

# Trans-Eurasian Energy Transportation Networks and the Necessity of Regional Cooperation

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The Central Asia-Transcaspian region is rich in energy resources. However, these resources cannot be fully developed without fostering international cooperation. The 'pipeline wars' between competing consortia is not conducive to profit maximization. A cooperative regional regime for oil and gas exploration, extraction, and transportation could help improve the business climate and international security. The existing regional integration organizations with a degree of sway in the area – the Eurasian Economic Union and the Shanghai Cooperation Organization – still have some way to go to prove their usefulness as true promoters of multilateralism. Regional countries that do not belong to either of the two organizations prefer to cooperate on a bilateral basis – and this is also true of member states. Regional coordination is necessary to overcome self-interested, beggar-thy-neighbor behavior by business players and states alike in order to maximize regional welfare.



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### *Introduction*

The future of the Eurasian region is connected to the development of modern transportation infrastructure, encompassing both human movement and commodity transportation. The major development of oil and gas pipelines and fields in the region only started following the collapse of the USSR. Azerbaijan led the way, signing the most production-sharing agreements (PSAs) of all the former Soviet Union countries. The 100,000 barrels of oil per day (bbl/d) capacity Baku–Novorossiysk pipeline started functioning in 1997; the 145,000 bbl/d Baku–Supsa pipeline was opened in 1999; and the 1,000,000 bbl/d Baku–Tbilisi–Ceyhan (BTC) pipeline started pumping oil in 2005. In parallel, in 2007 Azerbaijan started exporting natural gas via the South Caucasus pipeline, also known as the Baku–Tbilisi–Erzurum (BTE) pipeline. The pipeline’s capacity is billion cubic feet (300 bcf) of natural gas, potentially upgradable to more than 700 bcf.

After the 1998 merger of BP and Amoco, the newly enlarged company radically increased its activities in the Caspian Sea littoral states. By 2004, BP’s share in the Azeri–Chirag–Gunashli (ACG) oil field in Azerbaijan exceeded 34 percent. By late 2010, BP owned 37.4 percent of operating interest in the ACG, while the sum total of the stakes controlled by the US-headquartered Chevron, Exxon and Hess amounted to 22 percent. As a result, by 2010, Britain and the US accounted for more than half of all foreign direct investment inflows to Azerbaijan’s economy. While their combined share declined somewhat in subsequent years - to about 40 percent of the total volume of FDI inflows - the United Kingdom remains the largest source of foreign direct investment for the Azerbaijani economy. Among all of the UK-headquartered transnational corporations, BP stands out as the single most important business partner and investor in Azerbaijan’s petroleum sector. Following its entrance into the local market in 1992, the company has emerged as the country’s largest foreign investor.

### *The pipeline wars*

The BP-led consortium, which includes Azerbaijan’s state oil company SOCAR (25% stake) built the Baku–Tbilisi–Ceyhan (BTC) export pipeline at an estimated cost of \$4 billion, 70 percent of which was covered by public money. BP is the largest shareholder (30.1%), followed by SOCAR, Chevron (8.9%), Statoil (8.7%), TPAO (6.5%), ENI (5%), Total (5%), and others. The pipeline with the planned capacity of 50 million tons of oil

per year was opened in 2005 and pumped 790,000 bbl/d on average in 2009. Although the pipeline capacity was expanded to 1.2 million barrels per day, nearly 53 million tons per year, the actual volumes stayed at or near the 2009 level. In 2014, the BTC carried about 28.5 million tons of oil, and in 2015, 28.8 million tons, 5.5 million of which came from Kazakhstan and Turkmenistan.<sup>1</sup> In less than ten years of exploitation, BTC has supplied almost 300 million tons of oil to world markets.<sup>2</sup>

The situation regarding the northern route has been much more dramatic. In 2013 the Russian government annulled the 1996 contract on transportation of Azerbaijani oil via Novorossiysk due to the chronically low transit volumes. A new agreement was reached between Russia's pipeline operator Transneft and Azerbaijan's SOCAR in February 2014. Only 1.75 million tons of Azerbaijani oil flowed through the Baku-Novorossiysk pipeline in 2013, dropping to 0.9 million tons in 2014 and then increasing to 1.2 million tons in 2015. SOCAR's 2016 promise to send at least 1.4 million tons to Novorossiysk may or may not materialize. Both Russian and Azerbaijani analysts agree that whether you take a political or economic perspective, the northern route may well be heading into oblivion.

With most of the Azerbaijani oil destined for Ceyhan, Russia had refocused its attention on Kazakhstan and the eastern shore of the Caspian. In 1992, the government of Kazakhstan entered into negotiations with the Sultanate of Oman to establish the Caspian Pipeline Consortium (CPC). The Russian government soon joined the deal, becoming the third member of the CPC. The project connected the western Kazakhstan oil field of Tengiz with the port of Novorossiysk – Russia's main Black Sea coast oil terminal.

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In 1996, half of the consortium shares were sold to producing companies, which included Rosneft and Lukoil, Russia's first joint stock oil company. Other investors were Kazakhstan's national oil company (currently, KazMunayGas), the US-based Chevron and Mobil, British Gas, Agip S.p.A. of Italy and Oryx Energy (Qatar). The pipeline was commissioned in 2001, with a capacity of 684,000 bbl/d. After a series of consolidations, 31

1 Mamedova, N. (2016) 'V 2015 godu po truboprovodu "Baku-Tbilisi-Ceyhan" prokacheno 5.55 mln ton nefti tretyih stran'. *BNews.kz*, 21 January. Available at: [http://bnews.kz/ru/news/politika/vnutrennyaya\\_i\\_vneshnyaya\\_politika/v\\_2015\\_godu\\_truboprovodu\\_bakutbilisidzheiham\\_prokachenno\\_555\\_mln\\_tonn\\_nefti\\_tretih\\_stran-2016\\_01\\_21-1246991](http://bnews.kz/ru/news/politika/vnutrennyaya_i_vneshnyaya_politika/v_2015_godu_truboprovodu_bakutbilisidzheiham_prokachenno_555_mln_tonn_nefti_tretih_stran-2016_01_21-1246991) (Accessed: 10 February 2016).

2 ABC.az (2016) 'Transportirovka azerbaidzhanskoi nefti po BTC v ianvare snizilas na 7%'. *Fineko/abc.az*, 4 February. Available at: <http://abc.az/rus/news/main/93943.html> (Accessed: 10 February 2016).

percent of its shares ended up with the Russian government (24 percent managed by the oil transportation monopoly Transneft and 7 percent by the CPC Company). Producing companies controlled by Russian interests hold a further 20 percent. Kazakhstan's KazMunayGas controls 19 percent of the stock. The largest international investors are Chevron, with 15 percent, and Mobil Caspian Pipeline Company, with 7.5 percent.

In 2011, CPC partners began the expansion of the pipeline capacity to 1.4 million bbl/d, or 67 million tons a year; the work will be finished in 2016.<sup>3</sup> The CPC ended up as an important instrument of Russia's economic and political influence in the region - even as another Caspian-Black Sea oil transportation artery under Russia's partial control, the Baku-Novorossiysk pipeline, fell into relative neglect because of disagreement between its Russian and Azerbaijani operators.

Of course, Russian Gazprom still controls the 2800 bcf capacity Central Asia – Center (CAC) natural gas pipeline, commissioned more than 40 years ago. However, after many years of operation, its capacity dropped by nearly 50 percent, to 44 billion cubic meters (bcm), or approximately 1550 bcf, by 2009. By 2012 it had fallen even further, to roughly one-tenth of its original throughput capacity.<sup>4</sup> As Azerbaijan steadily worked to overcome its former reliance on Russia's technological inputs and infrastructure in oil production and transportation, so did Turkmenistan, seeking to wean itself off overreliance on the Russia-controlled natural gas transportation network.

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Parallel to the decline of the Russia-controlled infrastructure, the newly built oil and gas pipelines bypass Russia altogether, further undermining its previously unchallenged position as Eurasia's number one energy giant. The steady growth in the independent export capabilities of such countries as Azerbaijan, Kazakhstan, Turkmenistan and Uzbekistan have eroded Russia's positions as principal exporter and transit operator for Eurasian hydrocarbons exports on world market. Russia seems to be losing what industry analysts describe as the 'pipeline war' with

<sup>3</sup> KazMunayGas (2016) 'Caspian Pipeline Consortium'. KMG, January 2016. Available at: <http://www.kmg.kz/en/manufacturing/oil/ktk/> (Accessed: 10 February 2016).

<sup>4</sup> Alexander's Gas & Oil Connections (2009) 'Basic information on the CAC network', *An Institute for Global Energy Research*, 2 September. Available at: <http://www.gasandoil.com/news/russia/17c466d32b4875bf0b6929fe29c329ed> (Accessed: 12 February 2016); Mammadov, Q. (2015) 'Turkmenistan positions itself as Eurasian natural gas power'. *Oil & Gas Journal*, 12 July. Available at: <http://www.ogj.com/articles/print/volume-113/issue-12/transportation/turkmenistan-positions-itself-as-eurasian-natural-gas-power.html> (Accessed: 12 February 2016).

the West and China alike – the ‘war’ over who gets to control the primary export routes for the Transcaspian energy resources. While the Kazakhstan-Russia CPC pipeline is still leading, having transported 42.8 million tons of oil in 2015, BTC pumped 29 million tons to Ceyhan during the same period, while the Kazakhstan-China pipeline carried 11 million tons to China. Thus, the volumes are now roughly comparable, while in the future the other post-Soviet countries may start outpacing Russia’s oil and gas exports from the Central Asia-Transcaspian area.

The only country among the major oil and gas producers in the region that managed to maintain extensive cooperation ties with Russia, particularly via joint usage of major pipelines and oil refining facilities, is Kazakhstan. Its case is quite illustrative, in terms of both the benefits and challenges of such cooperation.

#### *Is economic integration viable? The case of Kazakhstan*

By 2000, Kazakhstan produced 30 million tons of oil and oil condensates per year, while Azerbaijan produced less than half this amount.<sup>5</sup> Although the gap between the two narrowed somewhat during 2007-2010, it increased again in 2011-2015. Kazakhstan remains by far the largest energy producer after Russia in the post-Soviet space, with a total of 1.72 million bbl/d in liquids production in 2015, according to the US Energy Information Administration. By comparison, Azerbaijan’s average in 2015-2016 has been projected at 880,000 bbl/d.<sup>6</sup>

However, Kazakhstan’s growth has been handicapped by historical limitations, namely its reliance on transportation networks and refinery facilities located in Russia. For the first few years after independence, all of the new republics’ energy exports were heading north and north-west, to Russia; there was simply no other way to reach the world market. Throughout the first decade of independence, the Uzen-Atyrau-Samara pipeline, with a throughput capacity of 17.5 million tons, was Kazakhstan’s major export route to the world. It linked to Russia’s Transneft distribution system, which delivered Kazakh oil to the Russian Black Sea port of Novorossiysk, or went through the Druzhba pipeline, across western Russia, Belarus or Ukraine. The Black

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<sup>5</sup> Shoemaker, M. W. (2013) *Russia and the Commonwealth of Independent States 2013*. Lanham, Md: Rowman & Littlefield, p. 255; Today.Az (2005) ‘Estimated oil reserves in Azerbaijan comprise 1 bn tons’. June 23. Available at: <http://www.today.az/news/business/19716.html> (Accessed: 21 January 2016).

<sup>6</sup> US Energy Information Administration (2016) ‘Short-Term Energy Outlook’. 9 February. Available at: [https://www.eia.gov/forecasts/steo/report/global\\_oil.cfm](https://www.eia.gov/forecasts/steo/report/global_oil.cfm) (Accessed: 24 January 2016).

Sea route has faced regulation and even challenges on environmental and safety grounds by Turkey. The Druzhba route has seen periodic disputes with Ukraine over transit fees. Finally, the loss of the Kazakh oil as a result of theft en route became a problem with the rise of criminal activity in the Samara oblast<sup>7</sup>, where the Transneft security recorded 1322 illegal siphoning incidents over ten years.<sup>7</sup>

Kazakhstan was forced to seek diversification of its export routes. Because of its inherited dependency on Russia's transit network, it had to proceed decisively, yet diplomatically, without antagonizing its northern neighbor. The construction and operation of the CPC (Tengiz-Novorossiysk) pipeline is illustrative. At the same time, Kazakhstan's official strategy has long sought to overcome the one-sided reliance on a single export route. As early as 1995, speaking to the attendees of the World Economic Forum in Davos, Switzerland, Kazakhstan's President Nursultan Nazarbayev emphasized that his country, possessing huge natural resources and qualified labor force, was considering exporting energy carriers both to the West and to the East. In his 1997 Address to the People of Kazakhstan, Nazarbayev specifically stressed that "only a large number of independent export routes can prevent dependence on one neighbor and the monopolistic price dependence on one customer."<sup>8</sup>

And this is how the country proceeded. In 1997, an agreement with the Chinese oil major CNPC provided for the joint development of oil fields and construction of an export pipeline to China. By 2003, Phase 1 of the future Kazakhstan-China pipeline, the Kenkiyak-Atyrau segment, was completed. By the end of 2005, the Atasu-Alashankou trunk had crossed the Chinese border, becoming Kazakhstan's first independently built export pipeline. Thus, Phase 2 was completed. Phase 3 connected the Kenkiyak oil field to the Kumkol oil field in the southern part of central Kazakhstan in 2009. Connecting all three sections with the Soviet-built Kumkol-Atasu line and reversing the flow of oil in the Kenkiyak-Atyrau segment from its original east-west direction heralded the next stage of the Kazakhstan-China project.

7 Kazantseva, M. (2013) 'Samara obognala Dagestan po ob'emam hishcheniia nefi [Samara beat Dagestan in the amount of stolen oil]'. *Izvestiia*, 24 January. Available at: <http://izvestia.ru/news/543568> (Accessed: 5 February 2016).

8 Nazarbayev, N. (1997) 'Poslanie Prezidenta Respubliki Kazakhstan N.A. Nazarbayeva narodu Kazakhstana'. 16 Oktyabr 1997 g. *Ofitsialnyi sait Prezidenta Respubliki Kazakhstan*. Available at: [http://www.akorda.kz/ru/addresses/addresses\\_of\\_president/page\\_poslanie-prezidenta-respubliki-kazakhstan-n-a-nazarbaeva-narodu-kazakhstana-oktyabr-1997-g\\_1343986436](http://www.akorda.kz/ru/addresses/addresses_of_president/page_poslanie-prezidenta-respubliki-kazakhstan-n-a-nazarbaeva-narodu-kazakhstana-oktyabr-1997-g_1343986436) (Accessed: 14 February 2016).

This doubled the pipeline's original capacity to 20 million tons a year, or 400,000 bbl/d.

The loss of Kazakhstan's oil, now channeled eastwards, means that transportation networks to Europe may remain underutilized. Significantly, the starting point of the Kazakhstan-China pipeline is essentially the same as the starting point of the Atyrau-Samara pipeline, which brings up to 15 million tons of oil into the Russian Transneft network annually. Hence, Russia is now competing with China over Kazakh oil. The Chinese are not happy that the 20 million ton capacity Atyrau-Alashankou pipeline pumped less than 5 million tons of crude in 2015.<sup>9</sup> Russia is concerned that the lifting of sanctions against Iran will further suppress crude oil prices, causing Kazakhstan to roll back production and lower the volumes of oil channeled via the CPC pipeline. Azerbaijan has been arguing for some time that the best route for the Kazakh oil to reach international markets is across the Caspian and via Baku's Sangachal Terminal, continuing to the Black Sea or the Mediterranean coast by the Baku-Tbilisi-Ceyhan pipeline.

The North Caspian Operating Company (NCOC) consortium, which operates the Kashagan field, does not include Russian participants. Its members are Kazakhstan's KazMunayGas (16.87%), transnational oil majors Exxon Mobil (16.81%) and Royal Dutch Shell (16.81%), the Italian ENI (16.81%), the French Total (16.81%), China's CNPC (8.4%), and Japanese Inpex (7.56%). Recently, they have agreed on an export strategy that would combine sales to the European Union and China. Given the fact that oil prices hit twelve-year low in January 2016 against the sluggish demand in Europe and elsewhere, the Chinese market is increasingly attractive – to the extent that Russian producers are increasing the supply through Kazakhstan's transit networks to China, taking away from Russia's own Transneft system.

In both Kazakhstan itself and in the West voices have been raised doubting the economic rationale of its participation in the Eurasian Economic Union (EEU), where western sanctions against Russia reverberated throughout the whole common economic space. The ruble's devaluation affected intraregional trade and currencies of other EEU member states. As a result, the trade between the core countries of the EEU – Russia, Belarus and

<sup>9</sup> Delovoi Kazakhstan (2016) 'Kazakhstan dolzhen bolee chem vdvoe narastit eksport nefiti v KNR, polagayut kitajskie eksperty'. 20 January. Available at: <http://dknews.kz/kazahstan-dolzhen-bolee-chem-vdvoe-narastit-e-ksport-nefiti-v-knr-polagayut-kitajskie-e-ksperty/> (Accessed: 14 February 2016).



Kazakhstan – shrank by roughly one-third in the first year since the Union’s inauguration.

Nonetheless, the EEU’s prospects are not necessarily bleak. In fact, Kazakhstan’s economists noted certain improvements in the structure of trade, e.g. growth in the machine-building share of exports.<sup>10</sup> The World Economic Situation and Prospects 2016 report, published by the UN Department of Economic and Social Affairs (UN/DESA), notes that the establishment of the Eurasian Economic Union “opens new possibilities for increased trade and investment in the region, although many aspects of the regional integration still have to be negotiated.”<sup>11</sup>

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The very model of Eurasian regional economic integration also has to be negotiated. At the moment, it appears too politicized, due to Russia’s precarious situation in international politics. However, once the situation in Ukraine normalizes and western sanctions against Russia are removed, the EEU is poised to take off. As US Principal Deputy Assistant Secretary of State for South and Central Asian Affairs Richard E. Hoagland has noted, “the Eurasian Economic Union should be trade-liberalizing rather than trade-restricting, should not become overly politicized, and should not impose conditions or restrictions on its members’ ties with other countries.”<sup>12</sup>

Russia’s trade war with the West and the worsening of economic and trade relations with Turkey have a serious impact on Kazakhstan, creating political and economic dilemmas that Astana would rather not face. One way to ensure that the EEU will not evolve along the path of self-imposed isolationism is to combine the membership in its structures with participation in multilateral trade regimes. From this point of view, Kazakhstan’s accession to the WTO is a step in the right direction. Parallel to that, inter-regional, transcontinental linkages should be developed and strengthened. EEU’s ties to the Shanghai Cooperation Organization, Economic Cooperation Organization and, of course, the European Union, will help cast aside misconceptions as to the

10 Trotsenko, P. (2016) ‘God soyuza: pervye itogi i perspektivy EAES’. *Vlast*, 6 January Available at: <https://vlast.kz/jekonomika/15071-god-souza-pervye-itogi-i-perspektivy-eaes.html> (Accessed: 14 February 2016).

11 United Nations (2016) *World Economic Situation and Prospects 2016*. New York: United Nations, p. 127. Available at: <http://www.un.org/en/development/desa/policy/wesp/> (Accessed: 14 February 2016).

12 Hoagland, R.E. (2015) ‘Central Asia: What’s Next?’, *US Department of State*, 30 March. Available at: <http://www.state.gov/p/sca/rls/rmks/2015/240014.htm> (Accessed: 15 February 2016).



organization's purpose and future. A cooperative trade regime making full use of the region's central location at the intersection of trade routes from the east to the west and from the north to the south will boost trade and maximize the participants' welfare.

*Toward a cooperative network regime*

There are two ways to deal with competition among Eurasian energy exporters: positive and negative. The first one entails actions through which "a seller tries to make his product cheaper, bigger, better, or more appealing to the buyer." The negative response to competition includes "efforts to reduce the saleability or availability of competitors' products."<sup>13</sup> The Western, and more specifically, Anglo-American efforts to undermine Russia's position in the hydrocarbons export markets under the pretext of "diversification of supply" is the prime example of this negative tactic, insofar as these efforts attempt to reduce the availability of Russian oil and gas in the European market in particular.

The positive approach to competition would require energy producers and energy infrastructure operators in the Central Asia-Transcaspian area to work together to enable joint usage of the existing transportation networks, thus replacing the 'pipeline wars' with regional economic cooperation and integration.

As I argue here, the region's oil and gas reserves and the transportation networks can be seen as either a locus of conflict or a common resource shared by all the states of the region. For the sake of both consumers and exporters, it is important to construct a multilateral cooperative regime in the area. Such a regime, implemented in the form of a socioeconomic network, would enable the region to benefit from the economies of scale, as well as generating positive spillover effects for other sectors.<sup>14</sup>

Until a cooperative international regime for the development of the region's energy resources is created, self-serving interests of the individual actors – national governments and transnational corporations – will stall collective welfare maximization. Bilateralism will undermine multilateralism. Meanwhile, a cooperative regime in the energy sector of the Central Asia-Caspian region

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<sup>13</sup> Machlup, F. (1952) *The economics of sellers' competition: Model analysis of sellers' conduct*. Baltimore: The Johns Hopkins Press, p. 83.

<sup>14</sup> Molchanov, M.A., Yevdokimov, Y. (2004) 'Regime building as a prime mover of technological progress: The energy sector in the Central Asia-Caspian region'. *Perspectives on Global Development and Technology* 3(4), pp. 417-435.

could promote knowledge sharing and technological transfers between the national oil and gas industries of participating countries, as well as harmonization with international standards via engagement with foreign investors. Such a regime would reduce transaction costs and initiate economies of scale in the energy sector, while helping to strengthen security and sustainability in the area. While stopping short of cartelization, it could also improve profit margins of the national energy champions and transnational oil and gas companies currently engaged in a winner-takes-all competition for the market share.

Regional coordination is necessary to transcend the inbound, self-interested behavior of individual business players and governments in order to achieve welfare maximization on a transnational, regional level. It is widely acknowledged that cooperation brings greater collective benefits than any form of strategic competition that seeks to maximize benefits of one player at the expense of the others. Competition policy experts argue that “a change from inbound-, national-welfare-focused competition policies to such pursuing supranational and suprajurisdictional welfare goals, as well as cooperation on concrete, specified cases, is necessary from an economic perspective. However, both topics are hardly compatible with the contemporary governance principles...”<sup>15</sup>

In the absence of regional coordination, market development proceeds under conditions of anarchy. Large-scale infrastructure projects, such as the construction of transcontinental oil and gas pipelines, require massive investments of money, labor, technology, and knowledge, and can only be successful with at least some cross-border, international cooperation. Any project of such scale and type should be based on a comprehensive preliminary assessment, scrupulous planning, and purposeful self-organization among producer groups to limit potential market anarchy and reduce any attendant risks.<sup>16</sup>

One way to reduce the uncertainty is through the harmonization, or approximation of policies; creating a more or less uniform international policy regime under the aegis of an authorized international agency. The WTO regime is one example of this model.

15 Budzinski, O. (2015) ‘International antitrust institutions’, in Blair R.D. and Sokol D.D. (eds.), *The Oxford handbook of international antitrust economics, Volume 1* (pp. 119-146). New York: Oxford University Press, p. 141.

16 Jessop, B. (2015) ‘The course, contradictions, and consequences of extending competition as a mode of (meta-) governance: towards a sociology of competition and its limits’. *Distinktion: Scandinavian Journal of Social Theory*, 16(2), pp. 167-185.

Another approach is policy coordination, or the establishment of a functioning regime of systematic multilateral cooperation based on mutually agreed-upon rules of behavior “around which expectations converge.”<sup>17</sup> Such rules must be voluntarily upheld by all participants, and without any one party acting as the enforcer. This is a path of soft regulation by means of joint elaboration of standards, their voluntary acceptance and implementation, negotiations of individually tailored modifications of policy and/or partial exceptions as necessary, and implementation agreements based on the principle of fair treatment of all participants.

### *Challenges of cooperation*

One specific economic integration instrument at the disposal of most of the Central Asia-Transcaspian countries is the abundance of natural resources, oil and gas in particular. Russia is the world’s largest exporter of natural gas and the second-largest exporter of oil. Kazakhstan ranks among the world’s top 20 largest petroleum and other liquids producers, while Azerbaijan is in the top 25. Kazakhstan is also the world’s largest producer of uranium. Turkmenistan is number 33 in the world ranking of petroleum producers, according to the US Energy Information Administration. It is also the sixth largest natural gas reserve holder in the world, according to the *Oil and Gas Journal*, and was among the top 15 dry natural gas producers in 2014.

Of course, countries of the Eurasian hinterland are vastly different in terms of size, economic potential and geographic location. For most Central Asian states today, China is more important than Russia. The transportation potential of these countries also varies greatly. Belarus, Kyrgyzstan and Tajikistan are landlocked; Azerbaijan, Kazakhstan and Turkmenistan have direct access only to the inland Caspian Sea; India, Iran, Pakistan and Turkey are all maritime powers, and Russia has access to three oceans. Rail density, according to World Bank data, varies from 2.2 km of rail line per 1,000 square kilometres of territory in Kyrgyzstan to 4.4 in Tajikistan, 5.2 in Russia, 5.4 in Kazakhstan, 9.85 in Uzbekistan, 22.7 in Georgia, 25 in Azerbaijan and nearly 27 in Belarus.

In short, some countries stand to benefit from regional and trans-regional cooperation more than the others. Azerbaijan in particular is very well positioned to develop as a major transportation hub for both energy and

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17 Young, O.R. (1980) ‘International regimes: problems of concept formation’. *World Politics*, 32(3), pp. 331-356.

cargo traffic. The Baku-Tbilisi-Kars (BTK) railway project, due to open for rail cargo transport in 2017, will become the shortest route connecting Asia to Europe. Adding to the existing Trans-Caspian transport route, the BTK serves China's ambitions of resurrecting the ancient Silk Road under Beijing's current One Belt, One Road initiative. The \$40 billion Silk Road Fund that China has established to finance infrastructure projects in Central Asia will further improve the east-west transportation links.

Azerbaijan is also a key member of the International North-South Transport Corridor (INSTC), which connects northern Europe to India via Russia and Iran. Other INSTC members include Belarus, Kazakhstan, Kyrgyzstan, Oman, Syria, Tajikistan, Turkey, and Ukraine. Bulgaria has observer status. The corridor is expected to help connect India to Russia within 16 to 21 days at competitive freight rates. At the January 2016 meeting in Baku four countries – Azerbaijan, Georgia, Iran and Ukraine – signed a memorandum of understanding on implementing the INSTC project along the third, western route via Georgian Black Sea ports of Batumi and Poti, in addition to the already tested Caspian shore routes via Russia.

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Energy production, transportation and trade have emerged as one industrial cluster that can help bring all of these countries together. Energy cooperation could become the backbone of regional integration initiatives, extending well beyond the energy sector. The benefits that such multilateral cooperation could bring to all the countries of the region, including energy producers and energy transit countries, are obvious.

And yet, most energy cooperation initiatives so far have been conceived and implemented as bilateral undertakings. The Customs Union bodies had little say over the scope and direction of energy deals between Kazakhstan and China, or Russia and the EU countries. The Eurasian Economic Community was not consulted in the bilateral negotiations between the Russian energy companies and their Central Asian counterparts. The Eurasian Economic Union still needs to demonstrate its independence from the overwhelming Russian influence and its ability to act as a truly multilateral regional entity, working to support the interests of all its members.

Another regional organization with huge economic potential is the Shanghai Cooperation Organization, which unites China and Russia with the Central Asian states of Kazakhstan, Kyrgyzstan,

Tajikistan and Uzbekistan. Afghanistan, Belarus, India, Iran, Mongolia, and Pakistan have observer status, and the process of admitting India and Pakistan as full members started in July 2015. Armenia, Azerbaijan, Cambodia, Nepal, Sri Lanka and Turkey are dialogue partners. Even the current member states, according to expert estimates, hold more than 50 percent of the world deposits of natural gas and nearly one-quarter of the world's oil. Moreover, these states also control 35 percent of the world's coal deposits and close to half of all the uranium found on the planet.<sup>18</sup> Some of the lengthiest and most important oil and gas pipelines in the world traverse the territories of these countries: notably the CPC, the Kazakhstan-China, the East Siberia – Pacific Ocean (ESPO) oil pipelines and the Central Asia–China gas pipeline.

The idea of the SCO Energy Club was proposed by Moscow back in 2006. However, the proposal has, to date, remained unrealized. One reason for this is the general preference that regional players have shown for bilateralism over multilateralism in the energy sector. The fact that the energy sector in some of the post-Soviet countries is, according to some estimates, one of the most non-transparent industrial sectors within the region is an additional impediment. Finally, the national priorities are divergent. Even though all of the SCO member states subscribe to the notion of energy security, security of energy suppliers (Russia, Kazakhstan, Uzbekistan) is different to the security of energy consumers (China, Tajikistan, Kyrgyzstan). Energy exporters implicitly compete with one another, and so do energy importers. Diversification of energy transportation routes, presumably a good thing for all, is not embraced by dominant transit countries such as Russia or Kazakhstan with the same degree of enthusiasm as by their partners.

As a major energy importer, China is interested in promoting regional energy cooperation in Eurasia. Chinese bilateral ties with energy-producing SCO member states have been strengthened through more active promotion of multilateralism following the formal institutionalization of the SCO Energy Club in 2013. If successful, the Energy Club could pave the way for the creation of a common energy space for the participant countries, which would require an agreement on price liberalization, standardization of energy transportation tariffs, development of a unified approach to taxation, and coordination of supply in order to avoid unnecessary competition between suppliers. Essentially, if the

18 Bushuyev, V., and Pervukhin, V. (2012) 'Energeticheskii klub ShOS: kakim emu byt?' *The SCO Central Internet Portal*. Available at: <http://infoshos.ru/ru/?idn=9616> (Accessed: 16 February 2016).

Energy Club is to become more than a platform for Russia-China dialogue with few other countries watching, a multilateral regulatory body may be required.

At present, no such body exists, and the Energy Club itself remains more or less an empty shell, a concept waiting for practical implementation. Among the SCO member states, Kyrgyzstan and Uzbekistan have not yet signed a memorandum on its creation. While Turkey is participating, neither Azerbaijan nor Turkmenistan has shown much interest to date. It is illustrative that two year after its establishment, Vladimir Putin had to use the SCO 2015 Ufa summit platform to plead with participants to develop 'concrete tasks' for the Energy Club agenda. Even more telling is that a recent decision to start the construction of a major, 33 bcm a year Turkmenistan-Afghanistan-Pakistan-India (TAPI) natural gas pipeline was reached without any involvement of the SCO structures. Similarly, the construction of the 16 bcm Trans-Anatolian natural gas pipeline (TANAP) and the work on the South Caucasus Pipeline Expansion (SCPX) project started following an agreement between Azerbaijan and Turkey. Once again, third power preferences did not played a major part in the outcome of the bilateral negotiations.

### *Conclusion*

Trans-Eurasian energy transportation routes connecting the Central Asia-Transcaspian region, the member states of the Eurasian Economic Union, and the broader Shanghai Cooperation Organization community could become the region-building instrument that unites wider Eurasia on primarily economic grounds. However, existing geopolitical divisions and distrust between the West and the majority of 'non-Western' Eurasia prevent this unification. Without a cooperative energy production and transportation regime, strategic competition (beggar-thy-neighbor) policies will prevail. Moreover, economic competition may spill over into other areas with negative effects, potentially affecting areas such as international security. This should be prevented.

Although the political-economic interests of the Eurasian countries essentially coincide in regard to the improvement of their transportation options, concrete ways to implement particular projects may differ and even operate at cross purposes. Rather than being complementary, these countries' economic policies are frequently at odds. While Russia would like to consolidate oil

and gas transportation infrastructure on a regional basis, others are much more interested in diversifying export-import routes. China and India are competing for the Caspian oil and gas supplies, while Iran is competing with other petroleum-exporting nations as a major supplier. The cooperative development of the SCO Energy Club could help resolve some of these issues, yet its multilateral potential remains underutilized. The same is true of the EEU. The need to consolidate the region without reducing national welfare of any single state requires the creation of a cooperative energy transportation regime on a truly multilateral basis.