THE WEALTH OF THE CASPIAN REGION: A MODERN HISTORY OF OIL AND NATURAL GAS EXPORT ROUTES

CPC CASPIAN POLICY CENTER

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The Caspian Policy Center (CPC) is an independent, nonprofit research think tank based in Washington D.C. Economic, political, energy, and security issues of the Caspian region constitute the central research focus of the Center.

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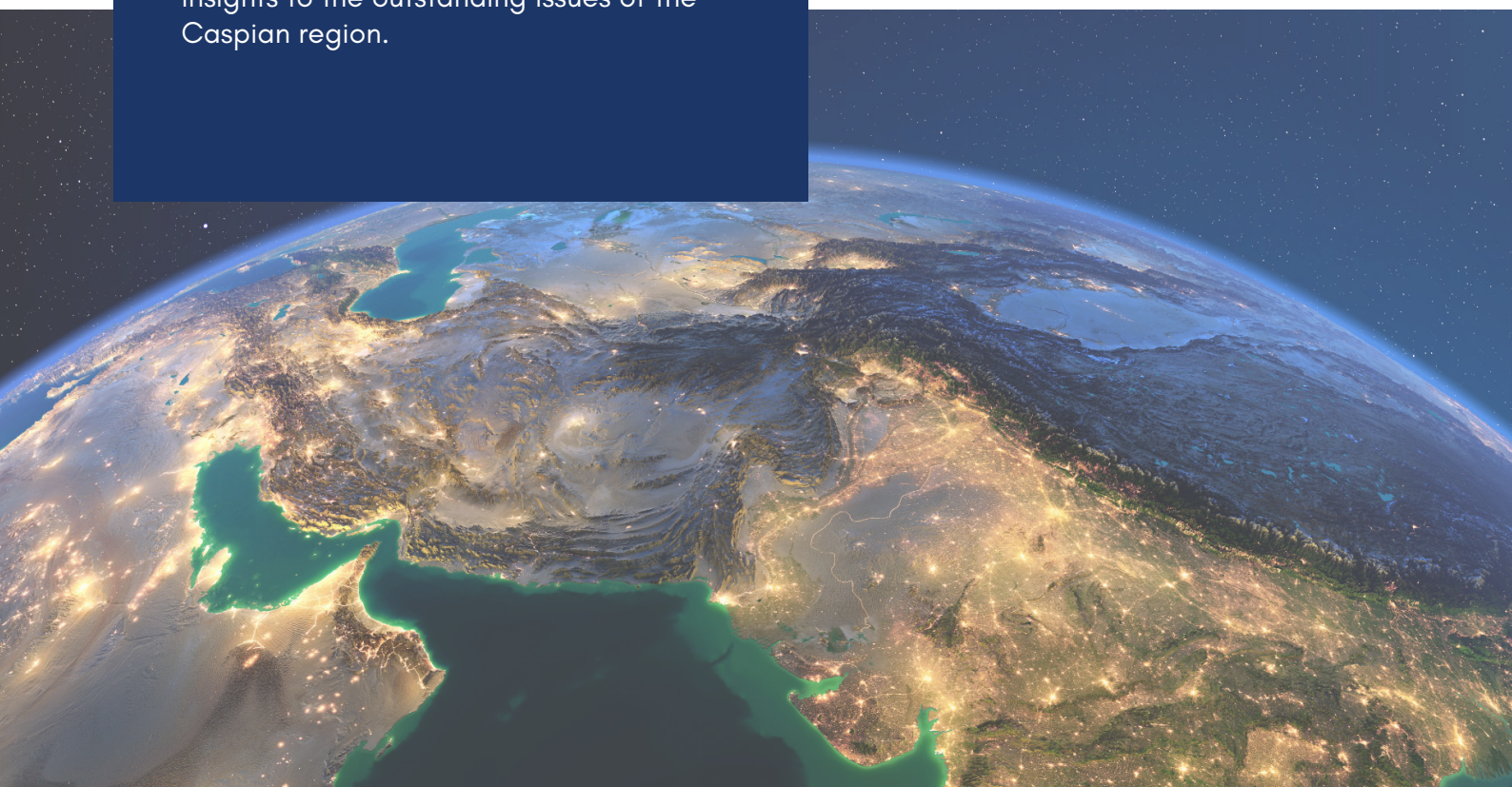

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Introduction

The economic condition of Caspian countries has been significantly affected by factors such as pipeline agreements, energy and transportation infrastructure, and trade arrangements. And, the import-export capacity of a country is influenced by its investment climate, market mechanisms, and its ability to influence global and regional dynamics. Long-term stability between nations can be facilitated by temporary agreements, while a diverse range of trade partners helps a country maintain a balanced foreign policy and avoid overreliance on a single source. To ensure economic stability, a country needs to maintain robust trade relationships, establish efficient transit infrastructure, and establish friendly customs regulations. This has led external powers and private entities to collaborate extensively with Caspian countries, investing in their energy-dependent economies to develop oil and gas resources. In return, Caspian countries have embraced these investments to enhance their global connectivity and economic progress. While these partnerships have boosted the region's energy potential, differences in geopolitical perspectives among major powers have sparked debates over the optimal export routes for Caspian hydrocarbons.

European/U.S. Pipelines

Throughout the 20th century, strained relations with the USSR encouraged strong ties between the United States and the Middle East in the quest for cheap oil, because the Middle East's geographical position allowed for easy transportation to the largest consumption centers in Europe, America, and Eastern Asia. However, starting in the 1970s, reliance on the Middle East became problematic as political instability and regional conflict disrupted energy supplies. The formation of OPEC, moreover, introduced ongoing leverage on energy consumers from oil-rich states. This weakening of energy security -- and most to the point, the skyrocketing oil prices of the 1970s -- pressured the West to expand its search outside the Middle East. With advances in offshore drilling technology, and then with the collapse of the Soviet Union, international energy companies found more solutions to energy supply uncertainty. One very promising aspect of this was the late 1980s/early 1990s wave of investment into the energy-rich Caspian region.

After decades locked under the Soviet system, the Caspian region lacked industrial modernity, meaning the states themselves could not retrieve the trillions of dollars' worth of oil and natural gas underneath its crust. Much of the oil is deep below the surface of the Caspian Sea in an extreme high-pressure environment, between two shifting tectonic plates, requiring highly sophisticated and unusually expensive technology to extract. Further, although rail transport was able to handle modest volumes of oil export in the Soviet period, the massive new investments meant that large volumes of oil would soon be in production -- meaning that the Caspian region had to rely on multinational corporations to fund the construction of pipelines. Western companies offered large investments plus advanced technological and managerial knowhow in return for equity shares in the major fields.

As field development proceeded, the question of pipelines came to the fore. In the Soviet era, all oil and gas exports from the Caspian and Central Asia flowed via rail and pipelines to the Soviet industrial heartlands of Russia and Ukraine. When independence came, the old Soviet pipeline monopolies -- Transneft for oil and Gazprom for gas -- found themselves, as before, controlling the export volumes from the newly-independent states. This allowed them to extort monopoly transit fees, and it gave the Kremlin leverage over the new governments. Thus the imperative for the West was to limit this commercial and political leverage by supporting new export routes.

As new Azerbaijani oil volumes came online, the so-called Early Oil Pipeline, connecting Baku's Azeri-Chirag-Guneshli oil fields to Novorossiysk in Northern Russia, known as the **Baku-Novorossiysk Pipeline**, handled rising volumes. The construction of this pipeline was followed by the Western Oil Pipeline from Baku to Supsa in Georgia. The full development of the Azeri-Chirag-Guneshli field, however, meant that a very large new pipeline would be needed. Led by British Petroleum (BP), investors designed a route to connect Azerbaijan's offshore fields to Ceyhan on Türkiye's Mediterranean coast - the project known as the **BTC pipeline**, the acronym standing for Baku-Tblisi-Ceyhan.

The BTC pipeline would be the first modern pipeline from the Caspian to the West, strategically bypassing Russia and securing a consistent flow of oil into Europe from Turkiye. The BTC project involved a large variety of actors, led by Azerbaijan International Operating Company (AIOC), the oil consortium developing Azeri Chirag Gunashli (ACG) oil fields complex in the Caspian Sea. AIOC contributed 30% of the pipeline's cost, and it received the remaining 70% in loans from an assortment of private banks, the European Bank for Reconstruction and Development, and the governments of Türkiye, Azerbaijan, the United States, and Georgia.

Although the U.S. Government contributed comparatively little in actual funds to develop the Caspian upstream and then the pipelines, its efforts were central in other ways:

- U.S. agencies, notably the Trade and Development Agency, funded feasibility studies for new pipelines. These feasibility studies gave investors and lenders confidence to move forward with the actual projects;
- Other U.S. agencies, notably the U.S. Export-Import Bank and the Overseas Private Investment Corporation (OPIC), provided funding and insurance that also bolstered investor confidence;
- High-level and bipartisan U.S. political engagement, from the Presidential level on down, assuring investors of Washington's strong backing;
- Hands-on diplomatic work to build confidence among investors, governments and Caspian publics and broker the necessary intergovernmental agreements for the projects.

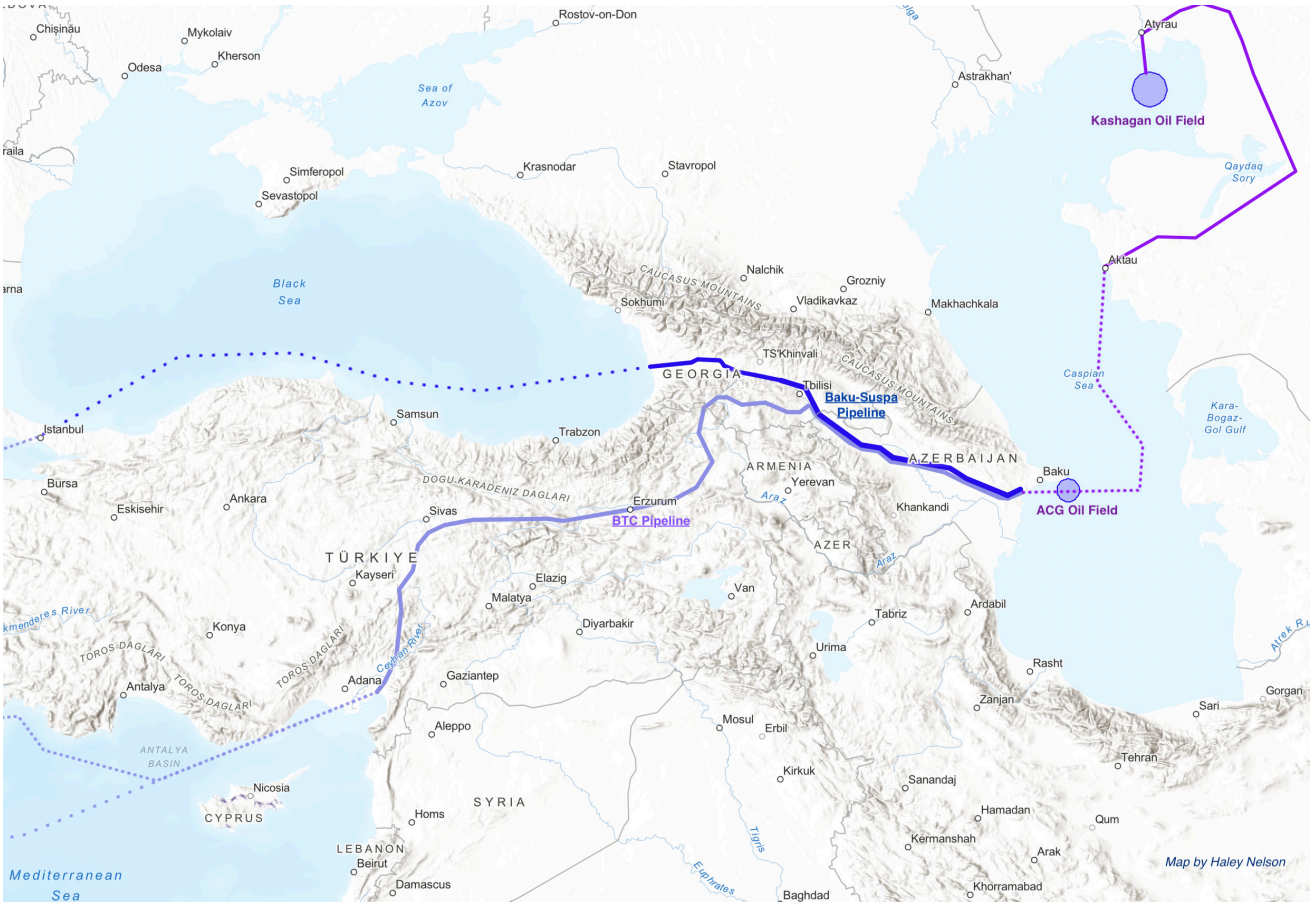
Azerbaijan's Sangachal Oil Terminal. Source: Google Earth

All of this American, and to some degree, European political action was designed to strengthen the sovereignty and independence of the new Caucasus and Central Asian states while supporting their U.S. and European corporations. Moreover, Türkiye's role should not be underestimated: the Turkish government and energy companies were an irreplaceable part of this energy transformation, for commercial and for geopolitical reasons. The Baku-Tbilisi-Ceyhan oil pipeline was the centerpiece of the effort. Former Energy Secretary in President Bill Clinton's administration, Bill Richardson, stated, "This [BTC] is not just another pipeline; it is a strategic framework that advances America's national security interests. It is a strategic vision for the future of the Caspian region."

After the 1994 ACG contract, the BTC expanded on an emerging geopolitical strategy to limit Moscow's leverage and open Caspian states to world markets - a project that benefitted producers and consumers alike. American and Turkish energy diplomacy of this period, promoting both the new pipelines and tens of billions of dollars in upstream investment, stands as an unquestioned geopolitical success.

The 1098-mile-long **Baku-Tbilisi-Ceyhan pipeline** flows through Azerbaijan, Georgia, and Türkiye, avoiding Russian and Armenian borders and stopping at eight pump stations (two in Azerbaijan, two in Georgia, four in Türkiye), one compressor station, two inspection stations, and 101 block valves. Top European energy investor BP holds the largest share of the pipeline at 30.1%, Azerbaijan BTC Limited holds 25%, Hungary's oil and gas company MOL holds 8.9%, Norway's Equinor holds 8.71%, and India-based TP Motor Oil holds a 6.53% share. At its highest

capacity, it transports an estimated 1.2 million barrels of oil per day; and it not only continues to carry Azerbaijani crude oil, but it also transports small amounts of oil from Kazakhstan's Tengiz oil field and from Turkmenistan.



In 2013, the BTC pipeline began accepting oil from the Tengiz field, traveling across the **Middle Corridor** Caspian Sea route to the Sangachal terminal in Baku operated by BP. Following Russia's invasion of Ukraine in 2022, Kazakhstan's state-owned KazMunayGaz (KMG), in cooperation with U.S.-owned Chevron, set a plan to increase Caspian Sea oil shipments to 1.5 million tons of oil annually. After the first shipment of oil was sent from Kazakhstan's Kuryk port to the Port of Baku in March 2023, the volume of oil transported from Kazakhstan's Port of Aktau to Azerbaijan's Port of Baku increased by 60.5 tons, or 75% in April 2023 when compared to March 2023. This increase was necessary after Russia invaded Ukraine in February 2022, Russia began periodically halting Caspian Pipeline Consortium (CPC) oil flows, citing "technical difficulties." This was unlikely an accident. Instead, it's been speculated that these halts were manufactured to reduce the oil transported from Kazakhstan through the CPC, to make Kazakhstan an unstable energy producer for Europe. Although shipping oil across the Caspian Sea via tankers is inefficient and costly, sending oil across the Middle Corridor to the BTC pipeline could, at the very least, promise consistent export rates.

The Russian and U.S.-backed oil transport route known as the **Caspian Pipeline Consortium** (CPC) currently transfers about 1 percent of the world's oil supplies. The CPC pipeline, which shipped 58.7 million tons of oil (52.2 million tons of which were supplied by Kazakhstan) in

2022, carries oil from the Tengiz oil field in Kazakhstan through Russia to the Novorossiysk-2 Marine Terminal off the coast of the Black Sea. Though the pipeline has significant investment by the Russian and Kazakhstani governments, other shareholders own the majority of equity, including Chevron, ExxonMobil, Shell, and Rosneft-Shell Caspian Ventures Limited - A joint venture owned by Shell and Russian company Rosneft. The Russian state-owned company, Transneft, currently has the greatest share of 24%, while the Kazakhstani KazMunayGas company holds 19% of the shares. However, with Russia's Rosneft joint venture owning the largest share, and the pipeline traveling through Russia to a Russian port, Moscow has immense leverage over the capacity and output of the pipeline. In July 2022, Russian courts placed a temporary halt on oil exports through the CPC, citing technical and logistical problems as the cause. Russian officials alluded to these halts being in retaliation to Western sanctions on Russian energy resources.

Another option to avoid Russian borders is the **Trans-Caspian Pipeline**, a proposed subsea pipeline, moving natural gas from Turkmenistan to Azerbaijan through a Caspian Sea route. The proposed pipeline capacity is an estimated 30 billion cubic meters per year of natural gas, and it would link to the **Baku-Tbilisi-Erzurum (BTE) pipeline** - a natural gas pipeline running parallel to the BTC Pipeline - and then extend to the **Trans-Anatolian Pipeline**, a gas pipeline which connects to the BTE and flows through Türkiye to Europe. Some proposals have extended the pipeline to the Tengiz field in Kazakhstan, but most of the natural gas would come from Turkmenistan's fields, flowing to Turkmenbay on the east shore of the Caspian Sea. It was first suggested in 1996 by the United States, and numerous working studies were completed before 1999 on the feasibility of the pipeline. The project never progressed past these feasibility studies due to the Turkmenistan Government's refusal to provide an acceptable investment climate for foreign investors. The last serious attempt to create a TCP ended in 2000. However, since Azerbaijan and Turkmenistan resolved their Caspian Sea demarcation issue in the summer of 2021, the project has started to receive more attention again.

In the year following Russia's invasion of Ukraine, European and U.S. investors have again begun to look eastward toward Turkmenistan's vast fields of oil and gas. Turkmenistan has the fourth-largest gas reserves in the world; however, export infrastructure potential is far from reached. The Turkmen government maintains investment policies that are hostile to foreign oil and gas companies. Until there is a radical change to these policies, there will be no Western oil and gas investment in the country -- and indeed, there has been no new investment since 2002, when Turkmenistan allowed Chinese firms to work on its sovereign territory.

Turkmenistan's Galkynysh Gas Field, south of Yoloten. Source: Google Earth

China-Funded Pipelines

Through a set of old, rusty pipelines, traveling northward across the vast and arid steppes, Central Asia's newly independent economies began to surface onto the global market through oil and gas deliveries to Russia. Specifically for Turkmenistan, during the early 1990s, export revenues totaling $1 billion annually were the mainstay of the Turkmen economy. Gazprom --with gas purchases brokered by the Itera firm -- remained Turkmenistan's dominant customer through the 1990s, a period that was characterized by frequent pricing spats and occasional cutoffs. Exercising its monopsony power, Gazprom was able to keep the price it paid for Turkmen gas very low.

Western companies attempted throughout the 1990s to gain investment footholds in the Turkmen onshore upstream, though all but a few minor players were driven out or abandoned their attempts due to government meddling and an unstable investment climate. The 1990s nationalization of Argentine firm Bridas's gas investments was the most egregious example of the government's hostile practices (and it was later forced to pay massive arbitral damages). Against this backdrop, China entered the Turkmen gas industry in 2002. Its companies operate with murkier accounting, ethical, and environmental standards than Western firms and are influenced by geostrategic aims in ways that Western firms are not. These factors allowed China to ease its way into the Turkmen market. China sees the diversification of energy sources as a significant geostrategic interest. Currently, about one-third of China's gas needs are met by natural gas, importing 53.2 billion cubic meters (bcm) of gas via pipelines in 2021, and the other two-thirds from liquefied natural gas (LNG), importing 109.5 billion cubic meters. Most of its pipeline gas comes from Turkmenistan, which supplies an annual 31.5 bcm of gas via pipelines,

compared to 15 bcm that China receives from Russia -- a number that is set to rise. With the Sino-Turkmen trade turnover increased by 53% for 2022, the majority of the $10 billion annual bilateral trade volume is made up of Turkmenistan's gas, and this dynamic could increase as Turkmenistan seeks investment for Line-D of the route to China.

The **Central Asia-China gas pipeline** (also referred to as the Turkmenistan-China gas pipeline) is a newer system of pipelines that connects China and Central Asia, starting in Turkmenistan. Since the start of its operation in 2009, the Central Asia-China pipeline has supplied more than 334 billion cubic meters of gas to China.

The transport routes include various lines (A through D) that carry gas through different parts of Central Asia to China. Lines A and B are used exclusively to import gas from Turkmenistan with a capacity of 15bcm/y. Line C carries natural gas supplies from Turkmenistan, Uzbekistan, and Kazakhstan with a capacity of 25 bcm/y (Turkmenistan and Uzbekistan are committed to supplying China with 10bcm yearly).

Line D is planned as an additional fourth pipeline meant to increase the current transport of 55bcm to 85bcm annually. The owner and operator of Line D of the Central Asia-China gas pipeline will be the Trans-Tajik Gas Pipeline Company. Because the additional route needs to pass through Uzbekistan, Tajikistan, and Kyrgyzstan to reach China, the initiative was agreed upon multilaterally among the Central Asian countries.

Turkmenistan also plays a useful role in China's Belt and Road Initiative (BRI), because its strategic location offers access to Caspian Sea ports and direct access to Iran. Since

Turkmenistan committed itself to play a larger role in the BRI in 2016, Turkmenistan has benefitted from helping plan the Turkmenistan-China Gas Pipeline, the International North-South Transportation Corridor, and the Lapis Lazuli International Transit Corridor.
China is a major player in Turkmenistan's gas exports because Turkmenistan is frankly willing to operate under investment and regulatory conditions that most other international energy companies refuse to tolerate. The actual terms of trade are not known: the Turkmenistan-China financial arrangements are a black box and the opportunities for corruption are ample. This is because cooperation between China and Turkmenistan is mutually beneficial in terms of geographic location, transit efficiency, and quantity. After the completion of the 10,000 km Central Asia-China Gas Pipeline in 2009, more than half of Turkmenistan's natural gas exports to China, approximately 40 bcm, have been delivered through this pipeline. And because of Turkmenistan's relative proximity to China, pipeline transmission of natural gas has a lower net cost than LNG imports for China.

For the first 11 months of 2022, Chinese imports of Turkmenistan's gas were priced at US$9.3 billion. Note, however, that the actual terms of trade remain murky: there appear to be no independent audits of volumes and pricing. Turkmenistan's reserves have the capacity to fulfill China's energy needs, but China will always want to retain a diversified energy portfolio. Although Turkmenistan is still China's primary Central Asian energy importer, Kazakhstan continues to seek to diversify from the Russian market through its energy sales to China.

In a bid to protect itself from overreliance on Russia, Kazakhstan is seeking enhanced cooperation with China. Since 2010, China's shares in Kazakhstan's oil and gas sector have halved, from 31% to 16%. Unlike Western companies, China has been an unconvincing alternative for Kazakhstan's export markets, and its single pipeline, moving from Kazakhstan to Western China, shows its limitations.

The **Kazakhstan-China oil pipeline** runs from the Caspian Atyrau offshore fields to Xingjiang, China, with joint ownership between Kazakhstan's state-run **KazMunayGaz** and the **China National Petroleum Corporation (CNPC)**. It was the first direct oil transport system connecting China and Central Asia. The pipeline is part of China's greater **Belt and Road Initiative (BRI)**, a massive initiative to expand Chinese infrastructure investments globally. This $3 billion project was initially separated into three segments; the first 448km section starts in Atyrau near the Caspian Sea and ends at Kenkiyak; Phase 2 flows from Atasu to Alashankou and Kenkiyak to Kumkol sections; and Phase 3 starts from Atasu in Kazakhstan and passes through three regions - Karaganda, East Kazakhstan, and Almaty, before terminating at Alashankou in China.

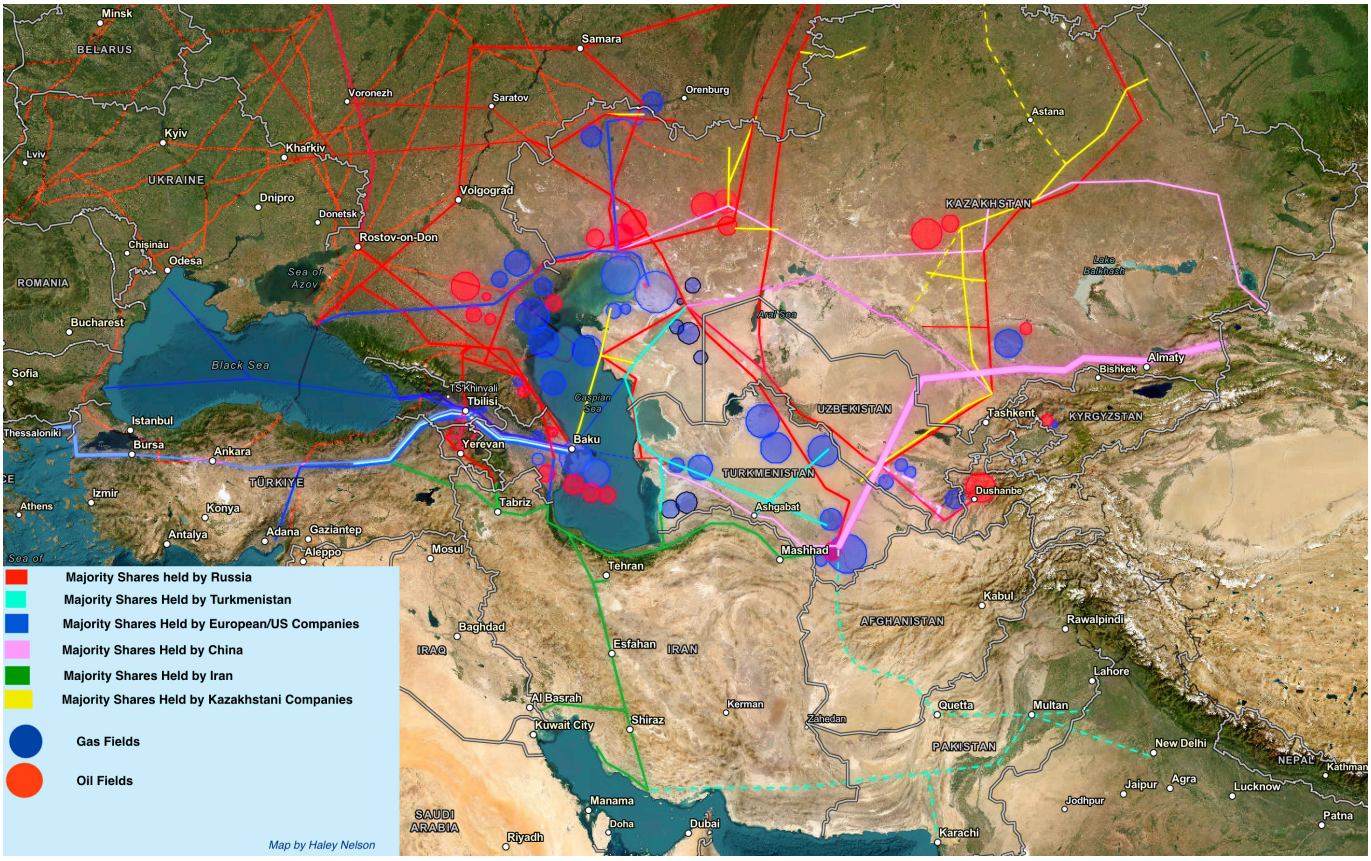
Kazakhstan, with the 12th largest oil reserves in the world, has been given the opportunity to reduce its dependence on Russia through increased energy sales to China. However, it is interestingly not doing so. In most economic sectors, Kazakhstan-China trade turnover has drastically increased since the start of the war in Ukraine, but energy exports to China have decreased. In the past two years, supplies of Kazakh gas to China declined from 13 billion cubic meters to 5.5 billion cubic meters. Some have blamed this on Kazakhstan's own growing energy consumption, while others have claimed Kazakhstan's energy sector is so entrenched in Russian influence that it cannot successfully diversify this sector without upsetting the Kremlin. But it is clear that Chinese interests in the region have just begun, and with growing imports from Turkmenistan, China is looking to become the next largest importer of Central Asian energy supply.

Russian-Funded Pipelines

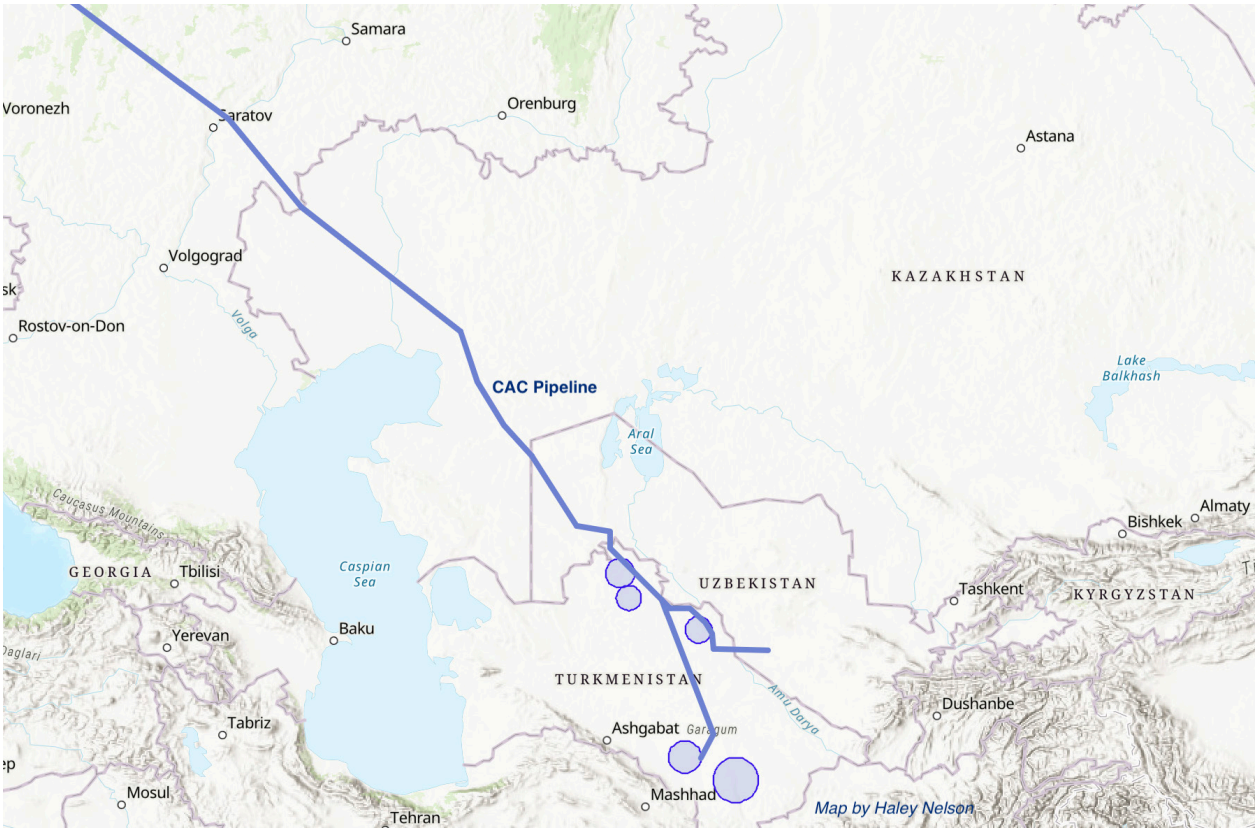
Since the turn of the century, Russia successfully developed its internal energy potential, attracting massive foreign investment -- up until the 2022 invasion of Ukraine. The initial rise of energy prices after the Soviet collapse led to the development of Russia's energy industry and the creation of energy agreements that bolstered Russia's position as the leading global energy supplier. However, Western success in the creation of the BTC pipeline was an obstacle to its energy security policy, and its dependence on Ukrainian oil routes posed a major risk to the stability of Russo-European trade partnerships. During the early 1990s, 95% of Russian oil exports to Europe passed through Ukrainian pipelines; and although Ukraine was within Russia's sphere of influence, Russia could not afford to give a single country too much leverage in its energy security policies.

Beginning in the late 1990s, Russia launched a series of energy projects, such as the Yamal-Europe gas pipelines in 1999, Blue Stream in 2002, Nord Stream in 2011, the Baltic Pipeline System 1 and 2, the Eastern Siberia-Pacific Ocean oil pipeline in 2009, South Stream, Turkstream, Nord Stream 2, and Blue Stream 2. The intensified energy competition that emerged in the early 2000s between Russia and Europe has complicated Russia's diversification projects and caused a shift in Russian energy security policy towards the Caspian region.

The threat of European expansion into the former Soviet space has become a fundamental determinant of Russian energy-security strategy, provoking decreased gas and oil flows, European acts against Russian interests. In 2014, Russia weaponized its European gas supplies and highlighted its dominance over the energy market by limiting gas supply to Europe via the Ukraine energy transit route and inflating gas prices. Because the Kremlin was dissatisfied with Ukraine's shift towards EU-oriented ideology and the ousting of then-President Viktor Yanukovych, Gazprom pipelines running through Ukraine were cut off; Gazprom complained that a debt of an estimated $5.3b was not paid off. Not only did this gas row punish Ukraine, but it also echoed through the European gas market, with an estimated 41% of European energy supplies coming from Russia, and threatened to cause a gas shortage in the Balkans and Northern European states. The EU warned that if Russia continued to disrupt Ukraine's gas flows, many private households would be "out in the cold" - specifically Estonia, Serbia, Finland, Bosnia, and Macedonia facing the worst shortages. Gazprom's Ukrainian pipelines supply some of these countries with up to 70% of their oil, and about half of Russia's energy supply to the EU comes from this pipeline. Kyiv and Gazprom's unresolved payment dispute was doing exactly what Russia had hoped: harming the EU for expanding influence into the former Soviet space, damaging the Ukrainian economy for rejecting Russian influence, and raising the importance of Caspian pipeline projects. Without well-established alternative energy suppliers, Europe is left to depend on Russian-controlled energy companies.



The **Central Asia–Center (CAC)** gas pipeline runs from the Dauletabad gas field and Okarem in Turkmenistan to Alexandrov Gay, Russia. The route includes passage through the Shatlyk gas field (Turkmenistan), Khiva, Kungrad, Cheleken, and Beyneu. It began operation during the Soviet-era via routes that pass through Uzbekistan and Kazakhstan. The eastern CAC pipelines (CAC 1,2,4, and 5) start from the southeastern gas fields in Turkmenistan, while the western portion (CAC 3) has a proposed addition that will run from the Caspian coast to the north. This gas system is controlled by Russia's Gazprom company, Turkmengaz, Uzbekneftegas, and KazMunayGas, each officially sharing equal ownership of the project.



Starting on October 1, 2023, the CAC pipeline will reverse its flows and begin transporting gas from Russia, through Kazakhstan and Uzbekistan, to Turkmenistan. Prior to this agreement, the CAC pipeline had been utilized to export small quantities of gas from Turkmenistan to Russia. However, due to gas disruptions in Turkmenistan that resulted in power outages in Uzbekistan in January 2023, a revision of this system became imperative. In preparation for this new export deal, several infrastructure enhancements will take place. A new gas metering station will be constructed in September, three gas pumping stations will undergo upgrades, and approximately 22 kilometers (equivalent to 13.67 miles) of pipeline will be added to the existing system. With this deal, Russia's state-owned Gazprom will supply Central Asia with 2.8 billion cubic meters of gas per year for the next two years.

The **East-West pipeline**, operated by Turkmengaz, connects to the eastern branch of the CAC pipeline. It runs from the Shatlyk compressor station in Turkmenistan to the Belek-1 compressor station at the western branch of the CAC. The East-West pipeline has a capacity of 10 bcm yearly. However, its usage is unconfirmed. It's been reported that it might be out of commission.

The route is designed to export gas to the Caspian and central regions of Turkmenistan and is a means of connecting major gas fields within the country.

Russia's Novorossiysk Terminal. Source: Google Earth

The **Baku-Novorossiysk pipeline** began operation in the Soviet era. Since 1996, the pipeline has transported oil from Azerbaijan's Sangachal terminal on the Caspian Sea to the Russian port, Novorossiysk, located along the Black Sea. Current capacity for the pipeline is about 100,000 barrels per day. The oil transported is extracted by the State Oil Company of the Azerbaijan Republic (SOCAR), and the route is operated by SOCAR and AK Transneft OJSC of Russia.

TurkStream is a natural gas pipeline connecting Russia and Türkiye through the Black Sea. Consisting of two lines, TurkStream has a total capacity of 31.5 bcm annually. It was inaugurated in 2020 and is run by Russian state-owned Gazprom and its subcontractor, South Stream Transport B.V., while Tekfen and Petrofac worked on the infrastructure for the projects from the Türkiye portions of the transport system. The pipeline starts at a compressor station near Anapa in Russia and runs to Kıyıköy, Türkiye. The first line diverges to a distribution center in Lüleburgaz, while the supplies can alternatively take a second line to Malkoçlar on the Turkey-Bulgaria border, where the pipeline will be connected to the existing Trans-Balkan pipeline system. Some of the gas moves on to Serbia and Hungary.

Though Türkiye has taken steps to diversify, it is still one of Russia's largest gas export markets after the EU.

Blue Stream is a natural gas pipeline owned by Russia's Gazprom and Italy's ENI, both holding a 50% share, and it travels from Russia, across the Black Sea, to Türkiye. In Türkiye, Turkish company BOTAS is the primary operator of the pipeline as it travels 300 miles from Samsun to Ankara. The pipeline has an annual capacity of 16 billion cubic meters of gas. According to a Gazprom spokesperson, this pipeline was constructed to offer an alternative route from Russia to the Mediterranean, without involving third countries. For NATO and EU allies of Türkiye, this pipeline signaled the growing economic relationship between Türkiye and Russia. While this project helped Turkey diversify energy imports away from volatile Middle Eastern governments, it subsequently increased Turkiye's vulnerability to Russian energy warfare.

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