to continue to monopolise the Turkish gas market but also participate in the profitable local distribution.

### ***Blue Stream changed the picture***

The Blue Stream project constitutes one of the most important facets of Turco-Russian relations<sup>43</sup>. The project

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<sup>43</sup> During Kasyanov's visit in late October 2000, Turkey asked Russia, its main gas supplier, at 12 bcm this year, for an extra 12 mcm of gas per day in addition to 33 mcm already being pumped. In addition, while Turkey wants to purchase electricity from Russia via Georgia, Russia is asking Turkey to help Russian companies in the construction of pipeline tenders

envisions bringing 16 bcm of additional Russian gas directly to Turkey. It is environmentally challenging, as a rupture in the pipeline would release a highly dangerous hydrogen-sulphite gas to the detriment of coastal life. Many observers, however, believe that available technology could overcome such environmental and technical challenges. A more serious problem associated with Blue Stream is its threat to the Trans-Caspian project. From the outset the Blue Stream Agreement has been a highly debated project in Turkey, as it was reached behind closed doors<sup>44</sup>. The argument in favour of the project was that Turkey and Russia are two giant neighbours that would gain from co-operation instead of regional rivalry. To underline the significance of the new-found partnership, then Prime Minister Chernomyrdin declared after the signing: "No more Chechen and no more PKK problems".<sup>45</sup>

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in Turkey. Turkey expects its electricity deficit to rise to 7 billion kWh at the year's end from 2 billion kWh in 1999, after a drought forced authorities to run coal and gas-fired plants to offset losses from hydroelectric stations.

<sup>44</sup> The Energy Ministry, under Yilmaz's direction, was accused of hiding the full content of the agreement from the rest of the Turkish State. In fact, it was speculated in the press that, if the President and the Foreign Ministry had not intervened at the last minute, the agreement would have given excessive concessions to Russia.

<sup>45</sup> He was referring to Russia's belief that Turkey aided the Chechens during the 1994-1996 war and to Turkey's own suspicions that Russia supported the terrorist PKK group. Prior to his arrest in February 1999, the PKK leader Abdullah Ocalan sought shelter in Russia to the dismay of Turkey. Blue Stream advocates have argued that certain Russian circles could revitalize the PKK unless there was strong commercial co-operation, with Blue Stream at the heart of the strategic partnership.

Blue Stream has steamed ahead of its faltering competitor, the Trans-Caspian Project. While American policy priorities<sup>46</sup> may very belatedly be shifting from Turkmen gas to Azeri gas in order to keep the gas portion of the Eurasian Energy Corridor project alive, rapid progress seems doubtful. The Turkish energy officials realise that the provision of cheaper Azeri gas is likely to raise further doubts in the minds of Turkish consumers about the advisability of even greater dependence on Russia, which primarily benefits certain Turkish companies as well as their Russian partners. However, one problem they may have to confront is that British Petroleum, which leads the Shah Deniz gas consortium as well as the AIOC is implicitly linking its possible support for the Baku-Ceyhan pipeline to Turkish willingness to buy Azeri gas. It is unlikely that all of these projects can win the Turkish gas race unless they are synchronised over a longer time horizon and unless a reliable connection to the European gas market can be constructed via Turkey and through South East Europe.

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<sup>46</sup> One should also note here that Romano Prodi, the President of the European Commission, assured Russian President Vladimir Putin on 4 October 2000 that the EU supports the creation of the east-west energy corridor proposed by Russia. Under its terms, Gazprom will sign agreements with major German, French, and Italian concerns to provide gas for 20 years. To support that effort, the two sides will construct new oil and gas pipelines from Russia to Europe. Gazprom Chairman Petr Rodionov said that that this project would require the construction of "at least seven major pipelines both to meet our obligations and to keep Ukraine out of this."

## Caspian Legal Status Disputes

Energy resource development requires, or is at least much facilitated by, clear jurisdictional rules developing in effect separate property regimes. Investment is discouraged if severe jurisdictional disputes undermine the security of title issued by one of the state parties to such disputes. The legal status of the Caspian Sea and its seabed and subsoil resources has been hotly contested by its littoral states since the dissolution of the former Soviet Union: whether those resources are owned in common or should be apportioned among the five littoral states and, if they should be apportioned, on what basis. These questions and environmental concerns have hindered—but not stopped yet—further development of the Sea's mineral resources.

Prior to the disintegration of the Soviet Union, the Caspian Sea was the border of Iran and the former Soviet Union. Iran lost its territorial contiguity with Russia. The Caspian Sea now has five littoral states. The legal status issue is not by itself the core of the disputes. The exploitation of mineral resources in the Sea and their transportation through pipelines have made the issue much more important and decisive.

To begin with, there is no clear rule for defining the legal status of the Caspian Sea and dividing the underlying energy resources among the coastal states. Neither previous (USSR-Iran) treaty practice (binding upon the successor states of the USSR) nor the United Nations Convention on Law of the Sea – UNCLAS - (which is not directly applicable) nor universal rules on the status of international lakes (which do

not exist) provide a clear solution. At the outset, Iran and Russia (which, following the collapse of the Soviet Union, became its successor state with respect to international treaties, among other things) insisted on applying the previous provisions set by the bilateral treaties of 1921 and 1940 on all five littoral states in connection with the delimitation and use of the Caspian Sea. In particular, they both believed that, in light of the provisions of the 1921 and 1940 treaties, the Caspian Sea should be under joint ownership and exploited on a condominium basis.

Russia, relying on the idea of the Caspian as an international lake, on a broader interpretation of earlier USSR-Iran agreements and environmental arguments, has used the "condominium" concept to oppose the interest of the main littoral countries in using analogies from the Law of the Sea (the "special circumstances", "equidistance" and "equitable principles" rules) to divide the Caspian among the coastal states<sup>47</sup>. The fact that Russia's own sector (as the Iranian) seemed at first to have little petroleum prospectivity made it easier for Moscow to pursue a policy that was meant to obstruct and delay energy development by the Caspian littoral states using Western oil companies<sup>48</sup>.

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<sup>47</sup> Russian legal argument hence masked a policy to discourage economic independence of the Caspian nations, and to prevent its geopolitical competitor, the US, to develop political and economic linkages with its "near abroad". The Russian interest in maintaining post-colonial suzerainty over its former colonies in the Caspian region is now challenged by more modern economic interest. Russia, in pursuing hegemonistic policies, is likely to lose economically.

<sup>48</sup> "International Good Governance and Civilised Conduct among the States of the Caspian Region: Oil and Gas as Lever for Prosperity or

### *The historic practice of the littoral states*

Present-day discussions over the legal status issue follow strictly the developing international legal conceptualisation, but the legal norms, in their character, leave a vast area for some other factors which may influence the case under discussion. The historical practice is recognized by the 1982 UNCLAS above the international legal regulations, if it is applicable<sup>49</sup>, and refers, in the particular case of the Caspian Sea, to the official documents on the status of the Sea and the historical legal practice of the neighbouring states.

The Caspian Sea in its whole history had been called with about 40 different names in reference to the nations, cities or geographical places by the Sea. The name “Hazar” or “Khazar”, which still refers to the Caspian Sea in Turkish and Persian, was given in reference to the Khazars, a medieval Turkic people who had established a vast empire stretching from the Black Sea to the Caspian Sea. It

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Conflict”, Prof. Thomas Waelde, available at <http://www.dundee.ac.uk/cepmlp/journal/html/vol14-16.html>

<sup>49</sup> In solving the conflictual cases, while also in setting rules of delimitation and bordering, 1982 UNCLAS sensitively sets the condition of lack of a historical point of agreement, as follows: “Where the coasts of two States are opposite or adjacent to each other, neither of the two States is entitled, failing agreement between them to the contrary, to extend its territorial sea beyond the median line every point of which is equidistant from the nearest points on the baselines from which the breadth of the territorial seas of each of the two States is measured. The above provision does not apply, however, where it is necessary by reason of historic title or other special circumstances to delimit the territorial seas of the two States in a way, which is at variance therewith.” United Nations, Oceans and Law of the Sea.

was also called as the “Girkanian Sea”, named after the state of ‘Girkania’. Russians for a long time named it as the “Khvalynskoe More” or Khvaly Sea, referring to the name of the people living in the mouth of Volga. The name ‘Caspian’ was given in relation to the people called Kaspi on the southwestern shores of the Sea.<sup>50</sup>

The Caspian Sea has been an important trade route since the Middle Ages. The Russian penetration started in the 16<sup>th</sup> century. As a result of the 1552 occupation of Kazan and then the 1556 occupation of Astrakhan and in about a decade establishing control on the north-eastern part of Caucasus down to the Terek river, Moscow became the owner of the waterway reaching the Caspian. In this way, Russia began to establish its dominance over the Caspian. In the beginning of the 18<sup>th</sup> century, the Caspian Sea was almost completely taken from the Persians during the reign of Peter I<sup>51</sup>. Russia occupied some parts of the Caspian shores and even in 1723 an agreement was reached with the Persian representative in St. Petersburg, recognising the sovereignty of Russian Tsar over Derbent, Baku, Gilan, Mazandaran and Astarabad. However, Persia did not ratify this agreement and later in 1732, Russia was forced to leave the occupied regions.

The first international rule of law concerning military navigation on the Caspian Sea was set after the wars between 1804-1813 by virtue of the

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<sup>50</sup> K.K. Gul, *Kaspiiskoe More*, Baku, Aznefteizdat, 1956, p.16.

<sup>51</sup> The ambitions of Peter I over the Caspian is obvious in his note to his commander fighting for the Caucasus: “Control over Baku is vital for the Russian dominance over the Caspian and thus to reach Central Asia.”

Gulistan Treaty of 12 October 1813. Because of this Treaty and of inclusion of the norms on military navigation by the Caspian Sea, serious political and economic disagreements emerged between Russia and Great Britain as the sides of the 'Great Game'. Despite all efforts of English diplomacy, Russia forced Persia to sign the 1813 agreement. According to the third article of this treaty, Persia had to recognise the sovereignty of the Russian Empire over Sheki, Shirvan, Derbent, Kuba, Baku and Talysh regions<sup>52</sup>. The legal status of the Caspian Sea came to the agenda later with the Russian-Persian treaty of Türkmençay in 1828.

After the establishment of the Soviet rule, the status issue was not a concern of the outside countries, this time simply because of the completely closed structure of the Soviet Union. The basic rules regulating the navigation by the Caspian Sea were set in the Contract of 1921, according to which the right to navigation was equally given to the both sides of the agreement. In this regulation the type of navigation was not exactly stated. Therefore, the interpretations of the article were also ambiguous and

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<sup>52</sup> Persia naturally was not satisfied with its humiliated situation, especially on the Caspian Sea. A new campaign against Russia between 1826 and 1828 ended in a second victory of Russia and on February 10, 1828 Türkmençay treaty was signed between the two sides. According to this treaty, Russia captured the Erivan and Nakhchevan Khanates. The borderline between Russia and Persia set beyond the earlier line at Astara on the river Arax. As it was in the Gulistan treaty Russian side had the exclusive right to have a military fleet on the Caspian Sea, while Persia had not. In the second half of the 19<sup>th</sup> century and in the beginning of the 20<sup>th</sup> century within approximately one century, from the point of regulations on military navigation on the Caspian Sea nothing was changed.

conflicting. Although there are arguments that practically neither Soviet nor Iranian warships passed a conditional line separating the Russian waters from Iranian, as in the Russian-Iranian contracts, there are no indications about the order of navigation of the warships by the Caspian Sea and the flights over it. The Iranian warships had the right to float in the Soviet part of the Sea. The same applied to the Soviet warships.

The ironic point in all the discussion on the military navigation is the fact that Iran did not have any military fleet on the Caspian Sea at all. Thus, the principle of freedom of military navigation did not become an effective and working rule. This article seems to be aimed at preventing the hostile activities of third powers (i.e. Britain, Turkey or another state, especially against the 'expansion of Russia towards the warmer seas'), trying to gain power in the region, rather than the contracting parties.

### ***What does the international law say?***

One has to examine the legal status of the Caspian Sea as a special case from the perspectives of history and international law. The Caspian is not an "enclosed sea" under the 1982 UNCLOS because, for centuries, the countries around it have exercised exclusive control over its use. Although five major rivers and more than a hundred minor ones drain into it, the Caspian has no contact with the world's oceans. Its only navigable outlets are the Volga River, and a series of canals and rivers extending to the Black and Baltic Seas. These, however, are long inland Russian

waterways, unusable without Russia's permission.

Neither can the Caspian be easily characterised as an "international lake," completely free of the international rules governing seas. It bears the oceanographic characteristics of a sea, and the number of states surrounding it make agreement on the use of its resources and the boundaries crossing it considerably more difficult than, say, the Great Lakes between Canada and the United States. Accordingly, it is appropriate in some respects to view the Caspian as a sea subject to the international laws of the sea. "Sea or lake, what difference does it make?" to borrow the words of one commentator<sup>53</sup>. Building on the solid UNCLOS framework, a hybrid legal model that works can be constructed, regardless of how the Caspian is classified<sup>54</sup>.

No Soviet-Iranian boundary in the Caspian was ever delimited. A comprehensive boundary treaty of 1954 delimits the boundary on both sides of the Caspian but is silent as to any boundary within the sea itself. Earlier treaties in 1921 and 1935 established a 10-mile exclusive fishing zone for each country, and a Soviet-Iranian treaty of 1940 gave each party an exclusive right of fishing in its coastal waters up to a limit of 10 miles. Exchanges of notes attached to Soviet-Iranian treaties of 1935 and 1940 declared that the Caspian "is regarded by the two Governments as a Soviet and Iranian sea" (1935)" and

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<sup>53</sup> Bernard Oxman, *Caspian Crossroads Magazine*, winter 1996.

<sup>54</sup> "Caspian Sea Legal Status, A practical regime for the use and development of Caspian resources", Theodore Jonas, Partner, Baker Botts L.L.P. at <http://www.usacc.org/azerbaijan/oil-caspian.htm>

that the "parties hold the Caspian to belong to Iran and to the Soviet" (1940).

The 1940 Contract has the most important place in the system of contracts regulating the international legal system of the commercial navigation by the Caspian Sea<sup>55</sup>. The Contract sets an extended definition and description of the conditions and rules of navigation. Article 12 states that: "Trade ships, under the flag of one of the contracting parties, will be treated the same as the national trade ships in every respect, as they approach, stay and leave a port of the other party."

These and other treaties provide for the right of free and equal navigation by ships of Iran and the USSR throughout the Caspian. The meaning of the provisions in the two exchanges of notes that the Caspian "belongs to Iran and to the Soviet" was, plainly, that no third state had any rights in the sea, including the right of navigation. The USSR was a zealous proponent of this "closed sea" doctrine, which it sought to extend to the Black Sea as well<sup>56</sup>. Iran agreed that the Caspian was a closed sea.

For many years the USSR carried out activities of exploration and exploitation in the Caspian, primarily in the area off Azerbaijan, which extended far more than 10 miles from shore. The USSR never paid or offered a one-half share of the proceeds to Iran or involved Iran in any way in its activities. The USSR took the position that the seabed and subsoil resources of the Caspian

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<sup>55</sup> See, e.g., D.P. O'Connell, *I The International Law of the Sea* 548-51(1982).

<sup>56</sup> See Joseph J. Darby, "The Soviet Doctrine of the Closed Sea," 23 *San Diego L. Rev.* 685 (1986).

belonged to the USSR and Iran within their respective areas of the sea<sup>57</sup>. Iran has never protested the USSR's petroleum activities or claimed a share of the proceeds from those activities; instead, it has conducted its own unilateral activities in the portions of the seabed and subsoil adjacent to it.

Within the USSR, while no formal boundaries in the Caspian were delimited among the republics, in practice petroleum operations were assigned to agencies associated with one or another republic on the basis of proximity to the maritime areas in question. The area that includes the present Guneshli, Chirag, Azeri and Kapaz fields was assigned for exploration to Caspmor Neftgaz, a "production association" located in and identified with Azerbaijan. Caspmor Neftgaz discovered the Guneshli, Chirag, Azeri and Kapaz fields, and developed and exploited the first of them while the Soviet Union still existed. A similar association in Turkmenistan was responsible for the area eastward of the Kapaz field.

When the area containing the Azeri field was tendered for bid in January 1991, the tender was made jointly by the USSR Ministry of the Oil and Gas Industry and by the Council of Ministers of Azerbaijan. The Resolution-Decree authorizing the tender specifically declared that four giant oil and gas fields have been discovered in the deep-water section of the Azerbaijan sector of the Caspian Sea. Negotiations on contracts

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<sup>57</sup> See William E. Butler, "Tile Soviet Union and the Continental Shelf," 63 Am. 'I. Int'l L. 103, 106 (1969); William E. Butler, *The Law of Soviet Territorial Waters* 77 (1967).

for the Guneshli, Chirag, and Kapaz fields were conducted solely by the Azerbaijan government following the break-up of the USSR. Likewise, with respect to natural resource development in the Caspian Sea sector adjacent to Kazakhstan, the negotiations with the Kaspisheif Consortium had been conducted solely by the Kazakhstan government.

Thus, practice and custom during the Soviet period recognized *de facto* internal administrative boundaries in the Caspian between the republics. Since the dissolution of the Soviet Union these *de facto* boundaries have been respected by the successor states, with each continuing to administer the resources within its *de facto* maritime territory<sup>58</sup>. In addition, Turkmenistan has proclaimed its "Block 1," whose western boundary runs east of the fields discovered and traditionally administered by Azerbaijan, thereby acknowledging the traditional *de facto* boundary between those two states. Similarly, both Azerbaijan and Kazakhstan have respected the rights of the Russian Federation to its sovereignty over its adjacent sector of the Caspian Sea. Lukoil, one of the newly created Russian oil and gas companies, has announced its intention to explore for hydrocarbons in the Russian sector.

Since 1991, various ideas have been expressed by the littoral states over the legal status of the Caspian Sea<sup>59</sup>:

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<sup>58</sup> Ministry of the Oil and Gas Industry USSR and Council of Ministers Azerbaijan SSR, Resolution-Decree No.25/25, Jan.18, 1991, p.1.

<sup>59</sup> "United States Energy Information Administration, Caspian Legal Issues," December 1998, p. 1. At <http://www.eia.doe.gov/emeu/cabs/capslaw.html> (April 19, 1999).

- The Soviet-Iranian treaties of 1921 and 1940 should be observed in defining the status of the Caspian Sea; and by virtue of the Almaty
- agreement of 21 December 1991, the successor states are obliged to observe the international treaties signed by the Soviet Union, until a new agreement is concluded unanimously by the present five littoral states.
- The former Soviet side of the Caspian Sea (above the imaginary line between Astarra and Huseinquli) had been divided in 1970s by the Soviet government into economic zones of four union republics which bordered the Sea, and the same arrangement shall be in force in the post-Soviet period.
- A temporary division of the Caspian Sea into national sectors shall be accepted until the new regime of the Caspian Sea is determined.
- Each littoral country may conclude an agreement with the adjacent littoral state, so as dividing part of the Caspian Sea, by bilateral agreements, between neighboring states.

#### ***Positions of Each Littoral State***

Today each littoral state proposes the solution for the ambiguity in the legal status of the Caspian Sea in a way serving to its economic interests best. Russia, Kazakhstan and Azerbaijan favour a division of the Sea using median lines. Iran opposes this because it would leave Iran with a share of only 13 percent and insists on an equal

division of the Sea that would give each country a 20 percent share.

#### **Russia**

As the natural and legal successor of USSR, Russia accepted the validity of the previous agreements of 1921 and 1940 between USSR and Iran, as these agreements were not rescinded formally, and argued that they should be applied until new regulations and agreements can be reached with the consensus of all the littoral states.

The Russian position has considerably evolved since early 1990s. As early as June 1994, Russian Foreign Ministry stated that: "Our position is that... by nature, the Caspian Sea is an enclosed water reservoir with a single ecosystem...." During the first meeting of the representatives of the littoral states to deal with the Caspian Sea's problems -- then the status issue was not dwelled on as the oil extraction contracts were not on the agenda -- Russia argued that the Caspian Sea was an 'enclosed sea'. According to the Russian position, the Caspian states could have their territorial waters and the middle area of the Caspian Sea would be the common property of all the littoral states. This argument followed the regulations of the 1940 Contract.

However, Russia did not need a long time to realize the disadvantage of defending this argument for its interests. Accepting the Caspian Sea a 'sea' meant that the rules of the 1982 UNCLAS have to be applied. According to the UNCLAS every littoral state of an 'enclosed sea', has the right to set 'internal waters', 'territorial waters', 'continental shelf' and 'exclusive economic zone'. Considering that the

Caspian Sea is not that large, the application of the above mentioned settings meant the delimitation of the Sea according to the 'median line' principle. The UNCLAS states that: "Where the coasts of two States are opposite or adjacent to each other, neither of the two States is entitled, failing agreement between them to the contrary, to extend its territorial sea beyond the median line every point of which is equidistant from the nearest points on the baselines from which the breadth of the territorial seas of each of the two States is measured<sup>60</sup>."

Besides, accepting the Caspian a 'sea' from the legal point of view, would give the other littoral states, which had no outlet to the high seas, right to freely navigate over the Volga-Don and Don-Baltic channels. If the rules of the 1982 Convention are applied to the Caspian Sea, then Russia has to accept the status of the stated channels as international waterways, thus has to open the Caspian Sea to other states. Realizing these geopolitical disadvantages of claiming the Caspian a 'sea', Russia quickly gave up this argument.

It is also not advantageous for Russia to argue that the Caspian Sea is a 'lake'. There are no regulatory rules or laws in international law regarding the lakes. However, the international custom is to divide the international border lakes among its littoral states. There are many examples of such divisions: Lake Victoria (among Kenya, Tanzania, and Uganda), Lake Malawi (between Malawi and Mozambique), the Great Lakes of

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<sup>60</sup> For detail see the 1982 United Nations Convention on the Law of the Sea, Part IX, Article 122. The Law of the Sea. 1983. United Nations. New York.

North America (between Canada and the United States), Lake Titicaca (between Bolivia and Peru), and Lake Geneva (between France and Switzerland). Dividing these lakes into sectors gives the littoral states exclusive sovereign rights over their sectors as state territory. There is only one exceptional case in which the border lake was not divided into sectors among the littoral states, but was set by the International Court of Justice (ICJ) as a common property of the surrounding states and is referred to as a condominium: the Gulf of Fonseca<sup>61</sup>.

Although there exist some contradictory official statements, the current official Russian position is that the Caspian should be recognized as one of these: 'enclosed water reservoir', 'inland basin', 'inland water', 'closed water pool'. Referring to the Caspian Sea in this way Russia officially aimed at escaping from giving a concrete description of the sea, such as naming it simply as a 'sea' or a 'lake', thereby rejecting all the regulations set by the International Law of the Sea, and laying the groundwork for a unique legal regime to be implemented in the Caspian Sea.

Russia's position has changed since the signing of the 1998 bilateral agreement

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<sup>61</sup> J.H.W. Verzijl, 3 International Law in Historical Perspective 19 (1970). Russia could insist on the application of the Gulf of Fonseca case to the Caspian Sea, and thus a condominium to be established. Nevertheless, the Gulf of Fonseca is a unique case. After all, it is not a "lake", or an "enclosed sea", but a wide-open gulf. Moreover, the other examples of delimitation of waters are so common that it is often said that equidistance delimitation of lakes and inland seas is a general rule of international law.

with Kazakhstan<sup>62</sup>. In its new approach to address the realities of the region, Russia argues that the Caspian Sea should not be divided into zones that becomes the territories of the littoral states<sup>63</sup>. The airspace above the Caspian Sea, the surface of the Sea, and the waters of the Sea should have open access, and be administered jointly. However, the seabed would be divided roughly along median lines between the littoral states to permit the development of mineral resources. These median lines would not be drawn according to strict rules from the shores of the Caspian and its islands, but would be open to negotiation between littoral states to take into account other issues such as equity and history.

### **Azerbaijan**

Since 1991, Azerbaijan (and Kazakhstan) has consistently maintained that the Caspian seabed should be divided into national sectors along a median line -- although they have had some differences over joint fishing and navigation rights. In the Azerbaijani constitution of November 1995, the status of the Caspian as a 'lake' is

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<sup>62</sup> "Legal Status of the Caspian: a Russian View", Iurii Merzliakov, Ambassador at Large, Head of the Working Group on the Caspian Sea of the Russian Ministry of Foreign Affairs, International Affairs: A Russian Journal, March 1999.

<sup>63</sup> It should be added that, although the Russian approach to the legal regime of the Caspian Sea has changed many times until 1993, its approach to the legal status of the Caspian Sea has not changed. Its definition of the legal status was the same when it defended that the Caspian Sea cannot be divided and should be accepted under the joint sovereignty of the littoral states, and when its position has changed to stating that the seabed may be divided, but the water surface has to be under joint management.

clearly established and the territorial sovereignty of the Republic on the matter of the division of the Caspian Sea was declared as such: "The Azerbaijan Republic territory shall include the Azerbaijan Republic inner waters, the Caspian Sea (Lake) sector relating to the Azerbaijan Republic, air space over the Azerbaijan Republic."

In April 1998, Russia and Azerbaijan agreed to divide the seabed adjacent to their coasts into national sectors. Iran exclaimed surprise at the development. Then, in July 1998, Russia and Kazakhstan also agreed to divide their adjacent seabed into national sectors. This time, Iran and Turkmenistan exclaimed even greater surprise. Neither of these agreements is public and in fact the provision of the Russian-Kazakh agreement which provides the criterion for demarcation of the offshore boundary is itself subject of a separate secret protocol.

Azerbaijan based its argument on the fact that the Caspian Sea was earlier, in 1970, delimited by the USSR Ministry for the Oil and Gas Industry into sectors among the neighboring republics, while the Sea was already delimited between the USSR and Iran by drawing a boundary line across the sea between Astara and Hasankuli, though it was not confirmed by the formal agreements. This practice meant that the Caspian Sea was accepted as a lake and Azerbaijan would continue the practice just as before<sup>64</sup>. The insistence of Azerbaijan on

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<sup>64</sup> While Azerbaijan is known as the most determined opponent of the Russian view, the contradictory statements of the Azerbaijani officials were no less confusing. During the Ashgabat meeting, then Azerbaijani Foreign Minister Hasan Hasanov set the Azerbaijani position in the following way: "The Caspian Sea

delimitation and especially delimitation in accordance with the 1970 decision of the USSR Ministry of Oil Industry is understandable, as this would give Azerbaijan the highest possible share.

When the Caspian Sea would be divided some of its largest oil and gas reservoirs will remain in the Azerbaijani sector. Azerbaijani sector is estimated to contain 25 of the 32 known oil and gas fields of the Sea as well as 145 of the 386 prospective structures. According to the mentioned delimitation of 1970, Azerbaijan had about 80,000 sq. km, the same share with Turkmenistan, Kazakhstan had 113,000 sq. km, and Russia had 64,000 sq. km of the Caspian floor. Today Azerbaijan insists that the Caspian Sea is a 'sea' to which the norms of the UNCLAS have to be applied.

## **Iran**

Iran's approach to the legal status of the Caspian Sea was not much different from that of Russia, arguing that the Soviet-Iranian Treaties of 1921 and 1940, which accepted the Caspian Sea as a 'joint Soviet-Iranian Sea', must govern until the five littoral states jointly devise a new legal regime for the Caspian Sea. Besides, Iran strictly argued that unilateral actions on the Sea, without the consensus of all the littoral states, are illegal<sup>65</sup>, although Iran remained silent to

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is a border lake like the Great Lakes between the United States and Canada. The traditional use of the Caspian Sea and the implementation of sovereign rights to ownership of its relevant sectors cannot be made dependent on the collective solution of the question of the Caspian Sea's legal status."

<sup>65</sup> In its letter to the United Nations, Iran severely criticised unilateral acts in the Caspian Sea without the consent of the other littoral states,

the unilateral exploitation acts of Azerbaijan until its expulsion from the Azeri projects due to the pressure from the US.

From the point of view of international law Iranian claims seems to be groundless. International Treaty law has one basic principle: "Pacta tertiis nec nocent nec prosunt", meaning that treaty between two states can not create obligations for third states. Therefore, Iran can not deprive other Caspian states from having their own national sectors, just because their names were not mentioned in the Soviet-Iranian treaties. On the other hand, even if to take Soviet-Iranian treaties as a basis Iran is in disadvantage. According to International Treaty Law treaties loose their obligatory functions for the side of the treaty in two cases: If object or subject of the treaties have significantly changed or ceased to exist<sup>66</sup>.

Iran, just like Russia, refrained from defining the legal status of the Sea precisely. The Iranian officials have officially pronounced neither the term 'lake' nor 'sea', for the Caspian Sea. The National Iranian Oil Company stated that: "The Caspian is an inland sea

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and warned, "the full responsibility for consequences of such illegal measures and actions, including damage caused to other coastal states, rests with the states violating the legal regime of the Caspian Sea."

<sup>66</sup> This principle is called "rebus sic stantibus," i.e., "complete change of the circumstances." In this case one of the subjects of the treaty, USSR, collapsed. Nothing changed with respect to Iran and Iran has no right to make any changes in its sea borders. Plainly speaking, Azerbaijan, Turkmenistan, Kazakhstan and Russia are involved in the process of dividing the heritage of the USSR in the Caspian and Iran has no right to interfere to this process or make any claims.

whose status is not defined as an open sea.” The Iranian foreign minister Velayati also named the Caspian Sea as ‘the world’s largest inland sea’. Thus, Iran claimed that the rules of the UNCLAS could not be applied to the Caspian, as it was not an open sea. Besides, it was not a ‘lake’; therefore, sectoral division as a part of international customary law was not under discussion. To the Iranians, due to its size, geographical situation, environmental condition, and the presence of littoral states, the Caspian Sea is quite a special and unique sea; thus, the usual international legal practices do not completely correspond to the needs of the area.

Accordingly, Iran defended the establishment of territorial waters for each littoral state and the remaining part would be under joint exploitation. In November 1996, Iran, Russia and Turkmenistan signed a declaration stating that the Caspian belonged to all riparian states and its oil resources be exploited equally and equitably with the consent of all states. The political implication was that no one state could exploit the resources of the sea without the consent of the others; this meant Iran, as well as any other state, would have a right to veto any future exploitation of the sea.

By 1998, the Iranian approach to the legal regime loosened as the Russian attitude towards the delimitation of the seabed softened. The major fear of Iran is that if the Caspian Sea were delimited into sectors, the Iranian share would be the minimum, namely the region below the Astara-Hasankuli line, which consists only a 12 percent of all the seabed. Besides, it was calculated that

the application of the equidistance line principle gave a 14,6 percent to Iran. For that reason, Iran gave the signal that it would not oppose a sectoral division on the condition that it would be an equal (20 percent) or at least an equitable division<sup>67</sup>.

Iran’s current legal position, in large part the by-product of Russia’s abandonment of its earlier position and Iran’s increasing isolation equally in the face of the likely resolution of Azeri-Turkmen disputes in mid-South Caspian, may be summarised as follows<sup>68</sup>: (a) the division of the Caspian into bands of territorial waters in which each state would have exclusive sovereignty over the water, seabed, subsoil and air space, and (b) equitable (no longer necessarily equal) apportionment of the outer seabed and subsoil into national sectors for the purpose of exploitation of oil and gas resources. Iran continues to insist, as before, on the freedom of navigation and fisheries in waters situated outside of a state’s territorial waters.

### **Kazakhstan**

Kazakhstan’s position regarding the Caspian’s legal status was yet unformulated in 1993 during the littoral states’ prime ministerial meeting in Astrakhan. Later, on July 1994, Kazakhstan submitted a draft “Convention on the Legal Status of the Caspian Sea” to the other littorals of the Sea. Since then, this draft formulated the Kazakh approach to the legal issues of

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<sup>67</sup>“Kharrazi: Condominium concept best solution to Caspian Sea issue”, Tehran, July 29, IRNA -- at <http://www.iran-embassy.org.uk/stoppress/300702kharrazi1.htm>

<sup>68</sup> The Iranian, October 29, 1998 <http://www.iranian.com/GuiveMirfendereski/Oct98/Caspian/>

the Caspian Sea, which is based on the 'enclosed sea' concept, arguing that "the seabed and the resources should be delimited among the littoral states" and "consequently, each state would have sovereign rights the seabed and its resources in its sector." Regarding the historical experience Kazakhstan insisted that on the Caspian Sea, the previous littoral states, USSR and Iran, had never applied common ownership; on the contrary, each one extracted and exploited the resources without the permission and information of the other.

Kazakhstan has proposed delimitation by drawing a median line which starts as a continuation of the onshore border and every point of this line is at equal distance from initial shore line of States located on adjacent or opposite sites of the sea. Kazakhstan has supported Azerbaijan's view for the establishment of national sectors, but has stated that co-operation on the environment, fishing, and navigation would be beneficial. In addition, its only agreement signed in 1998 to date (with Russia) divides only the seabed into national sectors, unlike the Azeri position for full division of the Caspian.

In 1997, Kazakhstan signed a communiqué with Turkmenistan pledging to divide their sections of the Caspian along median lines. Its bilateral agreement with Russia on 6 July 1998 divides the northern Caspian seabed only along median lines between the two countries<sup>69</sup>. Prime Minister

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<sup>69</sup> Although the agreement had vague articles, its significance lays in the fact that Russia for the first time had accepted some kind of a division, though the division was restricted to the seabed. Moreover, the document said that if any oil or gas deposit were in between the national sectors both sides would jointly develop it. The Russian

Kasymzhomart Tokayev has stated that Kazakhstan would consider modifying the median line on economic considerations; i. e., future hydrocarbon finds. Both of these agreements are interim until the status of the Caspian Sea is settled between all of the littoral states. Kazakhstan has opposed an Iranian proposal to divide the Caspian into five equal sectors, stating that this doesn't correspond to historical traditions.

Kazakhstan also refers to the 1982 UNCLAS with regard to the delimitation of the sea surface. After delimiting the seabed and its resources, in its opinion, the appropriate zones (territorial waters, exclusive economic zone), to which the coastal states' sovereignty would be applied, should be established. Besides, fishing and exploitation of biological resources should be carried out by each state inside the relevant offshore zones of an agreed width and also through the establishment of fishing quotas and licenses. Each littoral state should practice the exploitation of mineral resources inside its own zone. The development of deposits inside the zones of two or more states should be the subject of an agreement on sharing the output between the relevant states. At the same time, Kazakhstan claims the right of the land-locked littoral states to passage through the Volga basin to the high seas.

### **Turkmenistan**

Turkmenistan, different from the other four republics, did not have its own conceptualisation of the Caspian Sea's legal status, preferring to follow the

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side has recently proposed this rule as a solution to the current and potential disputable cases.

others' arguments and frequently changing sides. The sole act of Turkmenistan on the issue was its declaration of 12-mile territorial waters on the Caspian Sea in October 1993, which meant the acceptance of the UNCLAS. Turkmenistan initially supported Iran's condominium proposal and Russia's proposal for a 45-mile Exclusive Economic Zone at a November 1996 meeting in Ashgabat of the foreign ministers from five littoral states. At that meeting, Turkmenistan signed a protocol with Iran and Russia to develop a joint stock company to develop the energy resources in the national zones of the three countries.

However, Turkmenistan has changed its position since then. In February 1997, the presidents of Turkmenistan and Kazakhstan signed a statement calling for division of the Caspian Sea based on Soviet-era divisions until the littoral states agreed upon a new status of the Caspian. Azerbaijan and Turkmenistan also issued a statement in February 1998 that both countries agreed on the division of the Caspian Sea along the median line, but disagreements over where to draw that line caused a dispute over a field called Kapaz by Azerbaijan and Serdar by Turkmenistan<sup>70</sup>. Then, Iran and Turkmenistan issued a joint communiqué in July 1998 stating the importance of a consensus among the littoral states, and President Niyazov stated that Turkmenistan shares Iran's view that the Caspian should be divided equally and that negotiations should be multilateral.

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<sup>70</sup> "The new legal status of the Caspian Sea is the basis of regional co-operation and stability", Yolbars A. Kepbanov, Deputy foreign minister of Turkmenistan, *Perceptions Journal of International Affairs*, December 1997-February 1998.

President Niyazov's current position (at least for now) is that the Caspian Sea should be divided along the median lines into national sectors that are not equal in size. Turkmenistan is currently developing oil fields far from 12-mile off its shore, claiming ownership rights over the oil deposits which are on the border between Azerbaijan-Turkmenistan sectors and declaring that it shares 'very similar ideas' over the legal status issue with Iran, Russia and Azerbaijan, all of which contradicts with each other.

### *National Sectors with Disputes*

In 1997, when Turkmenistan still held the position that the Caspian should not be divided to national sectors, President Niyazov made claims to three oil fields of Azerbaijan -- "Azeri," "Chirag" and "Kapaz" --, which it believed were in its national sector and Azerbaijan had no right to exploit them. Interestingly, two out of three oil fields ("Azeri" and "Chirag") were part of the "Contract of Century," concluded between Azerbaijan and Western Oil Companies on September 20, 1994, and Turkmenistan's protest against those agreements came several years later.

Geographically and taking into account the principle of equidistance "Chirag" and "Azeri" are completely within the national sector of Azerbaijan<sup>71</sup>. Besides, there is the principle of "Estoppel," reflected in the article 45 of Vienna Convention on International Treaties

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<sup>71</sup> RFE/RL Newswire, 2(130) Part-I, July 10, 1998, Cited in Abraham S. Becker, "Russia and Caspian Oil: Moscow Loses Control," *Post-Soviet Affairs*, April-June 2000, 16(2), p. 98.

(1969) and later confirmed by a similar convention of 1982. According to the “Estoppel” principle, states lose the right to voice claims at a later stage, if they did not protest against certain state of affairs for some time. As for the third oilfield, “Kapaz” Azerbaijan recognized that it was in a boundary zone with Turkmenistan and it was ready to cooperate to share it, to jointly exploit, or include Turkmenistan to in the consortium<sup>72</sup>. On many occasions, either through diplomatic calls, or through SOCAR’s invitations, Azerbaijan called for a joint development of the field<sup>73</sup>. On 23 August 1999, Ilham Aliyev, son of the President and the President of SOCAR, proposed founding a joint Azeri-Turkmen company to develop the disputed oil field, Kepez. Turkmenistan perceived Azerbaijan’s efforts for a joint ownership as recognition of Azerbaijan’s flawed position.

A just division, based on the median line principle would most probably give the field to Turkmenistan, as Kepez is located 184 km off Azerbaijan coastline and 104 km off Turkmenistan’s coast. This meant that Kepez obviously remained in the Turkmenistan sector. However, Azerbaijani argument stated that the islands offshore had to be taken into account and the starting point must be measured from the island’s shore. This certainly decreased the above-mentioned distance of the field from 184 km to approximately 145 km. Accordingly, the field might be

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<sup>72</sup> “Issues of International Law and Politics in the Caspian in the Context of the Turkmenistan-Azerbaijan Discussion and Fuel Transport”, Yagmur Kochumov, Caspian Crossroads Magazine, Volume 1, Issue No. 4 winter 1996.

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<http://ourworld.compuserve.com/homepages/usazerb/131.htm>

considered to be on the borderline between the two opposite states, while its major part remained in the Turkmenistan sector.

Turkmenistan initially rejected even to discuss the issue. Azerbaijan certainly could not and did not want to cancel the oil agreements with Western companies and freeze any economic activity in the Caspian because of Russian and Turkmenistan claims. In these circumstances it became quite risky for Turkmenistan to hold a contradictory position on the one hand being against national sector principle, on the other hand claiming that Azerbaijan violated its national sector<sup>74</sup>. In February 1998 after consultations in Ashgabat Turkmenistan finally agreed to the principle of dividing the Caspian into national sectors and it accordingly signed a document with Azerbaijan.<sup>75</sup>

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<sup>74</sup>From a pure legal point of view, the delimitation rules regarding the median line principle set by the UN Law of the Sea Convention should be resorted to. In the 2<sup>nd</sup> Part and 15<sup>th</sup> article of the Convention, it is stated that: “Where the coasts of two States are opposite or adjacent to each other, neither of the two States is entitled, failing agreement between them to the contrary, to extend its territorial sea beyond the median line every point of which is equidistant from the nearest points on the baselines from which the breadth of the territorial seas of each of the two States is measured. The above provision does not apply, however, where it is necessary by reason of historic title or other special circumstances to delimit the territorial seas of the two States in a way which is at variance therewith.” If the historical practice is considered, it was clear that Azerbaijan (although it was known that Kepez is on the borderline between the states) explored and developed the oil field, so historical practice gave Azerbaijan the right to exploit the field.

<sup>75</sup> A joint statement was adopted, which says: “The sides have agreed to divide the sectors of the Caspian Sea between Azerbaijan and Turkmenistan along the median line in

Turkmenistan moved further away from Russian influence and already in February 1999 agreed to Trans-Caspian gas pipeline plan despite Russian protests<sup>76</sup>.

### **Is a settlement soon?**

It seems that the issue of the Caspian Sea status is coming to its logical end<sup>77</sup>. Previous documents never determined completely the legal status of the Caspian Sea, as they did not contain any provisions on such important issues as the exploitation of the seabed, the airspace over the sea, and the preservation of its ecosystem. The attempts to reach consensus among the five littoral states came to a deadlock first of all due to Iran's demand of 20 percent of the sea and due to the territorial disputes between Iran and Azerbaijan and Azerbaijan and Turkmenistan. The impasse led Astana and then Baku to make separate agreements with Moscow and each other through bilateral agreements.

In May 2002, Mr. Nazarbaev and Mr. Putin signed a bilateral treaty on elaborating both the maritime borderline

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accordance with the generally recognized principles and norms of international law on the basis of realising their sovereign rights to the Caspian and taking into account the existing interests of the littoral states." Though this joint statement seemed to solve the question theoretically, it came to nothing since the sides insistently continued to argue the ownership rights over the disputed fields, drawing their own median lines.

<sup>76</sup> The special representative of the US President on Caspian Region, Richard Morningstar visited Ashgabat and Baku and mediated between Azerbaijan and Turkmenistan on the border conflict in the Caspian.

<sup>77</sup> The Central Asia-Caucasus Analyst, October 23, 2002. [http://www.cacianalyst.org/2002-10-23/20021023\\_Caspian\\_Sea\\_Agreements.htm](http://www.cacianalyst.org/2002-10-23/20021023_Caspian_Sea_Agreements.htm)

and co-operation in the development of hydrocarbon reserves stretching over the Caspian seabed zones. Around the same time, on May 25-26 2002, the President of Azerbaijan, Mr. Aliyev, paid an official visit to Iran and met with his counterpart Mr. Khatami. Despite of the "non-smooth" relations between these two countries, mostly with regard a dispute over the Caspian seabed line distribution, the geopolitical imperatives have forced these countries to get closer for a settlement.

But, the bilateral Russian-Azerbaijani agreement of 23 September 2002 "on the delimitation of sectors of the Caspian seabed" was an encouraging new step in bringing the differing positions in the Caspian issue closer. According to this document, the Caspian seabed is delimited between Russia and Azerbaijan basing on the median line principle, drawn from equidistant points modified through agreement of the two sides, and also based on common principles of international law and practice. The document states that the agreement does not prejudice the reaching of a consensus among Caspian countries on the legal status of the Sea, and that the parties consider it as part of an eventual general agreement. This agreement to some extent accomplished the process of establishing a triple Caspian alliance. Moscow, Astana and Baku agreed on common approach on working out new legal status of the Caspian Sea.

Just on the day of the agreement's signing, Teheran spoke with sharp objection to this document. President Mohammed Khatami declared that Teheran would not accept foreign interference in Caspian issues, and the

agreement regarding delimitation of the sea bottom must be fair and acceptable to all Caspian countries. Otherwise it is impossible to reach a long-term agreement on the Caspian Sea, he added. Meanwhile, President Niyazov made a sensational statement, proposing to divide Caspian Sea into four shares, leaving Iran out. The U.S. supported the Moscow agreement of the "Caspian three" (Azerbaijan, Russia and Kazakhstan) in the dispute with Teheran on the Caspian status issue.

### **Conclusions: Progressing towards a *sui generis* Caspian regime**

An early settlement of the Caspian legal (and border) disputes to the satisfaction of the five littoral states is critically important for the future development of the region's energy resources and stability in the region. Therefore, the littoral states should proceed to negotiate a multilateral settlement of the Caspian's legal status, mindful of the juridical equality of the littoral states, equitable apportionment and reasonable utilisation of commonly-shared resources, respect for the basin's unique geographical and hydrographical features, and due regard for pre-existing special and historical circumstances.

Such an agreement could include the following elements, according to Jonas<sup>78</sup>:

- Twelve-mile territorial waters for each littoral country as provided under UNCLOS. Each state would

have complete sovereignty over its own territorial waters.

- Because the Caspian is not wide enough for countries on opposing coasts to have 200-mile Exclusive Economic Zones (EEZ), the lines between them must be drawn according to the median-line principle, taking into account special factors that may cause the line to deviate in certain areas. Within its EEZ, each country would have exclusive control over oil and gas development, fishing and the management of other resources. The EEZ would not, however, prevent free navigation by the military and civilian vessels of other littoral states, nor would it prevent one state from laying pipelines or cables through the EEZ of another state.
- Since the Caspian states are environmentally and economically interdependent, any agreement between them must incorporate mechanisms for co-operation, co-ordination of national policies, and the settlement of disputes. A joint governing body is not likely to work in practice. A better approach would be for the littoral states to form working groups to write model laws that could be adopted by each country individually. The adoption of uniform laws on fishing, hydrocarbon production practices, pipeline standards and environmental issues will not only assist economic development in the region, it will also ensure that each country is required, under its own legislation, to adhere to the best environmental, safety and conservation practices.

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<sup>78</sup> "Caspian Sea Legal Status, A practical regime for the use and development of Caspian resources", Theodore Jonas, Partner, Baker Botts L.L.P. at <http://www.usacc.org/azerbaijan/oil-caspian.htm>

- The agreement should create a neutral forum for the resolution of disputes by mediation or arbitration. In the first instance, the forum could adjudicate any disputes over the drawing of the median line that cannot be settled by negotiation. In addition, any Caspian state should have the right to bring legal action against another state for failing to enforce its own laws on fishing, hydrocarbon production practices, pipeline safety or protection of the marine environment.
- Finally, the agreement should provide for joint activities in those areas where the five countries are most likely to find it in their interest to co-operate. One obvious example is emergency response to oil spills and other environmental hazards. The agreement should provide for the joint training of environmentalists and game wardens. That training could be carried out under the auspices of a Caspian Co-ordination Center led by a neutral international organisation such as the UN Environmental Program, and staffed by the nationals of all five littoral states. If the five countries agreed to give it such powers, the Co-ordination Center could monitor and report on each country's compliance with its obligations under the agreement.

It is also worth looking at the experiences in other sea basins (i.e. the Aral Sea, the Baltic, the Black Sea, the Danube, the Mediterranean, and the Persian Gulf), which might provide useful insights on the factors necessary for successful regime and pitfalls to avoid. One of recommendations based

on such experience is to encourage deeper interdependence of regional actors by expanding the realm of their functional co-operation at the local, national, and international levels. It involves, first, assisting the Caspian states to develop the capacity and expertise for shared energy and environmental governance. It also involves norm-building and contestation. In each of these ways the actions of outside states, international organisations, and the transnational NGO community might play a key role as the Caspian regime takes shape.

The recent agreements on stratified ownership between Russia and Kazakhstan (involving individual state ownership of seabed resources and shared ownership of fishing stocks in the central aquatorium) could provide a solid legal foundation for a sustainable development regime, if ultimately accepted by Iran and Turkmenistan. Such a regime would underscore state interdependence by establishing functional issue-linkages between fishing, energy extraction, pollution control, transportation, and sea-level management.

The recommended approach for the Caspian has three main advantages.

- *First*, it is realistic. It builds on accepted principles of international law to create a system that gives each state maximum control over its own resources. It therefore respects the natural tendency of states, especially newly independent ones, to guard their sovereignty closely. Co-operation is accomplished through non-coercive means, focusing on issues that the states are

most likely to agree upon. And, because it is realistic, the proposal offers the quickest route to the solution of legal, economic and environmental problems that cannot afford to wait much longer.

- *Second*, it allows each state to maximise its own wealth while requiring it to give due regard to the interests of its neighbours. Supported by a multilateral agreement, common legislation and collective monitoring, and provisions for resolving disputes, each state is free to pursue its own interests in a more stable environment that ensures the protection of collective interests.
- *Third*, assured national control over hydrocarbon resources and the adoption of UNCLOS rules for underwater pipelines offers greater certainty to potential investors, who would be wary of a system based on unpredictable joint control mechanisms. This certainty is good not only for investors, but for the littoral states who need their investment.

The need to attract investors and financiers for hydrocarbon export projects will continue to drive this process of consensus building, but the littoral states need to be reassured that it will have a clear and mutually beneficial result. The international community and foreign investors should use their contacts with governments in the region to give them that confidence.

Although Turkey is undoubtedly an important player in the region, events today are being driven largely by other players. Competition between Russia

and the US is shaping the geopolitical environment, while energy development is proceeding primarily on the basis of the market realities reflected in the investment. Turkey's most sensible approach as politics and pipelines sort themselves out would be caution and moderation coupled with a focus on market-based economic co-operation rather than power politics. A policy along these lines would help to maximise the economic opportunities that the Caspian region offers to Turkey while minimising the risks of instability and geopolitical confrontation<sup>79</sup>.

To sum up: The not yet clarified legal status of the Caspian is a serious obstacle to full development of the Caspian oil and gas resources (and development of an effective environmental regime) under "normal" circumstances. International law does not have a clear and specific solution at hand (it never does), but it provides a full range of arguments, concepts, precedents and procedures. These are as yet not well utilised by any of the Caspian states. A mature, and civilised, way of inter-state negotiation less obstructed by threats of pure power play and domestic bashing of diplomatic solutions, needs to emerge. All states have not yet tested the justice, domestic viability and international legitimacy of

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<sup>79</sup> Turkey tries to reach an understanding with Russia, Iran, the US and other external powers that explicitly rules out any direct intervention in the internal politics of the Caucasian states. As crucially located as it is, Turkey will remain important to Western and Russian policy initiatives in the Caspian and Central Asia region. Its strategic partnership with the US, its prospective accession to the European Union, its historic, cultural ties, and geographical proximity to Eurasia and the Middle East all make Turkey an indispensable partner on all regional energy co-operation projects.

the legal procedures (e.g. submission of disputes to the International Court of Justice) and legal methods (e.g. Joint Petroleum Development Agreement) available and tested sufficiently elsewhere.

These countries should be supported by training, education and technical assistance in familiarising themselves with international legal procedures for settling disputes; they should be prodded into trying them out. The international legal procedure by itself forces to depart from the discourse of threats and subversion to a language of legal arguments, appeals to universally recognised legitimacy where each concept representing a state interest competes with similar concepts utilised by the other state. It compels to view oneself as one party involved in litigation before an impartial tribunal rather than a state pursuing its self-interest through militant action.

Yes, the problem of the Caspian's legal status is complicated, but it is solvable: the difficult task of getting 135 states to agree on the UNCLOS demonstrates that. All five states now agree on the principle of dividing the seabed into national sectors. The only real sticking point is Iran's insistence on a disproportionate share. Although other issues remain, such as where to alter the median lines to account for special factors, the views of the littoral countries are converging on the principles of individual versus joint control and co-operation on environmental matters. Because of the recent flexibility shown in Iran's position, the issue of Caspian's future legal regime appears much closer to resolution than one might expect. The time is right for the Caspian states to get

down to serious multilateral negotiations. The rewards -- in terms of increased trade, enhanced economic development, and the preservation of a precious ecological resource -- are far too important to ignore.