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The Georgia-Russia standoff and the future of Caspian and Central Asian energy supplies

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The latest military conflict between Georgia and Russia over the autonomous region of South Ossetia is likely to have a serious impact on export routes for the Caspian and Central Asian hydrocarbons and as a result on the existing European and Chinese plans of diversification of oil and gas supplies. The new energy game in the region is likely to be dominated by Russia, China and the energy producing nations of Kazakhstan and Turkmenistan, and could potentially include Iran, - says [Dr Shamil Yenikeyeff](#) of the Oxford Institute for Energy Studies.

The geographic proximity of Georgia to the Black Sea region, the Caspian and Central Asia makes this transit country an important player in relation to the current and future energy exports from Azerbaijan, Kazakhstan, Turkmenistan and possibly Uzbekistan.

For many years, Georgia has been considered by the EU and the United States as one of the main building blocks in the formation of alternative energy routes which bypass the territory of Russia. The first stage of the EU-US backed “fourth corridor” of energy supplies (the other three corridors include supplies from Africa/the Middle East, Russia and Norway) have already been implemented with the successful construction of Baku-Tbilisi-Ceyhan (BTC) oil pipeline and Baku-Tbilisi-Erzurum (BTE) gas pipeline, also known as South Caucasus Pipeline (SCP), and modernisation of Baku-Supsa oil pipeline, also known under the name of Western Route Export Pipeline (WREP). BTC and BTE, which run through Azerbaijan, Georgia and Turkey, initially relied on energy supplies from resource-rich Azerbaijan.² The second stage of the fourth corridor will rely on oil and gas volumes from Kazakhstan and Turkmenistan and will involve the expansion of the existing transit routes and construction of

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² BTE currently carries 6 billion cubic meters (bcm) of gas which is projected to reach 20 bcm by 2014. Oil volumes are also transported through Azerbaijan and Georgia via Baku-Supsa oil pipeline (with its current throughput of 150,000 barrels a day) and the Baku-Batumi rail network (150,000-200,000 bpd) to sea terminals.

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new ones such as the oil transportation project, the Kazakh-Caspian Transportation System and the Trans-Caspian and Nabucco gas pipelines.³

The August 2008 military conflict between Georgia and Russia over the autonomous region of South Ossetia, which has been de-facto independent from Georgia since the early 1990s, is likely to shift the balance of power between the main players involved in the formation of the future of the Caspian and Central Asian energy sector, including:

- Producer and transit countries: Azerbaijan, Georgia, Kazakhstan, Turkmenistan, Uzbekistan, Turkey and Iran;
- Foreign corporations operating in the region's hydrocarbon sector;
- Major external players: China, Russia, the European Union and the United States.

The volatility of these transit routes is likely to shape investment decisions of international oil companies involved in the development of Central Asian and Caspian hydrocarbons and their transportation to global markets. Governments of these resource rich countries are bound to have serious concerns about the safety of BTC, WREP and BTE pipelines, the railway networks and the oil terminals at the Georgian Black Sea ports of Batumi, Kulevi and Poti, all of which were halted by the Georgian-Russian hostilities.⁴ Although, the pipelines were only temporarily shut down for security reasons and were not targeted or damaged in the conflict, their future expansion and the construction of related new pipeline projects, such as the Kazakh-Caspian Transportation System, the Trans-Caspian gas pipeline and Nabucco are now uncertain. In this situation, Central Asian and Caspian producers may opt for traditional exports via Russia (providing Moscow successfully expands the capacity of its oil and gas export routes) and the new export pipelines to China.⁵

The 1990s were marked by low hydrocarbon prices, low demand for gas and, as a result, lesser preoccupation of member-states of the Organisation for Economic Co-operation and Development (OECD) with the security of energy supplies. Since 2000, the global energy scene has changed considerably, fuelled by volatile oil and gas prices, the emergence of powerful new consumers in the Asia-Pacific region, reserve depletion within the OECD, and instability within the energy producing and transit countries. After the Russian-Ukrainian gas crisis of January 2006⁶ there was a shift in the minds of EU policy makers in relation to European dependence on gas supplies from potentially "unfriendly" foreign countries that could use their supply power to wield political and economic demands on energy consuming

³ The Turkey-Greece-Italy Interconnector is another relevant project. Unlike Nabucco and Trans-Caspian, TGI has already been completed is used to transport small volumes of non-Russian gas (from Azerbaijan) into Greece. TGI is the first element of the Fourth Corridor.

⁴ The BTC pipeline had also been previously put out of service by fire for which Kurdish separatists took responsibility.

⁵ The Kazakhstan-China oil pipeline became Central-Asia's first successful new oil export project. The Atyrau-Alashankou 3000 km long oil pipeline is scheduled to be completed in several stages by 2011 and is projected to bring around 200,000 barrels of Caspian oil per day to China (or 20 million tonnes annually, with a potential to reach 50 million tonnes).

⁶ For a thorough assessment of this topic see: Jonathan Stern, *The Russian-Ukrainian gas crisis of January 2006*, Oxford Institute for Energy Studies, 16 January 2006, http://www.oxfordenergy.org/pdfs/comment_0106.pdf

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nations.⁷ As the dependence of industrialised nations on existing energy producers is projected to increase, their governments have been active in trying to diversify their gas imports. This applies not only to European nations but also to China, which is seeking to secure pipeline gas from Central Asia and Russia. Russia's own dependence on Central Asian gas deliveries and slow development of its new upstream projects has considerably boosted Kazakhstan's geopolitical profile as a potential gas supplier and a key transit country for gas produced in Turkmenistan and Uzbekistan.

The past eighteen months have been highlighted by an intense competition between three gas projects: pipelines to Russia (the expansion of the Central Asia-Centre route up to 80 bcm per annum and construction of the Caspian Littoral pipeline with a capacity of around 20 bcm), the Trans-Asia gas pipeline network to China (30-40 bcm) and the US/EU sponsored Trans-Caspian pipeline (30 bcm). None of these projects have been completed and it is unclear whether there is enough Central Asian gas for all three proposed pipeline routes.

Brussels and Washington view the successful operation of the BTC and BTE pipelines as a vital step towards future implementation of alternative gas pipelines, such as the Nabucco pipeline and the Trans-Caspian project, both of which depend on gas volumes from Turkmenistan and Kazakhstan. However, diverse approaches employed by major external players, China, Russia, the US and the EU, towards obtaining Central Asian energy supplies and the questionable stability of the region will play a pivotal role in the future of export routes for Caspian and Central Asian hydrocarbons.

Diverse approaches.

China and Russia employ different strategies toward securing Central Asian energy deals compared to the US or the EU. Whereas the latter are not averse to attaching political or economic reform measures as part of their loan offers and are apt to encourage these states to partake in international organisations, such as the Organisation for Security and Co-operation in Europe (which Kazakhstan has been approved to chair in 2010), Beijing and Moscow, in contrast, have traditionally been less questioning of the authoritarian political regimes typically prevalent in Central Asia.

In economic terms, a growing competition between China and Russia for securing Central Asian gas supplies has resulted in the determination of both countries to forge favourable commercial ties with Central Asian producers. In contrast, member-states within the EU (hence the EU as an entity) often lack a common political approach in this respect. So far, the European gas agenda, which includes Central Asian gas supply, has not moved toward practical implementation, unlike the Russian and Chinese projects.

Although Russia has often cashed in on pre-existing economic, political and cultural ties with Central Asian countries, it is now instead compelled to use solely economic rationale in order to forge ties with Kazakhstan, Turkmenistan and Uzbekistan. Central Asian gas is essential to Russia's own gas balance until its new hydrocarbon projects, such as the Yamal Peninsula

⁷ See: Jonathan Stern, *The New Security Environment for European Gas: Worsening Geopolitics and Increasing Global Competition for LNG*, NG 15, Oxford Institute for Energy Studies, October 2006, <http://www.oxfordenergy.org/pdfs/NG15.pdf>

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fields, come on-stream. The ever-increasing interest of Beijing, Washington, and Brussels in securing Central Asian energy supplies as an alternative (mainly to Russia and the Middle Eastern/African sources) has prompted Moscow to offer greater incentives to Caspian/Central Asian producers, in order to ship their oil and gas through Russian territory instead. It is therefore unsurprising that Russia has already agreed to pay European prices (minus transport and other related costs) for Central Asian gas from January 2009.⁸

Beijing is keen to secure additional energy supplies to fuel its growing economy at nearly whatever cost the construction of new pipelines may require. Central Asian countries are not indisposed to engaging with a rapidly growing China, despite their traditional cautiousness toward their Eastern Asian neighbour. Gas co-operation with Beijing can bring other considerable benefits for Central Asian states such as investment, infrastructure development (such as the construction of roads and railways), and growth in other trade sectors. China has an upper hand over Russia in terms of its “cash power” and in terms of effective implementation of large scale projects. However, the United States and Europe, on their part, have a serious technological advantage over Russia and China where Caspian offshore oil and gas development is concerned.

Stability of the region.

The Georgia-Russia stand-off has highlighted how many other frozen interethnic conflicts have serious potential to destabilise the “fourth corridor” of energy supplies to Europe which run through Georgia (with its break-away regions of Abkhazia and South Ossetia), Azerbaijan (with the de-facto independent and predominantly Armenian-populated Nagorno-Karabakh region), and Turkey (with unresolved issues of Kurdish separatism). Many of these conflicts have long histories of interethnic violence, thus representing “dormant volcanoes” ready to erupt.

The volatility of these transit routes and Russia’s resurging military might in the region could also influence decision-makers and producers in the Caspian and Central Asia. In this situation, the United States, Europe and China represent other external players with considerable military capabilities which could shape the security of the region and the energy routes which run through these volatile territories.

The unabated competition between Russia, the US, and Europe as traditional guarantors of security in the Caspian and Central Asian countries is likely to destabilize the region even further. In this situation, individual countries and break-away territories will side with different external interests or might try to play them against each other for political and economic gains. The way forward for external players is not the division of spheres of influence in the region, but the provision of legal mechanisms which will secure inter-ethnic stability in the region and diffuse potential grounds for local conflicts. In this case, the Kosovo example could be used by external forces to either stabilize or destabilize the region. The key issue here is how the main external players could share the responsibility of ensuring the stability of the region.

In the future, politically isolated Iran could also become an important player in energy supplies from the Caspian and Central Asia. First, Iran could become a potential gas supplier

⁸ “On working meeting of Alexey Miller and heads of gas companies from Kazakhstan, Uzbekistan and Turkmenistan”, JSC “Gazprom”, Press Release, 11 March 2008.

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to Europe, providing there is adequate investment available. Second, Iran has long been considered a potential transit route for Caspian and Central Asian energy supplies. Both Kazakhstan and Turkmenistan supply limited volumes of oil to Neka on the Caspian coast of Iran as part of oil swap deals for Iranian oil shipped from the Persian Gulf.⁹ In the recent wake of the BTC shutdown and the conflict in the South Caucasus, even more oil flowed through Neka, including supplies from Azerbaijan, reminding industry observers that Iran is the cheapest export route for Caspian crude. The Russian company, Gazprom Neft' is also supposed to provide assistance to the National Iranian Oil Company (NIOC) to build a pipeline from Neka to the Gulf of Oman. Additionally, in 2007 Kazakh and Iranian officials expressed interest in building a pipeline from Kazakhstan to Iran. There is therefore some momentum for a north-south export route through Iran, and the fighting conflict in Georgia only strengthened this sentiment, at least politically. A potential rapprochement between the US and Iran could further considerably change the energy game in the region and give a boost to alternative energy supplies to Europe as well as other exotic routes for Caspian and Central Asian oil and gas.

⁹ Turkmenistan has also been exporting its gas to Iran.

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