

10. Consumer Price Structure of the Caspian Oil, Levels of Cut-Off Prices by Directions of Supplies

The best answer to the question of comparative competitiveness of various routes for the supplies of oil from individual Caspian states to the market may be obtained by analyzing the c.i.f. price structure for each possible option of oil transportation to Europe and Asia.

We made some calculations to that effect that would allow us to evaluate the general level of production costs for oil produced in the sectors of individual countries (fig.10) and the transportation costs using different routes to the markets of Europe and Asia.

Our evaluations ignored the tax component in the price in different production scenarios; we did, however, incorporate a profit rate of 15 percent. The tax component was excluded deliberately on the assumption that the interested producing and transit states may grant various tax benefits to oil companies in direct taxation of the projects under consideration (up to a complete temporary exemption of investor companies from direct taxes) in order to attract an inflow of investments to oil producing and oil transportation facilities located in their territories. This scenario is well grounded more than just in terms of theoretical economy; it has been tested more than once in international investment practice, so it would appear quite probable as even with an exemption from direct taxes the state budgets will get more revenue through taxation of indirect income generated by the development of production and transportation of oil (i.e. so-called "multiplier" or "multiplication" effect [21, 26, 27]; at the same time an additional (expanded) tax base will be formed for future times (after the tax holidays in oil production and transportation are over). The goal of our calculations, therefore, (see the results in Fig. 10) was to find the approximate level of the "cutoff" price needed to implement a given Caspian project (i.e. the calculation of the aggregate level of costs and profits below which the average weighted prices of oil should not fall for the project to operate effectively and to obtain the needed finance from non-government investors on a set-term payback non-subsidy basis).

Fig.10 presents the data on cutoff prices of Caspian oil by the country of production (source of supplies). Fig.1 presents the picture of the same data grouped by markets where that oil can be supplied (directions of supply).

The data in that picture show that Azerbaijani oil is more competitive on the Western European market than oil from Kazakhstan, but not with all routes of its transportation. The lowest cutoff price in Western Europe is achieved if Azerbaijani oil is transported via the Baku-Novorossiisk route, with the Baku-Supsa route being the second best option. Next in line is the Kazakh oil transported via the CTC route. All three routes of supply of Caspian oil to Western Europe via Black Sea terminals are more competitive than the Baku-Ceyhan route both when using the Turkish straits (cheaper transportation) and with construction of a "bypass" Burgas-Alexandropolis pipeline (a more expensive option).

With today's prices of oil in Western Europe of about \$90-95 per ton as of mid-August, 1998, using a Trans-Caspian pipeline to transport oil from Kazakhstan to Western Europe is quite evidently impossible economically irrelevant of any tax benefits that may be granted to investors by host countries.

The economic feasibility of the Ceyhan route at today's price level seems more than doubtful: the "price niche" remaining for the taxes and fees in the producing country (Azerbaijan) and all

countries along the route (Georgia and Turkey) is left at just \$10 per ton which would require universal introduction of extremely high tax benefits and lowered transportation tariffs. Now, the main economic purpose of the Ceyhan pipeline construction is supposedly the struggle for transit revenue. Whether the transit countries will want to lose that revenue still to be collected (not even mentioning the obvious interest of oil companies in following the cheapest route possible, provided that all other conditions are equal)?

On the other hand, lower pipeline tariffs (to ensure that that cutoff price is in line with the world oil prices) may drastically reduce the possibilities for financing the Baku-Ceyhan project, as it would delay its payback period most likely moving this project from the project finance market (i.e. from the non-political and thus broader market of private investment, the market of commercial financing) to the market of limited state financing of the interested countries and (probably) some (primarily regional) international finance institutions.

A number of questions arise in this regard. How would the abandonment of project financing (in the case it is impossible to provide it) and an appeal to government financing of the countries involved in the project (either in the form of direct state participation in financing this project from the budget or in the form of government guarantees) worsen the current payment balance of these countries, especially its part on "investment income balance"? How much worse can the balance-sheets of these countries get, especially those of Azerbaijan and Georgia that have to follow the IMF recommendations and keep their budget parameters within certain frameworks in order to preserve the financial backing of international finance institutions?

As we already mentioned above, one should keep in mind that the appearance on the Western European market of all Caspian oil that is now orientated in that direction would inevitably result in a further price drop thereby increasing the cutoff price for all Caspian project by the amount of the drop provoked by additional excessive supply. Thus the very fact of implementation of the Baku-Ceyhan route may ultimately decrease the price of oil at the Western European market below the cutoff price for this route (let us keep in mind that the "padding" for this route is about \$10-15 per ton or \$1-2 per barrel that we calculated the cutoff price for a zero-tax situation).

The cutoff price for Caspian oil if it is supplied to Asia via Southern routes (see Fig.11) at today's oil price levels leaves a very narrow niche for taxation in that price. However in the case of supplies to the growing Asian market there is no evident threat of its being swamped with excessive oil and a resulting price slump. So the probability of a positive "price window" between the price of oil at the Asian market and the cutoff prices of Caspian oil is very high, if it is supplied to that market.

Table 13 shows the hierarchy of Caspian oil supplies by directions depending on the cutoff price levels which (ignoring the growth potential of markets) could be interpreted as suggesting that economic factors tie the Caspian to European markets.

As we showed above, however (this is further confirmed by data in Fig. 12), the implementation of the Western European scenario would contribute to a long-term unfavorable price situation at the world markets. In this situation, the slowing pace of development of Caspian fields can hardly be regarded as a coincidence – probably the Western companies seek to delay their development to a later time when the North Sea production starts declining. In this case, the emergence of Caspian oil on the Western European market would be more harmonious, although it would still create numerous problems for producers, related to excessive supply (see Table 5).

For these reasons, looking at the situation from an integrated economic angle (taking into account both price levels and market capacities) we can realistically expect two scenarios that can allow to avoid the collisions described above:

- (1) Supplying Caspian oil to the markets in Central Europe and the Black Sea basin in order to reduce excessive supplies to Western Europe. In that case there would be additional demand for Caspian oil supply routes via Black Sea terminals (further study of this scenario is needed, in particular, concerning the prospects for oil demand growth in the above-mentioned countries and the required pipeline capacities);
- (2) Supplying Caspian oil to Asian markets, that is to a region where the potential market capacity may absorb oil supplies from MNE, the Caspian and the Russian Far East. Crude can be transported to Asia either in the southern direction through Iran and Iraq to the terminals in the Persian Gulf with further transportation to South and South East Asia or from Kazakhstan to China under a scheme of substitution involving Russian oil from West Siberia (more calculations are needed to study this option further).

We already noted the economic problems of the "Southern" option, first of all, turning oil producing Gulf countries into oil transit countries as well [20] as well as the fact that this option is for the time being unrealizable due to political reasons. Nothing lasts forever under the moon, however – quite recently the US and the USSR were irreconcilable enemies for political reasons no less serious than US grievances against Iran and Iraq today. We would venture to suggest that as soon as the US business community realizes that there are no wide-scale economic alternatives to this scenario of Caspian oil development, American companies will somehow find the appropriate arguments to impress this understanding upon the US Congress and US Government. As we showed above, there is already movement in that direction.

11. Demand for Investments in the Production and Transportation of Caspian Crude and Possibilities of Meeting It: Main Scenarios

Our calculations show that the aggregate demand for investments during the first stage of Caspian oil development alone may reach at least \$60-70 billion (note that we mean the lowest possible level of demand for investments for new Caspian oil projects: due to above-mentioned limitations, we made our calculations not for all Caspian projects and just for two Caspian states). Over 80 percent of the money would be used for production of Caspian oil (in Azerbaijan's and Kazakhstan's sectors in more or less equal shares) the rest would be used for transportation systems (see Table 14).

What are the chances of meeting this demand? The problem should be considered on two different planes:

- On the one hand, evaluating the prospects for meeting the aggregate investment demand (proceeding from its average annual values); and
- On the other hand, evaluate the prospects of peak demand for investments in the development of the Caspian oil (proceeding from the actual evolution of investment demand based on the merits of specific projects).

In early to mid-1990s, average investments in exploration, development and production of oil amounted annually to \$80 billion worldwide [34, 35]. According to the study of prospects for financing the world energy sector performed under the aegis of the World Energy Council (WEC) [34], the annual level of investments in the above sectors of the oil business in 1996-2001 will achieve \$100-120 billion or a total of \$600 billion in the five-year period in question. Of that amount, about \$400 billion will be spent by the international oil companies, \$100 billion, by OPEC countries and the remaining \$100 billion by the CIS states, China and other countries.

If we evaluate the chances of meeting the aggregate demand for investments in Caspian oil as a whole in this period, the share of the region in the world investments in exploration, development and production of oil (so-called "upstream") without transportation may be about 7 or 8 percent (the total duration of the investment cycle of development of Caspian oil is close to 10 years, so \$60-70 billion needs to be correlated to the size of expected investments in the world oil production out of which the development of the Caspian will be financed, which is about \$900 billion in ten years). This share is almost three times as high as the total share of all countries of the Caspian in the world proven recoverable oil resources. This correlation may impose a significant restriction on possibilities for project financing of the development of Caspian fields as it means that the prospects for covering external borrowing at the expense of internal resources of the projects themselves are just about one third, if we proceed from the natural desire of international oil companies as strategic, and not venture investors, to pursue a policy of balanced investments in different regions in order to balance the risks in the expected incomes of companies across the board. In other words, in order to optimize the risks of investing normally done by international companies using borrowed capital, the share of a region in the world investments should not be significantly different from its proven recoverable oil reserves. (Let us remind here in passing that the size of proven recoverable reserves of a field is equal to the accumulated production for the duration of the project, which – along with the rights to use subsoil resources – can be used as a most effective liquid collateral against credit resources attracted to develop the field in question).

It is common knowledge that the problem of "peak passage" is one of the most challenging economic tasks. The investments in phase one of development of the Caspian oil will peak at the beginning to middle of next decade.

Fig. 13 presents the outcome of our calculations of evolution of demand for investment in new Caspian oil development projects and in the competing projects in Russia (Timan-Pechora and Sakhalin), which shows that the investment demand for development and production of oil in Azerbaijan (phase one) will peak in 2001 (\$6billion per year), and in Kazakhstan in 2004 (\$7billion per year). The general investment demand in the Caspian will peak in 2003-2004, with the estimated size of peak demand achieving \$8-9 billion, which is equal to 10-11 percent of the actual annual volume of investment in the world oil production (upstream) in 1990s or about 10 percent of the annual volume of upstream investment expected in the world in the immediate future (\$80-90 billion per year) within which the main oil producing countries may compete for investments. This increases the gap between the region's share in the world proven resources (i.e. in the future accumulated production) and the world upstream investments even further and thus aggravates the prospects and weighs down the parameters of project financing of oil production within estimated parameters.

As the delays with the start of new Caspian field development projects continue, the peak values of aggregate levels of investment demand in the Caspian development will become somewhat lower, thereby facilitating (making relatively cheaper) the financing of Caspian oil projects.

Considering the Caspian's remoteness from the main centers of liquid fuel consumption and the need for construction of long main pipelines in any scenario of development of the Caspian, the amount of investments in the transportation of the Caspian oil in addition to the investments needed to produce it will be a critical indicator in determining the scale of development of this region's oil and gas resources: for different scenarios of first phase development of the Caspian oil the ratio of investments in production and investments in transportation will be anywhere from 7:1 to 4:1 (see Table 14). As development of stage two fields proceeds (five Azerbaijani projects ignored in the calculations of this stage of the study for which investment agreements have already been signed, not yet contracted fields, etc), the transportation share of total investments will be decreasing somewhat, with additional decreases of that share caused by the slowdown (delays) of the start of implementation of development projects covering new Caspian fields.

Both production and transportation will therefore create the critical mass of investments in the development of Caspian oil (from the point of view of finding the possibilities for meeting this investment demand with real financing).

We have calculated the evolution of investment demand for the production and transportation of Caspian oil under scenarios of demand and supply presented in Tables 5-1, 5-3 and 5-3. The results of the calculations are presented in Fig. 14-17 (Scenario 1 corresponding to the demand and supply scenario presented in Table 5-1), Fig. 18-21 (Scenario 2, Table 5-2), and Fig. 22-25 (Scenario 3, Table 5-3).

The data in those figures show that the maximum level of demand for investment in production and transportation of Caspian oil under the first scenario (\$8.5-9 billion per annum) will be achieved in 2001-2004 (see Fig. 16); under the second scenario, \$9.5-10 billion per annum in 2001-2004 (see Fig. 20); and under the third scenario, \$9-10 per annum in 2001-2004 (see fig. 24).

The calculations show that the investments in transportation for the Caspian as a whole will not significantly increase the levels of "peak values" of the combined (production plus transportation) demand for investments. However, whereas Kazakhstan will not face this problem under the discussed scenarios (investments in transportation would be made before the peak of investment demand for production – see Fig. 15), this problem for Azerbaijan is quite significant, as the phase of investment in transportation schemes in that country (as the result of applying the concept of multiple transportation routes) will coincide with the peak of investment demand for production (see Fig. 14).

Nevertheless, the problem of passing the peak of investment demand remains quite serious. We believe that even at the first stage of development of Caspian oil there will arise serious difficulties with finding sufficient investment on acceptable terms. It is possible that some of the Caspian project under preparation today cannot be financed in the current situation, so they will remain at different stages of adjustment of evaluation of reserves, recalculation of their feasibility studies, conducting additional negotiations, etc., in order to give to the oil companies the opportunity to at least get the life cycles of those projects out of the depression phase of demand for oil at the world markets, without actually beginning to finance them. The coincidence with the depressed state of the world market and the global financial crisis can only protract the period of uncertainty in regard of the best possible scale of development and parameters of financing of Caspian oil.

The calculations presented invite yet another conclusion: the earlier the oil companies seek to supply Caspian oil to the world market, the more problems they will face from the point of view of balance of oil supply and demand (early expansion of production would generate excessive supply

and a corresponding downward pressures on prices) and from the point of view of financing the peak investment demand (early expansion of production creates an additional early demand for investments, which results in increased costs of borrowing or even in a sheer inability to find part of financing in a situation of low prices and the Caspian's exaggerated share in the investment demand). Thus the investment limitations would favor an even slower and more gradual development of the Caspian than it is presented in the "official" estimates of production levels in the region.

What is the correlation between the levels and volumes of demand for investments in Caspian oil and the competing oil projects?

A systematic evaluation of investment demand for main oil producing regions is nowhere to be found in the press (or, at least, we failed to find it), so we shall present some of the latest published non-systematic evaluations that would allow us to understand at least the order of those figures, say, for OPEC countries, Russia and the world shelf.

OPEC. According to the estimates presented in [36], in 1995-2000, the OPEC countries will require \$250 billion in order to maintain their current production, and another \$108 billion in order to increase their production to 2.1 billion tons per year, i.e. about \$70 billion per year, which, in our view, is totally unrealistic, as it is almost equal to the total annual investment in the world oil industry. This, however, provides us with one evaluation of the scale of investment demand in the main oil producing countries.

In the opinion of the Royal Institute of Foreign Affairs in London [31], most oil producing states reserve the possibilities of financing their oil production industry for their own national (state-owned) oil companies, which, according to the forecast of the WEC [34] would narrow the zone of investment availability for OPEC to \$100 billion for the five years or approximately to about \$20 billion per year.

According to the London Center of Global Energy Studies [37], in order to maintain their production in 1993-2000, the six main OPEC countries of the Persian Gulf (Iraq, Iran, Kuwait, the UAE and Saudi Arabia) will require \$29.6 billion, and in order to increase their peak production capacities by 335 million tons per year (6.7 million barrels per day of peak capacity) in the same period they will require another \$23.4 billion. The total: \$53 billion [38] or 6.5 billion per year.

Russia. Our calculations show that the investment demand for the Russian projects competing with Caspian oil (Timan-Pechora and Sakhalin) is equal to \$42 billion (see Table 16) or around \$3.5-4.0 billion per year (see Fig. 13).

We estimate the combined level of investment demand only in those projects that the Government of the Russian Federation was ready to propose to investors for development on the basis of production sharing agreements at \$130-140 billion or \$13-14 billion to \$22-23 billion per year [27].

The shelf. According to the estimates in [39], the total world oil upstream investments on the shelf in 1997-2001 will achieve almost \$200 billion, i.e. around \$40 billion annually.

And so on...

It is quite clear that the investment demand cannot be met fully in any of the oil producing regions (old or new). For this reason, it is important to see which regions and to what levels will account for production growth, i.e. where will the finance resources ultimately flow, and in what amounts. From this point of view, the Caspian region is but one of many alternatives under consideration.

Data in Table 14 show that only the first phase of development of the Caspian oil and the competing new Russian projects (\$105-110 billion) is on par with investment demand forecast for the whole world for the next few years (up to \$120 billion per year).

Hence the quite evident conclusion that even the first stage of Caspian oil development most likely cannot be financed at the required levels.

As we noted a; the risks of financing all of the projects under consideration would be too high and too unfounded, keeping in mind the clear threat of collapse of the world market in the case of their implementation, as a result of which the projects may never pay back for themselves financially.

12. Russia's Economic Interests in the Caspian Region

Azerbaijan, Kazakhstan and Turkmenistan have put Russia in front of a fait accompli and made it face the need to recognize the division of the Caspian into national sectors. By announcing in late 1997 a tender for the rights to use subsoil on a section of Caspian sea bottom (Vostochno-Morsakya, Rakushechnaya, Yuzhnaia, Druzhba and Eroziionnaya structures) Russia indirectly agreed with the division of Caspian sea bottom into national sectors even then. This conclusion is further supported by the fact of the Russian President's participation in the discussion of territorial ownership of Kyapaz (Serdar) field (its location in the Azerbaijani or the Turkmen sector of the Caspian Sea) and by his decisions rejecting in favor of Turkmenistan the agreements on this field signed by Russian companies Rosneft and LUKoil with the Azerbaijani side. Russia's de-facto recognition of the division of Caspian Sea bottom into national sectors was recently sealed by the signing of an intergovernmental agreement with Kazakhstan on the delimitation of the Caspian sea bottom in the conditional Russian-Kazakh sector.

Therefore, in formulating Russia's *economic* interests in the development of oil and gas resources of the Caspian we should proceed from the actual state of things as of today, i.e. from (direct and/or indirect) de facto recognition of the division of the Caspian sea bottom into national sectors (a detailed study of Russia's interests in the Caspian within the context of international law and international politics may be found, inter alia, in the works of Yu. Barsegov [40-43]).

In this situation, the following may be regarded as economic interests of ***the Russian State*** in the Caspian:

(a) As concerns the ***Russian sector*** of the Caspian Sea:

- Maximum attraction of direct production investments (both domestic and foreign) for geological research, prospecting, exploration and development of the oil and gas resources of the Russian sector;
- The earliest possible development of the oil and gas resources of the Russian sector providing the maximum positive discounted cash flow (within the existing environmental and other restrictions) and the maximum economic multiplier from the combination of fields under development (see [44] for more details),
- The maximum transit volumes of oil produced in the Russian sector through the Russian territory in line with the two criteria above;

(b) As concerns the ***national sectors of other states*** of the Caspian Sea:

- An active participation of Russian companies in the geologic studies, prospecting, exploration and development of fields located offshore in the national sectors of other states, provided that such participation does not result in scaling down or slowing down similar work in the Russian sector,
- The maximum economically feasible workload for Russian producers of products and services for geologic studies, prospecting, exploration and development of the above-mentioned fields (economic multiplier from the development of fields in other national sectors with the highest effect for Russia),
- The highest (in terms of discounted cash flows) volumes of transit of oil produced in other national sectors through the Russian territory and/or the maximum (in the same terms) participation of Russian companies in the transportation of Caspian oil via alternative routes.

The interests of **Russian companies** participating in the development of the oil and gas resources of the Caspian Sea will not fully coincide with the interests of the Russian State on this issue. The interests of the Russian companies that take part in the development of oil and gas resources of the Caspian Sea in several national sectors at the same time can be summarized as follows:

- The highest possible positive discounted cash flows from the development of oil and gas resources in the entire offshore area of the Caspian Sea within the combination of the company's fields and participation shares in individual projects in the sectors of different states (i.e. the optimization of development of hydrocarbon resources for the company across the board rather than for each individual national sector),
- Ensuring maximum diversification of transportation routes of hydrocarbons produced to the main export markets; the transportation routes do not have to lie through the territory of one country only,
- Placing orders for products and services for geologic studies, prospecting, exploration and development with suppliers (their national origin notwithstanding) that would provide the most competitive characteristics of the above products and services.

In this situation there is natural competition between different Caspian countries for the investments in the studies, prospecting, exploration and development of oil and gas resources of their national sectors. Foreign and domestic companies alike have a choice as to where, in the sector of which country, to invest their venture capital as a matter of priority. The main criteria for company decisions on this matter are legal and tax environments favorable to investments. By these criteria, Russia is currently lagging behind a number of other Caspian states.

Today, Russia is unable to speedily overcome its lagging behind other Caspian states (for instance, Azerbaijan) in ensuring legal stability of investments into the petroleum sector, which is predetermined by differences in the models of ensuring legal stability chosen by the legislators in each individual Caspian country:

- In Azerbaijan, every agreement (all of them are PSAs) is approved by the national Parliament and has the force of law (reliable guarantees of stability with short decision-making procedures). This legal model of ensuring stability of the terms and conditions of agreements is made possible by the small geographic size of the country, and the resulting relatively small number of oilfield development projects;

- Russia is still to resolve its problems with the “framework” (basis) legislation on production sharing as well as to define the appropriate legislative procedures, so the PSA regime has not yet been tested in practice (it is characterized by rather high guarantees of stability with undeveloped procedures), whereas the license regime, even using the mechanism of stabilizing reservations, does not ensure the required legal stability of license agreements (is characterized by low guarantees of stability with highly developed procedures) [45-47].

For these reasons, the economic interests of Russia would be best served by alleviating rather than increasing the tax burden on taxpaying companies to an extent that would more than compensate for the difference in the levels of legal stability of investment regimes offered by the Caspian coastal states, so that:

- Companies operation in the Russian sector of the Caspian Sea could reinvest their profits thus intensifying the development of the Russian sector and increasing the discounted cash flow and the multiplier effect from those investments;
- Companies operating in other sectors of the Caspian Sea were interested in additional priority investments in the Russian sector of the Caspian Sea thus increasing their obligations to transport the produced oil primarily through pipelines within the Russian territory.

An alleviated tax burden of Russian and foreign companies would give an opportunity to expand the economic presence of Russia in the Region (among others, through bringing in more Russian companies to operate here), which would be in conformity with the geopolitical interests of the Russian state.

In this situation both economic and geopolitical interests of Russia are best served by:

- Creating the environment for attracting investments into the region primarily through tax stimulation of investment operations in Russia in general and in the Caspian region in particular,
- Support of a broader penetration by a greater number of Russian companies into the region (both through the Russian and through other national sectors of the Caspian Sea).

In our view, Russia’s energy policy in the Caspian should be aimed at achieving those goals but we suspect that in the recent years this policy has mostly targeted quite different goals.

13. Evolution of Russia’s Energy Policy in the Caspian

In the years following the collapse of the Soviet Union, the Russian foreign policy in the Caspian has evolved through a number of stages (see Table 15).

The first so-called “post-imperial” approach (in the terminology of Yu. Fedorov [14, 48]) prevailed in the first half of 1990s. Its essence was the desire to prevent the Caspian States from beginning the development of their natural riches. At that stage, Russia was unable to take part in the development of Caspian oil on a broad scale, and any development of hydrocarbons without its participation was, in the thinking of the period, tantamount to a weakening of its influence in the Caspian. Therefore, the Russian foreign policy in the Caspian mostly concentrated on the need to first resolve all the differences concerning the legal status of the Caspian Sea as a prerequisite to

its economic development. As a result, the positions of the Russian Foreign Ministry and the Ministry of Fuels and Energy, the two main Russian entities responsible for energy policies abroad each to its own extent, began drifting apart, which was especially evident toward the end of this period. At that stage, methods of force or threat of its use were widely applied in the Russian foreign policy, which was the subject of numerous studies, including some Russian ones [1, 2, 14, 48 and others].

By mid-1990s it became evident that the "post-imperial approach" had become obsolete. Russia failed in preventing the start of development work on the Caspian shelf by other CIS countries, and the war in Chechnya dealt a final blow to the combat readiness of the Russian armed forces that could otherwise enforce the power policies. The need to adjust the foreign policy became quite evident. Starting from around 1996, the foreign policy has become more pragmatic, paying more attention to the prevailing realities (see Table 15). Russia began a gradual softening of its stance on the issue of the legal status of the Caspian Sea, in return obtaining for Russian companies the right to participate in Caspian projects. The positions of the Russian Foreign Ministry and the Ministry of Fuels and Energy began converging.

At that stage, the goal of Russia's foreign policy was to seek a monopolization of routes of transportation of the Caspian hydrocarbons to the export markets. At the same time, in the interests of oil companies operation in the region, including the Russian ones, a number of alternative routes were developed for the transportation of the Caspian oil, such routes lying through territories of more than one country. This approach was a reflection of the global trend toward diversification of sources of import and routes of supply of imported energy resources in order to spread and minimize the risks involved. Considering the obvious US support of the Turkish route and potential problems related to tanker passage through the Bosphorus, it became clear that the strategy of territorial "monopolization" of export routes orientated toward transporting Caspian oil to the Black Sea terminals through the territory of one country only with its subsequent shipment to the European ports of the Mediterranean did not have many chances for success from the very start.

This fact is probably not yet fully understood by the top echelons of Russia's rapidly changing leadership, so the new, so called "integration" approach is just beginning to emerge. In our opinion, this approach should be aimed at all-around expansion of all forms of participation of Russian companies in the development of the Caspian shelf (we stated the economic prerequisites for this approach above). In this case, the combined economic benefits for Russia (taxes, new jobs, service contracts and other similar results of the "multiplier effect") may exceed any potential income from the transit of oil through the Russian territory (although further calculations are needed to confirm or disprove this proposition).

Economic upturn in Russia is unthinkable without a broad-scale penetration of foreign markets by Russian companies. Support for such an expansion should become one of the main goals of the Russian foreign policy. Appropriate mechanisms of support of Russian business abroad are still at the stage of development, so the Caspian could (should) become a testing ground of sorts, for trying these mechanisms in practice.

Russian foreign policy in the Caspian should continue its evolution, finally discarding the orientation at gaining a dominating influence in the region, not backed by any realistic economic capabilities. The development of a mutually beneficial economic cooperation at the level of companies and

states in the Caspian region should be a result of objective economic circumstances, not of illusory impressions within the great-power cravings of Russia.

14. Conclusions

1. The Caspian oil, even within its first phase of development (2005 – 70 million tons, 2010 r. – 100 million tons, 2015 – 120 million tons), may fail to find its place on the traditional markets of liquid fuels in the Eastern Hemisphere (Western Europe, South East Asia) in the foreseeable future due to balance and price considerations.
2. A broad-scale emergence of Caspian oil on the Western European market would result in an excessive supply of liquid fuel in that region and in a drop in prices. Caspian oil on the Western European market would enter a price competition with both the traditional sources of supply (MNE, North Africa, North Sea, and West Siberia) and the “new” Russian oil from the European North of the country.
3. The Asian market will suffer from an expected unmet growth of demand for oil, so, for balance considerations, the Asian market is more attractive for Caspian oil than the Western European market. Transportation of Caspian oil to Asia, however, currently faces today greater economic obstacles than routes going in other directions. If supplied to the South and South East Asia, the Caspian oil would face price competition from the Middle Eastern oil and will have to be transported through the territories of oil-exporting countries.
4. Within the concept of “multiple routes of supply”, the routes through the territories of Russia and Georgia have indisputable economic advantages (including the options involving the construction of pipelines bypassing the Black Sea straits) as compared to the Turkish routes at any combinations of capacities of those pipelines. The routes to Ceyhan would cut the Caspian oil off from the most promising markets of states of Central Europe and the Black Sea.
5. Southbound transportation of Caspian oil is the more preferable option for economic considerations than the Turkish routes involving supplies to Western Europe; it will deliver the Caspian oil to the more capacious Asian market by the shortest route.
6. The main competition in choosing the routes of transportation for the Caspian oil involves the Baku-Ceyhan and the Tengiz-Novorossiisk (CTC) routes. These pipelines are mutually exclusive for economic considerations and may both remain unwanted given a sufficient slowdown in the development of Caspian oil.
7. There are serious doubts in the possibility of fully financing, on any acceptable terms, the investments needed even for the first phase of development of Caspian oil (\$60-70 billion).
8. Market niches for the Caspian oil mostly exist on new markets. The states of the Black Sea region (Azerbaijani oil) and SUAR in China (Kazakh oil) may absorb the extra supply of Caspian oil in the case of a rapid economic growth in those regions. Caspian oil may have indisputable competitive price advantages over the traditional sources of supply in these new regions of consumption of liquid fuels.
9. Orientation at these new markets presupposes a radical rethinking of the current concept of main routes of supply of Caspian oil to the world markets envisaging multiple routes of its transportation to Western Europe.
10. A multilateral cooperation between the states of the region would allow to find new and more effective transportation solutions. Supplies to SUAR may turn out to be most effective using schemes involving substitution of Russian oil from West Siberia for Kazakh oil.

11. An all-around expansion of any forms of participation of Russian companies in the development of the Caspian shelf is in the best economic interests of Russia. In this case, the combined economic benefits of Russia may exceed any potential income from transit of oil through the Russian territory.

15. Sources

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