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Brandenburg Institute for SOCIETY and SECURITY

The New Geopolitics of Energy Resources



Global energy politics and supply security

Stefano Casertano



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IMPRESSUM

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The New Geopolitics of Energy Resources

**Global energy politics
and supply security**

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Summary

This work describes the evolution of the geopolitics of energy from 1945 to the present day, with the aim of demonstrating that energy policies follow “cycles” of boom and bust, mostly due to limits of strategic oversight and a delay between investment decisions and their pay off. Current developments in the world energy market – most notably, U.S. shale gas and the rise of China – are compared to the “Cold War for Energy” from 1945 to 1991 as well as to the Post-Soviet energy developments to 1999. The “Boom and bust” character of this sector has long been dominant and depends upon loosely comparable political dynamics. The different cycles and grand strategies that the U.S. and Russia developed evolved from a territorial strategic competition of the Cold War to a more fragmented approach after 1991.

Energy resources are considered determinants of power, and a set of conclusions is derived concerning how energy policies interact with the broader global agenda of Russia, the United States, and China, in order to demonstrate how an increased supply worldwide will not lessen the strategic interests of the United States in the Middle East – and that shale gas could allow more freedom of movement for the U.S. in the region. Reduced energy prices in the past have also correlated with advancements in the Israeli-Palestinian peace process.

As for end markets and Russia-EU energy relations, this paper not only demonstrates how global energy policies exert a decisive impact on the local security of supply, mostly in terms of pricing, but also that end consumer states can secure an affordable flow of resources – impacting the equilibrium of global powers, as producing countries were able to introduce more aggressive political agendas during periods of high commodity prices. The European Union should consider the precedents of historical “energy cycles” to avoid a possible collapse of the present energy market, which could lead to an unsustainable energy inflation. Most notably, a recent relaxation in terms of EU policy of access of energy producers to the EU distribution market, together with a transformation of supply contracts from a “fixed price, long term” to a “spot price” structure, may represent a significant issue if new gas shortage develops – an unlikely, yet possible event.

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Introduction

Energy between Russia and the West: Time to abandon old concepts

Since the rise of Vladimir Putin as Russia's President in 1999, a large amount of analysis has been dedicated to Russia's energy policy as a means of fostering the political influence over continental Europe.. The increased assertiveness of Moscow in both the energy sector and in terms of international relations at large has been interpreted as a signal for such agenda, and new projects binding Russia's fossil resources with European markets are often viewed with concern. It seemed that Russia had finally completed that long sought after "post-Soviet resurgence", bringing the Kremlin back to a geopolitical position proportionate to its history and ambition.

The return of Russia has been probably the most important world geopolitical event of the early 2000s, right before the full-blown emergence of China. This was not only because Russia's return symbolized the end of the "Roaring Nineties" of the United States uncontested premiership. It led to anxiety in Europe, on whether the return of Moscow was to be feared or hailed. It led to doubts in the U.S., about whether the return of Russia could be "managed" or not, and if possibly the same vigorous return was due to chastised ambitions, frustrated by "ill directed" policies by Washington and the IMF. In Russia, the reemergence led to a revival of a sort of "nationalist sentiment", exploited also for its value in domestic political terms.

For the sake of the U.S., we might safely assume that, for better or for worse, that strong nation called Russia would have "returned" to the global arena anyhow. The U.S. enjoyed almost a decade of absolute global hegemony, but possibly no policy on earth would have achieved outcomes such as a "prevention" of the Russian return (given that someone really wanted to prevent it). Pretending that a U.S. policy might have ever be able to help Russia to the way of full democratization overnight, might sound like an overestimation of the reach of U.S. policies – or an underestimation of Russia's own will and personality.

We shall also reject the claim that Russia's return has been a simple story, in which the state simply reintroduces some sort of police state, regains control of energy resources, exports them and lets a government stay in power until the life-spans of leaders allow it. Putin's return has had many implications and been far-reaching. The "democratic" dimension of the idea can be certainly questioned, but – as we will see later – also Russia had grounds to question the democratic idea per se.

In general terms, Putin's energy policies in his first two terms can be characterized in three broad ways, aimed at reshaping the industry domestically and internationally.

First, Putin put some large extractive and infrastructural assets back under state control. Putin restructured the general relationship between the Kremlin and the so-called "oligarchs" – the group of private investors that surged to power during the late Boris Yeltsin's tenure. The oligarchs, and in particular Boris Berezovski, played a crucial role in the successful reelection campaign of Yeltsin in 1996 (who was already looming in the deepest recesses of alcoholism). The oligarchs had allowed a wide degree of freedom in the first post-Soviet years, as hard cash was hardly needed to get the energy industry working again (it was estimated that the technology gap with the West was about 25 years). After the sector had recovered, they started exerting an ever stronger influence over the Kremlin – and Putin decided to change course.

Second, Putin's Russia was successful at reasserting some kind of geopolitical agenda on the "Stan" republics of Central Asia. The interest of the country was defined militarily by means of direct intervention (as in Chechnya 1999), and by some indirect influence in local conflicts (as in Kabardino-Balkaria and Nagorno-Karabakh). Russia also tried to influence political change in some republics, sustaining elites with ties to the former Soviet Union. Moscow tried to prevent the installation of energy transportation infrastructures that could cut the Russian territory out of the routes. The strategy eventually succeeded in preventing the completion of pipelines such as the "Trans-Caspian Pipeline" (gas), connecting Turkmenistan to Azerbaijan; or a project to connect Kazakhstan's extractive regions to Azerbaijan; or any other route connecting Turkmenistan directly with the Arabian sea. Nevertheless, other important pipelines outside of the Russian territory were completed, such as – most notably – the "Baku-Tbilisi-Ceyhan" pipeline, from the Azeri coast of the Caspian sea, to the Turkish oil terminal of Ceyhan.

Third, Putin's Russia worked for the creation of additional gas pipelines connecting Russia's pipeline infrastructure with Europe. The "feed" of such new pipeline projects originates in part from Russian territory, and in part from areas around the Caspian Sea – but the pipeline routes transit through Russian territory. Russia has been harshly criticized for having sought to "cut" Ukraine out of the transit area, yet we should also consider that the opposite extreme – that of the absolute majority of Russian gas exports to Europe transiting through Ukraine – was not beneficial for any of the parties.

In the eyes of the Kremlin's critics, all of the three actions belong to the broader plan of bypassing Ukraine to install point-to-point infrastructures, and ultimately be able to "selectively" close down pipelines. In particular, creating high-capacity export routes such as Nord Stream (Russia-Germany) and, possibly, South Stream (Russia-South Corridor) would "separate Central Europe from Western Europe insofar as dependence on Russian energy is concerned¹", in the words of former U.S. National Security Adviser Zbigniew Brzezinski.

If Russia were able to deploy an energy plan of this sort in Europe, it could be able to exert a double-fold power on the continent, of "commercial" and "political" kind. In terms of "commercial power", through the control of a larger stake of Europe's gas supply, Russia would be in the position of deeply influencing gas prices, based on a partial monopoly. In particular, point-to-point energy transport infrastructures may significantly increase Russia's occupation of single national gas markets, with a situation of "geographical monopoly". As for "political power", the same ability to selectively block export routes can be interpreted as an opportunity to impose political will on import countries also in areas other than energy.

Observing the relations between Russia and its neighboring countries after 1999, some commentators described the whole situation even as a "New Cold War". This definition has been adopted by journalists², political leaders³ and some scholars⁴. Referring to the East-West tensions

¹ Natural Gas Europe of November 9, 2011, Nord Stream: A View from Poland, at:
<http://www.naturalgaseurope.com/nord-stream-a-view-from-poland-3421>

² See the book by the „Economist“ journalist Edward Lucas, *The New Cold War: Putin's Russia and the Threat to the West*, Palgrave Macmillan (2008); or MacKinnon, Mark (2007), *The New Cold War: Revolutions, Rigged Elections, and Pipeline Politics in the Former Soviet Union*, Basic Books;

³ Such was the definition adopted by last Soviet Union President, Mikhail Gorbachev, in 2008 while describing the U.S. attitude towards Russia (see The Telegraph of 6. May 2008, Gorbachev: U.S. could start a new Cold War). Also the former Prime Minister of Ukraine Yuliya Tymoshenko adopted used the terms "Cold War" in a Foreign Affairs article (Containing Russia, May/June 2007), although he declared that "I do not believe that a new Cold War is under way or likely. Nevertheless, because Russia has indeed transformed itself since Putin

related to pipeline politics, some have even talked about a “New Great Game” in Central Asia⁵. The “New Cold War” should differ from the “Old” one as it is based on a broader concentration on energy resources as a means of exerting political power. The Russian control on the feed of some oil and gas routes directed to Europe is leveraged (or could be leveraged) by the Kremlin to impose its will on transit and consuming countries.

Yet, it is time to look at situation with new eyes. Such interpretation of Russia’s energy initiatives was popularized years ago. New elements intervened in the meantime. Most notably, although the share of gas supply from Russia has increased in some states, it has been reduced in others, due to alternative suppliers from North Africa and from LNG sea terminals. Moreover, the European Commission took action to prevent a possible expansion of Russia’s control on gas pricing and flow, pushing for various measures to increase diversification and to allow EU countries a better leverage on gas contracts negotiations. Among the proposed measures there has been that of inviting European countries to prefer “spot” to “long term” contracts (in order to exploit eventual low-price supply from other partners); preventing Russian state companies from entering the European gas storage and local distribution market (otherwise Russia would be able to deploy “physical arbitrage” strategies); installing “reverse flow” gas infrastructures, capable for example of providing shut-off markets with supplies from other countries; developing alternative international gas sourcing infrastructures, such as the (improbable) “Nabucco/Nabucco West” pipeline, or many others between Turkey and the Balkans.

In the global context, a slump in gas pricing (attributed to U.S. shale, but actually mostly due to European stagnating demand) made clear how the gas dependence is mutual: Europe needs Russian gas, but Moscow needs hard-currency from gas exports, and therefore is as much dependent as Europe on its own gas exports. Russia is still far – if it will ever be able or willing to – from achieving that final transition from “energy dependent” economy to a diversified industrial system⁶, as the stock exchange of Moscow is still overly dependent on the pricing of fossil commodities. Also some ambitious energy infrastructure projects will probably never see the light. A change of course in Ukrainian policies (compared to the early 2000s) convinced Russian policymakers of the feasibility of a plan to simply revamp existing pipeline routes through Ukraine, and give up visionary investment in the Southern Corridor (Turkey-Black Sea).

For this reason, it is time to completely revise the approach to the “geopolitical structure” of East-West energy relations. It is not just a matter of change in the energy sector: the structure of great powers has changed. Talking about the “pipeline competition” as the sole dimension of the “energy game” is short-sighted: more fundamental dynamics have started influencing the sector, involving governments, industries and societies.

became president in 2000, the problem of fitting Russia into the world's diplomatic and economic structures (particularly when it comes to markets for energy) raises profound questions.”

⁴ A collection of fifteen academic essays focused on this topic is presented in Kiesbe, Stefan (2010), *Is There a New Cold War?*, Greenhaven Press. See also Korinman, Michel (2008), *Russia: A New Cold War?*, Mitchell Valentine & Company; Sakwa, Richard (2008), ‘New Cold War’ or twenty years’ crisis? Russia and international politics, *International Affairs*, Volume 84, Issue 2, pages 241–267, March 2008

⁵ See Kleveman, Lutz (2004), *The New Great Game: Blood and Oil in Central Asia*, Grove Press

⁶ Although some signals show that Russia indeed achieved some diversification, consumption and imports are still highly correlated to fossil commodity prices, as demonstrated by Gaddy, Clifford & Ickes, Barry (2010), *Russia after the Global Financial Crisis*, CRIFES Working Paper Series

Methodology and structure of the work

This work is divided into three main sections. The first section describes the “History of Oil and Gas in the Cold War” from 1945 to 1991. The idea is to provide a “historical framework” for understanding how the “diplomatic traditions” of Russia and the United States in the energy sector have matured. If history is a guide for the future, this first part also serves to evidence how “energy cycles” characterized global energy policies ever since WWII – and wise political planning is needed to find a positive stance as new cycles begin.

The second section describes the “Post-Soviet energy developments”. This narrative became very popular in the early 2000s, and somehow it is still considered central for the current energy situation. Yet, the structure of the global energy market has changed – not only due to shale gas – and I describe how the 1991-1999 political struggle developed and finally ended.

The third section builds on the first two sections, and describes how shale gas and the rise of China are affecting energy supply security in the West, and possibly the U.S. presence in the Middle East. As for supply security, this part claims that the current Western advantage is “temporary” and will not be sustainable without adequate political and economic investment. As for the U.S. in the Middle East, increased domestic production do not mean – technically and politically – that the Washington will reduce its interest in the region.

The methodology leverages both historical and quantitative approaches. More specifically, the methodology is based upon the consideration that current U.S. and Russian action depend on two “layers” of historical experiences (the Cold War and the post-Soviet development), and are then influenced by radical changes in the energy environment, although the post-Soviet disorder has been largely recomposed.

Table 1 - Basic analytical structure

Part	Objective	Analysis
1 – Oil and gas in the Cold War	Assessment of “traditional” energy geopolitics	Definition of the four basic “energy cycles” and of the overlying dynamics of energy geopolitics, also to assess the “diplomatic tradition” shaping the strategies of the blocs
2 – Post-soviet energy developments	Assessment of “Post-Cold War” geopolitical fragmentation	Definition of “geopolitical anarchy” due to the collapse of the Cold War order, in order to assess the recent experiences defining the strategic posture of great powers
3 – Contemporary developments	Assessment of “current” geopolitics	Analysis of the impact of current energy dynamics on the equilibrium of power and on the supply security of Europe

The methodology considers a classic, post-realist theory of international relations: strategic objectives are chosen depending on the interest of the domestic structure of power. In democracies, and especially in the Cold War U.S., such interest can be more closely identified with the interest of

the country at large. As for Russia, the Kremlin's moves have been constantly permeated by the interest of the ruling party to hold power, also – in some cases – giving up chances of achieving a broader and more diversified model of economic development.

Europe, in its quest for "energy security", has been often lacking a real geopolitical personality, and therefore the country plays only a residual role in the methodological assessment. Nevertheless, historical experience shows that in some cases European countries were able to find and exploit favorable positions within the global geopolitical competition. Such has been the case – as we will see – of Italy and the import of Soviet oil in the late 1950s; of Germany and the construction of the "Druzhba" pipeline in the early 1960s; of the UK and the new oil supply in the 1970s; and of Italy, Germany and the UK in the installation of the Urengoy pipeline in the 1980s.

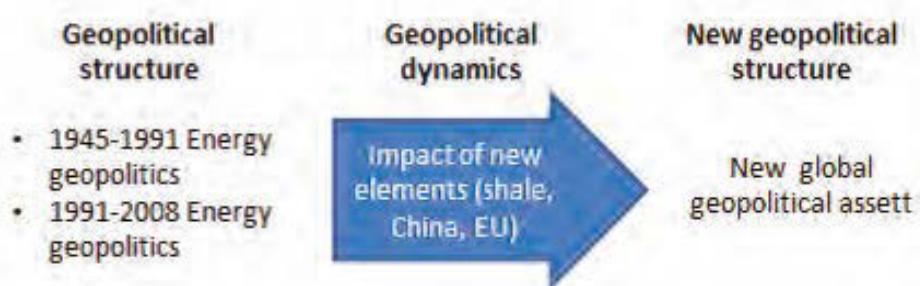
The approach will allow to assess an analytical structure such as the one described in the following table

Table 2 - Assessment of geopolitical goals by country/period

Country/region	Geopolitical goals 1945-1991	Geopolitical goals 1991-2008
USA	Xxx	xxx
Russia	Xxx	xxx
Europe	Xxx	xxx
China	Xxx	xxx

Defining a complete historical, political and quantitative "geopolitical model" will provide a reliable structure to better understand how recent dynamics are able to impact the system. "Shale gas", the "emergence of new consuming countries", and also the onset of the EU as a (somehow) functioning international organ representing the interest of European countries, will all be evaluated in their impact on the "geopolitical personality" of countries.

Figure 1 - Impact of geopolitical dynamics on the geopolitical structure



1. Oil and Gas in the Cold War

Keypoints

- This first part outlines the U.S.-Soviet energy grand strategies during the Cold War, to describe how inter-bloc energy relations belonged to consistent diplomatic lines, parallel and integrated to the “main” Cold War, as great powers consistently tried to affect others’ or enhance their own energy supply security in order to achieve political or commercial advantages.
- The aim is to provide a longer term “historical framework” to define some specific elements:
 - The “diplomatic and strategic tradition” of Russia and the U.S. in the energy sector, in the Mideast presence, and in the influence with Europe, with the aim to define which past experiences may still shape the current political personality of Washington and Moscow
 - The presence of “cycles” in the strategic relationship between the United States and the USSR/Russia mostly as a result of the effect of price variability. The variable of “energy price” is influenced by instability in producing countries, but can also be influenced by exogenous factors - such an increase in production in non-OPEC countries – that exerts decisive impact on the balance of power.
- In particular, this section shows how big powers may profit from a presence on resource-rich territories even in case they do not need resources themselves, with the aim of affecting the “energy supply security” of competitors. Such has been the case of the Soviet Union and its ambitions in the Middle East from 1945 to 1991: the Soviet empire had more than enough reserves for its own needs (and those of its satellites), yet a presence in the region was considered essential to limit the reach of the West on oil and gas. Similarly, a (possibly) energy independent U.S. in contemporary times may still have reasons to retain a presence in the Middle East, in a logic of power equilibrium with the presence of rising and resource-hungry powers (such as China). This element will be of pivotal importance while assessing the strategic rationale of an energy-independent U.S. (as forecasted by the EIA by 2030) and its presence in the Middle East.
- As for the theoretical approach, this chapter explores the “realist” question behind the Soviet Union’s energy resource exports, in terms of “imperialist” or “commercial” goals. The latter aspect tended to prevail over the years, although they both have always been contemporarily present. In particular, as long as the Soviet Union was chasing “imperialist” goals through energy exports, U.S. “territorial” counteractions proved largely ineffective. Only when Soviet “commercial” means started to prevail by the 1980s (together with a Soviet extractive slowdown and a partial switch to gas exports), a U.S. “market” reaction exerted some effect – although Reagan’s energy actions were not targeting exclusively Moscow. A specific analysis is dedicated to the role of Italy in the 1950s-60s, as the most relevant country influencing inter-bloc “energy diplomacy” in the period and in the following years.

1945-1991: The Four energy cycles

The potential of Soviet oil, in terms of both its commercial and political reach, has surfaced as a topic for research in different periods of the Cold War. After WWII, the main question was represented by the Soviet Union's chances to recover its oil extraction and transportation industry from the ruins of the global conflict⁷. After the Suez Crisis of 1956, Moscow inaugurated a large-scale policy of oil trading with the West, inspiring a set of intelligence analysis political dimensions of the new commerce⁸. In the 1970s, the explosion of two energy crises defined new prospects for the Soviet oil export potential and for the relations between Moscow and the Arab oil-producing states of OPEC⁹. Research focused on commercial¹⁰ and imperialist¹¹ aspects of the Soviet oil trade in that decade, with considerations about possibilities of further expansion. By the early 1980s it had become clear that most of the potential for Soviet oil relied on its ability to provide hard-currency earnings to Moscow, and some scholars focused on this topic¹². In 1986, the decreasing consumption of oil and some extraction liberalization policies in the West led to a collapse in the barrel price, contributing to the buildup of financial distress in the Soviet Union: the residual potential of Soviet exports and the new market situation became the subject of renewed research interest¹³.

The notable work by Simon Bromley about oil as a tool for U.S. hegemony¹⁴ draws closer to the aim of this chapter, yet it largely focuses on the mere "leadership" role of the U.S. in the oil industry. Oil relations between the U.S. and the Soviet Union are explored in a minor

⁷ See Hassmann, Heinrich, *Oil in the Soviet Union: History, Geography, Problems*, (Princeton, NY: Princeton University Press, 1953). The situation of the Soviet oil industry was also reviewed during the conflict, as it became clear that the extractive facilities represented a strategic determinant in the fortunes of the troops combating in Europe: see Nazaroff, Alexander, *The Soviet Oil Industry*, *Russian Review*, 1941, Vol. 1, No. 1, p. 81; and Schwarz, Solomon M., *How Much Oil Has Russia?*, *Foreign Affairs*, Vol. 24, No. 4, July 1946.

⁸ See Lubell, Harold, *The Soviet Oil Offensive and Inter-Bloc Economic Competition*, (Santa Monica, CA: The Rand Corporation, 1961); and Lubell, Harold, *Middle East Oil Crises and Western Europe's Energy Supplies*, (Baltimore, MA: Johns Hopkins Press, 1963). In 1961 the Library of Congress prepared a study concerning Soviet Oil in the Cold War, Library of Congress, HD9575.R82 U63. See also Hodgkins, J. R., *Soviet power: energy resources, production, and potentials* (Upper Sadle River, NJ: Prentice Hall, 1961); and Piercy, G. T., *Impact of Oil Exports from the Soviet Bloc* (Washington, DC: National Petroleum Council, 1962).

⁹ The most relevant publications from this period are Klinghoffer, Arthur Jay, *Soviet oil politics in the Middle East and Soviet-American relations* (Tel Aviv, Israel: Tel Aviv University Russian and East European Research Center, 1976); and Klinghoffer, Arthur Jay, *Soviet Union & International Oil Politics*, (New York, NY: Columbia University Press, 1977).

¹⁰ Campbell, R. W., *Trends in the Soviet oil and gas industry* (Washington, DC: Johns Hopkins University Press, 1976); Stern, Jonathan P., *Soviet Energy Prospects in the 1980s*, *The World Today*, 1980, Vol. 36. No. 5.

¹¹ Besides the work of Russel, Jeremy, *Energy as a Factor in Soviet Foreign Policy* (London, UK: Royal Institute of International Affairs, 1976); and Horelick, Arnold L., *The Soviet Union, The Middle East, and the Evolving World Energy Situation*, *Policy Sciences*, 1975 Vol. 6, No. 1.

¹² See Wilson, David, *Soviet oil and gas to 1990* (Boston, MA: Abt Books, 1982); United States Congress Office of Technology Assessment, *Technology and Soviet Energy Availability, International Security and Commerce Program*, 1981; Goldman, Marshall L., *The Enigma of Soviet Petroleum*, (Sydney, Australia: George Allen & Unwin, 1980). The question of Soviet oil capabilities surfaced also a decade earlier, as in Ebel, Robert E., *Communist Trade in Oil and Gas: An Evaluation of the Future Export Capability of the Soviet Bloc* (Westport, CT: Praeger Special Studies in International Economics and Management, 1970).

¹³ See Gustavson, Thane, *Crisis Amid Plenty: The Politics of Soviet Energy Under Brezhnev and Gorbachev* (Princeton, NJ: Princeton University Press, 1989); Chadwick, Margaret, *Soviet Oil Exports: Trade Adjustments, Refining Constraints and Market Behaviour*, (London, UK: Royal Institute of International Affairs, 1987); and Stern, Jonathan P., *Soviet Oil and Gas Exports to the West* (London, UK: Policy Studies Institute & Royal Institute of International Affairs, 1987).

¹⁴ Bromley, Simon, *American Hegemony and World Oil* (University Park, PA: Penn State Press, 1991)

portion of the book,¹⁵ and little attention is dedicated to the “dialogic” relationship in the energy field linking Washington and Moscow along the Cold War. Such an element is particularly important since the Soviet Union acted mainly as a producer, while the U.S. progressively transformed into an oil importing economy. Bromley’s work nevertheless provides useful insights concerning the interrelation between the system of international oil companies as a tool for U.S. global influence. Also the book dedicated by Fiona Venn to U.S. oil diplomacy¹⁶ reviews the role of oil in inter-bloc relations, yet the work was completed on the verge of the 1986 oil crisis and could not consider the impact of such pivotal event in Cold War relations.

Most scholarly accounts focus on the industrial aspects of oil in the twentieth century¹⁷, rather than on the political ones; or about the U.S. “addiction” to oil¹⁸. As for oil related policies and tensions, most scholars concentrated on specific periods, and their research has been geographically limited. Some research has been dedicated to the first post-war years, and specifically to the role of the superpowers in the Middle East¹⁹; others have focused on the strategic role of Iran; in most cases, the analysis of energy relations has been incorporated into assessments of Mideast policies under specific U.S. administrations, primarily those of Presidents Truman, Eisenhower and Kennedy²⁰.

This section seeks to contribute to the outlined debate through two main contributions. First, it implies that energy resources represented a key element in inter-bloc relations since the end of WWII, defining throughout, complete and continuous strategies. Of course, the Cold War has not been fought or determined by the control of energy resources, but oil and gas have played an important role in the East-West conflict.

Secondly, this part presents a rational analysis of the strategic directives aimed at leveraging oil as a “political” mean to exert power on other countries, from the directives considering oil as a “commercial” target per se, capable of providing financial resources to the Soviet system. The analytical approach is “realist”, as the goals in terms of inter-bloc energy relations were largely defensive on the U.S. side (limiting Soviet Union’s “energy leveraged” strategic approach) and offensive on the Soviet one (optimization of profits and exertion of political power through energy exports)²¹, although as energy prices slumped in the 1980s, positions were partially reversed (the specific connections between energy imperialism, energy commerce and offensive/defensive strategies are outlined in table 1). Clearly, also the U.S. controlled some portion of the world energy commerce and “offensively” leveraged it to secure commercial and strategic goals; yet, U.S. oil

¹⁵ Bromley, Simon (1991), quot., pp. 189-200

¹⁶ Venn, Fiona, *Oil Diplomacy in the Twentieth Century*, (New York, NY: Palgrave Macmillan, 1991)

¹⁷ Yergin, Daniel, *The Prize: The Epic Quest for Oil, Money & Power* (New York, NY: Free Press, 1993); and Sampson, Anthony, *The Seven Sisters: The Great Oil Companies and the World They Shaped* (New York, NY: Viking Press, 1975).

¹⁸ Notable works such as Klare, Michael T., *Blood and Oil: The Dangers and Consequences of America's Growing Dependency on Imported Petroleum* (New York, NY: Palgrave Macmillan, 2004); Rutledge, Ian, *Addicted to Oil: America's Relentless Drive for Energy Security* (London, UK: I.B. Tauris, 2006), focus on the mere aspect of the U.S. dependence on imported oil, and not on the need of oil as a determinant factor in the inter-bloc energy strategy.

¹⁹ Gerges, Fawaz A., *The Superpowers and the Middle East: Regional and International Politics, 1955-1967*, (Boulder, CO: Westview, 1994).

²⁰ Citino, Natan J., *From Arab Nationalism to OPEC – Eisenhower, King Saud, and the making of U.S.-Saudi Relations* (Bloomington, IN: Indiana University Press, 2002).

²¹ See Waltz, Kenneth, *Theory of International Politics* (New York, NY: random House, 1979)

exports to the Soviet Union and its satellite states have been extemporary and episodic – differently than the broad hard-currency exports policy of Moscow starting in the late 1950s.

The proposed approach is interdisciplinary in nature and bridges aspects of politics, diplomacy and economy of energy resources²². Covering a period of almost fifty years (from 1944 to 1991), the analysis refers to recognized secondary sources and completes them with selected primary ones. The work of Russian scientists and researchers has been included, although post-1991 energy sector events evidenced how Western sources proved more accurate in assessing the Soviet Union situation than Russian ones (see the CIA reports about Soviet production “records”).

The history of oil and gas in the Cold War can be organized into four main periods, based on events that had considerable impact on the oil market and that represented turning points in East-West strategies.

- The first period begins at the end of the Second World War to the Suez Crisis of 1956 and the beginning of large-scale Soviet oil exports to the West (termed by some “First Soviet Oil Offensive²³”).
- The second period commences at the completion of the Druzhba pipeline, linking the Soviet Union with Eastern Europe, to the oil crisis of 1973, with the booming Soviet oil-related hard-currency revenue (constituting a “Second Soviet Oil Offensive”).
- The third period from 1973 to the Islamic Revolution of 1979, with a third resurgence of Soviet hard-currency earnings (a “Third Soviet Oil Offensive”).
- The fourth period begins with the Soviet invasion of Afghanistan, to the collapse of the Soviet Union in 1991. Some observers termed it a “U.S. Oil Offensive”, yet (as we will review later) this definition can be easily questioned.

²² See Strange, Susan, States and Markets (London, UK: Pinter Publishers, 1980)

²³ See Lubell (1961), quot. This definition was also used in a 1962 U.S. Senate Study dedicated to the matter: Problems Raised by the Soviet Oil Offensive, a study prepared for the Subcommittee to investigate the administration of the Internal Security Act and other internal security laws of the Committee on the Judiciary, United States Senate.

From WWII to the Suez Crisis of 1956

After the end of WWII, the oil infrastructure of the Soviet Union was in a state of disarray. The first choice to satisfy Soviet Union consumption was to concentrate on Romania, by that time the twelfth largest oil producer in the world: the local industry was nationalized and put under the control of a Soviet -Romanian joint venture. The agreement was that 20% of production would go directly to Moscow as war reparation; another 40% would be purchased by the Soviet Union at 1938 prices. Contemporarily, the Soviet extractive industry underwent a wide restructuring program. The Soviet planners focused on the new “Volga-Urals” area, and by 1949 this new oil frontier had compensated for the wartime decline. New investments and the recovery of the damaged equipment allowed a strong increase in Soviet oil extraction, which by 1958 had become five times larger than in 1946²⁴.

On the U.S. side, in February the celebrated meeting between President Franklin Delano Roosevelt and the Saudi King Ibn Al-Saud, onboard the cruiser USS Quincy in the Suez Canal, conferred diplomatic dignity to the oil operations of some U.S. multinationals that had entered the Arabian country in the 1930s. Such a move by Roosevelt was due to the urgency felt in the United States to focus on foreign reserves to satisfy the rising oil demand of American consumers. Already in 1944, U.S. Secretary of the Interior Harold L. Ickes had publicly expressed his fear that the domestic fields would one day not suffice both in terms of security and for normal consumption²⁵; the U.S. would have begun importing foreign oil in 1948.

The Middle East was nevertheless still a region of predominant British influence, and America's room for maneuver in the region was limited. The strongholds of the UK presence, such as Iraq or Iran, could not be targeted by Washington. The United States and Great Britain first engaged in collaborative behavior, mostly aimed at containing Stalin's post-conflict aspirations in the region. The most relevant episode in this sense is the joint U.S.-UK diplomatic pressure to solve the 1946 “Iranian Crisis”. Due to the continuing Soviet presence in the Azerbaijan region of Iran, on January 30, 1946, the UN Security Council – under British and U.S. – pressure passed its “Resolution 2”, calling for the troops to withdraw. The Soviet troops left Iranian territory on May 9, 1946. Although the decision was mostly due to joint U.S.-UK diplomatic pressure, the oil factor also played an important part²⁶. The Soviets were offered a sort of compensation for leaving the country, in the form of barrels: an oil contract was signed between Teheran and Moscow²⁷. Nevertheless, the agreement was eventually rejected by the Iranian Parliament in 1947 (with the red Army well beyond the borders), earning the Iranian Premier Ahmed Qavam the well-deserved nickname of “The Old Fox”²⁸.

The Iranian crisis represented the first significant rift between the Soviet Union and its former WWII allies. In terms of inter-bloc relations in the Middle East, the post-war events in Iran convinced the Western powers of the necessity to protect the area from Soviet territorial expansion

²⁴ Croissant, Michael P., Oil and Geopolitics in the Caspian Sea Region (Santa Barbara, CA: Praeger Publishers, 1999), p. 12

²⁵ American Magazine of January 1944, We're Running Out of oil, pp. 26-27

²⁶ See Raine, F. S., Stalin and the Creation of the Azerbaijan Democratic Party in Iran, 1945, Cold War History, 2011, Volume 2, Issue 1, pp. 1 - 38

²⁷ See Hess, Gary R., The Iranian Crisis of 1945-46 and the Cold War, Political Science Quarterly, 1974, Vol. 89, No. 1, pp. 117-146; and Mark, Eduard M., Allied Relations in Iran, 1941-47, The Origins of the Cold War Crisis, The Wisconsin magazine of History, 1975, Vol. 59, No. 1, pp. 51-63

²⁸ For a more complete account about the role of oil in the Iranian Crisis, see Kocheshkov, Aleksey, North Iranian oil in World Politics, International Affairs, No. 5, 2008, pp. 119-127

attempts. Yet, Stalin's pressure on Iran did not cease after 1946. With Soviet support, ten weeks after the Red Army had left, the Tudeh party successfully encouraged a strike and a revolt at the British-led refinery of Abadan, the main oil infrastructure of Iran. Indeed, the tactic was not the only episode of Russian support to locals opposing the British: it was replicated also in Iraq, at the Kirkuk oil plant and at the Mosul oil terminal, where Soviet-trained leaders presented a list of grievances and requests to the UK management²⁹.

The U.S. State Department's Bureau of Near Eastern, South Asian and African Affairs (NEA) provided an assessment of the situation in 1950: the Soviet Union wanted to install a puppet regime in Tehran, to attain the "historic Russian objective" of gaining access to the Persian Gulf. Through such actions, the Soviets could "control part and threaten the entire Middle Eastern oil reservoir." In order to reach these results, "Russian attempts to subvert Iran have taken almost any conceivable form of pressure, threats and subversive operations," ranging from the infiltration of agents, to the funding of the still-surviving underground Tudeh organization³⁰. To counter the Soviet influence, the U.S. planned a strategy of economic expansion in Iran, leveraging the country's oil richness: a seven-year program was launched, "with the advice and the assistance of an organization of experts from American technical firms, under which Iranian resources, mainly those derived from the operations of the Anglo-Iranian oil Company, will be employed in projects of considerable magnitude³¹".



Figure 2 - The Azerbaijan provinces of Iran

In terms of Soviet goals in the Middle East, Moscow was well aware that in 1949 the U.S. had become net oil importer, and that Middle Eastern barrels were important to feed the resurging European economies and allowing the West to save on its precious domestic reserves³². In the post-

²⁹ TIME of August 12, 1946, Weather from the North

³⁰ NSC Staff study on certain problems relating to Iran, attached to "Statement of Policy by the NSC," 2 January 1954, in FRUS, 1952–1954, Vol. V, p. 466

³¹ Ibid.

³² National Security Council Paper 138/1 stated that "American and British oil companies thus play a vital role in supplying [petroleum]. The maintenance of, and avoiding harmful interference with, an activity so crucial to the well-being and security of the United States and the rest of the free world must be a major objective of United

Suez period, Eisenhower's Secretary of State John Foster Dulles stated that a broader U.S. presence in the Mideast region was needed since "if we do not act, the Soviets are likely to take over the area, and they could thereby control Europe through the oil on which Europe is dependent³³". In 1957, the "Eisenhower Doctrine" speech stated that the Middle East had to be stabilized, since "it contains about two thirds of the presently known oil deposits of the world [...]. The nations of Europe are peculiarly dependent upon this supply [...]. If the nations of [the Middle East] should lose their independence, [...] Western Europe would be endangered just as though there had been no Marshall Plan, no North Atlantic Treaty Organization³⁴". Eisenhower sought to gain approval for a 400 billion dollar aid package destined to Middle Eastern governments, with the authorization to grant military aid and to use force if needed.

There were substantial differences in the rationale of the U.S. presence in the Middle East, as compared to the British one with its "legacy of protectorates, political residents, and local military forces commanded by British officers³⁵". In 1955, Eisenhower's Secretary of State John Foster Dulles assessed the following: "Our policy in the Middle East has been directed towards retaining the area within the free world, developing the oil resources, assisting the economic and social development of the countries concerned³⁶". Washington pursued a policy of appeasement towards Arab self-determination. This tactic, on some extent, was consistent with the post-Leninist approach of the Soviet Union: rather than dreaming about socialist revolutions flourishing on the sand, Moscow tried to sustain Arab anti-colonialist and nationalist movements, postponing the question of an eventual proletarian dictatorship to a second phase. The interaction of both American and Soviet policies contributed to the emersion of Arab nationalism: an element that would go on to define the rules of play in the Middle East between the U.S. and Soviet Union for decades to come³⁷.

Together with the Middle East, the other end of the Soviet oil strategy was represented by consuming countries. The first post-WWII exports of Soviet oil began in 1949, benefiting Eastern Europe³⁸, in particular Bulgaria, Poland and Czechoslovakia. Unsurprisingly, such commercial agreements were bundled to the acceptance of the full political agenda as dictated by Moscow: as a consequence to a broadening political fracture, Josip Tito's Yugoslavia did not receive direct Soviet oil exports as of 1954. As for Western Europe, the oil supply in the post-war years was mostly funneled by the U.S., with a special focus on diverting Mideast resources to this area: about one-fifth of the Marshall Plan funds in the first year of the program (1948) were invested in oil³⁹.

The 1956 Suez crisis represented a turning point in the Soviet oil strategy. Soviet support played an important part in the decision of the Egyptian president, Gamal Abdel Nasser, to

States Government policy" (Report by the Departments of State, Defense and the Interior on security and international issues arising from the current situation in petroleum, January 1953).

³³ Memorandum of conversation by Goodpaster, December 20, 1956, FRUS, 1995-1957, 12:415.

³⁴ Dwight D. Eisenhower, Special Message to the Congress on the Situation in the Middle East, (the "Eisenhower Doctrine" speech), January 5, 1957.

³⁵ Citino (2002), quot., p. 2.

³⁶ Telegram from Delegation at the Foreign Ministers Meeting to the Department of State, Geneva, November 10, 1955, in FRUS, vol. XIV, 1955-57, "Arab-Israeli Dispute 1955", Document n. 396, p. 728.

³⁷ Nevertheless, the aim of this paper is not to question Eisenhower's policies towards the promotion of Arab nationalism. The development of a post-WWII Arab nationalism will be rather taken as a matter of fact, considered in its historical continuum after the Arab revolt of 1916-18.

³⁸ Vneshnyayatorgovlya SSR, statisticheskisbornik, 1918-1966, Moskva 1967, pp. 76-77, 98-99, quoted by Ebel, (1970), quot., p. 32; and Sutton, Anthony W., Western technology and Soviet economic development: 1930 to 1945 (Stanford, CA: Hoover Institution Press, 1971)

³⁹ See Painter, David S, Oil and the Marshall Plan, The Business History Review, Vol. 58, No. 3 (Autumn, 1984), pp. 359-383

nationalize the Suez Canal: two 1955 arms deals had fostered Nasser's self-assurance about the military power and international position of Egypt⁴⁰. Moreover, in the midst of the crisis the new Soviet leader Nikita Khrushchev ostensibly supported Nasser's actions, leading the CIA head Allen Dulles to note how "Nasser had apparently received assurances from the Soviet Ambassador in Cairo that Russia is prepared to support Egypt all the way, even risking World War III"⁴¹.

The impact of the crisis on the oil market was large. Before the conflict, some 2 million barrels of oil per day reached Western Europe from the Middle East, and two-thirds of them transited through Suez, covering more than 40% of demand⁴². As an act of retaliation to France and Britain, Nasser ordered the sinking of 40 vessels present in the Canal, effectively obstructing the passage until early 1957. The blockade caused a commercial problem also for the Soviets: the Soviet Union shipped oil from the Black Sea, through Suez, to reach its Asian customers. The quantities were not large, but still represented a potential that Moscow was eager to exploit. The nuisance of the blockade was nevertheless more than compensated by an unprecedented advantage: some "free" countries in Europe came to the conclusion that it was necessary to find alternative suppliers to the "traditional" Mideast sources – and the most immediate alternative was represented by Soviet oil.

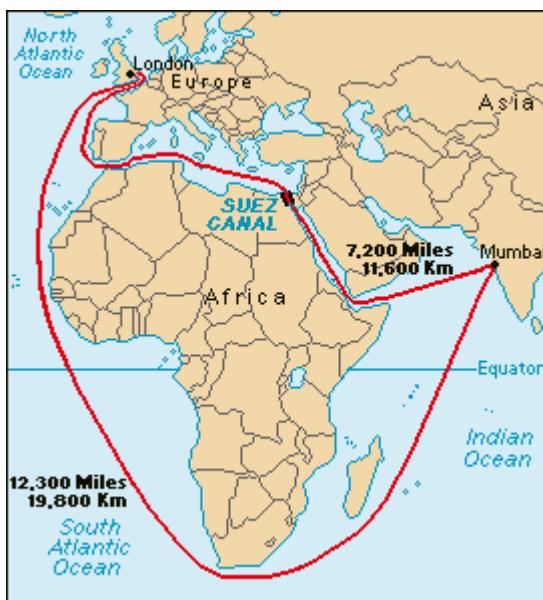


Figure 3 - The Suez Canal blockade and its effect on transit routes

Of course, oil price were not the ultimate reason for the Soviets to support Nasser. Yet, the Moscow policy had successfully led to a collapse in the region, which reverberated on the oil market – and, almost unexpectedly, represented a financial boon for the Kremlin coffer. Soviet oil exports ramped up from 3.7 million tons in 1955, to 85.8 in 1968, and more than 30% of the national production was sent abroad. More than a half of it reached the West⁴³. As observed by a commentator at the time "to secure a position in the European market, the Soviet Union has

⁴⁰ For an overarching analysis of the political goals bundled with the arms deals, see Ginat, Rami, The Soviet Union and Egypt, 1945-1955, (New York, NY: Routledge, 1994), pp. 205-219.

⁴¹ Quoted in McDermott, Rose, Risk-Taking in International Politics: Prospect Theory in American Foreign Policy (Ann Arbor, MI: University of Michigan Press, 2001), p. 142.

⁴² Time of May 12, 1956: State of business: Middle-East Echoes

⁴³ Ebel (1970), quot., p. 39.

employed the time-honored concept of cutting prices to dislodge already established suppliers. It may be that the Soviet Union wishes to realize the maximum return from its oil exports, but first has found it necessary to undercut prices as a means of entering the market⁴⁴.

The Italian state oil company “Eni”, led by self-made tycoon Enrico Mattei, played a pivotal role in this Soviet activity. In 1955, around 2% of the Italian demand was covered by Soviet oil, at 235,000 tons per year. After the Suez crisis, the trade increased considerably: in 1958, due to some new Eni agreements with Moscow, Italy imported 1 million tons, covering 7% of the country's demand. The following year, with 3 million tons, or 16% of the national demand, Italy became the world's largest oil importer from the Soviet Union, even more than any socialist country⁴⁵.

Italy was not alone in its quest for Soviet oil. The Soviet Union covered 25% of Austria's need, 75% of Iceland's, 40% of Greece's and 75% of Finland's. Moreover, the U.S. suspected that Mattei bought oil from the Soviets, refined it, and sold it to Switzerland and West Germany: countries that had explicitly renounced to the Soviet supply⁴⁶. Yet, not only was Eni working as a gate-opener for Soviet barrels to the West: Mattei also mediated with the Italian company “Fincantieri” for the building of oil tankers to be sold to the Soviets, serving additional purposes of market expansion. By the end of 1962, six tankers were under construction in Italy⁴⁷. Moreover, Italian technical components were order for the construction of the “Druzhba (or “COMECON”) Pipeline”, to connect the Russian oil reserves with Eastern European.



Figure 4 - The Druzhba oil pipeline

On March 17, 1962, U.S. Undersecretary of State George Ball met with Kennedy's counselor Arthur Schlesinger, Undersecretary of State for Political Affairs George McGhee and the Ambassador to Italy George Frederick Reinhardt: in order to limit the leftist tendencies of Italy's (or Mattei's) international relations, an “appeasement” strategy was adopted. Washington decided to tie Eni up to

⁴⁴ Ebel, Robert E., *The Petroleum Industry of the Soviet Union* (Washington, DC: American Petroleum Institute, 1961), p. 154.

⁴⁵ Toninelli, Pier Angelo, *Energy Supply and Economic Development in Italy. The Role of State Owned Companies*, in Beltran, Alain, *A Comparative History of National oil Companies* (New York, NY: Peter Lang, 2010), p. 125.

⁴⁶ Ibid.

⁴⁷ Piercy (1962), quot., p. 21.

the system of the oil majors, rather than trying to counter its business with Moscow. Eni could then be brought under the international system of the Western majors, if Mattei was ready to accept certain conditions (such as limiting Soviet oil imports, not interfering with the majors' relations with producing countries, and engaging in "fairer" competitive practices). On May 22, 1962, a meeting took place in Rome between Ball and Mattei demonstrated his openness to the appeasement approach – plans were made for a meeting with Kennedy. In the summer of 1962, the Italian branch of Exxon communicated its availability to provide Eni with 10 million tons of Libyan oil⁴⁸.

The impact of the Soviet oil exports to the West was essential in determining the energy policy of Moscow in the years to follow. The Kremlin had entered the Western market with aggressive pricing policies, although they were relaxed in the following years⁴⁹. By the early 1960s, hard-currency sales of oil and gas "represented 40% of Moscow's exports and constituted the largest single foreign-currency earner for the country. [...] The Soviet Union was the largest producer of oil in the world, producing over 600 million barrels per year. It was the world's second largest exporter of oil, second only to Saudi Arabia, exporting 150 million barrels a year⁵⁰".

In order to keep up with the lucrative hard-currency oil exports, on the verge of a domestic oil production crisis around the end of the decade, some reported that "Moscow instructed its Eastern European clients to begin purchasing oil elsewhere. This relieved some of the burden of supplying these states, reducing the Soviet share of their oil imports to roughly 65% (although Moscow had to be careful that the economic burden thus created for these weak states did not strain Soviet resources in other ways). Domestically, and perhaps most importantly, the Soviets began a strict energy conservation program. They thereby succeeded in reducing by half (from 8% to 4%) the yearly rate of increased domestic energy consumption. They also accelerated the development and increased the use of alternative energy sources with some success. They were less successful in seeking outside assistance for the improvement of oil extraction⁵¹".

Enrico Mattei died in a plane crash on October 27, 1962, under circumstances that remain unclear to this day. His company survived him, and was successful in placing Italy between the two blocs, and somehow in blurring the border between the Soviet and the Western oil markets. The Druzhba pipeline was completed in 1964. Eni enjoyed a 12 million ton oil supply contract with Exxon (two more than the initial proposal), and, soon afterwards, another one with Gulf. Furthermore, relations with the Soviet Union continued, with a new agreement for a supply of 25 million tons of oil to be delivered by 1970. Italy contributed to the clearance of Soviet oil in the Western markets, and allowed Europe to benefit from supply sources that were alternative to the Mideast ones. This element would prove particularly important in the years to come, when two energy crises hit the world markets in the 1970s.

As far as the political goals of the Soviet Union in the Mideast are concerned, a Russian observer stated, speaking of the outcome of Nikita Khrushchev's plan for the region, that the balance sheet "seemed favorable. He managed to neutralize the Arab countries and Afghanistan very

⁴⁸ For an assessment of the U.S.-Italy relations in this period, including the role of Enrico Mattei, see Nuti, Leopoldo, *The United States, Italy, and the Opening to the Left, 1953-1963*, *Journal of Cold War Studies*, Summer 2002, vol. 4, no. 3, pp. 36-55. The information concerning the meetings between Mattei and the U.S. officials, as well as the White House internal decisions, are reported by the historian and former Mattei collaborator Livigni, Benito, *La Grande Sfida* (Milan, Italy: Mondadori 1996)

⁴⁹ See Considine, Jennifer I. & Kerr, William A., *The Russian oil economy* (Northampton, MA: Edward Elgar Publishing, 2002), p. 102

⁵⁰ Golan, Galia, *Soviet Policies in the Middle East: From World War Two to Gorbachev* (Cambridge, UK: Cambridge University Press, 1990), p. 15.

⁵¹ Ibid.

effectively by helping them to strengthen their independence. British colonialism in the Arabian Peninsula was on its last legs, and foreign bases were disappearing from Egypt, Jordan, Iraq and the Sudan. Although on a limited scale, Egypt and Syria (and to some extent also Iraq) became Soviet allies⁵². Russia was present in Nasser's Egypt, had a role in the Yemeni conflict of 1962, and actively backed leftist organizations in Afghanistan, Iran, Iraq, Syria, and Oman. The Soviet Union was not only enjoying new income due to the opened export routes to the West, but could count on reliable strongholds in the oil-rich Middle East.

⁵² Vassiliev, Aleksei, Russian Policy in the Middle East (Ithaca, NY: Ithaca Press, 1993), p. 59.

From the 1960s to the 1973 oil crisis

The second period of the oil history of the Cold War started in the early 1960s and ended with the oil crisis of 1973. The 1960s saw the collapse of the Egypt-led United Arab Republic, and later the Ba'athist takeovers in Syria and Iraq. Arab nationalism became a powerful political movement in many Mideast countries, and both the U.S. and the Soviet Union engaged again in a strong push towards sustaining local powers. Together with Israel, the strong focus of Washington was on oil-producing countries in the region (Iran, Iraq, Saudi Arabia⁵³). This diplomatic line generated some resentment in those Arab countries characterized by smaller or no oil production: these latter countries (Egypt, Syria, Yemen) welcomed the help of Soviet Russia. The 1973 Yom Kippur war ignited an unprecedented oil price boom (orchestrated by OPEC), allowing the Soviet Union to engage in a “Second Soviet Oil Offensive”. The new flow of oil funds was invested in a significant restructuring of the domestic hydrocarbons industry, and fed the cash-strapped administrative and military apparatus.

One of the main questions that occupied Western analysts in the 1960s was to understand the possible aims of the Soviet Union in the Mideast, especially for what concerned oil matters. Some reports in the late 1960s argued that, possibly, a domestic oil crisis was about to hit the Soviet Union, and that Moscow wanted to satisfy its energy thirst through a more incisive presence in the Middle East: “It was argued that the Soviet Union could not keep up with the demand of its own domestic energy needs, which increased at a rate of 8% per year. Nor could it go on providing the vast majority (roughly 80%) of Eastern Europe’s needs (representing 55% of total Soviet oil exports) as it had in the past. At a minimum, Moscow would not be able to maintain its lucrative hard-currency sales of oil and natural gas.”⁵⁴

Yet still, the Seven-Year Plan of 1959-1965 was noteworthy for significant achievements in the oil sector. Production doubled from 949 to 1,800 million barrels over this period, and in 1964 the Druzhba pipeline was completed. Furthermore, new, important technological innovations were introduced, such as the self-elevating platform for drilling in the Caspian Sea (1966) and a further expansion of turbo-drilling techniques. There were also some problems: “petroleum exploration [...] lacked the presence of modern instrumentation. Efforts were hampered by the inappropriateness on occasion of Soviet technology and incentive systems. Complaints and inefficiency were especially widespread near the close of the Seven-Year Plan [...]. Many organizational and methodological difficulties persisted in the oil industry. There was often enormous waste. There were ill-advised practices in operating the pressure-maintenance installations [...]. As a result, large reserves of oil were rendered unrecoverable⁵⁵”.

Notwithstanding some grim reports by the CIA (including a popular 1977 report forecasting that, in the 1980s, the Soviet Union would have “to compete for OPEC oil for its own use⁵⁶”), the Soviet Union never became a significant oil importer; commercial interactions in the oil sector between Moscow and Mideast countries were motivated by politics or by the structure of the market. When some states nationalized their oil industries in the 1970s, the Soviet Union engaged in

⁵³ Iran had some commercial cooperation projects with the Soviet Union, which culminated with the completion of the “Transcaucasica network”, as evidenced by Stern (1987), quot., p.47.

⁵⁴ Golan (1990), quot., p. 15.

⁵⁵ Croissant (1999), quot., p. 14

⁵⁶ Central Intelligence Agency, The Impending Soviet oil Crisis, March 1977, ER 77-10147; completed by Central Intelligence Agency, Prospects for Soviet oil Production: a Supplemental Analysis, July 1977, ER77-10425.

some large orders of their barrels, to provide a temporary market until relations with Western purchasers normalized. As for the mere commercial aspects, there were some three-way deals, with the Soviet Union acting as “export agent” for Mideast suppliers: “the Soviets provided oil and natural gas to Egypt, which in turn exported oil to Japan and India for Moscow; the Soviets exported oil and gas to Europe for the Kuwaitis and the United Arab Emirates, who in turn sent oil to the Far East for the Soviets. Such three-way deals also existed with the shah’s Iran, which supplied southern Russia, while the Soviets exported to Western Europe. [However] such arrangements hardly made Moscow dependent upon Middle Eastern imports, any more than they made the Middle Eastern countries dependent upon Soviet imports⁵⁷”.

The Soviet Union, therefore, did not have an interest in Mideast oil per se. As assessed by Peter Mangold in 1977: “Capabilities apart, Soviet intentions vis-à-vis Western oil supplies are difficult to assess. Few in the West would quarrel with Pravda’s view that ‘to stop pumping Arabian Gulf oil [...] will be like an economic earthquake in the entire capitalist world.’ At the same time, however, the United States has made it abundantly clear that it will tolerate neither the strangulation of the Western economies, nor Soviet domination of the Middle East: indeed, the Americans have risked nuclear war to prevent the latter development⁵⁸”. The only viable approach for the Soviet Union in the Middle East was forcibly “mediated”, through more or less direct backing of nationalist governments and leftist groups.

There is no indication that the Soviets wanted a conflict in the Middle East, but “they were compelled to support the Arabs morally and politically and it was clear from the Soviet government’s statement on 23 May 1967⁵⁹ that Moscow would be on the side of the Arabs if the latter were attacked⁶⁰”. In practical terms, despite the opportunity to do so, the Soviets avoided direct intervention in the 1967 Arab conflict due to the firm U.S. response and a lack of agreement within the Moscow leadership⁶¹. Nevertheless, the Soviet Union seems to have played an important role in escalating Middle East tensions to the brink of war in 1967; some scholars argue that “evidence is accumulating that it actually instigated the conflict⁶²”. Recent research also suggests that “whether anticipated or not, the crisis escalated as a result of the Soviets providing the Egyptians with information about Israeli troops gathering on the border⁶³”. Yet, oil production and shipment reductions during the Six Day War were negligible. Moreover, having learnt the lesson of 1956, the world oil industry had restructured, and a new blockade of the Suez Canal exerted only marginal influence on the reliability of oil supply: larger oil tankers counterbalanced the time-delay due to the longer Cape of Good Hope route⁶⁴.

⁵⁷ Golan (1990), quot., p. 15

⁵⁸ Mangold, Peter, Superpower intervention in the Middle East, (Kent, UK: Croom Helm, 1977), p. 78

⁵⁹ The reference is to a statement appeared on the Pravda on that date

⁶⁰ Vassiliev (1993), quot., p. 67

⁶¹ See Ginor, Isabella, The Russians Were Coming: The Soviet Military Threat in the 1967 Six-Day War, Middle East Review of International Affairs, 2000, Vol. 4, No. 4 (December 2000)

⁶² Ibid. As an evidence, Ginor quotes documents from the Mitrokhin archives (“During 1964-66, [...], Israel was one of the countries where caches of arms and radio equipment were prepositioned for such operations. [...] The direct involvement of Soviet personnel on Israeli soil, at least on a small scale, had thus already been considered and approved) and the Khrushchev memoirs (Nikita S. Khrushchev, Vremya. Ludi. Vlast, memoirs in four volumes, Moscow: MN, 1999, v. 3, p.435; v.4 p.460)

⁶³ Golan, Galia, The Soviet Union and the Outbreak of the June 1967 Six-Day War, Journal of Cold War Studies, 2006, Volume 8, Number 1, Winter 2006, p. 8

⁶⁴ This outcome was largely due to the introduction of larger tankers, that could effectively ship huge quantities of oil through the African route to Europa (some 2.700 miles longer than the Suez route). See Huber, Mark, Tanker operations: a handbook for the person-in-charge (Centreville, MD: Cornell Maritime Press 2001), p. 23

The 1973 conflict had more pervasive effects on the situation of oil, because instead of hitting the “geographical” aspects of the oil industry (the Suez Canal was still closed since 1967 and the effects had been absorbed), the conflict had consequences on its “market” sides. The Soviet role in the build-up of the crisis was far more pregnant and decisive than in the 1967 conflict, and eventually the Soviets had to demonstrate a firm stance to prevent the Israelis from advancing too deeply into Egyptian territory⁶⁵. Nevertheless, the OPEC reaction to U.S. involvement in the conflict sparked the first “oil crisis” of the 1970s. This market situation provided room for additional (and highly priced) Soviet exports, inspiring a “Second Soviet Oil Offensive”. It was not in the original intentions of the Soviet Union to destabilize the region in order to gain additional hard-currency revenue, but Soviet support for local nationalism definitely contributed to igniting the 1973 conflict, and equally definitely, resulted in additional revenue in the end.

The 1967 war had also represented an opportunity for increased Soviet exports to the West, although the additional shipments were consistent with a long-time trend initiated by the first “offensive” of the late 1950s. From 1960 to 1964, exports had increased 123%; in 1965-69, the growth had been 60%. By the outbreak of the 1973 conflict, Soviet exports had largely stabilized, and had experienced the first decline in a long time⁶⁶. Since 1956, hard-currency revenue from oil exports to the West had become an important item for Soviet finances, representing 40% of the total energy exports and constituting the “largest single foreign-currency earner for the country”⁶⁷. As mentioned, by the end of the 1960s, the Soviet Union started experiencing some technical difficulties in the extraction, slowing down (yet not reducing) the development of the industry⁶⁸. Given such developments, Moscow even asked its allies in 1969 to buy oil in the Mideast and in North Africa, reducing their share of imports from the Soviet Union to 65%⁶⁹.

After the 1973 crisis, Soviet oil exports surged, also leveraging commercial agreements with Mideast countries. Moscow had some supply agreements with regional producers, anchored at pre-crisis prices set by long-term contracts. This oil was then re-sold to the West at the higher, “spot” value. The Soviet Union itself, by the mid-1970s, became the world’s largest oil producer, at 520 million tons per year⁷⁰. The Soviet state deficit before the Yom Kippur conflict was at 700 million dollars; in the first three quarters of 1973, it had exploded to 1,300 million. In the last quarter alone, the flow of hard-currency was so fast and heavy, that the year closed with a surplus of 360 million⁷¹, also thanks to renewed commercial vigor in other industrial sectors. As evidenced by Mangold, and in consideration of the new production record of the Soviets, the “import of Middle East oil is clearly a matter of advantage rather than necessity, largely because, at a period of expanding Soviet oil consumption, the Soviet Union still wishes to continue to export oil to Eastern and Western Europe”⁷².

Specifically, part of the Soviet’s dissatisfactory trade balance was due to a deliberate strategy of expanding purchases, mostly of industrial goods and grain, from capitalist countries. In 1972 and

⁶⁵ See Kober, Avi, Great-Power Involvement and Israeli Battlefield Success in the Arab-Israeli Wars, 1948–1982, *Journal of Cold War Studies*, 2006, Volume 8, Number 1, Winter 2006, pp 33-34

⁶⁶ Klinghoffer, Arthur Jay, *The Soviet Union & International oil Politics*, (New York, NY: Columbia University Press, 1977), p. 69.

⁶⁷ Golan (1990), quot., p. 15

⁶⁸ Croissant (1999), quot., p. 14

⁶⁹ The New York Times of November 24, 1969, Moscow Asks its Allies to Buy oil in Mideast and North Africa

⁷⁰ Klinghoffer, Arthur Jay, *Soviet oil Politics in the Middle East and Soviet-American Relationship*, (Tel Aviv, Israel: The Russian and East European Research Center, 1976), p. 4

⁷¹ ibid., pp. 73-74

⁷² Mangold (1977), quot., p. 23

1973, the balance improved largely due to an increase in physical exports (plus 73% in one year), with oil representing the major part. Notably, as prices surged, in 1974 the volumes of crude oil exported to the West dropped by 35%, demonstrating in the view of some observers that “the Soviet foreign trade policy is anti-mercantilist [...]. The Soviet Union exports goods only in order to finance the planned required level of imports. If this objective is met as a result of price increases in the world market, export volumes are reduced⁷³”.

The Soviet oil cash bonanza materialized at the expense of Moscow’s good relations with some Mideast oil-producing countries, since the Soviets were suspected of free-riding the cutting policies of OPEC. The Soviet Deputy Minister for Foreign Trade Ivan Semičastnov insisted that, during the crisis, Moscow had had no intention of expanding its commercial network, but that closed contracts had to be honored – including framework agreements, where supplied quantities were flexible⁷⁴. The historical diplomatic distrust between Russia and Saudi Arabia can be traced back to these 1970s events: later on, again, as OPEC reduced its output to keep oil prices up, Moscow did not miss the chance to cash in.

⁷³ Chadwick (1987), quot., pp. 105-106

⁷⁴ The Soviet Union’s Foreign Economic Ties Today, New Times, 1974, p. 8

From 1974 to the Iranian Revolution of 1979

The third period started in 1974 and ended with the oil crisis of 1979. In these years, the U.S. planned to reconstruct the Middle-East equilibrium that had been broken by the 1973 conflict, and engaged in a diplomatic initiative that culminated with the Camp David Accords. These agreements represented a reorientation of Egypt's foreign policy to favor a closer link with the U.S. As for the Soviet side, in the Brezhnev era "the actors in this region that Moscow was on good terms with were the ones that Washington was on bad terms with and vice versa⁷⁵". Moscow supported Syria against the U.S. aligned Lebanon; besides a short-lived contact with a leftist rebel organization, Moscow did not have diplomatic relations with U.S.-aligned Oman, and neither had any with other western-oriented countries such as Saudi Arabia, Bahrain, Qatar and the UAE. Nevertheless, the U.S. need to keep Iran insulated from Soviet influence prompted Washington to rely on the Shah – before he was ousted by the 1979 Islamic Revolution. The oil market crisis that ensued represented another cash-in opportunity for the Soviet Union, which could launch a "Third Soviet Oil Offensive".

The Russian moves in this period show an increased attention on the possible role of Mideast policies in influencing the oil market, although there was no blunt effort to ignite conflicts⁷⁶. Regarding Iran, Moscow was well aware of the strains that had started affecting the Tehran-Washington relations since the 1960s: the Shah "was troubled by what he perceived as American pandering to radical Arab nationalists. As a result, he began to entertain thoughts of a more independent policy vis-à-vis the United States. Specifically, the shah started to explore the possibility of a rapprochement with the Soviet Union⁷⁷". On September 15, 1962, the Shah announced that he would have never allowed any U.S. missile on his territory to be pointed at the Soviet Union. The Soviet Union invited the dictator to Moscow in 1965, at the time when the U.S. started believing that an Iranian policy shift in the direction of the Russians was possible⁷⁸.

Furthermore, in 1966, the Soviet Union agreed to build a gas pipeline and some other civil and industrial infrastructures in Iran. As the U.S. showed some restraints in expanding arms deals with the Shah, "the Iranian leader hinted ominously (if repetitively) that if Washington did not meet his demands, he might be forced to turn to Moscow⁷⁹". Despite some concessions granted by Washington, the Shah did extend his ties with Moscow, closing a 100 million dollars deal with the Soviets in January 1967. In May 1968 President Lyndon B. Johnson approved a 600 million dollars military credit sales package, after a long negotiation process⁸⁰.

⁷⁵ Katz, Mark N., Comparing Putin's and Brezhnev's Policies toward the Middle East, DOI 10.1007/s12115-008-9065-9 , Springer Science + Business Media, LLC

⁷⁶ The theory of the Soviets favoring conflicts to enjoy hard-currency revenues has not been proven for any of the Mideast crises: see Mozorov, Boris, The Outbreak of the June 1976 War in Light of Soviet Documentation, in Mozorov, Boris et al., The Soviet Union and the June 1967 Six Day War (Stanford, CA: Stanford University Press, 2007), p. 43; and Smolansky, O. M., Moscow and the Suez Crisis, 1956: A Reappraisal, Political Science Quarterly Vol. 80, No. 4 (Dec 1965), pp. 581-605. Notably, the then KGB Head Yuri Andropov for the Middle East, as he exhorted his organization to develop closer contacts with Arab terrorists to destabilize the Western strongholds in the region.

⁷⁷ Johns, Andrew L., The Johnson Administration, the Shah of Iran, and the Changing Pattern of U.S.-Iranian Relations, 1965–1967 "Tired of Being Treated like a Schoolboy", Journal of Cold War Studies, Volume 9, Number 2, Spring 2007, p. 67

⁷⁸ Telegram, Meyer to Department of State, 31 August 1965, in FRUS, 1964–1968, Vol. XXII, pp. 168–170.

⁷⁹ Johns (2007), quot., p. 80

⁸⁰ FRUS, 1964–1968, Vol. XXII, pp. 271-273, 277-281

In the end, the Soviet pressure prompted the U.S. to adopt an “appeasement” approach also with the Shah, abandoning large chunks of a policy of democratic reform intended for Iran. This decision paved the way for a further tightening of the monarch’s domestic rule, and inaugurated a period of somewhat excessive focus of his government on weaponry. The increased budget at disposal of Tehran after the barrel price spike of the early 1970s further reinforced Pahlavi’s motivation to pursue his independent stance. The Soviets sold the Shah some 344 million dollars’ worth of arms in total, yet this quantity represented a mere 12% of Iran’s arms purchases. The lion’s part was still played by the U.S., covering 85% of supplies. The Soviet option, beyond the outright military security objectives, had the “secondary motivation” for Pahlavi to signal his independence from Washington⁸¹.

Between East and West, the increasingly arbitrary rule of the Shah, coupled up with the dissatisfactory results of his “White Revolution” economic reforms, became fertile ground for the another Revolution, but of the Islamic kind⁸². The export cuts in Iran (some four million barrels per day) led to a global oil price surge, and between 1978 and 1980 the value of the exported Soviet oil and gas increased by 90%. The volume of Soviet hard-currency trade with the West ramped up by 101%⁸³. Contemporarily, the West had to face another economic crisis: U.S. President Jimmy Carter engaged in a broad energy restructuring plan described in his famous “Malaise Speech”.

As for the Mideast region in general, the Soviets suffered the loss of Egypt, as in 1976 President Anwar Sadat (the follower of Nasser) informed the Cairo parliament about his intention to abrogate a “Soviet treaty of friendship and cooperation” he had signed five years earlier. Nevertheless, Moscow engaged in a strategy of “territorial activism” in the region. A 1978 coup in Afghanistan had given power to communist formations; Moscow backed socialist Ethiopia in a conflict versus Siad Barre’s Somalia; Soviet-Yemeni troops stationed in Southern Yemen. There was also a rapprochement between the Soviet Union and Syria, with consistent shipments of weaponry and aid that replaced the losses of 1973 and built up a new arsenal.

However, besides the advantages enjoyed in the oil market, the Soviet Union did not manage to “capitalize” on the Shah’s fall. Those Mideast states that did not receive direct support from the Soviets matured the belief that Moscow planned to gain broader control on the territory, as further “demonstrated” by the intervention in Afghanistan. In January 1979 a national newspaper in Riyadh declared that “all the Soviet moves reveal the communist plan to stimulate disorders and encourage rebellion and chaos, so that in such state of confusion the communist can seize power⁸⁴”. In an interview with American journalists, Saudi prince Fahd Ibn al-Aziz, showing a map of the Middle East, described the Soviet moves as a “pincer movement” strategy around Saudi Arabia⁸⁵. A member of the Saudi royal family declared to the “New York Times” that the threat represented by the Soviet military presence in Cuba was not comparable to the much higher risk posed by the Russians in the

⁸¹ Ibid., pp. 89-90

⁸² See Dabashi, Hamid, *Theology of Discontent: The Ideological Foundation of the Islamic Revolution in Iran*, (Piscataway, NJ: Transaction Publishers, 2005); Milani, Mohsen M., *The making of Iran's Islamic revolution: From monarchy to Islamic republic*, (Boulder, CO: Westview Press, 1988); Bakhsh, Shaul, *The reign of the ayatollahs: Iran and the Islamic revolution*, (New York, NY: Basic Books, 1986).

⁸³ Wilson (1982), quot., p. 1

⁸⁴ Quot. in Ro'i, Yaacov, *The USSR and the Muslim World*, (Sydney, Australia: George Allen & Unwin, 1984), p.

262

⁸⁵ Newsweek of January 15, 1979, in Yaacov (1984), quot., p. 263

Middle East and in the Horn of Africa. On the verge of the Red Army entrance into Afghanistan, the Saudis urged Washington to be more “assertive” in countering the Soviet aims in the region⁸⁶.

Although no final evidence has been yet disclosed concerning eventual “oil targets” motivating Soviet operations in Afghanistan, the urgency of protecting Mideast reserves was among the priorities in the Western agenda. Despite the fact that in 1974 the Soviet Union had become the largest oil producer in the world, Western reports signaled an impending Soviet oil crisis: the Afghanistan move could be interpreted as an attempt to seize the precious reserves. There were estimates about the presence of oil in Afghanistan itself: some sources report that the Soviets believed there were some 100 million barrels under the soil of the country⁸⁷.

In a January 23, 1980 Congress Address, President Carter denounced that “The region which is now threatened by Soviet troops in Afghanistan is of great strategic importance: It contains more than two-thirds of the world’s exportable oil. The Soviet effort to dominate Afghanistan has brought Soviet military forces to within 300 miles of the Indian Ocean and close to the Straits of Hormuz, a waterway through which most of the world’s oil must flow. The Soviet Union is now attempting to consolidate a strategic position; therefore, that poses a grave threat to the free movement of Middle East oil. [...] Let our position be absolutely clear: An attempt by any outside force to gain control of the Persian Gulf region will be regarded as an assault on the vital interests of the United States of America, and such an assault will be repelled by any means necessary, including military force⁸⁸”.

The Soviet threat to the Mideast oil supply had become a constant concern for the U.S. policy makers: Mangold observed in 1978 that “The deployment of Soviet aircraft in Egypt in 1970 had ominous strategic implications. But it had no immediate, nor indeed necessary, effect on Europe, whereas the deployment of the oil weapon in 1973 caused widespread governmental panic, and was felt in homes throughout Western Europe, Japan and America⁸⁹”, as “nearly all members of the Western alliance depend directly or indirectly on Middle Eastern oil and consequently are vulnerable to domestic economic disruption as a result of interruption to supplies. Indeed it can be argued that economic security is a more immediate problem for many countries than military security. The threats to Middle Eastern oil supplies are numerous, and there is no comprehensive system for containing them similar to the politico-military balance established by the West to contain Soviet power. Not only are some threats entirely dependent on regional political developments in the Middle East, and particularly in the Gulf, but experience in the early 1970s suggests that there are relatively fewer constraints on the deployment of the oil weapon by OAPEC that there are on any Soviet attempt to exploit a military advantage vis-à-vis Western Europe⁹⁰”.

Also on the Washington side the option of a direct armed U.S. intervention to secure the oil flow was excluded, due to the fear of atomic retaliation by the Soviets⁹¹. Nevertheless, there were limits also in the likeability of a Soviet intervention in the area: “it is not entirely certain that the Soviets were willing to run the risks involved in interfering or even threatening to interfere in the flow of Middle Eastern oil to the West. Disruption of the world oil market might have adverse effects on Soviet involvement in this market as well, just as interference in the transportation routes could

⁸⁶ The New York Times of February 8, 1980, Saudis, Stressing Regional Stability, See Soviet Threat; Others Also Voice Concern

⁸⁷ Jalalzai, Musa Khan, The Pipeline War in Afghanistan (Lahore, India: Sang-e-meel Publications, 2003), p. 70

⁸⁸ A complete version of the speech is available at

<http://www.presidency.ucsb.edu/ws/index.php?pid=33079#axzz1NMeNh8u2>

⁸⁹ Mangold (1977), quot., p. 64

⁹⁰ Ibid.

⁹¹ See the post-oil crisis report Oil Fields as Military Objectives: A Feasibility Study, Congressional Research Service, 21/8/1975, Parts I-II, U.S. Government Printing Office, Washington DC, 1975, pp. 1-39.

have a negative effect on some Moscow's deals and merchant traffic. More importantly, an attempt at or even a threat of interference would be a high-risk action, bound to arouse a western, specifically American, response even of a military nature⁹².

In the late 1970s, most of the U.S. diplomatic achievements in the Mideast had taken place in the Western portion of the region, from the new Egyptian-Soviet rift, to the Camp David accords of 1978. All these gains were countered by the failure in Iranian policy and the Soviet entrance in Afghanistan, leading the U.S. and its Saudis allies to a feeling of increased instability. Another "asymmetry" was present in the oil market. As the U.S. and the West suffered two Energy crisis, the Soviet leadership could rely on the new oil income and on military and political successes in the Middle East, with the notable exception of Egypt, to deploy active policies of foreign presence and industrial reforms. A part of the oil revenue was invested in renewing the extractive infrastructures, and a railway was installed to connect Siberian oil fields with the Pacific coasts.

Although the goal of an actual takeover of the Mideast was never in the plans of the Kremlin, the policy of influence and presence by proxy conditioned the freedom of movement for the U.S. in the region. The Soviet support to the rising Arab nationalisms, with the corresponding U.S. "appeasement" policies, also contributed to the "region collapses" that affected the energy security of the West and benefited the Soviet finances: in the end, Moscow declared that OPEC was an "objectively anti-imperialist organization"⁹³, due to its success in increasing the Western energy bill. Such results probably overcame some of the Soviet leaders expectations: from an almost complete dominion of the U.S. and British "imperialisms", in less than thirty years the Middle East had become a region of strong political uncertainty, battered by local clashes and inter-bloc saber-rattling.

⁹² Golan (1990), quot., p. 17

⁹³ Vassiliev (1993), quot., p. 331

From the Soviet Afghanistan to the Soviet implosion in 1991

The fourth period started with the Soviet invasion of Afghanistan and ended with the Soviet implosion in 1991. The Soviet Union entered the decade with strong optimism due to the new oil-related financial income and the presence of a new communist regime in Afghanistan, close to the oil riches of the Gulf. The U.S. had lost the stronghold of Tehran, and had to re-settle its strategy envisaging a new role for Pakistan on one side, and relying on Egypt and Israel on the other, besides the uncertain situation of Lebanon, still under the Soviet-led pressure of Syria. As for the "market" situation of oil, in 1978 energy exports accounted for 64% of total Soviet hard-currency earnings; in the following two years, despite a decrease in exported volumes, such percentage increased due to the post-Islamic Revolution price boom⁹⁴. Notwithstanding such initial situation, largely favorable for the Soviet Union, in the turn of a decade the balance of forces reverted, and the Soviet Union disaggregated.

Examining the importance of the Soviet oil and gas revenue in this period, the most important question is to analyze whether the Soviet collapse was influenced by a decrease in energy resources related hard-currency income, and whether such decrease was consciously determined by outright policies set by President Ronald Reagan. The latter theory has been celebrated in some media⁹⁵, and is often quoted by scholars: under Reagan's administration, CIA's Director Bill Casey "formulated an explicit 'secret strategy' to exacerbate Soviet weaknesses and undermine Soviet power: [...] economic warfare by opposing Soviet oil and gas sales to Western Europe and by lowering, in cooperation with Saudi Arabia, the world price of oil, thus denying the Soviet Union badly needed foreign currency from one of its major exports⁹⁶".

The U.S. action could be termed as a "First American Oil Offensive", after the three Soviet ones in 1956, 1973 and 1979. The underlying concept is that the U.S. was successful in convincing the Saudis to relax their oil policy, generating an oil glut in 1986, hitting hard on the balance of the Soviet cash-flow. A definitive archival proof of the story is still missing, besides interviews to the direct U.S. players from the Reagan administration. However, there is a set of firm points that can be confirmed with few doubts.

Ever since the outbreak of the oil crisis in 1973, the U.S. was seeking a way to decrease its energy bill and to reduce the dependency from foreign imports. In the ten years to 1979, oil purchases from abroad had sky-rocketed up from 1.4 million barrels per day, to 6.5 million⁹⁷. Plans to produce better mileage cars and incentive research and adoption of alternative energies were introduced in the decade, also by other Western countries – notably by France with its ambitious nuclear energy plan.

The "turning point" embodied by Reagan's energy policies was mostly aimed at domestic priorities, rather than at countering Soviet power and gaining advantages in the oil market. The key was represented by the status of the U.S. domestic oil industry. In March 1973 President Richard Nixon had imposed price controls on the U.S. oil, containing the price of barrels produced from

⁹⁴ Müller, Friedemann, Die Ost-West Beziehungen im Energiebereich: zwischen Abhängigkeit und Verflechtung, Stiftung Wissenschaft und Politik, Forschungsinstitut für Internationale Politik und Sicherheit, 1980; and Gaidar, Yegor, The Soviet Collapse: Grain and Oil, American Enterprise Institute for Public Policy Research, 2007

⁹⁵ The most popular one is probably Schweizer, Peter, Victory: the Reagan administration's secret strategy that hastened the collapse of the Soviet Union, (New York, NY: Atlantic Monthly Press, 1994)

⁹⁶ Strayer, Robert, Why Did the Soviet Union Collapse? (Armonk, NY: M.E. Sharpe, 1998), p. 127

⁹⁷ From the U.S. Energy Information Administration Website,

<http://www.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=MCRIMUS2&f=A>

already active fields, with the intent of favoring new discoveries. Such ill-directed system had outlived the fall of Nixon, and had been only partially dismantled by Jimmy Carter. The remnants of the controls were removed by Reagan during his first day in office, on the evidence that the price paid for foreign oil was almost twice as much as that of domestically produced oil. The new impulse to the U.S. extractive industry inverted a general decline tendency that had begun in 1970⁹⁸. Also some new production from Alaska (after some more liberalization in extractive operations), together with new barrels from Europe's North Sea and an increase in the Mexican supply, favored a general price decrease.

In 1984, Bill Casey met with the Head of the Saudi "Al Mukhabarat Al A'amah" ("General Intelligence Directorate"), the legendary Prince Turki bin Faisal Al Saud, and made pressure on him, asking the Arabian country to increase its oil production. The intent of this diplomatic action, as reported by some, was to lower the barrel price and reduce Soviet hard-currency revenue, with the final aim of countering Moscow's military aggressiveness in the Arabian region. Yet, on the U.S. side, having more affordable oil was not primarily an anti-Soviet concern, but rather an economic and industrial one. A 1983 report by the U.S. Department of Treasury stated that the proper oil price for the American economy was 20 dollars per barrel (some 40% lower than the market price in the period), resulting into energy bill savings of more than 70 billion dollars per year⁹⁹.

The primary U.S. goal was to have cheaper oil, and the belief was that the intelligence connection could be leveraged: as reported by U.S. Secretary of Defense Caspar Weinberger, "We wanted lower oil prices: that's one of the reasons we were selling them arms¹⁰⁰". Casey's visit was just another step in the attempt to recalibrate the reach of OPEC on the oil market: the U.S. had already turned its back to the policy of "posted prices" set by the cartel, by opening the NYMEX to oil futures negotiations in 1983.

In the end, the Saudi decision to ease the national oil policy, announced in September 1985, was mostly due to factual market conditions, rather than diplomatic strategies¹⁰¹. By 1983, the production in Alaska had reached 2 million barrels of oil per day. Compared to 1973, even Soviet production had increased by a record 40%¹⁰², adding up to some additional oil flowing also from the Gulf of Mexico and the North Sea. In 1979 OPEC countries were producing 30 million barrels per day; after the Islamic Revolution, with the Iranian oil off stream, the cartel's production decreased to 26 million. Trying to counter the effects of the additional supply and the plummeting demand (due to the economic recession), OPEC hit its bottom at 16,3 million barrels in 1985¹⁰³. The OPEC share of world production was less than 30%: controlling prices had become virtually impossible. The problem was also political: some OPEC countries, starting with a troubled Nigeria, were finding it increasingly difficult to cope with the board's orders. The 1986 glut was expected: Yamani had kept on announcing for months and months that a price war was imminent, and declared that "if non-OPEC

⁹⁸ Data from the U.S. Energy Information Administration Website, at <http://www.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=MCRFPUS2&f=A>. The record year for the U.S. oil production has been 1970, with 9.6 million barrels of production per day. In 1976, production hit 8.1 million, and thanking the partial deregulation it increased in 1977 and 1978, before declining again. 1981 marked a year of change, with production constantly increasing until 1985.

⁹⁹ U.S. Treasury Department, International oil Pricing, 1983, Study n. 232, p. 3

¹⁰⁰ Schweizer (1994), quot., p. 217

¹⁰¹ The intention was announced by the oil Minister Zaki Yamani at the Oxford Energy Seminar. See Mambro, Robert, OPEC & the World oil Market (Oxford, UK: The Oxford Institute for Energy Studies, 1986)

¹⁰² On CERA-HIS data

¹⁰³ Energy Information Administration, International Petroleum Monthly (IPM), tab. 4.4, December 2011

producers do not cooperate with the organization, and we in OPEC do not discipline ourselves (...) I would expect the price would drop to a level between \$15 and \$18 a barrel after the winter¹⁰⁴".

Following the September 1985 announcement, Saudi production increased from 2.3 million barrels per day in the previous August, to 4 million by the end of the year, and 6.2 by mid-1986. In July, oil price plunged to 11.58 dollars per barrel, and even lower if FOB prices (at the Saudi harbors) were considered¹⁰⁵. The oil glut in the end affected the U.S. industry: the oil deflation was detrimental to smaller, domestic producers (the "wildcatters"), which could not recover their operation costs and declared bankruptcy. In April 1986 the then vice-President George Bush travelled to Saudi Arabia and, among other discussion topics, some words were dedicated to the Saudi oil policy, which had gone too far for the taste of the U.S. industry.

Besides the domestic interests of the Saudi and the U.S., in terms of international relations the "U.S. Oil Offensive" was aimed more at the Arabs, rather than at the Russians. Mideast producing countries had caused three energy crises, and had been keeping up oil prices for more than a decade. The need to limit the impact of bouncing barrel prices on the Western economies was key. If anything, Soviet oil had helped reducing the effects of supply shortages during conflicts and revolutions. The 1986 glut even caused a diplomatic rift between the Mideast largest producer, Saudi Arabia, and the Russians, frequently accused of free-riding on OPEC reductions. On the wake of the oil glut of 1986, a Soviet politician rebuked the idea that Moscow could ever coordinate with the cartel's policies, commenting that the Soviet Union was no "third world country"; nonetheless, the Soviets unofficially agreed to limit their production, but such decision had very limited scope – and was not too hard to comply with, given the dire situation of the Soviet extractive industry by the mid-1980s¹⁰⁶.

Some analysts even suggested that the very structure of the Soviet oil industry in its last decade of existence simply did not allow for any production adjustment policy: the Soviet Union supposedly had "little scope for manipulating oil export volumes for the purpose of intervention on the world petroleum market", as "the oil export policy should rather be viewed as a response in any year to the balance-of-payments surplus deficit that emerged in the preceding year, partly as a result of oil export performance in given world market condition". Moreover, "short-term variations in export volumes reflect binding constraints (which planners are able to relax to a greater extent in the medium and long term than in the short period)¹⁰⁷".

It had become nevertheless clear that oil exports for the Soviets had become a mere financing source, rather than a political weapon. The share of oil on the Soviet hard currency exports had reached 60% in 1984, right before the price glut two years later¹⁰⁸. The high oil and gas prices after the events of 1979 strongly benefitted Soviet finances. In the period between 1978 and 1980 the value of the Soviet oil exports increased by 88.9%, and hard currency exports in general rose by 101%. The trade surplus of 7.5 billion dollars reached by 1980 with European OECD countries covered

¹⁰⁴ See the Chicago Tribune of September 29, 1985, Are Saudis Really Willing To Risk An Oil Price War?, at http://articles.chicagotribune.com/1985-09-29/business/8503060448_1_barrel-quota-oil-price-war-saudi-arabia

¹⁰⁵ On data by the Energy Information Administration, http://www.eia.gov/dnav/pet/pet_pri_spt_s1_m.htm, December 2011

¹⁰⁶ Yergin (1993), quot., p. 761. Nevertheless, 1986 also marked a turning point in the Soviet oil industry, as a senior official of the Academy of Sciences declared in Vienna that "if oil prices continued to fall, it was likely that the Soviet Union would cut the rate of growth of its oil production and that, at low prices, oil might actually be purchased from the world market", in Stern (1987), quot., p. 47

¹⁰⁷ Chadwick (1997), quot.

¹⁰⁸ Ibid., p. 80, on Vneshnyayatorgovly SSSR Yearbook data

all the payments for the grain imports from the U.S. In the same year, oil and gas exports accounted for 63% of the total exports to OECD countries¹⁰⁹.

As for the political aspect of the oil trade, no West-European importer of Soviet oil had embraced socialism, and the interruption of the Soviet supply had not prevented some socialist countries to seek independence from Moscow, as in the case of Yugoslavia, Albania and China. The policy of interrupting oil shipments had become so evidently ineffective even in the eye of the Soviets, that it was not attempted against Czechoslovakia in 1968 or Poland in 1980¹¹⁰. The importance of hard-currency exports (and especially oil related ones) for the Soviet Union was largely clear to Washington by 1982-83: some CIA reports had been published, assessing the impact of the restriction of credits to the Soviet Union from the West¹¹¹; an assessment clearly described how "In 1982 the Soviet Union cut its hard currency trade deficit to \$1.3 billion, compared with \$4 billion in 1981, by strongly pushing oil exports and reducing imports. [However] in 1982 the volume of oil exports sold for hard currency was increased through another reduction in the exports directed to Eastern Europe, and through some resale contract with Mideast countries. Also domestic oil consumption was drawn down, and oil inventories were reduced, to satisfy Western demand¹¹²".

Although the first aim of the U.S. oil liberalization policy (and the subsequent oil price deflation) was targeted to the domestic situation and to the Arab producers, it also had the consequence of reducing hard-currency income for the Russians. Pursuing a reduction of Soviet hard-currency revenue was a constituent of the strategy defined in NSDD-32 with its order to force the Soviet Union to "bear the brunt of its economic shortcomings". Lowering the price would only partially alter the availability of Soviet oil, yet significantly limiting financial benefits for Moscow. Moreover, in 1983 the low free-market price also pushed some Eastern Europe economies into the awkward situation of having to pay a 10% higher price for the Soviet oil, compared to what the capitalist world paid, due to the fact that the socialist long-term supply contracts were anchored to older and higher benchmarks¹¹³.

As a matter of fact, a 1981 report by the Office of Technology Assessment evidenced how Western equipment and machinery was helping Soviet oil production, and that in 1979 some 22% of the Soviet hard-currency trade (at 3.4 billion dollars, with 2.7 billion destined to the oil and gas sector) had been dedicated to purchases of energy-related technology¹¹⁴. In particular, "energy related exports constituted nearly one-half of Japanese, one-third of Italian, approximately one quarter of West German and French, and about 10 percent of British exports to the Soviets¹¹⁵".

There was some U.S. legislation in place to limit trade relations in the field between the United States and the Soviet Union, including a ban on the shipments of U.S. extractive equipment to the Soviet Union since, existing since 1978¹¹⁶. Moreover, two congressional restrictions from 1974 limited "the ability of U.S. oil companies and petroleum equipment suppliers to sell their goods and

¹⁰⁹ Wilson (1982), quot., p.1

¹¹⁰ See Stern (1987), quot., pp. 50-51 and 74.

¹¹¹ See The Soviet Bloc Hard Currency Problem and the Impact of Western Credit Restrictions, NIC M 82-10092, March 1982; and The Soviet Bloc Financial Problem as a Source of Western Influence, NIC M 82-10004, April 1982.

¹¹² The USSR's Hard Currency Payments Position, SOV 83-10124

¹¹³ Hoffman, George Walter, *The European Energy Challenge: East and West* (Durham, NC: Duke University Press, 1986), p. 133

¹¹⁴ Congress of the United States, Office of Technology Assessment, *Technology and Soviet Energy Availability* Project Staff, November 1981, Library of Congress Catalog Card Number 81-600166, pp. 3-10.

¹¹⁵ Ibid., p. 12

¹¹⁶ The ban was eventually lifted by Reagan in early 1987.

services in the Soviet Union or invest in Soviet oil exploration and production¹¹⁷. Under these restrictions, Exim Bank loans for the purchase, lease or procurement of energy-related product or services to extract fossil resources in the Soviet Union were banned; there was a limit of 40 million dollars on export credit guarantees and insurance for energy exploration in the Soviet Union; and there was an overall ceiling of 300 million on the amount of financing that Exim could support with credit guarantees and insurance operations in the Soviet Union¹¹⁸.

Anyhow, the Russians were particularly effective in finding alternative suppliers to the U.S. ones, and Washington adopted a policy of “benign neglect” towards such trade, except for a short-lived technology trade ban imposed in early 1982 and lifted on November 13 in the same year, as we will review later. By 1980, 39% of the Soviet oil exports were directed to the West (1.1 million barrels per day)¹¹⁹.

Washington saw the opposition of two main opinion streams: proponents of the “development” strategy believed that Soviet oil exports could increase the world energy supply and generate advantages for Western economies; the “opposition” side believed that facilitating Russian exports could help Moscow get wealthier, i.e. more dangerous¹²⁰. There was a heated debate “among U.S. policy makers over whether it is in the best interest of the United States to assist the Soviet Union in its energy development. Those who favor such a policy believe it is justified to [...] to reduce the likelihood that the U.S.S.R. would intervene in the Middle East to acquire oil it could no longer produce in sufficient quantities at home¹²¹”. In the end, the “development” side prevailed: instead of limiting the physical availability of Soviet oil reaching the market, its pricing was leveraged.

The U.S. approach towards Moscow in the oil market was different than the one adopted for gas. The latter resource represented a mere 3% of the Soviet Fuel exports in 1971, and ten years later had reached 21.3%, due to an ambitious “gas-for-oil” substitution program. Reagan tried to prevent the adoption of Western technology for the building of the “Urengoy” gas pipeline, an infrastructure planned to deliver substantial amounts of the commodity to Western Europe.

Other than oil, gas is not traded in a fluid “global market”: it can be commercialized only after the completion of elaborate infrastructures. Therefore, preventing the completion of Urengoy would affect any “global gas market” or the U.S. one. As evidenced in 1981 by Reagan’s Defense Secretary Caspar Weinberger in a memorandum, “The U.S. should oppose the West Siberian pipeline project, consistent with our goals in overall East-West relations, as an essential part of the effort to impede the growth of Soviet political and military power and economic leverage. We must recognize that the earnings flowing from the development of Soviet oil and gas for export to the West will add significantly to the U.S. defense burden¹²²”. On the day following the presentation of this text, on July 9, 1981, a National Security Council meeting was held, to further discuss the matter¹²³. On December

¹¹⁷ Statement of Allan T. Mendelowitz, Director of International Trade, Energy and Finance Issues, National Security and Affairs Division, before the Subcommittee of European Affairs, Committee on Foreign Relations, U.S. Senate, on June 19, 1991, available at <http://archive.gao.gov/d38t12/144170.pdf>

¹¹⁸ Ibid.

¹¹⁹ Congress of the United States, Office of Technology Assessment, Technology and Soviet Energy Availability Project Staff, November 1981, Library of Congress Catalog Card Number 81-600166, p. 254

¹²⁰ Congress of the United States, Office of Technology Assessment, Technology and Soviet Energy Availability Project Staff, November 1981, Library of Congress Catalog Card Number 81-600166

¹²¹ Ibid., p. 3

¹²² Secretary Of Defense Memorandum For The Assistant To The President For National Security Affairs July 8, 1981, RRPL, NSC Meeting Box 91282, made available by MTF at:

<http://www.margaretthatcher.org/archive/displaydocument.asp?docid=110933>

¹²³ Minutes of the National Security Council Meeting held on July 9, 1981; the document has been made available by <http://www.jasonebin.com/nsc17.html>

29, 1981, the decision to leverage COCOM to impose trade controls on the export of Western technology was taken, as thoroughly discussed in a NSC meeting in early July 1981¹²⁴. At first, the decision was intended to target only “exports of equipment for the transmission and the refinement of oil and gas”, but was later expanded to include all oil and gas technology. The ban concerned also products manufactured in other countries, if they contained U.S. components, materials or technology licensed after August 1, 1978. In particular, in 1979 “the Soviet Union devoted approximately 22% of its trade with major western trading partners (some \$3.4 bn) to energy related technology and equipment. The vast majority of these purchases – about \$2.7 bn – were destined for the Soviet oil and gas sector (and most of this was for pipeline and pipeline equipment)¹²⁵”.

After Reagan’s move, Moscow focused more intensely on alternative suppliers, such as the Japanese “Komatsu”, the French “Dresser”, the Scottish “John Brown” and the Italian “Nuovo Pignone”. On June 18, 1982, Washington escalated its sanctions, in order to thwart also the shipments of any technology produced by subsidiaries or licensees of U.S. companies, even banning existing contracts¹²⁶. This decision touched off “the most violent dispute over extraterritoriality in the history of American trade controls¹²⁷”, and fomented a generalized revolt by European governments. Many heads of state decided to ask companies to comply with the supply contracts – with the notable support of the British Prime Minister Margaret Thatcher for John Brown’s some 400 million dollars’ worth of orders¹²⁸.

The sanctions were lifted on November 13, 1982. A few days later, President Reagan issued NSDD-66, accepting that the European countries “will not commit to any incremental deliveries of Soviet gas beyond the amounts contracted for from the first strand of the Siberian pipeline”, and sought and “accelerated development” of alternative resources, primarily from Norway¹²⁹.

In the end, the U.S. action did not prevent the Soviets from building the pipeline. The outcome of the Reagan’s anti-Urengoy plan is still source of debate. Some analysts stated that the final capacity was less than the one originally planned, and completion was delayed. Other observers have a rather negative opinion on the results achieved by the policy. Some argued that the financial impact of the project on Soviet finances was minimal, and that the U.S. lost reliability as a trade partner, both towards Moscow and the European partners¹³⁰. Others stated that “in terms of delaying the pipeline and/or dissuading European utilities from signing the contracts, the Reagan sanctions could generally be considered a failure and, after a very difficult period of relation within the Western Alliance, were finally lifted. European equipment export contracts were completed¹³¹”. Nevertheless, the actions by Washington caused delay in the shipments, but the Soviets scored a great propaganda achievement by adopting smaller, yet domestically produced compressors; and the

¹²⁴ Minutes of the National Security Council Meeting held on July 6, 1981; the document is available on <http://www.margaretthatcher.org/document/A5B961061F534C589485A7587DC83768.pdf>

¹²⁵ Congress of the United States, Office of Technology Assessment, Technology and Soviet Energy Availability Project Staff, November 1981, Library of Congress Catalog Card Number 81-600166, p. 10

¹²⁶ See 47 Fed. Reg. 27,252 (1982), amending 15 C.F.R. § 385.2(c)(2) (1982), repealed by 47 Fed. Reg. 51,858 (1982)

¹²⁷ Abbott, Kenneth W., Collective Goods, Mobile Resources, and Extraterritorial Trade Controls, Law and Contemporary Problems, 1987, Vol. 50, No. 3, p. 117

¹²⁸ TIME of August 2, 1982, Europe: Imbroglio over a Pipeline

¹²⁹ National Security Decision Directive 66, November 29., 1982, made available at <http://www.fas.org/irp/offdocs/nsdd/23-1933t.gif>

¹³⁰ Blinken, Anthony J., Ally Versus Ally: America, Europe, and the Siberian Pipeline Crisis (Westport, CT: Greenwood Publishing Group, 1987)

¹³¹ Stern (1987), quot., p. 33

"reduced capacity" was actually due to a "weakening of current and projected gas and energy demand as a result of the general economic recession in Western Europe¹³²".

However, a U.S. agreement between Europe and the United States concerning the maximal Soviet gas import quotas not to exceed 30% was all but a secondary achievement, since it perpetuated the "diplomatic tradition" of Washington's observation and control attempts on Russia's pipeline projects to the West. Such practice had begun with Kennedy's opposition to the Druzhba pipeline, and was due to continue years later with the U.S.'s skepticism on the gas pipeline project "South Stream"¹³³.



Figure 5 - The Urengoy pipeline

Besides the oil glut and the fight for Urengoy, we cannot downplay the role of plain domestic Soviet factors in generating a crisis in the national extractive industry that further enhanced the effects of the reduced rents on the exported commodities. Even during the "golden years" of the oil and gas exports to the West, opinions about the limits of the Soviet Union in managing the energy sector appeared in the western press: by 1982, Western commentators observed that the bureaucratic nature of the Soviet government was such that "the Russians could find themselves in the midst of an oil crisis before they realized it. Astonishing to relate, the Soviet Union does not even have a coordinating energy Ministry¹³⁴".

In that period, the older producing fields started declining sharply. Ill-planned state directed performance evaluation systems and poorly performed techniques did not allow for timely

¹³² Ibid.

¹³³ See Baran, Zeyno, Security Aspects of the South Stream Project, Center for Eurasian Policy 2008, Hudson Institute, at <http://www.hudson.org/files/publications/Baran-South%20Stream%20for%20EP.pdf>

¹³⁴ Wilson (1982), quot., p.2

production substitutions¹³⁵. In the last decade of its existence, the Soviet Union destined more and more capital investments to the energy sector; notwithstanding such efforts, new oil discoveries were smaller in number and size in comparison to those in the previous decades. In April 1989 the CIA observed that for the Soviets increasing the energy resources output by 3% in the previous year had requested 15% of the total investment of the country (excluding energy transportation investment), and that oil production was slowing down¹³⁶. Given the decreasing productivity of such investments, few months later it was calculated that in order to keep its oil output above 12 million barrels per day, the Soviet Union should have tripled its equipment imports to 6 billion dollars¹³⁷.

By the end of the 1980s the Soviets were experiencing also difficulties to balance foreign sales with the need of domestic consumption in the Soviet Union and its satellite states. The Soviet economy was “a glutton for energy. The Soviets require about one unit of standard fuel to produce the equivalent of \$1 in national product”, whereas the Americans and the Japanese required respectively 0.8 and 0.4¹³⁸. This problem generated structural disequilibria within the trade patterns of COMECON. From 1980 to 1984, Moscow reduced its oil and products exports to Bulgaria (-11.3%), Czechoslovakia (-13.5%), East Germany (-11%), Hungary (-12%) and Poland (-7.5%), with the limited decrease for Poland due to considerations about the financial fragility of the country in the period¹³⁹. The Soviet oil exports share destined to planned economies was 62% after the Islamic Revolution, and descended to 50% in 1983, to favor the West. In 1985, also the demand by capitalist countries contracted, causing a slump in oil and oil products hard-currency exports from 1.87 million barrels per day, to 1.42. Contemporarily, command economies experienced a further reduction in the Soviet exports destined to them, although not as much severe in comparison to the West, nevertheless sufficient to signal the beginning of a socialist economic crisis¹⁴⁰.

In order to counter the effects of descending oil prices, the Soviet Union spent all its efforts in trying to expand extraction as much as possible. Notwithstanding such determination, from the 12 million barrels per day extracted in 1988, the output slumped below the 10 million level in 1991. Total oil exports decreased by the half, from around 4 to 2 million barrels per day. Peak production had been achieved by the late 1980s, due to the ambitious plans of Mikhail Gorbachev to open up the economy and introduce increased flexibility mechanisms. It was too late for a change¹⁴¹.

¹³⁵ Goldman, Marshall I., Soviet Economic Trends, with Special Emphasis on Investment and Energy Policies, in Niiseki, Kinya, The Soviet Union in Transition (Boulder, CO: Westview, 1987), pp. 79-80

¹³⁶ Central Intelligence Agency, The Soviet Economy in 1988: Gorbachev Changes Course, April 1989, DDB-1900-155-89, retrieved on http://www.foia.cia.gov/docs/DOC_0000292349/DOC_0000292349.pdf

¹³⁷ Directorate of Intelligence, The Role of Western Participation in Soviet Petroleum Development, November 1989, SOV 89-10082X

¹³⁸ Directorate of Intelligence, The Soviet Energy Plight: Runaway Investment or Energy Shortfalls, January 1989, SOV 89-10002

¹³⁹ Chadwick (1977), quot., p. 139, on PlanEcon data of 1986

¹⁴⁰ Ibid.

¹⁴¹ An interesting review on the impact of the “oil crisis” in the collapse of the USSR is presented by: De Sousa, Luis (2011), Peak oil and the Fall of the Soviet Union: Lessons on the 20th Anniversary of the Collapse, The Oil Drum, at: <http://www.theoildrum.com/node/7878>

2. Post-soviet energy developments

Keypoints

- This part outlines the development of Russia's energy politics after the 1991 demise. Since energy in the previous fifty years had represented one of the main constituents of state financing and foreign policy, the dynamics of Russia's energy sector were strongly impacted by the Soviet Union collapse, and were at the center of the post-1991 resurgence.
- In broad terms, this part can be ordered into three main periods: from 1991 to 1994, from 1995 to 1999, and from 1999 to 2011.
- In the first period (1991-1994), after Russia had lost the “southern belt” of the central Asian republics, Washington was largely unaware of the energy potential of the area – also because there were abundant energy resources in the global market. The interest of the largest energy companies awakened the attention, calling for a diplomatic action that led also to a fundamental oil contract in Azerbaijan – and few weeks later to the first Chechnya War.
- In the second period (1995-1999), Russia remerged through the oligarchs system, yet the state apparatus was deeply weakened. The U.S. was faced with the option to help the Russian rebirth, or to gain advantage by securing political alliances with former territories of Soviet control. Washington led NATO managed to expand East, but was eventually blocked in Central Asia (see the following point)
- In the third period (1999-2008), as Putin surged to power, it seemed that Russia was on its way to enjoy a substantial monopoly on the gas supply to Europe, and had set a policy agenda aimed at securing a grip on the main energy routes. During his first two terms, Putin reassessed the “border of influence” between the East and the West, first deciding a new and more massive intervention in Chechnya, and then opposing the NATO annexation of Georgia, also through a military operation. The strong opposition of Putin did not anyhow prevent the completion of some important energy infrastructures bypassing Russian territory, and most notably the “Baku-Tblisi-Ceyhan” pipeline from Azerbaijan, to Georgia and Turkey.

From 1991 to 1994: Russian energy politics after the Soviet collapse

Concerning the energy sector it is possible to interpret the Boris Yeltsin years and the first two terms of Vladimir Putin as parts of a common framework, and not as contrasting phases. Yeltsin had to face a situation of industrial chaos and financial distress that had necessarily to be restructured through private capitals. When later the industry started performing again, Putin reorganized the system centering on state institutions and a power group revolving around former KGB operatives. Also geographically, the loss of important energy production regions (like Turkmenistan, Kazakhstan and Azerbaijan), as well as transit regions (Ukraine and Georgia) made urgent a policy of territorial reorganization and even of renewed foreign policy aggressiveness, in order to secure Russia's leverage on energy exports.

In this period, the identification of Russia's politics with the energy sector was completed: oil and gas revenue financed around 35% of the Russian state budget¹⁴². Yet, oil and gas activities in the Russian territory right after the soviet collapse were met by strict limits: in particular, exploration projects dropped by 22% from 1990 to 1991, and by a further 36% in the following year. International assessments evidenced how by the Soviet collapse a mere fifth of the Russian infrastructures was at par with international standards¹⁴³.

At a global level, an oversupply of oil in the market, together with the Soviet demise in Afghanistan, and the general Soviet system collapse, allowed the U.S. to enjoy a favorable position in the Middle East – something that had seemed impossible to achieve just a decade earlier. The United States could enjoy a precious opportunity to reshape their presence in the region, after the system of the “Three Pillars” (Egypt, Israel, Iran) had been reduced to virtually a single one (Israel). The only variable limiting the freedom of movement of the U.S. was represented by local powers, since some Mideast leaders believed that the post-Soviet fragmentation of the Middle East offered an opportunity to assess aggressive agendas. The most relevant case of the sort – besides the resurgence of various reborn nationalist movements in the entire region – was represented by Saddam Hussein’s Iraq. The dictator was trying to tailor for himself the position of “leader of the Arab world” or, more specifically, of its Sunni component.

Saddam was striving to get the economy of his country on path after a 1980-88 war with Iran – a conflict that set the record of second longest conventional war of the XX Century (after the Second Sino-Japanese War from 1937 to 1945). The Iran-Iraq conflict is considered to have been largely the product of a collection of miscalculations by Saddam. He feared that the “Iranian Revolution”, that ousted the Shah and introduced an “Islamist” form of government, might spill into his country, fomenting the Shiite component of the Iraqi population to revolt. Saddam also believed that invading the Iranian oil producing region of Khuzestan – a territory of Sunni majority and hosting some 90% of Iran’s onshore oil production – he could have had the Sunnis of Iran on his side.

As the war ended with no significant territorial gains or losses, Iraq had to face billions of debt, including a loan of 8.2 billion USD from neighboring Kuwait¹⁴⁴. The Iraqi finances had been also shattered by the low oil prices of the 1980s. Saddam sought for a period to have part of his debt

¹⁴² Forbes of March 10, 2013, Is Russia Ready for a Life After Oil?

¹⁴³ Locatelli, Catherine (1995), The Reorganization of the Russian Hydrocarbons Industry: an Overview, Cahier de recherche de l’IEPE n° 1bis

¹⁴⁴ Central Intelligence Agency, Iraq Economic Data 1989-2003, at:

https://www.cia.gov/library/reports/general-reports-1/iraq_wmd_2004/chap2_annxD.html#use-of-illicit-smuggling

pardoned, at no avail. He claimed that Iraq had served as “defense line” of the Sunni world towards a supposed Shiite aggression, and therefore he had carried on a conflict for countries such as Kuwait, the United Arab Emirates, and Saudi Arabia. The Iraqi invasion of Kuwait in 1990 was due to political frustration and to the misconceived belief that the West would have allowed him to do it – just as a means to repay Iraq for the “political credit” it believed to have. The diplomatic excuse for the invasion was that Kuwait did not respect its assigned OPEC production quotas (later investigations revealed that – for whatever it counts – Iraq’s accusation was right).

Besides the uncontrollable Iraqi variable, in terms of energy security the 1990s have been a time of relative stability. Similarly to other periods of low commodity prices – most notably, 1978 – the lack of funds to encourage wars or local aggressive agendas created favorable conditions for the 1993 Oslo accords. The possibility of armed intervention by the U.S. and by the “Desert Storm” coalition was also made possible by the oversupply of oil itself: the “production margin” (meant as the positive difference between potential oil production and demand) globally was significantly larger than the supply that had to be given up intervening militarily in Kuwait and Iraq.

The Soviet collapse exerted its deepest effects on Central Asia. In terms of energy geopolitics, the area of the “Stans” (Kazakhstan, Tajikistan, Kyrgyzstan, Uzbekistan, Turkmenistan) and the Caucasus played a double role for Russia’s interests. On one side, they represented the territorial and cultural connection with the Middle East – also regarding religion – and, on some extent, the return from Afghanistan of disillusioned Red Army veterans to the Stans contributed to the weakening of the Soviet national idea¹⁴⁵. On the other side – more strictly bundled to energy – some of the countries hosted important hydrocarbon production centers, such as Azerbaijan’s capital Baku, which had been already a target of “Case Blue”, the Wehrmacht operation intended to secure access to resource rich centers in Russian territory. The grand Soviet strategy would bind the “East” of the energy territories in Central Asia, to the export routes directed to the West – be it gas through Ukraine and Belarus, or Oil through pipelines and the export terminals on the Black Sea.

¹⁴⁵ Kerimov, Gasym (1996), Islam and Muslims in Russia Since the Collapse of the Soviet Union, Religion, State & Society, Vol. 24 Nos. 2/3, 1996



Figure 6 - The Caucasus and Central Asia

In the middle of Soviet decay, Russian leader Mikhail Gorbachev realized that the center of the federation was lacking funds and political drive to counter the fragmentation of the economic system of Central Asia, revolving around an area called “Fergana Valley”. Gorbachev chose to grant local states the permit to manage their oil and gas contracts autonomously. The decision was also due to the fact that local administrations also started lacking funds needed not only for administration purposes, but also to safeguard the military and nuclear facilities present on their territories. Somehow, the concession was due to a subtle threat: Moscow would allow “oil autonomy” in exchange of “nuclear safety” (we cannot downplay how precious nuclear trade could have been to replenish local accounts and those of the political acolytes of new presidents).

Part of the Central Asian fragmentation was also due to an accurate political work by Pakistan, on the East side of the region. Noticing the dynamics developing in the Stans, Pakistan defacto dictator, army general Zia-ul-Haq, started coveting aspirations of regional hegemony: he wanted his country to become the leader of an Islamic confederation in Asia. For this purpose, ul-Haq alerted Pakistan intelligence ISI – that had already cooperated with the CIA to supply Afghani mujahidin with weaponry – and ordered to set up distribution and trade channels for arms sales to the new governments in formation.

At first, ul-Haq’s initiatives were somehow tolerated by Washington. The U.S. were well aware of the risk factors that might have spread from the area: post-imperial anarchism is a risky situation, especially in the presence of uncontrolled military and nuclear arsenals. Nevertheless, as time passed by it appeared increasingly evident that the U.S. had to seek a more direct involvement in the region, also because the territory contained most of the “new hopes” of the Western world in terms of extractive perspectives. The fragmentation of the Southern Soviet border opened a new (black) gold rush, around the coasts of the Caspian Sea. As Moscow was retreating and hydrocarbon administration was assigned to shadowy local officers, international oil companies realized that the Caspian was up for grabs.

At first, estimates claimed that the new republics were sitting on reserves worth some 200 billion barrels of oil – a very large amount, considering that in 1991 global oil consumption was just 64 mbpd. Moreover, the area had yet to be explored with modern techniques, and hopes were high¹⁴⁶.

Before the official involvement by the U.S., the recovery of the energy infrastructure of the area awoke the interest of maverick negotiators of various extraction and nationality. In Kazakhstan, power was held by Nursultan Nazarbayev, who had been the secretary of the Kazakh Communist Party in Soviet times. In 1991, he had been elected president after a sensational 95% result at the national vote. Among his first decisions, he declared that he wanted to seek broader independence from Moscow in matters of energy resource extraction. The first negotiations to grant oil rights contracts to non-Russian companies were led by American businessman James Henry Giffen, who was operating through a company whose name sounded public, although it was completely private: "American trade Consortium". The appearance was further adorned by "recommendation letters" signed by U.S. President Bill Clinton.

After the Soviet Union collapsed, Nazarbayev had to face the opposition of local nationalist groups that were not enthusiastic about the access that the President had been granting to Western companies into the territory. There was also an agreement in place with Chevron, closed just six month before the Soviet breakdown: most of the Kazakhs opposed it, as it had been signed through Giffen and with some help by Moscow. In order to solve the stalemate, a new negotiator intervened: Johannes Deuss, a Dutch international oil trader, known for having sold oil to South Africa during the apartheid era – notwithstanding an international embargo. Deuss understood that Nazarbayev was looking for a new "diplomatic protection" – switching from Moscow to Washington – and operated in this sense. In 1992, the Kazakh leader had been invited to the White House for a meeting with President George Bush, and Deuss suggested him to formalize a new offer to Chevron, in order to land in the U.S. with an approved contract in his pocket.

The oil company was offered a "profit take" of 20% on the extractive activities of the "Tengiz" basin. The share was significantly lower than the 28% that Chevron had been requesting, but the offer was accepted – with the reward of being the "first Western company" to set foot in Kazakhstan. The agreement was signed on May 18, 1992; and just to secure the U.S. protection, the following day Nazarbayev ratified the "START" treaty, committing the country to dismantle all Soviet nuclear missiles left in the territory within seven years¹⁴⁷.

The Chevron contract set off a period of oil frenzy around the Caspian. Also Azerbaijan started to be targeted by multiple offers, regarding a basin called "Azeri". The first companies to move were the British BP and the American Amoco. Both companies were offering a profit share of 50% (quite lower than the accepted standards), yet Amoco was quicker at offering an additional condition: once the investment had been recovered, the profit share for Azerbaijan would have been increased to 75%. Due to the generous deal, Amoco was granted the exclusive right to negotiate with the country for one year.

BP and another company, the American Pennzoil, managed to start negotiations for two other basins called "Chirag" and "Guneshli", but another U.S. company, Unocal, risking to be excluded from any negotiation, informed the Azeri government that all basins were actually part of a

¹⁴⁶ Crandall. Maureen S. (2006), Energy, Economics and Politics in the Caspian Region: Dreams and Realities, Praeger Security International, p. 1. Please consider that those first estimates were a gross exaggeration – more recent data claims reserves up to a maximum of 50 billion barrels.

¹⁴⁷ The New York times of October 16, 1992, Chevron and Kazakhstan said to agree on oil venture

single geological formation, the “Absheron platform”, and that Baku was negotiating three different contracts for the same object¹⁴⁸.

Believing in the Unocal leak, Azerbaijan blocked all negotiations, and a new agreement with all of the four companies (BP, Unocal, Pennzoil, Amoco) was penned. The contract included the upfront payment of a bonus of 70 million dollars, and an additional bonus of 210 million would have had to be corresponded after signing a final contract in London, on October 22, 1992. Yet, as the first stake had been paid, the London meeting was called off and the money disappeared.

The reason for such an abrupt change of course was due to the onset of a phase of deep political uncertainty. At the time of the negotiation, Heydar Aliyev was emerging as a possible local leader – when he was KGB head in Azerbaijan, he had established precious connections with local businessmen. He had also been Deputy-Prime Minister of the Soviet Union until 1987. He was now governing his native region, Nakhchivan, which he was managing as an independent area beneath the newly independent Azerbaijan. The country was also involved in a conflict with neighboring Armenia: the object of the fight was an Azeri region, Nagorno-Karabakh, whose population has an Armenian majority. As the control of Moscow was retreating, Armenia declared the annexation of Nagorno-Karabakh in 1988; and Azerbaijan had reacted through an outright occupation of the region. The Kremlin tried to offer the creation of an “autonomous” region, but both parts did not accept the idea.

Aliyev emerged since, when Armenia had occupied a portion of Nagorno-Karabakh, he had managed to close a “separate peace agreement” for the region he was administrating, Nakhchivan. Months later, due to his successful experience he was invited to the Azeri capital Baku as chief mediator for the general peace agreement. The talks were met with success, and Alyev was capable to gather enough political support to make it to the presidency of the country.

The development of the Nagorno-Karabakh conflict has been the first notable expression of the Russia post-Soviet model approach to its Southern border. Azerbaijan and the Caucasus remain an interest area for Moscow, due to the presence of resources, to their transit routes, and to the connection with the Middle East. Nevertheless, in the 1990s Russia was not in the condition – militarily, politically and financially – to even consider any kind of direct intervention into a local dispute of such sort. In Nagorno-Karabakh, Moscow managed to side for the two factions contemporarily: it was supplying Azerbaijan with training and weaponry (including supplies for MiG-25 jets and Su-25 bombers), and Armenia could count on the presence of Russia’s 7th Army. Russia was trying to exploit the continuation of the conflict, so that local governments would then ask the Kremlin to solve the dispute – and so the Russians could retain a role in foreign territories, with very limited investment. In some 1993 words of a former Azeri President, Abulfaz Elchibey, “the [...] Armenian victories in the war can be chalked up to the presence of the Russian Seventh Army, which is stationed in the region and is helping the Armenians in their struggle. Russia has a vested interest in the continuation of the war. The conflict between Armenia and Azerbaijan gives the Russians a foothold in the Caucasus¹⁴⁹”.

Such strategy of international survival for the Russian also demonstrated how the Moscow leadership had never given up its aspirations of hegemony in the Caucasus. This attitude had been also openly stated in various occasions. At the time when political delegations from the West started landing in the area, Russian Energy minister Jurij Safranik told Bill White, U.S. Undersecretary of

¹⁴⁸ Actually, it seems that this information was known by all companies, but all players had decided not to disclose the data.

¹⁴⁹ Brzezinski, Zbigniew & Sullivan, Paige, *Russia and the Commonwealth of Independent States* (New York, NY: M.E. Sharpe, 1997), p. 227

Energy, that Caspian resources had been discovered by the Russians, and therefore they had to be developed by Russian companies – in Azerbaijan and in Kazakhstan¹⁵⁰.

As for the U.S. side, Azerbaijan at first was not really politically monitored by the Clinton administration: the presence of the “unofficial” negotiators – and their success – was quite representative of who was responsible for industrial operations in the area. Such lack of interest by the White House was largely due by the fact that oil at the time was plenty and cheap. At the beginning, the U.S. stance in the Caspian region was influenced by lobbies whose interests had few to do with energy, and political priorities were set basing on “cultural affinities” with the new states. In the specific case of Nagorno-Karabakh, “Christian” Armenia sounded preferable to “Islamic” Azerbaijan, and the U.S. Congress in its 1992 “Freedom Support Act” excluded Azerbaijan from the list of new independent States receiving aid – specifically, the “Armenian National Committee of America” (“ANCA”), pushed for the inclusion of “section 907”, specifically banning Azerbaijan (the only former Soviet State banned). Armenia received 330 million USD.

Azerbaijan realized that by concentrating on the mere “industrial” aspect of energy negotiations, it had ended up being stuck in a political gridlock, surrounded by Moscow, Western oil companies, and a politically active Armenia. Azeri leader Alyev was smart enough to understand that such “pressure network” could be reversed and used for the benefit of Azerbaijan, and oil could serve the purpose. The reason why the Absheron oil contract had been blocked was due to an abrupt change of course: Alyev wanted to restructure the agreement and involve the largest number of foreign oil companies possible.

After additional negotiations, a new consortium was presented, including a dozen of companies: together with the three original U.S. investors (Amoco, Pennzoil and Unocal) there were now companies from the UK, Norway, Turkey and Saudi Arabia. Most notably, also the Russian private company Lukoil was present with a stake of 10%. The contract was titled – not without a certain lack of modesty – “The Contract of the Century”, and was signed on September 20, 1994. It granted 80% of the profits to Azerbaijan, and concerned extractive rights for 4 billion barrels. Interestingly, also the down payment of 70 million USD resurfaced and was accounted¹⁵¹.

The presence of Lukoil might have suggested that Alyev had succeeded at involving Moscow in the new Azeri diplomatic frame, yet opinions in Russia were contrasting. In particular, there were (and still are) discussions concerning the criteria that should assess territoriality on the Caspian waters. Russian Foreign minister Andrey Kozjrev led a faction claiming that the Caspian was actually not a sea, but a lake, and therefore States only control coasts – whereas waters are a “common good”. In Kozjrev’s vision, Alyev had therefore sold concessions for something that Azerbaijan did not own. This movement of opinion made pressure on Trade minister Viktor Chernomyrdin to apply sanctions to Azerbaijan. The impasse was solved by mediation: accept the contract, but in exchange of the inclusion of Lukoil. Alyev’s example provided a model for other contracts later on. In 1995, the “Garabag” basin was assigned to a consortium of Italian (Agip/Eni), Russian (Lukoil) and U.S. (Pennzoil) companies, and later companies from France, Japan, Iran and Turkey entered the area. President George W. Bush waived section 907 of the Freedom Support Act in 2002, and also Azerbaijan started receiving U.S. state aid.

¹⁵⁰ LeVine, Steve, *The Oil and the Glory* (New York, NY: Random House, 2007), p. 189

¹⁵¹ For a complete list of the investors and the respective share, see: Azerbaijan International of Winter 1994 (2.4), Azerbaijan’s “Contract of the Century”, at:

http://www.azer.com/aiweb/categories/magazine/24_folder/24_articles/24_aioc.html

From 1995 to 1999: The oligarchs and Putin

The mere repartition of the shares within the two main contracts in Azerbaijan and in Kazakhstan (the Chevron one) suggested that Russia was strategically retreating. Although Lukoil had grabbed a 10% participation at Absheron, a Western company such as BP had 17% - not to mention the "exclusive" contract of Chevron in Kazakhstan. Yet Russia, besides military and diplomatic influence, had another card to play: energy interconnections. No oil and no gas were to leave the Caspian basin without the consent of Moscow.

This moment in recent energy history opened up a phase of negotiations that was reminiscent of previous episodes in Europe in the 1960s and in the 1980s. In Kazakhstan, Chevron had downplayed the difficulties of developing a pipeline connecting Kazakhstan to the export terminals at the other side of the Caspian. At the beginning of the extractive operations in Tengiz, it became immediately clear that things were more difficult than what had been thought. Specifically, oil had to transit into Russian territory and be collected by the "Samara" interconnection point, but here – it was declared by the Russians – there was an available capacity of mere 30,000 barrels per day, or less than 50% of what had been promised to Chevron. Moreover, oil from Tengiz had a relatively good quality compared to the Russian "Ural Blend" flowing to Samara, and the two different qualities had to be mixed without any compensation for Chevron¹⁵².

Also in Azerbaijan the situation was not positive for the Western investors. Moscow's blessing to the "Contract of the Century" had been granted not just through the entrance of Lukoil in the consortium: Russia also wanted to control the export routes flowing from Azerbaijan to the West. A week after the contract had been signed in New York, Aliyev met with U.S. President Bill Clinton in New York, and "Aliyev requested a favor - that Clinton persuade Russia's Boris Yeltsin to acquiesce to the oil deal and be flexible on the issue of pipelines. Russia cannot "dictate this question," Aliyev declared. Clinton promised to try¹⁵³".

The American President met with Boris Yeltsin on September 28, 1994, in Washington. Two days earlier, Yeltsin at the UN had declared that his country would have the responsibility of "peacekeeping" in all former Soviet territories. The U.S. wanted to convince Russia to involve the UN in any initiative concerning the Caucasus. Interestingly, in the agenda of the same meeting there was also a point about arms supplies from Russia to Iran, which had totaled one billion USD.

Yet, the Russian President did not accept to soften his stance. Just to reassert Moscow's grip on the Caucasus, the first military operation in Chechnya began on October 30, 1994, with the bombing of the capital city, Grozny. A full-blown Russian ground attack followed on December 11, and the conflict lasted one year and a half. The intervention signaled also an abrupt change of stance towards independence movements from Gorbachev to Yeltsin: if Gorbachev had used the same military approach on the other republics that declared independence, the Soviet split would have been far more problematic than it actually was. As for the West, the U.S. was never in the position to take any hard stance against the intervention, since the political position of Yeltsin was delicate and he could not have sustained any form of real international pressure¹⁵⁴.

¹⁵² World Politics Review of June 27, 2008, Lack of Export Infrastructure Hinders Kazakhstan's Bid to Become Oil Power, at: <http://www.worldpoliticsreview.com/articles/2354/lack-of-export-insfrastructure-hinders-kazakhstans-bid-to-become-oil-power>

¹⁵³ Steve LeVine, 2007, cit. p. 200

¹⁵⁴ There were anyhow some isolated declarations. U.S. State Secretary Warren Christopher threatened to stop financial aid to Russia in case the invasion continued. The aid eventually did not stop.

The Chechen conflict had a strong repercussion on the energy situation of the region. Between Azerbaijan and the Black Sea there was an old Soviet pipeline, running from the Azeri capital Baku to Novorossiysk (the main Russian port), that could have been restructured. The only issue was that the pipeline was transiting through Groznyy, the Chechen capital, with high risk of sabotage by local rebel forces (for this reasons, the few oil pumped in the pipeline had already been blocked). Close to Groznyy, Moscow had also an important center of oil refining. A tight control of Moscow on the region could have allowed a safe grip on a possible new center for the new pipeline network.

The first large pipeline initiative to be projected concerned Kazakhstan, where Chevron was still facing the problem of reduced available capacity at the oil terminal of Samara. Dutch negotiator John Deuss, the same that had developed the extraction contract, orchestrated the creation of a "Caspian Pipeline Consortium" ("CPC"), to create a pipeline connecting the coastal Kazakh oil center of Tengiz with Novorossiysk, transiting through Russian territory North of the Caspian. Also Russia was invited to enter the consortium, although its role would have been merely that of "transit fee collector", with no operative leverage, to avoid that Russia could enjoy any power of deciding available capacities here as well.



Figure 7 - Kazakhstan and the Russian oil terminal of Samara

Yet, this time Washington sensed early enough that Russia could have gained control of the negotiation, and that it was too risky to leave the business to the entrepreneurial capacity of Mr. Deuss alone. Washington engaged into an overarching diplomatic capacity to force the Dutch negotiator to leave the table. Russia was invited to enter the extractive consortium in Tengiz, which was opened also to the Italian oil company Eni, to Mobil and to BP, and some 520 million USD were collected to install 1,500 km of pipes (partially simply restructuring existing pipelines). A contract was signed in April 1996¹⁵⁵.

On the other side of the Caspian, also Azerbaijan was looking for a route to export the increasing quantity of oil it was producing. A first possibility was represented by the restructuring of a pipeline (with 50 million USD investment), transiting also through Chechnya. The alternative was

¹⁵⁵ See Dellecker, Adrian, Caspian Pipeline Consortium, Bellwether of Russia' Investment Climate?, 2008, Russia/NIS Center

the creation of a pipeline on the “South-West” route, to the Mediterranean coast of Turkey. Ankara was favorable to the project, because the Turkish coastal terminal of Ceyhan had lost all of its profits when oil exports from Iraq had been blocked in 1991. Moreover, more oil to Novorossiysk would have meant more oil tankers transiting through the bottleneck of the Dardanelles, which was already close to full capacity: the new pipeline would have helped to relieve the Strait.

The “Baku-Ceyhan” pipeline is the initiative that projected Turkey into his new status at the center of the energy network of the Eurasian platform. There was a significant obstacle to the plan, represented by the promise to the Russian that they would have retained territorial control on the export routes from Azerbaijan. The U.S. decision to facilitate the project – as set by Rosemarie Forsythe, head of a commission about Caspian policies in Washington – was to sponsor both routes, within and outside Russian territory. The U.S. also reorganized the entire approach towards the region: a CIA report of 1997 titled “Caspian Policy Review” clearly stated that the preferred goal was to keep Russia outside the new transits. Clinton also instituted the position of “Special Advisor to the President and Secretary of State on Assistance to the New Independent States of the Former Soviet Union”. Morningstar made soon clear that the energy independence of the new states was fundamental, and that they could not depend on “antagonist states” such as Iran to get their resources out, as “energy is a strategic interest”¹⁵⁶.

Eventually, the Northern route was restructured and exports began in 1997, and already in 2000 a connector was built to cut Chechen territory out of the transit route – although the pipeline was still transiting in Russia, through the Dagestan province. The first oil from Baku reached Ceyhan on May 28, 2006¹⁵⁷.



Figure 8 - The Baku-Tbilisi-Ceyhan pipeline

Boris Yeltsin stepped down on December 31, 1999, and the responsibility to lead Russia was assigned to Vladimir Putin, who had been Prime Minister for the previous four months. The political legacy of Yeltsin did not leave much space for optimism: as noticed by Madeleine Albright, replacing Warren Christopher ad Secretary of State in Clinton’s second mandate, «few societies have

¹⁵⁶ America's Defense Monitor of November 5, 1998, Ambassador Richard Morningstar

¹⁵⁷ BP Website, at: <http://www.bp.com/sectiongenericarticle.do?categoryId=9006669&contentId=7015093>

crashed harder without a war. During the Great Depression America's economic output declined by one-third. During the 1990s, Russia's economy shrank by 55 percent, reaching roughly the level of the Netherlands'. By decade's end Moscow was barely collecting taxes, foreign investment had dried up, and 70 percent of Russians lived at subsistence level¹⁵⁸».

Part of Russia's problem rooted also on the price of oil that was still stagnating. The crisis of the Asian Tigers was the final blow for Russia's already fragile economy. In 1996 oil pricing had increased above 20 USD, setting the record since Desert Storm in 1991. Traders had been betting on further price increases due to the rising Asian consumption, and as the rising economies crashed, this financial situation pushed the barrel price further down. Oil price touched 11.91 USD per barrel: inflation adjusted, it was the minimum since the 1940s¹⁵⁹. The decision by OPEC to cut production by some 2 mpbd in five months, and the additional million cut by non-OPEC members, did not help to revitalize quotations.

Putin had to face also the challenge of restructuring a dysfunctional Russian oil industry. Oil production in the federation had fallen from 8 mbpd in 1991, to 6 mbpd – and there was no sign of recovery, since production had been decreasing since the 1980s (as the CIA had noticed¹⁶⁰). In terms of security, some important territories that hosted energy infrastructures had not stabilized yet: in 1996 a bomb in Dagestan had destroyed a building hosting Russian border guards, and in the following years other attacks had followed throughout the federation, and a total of 300 people had lost their lives. In most cases, Moscow assigned the responsibility of the attacks to "Chechen terrorism".

In August 1999, Chechen separatist leader Samil Basaev led a 2,000 strong army to Dagestan to support an Islamist secessionist movement. The reaction by Moscow was immediate: artillery intervened to cut Basaev's supplies, and a counteroffensive forced him to retire. On August 26, the then-Prime Minister Putin ordered a full-blown attack to Grozny and to various military installations. Ground operations began in October. By May 2000, President Putin had reestablished Russian "federal authority" on Chechnya, and in Grozny there was a new government more favorable to Moscow.

The intervention persuaded Washington to reconsider the organization of its global military structure. The command on the Caspian area was assigned to the direct management of central defense apparatus (before it responded to the Pacific Command). Washington wanted direct control on the situation. As for the political side, the Clinton administration declared its criticism towards how Putin had handled Chechnya, but – as in the case of Yeltsin – could never push too hard, because Washington wanted to avoid a destabilization of the still fragile political structure of Moscow. At best, Clinton invited the Russian President to «free Grozny». Somehow, the point about Russian intervention was that a pacified Chechnya was also in the interest of the West. Nevertheless, Washington made pressure on Russia to allow international observers enter the territory and assess the condition of migrants¹⁶¹.

Putin won the elections on March 26, 2000. Russia was still overly dependent on hydrocarbons: energy companies represented around 60% of the Moscow stock exchange capitalization, and oil and gas accounted for 22% of the state revenue¹⁶². He believed that a plan to restructure and diversify the economy would have taken too long, and could not possibly represent a

¹⁵⁸ Albright, Madeleine & Woodward, Bill, Madame Secretary, (New York, NY: Miramax Books, 2003), p. 554

¹⁵⁹ See: http://www.inflationdata.com/inflation/Inflation_Rate/Historical_Oil_Prices_Table.asp

¹⁶⁰ EIA Data – Russia. At: <http://www.eia.gov/countries/country-data.cfm?fips=RS#pet>

¹⁶¹ The New York Times of February 3, 2000, A 3-hour talk with Putin leaves Albright encouraged

¹⁶² Wolosky, Lee S., Putin's plutocrat problem, Foreign Affairs of March-April 2000

solution to cure the impending Russian malaise. Moreover, a system of “oligarchs” that had sustained the rule of Yeltsin – including his reelection in 1996 – would have represented a strong obstacle to change. The most urgent action was therefore to accept the energy dependence, but to refocus the control of the sector from private rentiers to the Kremlin: “On July 28, 2000, Putin sat down with the most powerful oligarchs and set forth the system’s new reality. As long as the oligarchs paid taxes and did not criticize the Kremlin, Putin pledged to respect their property rights and refrain from prosecuting them for any past (or continuing) corruption. Many complied, but in 2003, Mikhail Khodorkovsky, the chairman and CEO of Russia’s largest oil-producing company, began funding opposition parties and independent media critical of the Kremlin. The result was a harsh hammer blow. The lawfare state jailed him, destroyed his oil company and forced most of his family into exile. The message to other oligarchs was clear: follow the rules or face devastating legal consequences¹⁶³”.

To counter the private power of the oligarchs, Putin decided to leave the system of political support he had inherited from his predecessor Yeltsin. Putin had had a long experience in Russia’s KGB services. The first group of Putin’s strongmen was nicknamed “The Checkists of Petersburg” – as Putin had been the major of St. Petersburg. Another group was nicknamed “The Liberals of Petersburg”, and included people that had assisted him during his tenure as major, including Finance minister Aleksej Kudrin and Economics minister German Graf. In few months, the system managed to place people at important administrative posts.

In terms of organization of the federation, Putin realized that too many local politicians were governing with just a formal link to the center. In some cases, rulers claimed absolute authority also on resources reserves – as noticed by the economist Daniel Yergin, the Russian energy sector was somehow suffering from the same ethical conflict that had exploded during the Soviet collapse¹⁶⁴. In August 2000, Putin introduced a decree that reorganized the 89 Russian regions into seven federal districts, led by delegates nominated by the president. This change transformed the status of the 89 local governors from “national authorities” to “regional representatives”. Out of the seven federal delegates, five had a past in the FSB¹⁶⁵. In economic terms, anyhow, some results were achieved – it was recognized also by the IMF: “we, like others, fully recognize the impressive forward movement. Achievements in 2001 include far-reaching tax and legal reforms, the replacement of Soviet-era Labor and Land Codes, a deregulation package, and a new pension system¹⁶⁶”.

Putin was convinced that state restructuring had to be based on some sort of public control on strategic sectors, and in particular on the energy sector. By the end of his first mandate, the state energy company Gazprom would reach a value equal to 8% of the country’s GDP. The largest extractive company was also public (Rosneft), and reached such dimension after acquiring the assets of a private company (Yukos) dismissed by Mikhail Khodorkovsky. The state had control also on Transneft, a company managing the energy transport infrastructure of Russia – and the “legal successor” of the “Soviet Ministry of Oil Industry Main Production Department for Oil Transportation and Supplies”.

As Russia was “closed for restructuring”, the U.S. was eager to reshape the map of power in Europe: redrawing influence borders would have determined also the equilibrium of power,

¹⁶³ Partlett, William (2013), Putin’s Artful Jurisprudence, The National Interest of Jan-Feb 2013

¹⁶⁴ Yergin, Daniel (1993), quot., p. 780

¹⁶⁵ Taylor, Brian D. (2002), Strong Men, Weak State - Power Ministry Officials and the Federal Districts, PONARS Policy Memo 284

¹⁶⁶ IMF, Putin at Mid-Term: Where Should Economic Reforms Go From Gere?, A commentary by John Odling-Smee & Paul M. Thomsen, April 15, 2002, at: <http://www.imf.org/external/np/vc/2002/041502.HTM>

influencing also energy transit rules. The expansion of NATO to the East responded to this logic: Madeleine Albright staunchly defended this policy, claiming that since democracy had moved East, it made no sense to respect the line that had been reached by the Red Army in 1945.

As the U.S. was proving quite aggressive in the region of the Caspian Sea and in Eastern Europe, it was also closely monitoring Moscow's efforts at reorganizing economically. This contradiction was also a primary challenge that George W. Bush had to face upon his election in 2001 – apart, of course, from the global emergence of terrorism. Vice-President Dick Cheney had been Defense Secretary in the administration of President Bush and in 1991 had redacted a programmatic document titled "Defense Planning Guidance", which had been inspired by traditional anti-Soviet logics – and was leaked to the New York Times.

Cheney had envisioned the creation of a special army for immediate intervention, and claimed that "The former Soviet state achieved global reach and power by consolidating control over the resources in the territory of the former U.S.S.R. The best means of assuring that no hostile power is able to consolidate control over the resources within the former Soviet Union is to support its successor states (especially Russia and Ukraine) in their efforts to become peaceful democracies with market-based economies. A democratic partnership with Russia and the other republics would be the best possible outcome for the United States. At the same time, we must also hedge against the possibility that democracy will fail, with the potential that an authoritarian regime bent on regenerating aggressive military power could emerge in Russia. [...] For the immediate future, key U.S. concerns will be the ability of Russia and the other republics to demilitarize their societies, convert their military industries to civilian production, eliminate or, in the case of Russia, radically reduce their nuclear weapons inventory, maintain firm command and control over nuclear weapons, and prevent leakage of advanced military technology and expertise to other countries. [...] NATO continues to provide the indispensable foundation for a stable security environment in Europe. Therefore, it is of fundamental importance to preserve NATO as the primary instrument of Western defense and security, as well as the channel for U.S. influence and participation in European security affairs¹⁶⁷".

Ten years later, Vice-President Dick Cheney presented a "National Energy Policy Report", where the Caspian was mentioned as "a rapidly growing new area of supply". Specifically, "Proven oil reserves in Azerbaijan and Kazakhstan are about 20 billion barrels, a little more than the North Sea and slightly less than the United States. Exploration, however, is continuing, and proven reserves are expected to increase significantly. [...] Current exports from the region are only about 800,000 barrels of oil per day, in part due to limited export route options. However, potential exports could increase by 1.8 million barrels of oil per day by 2005, as the United States works closely with private companies and countries in the region to develop commercially viable export routes, such as the Baku-Tbilisi-Ceyhan (BTC) and Caspian Pipeline Consortium oil pipelines¹⁶⁸".

In the following years, the Western involvement in the "Colored Revolutions" of Georgia (Rose), Ukraine (Orange) and Kyrgyzstan (Tulip) evidenced how much the U.S. was caring about installing systems of democracy and free market, that could be profitably coopted.

¹⁶⁷ The New York Times of March 8, 1992, Excerpts From Pentagon's Plan: 'Prevent the Re-Emergence of a New Rival'. The original document is available at:

http://www.gwu.edu/~nsarchiv/nukevault/ebb245/doc03_extract_nytedit.pdf

¹⁶⁸ National Energy Policy Development Group, National Energy Policy, May 2001, at:
<http://www.wtrg.com/EnergyReport/National-Energy-Policy.pdf>

From 1999 to 2008: Putin in power and Baku-Ceyhan

When Baku-Ceyhan was being planned, Zbigniew Brzezinski, former NSA of Jimmy Carter, surprised most of the establishment claiming that a more appropriate route for the pipeline would have been straight from the Caspian area to the Persian Gulf, through Carter's historical nemesis: Iran. Brzezinski claimed that "My perspective about Iran is rather idiosyncratic. I think that the United States should approach the American-Iranian relationship from a broad, long-range perspective. America and Iran share fundamental, geo-political interests. The present phase of antagonism, in my view, is only a transient phase. [...]It's a mistake for the U.S. to exclude the possibility of pipelines going through Iran. Iran will not always, and forever, be antagonistic to the United States. Pipelines take many years to construct. In the meantime, excluding Iran tends to stimulate the Iranian-Russian partnership against Azerbaijan. And that, I think, is counterproductive to our interests and to those of Azerbaijan and Central Asia¹⁶⁹".

This approach was exposing a fundamental flaw in the U.S. policies of the time: the problem of the "vanished frontier" between the Middle East and the Caspian republics. During the Cold War, the presence of the Soviet Union had given impulse for the creation of a "Central Treaty Organization" binding Iran, Iraq, Pakistan and Turkey (and the UK). In the early 1990s, the presidium on the area was practically left to Pakistan, as Russia was checking the equilibrium of local conflicts (as in Nagorno-Karabakh). Not least, the unchecked flows of Afghanistan veterans had created the fertile ground that led to the spreading of contemporary terrorism. As for energy, the development of the most relevant projects had been "outsourced" to private negotiators, and West companies could be freed from the Russian-Central Asian stalemate only after a full-blown diplomatic intervention by Washington. In this context, the U.S. had to develop alliances with Georgia, Kazakhstan and Azerbaijan, and the Russians decided to retain a strong presence in Armenia, intervening militarily in Chechnya twice. South of this belt, the area had been somehow "forgotten". Afghanistan, Pakistan, Kurdistan: here there was no real political investment and, as the 2000s would have shown, the real threats for international security originated from here.

On the energy side, the consequences of this lack of order in the "Southern belt" were deeply felt by the U.S. oil company Unocal, which was looking for ways to transport natural gas from Turkmenistan to an export terminal. A possible route included Iran – as Brzezinski was suggesting also for Azerbaijan – but the "Iran-Libya Sanctions Act" was preventing any initiative of the sort. The alternative solution was represented by a pipeline through Afghanistan and Pakistan, to the Indian Ocean. Turkmenistan was ready to support any project that could be quickly realized. Since independence, Turkmenistan was relying on years gas export worth some 2 billion USD – yet in 1993 Moscow had consistently reduced access to export routes, quoting the usual "congestion", and Turkmenistan was able to sell its production only to Ukraine and some areas in the Caucasus, that were financially less attractive than Europe.

Turkmenistan was headed by Saparmurat Niyazov, who had been – as many other local leaders in the region – a Party leader at the times of the Soviet Union. In 1994 he had been confirmed president with an incredible 99.9% of preferences. He had promoted the development of a new Turkmeni identity, largely based on the cult of his personality (as a matter of fact, some months changed name and got new ones inspired by Niyazov's biography). It has been reported that

¹⁶⁹ Azerbaijan International of Winter 1995 (3.4), pp. 20-22, Geopolitically Speaking - Interview with Zbigniew Brzezinski

a foreign oil manager once counted as many as fifteen portraits of Niyazov in the office of a minister¹⁷⁰.

The first attempt to develop an export route avoiding Russia's territory had been tried in the early 1990s, when Shell had tried to connect Turkmenistan to Azerbaijan passing through the Caspian Sea, yet the opposition by the Kremlin had convinced Turkmenistan to abandon the idea. In terms of extraction, the first company that managed to hit an exploration contract in Turkmenistan was the Argentinian "Bridas", led by Carlos Bulgheroni, a much known figure in his country. Bridas had been granted extractive rights on two basins: the Keimar bloc close to the Caspian coast, and Yashlar at the border with Afghanistan. In March 1995 Bridas had reached an agreement with Pakistan for the transit of a pipeline, but the possibility of developing an infrastructure through Afghanistan were problematic, due to the instability of the mujahidin government, and the few control they had on the territory.

Since Bridas could not enjoy any particular leverage to influence the situation, the company asked for an intercession by Pakistan. In 1992 the country had ordered to stop weaponry shipments to the mujahidin, and to close military training camps. The following year Pakistan elected Benazir Bhutto as president: she believed that the pipeline and the Bridas project could have served the purpose of furthering the "hegemonic" (post- ul-Haq) aims of her country in the region, and gave strong support to the initiative. Bhutto initiated a vigorous diplomatic initiative to gain support by central and local Afghani leaders, from Herat to Kabul, and also invited representatives from the West to take part to diplomatic missions to Afghanistan.

On October 29, 1994, a column of thirty trucks loaded with medicines and food supplies left Pakistan to reach Turkmenistan, with the intention to transit through Afghanistan. The column was protected by two ISI officers and an armed group of students calling themselves "Talibans". The Talibans were a new political and military force originating from Sunni schools in North-West Pakistan. Among their declared intent there was that of overtaking Afghanistan and convert it into a fundamentalist country. As the trucks column was entering Afghanistan, the Taliban were declaring to have occupied five provinces out of the total thirty of the country¹⁷¹. When the trucks were close to Kandahar, they were sequestered by the militias of a local warlord and were later freed by other Taliban led by a rising leader, Mullah Omar.

Through the Pakistani intercession, in 1995 Bulgheroni was able to close a deal with the Afghani government for a 1,400 km pipeline. At first, the Taliban presence was actually regarded with optimism by Pakistan and other Mideast countries because, for better or for worse, the students were able to provide some basic order to semi-anarchical areas in Afghanistan – creating also the necessary conditions of stability to develop the sensible Bridas infrastructure. Also Saudi Arabia, and specifically Prince Turki, had a deep interest in the Taliban option, mostly due to the fact that the Taliban could represent a strong Sunni presidium on the Shiite influence of Iran, between the Caspian and the Persian Gulf. Not by chance, Iranian president Ali Akbar Rafsanjani had already made clear to Benazir Bhutto that the Taliban were a dangerous group.

It seems that the Taliban rise was fostered by unofficial channels: Pakistan's ISI was in close contact with Turki's intelligence, and the students could enjoy access to financing, training and weaponry. In the same period, Bridas was progressively excluded from the project, and the U.S. company UNOCAL was favored: the contract ratifying the new choice was signed in October 1995. Unocal had the support of Turkmenistan, Pakistan, Afghanistan and also Uzbekistan to develop the

¹⁷⁰ Steve LeVine (2007), quot., p. 293

¹⁷¹ O'Balance, Edgar (2002), Afghan Wars: Battles in a Hostile Land. 1839 to the Present, Brassey's, p. 242

infrastructure. The outcome did not come by surprise: for all participants, it was more advisable to enjoy the diplomatic protection of the U.S., than Argentina. More specifically, Unocal could count on the effort of Assistant Secretary of State Robin Raphael, who had set up an efficient diplomatic campaign to support the initiative. Raphael also contacted a Saudi commercial partner, Delta Oil that deployed negotiations with Sunni leaders in the region. Delta Oil was connected to Prince Turki, and formed a consortium with Unocal called “CentGas”.

The activities of Unocal in Afghanistan had to be suspended in 1998, due to the changed perception of the U.S. public opinion towards the Taliban. Evidence of implication in some terrorist actions (including the attacks on the U.S. embassies in Kenya and Tanzania) and media reports about brutality had revealed the true nature of the students – that by that time had conquered power in Afghanistan. On August 20, cruise missiles hit terrorist training camps in the country.

On the Russian side – at the time Yeltsin was still in power – the Afghani events were interpreted with concern and preoccupation due to the perceived inability to act. As the Taliban took over Kabul at the end of 1996, Russian Foreign Minister Andrej Kozjrev claimed that the students' success was “a threat to international peace, potentially capable of destabilizing the entire region¹⁷²”. Russian Defense Minister Igor Rodionov declared that the takeover was “a threat to Russian national security, as well as of that of the other CSI countries¹⁷³”. Moscow was convinced that the Taliban were aiming at using the Afghan platform to unify all the Islamic forces in the area, with the general intent of installing a new Sunni Pan-Islamist political subject in Central Asia. The period that followed was quite peculiar: reports claimed that Moscow was financing and supplying the mujahidin forces of Massood, a military leader that in the Eighties had fought against the Red Army. It seems that the Russian leadership feared the U.S. support for the Taliban, and believed it was an attempt to push Russia out of Central Asia¹⁷⁴.

It was later learned that also the U.S. at first adopted a policy of “benign neglect” towards the Taliban, who could already profit from outright support by Pakistan and the Saudi intelligence. With September 11, 2001, the goals of Russia and the U.S. in the region partially converged: the threat of international terrorism from Afghanistan called for cooperation, in exchange for a harder U.S. stance on the Chechen resistance. The White House openly recognized that the Chechen government had contacts with international terrorism, and asked for the ties to be severed¹⁷⁵. Moreover, the threat to global security imposed an order to the region: Russia could freely act on the Western Islamic border of the Caspian, along Chechnya; and the U.S. could intervene in Afghanistan. The Republics of Uzbekistan and Kyrgyzstan allowed the installation of U.S. bases on their territory.

The parallelisms between Russia and the U.S. in terms of antiterrorism strategy did not lead to any sort broader understanding about the strategy to be adopted in the Middle East. The first significant occasion of dispute was represented by the American decision to intervene in Iraq after 9/11. In addition to the military reasons for the intervention, Washington was aware that Russia had around fifty oil agreements (closed or under negotiation) in place with Iraq – thus, the interest of Moscow was that few or nothing would change in the power structure of Baghdad. Moreover, the Russian oil company Lukoil as recently as 1997 had closed a deal for the development of a field called “West Qurna”, with an estimate of 40 billion barrels of reserves. As evidenced by a Congress report

¹⁷² RIA Novosti Agency of September 27, 1996

¹⁷³ Vv. Aa. (1998), Afghanistan and Asian Stability, Gyan Publishing House, p. 72

¹⁷⁴ Ibidem

¹⁷⁵ White House spokesperson Ari Fleischer on September 26, 2001, at: <http://georgewbush-whitehouse.archives.gov/news/briefings/20010326.html>

of 2003, "In general, Russia seeks to obtain repayment of Iraq's \$7.6 billion in debt to Moscow and possibly to earn funds selling arms to Iraq if such sanctions are eventually lifted"¹⁷⁶"

The Bush administration also spent some efforts to introduce some sort industrial integration between U.S. and Russian companies, with the intent to create some common business goals to be pursued in Iraq, and to demonstrate that the intent of the 2003 intervention was not to exclude Moscow from the country. In 2004 U.S. oil company ConocoPhillips acquired a stake in Lukoil for initial 7.6%, later increasing up to 20%, with the intent to jointly develop a portion of the West Qurna field¹⁷⁷. The U.S. also assured that the Iraqi debt to Russia would have been repaid also in case of regime change¹⁷⁸. Putin rejected the offer claiming that "war could throw the Islamic world into turmoil" and that "a crisis of this kind should be solved by exclusively peaceful means"¹⁷⁹".

By the beginning of 2004, it became also clear the U.S. had the intention to retain its permanent military presence in Uzbekistan and Kyrgyzstan. Contemporarily, U.S. and other western diplomacies (together with NGOs such as Open Society of George Soros, Freedom House and the National Endowment for Democracy¹⁸⁰) pushed for a government change in Ukraine, favoring the invalidation of elections that had brought to power a candidate aligned with Russia, Viktor Janukovic. The West actively sustained the aggregation of a popular protest nicknamed "Orange Revolution", which contested the regularity of the election and supported a pro-Western candidate, Viktor Jushchenko. A new electoral round assigned the presidential seat to him.

The political loss of Ukraine hit one of the two poles of the Russian foreign policy strategy: the "energy connection" between Central Asia and Eastern Europe, as gas from Turkmenistan and hydrocarbons from the Caspian would flow through Russian territory, to Ukraine and finally to the consuming markets. Contemporarily, NATO was further advancing East, and after the 1999 entrance of Poland, Hungary and the Czech Republic in the organization, on March 29, 2004, seven other former socialist countries joined in: Lithuania, Latvia, Estonia, Slovenia, Slovakia, Bulgaria and Romania. Few months later – in May 2005 – the first oil was pumped into the just completed Baku-Ceyhan pipeline in Baku.

These years were anyhow the last ones of "Russian retreat". Profiting from a rapidly increasing oil price (with a positive trend started in 2003), the condition of Moscow's public finances changed. Moreover, Putin's strong hand had assured that all the largest private companies started paying taxes. In February 2005 the Russian state was able to repay an IMF loan of 22 billion USD. At the beginning of Putin's first mandate, Russia had debts for some 96% of the GDP; in 2006 the percentage had lowered to 10%¹⁸¹. Also the internal structure of the federation was further revised: the presidents of the 83 federal subjects were not elected anymore, but nominated by Moscow – and electors would enjoy the mere faculty of approving or disapproving of the candidate. The mechanism for parliamentary elections was changed to party lists with proportional system, with a threshold increased from 4 to 7 percent.

¹⁷⁶ Report for Congress of April 16, 2003, Iraq: Oil-For-Food Program, International Sanctions, and Illicit Trade, Order Code RL30472, p. 15. The same report lists the information about Russia-Iraq relations in the period when the conflict broke out.

¹⁷⁷ Middle East Economic Survey, VOL. XLVII, N. 41, Lukoil Seeks West Qurna Development/ Iraq Debt Deal 11-October-2004

¹⁷⁸ The New York Times of March 1, 2003, Putin Again Rejects U.S. Calls for Support of a War, Fearing Effect on the Mideast

¹⁷⁹ Ibidem

¹⁸⁰ Le Monde Diplomatique, Atlas der Globalisierung 2006, p. 59

¹⁸¹ IMF Website, Press release 05/19 of February 2, 2005, Russian Federation Completes Early Repayment of Entire Outstanding Obligations to the IMF

Putin had therefore succeeded at restructuring Russia's finances and at recentralizing the rule of the central state. This fact, completed by other initiative such as a return of permanent flight patrols above the country, signaled that a new border between Russia and the West, in Europe and in the Middle East, had been reestablished: the West could not advance farther East or farther North. It seemed that from that moment any possible change in the diplomatic or military presence of Russia and the U.S. in Central Asia and Europe was prevented. Georgia never managed to really free itself from Russian influence, and his process for NATO accession was blocked. Russia did not comply with a 1999 OECD agreement ordering to recall troops from Georgia and Moldova, and – by 2017 – to terminate its presence in the naval base of Odessa in Ukraine. Also the “Agreement on Adaptation of the Treaty on Conventional Armed Forces in Europe (CFE-II)” was suspended by the Russians. Moscow also lobbied (with success) in Uzbekistan to have the government inviting the U.S. army to leave the country (it had to abandon the base of Karsi-Khanabad, at U.S.’ disposal since the first U.S. operations in Afghanistan). Uzbekistan ordered also all foreign NGOs to leave the country.

Between 1991 and 1994 the Soviet Union went through a process of pulverization that had been predicted forty years earlier by Zbigniew Brzezinski in his Master thesis at McGill University: the Soviet empire was coercing different national entities to live together, and as the central rule started to lose power, the collapse succeeded. Such disintegration had not meant anyhow the end of the Russian political subject, but the mere failure of a strategy, focused on the physical occupation of territories – including the energy relevant ones – ordering it with socialist-statalist criteria and partially financed through oil rents. In the first 1990s, Russia was forced to transit to a more flexible economic system, better capable to allocate scarce resources.

As for the U.S. in the 1990s, the Clinton administration was well aware that Moscow would have risen again from its ashes, and the aim of his policies has never been that of “appeasing” Russia, but rather that of gaining as much territory as possible during the years of crisis – in order to enjoy a position of relative advantage later on. Washington recognized that the country had to be kept together, because an excessively weak Russia would have projected Eurasia into chaos; but contemporarily the U.S. managed to access some of the areas that had been building constituents of the Soviet Union: Poland, Ukraine, Georgia, Central Asia, and even Baku, with the successful completion of a pipeline (Naku-Ceyhan) that – in any case – was cutting out any portion of Russian territory. The IMF was lending funds to Russia, but contemporarily NATO was expanding East annexing former Soviet satellite States. Baku-Ceyhan exerted an fundamental consequence: it repolarized the political positions of all the new republics in the region, and reorganized the relationship of power between the U.S. and Russia – with the latter that then decisively took an energy autonomist path, with considerable fewer trust granted to Western counterparts. Also George W. Bush sought an agenda of geopolitical containment for Russia. The problem was that containment failed at assigning a role to Russia – and resurged Russia, then, refused to cooperate. The armed intervention in Georgia in 2008 evidenced without any shadow of doubt that Russia had reemerged.

3. Contemporary developments: shale gas, the Arab revolts, China

Keypoints

- This section describes how the new supply of shale gas and oil may shape the relationship of power between Russia and the U.S., and how such change may impact supply security for the West. The analysis is completed by an assessment of the impact of China on Mideast order and on the central Asian gas development.
- The impact of U.S. shale on global geopolitics is more “indirect” than commonly thought. On the technical side, gas is not a perfect substitute for oil; and gas is a “set of globally integrated local markets”, whereas oil is “a global market with local declinations”. On the political side, the Middle East traditionally played only a marginal role in the portfolio of the U.S. energy supply, and increased U.S. reserves may only partially alter the U.S. stance in the Middle East.
- Similarly to Russia in the Cold War, an “energy independent” U.S. will retain a deep strategic interest in the Mideast region. The priority of securing access to resources for their own market (or for the own sphere of influence) is as much important as preventing other powers from enjoying free access to resources. Leaving the Middle East for the benefit of new rising power would not be beneficial for the global U.S. prowess.
- As for Europe, the prospect of prolonged energy commodity price stagnation has altered the relationship with Russia, and led to a revision of all the initiatives aimed at connecting Russian resources to the West. Also contractual frameworks are undergoing a deep process of revision, radically altering the situation in comparison to the 2010s.
- China and its role in the energy game should be reconsidered, as the impact of Chinese demand on the global politics – especially in perspective terms – may be met with more limits than commonly thought. The potential of the energy connection with Russia is constrained by aspects of “geopolitical coexistence” on the Asian plateau. Also the rising influence of China in Africa, Central Asia and the Middle East has to face the competition of global and regional powers.

The impact of shale gas on global geopolitics

Shale gas in the United States is exerting significant impacts not only on North American energy, but also on the global context. The new injection of new natural gas resources has had dramatic consequences: the “Energy Information Administration” (“EIA”) forecasted that the U.S. may start exporting some quantities of gas per ship lane (“Liquefied Natural Gas”, or “LNG”) as early as 2016. Forecasts show that by 2021 the U.S. may even become net natural gas exporters, producing 720 bcm, and consuming 722¹⁸².

Moreover, also the U.S. oil sector is rapidly changing. Paris based “International Energy Agency” (“IEA”) stated in its “World Energy Outlook 2012” that the U.S. might become energy self-sufficient by 2035¹⁸³. This would not mean that the U.S. would cease importing oil, but rather that in terms of total accounting the exports in gas and coal would outplace barrel imports. Yet, also an actual increase in oil production is predicted: U.S. output may (briefly) pass that of Saudi Arabia by 2017, reaching 11.1 million barrels per day in 2020, compared to the Saudi’s 10.6. The positive balance in the energy account would be the result of new shale and oil new production combined, coupled up with ambitious energy saving plans, as IEA forecasts an U.S. oil consumption in 2035 of one-third less than 2011¹⁸⁴.

This data has been enough to inspire a new set of discussions and hopes about the energy future of the United States and all the energy consuming West. The increase in the adoption of techniques for shale gas drilling in the last years has been intense: “from virtually nothing in 2000 to over 10 billion cubic feet¹⁸⁵ per day in 2010, and it is expected to more than quadruple by 2040, reaching over 50 percent of Total U.S. natural gas production by the 2030s¹⁸⁶”. Together with its virtues in terms of availability, shale gas also offers the advantage of being often located in territories close to the areas of end users, making operations of transport and storage easier.

We may anticipate here that, in terms of political effects, contrarily to what is commonly thought the fact that the U.S. may be energy independent by 2035 does not mean that Washington would or should fully disengage from the Middle East. The area still accounts for a large stake of world reserves, and their extraction and use is fundamental for the world order. In a comparative historical perspective, Russia never needed Mideast reserves for its own use, but nevertheless Moscow always tried – and is still trying – to influence the political and strategic equilibrium of the region. The recent developments in the region seem to evidence how a border between the influence of great powers has already been established, representing the latest development in a struggle started with the 1946 Iranian crisis. A solution must necessarily come through a wider involvement of Europe, and possibly a better cooperation between the Old Continent and the United States.

But how can such new energy availability affect the dynamics of the energy sector at large? A paper by the conservative James A. Baker III Institute for Public Policy at Rice University stated in

¹⁸² DOE/EIA, Annual Energy Outlook 2012 – with projections to 2035, DOE/EIA-0383(2012), June 2012, p. 94.

Available at: [http://www.eia.gov/forecasts/aeo/pdf/0383\(2012\).pdf](http://www.eia.gov/forecasts/aeo/pdf/0383(2012).pdf)

¹⁸³ IEA, World Energy Outlook 2012, released on November 12, 2012, at <http://www.iea.org/W/bookshop/add.aspx?id=433%20>

¹⁸⁴ EIA data

¹⁸⁵ Or 283 bcm

¹⁸⁶ Medlock, Kenneth B.; Jaffe, Amy Myers & Hartley, Peter R. (2011), Shale Gas and U.S. National Security, James A. Baker III Institute for Public Policy, p. 10

2011 that “rising shale supplies have significantly reduced U.S. requirements for imported liquefied natural gas (LNG), which has already had geopolitical implications. For example, it has played a key role in Russia’s ability to wield an ‘energy weapon’ over its European customers by increasing alternative supplies to Europe in the form of LNG displaced from the U.S. market¹⁸⁷”. A closer look at the mechanism of correlation between U.S. shale gas availability and global energy situation may nevertheless suggest that the system is slightly more complex. First of all, the impact of shale gas should be kept closely separated from that of the new oil being tapped in North America. Moreover, the markets of oil and gas are completely different – although some sort of connection may still be detected, as we will review later.

First: the increased availability of shale gas has been offset by an increase in U.S. domestic demand

As shown in Figure 9, unconventional gas resources (tight gas, coal bed methane and shale gas) have made up for the decline in conventional gas production in the U.S. Yet, so far gas production has not been able to cover gas demand completely, notwithstanding the strong increase in production starting in 2006.

The gross need of the U.S. market has been constantly between around 800 to 1,000 MCF from 1990 to 2011¹⁸⁸. This has been due also to market reasons: U.S. natural gas production has been set to meet market needs. Moreover, the high prices up to 2008 stimulated investment, and low prices ever since favored consumption – and have been high enough to allow the return of investments, except for a short-timed glut in the first half of 2012. In this sense, the impact of U.S. shale gas on global energy flows shall be mostly interpreted in terms of “missed additional market” for LNG exporters. This means that if the U.S. had not had shale gas to tap, they would have resorted to other regions for their natural gas sourcing. This is indeed some sort of impact, but different than that “interrupting flows of LNG from abroad”. Simply, no new ones have been delivered from all over the globe to the U.S..

Of course, part of the increase in U.S. consumption can be explained by the “shale gas opportunity”. Until the shale gas boom, natural gas prices had been loosely indexed to oil prices, and followed the barrel quotation boom in the 2000s: the reference “Henry Hub” natural gas price in 2002 was 3.38 USD/MBtu, reaching 8.86 USD/MBtu in 2008. In the following year, prices had dropped to below 4 USD, stimulating consumption¹⁸⁹.

¹⁸⁷ Medlock, Kenneth B.; Jaffe, Amy Myers & Hartley, Peter R. (2011), Shale Gas and U.S. National Security, James A. Baker III Institute for Public Policy, p. 10

¹⁸⁸ We consider here “gross need”. The U.S. exports some volumes of gas to Canada and Mexico through pipeline, and minimal volumes to other countries through LNG. Therefore, the real need of gas (Demand – Domestic Production – Exports) would be a little larger.

¹⁸⁹ U.S. Energy Information Administration, Natural Gas Data, at:
<http://www.eia.gov/dnav/ng/hist/rngwhhdA.htm>

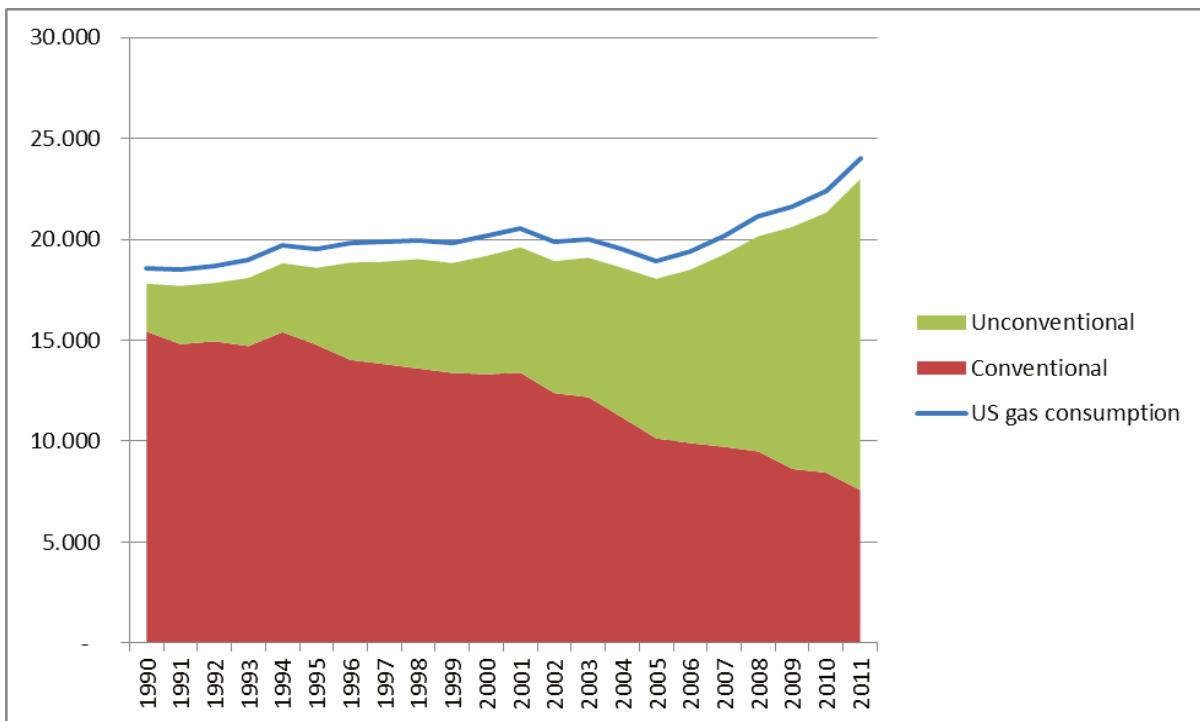


Figure 9 - U.S. consumption and dru natural gas production (in Bio CFT/Year). Source: EIA AEO 201
http://www.eia.gov/forecasts/aoe/er/executive_summary.cfm

Second: the main direct geopolitical impact of shale gas concerns Mexico and Canada

Common belief holds that higher degrees of natural gas independency could lead the U.S. to disengage from the Middle East and other troubled areas of the world, as there would be no more interest in foreign energy resources.

Yet, as for quantitative considerations, the U.S. is largely independent from the Middle East in terms of natural gas imports. Due to the impact of shale gas, the U.S. have already further reduced their dependence on imported volumes. In 2007, some 19% of the gas consumed in the U.S. came from abroad. By 2011, imports had dropped to 8% - the level of 1990. The spike of 2007 (see Figure 10) can be explained by the fact that consumers reduced consumption due to high prices, but the U.S. were forced to keep on importing natural gas volumes committed on long-term and rigid pipeline contracts¹⁹⁰.

¹⁹⁰ EIA data

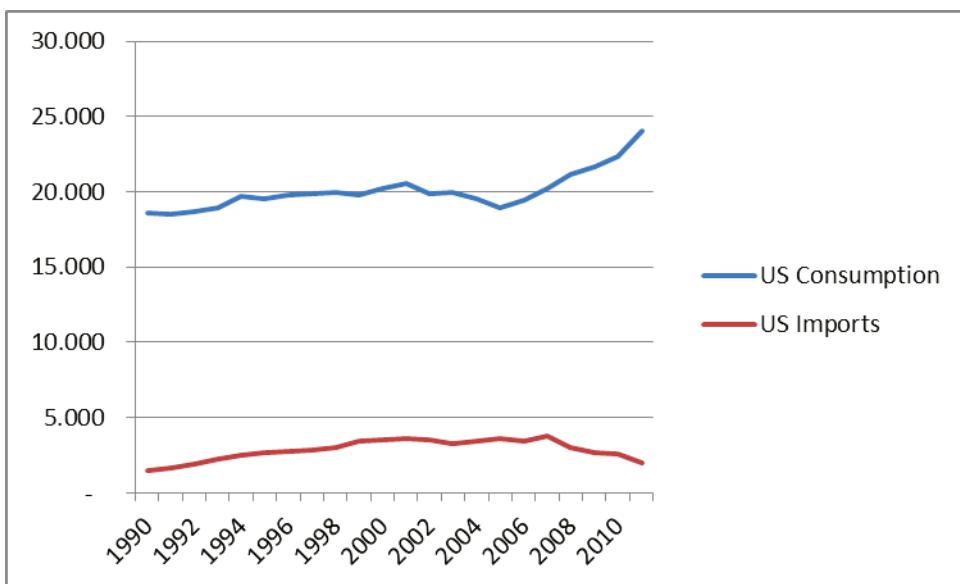


Figure 10 - U.S. dry natural gas consumption and imports in Bio CFT/Year. Source: EIA data

In terms of imports, the most important U.S. suppliers are Mexico and Canada, as shown in the Figure 11. The decline in U.S. imports has mostly affected these two countries, which deliver their gas through pipelines. The U.S. Energy Information administration claims that “rising shale gas production in the United States, especially in the Northeast, is the key among several factors affecting this trend¹⁹¹”. As such, the shale gas boom is most likely to concern Canada: the Annual Energy Outlook by the U.S. Department of Energy forecasts that the drop in Canadian exports to the U.S. from 2011 to 2035 could be 62%¹⁹².

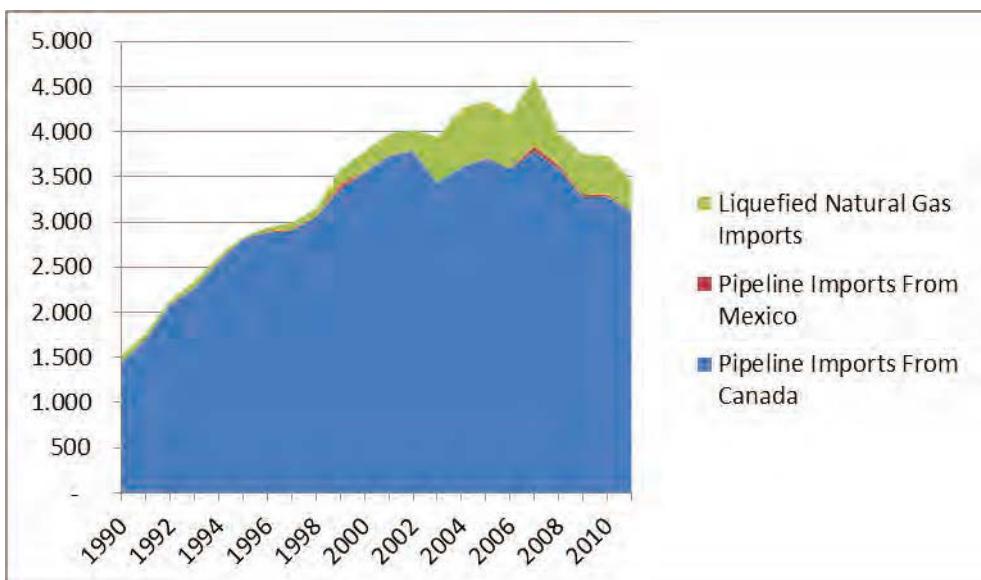


Figure 11 - U.S. natural gas imports by source in Bio CFT/year. Source: EIA data

Moreover, if we consider LNG volumes from the Middle East, such imports historically make up only for a tiny percentage of total U.S. natural gas consumption: it was 0.45% in 1990, entirely coming from Algeria, reaching a maximum of 0.95% in 2007. The following year supplies from Algeria

¹⁹¹ U.S. Energy Information Administration, Canada Week: Natural gas net imports from Canada continue to decline, November 30, 2012, at: <http://www.eia.gov/todayinenergy/detail.cfm?id=8990>

were cut, and the ME dependence dropped again to 0,26% (also due to stagnating LNG demand because of the economic crisis).

Third: natural gas autarchy does not end the importance of imports

So far we have been dealing with the concept of “gross need forma abroad”, intended as the total balance of exports and imports – that may present a surplus for the U.S. in the future. Yet, given that natural gas is difficult and expensive to transport also on land (pipelines and pressurized tanks are needed), it is still possible that – notwithstanding the presence of on-shore reserves – some coastal areas may still remain better and more conveniently served by LNG from abroad. Therefore, the concept of “gross need” differs from that of “imports”. If gas accounting signals a general situation of independence, it will not exclude the fact that some gas may still be imported to basins that are not connected to domestic reserves, or where LNG gas a cheaper solution compared to a pipeline connection to domestic reserves.

New technologies have also exerted an effect in the oil sector: together with a “shale gas revolution”, also a “new oil revolution” has taken place in North America. The most known evolution has been that of “tar sands” mostly located in the province of Alberta, in Canada; but also U.S. domestic production increased at a dramatic pace. As mentioned in the introduction of this chapter, the International Energy Agency forecasted that by 2020 the U.S. will become the top oil producer in the world, even above Saudi Arabia¹⁹³. The new technologies concern all the aspects of the extractive industrial chain, ranging from better simulation models for geophysics to detect basins, and drilling techniques that allow recovering more oil from certain formations.

The U.S. oil boom is a building component to reach that “energy independence” forecasted by IEA for 2035, and it seems that the U.S. oil sector has already started moving in such direction, as imports have already been decreasing: the U.S. imported 13,5 mbpd in 2007, and 10,6 in 2012; the rest was covered by domestic production. Yet, the decrease in imports mostly reflected lagging consumption: since the crisis, U.S. oil demand has been decreasing: from 20,7 mbpd in 2007, to 18,6 mbpd¹⁹⁴.

The decrease in consumption is not exclusively a product of the economic downturn: in the last decade, upon economic stagnation or recession oil consumption decreased at a higher phase; and in recovery years the increase in U.S. oil consumption has been lower than the economic expansion, as shown in Figure 12.

¹⁹² U.S. Energy Information Administration, Annual Energy Outlook 2012 – with projections to 2035, DOE/EIA-0383(2012), June 2012, p. 62

¹⁹³ Reuters of November 12, 2012, U.S. to overtake Saudi as top oil producer: IEA

¹⁹⁴ EIA data 2013

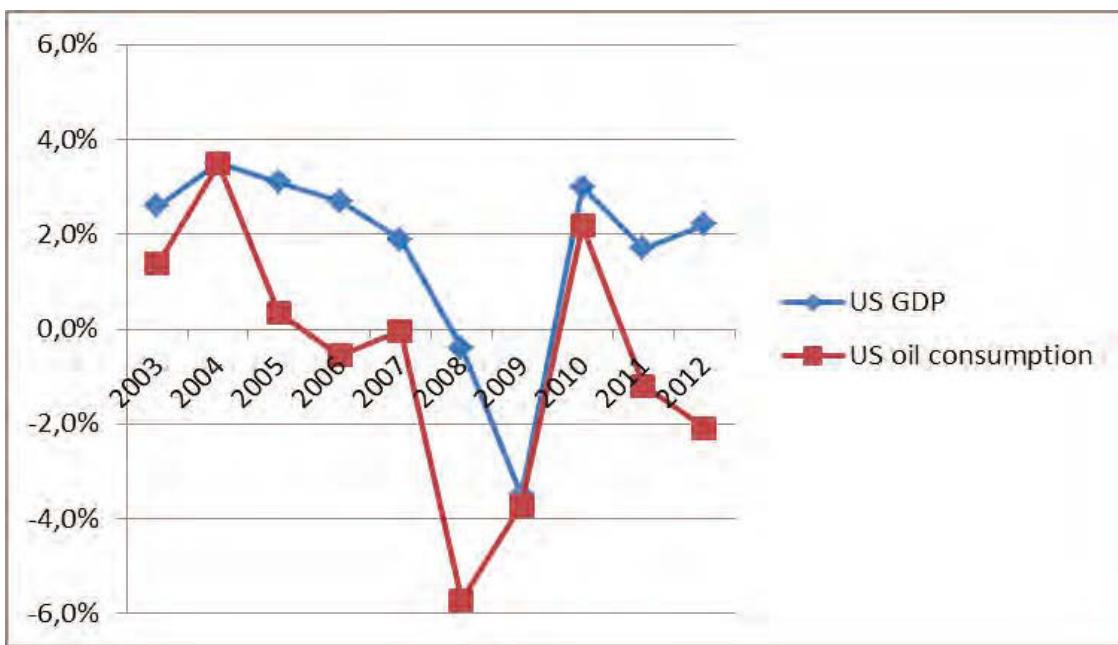


Figure 12 - Yearly U.S. GDP and oil consumption growth/decrease. Source: World Bank and EIA data

The decrease in oil consumption is also due to the impact of shale gas: although gas and oil are not perfect substitutes, a partial substitution is possible – for example in automotive traction or heating. If we compare the situation of oil with that of gas, we can see how a general decrease in oil consumption has been made up for by increased gas consumption; and in both the oil and gas sectors domestic reserves limited or even reduced the relevance of imports.

In the oil sector, the importance of domestic production had been evidenced by the pricing difference in the oil blend marketed in the U.S. (the WTI) and the European blend (Brent – also used to price part of the oil from the Middle East and Africa). Until 2008, WTI used to be (a little) more expensive than Brent.

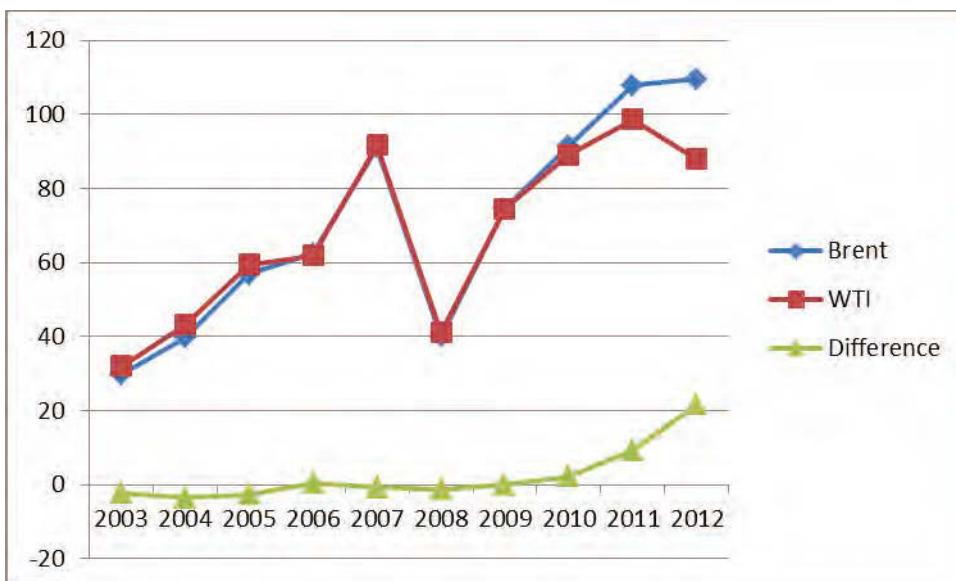


Figure 13 – Quotation of Brent and WTI oil blends. Source: EIA data

The difference disappears in 2009, and then the Brent becomes consistently more expensive, along with the increase in U.S. oil and shale production. This means that the existing bottlenecks in

the distribution of oil – including eventual transportation costs dividing the Eurasian platform and North America – generated the difference, as production in the U.S. soared.

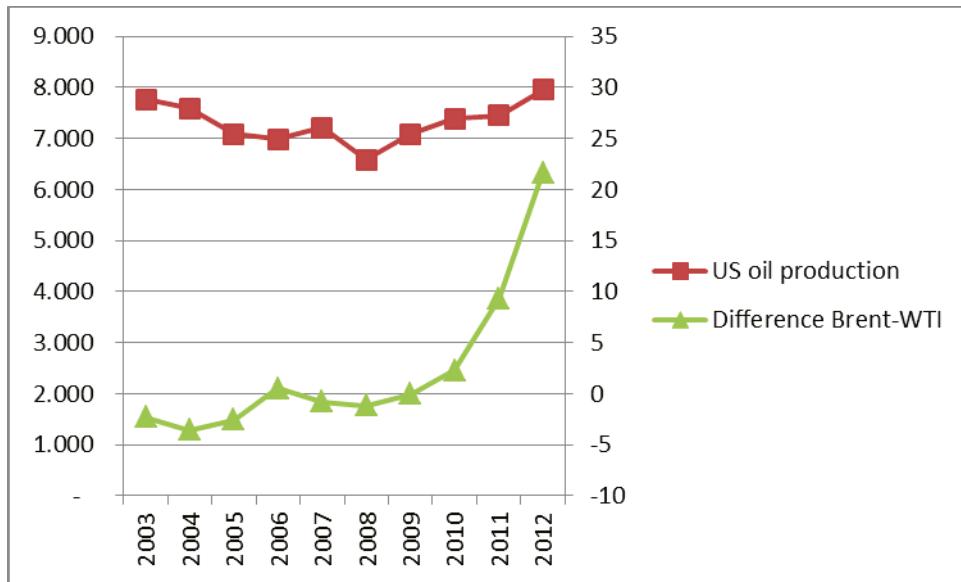


Figure 14 - U.S. oil production and price difference Brent-WTI. Source: EIA data

In general terms, oil prices around the world are more likely to be similar than those of gas in different markets, since oil is more easy to transport and trade than gas; moreover, gas sale often relies on more complex and long term contract structures, that make prices more rigid and geographically different (depending how areas are served by infrastructures, that are bind to peculiar contracts). If also oil, a more “global” commodity, resents from regional price differences, this reinforces the case that also gas, a more “local” commodity, is far from relying on a globally integrated system. We may therefore infer that oil is a “global commodity with local differences”, whereas gas is a “local commodity with global connections”. We have reviewed how “local” U.S. shale gas exerts mediated effect on the international system. In comparison, the impact on the globe due to oil is more pervasive than that of gas, not least because the U.S. directly imports barrels from the Middle East and Africa.

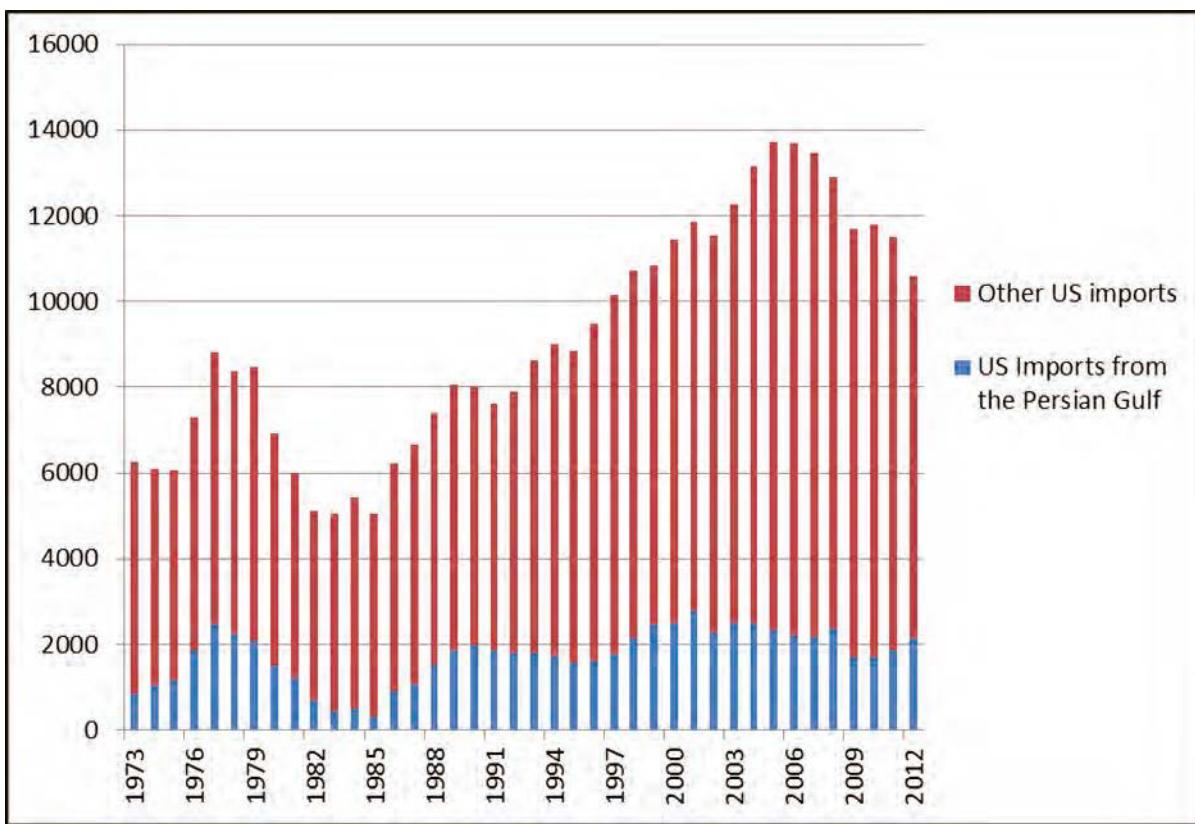


Figure 15 - U.S. oil imports from the Persian Gulf and other imports in mbpd. Source: EIA data

Notwithstanding the growing oil imports in absolute terms from 1985 to 2005, in relative terms U.S. oil imports represented a decreasing percentage of U.S. total oil consumption, touching 24,5% of total imports in 1990, and an average of 18,8% in the period to 2012, with the lowest point at 14,4% in 2009 – despite a U.S. oil consumption that increased until the 2000s, as shown by Figure 16.

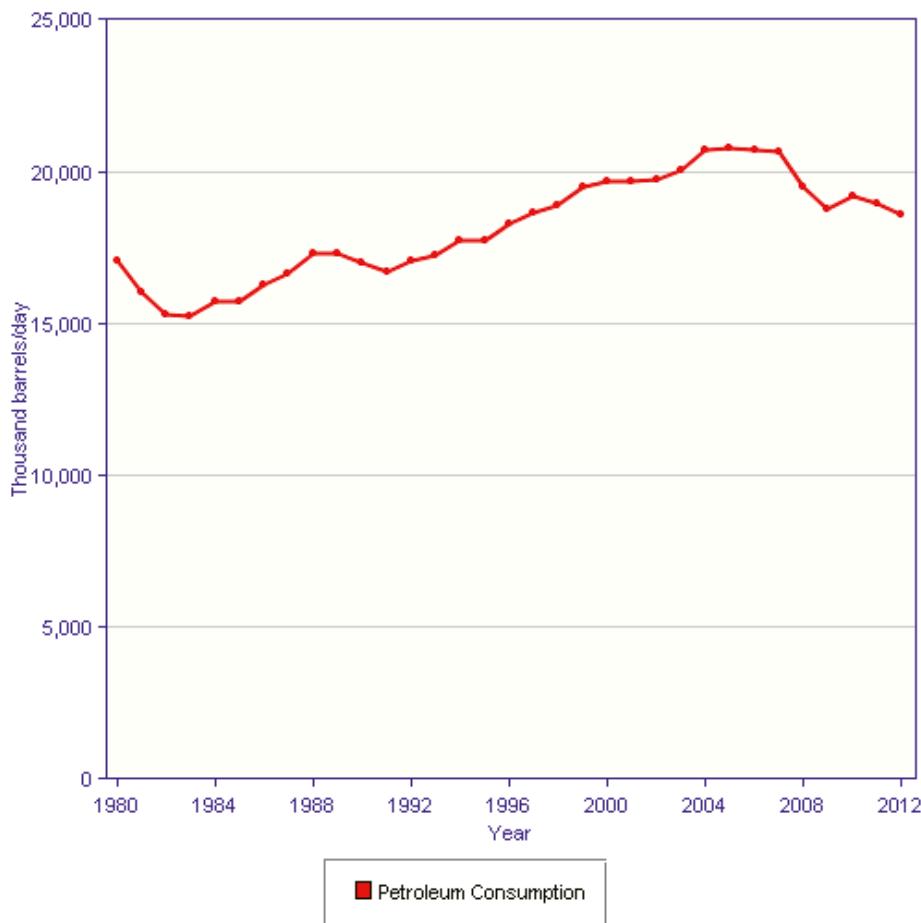


Figure 16 - U.S. oil consumption in mbpd. Figure presented by EIA at:
http://www.eia.gov/countries/img/charts_png/U.S._petcon_img.png

The additional need for oil was covered by domestic production and increased supply by neighboring countries such as Canada (from 1.033 mbpd in 1990, to 2.955 in 2012) and Mexico (from 755 mpbd in 1990, to a record 1.705 in 2006, decreasing to 1.031 in 2012)¹⁹⁵.

Such elements allow a reconsideration of the geopolitical dimension of the oil relationship between the U.S. and the Middle East. Michael E. Cohen on Foreign Policy recently recognized that all the discussion about a “U.S. decline” is mostly focused on the “relative power” of the country, concerning the presence of any “existential threat” or “foreign power” able to challenge the U.S. supremacy. Yet, Cohen believes, a more accurate measure of U.S. power should also consider domestic factors, including the competitiveness of its economic system¹⁹⁶. On this extent, it seems that the variable of shale gas and new oil extraction technologies entered U.S. and global politics at the most sensible moment possible. By providing precious help to the U.S. economy – granting available, controllable, job-creating and relatively cheaper energy resources – shale gas and new oil extraction may help solve exactly those problems Cohen refers to.

¹⁹⁵ EIA data

¹⁹⁶ Foreign Policy of February 21, 2012, Rotting from the Inside Out, at:
http://www.foreignpolicy.com/articles/2012/02/21/rotting_from_the_inside_out?page=full

Shale gas and the U.S. interest in the Middle East

Global prowess is the product of domestic power, which determines the reach of a country's international policy; and of domestic interest, that shapes it. The benefit of shale gas seems to have, at least, "limited the decay" of the U.S. (for those who believe in a scenario of U.S. decay – the author does not): reducing energy imports may help contain the national trade deficit, and creating jobs at home may reduce social spending and increase tax revenue. Yet, how does the U.S. international interest change in response to the presence of new domestic resources? If we are to believe in EIA's forecast (that of an energy independent U.S. by 2030) what would be the new goal of the U.S. in a key resource producing region such as the Middle East? The U.S. investment in the region has been significant ever since the end of WWII, with renewed effort in the latest years.

In particular, the U.S. financial effort in the Middle East has been very large. In constant USD (2010), the "Foreign Assistance Act" between 1962 and 2010 committed to support Middle East and North African countries with an estimated 4,936.9 million USD, equal to almost one third of the current U.S. national debt¹⁹⁷. If we consider only 2010, then, among the first top fifteen countries benefitting from U.S. Economic and Military assistance, seven are located in the "Greater Middle East" – plus Sudan and Ethiopia, which also play important roles in the political dynamics of the area.

Yet, first and foremost, the Middle East already represents a "secondary source" for the U.S. oil imports, with a percentage normally below 20% of total imports (and a minor share of total U.S. consumption, at around 10%), as shown in Figure 15. Moreover, increases in demand have been satisfied through sources other than those located in the Persian Gulf, and an active "energy collaboration" between Canada, Mexico and the U.S. has been put in place. An eventual, additional increase in U.S. oil production would therefore not lead (or, at least, shall not lead) to an abrupt lack of interest of the U.S. in the Middle East. As evidenced by Figure 15, when the Reagan administration could enjoy the results of the new energy saving and non-OPEC resource production plans, most of the burden for the decrease in demand had to be suffered by a reduction of exports from Persian Gulf countries to the U.S.. This change anyhow did not lead to any sort of U.S. disinterest for the region, and even inspired the Soviet Union to ignite a war in Afghanistan against the mujahidin – and the U.S. covert reaction with the supply of weaponry through the Pakistani intelligence.

On some extent, the U.S. was well aware by that time that the 1986 boon was not due to last forever, and that sooner or later the U.S. would have started consuming resources again. Moreover, the reason for the presence in a resource-rich region derives from "imperial" logics of power: gaining access to resources is as much important as preventing adversaries from doing the same. In a context of fragmented supremacy, the idea that a resource-independent U.S. could allow free movement to new powers in the Middle East is unthinkable. Basically, also the Soviet Union acted in the same way in post-WWII history: although Russia was energy independent, it always sought access to the Gulf.

In terms of supply security, a Middle East with a "political order" is also a Middle East capable of providing a secure supply of resources to consumer states. There seems to be a relation between Mideast stability and low energy prices, and interestingly the biggest achievements in the pacification of the region have been reached during periods of low barrel prices. History shows that the Camp David Accord of 1978 and the Oslo Accords of 1993 have been reached in periods of oil price stagnation.

¹⁹⁷ Based on USAid Data, Standard Country Report, Middle East & North Africa (not specified), consulted on January 30, 2013, at <http://gbk.eads.usaidallnet.gov/>

This is due to both the regional and international decrease in oil price rents, which seems to affect the building of nationalist and military sentiments. At a local level, higher energy prices fuel can exert a destabilizing influence due to the promotion of military agendas by dictatorships, by economic problem caused by ill-directed management of rents, and by the increase of opportunity costs for rebellion¹⁹⁸. It is possible that nationalist sentiment propelled by oil rents may generate trans-national conflicts, as happened for the Iran-Iraq war started in the early 1980s. At an international level, oil rents may finance the reach of regional and great powers on the Israeli-Palestinian conflict, destabilizing the region. In particular, the ties proven between Iran, the Shiite crescent and the armed groups in Southern Lebanon and in Gaza demonstrate how the regime of Teheran, stabilized by oil rents, may be capable to influence the (dis)order in the region¹⁹⁹.

Lower oil prices, therefore, seem to act as “pacifiers” in the Mideast context. In particular, the 1986 price slump influenced the Soviet retreat from Afghanistan, and also the end of the Iran-Iraq conflict. The 1991 Iraqi led invasion of Kuwait was related to the dire status of Iraqi finances after the long conflict with Iran, and possibly proves an “exception” to this rule, but it cannot be denied that the dictatorial and aggressive path taken by Iraq’s dictator Saddam Hussein was due to years of oil rents boom. After 1986 for some fifteen years the influence of Arab countries was undeniably lower than before the price glut. Most notably, by the end of the 1990s Israel and many Islamic countries had managed to open diplomatic and commercial relationships, even with the opening of a commercial outpost in Oman. Most relations were severed in the 2000s.

On this extent, the effect of non-OPEC oil production passing the OPEC production had a devastating impact on the reach of the petroleum cartel. Is this again the case, with the influence of fracking and non-conventional oil? Some dynamics are similar. Oil production in the central U.S. states has increased so much (or is forecasted to increase), that some commenters gave the region the name of “Saudi America”²⁰⁰. Analogously to 1986, OPEC by the end of 2012 had already started reducing production, be it for issues of demand or physical availability: “A Dow Jones Newswire survey in October 2012 revealed that OPEC production had actually fallen to 31.32 mbpd, and by January 2013 was down to 30.34mbpd. While the Energy Information Administration (EIA) expects production to rise in the coming year, it anticipates the level will remain below that reported in 2011 and well below the high of 2002²⁰¹”.

Similarly to 1986, such decrease in oil prices has not been intended by the U.S. as a means of containing disorder in the region: The most urgent reason pertained the need to increase domestic supply security. If anything, increasing the share of oil produced domestically increases the opportunity to militarily intervene in the Middle East, exactly for the reason that the U.S. would not need the oil whose flow would be interrupted by military operations. We may consider what happened in 1991 with operation Desert Storm: the intervention did not cause excessive or prolonged price increases, and did not hamper U.S. growth for the rest of the 1990s.

In terms of contemporary likeability of military operations in the Middle East, an impellent question is that of the Iranian nuclear agenda. Decreasing oil prices may help lower tensions. Differently than 1986, we shall not consider here just the mere element of oil price – that still is quite

¹⁹⁸ See COLLIER, Paul & Hoeffler, Anke (2000), Greed and Grievance in Civil War, The World Bank Policy Research Working Paper 2355

¹⁹⁹ See Casertano, Stefano (2012), Gaza 2012: La Battaglia d’Israele, GoWare

²⁰⁰ See, among others, The Wall Street Journal of November 14, 2012, Saudi America, at: <http://online.wsj.com/article/SB10001424127887323894704578114591174453074.html>

²⁰¹ The Commentator of April 24, 2013, OPEC fracked, at: http://www.thecommentator.com/article/3339/opec_fracked

high compared to historical series – but the general impact of alternate energy resources, such as shale gas, bioethanol and renewable resources. On this extent, the quotation of oil barrel is still very low relatively to the general situation of the region. Notwithstanding civil wars in Libya and Syria, and uprisings involving important hydrocarbons producing countries such as Saudi Arabia, Bahrain and Iran, Brent prices never reached the level of July 2008 at above 140 USD, and by April 2013 prices had slipped below 100 USD. The long-planned agenda of energetic differentiation both limited rents for Iran, and prevented oil price from skyrocketing when rebellions exploded.

Additionally, the creation of alternatives to Iranian oil poses a direct threat to the Teheran regime, because it makes military options feasible. Moreover, the possibility of an interruption of flow from Iran would directly impact its usual oil purchasers – such as China, which is the buyer of some 22% of Iran's oil. For this reason, as the UN started considering the new set of sanctions between 2008 and 2012, most portion of the negotiations involved convincing China to join the imposition.

For what concerns Russia, the movements of Moscow in the region also signal the possible success of the new U.S. strategy. As in the previous decades, also in the 2010s Russia has no direct interest in the oil of the Middle East, but still believes that retaining influence in the Middle East is a building element for its world power. Russia has taken a precise stance. Sectarian fights between different Islamic confessions (mostly Sunni and Shia) developed in the Middle East alongside the "Arab Revolts", and Russia sidelined with the Shia population. The Sunni component of the Mideast World, as Saudi Arabia, Jordan, Egypt, and a large portion of the Maghreb, enjoys continuous support from the U.S.²⁰². The Russian backing of Iran's civil nuclear program (until recently), as well as weaponry supply to countries in the region of Shia leadership, belongs to a political pattern that connects Moscow, with Teheran, Syria, Southern Lebanon and Gaza, due to different intents. Among them, there is the goal of preserving a navy base on the Mediterranean, on the Syrian coast of Tartus; and the goal of influencing the Peace Process between Israel and Palestine.

Contemporary Russia in the Middle East is chasing a double-fold geopolitical goal that is quite reminiscent of Soviet Times, of "indirect" and a "direct" kind. The "indirect" kind concerns the possibility of affecting the political reach of competing powers. In this case, as gas is not a perfect substitute for gas, for Russia is still important to set limits to the freedom of operation of oil consuming countries. This directive is not aimed exclusively to the West, but is meant also to keep an eye on China (see also the last chapter of this part). Russia is actively supplying Beijing with resources, but containing the political freedom of China in territories of alternative supply allows Russia to enjoy a potential market advantage. Moreover, on a larger extent it is still possible that unexpected disruption in supplies from territories outside of the Middle East will make the region again more central in the global energy system – and in this sense Russia's moves represent a "geopolitical investment" that may pay out in the years to come. Russia seems to have learned the lesson that the "pendulum" of energy supplies, following long-term economic and political fluctuations, may play at its advantage again – as the situation for Moscow looked grim in the late 1980s, and overly favorable in the 2000s.

As for "direct" goals, retaining control on the port of Tartus in Syria serves the purpose of being able to militarily patrol the Dardanelles Strait and the new frontier of carbon development between Cyprus and Israel. As for the first element, Tartus allows Russian vessels to deploy maintenance operations, refuel and replenish stocks without having to sail all the way back to the

²⁰² Of course, due to the uncertain outcome of post-revolutionary processes, the extent and dimension of the U.S. effort in government building has been varying – in all post-Arabist contexts.

Black Sea – especially considering that the Dardanelles is a clogged waterway, with ships having to wait even days before their turn to transit. Not by chance, already in 1945 one of the declared intent of Stalin while negotiating the conditions to end the Iranian Crisis was to have the Dardanelles under Soviet control. Moreover, in recent times a set of new gas discoveries in the waters of Israel and Cyprus ignited Russia's interest for the Mediterranean even further. Israeli waters may host enough gas to satisfy its domestic demand for fifty years – an amount corresponding to one-tenth of total Russia's reserves (or 3,500 bcm of gas). The discoveries may exert a fundamental impact on the local geostrategic assets: Israel may grow independent from Egypt's gas supplies, and may deliver gas to Jordan. A paper by the conservative "Jerusalem Center for Public Affairs" speculated that Israeli gas supplies may represent even a source of competition for Russia in the European and the Asian markets. From Eilat on the Red Sea a regasification terminal may allow Israel to export gas to the global markets – and such opportunity has been connected to the unprecedented decision by Iran to deploy naval exercises in the Red Sea. In particular, the paper claims that "an export structure operating directly from Eilat to markets in Asia would face a rising strategic problem: Iran's increasing naval presence in the Red Sea. This will require Israel to establish and expand a Red Sea fleet as well as a significant expansion in the size and capability of its Mediterranean fleet²⁰³".

Also in contemporary times resource-rich Russia is therefore still trying to retain a presence in the Middle East. The task has become more complicated than the past, in particular because some Muslim territories are not part of a unified federal entity with Russia (as it was the case of the Soviet Union). Those territories were not only rich in resources per se, but represented also the connection point between Moscow and all the areas in the South. Russia had necessarily to switch from an outright "territorial" strategy, with the operations in Afghanistan and the presence of military personnel in the region, to a "western" strategy made out of, commercial goals, as well as political and financial support.

The presence of China also has implications for the strategic game. China imports some 55% of its oil from the Persian Gulf, and is investing its profits in the region – including a 1.5 billion USD to finance the construction of a shrine in Algeria²⁰⁴. In the last years, China vetoed two resolutions against the Syrian leadership, and abstained at the vote for another one favoring the Libyan rebellion at the time of the civil war.

So far, China has been "free-riding" the military presence of the U.S. in the Middle East, but it still uncertain whether the presence of Beijing will act as an agent of stabilization. For certain we cannot expect China to exert the same influence as Russia did years ago- Russia was in no need of oil from the region, and was actually profiting from price hikes. If anything, Russia may still profit from destabilization, in order to counter the growing Chinese influence – especially due to the historical problems of coexistence on the Eurasian plateau. The relevance of the Middle East towards global order and the relationship of power between Russia, China and the US is still the central geopolitical question of the coming decades.

The future of the Middle East are now being determined by China, the U.S. and Russia.. The Arab revolts and the global economic uncertainties make the future of the region as unclear as ever before. The most urgent problem in the region – the Israeli-Palestinian peace process – currently enjoys very few chances of being revitalized. One element appears clear: the peace process will not be solved in Israel or Palestine, because the conflict is actually part of a larger confrontation that

²⁰³ Wurmser, David (2013), The Geopolitics of Israel's Offshore Gas Reserves, Jerusalem Center of Public Policy

²⁰⁴ Los Angeles Times of April 26, 2013, China's Middle East Footprint, at:

<http://www.latimes.com/news/opinion/commentary/la-oe-0426-schenker-china-middle-east-20130426,0,5765641.story>

involves local and global powers. Pretending to solve the conflict in Jerusalem is the strategic equivalent of solving the Berlin Wall tragedy as if it were a neighborhood quarrel.

The Berlin Wall fell because of events in Moscow, not Berlin. The Wall came down when the Soviet Union became unable to continue on with its economic system , and the centrifugal forces of political fragmentation became impossible to heal. In the Middle East today, energy interests loom heavily over politics. It would be too much to claim that energy is the defining and solely element driving Middle East relations since 1945 – or even before – yet; energy relations represent a key element. In this sense, any major event concerning regional politics included some aspect related to energy.

Even the Arab-Israeli confrontations (1956, 1967 and 1973) implied important energy aspects. Since the last conflict was fought, with high expenses in terms of human lives and military equipment, no large scale confrontation took place. This has been due to a set of concurrent developments, such as the change of political attitude since the 1967 Arab loss (and the failed 1973 conflict). Egypt played a key role: Fouad Ajami wrote – already in 1995 – that “Presumably victorious in October 1973 in the war against Israel, [Anwar Sadat] was yet judged a lesser figure than his predecessor [Gamal Abdel Nasser], who was defeated in 1967. But a certain measure of vindication has come Sadat’s way: he had broken with Arab radicalism, and the years were to show that Arab radicalism’s harvest had been ruin and bankruptcy. He had opted for peace with Israel; the Palestinians and other Arabs, so many of them shouting treason and betrayal, had followed in his footsteps. The crafty ruler, to his fingertips a wily man of the countryside with a peasant’s instinctive shrewdness and wisdom, was able to see before it was evident to others that the Soviet Union was no match for American power²⁰⁵”.

We may consider also the additional element of Israel having reached full military scale nuclear capability. The country’s nuclear program had been accelerated after the 1967 conflict. Recent speculation claim that the Israeli government was ready to choose the “Samson Option” in 1973 in case the country drew closer to losing the conflict – as premier Golda Meir talked about a “crazy idea” (sic) to counter Syrian and Egyptian attacks, even if military censorship still prevents from gaining full knowledge on the matter²⁰⁶.

If we consider these two political changes in the region – together with the general changed asset of power – it appears clear how the idea of “Israeli-Arab” conflict simply switched from outright military confrontation, to “diplomatic attrition warfare”, where the Palestinian issue is sacrificed to the realist goal of political interest. The confrontation has moved from the battlefields to the media, and has taken the shape of arms supplies to extremist factions in Gaza – and often in the West Bank – prompting a conservative reaction from the Israeli establishment (that also reacted with strong measures). The choice of deliberately empowering Hamas with means and finance to retain control of a population cannot be explained with the mere goal of political affinity, but responds to a political agenda that connects the radical Arab world, with Iran and Russia. The Israeli Wall, in the end, is not that much different from the Berlin Wall.

²⁰⁵ Ajami, Fouad (1995), The Sorrows of Egypt, Foreign Affairs Sep/Oct 1995, in The Arab Revolt, Council on Foreign Relations 2011, pos. 271

²⁰⁶ See Haaretz of October 7, 2010, Did Israel ever consider using nuclear weapons?; and Colby, Elbridge et al. (2013), The Israeli “Nuclear Alert” of 1973: Deterrence and Signaling in Crisis, CNA, DRM-2013-U-004480-Final April 2013

Shale gas and Europe's supply security

As shown by the historical development of Russia-European energy relations, the “political” goal of gas exports by Moscow has progressively lost importance. This tendency has been due to limits in the strategy itself: the eventuality that a country may change its political course in response of Moscow’s energy supply policy never materialized. At best, the transformation of Eastern Europe energy systems from coal to oil & gas power indeed made such economies more dependent on Soviet Union supplies – but the switch from coal was part of a broader transformation of European countries also in the West, as a component of new industrialization.

Energy interdependence became a dual-edged sword as Soviet satellite states experienced reductions in oil and gas supplies during periods of economic uncertainty, when Moscow chose to increase shipments to Western hard-cash endowed customers. This element also leads to a consideration of the second main cause for the decay of the “political” strategy or Russian oil: the emergence of the “commercial” strategy. Not only had socialist states in Europe become dependent on Russian oil and gas; also Russia had become partially dependent on its exports to Europe.

If historical experience defines the set of values that determine the course of action in international relations, we are led to believe that “political” oil exports are not a goal for the Russians, as commercial aspects have been favored at last, leading also to a persisting dependence of Moscow’s finances on exports. Nevertheless, the fact that the “political” strategy did not work so far does not provide a definitive answer to whether the Russians might believe it could work in the future.

Possibly, an answer to the question can be provided by considering additional elements besides the dichotomy between “commercial” and “political” goals in the strategic moves of Russia. Any strategic move may offer opportunities for increasing both income and political advantage. More specifically:

- Russia is still largely dependent on energy commodities, and must secure adequate flows of exports in order to sustain the financial burdens of the state, including the military.
- In order to secure the commercial prospects of any Russian approach in the energy industry, “political” goals are part and parcel of any commercial strategy

The latter point can be envisioned in various ways. In the most extreme version, Russia’s contemporary political identity cannot be separated from energy, therefore any commercial move is also a political move – and investing in a pipeline project, securing a transit and trade relation, has an intrinsic political value²⁰⁷. In other words, if an investment outside Russia is beneficial to the energy sector, it is beneficial to Russia’s politics, as politics is energy.

Yet, the total identification of energy and politics is not the only possible one. Strategic moves in the area of energy trading, and those that aim at leveraging energy to achieve political goals, can be sometimes identified, are not mutually exclusive, and could also be ordered as “progressive steps” in a strategy of “imperialist” expansion (at least as a model), in which energy trade sustains power abroad, and power abroad sustains energy trade.

This claim has been often confirmed by facts: at a first stage, every Russian infrastructural project has a commercial foundation. Yet, this does not exclude the fact that the complex of Russian

²⁰⁷ See Goldman, Marshall I. (2008), *Petrostate: Putin, Power, and the New Russia*,

energy export infrastructures is capable of granting other kinds of advantages, that some commentators have defined as “political” ones.

Post-ideological foreign policies are adopted if they “deliver domestic advantages” on the logic of national interest, ad advantages are defined as those benefits that may favor the existing power structure. In the case of Russia, the centralized state structure of power benefits from additional and secure commodity rents and for a reduced risk in the trade. The goal of additional rents can be achieved through the development of new pipelines, and in this case there is a continuum with the large energy projects of the twentieth century. As for risk mitigation, the goal calls for a tactic of “territorial control and coordination” in order to enjoy a stronger leverage to manage the sector. This “risk mitigation tactic” is actually what many commenters interpret as the “politically motivated” energy goal of Russia.

Yet in contemporary Russia it is not “energy” serving “imperialist goals”, but “imperialist goals” serving “energy”, as the interest of the state is towards the security of energy trade. At the time of Soviet foreign policy, “territorial” goals in Eastern Europe had a military foundation, and also an economic one: imperialist-territorial integration was needed to develop a state-centered system. As the world economy shifted towards global capitalism, post-1999 Russia gave up pursuing an old territorial means of economic integration with other countries, as it would represent just an ideological luxury with reduced actual advantages. The sense of new Russian territorialism only concerns Russian freedom to transport energy in the quantity and the price it wants.

This is not to imply that Russia’s control on the industry will be attainable only if Moscow achieves to complete its energy transportation network the way it has planned, with the capacities it wants, in order to finally be able to impose its political will on Europe also in sectors beyond energy. Such eventuality is just a “final stage” whose likeability is minimal, and surely does not drive Russia’s foreign policy. It is much more probable for Russia to be able to politically influence Europe if the country succeeds in strengthening economically through energy – and not if it attempts to “selectively choke” single countries if they do not obey informal political orders.

To this extent, it seemed that Russia in the early 2000s had good chances of achieving some degree of monopoly on gas deliveries to continental Europe, as:

- Forecasts suggested that local resources in Europe were set to decline, and some estimates calculated that Norway and the North Sea had reached peak production around 2001²⁰⁸
- Before the financial crisis of 2008, forecasts concerning European demand were very optimistic – ranging from 500 to 600 mtoe in 2015 in the EU-27
- Russia was well on its way toward fostering an agenda of prevention of the development of a wide set of “alternative routes” that could allow Caspian countries to export energy resources bypassing Russian territory. Additionally, some major extraction and transportation infrastructure in the region saw the involvement of Russian companies – as a means by Central Asian republics to solve diplomatic issues with the Kremlin
- Russian supplies to Europe were bundled to long-term and fixed-priced contracts, that could allow Russian companies a certain stability in terms of oil rents, and would prevent excessive losses in case of reduction in consumption (due to the so-called “take or pay” provisions)

²⁰⁸ See – among the others – Karasu, Scherzando (2009), Norwegian Oil and Gas: Managing Decline of a Sunset Industry, The International Resource Journal, June 2009

All that Russia had to do in order to exploit such an advantage was to further develop some major pipeline projects to Europe (most notably, Nord Stream and South Stream), to prevent the installation of some important pipelines outside of the Russian territory (like Nabucco), and try to secure some degree of coordination with key transit territories.

The advantages enjoyed by Russia were mostly of the “territorial” kind, and Western reactions were understandably of the same kind. Fearing the risk of Russia enjoying a de-facto monopoly in the gas market, an accurate tactic of political cooptation of former Soviet territories and satellite states was promoted by the West. The approach was mostly deployed through the enlargement of NATO to the East and the Western support to the so-called “Colour Revolutions” in Ukraine and Georgia²⁰⁹. Although the reason for the political upheavals of the period can be traced back to various political factors, considerations about pipelines tracks was also among the main motivation for the Western interest in political change.

On a more strict policy side, the EU priority was also to limit the reach of Russia’s Gazprom on the downstream distribution network of Europe. In particular, the liberalization of energy markets in Europe (and specifically the “Second Gas Directive” of the Commission of 2003, 2003/55/EC), provided an opportunity for Gazprom to expand its reach on domestic networks, through a system of controlled companies operating in gas trading and marketing, raising also some concerns in terms of antitrust²¹⁰. This decision to enter end-user gas markets has been meant to seize also the price margin relative to domestic networks. In September 2012, the European Commission initiated an antitrust investigation against Gazprom.

Another concern by the EU was represented by the recurring “energy crises” between Russia and its transit countries, and in particular Ukraine. The former Soviet Union country in the 2000s transported some 100 bcm of gas per year to Western Europe. In three different occasions (2005-6, 2007-8 and 2008-9), disagreements with Russia and outright supply problems led to discontinued service for final customers. The episodes made clear how Ukraine represented a technical and political “bottleneck” for gas deliveries to Europe, and presented EU policymakers with two main options. The first one was to foster the development of alternate pipeline routes and circumvent Ukraine, and the second was to accept a “restructuring” of Ukraine pipelines, in exchange of concessions to Russia.

Both solutions offered advantages and disadvantages. The idea of different delivery systems would have provided the most immediate technical solution to the bottleneck problem, and included the development of the “Nord Stream” pipeline (with a capacity of 30 bcm per year) and a “South Stream” in the southern corridor (with a capacity of up to 63 bcm per year). Nevertheless, a complete plan of the sort would have provided Russia with the material opportunity to exert a broader control on the gas market – together with the growing presence in the retail sector. In the most pessimistic vision, Russia would have enjoyed the chance to selectively switch on and off gas flow to countries, depending on political preferences.

The second solution that of “Ukrainian upgrade”, would have come at the cost of some sort of political exchange. Specifically, the independence of Ukrainian politics did not provide Russia with the necessary guarantees to engage in closer commercial relations with the country. A possible

²⁰⁹ See Sussman, Gerald & Krader, Sascha (2008), Template Revolutions: Marketing U.S. Regime Change in Eastern Europe, Westminster Papers in Communication and), Vol. 5(3): 91-112; and The Guardian of November 26, 2004, U.S. campaign behind the turmoil in Kiev; and

²¹⁰ Heinrich, Andreas (2008), Gazprom’s Expansion Strategy in Europe and the Liberalization of EU Energy Markets, Russian Analytical Digest 34/08; and Riley, Alan (2012), Commission v. Gazprom: The antitrust clash of the decade?, CEPS Policy Brief, n. 285, 31 October 2012

comparison could have been with the situation of Belarus, where the local dictatorship (as ranked by the “Polity IV” index, with a score of -7 since the late 1990s – with -10 being the worst possible score) offers Russia all the necessary guarantees for a cooperation, and no service interruptions have been reported. Belarus transports about a half of Russian oil flowing to Europe, and one quarter of the gas.

The West believed that the cost of a transition of Ukraine towards a Belarus model was not justified by the advantages in terms of the technical solution of the upgrade. As a matter of fact, the upgrade of the Ukrainian pipelines had an estimated cost of 6.5 billion USD, whereas South Stream’s investment is around 36.5 billion USD. The Western interest in the “Orange Revolution” was partially justified by the idea that political independence of Ukraine had to prevail, leading in the end to the success of a pro-independence candidate at the elections (Viktor Yushchenko) and a substantial stalemate in any further development either in Ukraine or in the Southern Corridor.

Faced with such situation, European policies at the time concentrated on three main directions: an alternative project to South Stream, called “Nabucco”; the installation of new LNG terminals on the European coasts, and the creation of “reverse flow” pipelines.

The original version of Nabucco envisaged a connection between the Turkish gas terminal of Erzurum, to Austria, feeding gas from Azerbaijan and Iran. The geopolitical uncertainties of the initiative were clear from the beginning, with the challenges of having Azerbaijan preferring a European initiative on a “Russian” one (as South Stream, also partially dependent on Azeri reserves) – not to mention the idea of getting gas from the Iranians. For this reasons, together with uncertainties about the budget (growing from an initial figure of 7 billion euro, to some 12-15 billion) led its abandonment. Former Clinton’s envoy in the Caucasus, Richard Morningstar, was appointed under Obama as “Special Envoy of the United States Secretary of State for Eurasian Energy”, and spent numerous efforts at monitoring the South Stream-Nabucco competition – favoring the latter.



Figure 17 - Planned South Stream and Nabucco pipelines

In terms of LNG, as of 2006 there were 12 plants under construction in Europe, and 39 additional proposed projects, for a total capacity of existing and under construction project of staggering 147 bcm per year²¹¹; by the end of the decade, the European capacity to convert LNG into gas had reached 179 bcm²¹² – compared to a total EU-27 demand of 490-500 bcm²¹³. The presence of new terminals allowed to differentiate from traditional suppliers, and was completed by upgrades

²¹¹ IEFE data, 2006

²¹² Natural Gas Europe of September 21, 2012, Liquefied Natural Gas Development in the EU

and installation of new pipelines from North Africa to Europe, including the capacity increase of the “Trans-Mediterranean Pipeline”, and the construction of the “Greenstream Pipeline” from Libya in 2004. Additionally, other projects were developed to service the Southern Corridor, such as the “turkey-Greece-Italy” pipeline and the “Trans-Adriatic-Pipeline”, all requiring an upgrade in Turkish infrastructure, and avoiding direct transit on the Russian territory.

Another action by the EU concerned the development of gas interconnections to curb any possible Russian effort to selectively switch off supply pipelines to the continent, and also to create delivery alternative in case any regular supply point – as an LNG terminal – may falter. The European Commission created also a “High level Group” to monitor projects of energy integration (including electricity), with a deep involvement of countries from Eastern Europe. In total, the “action plan” produced by the group in 2011 included 43 priority initiatives in the area of gas²¹⁴. Not by chance, the list did not include initiatives such as “Nord Stream” or “South Stream”, although the latter has a European section trailing through Bulgaria, Serbia, Hungary and Slovenia.

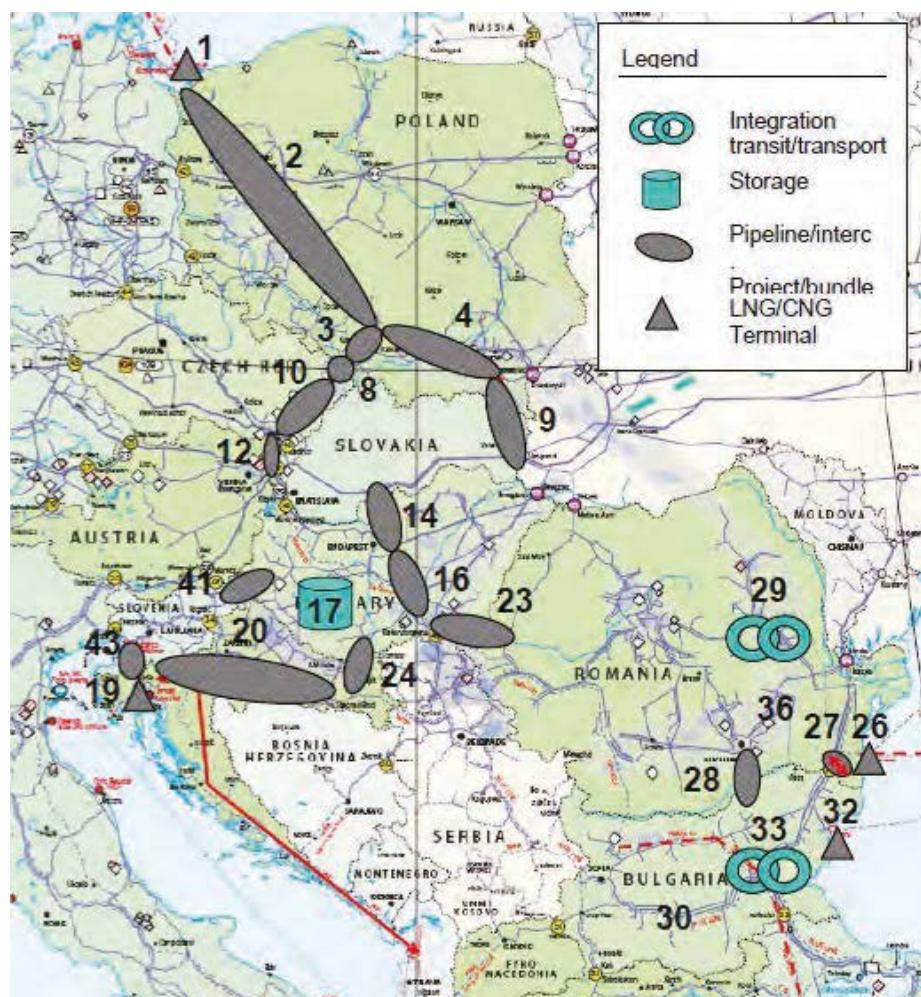


Figure 18 - Map outlining priority gas infrastructural projects in Europe as by the Action Plan for North-South Energy Interconnections by the "High Level Group" of the European Commission

It seemed therefore that the strategic game in terms of gas interconnections up to 2011 was has been broadly similar to the strategic asset of previous transatlantic diplomatic stalemates. In the

²¹³ Eurostat data referred to 2009-10

²¹⁴ European Commission “High level Group”, North-South Interconnections in Central-Eastern Europe, Action Plan, November 23, 2011

same way of the development of the “Druzhba” oil pipeline in the 1960s and the Urengoy gas pipeline in the 1980s, also Nord- and South Stream included an involvement of Germany and Italy, and has been feared by the U.S. as an attempt to make Europe overly dependent on Russian commodities.

Yet, again a new factor intervened in changing the context of the energy game, represented by a new oversupply of gas worldwide. The new availability of shale gas and oil in North America played some role in it, although the effect was indirect: the U.S. is not exporting (yet) LNG to the world, but it purchased less gas than expected worldwide. The availability of shale gas in the United States is exerting significant impacts not only on the situation of energy availability of North America, but also on the global context. As mentioned, the “Energy Information Administration” (“EIA”) recently forecasted that the U.S. may start exporting some quantities of gas per ship lane (“Liquified Natural Gas”, or “LNG”) as early as 2016. Even more notably, forecasts show that by 2021 the U.S. may even become net natural gas exporters, producing 720 bcm, and consuming almost the same quantity.

The U.S. energy system also diverted from coal to a broader use of gas: coal made up some 50% of the U.S. energy mix in 2005, and it is now at 30%²¹⁵, with a significant increase of European imports of coal from North America. In general, the global natural gas reference price (termed “Henry Hub”) reached an average of 12.69 USD/BTU in June 2008, and bottomed at 1.95 USD/BTU in April 2012²¹⁶. Furthermore, there are prospects of possible U.S. exports of LNG to Europe to a conversion of Atlantic LNG regasification into liquefaction terminals.

The most urgent problem for Russia concerns Europe itself, and most notably:

- Contrarily to expectations, the decline in the gas basins in the North Sea was less dramatic than expected – in particular, Norway’s output has not declined, and even doubled up from 54 bcm/year in 2001, to above 106 bcm in 2010²¹⁷ – decreasing later on due to demand issues. The magnitude of the Norway increase alone was comparable to the new capacity that could be added by the South Stream pipeline
- The development in LNG technology and the installation of new European terminals made available additional quantities of gas from previously unconnected regions. Most notably, the traditional separation of the LNG world into an “Atlantic” and a “Pacific” basin is vanishing, and countries such as Bahrain and Qatar can offer now significant volumes of gas – competing with the Russian routes²¹⁸
- The economic crisis, together with the impact of coal based production and renewable sources reduced natural gas demand in Europe. The EU-27 was consuming around 400 bcm/year of natural gas per year, and demand increased to almost 500 bcm in 2005. In 2011, demand had plummeted to 440 bcm²¹⁹. Gas transit through Ukraine in 2012 decreased by almost 20 bcm, or 20% compared to 2011, at 84 bcm per year²²⁰.

²¹⁵ Forbes of July 13, 2012, In Europe, Coal Regains its Crown

²¹⁶ EIA Data 2013

²¹⁷ EIA data, 2013

²¹⁸ EIA (2012), Effect of Increased Natural Gas Exports on Domestic Energy Markets, January 2012, at: http://www.eia.gov/analysis/requests/fe/pdf/fe_lng.pdf

²¹⁹ Eurostat data 2013

²²⁰ UA Energy of January 18, 2013, Gas transit through Ukraine 19% down in 2012, at: <http://ua-energy.org/en/post/28518>

Still in 2008, forecasts concerning Russia's energy future were very favorable – an assessment by IFRI declared that “Russia is today pursuing its development using energy resources, particularly natural gas, notably on European and Asian markets, and possibly North American ones²²¹”. The pivotal changes in the energy sector led to a complete rethinking of Russian and European strategies.

The situation made clear once again how it is not just Europe being dependent on Russian gas, but also Russia being dependent on Europe²²². In 2010, oil revenues represented a half of the federal budget revenue and about one quarter of the GDP of Russia – and for the same reason the price fall of 2009 led to a GDP crunch of 9%²²³. The market became uncertain for Russia, and somehow EU policies – completed by radical global changes in the sector – seemed to work favorably for Europe. Such circumstances led to the decision to focus on the upgrade of Ukrainian pipelines as a means to secure gas supply also in periods of high consumption. Ukraine launched a first project stage to refurbish the Urengoy pipeline in July 2011, with a cost of some 400 million euro²²⁴. This outcome was determined also by a new agreement cut in 2010 by Russia and Ukraine, including gas discounts to Ukraine and the possibility for Russia to use the Ukrainian naval base of Sevastopol for up to 30 more years²²⁵.

The “commercial retreat” of Russia outlined here does not mean that Russia's energy power is at the end. There are certainly significant issues characterizing the structure of the system and the political framework: Russia must face a harsh round of contractual renegotiations and is having a hard time at developing energy infrastructures. Yet, Russia has been able to survive deeper crises than the current one. The West should not commit the mistake to consider the favorable energy situation as a “permanent condition”, because this would expose Europe's energy to much deeper problem if general dynamics change. Moreover, compared to the situation of the previous Russian energy downturn in 1986, this time Russian energy has the chance of finding more buyers. In the early 1990s, the lack of real alternative consumption market to the West allowed for more than a decade of low energy prices. This time the demand of the BRICs – given they are able to keep up with solid growth patterns – will drive up global demand and prices at a much higher pace than before.

²²¹ Locatelli, Catherine (2008), EU Gas Liberalization as a Driver of Gazprom's Strategies?, IFRI Russia/NIS Center, Russie.Nei.Visions n. 26

²²² See Paillard, Christophe-Alexandre (2010), Rethinking Russia : Russia and Europe's Mutual Energy Dependence, Columbia SIPA Journal of International Affairs, Vol. 63, No. 2, Spring/Summer 2010

²²³ Financial Times of June 15, 2011, Unable to shake off energy dependence

²²⁴ The Jamestown Foundation of July 27, 2011, Ukraine Starts Upgrading Gas Pipelines, Hoping for EU Assistance

²²⁵ Diploweb.com of May 23, 2010, Russia's Black Sea fleet in Sevastopol beyond 2017

Chinese demand and the risk to European supply security

In 1997 China and Kazakhstan reached an agreement for the construction of an oil pipeline and for general cooperation in the field of energy. The pipeline was started on September 28, 2004, and by July 11, 2009, 2,228 km of it had been completed, all the way to the “Dzungarian Gate” in the Alataw Pass, at the border between Kazakhstan and the Chinese autonomous region of Xinjiang, with a capacity of some 0.4 million barrels per day²²⁶. Today this quantity accounted for a mere 4.3% of total Chinese oil consumption, yet the diplomatic value of the infrastructure also needs to be considered: it can be enlarged and extended. China knows that the creation of an energy network requires a progressive approach and investments, in order to fulfill prospective demand – still in 1992, the country was actually a net oil exporter, and currently is importing almost 60% of its oil²²⁷.

Additionally, through Alataw there is another infrastructure transiting: a gas pipeline originating from Turkmenistan, a 1,833 km long, that started operations in December 2009 and is bundled with a supply agreement for 40 bcm per year for three decades²²⁸. Currently China does not have a significant gas production deficit, and the prospect of shale gas may also bolster domestic production, but the ambition of the investment seems justified by the prospective increase of the demand and with the goal to operate a partial substitution of coal-powered plants with gas-fired ones. The EIA in its Energy Outlook of 2009 estimated that by 2030 one-third of China’s gas consumption will depend on imports, and total consumption will be above 300 million cubic meters per year. The strategic importance of this pipeline, named “Central Asia-China” pipeline, has been evidenced by a new agreement signed with Kazakhstan in June 2010, to connect it with Kazakh gas to be supplied to China.

²²⁶ Global Times of July 16, 2009, CNPC shops oil via New Kazakhstan-China pipeline

²²⁷ CIA World Factbook data

²²⁸ The Wall Street Journal of June 16, 2009, China to boost its purchases of Turkmenistan natural gas

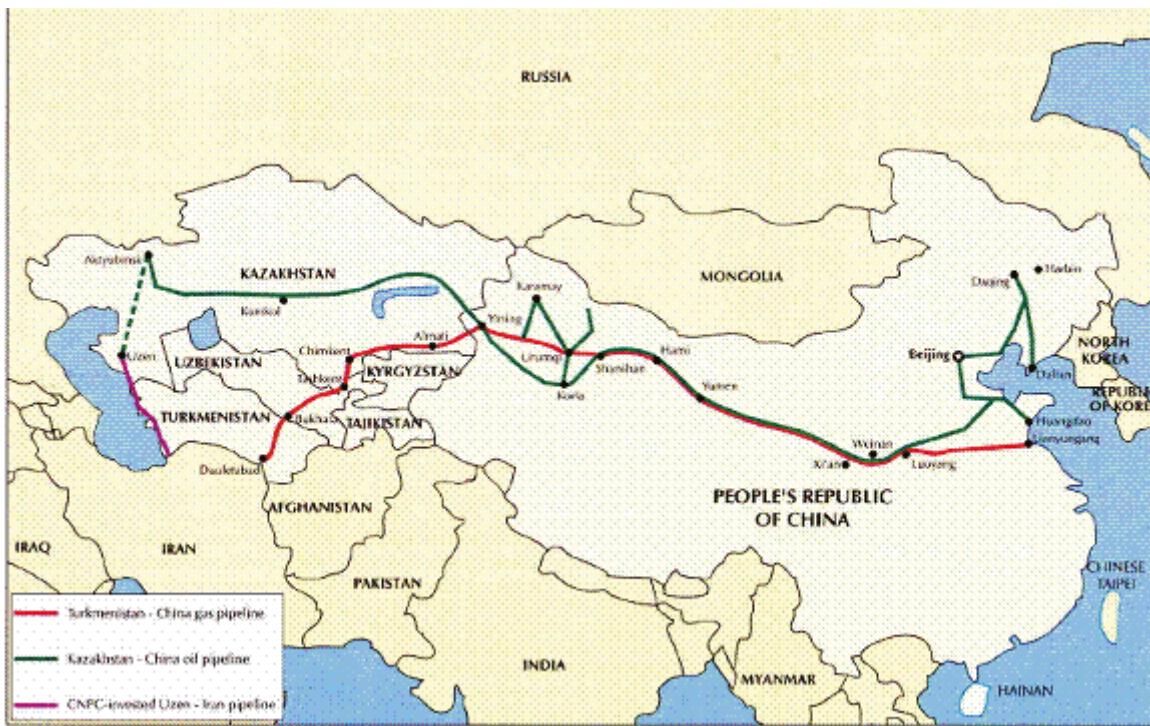


Figure 19 - Pipelines from the Caspian to China. Figure presented at:
<http://energeopolitics.files.wordpress.com/2013/01/china-central-asia-gas-pipelines.gif>

No section of the pipeline between Turkmenistan and Kazakhstan will touch Russian territory. Yet as the experience of Azerbaijan in the early 1990s shows, Central Asian countries are not choosing a side: they have not turned their back on either China or Russia. They are trying to use energy to create a political web and sit at its center. Most notably, Russia also exports oil to China using the Kazakh pipeline. As in the West Moscow depends on Ukraine to export energy, in the East it must coordinate with Kazakhstan²²⁹. On his side, Turkmenistan in 1997 even inaugurated a small pipeline to Iran, the 200-km long "Korpeje-Kordkuy" pipeline, with a capacity of 8 bcm per year.

The Chinese challenges for the sourcing of gas from Central Asia do not concern just the general structure of international politics. On the Chinese side of the Alataw pass, Beijing must face impending issues regarding the domestic territory. Geographic destinies decided that the first province in Chinese territory to host the pipelines as they enter the national territory is "Xingjian", an autonomous area, with language, culture and religion differing from the rest of the country. The dominant ethnicity in China is the "Hans", and in Xinjiang the majority is "Uighur" of Islamic belief. The area itself is rich in hydrocarbons, producing more than half a million barrels per day of oil; and the natural gas that is produced here satisfies one-third of the Chinese demand²³⁰. Moreover, from the Xingjian city of Lunnan departs a gas pipeline with a total length of 4.000 km, transporting 17 bcm of gas per year to the Yangtze delta, on the Pacific coast – the most industrialized area of China.

The supply security strategy is therefore reminiscent of the old Soviet strategy: binding the two sides of the territory, from the East to the West, through a network of economic interests and military power. The general economic blueprint had to face cultural differences, and the idea that local resources had to serve the economic development of the Eastern coast. One of the reasons for tensions is represented by internal immigration: in 1950 the Hans were representing a mere 6% of

²²⁹ Reuters of March 12, 2008, Gazprom Neft asks to send more oil to China

the population, whereas now they reached 40% and they represent the absolute majority in the wealthy urban and industrial areas. In 2001 the U.S. in Afghanistan found out that some Uighurs were present in terrorist camps to plan attacks to Beijing²³¹. In 2006, during a “Consultative Political Popular Congress” representatives from the province asked for reforms concerning the distribution of extractive rents. In order to contain protests, Beijing opted for a “social engineering” plan to curb possible sources of dissent. Together with facilitating Han immigration to Xingjian, the central government also pushed for the emigration of local Uighurs to the Yangtze Delta region – with the intent to facilitate local Xingjian development through savings wired from the Yangtze, without interfering with the Han leadership. This approach could not prevent the outbreak of violence in July 2009, curbed with extensive use of military force.

One of the main questions concerning China is whether the growing relationship with Russia and Central Asia might impact the European supply security. Russia has been able to rebuild some sort of preferential relationship with the new Stans, and in particular with Turkmenistan. Until 2004, Russia could rely on Turkmenistan gas to feed its own and Ukraine’s network, at a price of 44 USD per thousands of cubic meters – compared to the 130 paid by Europe at the time²³². In July 2008, two years after the death of the historical leader Saparmurat Niyazov, Gazprom was able to sign two important agreements with Turkmenistan in the energy sector. The first one regards the system to calculate gas price for the next twenty years, closer to the international benchmark. The second one concerns the financing and building of infrastructure for gas exploration and transportation in Turkmenistan for 6 billion USD²³³.

The Russian motivation to look for new export routes to China has been stimulated by the crisis between 2008 and 2009. As European gas consumption stagnated, Russia had to face enormous economic risks, with a decrease in exports that in some months was 50% less in comparison to 2007. The largest part of the capitalization of Moscow Stock Exchange depends on the energy industry, and the crash of the market has been much harsher than that of the capital markets of the West. China could have been an opportunity for Moscow also before the crisis, but Moscow needed time to be sure that the Chinese market was growing – as when negotiations were concluded China had just a small supply deficit. Between 1990 and 2007, China’s gas consumption increased fivefold.

Yet, we cannot disregard the fact that China and Russia always had problems of coexistence on the Eurasian platform, leading in the past to a major conflict in 1929, a border clash in 1969, and a general political confrontation for most of the XX Century. In 2001 China and Russia signed a “Friendship Treaty” that opened the possibility also for military collaboration; and in 2005 the two countries took part to a joint military drill termed “Peace Mission 2005” – although it was not clear how a peace mission could ever include mock amphibian assaults, submarine attacks and the involvement of Russian long range bombers.

Such initiatives were completed also by the consequences of the economic crisis – when Beijing intervened to help Russia to face the problem of diminishing energy rents: in February 2009, the two countries closed a twenty-year long deal, where China will finance the Russian energy industry for 25 billion USD, in exchange for the supply of 300,000 bbd of oil; considering interests on debt, China will pay 20 USD per barrel, covering 4% of national demand at the level of 2010²³⁴. A few

²³⁰ Sina of January 2, 2009, Xinjiang becomes China's second largest crude oil producer

²³¹ Asia Times of November 4, 2004, China's Uighurs trapped in Guantanamo

²³² Cera Advisory Service, Turkmenistan Changes the Game, February 28, 2005

²³³ Asia Times of July 30, 2008, Russia takes control of Turkmen (world?) gas

²³⁴ Financial Times of February 19, 2009, The Lex Column

months later a second large deal was closed for 100 billion USD, covering also the areas of nuclear energy, together with oil, gas and pipelines.

At the time of the agreements, most of the Russian exports to China were still being made on railway, ready to be interrupted as any political issue surfaced. In November 2005, the then Chinese premier Wen Jiabao and his Russian counterpart Mikhail Fradkov signed a joint press release announcing the beginning of negotiations for the building of an oil pipeline from Siberia to the Chinese markets, the “East Siberia – Pacific Ocean” (“ESPO”) pipeline. At the first stage of completion (reached in December 2009) oil was shipped to the city of Skovordino, in Russia, and from there it used railroads until the completion of a second stage in December 2012²³⁵.

Evaluating the impact on Europe, some key-points shall be considered. First, we shall accept that a Russian “economic diversification” is not a short-term solution, and not even a medium-term one: it might take years to be realized. If the economy is overly dependent on energy commodities, in order to make it more stable it is easy to diversify energy export markets, than the economy as a whole. We can compare the decision of Russia to develop the ESPO pipeline from final investment decision to completion (less than four years) to an overarching plan of economic diversification. This is not to say that economic diversification is not necessary, but just that diversifying markets may also help Russia to better plan investment decisions, reducing financial risk.

The diversification of supply market might anyhow reinforce the Russian leverage on Europe, as the possibility to selectively restrict supply to European markets, as Moscow might rely on the alternate Eastern source of revenue if it needs to shut an export route in Europe. Nevertheless, the situation is not as easy as it may seem. First, Russia has no geopolitical interest in expanding the energy relationship with China to the size of Europe, due to problem of cohabitation. In particular, the Eastern border of Russia – that also hosts important production centers – resents from deep demographic problems, with Chinese males relocating to Russian territory, as the effect of “one-child policy” has led to sex imbalance – compared to population decay in Russia. If Russian resources become overly important for China, demographic pressure might lead to conflict. Second, an action of “selective shut-off” of European pipelines might be countered by reverse-flow pipelines (for example: from Germany to Poland) making such actions less effective – and also LNG shall be accounted for.

Possibly, Russia sees the Chinese opportunity as a mere business opportunity, and the “political idea” of the energy connection is just secondary. This idea does not concern the “imposition of political will” based on the control of the supply tool, but focuses more directly on the control of the energy market. If Russia manages to deploy its full-blown energy strategy, it might influence gas process through the control of gas storage in Europe (see below) and leading a Central-Asian block of gas producers, capable of influencing gas prices. Yet, when this plan was prepared, the shale gas boom was still at its first stage – but U.S. shale gas will not last forever.

Yet, there is still a new shale frontier to be explored: China itself. Estimates by the EIA claim that the Asian country hosts twice as much shale reserves as the U.S.²³⁶: it is enough (and more than enough) to make “traditional” gas from Russia not necessary to China for many years to come – unless Moscow is ready to offer low prices and no political claims.

Chinese energy and its potential are parts of the broader discussion about the approach of China in global politics. A recent publication by David Shambaugh claims that “The elements of

²³⁵ Center for Eastern Studies, Eastweek of january 9, 2013, Completion of the ESPO oil pipeline connects Siberia to the Pacific Ocean

²³⁶ Business Week of April 18, 2013, China's Shale-Gas Potential and Peril

China's global power are actually surprisingly weak and very uneven. China is not as important, and it is certainly not as influential, as conventional wisdom holds²³⁷; and that "some observers have already triumphantly proclaimed that China will 'rule the world'. This perspective is profoundly overstated and incorrect [...]. China has a very long way to go before it becomes – if it ever becomes – a true global power. And it will never 'rule the world'²³⁸". Also Avery Goldstein, professor of Global Politics at Pennsylvania University, claims that "China is way less powerful than what many people believe, alarmed by its ascent – although it is more powerful than what it has been for centuries"²³⁹.

Such considerations of China as "unwilling global power" are particularly important when assessing China's international energy policy. Shambaugh adds in his book that "China's energy-driven diplomacy in the Middle East, Africa and Latin America began to produce further strains in Chinese diplomacy"²⁴⁰. This means that an expansion on the "energy directive" of China's international approach may be halted by the lack of a real concept to bind foreign countries.

In general terms, the limits of China's global energy policy may be clustered as "positive" and "negative". The "positive" limits are represented by the fact that China does not seek to deliberately introduce an imperialist concept bundled to its energy diplomacy – or at least does not seem to. Although it could be claimed that the lack of a deliberate ideology is an ideology itself, it seems that China's approach lacks the traditional, multidimensional approaches of Russia and the U.S. Possibly, claiming that China lacks a real international policy might be the result of misperception by Westerns analysts. As the Asian power prefers mere commercial relations to full-blown political coordination, and does not seek to introduce particular political values – like democracy and free-market – Western analysts tend to interpret it as either a "preliminary phase of an ideology in formation"²⁴¹, or as a lack of ideology. Nevertheless, we cannot forget that China's tradition do not include democracy, and it is understandable that the same political concept is absent from its international policy. The subtle policy of "international commercial presence" is as much influential as a deliberate policy of imperialist political expansion.

The "negative" limit is also the limit that might affect the "positive" side of China's international policy. Foreign countries may seek other advantages than that of having a growing energy commodities buyer such as China. Commercial presence is – in the end – also political presence – especially in the case of the state-owned Chinese companies. This is due to the fact that the flow of foreign rents may alter the domestic situation of supplying countries, even on the social side. Believing that commercial relations can be expanded at unlimited extent without any responsibility in terms of social development is senseless – for example, some of the recent revolts in the Arab world had been influenced by the inflow of Chinese rents, that generated effects such as inflation or income polarization; moreover, the social benefit of some large public projects (especially in Algeria) has been limited by the fact that large portions of the low-skilled workforce profiting from them was coming from China.

Yet, these limits may be "normal" for a country that developed an interest in expanding its international presence only in recent times. An answer to the question of the rising Chinese interest in the energy sector will not come soon, especially if we consider what happened in the energy

²³⁷ Shambaugh, David (2013), *China goes global: the partial power*, Oxford University Press, p. X

²³⁸ Ibidem, p. 6

²³⁹ Interview by the author, July 5th, 2013

²⁴⁰ Shambaugh, david (2013), cit., p. 52

²⁴¹ Pieter Bottelier, professor of China Studies at Johns Hopkins University, believes that "China is already an economic and military power. If it manages to develop domestic technological innovation and "soft-power" internationally (as defined by Nye), it will become a real tiger" (interview by the author, July 8th, 2013)

sector during the Cold War. It took almost fifty years to find a situation of “temporary supremacy” of the U.S. over Russia – and the two countries were “mature imperialist powers” since the start of their confrontation. Moreover, the temporary U.S. supremacy of the 1990s has been affected by a Russian resurgence, then again counterbalanced by a return of the U.S. on the side of energy commodity production. China is no mature imperialist power – or at least this seems to be the only consensus among scholars – and it is expectable that it will take years before a real personality in the energy sector is developed, from the current mosaic of fragmented and extemporary initiatives.

Conclusions

The strategic dynamics of inter-bloc energy relations from 1945 to 1991 should not be conceived as an exclusively “offensive” Soviet Union and an exclusively “defensive” United States. In the Middle East, for example, the aspect that mostly concerned Western strategy was the possibility that Moscow targeted Middle-Eastern oil rich areas to disrupt the resource flow to Europe, be it in the immediate years after WWII, or in the economically fragile 1970s, and even later. Jeopardizing oil routes had a huge potential for economic damage to Europe, larger than the one related to possible Soviet military initiatives in the Maghreb and around the Persian Gulf.

Table 3 - Outline of the political/commercial energy strategies and the offensive/defensive approach of the U.S. and the Soviet Union.

	Soviet Union	U.S.
Energy endowment and strategic situation	Oil exporting state, partially switching to gas exports by the end of 1970s	Leader of a bloc of mostly energy importing countries (and itself energy importer since 1949)
Energy Political strategy	Territorial offensive strategy: leveraging oil exports to create political bundles with aligned and independent countries	Territorial defensive strategy: providing energy assistance (sourced mostly from the ME) and promotion of diplomatic actions to limit Soviet Union's reach
Energy Commercial Strategy	Market offensive strategy: favoring exports to the West to increase hard-currency revenue	Market defensive strategy: limiting Soviet Union's revenue and reducing the West's energy bill

Yet for most part of the Cold War, the Soviet Union indeed had an “offensive” stance, at least until the pivotal market changes of the 1980s (see Table 4). Especially between 1945 and 1973, oil was seen by the Soviet Union as a “means” to exert political influence, by supplying barrels to allied countries and cutting shipments to “problematic” soviet regimes (Albania, Yugoslavia, China). Nevertheless, partially since the 1956 Suez crisis, and with increasing confidence after 1973, oil became for the Soviet Union a mere “goal” in terms of its capability to increase hard-currency revenue. Suez represented an opportunity for the Soviets to escalate their sales to the capitalist world, since some Western European countries sought alternatives to Mideast oil and the Suez bottleneck. In the following years, Moscow promoted the development of export infrastructures that connected the resource-rich areas of Soviet Union, from the Caspian to Siberia, to the consuming markets. The hard currency earnings related to Soviet oil and gas exports became increasingly important to sustain Moscow’s finances, and reached record levels in the years after the Islamic Revolution of 1979. Such strategy was enhanced by the Soviet plan to differentiate hydrocarbon exports with a broader focus on gas, in the late 1970s.

Also the two main pipeline initiatives, “Druzhba” and “Urengoi”, represent different moments in the Soviet attitude towards energy resources exports. In the former case, the infrastructure was directed to Socialist allies, and had a “political” aim, in order to make customer countries dependent on Moscow supplies – possibilities of interconnections with the West were excluded at the beginning. In the latter case, the “Urengoi” pipeline had the main goal of reaching the Western market and contribute to hard-currency earnings (“oil as goal”). Also the strategic

dimensions of gas export differ from those of oil, as the creation of a gas pipeline calls for a direct dependence between supplier and buyer (differently than oil, gas cannot be “rerouted” in case of any problems).

The “political” and the “commercial” aspects of the Soviet oil & gas strategy were not mutually exclusive, but were contemporarily present in the political agenda of Moscow, with a stronger presence of one element above the other depending on the historical period. The two Soviet strategic directives were interrelated. For example:

- A positive development of the “commercial” dimension could exert negative effects on the “political” dimension. To fulfill political needs, the Soviet Union offered advantageous oil supply contracts to its allies (“political” strategy), thus reducing present or future opportunities to cash hard-currency revenue (negative impact on the “commercial” strategy)
- Aiming at the “commercial” dimension could also exert negative effects on the “political” dimension. The need to maintain or increase hard-currency revenue (positive “commercial”) led Soviet Union on some occasions to ask its satellite states to look for “alternative suppliers”, contributing to the outbreak of economic problems, i.e. reducing the dependence of some socialist allies from the Soviet Union (negative impact on the “political” dimension)
- In some cases, the correlation was “positive”, as “political” objectives could benefit the “commercial” dimension, and vice-versa. For example, an increased Soviet political reach in the Mideast region (positive “political”) could destabilize the Western oil market, increasing the barrel price and fostering hard-currency revenue (positive “commercial”)
- Conversely, increased hard-currency revenue due to an expansion in the exports (positive “commercial”) could increase the financial resources at disposal of the Soviet Union to sustain its Mideast allies (positive “political”)
- In other cases, the correlation has been “negative”, as negative developments in the “political” dimension could be detrimental to “commercial” aspect, and vice-versa. For example, a diminished Soviet presence in the Mideast region (negative “political”) could contribute to the stabilization of the oil market, lowering the barrel price and adversely impacting Soviet hard currency earnings (negative “commercial”).
- Conversely, decreased hard-currency revenue due to a contraction in the exports (negative “commercial”) could decrease the financial resources at disposal of the Soviets to sustain its Mideast allies (negative “political”). See Table 4 for a rationalization of the possible strategic situations.

The American approach largely differed from the Soviet one, as Washington mostly adapted its strategies to counter the Soviet moves along the decades, with a turning point represented by the economic crises of the 1970s. The U.S. oil strategy from 1945 to the mid-1970s mainly focused on securing a certain degree of political reach on Mideast producing regions supplying Europe and the West (including the Shah’s Iran oil shipments to Israel), countering the Soviet approach mostly on the “political” territorial dimension of the Moscow’s strategy. There was also some U.S. diplomatic focus on the limitation of Soviet oil exports to Western Europe (countering the “oil as goal” dimension), for a relatively limited period of time (the Druzhba crisis of 1958-1962), until some form of compromise between European purchasers and Washington was reached.

After the loss of Iran in the Mideast region in 1979, the attention of Washington progressively switched from the “territorial” to the “market” dimension of oil. President Jimmy

Carter's and later Ronald Reagan's oil extraction and trading liberalization policies were mostly due to domestic factors (as we will review later), yet they also had a negative impact on the Soviet hard-currency earnings, contributing to the financial collapse of the Union in the late 1980s.

This is not to say that an oil crisis caused the implosion of the Soviet Union, but rather that the implosion was generated by a confluence of events, general economic problems and coupled with a declining oil market. The 1986 slump in oil and gas related hard-currency revenue materialized in a time when the oil industry was already experiencing technical difficulties, due to general economic mismanagement. The diminished income flow, in turn, hastened the economic problems and reduced the room for maneuver to correct negative tendencies, both in the industry and the country in general. Without the 1986 oil price crash, the Soviet oil industry would have been better in shape at the end of the decade, but it is likely that the Soviet Union would have collapsed in any case, although maybe a few time later.

Table 4 - “Offensive” and “Defensive” actions of the Soviet Union and the U.S. along the dimensions of “Energy Political” and “Energy Commercial” strategies

	Soviet Union	U.S.
Energy Political Strategy	Offensive: tying up satellite states and socialist countries through oil dependence Defensive: countering U.S. influence in the Middle East	Offensive: securing stability and alignment to the West of Mideast countries and non-aligned producing states Defensive: countering the exports-leveraged political influence of Soviet oil exports worldwide
Energy Commercial Strategy	Offensive: increase hard-currency revenue through oil and gas exports to the West Defensive: (since the 1980s) countering declining oil prices through gas substitution, to increase hard currency revenue base	Offensive: (since the 1980s) expanding production base to limit commodity price variability Defensive: limiting commodity export related hard currency revenue opportunities for the Soviet Union

After the collapse of the Soviet Union, the strategies of the two blocks became more similar. The U.S. had the chance to exert a broader “territorial control” on the key areas of the Middle East, intervening when it had the chance to. Russia became more sensible in terms of the market aspects of its trade, abandoning the “simple” strategy of facilitating Mideast crises to free-ride OPEC cuts, to favor a multidimensional approach including industrial, political and commercial aspects.

Surprisingly for some, notwithstanding the dire situation of the gas market – and the even grimmer prospects due to the booming shale gas sector in the U.S. – Russian projects concerning alternatives to Ukraine mover forward. In 2012, Gazprom even set a “virtual ceremony” to launch the South Stream pipeline, “before all necessary permissions had been acquired, and before the demand for energy in Europe, where Gazprom exports two-thirds of its produced gas, had stabilized²⁴²”.

²⁴² Institute of Modern Russia, blog post of February 5, 2013, How Gazprom Snoozed through the “Shale Gas Revolution”

Different reasons have been suggested for such move. Possibly, Russia is using South Stream as a “swift project” to persuade Ukraine to stay at Russia’s side. Some critics believe that the South Stream decision is just a product of a general Russian skepticism about the “U.S. shale gas revolution”: Gazprom’s deputy chairman Alexander Medvedev called the U.S. shale gas revolution a “bubble” similar to the dotcom boom²⁴³.

On the other hand, Europe seems to believe that the shale gas boom is there to stay. This can be detected by the strong pressure by European energy companies to renegotiate long-term supply contracts with Russia, based on prices and quantities largely fixed. If the buyer buys less gas than a certain agreed amount, is requested to pay a “fine” for the quantities it did not use (below a certain threshold). Due to the steep decrease in both natural gas prices and consumption in the continent, the rigid structure of Russian energy contracts forced to a wide set of renegotiations (details of contracts are secretive). Interestingly, also Ukraine was affected by the problem, and Gazprom is allegedly pursuing a payment of some 7 billion USD for unused gas by Ukraine²⁴⁴.

The liberalization plan of the gas sector in Europe also prescribed a stronger focus on spot prices, and was met by industrial dynamics to the same direction²⁴⁵. Russia answered to the new popularity of spot contracts with the declared intention to invest on gas storage facilities in Europe: up to 300 billion euro to double up the underground storage capacity at 5 billion cubic meters by 2015²⁴⁶. Although the planned storage capacity is minimal when compared to the annual natural consumption of the EU-27 (at 440 bcm per year), it still represents a significant amount considering daily consumption – with the possibility of making up for around three days of full consumption in winter. As the eventuality of a total supply interruption is to be excluded, the new storage could represent an important resource to limit the problems of a prolonged discontinuation. Most notably, storage may help to contain the risk of renewed Ukrainian clash; and may also grant Gazprom the opportunity to exercise “physical arbitrage” of gas quantities, making up for the margin possibly lost switching from long-term to spot structure contracts.

Together with such concerns, some analysts²⁴⁷ also argued that the recent decision to focus on a new interconnection with Azerbaijan called “Trans Adriatic Pipeline” (different than the old TAP in Asia) also presents issues in terms of energy independency. One of the owners of the pipeline, the Norwegian company Statoil, is also an operator of the supply field in Azerbaijan, and such situation might be problematic in terms of guarantees of the best conditions for final price formation.

The present outcome of the Russia-West energy debate seems therefore to have followed again the dynamics of 1980s. The heated diplomatic clash about the development of the Urengoy pipeline was solved in the end not only by the decision of the U.S. to release pressure about the initiative, but also by the fact that the prospect of decreasing fossil commodity prices. Analogously, the prospect of commodity oversupply led to a reshuffle in the strategic positions of EU, Russia and

²⁴³ Ibid.

²⁴⁴ RiaNovosti of January 26, 2013, Gazprom Bills Ukraine \$7 Bln for Unused Gas - Naftogaz

²⁴⁵ See Stern, Jonathan & Rogers, Howard (2011), The Transition to Hub-Based Gas Pricing in Continental Europe, The Oxford Institute for Energy Studies, NG 49, March 2011; and Konoplyanik, Andrey A. (2010), Evolution of Gas Pricing in Continental Europe: Modernization of Indexation Formulas Versus Gas to Gas Competition, Centre for Energy, Petroleum, & Mineral Law & Policy, International Energy Law and Policy Research Paper Series, No. 2010/01

²⁴⁶ RiaNovosti of February 15, 2012, Gazprom to Invest 300 Mln euro in European Storage

²⁴⁷ Boersma, Tim (2013), What the Trans-Adriatic Pipeline Means for Europe's Energy Diversity, The German Marshall Fund of the United States, at: <http://blog.gmfus.org/2013/07/26/what-the-trans-adriatic-pipeline-means-for-europe-s-energy-diversity/>

the U.S., and the solution of Ukrainian pipeline revamping – rejected by the West at first – has been accepted.

In this game there will never be a final winner or a final loser. There will be no definitive outcome: the equilibrium will be reestablished year after year. At current, it seems that Russia may suffer indeed from a downturn on the energy side, but such downturn will persist until the European demand will remain low. The actions undertaken by the West to counter the possible formation of a Moscow centered gas monopoly have been effective – be it the focus on shale gas in the U.S., or the EU's infrastructural and supply diversification. If the price outlook of fossil commodity remains low, the EU and the U.S. shall further invest in solutions to avoid a sudden change in equilibrium. In particular, if the solution is that of a Ukrainian upgrade, a decrease in gas availability from international market may lead to filling up the capacity of Russian pipelines, with possible issues in terms of supply pricing – especially if the pricing formula will tend to spot structures.

The constant “swings” of the energy availability pendulum in the last years also open the question whether “democracies” may be fit for long-term planning in the sector of energy. The experience of the last thirty years, with its series of “booms” and “busts” – and their effect on the Western economies – make clear that the most problematic issues for Europe and the U.S. was the possibility of introducing strategies whose vision would go beyond the mandates incumbent governments. The Polity IV index claims that Russia’s development state is not at par with that of the West (the score is 4 in a range from -10 to +10), classifying it as an “anocracy”: “a regime-type where power is not vested in public institutions but spread amongst elite groups who are constantly competing with each other for power”.

Does Russia enjoy an “autocratic advantage”? There is a compelling amount of evidence to suggest that closed yet stable systems of government might be preferable to predatory and unstable democracies, as in the latter case rulers cannot be sure to stay in power in the following period, and will exert all the wealth they can from resource production – even pushing production to the extreme, negatively affecting the domestic economy in the long run²⁴⁸. Such consideration differs from general theories about the relationship of dictatorship with economic development: the energy sector works differently. In particular, the energy sector might work efficiently also if ownership is concentrated in few hands, and may operate also independently of the general economic condition of the population. This is different from aiming at general economic development, which requires openness to business initiative and – consequently – the opportunity of political participation. Of course, if an energy state severely lacks economic development, the problems might end up impacting also the energy sector – as demonstrated by the case of Russia and its problem with investment and coordination in the area (in the mid-1970s, in the late 1980s – and possibly today²⁴⁹).

The risk for Europe is that short-sighted planning may lead the continent to fall again into a “problem of delayed production²⁵⁰”, with an energy crisis due to poor investment and attention in the boon years. The outcome of an energy investment may be visible even fifteen or twenty years after the decision, and the electorate may often not recognize the need of certain investments, and make deciders accountable for expenses, without recognizing future benefits. Conversely – and most unfairly – rulers that come next may enjoy the dividends of the investment, without having had to

²⁴⁸ See, among the others, Smith, Benjamin (2005), Oil Wealth and Regime Change, University of Florida; and Smith, Benjamin (2004), Oil Wealth and Regime Survival in the Developing World, Harvard University

²⁴⁹ See Bloomberg of June 10th, 2013, Gazprom’s Demise Could Topple Putin, at:

<http://www.bloomberg.com/news/2013-06-09/gazprom-s-demise-could-topple-putin.html>

²⁵⁰ See Davis, Allan (1956), An economic theory involving production delay periods, University of California, Dept. of Mathematics

bear the political burden of the expense. On such extent, the biggest risk for the EU supply security is to take the shale gas boom for granted, and to avoid engaging in those necessary investments needed to secure an adequate portfolio of alternative suppliers. The history of energy relations shows how the winds may change suddenly.

In terms of the broader EU-Russia relations and their impact on supply security, it is indifferent whether the goals of Russia are “political” or “commercial”. This is due to the fact that the two goals can be partially identified, as the political soul of contemporary Russia is strictly correlated with energy. Russia would never try to expand a “political empire” beyond the matter of gas, because it simply does not serve the domestic purposes of the country. In the same terms, Russia does not enjoy any domestic incentive to differentiate from energy, as it would alter the power structure that dictate the political life of the federation.

The current situation in the global energy interconnection dynamics is a perfect expression of such tendencies. In July 2012 a 10 billion USD agreement was signed for the development of an Iran-Iraq-Syria pipeline, with a capacity of 40 bcm /year of gas²⁵¹; the project will take its feed from the “South Pars” field, which is shared by Iran and Qatar. Yet, Qatar seems to prefer an alternative route, through its “North Field” (close to South Pars) passing through Saudi Arabia, Jordan, Syria and Turkey, where it would interconnect to the local network, accessing the market of Western Europe. The key difference between the two projects is that the first one (Iran-Iraq-Syria) would pass through a Russian network of influence, from Iran to the Syrian port of Tartus; whereas the second project would bypass it. The uncertainties in Syria, of course, have led to a halt to both initiatives; but the winning force will also be the one deciding which initiative to favor.

Also east of Iran the situation is changing, due to new role that the Pakistani port of Gwadar will play for the presence of China: it is intended to be the “second link” between resource-rich regions and China, connecting the Middle East to Beijing, as the Alataw Pass does for Central Asian resources. A pipeline from Iran to Pakistan, with the possibility of an Extension to China, is planned. In case the old “TAP” project from Turkmenistan is revived, Gwadar will also be the interconnection hub with China. The military tension in the South China Sea can also be explained by the question of control on energy connections. The area hosts the most important sea lanes connecting the Persian Gulf to China, through the Strait of Malacca (between Malaysia and Indonesia’s Sumatra), and in the future may host additional LNG traffic from Pakistan in case pipeline projects will be completed.

What is the role of the U.S. in such development? Seemingly, it seems to be a competition between Russia, China and the U.S. Russia is facing a dramatic decline in all sides of society, and tries to keep the system alive through energy exports and other state-centered initiatives. The U.S. reacted to the reduced influence it started experiencing in the 2000s, through an increased focus on domestic resources. It seems that, as the center of global relations has moved east, the U.S. are struggling to find means and rationale for an intervention to influence the new energy tendencies to China. Possibly, the change in energy equilibrium is both a source and a consequence of global power; but as the experience of Soviet Union showed, a period of decline (as the 1965-73 in the Soviet Union) does not mean a complete retreat from a region that will remain pivotal as discriminant of global power. No great power is in the position to exert a fully hegemonic control on foreign energy producing areas. In particular, in the Middle East the wave of independence started in the 1970s, lately inspired by the “Azeri style” multidimensional diplomatic approach, is transforming every country in a possible center of interest and in an important actor in the balance of power.

²⁵¹ Al Arabiya News of February 20, 2012, Iraq green lights gas pipeline deal with Iran, Syria

Great powers are adopting “similar” international tactics of influence, mixing territorial and market approaches, abandoning the more strict delineation that characterized the Cold War competition. As for China, it remains unclear whether the country will be able to deploy a full-fledged international approach, besides the interest-driven selected presence in some territories. The impact of shale gas further fragmented the situation, as the globalization of gas market jeopardizes the reliability of rents related to long term investments, and the global price structure. Current political concerns are deeply influenced by shale and its mediated effect on commodity prices, yet the main assumption is that the shale boom forever will last for at least two decades. Is this a risk the West really wants to run?

FINAL POLICY OPTIONS

- The global energy sector has been impacted by recurrent “boom and bust” cycles, which can be explained at a political level by poor strategic oversight in the West. Since the expected return of energy investments may materialize decades after the investment decision, democracies face the challenge of better distributing the “political burden” of expensive investment decisions between the incumbent and future governments. Ideally longterm investment decisions in the energy sector should be agreed upon by multistakeholder groups at an international level.
- In terms of supply security, it is important to involve the private sector in diplomatic and political decisions. Every time the West was able to reach more reliable supply security, and also at a more affordable price, this was due to a more significant influence of private initiatives by industry (see the case of the 1986 price slump; or of the recent shale gas boom). The only constraints to private sector development may be environmental concerns – and there the state should intervene.
- Increased supply security in the West means increased stability worldwide. Lowering oil rents of producing countries limits the reach of the nationalist/imperialist agenda of regional powers. Spare capacity in the global energy markets allows also more freedom for Western powers to intervene more deeply – diplomatically or militarily – in resource-rich regions. This is no justification for the 2003 intervention in Iraq, but more for the 1991 operation in the same country – when Iraq’s aggressive designs were about to

alter the Mideast equilibrium. Without spare capacity, an intervention would cost much more in terms of booming energy prices. The current building spare capacity is altering also diplomatic discussions concerning Iran’s nuclear agenda. This also means that shale gas will not prevent the U.S. from having an interest in the Middle East.

- Reduced energy commodity prices seem to exert an influence on the Israeli-Palestinian peace process as well. The Palestinian issue is not just a local political confrontation, but the area where interests of global and regional powers meet. Reducing energy rents allows not only more decisive political initiatives, but also reduces the reach of countries with an aggressive agenda, eager to exploit the confrontation for their benefit.
- Europe is profiting from the U.S.’s success in shale gas, and less from reaping the benefits of its own strategic foresight. The drive towards the construction of LNG terminals allowed for the introduction of more supply diversity, reducing the current and prospective power of Russia. Yet, Europe should closely monitor Russia’s plan to expand its presence in Europe’s gas storage facilities, since controlling storage would allow Russia to deploy a strategy of “physical” arbitrage (filling and emptying storages to influence the market and exert better gas prices). Europe should also continue investing in alternative supply sources, as increased consumption of gas worldwide may strongly affect the situation – in other terms, Europe should avoid being on the “losing side” if the energy sector enters another cycle.

Autor

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