CHAPTER 4

IMPACT OF INTERNAL AND EXTERNAL FACTORS ON SHAPING RUSSIA’S ENERGY SECURITY POLICY

Introduction

The years followed the disintegration of Soviet Union; newly emerged Russian federation faced a turbulent period. Every sectors; economy, military, society, were in a chaos. The sudden break up followed by a drastic economics liberalization policy of President Boris Yeltsin led Russian federation to an unprecedented situation. The selling off of many public sector companies created a new, powerful class who could influence every matters of the federation. The human development and economy indexes reached the lowest level, inflation rate blown up, nearly for eight years this situation continued. After the take over of Vladimir Putin as president turned things dramatically. Putin push forward an assertive foreign policy to restore Russia’s lost glory. He tried to rein in powerful oligarchs, who often meddled with Kremlin affairs and posed a threat, to some extent Russian federation national security interests. For restoring the importance of Russia in the international politic, it was necessary to follow a very strategic policy in the energy sector because it was the only way out of a sick economy.

Two main competing agencies, the Foreign Ministry and the oil industry faction, pursued varying policies toward the Caspian Sea believing that precisely their policies accorded with Russian national interests. The Foreign Ministry sought to dominate the Caspian Sea by refusing to divide the sea, whereas the oil industry faction sought cooperation with the Caspian littoral states by favoring the division of the sea. Also domestic political and institutional influenced the issues of the Russia’s energy security policy in general and Caspian policy Caspian policy in particular.

In this chapter, we first provide a brief survey of Russia’s foreign policy especially toward the “near abroad” after the collapse of the Soviet Union. We focus on the chaotic nature of Russia’s policy and thus describe the general context under which policy struggle between the two competing agencies toward the Caspian Sea began. Then we demonstrate that different ideas held by these two agencies produced
varying policies toward the Caspian Sea. To be more specific, we investigate how the two competing agencies under varying domestic political and institutional settings interpreted the issues of the Caspian legal status focusing on their sensitivity about relative gains. We then discuss how these two agencies pursued different policies based on their varying interpretations.

It must be stressed at this point that sensitivity about relative gains refers to sensitivity to gains made by one state disproportionate to those of its negotiating partners. This implies that relative gainers, unlike absolute gainers, are concerned about “who will gain more” rather than about “will both of us gain” (Waltz 1979:122). Russia’s negotiating partners include not only the four Caspian littoral states: Azerbaijan, Iran, Kazakhstan, and Turkmenistan, but also Western powers, especially the United States. This is especially true because all these states directly or indirectly engage in the issues of the Caspian status. Thus, we consider any statements which show concerns over Russia’s disproportionate gains relative to its negotiating partners as reflecting high sensitivity to relative gains.

Russia’s Foreign Policy Chaos

After the breakup of the Soviet Union, Russia lacked a clear sense of direction in its external policy. This was not so surprising given the magnitude of the changes associated with the collapse of the Soviet system. For example, few expected that the collapse would take place so swiftly. Andrei Kozyrev recalled in 1994 that I had “not dreamed of the dissolution of the disappearance of the Soviet Union” (Raphael 1994:58). Moreover, the collapse of the Soviet empire led to confusion over the idea of Russian statehood. Igor Tishin was correct in saying that the Russian Federation “is not the same country that has simply changed his name. In the past, there was no such state as today’s Russia either on a political plane (a democratic system), or on the economic (transition to the market economy) or even more on the geographic plane within the borders of the former RSFSR” (Tishin1995:165).

This was true in part because Russian statehood coexisted with an empire for more than 300 years. As Geoffrey Hosking noted, Muscovite Russia began its career of empire by conquering the Khanate of Kazan in 1552 and from this moment Russia “embarked on a course of conquest and expansion which was to last for more than
three centuries and create the largest and most diverse territorial empire the world has ever seen.” (Hosking 1997:145) This was probably one reason why Russian Vice-President Aleksandr Rutskoi asserted in early 1992 that “the historical consciousness of the Russians will not allow anybody to equate mechanically the borders of Russian with those of the Russian Federation and to take away that constituted the glorious pages of Russian history.” Boris Federov, the minister of Finance, also pointed out, in 1993 that most Russian’s still failed to realize that Armenia, say, is a foreign country in his words, “to them, its independence is make-believe”. Hence, Russia lacked a clear of direction in its foreign policy. Sergei Stankevich, a foreign policy adviser to President Boris Yeltsin, stated in early 1992 that “Foreign policy with us does not proceed from the directions and priorities of a developed statehood. On the contrary, the practice of our foreign policy will help Russian become Russia (Tishin1995:238).

In these conditions, Russia’s foreign policy was characterized by unprecedented confusion (Arbatov 1993:5-43). The country’s political leadership certainly sought to remedy this problem. For instance, it sought to formulate a foreign policy concept for the country from early 1992 (Light 1996). This effort bore fruit in 1993. In April of that year Yeltsin signed the Russian official foreign policy concept, reportedly prepared by the country’s Security Council, into law. In this policy concept the so called “near abroad” became an area of “top priority” and fundamental importance” in Russia’s foreign policy. The official policy concept defined Russia’s status as a great power in spite of its internal crisis. It then stressed that Russia has special responsibility “for the creation of a new system of positive relations among the states that used to make up the Soviet Union,” serving as “the guarantor of the stability of these relations”. In these regards, Russia should seek “the greatest possible degree of integration” (Donaldson and Nogee 2002).

Despite this official foreign policy concept, however, the Russian political leadership had no clear idea on how to integrate the “near abroad”. As Dimitri Trenin pointed out, diverse views existed on “what integration within the former USSR should look like, which states it should include, and by what means it should be realized” (Garnett 1999:38). To make matters worse, no new institutions emerged to play the role formerly reserved by the International Department of the Communist Party Central Committee and the Politburo, which coordinated the foreign policies of
the Soviet Union. Krasnaia Zvezda pointed out in late 1992 that “We do not have a procedure for interagency consultation prior to the taking of foreign policy decisions” (Malcolm 1996:239). To be sure, Yeltsin sought to fix this problem. For example, in November 1992 he issued a decree which made the Foreign Ministry responsible for coordinating the country’s foreign policy. The decree was aimed at creating “a unified policy line by the Russian Federation in relations with foreign states” (Parrish 1996:33).

However, this attempt failed. The ministry acknowledged that it “lacked the necessary powers to overcome interdepartmental conflicts” (Parrott 1996:202). In March 1995 Yeltsin issued another decree which employed almost the same words as in his November 1992 decree (Parrish 1996:50). Then a year later Yeltsin issued yet another decree specifying that the Foreign Ministry would play the role of coordinating the country’s foreign policy. Commenting on the 1996 decree, the presidential spokesman Sergei Medvedev acknowledged that in the past similar decrees had been issued to little effect. But he stressed that this time the Foreign Ministry would more intensively coordinate the other government bureaucracies. As Scott Parrish pointed out, Yeltsin’s repeated attempts indicated “a familiar Russian pattern: decrees are poorly implemented and the remedy is more decrees repeating the same order” (Parrish 1996:64).

Naturally, Russia’s foreign policy lacked any coherence. For example, the Defense Ministry made its own policy which often contradicted the policy line of the Foreign Ministry. Yurii Baturin, Yeltsin’s National Security Advisor, well described this situation after an early March 1996 trip to Tajikistan. In response to a question as to who made the Russian policy toward Tajikistan – the Foreign Ministry, the Defense Ministry, or the Federal Border Service, Baturin said that “All of them. All departments are in on the act. The problem is that there has been no single department to coordinate this work.” (Freedman 1997:35). There was also a policy struggle between the Foreign Ministry and the oil and gas industry toward the Baltic States. The ministry called for sanctions against Estonia in 1997 and against Latvia in 1998 in connection with these states’ treatment of the ethnic Russian population there. However, the oil and gas industry headed off the ministry’s demand because these Baltic States were valued customers who paid for energy resources on time (Lo 2003).
This lack of policy coherence was not limited to the “near abroad”. For instance, both the Foreign Ministry and Defense Ministry certainly opposed NATO’s expansion into Eastern Europe. Yet these two ministries differed on how to oppose the expansion. The Defense Ministry issued warnings that if NATO expanded, Russia would take countermeasures such as transforming the Commonwealth of Independent States (CIS) into a full-scale military alliance. Foreign Minister Kozyrev contradicted these warnings by stating at a session of the North Atlantic Cooperation Council in 1995 that the position of the Defense Ministry did not represent Russia’s official position (Parrish 1996). Russia’s policy toward Iran was no different. The Atomic Energy Ministry carried out its own policy by agreeing to sell not only light-water reactors but also gas centrifuges intended for enriching uranium without consulting the Foreign Ministry and the Kremlin. Therefore, when the agreement became public, the Russian diplomats had to say that the Foreign Ministry and the Kremlin knew nothing about the agreement.

In these conditions, many Russian observers deplored the country’s lack of coherence in its external policy. For instance, the prestigious Council for Foreign and Defense Policy pointed out that None, even the most elementary strategy for the defense and realization of the national interests of the country, can be implemented under the present condition of the institutions intended to formulate and implement it. Each official enjoys the freedom to have his own policy. This situation not only weakens the position of the country but also disgraces it. This is one of the most difficult challenges for Russian foreign policy.

In a similar vein, one Russian analyst noted that in today’s Russia each branch of power thinks itself a “Politburo” and believes it has the right to carry out its own foreign policy. He then added that “several Politburos of this kind have appeared within the executive branch. They do not allow the foreign ministry to conduct a clear and consistent policy in world affairs” (Bazhanov 1997). It was under these circumstances that an “oil war” between the two main competing agencies began. To be sure, these two agencies sought to maintain Russian preeminence in the Caspian Sea. Nevertheless, they disagreed “over the form this preeminence should take and how to achieve it” (Sokolsky and Paley1999:282). For example, the Foreign Ministry sought Russian preeminence by advocating joint control over the Caspian Sea. This
joint control would provide Russia veto power on oil development in the Caspian Sea. This in turn would allow Moscow to prevent Western economic and political advances into the Caspian basin. For example, in April 1994 the ministry sent a diplomatic note to the British Embassy in Moscow to warn that British participation in the Azerbaijani oil project was illegal. This note indicated Russia's efforts to preserve control over the energy resources of the Caspian Sea. It stated that the Caspian is by its nature an enclosed body of water with a single ecological system and constitutes an object of joint use, within whose bounds all questions of activity, including the opening up, surveying, and utilization of resources, must be resolved with the participation of all the Caspian states.

In contrast, the oil industry faction sought Russian preeminence by participating in Caspian oil projects in the sea. For instance, in an interview with Interfax, a senior government official, responsible for the oil and gas complex, suggested that national interests in the Caspian region would be better served by helping Russian companies to consolidate their position in the region and by developing the network of export oil pipelines. The press report, he added, that Russia was demanding the right to veto the Caspian shelf's development was wrong, and he described the report as a campaign designed to favor Western oil companies. In his words, "Charges that Moscow is striving to dominate or assume some exceptional rights to develop Caspian oil deposits are ludicrous" (Interfax 1994). Similarly, Lukoil's leadership believed that the Russian Foreign Ministry's policy merely hurt the company by helping Western oil firms to consolidate their position in Caspian oil projects. Within this context Minister of Fuel and Energy Iurii Shafranik noted that it would be a "big mistake" for Russian not to participate in Azerbaijani oil projects (Ivantsov 1994). Likewise, Lukoil's President also argued that Russia should actively participate in oil projects in the Caspian Sea.

Clash of interests between Oil Industry faction and foreign ministry

The two main competing agencies pursued different approaches toward the Caspian Sea. These different approaches resulted from how the two competing agencies under varying domestic political and institutional settings interpreted the issues of the legal status of the Caspian Sea differently. After the collapse of the Soviet Union, the Foreign Ministry and the oil industry faction faced different domestic political and
institutional settings. This was especially true in the case of the settings which had varying significance for those two main competing agencies. On the one hand, the most crucial setting for the Foreign Ministry was that it was subject to heavy criticism for ignoring the "near abroad" especially in 1992. Under this circumstance the ministry interpreted the issues of the Caspian legal status in zero-sum terms and attempted to dominate the Caspian Sea by opposing the division of the sea. On the other hand, the most critical setting for the oil industry faction was "great depression" in its industry sector. (Lee 2004) Hence, maximization of oil production became a top priority. In this condition, the faction tended to interpret the issues of the Caspian legal status in positive-sum terms and sought cooperation with the littoral states by favoring the division of the sea.

The Foreign Ministry

After the collapse of the Soviet Union the hallmark of Kozyrev's foreign policy was its preoccupation with the West. Kozyrev, a leader of Liberal Westernisers, maintained the "Russia should renounce Tsarist and Soviet imperial ideology, outgrow its excessive 'Russianness,' and act as a 'normal' power without entertaining global ambitions and interfering in the neighboring states" (Valkenier 1994:25). Instead, Kozyrev declared the need for Russia to take its place among the civilized nations of the earth and left no doubt that this implied focusing on integration with Western economic institutions and partnership with the United States and European countries (Prizel 1998). This principle created a multi-tiered foreign policy, in which the CIS states occupied a secondary tier. These CIS states became the "near abroad", accepted formally as independent neighbors but taken for granted as not quite foreign. This was probably one main reason why it took the Foreign Ministry six months to create a department to deal with the new countries of the CIS. In particular, Central Asia and the Caucasus received the least attention from the ministry. As a matter of fact, Kozyrev regarded these southern republics as a burden which would inhibit Russia's integration into the West. Ilya Prizel a Russian expert pointed out, Russia's policy toward these southern republics was "one of indifference bordering on contempt" (Prizel 1998:243).

Kozyrev's pro-Western policy was subject to heavy criticism from the beginning the criticism came from diverse sources such as government officials,
politicians, academicians, and industrialists. For example, from early 1992 the Russian military resisted Kozyrev’s approach in part because the military believed that the West was not so benign. The draft Military Doctrine released in May 1992 indicated this belief. The draft doctrine did not name the United States and NATO as the enemy. Yet it clearly pointed to them in referring to “some states and coalitions” which sought to dominate the world (Baev 1997). The military also believed that Russia’s relations with the “near abroad” were critical for the country’s security interests. Similarly, the Council for Foreign and Defense Policy established by politicians, entrepreneurs, civil servants, and academicians issued a report titled “Strategy for Russia” in August 1992. In it the council stressed two points: “Russia’s interests were not symmetrical to those of the West and the divergence between two would increase”; “the main priority was not the West, but the Near Abroad, since the crucial external challenges to Russia’s security would come from the newly independent states” (Baev1997:123). Moreover, industrialists suggested that Kozyrev ignored the fact the Russia’s relations with the “near abroad” were critical for the country’s economic interests.

Thus, critics argued that Kozyrev should change the country’s foreign policy. For example, in March 1992 Stankevich called for a more balanced foreign policy, with much more attention paid to the former Soviet space (Sakwa 1996). A more extreme criticism to the foreign policy came from Evgeni Ambartsumov, Chair of the Russian Supreme Soviet Committee for Foreign Affairs and Foreign Economic Relations. He argued in August 1992 that Russia should play a special role in the entire space of the former USSR. In his words, “As the internationally recognized legal successor to the USSR, the [Russian Federation] must proceed in its foreign policy from a doctrine declaring all the geopolitical space of the former Union as a sphere of its vital interests (Idib:235).

This criticism had profound impact on Kozyrev’s thinking. This was especially so because the principal assumptions of Kozyrev’s policy did not correspond to reality. The West did not turn out to be so benign. For example, while the United States promoted its arms exports, it sought to prevent Russia from exporting rocket engines to India and submarines to Iran. The Council of Europe was unwilling to accept Russia because of its treatment of inmates and conscripts, but admitted Estonia and Latvia as council members despite the Russian perception of
unequal treatment of ethnic Russians in those two Baltic States (Prizel, 1998). Western aid was far smaller than expected. Much of western aid was in the form of loans and credit guarantees, while outright grants formed a small fraction of the aid. This put more pressure on Russia’s already massive debt burden. Worse still, the aid was often misallocated with little positive impact on the lives of the Russian population Light (1996), Parrott (1995).

In these conditions, Kozyrev’s thinking began to shift from that of Liberal Westernizes to that of Pragmatic nationalists in early 1993. One episode illustrates the shift of Kozyrev’s thinking. At a CSCE meeting in Stockholm in December 1992 Kozyrev asserted that “I must amend the conception of Russian foreign policy.” He then enumerated several points that shocked the Western delegates. For example, Kozyrev maintained that UN sanctions against Serbia should be cancelled and that Russia was willing to support Belgrade. He also asserted that the “near abroad” was Russia’s sphere of interests and Moscow was prepared to defend its interests by all available means. But later, Kozyrev explained that his speech was aimed at alerting the Western community the consequences if the “forces of reaction” succeeded in taking control of Russia. In the preface to the book that Kozyrev published in 1995 he noted that the trick at the CSCE meeting accomplished his aim: “the West had been alerted and the forces of reaction had been repelled” (Donaldson and Nogee 2005:180). However, as Margot Light pointed out, what Kozyrev did not acknowledge was that his thinking began to closely resemble many of the things he warned against in 1992 (Light 1996). Similarly, according to Robert H. Donaldson and Joseph L. Nogee, Kozyrev became “a forceful spokesman for the policies he had denounced in Stockholm” (Ibid:233).

Kozyrev began to assert Russia’s interests in the “near abroad, at a Foreign Ministry conference in January 1994 Kozyrev asserted that “We should not depart from regions which have been Russian spheres of influence for centuries and we should not be afraid of saying these words” (Malcolm 1996). He again stated “Let the West react as it pleases, we will do our work as we need, we have nothing to explain to anyone, and we won’t have to justify ourselves … There are, of course, those who see any strengthening of Russia or the CIS as harmful because they prefer a weak partner to a strong one. Well, let them think that way while we strengthen both Russia and the CIS” (Cohen 2005:45).
It is necessary to understand the Russian nationalists’ views on the issues of the Caspian and energy security. This is especially necessary because the Foreign Ministry bore a great impact of the criticism. The nationalists’ view touched various issues related to the Caspian Sea. The essence of Russian nationalists’ thinking was to prevent the penetration of western powers into the Caspian basin and to maintain Russia’s sphere of influence in the region. The expert group of Moscow State University’s Independent Institute for Socio-historical Problems the “Foros” Foundation published its view on oil development projects in the Caspian Sea; certain former union republics are not only moving further and further away from Moscow but also typing to ‘incorporate’ themselves in the political and economic habitat of other states. Western countries are beginning to exert an influence in these oil regions which have recently been ‘thrown open to the West’ through their oil companies. They are penetrating into Azerbaijan and Central Asia and creating ‘windows’ onto the Mediterranean there. In connection with this, it is becoming extremely important for Russia to gain a firm foothold in Armenia, through whose territory the oil pipeline from Azerbaijan to Turkey’s Mediterranean coast may be laid. A very large system of gas and oil pipelines running outside Russia may change the situation in this region radically. Its consequence is compared to the discovery of the sea route to India around Africa and the discovery of the continent of America, because of which the Italian city-states were pushed onto the periphery of European politics. If the project to construct a new oil pipeline is successfully implemented, we should expect a weakening of Moscow’s influence not only on the states of Central Asia and the Caucasus, but also of the Balkan Peninsula.

In his meeting with the Iranian Foreign Minister, Aleksandr Vengerovskii, Deputy Chairman of the Russian Duma, also commented that the arrival of U.S. oil companies in the Caspian basin would be inevitably followed by U.S. political presence in the region. Therefore, he stressed that Russia and Iran should cooperate in order to prevent U.S. hegemony in the Caspian region. Vladimir Lukin, Chairman of the Russian Duma Committee for Foreign Affairs and former Ambassador to the United States, reiterated the point in October 1996. He suggested that Russia and Iran should prevent “foreign intervention” in the Caspian Sea.
The Foreign Ministry’s officials in general expressed their views on the issues of the legal status of the Caspian Sea in less crude terms than these nationalists did. Nevertheless, one can sense that the ministry’s officials were very sensitive to relative gains. The ministry tended to see American participation in the Caspian oil development in “the old terms of East-West confrontation” (Shams-UD- Din 2000:135). Shams-UD Din suggested that the ministry viewed the Caspian oil development “in zero-sum terms, rather than as a cooperative effort from which everyone can benefit” (Shams-UD- Din 2000).

This sensitivity to relative gains is discernable in policy memos, interviews, and public statements. For example, a letter sent by Kozyrev to Russia’s Prime Minister Viktor Chernomyrdin in October 1994 clearly indicated the Foreign Ministry’s sensitivity to relative gains. In the letter, Kozyrev pointed out that the Russian oil company Lukoil participated in the Azerbaijani “contract of the century” by obtaining a 10 percent stake. He then said, if Russia assumed that Azerbaijan would continue its unilateral actions by implementing the oil contract, it would believe that “it is better to have something than nothing”. However, Kozyrev stressed that this would mean “in essence recognizing Azerbaijan’s sovereignty over a considerable sector of the Caspian Sea, which would inevitable lead to the division of this enclosed body of water, and Russia would end up in the most disadvantageous position because it would acquire the most insignificant and prospect less sector of the Caspian, This would cause significant harm to Russia’s economic interests” (Hrair and Simonian 2001:156).

Officials of both Azerbaijan and Kazakhstan provided useful insight for understanding the Russian Foreign Ministry’s position. For instance, Azerbaijan’s Foreign Minister Hasan Hasanov said that “It is our luck that main oil resources are in the Azeri sector of the Caspian. Just that is why the position of Russia and Iran are very close to each other in the question concerning the status of the Caspian”. Likewise, Kazakhstan’s President Nursultan Nazarbaev suggested that the problem of the Caspian Sea arose because large oil deposits had been discovered in Kazakhstan and Azerbaijan’s sectors and in a part of Turkmenistan’s sector. He then added that if large oil reserves had been discovered in the Russian sector, “Russia would have behaved differently” (ibid:189).
The Foreign Ministry's sensitivity to relative gains was not limited to the area of economy. One can sense this sensitivity to relative gains in the area of geopolitics. As a matter of fact, the ministry's sensitivity to relative gains appeared to be greater in the area of geopolitics than that of economy. For instance, a policy memo prepared by Kozyrev and then the Head of Russia's Foreign Intelligence Service Evgeni Primakov in 1994 for the President's approval advocated the Russia should maintain its sphere of influence in the Caspian basin by opposing the national division of the Caspian Sea (Barylski 1995). Moreover, during his regular meeting with Yeltsin Primakov noted in 1994 that the Azerbaijani oil deal posed a threat to Russia's nation security interests.

This concern was also best illustrated in the Foreign Ministry's response to the oil industry faction's argument that Lukoil's participation in Azerbaijani oil projects served Russian national interests. The ministry's official asked: "What exactly have you accomplished by your participation in Caspian oil projects, if, as a result, you have become de facto accomplices in reorienting the entire strategic system of energy transit routes from Russia to other countries in the region, above all Turkey? And Kazakhstan, following Azerbaijan's lead, is already taking concrete moves to develop alternatives routes to transport Tengiz oil bypassing Russia" (World News Connection April 10 2001).

Indeed, the Foreign Ministry demonstrated its high sensitivity to relative gains in the area of geopolitics. The best evidence of this was the ministry's concern over the advances of third party countries in the Caspian basin. The ministry's officials frequently expressed their concern that the penetration of Western countries, especially the United States, into the Caspian basin would lead to Moscow's loss of its influence in the region. For instance, Valter Shonia, the Russian Ambassador to Azerbaijan, denounced British criticism of the Russian Foreign Ministry's insistence on joint control over the Caspian Sea. He then held that "We are for cooperation. But we are not going to accept those [Western states] who are foolish enough to think that they can kick out Russia" (Chufrin 1997:234).

Albert Chernyshev, Russia's Deputy Foreign Minister in charge of Middle Eastern and Trans Caucasian countries, expressed similar concern on numerous occasions. For example, in his visit to Iran 1995, Chernyshev noted that Iran's stance
on the legal status of the Caspian Sea coincided with Russia’s. He then suggested that Russia opposed intervention of any third state in determining the issue of mineral resources exploitation. A month later, Chernyshev opined that no third country should interfere in the settlement of the Caspian dispute. He then stated that “The Caspian Sea is, first of all, a sphere of interests of five coastal states, their rights should be ensured first”. This message seemed to be the strongest at a news conference on November 1995. He asserted that “The Caspian and all that connected with it are the issues of strategic and economic importance, as well as issues of national security of all 5 countries of the Caspian basin; We do not recognize others’ strategic interests in this region” Similarly, Mikhail Demurin, spokesman of the Foreign Ministry, stated at a briefing that “Russia rejects any unilateral measures to seize areas of the Caspian Sea and the attempt of several non-Caspian states to interfere in the normal process of consultations among the five Caspian countries (Itar Tass 22-12-1995).

All these statements were aimed at the Western powers, especially the United States. Iakov Ostrovskii, Deputy Director of the Foreign Ministry’s Legal Department, made this point clear at parliamentary hearings on legal, economic, and environmental problems of the Caspian Sea in July 1995. He deplored that the process of “tearing” the Caspian Sea away from Russia already started by such Caspian littoral states as Azerbaijan and Kazakhstan. He added that if Russia did not stop this process, it would lose the Caspian Sea. According to him, Azerbaijan and Kazakhstan de facto exercised their sovereignty over their sector of the sea. Ostrovskii then stressed that “we should not forget that behind Azerbaijan and Kazakhstan there are US and UK monopolies urging these countries not to reach any agreements including the legal status of the Caspian Sea with Russia” (World News Connection, July 1995).

The Foreign Ministry continued to express similar points. Foreign Ministry’s, accused the United States of attempting to interfere in the issue of the Caspian legal status. Only the Caspian littoral states have the right to define rules for the use of the Caspian natural resources, also that no third country should interfere in these legal matters, in what ways and by which methods they should perform their activities in the Caspian Sea. It stressed that there was no legal guarantee for investment of the oil consortium on developing oilfields in the Azerbaijani sector of the sea.
Likewise, a senior Russian diplomat asserted that Russia opposed any attempts by non-Caspian countries to promote their recommendations on the legal status of the Caspian Sea and on pipeline routes to transport Caspian oil. In his words, "those problems must be dealt with by the littoral countries themselves without any pressure from outside." He then denounced the statement by James Collins, the U.S. Secretary of State's Special Adviser on the Newly Independent States, who stated in Baku that Washington was in favor of dividing the Caspian Sea into national zones. The Foreign Ministry's reaction to the visit of NATO Secretary-General Javier Solana to Baku in February 1997 was also similar. During his visit, Solana discussed with the Azerbaijani leadership issues such as ensuring the security of oil transport and resolving the Nagorno-Karabakh conflict. In response, Russia's Foreign Ministry issued a statement that the Caucasus "does not lie within NATO's recognized sphere of activity, and the alliance's involvement can hardly help settle conflicts there" (Kommersant 29-4-2007).

This sensitivity to relative gains led the Foreign Ministry to pursue the policy aimed at dominating the energy resources in the Caspian Sea. The ministry sought to accomplish this aim by advocating joint sovereignty over the sea. This joint control would provide Russia "the greatest voice in the exploitation" of the sea's energy reserves (Croissant and Croissant 1996). This in turn would allow Moscow to block the penetration of Western countries into the Caspian basin. Cynthia M. Croissant and Michael P. Croissant were correct when they suggested that the Foreign Ministry's insistence for joint sovereignty over the sea was closely linked to its desire to prevent the emergence of a Western economic and political foothold in Russia's "backyard" (Croissant and Croissant 1999).

Thus, the ministry consistently opposed any unilateral actions in the Caspian Sea. For example, shortly before the signing of the "contract of the century" in Azerbaijan, Russia's Foreign Ministry sent diplomatic notes to Caspian states such as Azerbaijan, Kazakhstan, and Turkmenistan. These notes said that these three states should not invite Foreign oil firms to develop the mineral resources in the Caspian Sea. In addition, after Azerbaijan signed the "contract of the century" in September 1994 Russia's Foreign Ministry consistently questioned the legitimacy of that deal. For
example, the ministry demanded that the UN Genera Assembly should include in the agenda of its winter session the issue of the Caspian legal rime. In its diplomatic memorandum entitled “Position of the Russia Federation on the Caspian Legal Regime,” the Foreign Ministry argued that Russia “reserves the right to take necessary measures at a time it considers best to restore the broken order and eliminate the consequences of unilateral actions.” Then the ministry warned that “all the responsibility in these cases, including possible material damage, will rest on those taking unilateral actions and showing their contempt for the nature of Caspian Sea and obligation on international treaties.

Shortly thereafter, Kozyrev also cast doubt on the legitimacy of the Azerbaijani oil deal. He noted that since on one repealed the Soviet-Iranian agreements of 1921 and 1940 which regulated all issues concerning the Caspian sea, these agreements still would apply to all the states which were the legal successors of the Soviet Union. Thus, he questioned the legitimacy of the Azerbaijani oil deal. He then stressed that all decisions on the Caspian Sea should be joint. Moreover, in late 1995 the Foreign Ministry also sent a diplomatic note to the Kazakhstan Foreign Ministry. The note expressed Moscow’s objection to the draft convention worked out in Almaty on the legal status of the Caspian Sea. The note said that “The Russian side cannot in any way agree with draft convention, which presupposes the division of the Caspian sea as the legal international means of the settlement of this [legal status of the Caspian Sea] problem” (Itar-Tass 23-8- 1995).

The Russian Foreign Ministry’s policy also included its efforts to form an alliance with other Caspian littoral states such as Iran and Turkmenistan to prevent any unilateral actions in the sea. For instance, shortly after the signing of the Azerbaijani “contract of the century” Russian-Iranian consultation began in Moscow at the Deputy Foreign Minister level. According to a senior Russian diplomat, the consultation focused on the utilization of mineral resources in the Caspian Sea especially given the signing of the “contract of the century” in Azerbaijan. He then added that the resolution of the Caspian legal status was possible only through consensus by five Caspian littoral states.

The Russian Foreign Ministry’s efforts led to the adoption of a joint declaration between Moscow and Tehran in October 1995, which indicated a common
stance of Moscow and Tehran with regard to the extraction of natural resources of the Caspian Sea. According to the declaration signed by Russia Deputy Premier Aleksei Bolshakov and Iranian Foreign Minister Ali Akbar Velayati, the two countries took the position that no unilateral actions of the Caspian littoral states should be permitted, until the rules of the exploitation of natural resources were established on the basis of an agreement between all Caspian states. The declaration then stressed that all the right to the Caspian Sea and its resources belonged to the Caspian littoral states only. Accordingly, those states were the only ones which could jointly establish the rules of the activities in the Caspian Sea, and thus no other country should interfere in deciding the forms and methods of exploiting the sea’s natural resources. Commenting on the joint declaration, Russia’s Deputy Foreign Ministry Chernyshev noted that “Our approaches to a new legal status of the Caspian Sea are very close or identical” (Hrair and Simonion 2001:132).

Furthermore, Russia’s Foreign Ministry signed an agreement with Iran and Turkmenistan to establish a joint company to develop energy resources in the Caspian Sea in November 1996. Russia has an excellent change to demonstrate the effectiveness of its model of cooperation in the Caspian, and at the same time, to notably amend its positions in the Caspian region, from where Western companies have been trying to unceremoniously oust it (Rossiiskaia Gazeta 28-8- 1997).

The Oil Industry Faction

It is necessary to understand the relationship between the Ministry of Fuel and Energy and the Russian oil companies including Lukoil. One primary task of the ministry is to promote the country’s fuel and energy complex. Among various branches of the complex such as coal, electric power, gas and oil, and ministry maintains the closest relations with the oil industry. According to Russian energy expert Yakov Pappe, the oil industry is the center of the ministry’s attention. The Ministry of Fuel and Energy certainly does not manage oil firms. However, it coordinates their activities and development strategy and directs the implementation of large-scale projects (Becker 1998:184).
Moreover, the ministry and the Russian oil firms often see eye to eye in defining their interests; to a degree hard to imagine in the West, the former and the latter tend to see their interests as almost identical and say so publicly. For example, the Minister of Fuel and Energy Shafranik stated that "The interests of our [oil] companies outside of Russia [the CIS states] are Russia's sacred interests." He added that "If a Russian company pursues an active, strict policy of movement into the near aboard, the support of both the ministry and the government is guaranteed" (Becker 1998:67). Likewise, at the first general meeting of Lukoil's shareholders in 1995 Sharranik announced unconditional government support for the company. This relationship between the Ministry of Fuel and Energy and Lukoil is reinforced further by the fact that Shafranik is one key shareholder of Lukoil. The oil elites also regard Shafranik as their lawful representative in the highest realm of the Russian leadership. In Pappe's words, he is considered "not as a 'boss' or bureaucrat who has been appointed by some higher authorities, but as 'the first among equals' who is trusted and given the right to express and represent the common interests [of the oil industry]" (Pappe 1995:197).

The most significant domestic political and institutional setting for this oil industry faction was the 'great depression' in its sector. This great depression did not emerge overnight. Soviet mismanagement of the oil industry bore much responsibility for the depression. The centrally planned economy was certainly capable of accomplishing production targets. Yet his came at the expense of colossal waste and inefficiency. This mismanagement began to take its toll in the late 1980s. Society soil production reached its peak in 1987 at 12.48 million bpd. Then oil output began to decline. As a result, at the end of 1993, the former Soviet Union's domestic oil production fell to less than 8.1 million bpd. The Russian production took much of this decline: its output decreased from 11.7 million bpd in 1988 to less than 7.1 million bpd in 1993 (Ebel 1994:215).

This great depression posed a serious problem for the oil industry faction. Robert Ebel well described the severity of the problem by saying that "No other produce in the history of the world oil industry has undergone such a transformation under circumstances dictated not by war or by the workings of the marketplace but, rather by the mismanagement of a superior natural resource base" (Ebel 2000:153).
The decline in Russian oil production showed no sign of improvement in the mid-1990s, even through the speed of decline slowed down. Oil production fell each year: it fell 12 percent in 1994, 3 percent in 1995, and 2 percent in 1996. Annual oil output decreased from 390 million tons in 1992 to 293 million tons in 1996, which was 45 percent down from its 1987 peak. (Rutland 1997) This decline was not so surprising given the fact that existing wells were closed down three times faster than new wells were being started; only 10 percent of the entire oil output was produced by the most advanced technology.

In these situations, one top priority of the oil industry faction, namely, maximization of oil production became urgent. To realize this priority capital investment became essential. According to Peter Rutland, the oil industry needed money not only to open new oilfields and restore defunct wells, but also to fix its refineries, most of which are more than 20 years old (Rutland 1997). Ebel estimated in 1994 that Russia’s crude oil industry would need an initial investment of $25 billion and annual infusion of $6 to $7 billion in order to region its lost production level by 2000 (Ebel 1994: 137).

Nevertheless, it was difficult to find sources of capital investment inside Russia. All Russian oil companies faced financial problems primarily because of such factors as the crisis in the oil market within Russia, the substantial amount of non-payment, and the tax pressure from the government (Rutland 1997). For instance, as the economy of Russia and other CIS countries dramatically declined after the collapse of the Soviet Union, customers in these states could not make payments. This problem of non-payment became increasingly severe. Total debts owned to energy companies increased from 39 trillion to 86 trillion rubles in the course of 1995 and to 320 trillion ($58 billion) by the end of 1996—a sum equal to two thirds of their annual sales (Rutland 1997). Sergei Muraavelenko, the General Director of Yuganskneftegaz, excellently described in 1994 this problem of non-payment for the oil industry: “In 1993 processing plants began to delay payments deliberately. The government was not even going to seek justice for them. Moreover, in November it retroactively exempted plants from custom duties. ... This is, the money went towards the needs of federal authorities and plants which had gone into bankruptcy.... As you see.... the more produce we supply, the, less money we get. As if some devilish force is breaking the neck of the goose that laid the golden eggs” (Cutler 2003:98). Similarly,
Shafranik deplored the situation by saying that “We have been going toward the market, but have arrived at communism” (ibid:).

Hence, all Russian oil companies suffered from a lack of cash flow. Lukoil, Russia’s most highly valued company was no exception. Izvestiia reported that Lukoil’s loss alone exceeded 450 billion rubles in 1993. Lukoil’s President Alekperov succinctly described the company’s financial problem by saying the Lukoil had reserves equalizing those of Shell, the biggest Western oil company, but lacked the financial resources to carry out plans to expand outside Russia including the Caspian. This was true despite the fact that participation in the Caspian oil projects was highly desirable for two main reasons. In the first place, exporting Caspian oil to Western states did not have to deal with the problem of non-payment (Federov 1997). In addition, oil production in the most crucial area within Russia, namely, West Siberia, had peaked in 1988. As a result, the Caspian basin within the former Soviet space became very attractive for the Russian oil companies.

Lukoil’s financial problem was further aggravated by the fact that the company was not able to raise sufficient capital on Russia’s poorly developed markets. Therefore, according to Alekperov, Lukoil planned to attract foreign investment by raising more than $100 million through an international convertible bond issue. Despite this plan, however, Alekperov noted that Lukoil would need Western oil companies to help fiancé its projects in the Caspian Sea. Indeed, Lukoil sought to overcome this financial problem. For instance, in July 1994 Lukoil announced that it would raise over $3 billion worth of investment by selling 15 percent of the company’s shares to foreign firms In September 1996, Lukoil and American oil company Atlantic Richfield Company (ARCO) formed a joint venture with a program of investing $3 billion over 10 years in various oil projects, including Caspian.

Lukoil also lacked technological resources to independently carry out oil development in the Caspian Sea. This was true primarily because the Soviet oil industry had no capacity or experience in developing offshore oilfield deeper than about 300 meters. As a result, all development in the Caspian Basin during the Soviet era took place either onshore or in the shallow water offshore from Baku (Gustafson 1995). It was in this setting that the oil industry faction interpreted the issues of the Caspian legal status.
In general, the oil industry faction’s sensitivity to relative gains was much less than that of the Foreign Ministry. Thomas Waelde defined two varying views by these two agencies traditional (the Foreign Ministry) versus commercial (the oil industry faction). According to Waelde, the traditional paradigm, on the one hand, called for “the polices pursued by other ex-imperial powers after decolonization, such as France and Britain, where the demise of empire was overshadowed and suppressed by illusions that power can be kept over the newly independent state” The commercial paradigm, on the other hand, advocated that Russia should attempt to “draw maximum economic benefits for its own prosperity out of the relations with the Caspian states” (Waelde 2000:242).

Though, that the oils industry faction did not solely focus on its absolute gains. This faction often expressed its sensitivity to relative gains. For instance, in December 1993 Kazakhstan and an international oil consortium signed an agreement on exploring oil in the Caspian Sea. At the time, the leadership of the Ministry of Fuel and Energy expressed concern that Kazakhstan planned to exploit mineral resources in the Caspian shelf without prior arrangement. In particular, it worried that Russia would be excluded from economically profitable oil projects.

In addition, as the Azerbaijani “contract of the century” proceeded, the Ministry of Fuel and Energy advocated its belief that if Russia waited for a diplomatic solution to the problem of the Caspian legal status, it would risk being squeezed out of the Caspian region by Western competitors. For example, at parliament hearings on legal, economic, and environmental problems of the Caspian Sea a representative from the ministry maintained that “while we sit and wait, they [Western oil companies] will pump out oil.” Thus, according to him, Russia must do the same because the oil development process, once started, cannot be stopped (Page 1994:797).

After signing an agreement on the main principles for development of the Kyapaz oilfield in the Azerbaijani sector of the sea, Boris Nemstov, Russia’s Minister of Fuel and Energy, said in 1997 that “Oil is gold, it is the wellbeing of the Azerbaijani people and Russian budget and provides taxes for the budget. Since Azerbaijan has established favorable conditions for foreign investment and many Western companies are working in the Caspian, Russia should not get left behind
Introducing the newly-appointed Minister of Fuel and Energy Sergei Kiriyenko to the ministry’s staff, the departing Minister, Nemstov, suggested that one of the priorities for the ministry was the development of oil deposits in the Caspian Sea. He then stressed that “We shouldn’t lose ground in this region. “We have won the first game, early Caspian oil is now being transported by the Russian pipeline. However, this is only the beginning. We are in for new economic battles” (Croissant 2000).

The Foreign Ministry was that Russia should not merely engage in “standing by and protesting.” Instead, it should actively get involved in the oil projects before other Western companies divide everything up without. Hussein Aliyev, Deputy Director of Lukoil-Baku Company, the daughter company of Russian Lukoil, expressed Concern that the development of oilfields in the Azerbaijani sector of the Caspian Sea by Western companies would lead to the establishment of monopoly of Western companies in Azerbaijan. Thus, he asserted that Azerbaijan must expand cooperation with Russia.

Similarly, Alekperov know that Lukoil’ s participation in the Azerbaijani “contract of the century” must be considered a success not only for the company but also for Russia as a whole because this issue entailed the question of isolation of Lukoil from the market of the former Soviet Union by Western firms. He also pointed out that “Russian oilmen are ‘bewildered’ by the fact that Azerbaijan, Kazakhstan, and Turkmenistan [together with Western oil companies] have already started developing the shelf without consultations with Moscow, unless decisive actions are taken Russia ‘risks losing its positions on the Caspian Sea.

Despite this, the oil industry faction believed that they could gain maximum economic benefit by actively participating in oil projects in the Caspian Sea. This clearly indicated that the faction’s sensitivity to relative gains was much less than that of the Foreign Ministry. Douglas W. Blum was certainly right when he noted that when faced with geopolitical questions in the Caspian Sea, the oil industry faction preferred solutions that “maximize Russian productivity and state power in absolute - but not necessarily relative - terms” (Blum 1998:156). Shua Bolukbasi also pointed out that the oil industry faction tended to see Russia’s interest not in excluding the West from oil contracts that Caspian states such as Azerbaijan and Kazakhstan
signed, but in accomplishing the involvement of the Russian oil companies in those oil contracts (Bolukbasi 1998). Likewise Certainly, one can detect that the oil industry faction's sensitivity to relative gains was not so high. For example, commenting on the planned participation of Lukoil in the Azerbaijani oil deal, Aleksandr Degtiarev, representative of the Ministry of Fuel and Energy, stated that “We regard this as our companies’ normal emergence on the markets of the states of the so-called near abroad, where we had unwisely relinquished lately some of our positions” (Ebel 1998:200).

As such, the Ministry of Fuel and Energy refused to accept the negative reaction from the Foreign Ministry concerning the Azerbaijani oil deal of 1994. A high-ranking official from the Ministry of Fuel and Energy cited the opinion of its specialists: “the 10- percent share in the project handed to Lukoil is not a bad result” (Guseinov 2000). Hence, 10 percent profits that would go to Lukoil if the contract was implemented was “a weighty argument” of the oil industry faction against the Foreign Ministry’s idea of joint sovereignty. Moreover, at the ceremony of the Azerbaijani oil deal Stanislav Pugach, Head of the Department of International Cooperation in Russia’s Ministry of Fuel and Energy, noted that Lukoil was ready to begin its activity. He then thanked Aliyev for his support and he wished the best for Azerbaijan by saying that the implementation of the contract would be profitable for the Azerbaijani people.

This positive-sum interpretation was evidenced when State Oil Company of Azerbaijan (SOCAR) and an international oil consortium including Lukoil agreed to develop the Karabakh oilfield in the Azerbaijani sector of the sea in November 1995. Congratulating Baku on the signing of the Karabakh contract, Shafranik mentioned the willingness of cooperation between Azerbaijan oil ministry and Russia since the beginning.

One can also sense Shafranik’s positive-sum interpretation in the area of pipeline routes. He described the decision of the AIOC in late 1995 to deliver early Caspian oil along two pipelines, Russian and Georgian, a victory for Russia. Shafranik noted that Russia should be “satisfied” with the AIOC decision. In addition, he suggested that more oil would be transported through Russian territory because Azerbaijan planned to develop other offshore oilfields with foreign investors.
Shafranik then added that “...we have a ready option for transportation, great influence, and wide-ranging contacts in this [Caspian] region so we do not need to worry [about losing influence in the Caspian region]” (Blum1998). Kiriyenko, who became the Minister of Fuel and Energy in 1997, also held a positive-sum interpretation of the Caspian issues. Commenting on the Kyapaz/Serdar dispute between Azerbaijan and Turkmenistan, he said that Russia, Azerbaijan, and Turkmenistan should reach a political mutual understanding, so political issues do not interfere with mutually advantageous cooperation in developing Caspian oilfields.

By the same token, Lukoil representatives’ statements indicated a positive-sum interpretation of the Caspian issues. For instance, at a conference on the legal status of the Caspian Sea in October 1995, Lukoil’s Vice President Vitalii Lesnichii pointed out that the development of hydrocarbon resources in the Caspian Sea was likely to “bring a tangible economic profit to those who will be developing these deposits in the future” (Klepatsky and Pospelov 1995). Speaking of oil projects in the CIS countries, Lukoil’s President Alekperov stated that “It is essential to include [Western] partners who can contribute their own traditions and practices. Some of them have good technical skills, some geological, others financial”. Alekperov’s view on this bore much responsibility for Lukoil’s close cooperation with Western oil companies such as Amoco, BP, and Chevron in the CIS countries such as Russia, Azerbaijan, and Kazakhstan (Ibid.).

Obviously, the oil industry faction’s view on oil development in the Caspian Sea was different from that of the Foreign Ministry. Pappe summarized this by noting that The oil producers do not look favorably upon Russia’s attempts to exercise pressure at all costs on its southern neighbors; the Islamic states... are regarded.. as ‘an area of special Russian interests.’ Such an attitude is not shared by the oil producers because they do not believe it is an objective approach to the realities of today. They want to have a chance for expansion right away, while there is still room for it. Therefore, the oil producers of Russia today advocate a highly respectful attitude towards the ambitions of neighboring countries, expecting at the same time to be able to use to the maximum extent possible the technological, human and other links and contacts that have been preserved since Soviet times. It is precisely here that differences of opinions between the Foreign Ministry and Lukoil lie (Pappe 1997:276).
In keeping with its interpretation the oil industry faction sought cooperation with such countries as Azerbaijan and Kazakhstan. One of the best pieces of evidence was that this faction treated the outcome of the debate over the legal status of the Caspian Sea as if it was a settled matter. For instance, prior to his official meeting with Aliyev in mid-1995, shafranik said that he had a positive attitude toward the “contract of the century” and any discussions about the Caspian legal status were “unjustified”. Likewise, Alekperov mentioned that the problem of the Caspian legal status was “artificially inflated”.

Lukoil sought to participate in as many Azerbaijani oil projects as possible. In June 1995, Lukoil, together with Italy’s Agip and U.S. Pennzoil, signed an agreement with SOCAR to develop the Karabakh offshore oilfields. Lukoil obtained a 33 percent stake in the Karabakh consortium (Khripunov and Matthews, 1996). In June 1996 Lukoil signed a $4 billion agreement with SOCAR on developing the Shah-Deniz deposit. It obtained a 10 percent stake. In July 1997, LUKoil also signed an agreement with SOCAR to develop the Yalama/D-222 and Kyapaz/Serdar oilfields in the Azerbaijani sector of the Caspian Sea.

Moreover, Lukoil sought to expand its operation to Kazakhstan. In August 1995 Lukoil signed an oil agreement with the Kazakhstani authorities on developing Kumkol' oilfield. The company acquired a 50 percent stake (Pappe, 1997). After the signing of the agreement, Alekperov mentioned that the company intended to participate in the exploration of oilfields in the Kazakhstani sector of the sea, which was believed to be richer than the Azerbaijani sector. Less than a year later, Alekperov was more specific. After his talks with Kazakhstan’s President Nursultan Nazarbaev, Alekperov noted that Lukoil was interested in obtaining a 20 percent stake in KCS which would develop the Kasha an oilfield.

**Conclusion**

In some the years followed the disintegration of Soviet Union witnessed total chaos in every aspect of governance, the energy sector was not an exception. The foreign ministry, energy ministry and the newly created oil oligarchs or oil industry faction, all pushed the policies in different direction. It is not a surprise that the littoral states of Caspian region has been attracted to lucrative western investments. During this period the oligarchs through their influence in different ministerial offices made advantages to their business at the cost of Russia’s national interest.