East, West jockey for position in Caspian region

Giandomenico Picco

Giandomenico Picco is renowned for his negotiating skills and knowledge of people and politics in the Middle East. Five nations have honored him with their highest civilian awards. A 20-year senior official of the United Nations, Picco was the secret U.N. negotiator who ended the Iran-Iraq War, and convinced the Soviets to leave Afghanistan. He led the negotiations with Islamic Jihad that resulted in the release of Tom Sutherland and other hostages. After leaving the U.N. he founded GDP Associates, a strategic consulting firm that helps companies set up operations in the Middle East.

Oil and politics - historically a volatile mix - are fueling dissension in the Caspian Sea, according to Giandomenico Picco in his address to the Global Executive Forum. "The Caspian Sea region has more political than oil value; however, in the imagination of the world it has become the great mecca of hydrocarbons."

Estimates of the Caspian Sea's oil potential vary, primarily because most of the region remains unexplored. The Azerbaijani International Operating Company (AIOC) estimates these reserves at 12 billion barrels with another 25 billion barrels to be discovered. The U.S. Energy Department puts proven oil reserves at 15.4-29 billion barrels with a possible 163 billion barrels in further reserves.

"The underbelly of Russia can develop in a way that, politically and economically, will use and exploit these energy resources," said Picco.

There are five countries bordering the landlocked Caspian: Turkmenistan, Russia, Azerbaijan, Kazakhstan and Iran. How the wealth will be divided among these countries, and under whose sphere of influence the region will fall, is part of the ongoing discord in Central Asia.

"The controversy concerns not just the oil, but the pipelines through which the oil will flow to world markets," said Gianni Picco. The U.S., Russia, Iran, and China are each pushing for a pipeline route that would serve their own interests in the region.

War over pipelines

It's one thing to have precious energy resources; it's another thing to get them to market. For the landlocked Caspian Sea, distribution is the biggest challenge. The solution is to develop a series of pipelines through which it can transport its oil and gas.

"In this region, pipelines are much more important than borders," said Picco, adding that the relationships among the countries are governed by economics, not religious beliefs.

The existing crude oil pipeline route goes from Baku, Azerbaijan to the Russian port of Novorossiisk in the Black Sea, a pipeline hub built over 70 years ago by the Soviet Union. These 100,000 barrels per day (bpd) line crosses the breakaway republic of Chechnya, which is seeking its independence from Russia. "The Chechnya-Russia war was nothing less than a war over pipelines or rather over a pipeline hub," said Picco. "No Russian would ever willingly give up this pipeline hub, some 50 km from Grozny."

An additional westward oil pipeline with a capacity of 120,000 bpd is under construction from Baku, Azerbaijan to Supsa, Georgia. This pipeline bypasses Russia. But it, too, is in an unstable region with renewed conflict in Abkhazia, Georgia.
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At the beginning of 1998, a gas pipeline opened from Turkmenistan's Korpeje gas field to Kord-Kuy in northern Iran, a pipeline that also bypasses Russia. Construction work is supposed to continue all the way to Turkey, thus carrying Turkmeni gas to the Mediterranean via Iran. Once a gas pipeline corridor exists, it is relatively easy to run a crude oil pipeline through the same corridor.

Washington wants a direct pipeline from Baku, Azerbaijan, through Georgia to Turkey's Mediterranean seaport of Ceyhan, with a pipeline under the Caspian connecting Turkmenbashi, Turkmenistan with Baku. This route is also favored by Turkey.

Russia objects to the Turkish route and wants the pipeline to go west from Baku, Azerbaijan and to terminate in the port of Novorossiisk or another Russian seaport in the Black Sea, thus maintaining control of the pipelines and dominance of the Caspian Sea's oil resources. This lacks popularity with former Russian countries that are trying to solidify their independence from Russia.

The AIOC and its Georgia affiliate already own rights to develop a new pipeline from Baku, Azerbaijan to Supsa.

Investments

Western oil companies have a strong presence in the region. They have poured an estimated $50 billion dollars into oil and gas exploration, betting on a future payoff. And for the first time since Genghis Khan, China is back in the Caspian with investments of $9.5 billion in two oil fields in Kazakhstan. An agreement between Beijing and Kazakhstan calls for the construction of a 3,000 kilometer pipeline from Kazakhstan to the west of China, according to Picco.

"American oil companies have investments in Azerbaijan, Kazakhstan and Turkmenistan, the three countries currently producing oil in the Caspian Sea region. At some point, the United States will have to deal with Iran because it is the only country in the region that makes sense economically, based on its population and its financial resources, for regular sized American companies.

"The transportation costs from the Caspian make that oil four times more expensive to bring to the market than the oil from the Iraqi desert, for example," said Picco.

Boom or bust?

While foreign oil companies have a lot riding on their investments, oil profits may be slow to materialize. Caspian oil is facing unknown prospects even before its oil begins flowing through a major pipeline, yet to be built.

The once booming economies of Southeast Asia - the biggest market for Caspian oil - have fallen on hard times and there is a decreased demand for oil in the region. Analysts do not expect the demand to rise in the near future, with the exception of China.

"I think the people in the Caspian Sea oil producing arena are in deep trouble because if the Asian countries do not continue to buy the amount of oil that is expected of them in the next 15 years, then the question is, why are we talking about Caspian Sea oil?" said Picco.

"There is no expectation of an oil shortage in the next 15 years," said Picco, pointing to low oil prices and oil discoveries popping up all over the world.
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At the beginning, it made sense to develop Caspian oil. A gentle paced oil development in this region was the perfect solution for the Saudis and for the oil companies in the United States and Europe. This put a stop to the huge production of oil in Iraq and didn’t put existing oil enterprises out of business, according to Picco.

Now Caspian Sea oil is at a competitive disadvantage. It comes with a price tag that is four times higher than oil from the Persian Gulf, and getting it to the end users is difficult. Also, the oil has a high sulphur content and is not of high quality.

Iraq, which sits on the Persian Gulf, is not involved in the machinations of the Caspian, but it casts a giant shadow on the region. Currently, Iraq produces oil at the rate of 2 million barrels per day, which is as much as it can produce under U.N. sanctions. When and if sanctions against Iraq are removed, the demand for Caspian oil will encounter greater competition because Iraq can produce better, cheaper oil.

Iraq’s proven oil reserves are 112.5 billion barrels according to the U.S. Department of Energy. Contrast that with the Caspian Sea’s proven reserves of 15.5-29 billion barrels. Kazakhstan, Azerbaijan and Turkmenistan’s combined production of just over 608,000 bpd would have a long way to go to equal Iraq’s current 2 million bpd. Even the most optimistic projections indicate that it could take 8-10 years for the Caspian Sea region to produce 2 million bpd.

If sanctions against Iraq were to be lifted, the oil landscape would look very different. "With the price of oil today, if Iraq were to put on the market double what it produces now, this would close down Oklahoma, Texas and Tennessee, and I wonder about its effect on the Caspian," said Picco.

"The significance of the energy resources of the Caspian would be relevant only in so far as it is good for oil companies to have different sources of oil. Some sources are expensive; others are not as expensive. I may be able to show a very good profit even if my costs are high, if I have negotiated a beneficial contract."

A member of the Forum speculated that Amoco and Mobile are betting that the United Nations and the United States will not lift sanctions on Iraq for a long time and, therefore, are putting their money on the Caspian oil.

Picco commented that, on the one hand sanctions can last a very, very long time; on the other hand, everything changes over time.

Many non-American companies are betting that the sanctions will end. In Iraq today, 48 oil companies from 29 countries have been signing contracts. "There is not one American company that has done that. Nevertheless, in the long run," said Picco, "America has a much bigger chance in Iraq than any other place."

Added Gianni Picco: "The future of Iraq will be really the future of who exploits, develops, and buys the oil of Iraq. There are only three possibilities: Russia, France, and America. And there is no other oil industry like the American oil industry that could transform Iraq into a new mecca. And everybody knows that. If I were Saddam, I would come to the conclusion that the future of Iraq is with America, or it is nothing at all."
Countries bordering the Caspian Sea

1. Kazakhstan
   - Land area: 2,670,000 sq km
   - Population: 16,882,000
   - Proven oil reserves: 16 billion barrels
   - Current oil production: 400,000 bpd

2. Turkmenistan
   - Land area: 488,100 sq km
   - Population: 4,230,00
   - Proven oil reserves: 1.5 billion barrels
   - Current oil production: 88,000 bpd

3. Iran
   - Land area: 1,636,000 sq km
   - Population: 67,540,000
   - Proven oil reserves in Caspian region: 0 barrels
   - Proven oil reserves in country: 93 billion barrels
   - Current oil production/Caspian region: 0 bpd

4. Azerbaijan
   - Land area: 86,100 sq km
   - Population: 7,798,000
   - Proven oil reserves: 11 billion barrels
   - Current oil production: 120,000 bpd

5. Russia
   - Land area: 16,996,000 sq km
   - Population: 147,306,000
   - Proven oil reserves in Caspian region: 0.2 billion barrels
   - Proven oil reserves in country: 50 billion barrels
   - Current oil production in Caspian region: 0 bpd