

Caspian Energy Accords:

A Job Half Done

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Brief Analysis

The November 18 signing of a pipeline accord in the Turkish port city of Istanbul, in the presence of President Clinton, gives further momentum to the oil export link project between Baku, the capital of the Caspian littoral state of Azerbaijan, and Ceyhan, on Turkey's Mediterranean coast. Another piece of paper signed as an "intergovernmental declaration of principles" increased the chances for a gas pipeline between Turkey and the Caspian state of Turkmenistan. Both agreements are crucial to creating a "Euro-Asian energy corridor," allowing the small states of the area to develop economies and political systems independent of either Russia or Iran. But U.S. policy has concentrated on diplomatic action rather than winning the commercial backing necessary for the projects to become a reality. Much work remains if the "northern tier" of the Middle East is to be reshaped permanently in favor of Washington's regional friends.

Is Baku-Ceyhan commercially viable?

Although Turkmenistan and Kazakhstan are part of the equation, the focus is on Azerbaijan, whose offshore oil reserves are being developed by an international consortium, the Azerbaijan International Operating Company (AIOC), led by BP Amoco. Currently, oil is being exported from a point south of Baku, through a pipeline across Georgia to the Black Sea port of Supsa. By adding more pumping stations and through other similar actions, that pipeline can take more oil, a much cheaper option than building a new line across a mountainous area of Turkey to the Mediterranean Sea at Ceyhan. The Baku-Ceyhan line, however, only becomes economical if export volumes reach 1 million barrels a day, which will not happen until 2006--if then--unless other supplies are added, perhaps from Kazakhstan.

BP Amoco has been reluctant to back the Ceyhan line while adequate volumes have been neither available nor in prospect. As the biggest component of the AIOC consortium and the actual operating company in Azerbaijan, it finds itself in a bind. The company needs to go ahead with its program of expanding existing production, but unless either Baku-Supsa is expanded or Baku-Ceyhan is built, the consortium will have no way of exporting the extra oil. Yet from BP Amoco's point of view, the first obstacle to be overcome is the need for the governments of Azerbaijan, Georgia, and Turkey to reach agreements on creating a legal framework, defining commercial relations between

them, and setting out the terms of a construction contract with cost guarantees. Many of these agreements need to be ratified by the three parliaments.

The company is in a vulnerable position because its proposed merger with the U.S. oil company, Arco, is likely to be turned down on competition grounds by the Federal Trade Commission (FTC); the FTC staff has recommended rejection. Negotiations are likely to resume for the purpose of seeking a new compromise, and some might suggest using this as a lever for more concessions by the company on the Caspian pipeline. Although a BP Amoco spokesman was quoted last month as saying, "Since when has the FTC been interested in Caspian pipelines," the company's public statements on the Ceyhan line have become more conciliatory in recent weeks. It was quoted, for instance, as expressing a readiness to commit "expertise, capital, and Caspian oil volumes to making the Baku-Ceyhan line a reality."

Extra oil might be available from Kazakhstan, which has much larger proven reserves than Azerbaijan and for which the new pipeline being built across Russia to the northern Black Sea will not be large enough. Last month, the AIOC consortium was reported to have contacted Kazakhstan, asking that oil unable to travel the new route across Russia to the Black Sea should be sent to Azerbaijan, making the Ceyhan project more viable. Much depends on current Kazakh exploration, offshore in the Caspian Sea. New oil discoveries there could be exported via an Azerbaijan pipeline, which would reduce Moscow's ability to extract high transit fees from Kazakh oil going through Russia.

Just as with the Baku-Ceyhan oil pipeline, there are serious commercial issues needing to be resolved before the projected gas pipeline from Turkmenistan can be finalized. This gas pipeline would run under the Caspian to Azerbaijan and then across Georgia to link up with the Turkish national gas grid. Significant amounts of gas have been found in Azerbaijan, however, so Baku must accept the transit of Turkmenistan gas to markets it might one day look upon rightfully as its own.

Political challenges

The two pipeline projects are sensitive to Russia and Iran. Russia has actively tried to dissuade Azerbaijan from pursuing Baku-Ceyhan. A spokesman in Tehran described the agreement as "political," insisting that the Baku-Ceyhan oil pipeline would never be built. To be sure, the easiest technical way to export Azeri oil is by sending it across the border to Iran for use in that country's northern industrial cities. Under such a system, Azerbaijan and oil-producing companies would benefit from access to oil "swapped" from Iran's southern oil fields for export via the Persian Gulf to the reviving Asian economies. But such a deal would face not only U.S. opposition on geostrategic grounds, but other problems as well: Tehran has had difficulty in negotiating with international oil companies, and Iranian-Azeri relations have at times been poor.

Two of Washington's closest allies in the region--Turkey and Kazakhstan--appear to be considering other options in addition to the Trans-Caspian oil and gas pipelines favored by Washington. Last week President Nazarbayev of Kazakhstan was in Beijing where he discussed an oil pipeline running 1,900 miles eastward--a "pipe dream" in the eyes of some--to serve China's industry. Nazarbayev will probably be asked how this project fits in with the Istanbul protocol, which he formally witnessed, when he visits Washington later this month. For its part, Turkey is actively exploring other options for importing gas, in addition to, or instead of, the volumes proposed from Turkmenistan. A week after the signing ceremony in Istanbul, Turkey signed an agreement for an Italian pipeline company to bring Russian gas to Turkey via a pipeline under the Black Sea. This north-south route, the so-called "Blue Stream" line, would be the world's deepest undersea pipeline and would confirm Russia as Turkey's principal gas supplier. The contract is contingent on Turkish ratification and the completion of financing arrangements. Washington is unhappy about Turkish interest in the project, which the U.S. feels will undermine the Trans-Caspian project from Turkmenistan. Last month, the U.S. deputy assistant secretary of state responsible for pipelines and sanctions, Peter Bass, at a London energy conference, warned that both Turkmenistan and Azerbaijan could lose if they fail to move

quickly on the proposed Trans-Caspian (gas) Pipeline and to agree to cooperate rather than compete on the export of gas to Turkey.

The local political difficulties facing U.S. diplomacy are numerous. President Aliyev of Azerbaijan is in his 70s and had major heart surgery in the United States earlier this year. President Shevardnadze of Georgia, the transit country for both lines, has been the frequent target of assassination attempts. President Niyazov of Turkmenistan has built a tall statue of himself in his capital, Ashgabat, which revolves slowly as the day passes. (Local cynics suggest that the world might actually be revolving around the statue.)

Secretary of Energy Bill Richardson described the November 18 signing as "a major foreign policy victory" and "a strategic agreement that advances America's national interest." Yet the success of bringing the parties to signing ceremonies in Istanbul only magnifies the importance of maintaining momentum in the face of numerous remaining obstacles. This policy requires continuing diplomatic pressure on the parties as well as anticipated enhanced commercial incentives. Russia, though benefiting from the transit of Kazakh oil, is intensely sore at the loss of its regional influence and suspicious of American intentions. The stamina of Washington for the task is already publicly in doubt. These doubts must be allayed if serious damage to the policy's momentum is to be avoided.

London-based Simon Henderson, an adjunct scholar of The Washington Institute, writes about Middle East energy issues and visited Baku earlier this year.



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