

# Russia and the Caspian region: Challenges for transatlantic energy security?

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## **Abstract**

The EU and the USA have not always agreed on Europe's approach to energy security, particularly Europe's relationship with Russia. But even when transatlantic interests have converged vis-à-vis Russia or the Caspian region, mere concurrence has not always been sufficient for producing positive outcomes. By analysing in broad-brush strokes the motivations of the EU, the USA and Russia in four arenas Russian and Caspian oil to world markets and Russian and Caspian gas to the EU the contradictions and challenges are illuminated. As this analysis demonstrates, success is more likely when the EU member states are unified around a position and the transatlantic partners agree on both objectives and strategies.

Keywords: Russia; Caspian; Caucasus; Central Asia; energy security

## **Introduction**

In the past 20 years, talk of a 'new great game' has emerged as the USA, Europe and Russia vie for influence over Eurasian oil and gas and the means of bringing those resources to market. At the broadest level of energy security interests, the transatlantic community shares the goals of stabilising global oil markets and ensuring reliable supplies for Europe, while protecting Europe's independence and freedom of action. More specifically, the transatlantic community seeks to minimize European vulnerability to Russian energy manipulation and to develop a Southern Corridor for transporting Caspian gas to the EU as a means of supply diversification. Here though there is an important degree of nuance: the transatlantic partners are driven by divergent interests and face differing constraints.

The USA is not directly dependent on Russia or the former Soviet republics for its energy supplies. From Washington's perspective, bringing Caspian basin resources to market via non-Russian (and non-Iranian) transit routes is of geostrategic value, given broader US interests. Europe, however, is highly dependent. Thus, even though non-Russian transit routes would augment the EU's supply diversification, Europe's proximity to Russia and the many facets of interdependence characterising the EU-Russia relationship mean that Europe must tread a bit more carefully with Russia. Moreover, Europe must contend with its own internal divisions and struggle to achieve a coherent foreign energy policy.

Russia, for its part, has become a more assertive energy actor on the Eurasian stage and, with each new term in leadership, Vladimir Putin has strengthened the

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hand of Russia's national energy companies. Russia's broad objectives are to not only keep its current European customers but also to gain new ones and to become the transporter of Caspian hydrocarbons to the West.

The movement of Eurasian hydrocarbons Caspian and Russian gas to Europe, and Russian and Caspian oil to world markets can be thought of as four arenas in which the EU, the USA and Russia manoeuvre and attempt to attain leverage. By analysing in broad-brush strokes the strategies of the various actors in each arena and the outcomes, we will highlight, from the transatlantic perspective, the contradictions and the ironies and illuminate the conditions for success of the transatlantic objectives.

### **Arena 1: Russian oil to world markets**

During the cold war, the USA strongly objected to energy links between the Soviet Union and Europe, seeing this as a means by which Moscow could exert undue pressure and influence on energy-dependent governments.<sup>1</sup> In the 1980s, for example, the USA worked behind the scenes to discourage its European allies from supporting the construction of gas export pipeline links across Ukraine and Belarus.<sup>2</sup> After the dissolution of the Soviet Union, however, the USA did not object to its companies helping Russia improve its oil production capacity. In contrast, of the four arenas this paper will explore, the first arena is the least contentious because the three main actors, the USA, Europe and Russia, have been highly interested in bringing Russian oil to market. Russia is interested in garnering income, and the USA and Europe, whose economies are dependent on low-cost and readily available hydrocarbons, are interested in bringing oil, particularly non-OPEC oil, to world markets. Since oil prices are determined by the international markets, both the EU and the USA are negatively affected by price increases and volume decreases and thus seek oil to stabilise world markets.

At the time of its peak production in 1988, the Soviet Union was the top producer of the world, with its 11.8 million barrels per day (mmb/d) – 95% of which was from inside Russia – far above that of the next two producers, the USA with 8.1 mmb/d and Saudi Arabia with 5.3 mmb/d. In the early 1990s,

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<sup>1</sup> Peter Rutland, 'US Energy Policy and the Former Soviet Union: Parallel Tracks', in *Russian Energy Power and Foreign Relations. Implications for Conflict and Cooperation*, ed. Jeronim Perovic, Robert Ortung, and Andreas Wenger (London and New York: Routledge, 2009), 181-200.

<sup>2</sup> The Margaret Thatcher Foundation, 'The Polish Crisis of 1980-1981', [http://www.margaretthatcher.org/archive/us-reagan\(Poland\).asp](http://www.margaretthatcher.org/archive/us-reagan(Poland).asp).

however, the political and economic disarray ensuing from the Soviet Union's dissolution combined with technological shortcomings led to a sharp decline in Russia's production capacity.

Russia's output of oil fell from 11.8 mmb/d in 1988 to about 6 mmb/d at the end of 1990s.<sup>3</sup> In order to revive the oil industry, the Russian government invited foreign investors to take part in the development of the oil sector. Three forms of foreign direct investment were launched: (1) joint ventures, (2) investment within the framework of a production sharing agreement and (3) foreign equity investment.

As a result, foreign direct investment had achieved US \$6 billion by 2000 and helped to increase production to 7 mmb/d in 2001.<sup>4</sup> In 2011, it reached 10.2 mmb/d – its highest post-Soviet record for yearly crude output.<sup>5</sup> Russia has had problems, however, in maintaining its production, and significant drops will occur if it does not manage to replace its declining West Siberian output with new sources – a task that will require advanced, read western, technology.

Just as Russia has experienced swings in its production, it has experienced swings in its national energy policies. President Vladimir Putin began his career in national political office after the ruble devaluation and financial crisis of 1998, when he was

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appointed Prime Minister in 1999 by then-President Boris Yeltsin. In 2000, Putin became president, succeeding Boris Yeltsin, whose time in office was marked by the privatisation of oil and gas assets.<sup>6</sup> Most of these assets fell into the hands of individual private Russian investors – the so-called 'oligarchs' – since foreign companies were forbidden to outright own Russian assets and participate in the privatisation. During Putin's first term, it was accepted within the energy industry that as long as the oligarchs stayed out of politics, they could hold on to their acquired gains. The fact that Putin in June 2003 blessed the 50/50 joint venture between the private Russian company TNK, which was controlled by a group of well-connected oligarchs, and the UK company BP, was viewed as a positive sign that foreign investors were welcome in the country.<sup>7</sup> This perception would rapidly change as Putin took steps to regain state control of the industry.

In October 2003, Mikhail Khodorkovsky, the founder of Russia's most successful private oil company, Yukos, was arrested and the company's assets were seized by the Russian national oil company, Rosneft. Khodorkovsky had mounted a political challenge to Putin and was also in the process of negotiating a sale of up to 51% of his company to the US firms ExxonMobil and Chevron, prior to his arrest. Khodorkovsky has languished in prison since then, while Rosneft grew during Putin's second term as president (2004-2008) into one of Russia's most successful enterprises, backed by Yukos' assets. Putin

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<sup>3</sup> Production figures presented by the Russian Federal State Statistics Service, <http://www.gks.ru>.

<sup>4</sup> For more see Andreas Heinrich, Julia Kuszniir, and Heiko Pleines, 'Foreign Investment in Russian Oil and Gas', *Post-Communist Economies* 14, no. 4 (2002): 495-508.

<sup>5</sup> See note 3.

<sup>6</sup> Anders Åslund, 'Comparative Oligarchy: Russia, Ukraine and the United States', *CASE Network Studies and Analyses No. 296* (2005); and Carnegie Endowment for International Peace, [http://www.case-research.eu/upload/publikacja\\_plik/4931074\\_SA296last.pdf](http://www.case-research.eu/upload/publikacja_plik/4931074_SA296last.pdf) (accessed September 13, 2012).

<sup>7</sup> TNK-BP, 'Sign Pipeline Memorandum – Governments Will Attempt to Clear Away Obstacles for \$7 Billion Construction', *TNK-BP News*, June 27, 2003, <http://tnk-bp.ru/en/center/media/2003/06/4695/> accessed September 13, 2012).

had clearly begun to favour the state sector over the private oligarchy, whose room for manoeuvre became increasingly restricted.<sup>8</sup>

During Putin's second presidential term, the Russian state gas company, Gazprom, also flourished. In 2005, Gazprom took over the private oil company Sibneft, owned by a well-connected Russian oligarch, Roman Abramovich, which provided the gas company with its oil arm, Gazprom Neft.<sup>9</sup> Shortly thereafter, Russian discomfort with foreign investment in Russia proper became glaringly apparent. For example, in 2006 the Western energy giant Royal Dutch Shell (Shell) had serious troubles with its business in Russia when the Sakhalin Energy company, operator of the Sakhalin-2 energy project in which Shell had a controlling interest, had to suspend construction work on its pipelines per the orders of the Russian Federal Service for Natural Resources. The official reason for this was violations of environmental regulations by a subcontractor on the Sakhalin-2 project. However, the suspension occurred while Gazprom was negotiating with Shell for the transfer of half of its 55% interest in Sakhalin-2. Consequently, Shell agreed to sell 27.5% of its share in the Sakhalin Energy company to Gazprom. Around this same time, two additional project members, Mitsui and Mitsubishi, reduced their shares to 12.5% and 10%, respectively, in favour of Gazprom. As a result, Gazprom now has a 50% plus one share in the Sakhalin-2 project.<sup>10</sup>

In the period 2008-2012, when Putin was Prime Minister, the strengthening of the Russian state companies continued. The private sector had limited room for growth and foreign investors were excluded from the country's 'strategic assets'. Starting in 2008, another large international company, BP, began experiencing problems. Its Moscow headquarters were searched repeatedly by Russian security forces and the CEO of the Russian joint-venture business TNK-BP was forced to leave Russia after his visa was revoked. In 2011, security forces again raided the headquarters after BP's attempts to rescue an oil exploration agreement in the Russian Arctic with Rosneft fell through.<sup>11</sup>

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During Putin's third presidential term (2012-2018), an effort is being made to selectively engage with carefully chosen foreign partners in areas where Russian companies need technology and want to avoid risking their own money. This mainly means offshore exploration and production, but also applies to certain onshore projects where shale oil and tight oil developments are being targeted by Rosneft in cooperation with the international oil industry. Putin wants to maintain Russian oil production at its current high levels and understands that foreign help may be needed to unlock the potential of difficult to develop and expensive reserves.<sup>12</sup>

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<sup>8</sup> Martha Brill Olcott, *Vladimir Putin and the Geopolitics of Oil*, Online Paper (Houston: The James A. Backer III Institute for Public Policy of Rice University, 2004), [http://www.carnegieendowment.org/files/wp-2005-01\\_olcott\\_english1.pdf](http://www.carnegieendowment.org/files/wp-2005-01_olcott_english1.pdf) (accessed September 13, 2012).

<sup>9</sup> Andrew Kramer, '\$13 Billion Sibneft Deal Fulfills Gazprom Quest', *New York Times*, September 29, 2005, <http://www.nytimes.com/2005/09/29/business/worldbusiness/29iht-gazprom.html> (accessed September 13, 2012).

<sup>10</sup> Andrew Kramer, 'Shell Cedes Control of Sakhalin-2 to Gazprom', *New York Times*, December 21, 2006, <http://www.nytimes.com/2006/12/21/business/worldbusiness/21ihtshell.3981718.html> (accessed September 18, 2012).

<sup>11</sup> Timothy Heritage, 'New Blow for BP in Russia as Office Raided', *Reuters*, August 31, 2011, <http://www.reuters.com/article/2011/08/31/us-bp-russia-raid-idUSTRE77U1EP20110831> (accessed June 27, 2012).

<sup>12</sup> Julia Nanay, *Russian Arctic Strategies and Recent Deals* (Washington, DC: Wilson Center Canada Institute, 2012), <http://www.wilsoncenter.org/sites/default/files/NanayArctic7-1212.pdf> (accessed September 17, 2012); and Jake Rudnitsky and Ilya Khrennikov, 'Putin Pushes International Oil CEOs for Access to Assets', Bloomberg News, June

However, the history of less than professional and unequal treatment of international companies could frustrate Western efforts vis-à-vis Russia in the future, despite the fact that all major actors share a common interest in Russian oil reaching world markets and that the expertise of such companies is necessary to achieve common goals. At the moment, companies from both the USA and the EU are at the forefront of exploration and production efforts for Russia's next generation of offshore reserves, with the Arctic's Barents and Kara Seas as focal points, along with the Black and Okhotsk Seas. For example, ExxonMobil, Eni and Statoil recently signed contracts to explore in these offshore areas, together with Russian national oil company Rosneft. This type of joint work will only be productive if the companies are protected from the abusive practices of the state.

In sum, during the cold war, the transatlantic allies disagreed over Europe's importation of Russian hydrocarbons, with the USA unable to discourage Europe. In the post-cold war era, however, the transatlantic partners have both been highly interested in helping Russia improve its oil production capacity. But, in this arena, the USA, Europe and Russia are now at a juncture. Western companies are poised to help in – and, of course, gain from – the continued revitalisation of the Russian oil sector. Without their participation, Russia risks a significant drop in production, which would put upward pressure on prices and negatively affect the economies of both the USA and the EU. One of the ways to ensure the development and reliable delivery of Russian oil to global markets is to have US and EU companies, with their global experience and sophisticated technologies, maintain deep involvement in Russian exploration and production. However, can Russia tolerate this presence and loss of control? Can it be compelled to increase its tolerance threshold?

After the problems encountered by BP and Shell, British Prime Minister David Cameron made pointed remarks during a state visit in 2011 to Moscow that British businesses need assurances they will not be interfered with and, in a meeting with Russian President Medvedev, raised the issue of the searches of BP's offices.<sup>13</sup> While Cameron's bilateral efforts are laudable, it would seem that the USA and Europe would have more leverage if their leaders publicly confronted questionable Russian commercial practices together: Cameron confronting Putin and Medvedev while accompanied by US and other European leaders would have far more impact than that of one leader alone.

## **Arena 2: Caspian oil to world markets**

In the first arena, transatlantic consensus on both ends and means has helped Europe and the USA achieve their respective policy objectives, at least so far. This was made easier since Russia was eager to bring its oil to market. In the Caspian region, however, Russia is pursuing an objective at odds with those of the West.

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22, 2012, <http://www.businessweek.com/news/2012-06-21/putin-pushes-international-oil-ceos-for-access-to-assets> (accessed June 27, 2012).

<sup>13</sup> Louise Armitstead, 'David Cameron: "UK Companies Put Off Russia Because of Corruption"', *Telegraph*, September 12, 2011, <http://www.telegraph.co.uk/finance/globalbusiness/8758532/DavidCameron-UK-companies-put-off-Russia-because-of-corruption.html> (accessed September 17, 2012).

Contemporary Western involvement in Central Asia dates back to October 1990 when the Soviet Union – frustrated by the technical challenges of exploring and producing in the Caspian basin – invited bids from international energy companies. At the beginning of the 1990s, the first agreements were signed and, after the dissolution of the Soviet Union, the new independent states became contractual partners with various foreign companies – several of which were American. Over the next few years, the companies discovered that the Caspian contained far greater wealth than anyone – including Russia – had previously estimated and the modern-day struggle for control began. The US companies apprised the US government of the potential size of the resources in the Caspian region and the USA became interested in bringing those resources to western markets, but via non-Russian and non-Iranian routes. To stymie other potential routes, Russia pursued various tactics (such as disputing the legal status of the Caspian as a sea) to persuade the former Soviet republics and the foreign firms to use Russian pipeline infrastructure for exporting Caspian oil. The Caspian states, the international energy companies and the US government, however, were set on ‘freeing’ the region from further Russian influence.<sup>14</sup>

Eventually two options were selected: a temporary Russian route for ‘early oil’ and a to-be-determined non-Russian route for the later movement of large quantities of oil. Finding a suitable non-Russian route, however, was a lengthy process. The most straightforward routes were blocked by geopolitical considerations: a southern route would transit Iran, which the USA was against; and a straight western route would cross the disputed Nagorno-Karabakh region between Azerbaijan and Armenia. The USA viewed finding a non-Russian/non-Iranian route as a strategic project and ultimately championed the 1768 km-long Baku-Tbilisi-Ceyhan (BTC) pipeline that would flow from Baku, via Georgia, to the Ceyhan port in Turkey.<sup>15</sup>

The USA actively supported the realisation of the BTC project in many ways.<sup>16</sup> It helped in negotiations between the different institutions involved, including the presidents and publics of Azerbaijan, Georgia and Turkey, international energy companies, and international financial institutions, on issues such as petroleum transport options and environmental questions. Additionally, the participants of the BTC project received financial support from US governmental agencies – the Overseas Private Investment Corporation (OPIC) and the Export-Import Development Bank. In addition to seeking to limit Russian and Iranian influence in the region, Washington, viewed the BTC pipeline as a way to shore up its relationship with NATO-ally Turkey.

Unsurprisingly, the BTC pipeline received strong support from the Turkish government, as it would help Turkey better manage its own energy shortages; position it as a transit country as well as the

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<sup>14</sup> Karen Smith Stegen, ‘Deconstructing the “Energy Weapon”’: Russia’s Threat to Europe as Case Study’, *Energy Policy* 39, no. 10 (October 2011): 6505-13.

<sup>15</sup> For background, see Leon Fuerth, ‘Oil, Oligarchs and Opportunity: Energy from Central Asia to Europe’, Testimony to the US Senate Committee on Foreign Relations, June 12, 2008, <http://www.foreign.senate.gov/testimony/2008/FuerthTestimony080612p.pdf> (accessed September 18, 2012). The testimony of the other experts at this hearing is also enlightening.

<sup>16</sup> Richard Morningstar, ‘From Pipe Dream to Pipeline: The Realization of the Baku-Tbilisi-Ceyhan’, *Event Report*, Council on Library Resources, Belfer Center for Science and International Affairs, Harvard University, May 20, 2003, [http://belfercenter.ksg.harvard.edu/publication/12795/from\\_pipe\\_dream\\_to\\_pipeline.html](http://belfercenter.ksg.harvard.edu/publication/12795/from_pipe_dream_to_pipeline.html) (accessed September 17, 2012).

champion of the new, oil producing countries; and strengthen its geopolitical status as the connection between the Caspian region and Europe.<sup>17</sup>

Europe, in contrast, was initially less active in the Caspian region. On the basis of the Program of Technical Assistance to the Community of Independent States, launched by the European Commission (EC) in 1991 to promote the economic development of the post-Soviet countries, Europe only facilitated the newly proposed Caspian oil and gas transportation routes by providing technical support and assistance in framing agreements between the countries involved (such as Azerbaijan, Kazakhstan and Georgia). The paucity of EU engagement in the 1990s has been

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attributed to various causes ranging from the lack of an institutional structure that would have allowed the EU to take a common position on how to approach the former Soviet republics<sup>18</sup> to doubts over the energy potential of the region to European nervousness that encroaching on Russia's 'Near Abroad' would have risked negatively impacting EU-Russian energy relations.<sup>19</sup>

The reaction from Russia towards BTC was initially mixed. On the one hand, Russian companies indicated an interest either in joining the project directly or building a line connecting it to Novorossiysk, Russia's leading Black Sea port (both ideas were resisted, but a Russian company did gain a minor consortium share). Russian policy-makers, however, reacted negatively to the pipeline. Aside from questioning the project's commercial viability, Russian Minister of Foreign Affairs Igor Ivanov stated that Russia opposed the BTC pipeline because its goal was 'to oust Russia from regions which are historically the regions of lawful interest of Russia'.<sup>20</sup>

In addition to not wanting its transit monopoly weakened, Russia resisted Georgian and Azerbaijani integration into the Euro-Atlantic space. Despite Russia's opposition, the construction of BTC began in May 2003 and the first oil flowed in June 2006.

In the case of the BTC pipeline, western interests prevailed. The USA (and Turkey) pushed hard to achieve its objectives and the EU, although not a strong partner, was at least unified in favour of the project. The widespread convergence of interests prompted one analyst to note that support for the BTC pipeline survived the test of time and of ideological differences:

There is much that divides prime ministers Özal and Erdogan in Turkey, Major and Blair in Great Britain, and Brundtland, Suipé, Jagland, and Bondevik in Norway, or that separates presidents Shevardnadze and

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<sup>17</sup> For example, see Zeyno Baran, 'The Baku-Tbilisi-Ceyhan Pipeline: Implication for Turkey', in *The Baku-Tbilisi-Ceyhan Pipeline: Oil Window to the West*, ed. S. Frederick Starr and Svante E. Cornell (Washington, DC: Central Asia-Caucasus Institute & Silk Road Studies Program, Joint Transatlantic Research and Policy Center, 2005), 103-18.

<sup>18</sup> Manja Vidic, 'The EU Institutional Capacity in Securing Energy', *Turkish Policy Quarterly* 6, no. 4 (2007): 79-85; and Samuel Lussac, 'Energy Security in Russian "Near Abroad": The Case of the South Caucasus', *European Security* 19, no. 4 (2010): 607-625.

<sup>19</sup> Richard Youngs, *Energy Security: Europe's New Foreign Policy Challenge* (London: Routledge, 2009), 100-25.

<sup>20</sup> Transcript of Replies by Russian Minister of Foreign Affairs Igor Ivanov to Journalists' Questions at Press Conference in UN, New York, September 17, 2002, [http://www.mid.ru/bdomp/brp\\_4.nsf/e78a48070f128a7b43256999005bcbb3/86cdf76985bfe27d43256c3900520212!OpenDocument](http://www.mid.ru/bdomp/brp_4.nsf/e78a48070f128a7b43256999005bcbb3/86cdf76985bfe27d43256c3900520212!OpenDocument) (accessed September 18, 2012).

Saakashvili in Georgia, Heydar Aliyev and Ilham Aliyev in Azerbaijan, and Clinton and Bush in the United States. But with respect to the BTC project, they all spoke in one voice.<sup>21</sup>

### **Arena 3: Russian gas to the EU**

In contrast to the first two arenas – which saw transatlantic consensus around objectives and, for the most part, agreement on strategies – convergence between the USA and Europe has not been a hallmark in the third arena. The USA has been wary of Europe's dependence on Russian gas pipelines for decades. Europe, on the other hand, historically perceived its gas relationship with Russia as a mutually beneficial economic arrangement, secured by interdependence, and allowed the gas trade to grow. Today, despite earlier US efforts to prevent it, the EU has become Russia's largest gas export market and EU companies have become investors in gas pipelines from Russia to Europe.<sup>22</sup>

From the Russian perspective, the European market is a significant source of hard currency; the Russian state receives 8% of its GDP through Gazprom, which earns most of its revenues from Europe.<sup>23</sup> Russia is thus intent on keeping Gazprom's current customers and gaining new ones, including the hitherto Russian-free UK market. Russia plans to accomplish both these tasks by constructing new pipelines.

In 1997, Gazprom and a Finnish partner began planning a northern pipeline, which evolved into the 55 billion cubic meter per year (bcm/y) Nord Stream project and later included German, French and Dutch partners. Although some EU member

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states were dubious about the pipeline – for a mix of reasons including concerns about its environmental impact, increasing EU dependence on Russia, and the bypassing of EU member states that would have appreciated becoming transit countries – in 2000 the EU gave Trans-European Energy Network (TEN-E) status to Nord Stream and provided it with support. Nord Stream's first leg was completed in November 2011 and the second leg should be in operation by October 2012. Nord Stream runs 1220 km under the Baltic Sea from Vyborg, Russia on the Gulf of Finland to Greifswald, Germany. It is through Nord Stream's northern onshore route that Russian gas could eventually be directed to the growing UK market, flowing through a series of existing and planned pipelines along the way. Through a southern route from Greifswald to the German-Czech border, there are plans for gas shipments in the future to reach the Czech Republic, Slovakia, Poland, Austria and Hungary.

Following its 2006 dispute with Ukraine (which had historically moved about 70% of Russian exports to Europe), Russia made a strategic decision to limit Ukraine's role in its exports and proposed a southern route, the 63 bcm/y South Stream pipeline. Not only would South Stream allow Russia to bypass Ukraine, it would pre-empt potential competitor gas pipelines that could encroach on Gazprom's

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<sup>21</sup> S. Frederick Starr, 'The Baku-Tbilisi-Ceyhan Pipeline: School of Modernity', in *The Baku-Tbilisi-Ceyhan: Oil Window to the West*, ed. S. Frederick Starr and Svante E. Cornell (Washington, DC: Central Asia-Caucasus Institute & Silk Road Studies Program, Joint Transatlantic Research and Policy Center, 2005), 14.

<sup>22</sup> Smith Stegen, 'Deconstructing the "Energy Weapon"', 650-56.

<sup>23</sup> R.E. Ericson, 'Eurasian Natural Gas Pipelines: The Political Economy of Network Interdependence', *Eurasian Geography and Economics* 50, no.1 (2009): 28-57.



Southeast/Central European monopoly. South Stream is planned to cross the Black Sea to Bulgaria, with a branch serving Greece and Italy and a second branch to countries in Central and Eastern Europe. Gazprom has adopted an interesting ‘patch work’ approach for South Stream’s realisation. Instead of creating an international project company to develop the pipeline with the participation of all transit countries, Gazprom has chosen to conclude bilateral agreements with each transit country. This provides Gazprom with the strategic advantage of being the only investor with an overview of the entire project, while individual investor/ participant countries have no information about what has been negotiated with other participants.<sup>24</sup>

The EU’s support of the Nord Stream pipeline – such as endowing it with TEN-E priority status – despite the objections of some member states and the general displeasure exuding from Washington with regard to European dependence on Russia, has not recurred for South Stream. Indeed, in recent years, the EU has begun to view its dependence on Russia with increased apprehension. Just as Russia made significant adjustments following the 2006 gas crisis with Ukraine, the various 2006-2009 gas disputes between Russia and Ukraine – in which EU member states suffered shortages – prompted the EU to reassess its earlier assumptions regarding Russian supply reliability.

The EU has become more defensive and has initiated a number of measures to both reduce its vulnerability and exposure. It has, in effect, attempted to establish a series of firewalls. In the late 2000s, for example, the EC produced the Security and Solidarity Action Plan for developing a common external energy policy and internal market, diversifying suppliers and increasing domestic production of energy, including renewables. In 2009, the EU introduced the Third Energy Package which called for ‘unbundling’, meaning that resource suppliers like Russia must separate production and retail from transit. The 2009 Treaty of Lisbon designated energy policy as an area of ‘shared competence’ between the EC and the EU member states and the EC acquired new powers to negotiate and develop international agreements, such as those involving non-EU countries and projects of ‘European interest’.<sup>25</sup> In

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addition to these types of measures, the EU has also encouraged its external energy partners to sign the European Energy Charter Treaty (ECT), which sets cooperation guidelines, including transit obligations and dispute resolution. Russia signed the ECT in 1994 and followed it provisionally, but ultimately refused to ratify the ECT (Norway, another major supplier to the EU, has also refused to join the Energy Charter).

In addition to protecting itself from disruptions and diversifying away from its heavy reliance on Russia, the EU seeks to challenge the basis for the profits Gazprom extracts from Europe. The EU would like Gazprom to change its price formula, which has been based on linking gas and oil prices, a practice that has resulted in the most dependent countries – those for which Gazprom is the sole source for gas

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<sup>24</sup> Information from the personal archives of the first author, an international energy consultant who travels frequently to the Caspian region.

<sup>25</sup> Jan Frederik Braun, ‘EU Energy Policy Under the Treaty of Lisbon Rules: Between a New Policy and Business as Usual’, *EPIN Working Papers* No. 31 (February 2011): 1-2, <http://www.ceps.eu/ceps/download/4250> (accessed September 13, 2012).

– paying among the highest prices. In 2011, Gazprom’s price increases for German companies were among the highest in Europe (just as Germany launched plans to exit nuclear energy) and the German utilities RWE and E.ON have reduced purchases and engaged in intense efforts to get Gazprom to change its oil-indexed pricing formulas.

E.ON reached a settlement with Gazprom to reduce its oil-indexed price in July 2012 and RWE’s negotiations were still ongoing in September 2012 when the EC made the stunning announcement that it was launching an investigation into whether Gazprom is inhibiting competition by abusing its dominant position and hindering the free flow of gas across EU member states. The EC said it would look into three areas of potential violations by Gazprom, including the charge that it was dividing gas markets by impeding gas flows, preventing the diversification of gas supplies and engaging in unfair pricing because the gas price is linked to oil prices.<sup>26</sup> The EC’s actions drew an immediate response from Russian President Vladimir Putin, who issued a decree prohibiting Russian strategic companies from responding to foreign claims without getting permission from the government. The Kremlin, in other words, would involve itself in Gazprom’s talks with the EC. The emergence of this conflict between the EC and Gazprom just prior to Gazprom’s final investment decision for the South Stream gas pipeline raises questions about the future of that project, particularly as the Commission is unlikely to award TEN-E status to South Stream because it does not provide supply diversification.

For its part, Washington’s opposition to heavy European dependence on Russian gas has remained more-or-less continuous. As will be discussed more fully in the next arena, Washington has worked to mitigate the impact of the EU’s existing gas pipeline links with Russia by stressing the need for supply diversification and championing the construction of pipelines that bypass Gazprom’s reach. To counter US and EU efforts, Gazprom has taken advantage of Europe’s lack of energy solidarity and has pursued what has been described as a divide-and-conquer strategy: it recruits allies among companies from key European countries such as France, Germany and Italy and brings them into upstream gas projects in Russia and Russian-led gas export pipeline consortia.<sup>27</sup> Companies such as GDF Suez, EDF, Eni, E.ON and Wintershall are partnering with Gazprom in its new gas pipelines to Europe and receive considerable benefits from their gas business with Russia.

In sum, the USA has and continues to be uncomfortable with European reliance on Russian pipeline gas and the EC’s perspective has shifted from receptiveness to Russian pipelines to wariness and defensiveness. There is little, however, that the USA, or the EC for that matter, can do to stop bilateral deals between

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companies and companies of non-European countries, such as Russia. The EC, however, has been pushing to expand its scope. In mid-September 2012, for example, it was granted the power to require

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<sup>26</sup> ‘Russia: Gazprom Faces European Probe’, *PFC Energy Russia and Caspian Service*, September 10, 2012.

<sup>27</sup> For perspectives on Russia’s tactics, see Helén Henry, ‘The EU’s Energy Security Dilemma with Russia’, *POLIS Journal* 4 (Winter 2010): 24-31; and Zeyno Baran, ‘Developing a Cohesive EU Approach to Energy Security’, in *Europe’s Energy Security: Gazprom’s Dominance and Caspian Supply Alternatives*, ed. Svante E. Cornell and Niklas Nilsson (Washington, DC: Central Asia-Caucasus Institute & Silk Road Studies Program, Joint Transatlantic Research and Policy Center, 2008), 157-68.

'information exchanges' in which member states will have to inform the EU of supply agreements reached with non-EU countries.<sup>28</sup> Some member states are also pushing for the EC to be a party to their negotiations with Gazprom.<sup>29</sup>

#### **Arena 4: Caspian gas to the EU**

The geopolitical wrangling over export routes for natural gas from the Caspian region has been just as tumultuous as it was over oil routes in the second arena. Once again, Russia would prefer transport through Russian pipelines, such as South Stream, and the USA would prefer pipelines that bypass Russian infrastructure. Even as early as 1996, the USA pushed for a trans-Caspian gas (TCGP) pipeline, which would transport gas from the eastern Caspian states. As mentioned above, Europe's role in this region was subdued during the mid-1990s. Russia was strongly against the pipeline, as a trans-Caspian link would mean that the eastern Caspian states could send their gas westward without using Russian infrastructure. The TCGP idea died when Russia and Iran, both littoral states, vetoed the project as well as objected to the reclassification of the Caspian from a lake to a sea, which would have changed territorial demarcations to their disadvantage.

Planning for another contested major project began in 2002 when several smaller European companies and Turkey's BOTAS proposed the 3900 km Nabucco pipeline. This pipeline was envisioned to eventually transport 31 bcm/y of Caspian gas through Turkey, Bulgaria, Romania and Hungary to Austria. Up until 2009, the USA strongly supported the Nabucco pipeline and American diplomats lobbied heavily for Azerbaijan to commit gas to Nabucco. The EC gave Nabucco TEN-E status, but seemed reserved about actively advocating the pipeline in the Caspian region, even after it launched the Southern Gas Corridor initiative in 2008, explicitly designed to diversify suppliers and encourage non-Russian transit of Caspian and Middle-East gas to Europe (particularly from Azerbaijan but also potentially from Turkmenistan and Iraq).<sup>30</sup> The EU's lack of engagement was noted in the region and one former US diplomat commented that, 'The Azeris have reportedly questioned visitors as to why the United States has appeared to be more supportive of diversifying Europe's gas supplies than have the Europeans'.<sup>31</sup>

Whether it was the result of the EU's ambivalence towards Nabucco or Azerbaijan's own reluctance (and possibly ulterior motives), after years of difficulties securing gas commitments, the Nabucco project was scaled down to a smaller Nabucco West pipeline, which would transverse only Europe. Around the same time the reduction in Nabucco's size was announced in early 2012, Azerbaijan

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<sup>28</sup> 'Commissioner Oettinger Welcomes European Parliament Vote on the Decision on the Intergovernmental Agreements' Mechanism', [http://ec.europa.eu/commission\\_20102014/oettinger/headlines/news/2012/09/20120913\\_en.htm](http://ec.europa.eu/commission_20102014/oettinger/headlines/news/2012/09/20120913_en.htm) (accessed September 18, 2012).

<sup>29</sup> 'Large Countries Oppose Gazprom Deals Scrutiny', *Euractiv.com*, September 12, 2012, <http://www.euractiv.com/energy/largest-eu-countries-oppose-gazp-news-514739> (accessed September 17, 2012); and 'Gazprom Meets its Match, as Brussels Seeks Seat in Gas Talks', *World Gas Intelligence*, September 12, 2012.

<sup>30</sup> Jozias Van Aartsen, *Project of European Interest* (Brussels: European Commission, February 2009), [http://ec.europa.eu/energy/infrastructure/tent\\_e/doc/axis/2009\\_axis\\_linking\\_activity\\_report\\_2007\\_2009.pdf](http://ec.europa.eu/energy/infrastructure/tent_e/doc/axis/2009_axis_linking_activity_report_2007_2009.pdf) (accessed September 13, 2012).

<sup>31</sup> Keith Smith, *Russia-Europe Energy Relations: Implications for US Policy*, Report (Washington, DC: Center for Strategic and International Studies, February 2010), 11.

and Turkey made an announcement that rapidly transformed prospects for Europe's Southern Corridor initiative: they agreed to build a new natural gas pipeline, the Trans-Anatolian Pipeline (TANAP), from Azerbaijan to Turkey to link with a new gas pipeline in Europe. TANAP is designed to bring 16 bcm/y from the Azerbaijani Shah Deniz gas field by 2018 and 31 bcm/y (equal to the Nabucco project's primordial version) by 2026. Azerbaijani SOCAR is a majority shareholder in TANAP with an 80% stake, while Turkish state-owned companies BOTAS and TPAO have 20%.<sup>32</sup> SOCAR envisions an eventual 51% share, with the

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remainder in TANAP divided among some members of the Shah Deniz consortium, which is owned by BP (25.5%), Statoil (25.5%), NIOC (10%), SOCAR (10%), Total (10%), Lukoil (10%) and TPAO (9%).

In 2013, the Shah Deniz consortium will decide whether to link TANAP to Nabucco West or to the Trans Adriatic Pipeline (TAP), proposed by Statoil (42.5%), E.ON Ruhrgas (15%) and EGL (42.5%), a Swiss trading company, to cross Greece and Albania and terminate in Italy. The creation of TANAP also indicates that Azerbaijan in particular is no longer as malleable as it seemed to be when the 'new great game' between Europe, the USA and Russia began 20 years ago. Turkmenistan is also able to play its cards with more self-assuredness, since it has China to back it up. Although they still need western involvement – for example, to develop their resource potential and to finance infrastructure to Europe – the Caspian countries are generally becoming more astute actors and contenders for power and influence.

These recently proposed pipelines have ultimately amounted to a plan on which the EU and the USA can agree. In the words of the EU Energy Commissioner Günther Oettinger, 'Europe is now a step closer to its aim to get gas directly from Azerbaijan and the other countries in the Caspian region'.<sup>33</sup> And, the US president Barack Obama stated that, 'The agreement between Azerbaijan and Turkey on gas sales and transit opens a path for Azerbaijani gas to reach European markets and sets the stage for Azerbaijan to play an important role in Europe's energy security'.<sup>34</sup> Another positive development for the transatlantic objectives occurred in September 2011 when the European Commission was granted the power to negotiate an Intergovernmental Agreement between Azerbaijan and Turkmenistan for a new TCGP project on behalf of all member states. This is the first time the Commission has been given this degree of 'one voice' negotiating power.<sup>35</sup>

Meanwhile, the TANAP project has engendered stiff criticism from Gazprom: in response to the agreement between Turkey and Azerbaijan over TANAP, Gazprom warned Ankara, its second-largest gas customer, that if TANAP is completed as planned in 2018, Turkey could apply to Baku for help if it needed emergency supplies of gas, implying that Moscow would not be willing to help Turkey in a

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<sup>32</sup> Vladimir Socor, 'Interest Growing All-Round in Trans-Anatolia Pipeline Project', *Eurasia Daily Monitor* 9, no. 70 (April 9, 2012).

<sup>33</sup> 'Gas Pipeline Deal Sidelines Original Nabucco Project', Euractiv.com, June 28, 2012, <http://www.euractiv.com/energy/tanap-gas-pipeline-shelves-nabuc-news-513593> (accessed September 13, 2012).

<sup>34</sup> From Barack Obama, the President of the United States of America, June 05, 2012, <http://en.president.az/articles/5134> (accessed September 13, 2012).

<sup>35</sup> On Security of Energy Supply and International Cooperation – "The EU Energy Policy: Engaging with Partners Beyond Our Borders", *European Commission*, COM(2011) 539 final, Brussels, September 7, 2011, <http://register.consilium.europa.eu/pdf/en/11/st13/st13941.en11.pdf> (accessed September 17, 2012).

crisis.<sup>36</sup> At the same time, European countries are entering and exiting the South Stream project – as the pipeline’s route changes – and the project’s patchwork configuration will make financing difficult. While Russia’s pipeline proposals compete with European projects to bring Caspian gas to Europe, China, meanwhile, has been establishing a greater presence in the region and has made significant energy investments, including an oil pipeline with Kazakhstan and a gas pipeline from Turkmenistan to China, which began operations in 2009.<sup>37</sup> It would seem that Europe should not dither too long in taking the steps to secure significant quantities of Caspian gas, before it becomes dedicated to eastern and not western routes.

In sum, while the USA and the EU have both viewed the Caspian region as a major source of new gas for exports, little progress was made for many years because the transatlantic partners gave differing levels of attention to the Southern Corridor initiative and did not back the same project. Recent events seem to have quickly propelled the initiative forward, but it is still a region that requires considerable political manoeuvring and careful navigation among numerous interests. Gas from the southern Caspian would of course present competition for Russian gas in the EU markets. Moreover, with the enormous production potential of the Turkmen onshore sources, there would be ample gas to feed a TCGP.

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One significant challenge to transatlantic objectives in the Caspian has been Europe’s wavering and disunity, which has allowed Russia (and Gazprom) to split apart the western partners. However, several developments occurred in September 2012, shortly before this article went to press, that could indicate movement towards greater solidarity in energy foreign policy, or, at least that member states are becoming more comfortable with allowing the European Commission to take the lead on some external matters: first, EU Energy Commissioner Oettinger, endowed with the authority to negotiate a trans-Caspian pipeline deal in 2011, met with several regional leaders to move the project forward and Turkey, which also participated in the meeting, made the important step of agreeing to buy TCGP gas;<sup>38</sup> second, the European Commission launched an investigation into Gazprom’s pricing, on behalf of member states; and third, the European Commission gained the power to collect information from member states on their energy deals with external countries.

In addition to greater EU solidarity, the Southern Corridor project would benefit from a more stable and harmonised legal framework, particularly for transit fees and tariffs at the EU level. European prioritisation of the Southern Corridor holds many opportunities for common EU-US energy security interests, but only much closer cooperation between European and American institutions, national governments in the Caspian region, and international energy companies involved in the pipeline projects could guarantee successful management of the many political, commercial and legal challenges related to the Southern Corridor.

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<sup>36</sup> ‘Update 1-Gazprom Warns Turkey Over Azeri Gas Pipeline Deal’, *Reuters*, June 29, 2012, <http://www.reuters.com/article/2012/06/29/gazprom-turkey-idUSL6E8HT3S220120629> (accessed July 2, 2012).

<sup>37</sup> For example, see Christina Lin, ‘The Caspian Sea: China’s Silk Road Strategy Converges with Damascus’, *China Brief* 10, no. 17 (August 19, 2010).

<sup>38</sup> ‘Azerbaijan, Turkey, Turkmenistan, EU hold Talks on Gas Supply’, *Trend.az*, September 3, 2012, <http://en.trend.az/capital/energy/2061111.html> (accessed September 17, 2012).

## Conclusion

The story of relations among the USA, Europe and Russia in the context of the arenas outlined above indicates that when the transatlantic community agrees on objectives, it is typically successful at achieving them. In the two arenas involving oil, the transatlantic partners prevailed. Both the USA and Europe have supported efforts to increase Russian production and both pushed ahead with their goal of securing a non-Russian transit route for the BTC pipeline to export Caspian oil independent of Russia. As no EU member state opposed the BTC pipeline or championed an alternative route, the EU was unified in its support of the pipeline. One could argue, however, that the lack of EU unity has complicated the search for a route to transport Caspian gas via non-Russian infrastructure.

Although the EU and the USA both strongly support establishing a Southern Corridor to transport Caspian gas to the EU, for many years the EU was not unified around a particular approach – so while the transatlantic community may have had coherence in terms of broad objectives, differences in strategies caused challenges. Indeed, several EU member states support either Nabucco West or TAP, others have signed onto Gazprom's South Stream project, and some have done both. While it appears, at the moment, that Europe will eventually be able to import Caspian gas, one wonders if this could have been accomplished more quickly if the EU had thrown heavier support – in the early years – behind the Southern Corridor initiative. This leads to a more nuanced finding: the degree of success for the transatlantic objectives dramatically improves when the EU is internally united on a plan of action. And, if the member states cannot achieve a strong internal consensus or resolve to vigorously back a project, then they should at least 'do no harm'. This

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occurred in the case of the BTC pipeline: Europe was inhibited from pursuing the project full tilt, but did not – through disunity and offering Russia an opening to exploit differences – stand in the way of the USA and Turkey, who were pursuing an objective the EU shared.

Whether it is Nabucco or a different route, the Southern Corridor objective is clearly a case in which EU solidarity combined with greater transatlantic coordination would have been (and still could be) beneficial. A second example of where greater transatlantic coordination could be helpful is in confronting Moscow over its treatment of western companies operating in Russia. Despite multiple incidents in which western companies have been subjected to severe interference, multilateral responses from transatlantic leaders have been muted, at least publicly.

One could question whether the transatlantic disconnects and weak or missing cooperation delineated in this article are due to the lack of intensive transatlantic coordination or to a lack of European energy solidarity. In recent years, the issue of Europe's external energy policy has received considerable attention and scholars have pondered whether the EU can or should move towards solidarity.<sup>39</sup> The problems of achieving meaningful energy solidarity are manifold. The energy needs, endowments and constraints of the EU-27 are so varied, it would be exceedingly difficult to find a 'one size fits all' external energy policy. Moreover, would the EU member states ever accept that technocrats

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<sup>39</sup> For example, see Youngs, *Energy Security*; and Frank Umbach, 'Energy: A Single Voice is needed in Europe for its Future Energy Security', *Geopolitical Information Service* (January 30 2012): 14.

in Brussels – particularly a technocrat from a different member state – have the power to control major business deals? The goal should rather be more nuanced coordination, a goal to which the EU, in fits and starts, may be headed. Even before the Russian-Ukraine disputes, the EU had been encouraging projects it deemed valuable to the entire community. After the crises, the EU became acutely cognizant of the need to defend itself and rapidly promulgated protective legislation, namely flattening regulatory and infrastructural borders between member states and creating an institutional space for itself in energy issues.

However, for the EU to be truly effective in protecting the energy interests of all member states, several steps would have to be undertaken: the EU would have to first credibly develop this competency and, second, the member states would have to sufficiently trust the EU's capabilities in order to relinquish sovereignty over energy matters. As the EU becomes more interlinked, an economic disruption in one country will have a larger ripple effect – and an energy shortage can cause immediate economic damage. As the EU becomes more dependent on foreign energy sources and vulnerable to disruptions, a time may come when the EU member states both need and desire intra-EU coordination and greater energy solidarity for both internal and external policies. Indeed, the September 2012 developments may be an indication that member states are starting to better appreciate the value of speaking with 'one voice'. Another major step, particularly one that would help the EU consolidate energy competency, would be to appoint a High Representative for Energy Policy, similar to the figure of the High Representative for Foreign Affairs and Security Policy that was introduced with the Lisbon Treaty in 2009.

What role could the transatlantic relationship play in Europe's external energy policies? As the dynamics in the arenas indicated, the interests and broad goals of the EU and the USA – for example, stabilising world oil prices and securing reliable gas supplies for Europe through diversification – are still fairly closely aligned. The difference between successes – or the speed with which success was obtained – often came down to whether the transatlantic partners were pursuing the same strategies.

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The key to strategy coordination is not just EU solidarity or greater transatlantic alignment, but the combination of the two. As was observed a decade ago, 'When the United States and Europe see eye to eye, there is little they cannot accomplish. When they do not agree, however, there is little they can achieve'.<sup>40</sup> The broad transatlantic energy objectives still seem to hold traction, but unless there is more conversation within Europe and across the Atlantic, the transatlantic partners may face an increasingly challenging environment in Central Asia as the other actors – Russia, China and the Caspian states – intensify pursuit of their own objectives.

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<sup>40</sup> Jessica Matthews, 'Estranged Partners', *Foreign Policy* No. 127 (November/December 2001): 48-53.

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