



REVIEWING CASPIAN OIL EXPORT ROUTES: RUSSIA, IRAN AND TURKEY

November 6, 2001

On November 6, the Caspian Energy Project reviewed the transportation of Caspian oil to world markets via existing and projected export routes through Russia, Turkey and Iran in the aftermath of the September 11 attacks and the U.S.-led multinational campaign against terrorism.

Bob Ebel, Director of the CSIS Energy and National Security program and Co-Director of the Caspian Energy Project, began the meeting by looking at Russia, which has been supportive of U.S. efforts since September 11. Ebel underlined Russia's continuing focus on investment and support from the U.S. as well as from the European Union in order to fully realize its own energy potential and to resume its level of oil production in 1988. Ebel said that the Russian oil sector was not complaining about market opportunities, but about lack of investment. Noting the positive developments relating to energy in the region, such as the completion of the Caspian Pipeline Consortium (CPC) pipeline, the signing of the Shah Deniz-Turkey gas pipeline agreement between Azerbaijan and Georgia and progress on the Baku-Tbilisi-Ceyhan (BTC) oil pipeline project, Ebel nevertheless cautioned that the absence of resolution of the dispute on the legal status of the Caspian Sea was likely to continue to hamper the full exploitation of the energy potential of the Caspian region.

Shireen Hunter, Director of the CSIS Islam and the West Project, predicted that what she saw as "the asymmetry of interest" dividing the US and Iran would be eradicated parallel to the war against terrorism and that Washington would embrace a moderate Iranian regime within the next five years. Hunter said that the Caspian Sea region would benefit from a more positive U.S. approach to Iran because discussion had been confined to two competing visions of Eurasia, namely the Russian and the Turkish, and the southern route through Iran had been neglected. Hunter argued that a possible southern pipeline route did not necessitate a choice between Turkey and Iran, but could instead include both countries. Although directing Caspian oil to markets through Iran would not be economically significant for Iran, Hunter said that this would nevertheless be important symbolically for Iran in the international political arena.

Bulent Aliriza, Director of the CSIS Turkey Project, and Co-Director of the CSIS Caspian Energy Project, then focused on the role of Turkey and the projected Eurasian Energy Corridor for Caspian oil. Aliriza said that the BTC project promoted by Turkey continued to be an important component of the Caspian oil transportation equation, not least because the Turkish straits could not handle increasing volumes of Caspian and Russian oil in addition to all the other traffic ad infinitum.

Aliriza noted that Turkey had taken full advantage of US political support since 1995 as it concluded agreements with Azerbaijan and Georgia and a host government agreement with the Azerbaijan International Operating Company (AIOC) and was undertaking a detailed engineering study of the BTC due to be completed next summer. Buoyed by the support of BP-Amoco, the biggest shareholder and manager of the AIOC, Turkish officials were confident of success. However, Aliriza cautioned that the BTC had yet to prove its commercial and political viability for the date chosen for its inauguration, 2005.

With the AIOC having only an estimated 4.6 billion barrels of the 6 billion barrels needed to make BTC viable, hopes for additional south Caspian oil diminishing and little prospect of meaningful volumes of Kazak oil being directed to BTC before 2008 at the earliest, Aliriza said the use of the BTC was likely to be limited to an economically unattractive fraction of its 50 million ton per annum capacity for a number of years. Although the AIOC expected to raise its yearly production to 17.5 - 18.5 million tonnes by 2005, companies controlling nearly a quarter of the AIOC equity had not joined the main export company, MEPCO, which would build the BTC, and were unlikely to commit their share of volumes. They were still looking at other options, such as continued utilization of the early oil Baku-Supsa pipeline, currently handling around 6 million tonnes of AIOC oil a year, or the Baku-Novorossisk line which was upgraded last year to handle up to 17 million tonnes.

While the lack of sufficient volumes is certain to be an issue during the upcoming financing phase of the BTC, another problem worthy of examination, according to Aliriza, was the Turkish Government guarantee of cost overruns beyond the \$1.4 billion estimated for the Turkish leg of the BTC, the overall cost of which was revised in June by AIOC President David Woodward from \$2.4-2.7 to \$2.8-2.9 billion. After all, Aliriza noted, Turkey was going through a grave economic crisis, having to resort to massive IMF credits to avoid possible default on its daunting external and internal debts, facing problems borrowing on the private financial markets and having trouble fulfilling guarantees for a number of energy

projects involving western companies. Moreover, with transit fees fixed at only 55 cents per barrel for the first sixteen years of BTC and an estimated 20 cents for operating costs, Turkey was likely to make little more than \$100 million a year or so even from the full operation of BTC.

Finally, Aliriza argued, the ongoing transformation of the international system ushered in by the events of September 11, seemed certain to affect the political underpinnings of BTC notwithstanding assurances to the contrary. After all, Aliriza said, support for the Eurasian corridor was justified in Washington, to a great extent, on the grounds that BTC would help prevent a Russian monopoly on Caspian oil exports and exclude Iran. In view of their close cooperation during the Afghan operation, Aliriza said it was likely that the U.S. would be less aggressive in its promotion of a pipeline project opposed by Russia. He said that at a general level, Washington might also look less unfavorably on Moscow's attempts to buttress its position in Central Asia and the Caucasus, with the key transit country in the BTC, Georgia, an early test. Aliriza added that with Iran, there was a still slim but very real possibility of a change in the U.S. attitude based on common opposition to the Taliban and Bin Laden's terrorism.