



“Oil Actually”

- Chinese and U.S. Energy Security
Policies in the Caspian Region -

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FORORD

Hvordan endte vi her? Olje- og energipolitikk var ikke et område vi noen gang så for oss at vi skulle bli fagnerder i, men englenes veier er uransakelige... En slitsom tid er over og vi vet begge langt mer om både olje og Kaspiahavet enn vi egentlig vil. De fleste slipper unna med Borat, men vi liker jo alltid å ta ting ett skritt lenger. Likevel føler vi nå et behov for å beklage dypt og inderlig til alle vi har utsatt for vår lett skremmende faghumor og håper vi ikke har mistet for mange venner i prosessen.

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CHAPTER 1: INTRODUCTION

“Nations have no permanent friends or allies, they only have permanent interests”

- Lord Palmerston -

1.0 INTRODUCTION AND RESEARCH QUESTION

Despite predictions that it would go on indefinitely,¹ the Cold War came abruptly to an end in the early 1990s, leading some to think that the “end of history” was at hand and the final victory of liberal democracy everywhere was unavoidable.² History, however, soon made its comeback. Immediately after the collapse of the Soviet Union, the U.S. seemed for many to have achieved a position of unprecedented power: its armies unchallenged, its economy the envy of the world. Out of the rubble of the old communist order, however, the Chinese dragon reared its head. Long mired in poverty, its centrally-planned economy struggling with the inefficiencies of the communist system, China had gradually introduced market reforms and was now racing ahead with one of the fastest growing GDPs in the world.³ This development largely took place below the radar screens of the West, which for a while was more concerned with developments in the former Warsaw Pact countries. Eventually, however, the new China became impossible to ignore and despite assurances of its intention to pursue a so-called “peaceful rise” policy, its newfound power and increasing assertiveness in the East Asian region aroused fears among its neighbors as well as concern on the other side of the Pacific. These developments also raised new questions about the U.S.’ unchallenged dominance in the international system.⁴

While the U.S. and China are still at radically different stages of their economic and military development, these two states share some fundamental problems and concerns, one of which is energy security. Vast amounts of energy are required to satisfy the needs of these juggernauts: industry, private consumption, and military machinery. Particularly, China and the U.S. share an unquenchable thirst for oil. In 2005, the U.S. imported approximately 12,4 mbpd, about 60% of its consumption, whereas China imported approximately 3,1 mbpd, or

¹ John Lewis Gaddis. 2005. *The Cold War: A New History*

² Francis Fukuyama. 1998. *The End of History and the Last Man*

³ John A. Bishop, Andrew Grodner, Liu Haiyong. 2006. “Chinese Economic Reform and Labor Market Efficiency”, published in *United Nations Online Network in Public Administration and Finance*

⁴ Casimir A. Yost. 1997. “The China Challenge and the U.S. Response”. *ISD Report*, Vol IV, No. 1

45% of its consumption.⁵ While this dependence on foreign oil is nothing new in the case of the U.S., China has only recently started to look outside its own borders for oil supply.

Oil is a unique natural resource in several ways. First of all, it is a non-renewable resource, which means there is an absolute limit to how much exists in the world. The current technology also places constraints on the ability to extract the amount of resources actually available. Secondly, as we have briefly touched upon already, it is of vital importance, more than any other resource, to modern societies and, at least for the time being, an irreplaceable resource. In fact, it would be difficult to imagine life in industrialized countries without it. While alternatives to oil are being developed and it is imaginable that these may eventually become viable replacements,⁶ this is generally considered a very long-term prospect. What this means is that oil, more specifically the stable, reliable supply of oil, is always a high priority for industrialized and industrializing states.

The ever growing dependency on oil has given birth to the concept of energy security. While this concept does include other energy sources, such as natural gas, coal and hydro-power, oil is normally considered to be the most important. At the most basic level energy security can be defined as “enjoying sufficient supplies at an acceptable cost”.⁷ The question of energy security has been steadily growing in salience, as the Middle East remains politically unstable and several growing Asian economies require ever greater supplies of energy to sustain their growth. At the same time, the “old” industrialized countries of Europe and North America continue to require large, and growing, supplies.⁸ There is thus no reason to expect that concern over energy security is likely to diminish in the foreseeable future.⁹ Such concern is in fact likely to continue to grow proportionally with the growth in demand for, and the steady decline in, oil reserves.

The Caspian Region contains a lot of natural resources, particularly oil. The Middle East has for a long time been perceived as the only region with capacity to provide sufficient supplies of oil to meet the world’s growing energy requirements, but due to the continuing political instabilities in the area several states now look for alternative sources of oil. The Caspian

⁵ EIA. 2006. *Top World Oil Net Importers*

⁶ U.S. Department of Energy. *Alternative Fuels Data Center*

⁷ Christian Constantin. 2005. “China’s Conception of Energy Security: Sources and International Impacts”, *UBC Working Paper, No. 43*

⁸ EIA. 2006. *International Energy Outlook 2006*

⁹ *Ibid.*

region is one of the most promising regions in this respect, and is drawing considerable international attention. Still, uncertainties remain as to the extent of the oil reserves¹⁰ in the region, and also to the costs involved in the extraction and transportation of the actual resources. The EIA estimates total reserves, which includes both proven and possible¹¹ reserves, to between 203 and 235 billion barrels of oil.¹² The viability and stability of the Caspian states is another uncertainty, even though the area is not prone to the same levels of conflict as the Middle East. Nonetheless, the great powers are eager to reduce their dependency on Middle Eastern oil, so despite these uncertainties the Caspian region is still attracting foreign interest and investment from states in pursuit of energy security. Chinese and American companies have been at the vanguard of this foreign influx, along with already established Russian competitors.

There is theoretical disagreement over where to place the emphasis when discussing energy security.¹³ Realists tend to emphasize supply, whereas liberals tend to stress the “cost” element. Realists view oil as a strategic commodity different from other trade goods, among other things due to the fact that it is of such vital importance to their conception of power. Energy security in a realist world is first and foremost a struggle to control the sources of oil and can also be defined as a “strategic approach” to energy security. Liberals, on the other hand, view oil, in the modern global marketplace as a somewhat normalized commodity, making liberal theories of complex interdependence and the importance of international institutions more significant for understanding energy security. This approach to energy security can also be defined as a “market approach”, due to the liberal emphasis on the market as a suitable mechanism for the distribution of oil as for any other trade good.

In this thesis we will be looking into two separate, but related, research questions. The first is empirical, while the second seeks to explain the empirical findings using theory:

(1) What policies do China and the U.S. pursue to ensure their energy security in the Caspian Region?

(2) How can Realism and Liberalism help explain these policies?

¹⁰ BP. *Oil reserves*

¹¹ Possible reserves are surrounded by a great deal of uncertainty, so the total number could easily be both higher or lower.

¹² EIA. 2006. *Caspian Sea Region: Survey of Key Oil and Gas Statistics and Forecasts*

¹³ Christian Constantin. 2005. “China’s Conception of Energy Security: Sources and International Impacts”, *UBC Working Paper, No. 43*

The purpose of the first research question is, essentially, to chart the terrain, collecting as much as possible empirical data about the energy security policies of the two states in the Caspian region. This is primarily done in chapters 4 and 5. The second research question uses two theories and their general concepts to simplify a complex reality and helps structure our findings into categories that make comparison, and thus explanation, possible. This draws on theoretical assumptions about what variables contribute most to explaining, in our case, the energy security policies of China and the U.S. Without such general theories to serve as guides for research, one might easily end up trying to include all aspects of reality in the analysis, which would be quite impossible and most likely only serve to create more confusion rather than understanding.

Combining comparative case studies with theoretical analysis is a method known as theoretically informed comparative case studies,¹⁴ (our translation) which will be discussed later. Our comparative study involves only two cases, which is necessarily the minimum possible number for comparison. This means that there are few possibilities for cross-checking findings, which somewhat increases the chance of drawing false conclusions. Our reasons for comparing only these two cases, and our attempts to compensate for the weaknesses associated with this, will be discussed later in this chapter as well as in chapter two. As our study involves a comparison of two states, it is thus also a cross-national analysis. Stein Rokkan distinguishes two aims of cross-national analysis, the first of which is “the testing of ‘macro hypotheses’ concerning the interrelations of structural elements of total systems.”¹⁵ This is the application of the method which is most relevant to our second research question.¹⁶ Our goal is not explicitly to test how well the macro hypotheses of realism and liberalism concerning the structural elements that define, or constrain, energy security policies in general help explain the energy security policies of China and the U.S. in the Caspian region in particular. While our main purpose is to apply these theories to our particular cases, however, a part of this process will necessarily be examining how suitable they are for the task. Should the policies of these two, otherwise quite different, countries in their pursuit of oil turn out to be similar in many respects, this can be taken as an indication that the need for oil takes precedence over other foreign policy goals or domestic concerns. Similar behavior despite different rhetoric and different domestic concerns suggests that the

¹⁴ Svein A. Andersen. 1997. *Case-studier og generalisering*

¹⁵ Stein Rokkan. 1966. “Comparative Cross-National Research: The Context of Current Efforts”, in Richard L. Merritt and Rokkan, eds., *Comparing Nations: The Use of Quantitative Data in Cross-National Research*

¹⁶ Therefore, somewhat irreverently, the second, “micro replications”, will not be discussed further

shared need is strong enough for policymakers to set aside other interests. This would again suggest that systemic theories, like realism and liberalism, can make a valuable contribution to the study of oil politics, albeit with some modifications to the original theories. If other, less universal, concerns were equally or more important one would expect to see greater differences in the policies chosen. If domestic variations seemingly do not affect policies, it is reasonable to assume that the determining factors must be found on the systemic level and must apply more or less equally to both actors.

1.1 POLICY

As the policies of two states are the subject of our study, it is of essence to have an understanding of what *policy* is. This is particularly true because policy is a term so commonly used that its meaning may seem vague. Simply put, “a policy is a plan of action to guide decisions and actions”.¹⁷ There are, however, several aspects of this rather simple definition that need further clarification to reach a full understanding of the concept. First of all, a policy is not an action in itself, it is an underlying plan of action guiding action. While this may seem like a mere repetition of our previous definition, it is of the utmost importance that the difference be kept in mind, as it often seems the two are confused. Policy implementation is only one part of the policy cycle,¹⁸ it is not synonymous with the policy itself. Nonetheless, as our definition makes clear, policy implementation is the most visible result of policy. Given the relative opacity of the foreign policy decision-making process in most countries, policy implementation is in fact often the part of the policy cycle most open to scholarly examination. This obviously creates some difficulties for policy studies, but as long as one keeps in mind that the milk is not the same as the cow from which it flows, it is certainly still possible to make excellent policy analyses.

Another point is that policy normally aims for a certain goal, the specificity of which may vary. In some cases, the goal for which a policy strives may be vague, which often results in a disconnection of means and ends, even though the rhetorical underpinning may remain intact. A policy is nonetheless clearly intended as a means to an end. As such, it is closely connected with interests.¹⁹ Policies are instruments through which interests are transformed into action.

¹⁷ Wikipedia definition of policy

¹⁸ Ibid.

¹⁹ Interests, specifically the national interest, can be simply defined as a state’s goals and ambitions, primarily economic, military, and cultural ambitions. In other words overarching ambitions, without specific endpoints, where policies are only meant to serve limited objectives in the ongoing pursuit of these interests.

Through the policy-making process, policymakers attempt to develop the most suitable plan of action to secure limited objectives, which again spring out of underlying interests. Successful policies are therefore those policies that serve the interests of the state.

1.2 THEORETICAL APPROACH

We have chosen realism and liberalism to help explain the energy security policies of China and the U.S. in the Caspian region because they are the dominant theories in the field of IR. Both theories have gone through major changes over time, resulting in their most recent incarnations of neorealism and neoliberalism, which is what we refer to when using the terms realism and liberalism in this thesis. Realism and liberalism have mostly been applied to questions relating to traditional security, but with the gradual expansion of the field of security studies, we believe it would also be interesting to see how, if at all, the traditional theories can be adapted to new issues, like energy security. Realism and liberalism view the world differently, although to some extent the difference is found more in what they choose to emphasize, as contemporary liberalism tends to accept most realist assumptions about the nature of the international system.²⁰ Neither theory was originally developed with questions of energy security in mind. Rather, realism deals primarily with problems of national security and causes of conflict in the international system, while liberalism deals mostly with the potential for cooperation under the difficult circumstances presented by realism. This does not mean, however, that the two theories are wholly unsuitable for the task at hand. Our research question requires extrapolating on some of the basic claims of realism and liberalism in order to make arguments that are relevant to the problem of energy security.

We will discuss more thoroughly in the second chapter what kind of policies we believe would be consistent with either realism or liberalism, but for now table 1.1 will provide a brief overview of the policy recommendations and priorities of the two theories.

²⁰ Joshua S. Goldstein. 1999. *International Relations: Third Edition*

Table 1.1: Ensuring Energy Security

| | Realism | Liberalism |
|-----------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------|
| Relative/Absolute gains | Attention to relative gains, as oil is a severely limited resource. | Absolute gains. Oil is a more normalized commodity than realists claim. |
| Zero Sum | Zero sum game due to limited availability of oil | Not a zero sum game, as production can be increased over time through cooperation and a well-functioning market |
| Institutional or bilateral agreements? | Bilateral agreements are more predictable, and provide importers with more leverage. | International regimes and institutions will create more predictability and benefits for all, as well as allow for issue-linkage |
| Role of the market | The risk of market failure is unacceptable. Greater control of oil resources is essential and provides greater predictability. | The invisible hand of the market ²¹ will keep prices at an acceptable level and ensure continued production and investment |
| Conception of energy security | Strategic resource | Market commodity |

The table presents the categories, developed on the basis of central issues in the debate between liberalism and realism, which will be used to organize our empirical data in chapter six. In the first three categories we deal with well-known debates between realists and liberals, although some concepts have had to be translated to the context of energy security. These translations are presented briefly in the table, along with the basic claims of both theories, but will be discussed in greater detail in chapter two. The “role of the market” category is partially based on an extrapolation of common realist and liberal arguments. Normally, the role of the market is not discussed as explicitly as a part of the debate between realism and liberalism as presented here, but it is often implicitly part of the debate, especially as liberalism primarily emphasizes the possibilities of economic cooperation. The general arguments of both theories also lend themselves well to a discussion of markets, as it is the inherent uncertainty of the market that makes it unsuitable for the handling of what realists deem a strategic resource. This relates to one of the core assumptions of realism: that the uncertainty stemming from the anarchic nature of the system of states prevents cooperation. There is a shared understanding that oil is more important to states than other resources, but

²¹ Adam Smith. 1991. *Wealth of Nations*

the two theories have different conceptions of energy security largely as a result of their disagreement on the role of the market.

1.3 SCOPE

The primary focus of our thesis will be the policies of the great powers, China and the U.S., in the Caspian region. The Caspian region, as defined in this thesis, is made up of the following countries: Azerbaijan, Kazakhstan, and Turkmenistan. While Russia and Iran are also littoral states, we have chosen not to include them among the Caspian countries, as only relatively small parts of these countries, as well as a fairly insignificant part of their oil production, are located in the region and both can be more meaningfully viewed as major external actors, as well as important, or potentially important, transit countries for Caspian oil. The countries we have included in the Caspian region share several features, many of them a result of their shared Soviet history. As we have already mentioned, one common feature entirely unrelated to their shared history, although perhaps more important in the current situation is that they have, or are assumed to have, considerable energy resources.

Even though the independent states of the region all have their own agendas and complex internal politics, our focus will be on their relationships with China and the U.S. The main time frame of our analysis will be the period after 1993, when China became a net importer of oil. Up until this time China had been mainly self-sufficient when energy is concerned, but since 1993 it has become more and more dependent on import to sustain its growing economy and the expansion of its military. This time frame also corresponds closely with the end of the Cold War and the resulting transformation of the Caspian region along with the rest of the former Soviet Union. This has been an eventful period, as the Caspian states have worked to strengthen their independence and national cohesion. Of greater significance to us is the opening up of the newly independent states to foreign, specifically Chinese and American, energy interests. During the Soviet era, the countries of the Caspian region were all Soviet republics and thus fully integrated in the centrally planned economy of the Soviet Union. The Kremlin did not see fit to develop the oil industry in Kazakhstan and Turkmenistan. However, Azerbaijan was the cradle of the Soviet oil industry and at the beginning of the 20th century was the source of more than half of total world production.²² Even as the bulk of Soviet production shifted north to Siberia and the Russian Far East, Azerbaijan maintained a

²² Mir-Yusif Mir-Babayev. "Azerbaijan's Oil History", *Azerbaijan International*, Summer 2003

considerable production of its own throughout the period and provided people and know-how for projects in other parts of the Soviet Union.²³

1.4 METHOD

1.4.1 Case Studies and the Comparative Method

Case studies are characterized by their focus on one or a few cases. As such, case studies primarily seek to explain limited phenomena, although generally exploring these in more depth than what is typically done in quantitative studies, which seek to include as many variables and as many cases as possible. The goal of quantitative studies is to make wide-ranging generalizations, but these run the risk of ignoring significant local differences. A theoretically informed comparative case study like ours seeks to apply established theoretical concepts to systemize differences and similarities in order to explain a dependent variable.²⁴ This also makes it possible to make partial generalizations. What this means in our case is that it may be possible to show that a certain type of states, great powers with vast energy needs, in a certain environment, such as the Caspian region, will tend to act in a certain way. As long as one accounts for the circumstances under which the partial generalizations apply, the case study method does allow for making statements about general empirical relationships beyond the specific case or cases being studied. Nonetheless, the main objective of this thesis is to explain the current energy security policies of China and the U.S. in the Caspian region.

In order to better understand the policies of the two great powers in the region, we will make a comparison, looking for differences and similarities that may shed some light on why these states do what they do. As part of this, we will first account for the needs and motivations of China and the U.S., respectively, as well as differences in power, both militarily and economically. In other words, the interests and capabilities that may contribute to an explanation of their energy policies in the Caspian region. In this, we will explore policies in a variety of fields that may nonetheless be related to questions of energy security.

As we have chosen to utilize a comparative method in our examination of the policies of China and the U.S., it is necessary to say a few words about the comparative method in general, its potential and limitations, and how we intend to apply it in our analysis. At the most basic level, the comparative method is “a method of discovering empirical relationships

²³ Ibid.

²⁴ Svein S. Andersen. 1997. *Case-studier og generalisering*

among variables”.²⁵ However, it is important to understand that in this respect the comparative method is imperfect. While the social sciences in general can never attain the same degree of precision as the natural sciences, which have the benefit of dealing with phenomena that can be studied in far more controlled environments, it is true that the comparative method is also in some ways less precise than other methods common in the social sciences, such as the statistical method. Nonetheless, the use of the comparative method is justifiable “when the number of cases available for analysis is so small that cross-tabulating them further in order to establish credible controls is not feasible”.²⁶ This is certainly the case in our thesis, as the analysis is, and reasonably can be, based on only two cases: the policies of the U.S. and China in the Caspian region.

To clarify the method at this point, the following can be stated: the comparative method basically consists of holding up two or more cases and, through thorough, logical consideration of what are likely to be the most influential, or “key” variables in a given situation, looking for differences or similarities that help explain the phenomenon or phenomena in question. As such, the comparative method is arguably more demanding in terms of scientific rigor and raw logic than the statistical method. The researcher first of all needs to find comparable cases, meaning cases that are “similar in a large number of important characteristics (variables) which one wants to treat as constants, but dissimilar as far as those variables are concerned which one wants to relate to each other.”²⁷ There is always a danger that the researcher might end up comparing cases that are really not comparable in this sense, either due to poor judgment by the researcher himself or simply a lack of information which, if known, would have shown the cases to be incomparable. The same is true of the second step in the process, that of defining the key variables. As it is impossible to compare all the variables that might possibly have some greater or lesser relevance, the researcher must determine which variables are most important, or rather which variables are most likely to provide insight and ideally prediction power. This is taken by many as an indication as to why parsimony, rather than absolute truth, must be the goal of the social scientist. When constructing models, there is no hope of ever being able to accurately measure and include all potentially relevant variables or cases in any study, which would be a requirement for creating immutable laws of political behavior. As that is not an option, one

²⁵ Arend Lijphart. 1971. “Comparative Politics and Comparative Method”, *American Political Science Review*, No. 3 1971, p. 683

²⁶ *Ibid.*, p. 684

²⁷ *Ibid.*, p. 687

must strive for parsimony, attempting to find those variables which, more than others, help in making reliable predictions and explanations of behavior. There are clearly complications in this application of the comparative method, as we have attempted to show. This, however, should not drive researchers away from the method, but rather instill in them an awareness of these potential pitfalls, which should hopefully help to avoid them.

1.4.2 Data and Sources of Data

When comparing the policies of the U.S. and China we will utilize books and articles by other scholars in International Relations, and furthermore, articles from mainstream news sources. Due to the fact that this is not a historic analysis and that we are studying events that are still unfolding, the Internet is a valuable tool, as online sources are continually updated. Books and printed articles on the other hand will only become available some time after the events they describe. Our sources of data have the benefit of being highly relevant and dealing directly with the research topic. On the other hand, reliability may be an issue in some cases. An example of this is our use of Wikipedia, an online, user-created information database, for some definitions. As Wikipedia content is created by the users, there could be some reliability issues. However, Wikipedia does have stringent quality control mechanisms, including scholars who read through articles relating to their fields before publication online, and studies have shown it to be as reliable as the *Encyclopaedia Britannica*.²⁸ Another issue when using Wikipedia in scholarly works is the possibility that content may change over time, making reader verification somewhat more complicated. Nonetheless, limited use of this source should not be a problem, especially when restricted to basic definitions of well-known concepts. More importantly, all our sources are secondary, which means that the data has already been interpreted to some extent by others. This can be a particular problem when dealing with news sources, as these are not subject to the same scrutiny as scholarly works. We have tried to compensate for these problems by using a wide variety of sources and attempting whenever possible to cross-check information with several sources. Also, the problem of reliability is smaller when dealing primarily with actual state behavior, as we have in our data gathering, rather than intentions or policymaking processes.

It is important to keep in mind that the sources available for studying Chinese foreign policies are more limited than in the case of the U.S. Official documents stating U.S. policies, and also

²⁸ Stephen Cauchi. "Online encyclopedias put to the test", *The Age*, December 15, 2005

speeches and the like by U.S. officials, are available, but finding official Chinese documents stating policies are near to impossible, especially if one does not speak Chinese. As such, documents on Chinese energy strategies are harder to come by than in the case of the U.S. For comparative reasons we have, thus, chosen not to focus very much on stated policies by U.S. officials either, but instead focused on sources that describe what the U.S. and China in fact do. This is also due to the fact that stated policies do not always correspond with what a state actually does, which is what we are interested in finding out and analyzing.

1.5 OUTLINE OF THE THESIS

After this brief introduction, we will move on to the second chapter, in which the theoretical framework of the thesis will be outlined. This chapter will consist of two main parts. First, a brief presentation of realist and liberal IR theory, then a more thorough discussion of the concept of energy security and its theoretical implications. As we have already mentioned, energy security is a concept that has not been fully incorporated into most traditional theoretical approaches, which means that it is necessary to make some adaptations to traditional realist and liberal theory for them to be applicable to our analysis. Chapter three will be a background chapter, divided into two main parts, the first of which will examine the significance of oil and energy security on the world stage. In this we will primarily look at the relations between exporters and importers. The second part will be devoted to the Caspian region itself. Here we will look at the history of the region as well as recent political and economic developments. Also, we will try to place the Caspian region in a larger context, looking at its geography, geostrategic importance, oil reserves, and disagreements over oil pipelines.

The following two chapters will present the interests and policies of China and the U.S., respectively. In these chapters we will also discuss relations between China and the U.S. and other major external actors in the region. At the end of chapter five, we will give a brief overview of the relationship between the two. The purpose of these two chapters, besides providing empirical data for our analysis, is to answer our first research question. In chapter six we will attempt to synthesize our findings about U.S. and Chinese policies in the Caspian region and organize these according to some central categories from realist and liberal thinking. Then we will try to analyze their energy security policies using the realist and liberal approaches and looking at differences and similarities between the two. The final chapter will summarize some conclusions from the analysis and attempt to answer our research questions.

CHAPTER 2: THEORIZING ENERGY SECURITY

“Safety and certainty in oil lie in variety and variety alone”

- Winston Churchill -

In this chapter we will first present a realist and then a liberal perspective of international relations (IR). These are the oldest theoretical traditions in IR, and also the two which have been the root of most major debates in the field. Neither of the two theories were developed with issues of energy security in mind, but as this chapter will show, they may yet be suitable for the task. We will first present the theoretical framework of “pure” (neo)realism and (neo)liberalism. Thereafter, we will discuss the applicability of the theories to issues of energy security and some fundamental disagreements between them.

2.0 REALISM

Contemporary realism traces its roots to one of the oldest traditions in IR. It has been modified and gone through paradigmatic shifts in recent times in an attempt to create a more scientific theory of IR. The greatest shift in this respect came with the publication of Kenneth Waltz’s *Theory of International Politics*,²⁹ which has provided the basic framework for modern neorealism (sometimes referred to as structural realism).

Realism is a systemic theory, meaning that all analysis takes place on the systemic, rather than unit, level. This is because realists believe it is the structure of the system that determines state behavior in IR. The structure of the system never changes and cannot be altered. The elements of the system discussed below supposedly perpetuate a certain kind of behavior, efficiently rooting out any deviants. Furthermore, realism seeks to be a scientific theory of IR, while acknowledging that IR has no certain and immutable laws like those found in the sciences. Rather, realists claim, what makes realism a superior theory to its rivals is parsimony: providing a great deal of prediction power with a relatively small amount of data. In fact, realists argue that all that is necessary to make fairly accurate predictions of state behavior in IR is an understanding of their relative power. We will return to this in greater detail below.

²⁹ Kenneth Waltz. 1979. *Theory of International Politics*

The system in question is the international system of sovereign states. The defining feature of this system is its anarchic nature, which in realist theory is defined as the absence of any higher authority than the states themselves. The international system lacks a supreme authority, as there is currently no world government.³⁰ This point is perhaps best clarified by a comparison with the domestic life of these states. In a sovereign state the government is in all things the highest authority, with a monopoly on the legitimate use of force to extract from the state's citizens compliance with its laws and regulations, as well as the funds necessary for the maintenance of the state. In fact, this is the most common definition of sovereignty.

Obviously, this is not to say that only the state ever uses force, but merely that it is the only entity which can legitimately do so.

A fundamental assumption of realist theory is that states are functionally identical, only varying in the means available to them to secure their identical goals. The main objective that all states are assumed to share is the survival of the state, and the way to ensure survival is the accumulation and proper application of power, more specifically military power. Realism focuses primarily on the most powerful states, the great powers of the world. As such, power is central to a realist analysis of IR: "might is right" in the international system of states.

States are taken to be the only relevant actors in IR. When the hammer comes down, realists assume that interest groups or international organizations are merely tools for the most powerful states in the system. Therefore, states are perceived as unitary actors. The domestic life of states has no impact on IR, because of the demands anarchy places on all actors in the system. In fact, realism tends to assume that the pressures of an anarchic system will force states to adjust their foreign policies to this view of the world or perish, which essentially means that all existing states act rationally according to realism, or they would have ceased to exist long ago.

States are thus assumed to be rational actors, in the sense that they seek the best means available in the pursuit of a predetermined, and universally shared, goal, that of state survival. The best policy in the pursuit of security, according to realists, is a constant vigilance and concern with relative gains. What this means is that it is more important to increase one's own power relative to that of others than to achieve the maximum possible increase in power, if

³⁰ The UN, largely through reference to international law, has at times attempted to take on the role of legitimizer, but with varying degree of success.

this would involve a relative weakening of one's own position in relation to others. In the most extreme cases, accepting a small loss is considered beneficial if one's opponents suffer even greater losses. The underlying logic is that the insecurity of anarchy, particularly the impossibility of knowing with certainty the intentions of other states in the absence of a supreme arbiter, leads to an inability to tell friend from foe with any degree of certainty. Any other state is a potential enemy, since they also strive for maximum relative power and the associated security, and are assumed to be willing to do whatever it takes to achieve this goal. In short, the inherent uncertainty of an anarchic system means that trust is a luxury no state can afford, because even a momentary lapse of attention to relative gains could lead to total annihilation.

The uncertainty of anarchy also leads to a concern with the balance of power in the system. This means that states' actions must always take into account the actions, and possible actions, of all other relevant states, because no state acts in a vacuum. China and the U.S., even when dealing directly with each other, cannot ignore other states that might interfere or somehow affect the outcome of their dealings. The system as a whole, or the sum of relations within the system, is what determines behavior. What this means is that states must try to, however temporarily, align themselves with other states in a way that contributes to the stability of the international system. Alliances can, and must, be changed freely, as it is quite irrelevant to the stability of the system who holds the power; all that matters is its distribution. Realism, thus, does not recognize the possibility of permanent alliances. In fact, since one can never fully trust other states, dependency is a weakness that should be avoided if at all possible. Dependency gives the states on which an actor is dependent a certain power over that state and its policies, which can limit its ability to act according to the national interest.

2.1 LIBERALISM

Liberalism tends to accept most realist assumptions about the nature of the international system: "The appropriate response to the changes occurring in world politics today is not to discredit the traditional wisdom of realism and its concern for the military balance of power, but to realize its limitations and to supplement it with insights from the liberal approach."³¹ Thus, they accept that the international system is a system of sovereign states and that there is no central enforcement mechanism in the system. But for liberals this does not mean that

³¹ Joseph Nye. 1990. Quoted in Jackson and Sørensen (ed.). 2003. *Introduction to International Relations*

there is nothing that regulates the actions of states, or that states are only interested in maximizing their relative power in comparison to other states. Liberalism has a more optimistic view of IR than realism, and focuses on the potential for progress in the modern civil society and capitalist economy.³²

The birth of the liberal tradition is closely connected to the emergence of the modern liberal state.³³ The tradition is wide, including several related ideologies, as well as philosophical and social science schools.³⁴ It is therefore necessary to clarify how the neoliberal approach to IR fits into this tradition, both to understand its wider context and more importantly to separate it from the schools of thought that are not part of this thesis. *Classical liberalism*, the liberalism of Adam Smith, David Ricardo, Jeremy Bentham, and John Stuart Mill, is “a doctrine stressing the importance of human rationality, individual property rights, natural rights, constitutional limitations of government, the protection of civil liberties, laissez-faire economic policy, and individual freedom from restraint.”³⁵ This form of liberalism particularly emphasizes the beneficial effects of the invisible hand of the market, for which the abovementioned elements are preconditions. Neoliberalism as a theory of international relations is often connected to neoliberal economic theory, which emphasizes the effectiveness of free markets, much like classical liberalism. While elements of neoliberal economic theory are part of neoliberal international relations theory, they deal with different issue areas, and as such are not identical. Our focus will be on the IR theory, which is part of the liberal tradition in the sense that it attempts to bring many liberal concepts into the study of international relations, as the above quote from Joseph Nye explains.

Liberals claim that increased interaction across borders has led to what they term complex interdependence. The essence of this concept is the idea that with increased levels of interaction, including a great variety of long-term, binding cross-border agreements, both between states and sub-state actors, states come to depend on each other to a great extent. Particularly, this is said to be true in relations between industrialized states, which tend to rely on other states for imports of needed goods (such as oil) and as export markets for their own products (such as oil). Modern interdependence theory has been inspired by the belief that

³² Joshua S. Goldstein. 1999. *International Relations: Third Edition*

³³ Ibid.

³⁴ Liberalism in contemporary colloquial American usage often refers to *social liberalism*, sometimes called *new liberalism*, a centre-left political philosophy, maintaining many core elements of classical liberalism, but claiming that the market must be regulated to some extent in order to function properly.

³⁵ Wikipedia definition of classical liberalism

conflict between states is less likely if states in the same geographical region have a common ground of interests in trade and economic collaboration³⁶. Liberalism assumes that, while war will always be “ultima ratio regum”, a great deal can nonetheless be done to reduce the risk of war by facilitating cooperation. War is, after all, a rather costly way of resolving disputes and rational, unitary actors should therefore be expected to avoid it if possible. Avoiding war is, however, as realism has shown, hard. The international system, suffering the harsh effects of anarchy, particularly uncertainty about the intentions of others, will always be prone to warfare. While accepting this as a fact, liberals believe there is a way out, or rather that there is a way of mitigating the negative effects of anarchy. This can be done through international regimes³⁷ and institutions.³⁸

Liberals believe that international institutions and regimes can help facilitate cooperation between states by significantly reducing the risks involved and increasing the benefits, making war, or any other violation of the terms of agreement, less attractive. Assuming that most participants respect the rules of the regime, noncompliance by any single state will have serious negative consequences, both in the form of sanctions and through exclusion from the collective good provided by the regime. It is, however, important to note that most liberals would agree that the effect of regimes and institutions is greatest when it comes to economic cooperation, while admitting that states will generally not trust their physical security entirely to others.³⁹ Despite this, regimes and institutions are also assumed, over time, to lead to increased interdependence between the participants, thus further decreasing the risk of international disputes turning violent. Furthermore, while not granting economic concerns precedence over security, liberals say that states do seek economic prosperity, and when conditions can be created under which security concerns are not all-consuming, this desire for prosperity will lead rational actors to cooperate and resolve their disputes peacefully. The use of force, or even the threat to use force, would be foolish, because the close ties between states will result in the aggressor actually harming himself. In a way, it can be compared to throwing a hand grenade at an enemy standing a mere foot away.

³⁶ Joshua S. Goldstein. 1999. *International Relations: Third Edition*

³⁷ An international regime can be simply defined as “a set of rules, norms and procedures around which the expectations of actors converge in a certain issue area” (Stephen D. Krasner in Joshua S. Goldstein. 1999. *International Relations: Third Edition*)

³⁸ Successful regimes will often be institutionalized, meaning that the regimes are supported by a staff and headquarters, usually allowing the institution to more actively promote adherence to the rules of the regime. (Joshua S. Goldstein. 1999. *International Relations: Third Edition*)

³⁹ A bipolar system is arguably an exception to this rule, both for realists and liberalists, as it leaves minor powers, at least those caught geographically between the two poles, with little choice besides bandwagoning.

In order to create complex interdependence between states, there must be significant volumes of trade and communication back and forth. Not only is this necessary to create multi-level links, but there will never be real dependence unless the goods being traded make up a significant share of each state's needs for them. Therefore, free trade and the removal of trade barriers are at the heart of interdependence theory, and this is also one of the reasons why liberalism is sometimes referred to as the "market approach".⁴⁰ Liberals believe in the beneficial effects of the market and furthermore that cooperation can facilitate the smooth functioning of the market by creating greater transparency and mutual trust between states.

In opposition to the realist claim that states are only concerned with relative gains, liberals claim that states actually seek absolute gains, meaning the maximum possible gains in any given situation, regardless of the gains of others. The debate over whether states are primarily concerned with relative or absolute gains is at the heart of the disagreement between realists and liberals. Liberals agree that when tensions are high and uncertainty is great, states will tend to focus on relative gains, but as has been explained above, liberals disagree when it comes to the possibility of reducing risk and uncertainty. Where realists say these negative effects of anarchy simply cannot be mitigated, liberals point to regimes, institutions and interdependence and say these make it possible to focus on absolute gains. A consequence of this is that liberalism is less focused on issues of security and often tends to emphasize cooperation on economic issues as a way to improve security for all states, but otherwise accepting the fundamentals of realist security thinking.

2.2 ENERGY SECURITY

The idea of energy security takes the concept of security beyond the dominant realist and liberal thinking on security. As such, energy security can be placed within the context of a larger debate on how security should be defined and what are the most important issues in security thinking. In this context energy security is often linked to environmental security, which deals with the threats caused by environmental degradation. The effects of large-scale burning of fossil fuels impact seriously on the global environment. Many consider this to be a greater threat than that of disruption of energy supplies, which is what this thesis primarily deals with. For this reason, some have argued that the study of energy security should focus on how to provide for energy needs in an environmentally safer way or reduce consumption in

⁴⁰ Christian Constantin. 2005. "China's Conception of Energy Security: Sources and International Impacts", *UBC Working Paper, No. 43*

order to reduce the damage caused. However, we have chosen to emphasize the traditional understanding of energy security, “enjoying sufficient supplies at an acceptable cost”,⁴¹ leaving out the related environmental issues, as they do not impact on our research questions. The concept has many different dimensions, ranging from political and military, to technical and economic.⁴² Having sufficient supplies “determines whether our lights will go on or off, our agriculture and industry will go forward or backward, our homes and offices will be habitable or become shells – and in fact whether or not we can defend ourselves”.⁴³

Oil production cannot be increased in the short term, unless there are producers maintaining buffer capacity. Developing new sources takes considerable time and investments, both for practical reasons and because of various formalities⁴⁴ that must be sorted out in advance. As long as oil is not available in abundant supply and the supply cannot be quickly increased, which is the case today, the uncertainty of oil supply might take on the same significance for energy security as the uncertainty of anarchy does for traditional security. Certainty is in limited supply for states seeking state survival in traditional realist thought, just as oil is in limited supply for oil importers. The fear of a sudden loss of supply, due to natural disasters, wars, revolutions, terrorism, conflicts with exporters, or other unexpected disruptions intensifies the uncertainty of the system, and means that for most importers a significant buffer of excess production and supply is desirable. These are the conditions, present in the contemporary world, which actualize realism and liberalism as theories potentially suitable for explaining energy security policies.

There are several different types of events that may cause disruptions to energy supply or an increase in price. Normally one distinguishes between events that have a global impact and those that only have impact for one specific region or country.⁴⁵ The most serious threat for importing countries today is the “policy discontinuity”⁴⁶ caused by OPEC policy decisions concerning output levels. This is what OPEC does when it wants to change the price of crude oil and, furthermore, is something that is known to happen every few years and will continue

⁴¹ Christian Constantin. 2005. “China’s Conception of Energy Security: Sources and International Impacts”, *UBC Working Paper, No. 43*

⁴² Janusz Bielecki, “Energy Security: Is the Wolf at the Door”, *The Quarterly Review of Economics and Finance, Vol. 42, No. 2, Summer 2002*

⁴³ Lee H. Hamilton: “Foreword”, in Jan H. Kalicki & David L. Goldwyn (eds.). 2005. *Energy & Security*, p. xxi

⁴⁴ Contracts, licenses, permits, etc.

⁴⁵ Philip Andrews-Speed, Xuanli Liao and Roland Dannreuther: “The Strategic Implications of China’s Energy Needs”, *The International Institute for Strategic Studies*, 2002.

⁴⁶ *Ibid.*

to occur unless better information on production and stock levels is made available for importing countries.⁴⁷ The consequence of such OPEC policies is a sudden change in oil prices that states are not prepared for. An even worse scenario for oil importing countries is what is known as “fundamental discontinuity”,⁴⁸ which is a global shortage of production capacity. “A long-term failure to invest in production, transportation or processing capacity could result in an absolute shortage of supply of energy with respect to the demand.”⁴⁹

Other global events that may cause disruptions in energy supply are events such as civil unrest, war, deliberate blockade of trade routes (so-called “force majeure” disruption⁵⁰), export disruption and embargo disruption. Export disruption is when a main exporter cuts back on exportation, whereas embargo disruption is when a specific exporting state is made victim of an embargo by importers, which is the case of Iran today.

Local events that are a threat to a state’s energy security may be embargo disruption, where one state suffers from a general embargo by one or several/all oil exporters, or logistical disruptions such as accidents or terrorism, especially along transportation infrastructures, such as oil-pipelines. Furthermore, states may also experience local market disruptions by monopolist suppliers, pressure groups or through government mismanagement.⁵¹

2.3 ENERGY AND POWER

“Ever since the Industrial Revolution, energy and the need to secure its supply have been fundamental to any position of power in the world”.⁵² This statement by James R. Schlesinger, the U.S.’ first Secretary of Energy and later Secretary of Defense, illustrates why realism may be able to contribute to the study of energy security. Energy is intimately linked to power, and without energy security national security will always remain elusive.

⁴⁷ Ibid.

⁴⁸ Ibid.

⁴⁹ Ibid. p. 13

⁵⁰ Ibid.

⁵¹ Ibid.

⁵² James R. Schlesinger. “Foreword”, in Jan H. Kalicki & David L. Goldwyn (eds.). 2005. *Energy & Security*, p. xiii

The traditional realist conception of security is very much focused on power and the military/physical aspect of security. Power is taken to be a state's only guarantor of security, which is why the accumulation of power is assumed to be the main priority of all states in the international system. Even though most realists have not examined energy security very closely in their writings,⁵³ most would agree that it is important, as it is normally taken for granted as an integrated part of their understanding of power. In times of conflict, or even war, sufficient energy supplies are vital to the ability of a country to utilize its military power. No amount of warships or tanks will make a difference without the fuel to operate them. Indeed, the U.S. and British oil boycott of Japan is generally accepted as one of the main motivations for the Japanese attacks on the Dutch East Indies and Germany's lack of domestic natural resources for the German push toward the Caucasus during WWII.⁵⁴ Adolf Hitler supposedly even told Field Marshal Erich von Manheim in a phone call: "Unless we get the Baku oil, the war is lost!"⁵⁵ As will be discussed in greater detail later on, it also provided a major impetus for the establishment of the special relationship between the U.S. and Saudi Arabia near the end of the war.⁵⁶ One of the main assumptions of this thesis will be that energy security is one of the pillars on which military power rests and that realist claims about how states act to ensure traditional security could therefore be relevant to the study of energy security and energy policy.

Realists do tend to acknowledge that military power is dependent on other types of power, particularly economic and industrial power, as military power does not arise out of sheer will alone.⁵⁷ It is thus important to note that even most realists recognize that economic power is a requirement and important determinant of military power. This means that oil influences military power both directly, in terms of fuel requirements for military machinery, and indirectly, through its importance to the economy, as illustrated in figure 2.1

⁵³ Morgenthau does, however, discuss the importance of oil as power capability in *Politics Among Nations* (1973)

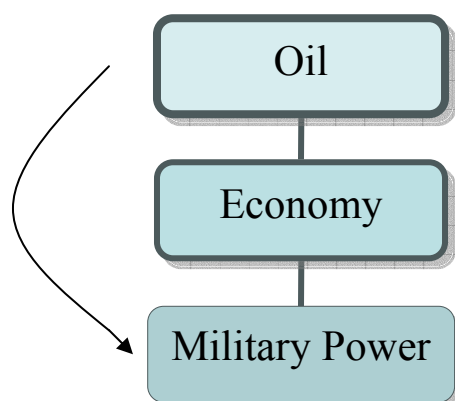
⁵⁴ Amos Nur. 2004. *Oil Future and War Now: A Grim Earth Sciences' Point of View*

⁵⁵ *Ibid.*, p. 17

⁵⁶ Wikipedia definition of the Carter doctrine

⁵⁷ Karen Mingst. 2001. *Essentials of International Relations: 2nd Edition*

Figure 2.1: The relationship between oil, economy and military power



For realists, economic and military power are often pursued simultaneously and in support of each other, with the overarching goal of creating a stronger, more powerful state. Economics is nonetheless always subordinated to politics and the pursuit of state security, should there be a conflict between the two.⁵⁸

2.4 INSTITUTIONALIZED OR BILATERAL COOPERATION

While liberals tend to consider economics more important than realists, their acceptance of most fundamental realist assumptions means that the same arguments we have used to justify the application of realism to energy security questions also apply to liberalism. As the typical definition of energy security suggests, however, energy security can also be interpreted in more economic terms than realists would, placing greater emphasis on acceptable price. What this means is that even though there can be no question that oil is a unique natural resource, liberals believe it is still fundamentally a trade good that can be the object of negotiation, unlike national security. If the acquisition of oil is in fact a question of economics, it could more easily be included in the kind of wide-ranging institutionalized cooperation that liberals tend to emphasize as a way out of the constraints of the system. Liberals point to the advantages of multilateral, institutionalized cooperation, which they believe will be obvious to rational state actors. Institutionalized cooperation will draw a greater number of states into a complex web of trade and interaction and if a successful regime can be established, where all involved states are willing to sanction those that withdraw from the regime, this web will be hard to get out of. As has been mentioned, liberals believe the advantages of cooperating

⁵⁸ Charles W. Kegley, Jr. and Eugene R. Wittkopf. 1999 *World Politics: Trend and Transformation*

under an effective regime, and the disadvantages of remaining outside the regime, will ensure the regime's continuation and growth, as long as there is no major disruption. Furthermore, successful regimes allow for issue-linkage, where states are able to recuperate losses in one area by gains in another. If oil could be included in issue-linkage, it would reduce uncertainty for all involved actors. Even though all states need oil, they would also prefer to get it through stable mechanisms and peaceful negotiation, rather than through forceful, and costly, means. Strategic policies, while arguably providing greater predictability, tend to be more expensive than a laissez-faire approach.

The realist conception of energy security, on the other hand, would suggest that bilateral cooperation,⁵⁹ or the subordination of foreign states, is the way to go when self-sufficiency is not possible. This kind of close attention to bilateral relations would give states a greater degree of certainty and some minimum of control, which realists deem absolutely necessary. The relationship between the U.S. and Saudi Arabia can serve as a good example of this. The U.S. helps provide security and stability for the al-Saud regime in return for oil, or at least the guarantee that Saudi Arabia will not suddenly make dramatic cuts in its production. While this arrangement certainly gives the Saudi regime greater influence with the U.S. government than other states of comparable size and power would have,⁶⁰ it also gives the U.S. sufficient leverage over Saudi Arabia to help ensure the continued flow of oil. From a realist perspective, a series of such bilateral relationships would be preferable to any wider multilateral cooperation, because it provides the importer with the leverage it needs over exporters. Unless an importer could gain a position of hegemony in a multilateral cooperation, there would still be too much uncertainty involved and potentially too much power surrendered to exporters. Hegemony would, however, be much harder to achieve in energy-related cooperation than traditional security-based alliances, as importers are by definition in a weak position.⁶¹ This is an additional advantage to cooperating closely with a key exporter. Some have claimed that Saudi Arabia has a near-hegemonic role within OPEC,⁶² making a close partnership with such a state a back-door to hegemony for importers, who by their very nature cannot achieve that position for themselves.

⁵⁹ When discussing bilateral cooperation in this thesis we are talking about ad hoc bilateral cooperation, as bilateral cooperation can also be institutionalized

⁶⁰ It is a general dynamic in the importer/exporter relationship that exporters tend to gain unusual influence over dependent importers, but this is accentuated in Saudi-U.S. relations

⁶¹ If oil could become part of wider cooperative arrangements, power in other areas would come into play

⁶² Dag Harald Claes. 2001. *The Politics of Oil-Producer Cooperation*

2.5 RELATIVE VERSUS ABSOLUTE GAINS

Because oil is such a limited resource, both in its ultimate availability and in the currently available supply, realists would likely consider the global competition for oil a zero-sum game, much like the competition for traditional security. This leads to a concern with relative gains, simply because a rival's increase in supply will necessarily lead to a decrease in one's own supply. When, for example, China strikes a deal with Kazakhstan for a fixed volume of oil delivered daily, that means not only that the same volume of oil will be unavailable to the U.S., but also that the pipelines necessary to deliver said oil to the U.S. will not be constructed, shutting the U.S. off from that oil both in the short and long term. Liberals, however, view the issue differently, with a greater focus on absolute gains. It is still possible to increase production from known oil fields, new reserves are still being discovered, and technologies are continuously being improved. What is needed is the kind of cooperation between importers and exporters that will make it desirable for exporters to increase their capacity. If all parties were to focus on absolute gains this could happen, through institutionalized cooperation that might remove the uncertainty of the situation and trust in the ability of the market to deliver the required supply of oil, making the considerable investments necessary more acceptable.

Realists see a significant problem with these liberal arguments, besides the liberal trust in international institutions and cooperation. Concern with relative gains generally also means a concern with the short-term perspective. No state can risk endangering its short-term energy security based on faith in the ability of an international regime to deliver future benefits. Lacking sufficient supplies of oil, even temporarily, places a state in a weak position, both militarily and economically, which can be taken advantage of by its rivals. Liberals, on the other hand, maintain that international regimes and institutions and the interdependence they breed over time, provide enough certainty and predictability for states to focus on the long term, involving themselves in cooperative efforts to ensure a greater supply of oil for all, as rational actors looking out for their absolute gains would. This is also linked to the liberal perception of oil as a more normalized commodity and their resulting belief in the market as a suitable mechanism for regulating the production and distribution of oil.

2.6 ROLE OF THE MARKET

At the most basic level, markets can be defined as “(...) mechanisms for the production, circulation, and valuation of goods and services”⁶³ The idea is that under free market conditions, supply and demand in a market will be balanced, because this is in the interest of all involved parties, providing needed goods for importers and maximum long-term income for exporters. The oil market has several peculiarities that need to be taken into account, however. More than perhaps any other market, the market in oil is dominated by the sellers. This is a result of the tight supply, state control of more than three quarters of the world’s oil reserves, importers’ dependence on oil, and exporters’ cooperation through OPEC.

While “the chief function of a market is to adjust prices to accommodate fluctuations in supply and demand in order to achieve allocative efficiency”,⁶⁴ adjusting prices is also the main function of OPEC, the cartel that is the source of 40% of total world production.⁶⁵ OPEC, when it successfully maintains its internal discipline, can modify prices to some extent by increasing or lowering member countries’ production.⁶⁶ Also, it contributes to market uncertainty, because it is impossible to predict whether OPEC will attempt to interfere with prices or hold to a laissez-faire approach. Indeed, merely the fear of OPEC manipulation has at times contributed to higher oil prices.⁶⁷

The pricing mechanism in the international market in oil has at times failed to reduce demand to match supply, because the need for oil is often considered so great as to make states willing to pay exorbitant prices or seek solutions outside the market rather than reduce consumption, which would be the normal response in most other markets. Furthermore, the massive volumes involved result in significant transportation costs, which will at times limit the number of potential importers. Long-haul transport will tend to increase prices of oil more than is the case with most trade goods. Oil exploration and production is also an extremely costly and time-consuming affair, requiring huge investments before production even begins, which means that creating new capacity cannot be done overnight, resulting in a risk of considerable lag when consumption increases rapidly. Also, the fact that most of the world’s

⁶³ Neil J. Smelser and Paul B. Baltes (eds.). 2001. *International Encyclopedia of the Social and Behavioral Sciences*. p. 9197

⁶⁴ Wikipedia definition of market

⁶⁵ EIA report “International Energy Outlook 2006” (June 2006), (sitat fra Oil & Gas Journal)

⁶⁶ For an introduction to the role of OPEC in the oil market, see:
Dag Harald Claes. 2001. *The Politics of Oil-Producer Cooperation*

⁶⁷ Heather Stewart. “Petrol price fear as OPEC cuts production”, *The Guardian*, December 29, 2001

oil reserves are in the hands of states, normally through state-owned corporations, means that concerns other than profit for shareholders come into play.

Liberals believe that energy security can largely be trusted to the invisible hand of the market, as most exporters are themselves dependent on the income oil export provides. Thus, they say, there is little or no chance of another long-term halt in deliveries for political reasons, as happened during the oil crisis of 1973. Furthermore, production is likely to increase to meet increasing demand in the market, as there will always be producers with some spare capacity, or the ability to increase production, and the desire to take advantage of increasing demand. Obviously, this assumes that there is a relatively open global market, where an increase in supply anywhere in the world automatically leads to lower prices on a global scale. Finally, the market is expected to contribute to lower, that is 'acceptable' prices, which relates to liberals' emphasis on the cost aspect of energy security, the second half of our definition.

The main realist objection to this faith in the market is the unacceptable risk of market failure. As energy is considerably more important to most states than any random luxury product or other trade good, market failure will have far more dramatic consequences. Realists, as we have discussed, consider even a short-term loss of oil supply to be a major problem. Some states have, after the shock of the 1973 oil crisis, taken some precautions against this by building up strategic oil reserves. However, due to the enormous daily consumption of oil in major economies, it is impossible to create reserves that will last for any longer period of time.⁶⁸ Also, most states have not adjusted their strategic reserves up as consumption has increased,⁶⁹ meaning a gradual reduction in their ability to counteract supply problems.

The global oil market is not currently operating as a free market. OPEC works as a cartel in the market, with considerable ability to regulate prices and production due to the fact that it includes several major oil producers.⁷⁰ This in itself constitutes serious state intervention in the functioning of the market, and from a realist perspective has the added problem of leaving

⁶⁸ IEA members are required to commit themselves to maintaining Strategic Petroleum Reserves (SPR) sufficient to compensate for 90 days of lost imports. Most members do not meet these requirements however. The U.S.' SPR, even if filled to maximum physical capacity, would only meet requirements for 69 days, according to the DoE (Jim Hart, *Strategic Petroleum Reserves in the United States of America*). Furthermore, current stocks are far below maximum capacity.

⁶⁹ Jim Hart. 2002. *Strategic Petroleum Reserves in the United States of America* (IEA report)

⁷⁰ OPEC currently accounts for about 40% of world oil exports, but that share is expected to increase over time ("A Dangerous Addiction". *The Economist*, December 13, 2001)

immense potential power in the hands of exporters. While OPEC currently concerns itself primarily with prices, its power in the market leaves major consumers, like China and the U.S., dangerously exposed. “History repeats itself”, realists tend to say, and the “oil weapon” has been used in the past for political purposes.⁷¹ The cost aspect is furthermore not nearly as important to realists as it is to liberals, because realists are more concerned with dependable supply than price.

Trusting the market also creates dependence on the market, which realists consider another problem. Self-sufficiency would be the ideal solution from a realist perspective, but as that is clearly not possible, realists say major importers must seek greater degree of control over foreign sources of oil than the market will allow, even if this should result in some price hikes. As we have mentioned earlier, bilateral cooperation and long-term agreements can help provide some degree of control, in the form of leverage over producers. Pipelines are extremely important in this respect, at least with regard to landlocked countries, like those in the Caspian region, as exporters’ dependence on pipelines for delivery makes it impossible for them to quickly go from one buyer to another. Getting a pipeline constructed is thus one of the most important means available to an importing state to gain leverage over an exporter.

Liberals will, on the other hand argue that the global oil market has functioned relatively smoothly after 1973 and emphasize the work of the International Energy Agency (IEA)⁷² in monitoring the market and helping to provide the kind of information necessary to reduce uncertainty and distrust. Christian Constantin also claims that non-OPEC producers have been increasing their market share, decreasing OPEC’s stranglehold on importers.⁷³ It is expected, however, that OPEC will have to ramp up its production to a significantly higher share of world production in order to avoid a major supply shortfall in the future.⁷⁴ To realists, however, the current effectiveness of the market is largely irrelevant, as there will always be an element of uncertainty about the future, suggesting that oil-dependent states need additional insurance.

⁷¹ Most notably, the Organization of Arab Petroleum Exporting Countries initiated an embargo against the U.S. and other Western powers supporting Israel in the Yom Kippur war in 1973.

⁷² An organization founded by oil importing countries after the crisis of 1973 to help prevent another major breakdown in the market.

⁷³ Christian Constantin. 2005. “China’s Conception of Energy Security: Sources and International Impacts”, *UBC Working Paper, No. 43*

⁷⁴ EIA. 2006. *International Energy Outlook 2006*

2.7 DIVERSIFICATION OF SUPPLY

For realists energy security is an issue that must take priority over others. This means that issue-linkage is not acceptable to realists, in the respect that any loss or stagnation of oil-supply is not something that can be justified through gains in other areas. Energy is far more important than other normalized trade-goods. For realists, the main objective is not having the greatest amount of oil at any given time, but always having sufficient supply. Furthermore, oil is never produced in such a large quantity that storing for long-term consumption is a realistic option.

While the main objective is always having sufficient supply, diversification of supply is a means to that end. In the words of Sir Winston Churchill: “Safety and certainty in oil lie in variety and variety alone”.⁷⁵ Having multiple suppliers, instead of relying on one or few, provides security in cases of temporary or permanent disruptions of supply. Should one supplier fall victim to natural disasters, terrorism, war, regime change or other export-damaging events, importers will only experience minor disruptions in their total supply. Furthermore, dependency, as mentioned earlier, is a weakness that gives others influence that may limit the options available to a state in pursuing their national interest. For liberals, dependency is in any case unavoidable, and may in a fact be positive as long as one has mutual dependency. Furthermore, according to liberals disruptions due to export-damaging events will normally be compensated for by the invisible hand of the market, as some states are likely to maintain spare capacity and want to take advantage of the price hike resulting from such events, and will therefore not be a vital problem to states.

2.8 ENSURING ENERGY SECURITY

In this chapter we have seen that modern industrialized states are dependent on several features, and one of the most important of these is the resources to actually drive the machinery of modernity. Oil is, we have argued, the most important of these resources.

Realists believe that energy security is best ensured by strategic competition and through gaining as much control as possible over the sources of oil. Neither the market, nor international institutions can be depended upon to provide such a vital resource, the same way that alliances can never be fully trusted to last and provide traditional security. Every state

⁷⁵ Jan H. Kalicki & David L. Goldwyn (eds.). 2005. *Energy & Security*, p. viii

must see to its own interests first and foremost, not because their interests necessarily conflict with those of other states, but simply because the uncertainty of the system does not leave room for trust. Realists do not believe in the possibility of obtaining reliable information about the intentions of other states and also fear that misinterpretation may be fatal. This leads to the conclusion that while cooperation may be advantageous a state cannot afford to assume that it will last or trust its security, be it energy security or traditional security, entirely to it. While absolute control over suppliers is rarely possible, importers must nonetheless strive to maintain some leverage over several suppliers. By dealing with several suppliers importers avoid excessive dependence on any particular state and this supports its strategic efforts to gain leverage over as many suppliers as possible.

For liberals the best way to ensure energy security is for states not to enter into strategic competition over oil, but instead focus on cooperation between importers and exporters. In the liberal view, oil is a more normalized commodity than realism would suggest, partly due to the regular discoveries of new oil deposits and the possibility of issue-linkage in international institutions. Oil is thus becoming less strategic, and should not be diversified from other products on the international market. Instead, oil importing states can ensure energy security better by decreasing trade- and investment barriers and by not intervening in the daily functioning of the market.⁷⁶

For realists, thus, states - through strategic thinking and struggle to control resources- best ensure energy security, whereas liberals find that energy security is better protected by the market⁷⁷ and through cooperation between states.

⁷⁶ Christian Constantin. 2005. "China's Conception of Energy Security: Sources and International Impacts", *UBC Working Paper, No. 43*

⁷⁷ William W. Hogan. "Energy, the Economy, and Oil Security", in Gonzales, Smilor, Darmstadter (eds.). 1985. *Improving Energy Security*

CHAPTER 3: OIL AND THE CASPIAN REGION

“Who rules the Heartland commands the World Island (Eurasia)

Who rules the World Island commands the World.”

- Halford Mackinder -

3.0 THE IMPORTANCE OF OIL

In order to comprehend the significance of the oil reserves of the Caspian, one must first understand the significance of oil on a global scale, as well as the general issues of import/export. We have briefly discussed these issues in the introduction to this thesis, and will now examine them in more detail.

Industrialized, and industrializing, states are at present absolutely dependent on fossil fuels, both for their industries and transportation needs. Oil alone accounts for almost 40% of world energy consumption.⁷⁸ While there are alternatives to oil, at least for some purposes, these are generally not nearly as effective, are harder and more costly to exploit, or will probably not be viable alternatives for decades.⁷⁹ Not only is the world today largely dependent on oil, but consumption is steadily rising and predicted to grow from the current 80 mb/d to 118 mb/d in 2030, an almost 50% increase in demand, which will require an equal increase in production.⁸⁰ This growth in demand will largely come from non-OECD countries in Asia, particularly China and India, as well as the traditional major consumers in North America. Growth is predicted to be much slower in Europe and OECD Asia, due to expectations of slowing economic growth as well as stagnating or shrinking populations over the next 25 years. The growth in the aforementioned regions is largely due to expectations of the opposite development: fast-paced economic growth as well as sharp increases in industrial activity. Most of the increased demand is expected to come from the transportation sector, which is heavily dependent on oil.⁸¹

71 percent of the world’s total proved oil reserves, 1,293 billion barrels according to the *Oil & Gas Journal*,⁸² are located in the Middle East and Canada.⁸³ OPEC countries hold 69% of

⁷⁸ EIA. 2006. *International Energy Outlook 2006*

⁷⁹ U.S. Department of Energy. *Alternative Fuels Data Center*

⁸⁰ Ibid.

⁸¹ EIA. 2006. *International Energy Outlook 2006*

⁸² *Oil & Gas Journal* estimates, quoted in EIA. 2006. *International Energy Outlook 2006*

proved reserves, but only 40% of current production. 89% of refining capacity is located in non-OPEC countries,⁸⁴ which means that these countries are primarily exporters of crude oil, with relatively little domestic consumption of petroleum products. Despite the fact that OPEC's share of oil production is considerably smaller than its share of proved reserves, it is OPEC's ability to manipulate the market that is one of the main reasons for the considerable interest in the Caspian region. While this ability is dependent on strong internal discipline within OPEC, which has not always been present, the threat of it is intimidating, especially to major oil importers, like the U.S. and China. This is comparable, in a way, to certain aspects of the security dilemma in realism, as it is the tremendous uncertainty involved, rather than immediate, overt threats, that causes concern. Any increase in production in what can be called a new oil producing region⁸⁵ is valuable not primarily because it can contribute a volume of production even close to that of the Middle East, but because it reduces the danger of an OPEC stranglehold on the market. Furthermore, the existence of alternative suppliers reduces dependency on a small number of Middle Eastern states, which are politically volatile, and whose interests are not always in agreement with those of importing states. In fact, Brenda Shaffer states that: "diversity of sources is a key to energy security".⁸⁶ The oil must flow, even if some suppliers should, for whatever reason, be temporarily or permanently unable or unwilling to deliver.

The oil crisis of 1973 was an immense shock to oil importers, illustrating some of the points mentioned above. The cause of the crisis was an announcement by the members of the Organization of Arab Petroleum Exporting Countries (OAPEC, consisting of the Arab members of OPEC, plus Egypt and Syria) that they would not ship petroleum to nations supporting Israel in the Yom Kippur war (specifically the U.S. and the Netherlands).⁸⁷ When combined with an almost simultaneous decision by OPEC to use its leverage to attempt to near-quadruple oil prices, the ensuing crisis demonstrated clearly not only the vulnerability of industrialized economies to oil supply problems, but also the intense mood of panic and chaos even the idea of an oil crisis can cause. The oil crisis of 1973 is also one of the few known

⁸³ The Canadian reserves mostly consist of oil sands, which are difficult and expensive to extract with current technology

⁸⁴ Numbers from OPEC website

⁸⁵ This description is not entirely accurate when it comes to Azerbaijan, but having been part of the Soviet Union, the region is new to other consumers and little exploration and development has taken place until recently outside Azerbaijan.

⁸⁶ Brenda Shaffer. 2001. "Caspian Oil Fields Rise In Significance With Gulf Volatility", in *Investor's Business Daily*, 8 November 2001

⁸⁷ Dag Harald Claes. 2001. *The Politics of Oil-Producer Cooperation*

cases where the “oil weapon” has been actively used by exporters to damage importers, as King Faisal of Saudi Arabia and President Anwar Sadat of Egypt had met in secret in advance of the Yom Kippur war, agreeing to include an oil embargo in their arsenal for the upcoming conflict.

The oil crisis brought a dramatic new awareness of Western vulnerability to oil supply disruptions that still looms large in the minds of policymakers around the globe. The oil crisis brought home, in dramatic fashion, the power that Western dependence on oil had placed in the hands of a few major producers. Indeed, it was arguably this crisis which fully actualized many of the theoretical arguments we have discussed in the preceding theory chapter, and also that has actualized the notion of diversification of supply and the Caspian as a new oil exporting region.

3.1 THE CASPIAN REGION

The Caspian region has a long and complicated history and is populated by diverse ethnic and cultural groups, contained within three independent states. In this section of the chapter we will provide a brief introduction to the Caspian region as a whole, looking at some important issues and developments that have shaped, and are shaping, the region. Besides some general questions of history, economy, political developments and potential sources of regional instability, we will be looking at some issues more directly related to this paper, such as the potential for development of the region’s oil resources and the significance of these resources for the world. We will begin with a brief overview of the region’s history, focusing on a few major events.

Map 3.1: The Caspian Region



3.1.1 HISTORY OF THE CASPIAN REGION

Nestled between the Tien Shan Mountains and the Black Sea, the Caspian region has always been a meeting place of people and cultures from all over Eurasia. Invaders from the east, the north and the south have repeatedly made incursions into the region, striving to maintain control of what has been called a geopolitical pivot area in the Eurasian heartland.⁸⁸ Even disregarding geostrategic theories about the importance of the heartland, the Caspian region undeniably occupies a location of immense strategic importance, separating several great and potentially great powers of Asia and Europe. For countries such as China, Russia and India, Central Asia holds tremendous potential as a “buffer zone” against the other great powers.

Historically, Turkic tribes were the first known wave of invaders to settle in the region. These tribes were conquered by Arab invaders during the first Islamic expansion, and thus Islam was

⁸⁸ Zbigniew Brzezinski. 1997. *The Grand Chessboard*

adopted as early as the 7th century AD. Mongol tribes under Genghis Khan then seized control of the region for the Mongol empire in the 13th century, but were quickly assimilated by the original inhabitants. The gradual breakup of the Mongol empire took the tribes in different directions, with the Kazakhs creating their own Khanate, while the Turkmen and the Azeri came under Persian rule.

During the 18th and 19th century the whole region, with the exception of those areas that are still part of Iran, came under Russian domination, which lasted until the breakup of the Soviet Union in the early 1990s. Southward Russian expansion was of great concern to Britain, who believed Central Asia to be of vital importance to the security of her South Asian empire. Both the great powers wanted supremacy in the region, which led to what is commonly referred to as “the Great Game”.⁸⁹ The first phase of Great Game started in the early 19th century, and ended with the Anglo-Russian convention in 1907. A second but less intense phase of competition started after the Russian revolution in 1917, but due to the alliance of Britain and Russia during WWII and the collapse of the British Empire, which followed soon after the end of the war, the original Great Game finally came to an end. As the use of the term game implies, this competition never led to open conflict between the two powers, but rather consisted primarily of espionage and imperialistic diplomacy (which, of course, was not always entirely as diplomatic as the word is commonly understood today).⁹⁰

3.2 ECONOMIC DEVELOPMENT

All of the former Soviet republics experienced dramatic reductions in GDP and considerable economic troubles after the collapse of the Soviet Union. Much of the reason for this was the resulting collapse of the Soviet centrally directed economy and the loss of aid and other transfers from Moscow. The centrally planned system tended to allocate specific tasks to each republic, with little diversification of the economy within the individual republics. As a result, none of the former Soviet republics had fully developed economies, nor currencies or fiscal policies, of their own on the eve of independence. The general collapse of industrial production in the Caspian region resulting from the collapse of the centrally directed economy in turn led to vast unemployment, inflation and the aforementioned sharp decline in GDP. This could perhaps have been avoided, or the shock at least dampened, if not for Caspian

⁸⁹ An expression first used by the British author and poet Rudyard Kipling

⁹⁰ The Great Game specifically refers to the competition for dominance in Central Asia. While the Crimean War involved the two major actors of the Great Game, as well as similar concerns, it took place in a different region and as such was not part of the Game itself.

states' failure to adopt free market policies, which might have allowed them to turn their specialization into an advantage in the regional or global market.

For a long period following independence, the Caspian states also continued to be heavily influenced by developments in the Russian economy, which was clearly demonstrated during the Russian financial collapse of August 1998. All the Caspian economies experienced considerable turbulence as a result of this crisis, after showing some signs of economic recovery in the preceding years. After the financial crisis, though, Russian influence has been reduced due to increased foreign investment from other countries, including China and the U.S. This foreign investment has mostly been in the oil and gas sector, however, which has contributed to a trend toward narrower focus on the energy sector in most of the Caspian states. In recent years, largely due to favorable oil prices, the Caspian states, particularly Azerbaijan and Kazakhstan, have seen considerable economic growth. Concerns remain, however, over the vulnerability caused by dependence on oil and gas prices and failure to develop other industries, which is commonly known as *Dutch disease*. This is often attributed to the raise in the exchange rate of a nation's currency, which makes the manufacturing sector less competitive.⁹¹

3.3 ETHNICITY AND RELIGION

Following the break-up of the Soviet Union, the new states of the Caspian region were largely formed along the lines of the old Soviet Republics, rather than along ethnic divisions. With the exception of Azerbaijan, which is 90% Azeri, the countries of the Caspian region have sizeable minority populations. In fact, ethnic Kazakhs only make up 41% of the population of Kazakhstan, with ethnic Russians accounting for more than 1/3 of the population.⁹² This diversity has so far not led to major conflicts, with the exception of the Azeri-Armenian war over the Armenian enclave of Nagorno-Karabakh in Azerbaijan.

Unlike many of the other successor states to the Soviet Union, such as the Baltic states, which have clearly aligned themselves with the West and seem to define themselves as clearly European and Western, the Caspian states find themselves being pulled in many different directions at once. Russia still considers the Caspian region, as well as the other Central Asian

⁹¹ Christine Ebrahim-zadeh. 2003. "Dutch Disease: Too much wealth managed unwisely", *Finance & Development*, Volume 40, No. 1

⁹² Zbigniew Brzezinski. 1997. *The Grand Chessboard*

successor states, as part of their geostrategic backyard. Sizeable Russian minorities also contribute to a continuing cultural and linguistic influence in the region. There is also considerable concern among governments in the Caspian region about the rise of Islamism in parts of the Muslim world, including nearby Afghanistan and Iran. Wahhabi preachers from Saudi Arabia have also been attempting to spread more radical interpretations of Islam to this relatively moderate, even secular, region.

Generally low levels of economic development in the region, as well as structural problems, are features that may lead to unrest and increased support for radical ideologies, in which case Islamic fundamentalism may seem attractive. While radical Islam is not currently a strong political force in the Caspian region, there is concern that this may change in the potential search for a new, post-Soviet identity and due to economic underdevelopment. A defining feature of Islamic fundamentalism in Central Asia, which, at least so far, separates it from Islamic radicalism in other regions, is the absence of anti-Western rhetoric and rejection of violence as a method.⁹³

3.4 POLITICAL UNCERTAINTIES

S. Frederick Starr points out that the countries of the Caspian region (along with the other Caucasian and Central Asian countries of the CIS) “share certain common features deriving from [their] common twentieth century background”,⁹⁴ that is the shared experience of being part of the Soviet Union. These common features are, mainly, “powerful inter-personal networks that work informally and often outside the law”, “a general lack of accountability except when top leaders intervene to impose goals”, “they are all underinstitutionalized in comparison to Russia” and finally, “the practice of strong and even authoritarian presidential rule”.⁹⁵ Turkmenistan’s recently deceased president Niyazov, who styled himself Turkmenbashi (father of the Turkmen) was perhaps the most extreme example of the practice of authoritarian rule, having set up a cult centered around himself, introducing new “holy scriptures” (written by himself) and erecting magnificent monuments (of himself) all over the country, including a golden statue in central Ashgabat, which is designed to turn on its pedestal so that it always faces the sun.

⁹³ R. Hrair Dekmejian & Hovann H. Simonian. 2003. *Troubled Waters*

⁹⁴ S. Frederick Starr. 2001. “The Investment Climate in Central Asia and the Caucasus”, *Central Asia-Caucasus Analyst*, p. 1

⁹⁵ *Ibid.*, pp. 1-2

The abovementioned features, taken together, amount to what can be called a democratic deficit. This contributes to the region's unpredictable nature, as it is generally difficult to say with any degree of certainty how long the sitting presidents will remain in power, or what will happen when they die or if they, which currently seems unlikely, eventually step down. Furthermore, the gradual expansion of presidential powers in Kazakhstan, Turkmenistan and Azerbaijan creates tremendous uncertainties with regard to the future development of these countries and the accountability of their leaders. Being young states, none of which have any history of independent statehood previous to their annexation to Russia,⁹⁶ their interests and identities are still only taking shape.

3.5 COSTS AND COMPLICATIONS

There are some particular problems and uncertainties related to the development of oil resources in the Caspian region that need to be addressed. First of all, there is considerable disagreement as to the existing energy reserves in the region. Estimates of proven oil reserves vary widely, from 17,2 billion barrels to 49,7 billion barrels.⁹⁷ It seems certain that the region will never be able to replace a region like the Middle East, neither with regard to reserves nor production. However, as has been mentioned, that does not mean the region is insignificant as an oil producer or that it will not attract foreign attention. Any increase in production from a new source is important, and while the Caspian region may never match the production of some other regions, it is beyond doubt that the region will make a considerable contribution. The EIA estimates that Caspian oil production will reach 4,2 million bbl/d by 2015, which will account for approximately 4,5% of estimated total world production by that time.⁹⁸ This amounts to a significant buffer for importers, as well as a reduction of OPEC's leverage.

A second complication is the relatively high cost of oil extraction in the Caspian region, particularly on offshore fields, which is primarily due to geological and technical problems. Added to this are the costs resulting from the region's poor infrastructure and its remoteness. In fact, only the North Sea presents higher costs associated with oil extraction than the Caspian. Whereas the North Sea is already well-developed, however, the Caspian region still requires considerable exploration before full-scale production will be possible, which also entails considerable cost and risk.

⁹⁶ Azerbaijan did, however, enjoy a brief period of independence immediately after the Russian revolution and during the following civil war.

⁹⁷ EIA. 2006. *Caspian Sea Region: Survey of Key Oil and Gas Statistics and Forecasts*

⁹⁸ EIA. 2006. *International Energy Outlook 2006*

3.6 PIPELINES

Finally, transportation of the extracted oil from the region to distant consumers involves considerable problems and costs. There are currently few alternatives; in fact the capacity for transportation does not even fully match the current production.⁹⁹ Kazakhstan, Turkmenistan and Azerbaijan are all landlocked and as such need access to foreign ports in order to deliver their energy resources to consumers unless pipelines long enough to deliver the oil directly can be constructed. In any case, a large network of oil pipelines, going through several transit states will be necessary. This requires the Caspian states to maintain good relations with neighboring countries and, again, creates dependency. Predictability with regard to transportation is essential both to energy security and for the oil-producing states of the Caspian region. The construction of oil pipelines is both time-consuming and extremely expensive and once a pipeline has been constructed it cannot be moved. It is therefore extremely important that all involved parties feel confident that the pipeline will not, for any reason, become inoperative in the future. Any disruption of supply, be it due to conflict or natural disasters, will have far-reaching consequences, both for producers and consumers. For these reasons, the construction of pipelines is usually taken as a good indication of confidence in the existence of considerable oil reserves.¹⁰⁰

Most of the existing pipelines pass through Russia, which gives Russia considerable leverage over the countries of the region. Russia seems to want to keep things that way, and has been doing its utmost to ensure that most transportation of energy resources in the future will also be under Russian control.¹⁰¹ Recently, however, a major pipeline running from Baku in Azerbaijan to the port of Ceyhan in Turkey, through Georgia, has been constructed, with American support.¹⁰² Not only will this pipeline deliver a considerable volume of Azerbaijani oil to Western consumers, but should a trans-Caspian pipeline be constructed from Kazakhstan to Azerbaijan sometime in the future, this could also be connected to the Baku-Tbilisi-Ceyhan (BTC) pipeline. Another significant development is the recent construction of a pipeline from Kazakhstan to Western China. This pipeline may indeed be only a first step, as China not only hopes to import Kazakh oil through this and possibly other future pipelines,

⁹⁹ EIA. 2000. *Privatization and the Globalization of Energy Markets*

¹⁰⁰ R. Hrair Dekmejian & Hovann H. Simonian. 2003. *Troubled Waters*

¹⁰¹ Harun ur Rashid. "The Caspian Sea Oil Bypasses Russia and Iran: US Plan Wins", *Holiday*, 2. September 2005

¹⁰² "Giant Caspian oil pipeline opens", *BBC News Online*, May 25, 2005

but also sees Kazakhstan as a an important transit route for Russian oil.¹⁰³ In addition to these pipelines, other routes through Russia, Georgia, Turkey, China, Afghanistan, and Iran have been discussed, and “the negotiating process for each alternative route has been shaped by the ambitions of various participants to capture both the economic and geopolitical benefits of sponsoring the transport of oil from the region.”¹⁰⁴

In this chapter we have discussed the significance of oil on a global scale and general issues concerning import and export. We have seen that importers, particularly after the 1973 oil crisis, have become increasingly aware of their exposed position and seek diversification of supply to minimize the impact of disruptions. Being outside OPEC, the Caspian region is a valuable source of diversification. The chapter has also presented an overview of the Caspian region, particularly its history, economic development, and political situation, as well as costs and complications associated with the extraction and transportation of Caspian oil. The next chapter will present the energy security needs of China and its policies to ensure energy security.

¹⁰³ Marat Yermukanov. “Chinese Need Russian Oil to Fill Pipeline From Kazakhstan”, *Eurasia Daily Monitor*, Vol. 2, No. 216

¹⁰⁴ Amy Myers Jaffe and Edward Djerejian. “Introduction”, in Yelena Kalyuzhnova, Amy Myers Jaffe, Dov Lynch and Robin C. Sickles (eds.). 2002. *Energy in the Caspian Region*, p. 5

CHAPTER 4: THE EASTERN DRAGON

“Keep cool-headed to observe, be composed to make reactions, stand firmly, hide our capabilities and bide our time, never try to take the lead, and be able to accomplish something.”

- Deng Xiaoping -

4.0 THE DRAGON REBORN

The EIA projects that global oil consumption will continue to grow rapidly in the next 20 years. The largest growth of consumption will come from Asia, especially from India and China, both already major, and growing, economies. The total oil demand of the region is already larger than that of the U.S., and China alone accounted for 31% of global growth in demand in 2004.¹⁰⁵ By 2020, Asian energy consumption is projected to account for more than one-third of global energy consumption, thereby rivaling North America and Europe where oil consumption is expected to continue to rise, but not nearly to the same extent as in Asia.¹⁰⁶

The People’s Republic of China is a vast and populous country with an impressive resource base of its own. Up until 1993 the country was actually the largest oil-exporter in Asia, but with the rapid industrialization of the country that all changed, and since 1993 China has been a net importer of oil.¹⁰⁷ The volume of oil imported has increased steadily, and today China is the second largest importer of oil in the world, only surpassed by the U.S. What is more, the volume of imports is projected to rise significantly as its economy and level of industrialization continue to grow.

In this chapter we will present the energy security needs of China, and assess how they seek to ensure their energy security. To better understand the context of this, we will try to give a brief overview of the political and economic situation in China today, along with a discussion of its capabilities and its position on the world stage. A significant part of the chapter will then be devoted to the Chinese oil industry, which is mostly state-owned. Our focus will be on the period after 1993 when China became dependent on foreign sources of oil. We will

¹⁰⁵ David Zweig & Bi Jianhai. “China’s global hunt for energy”, *Foreign Affairs Sep/Oct 2005*

¹⁰⁶ EIA. 2006. *International Energy Outlook 2006*

¹⁰⁷ Philip Andrews-Speed, Xuanli Liao and Roland Dannreuther. 2002. *The Strategic Implications of China’s Energy Needs*

present the energy needs and motivations of China at the present, but also look at their estimated future needs and what policies they employ to meet current and future demand. More specifically, we will investigate China's involvement in the Caspian Region and the policies they employ there in seeking supply of oil. Finally, we will examine the relations between China and other major external actors in the Caspian region, in order to place their policies within a larger context.

4.1 CHINA TODAY

China has the largest population of any country in the world today, and is home to more than 1.2 billion people.¹⁰⁸ It is also the world's fourth largest economy, the world's third-ranking trading nation and is apparently on its way to becoming perhaps the world's most powerful maritime power.¹⁰⁹ Furthermore, China is the world's largest Communist state, and even though the country has opened up to the outside world in many respects, Marxism and economic nationalism have experienced a revival in the political sphere.¹¹⁰ The Communist Party of China (CPC) remains firmly in power and maintains control over most areas of Chinese society.

Before market liberalization began, China's policymaking was extremely centralized, with a hierarchic decision-making structure that sought to ensure that all policies were imposed from above by the CPC. Deng Xiaoping initiated the opening up and liberalization of policymaking in 1978, and since then there has been a greater degree of consultation, bargaining among different interest groups, and a more careful monitoring of the implementation of policies.¹¹¹ Still, there are no clear signs of political democratization and all important political decisions remain in the hands of the top leadership of the CPC. If one looks at developments such as media control being tightened, along with the growing personal influence of president Hu Jintao, who has appointed a number of close allies to key government and party positions and even launched his own personal philosophy, called the "eight virtues and eight disgraces", there is little to suggest that significant progress will be made on political reform in the short term.¹¹² Measures have been implemented to bring greater transparency to decision-making

¹⁰⁸ Jan H. Kalicki & David L. Goldwyn. 2005. *Energy Security: Toward a new foreign policy strategy*

¹⁰⁹ Hugh White. "Just who's afraid of China?", *The Age*, June 21, 2006

¹¹⁰ Economist Intelligence Unit. 2006. *Country Analysis Brief: China*

¹¹¹ Philip Andrews-Speed, Xuanli Liao and Roland Dannreuther. 2002. *The Strategic Implications of China's Energy Needs*

¹¹² Economist Intelligence Unit. 2006. *Country Analysis Brief: China*

processes, but most of these efforts have had limited impact so far.¹¹³ Today, however, the Chinese state may be defined as neo-Leninist rather than Maoist. Neo-Leninism blends one-party rule and state control of key sectors of the economy with partial market reforms and an end to isolation from the world economy.¹¹⁴

China's rapid growth in energy consumption began in earnest approximately 20 years ago with the introduction of the abovementioned market reforms. Since 1978 China's economy has grown at an average of about 9% per year, fueled by market liberalization, opening to outside investment, and exports. In 2004, China's Gross Domestic Product (GDP) grew by 9.1%.¹¹⁵ This incredible economic development is correlated with increased urbanization, industrialization and electrification. The economic growth has been fueled by rapid growth in the previously extremely inefficient industrial sector, which is particularly energy intensive in China. Furthermore, this rapid economic growth has led to a massive migration to urban areas as well as a rapid growth of the middle class, almost nonexistent at the height of Maoism. With greater personal wealth comes demands for a higher standard of living, and this has further contributed to the overall increase in energy demand. The most significant development with regard to oil is the growth in the use and private ownership of automobiles. More than half of China's projected future increase in energy consumption is assumed to come from the transportation sector. While Chinese fuel efficiency standards are actually far stricter than those of the U.S., the immense population of China nonetheless means that even a level of motorization significantly lower than that of most Western countries will require vast amounts of oil. Projections suggest that energy demand in the transportation sector will grow at about 4.8 % per year in China, more than tripling by 2020,¹¹⁶ by which time China will have 140 million cars, more even than the U.S. To quote Ian Rutledge: "China (...) is following the U.S. and the rest of the industrialized world down the primrose path of mass motorization."¹¹⁷

¹¹³ Ibid.

¹¹⁴ Minxin Pei. "The dark side of China's Rise", *Foreign Policy*, March/April 2006

¹¹⁵ CIA World Factbook: China

¹¹⁶ Mehmet Öhgütçü. 2000. *China's Worldwide Quest for Energy Security (IEA Study)*

¹¹⁷ Ian Rutledge. 2005. *Addicted to Oil*, p. 135

4.2 THE OIL INDUSTRY IN CHINA

4.2.1 Chinese oil companies

The energy industry in China is dominated by three state-owned oil companies: The China Offshore Oil Corporation (CNOOC), The China Petrochemical Corporation (Sinopec), and China National Petroleum Corporation (CNPC). All three were established in the 1980s, but in 1998 they were reorganized by the government. Sinopec and CNPC were organized into two vertically integrated oil companies along geographical lines, dominating different parts of the country.¹¹⁸ CNPC also established a share-holding company named PetroChina in 1999. CNOOC controls most of the offshore oil business. This part of the Chinese oil industry is intimately linked to the international energy system, as the development of China's offshore oil resources has depended heavily on the participation of foreign companies. The offshore sector of the industry was thus the first to open up to foreign investment, which happened as early as 1980. Furthermore, China has several oil trading companies, five larger and several smaller ones, which have received considerably more business after China entered the World Trade Organization in 2001. After market liberalization, China has also seen the establishment of some private oil companies. These, however, suffer under the fact that government policy favors the state-owned companies, and they eagerly await liberalization of the energy sector.¹¹⁹ The Chinese oil industry has also seen an increase in foreign investment in the last few years.

The government has set a goal of raising the level of oil imports from overseas production to 50 million tons by 2010, and CNPC has been given a central role in enhancing this goal. CNPC for its part has ambitions of becoming an international player, and thus has welcomed the government's objectives. In fact, several Chinese companies are quickly becoming aggressive buyers of overseas assets. According to China's State Administration of Foreign Exchange (SAFE), Chinese firms' net outward direct investment rose 526% in 2005, to \$11.3 billion. CNPC accounted for a large amount of this growth, approximately \$4.2 billion.¹²⁰ These objectives and the internationalization of Chinese oil companies can furthermore be

¹¹⁸ U.S. Department of Energy. 2006. "Energy Policy Act 2005 section 1837: National Security of International Energy Requirements"

¹¹⁹ Philip Andrews-Speed, Xuanli Liao and Roland Dannreuther. 2002. *The Strategic Implications of China's Energy Needs*

¹²⁰ "A dragon on the Prowl". *The Economist*, May 15, 2006.

seen as an indirect way of ensuring energy security through reducing dependency on Western private international oil companies (IOCs).¹²¹

Asian national oil companies often have an advantage over IOCs when investing in foreign countries. Their commercial criteria for investing, for example in the Middle East, are often more in line with what producers are willing to offer. Furthermore, IOCs are often valued in terms of the amount of reserves they control, whereas when control stays with the government, as is the case with Chinese oil companies, there is less pressure on reserves and more interest in securing immediate access to supplies.¹²² Because the national oil companies do not have to answer to shareholders, they can more easily invest in new projects without having to worry as much about profit margins, as long as they produce the needed oil. In maintaining control over companies, Beijing is furthermore able to push companies into overseas projects that are seen to be of strategic importance.

4.2.2 The energy sector

The entire energy sector in China is, as we have shown, dominated by the government, which in practice means the CPC. The party is involved in, and poses its restrictions on, all areas of the energy industry. “(...) The Chinese Communist Party plays a dominant role in policy decision-making and economic affairs at virtually all levels. This is especially the case in the economic sectors deemed to be of strategic importance.”¹²³ In Chinese oil trade policy, more so than in overall trade policy, there are clear signs of the protectionism often associated with command-economies. On several occasions, the Chinese government has imposed import bans on both refined petroleum products and crude oil in order to shield domestic producers in times of surplus on the international market.¹²⁴ This is part of China’s ongoing effort to maintain the greatest possible degree of self-sufficiency. In fact, such a ban kept gasoline prices in China artificially high for much of the late 1990s.¹²⁵ When a government views trade as a variable that can be manipulated to restore domestic balance, as the Chinese government did with its import ban on gasoline and diesel fuels in 1998, it tends to disrupt markets and distorts the relationship with other actors on the market.

¹²¹ Ibid.

¹²² Valerie Marcel. “The Nationals are Coming”, *The World Today*, October 2005

¹²³ U.S. Department of Energy. 2006. “Energy Policy Act 2005 section 1837: National Security of International Energy Requirements”

¹²⁴ Shaofeng Chen. “State-Regulated Marketization: China’s Oil Pricing Regime”, *Perspectives*, Vol. 7, No. 3 (September 2006)

¹²⁵ Ibid.

Despite the evident importance of energy policy to China, the government has lacked a supra-ministerial government agency with broad policymaking authority, which has led energy policymaking to resemble the “fragmented authoritarianism” that in many respects have characterized the post-Mao governments in China.¹²⁶ Policymaking has generally been a result of relation-building and competition between different parts of the bureaucracy for power. There has thus been no coherent centralized energy policymaking agency in China, and the old Energy Ministry was even dismantled in 2003. However, energy security is of growing importance to the Chinese leadership, and in the last two years there has been a considerable effort to coordinate and implement a more coherent policy. In 2005 the government created the Energy Leading Group (ELG) and the State Energy Office (SEO) to “enhance the state’s ability to formulate and implement national energy policy”.¹²⁷ The ELG and the SEO are supra-ministerial agencies and the first senior leadership bodies that deal with issues of energy and energy security. The ELG has been granted wider powers than any government ministry, and will be responsible for formulating the government’s specific energy policies and see to their execution. The Chinese energy sector is still dominated by a complex web of relationships between people in the government and the head-executives of the state-owned oil companies, however.

In China’s foreign policy, energy issues have clearly taken a higher priority since the early 1990s. Energy security has become a national imperative and the necessity of participating in the global energy system to maximize domestic energy security soon became clear, especially since the economy has become increasingly vulnerable to energy shocks. “After all, with a widening gap between domestic supply and demand, energy is being recognized as a core national interest among China’s national security apparatus. As such, energy security is not only economically vital, but also has political, diplomatic and military implications”.¹²⁸ One of the main objectives of Chinese energy security policy in recent years has been to gain access to foreign supplies of oil.

4.3 ZOUCUQU (GOING ABROAD)

The discovery of the Daqing oilfields in 1959 made China self-sufficient in oil for generations. Thus, it came as something of a shock to the Chinese leadership when they eventually

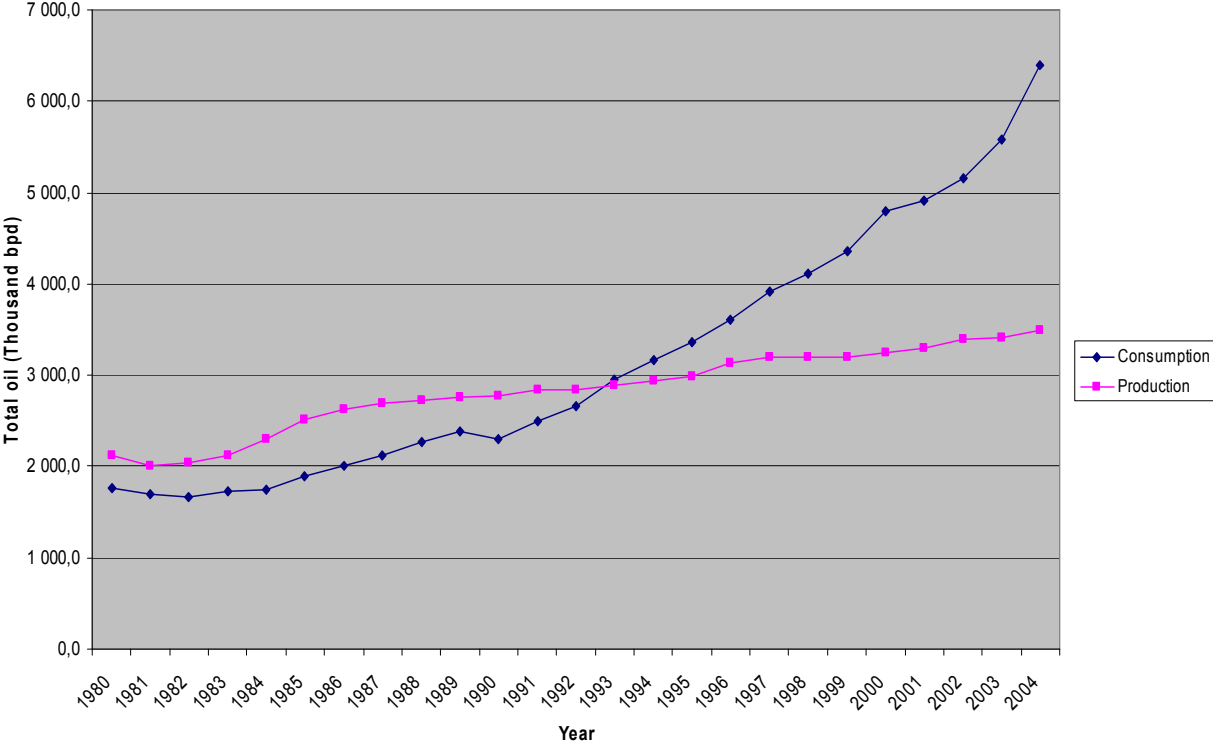
¹²⁶ Eurasia Group. 2006. *China’s overseas investments in oil and gas production*

¹²⁷ Ibid.

¹²⁸ Wu Lei & Shen Qinyu. “Will China go to War over Oil?”, *Far Eastern Economic Review*, April 2006

realized that the glorious times of self-sufficiency were over and that the dragon would have to leave its lair if it wanted to continue its rise. It became obvious as early as 1985 that self-sufficiency could not be maintained in the long term, but up until 1990 China still exported considerably more oil than it imported. By 1997, however, imports were twice as high as exports. As figure 4.1 illustrates, consumption has long since overtaken domestic production and the gap is rapidly widening, with relatively little domestic production being added since consumption overtook production in 1993. Certainly, what increase there has been in domestic production has not been anywhere near sufficient to keep up with the growth in consumption. Thus, from 1993 China started to pursue foreign sources of oil to make up for its shortfall.

Figure 4.1 China’s consumption and production of oil:



After realizing that self-sufficiency had come to an abrupt end, Chinese leaders and the big state-owned oil enterprises soon took hold of the matter and started the search for reliable foreign suppliers of oil. “Reliable” meant states that were politically friendly to China and had the capacity to export large amounts of oil without major disruptions. One can point to four main policy objectives after China became aware of their growing dependency on imports: to maximize domestic output of oil and gas in order to minimize dependence on foreign sources,

to diversify the sources of oil purchased through the international markets, to invest directly in overseas oil and gas resources through the Chinese national petroleum companies, focusing on Asia and the Middle East, and to construct the necessary infrastructure to bring this oil and gas to the consumers.¹²⁹

The rising import dependency has led to a partial shift in traditional Chinese energy trading patterns. Until the 1990s China imported and exported mostly within Asia. But China has, like most other states in the international system, shifted its eyes toward the Middle East. To compete in the global market of oil no state can afford to ignore the region which contains the most abundant supplies in the world and which at times to a large extent even dictates global oil policy. For the Middle East, China is an alternative to Western importers, providing Middle Eastern states with greater leverage when dealing with both sides. This does not mean, however, that China is turning away from their traditional energy partners, but instead reflects a regional trend because rapid economic growth in East and South Asia has led to energy demand beyond the capacity of Southeast Asian suppliers. The Asia-Pacific area is still China's principal source of foreign oil and is projected to remain a major source in the future. China is in any case determined to continue the positive energy relationships it has created in this region, for example with Japan and Korea, because they also contribute to the development of wider energy ties. This is particularly true in reference to the inward investment and technology that China is dependent on in its quest for energy security.

China has also invested heavily in other regions of the world, such as Africa, South America and the U.S., which is all a part of the greater Chinese strategy of "going abroad" (*zouchuqu*). Furthermore, China seems to have recognized that it is surrounded by a "belt" of untapped resources in Russia and Central Asia.¹³⁰ Not only does the Eurasian region have considerable known oil reserves, but it also has considerable potential for further discoveries, so even though China invests in several parts of the world, it seems clear that their main focus will be on Central Asia and Russia, along with the unavoidable Middle East, in the future.

¹²⁹ Philip Andrews-Speed, Xuanli Liao and Roland Dannreuther. 2002. *The Strategic Implications of China's Energy Needs*

¹³⁰ Philip Andrews-Speed, Xuanli Liao and Roland Dannreuther. 2002. *The Strategic Implications of China's Energy Needs*

4.3.1 Strategies of Investment

The Chinese government seems determined not to become too dependent on only a few suppliers, and constantly strives for diversification.¹³¹ In addition, there seems to be an underlying philosophy in China's energy policies, which is that China cannot afford to be entirely dependent on international markets for oil either.¹³² As we have seen, realism finds that depending on the international market for oil is too uncertain, and expects great powers to be unwilling to accept the risk of market failure, which requires additional measures to provide a minimum of energy security. "Beijing's goal is to insulate itself from the ever-volatile international energy market; its strategy abroad revolves around securing diverse suppliers."¹³³ As a result of this the government pursues a line where the flow of investments into projects is directed to reduce such unwanted dependencies. One of China's main priorities in its energy security strategy since the early 1990s has been the acquisition of equity stakes in foreign oilfields. This "equity oil" is "oil that Chinese firms have a right to take or market as a result of equity ownership in development projects".¹³⁴ In other words, this is the most direct form of control of oil resources, essentially amounting to direct Chinese ownership of foreign oil reserves and eliminating the need to go via the market. So far, an estimate suggests that equity oil only supplies about 10% of China's import needs, but China is constantly working to raise this share.¹³⁵ The low share is partly because of constraints related to transportation problems, which has been the case with much of the oil produced at Chinese-owned upstream assets in Kazakhstan. Currently, Chinese equity oil production in Kazakhstan amounts to about 270,000 bpd, of which only approximately 100,000 bpd flow through the Kazakh-China pipeline.¹³⁶ With the recent acquisition of the Karazhanbas oilfield, this is likely to increase, however.

Another strategy pursued by the Chinese government is creating political ties with oil-rich countries. This has often been supplemented by foreign aid and outward investment. This strategy has at times led China to engage with regimes often considered too brutal or unreliable by Western states.¹³⁷ This is a risky strategy, but if successful the benefits could be

¹³¹ *ibid*

¹³² Philip Andrews-Speed, Xuanli Liao and Roland Dannreuther. 2002. *The Strategic Implications of China's Energy Needs*

¹³³ Ziad Haider. "Oil fuels Beijing's New Power Game", *YaleGlobal Online*, March 11, 2005

¹³⁴ Eurasia Group. 2006. *China's overseas investments in oil and gas production*

¹³⁵ *Ibid.*

¹³⁶ *Ibid.*

¹³⁷ Heidi Vogt. "African oil's allure increases as other regions tighten reins on foreign companies", *The Associated Press*, December 15, 2006

great. China often finds itself without competitors in these countries and is thus able to strike favorable deals. In this way China finds “niches” where it can function as a major player rather than being just one among many. By pursuing such policies, Chinese companies may take greater political risks and accept possibly lower returns, but “such firms can afford to settle for less because they do not answer to shareholders, but instead report to political leaders who prize control of oil-producing assets over the promise of hefty future financial returns”.¹³⁸

4.3.2 Vulnerabilities and Instabilities

Currently, 80% of Chinese imports have to pass by ship through the Strait of Malacca and 24% first through the Strait of Hormuz. This makes China extremely vulnerable to a blockade of either of these sea-lanes, or other “choke points”, that are outside of Chinese control (“force majeure” disruption). Oil from Russia and Central Asia can be delivered through pipelines, which eliminates this risk. Pipelines would thus substantially reduce the risk of military blockade. Furthermore, of the seaborne oil only 10-12% is carried by Chinese flagged vessels,¹³⁹ whereas transportation by pipeline involves fewer actors and fixed routes that lock suppliers into long-term relationships that are easier to control. This is one of the main reasons for China’s growing interest in the Caspian Region.

Another reason for China’s interest in the Caspian region is the continuing instabilities in several other exporting regions. Two African countries, Angola and Sudan, are among China’s main sources of imported oil. Both are politically unstable, having recently been through destructive civil wars, which have seriously impeded oil exploration and development. Sudan is furthermore still engaged in suppressing insurgencies in several regions of the country, with serious threats of renewed fighting in others. In Asia, China’s near abroad, Indonesia has been the main source of oil since 1990. Conflict over the Spratly Islands has negatively influenced relations between the two countries, however. Indonesia is also domestically unstable, having experienced several military coups as well as sectarian and separatist violence. China has attempted to strike deals with Iraq, which could not be finalized while Iraq was under UN embargo. Access has been even more restricted after the US invasion in 2003, and it still remains to be seen whether the new Iraqi regime will respect deals concluded during Saddam Hussein’s reign. In fact, the Middle East is generally an

¹³⁸ Valerie Marcel. “The Nationals are Coming”, *The World Today*, October 2005

¹³⁹ Gabe Collins. “China seeks oil security with new tanker fleet”, *Oil and Gas Journal*, October 9, 2006

unstable region, which has provided great incentive for China, as well as the U.S., to seek elsewhere, if not to supply the bulk of its needs, then at least to contribute to diversification.

4.4 CHINA IN THE CASPIAN REGION

In this part of the chapter we will look at China's interests and policies in the Caspian Region more specifically. U.S. and Russian companies remain the major players in the region, but the Caspian has now become an attractive prize in China's search for energy security, making China a new major importer of oil from the region. China remained a passive observer of Central Asia's power plays for a long time, but "China has now thrust itself onto the center-stage of the region's energy geopolitics by winning several major oil and gas deals."¹⁴⁰

China first became interested in the Caspian region in the early 1990s, as the independence of the potentially oil-rich former Soviet republics of the Caspian region and China's new dependence on foreign oil largely coincided. Furthermore, the Chinese were concerned that these newly independent states might lend support to separatist Uighurs in China's western Xinjiang province, who are linguistically, culturally and ethnically related to the Turkic peoples of Central Asia. Gradually, however, energy interests came to dominate China's relations with its Central Asian neighbors more and more. "China's interest in countries such as Kazakhstan and Turkmenistan is motivated to a large extent by its need for energy resources"¹⁴¹.

Chinese engagement with the newly independent states initially was limited to establishing diplomatic relations and promoting bilateral economic ties. Not until Premier Li Peng visited the Central Asian states in April 1994 did a higher-level political dynamic evolve.¹⁴² One of the most important outcomes of this visit was the agreement to build a pipeline connecting the gas fields of Turkmenistan with China, but this project was never initiated. Since that failure, the efforts of China in the Caspian region have primarily concentrated on Kazakhstan, a relatively stable state which not only borders to China, but is also expected to possess the largest oil reserves in the region, with production projected to rise to 3,5 mb/d within the next decade. The first contracts between the two were not signed until 1997 when CNPC bought a controlling share of Aktobemunaigaz Production Association as well as a 51% share in the

¹⁴⁰ Mehmet Öhgütçü. 2000. *China's Worldwide Quest for Energy Security (IEA Study)*, page 66.

¹⁴¹ Jeremy Branstern. "Central Asia: China's Mounting influence", *YaleGlobal Online*, November 24, 2004

¹⁴² Philip Andrews-Speed, Xuanli Liao and Roland Dannreuther. 2002. *The Strategic Implications of China's Energy Needs*

Uzen oil field and the right to develop two oilfields in Akhtubinsk. In the bid for the Akhtubinsk field CNPC beat off competition from Texaco, Amoco and Russia's Yuzhmost.¹⁴³ CNPC has been the vanguard of Chinese involvement in the Kazakh oil industry, buying up shares in Kazakh oil companies as well as rights to develop, or participate in the development of, several fields. The most significant Chinese success, however, was the construction of the Atasu-Alashankou pipeline, completed in late 2005. The pipeline is a 50/50 venture with KazMunaiGaz, the Kazakh state oil company and is the second section of a three-phase pipeline that will carry oil from Western Kazakhstan to the Xinjiang province in China, where several refineries have recently been completed to process this inflow of crude oil.¹⁴⁴ The pipeline will initially carry 10 million tons a year, but depending on demand, this may increase to 20 million tons by 2011.¹⁴⁵ The Kazakh-China pipeline (the entire three-phase pipeline) has been poetically referred to as the "Energy Silk Route".¹⁴⁶

Up until recently there was considerable uncertainty with regard to where the oil to fill the Atasu-Alashankou pipeline would come from, as the venture with KazMunaiGaz specified that CNPC would be responsible for sourcing the oil. In late 2005, however, PetroChina, a subsidiary of CNPC, in what is still the largest overseas takeover transaction ever made by a Chinese company,¹⁴⁷ successfully acquired PetroKazakhstan, a Canadian-based company, which was until then Kazakhstan's second-largest foreign oil-producer, as well as the country's largest supplier of refined products. Perhaps most importantly, this takeover secured Chinese control over considerable reserves and production in Kazakhstan, which can now be carried through the Atasu-Alashankou pipeline.¹⁴⁸ This takeover is, however, interesting for several reasons. PetroChina got the deal ahead of competitors which made an almost identical offer.¹⁴⁹ Even before the actual sale, it was suggested that geopolitics would affect the outcome, and that a sale to China could therefore be interpreted both as an indicator of the direction of Kazakh foreign policy as well as China's intention to increase its presence in the

¹⁴³ Philip Andrews-Speed, Xuanli Liao and Roland Dannreuther. 2002. *The Strategic Implications of China's Energy Needs*

¹⁴⁴ U.S. Department of Energy. 2006. "Energy Policy Act 2005 section 1837: National Security of International Energy Requirements"

¹⁴⁵ Stephen Blank. "Energy at the Source of Sino-Kazakh Rapprochement", *Eurasianet*, November 8, 2004

¹⁴⁶ Mehmet Ögütçü. "China's Energy Security: Geopolitical Implications for Asia and Beyond", *Oil, Gas & Energy Law Intelligence*, Vol. 1, No. 2, 2003

¹⁴⁷ "China's CITIC Acquires Kazakhstan Oil Assets for US\$1.91 bln", *Asia Pulse*, January 1, 2007

¹⁴⁸ Bruce Pannier. "Kazakhstan/China: Oil Deal Marks Beijing's 1st Foreign Energy Takeover", *Eurasianet/RFE*, August 23, 2005

¹⁴⁹ "Kazakh oil coup for China, India cries foul", *Asia Times Online/Asia Pulse*, August 24, 2005

region.¹⁵⁰ Another interesting aspect of this deal was the fact that China had already laid the groundwork by constructing refineries in Xinjiang and securing a deal for the pipeline, before any agreements for oil deliveries were even signed. This suggests long-term strategic planning by the Chinese government to gain access to the oil resources of the Caspian.

While Kazakhstan has been China's main focus in the Caspian region, Chinese companies have recently become involved in projects to rehabilitate decaying oilfields in Azerbaijan. Also, the Chinese government has signed an agreement on oil and gas cooperation with Turkmenistan as well as provided several small loans to help develop the country's oil industry. So far, these efforts have been dwarfed by China's involvement in Kazakhstan, however. In the case of Azerbaijan, this can partly be attributed to the fact that the country is separated from China by the Caspian Sea itself, and its oil is now primarily going to Western markets through Russia, Georgia, and the Baku-Ceyhan pipeline. As for Turkmenistan, its oil reserves are relatively small and interest in Turkmenistan is most often related to gas, not oil. Furthermore, China also hopes to participate in an Iranian pipeline project, the Nekka project, whereby a pipeline would link Teheran to the Caspian Sea and later be linked to a pipeline from Kazakhstan to China.

A clear sign of China's focus on Kazakhstan are the almost annual high-level diplomatic and state visits back and forth between the two. Most recently, Kazakh president Nursultan Nazarbayev visited Beijing in late December 2006 for talks on several issues, although "the dominant theme in Kazakh-Chinese talks is and will remain economic cooperation, particularly in the oil and natural gas spheres."¹⁵¹ A concrete result of the visit was the signing of 12 documents on the economy, energy, finance, education, and culture, most significantly the "China-Kazakhstan Cooperation Strategy for the 21st Century", which "agrees to support cross-border construction of oil and gas pipelines and work closely on oil and gas processing, building new power facilities and providing electricity to third countries."¹⁵² It seems, therefore, that oil still dominates Kazakh-Chinese relations. Despite hints of trouble, such as the long postponement by the Kazakh government of CITIC's recent attempt to acquire the Karazhanbas oilfield, China has so far seen several significant successes in its attempt to

¹⁵⁰ Bruce Pannier. "Kazakhstan/China: Oil Deal Marks Beijing's 1st Foreign Energy Takeover", *Eurasianet/RFE*, August 23, 2005

¹⁵¹ Bruce Pannier. "Kazakhstan: Nazarbaev Talking Energy, Economic Cooperation on China Visit", *Radio Free Europe/Radio Liberty*, December 19, 2006

¹⁵² "China, Kazakhstan sign energy deal", *China Daily*, December 21, 2006

secure Kazakh oil for China.¹⁵³ It has been argued that one important reason for China's success has been the positive relations created through the Shanghai Cooperation Organization, which will be discussed in the next subchapter.

4.5 SHANGHAI COOPERATION ORGANIZATION

Oil and energy security does not paint the entire picture when it comes to China's interest in the Caspian Region and Central Asia as a whole. Even though the quest for natural resources to a large extent shapes China's policies in these regions, there are also other incentives drawing China in. One other main interest for China is securing its borders and creating a zone of friendly and stable countries in its strategic backyard that may provide it with political support and over which it may possibly gain considerable economic leverage in the future. One of the ways China has sought to accomplish these goals is through cooperation with surrounding states in various fields, particularly through the Shanghai Cooperation Organization (SCO). China has been the driving force behind this organization and has spent more resources than any other member states to maintain and strengthen it.

The Shanghai Cooperation Organization grew out of "The Shanghai Five", a Chinese initiative begun in 1996, which then consisted of China, Kazakhstan, Kyrgyzstan, Tajikistan, and Russia. Initially, China's primary motivation was a reduction of tension along its borders with these states. Concern with this threat was reflected in the fact that the first two treaties signed were *The Treaty of Deepening Military Trust in Border Regions* and *The Treaty on Reduction of Military Forces in Border Regions*.¹⁵⁴ These treaties did lead to a reduction of military presence in the border regions and some reduction of tension, especially when combined with successful Chinese efforts to settle long-standing border disputes with Kazakhstan. Under the terms of the first agreement the five states were required to remove strategic warplanes, heavy armor, and some troops back 100 kilometers from the border. The Shanghai Five continued to hold annual meetings, mainly discussing border issues, but also touching upon other issues, such as economics, trade, energy, diplomacy, and security.

On the fifth anniversary of the Shanghai Five, in 2001, Uzbekistan was admitted as the sixth member state and the SCO was created, further formalizing the cooperation between these six

¹⁵³ "Kazakhstan may block sale of major oil field to Chinese company". *BBC News Online*, December 13, 2006

¹⁵⁴ Sharif Shuja. "China, Iran and Central Asia: The Dawning of a new Partnership", *Contemporary Review*, September 2005

states. The SCO charter was signed in St. Petersburg in 2002. Cooperation within the SCO has been strengthened over time, increasing both in width, that is in the number of issue areas included, and depth, that is the level of cooperation. Among these issue areas cooperation on anti-terrorism/anti-separatism has been perhaps the most important so far, but energy is now also increasingly being discussed in SCO settings. The issues of anti-terrorism and energy security do see some overlapping, however, as terrorism can also be a threat to energy security. Energy security, as it is commonly understood today, means that the supply of oil must be secure at all stages, including the transportation phase. As has already been mentioned, pipelines are considered to be easier to secure than sea-lanes, but they still need to be secured from various threats, of which terrorist attacks can be among the most devastating. Through the SCO China has secured deals and arrangements that reduce the risk of terrorist attacks on their pipelines, and have also gained the support of other SCO governments in combating terrorism and separatism.

China and Russia have pushed the SCO to counter increased U.S. influence in Central Asia, stressing that the U.S. should remove troops that were deployed in the region for operations in Afghanistan after the September 11 attacks.¹⁵⁵ One main reason for this Russo-Chinese backed request by the SCO was concern that U.S. energy interests have emerged as an important motivating factor in base agreements with Central Asian states.¹⁵⁶ “The Shanghai Cooperation Organization, a major vehicle for a Chinese-Russian strategic cooperation, is exerting increasing pressure on US strategic interests in Central Asia.”¹⁵⁷ The SCO has a vast security agenda, and has been compared to the Warsaw Pact and been referred to as “the NATO of the East”.¹⁵⁸ China and Russia even engaged in a major joint military exercise in the summer of 2005. After the SCO published a statement calling for a deadline to be set for the withdrawal of U.S. military personnel in Central Asia, questions have been posed as to what China’s intentions for the SCO really are.¹⁵⁹ China has contributed more money than any other SCO member state and has been perhaps the most active country in using the SCO to remake the Central Asian order. China also seems eager to expand its own regional military influence in Central Asia and has even contacted Kyrgyz officials to explore the possibility of

¹⁵⁵ Valentinas Mite. “Shanghai Cooperation Organization Signs Agreement in Bishkek”, *YaleGlobal Online*, 25 September 2004

¹⁵⁶ Ahmed Rashid. “Great Game Reloaded”, *YaleGlobal Online*, July 26, 2005

¹⁵⁷ Ariel Cohen. “What to do about the Shanghai Cooperation Organization’s rising influence?”, *EurasiaNet*, September 21, 2006

¹⁵⁸ M. K. Bhadrakumar. “The Great Game on a razor’s edge”, *World Security Network*, January 3, 2007

¹⁵⁹ *Ibid.*

Chinese military bases in Kyrgyzstan, where both Russia and the U.S. already maintain bases of their own. “The increasing militarization of the region raises the possibility of the use of military means to address regional issues, especially religious radicalism, terrorism, separatism and narcotics trafficking.”¹⁶⁰

Liberals would point to the SCO as an important element of China’s relative success in gaining access to the oil resources of the Caspian, especially Kazakhstan, which remains their main interest in the area. Recently, at a meeting of SCO prime ministers, held on September 15, 2006 in the Tajik capital Dushanbe, member states expressed an interest in expanding the region’s trading infrastructure and engaging in joint efforts to develop energy export routes.¹⁶¹ “Driven by Chinese demand, energy business in the SCO, often nicknamed the Shanghai Six, is booming”.¹⁶² China has also entered into regional cooperation with other Asian states on energy issues, however. One of these is the ASEAN+3 Energy Partnership which seeks to develop an Asian energy security network and to distribute energy related information. Furthermore, China has developed a working relationship with the IEA, even though it cannot participate directly in the organization.

According to Stephen Blank of the U.S. Army War College, China has recognized that the best way for it to gain influence in Central Asia is through multilateral cooperation, especially due to the fact that the U.S. and Russia are already influential in the area. Furthermore, the U.S. and Russia have several military bases in the region, making it even more difficult for China to gain leverage in any other way than through cooperation. This cooperation, according to Blank, is multilateral because China does not have enough power or influence to pressure Central Asian states sufficiently in a bilateral setting. Others, on the other hand, believe that this is underestimating China’s capabilities, claiming that China’s military spending is much higher than the official data suggests, and that China ranks third after the U.S. and Russia and first in Asia in military spending.¹⁶³ Concern has been voiced over the buildup of the Chinese military potential and the double-digit annual budget increases for military modernization. Even though China’s military is nowhere near as large or technologically advanced as that of the U.S., Pan at Beijing University claims that: “China

¹⁶⁰ Ariel Cohen. “What to do about the Shanghai Cooperation Organization’s rising influence?”, *EurasiaNet*, September 21, 2006

¹⁶¹ Ariel Cohen. “What to do about the Shanghai Cooperation Organization’s rising influence?”, *EurasiaNet*, September 21, 2006

¹⁶² “Asia: Suppression, China, Oil; The Shanghai Co-operation Organization”, *The Economist* 2005

¹⁶³ Yakov Berger. “China’s Rise Eminence”, *International Affairs*, December 2005

will never have the capacity to be the world's leader, but it has more than enough capacity to pull the world's leader down from the stage".¹⁶⁴ Furthermore, as some have pointed out, if there should ever be a situation where China is denied outside oil supply, there still are, and will remain sufficient indigenous supplies of oil to ensure China's war-fighting capabilities, which means that the military can still operate if there should be disruption in imports of oil, although oil supplies to other sectors would likely have to be shut off.¹⁶⁵

As such, it can be difficult to determine whether China is truly committed to multilateral cooperation or if it is rather playing the "balancing game", forming short-term coalitions to balance against U.S. power until it is powerful enough to challenge that power directly, as would likely be the realist claim. Deng Xiaoping's call to "hide our capabilities and bide our time" would seem to suggest such a strategy, although one must always be careful when attempting to draw conclusions about actual policy from public statements.

4.6 CONTEXT OF POLICY

As several major powers are involved in the region, the policies of China, and the U.S., not only have to take these actors and their interests into account, but indeed its policies are often directed more at these than the states of the Caspian region themselves. Policies are never shaped in a vacuum, and it thus important to see them as part of their larger context. To quote Eugene Rumer: "The one remarkable and unique feature of Central Asia is that it is the strategic backyard of every major Eurasian power".¹⁶⁶ This subchapter will present China's relationship with these important external actors in the region.

The relationship between Russia, then still the Soviet Union, and China in the mid-1980s has been referred to as militarized and antagonistic.¹⁶⁷ However, in the last two decades, they have created a more strategic relationship. In 1994 they established a "constructive partnership", which two years later was upgraded to a "strategic partnership". In 2001 they also signed a treaty of friendship and cooperation.¹⁶⁸ One of the main reasons for this newfound love between two traditional competitors is their shared interest in reducing the

¹⁶⁴ David Lague. "Coming to Terms with China's Ascent", *YaleGlobal Online*, November 8, 2005

¹⁶⁵ Philip Andrews-Speed, Xuanli Liao and Roland Dannreuther. 2002. *The Strategic Implications of China's Energy Needs*

¹⁶⁶ Eugene Rumer. "The U.S. Interests and Role in Central Asia after K2", *The Washington Quarterly*, Summer 2006 Edition

¹⁶⁷ Philip Andrews-Speed, Xuanli Liao and Roland Dannreuther: "The Strategic Implications of China's Energy Needs", The International Institute for Strategic Studies, 2002.

¹⁶⁸ *ibid*

global dominance and influence of the U.S. Both Russia and China feel threatened by the policies of the U.S., specifically its penetration into Central Asia, which both countries perceive as their “backyard”. This is also the reason why they have put pressure on the countries of the SCO to remove U.S. troops that were deployed in the region for operations in Afghanistan, as we have seen. In the summer of 2006, at the annual meeting of the SCO, its member states agreed to hold annual military exercises, supposedly to improve the organization’s ability to fight what China has dubbed “the three evils”: terrorism, extremism, and separatism.¹⁶⁹ As suggested by the nickname “NATO of the East”, there are some who fear that the SCO could develop into a full-blown military alliance.¹⁷⁰ The joint military exercises between Russia and China held in 2005 were the first large-scale military exercises between the two since 1958.¹⁷¹

Beyond this wide-ranging cooperation within the SCO, however, Russia is also a major new source of oil for China, and whenever China has promoted their ambitions of energy linkages with Central Asia and the Caspian Region, this has always been counterbalanced with assurances of strong commitments to developing energy ties with Russia as well. The “China Threat” school, which focuses on the potential threats of a strong and developed China, has pointed to how energy linkages are binding together the Sino-Russian relationship.¹⁷²

Iran is another important state that influences policies in the Caspian region. For China, Iran is primarily an important source of its oil imports. China has no restrictions on cooperating with one of the countries deemed to be part of “the axis of evil” by the U.S. The most visible sign of this relationship is perhaps China’s long refusal in the Security Council to agree to strong measures to prevent Iran from going nuclear.¹⁷³ China has even provided Iran with “systems and technologies that contribute to further development of its cruise and ballistic missile capability, as well as to its nuclear, chemical and biological weapons programs.”¹⁷⁴ This contravenes the U.S.-Iran non-proliferation act of 2000, which specifically states that

¹⁶⁹ Bruce Pannier. “China/Kazakhstan: Forces Hold First-Ever Joint Terrorism Exercises”, *Radio Free Europe/Radio Liberty*, August 24, 2006

¹⁷⁰ M. K. Bhadrakumar. “The Great Game on a razor’s edge”, *World Security Network*, January 3, 2007

¹⁷¹ Jephraim P. Gundzik. 2005. “The ties that bind China, Russia and Iran”, *Asia Times Online*, June 4, 2005

¹⁷² *ibid*

¹⁷³ China and Russia did, however, agree to some sanctions in December 2006

¹⁷⁴ Gill Bates. 1998. “Chinese Arms Exports to Iran”, *Middle East Review of International Affairs*, Vol. 2, No. 2

“sanctions will be imposed on countries whose companies provide assistance to Iran in its efforts to acquire weapons of mass destruction and missile delivery systems.”¹⁷⁵

The Nekka pipeline mentioned in this chapter would be extremely damaging to U.S. interests in the region, as it would eventually provide China with a direct pipeline to Iranian oil through Kazakhstan. Preventing closer relations between Iran and the major Eurasian powers is therefore also vital to U.S. strategy in the Caspian region and Central Asia. The recent signing of a long-term \$128 billion contract, which includes deliveries of oil and Chinese involvement in the development of the major Yadavaran oilfield, seems to indicate this relationship will continue for some time. As long as Iran is such a central part of China’s strategy to ensure its energy security, it is unlikely that China will support the U.S. containment policy on Iran with much enthusiasm.

The relationship between China and India was for a long time determined by unresolved border issues and both countries’ quest for regional hegemony.¹⁷⁶ But relations between the two Asian powers have improved in the new millennium and have been fuelled by the recognition by both states’ governments of the mutual benefits of a strategic partnership. In June 2003 China and India signed a Declaration of Cooperation as well as nine protocols of bilateral cooperation.¹⁷⁷ The cooperation between China and India is slowly evolving from the economic sector into the political arena, which can also be seen as a way of balancing against the U.S.¹⁷⁸ Indian foreign minister George Fernandes has even proclaimed that: “We are both in the same boat”.¹⁷⁹ India and China have both experienced an incredible economic growth, and through this they face many of the same challenges.

Trade between the two countries has grown immensely the last few years and has helped to build confidence between the states, but still there is aggressive rivalry when it comes to energy resources. India has, as mentioned, also seen an incredible economic growth and needs energy to fuel its expanding economy and military machinery. “The two are battling each other in the search for oil from Sudan to Siberia (...)”.¹⁸⁰ When China secured the take-over

¹⁷⁵ Ibid.

¹⁷⁶ “Tensions Underlie India-China Trade Ties”, *Oxford Analytica*, November 15, 2006

¹⁷⁷ Gillian Hui Lynn Goh. 2006 “China and India: Towards Greater Cooperation and Exchange”, *China: An International Journal*, Volume 4, Issue 2

¹⁷⁸ Ibid.

¹⁷⁹ “The Tiger in Front”, *The Economist*, March 3, 2005

¹⁸⁰ ibid

deal for PetroKazakhstan it, as mentioned, surpassed a bid from the Indian state-owned Oil and Natural Gas Corporation (ONGC), which has also been the case in other areas where both countries have had energy interests. There are signs though that China and India are looking to cooperate more also in the energy sector. While there is currently no agreement on specifics, “a formal MoU is expected to be signed in the second fortnight of December when [Indian oil minister] Deora visits Beijing for a brainstorming session of the Big-5 oil importers - the US, China, Japan, Korea and India.”¹⁸¹

In this chapter we have presented the energy security needs of China, and ways in which the country seeks to ensure energy security. In order to better understand the context of Chinese policymaking, we have given a brief overview of China’s position in the world and its political and economic situation. The organization of the Chinese state-owned oil industry has also been touched upon. China has only recently been forced to look outside its own borders to supply its growing economy and increasingly demanding population. We have seen that one of the main strategies of the Chinese government is diversification of supply, and that China seeks to get its oil from various parts of the world. One of China’s main areas of focus in this respect is the Caspian region, especially Kazakhstan. However, China’s interest in the region goes beyond oil, as it also considers Central Asia to be its strategic backyard. In its quest for oil China has pursued different policies. It has sought to gain direct control of energy sources through equity stakes and the construction of pipelines, sometimes even paying well above market price for such stakes,¹⁸² and also used non-market means to achieve its goals, both in the Caspian region and elsewhere. This has included foreign aid and direct investment in projects, as well as getting involved in countries otherwise barred from access to the market through international sanctions. They have also been involved in wide-ranging cooperation through the SCO, of which it has been the most enthusiastic proponent. Recently, the SCO has also been moving gradually into the domain of energy.

This chapter has also sought to contextualize the space in which Chinese policies are shaped, and presented the other main external actors that impact on their policy choices in the Caspian region. The next chapter will focus on the U.S. and its energy security needs and policies, and the context in which their policies are shaped as well. Even though China and the U.S. are both great powers and both have a vast and growing need to secure resources, we will see that

¹⁸¹ Sanjay Dutta. 2006. “India, China to bid for oil fields jointly”, *The Times of India*, November 28, 2006

¹⁸² Charles Recknagel. “China seeks to Build Regional Influence at Summit”, *YaleGlobal Online*, July 7, 2005

there are some fundamental differences in the choices available and the strategies pursued by these two major powers in the Caspian region.

CHAPTER 5: THE WESTERN EAGLE

“We will never again permit any foreign nation to have Uncle Sam over a barrel of oil.”

- Gerald R Ford -

5.0 THE WORLD’S ONLY SUPERPOWER

After the end of the Cold War the U.S. was left the world’s only Superpower with an unchallengeable military force and the world’s largest economy measured in GDP. While the U.S. is generally regarded as a hegemonic power in the Western hemisphere, there is also an ongoing debate over whether or not the U.S. should be classified as a hegemon of the international system of states as a whole. We will not attempt to define what constitutes hegemony as this is a complicated issue which does not really affect the subject matter of this thesis.¹⁸³ It is clear, however, that the U.S. is superior in its capabilities and material resources to any potential challengers at present, including China.

The U.S.’ immense wealth and power is founded on the highest per capita consumption of energy, and particularly oil, in the world. The U.S. was able to provide sufficient supplies of oil to sustain its own needs up until 1956,¹⁸⁴ and was also one of the world’s largest exporters. In fact, the U.S. is still the world’s third largest producer of crude oil.¹⁸⁵ Since then, however, the U.S. dependence on foreign imports has grown steadily. Although the U.S. dependence on imports as a share of total consumption is considerably lower than that of many other industrialized states, (Germany and Japan, for example, both have import dependency of 90-100%) in absolute numbers it imports as much as 10,3 mb/d,¹⁸⁶ making the U.S. by far the largest oil importer in the world. As a consequence of this, ensuring the continuous flow of oil is of the utmost importance to the U.S.

In this chapter we will look at the energy security needs of the U.S. and how it seeks to ensure its energy interests, with special attention to its policies in the Caspian Region. In order to understand some significant limitations on U.S. policy choices, we will discuss the U.S. oil industry, which unlike the Chinese is entirely in private hands, and discuss relations between

¹⁸³ For a discussion of hegemony and America’s role in the world system, see: Robert Gilpin. 2002. “The Rise of American Hegemony”, in Patrick Karl O’Brien and Armand Clesse (eds.). *Two Hegemonies*

¹⁸⁴ Ian Rutledge. 2005. *Addicted to Oil*

¹⁸⁵ EIA statistics

¹⁸⁶ EIA website: *U.S. Imports by Country of Origin*

the U.S. government and the industry. We will present more details concerning the U.S. consumption of oil, both of today and projected future consumption, and what policies it currently employs, to meet these demands. This, in combination with the chapter on China, will allow us to compare the policies of the two states in their pursuit of energy security, providing a basis for an analysis of the theoretical implications of these policies later on. To help in the comparison, this chapter also has two subchapters at the end devoted to U.S. relations with other major external actors in the region as well as Sino-American relations.

5.1 “OUR ECONOMY, OUR STANDARD OF LIVING, AND OUR NATIONAL SECURITY”

The U.S., perhaps even more so than any other country in the world, is entirely dependent on oil to maintain its economy, its power and its “way of life”. As the U.S. economy is still by far the largest in the world, both in absolute and per capita terms, its energy requirements are equally large. The U.S. economy, being a mature, developed economy, has relatively low energy intensity,¹⁸⁷ compared to up-and-coming economies like China, which still fuel much of their economic growth and development through significant increases in energy consumption. Nonetheless, the U.S. is still the world’s largest energy consumer, well ahead of China, soaking up one quarter of the world’s total oil production.

Speaking of the imbalance between energy supply and demand, The National Energy Policy Development Group (NEPD) points out in its report, “Reliable, Affordable, and Environmentally Sound Energy for America’s Future”, that “[t]his imbalance, if allowed to continue, will inevitably undermine our economy, our standard of living, and our national security.”¹⁸⁸ The NEPD Group was made up of several highly influential people in the current U.S. administration, including Vice President Dick Cheney and then Secretary of State Colin L. Powell, as well as the heads of most government departments with any relevance to questions of energy policy. This suggests that its report, while certainly littered with statements of good intentions perhaps intended mostly for public consumption, may provide some important insight into how the U.S. government thinks about questions of energy security. The title of the report can be seen as a first indication. Perhaps significantly, “reliable” energy is mentioned first, “environmentally sound” last. While one must be careful

¹⁸⁷ A measure based on the energy required to create \$1 of GDP

¹⁸⁸ National Energy Policy Development Group. 2001. *Reliable, Affordable, and Environmentally Sound Energy for America’s Future*, p. viii

not to read too much into a title, it seems not entirely unlikely that this also reflects U.S. priorities. Also, the report is clear in its statement that “Energy security must be a priority of U.S. trade and foreign policy.” This, it continues, means that “We must look beyond our borders (...)”¹⁸⁹ While one could argue that this is simply stating the obvious, it does show clearly that the U.S. government recognizes the problems brought on by its dependence on foreign oil and considers this a top priority. Looking back to the days of the Arab oil embargo, a statement by then president Richard Nixon in a nationally televised address illustrates the continuity in this openness about U.S. priorities: “Let us set as our national goal, in the spirit of Apollo, with the determination of the Manhattan Project, that by the end of this decade we will have developed the potential to meet our own energy needs without depending on any foreign sources (...)”, an endeavor he dubbed ‘Project Independence’.¹⁹⁰

While the goal of complete self-sufficiency proposed in Nixon’s address has now been abandoned, as reality has caught up with U.S. policymakers, the statements above help illustrate that energy security, in the form of adequate and reliable supply of oil, has been one of the main priorities of every American administration since the U.S. became dependent on foreign imports to meet its domestic needs. Indeed, it has been argued that energy security is only surpassed by national defense in the U.S. hierarchy of interests.¹⁹¹ Not only is energy security, as we have discussed earlier, essential to the national security of the U.S., but it is central to, and inextricably linked to, the American economy¹⁹² and furthermore it is a goal shared and supported by most ordinary Americans. Whereas state survival currently seems like an undisputable certainty for the U.S., energy security remains elusive, and the American public has proven extremely sensitive to the consequences of energy insecurity, such as price hikes at the gas pump. While the simple economic and military consequences of failure to achieve energy security should be quite sufficient to make it a priority for any state, this popular demand for cheap gas provides a further incentive to the U.S. government.

In the most extreme of cases, the U.S. has even shown its willingness to apply force in pursuit of energy security. In a few cases, energy security even seems to have been an important factor in leading the U.S. to war. Of course, states rarely go to war for any single reason, and

¹⁸⁹ Ibid., p. xv

¹⁹⁰ Hans Jacob Bull-Berg. 1987. *American International Oil Policy*

¹⁹¹ Lee H. Hamilton. “Foreword”, in Jan H. Kalicki & David L. Goldwyn (eds.). 2005. *Energy & Security*, p. xxi

¹⁹² Rutledge (2005) even claims that oil-related industries, especially the automobile industry, are at the heart of the success of the American economy

it can be hard to separate the events that trigger a war from its underlying causes. Nonetheless, there is general agreement that the first Gulf War was primarily about oil.¹⁹³ Had Iraq been allowed to annex Kuwait, Saddam Hussein would have controlled 20% of the world's proven oil reserves. This would have made Iraq something of a mini-OPEC in itself, with immense influence in the world market and dangerous leverage over importers, especially in the long term, as other supplies are being exhausted. Furthermore, such a south-eastern expansion would have brought the Iraqi army dangerously close to the oilfields of Saudi Arabia, the capture of which would place another 20% of world reserves under Iraqi control. Combining the production capacity of Iraq and Kuwait¹⁹⁴ would provide Saddam Hussein with a mighty weapon. Even more threatening was the ability to take up to 16-17% of total world production¹⁹⁵ offline. This would, in fact, be more than sufficient to cause huge underproduction for an extended period of time, leading to chaos and a major global economic downturn, likely accompanied by forceful attempts by major powers to secure their own energy needs. Furthermore, the combined income from these oilfields would have proven extremely valuable to Iraqi attempts to produce weapons of mass destruction, including nuclear weapons. While other reasons may have influenced the decision to go to war to some extent, oil certainly seems to have been the primary motivator in the case of the first Gulf War.¹⁹⁶

5.2 THE OIL INDUSTRY

The American oil industry, unlike its Chinese counterpart, is not state-owned, which requires some analysis of its relationship with the U.S. government, in order to determine to what extent American oil companies can be seen as an arm working for U.S. interests in the Caspian region or elsewhere.

The American oil industry is quite diverse. Small producers are responsible for 60% of domestic production,¹⁹⁷ while the U.S. is also home to several of the largest International Oil Corporations (IOCs) in the world. These generally have the bulk of their reserves and production outside the U.S. and therefore, naturally, do not share the priorities of the small domestic producers. It is the IOCs, however, that are most relevant to our thesis. The only

¹⁹³ Ian Rutledge. 2005. *Addicted to Oil*

¹⁹⁴ The two taken together accounted for about 5% of total world production at the time, with capacity to spare

¹⁹⁵ Iraq, Kuwait and Saudi Arabia combined

¹⁹⁶ Ian Rutledge. 2005. *Addicted to Oil*

¹⁹⁷ *Ibid.*

way in which the U.S. government actually directs these companies and overtly limits the choices available to them is through sanctions, which the U.S. has imposed on a few oil-producing states, such as Iran and Sudan. Obviously, these countries are entirely inaccessible to American IOCs, unless they are willing to risk serious repercussions. Beyond this direct control, however, the U.S. and American IOCs have certain goals in common that lead to considerable interaction and cooperation between the two. Foremost among these is one very simple, basic interest, one might even say need: access to foreign oil. While the main objective of the U.S. government is of course access to the crude oil itself, American IOCs are most concerned with access to oil reserves. IOCs want a share of rights to oilfields and production, whereas the U.S. wants the product. Ensuring access for American IOCs in foreign markets is, however, seen as one of the most important ways for the U.S. to ensure its own access to crude oil, which is why the NEPD Group advises the President to “(...) direct the Secretaries of State, Commerce and Energy to *continue* supporting American energy firms competing in markets abroad (...)”¹⁹⁸ (our italics). Even though there is no explicit guarantee that oil extracted by American oil companies will be delivered to the U.S., it does ensure that it will usually be available to the U.S., even if it has to compete with other buyers. This is more than can be said for oil extracted by state-owned companies in some producing countries.

The considerable interaction between the government and IOCs also means that both parties are likely to take the interests of the other into consideration. In the case of the government supporting the industry, this has, as we have shown, been stated quite explicitly. As for the industry coordinating its operations with the U.S. government, one can only speculate, as this is not as public. It seems reasonable to assume, however, that the industry does listen to recommendations from the government when considering where to invest its resources. This is partly because the government can likely help IOCs determine where such investments will be safe, economically, as the risk of political turmoil is often great in oil producing countries, and IOCs may not always possess the resources and intelligence that is available to the government. Partly, however, it is also because government support is more likely to be forthcoming if the IOCs act in accordance with the government’s definition of the national interest. This is important because diplomatic pressure and other forms of government assistance are often not just beneficial, but even necessary, when dealing with the regimes of

¹⁹⁸ National Energy Policy Development Group. 2001. *Reliable, Affordable, and Environmentally Sound Energy for America’s Future*, Chapter 8, page 6

some oil producing states, which can be unpredictable, uncooperative and even dishonest in their dealings if IOCs are operating without any support from a “higher power”. While this does not amount to government control of the industry, it does suggest that the two cooperate, and have to cooperate, to achieve their objectives. Acting entirely without government approval certainly leaves IOCs more exposed. With the more aggressive internationalization of NOCs in recent years, however, some have argued that the current level of support is insufficient to secure U.S. interests and that the U.S. should perhaps even consider establishing its own NOC to ensure supply.¹⁹⁹ The fear is that the inherent advantages of state-owned companies when bidding for foreign resources, which will be discussed more thoroughly later in this thesis, will gradually kill off private competitors.²⁰⁰

5.3 SOURCES OF IMPORTS

5.3.1 Saudi Arabia

The immense consumption of the U.S., of which only about one third is covered by domestic production,²⁰¹ means that it is dependent on considerable imports, which it currently procures from a wide variety of sources. Among the most important sources is Saudi Arabia, which in the last six years has typically provided 15-20% of U.S. imports. As has been mentioned earlier, Saudi Arabia and the U.S. have a special relationship, one might even say partnership, meant to secure the interests of both states. This cooperation was initiated during World War II, as the U.S. worried about its ability to provide sufficient supplies of oil for itself and its allies.²⁰² In 1943, President Franklin D. Roosevelt stated that “the defense of Saudi Arabia is vital to the defense of the United States.”²⁰³ Since then, the special relationship has been reaffirmed on several occasions. President Harry Truman wrote to King Ibn Saud in 1950 that “[n]o threat to your Kingdom could occur which would not be a matter of immediate concern to the United States.”²⁰⁴ The Eisenhower Doctrine moreover guaranteed military support to help defend U.S. allies in the Middle East against Soviet-backed enemies. Under President Nixon, the U.S. provided military aid to Iran and Saudi Arabia. Finally, after the 1979 Iranian

¹⁹⁹ James M. Day. “Can U.S. Petroleum Companies Compete With National Oil Companies?”, *Business Law Brief*, Fall 2005

²⁰⁰ Ibid.

²⁰¹ EIA statistics

²⁰² Wikipedia definition of the Carter doctrine

²⁰³ Ibid.

²⁰⁴ Ibid.

revolution, which ended the U.S.' close relationship with Iran,²⁰⁵ and the Soviet invasion of Afghanistan, the Carter Doctrine, in very clear terms, provided an explicit security guarantee to the states of the Persian Gulf. The Carter administration perceived the presence of Soviet troops in Afghanistan, so close to the Middle East, as "a grave threat to the free movement of Middle East oil".²⁰⁶ While the Caspian region is not the Middle East, and one cannot necessarily draw conclusions about U.S. policy in one region based on policy elsewhere, it is interesting that the U.S. has apparently always been willing to state, quite explicitly, the importance of oil to U.S. national interest, and its willingness to protect the supply of oil, by force if necessary.

Currently, the special relationship between Saudi Arabia and the U.S. means that the U.S. helps prop up the Saudi regime, primarily through military assistance and security guarantees.²⁰⁷ While it would be an exaggeration to call the Saudi royal family a puppet regime, Saudi Arabia provides some influence with OPEC for the U.S., as well as a guarantee of sorts that OPEC will not take actions that have dramatically negative effects for the U.S. Even if this was not the case, however, the stability of Saudi Arabia, or rather the stability of its oil production, would still be of great concern to the U.S., or any other oil importer for that matter. Both the reserves and current production of Saudi Arabia are immense, and any disruption of production there would quickly be felt around the globe. Saudi Arabia has partly repaid the U.S. for its support by maintaining spare production capacity to help cushion the shock of supply disruptions elsewhere. These factors taken together should make it clear why the special relationship has been a cornerstone of U.S. foreign policy and why, according to the EIA "Saudi Arabia's national security concerns dictate that it maintain a very high profile as a supplier to the United States market, even at the cost of lower netbacks."²⁰⁸

In fact, Saudi Arabian production is so important to the U.S. that plans for seizing the Saudi Arabian oil fields, should the Saudi regime be overthrown, have been discussed.²⁰⁹ The problem with this reliance on Saudi Arabia is, as the existence of such plans indicates, the relatively weak position of the Saudi monarchy domestically. Radical Islamic groups, in

²⁰⁵ Up until the revolution, the shah's Iran was a close regional ally of the U.S. as well as an important and reliable source of oil, largely because of a "special relationship" similar to that the U.S. still maintains with Saudi Arabia.

²⁰⁶ Wikipedia definition of the Carter doctrine

²⁰⁷ Backed up by the aforementioned numerous earlier statements guaranteeing the security of Saudi Arabia and other Gulf states

²⁰⁸ EIA: *Oil Market Basics*

²⁰⁹ Ian Rutledge. 2005. *Addicted to Oil*

particular, seek to undermine and eventually overthrow it, and find considerable support in the population for this goal. Due to its fragility, the Saudi regime is hesitant to crack down hard on the radical clerics who provide ideological fuel to this fire.²¹⁰ This results in a highly unpredictable and unstable situation, which is cause for concern in Washington, D.C. Saudi Arabia is not the only unstable Middle Eastern oil producing state, however. Instability and unpredictability seems to be the norm, rather than the exception, in most of the Arab world and most Middle Eastern oil producers have considerable, and influential, anti-American elements in domestic politics. As Middle Eastern states taken together provide almost a quarter of U.S. imports, this leaves the U.S. vulnerable. The instability of the region, and the political costs associated with close relations with “unsavory” regimes has led the U.S. to seek sources outside the Middle East. In other words: diversification of supply. In fact, the relatively low share of Middle Eastern producers among suppliers to the U.S., compared to their share of production, is in itself testament to this.

5.3.2 The Western Hemisphere

Producers in the Western hemisphere supply more than half of current U.S. imports. This is partly because of their close proximity, which reduces transportation costs and risks, and partly because the U.S. has consciously preferred to import from its “near abroad”, with which it has traditionally maintained better relations and held greater influence. Venezuela, the largest Latin American oil producer, is an OPEC member, and therefore subject to OPEC production quotas, but has been a reliable supplier, despite recent political disagreements. Again, this is partly because low transportation costs and almost unlimited demand make the U.S. an attractive market for exporters in the region, just as it makes the Western hemisphere an attractive source for the U.S. Even if Venezuela, for political reasons, might prefer to ship more of its oil to other importers, like China, the logistics involved make it very difficult and expensive. On the other hand, it is believed that Venezuela, with sufficient foreign investment and political will, could be able to supply half or more of the U.S.’ import needs.²¹¹ The coup-makers who attempted to topple Hugo Chávez’ government in 2002 did so after Chávez’s attempted to bring the state-run oil company, PDVSA,²¹² under the control of his loyalists.²¹³ The U.S. did openly support the coup after it had apparently succeeded, although U.S.

²¹⁰ “Anti-terrorism in the Gulf: Rooting out their radicals”, *The Economist*, November 21, 2002

²¹¹ It currently supplies approximately 15% of U.S. imports, according to EIA figures.

²¹² PDVSA is the cornerstone of the Venezuelan economy, which explains the upheaval caused by this action

²¹³ Tim Padgett. “Crazy Like a Fox”, *Time Magazine*, September 24, 2006

officials have always denied supporting it in advance.²¹⁴ In any case, Chávez' supporters brought him back to power after only a few days.

Regardless of American concerns over Chávez's anti-American attitudes, there are also problems associated with such heavy reliance on producers in the Western hemisphere. There is a particular kind of short-term insecurity associated with short-haul oil, such as that delivered to the U.S. by Western hemisphere producers. Any disruption of production, and hence deliveries, will be felt almost immediately by U.S. refiners, who will have little time to adjust and find other sources to compensate for losses of deliveries. With long-haul oil, such as that coming from Middle Eastern producers, the effects of disruptions in production will not be felt for weeks in the U.S., giving more time to take the appropriate measures. The EIA points to the case of hurricane Roxanne, which damaged several off-shore Mexican production facilities in 1995 to illustrate this: "Some 40 million barrels of Mexico's production was eliminated, the vast majority earmarked for refineries along the U.S. Gulf Coast. These refiners, less than a week's sailing time away, had little time to compensate for this sudden hole in their planned supplies."²¹⁵ What this means for the energy security of the U.S. is that over-dependence on nearby producers carries its own risks, which ideally should be compensated for by a healthy mix of long-haul and short-haul imports.

5.3.3 Africa

Producers in Africa, primarily Nigeria and Angola, also provide a considerable share of U.S. oil imports. Like so many other oil producers, however, there are several problems associated with both of these countries. Angola has only recently emerged from a 27 year civil war, which was Africa's longest-running conflict and followed shortly after Angola's war of independence with Portugal. The country has only just started recovering and the situation is still somewhat uncertain. Nigeria's oil industry regularly comes under attack from insurgents in its oil producing Niger Delta region, who feel the local inhabitants are not getting their fair share of the country's oil riches. These insurgents have attacked oil production facilities and kidnapped foreign employees of IOCs operating in Nigeria, leading to uncertainty about Nigeria's ability to maintain a reliable, undisrupted flow of oil.²¹⁶ In fact, the recent turmoil in

²¹⁴ Tom Gibb. "Analysis: After the Would-be Coup", *BBC News Online*, April 14, 2002

²¹⁵ EIA. *Oil Market Basics*

²¹⁶ "Attack on Nigeria oil facilities", *BBC News Online*, October 25, 2006

"Oil workers released in Nigeria", *BBC News Online*, November 7, 2006

"Oil workers flee Nigerian siege", *BBC News Online*, November 9, 2006

the country has reduced its oil production by more than 20% from peak levels.²¹⁷ This uncertainty is compounded by occasional sectarian violence and fear about Nigeria's future viability as a unified state. Despite this, the U.S. is expected to import more crude oil from Nigeria by 2020 than it currently does, both in absolute terms and in share of total imports.²¹⁸

These problems and uncertainties in almost all the regions from which the U.S. imports its oil contribute to the need for diversity of supply and help draw the U.S.' attention toward Caspian shores. While the states of the Caspian are not democracies and all have questionable records on human rights, they are considered relatively stable compared to many other oil producers. Clearly, there are uncertainties, particularly with regard to the question of the eventual transfer of power from the current leadership, which is generally made up of people who have remained in power from the Soviet period, to the next generation.²¹⁹ Nonetheless, the Caspian region seems more stable than most alternatives.

5.4 THE U.S. IN THE CASPIAN REGION

As we have seen, OPEC countries currently supply more than half of the U.S.' imports, which works as a significant incentive for the U.S. to seek diversification of its supply. While OPEC is not one single exporter to be dealt with, the members of the organization do generally, although to varying degree, coordinate their export policies. This potentially gives the organization immense leverage over an import-dependent country like the U.S., which is something the U.S. actively seeks to avoid. It is in this environment that the Caspian region finds its greatest significance to the U.S., not primarily as a major source of imports,²²⁰ but more importantly as an alternative to OPEC producers. To some extent this is simply part of the general desire for diversification of supply, but the Caspian's independence of OPEC gives it some added value to the U.S., as well as China and other major importers. As has been mentioned, the existence of buffer production capacity is important not just because it reduces dependence on OPEC, but also because it reduces the power of OPEC. Non-OPEC oil production, in particular spare production capacity, reduces both OPEC's ability to manipulate prices and its ability to use oil as a weapon, through the use of sanctions or production cuts. Beyond this concern with OPEC, spare capacity is important because it

²¹⁷ John C. K. Daly. 2006. "Nigeria Continues to Slide Toward Instability", *Terrorism Monitor*, Vol. 4, Issue 24

²¹⁸ Keith Somerville. "US looks to Africa for 'secure oil'", *BBC News Online*, September 13, 2002

²¹⁹ Eugene Rumer. "The U.S. Interests and Role in Central Asia after K2", *The Washington Quarterly*, Summer 2006 Edition

²²⁰ The Caspian region will, after all, never be able to match the Middle East in production

reduces the risk of reductions in supply caused by disruptions in production. Saudi Arabia, as has been pointed out, has long maintained considerable spare capacity, largely as a favor to the U.S., in order to compensate for such disruptions, which it has done on several occasions, most recently when it increased its daily production by 1,5 million barrels in connection with the Second Gulf War.²²¹ As Saudi Arabia's spare capacity is now near zero, however, other producers are urgently needed. Even if these new producers should not be willing to maintain any spare capacity, they may at least help enable Saudi Arabia to return to less-than-capacity production by filling in the gap of reduced Saudi production.

The U.S. became interested in the Caspian region almost immediately after the collapse of the Soviet Union, first primarily hoping to be able to draw the former Soviet republics away from Russia's iron grip. As the Caspian was generally believed to hold vast, undiscovered reserves of oil, American IOCs were also quick to move in, with Chevron becoming involved, as the largest private stakeholder, in the development of the Tengiz oilfield, one of the largest fields discovered in recent times. Coming as early as 1993, this made Chevron the first foreign oil company to become involved in the Kazakh oil industry. As great uncertainty surrounded the potential reserves of oil and gas in the Caspian during most of the 1990s, however, the U.S. at times seemed hesitant to expand its involvement in the region. Nonetheless, the U.S. quickly established bilateral investment treaties with both Azerbaijan and Kazakhstan, laying down rules and regulations for trade and foreign direct investment between the U.S. and these states. Such agreements are essential to American IOCs as they provide some protection against random, unpredictable changes in the legal framework of their industry, as well as protection against unfair or discriminatory treatment in the legal system of the country in which they operate. Talks about the BTC pipeline, central to U.S. strategy in the region, also began in the late 1990s, after President Bill Clinton first backed it in 1998,²²² and the region seemed set to begin shipping oil West within a relatively short period of time.

Of the countries in the Caspian region, Azerbaijan is currently the U.S.' closest ally, and has pursued closer ties with the West generally, and is a member of NATO's partnership for Peace as well as the Council of Europe. Importantly, Azerbaijan has been more than willing to send its oil west, as the construction of the BTC pipeline indicates. Azerbaijan in many ways functions as a pivot for U.S. energy policy in the Caspian region, being the starting point of

²²¹ "Saudis aided in Iraq more than thought", *China Daily*, April 25, 2004

²²² F. William Engdahl. "Revolution, Geopolitics and Pipelines", *Asia Times Online*, June 30, 2005

the BTC. The significance of Azerbaijan to U.S. policy in the region is underscored by the impressive list of board members of the U.S.-Azerbaijan Chamber of Commerce (USACC), which includes in its Council of Advisors former Secretaries of State, Henry Kissinger and James Baker III, former National Security Advisor and well-known scholar, Zbigniew Brzezinski,²²³ Chairman of the President's Foreign Intelligence Advisory Board, Brent Scowcroft and former Chief of Staff, John Sununu. The board itself is primarily made up of representatives of the oil industry, including Chairman of the Board, A. Tim Cejka, who is also President of ExxonMobil Exploration. President and CEO of Halliburton, Dick Cheney was also a member of the Advisory Council before being elected Vice President of the U.S.²²⁴ To quote F. William Engdahl: "This group of prominent individuals certainly would not give a minute of their time unless an area was of utmost geopolitical strategic importance to the US or to certain powerful interests there."²²⁵

Several state visits between the two countries also suggest strong ties. Former Azerbaijani President Heydar Aliyev made several such visits to the U.S. during his presidency. As part of his first visit, in 1997, several oil development contracts were signed between U.S. companies and the State Oil Company of Azerbaijan Republic (SOCAR) in the White House, with President Aliyev and U.S. Vice President Al Gore present.²²⁶ Heydar Aliyev's son and successor, Ilham Aliyev, was invited for talks in the White House in April 2006, after the Azeri opposition had suggested the lack of such an invitation was an indication of U.S.' displeasure with the country's slow progress on democratic reform. The eventual invitation was widely interpreted in Azerbaijan as a rebuttal of those claims and reaffirmation of the good relationship between the two countries.²²⁷

Indeed, there has also been heavy speculation about the possible establishment of U.S. bases in Azerbaijan, particularly after U.S. troops were evicted from the U.S.' erstwhile ally Uzbekistan, which now seems to be distancing itself from the U.S. and aligning itself more closely with Russia.²²⁸ Since the Azerbaijani constitution currently forbids the stationing of

²²³ Who, incidentally, also claims in his book "The Grand Chessboard", that Azerbaijan is an essential geopolitical pivot for control of the Eurasian "heartland" and its resources

²²⁴ USACC website

²²⁵ F. William Engdahl. "Revolution, Geopolitics and Pipelines", *Asia Times Online*, June 30, 2005

²²⁶ Mir-Yusif Mir-Babayev. "Azerbaijan's Oil History", *Azerbaijan International*, Summer 2003

²²⁷ Rovshan, Ismayilov. "Attention Focuses on Iran in Bush-Aliyev Talks", *EurasiaNet*, April 11, 2006

²²⁸ Alman Mir Ismail. "A Base or Not a Base for Azerbaijan?", *EurasiaNet*, September 12, 2005

F. William Engdahl. "Revolution, Geopolitics and Pipelines", *Asia Times Online*, June 30, 2005

foreign troops on Azerbaijani soil, the possibility of a U.S. base there has been dismissed by both sides, but this has hardly reduced speculations. The Russian daily Pravda even insists that agreements on the establishment of U.S. bases in Azerbaijan were in fact signed during then Secretary of Defense Donald Rumsfeld's visit to Baku in 2005.²²⁹ It has furthermore been suggested that the establishment of a base in Azerbaijan could be a first step leading up to an invasion of Iran, which has only made both governments deny the claims even more strongly.²³⁰ A more realistic plan in the short term, which is also more directly linked to energy security issues, is the establishment of a so-called Caspian Guard of military special forces, which would be responsible for monitoring the Caspian Sea, primarily the Azeri-Kazakh border area of it, and protecting oil and gas transportation routes, primarily the BTC. The U.S. has committed \$100 million to this project, which would be a cooperative effort between Azerbaijan and Kazakhstan, with a somewhat unclear level of U.S. involvement, headquartered in Baku. "[The] Caspian Guard addresses counterproliferation, counterterrorism, and illicit trafficking as well as defense of key economic zones such as Caspian Basin petroleum".²³¹ As part of the Caspian Guard project, Baku would also become the site of a radar station capable of monitoring sea traffic in all of the Caspian.²³² Russia has, however, launched a similar project, dubbed "CasFor", which many analysts consider an attempt to undermine the Caspian Guard project as well as U.S. policy in the area more generally.²³³ So far, Kazakhstan has appeared willing to take part in both, although Russia has hinted that it may at some point demand a choice between the two.²³⁴

Besides the Caspian Guard project, the U.S. has held joint military exercises with Azerbaijan to train its navy to protect off-shore oil production facilities and conducted some anti-terrorism exercises with Kazakhstan. These exercises with Kazakhstan have been few and small in size, however.²³⁵ Perhaps more significantly, the U.S. has provided both Azerbaijan and Kazakhstan with substantial financial aid for their armed forces as well as training, and

Fariz Ismailzade. "US Troop Redeployment Sparks Speculation on Azerbaijani Base", *EurasiaNet*, August 23, 2004

²²⁹ "Noiseless diplomacy: USA is quietly building a corridor from the Black Sea to the Caspian Sea", *Pravda*, May 25, 2005

²³⁰ Alman Mir Ismail. "A Base or Not a Base for Azerbaijan?", *EurasiaNet*, September 12, 2005

²³¹ "Caspian Guard", *GlobalSecurity.org*

²³² F. William Engdahl. "Revolution, Geopolitics and Pipelines", *Asia Times Online*, June 30, 2005

²³³ Roger McDermott. 2006. "Nazarbayev's Caspian Security Deals: What Can Moscow Offer?", *Eurasia Daily Monitor*, Volume 3, Issue 124

²³⁴ *Ibid.*

²³⁵ Robert McMahon. 2005. "US: Central and South Asian Military Officers Attend Crisis Training", *EurasiaNet*, July 23, 2005

most recent arms acquisitions by the Kazakh armed forces have come from the U.S.²³⁶ In 2003, the U.S. also financed the construction of Kazakhstan's first military base on the Caspian. An official from the Military Cooperation Department of the U.S. Embassy in Almaty told journalists that the United States is interested in the base because "the oil riches of the Caspian should be under reliable protection".²³⁷ While these initiatives do not amount to an actual alliance with either state or even a major military cooperation, they do demonstrate the U.S.' interest in the region. Furthermore, this can be seen as part of the U.S.' ongoing effort to make the region more hospitable to foreign, primarily U.S., oil companies.

By laying this kind of groundwork and helping to provide security and stability in the region, the U.S. provides incentives for American IOCs to take a more active role. This becomes more significant when seen in the context of continuing U.S. diplomatic pressure on Kazakhstan to open up further to foreign participation in its oil industry. The 2001 establishment of the U.S.-Kazakhstan Energy Partnership was a major success in this respect: "Goals of the partnership include creating opportunities for U.S. energy companies to expand their investments in Kazakhstan, and to influence the direction of energy policy and regulation by an exchange of information and demonstration of policies and regulations that have been effective in other countries of the world."²³⁸ With U.S. efforts to establish a military foothold in the region floundering, and failing to gain even observer status in significant regional organizations like the SCO, the second best alternative to U.S. policymakers may lie in ensuring the participation of American IOCs in the development of the region's resources. As the U.S. government has no direct control over IOCs, this goal can only be achieved if American IOCs themselves feel they stand to gain by investing in the region. Providing a hospitable environment and displaying the government's commitment to supporting American business interests in the region is therefore essential.

The Bilateral Investment Treaties (BITs) signed between the U.S. and Kazakhstan and Azerbaijan (being bilateral, these are separate treaties) are important tools in this respect. These treaties guarantee the right of American companies to invest in the oil industry of these countries, including purchasing equity oil, although with some minor restrictions. This is in fact quite extraordinary, as most of the major oil producing states have severe restrictions on

²³⁶ Ilan Berman. 2004/2005. "The New Battleground", *The Washington Quarterly*, Volume 28, no.1

²³⁷ Pepe Escobar. "Silk Road Roving: The king of the steppes", *Asia Times Online*, November 5, 2003

²³⁸ U.S. International Trade Administration. *U.S.-Kazakhstan Energy Partnership*

foreign direct investment in their oil industries. Many of them, such as Saudi Arabia, actually maintain state monopolies on oil production, shutting out IOCs altogether. While both Kazakhstan and Azerbaijan do have state-run oil companies, neither are monopolies, and both countries have been relatively open to the involvement of IOCs. In fact, a joint declaration by the governments of the U.S. and Kazakhstan from 1992 states that: “A critical feature of our cooperation will be an effort by Kazakhstan to lower barriers to trade and investment to allow greater access for American and foreign firms, especially in sectors such as oil and natural gas, mining, agriculture, manufacturing, and food processing.”²³⁹

After the September 11 attacks the U.S. has had an increased military presence in Central Asia due to their operations in Afghanistan. The U.S. still maintains a base in Kyrgyzstan, as well as refueling and overflight rights in Kazakhstan as well as Tajikistan, where there is also a small NATO base. China and Russia have voiced their concern over this continued presence, and have put pressure on the countries of the region to get the U.S. out.²⁴⁰ In fact, the Shanghai Cooperation Organization (SCO) released a declaration in July 2005 calling for a timetable for a withdrawal of U.S. troops from the region. The U.S. maintains that the bases are there only to support its operation in Afghanistan and are still necessary to ensure the success of that operation. Ahmed Rashid claims, however, that “Further goals include controlling oil supplies from the Caspian Basin – especially now that a wholly owned Western pipeline transporting oil from Azerbaijan and Kazakhstan to the Mediterranean via Turkey is in operation...”²⁴¹ The possibility that this may be true is what also worries Russia and China. There is concern that the U.S. is in Central Asia to stay and will use its military presence in the region to support its geopolitical and energy policy objectives. Removing the U.S. military presence is seen as an important step in reducing American influence in the region, which is important to China as it competes with the U.S. for the oil resources of the Caspian. The U.S. has rebuffed Russia and China’s demands by pointing to the continuing instability in Afghanistan, and saying it would hold talks with the individual states in question, rather than dealing with an SCO dominated by the two major powers. Uzbekistan evicted all U.S. forces shortly after the SCO declaration, while Kyrgyzstan asked for a review of the base treaty, resulting in a significant price hike, although U.S. troops were allowed to remain in the country.

²³⁹ U.S. Department of State. 1992. *US-Kazakhstan relations - joint declaration and Department of State statements*

²⁴⁰ Speaking of SCO countries, which does not include Azerbaijan.

²⁴¹ Ahmed Rashid, “Great Game Reloaded”, *YaleGlobal Online*, 26 July 2005

The bases are certainly valuable to the U.S. in its pursuit of control over Caspian oil resources. They are, however, clearly there for other reasons as well. There is no reason to doubt that the specific location of most of these bases is primarily related to the needs of the Afghan military operation. Furthermore, they are considered essential to the war on terror, as the U.S. has been concerned that Islamic militancy might spread throughout the region. On the other hand, there is no reason to think that other interests did not come into play when setting up the bases. To quote Ariel Cohen: “The United States is waging an enduring struggle to safeguard the West in general and America in particular, not only from terrorist threats emanating from Afghanistan, but also from over reliance on unstable sources of hydrocarbons in the Middle East.”²⁴² The actual number of troops and equipment present is marginal, of course, but any such military presence has tremendous symbolic value, as it gives some indication of the relationship between the host country and the foreign power with bases on its soil. The mere presence of American military personnel serves as a clear warning to other major regional powers that the U.S. considers the host country, and to a lesser extent the region as a whole, to be of vital importance to U.S. interests. This means that any undue interference in the affairs of those countries may cause the U.S. to get involved and serves as a security guarantee, although a relatively weak one. Therefore, American presence in the region is a constant reminder to China and Russia that their actions can result in an unpleasant U.S. response, if they do not take U.S. interests into account.

While Kyrgyzstan is not part of the Caspian region per se, its relative proximity, both to the Caspian region itself and to China, makes it important in the sense discussed above. The presence of U.S. troops in Kyrgyzstan helps remind nearby countries like Kazakhstan of the need to, at the very least, keep up “(...) a balancing act between the Bear, the Dragon, and the far-away American Eagle”²⁴³ and ideally helps tip the scales in favor of U.S. interests. It also helps in limiting the policy choices available to China in the struggle for access to the energy resources of the Caspian, as it makes overt power politics or threats more difficult. Indeed, it has been claimed that this (along with the more substantial Russian military presence and extensive interests in the region) is part of the reason why China seems to be relying more on multilateral cooperation through the SCO to secure its energy policy objectives, as opposed to

²⁴² Ariel Cohen. 2006. “U.S. Interests and Central Asia Energy Security”, *Backgrounder No. 1984*

²⁴³ Ariel Cohen. “Washington Ponders Ways to Counter the Rise of the Shanghai Cooperation Organization”, *EurasiaNet*, December 17, 2006

what Stephen Blank has called its earlier “(...) go-it-alone approach in the great energy game.”²⁴⁴

5.5 CONTEXT OF POLICY

This subchapter will serve to contextualize the space within which U.S. policies are shaped. Other major powers in the region limit and shape the policy choices available to the U.S., and of China, as well as sometimes representing other, overriding interests. In order to properly understand the subject matter at hand, it is necessary to identify some of these circumstances that impact on how energy policies in the region are shaped.

For the U.S., Russia’s presence in the region in many ways limits its policy choices, but still it is not a worst-case scenario. Russia, unlike China, is currently a net exporter of oil, so oil that is transported through Russia is unlikely to remain there. Furthermore, since Novorossiysk is a Black Sea port, Western states are the natural destinations for CPC oil. If not the U.S. itself, then at least its European allies will likely benefit from this. Additionally, two American companies, Chevron and ExxonMobil, hold major stakes in the CPC. Russian control of the transport route is of course a less-than-ideal situation that the U.S. would prefer to avoid, as Russia has, arguably, demonstrated in the past its willingness to use that control for political ends.²⁴⁵ The consequence of this is not that U.S. policy seeks to keep Russia out of the Caspian altogether, as this would not only be impossible, but in the unlikely event that it succeeded, could also end up pushing Kazakhstan into the hands of the Chinese. On the other hand, it means that the U.S. works hard to avoid a Russian monopoly on transportation routes for Caspian oil. It is not a problem that some oil runs through Russia, but it is potentially a huge problem if all of it does, because that would hand the Russians a mighty weapon to be wielded against oil importers. This is another reason why the BTC and a future trans-Caspian pipeline are vital to U.S. interests in the region: Russian influence in the region must be limited, even as it is clear that it cannot be eliminated.

While its actual influence in the Caspian region and Central Asia generally has been limited,²⁴⁶ Iran has for a long time played a major part in shaping U.S. policy in the region. The U.S. has worried that Iran might support Islamic extremists in the region or attempt to

²⁴⁴ Stephen Blank. “China Makes Policy Shift, Aiming to Widen Access to Central Asian Energy”, *EurasiaNet*, March 13, 2006

²⁴⁵ Anne Applebaum. 2006. “Playing Politics With Pipelines”. *The Washington Post*, January 4, 2006

²⁴⁶ Leon T. Hadar. 1992. “The “Green Peril”: Creating the Islamic Fundamentalist Threat”, *Cato Policy Analysis* No. 177

spread its ideology. In practice, while Iran has at times attempted this, it has met with little success, largely because of sectarian differences: Iran is predominantly Shiite, while Central Asian Muslims are overwhelmingly Sunni. In fact, Iran was a longtime enemy of the Taliban in Afghanistan, which received more support from Pakistan, now presented as an ally of the U.S. in its “war on terror”.²⁴⁷ Nonetheless, relations between the U.S. and Iran have been openly hostile since the Iranian revolution in 1979, with the U.S. even actively supporting Iran’s enemy, Iraq, in the Iraq-Iran war.

The U.S. containment policy toward Iran is relevant to the Caspian region, as the U.S. has actively opposed any plans to construct pipelines from the Caspian through or to Iran, which many argue would be by far the cheapest, easiest and safest route. Indeed the U.S. has applied great diplomatic pressure every time Caspian states have considered this option, and so far seems to have succeeded. Speculations about U.S. intentions to construct military bases in Azerbaijan have also been linked to U.S.-Iranian relations, as Azerbaijan would be a vital strategic location in case of a U.S. invasion of Iran. Both states have repeatedly denied rumors that this has even been discussed, however.²⁴⁸ Iran continues to be a great concern to the U.S. and the fact that Iran, unlike the U.S., has been granted observer status in the SCO has not diminished this concern. Indeed, there were speculations in advance of the 2006 annual meeting of the SCO that Iran might be accepted as a full member of the organization, which did not happen because the current member states felt they needed a more fixed framework for the organization as it is before expanding it further. Furthermore, Russia has traditionally had relatively good relations with Iran.

As the U.S. would prefer to limit shipments of Caspian oil to China, an alternate Caspian strategy has been orienting the Central Asian states toward its South Asian allies, supporting efforts toward wide-ranging energy cooperation between these two regions. This has been hampered by the failure to provide sufficient security and stability in Afghanistan, which would be a necessary link. Any pipelines south from Central Asia to Pakistan and India would have to go through either Afghanistan or Iran, and seeing as Iran is currently an unacceptable option for the U.S. this leaves only Afghanistan. The South Asia plan has not been at the top of the U.S. agenda, especially after the BTC pipeline became operational, but it remains on the table. What makes this something of a backup plan is that it does not provide direct

²⁴⁷ Afzal Khan. 2004. “Pakistan: Uncertain Ally in the War on Terror”, *Terrorism Monitor*, Volume 2, Issue 17

²⁴⁸ Alman Mir Ismail. “A Base or Not a Base for Azerbaijan?”, *EurasiaNet*, September 12, 2005

benefits to the U.S. itself. On the other hand, it would possibly be easier and more realistic than aiming to ship most Caspian oil west. India and to a lesser extent Pakistan will need increasing supplies of oil to fuel their own growing economies and from an American perspective it would be better to see Caspian oil go to its South Asian allies than either to China or Russia. After all: “As India is a U.S. strategic partner, a stable democracy, and a growing economic power, a greater Indian presence in the region may be beneficial for U.S. interests.”²⁴⁹ Significantly, this would also prevent, or at least reduce, Indian dependence on Iran, which is a concern to the U.S. as it might lead India to develop closer relations with Iran and even undermine U.S. policy in the long term.

India itself has also sought to develop closer ties with Central Asian nations, including attempts to acquire oil fields and companies in Kazakhstan. Most recently, ONGC Videsh, the overseas arm of state-owned Indian oil company ONGC, made a bid for PetroKazakhstan, which was eventually sold to the Chinese CNPC.²⁵⁰ India has become an important supporter of U.S. policy in the region generally,²⁵¹ and is also an observer at the SCO. The Kazakh government has expressed support for its ambition to become a full member of the organization. Assuming the close cooperation between India and the U.S. continues, this could become a considerable advantage to the U.S., perhaps offering a back door into influence with the SCO, similar to the special relationship with Saudi Arabia.

As we have now presented the policies of China and the U.S. in the Caspian region separately, we will move on to examining their relationship with each other. It is important to have a basic understanding of Sino-American relations generally and their dealings with each other in the region specifically, as it is an aid in our analysis by making the context in which their energy security policies in the region are shaped more comprehensible.

5.6 THE DRAGON AND THE EAGLE

Sino-American relations have at times been tense, due to the U.S. occasional criticism of Chinese suppression of democratic opposition and its record on human rights. Recent events, like the efforts by the U.S. congress to bar CNOOC from acquiring Unocal, and Chinese

²⁴⁹ Ariel Cohen. “U.S. Interests and Central Asia Energy Security”, *Backgrounder No. 1984, November 2006*

²⁵⁰ Bruce Pannier. “Kazakhstan/China: Oil Deal Marks Beijing’s 1st Foreign Energy Takeover”, *Eurasianet/RFE*, August 23, 2005

²⁵¹ Subodh Atal. “Central Asian Geopolitics and U.S. Policy in the Region: The Post-11 September Era”, *Mediterranean Quarterly*, Spring 2003 Edition

President Hu Jintao's humiliating visit to Washington, D.C.,²⁵² have also contributed to an apparent chill in relations. On the other hand, China and the U.S. are ever more closely tied together economically. Trade between the two countries has mushroomed in the last ?? years, although the exchange is somewhat unequal, with far more goods going from China to the U.S. than the other way around. This imbalance is in fact an important reason for the recent tension, as many in the U.S. feel it is a result of unfair Chinese practices.²⁵³ Several U.S. companies have also made inroads into the Chinese economy, with franchises like McDonalds and Starbucks popping up all over the country. Adding to this economic interdependence is the fact that China holds billions of dollars in U.S. treasury bonds, which essentially gives China the ability to plunge the U.S. economy into a deep crisis, should it suddenly withdraw its investments. "It would devastate the U.S. economy more than any nuclear strike could manage at the moment."²⁵⁴ Furthermore, the U.S. has been none too pleased with China's cozy relationship with Iran and other evildoers around the world, believing this to undermine U.S. policy toward these countries. China, on the other hand, is not comfortable with U.S. attempts to interfere with its foreign, and at times even its domestic, policies. Particularly with regard to what China perceives as its near abroad, U.S. involvement has been most unwelcome.

China is often presented as a likely future superpower, due to its continuing strong economic growth and the potential inherent in a country as vast and populous as China. Despite constant Chinese reassurances that it is committed to what it calls "China's peaceful rise", there has been much concern, particularly among representatives of the "China threat" perspective in Washington, D.C., also known as "The Blue Team", that China and the U.S. will inevitably become rivals on the global stage.²⁵⁵ This is consistent with the realist assumption that great powers will always tend to be locked in rivalry as a result of the anarchic nature of the international system.²⁵⁶ As a result of this, members of "The Blue Team", along with some realists, argue that China and the U.S. will face each other in a new Cold War, unless the U.S. takes steps to limit China's power before it is too late.²⁵⁷ The opposite view, which despite serious disagreements over issues like Taiwanese independence and general ideological

²⁵² Dana Milbank. "China and Its President Greeted by a Host of Indignities", *The Washington Post*, April 21, 2006

²⁵³ This raises some interesting questions about the liberal claim that increased trade and interdependence leads to improved relations between states, but there is no room in this thesis for that particular theoretical debate

²⁵⁴ Ian Williams, "China-U.S.: Double bubbles in danger of colliding", *Asia Times Online*, January 2004

²⁵⁵ John Pomfret. "U.S. now a 'threat' in China's eyes", *Washington Post*, November 15, 2000

²⁵⁶ Mearsheimer, John J. 2001. *The Tragedy of Great Power Politics*

²⁵⁷ Robert Kaplan. "How We Would Fight China", *The Atlantic Monthly*, June 2005

differences seems to remain dominant among U.S. policymakers, is the liberal view that economic ties between China and the U.S. will contribute to complex interdependence between the two. It is believed that this development will prevent serious enmity, or at least enable them to resolve their differences peacefully, because of the negative economic consequences of a disruption in relations.

In the Caspian region, Chinese and American interests to some extent converged after September 11, as both sought to contain and combat terrorism and Islamic extremism. This has particular significance to China, as it was greatly concerned about the possibility that Central Asian states, because of the aforementioned ethnic, cultural, and religious ties, might lend support to Uighur insurgents in Xinjiang. In any case, this shared concern with Islamic extremism made China more willing to accept a temporary American military presence in the region to combat the Taliban regime in Afghanistan. As the end of the Afghanistan operation seems ever more distant, however, tension has arisen, especially with the joint SCO demand for a timetable for withdrawal of U.S. troops from the region. China is still very much concerned with the problems of terrorism and separatism, but seems to have decided that combating these problems through the SCO is a better solution than allowing the U.S. to continue its campaign in the region. This is closely linked to China's fear that a permanent military presence in the region may be a U.S. strategic goal. Of particular concern to China is the possibility of permanent U.S. bases near the Chinese border, such as the Manas airbase in Kyrgyzstan, a country which has also recently gone through a so-called "color revolution", aligning itself more closely with the West.

From an American perspective, the construction of pipelines and ensuing sale of oil to China is perhaps the least favorable outcome. Pipelines are generally a long-term commitment, and oil sent east is entirely unavailable to the U.S. It is hardly a devastating blow to U.S. interests if some oil goes to China, but should China become the main destination for Caspian oil, the Caspian region could no longer serve as a buffer producer or in any way supply the U.S. or its allies with significant volumes of oil. This is especially worrisome due to China's strategy of securing direct control of oil resources, rather than relying exclusively on the market, which contributes to shutting the U.S. out of the Kazakh oil industry. Direct Chinese control of Caspian oil dramatically reduces the policy options available to the U.S. in the region. Unlike market contracts, direct control "locks up" oil, to borrow a term from the U.S. National Security Strategy, permanently keeping the U.S. out. The U.S. is also concerned that direct

Chinese control of oil could be part of a greater Chinese strategy to keep the U.S. out of the region altogether, a fear which has been strengthened by the SCO's demand for a timetable for the withdrawal of U.S. troops in Central Asia. Finally, this could reduce policy options for the U.S. globally by reducing the number of sources for diversification of supply as well as forcing it to look elsewhere for buffer capacity in case of a crisis.

Competition between the two is primarily over Kazakh oil, as Azerbaijani oil is relatively inaccessible to China. This is why the recently agreed shipments of Kazakh oil through the BTC pipeline are so important to the U.S. For now, Kazakh oil will be shipped by tankers from the Kazakh port of Atyrau, where the U.S. has also financed the construction of a Kazakh military base with the stated goal of protecting oil shipments. It has been estimated, however, that if these shipments reach 20 million tons annually, as Kazakhstan has said they will, but only in the very long term, a trans-Caspian pipeline would be economically feasible.²⁵⁸ This would vastly increase the potential for oil shipments from Kazakhstan to the U.S. or its Western allies, and would have the additional benefit of being transported entirely through Western-controlled pipelines.

Also, Azerbaijan's own current, and projected, oil production is nowhere near that of Kazakhstan. In fact, Azerbaijan's production is unlikely to become sufficient to fill the BTC to capacity. This means that for the U.S., as for China, good relations with Kazakhstan are of the utmost importance. Justin Burke even claims that: "Any chance of US success seems to be tied to the fate of two pipelines running through Azerbaijan and Georgia to Turkey; the Baku-Tbilisi-Ceyhan (BTC) oil route that opened in 2005; and the Baku-Tbilisi-Erzurum natural gas link that is projected to open later this year. It appears that for both pipelines to accomplish their strategic aims, Kazakhstan must opt to ship a large amount of its abundant natural resources via those two routes."²⁵⁹ In other words, the BTC pipeline, which is the only fully Western-controlled transport route out of the region, is not likely to be filled to capacity unless Kazakhstan agrees to ship a significant share of its production across the Caspian Sea and then onward through the BTC pipeline. Kazakhstan only recently committed to shipping any oil at all through the BTC pipeline and its current pledge of 25 million tons a year in the long term, when the necessary infrastructure is in place, pales in comparison with

²⁵⁸ Vladimir Socor. 2006. "Kazakhstan-Azerbaijan Oil Transport Agreement: Not Yet Historic, But Might Become So", *Eurasia Daily Monitor*, Volume 3, No. 118

²⁵⁹ Justin Burke. "The United States Is Ill-Prepared to Wage a New Cold War", *EurasiaNet*, May 8, 2006

Kazakhstan's recent agreement to ship 67 million tons a year through the Caspian Pipeline Consortium (CPC) pipeline to Novorossiysk in Russia.²⁶⁰ In short, there is no sign that U.S. efforts so far have succeeded in gaining the desired leverage over Kazakhstan. If a trans-Caspian pipeline is in fact constructed to transport oil from Kazakhstan's Kashagan field to Baku and the BTC, that could be seen as a sign of a more firm commitment from the Kazakhs, but as for now it would seem that Kazakh foreign minister Kasymzhomart Tokayev was accurately describing Kazakh policy when, in a recent speech in New York, he stated that: "Our slogan is: 'the more pipelines, the better for Kazakhstan.'"²⁶¹ This means that for now, China and the U.S. will continue to compete for the same resources in Kazakhstan.

We have now attempted to give an overview of the U.S.' current position in the world, its oil requirements and the policies it has pursued, particularly in the Caspian region, to provide for these needs and hence its overall energy security. We have shown that the lack of any state-owned oil companies places some limitations on the options available to the U.S. In this context it was necessary to discuss the relationship between the U.S. government and American IOCs, where it seems there is at times considerable cooperation and coordination, although certainly not direct government control. The U.S. government also states openly that it seeks to support American IOCs abroad, which it demonstrates with its policies in the Caspian region. Perhaps its most visible efforts with regard to energy security policies in the region are related to supporting American IOCs through negotiating favorable terms for doing business in Caspian countries and helping to provide for the necessary infrastructure, such as westbound pipelines. In doing this, the U.S. has mostly dealt with regional states on a bilateral basis, with few efforts directed through international institutions. The U.S. has also lent some military support to Caspian countries, as well as engaging in small military exercises.

Finally, we have discussed the relationship between the U.S. and several major external actors in the region, as well as the relationship between China and the U.S. generally and more specifically in the region. This helps to understand the wider scope of Chinese and U.S. strategies in their pursuit of Caspian oil. Thus, the previous two chapters to a large extent answer our first research question: "What policies do China and the U.S. pursue to ensure

²⁶⁰ Sergei Blagov. "Russia Registers Significant Victory in Caspian Basin Energy Contest", *EurasiaNet*, April 5, 2006

²⁶¹ Joanna Lillis. "Nazarbayev Visit to Washington: Looking for Recognition as a Regional Leader", *EurasiaNet*, September 26, 2006

their energy security in the Caspian region?” In the next chapter we will try to place these policies within a theoretical framework in order to answer the second research question.

CHAPTER 6: ENSURING ENERGY SECURITY

“This case has had full analyzation and has been looked at a lot.”
- George W. Bush -

6.0 INTRODUCTION

In this chapter we will analyze the policies of China and the U.S. in the Caspian region in light of the assumptions of realism and liberalism about how states are likely to pursue energy security. Both realism and liberalism deal with the conditions that work on all states of the international system, and as such it is the relationship between these forces, more precisely the structure of the international system, and state behavior that one or both theories can be expected to shed some light on. Their main contribution is in providing some concepts and categories that simplify a complex reality sufficiently to make analysis possible. The main goal of this analysis is to answer our second research question: “How can realism and liberalism help explain the energy security policies of China and the U.S. in the Caspian region?” In doing this we will be using the comparative method to examine differences and similarities between the two, with the help of categories from the debate between realism and liberalism.

6.1 STRATEGIC AND MARKET APPROACHES

Realism is closely associated with what has been called the strategic approach, while Liberalism is closer to the so-called market approach. The table below, which is a slightly modified version of a table from “The Strategic Implications of China’s Energy Needs”,²⁶² briefly summarizes some of the main strategies to be expected from states following either a realist (or strategic) approach or a liberal (or market) approach. The various elements of either approach will be discussed later in this chapter.

²⁶² Philip Andrews-Speed, Xuanli Liao and Roland Dannreuther: “The Strategic Implications of China’s Energy Needs”, The International Institute for Strategic Studies, 2002.

Table 6.1 Approaches to Enhancement of Energy Security:

| | “Strategic”/“Realist” approach | “Market”/“Liberal” approach |
|--------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Supply-side economic measures to reduce probability of disruption | <ul style="list-style-type: none"> - Control through state companies - Self reliance - Investment in domestic and overseas production and transportation | <ul style="list-style-type: none"> - Liberalize energy markets - Integrate with international markets - Encourage domestic and international investment in production and transportation |
| Political measures to reduce probability of disruption | <ul style="list-style-type: none"> - Enhance political links with energy exporters - Outward investment and aid to energy exporters | <ul style="list-style-type: none"> - Promote the efficient functioning of international energy markets |

Andrews-Speed, Liao & Dannreuther describe a strategic approach to energy security as follows: “The strategic approach would combine state-sponsored economic measures with political initiatives. Economic measures would include direct government participation in both enhancing domestic energy production and in investing in overseas sources of energy. Political links with energy exporters would be of great importance, and these would be supported by a range of economic measures such as aid, inward investment and sales of key goods. Governments pursuing this approach might not be overly concerned about the cost of implementation compared to the probability and impact of the disruptive event.”²⁶³

This, in fact, reads almost like a summary of China’s energy security strategy in the Caspian region. As we have explained, China seems relatively unconcerned by costs as it pursues energy security through its state-owned oil companies. Even though China has sought a more prominent position in the global markets, one of the main ingredients in its quest for oil has been to create political ties with oil-rich countries, especially Kazakhstan, as we have seen. From a realist perspective China does this because it cannot risk being too dependent on energy from the international market due to the risk of market failure. As we have shown, China has also provided several energy-rich states with considerable economic and military aid and invested heavily in their oil industries.

²⁶³ Ibid., p. 19

The market approach, or what we have defined as the liberal approach, to energy security has some rather different implications: “The market approach would rely on the national and international energy markets and would seek to reduce the risk of disruption by improving the efficiency of these markets. The last 20 years have seen a tendency for the world’s largest economies to prefer a market approach for long-term measures to energy security.”²⁶⁴

From what we have seen so far, the strategies of the U.S. in the Caspian region seem to suggest a more market-oriented approach. Bringing Caspian oil to the open seas through the CPC and BTC pipelines rather than transporting it through pipelines directly to importing countries means that the oil is likely to end up on global markets. A centerpiece of the U.S. strategy in the Caspian region has also been its attempts to provide a friendly business climate for American IOCs in Azerbaijan and Kazakhstan. The construction of the BTC, which was strongly supported by U.S. diplomatic efforts, is in itself an incentive to investments in the Caspian region, as it provides Western IOCs with an additional way of getting the crude oil to refineries and markets in the West. As the Caspian region has traditionally had very few alternatives for exporting the crude oil, this becomes especially important. These efforts all contribute to integrating Azerbaijan and Kazakhstan further with international markets. As for the points that fall within the “Political measures to reduce probability of disruption” label in the table, the U.S. approach will be consistent with both the realist- and the liberal-inspired measures. Like China, the U.S. has actively pursued closer political ties with Caspian states, through high-level diplomatic visits and close interaction on a wide variety of issues. Also, the U.S. has provided extensive military and economic aid, perhaps most visibly through the Caspian Guard project, which involves both Kazakhstan and Azerbaijan. This could, in fact, be seen as part of the U.S.’ ongoing efforts to link these two countries closer together, thus ensuring future shipments of Kazakh oil across the Caspian and then onward through the BTC.

American efforts to promote the efficient functioning of international energy markets have mostly revolved around the International Energy Agency (IEA). The IEA was established after the Arab Oil Crisis of 1973, at the initiative of the U.S. The organization’s membership is made up of most major importing countries, with the notable exception of China. One of the organization’s main objectives is to operate a permanent information system on the international oil market.²⁶⁵ To achieve this objective “the IEA prepares current oil market

²⁶⁴ *ibid*

²⁶⁵ IEA. *An Overview*

assessments from information submitted by IEA Member governments, international oil companies and others. Issues covered include: oil exploration and production developments; supply, demand, price and refining trends; and international trade in crude and products.”²⁶⁶ This contributes to greater transparency in the global oil market, which again leads to more predictability for importers and more reasonable price-setting, in other words more efficient functioning of international energy markets. A notable weakness is that relatively few major exporters are IEA members, which reduces the information available. In short, The U.S. seems to have one foot in each camp with regard to political measures to reduce probability of disruption in supplies. Its approach is not an exclusively liberal approach, but incorporates elements of both.

While not a member of the IEA, although maintaining a working relationship with the organization, China is involved in the ASEAN+3 Energy Partnership, which is an Asian regional organization with similar functions to the IEA. On the other hand, however, China’s policy of using its state-owned oil companies to ‘lock up’ energy resources abroad through equity stakes in Caspian oil fields works counter to the efficient functioning of international energy markets. Its tendency to link energy contracts with economic and military aid, which has, however, been more prominent in other regions, also has a similar effect.

Both China and the U.S. have made efforts toward self reliance, which according to the table above would seem to fall within the strategic, or realist, approach. We would argue, however, that all states would prefer self reliance if possible, due to the enormous advantages this provides with regard to reliability of supply. Major consumers like China and the U.S. simply do not have that option, as their domestic production could never match consumption. Therefore, it is hardly surprising that even the U.S., which otherwise seems to prefer the liberal approach, tends to enact policies to provide the greatest possible degree of self reliance. The internationalization of Chinese oil companies can be interpreted as a form of extended self reliance, due to the fact that it reduces dependence on foreign oil companies. Furthermore, due to the fact that Chinese oil companies are state-owned they can pursue the acquisition of equity oil, which gives China direct control over foreign resources, the very strategy the U.S. has criticized. As long as there is no major disruption in relations between China and producing countries, like Kazakhstan, this is about as safe as supplies can get, particularly

²⁶⁶ Ibid.

when the two are immediate neighbors. On the other hand, this requires China to emphasize another aspect of the realist approach, namely enhancing political links with energy exporters. Indeed, it would seem that the underlying philosophy in China's energy policies is that it cannot afford to be too heavily dependent on international markets for oil.²⁶⁷ This corresponds to the realist skepticism toward the international oil market. Realism argues that the international market is too unreliable for a vital strategic good like oil, and that great powers will not accept the risk of market failure, the fallout of which could be devastating. According to Ziad Haider "Beijing's goal is to insulate itself from the ever-volatile international energy market (...)",²⁶⁸ which suggests that the Chinese leadership share the realist understanding of their situation. The potential consequences of one or more major importers following this strategy will be discussed further in the absolute vs. relative gains subchapter.

6.2 PRIORITY OF ENERGY SECURITY

While it is obvious that oil is important to just about any state anywhere, it is necessary to establish more exactly where energy security is located in the hierarchy of state interests. This contributes to an understanding of how far states may be willing to go to ensure their energy security. As it is not necessarily the case that energy security is equally important to all states, nor that they understand what constitutes energy security in the same way, part of this endeavor will be determining where it ranks for the U.S. and China and how these states believe their energy security is best ensured. As this is a question of policy more generally, not specifically related to the Caspian, we will include examples from other regions to support our analysis.

Several experts on the oil industry believe that China and the U.S. view energy security somewhat differently. According to Daniel Yergin at the Cambridge Energy Research Associates: "Most everybody's in favor of energy security. There's just a wide difference on what does energy security mean."²⁶⁹ More specifically, Karen Harbert, assistant secretary for policy and international affairs at the U.S. Energy Department, claims that "We [the U.S.] define it [energy security] as having a supply of reliable, affordable energy, and they [China] define it as having secure access and owning access to that product."²⁷⁰ In other words, at least from a U.S. perspective, China is attempting to "lock up energy supplies around the

²⁶⁷ Philip Andrews-Speed, Xuanli Liao and Roland Dannreuther: "The Strategic Implications of China's Energy Needs", The International Institute for Strategic Studies, 2002.

²⁶⁸ Ziad Haider. "Oil fuels Beijing's New Power Game", *YaleGlobal Online*, March 11, 2005

²⁶⁹ Chris Baltimore. "U.S., China Take Different Views of Energy Security", *Reuters News*, November 27, 2006

²⁷⁰ Ibid.

world or direct markets rather than opening them up...”²⁷¹ This refers to the Chinese strategies of buying up equity oil and signing agreements for long-term supply guarantees, thus barring access to oil for other buyers. Basically, the U.S. claim is that while the U.S. promotes the unhindered operation of the market, seeking to provide energy security through the free flow of oil on the world market, China seeks direct control of resources, taking them off the market altogether. To what extent these claims reflect the realities of the situation has been discussed to some extent in the chapters on China and the U.S., but will also be discussed further when we evaluate the two states’ positions on the role of the market later on.

Both China and the U.S. have displayed, ever so often, through their foreign policies how important they deem energy security. The U.S.’ special relationship with Saudi Arabia is an example of this. It has often been claimed that this relationship negatively affects other U.S. interests, as Saudi Arabian clerics have been behind the spread of the extremist branch of Islam called wahhabism throughout the Muslim world, and the Saudi regime, due to its weak domestic position has not been willing to crack down on these clerics. Similarly, U.S. governments, regardless of the party in power, have regularly been accused of ignoring its proclaimed concern with human rights and democracy to curry favor with authoritarian regimes in oil-producing states, such as Kazakhstan and Azerbaijan, which has been discussed in our thesis. The political opposition in both countries has complained about the U.S.’ willingness to ignore fairly obvious electoral fraud and voter intimidation. Furthermore, the U.S. has been criticized for lending credibility and support to the supposedly democratic regimes of these countries through frequent high-level diplomatic visits back and forth.

China, while apparently not professing any qualms about ignoring democracy and human rights, has also been utterly indifferent to the domestic policies of the states where it pursues oil. Chinese officials have made clear China’s opinion that they prefer to “separate politics from business”.²⁷² Most recently, Javier Solana told a conference in Brussels on energy supply security that “The scramble for territory of the past may be replaced today by the scramble for energy”²⁷³ and furthermore “Solana cited the crisis in Darfur and the situation in Burma as examples of where it had proven difficult to secure support from key countries for

²⁷¹ U.S. National Security Strategy 2006, Chapter VIII, Section 7

²⁷² Jim Fisher-Thompson. “China’s Economic Focus on Africa is Mixed Picture, Scholar Says”, *USINFO*, June 26, 2006

²⁷³ David Brunnstrom and Jeff Mason. “EU’s Solana warns of global scramble for energy”, *Business Day*, November 21, 2006

EU policy objectives, given the importance of energy resources to states such as China and India.”²⁷⁴ Even though this disregard for human consequences in itself does not prove the importance of energy security to China, the fact that cooperating with such regimes involves considerable risks and uncertainties is more significant. Investments in countries led by authoritarian regimes can easily be lost in nationalization sprees, political turmoil or civil war. This seems to suggest that China is willing to accept financial losses to help ensure its energy security. China has furthermore, on several occasions, paid well above market price for oil as well as for equity stakes in oilfields and companies, suggesting that its interest in energy security goes beyond mere economic concerns. Oil, being a unique resource, is deemed to be of greater value to China than its market price. This shows that oil is certainly more important than any “normal” trade good. As economical development and energy security are closely linked, however, it can hardly be argued that one is valued above the other, but this does seem to indicate that energy security is at least equal with economic development in the hierarchy of national interest. Unless some miraculous scientific breakthrough should suddenly appear and make oil altogether insignificant, economic development without energy security is impossible. Indeed, the economic downturns regularly caused by the mere suggestion of an oil crisis make this perfectly clear.

While China’s policies toward undemocratic exporters seem more extreme, even cooperating with regimes in the midst of committing genocide of their own populations, the U.S.’ policies are also quite revealing, as there is a much greater discrepancy between actual U.S. policy and stated policy objectives. The most prominent example of this is the U.S. special relationship with Saudi Arabia, but as mentioned the U.S. has also been criticized for being too understanding with the slow, if any, progress on democracy and human rights in energy-rich countries both in the Caspian region and elsewhere. China has always stated publicly that it does not concern itself with the domestic policies of partners, whereas the U.S. regularly claims that the spread of democracy and human rights are important foreign policy objectives. By seemingly ignoring this in its pursuit of energy security, the U.S. sends an even stronger signal about the real significance of energy security. However, the U.S. does have some restrictions on what states it will deal with, Sudan being an example where it has chosen to apply sanctions keeping U.S. companies out, while Chinese move in.

²⁷⁴ Ibid.

The above findings seem to lend support to realist views of oil's importance to the national interest. China and the U.S. seem not only unwilling to accept decreases in energy security to gain other benefits, but rather, both states seem to accept certain losses in other fields in order to ensure their energy supply. In other words, there is some issue-linkage, but it would seem that oil supply is non-negotiable. Issues can be linked, but only to gain more oil. The U.S. sacrifices political credibility and, many would argue, reduces its own chances of success in the "war on terror" in order to maintain relationships with oil-producing states. China, for its part says "to hell with the Darfurians" and insists on the supremacy of state sovereignty, in other words states' right to do as they please within their own borders, without foreign interference.

6.3 ROLE OF THE MARKET

The U.S. and China take rather different approaches to the role of the market. While the U.S. has traditionally been a promoter of the liberal market, China was up until the early 1990s isolated from the outside world in most respects. In the case of energy, the U.S. government does not maintain control over the American oil companies, even though it does have measures and incentives to influence them, as we have seen. The Chinese government on the other hand, remains firmly in control over most areas of the energy industry, and all the major oil companies, as well as several holding companies, are state-owned.

There are several advantages to maintaining national control of the oil industry, at least from a realist perspective. Securing access to supplies is one of the main focuses for realism with regards to energy security, and is more important than reserves or the price of resources. Reserves are certainly important in the long term, but they do little good until the oil is actually out of the ground. Merely holding the rights to develop reserves also entails an element of risk, as there is always some chance that political or other developments may snatch those rights away or remove access to the reserves. Put differently, reserves have potential, but unrealized, value. Given the acute instability in many oil producing regions of the world, it is generally preferable, from an energy security perspective, to get the oil out of the ground and back home as soon as possible, before someone, or something, shuts off the tap. Furthermore, untapped oil reserves do nothing to solve the energy security problems faced by a state right now, and as we have discussed earlier, realists are unwilling to accept even short-term shortages based on promises of greater benefits in the future.

Chinese state-owned oil companies have advantages over Western IOCs in the respect that they can enter countries that are under international sanctions, where U.S. or European firms are restricted. Also, Chinese firms can get financial support from state-owned banks which are more willing to back risky projects than ordinary investors would be.²⁷⁵ In practice, this is just another way for the Chinese government to reallocate state funds according to its priorities. When China is willing to take risks such as investing in unstable countries and entering into projects that possibly will not pay off financially, it is a clear sign of China's commitment to securing control over resources and demonstrates that price is a secondary concern in their hierarchy of priorities. This worries the U.S., and representatives of the DOE have suggested that "China's soaring demand for energy is not a concern in itself, but its willingness to overpay for crude oil and other resources is."²⁷⁶

Another obvious advantage of state-controlled oil companies is the ability to buy equity stakes in foreign oil fields on behalf of the state, a more direct form of control with foreign oil sources which will be discussed further down. Also, state control allows the state to direct oil companies to invest their resources where it will most benefit the energy security interests of the state. When PetroChina acquired PetroKazakhstan and its assets in Kazakhstan, it paid well over market price. This was possible because PetroChina does not represent private shareholders looking for quick profit, but rather is a weapon in China's quest for energy security. Even if the acquisition of PetroKazakhstan should turn out to be a poor investment financially, it will still have contributed to China's energy security, which was the goal all along. Kazakh oil has strategic advantages that outweigh the additional costs involved, as it can be shipped through a pipeline entirely controlled by China and Kazakhstan through a joint venture. This transportation route will be much harder for China's enemies to disrupt than the sea-borne transportation routes China is forced to rely on for most of its oil imports today. The examples above show the strategic advantages of national oil companies. These advantages are not recognized by China alone. Most contemporary oil production is in fact carried out by national oil companies. Another major Eurasian power, India, also maintains a national oil company, Oil and Natural Gas Corporation Ltd. (ONGC), which is in fact India's most valuable company. Interestingly, ONGC states explicitly on its website: "ONGC

²⁷⁵ Eurasia Group. 2006. *China's overseas investments in oil and gas production*

²⁷⁶ Chris Baltimore. "U.S., China Take Different Views of Energy Security", *Reuters News*, November 27, 2006

represents India's energy security",²⁷⁷ suggesting that these national oil companies themselves are well aware of their strategic role and importance.

Having national oil companies seems to be clearly in the realist spirit, or at least provides a valuable tool for pursuing a realist approach to energy security. It is a central realist idea that fields vital to national security should be kept under state control in order to ensure that the necessary steps can be taken at all times, without interference from non-state interests.

Leaving the conquest of foreign oil resources to private initiative, on the other hand, as the U.S. does, would therefore seem to stand in opposition to realism. In fact, such trust in the beneficial effects of the market is more in line with liberalism, as it reflects the idea that optimal allocation of scarce resources is achieved when all actors pursue their self-interest within the framework of the market. Trust in the market might suggest a widespread impression that oil is not the unique strategic resource realism would suggest, but rather a more normalized commodity which can safely remain outside state control. It also suggests a greater concern with price than realism would normally allow. The liberal argument, however, is that letting go of state control and trusting the market will in fact also lead to greater production, as a free market should be able to balance supply and demand effectively.

The role of the market under optimal circumstances is to provide sufficient supply to meet demand, while at the same time maintaining prices at an acceptable level. The international market in oil does not function optimally, however, and the U.S. and China have chosen different ways to deal with this, which we will investigate further below.

6.4 INSTITUTIONAL VS. BILATERAL COOPERATION

At the most basic level, institutional cooperation is defined by the existence of a framework of fixed rules regulating how states within the cooperation deal with each other in pursuit of their individual objectives. As the term is used here we also include international regimes under the label institutional cooperation. Bilateral cooperation involves only relations between two states and is more ad hoc, in the sense that there are no fixed rules, but rather issues are dealt with on a case-to-case basis. This, by realists in particular, is assumed to be of advantage to the stronger power in the cooperation, as weak states cannot draw on the support of other

²⁷⁷ ONGC website

participants in the cooperation or the rules of any regime, but must stand alone against whatever pressures the greater power chooses to apply.

The global market in oil can be described as a regime of sorts, as it is governed by a relatively fixed set of rules and expectations. Indeed, the invisible hand of the market is entirely dependent on respect for a certain minimal set of rules and regulations in order to function at all. As such, willing and active participation in the global market can be seen as taking part in, and accepting, this regime. The U.S. is clearly an active participant in the market, even though it at times seeks to secure advantages for U.S. IOCs that could be seen as a form of market manipulation on a small scale. China participates to a lesser extent, often attempting to provide for its energy security needs by going outside the market, acquiring direct control of resources. Participation in the market, by buying and selling oil through established market mechanisms would seem to indicate support for the liberal argument that international regimes and institutions are the best way to handle the problems of scarce, but essential, resources. China's undermining of this regime, on the other hand, suggests it is not entirely convinced by the liberals, or at least that it also lends an ear to realist arguments about the unacceptable risks involved in trusting one's own security fully to such regimes.

Whether or not the global market in oil is a regime, however, it is not covered by any institutionalized form of cooperation. It does not create the same ties between participants, and does not lead to the same level of complex interdependence as wide-ranging institutionalized cooperation would. However, “[m]arkets can be supported by other social institutions that encourage values such as honesty, reciprocity, and trust.”²⁷⁸ Western states have organized themselves in the IEA, by now very much an institutionalized cooperation involving primarily industrialized importers, which serves to reduce the uncertainties of the market. This, according to liberalism, makes the market more transparent and effective. The fact that most of the major exporters are not involved means that the IEA is wholly unsuitable as a *regulating* mechanism for the market. Several major producers have also organized themselves through OPEC, which to some extent undermines the efforts of the IEA, and also does not regulate the market as such, although it does at times seek to manipulate the market in favor of producers.

²⁷⁸ Neil J. Smelser and Paul B. Baltes (eds.). 2001. *International Encyclopedia of the Social and Behavioral Sciences*. p. 9201

Liberal theories on institutional cooperation are closely linked to the market, as the types of cooperation imagined are by and large related to free trade and economic collaboration. Such cooperation tends to be regional, as states that are geographically close also tend to have common problems and interests. The SCO is growing into a fairly wide-ranging institutionalized cooperation, which has recently come to place a greater emphasis on energy questions. Indeed, at the 5th anniversary meeting of the heads of SCO member states in 2006, Russian President Vladimir Putin proposed the establishment of an SCO “Energy Club”, which would work on coordinating the energy policies of member states and facilitate greater energy cooperation.²⁷⁹ Such cooperation would be particularly potent if Iran ever becomes a full member of the organization, as many had even speculated it would at the last summit.²⁸⁰ Significantly, from a liberal viewpoint, the SCO covers a wide range of issues, from combating terrorism and separatism to trade and infrastructure.

Liberals would point to the SCO as one of the most important elements of China’s relative success in gaining access to the oil resources of the Caspian. The SCO has so far not developed a common framework for energy cooperation, but the interdependence and issue-linkage that has been created through this wide-ranging cooperation, may have played an important part in securing China’s access to Caspian oil. Stephen Blank has, in fact, argued that multilateral cooperation is China’s only real option to gain influence in the Caspian region, as Russia, and to a lesser extent the U.S., are already influential in the region, with the potential to serve as counterbalances to Chinese power, making bullying tactics less effective.²⁸¹ In any case, China’s work through the SCO breaks somewhat with the trend set by its tendency to prefer direct control of oil resources. While the latter suggests a strategic approach, lending credibility to realist claims about how states pursue energy security, the SCO and the wide range of cooperation within it seems to support liberal assertions.

On the other hand, it is difficult to determine the role of the SCO in Chinese policy, as it has seemingly not had any direct influence on Chinese acquisitions of Kazakh oil assets. The fact that Russian companies have been at the losing end of some of these deals also suggests that the SCO alone cannot fully account for the outcome. Furthermore, in other regions China has

²⁷⁹ Sergei Blagov. “Russia Sees SCO as Potential Energy Cartel”, *Eurasia Daily Monitor*, Vol. 3, Issue 224

²⁸⁰ Gulnoza Saidazimova. “Eurasia: Observer Iran Grabs Limelight Ahead Of Shanghai Alliance Anniversary”, *Radio Free Europe/Radio Liberty*, June 13, 2006

²⁸¹ Stephen Blank. “China Makes Policy Shift, Aiming to Widen Access to Central Asian Energy”, *EurasiaNet*, March 13, 2006

tended to pursue a go-it-alone approach to energy security. Another significant point is that where China has seen major successes in Kazakhstan, this has usually been the result of its willingness to pay well above market price for oil assets, which other states/companies have not been willing or able to match. As such, it would seem that until now, the alternative strategies of bilateral or institutional cooperation have not been the determining factors of success or failure in the race for Caspian oil, although it would probably be rash to conclude that they have been entirely insignificant. It will also be interesting to see how the recent “Energy Club” initiative by Russian President Putin develops and what it will mean for the future. Some have already speculated that it could result in a “new OPEC”.²⁸²

The U.S. has not engaged the states of the Caspian region in any major institutionalized cooperation and has so far shown little interest in doing so. It did however attempt, unsuccessfully, to gain observer status in the SCO²⁸³. Azerbaijan and Kazakhstan are both members of NATO’s Partnership for Peace program, which is essentially an outreach program to the successor states of the Soviet Union, attempting to tie them closer to the West. The Organization for Security and Co-operation in Europe (OSCE) was also quick to accept Azerbaijan and Kazakhstan as members. In fact, Kazakhstan has sought the chairmanship of the SCO, hoping for U.S. support in its efforts. The U.S. has not lent such support, however, insisting that Kazakhstan must improve its democratic record before it can take on a leadership position in an organization like the OSCE. This has caused some friction in U.S.-Kazakh relations, which was partly, although not entirely, offset by inviting Kazakh president Nazarbayev on a state visit to the U.S. Mostly, U.S. efforts have focused on bilateral cooperation, particularly negotiating with Caspian states to secure a friendly environment for American investment, such as the bilateral investment treaties signed with Azerbaijan and Kazakhstan. The U.S. has also actively negotiated with states in the region to secure the construction of the BTC as well as, more recently, secure Kazakh deliveries to the BTC terminal in Baku. There has also been some military cooperation on a relatively small scale, as well as the Caspian Guard, a more formalized, although yet unrealized cooperation, between the U.S., Azerbaijan, and Kazakhstan, which is closely linked to U.S. energy security interests. The U.S. has also worked on improving relations with the regimes of Kazakhstan and Azerbaijan through several high-level diplomatic visits, which is in stark contrast to its

²⁸² Sergei Blagov. “Russia Sees SCO as Potential Energy Cartel”, *Eurasia Daily Monitor*, Vol. 3, Issue 224

²⁸³ Tim Murphy. “East of the Middle East: The Shanghai Cooperation Organization and U.S. security implications”, *Center for Defense Information*, December 21, 2006

attitude toward less energy-rich countries in the Central Asian region. Indeed, the U.S. has even been accused of contributing to the overthrow of the former regime in Kyrgyzstan, a country with only insignificant reserves of oil and gas.²⁸⁴

Oil pipelines, which are essential as a means of transportation out of the Caspian region, tend to favor bilateral cooperation on energy security, although in some cases they can actually require multilateral cooperation. Limiting the number of transit countries is generally seen as a major advantage, as it reduces the risk of interference from third parties. In the case of the Kazakh-China pipeline, those two countries have been able to avoid any transit countries, whereas the BTC has actually led to considerable cooperation and coordination between the U.S. and the three host countries. Nonetheless, the business of filling the pipeline is necessarily left to the producer and destination countries, and it is these countries that primarily have to develop closer bilateral cooperation to ensure the success of the pipeline. Furthermore, pipelines tend to chain the producer and destination countries to each other, as a pipeline, once constructed, can serve no other purpose than transporting oil between those two countries. It is therefore a major commitment, which tends to exclude other parties.

6.5 ABSOLUTE VS. RELATIVE GAINS

With regard to energy security, emphasis on absolute gains would suggest a more market-oriented approach. The assumption is that the market, if allowed to operate without state intervention, will find a state of equilibrium through the invisible hand of the market, which tends to balance supply and demand. Therefore, states should interfere as little as possible in the operation of the market and instead focus on efforts to increase transparency and the efficient functioning of the market, for example through the creation of international institutions and regimes. The IEA is, in this sense, very much a liberal tool. Its main purpose is to prevent manipulation of the market, by making as much information as possible available to importers.

In the theory chapter we presented the realist argument that the market is an unsuitable mechanism for the distribution of a unique strategic good like oil, due to its uncertainty and unpredictability. As mentioned, China seems to accept this tenet, as to some extent does India, another major importer with growing import needs. The strength of the realist argument in

²⁸⁴ Richard Spencer. "Quiet American behind tulip revolution", *The Guardian*, April 2, 2005

this respect is that when one or more major importers choose to follow a realist strategy to ensure their own energy security, it creates an incentive for others to do the same. Oil, at least the available supply of oil at any given time, is a limited resource. This creates a certain feeling of insecurity among states, essentially a parallel to the security dilemma used by realism to illustrate the effect of anarchy on traditional security policy. Organizations like the IEA or the ASEAN+3 Energy Partnership seek to mitigate these effects by providing information that makes the market more predictable and less opaque. This, in turn, mirrors the effect attributed by liberals to international regimes and institutions in traditional security thinking.

“Rogue states” that disregard these efforts seriously undermine the market as a whole. By seeking to ensure their energy security through direct control of resources, which is what China does when it buys equity stakes in Kazakh oilfields, they effectively remove those resources from the global market. When making such acquisitions China has tended to pay above market price, making it difficult for market-oriented actors to compete, as these are limited by profit concerns. China’s strategy has also included involvement in states under U.S. and other sanctions, or simply deemed too unstable and unpredictable by profit-sensitive actors and in this way China has found niches where Chinese companies can operate as monopolists, or at least with little foreign competition. This undermines sanctions largely intended to bring the states in question in line with market practices, and removes incentives for these states to ever link themselves to the global market. In fact, it causes China to operate entirely outside the global market.

In a situation where supply is tight, as is the case today, such strategies could set off a kind of domino effect where states that would otherwise trust the market become concerned that the states that do not will take enough oil off the market to shrink it to a level where it can no longer provide for the needs of market-dependent states. If this feeling of insecurity becomes acute, more states may follow suit. This amounts to an emphasis on relative gains, as states will seek to provide for their own needs first, preferably controlling more resources than they currently need in order to provide for growing consumption, out of fear that what resources are not secured now may become unavailable in the future. If such states are not brought back into the free market fold, the system is likely to collapse altogether, leading to a kind of energy security free-for-all. Under such circumstances, even states that would prefer to focus on absolute gains, trusting the market to provide for all, will be forced to take action or be left

with nothing. In short, failure to make major importers like China and India abandon their strategic energy security policy, could force all importers instead to adopt the same strategic approach.

6.6 ZERO SUM

The question of whether or not the U.S. and China deal with the pursuit of Caspian oil as a zero-sum game is an interesting one, as it is likely to have considerable impact on how aggressively and urgently they pursue their goals. The amount of oil being produced every day in the Caspian region is finite. Hence, the countries of the region are unable to supply more than a fixed amount. This means that a commitment to supply a certain amount of oil through the Kazakh-China pipeline reduces the amount that may be shipped through the CPC or BTC pipelines by an equal amount. As long as there is surplus transportation capacity, an increase in deliveries to one importer necessarily reduces exports to another. Currently, there is surplus transportation capacity out of both Kazakhstan and Azerbaijan, leading to competition between outside states to fill their own pipelines. The consequence of this is that energy security becomes a zero-sum game, in other words a focus on relative gains. More oil for China means less oil for the U.S. and vice versa. The only limitation on this is transportation capacity, since neither country can get its hands on more oil than it has pipeline capacity to import, either for itself or its allies.

So far, both China and the U.S. have pursued a policy of attempting to funnel as much oil as possible through “their” pipelines: the BTC and Kazakh-China pipelines. For China, this has primarily involved acquiring equity stakes in Kazakh oilfields in order to have control at all stages: production, transportation, refining, and domestic distribution. As for the U.S. it initially relied mostly on its close relationship with Azerbaijan. As it soon became apparent that Azeri oil could never fill the BTC pipeline to capacity, however, it engaged with Kazakhstan to provide the remaining oil needed to fill the pipeline. Again, according to Justin Burke: “It appears that for [the BTC pipeline] to accomplish [its] strategic aims, Kazakhstan must opt to ship a large amount of its abundant natural resources via [that] route.”²⁸⁵ To achieve this goal the U.S. has engaged Kazakhstan diplomatically through several high-level diplomatic visits and public statements of support for Nazarbayev’s regime, military and other forms of aid, as well as initiatives to forge closer ties between Kazakhstan and Azerbaijan.

²⁸⁵ Justin Burke. “The United States Is Ill-Prepared to Wage a New Cold War”, *EurasiaNet*, May 8, 2006

This has included efforts to facilitate negotiations between the two on transportation of oil from Kazakhstan to Azerbaijan. Apparently, the U.S. efforts have been successful, as Kazakhstan agreed in the summer of 2006 to ship considerable volumes of oil through the BTC, at least in the long term.

China's attempt, along with Russia, to pressure the other member states of the SCO to deny military bases to the U.S. and get rid of existing U.S. bases in the region, would also seem to be a result of zero-sum thinking. China and Russia have both been concerned about the implications of having a U.S. military presence in their strategic backyard. While this does not relate exclusively to issues of energy security or control of Caspian oil, the Chinese and Russian response reflects a zero-sum approach to foreign policy in the Central Asian region in general. The demand for a timetable for withdrawal of U.S. troops from the region could be seen as part of a greater effort to roll back U.S. presence in Central Asia, reducing its influence and ability to interfere in regional politics. With regard to Caspian oil, reducing U.S. leverage over Kazakhstan would make it easier for China to secure a greater share of Kazakh production. As Kazakh policy so far has been something of "(...) a balancing act between the Bear, the Dragon, and the far-away American Eagle"²⁸⁶, anything that reduces the need or ability to balance between these three forces is likely to give China a bigger piece of the pie.

China would seem to view competition for Caspian oil as a zero-sum game, and is not willing to gamble on long-term benefits. Concerns with relative gains therefore dominate the Chinese approach. China is trying to get as much as it can, while it can, which is why it is actively buying up equity stakes in Kazakh oilfields. In fact, with CITIC's recently completed acquisition of the Karazhanbas oilfield, which contains reserves of approximately 340 million barrels and has a daily production of about 50,000 barrels, China controls 30% of Kazakh oil reserves, and has taken a significant step toward filling the Kazakh-China pipeline with equity oil.²⁸⁷ There were indications that the deal might be stopped by Kazakh authorities, however, with Kazakh Energy Minister Baktykozha Izumkhambetov even stating during the chaotic negotiations that the government "should take emergency measures to halt the deal".²⁸⁸ Under a Kazakh law passed in 2005, in connection with PetroChina's takeover of PetroKazakhstan, the Kazakh government has priority rights to buy oil assets if the previous owners decide to

²⁸⁶ Cohen, Ariel. "Washington Ponders Ways to Counter the Rise of the Shanghai Cooperation Organization", *EurasiaNet*, December 17, 2006

²⁸⁷ Andrew Yeh. "Citic completes Kazakh oil assets deal", *Financial Times*, January 1, 2007

²⁸⁸ "Kazakhs seeking to halt deal", *Upstream*, November 24, 2006

sell. Speculations had suggested that the Kazakh government would approve the sale, but take a significant stake in Karazhanbas for itself, similar to the sale of PetroKazakhstan, where the state-owned KazMunaiGaz took a 25% stake.²⁸⁹ In fact, the sale was eventually approved without any conditions attached. This rapid Chinese takeover of Kazakh reserves and production capacity suggests an intention to take control of as much as possible for China, before other actors can get involved, restricting Chinese access. Such a policy is very much in line with relative gains thinking.

CNOOC's failed attempt to acquire Unocal can be interpreted as an indication of zero-sum thinking among U.S. policymakers with regard to energy security. While the U.S. normally wants to be seen as encouraging the liberalization of energy markets and often pressures oil producing countries, like those of the Caspian region, to allow American IOCs unhindered access to their domestic oil industries, this attempted acquisition of a relatively minor U.S. company by a Chinese state-owned company was effectively blocked by Congress. It would seem, therefore, that there are limits to U.S. commitment to free markets. Indeed, the value of oil as a strategic resource was prominent in the debate prior to the modification of the energy bill that made CNOOC withdraw its bid. There was concern that if an American IOC was sold to a state-owned Chinese company, this would essentially constitute surrendering valuable oil reserves to the Chinese, perceived by many as a rival to the U.S. Kang Wu, a senior fellow at the East-West Center in Honolulu, which studies issues of common concern to Asia and the United States pointed to the tendency among U.S. officials to "(...) increasingly equate energy security and national security, which emphasizes non-economic goals over trade and bilateral cooperation."²⁹⁰ If this analysis is correct, it could support the hypothesis that the application of realist strategies by some major actors may provoke similar strategies from others.

In this chapter we have attempted to synthesize our findings about U.S. and Chinese policies in the Caspian region and organize these according to some central categories from realist and liberal thinking. We have tried to analyze their energy security policies using the realist and liberal approaches and looking at differences and similarities between the two. The next chapter will summarize some conclusions from this analysis and attempt to answer our research questions.

²⁸⁹ "Kazakhs seeking to halt deal", *Upstream*, November 24, 2006

²⁹⁰ Chris Baltimore. "U.S., China Take Different Views of Energy Security", *Reuters News*, November 27, 2006

CHAPTER 7: CONCLUDING REMARKS

“There is a tide in the affairs of men, which taken at the flood, leads on to fortune. Omitted, all the voyage of their life is bound in shallows and in miseries. On such a full sea are we now afloat. And we must take the current when it serves, or lose our ventures.”

- William Shakespeare -

7.0 INTRODUCTION

Having enjoyed a brief period of unchallenged supremacy on the global stage after the collapse of the Soviet Union,²⁹¹ the U.S. is now increasingly seeing its position challenged. China, no longer content to be relegated to third world status, is making its presence felt, through its rapidly expanding economy and power. In this way, China has also come to threaten U.S. energy security by importing ever more oil to fuel its own growth. This has forced the U.S., like China, to be more conscious of its strategy to ensure the supplies of oil that are so vital to the American economy, way of life, and national security.

In this thesis we have presented two theories, realism and liberalism, with some adaptations to make them applicable to the subject matter. The adaptations have basically consisted of drawing on the underlying logic and arguments of these theoretical traditions to develop frameworks for energy security studies, often drawing parallels between realist and liberal concepts and various elements of energy security. Also, we have provided some background information on the Caspian region and its place in the wider context of strategic and energy-related issues. An important precondition for understanding policies in the Caspian region is a basic knowledge of the significance of energy security in general, and oil in particular, on the world stage. After this important groundwork was laid, we presented the energy interests and policies of China and the U.S., both generally and more region-specific. Finally, we applied these data to an analysis attempting to answer our research questions:

- (1) What policies do China and the U.S. pursue to ensure their energy security in the Caspian Region?*
- (2) How can realism and liberalism help explain these policies?*

This chapter starts with a discussion some methodological issues relating to theoretically informed comparative case studies and our context, as these are important to the

²⁹¹ Pascal Boniface. 2000. "Reflections on America as a World Power: A European View", *Journal of Palestine Studies* XXIX, no. 3 (Spring 2000)

understanding of our empirical findings. Having discussed these issues, we then present a summary of our main empirical findings, which have served to answer the first research question. Thereafter we discuss some theoretical implications based on our analysis in the previous chapter. In this we also discuss the concept of energy security and the applicability of our chosen theoretical framework to energy security. Finally, we look at the potential for future research within the energy security field generally and in the Caspian region specifically.

7.1 METHODOLOGICAL QUESTIONS

Quantitative studies are generally assumed to be better suited for generalization than case studies, as they include a higher number of units of study that are chosen randomly. Case studies are conducted with only one or few units, and these are often chosen because of specific features that the researcher has an interest in studying more in depth. Generalizing from one or a few cases, though, involves several difficulties. Therefore, it can be more fruitful to regard case studies, beyond their value in providing case-specific knowledge, rather as a first step toward a wider study that can be used to make generalizations. In our case, knowledge about Chinese and U.S. energy policies in the Caspian region may not be sufficient to fully understand these countries' energy policies elsewhere, but should provide some valuable insight that can be applied in other settings and may contribute to a more complete understanding of the basic elements of their global energy policies. Some of the problems associated with the narrow focus of case studies can be partially compensated for by holding up two or more cases for comparison, which helps identify and eliminate some of the narrowly case-specific features. By comparing one may be able to grasp the structural factors that work on all actors, if not necessarily equally, which contributes further to the significance of the study in a wider context.

The U.S. and China have a lot in common with regard to energy security. Both are major consumers and importers of oil, with rapidly growing consumption. Furthermore, the U.S. and China are major global actors, with considerable economic and military power to support their policies. While globally the U.S. is still the world's only superpower, with superior capabilities, the regional playing field is more level, making the Caspian region a particularly interesting area for this case study. Despite these important similarities, there are some differences between the two that need to be taken into consideration. The most important of these is China's geographical proximity to the region. The U.S. is an ocean away, while China

shares border with one of the Caspian states, Kazakhstan, which is also the most oil-rich state in the region. While such geostrategic factors are often ignored in contemporary IR research, they seem to have some impact when studying energy security policy in Central Asia, and specifically the Caspian region. A less region-specific difference relates to the different organization of the oil industry in the two countries. China having state-owned oil companies provides it with some policy options that are simply not available to the U.S. The similarities are sufficient to make the two comparable in energy matters in the Caspian region, but the differences need to be taken into account in the analysis. These differences affect the policy options of the two states, which means that their policies cannot be analyzed only as matters of choice, but also matters of circumstance.

7.2 EMPIRICAL FINDINGS

Both China and the U.S. share a desire to see as much oil as possible going in their direction. For China this flow has already been initiated through the Kazakh-China pipeline. Even though oil shipped through pipelines to the Black Sea and the Mediterranean has not so far been sent on to the U.S. in large volumes, the U.S. is concerned with ensuring access to Caspian oil should the need arise. The main reason for this interest is diversification of supply and maintaining buffer capacity in a new oil-producing region.

China, through its state-owned oil companies, has often pursued a policy of acquiring direct control of foreign oil resources. This is particularly true in Kazakhstan, where China now controls 30% of the country's oil reserves. Furthermore, China has sometimes paid above market price for Caspian oil. Both these actions seem to suggest that China values oil more than it would a regular trade good, it literally values it above its market price. It seems reasonable to assume that this is the result of oil being considered a strategic resource, as realism would claim. Even if the supply of oil is thus seen as a vital national interest, as U.S. policymakers have in fact stated openly, there are still more ways than one to secure supply. After all, while China has had considerable success in acquiring equity stakes in the Caspian region, an estimated 90% of China's total import needs are still provided through the market.²⁹² Furthermore, China is involved in an expanding institutionalized cooperation through the SCO, which has gradually made energy a more important part of its agenda. Outside the region, China is a member of the ASEAN+3 energy partnership, which suggests

²⁹² Eurasia Group. 2006. *China's overseas investments in oil and gas production*

that China also accepts a need to regulate the energy trade through international organizations in some cases.

The very fact that the U.S., unlike China, does not have any state-owned companies, limits its ability to seek direct control of oil and essentially forces it to primarily pursue a market-oriented liberal approach. It has worked to ensure access to Caspian oil for private companies, which it must be noted are more often than not Western, if not necessarily American. The U.S. has actively supported the construction of the BTC pipeline, which due to its end point on the Mediterranean is bound to primarily supply Western consumers. In this sense, while pipelines are a necessity to transport Caspian oil to foreign consumers, they do have the effect of limiting the free trade in oil, by reducing the number of buyers oil shipped through the pipeline can potentially be sold to. As such, pipelines provide some degree of control over oil supplies, particularly from a region as isolated, without direct access to open seas, as the Caspian. China has been doing the same with its Kazakh-China pipeline, although taking their direct control one step further by also seeking to fill the pipeline with equity oil. Due to the problems associated with using other forms of transportation for Caspian oil, it is difficult to say how important the control aspect, which is central to realism, is with regard to these two pipelines. They are, after all, a necessity to get access to Caspian oil at all. Nonetheless, the pipelines do tie Caspian producers to a limited set of foreign buyers. Indeed, the resources and the diplomatic effort that went into building both pipelines suggest that, at the very least, securing that access to Caspian oil was considered vital by both China and the U.S. A significant difference in the Chinese and U.S. approach to the construction of these pipelines, which reflects the difference between the “strategic” and “market” approach presented in figure 6.1, is that China invested directly in the construction of its pipeline, whereas the U.S. encouraged private entities to construct the BTC pipeline, and helped facilitate its construction. Clearly, however, providing for the necessary transportation infrastructure seems to be a shared policy objective for both China and the U.S.

On the other hand, although the U.S. has no state-owned oil companies that the government can use as tools to achieve its policy goals, it has worked tirelessly to provide a friendly environment for U.S. oil companies in the Caspian region. In this context the U.S. has negotiated bilateral treaties providing favorable terms, as well as guarantees of predictable industry regulations, for U.S. companies in Kazakhstan and Azerbaijan. Working bilaterally in this way, which tends to provide a great power like the U.S. with some leverage over the

smaller states with which it negotiates, is a more realist and strategic approach to the issue of energy security.

The issue of energy security cannot, however, be seen entirely in isolation from other concerns. Broader geostrategic considerations influence U.S. and Chinese policy in the Caspian region. In some cases energy security policies are intertwined with other policy objectives, which leads to different outcomes than would be expected if energy security policy could be held entirely separate from other concerns. Significantly, all major Eurasian powers perceive Central Asia, and the Caspian region as a part of it, as their strategic backyard. The region serves as a buffer between these states and control, or at least influence, over it is seen as essential to their national security and ability to respond to military threats. The SCO's call for a timetable for withdrawal of U.S. forces in Central Asia, which was proposed by China and Russia, demonstrates these major regional powers' unease at U.S. military presence in such a vital region. Another example of concern with wider issues affecting energy security policy is the construction of pipelines to transport oil out of the region. The U.S. has actively, and so far successfully, opposed alternatives running through Iran, which from an economical viewpoint would be the optimal solution. This has partly to do with energy concerns, as Iran would be able to shut off transportation through the pipeline for political purposes. However, it is also a result of another policy objective which apparently takes precedence at the moment: that of containing Iran. The above illustrates that energy security is a part of the wider national security policy, rather than taking precedence over other security concerns.

Realism and liberalism offer two different views on how energy considerations might affect the broader geostrategic developments of the Caspian Region. Realism would focus on the threat that Chinese energy security needs poses to U.S. interests by pulling Russia and China closer together. Russia is a major, and geographically close, oil exporter and China urgently needs all the oil it can get. This is a major incentive for both to strengthen their cooperation, both bilaterally and through the SCO. Recent joint military exercises have also caused concern that the two may be seeking to create an alternative pole to U.S. power. Indeed, "The Russia-China Friendship and Cooperation Treaty" mentions, as one of five important areas of cooperation, "Joint actions to offset a perceived U.S. hegemonism".²⁹³ A related fear is the

²⁹³ Ariel Cohen. "The Russia-China Friendship and Cooperation Treaty: A Strategic Shift in Eurasia?", *Backgrounder* #1459, July 18, 2001

possibility of Chinese hegemony in the strategically important Central Asian region, which has become a more realistic possibility as a result of China's increasing military and economic capabilities. Furthermore, oil has been seen as a potential catalyst for wider regional confrontations between the largest oil-importing countries of the region – China, India and Japan – and with the main external regional actor, the U.S. For liberalism, on the other hand, energy linkages are viewed as something that can promote cooperation and integration instead of conflict and confrontation.²⁹⁴ Where for example “the China threat” view would see the improvement of relations between Russia and China as a security threat, liberalism would point to the security benefits of the overcoming of enmity between the two states and oil as a material foundation for continued improvement of relations.

To briefly summarize Chinese and U.S. policies in the Caspian region, we have found that the Chinese approach is fundamentally strategic, seeking direct control over the oil resources themselves, as well as control at all stages, from production, through transportation, to refining and distribution. There are still aspects of Chinese policy that suggest an approach more in line with liberal thought, though, such as institutionalized cooperation through the SCO. The U.S. strategy, on the other hand, is based on the market approach, but to some extent it also seeks to enhance the U.S. position by realist or strategic measures. This is particularly visible in U.S. attempts to support American IOCs in the region, the establishment and maintenance of military bases, as well as policies aimed at gaining leverage over Kazakhstan and Azerbaijan.

7.3 THEORETICAL IMPLICATIONS

The traditional realist, and liberal, concept of security emphasizes physical, military security, or in other words the immediate requirements of state survival. A satisfactory understanding of the concept of energy security requires that we go beyond these immediate requirements and look at the foundations of military power and this traditional concept of security. In the long term, a state in economic decline will eventually weaken militarily, reducing its ability to defend itself from physical threat and preserve its integrity. As oil is a cornerstone of the modern economy and essential for the operation of several modern technologies, an inability to provide for oil requirements will over time degrade a state's military capabilities along with its economic power. As the link between energy security and self-defense capability is not as

²⁹⁴ Philip Andrews-Speed, Xuanli Liao and Roland Dannreuther: “The Strategic Implications of China's Energy Needs”, The International Institute for Strategic Studies, 2002

immediately obvious as that between military capability and self-defense, this might affect the shaping of energy security policy. In a situation where the link between the two becomes more obvious, as was the case during the Second World War, it seems likely that policies will become more aggressive. Indeed it has been claimed that, while they were likely not the initial causes for the war, the desire to secure oil supplies contributed to the eventual aggressiveness of the war policies of Germany and Japan, as well as their direction.²⁹⁵ Furthermore, it has been argued that restoring the supply of Kuwaiti oil was the main motivation for the involvement of the U.S. and its allies in the first Gulf War.²⁹⁶ The fact that withdrawing Iraqi forces torched several oil wells suggests that the Iraqis, at least, believed oil to be the central issue of contention. Accusations about Kuwaiti disregard for its allotted OPEC quotas and its supposed “theft” of oil from the Rumaila field in the border region between Iraq and Kuwait were also among the reasons given by the Iraqi government for going to war in the first place, although there is considerable disagreement as to whether these had significant impact on the decision to invade Kuwait.²⁹⁷ Few interests are powerful enough to drive a state to open warfare and Javier Solana’s assertion that “[t]he scramble for territory of the past may be replaced today by the scramble for energy”,²⁹⁸ suggests that in a world where wars over territory have become relatively infrequent, wars over vital resources, of which oil is the most important, may be increasingly likely. This illustrates the duality of oil being “just” a natural resource, but at the same time one so vital, in so many ways, that every modern state is so dependent on.

It would seem that energy security does not fit neatly within traditional understandings of security, like those found in realism and liberalism. One cannot present a simple equation where oil equals security, and the policies of China and the U.S. in the Caspian region are not consistent with the view that oil supply is pursued as aggressively as physical security. But still, reliable supply of oil is certainly a more vital interest to states than the supply of other goods. The U.S. or Chinese economy will not be thrown into depression, nor their physical security be threatened, if bananas suddenly become hard to get by. Serious disruptions in the oil supply, however, will have devastating effects, at least for industrialized or rapidly industrializing states, on several levels. Partly as a result of this, the policies applied to ensure

²⁹⁵ Amos Nur. 2004. *Oil Future and War Now: A Grim Earth Sciences’ Point of View*

²⁹⁶ Ian Rutledge. 2005. *Addicted to Oil*

²⁹⁷ Dag Harald Claes. 2001. *The Politics of Oil-Producer Cooperation*

²⁹⁸ David Brunnstrom and Jeff Mason. “EU’s Solana warns of global scramble for energy”, *Business Day*, November 21, 2006

the supply of oil tend to be more complex and varied than either realism or liberalism alone can account for, and the resources and effort spent greater than those devoted to acquiring other goods.

Realism focuses on securing control over the sources of oil, and that states will apply policies to ensure energy security that in many respects are similar to those applied in pursuit of traditional security. What we have found, however, is that while this is true in some cases, the policies of both states also seem to conform to some extent to the behavior predicted by liberalism. Liberalism focuses more on the market, as well as regimes and institutionalized cooperation. As our empirical findings have demonstrated, neither realism nor liberalism is fully capable of explaining the energy security policies of China and the U.S. in the Caspian region. While both states demonstrate an inclination toward one of the two approaches we have presented, our findings in this case suggest that neither theory on its own can give a satisfactory account of the structural forces that determine energy security policy for all states, if such exist. It is, however, a well-known problem within the social sciences that no general theories manage to include all aspects of reality to explain all specific situations. Therefore it may be necessary to combine different theoretical perspectives, develop or modify existing theories, or at times reject existing theories altogether in favor of new ones.

7.4 TAKE THE CURRENT WHEN IT SERVES...

While this thesis has answered some questions, even more new questions have presented themselves in the process. The concept of energy security itself and its relationship to other understandings of security could perhaps benefit from further examination and clarification, within the wider framework of the security debate. Energy security as a concept has many aspects begging for further discussion. This could be primarily a theoretical debate, but would also likely benefit from further empirical studies. In order to discuss the general concept, a better understanding of the realities of energy security policy would be useful, as empirical studies in the field have so far been few and far between, while the subject has only been growing in salience. This is true with regard to the Caspian region, but also generally. In this respect, the empirical findings of our study could hopefully be a useful contribution to future research on energy security questions in the Caspian region, independent of the theoretical implications we have discussed. In particular, further inter-regional or cross-national comparative studies, of which our findings could be a part, might be valuable in constructing general energy security hypotheses.

While our study of the situation so far does not indicate that either theory can give an entirely accurate explanation of energy security policies in the Caspian region, it will be interesting to see how the emergence of a relatively new competitor with a more strategic approach to energy security will affect the energy security policies of the U.S. in the future. China has only recently become a major oil importer and has been frantic in its attempts to secure control over oil resources, particularly in the Caspian region, but also on a global scale. As we touched upon in our analysis, this could imaginably cause a shift toward more strategic policies among other major importers, especially in a situation where the market is as tight as today. As the growth in demand seems to be outstripping the growth in production, competition could conceivably become more intense with time, seriously testing the U.S. commitment to the invisible hand of the market.

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