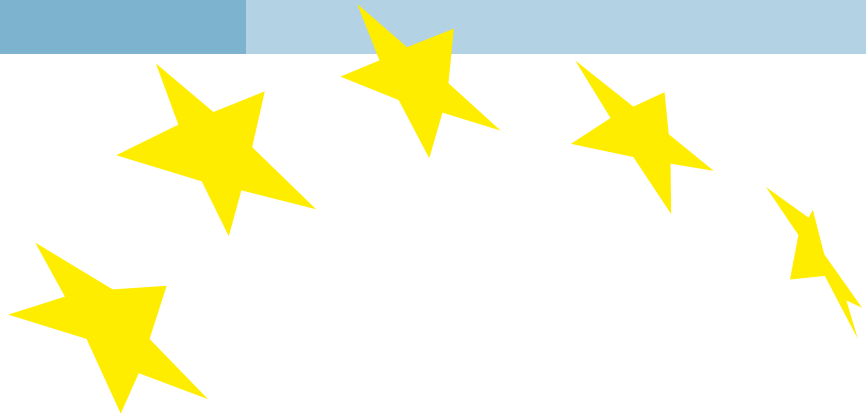


# The New Great Game: Opportunities for Transatlantic Cooperation in the Caspian Region

Transatlantic Thinkers



## TRANSATLANTIC THINKERS, PART 1

The transatlantic relationship is not over, as has sometimes been suggested in recent years – but it has changed. There is still consensus in Europe and the US that the urgent global challenges confronting us today can only be met in a joint effort. The goal is to identify specific fields for strategic cooperation and formulate effective and coherent policy options towards them.

The Bertelsmann Stiftung aims to help in this process. As part of its long-standing project work on “Europe's Global Responsibilities”, it has made a major effort to foster transatlantic ties. One of the measures taken is the annual “Brussels Forum”, an initiative launched jointly with the main organizer German Marshall Fund, Daimler-Chrysler, Monitor, Fortis and the Belgian government. The "Brussels Forum" aims to bring together the best and the brightest from the spheres of politics, industry, and ideas on both sides of the Atlantic. In the run-up to this major event in late April 2007, we would like to outline the main opportunities for a common transatlantic agenda.

Our new paper series “Transatlantic Thinkers” provides a fresh perspective on these opportunities, touching upon topics such as energy security, climate change, civil liberties in an age of terror, trade and many others. These short papers are “mind-challenging” in the best possible sense – sharp, precise and provocative. Often, we will form “Transatlantic Doubles”, pairing up prominent voices from both sides of the Atlantic to collaborate on one issue.

Richard Morningstar, the former US Ambassador to the European Union and US Special Representative for the Caspian Region, has written the first piece in our series. Morningstar focuses on the importance of the Caspian Region for a future EU energy policy. He chastises the European decision makers for having neglected the strategic importance of the region – and delivers pointed recommendations for re-evaluating European energy policy.

## The New Great Game? Opportunities for Transatlantic Cooperation in the Caspian Region

By Richard L. Morningstar\*

In July 2006, the Baku-Tbilisi-Ceyhan (BTC) Pipeline, which runs from the Caspian port of Baku, through Azerbaijan and Georgia to the Mediterranean port of Ceyhan on the Turkish Coast, became operational. The successful completion of this oil pipeline and the opening in coming months of a gas pipeline mirroring the BTC route, to ship Azerbaijani gas to Turkey, and perhaps ultimately to Europe, make clear the critical importance of the Caspian region to the United States and Europe. Since the nineties, successive American Administrations have focused attention on this region. Policymakers understood the link between geopolitics, the development of energy resources and commercial interests.

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The European Union and member states have taken a less focused view and have generally taken the position that decisions relating to energy are commercial in nature, and governments should not interfere with those decisions. The successful completion of BTC and Europe's over-dependence on Russian natural resources – which has made the supply of natural gas to Europe an issue of public concern for the first time since the Cold War – demonstrate that this position is ill-advised, that European Governments should take a high profile in promoting the development of Caspian natural resources and that Europe and the United States should work together in achieving this goal.

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## INTRODUCTION

Whereas U.S. Caspian policy is intended to increase the world-wide supply of natural resources, not to direct specific Caspian resources to the United States, Caspian resources, particularly natural gas, should be even more important to Europe than to the United States. The huge natural gas resources that can be found in Kazakhstan, Uzbekistan, Turkmenistan and the Western Caspian are critical, because they can ultimately lessen Europe's over-dependence on Russian gas. As EU

Energy Commissioner Andris Piebalgs recently pointed out in a Wall Street Journal interview, Kazakhstan by 2015 could be producing 20% more gas in a year than consumed by all of Germany. Also, the region is the only one apart from the Persian Gulf where oil production is likely to increase over the next decades.

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See also: Richard Morningstar, "The Baku-Tbilisi-Ceyhan Pipeline: A Retrospective and a Look at the Future", *Central Asia-Caucasus Analyst* (published by Johns Hopkins University), Volume 8 Number 16, 23 August 2006, <http://www.cacianalyst.org>

### A: The U.S. Role in the Caspian

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The opening of the BTC pipeline was the successful culmination of a consistent, bipartisan United States policy relating to Caspian Basin energy resources that has spanned both the Clinton and Bush Administrations.

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The objectives that served as the framework for U.S. policy during the Clinton Administration remain equally valid today in this critical post 9/11 world. It is worth exploring how this policy developed and the implications to be drawn from this experience for future European activity and transatlantic cooperation in the region.

One need only look at a map of the greater Caspian region, which stretches from Turkey to Kazakhstan, to realize its huge geopolitical and economic importance. The United States' strong interest in the Caspian dates to the break-up of the Soviet Union. Virtually overnight eight new independent states came into existence in an area rich with natural resources: Georgia, Armenia, Azerbaijan, Kazakhstan, Uzbekistan, Kyrgyzstan, Turkmenistan and Tajikistan. The principal

component of U.S. policy was to help these new states develop as stable independent countries that would ultimately become market democracies in an uncertain part of the World. Now, several years later, democratization in most of these countries has been slow, but these countries to date have maintained their independence, which many predicted would be impossible.

In addition, the United States believed and still believes that the development of natural resources in the region should provide an alternative source of oil and gas at a time when South Asia and the Middle East are becoming increasingly unstable and demand is soaring from India and China. The U.S. has wanted to make sure that these resources be available for development by American companies as well as business interests from friendly countries; that Turkey, because of its own historical roots, become more involved in the region to help insure the independence of these new countries; and that multiple routes of access be developed for resources to be exported from the region. The U.S. position was and still is that Russia should not have a monopoly on pipelines transporting Caspian resources, and that no pipelines should

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go through Iran thereby subjecting these new resources to the whims of a dangerous government.

Before discussing the implementation of U.S. policy regarding pipelines since the mid- Nineties, we should look at what the existing and proposed pipelines in the region were following the break-up of the Soviet Union. In the Western Caspian, apart from the proposed BTC pipeline, there was already in existence a small and decrepit pipeline from Baku to Novorossiysk, Russia on the northern coast of the Black Sea. In addition, the so-called Baku-Supsa early pipeline, opened in the spring of 1999. This limited-capacity pipeline was designed to carry “early” oil from Western Caspian sites to Supsa, on Georgia’s Black Sea Coast.

With regard to the Eastern Caspian, the Caspian Pipeline Consortium, consisting primarily of Chevron, other oil companies and Kazakh and Russian state companies, was well under way by the late nineties in developing a pipeline (CPC pipeline) from the oil fields of western Kazakhstan through Russia to Novorossiysk. The United States extended strong support to this project, which opened in 2001.

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This is evidence that the U.S. never had an “anti-Russia” policy in the Caspian. But the U.S. has insisted that the sovereignty of new states in the region be respected and that those states have the ability to freely export their resources.

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Finally, the United States had a strong interest in the development of a Trans-Caspian gas pipeline (TPC) from Turkmenistan, across the Caspian Sea to Baku, which would then run parallel to the BTC to Turkey. This pipeline would have transported natural gas into Turkey, easing its reliance on Russia and Iran for gas supplies at a time of rising demand for gas. In spite of a lot of false starts, the TPC never got off the ground. President Saparmurad Niyazov, the mercurial late President of Turkmenistan, never was fully committed to the project. He was wary of recriminations and retaliation from Russia and Iran, which were Turkmenistan’s principal gas customers. In retrospect, Azerbaijan never had much interest in a Trans-Caspian pipeline, since it had its own gas in the Western Caspian, and, indeed, a pipeline will

soon open mirroring the BTC route, to ship Azeri gas into Turkey, and perhaps ultimately into Europe.

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**The BTC pipeline became the centerpiece of U.S. Caspian energy policy.**

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The United States, despite criticism from several quarters strongly supported construction of the BTC pipeline, because it clearly met U.S. policy objectives. The BTC pipeline was consistent with the policy of multiple pipelines. It avoided all major pipelines from the Caspian going through Russia and into the Black Sea. It also avoided a major pipeline going through Iran. In addition, Turkey strongly supported the BTC, because it would keep additional large tankers from exiting the Black Sea through the narrow straits of the Bosphorus, would provide transit fees to Turkey and would help to develop Eastern Turkey.

## UNITED STATES ACTIONS IN THE REGION: CARROTS AND STICKS

### **B: United States Actions in the Region: Carrots and Sticks**

#### **The sticks**

On the US side, there was less pressure to build a pipeline through Iran, but some companies would have clearly preferred this alternative. The U.S. position was that it was unclear that an Iranian route would be less expensive than the BTC pipeline, but that, in any event, a pipeline through Iran would be a violation of the Iran-Libya Sanctions Act (ILSA). U.S. officials argued that a pipeline through Iran would be foolhardy for both geopolitical and commercial reasons. Why would companies want to take the commercial risk of transporting oil through Iran? How could the U.S. grant a waiver under ILSA that would subject new sources of oil to the whims of an Iranian Government? Even though some in Europe still believe that pipelines through or from Iran are still viable, recent history makes it clear that U.S. policy regarding transit through Iran was absolutely correct.

Western European countries, particularly Britain and France, voiced concerns about U.S. Caspian policy regarding the American role in encouraging a specific route, as well as its policy towards Iran. French and British officials in private meetings took the position, similar to several companies, that the U.S. should not let politics interfere with commercial decisions. A high-level official at Whitehall said to a group of American officials that “Tony Blair may be Prime Minister, but we are all “Thatcherites”. The view that commercial and political issues are not related would appear to be rather naïve, if not cynical. How can commercial decisions be made without considering Turkey’s views on transit through the Bosphorus? How can commercial decisions be made with respect to building a pipeline through Iran without considering the “politics” whether domestically or in Iran? Recent events have made perfectly clear that constructing a pipeline through Iran would have been foolhardy and dangerous.

#### **The carrots**

Ultimately, BP, as the manager of AIOC, came to realize that BTC was the only alternative for the transit of oil from the Western Caspian.

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However, the U.S. Government did more than beat the companies' with sticks to force them to accept BTC. The U.S. took many constructive steps to help make the project possible.

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Perhaps, the biggest breakthrough came with respect to cost of construction. Turkey's cost estimates for construction of the pipeline were significantly less than AIOC's estimates. The U.S. took the position with Turkey that if it believed its numbers and wanted the pipeline to be constructed, it should give a formal guaranty that costs would not exceed a set amount. After much negotiation, Turkey agreed in principle to a cost guarantee and ultimately agreed to guarantee the cost of the Turkish portion of the pipeline. This made sense because the Azerbaijani and Georgian portions of the pipeline would have to be built even if the pipeline were to go to Supsa. The U.S. role in conceiving and obtaining the guarantee gave it considerable credibility with the companies. Turkey also attained significant credibility with the companies that it was serious about the pipeline.

In addition, U.S. government agencies, the Overseas Private Investment Corporation (OPIC) and Export-Import Bank provided financing and, in the case of OPIC, political risk insurance for the project. Funding in the form of loans was also made available by the World Bank and European Bank for Reconstruction and Development.

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A third area where the United States played a constructive role was in working closely with the leadership and other officials of the three transit countries; Azerbaijan, Georgia and Turkey.

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The U.S. helped at various points to further the negotiations of the intergovernmental agreement among the transit countries as well as the host government agreements between AIOC and each of the three transit countries. These agreements provided the political and legal foundation for the pipeline, without which financing would have been impossible and the pipeline would not have been commercially feasible.

There can be no question that BTC has been a success from the standpoint of United States energy policy. The Caspian basin pro-

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## UNITED STATES ACTIONS IN THE REGION: CARROTS AND STICKS

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vides a necessary alternative source of energy that can provide a significant percentage of increased world demand for oil over the next several years, and BTC provides an outlet for these resources that neither traverses Iran nor contributes to an over dependence on Russia for energy supply.

### C: The European Approach

The foregoing analysis is intended to show that governments can play a constructive role in achieving important policy objectives even when commercial interests are involved. Many European companies are involved in the Caspian, including BP, Shell, Total-FinaElf, Statoil and others,

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but European governments and the EU have not yet seen it in their interests to actively work together with companies and governments to promote these companies' interests as well as important policy objectives.

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What could be more important to Europe than to secure transit routes which would bring alternative energy resources to Europe? While the United States has pursued specific objectives in the Caspian region, Europe has taken a more generalized and diffused approach. This writer was particularly struck, for example, in the spring of 1999 at the dedication in Georgia of the Baku-Supsa early oil pipeline, that the EU and Georgia were simultaneously celebrating the establishment of a rail-ferry link across the Black Sea, as part of the EU's Traceca Program

to create a transport corridor from Central Asia and the Caucasus to Europe. Certainly this link is useful and is to be applauded but at the same time no emphasis was being given to energy links. The related Inogate Program, which stands for interstate transport of gas and oil to Europe, has been markedly unsuccessful.

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It is also striking that The European Security Strategy, adopted by the European Council in December 2003 and EU Neighborhood Policy, adopted in 2004 give short shrift to energy issues.

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Although Caspian energy resources are described in the Neighborhood Policy, no specific program is put forward. Likewise, the Azerbaijan and Georgia Strategy Papers, which set out how these countries and the EU can achieve greater cooperation as part of the Neighborhood Policy, make no reference to energy until the very last section of the papers and then set out no concrete steps for cooperation. Very recently at an EU meeting in Kazakhstan with regional energy ministers that produced a roadmap toward energy and regulatory cooperation, no mention was made regarding the transit of Caspian gas to Europe.

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## THE EUROPEAN APPROACH

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The EU has appointed special envoys to the Caucasus and to Central Asia. But these envoys deal principally with political, security and development issues. Energy should become a priority part of their mission.

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A better alternative would be for the EU to appoint a special envoy to the Caspian region on energy diplomacy, as the United States did in the late nineties. Such an action would make clear to leaders in the region and to companies that the EU intended to be a serious participant in the energy area.

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**Most important, Europe must develop a coordinated overall energy policy, of which Caspian development would be a part.**

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Too often, member states pursue individual policies without adequately taking into account geopolitical issues or the interests of other member states and bordering countries. Energy supply is a geopolitical issue but must be considered in the overall geopolitical context. It should not divide the European Union.

The best example of lack of coordination is Germany's pursuit of a gas pipeline from Russia to Germany under the Baltic Sea. Presently, 44% of Europe's gas imports come from Russia. This pipeline will significantly increase dependence on Russia. In addition, Germany apparently took little notice of the interests of Poland and Ukraine, through which Russian gas presently transits to Europe. This new pipeline may well allow Russia to put even greater political pressure on Ukraine than it did last year when it temporarily cut off gas supplies to Ukraine. Russia had to back off, because the interruption was having an adverse effect on Europe's gas supply, which might not have been the case if there had been a Baltic pipeline. Finally, pipelines cannot be looked at in a vacuum. New pipelines have to be closely studied to determine effects on other possible pipelines. A coordinated policy is essential for Europe to meet what could well become an energy crisis.

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**Some steps have been taken. The EU has recognized energy supply and security issues as a top priority.**

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In 2005, the EU and eight Balkan countries signed a treaty establishing the Southeast Europe Energy Community. The purpose of the Treaty is to increase electricity production and transport networks in the Balkans. This Treaty should be expanded to include Turkey, which at the time refused to sign the treaty, and countries in the Caspian region. It could become a vehicle to help develop and transport Caspian resources. In early March 2006, the European Commission presented a Green Paper, asking European governments to coordinate their policies on energy matters. José Manuel Barroso, President of the European Commission, urged the European governments to “use the size of our market and the range of our instruments to manage our energy dependency and to diversify our energy suppliers”.

In January 2007, the Commission has also issued its strategic energy review following the publication of its Green Paper earlier this year, which gave scant attention to Caspian resources. In March 2007, European heads of state and governments will adopt an action plan for a common European energy policy. These are opportunities for the EU to declare as part of its overall strategy that the EU will fully engage in

the Caspian, develop a coordinated strategic plan and work at high levels with government officials and companies to insure that Europe can reap the benefits of Caspian resources.

In doing so, Europe could build on previous commitments. After all, the EU supports the extension of the Odessa-Brody oil pipeline to Plock in Poland. This pipeline could ultimately bring Kazakh oil to Europe. Pipelines are presently in the planning stage to transport gas from Turkey into the heart of Europe, but greater coordinated efforts must be made to bring these projects to fruition and to determine from what countries and by what routes the gas will reach Turkey.

### **D: The United States and Europe: Opportunities for Cooperation in the Caspian Region**

The United States and Europe have a major opportunity to cooperate in the Caspian region. Supplying Europe with Caspian energy resources and helping to relieve Europe of overdependence on Russia is in the interest of both the United States and Europe. The United States and Europe can cooperate in the following ways.

**First**, the United States and EU should begin a formal cabinet level energy dialogue to set out a common overall energy strategy, including a strategy regarding the Caspian region.

**Second**, high-level U.S. and European officials should work together with high-level officials of Caspian countries, other Black Sea countries and with companies to plan and implement transit projects. Europe must recognize that there will be major competition for Caspian resources. China has already become active in developing transit routes for Caspian resources.

**Third**, the United States and EU should recognize that Turkey is the bridge to the Caucasus and Central Asia. This region is of huge strategic importance, not just because of its resources, but also because of its critical geographical location which borders on Russia and China as well as major trouble spots such as Afghanistan and Iran. The U.S. and EU should encourage Turkey to re-emerge as a major participant in the Caucasus and Central Asia. In the last few years, Turkey's new leaders appear to have looked away from this region. Turkey because of its historical roots can and should play a productive role both economically and politically in helping these new countries move forward on the path towards market democracy. As part of this role, Turkey should strive to reach accommodations with Armenia and play a positive role in trying to resolve the Nagorno-Karabakh conflict. In addition, as Turkey looks towards European integration, it can play an important role in partnering with Europe and the United States in developing the region. Turkey must also play a major role as a transit country for natural gas to Europe, which would reduce Europe's over-dependence on Russian gas. In light of Turkey's decreased gas demand from earlier projections, the new gas pipeline from Azerbaijan should be extended into Europe.

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Turkey should step forward as a major player in the region and leverage that role into greater cooperation with Europe as Turkey undertakes its difficult accession negotiations with the European Union. Such cooperation could be a substantial confidence building measure as accession negotiations progress.

**Fourth,** the United States and Europe cannot and should not ignore Russia. Given the energy relationship and other relationships between Europe and Russia, Europe cannot afford to alienate Russia. At the same time it should not be forgotten that Russia will be dependent for the foreseeable future on the European market. U.S. and European policy toward Russia on energy issues should be coordinated, so that Russia cannot use energy to divide the United States and Europe. The relationship between the United States and Russia in the Caspian Region, but for a brief post 9/11 honeymoon period, has been tenuous at best. When this writer was first introduced to Russia's former Foreign Minister Igor Ivanov in 1999, Mr. Ivanov said in a somewhat jocular but biting way, "We know you, and we do not like what you are doing!" The United States has never sought to, nor could it, exclude

Russia from the region. But it also cannot be American or European policy that all pipelines lead through Russia. No country should have an effective monopoly on Caspian resources and potentially limit the sovereignty of new states in the region. Europe should be particularly concerned about any such monopoly, given the dependence that it already has on Russian-sourced energy. The logical solution is for Russia to encourage its companies to partner with companies from other countries to develop alternative routes. Instead, for example, of resisting gas pipeline routes to Europe that do not originate in Russia, Russia should encourage its companies to participate in and reap the benefits of new ventures and new routes. It is also critical that Russia respect the independence of the new states in the region, not use energy as a lever as it has with Georgia, and that Russia cooperate with the United States and the EU to resolve ethnic conflicts in the region, such as those in Georgia and Nagorno-Karabakh.

**Fifth,** the U.S and EU should leverage the region's energy resources to promote regional economic cooperation and to resolve regional conflicts. How, for example, can there be real regional cooperation if

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Nagorno-Karabakh is not resolved and if Armenia cannot benefit from the development of the region. The U.S. and EU together with its Minsk Group partners and countries in the region should explore further what tangible benefits can accrue to both sides through resolution of the conflict and through incentives should continue to work with willing partners to push the parties towards a fair and comprehensive settlement.

**Sixth**, U.S. and EU policy goals cannot be limited to energy. We must help countries in the region make progress in the development of civil society. We must also recognize that economic development and security are essential to the development of civil society and democratic institutions. So far, the state of democratization in the respective countries remains worrisome and backlashes in the progress towards a more open society have been experienced on a regular basis. Europe's Neighborhood Policy is designed to condition increased cooperation with Europe on implementation of reforms and the development of civil society. United States, EU and EU member states all have programs in this area. They should be coordinated and leveraged to have maximum effect.

The development of natural resources need not be inconsistent with the development of civil society. Critics say that the BTC pipeline rewards Azerbaijan which has a questionable record on democracy, as most recently reflected in its recent Presidential elections. There certainly, however, is no reason to believe that without BTC, Azerbaijan would have a better record on democracy. BTC has made possible increased engagement with Azerbaijan, which should have an incrementally positive effect in the human rights and democracy areas. However, this means positive involvement. The U.S and EU must work with Azerbaijan's leaders and leaders of other countries in the region to demonstrate that it is in their interest to improve their democracy record. We must also give assistance to the private sectors in these countries to help develop civil society. But it must also be remembered that it is difficult to work with the private sector without some cooperation from the Government.

Neither the U.S. nor EU can have a cookie-cutter approach to the development of civil society. Balancing the importance of strategic interests versus records on democracy and human rights is extremely difficult.

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Each country should be treated individually. We should go the last mile in working with leaders that we believe we can influence in a positive direction, such as President Ilham Aliyev of Azerbaijan. But when leaders reach the point where it makes little sense to deal with them any longer, we should limit our ties with their governments, even when there may be competing strategic interests, while at the same time attempting to work with non-governmental sectors to develop civil society over the long term.

**In summary,** the successful completion of the Baku-Tbilisi-Ceyhan pipeline is an example of what can be accomplished when policy is consistent and has sound objectives. While an uncoordinated European energy strategy, ranging from Polish proposals for an Energy NATO (as a counterbalance to Russian's growing power) to Germany's close and nearly exclusive cooperation with Russia, fails to secure strategic objectives, transatlantic cooperation could help to facilitate energy supplies for decades to come.

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The Caspian Region continues to be vital to the interests of the United States and Europe. Europe should make the Caspian region a top priority. Together we can benefit from the region's resources, while at the same time enhancing the stability of the region and working to develop vibrant civil societies.

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