

The Caspian Region's Challenge to Russian Energy Dominance

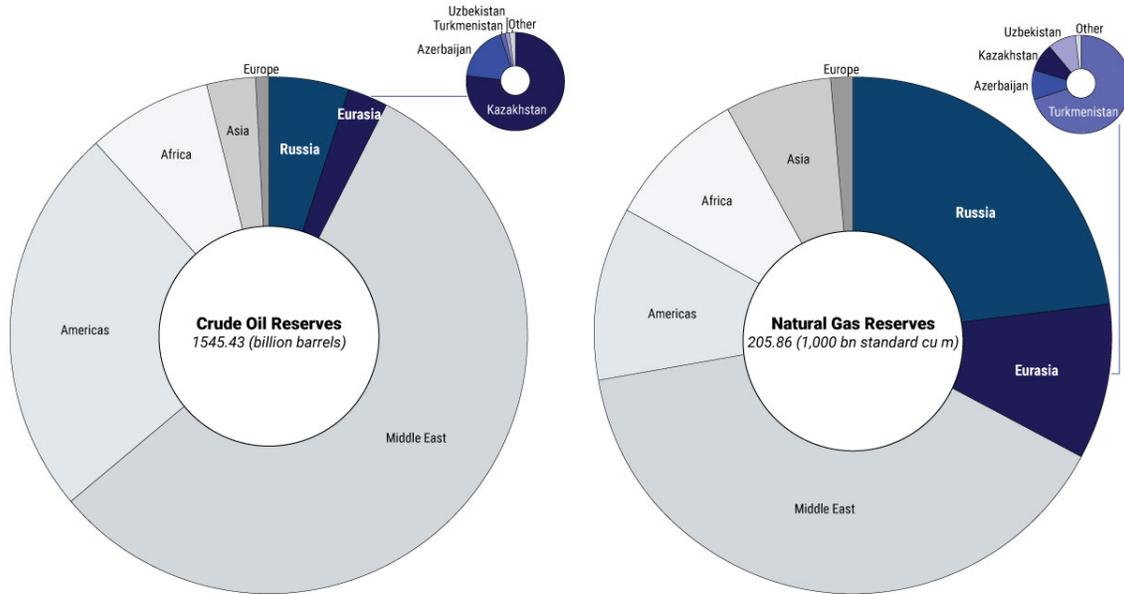
by Ekaterina Zolotova - July 12, 2022

Since Russia's military campaign in Ukraine began in February, European countries have been looking for alternative energy sources to reduce their dependence on Russian supplies. So far, these efforts have been unsuccessful because, in the short term, it's impossible to ramp up production to the level needed to replace Russian energy exports and create the infrastructure to get the supplies to European markets. In the long term, however, energy diversification is a real possibility, and European countries are focusing their strategies on the Caspian region – specifically, resource-rich Kazakhstan, Turkmenistan and Azerbaijan. These countries have traditionally been considered a zone of Russian influence, but Moscow may soon see them as a significant challenge to its domination of the European energy market.

Focus on Energy

Why is the Caspian region so promising as a replacement for Russian energy? The Caspian Sea is one of the world's largest and oldest oil- and gas-producing regions. Like Russia, the post-Soviet countries located there used their energy resources to build up their economies, growing increasingly dependent on oil and gas exports in the process. With weakened post-pandemic economies and amid the growing disruptions caused in large part by the Russian invasion of Ukraine, maintaining supplies is critical in this region.

Global Gas & Oil Reserves - 2021



Source: OPEC

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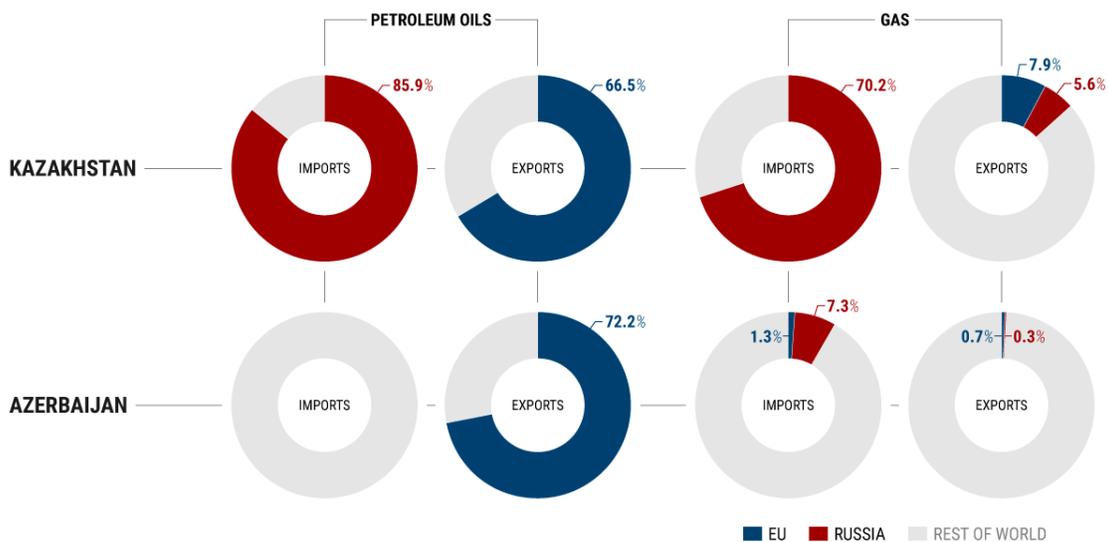
Kazakhstan is the largest oil producer in Central Asia and a major supplier of natural gas. It boasts about 30 billion barrels of oil reserves and ranks third in terms of gas reserves among the Commonwealth of Independent States, after Russia and Turkmenistan. There are more than 250 oil and gas fields in Kazakhstan, operated by 104 enterprises, including large international companies like Chevron, Eni, Total, ExxonMobil, Royal Dutch Shell and British Gas. In 2021, **the oil and gas industry accounted for about 17 percent of Kazakhstan’s gross domestic product**, while oil accounted for about a third of its budget. The energy upstream sector attracted 28 percent of gross foreign direct investment inflows. Exports of crude oil, natural gas and petroleum products accounted for 57 percent of Kazakhstan’s total exports.

In Turkmenistan, natural gas accounts for 85 percent of its budget revenue. The country holds the world’s fourth largest natural gas reserves, including Galkynysh, the second largest gas field in the world. Azerbaijan, meanwhile, produces 590,000 barrels of oil (with gas condensate) per day, with reserves totaling 7 billion barrels of oil and 1.9 trillion cubic meters of gas. Despite the country’s desire to develop its non-energy sectors, Azerbaijan’s oil exports still account for about 86 percent of its total exports.

European Links

For Europe, the Caspian region is particularly attractive because of its proximity and existing energy infrastructure, including pipeline networks. Its appeal has grown since the Russian invasion of Ukraine, for the obvious reasons but also because European capitals are no longer wary of antagonizing Russia – the largest supplier of oil and gas to Europe – by encroaching on its traditional sphere of influence. As the West continues to isolate Moscow and as anti-Russia sentiments run high, European countries are more willing to get involved here regardless of whether their efforts could interfere with Russian interests or provoke a response from the Kremlin.

Energy Trade Share with Russia and the EU | 2020



Sources: UNCTADstat

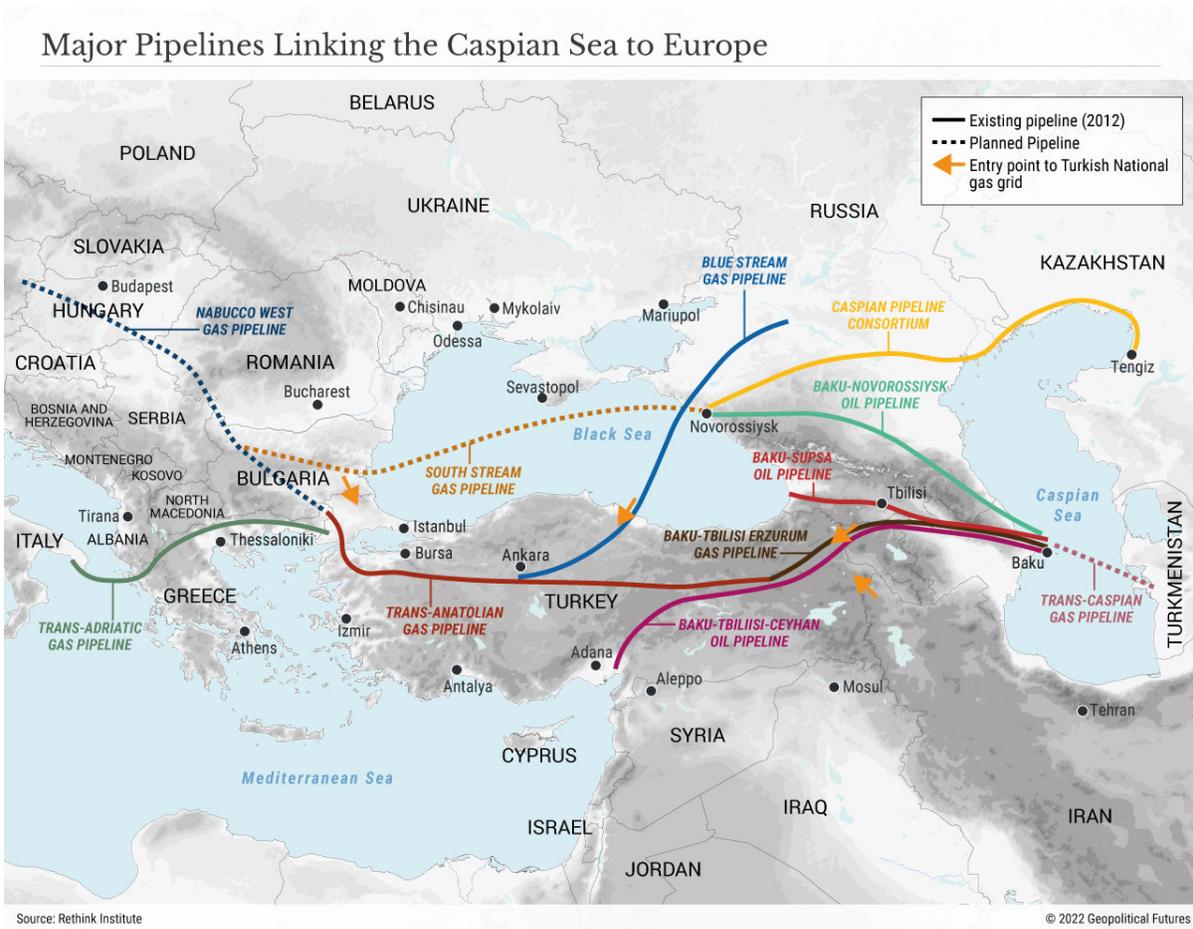
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The member states of the European Union are already major purchasers of energy from Central Asia and the Caucasus. The EU as a whole is the largest buyer of oil from Kazakhstan. In a recent

call with European Council President Charles Michel, Kazakh President Kassym-Jomart Tokayev said his country was ready to use its hydrocarbon potential to help stabilize world and European energy markets.

The problem, however, is that nearly all of Kazakhstan’s exports to Europe pass through Russia, mainly via the Caspian Pipeline Consortium network, giving Moscow significant influence over this trade. New routes will need to be developed to increase Kazakh oil supplies to the Continent in order to bypass Russian territory. One important option is the Trans-Caspian International Transport Route, otherwise known as the Middle Corridor, which links Kazakhstan, Turkmenistan, Azerbaijan, Georgia, Turkey and Europe, avoiding the traditional Russian routes. The first major talks in Brussels on development of the Middle Corridor took place on June 15.



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Azerbaijan also has key existing energy links to Europe. Italy purchased 43.3 percent of the country’s oil exports in January-February 2022. However, Azerbaijan is seen more as a transit

country than a supplier due to its limited resources compared with the countries of Central Asia. It argues that it can play **a critical role in increasing gas exports to Europe**, particularly through the Southern Gas Corridor, which includes the Baku-Tbilisi-Erzurum Pipeline, Turkey's Trans-Anatolian Natural Gas Pipeline (TANAP) and the Trans-Adriatic Pipeline (TAP). Expansion of exports through this corridor, however, will require significant investment to increase the capacity of the pipelines. TANAP, for example, was designed with a capacity of 16 billion cubic meters per year, while TAP has a capacity of 10 bcm per year. By comparison, Russian gas supplies to EU countries total 175 bcm to 200 bcm annually.

For Turkmenistan, meanwhile, Europe isn't yet a major market, as some 80 percent of its gas exports go to China. Still, there are plans to increase these supplies through the proposed Trans-Caspian Gas Pipeline, which could be connected to the TANAP and TAP systems. The 2018 Convention on the Legal Status of the Caspian Sea could help make this happen. According to the agreement, signed by Azerbaijan, Iran, Kazakhstan, Russia and Turkmenistan, laying a pipeline along the Caspian seabed requires the consent only of the country through whose territorial waters it will run. The project, which would cost roughly \$5 billion, has an estimated length of 300 kilometers (186 miles) and a capacity of 30 bcm per year.

Russian Levers

For Russia, the Caspian is a critical region for both security and economic reasons. From a security perspective, it separates Russia's southern borders from Iran, gives Moscow a presence in the often volatile Caucasus region, and serves as a location from which to launch strikes in Syria. From an economic perspective, the sea is a link to the Caspian countries and holds large reserves of natural resources. Late last month, Russian President Vladimir Putin visited Ashgabat, Turkmenistan, to attend the Caspian Summit in his first trip outside of Russia since the start of the war in Ukraine. He discussed with the presidents of Azerbaijan, Iran, Kazakhstan and Turkmenistan possibilities for cooperation in various fields.

Russia will be watching the region closely to ensure that the balance of power does not skew too far toward the West. Right now, it's not too concerned about the West's ability to erode its influence for a few of reasons. First, it understands that rapid increases in energy exports to Europe are nearly impossible. They would necessitate increasing the capacity of existing pipelines or building new ones – namely, the Trans-Caspian Gas Pipeline, which will require a multibillion-dollar investment and years to complete. Second, the Tehran Convention – a framework to help prevent, reduce and control pollution in the Caspian region signed by all five Caspian Sea countries – could help Moscow

stall energy and infrastructure projects for years. For example, Kazakhstan is **planning to dredge the Caspian seabed** to make it easier for ships to access oil platforms as sea levels drop. The project could damage the environmental integrity of the sea, which Russia could use as a reason to delay its implementation. In addition, the Caspian Sea has still not been fully demarcated. Under the Convention on the Legal Status of the Caspian Sea, delimitation of the bottom and subsoil of the sea needs to be carried out on the agreement of all adjacent and opposite states. This could further complicate any infrastructure projects in the region.

Russia remains highly dependent on energy exports for its economic well-being, as do its traditional allies in the Caspian. In the long term, it will face the difficult tasks of increasing its presence in this strategically important region and seeing it as a growing competitor in the energy market.

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