Setting the Agenda in the Caspian Basin: The Political Economy of Russia's Energy Leverage

Adam N. Stulberg
Setting the Agenda in the Caspian Basin: The Political Economy of Russia’s Energy Leverage
Adam N. Stulberg is Assistant Professor at the Sam Nunn School of International Affairs, Georgia Institute of Technology. His research and publications focus on Russian and Eurasian foreign and security policies, energy security in Central Asia and the Caucasus, Russian grand strategy, and weapons of proliferation challenges in the former Soviet Union. Dr. Stulberg earned his Ph.D. in political science from the University of California, Los Angeles. He also holds a Masters of International Affairs from Columbia University’s School of International and Public Affairs, and a B.A. in history from the University of Michigan. Dr. Stulberg has worked at RAND and the Center for Nonproliferation Studies, and is an International Policy Scholar at the EastWest Institute.
Introduction

With the collapse of the Soviet Union, Russia emerged as the dominant successor state in Eurasia. Yet much to the surprise of great power enthusiasts, Moscow has both succeeded remarkably and failed miserably at exploiting its preponderance to set the terms for ownership, development, and export of the prized energy reserves in the Caspian Basin. One the one hand, it has effectively manipulated favorable power asymmetries and monopoly over the existing pipeline infrastructure to strand competitive gas exports from Turkmenistan. On the other hand, Russia has been able only to retard the pace of Kazakhstan’s independent gas exploration and has reluctantly conceded to Astana’s preferred legal remedy for dividing the Caspian seabed. Moscow has had even less success with Azerbaijan, incapable of deterring Baku’s campaign to diversify main oil export routes at Russia’s expense. The Kremlin has seemingly lost control over Russian oil firms in the process, unable to prevent them from participating in Azerbaijani-sponsored consortia that are dominated by foreign competitors. How do states use their preponderance as an instrument of coercive power, and how does this explain Russia’s mixed success in the Caspian Basin?1

That Russia’s regional shadow comes in different shades is intriguing. The pattern of variation contradicts the finding from the literature on statecraft that leverage derives directly from a state’s ability to inflict pain on a target.2 This suggests that we need to identify conditions favorable for exploiting relative advantage for desired political effect. Understanding the nuances of Russia’s Caspian leverage has practical significance as well, as the region is expected to rank second worldwide in unproven oil reserves and to hold roughly 7 percent of the world’s proven natural gas reserves. Notwithstanding drilling and transport hurdles and geological uncertainties, these resources are potentially critical for diversifying the global energy supply and fueling political and economic development in Eurasia for years to come.3 An overestimation of President Vladimir Putin’s ability to impose Russia as the energy hub for the region could foster misperceptions of resurgent Russian imperialism and unleash reflexive geostrategic competition over Caspian resources with deleterious consequences for regional stability and the efficiency of global energy markets.4 Conversely, failure to appreciate the scope of Russia’s influence in the Caspian Basin risks blinding outside states to mutually beneficial opportunities for engaging Moscow in this strategic region.

This essay explicates the puzzle of Russia’s variable leverage in the Caspian Basin and attempts to broaden assessment of statecraft to include not only the ability to penalize defection, but to lower the costs of compliance. Unlike most studies, this analysis does not focus on relative or issue-specific power imbalances
between contending states, or simply on the costs of punishing noncompliance at home or abroad. Although these factors are important, they are not sufficient for explaining the variable effectiveness of statecraft practiced under different global market and domestic institutional conditions. Thus, I begin by exploring the broader international and domestic circumstances that structure the choices and costs of statecraft.

From this perspective, I argue that states should be more successful at exercising leverage when they enjoy “agenda control,” that is, the capacity to preempt defection by raising the appeal of compliance. Agenda control is an important dimension to statecraft because it allows states to manipulate indirectly incentives for compliance without having to reverse a foreign target’s behavior or rely on costly instruments to control the overseas operations of domestic firms. There are two key variables to exercising successful agenda control, namely, market power and the clarity of the state’s policymaking authority. Together these two factors specify the extent to which a leadership can recast the appeal of different policies for targets at home and abroad. Where a state can set substantive and procedural agendas to modify the appeal of alternative policy options, it is well poised to discourage defection and guide targets toward favored outcomes on a particular issue. Accordingly, I infer that the success of Russia’s Caspian energy statecraft should vary directly with Moscow’s agenda-setting capacities to reduce the opportunity costs of compliance for regional targets and domestic firms in the oil and gas sectors.

This proposition is tested against the pattern of Russia’s leverage over the Caspian energy policies of Turkmenistan, Azerbaijan, and Kazakhstan for several reasons. Given Russia’s multifaceted regional preponderance, its efforts to coerce or induce favorable energy policies from these small states should constitute “easy cases” for realist and dependency explanations of influence. Yet, it is difficult to reconcile Moscow’s variable leverage with explanations of relative power and asymmetric interdependence, especially in the energy sector where Russia possesses both the incentive and muscle to impose imperial control. Similarly, the combination of strong, autonomous leaderships among the post-Soviet states of the South Caucasus and Central Asia (SCCA) and a conspicuously “weak” Russian government offer “easy cases” for traditional domestic institutional explanations of regional leverage. However, the uniform political insulation of target SCCA regimes cannot explain why some regularly concede to Russia while others do not. “State strength” arguments also are hard pressed to explain how a highly penetrated and divided Russian government has
successfully secured the compliance of the concentrated national gas lobby on critical issues of Caspian statecraft but has been unable to obtain the same deference from the more diffused domestic oil industry.\footnote{6}

This essay is divided into four parts. The first section summarizes the logic of four traditional approaches to leverage and their implications for Russia’s influence in the Caspian Basin. I then propose an alternative framework that introduces salient international and domestic conditions linking agenda control to leverage. The third section probes the plausibility of these rival explanations in cases of the Russian government’s successes and failures at securing the accommodation of Azerbaijan, Kazakhstan, and Turkmenistan on Caspian energy ownership, development, and export policies. My primary intention is not to present definitive case studies, as much as to draw inferences about Russia’s regional posture and to recast the debate over leverage. The essay concludes with implications for theories of statecraft and for managing the geostrategic competition that is heating up in the Caspian Basin.

**Competing Perspectives on the Source of Leverage**

The concept of leverage in international relations is both fundamental and elusive. Because interests often conflict, one state’s ability to prevail over another lies at the crux of statecraft. Yet, leverage often is misunderstood as an instrument of policy or mistakenly inferred from the behavior of other states irrespective of prior preferences or available choices.\footnote{7} Leverage is indeed a relative concept, but it refers to a state’s ability to secure policy compliance from targets at home and abroad that would otherwise behave differently. This raises two key issues demanding further explanation. The first is to explain the costs of compliance for targets with divergent preferences and alternative policy options.\footnote{8} The second is to explain the variable effectiveness of leverage: Why in some cases can a state secure preferred policy responses from targets, while in others it can only prevent least-preferred options or is impotent to affect the policies of other targets altogether? Scholars typically attribute answers to four factors: relative power advantages, asymmetric interdependence, structural power, and domestic institutional fortitude.

**Relative Power and Issue-Specific Dominance**

There are three general explanations that attribute successful statecraft to relative power advantages. The most basic is realism that ascribes leverage to material power differentials and to concerns about inferiority.\footnote{9} Power is assumed to be generic and fungible, vesting a hegemon with both the incentive and strength to punish noncompliance and extract uniform political concessions across issue
areas. Other scholars contend that relative power is not transferable to different policy contingencies; leverage is issue-specific, depending on “who is trying to get whom to do what.” A neomercantilist variant posits that this is especially relevant to the energy sector, where the sunk costs and appropriability of asset-specific investments should incline a hegemon to exercise imperial control.

Different realist arguments expect that Moscow’s leverage throughout Eurasia should be uniform and impressive. This is because the scope of Moscow’s regional dominance has widened across all indices of material power since the Soviet collapse, notwithstanding the protracted economic, political, demographic, and military problems that have afflicted Russia’s transition. This gap is especially conspicuous in the oil and gas sectors, as Russia’s annual production in each industry has exceeded respective demands across the entire post-Soviet space and consistently dwarfed the output of all rival SCCA suppliers.

**Asymmetric Interdependence**

Another perspective attributes leverage to a target’s “sensitivity” to the effects of disengagement, measured in terms of the volume and distribution of specific resources exchanged. If, for example, change in a bilateral trading relationship threatens to disrupt a greater percentage of one state’s overall trade, that asymmetry is predicted to be a source of leverage for the other state. Accordingly, it is expected that Russia’s leverage should be significant but varied across the SCCA. As part of the legacy of centralization and specialization in the Soviet planned economy, Russia remains the principal trade partner for the region, as a percentage of total trade. Kazakhstan’s trade, in particular, has been dominated by bilateral exchange with Russia since the Soviet collapse, despite concerted attempts at diversifying economic ties with the outside world. This holds especially for the energy sector, because Astana has become increasingly sensitive to imports of Russian oil and gas as a percentage of its total domestic consumption, while Moscow has steadily reduced its already paltry levels of hydrocarbon imports from Kazakhstan. Consequently, interdependence theories expect that Russia should be able to exploit favorable aggregate and energy-specific trade balances to intensify political leverage across the Caspian region, and over Kazakhstan’s oil and gas policies in particular.

Trade sensitivity arguments also expect that Russia should wield more restricted energy leverage over Azerbaijan and Turkmenistan. Both states trade less with Russia as a share of respective total trade than do other SCCA partners, most notably Kazakhstan. Yet, Russia has remained an integral trade partner for both states, especially in the oil and gas sectors. Therefore, asymmetric interdependence models predict that Azerbaijan and Turkmenistan should be
less sensitive than Kazakhstan to fluctuations in trade with Moscow, but that Russia should be able to block their competing Caspian energy initiatives nonetheless.

**Structural Power**

The common claim among structural power theorists is that leverage obtains when a preponderant state controls not only what other states do, but what they want. One version ascribes this to the reverberation of a hegemon’s policies within the domestic affairs of regional targets. By its sheer weight in “deterritorialized” markets and political networks, a preponderant state can skew material incentives and trigger policy adjustments from foreign targets merely by taking unilateral action at home. Structural leverage, in the context of energy relations, accrues from the dependence of foreign targets on the availability and use of a leader state’s domestic energy infrastructure. Another normative variant attributes leverage to the allure of beliefs, practices, and identities that are constructed through political, cultural, and social interactions, independent of balances of power or trade. Leverage is exercised in the spirit of emulation and consent, with the hegemon setting normative standards for domestic and regional targets alike.

Moscow’s leverage in Eurasia often is credited to structural dominance of SCCA energy sectors. The residual Soviet pipeline network constitutes a “steel umbilical cord” that binds SCCA energy suppliers and customers to Russia. Most of Kazakhstan’s oil and Turkmenistan’s gas exports tap directly into the Russian pipeline system, placing both states at the mercy of shifts in Moscow’s practices for regulating access to national export terminals and pipelines. This presence is predicted to grow with the participation of Russian oil and gas firms in international energy consortia. Accordingly, decisions taken by Russia to reduce national subsidies, adjust domestic prices, reallocate pipeline access, and reorient national energy production toward international markets are expected to inflict energy shocks across the SCCA. Because the different SCCA leaderships have tied national security and welfare, as well as near-term political legitimacy, to projected payoffs of extracting and exporting Caspian energy, they should be increasingly responsive to shifts in Russia’s domestic energy policies.

**Institutional Strength**

A fourth cut at explaining leverage emerges from relaxing assumptions that states have uniform preferences or governing capacities. This leads to considerations of the independent impact that domestic political institutions have on the practice of statecraft. Because institutions determine how specific domestic
preferences are defined and translated into international commitments, they are expected to determine the effectiveness of statecraft. One hypothesis attributes international leverage to a regime’s institutional “strength” relative to domestic legislatures and interest groups. Policymakers who stand above the parochial interests and competition among societal forces — to extract, mobilize, and employ national resources toward a specific foreign objective — can wield significant foreign leverage. Because authoritarian regimes enjoy autonomy to impose domestically unpopular policies, the leadership should be more effective at channeling national capabilities directly in support of foreign objectives. Alternatively, democratic structures provide multiple access points for concentrated interest groups that make them distinctly prone to generating inconsistent foreign policies. “Democratic statecraft” is tempered by the related difficulties of restricting legislative dissent and building supportive coalitions among competing interest groups that ultimately render the efficacy of leverage contingent upon which group prevails on a specific policy issue. As a quasi-democratic state, Russia’s specific influence over the ownership, extraction, and transportation of Caspian energy is predicted to mirror the ascendancy of alternative domestic coalitions comprised of concentrated energy interest groups, financial oligarchs, and independent-minded regional leaders, on the one hand; and environmental protection lobbies, advocates of realpolitik, and “Great Russian” nationalists, on the other. Periods of intense competition between these domestic lobbies, however, should match inconsistencies in Moscow’s leverage.

An alternate institutional argument stresses the importance of regime “capacity,” summed up by a central leadership’s authority to monitor domestic compliance and punish noncompliance (i.e., shirking). The degree to which political authority is centralized and policymakers can observe the actions of functionaries and firms determines a regime’s competence at securing extraterritorial compliance. Those regimes that can detect and reverse the opportunism of self-interested administrators and interest groups to promulgate and implement coherent foreign policies are taken more seriously by target states. Conversely, confusion in domestic decisionmaking frustrates the pursuit of “national” objectives by raising the costs of monitoring and enforcing desired policy implementation. Gaps in administrative oversight encourage bureaucracies and firms to exploit advantages in information and expertise by pursuing policies that satisfy their own narrow interests, thus crippling the coherence and credibility of a hegemon’s statecraft. Suffering from rampant opportunism on the part of competing federal branches, agencies, and local authorities, the Russian
government is expected to exert only marginal and *ad hoc* leverage in the Caspian Basin, marred by contradictory policies toward the ownership, extraction, and export of the region’s energy.\(^{27}\)

**Agenda Control and Leverage**

The focus on agenda control predicts a different dynamic for leverage premised on three basic assumptions. First, a central executive is both a political representative and the principal decisionmaker in the policymaking process and, therefore, is responsible for advancing national interests in the most efficient manner possible.\(^{28}\) To influence the behavior of another state, a central executive must convince foreign targets to sacrifice preferred policies, as well as secure the dutiful implementation of statecraft by functionaries and interest groups at home. Accordingly, successful leverage turns on what foreign targets will accept and what potential domestic challengers and agents will uphold.\(^ {29}\) Second, there are indirect costs of compliance borne by foreign and domestic targets. By complying, targets not only avoid the pain imposed by noncompliance but incur the costs of forsaking desired policies. Third, a central executive can influence the choice of behavior for targets either by reducing the costs of compliance (i.e., making concessions more rewarding than pursuing other options) or raising the costs of defection (penalizing insolence). The two strategies are substitutes, as reducing the advantages of alternatives to compliance are functionally equivalent to increasing the direct costs of noncompliance through punishment. Both strategies are intended to encourage a target to adopt a specific policy that it would otherwise resist. The former, however, entails dissuading defection by strengthening the relative appeal of an imposed outcome; the latter entails raising the direct costs of resisting it.

Given these assumptions, one can deduce a theory of *agenda control* that specifies conditions under which preponderance can be used effectively to exert leverage. All else equal, statecraft will be more successful when a central executive can credibly and vividly reduce the economic and political costs that target states and domestic actors bear in foregoing possible alternatives to compliance. Successful leverage depends less on the raw power to impose or enforce compliance, than on the indirect ability to define issues to be addressed, initiate and order proposals for policy change, and reduce the relative appeal of policy options that otherwise are available to foreign and domestic targets. Possessing agenda control empowers a central executive to guide a target toward a desired outcome by manipulating the opportunity costs of compliance without having to reverse the behavior of targets at home or abroad.\(^ {30}\) For example, a state that can preempt a showdown and woo a target by making alternative
responses less appealing, does not have to engage in costly confrontations or compel a target to reverse its behavior. Two conditions, one international and one domestic, are critical for determining a state's agenda control.

At the international level, the ability to manipulate the costs of compliance depends on the “vulnerability” of a target to the decisions made by a state that alter the relative appeal of different policy options. It is not just “sensitivity” to the disruption of an existing relationship, but the compensatory costs that define one state’s dependence on another. In order to explain why a foreign target adopts a certain policy consistent with the constraints imposed by another state, we must know what difference it makes for that target to cooperate or defect, that is, the opportunity costs of compliance. For example, the more costly it is for a target state to secure access to new energy markets, the more vulnerable it is to disruptions in the existing supply. Lacking alternate suppliers or markets, target states have no choice but to acquiesce to foreign pressure. This is because the economic future of the target state is dependent on the decisions and conditions in the other state. Conversely, the more policy options that are readily available, the less vulnerable a target is to outside pressure. Defiance in this context is both viable and beneficial, notwithstanding the level of exchange with a specific state. Thus, a necessary condition for exerting effective leverage is the “structural vulnerability” of foreign targets to the unilateral policy choices taken by the preponderant power.

In the energy sector, structural vulnerability can be measured in terms of market power. This is a function of the percentages of global imports and exports accounted for by a state’s markets and suppliers for a specific resource. The greater the percentage, the greater the concentration of exchange, the lower the probability that alternate trade partners will be available, the higher the costs of adjustment, and the greater the capacity of a state to orchestrate the material incentives confronting foreign targets in that sector. Conversely, the lower the percentage, the lower the concentration of exchange, the more likely opportunities exist to diversify relations, the lower the costs of changing the terms of an existing relationship, and the more difficult it will be for a state to manipulate a foreign target’s behavior. All things equal, the lower the opportunity costs of compliance for other states, the more likely a hegemon will be able to leverage its strategic goods advantages over a weaker state.

Structural vulnerability alone does not determine the effectiveness of leverage, however, as a national leadership faces domestic difficulties with exploiting comparative advantages for international effect. By subverting executive decisions or avoiding implementation of national policies, domestic veto groups (legislatures, government bureaucracies, and private firms) may
impose political costs on exercising foreign leverage or alter the adjustment costs confronted by targets. Left unabated, such domestic “intrusion” into the international bargaining process undermines the coherence and credibility of a central executive’s statecraft. Therefore, a central executive must search out mechanisms for restraining domestic challengers and strengthening administrative control if it is to succeed at exploiting preponderance.

It follows that there is a second, domestic dimension to practicing statecraft; a national leadership must bring divergent domestic interests into line by independently manipulating the costs of compliance. Given that domestic societal interest groups derive different benefits from strategic interaction, attempts at exercising foreign leverage are bound to affect them in different ways. In particular, government agencies or interest groups that enjoy comparative advantages, depend on foreign investments, and stand to profit from deeper engagement with target states should possess different strategic outlooks than do groups with little or adverse foreign exposure. Under the circumstances, a state’s ability to formulate and implement coherent policies depends on the institutional capacity to coopt both the potential domestic winners and losers of foreign policy change and to convert their stakes into support for different forms of statecraft.

One approach to bolstering administrative control derives from the procedural capacity to initiate policies that alter the opportunity costs of compliance for domestic groups that could otherwise subvert the formulation and implementation of a central executive’s statecraft. National agenda control reflects a statesman’s administrative capacity to preempt other domestic actors from deciding how and when to intervene in the policymaking process. This consists of procedural rights to “stack the deck” and improve the substantive appeal of preferred options for those domestic groups directly affected by the exercise of state leverage before the action is taken. Accordingly, agenda control contrasts with the reliance on costly oversight mechanisms for monitoring, sanctioning, and overcoming domestic opportunism by resting on the discretion to modify the relative appeal of policy alternatives so that compliance with national objectives becomes a rewarding strategy for potential domestic challengers. In the energy sector, for example, the state can indirectly induce national firms to line up behind its coercive energy statecraft by mandating lower energy prices at home that, in turn, create parochial incentives for national energy suppliers to be more aggressive in protecting lucrative foreign market share. In this case, the energy company would have strong incentive to comply with the state’s competitive foreign policy, irrespective of the threat of extraterritorial sanctions on deviant firm behavior.
The institutional structure of decisionmaking is critical for defining this domestic dimension to agenda control. Key features of domestic institutions are that — by defining the rules of the game and delegating responsibilities to negotiate, approve, and implement foreign policies — they assign who bears the rewards and costs of specific decisions and determine the costs of bargaining within a policymaking process. Economic theories of property rights and agency suggest that the most effective institutional arrangements in this regard are not those that stipulate overall state strength or capacity, but those that concentrate decisionmaking authority. A single actor with complete discretion over the "bundle of rights" within a policymaking or regulatory process can more easily derive the full benefits and costs of its decisions and limit the costs of delegation, than is otherwise possible within regimes that divide decisionmaking responsibilities among multiple actors. Where regulatory rights are concentrated there are fewer preferences that need to be brought into line, reducing significantly the need for costly oversight and enforcement mechanisms.

Yet, to preempt defection it is not necessary that decisional responsibilities be concentrated. At issue is not the ability to overturn a legislative veto or reverse the opportunism of domestic agents; rather what matters for agenda control is the ability to lower the opportunity costs of compliance. The premium here is placed on a central executive's capacities to anticipate the probability of a veto and to initiate policies that alter the substantive appeal of compliance in order to discourage, not prevent, defection. To do so depends, perhaps above all, on the clarity by which decisional authorities are delineated within a policymaking process.

From a central executive's perspective, the beauty of domestic institutions that clearly delineate decisionmaking authority lies in their subtlety. Possessing discrete responsibilities, domestic administrators and interest groups must bear the explicit costs and benefits of their behavior. As such, their policy preferences are more transparent, thus making it easier for policymakers to identify potential allies and adversaries, understand the implications of slight differences in the cost of alternative policy options, and target policies accordingly. This clarity of responsibility obviates the need to bludgeon societal interest groups into strict conformity via costly sanctioning mechanisms and opens up avenues for indirectly inducing domestic compliance. A central executive, for example, does not need to exercise direct control over the decisionmaking of domestic energy companies that might otherwise have strong preferences for dealing independently with foreign governments. Instead, a central executive can use exclusive discretion to modify the appeal of specific policy options so that companies and bureaucrats favor compliance with the state's diplomacy. By tapping exclusive authority to
alter energy supplies, prices, export duties, or pipeline access at home, a central executive can affect the appeal of engaging in energy markets and projects abroad for the same domestic firms. Vested with clear and exclusive discretion to initiate policies on a specific issue, a central executive can manipulate proposals to discourage domestic noncompliance in the first place. Therefore, the more transparent and exclusive is a central executive’s procedural authority to initiate policy change, the more discretion the leadership should have to manipulate substantive policy choices for domestic actors consistent with its statecraft.

Conversely, the more imprecise the allocation of policymaking authorities, the more difficult it should be to discern discrete policy responsibilities or observe the behavior of state administrators or private interest groups. The costs of bargaining and the potential for domestic deviation increase as multiple domestic actors are assigned partial and overlapping authority to formulate, amend, and implement national policies. Redundant responsibilities shield rival claimants from accountability for independent actions and insulate decisionmaking on separate issues within a regulatory stream. This raises risks of opportunism on the part of self-interested administrators and private actors. Overlapping authority obfuscates preferences and accountability among domestic actors, making it difficult to distinguish potential allies from adversaries on specific policy issues. Under such conditions, procedural advantages to initiate policy change in one area are offset by the difficulties of identifying potential challengers and curbing their incentives to act with impunity. This, in turn, encourages domestic shirking of national policies, thus raising the costs of organizing and channeling domestic behavior consistent with a state’s external ambitions. With respect to regulation in an energy sector, policymaking opacity complicates problems of oversight and divorces the consequences of decisions taken in one realm, such as domestic pricing, from other considerations involving access to foreign markets and supply.

Combining the international and domestic dimensions of a regional hegemon’s agenda control yields three hypotheses regarding the scope of Russia’s energy leverage. First, the more authority Russia enjoys as an agenda setter in a particular energy sector (both at home and abroad), the more likely it will be to influence the behavior of a foreign target. In the Caspian energy scenario, Moscow should be able to dictate successfully the terms of SCCA development and export in those energy sectors where Russia enjoys significant global market power and the government has clearly delineated preemptive discretion to coopt key potential domestic challengers. In the obverse, Russia should be deprived of hegemonic leverage in those sectors where it does not possess agenda control. Russia’s attempts at coercing or inducing regional developments should fall short precisely on those energy issues where its smaller neighbors are not vulnerable and where
the Kremlin lacks the authority to offset the opportunity costs of domestic compliance. On these issues, Moscow’s leverage can be easily subverted by the availability of alternate investors or low-cost options for transiting energy exports, and by the unrestricted competition among domestic agents vested with ambiguous authorities to pursue separate energy policies. Finally, where the Russian government enjoys only partial agenda control, marked by either global market power over the energy interests of a target state or the clear allocation of authority and accountability in energy regulatory mechanisms at home, regional leverage should be confined to obstructing the independent Caspian energy initiatives of target states.

**Russia’s Caspian Conundrum**

In this section, I test alternative theoretical claims by comparing Moscow’s successes and failures at bringing to heel the policies of Turkmenistan, Azerbaijan, and Kazakhstan regarding ownership, development, and export of Caspian oil and gas resources from 1991 to 2001. To avoid the logical trap of equating leverage with target behavior, I examine the fit between policy preferences and outcomes using empirical and counterfactual analysis. In each case, the main focus is on discerning the form and effectiveness of Russia’s statecraft. Evidence for rival explanations is considered, but more emphasis is placed on observing the impact of Russia’s agenda control on the policy choices of Caspian energy targets, as this remains a new and untested approach. These cases not only provide “easy” tests for traditional theories of leverage, but serve as critical probes for a theory of agenda control, given Russia’s unambiguous and growing regional preponderance and the respective similarities of semiauthoritarian SCCA regimes. This is reinforced by exploring the different types of regulatory processes in the oil and gas sectors that took shape within an otherwise weak Russian government structure throughout the period analyzed. Accordingly, evidence of variation in Russia’s leverage across these similar cases should strongly support the hypothesis for agenda control.

Before proceeding, however, it should be clear that variation in Moscow’s energy leverage cannot be attributed to a lack of interest or effort. Policymakers and strategists from across the Russian political spectrum were in rare agreement over the strategic importance of protecting the nation’s “special interests” and dictating the course of energy policies in the Caspian Basin. Notwithstanding fluctuations in world energy prices or doubts about the actual quantity of petroleum reserves in the region, control of the Caspian energy sweepstakes was jealously guarded by Moscow to arrest “geopolitical pluralism” along Russia’s southern periphery and to preserve its great power status.
In this spirit, Moscow embraced a three-pronged strategy to exert influence in the region throughout the period. Russian leaders clutched the monopoly over the existing pipeline infrastructure in order to retain a commanding position in an expanded transit network and to contain impulses for diversification harbored by the newly independent states. Steering pipeline routes across Russian territory promised to generate additional rents and allow Moscow to “keep a hand on the spigot.” Second, senior Russian officials defined the Caspian Sea as an inland lake and demanded that all littoral states share in its riches. By pressing the case for joint ownership, the Russian government hoped to keep extraregional influences at bay while increasing the amount of Caspian resources under its jurisdiction, thus securing a veto over future exploration projects. Third, Moscow attempted to sow confusion and amplify the political and commercial risks of those Caspian energy projects that competed directly with Russia’s strategic interests.

Pursuant to these competitive ends, Russia’s Caspian statecraft included both sanctions and inducements. In the immediate aftermath of the Soviet collapse, Moscow relied almost exclusively on coercion to bring its southern neighbors into line. The general approach was to combine support for environmentalism with aggressive attempts to oppose foreign intrusion, foil regional diversification, restrict use of the Russian transit infrastructure, and impose alternative legal interpretations of the Caspian Sea that would effectively secure Moscow’s access to the richest subsea energy fields. By mid-1997, however, Moscow softened its stand by openly promoting preferential participation of Russian companies in regional energy consortia. It also endorsed the principle of multiple oil pipelines for the region, with the caveat that at least one of the main export projects should include the “northern” (Baku-Novorossiisk) route that crosses Russia. Similarly, Russia advanced a highly qualified concession to Kazakhstan in 1998 that recognized division of the seabed into national sectors, while insisting that the surface and water columns remain under the joint ownership of all littoral states. Yet, all the while the Yeltsin administration continued to court a “rejectionist” front with Iran, restrict “outside” influence on energy security issues in the region, and impose heavy-handed restrictions on access to the Russian-controlled regional gas pipeline system.

Upon entering office, President Putin reinvigorated this carrot and stick approach. On the one hand, he encouraged development of “commercially viable,” not strategically sensitive pipeline routes, as part of a general shift toward pragmatism for protecting Russia’s economic interests in the region. Consistent with this mantra, the Russian government endorsed the commercial operation of the Caspian Pipeline Consortium (that linked Kazakh oil to Russian terminals...
on the Black Sea) in September 2001. In the process, Putin went so far as to intimate more relaxed postures toward oil swaps with Iran and the participation of Russian oil firms in the rival Baku-Ceyhan project. Similarly, the new Russian leadership extended the principle of modified median-line division of the Caspian seabed in a 2001 bilateral declaration with Azerbaijan that conspicuously distanced Russia from Iran’s calls for establishing collective and equal ownership of undersea resources. At the same time, however, Putin put relations with SCCA states atop Russia’s foreign policy agenda and moved decisively to streamline policymaking toward the Caspian Basin. In doing so, he deliberately sustained hardline impulses directed at pressing for collective resolution of the Caspian Sea’s legal status, denying “outside” intervention in the settlement of Caspian energy issues, discouraging non-Russian export pipelines, and adopting predatory policies toward the development and export of Caspian gas. The results, however, remained the same. Notwithstanding the regeneration of Russia’s Caspian strategy and successive tactical maneuvers under the two Russian leaderships, Moscow continued to both succeed remarkably and fail miserably at getting its way on Caspian energy-related issues. Why?

Turkmenistan: A Case of Compliance

Beginning in 1993, Russia imposed a series of restrictions on Turkmenistan’s natural gas exports as part of a broad strategy to assert its presence in the Caspian Basin. Moscow took particular exception to Ashgabat’s handling of a 1992 price dispute with Ukraine that, in turn, led Turkmenistan to halt supplies to Kiev and compelled Russia to increase gas subsidies to debt-ridden Ukraine as compensation. Russia responded by reducing Turkmenistan’s gas export quota to Europe by 20 percent and relegating Ashgabat’s deliveries to insolvent markets in Eurasia. Pressure was turned up at the end of 1993, when Moscow closed off Ashgabat’s access to lucrative markets in Europe that cost Turkmenistan $2 billion per annum. After an unsuccessful search for alternative pipeline routes, the president of Turkmenistan cut a new deal with Russia that established a joint venture, Turkmenosogaz, to exploit gas reserves and obligated Ashgabat to sell gas to Russia at prices well below the world market rate, in return for the piping of Turkmen gas to European markets. Dissatisfied with Russia’s continued restrictions on access to Europe, President Saparmurat Niyazov ultimately canceled the deal and suspended operation of the joint venture in 1997. In retaliation, Moscow denied Turkmenistan access to the Russian pipeline system altogether, virtually depriving Ashgabat of all hard currency earnings from its gas exports until 1999. Turkmenistan was allowed subsequently to resume deliveries to Ukraine (and later to Russia), but only after Moscow extracted
monopoly transit rents by forcing Ashgabat to sell its gas at a discount and to accept lower annual European export quotas. By the end of 2001, despite Turkmenistan’s earlier protests and subsequent break with Russia, the volume and value of its gas exports remained at the mercy of Moscow.47

Hostage to Russia’s heavy-handed gas policies, Turkmenistan practiced a strategy of “pragmatic neutrality,” deliberately waffling on policies regarding ownership and exploration of Caspian resources. In 1996, for example, Ashgabat sacrificed potential control of the largest gas reserves on the Caspian seabed and distanced itself from Baku and Astana by endorsing Moscow’s proposal for creating a joint company to develop energy in the coastal waters. This deference was repeated at the 1997 Moscow summit, when Turkmenistan reluctantly committed to use the Russian pipeline system as its main export route to new markets in Central and Western Europe, as well as for piping gas to Kazakhstan, all at prices below world market levels.48 In addition, Russian officials pressured the president of Turkmenistan to reinstate the Turkmenrosgaz joint-stock company that was 45 percent owned by the Russian gas giant, Gazprom, and had a record of mismanaging transport and sales of Ashgabat’s natural gas to customers in the Commonwealth of Independent States (CIS). Moscow succeeded in garnering Turkmenistan’s support “in principle” for a formal convention on the division of the sea to be signed by all five littoral states and at several key junctures convinced Ashgabat to temper sporadic claims to offshore resources, further obfuscating the legal status of the Caspian Sea.49

These concessions were especially costly for Turkmenistan. The country’s natural gas potential was regarded as world-class at the time, projected at holding up to 14 trillion cubic meters (tcm) of proven and unproven reserves (ranking fourth in the world), with a projected annual production capacity between 90 and 130 billion cubic meters (bcm) by 2010.50 With independence, the health of the economy turned on natural gas export revenues, which accounted for as much as 74 percent of national export earnings and 60 percent of the central budget up through 2000.51 Due to low domestic consumption rates, Turkmenistan also was poised to become a significant supplier for dynamic gas markets in Europe and Asia. Yet Russia’s policies virtually cut off access to these solvent markets and severely restricted production and GNP rates. This, in turn, led to customer indebtedness, creating severe cash-flow problems for the government.52 In practice, Ashgabat’s compliance stranded Turkmenistan’s vast gas reserves and prevented it from monetizing its significant export potential at the same time that conditions in the domestic economy were deteriorating.
Why was Russia’s energy statecraft so effective in this case? While considerations of asymmetric interdependence or Russia’s structural power capture important aspects of Turkmenistan’s weakness, neither can fully explain Ashgabat’s steadfast compliance. Ironically, Turkmenistan was the least sensitive SCCA state in terms of overall and natural gas trade balances with Russia, but it was the most susceptible to Moscow’s predatory Caspian gas policies. In addition, Turkmenistan’s dependence on the Russian pipeline system, although considerable, was not complete. With an integrated national gas sector, Ashgabat did not rely on Russian pipelines for domestic refining and delivery (unlike Kazakhstan) or for exports to Kazakhstan and Uzbekistan. Furthermore, Turkmenistan remained proximate to potential export markets in South Asia, Turkey, and the Middle East. In 1997, Ashgabat established a direct transit link to Iran, and for a number of years was courted to be a partner in the international Trans-Caspian Pipeline (TCP) project and an Iranian project. These presented Turkmenistan with both large-scale and incremental options, respectively, to bypass Russian pipeline operators, giving it direct access to the expanding Turkish market, as well as to two proposed outlets to India and Pakistan and China and Japan, respectively. That Ashgabat did not effectively break out of Russia’s pipeline vice, therefore, was not due to a lack of opportunity. Moreover, Russia’s leverage did not derive from a compelling normative standard, as President Niyazov rejected Moscow’s identification with political liberalism, preferring instead to cultivate a unique brand of pan-Turkic authoritarianism as a springboard for constructing an independent identity as the “Kuwait of Central Asia.”

Similarly, authoritarian rule in Turkmenistan was not especially conducive for strict compliance with Russia’s energy policies. With independence, President Niyazov placed the highest priority on increasing energy revenues to maintain stability and control over all aspects of political and economic life at home. In the still centrally planned system, the president retained, at least in principle, the political incentive and strength to pass down the short-term costs of deadlock with Russia to the Turkmen people, in exchange for acquiring potentially greater energy rents from new markets. Given the availability of prospective substitutes for Russia’s pipelines and markets, this strategy could have been pursued to sustain domestic subsidies and avert indefinitely the immediate political and economic difficulties of reform experienced by other post-Soviet states. That Niyazov opted instead to accommodate Russia, incurring significant short-term costs while forsaking potential future payoffs in the process, suggests that state strength alone does not provide a sufficient explanation. Niyazov’s basic deference to Moscow at critical junctures in the Caspian contest also contrasted sharply with his erratic behavior toward other states and investors in the region.
From the perspective of Russia's agenda control in the gas sector, Ashgabat's compliance is less puzzling. Throughout the period, Russia's global market presence was significant, as it controlled over 35 percent of the world's proven gas reserves, approximately 25 percent of international gas production, and almost 50 percent of world gas exports. More significantly, given the regional nature of gas markets, Russia maintained a 25 percent stake in the prized Western Europe market since the breakup of the Soviet Union and signed long-term contracts to remain the dominant supplier for traditional markets in Central and Eastern Europe well into the future. This profile, which was augmented by the scope of Russia's gas pipeline infrastructure and geographic location, armed Moscow with significant economies of scale at landing large volumes of gas in existing markets.\(^5^6\)

While in principle there was no limit to where Turkmenistan's gas could be sold, Russia successfully exploited these critical advantages to lower the appeal of breaking into established markets. Moscow preempted Ashgabat's foray into the West European market by flaunting Russia's proven track record as a reliable supplier and its available "ramp-up" advantages. Moscow exploited these advantages to garner a larger share of the growing EU market, while simultaneously rendering deliveries from Turkmenistan virtually uneconomical.\(^5^7\) Russia moved to increase economies of scale at delivering larger volumes of gas from its huge reserves by constructing two additional transit routes to Europe. When completed, they would bolster Russia's competitive advantages at meeting the projected 400 bcm annual increase in global demand by 2010 vis-à-vis traditional rivals from Scandanavia, North Africa, the Persian Gulf, the Middle East, and East Asia. It also ensured that Ashgabat's ability to compete for the future residual demand, even with the liberalization of regional gas markets, would be impaired by disproportionately acute transportation costs associated with piping small amounts of gas at a greater distance from Turkmenistan.\(^5^8\) This maneuver effectively converted gas markets of last resort in the CIS (e.g., Ukraine and Russia) into Turkmenistan's best available export options. For Ashgabat, the short- and long-term costs of gaining independent access to European markets became greater than the costs of serving end users in the former Soviet Union, especially with Moscow's burgeoning appetite for cheap substitutes for its own subsidized deliveries to the CIS to free up domestic supplies for guaranteed hard currency payments in global markets. Therefore, by aggressively pursuing larger stakes in established European markets, Moscow effectively reduced the relative appeal of competing in these markets for Turkmenistan.
Moscow also successfully lowered the opportunity costs of using the Russian pipeline system relative to breaking into new markets for Turkmenistan. Until 1997, Russia enjoyed a virtual monopoly over the export of Turkmenistan’s gas outside the former Soviet Union, as none of the proposed Asian routes for diversifying Turkmenistan’s exports showed promise of becoming commercially or politically viable. With the opening of spurs to Iran, Moscow lost control over Turkmenistan’s access to Iranian and, potentially, to Turkish markets. In order to arrest these trends and boost the relative appeal of the Russian pipeline network, Moscow moved to exploit incremental advantages at landing large volumes of cheap gas in emerging markets. This effort focused on out-competing Turkmenistan for the fast-growing Turkish market and transit hub by offering potentially high volumes of gas via an unusually low-cost Russian alternative that benefited from shorter distance and more reliable supplier financing. By sealing an agreement in 1999 to construct the 1200 km Blue Stream pipeline between Russia and Ankara — consisting of a 345 km segment to be laid at the bottom of the Black Sea — Moscow locked in 80 percent of Turkish customers by 2010 and squeezed the commercial value of Ashgabat’s TCP option out of the region’s biggest prospective market. Combined with the financial and political uncertainties associated with landing Turkmen gas in Turkey via Iran, this move strengthened the long-term appeal of the Russian pipeline system as Turkmenistan’s only commercially viable conduit to emerging hard currency gas markets in the Balkans and Europe.

Moscow’s capacity to manipulate Turkmenistan’s market vulnerability was reinforced by the structure of the Russian gas industry. Throughout the period, 95 percent of Russia’s gas production was carried out by thirty-seven production associations owned by a single joint-stock company, Gazprom. The firm’s monopoly extended across the entire cycle of gas production, transportation, and processing (excluding distribution), and included 100 percent ownership of Russia’s high-pressure natural gas pipelines and transit infrastructure. Unlike other Russian natural monopolies that shared licenses to underground minerals with subsidiaries and regional authorities, Gazprom held exclusive rights to exploit almost 70 percent of Russia’s established gas fields and many others that were under development. Moreover, Gazprom possessed full discretion to set domestic production and export gas quotas, establish prices along the domestic processing and transit chain, and transfer revenues to corresponding regional and federal accounts. The Russian government, via the Federal Energy Commission, retained narrow but exclusive authority to administer wholesale and retail prices for domestic consumers, as well as to impose royalty fees, excise taxes, and export tariffs.
Gazprom also was authorized to participate directly as a lobby inside Turkmenistan. The formation of the Turkmenrosagaz joint venture gave the Russian gas monopoly a 45 percent stake in Turkmenistan’s gas projects, over and above its control over the export pipeline system. Accordingly, Gazprom wielded a potential veto in internal deliberations over prospective exploration, production and export projects. This was not lost on the chairman of Gazprom, who threatened repeatedly to exercise the firm’s corporate veto to discourage Ashgabat’s construction of competing export pipelines to European markets.64

Gazprom’s unique ownership privileges and exclusive decisionmaking authority over the domestic distribution network and access to the Russian pipeline system allowed the firm to promote a predatory strategy in the former Soviet south. Vested with near complete discretion to ramp up domestic exploration and development projects to exploit its comparative advantages at gas-on-gas competition in global markets, Gazprom set its sights on seizing ownership rights to downstream projects in the “near abroad” (via debt-equity swaps and direct purchases) and extracting monopoly rents at the border from states that used its pipelines. Gazprom also was intent on acquiring a strategic presence in negotiations among Turkmenistan, Iran, Turkey, and Pakistan over viable alternative gas export routes. The preference for exerting its commanding position was made painfully clear in August 1997, when the chairman of the board of Gazprom threatened explicitly to quit the partnership with Turkmenistan and cut off gas outlets unless Ashgabat came to appreciate that “he who controls the valve controls everything.”

While there is no denying that Gazprom acted as a powerful and concentrated interest group in Russian policymaking, strict focus on the institutional weakness of the government overstates the independence of the gas monopoly to work its will in the region. Weak-state theories would predict that Russia’s policy toward Turkmenistan would follow Gazprom’s predation in the region, but cannot account for why the firm’s choice of action would necessarily coincide with Moscow’s preferred policies given other commercially viable options. Because of the huge fixed costs for exploration, production facilities, and pipelines and the relatively small variable costs in the gas sector, Gazprom had an incentive to exploit its monopoly over the existing post-Soviet gas infrastructure via price discrimination. Given Gazprom’s comparative advantages in supply and delivery, an alternative strategy would have been to explore the predatory practice of “dumping” in existing export markets. If successful, this would have positioned Gazprom to drive out foreign competition, increase its market share, and control prices in lucrative markets. At least in the short run, this strategy would have necessitated relaxing constraints on Turkmenistan’s
exports, albeit at favorable prices at the border, allowing Gazprom to land more gas in foreign markets at below marginal costs. Only after boosting market share would there have been commercial incentive to turn off the spigot for Turkmenistan. It is telling, however, that Gazprom did not seriously consider such an approach. Rather, it chose to synchronize its strategy with Moscow’s diplomacy toward Ashgabat, first by pursuing the opposite strategy of “reverse dumping” (pricing exports higher than sales on the Russian market), and then by subsequently shifting tactics to import Turkmen gas at a discount to meet the rising Russian demand. This behavior suggests that the gas giant did not operate in an institutional vacuum and that its price discrimination strategy was subject to regulatory pressure by an otherwise weak Russian government.

Neither fully captive of Gazprom’s interests nor completely above them, the Russian government was well positioned to manipulate the opportunity costs in the gas sector to ensure the convergence of respective foreign policy aims. First, it retained a direct vote in the company’s decisions, because the state owned a 38 percent stake in Gazprom that was managed through a trust by the company’s board. Second, unlike other Russian firms, Gazprom was not authorized to set prices for domestic consumers. Instead, gas prices and transit fees were subject to the Russian government’s direct approval, via the Federal Energy Commission. This discrete authority, for example, enabled the government to adjust domestic gas prices that, in turn, affected the ease of collecting payments at home and the relative value of domestic deliveries and exports for Gazprom. It was precisely by setting domestic prices higher for Russian consumers than Gazprom preferred, rendering the firm increasingly dependent on barter payments, that the Russian government initially guided the company’s predation in internal and external markets consistent with the diplomacy of stranding Turkmenistan’s gas supply. At a time of low global energy prices, Gazprom had little choice but to recoup mounting domestic losses by restricting Ashgabat’s competition in international markets. Alternatively, with new demands from Gazprom for increasing domestic prices to keep pace with rising global prices, Moscow was careful to take action that kept it cost effective for the company to substitute cheap gas imports from Turkmenistan in order to free up Russian gas supplies for lucrative international markets. By holding domestic gas prices below marginal costs for Gazprom during a period of booming international energy prices, the Russian government made it attractive for the gas giant to tighten its grip over Turkmenistan, thus strengthening Moscow’s international leverage.

The Russian government also provided diplomatic cover for Gazprom’s foreign activities that reduced the transaction costs of asserting the firm’s regional dominance. President Boris Yeltsin and the Russian Foreign Ministry, in particular,
played crucial roles brokering Turkmenistan’s reinstatement of Gazprom’s participation in Turkmenrosgaz by sweetening the offer with promises to annul the contract with Azerbaijan for joint development of the Kyapaz (Serdar) oil field in the Caspian Sea. Moscow also smoothed the way for Gazprom’s megadeal for gas exploration with Iran by officially endorsing the contract, wooing support from Western Europe, and defending it against U.S. sanctions. By increasing the stakes for Tehran of doing business directly with Russia, Moscow improved Gazprom’s potential leverage to discourage the expansion of Turkmen gas exports via Iran. President Putin was quick to tap this authority as well, extending diplomatic recognition of Ashgabat’s neutrality and promises to broaden the bilateral dialogue that paved the way for the resumption of Gazprom’s discounted imports of Turkmen gas. He also sweetened the Blue Stream undersea pipeline project for Ankara and moved to allay Turkey’s concerns of becoming increasingly dependent on Gazprom with diplomatic offers to deepen bilateral economic and security cooperation in the region. Consequently, while Moscow lacked the capacity to impose policies directly on Gazprom, it was able to harmonize respective interests by lowering the opportunity costs of manipulating Turkmenistan’s gas potential.

**Azerbaijan: A Case of Defiance**

In contrast to the hardline approach toward Turkmenistan, Moscow employed both carrots and sticks to secure Azerbaijan’s compliance on Caspian energy issues. Consistent with the strategy of precluding independent energy development, the Russian Foreign Ministry initially threatened retaliation against Baku’s unilateral seizure of Caspian oil deposits. This was followed by closing off Baku’s access to the Volga-Don canal as a transit corridor for oil drilling equipment to the Caspian Sea and restricting all road and rail traffic to Azerbaijan. Russia later shifted course by seeking preferential participation in energy exploration projects brokered by Baku and by presenting commercially attractive offers to lure the transit of Azerbaijan’s early and main oil to Russia’s Black Sea port of Novorossiisk. Moscow also signed a Treaty of Friendship with Baku in 1997, officially recognizing Azerbaijan’s sovereignty. Yet throughout the period, Moscow continued to stress the risks of excluding Russia from Baku’s “main” oil export plans by pressing for common jurisdiction over the water columns and surface of the Caspian Sea, championing a north-south regional energy corridor, and upgrading military assistance to rival Armenia.

Despite the Kremlin’s tactical moderation and the similarities with Turkmenistan’s strategic weakness vis-à-vis Russia, Azerbaijan remained openly defiant on Caspian energy issues. Baku did not let legal ambiguities retard
campaigns to woo multinational corporations or to initiate oil development projects based on the *de facto* division of the Caspian Sea into national sectors. Although welcoming Russia’s commercial participation in international energy consortia, Azerbaijan avoided the seduction of Moscow’s post-1997 cooperative gestures, maintaining a “use it or lose it” approach and carefully regulating the shares allocated to Russian firms for the development of oil deposits in its self-proclaimed national sector. Baku also solicited aggressively the strategic presence of extraregional patrons, such as NATO, Turkey, and the United States, and promoted non-Russian regional security arrangements both to protect national interests in the Caspian and to counter Moscow’s impulse for imposing economic and military reintegration.

The failure of Moscow’s Caspian statecraft contradicts basic predictions generated by the extant literature. That Baku’s record of compliance differs from Turkmenistan’s and that Russia had to concede on energy issues where it dominates another SCCA state, belie the strength of static realist, social power, and mercantilist explanations of leverage. Furthermore, in contrast to the case of Turkmenistan, the legacy of structural dependency on Russia’s pipeline infrastructure did not prevent Baku from embracing alternate east-west transit routes for both early and main oil exports from the Caspian Basin that circumvent Russian territory altogether. Ironically, the Soviet government’s earlier decision to create a “steel umbilical cord” of dependence on Russia’s energy left Baku with vast untouched oil reserves that, following independence, it successfully tapped to break out of Moscow’s direct control and diversify strategic relations.

Rather, close inspection of Moscow’s energy impotence reveals an inability to reduce the opportunity costs of Azerbaijan’s compliance. As opposed to Turkmenistan, Azerbaijan’s primary strategic resource concerns in the Caspian Basin from 1991 to 2001 rested with crude oil production and export. Yet the size of both Caspian and Russian oil reserves are dramatically less significant in the global market than is the case with the gas sector. Modal estimates show that Russia retains 15–19 percent of the world’s proven and unproven oil reserves, while Caspian reserves constitute only between 2 and 3 percent of global supply. By implication, the Caspian oil reserves have not been nor will be on a par with those controlled by OPEC. Under favorable investment, production, consumption, and transportation scenarios, Russia’s export potential is projected to capture only 2.5 percent of the global demand for oil by 2010, while Azerbaijan is estimated to be able to meet less than 1 percent of the demand. Both states are price-takers in international oil markets, and Russia, given its limited import capacity, represents a small and declining potential market for Caspian crude.
Consequently, Russia was not in a position to alter real or future prices for Azerbaijani oil, as there were other more significant international suppliers and markets.

In addition, there were significant opportunity costs associated with transporting Azerbaijan’s crude across Russian territory. Beginning in 1994, Baku was courted aggressively by potential transit states and foreign investors for at least two early and one main oil alternate routes (with different variants) that bypass Russian territory altogether. These alternatives were more direct and politically expedient than Russia’s preferred northern route and typically offered larger economies of scale. Given that the burden of financing pipeline routes would ultimately fall to the producing firms and the Azerbaijani government, the ground rules for selecting Baku’s main oil pipeline routes were defined largely by technical and economic criteria. This ultimately weakened Russia’s control, as competition for export routes generated commercial incentives among rival transit states and investors (including respective “outside” benefactors) to offer lower tariffs and competitive rates of return for the construction of new pipelines with larger diameters and excess capacity. Such sweeteners reduced the cost-effectiveness of using the existing Russian pipeline infrastructure that would otherwise require lower start-up investments. Furthermore, the projected long-term glut in the world oil market provided little incentive for oil producers to rush to a decision about the choice of pipelines. Thus, from a commercial perspective, Azerbaijan and its international partners were in the driver’s seat regarding the selection of main oil pipelines and risked incurring significant opportunity costs by committing early to use Russia’s existing system.

Notwithstanding these global market constraints on Moscow’s leverage, it is plausible that Russia ultimately could have induced Azerbaijan’s compliance by inflating regional security and political risks to slow or stop the flow of Baku’s oil via alternative bypass routes, while simultaneously boosting the appeal of using the Russian pipeline system. There were disadvantages associated with each western alternative for piping Azerbaijan’s main oil that were vulnerable to manipulation. The central route across Georgia, while direct and cost effective, was subject to Russia’s threats of using its forward military presence to destabilize the region. Similarly, Moscow’s arms transfers to Armenia intensified the security dilemma between Armenia and Azerbaijan that, in turn, compromised the security of a prospective Baku-Ceyhan route. It was widely believed that Russia could have gone one step further by directly fanning the flames of the separatist conflict in Nagorno-Karabakh to disrupt oil exports via pipelines built across northwest Azerbaijan.
In practice, however, Russia’s capacity to play the role of a regional spoiler on oil issues was quite limited. Its pressure tactics generally backfired, provoking Baku to solicit extraregional assistance and to restrict Russian oil firms to possessing minority stakes in only seven out of twenty-three of Azerbaijan’s major international oil contracts. The persistence of intra- and interstate conflicts in the Caucasus raised the political risks of circumventing Russia, but also limited the effectiveness of the Kremlin’s reach and undermined the relative appeal of using Russian pipelines. Successive wars in Chechnya exacerbated anxieties about transiting oil across Russia, while the conflict in Abkhazia raised the costs of constructing a southern spur from Russia’s Black Sea port to redress problems with under capacity and year-round access. Lingering tensions over the status of Nagorno-Karabakh became a lightning rod for greater international intervention in the region, via mediation attempts sponsored by the Minsk Group of the Organization for Security Cooperation in Europe (OSCE). This provided the basis for Baku’s closer cooperation with the United States and Europe, as opposed to an opportunity for Moscow to exploit. Ultimately, however, Moscow’s failed attempts at making compliance with its preferred northern oil pipeline route more attractive were reinforced from below by the peculiarities of the domestic regulatory mechanism.

In sharp contrast to the gas sector, the Russian government did not play a decisive role in setting the development and export agendas for the national petroleum industry. As one of the early subjects of “de-statization,” the Russian oil industry was no longer owned or controlled exclusively by the government, and after 1992 it was dominated by a mélange of eleven to thirteen vertically integrated private, semiprivate, and state oil companies. The Russian oil sector was more diffuse than the gas sector and therefore should have been both less influential and more vulnerable to manipulation by the government. Yet this transfer of ownership did not include a clearly defined system of property rights; shareholders were fragmented among a diverse set of employees, managers, banks, and foreign investors, as well as multiple federal, regional, and municipal authorities. What emerged was a “recombinant” property rights structure in the Russian oil sector that obfuscated the distribution of decisionmaking and economic power, increased the practical autonomy of firm managers, and reduced responsiveness of the industry to specific political and financial pressures. While the oil sector was institutionally weaker than the gas sector, the Russian government nonetheless lacked the decisive authority to meddle in the internal affairs of competing oil companies, with the exception of a few in which the state maintained a controlling stake.
Scattered ownership structures spawned the adoption of multiple and competing production, investment, and export portfolios among Russia’s new “petroarchy.” Some companies, such as Yukos and the regionally owned Nors and Bashneft companies, concentrated primarily on domestic upstream and downstream projects; while others, such as the state-owned company Rosneft and Zarubezhneft opted to cultivate joint projects with states in the Middle East. The largest private Russian oil company and aspiring international “major,” LUKoil, aggressively pursued an upstream strategy in the Caspian Basin. Commercially motivated to reduce production costs, attract foreign investment, modernize technology, and search out more solvent customers, LUKoil focused on expanding participation in joint exploration projects with Azerbaijan and other international oil companies to secure stakes in the development of onshore and offshore Caspian deposits.85

Divergent interests and mounting competition both at home and abroad for offshore acreage deprived Moscow of the capacity to secure the compliance of the Russian oil industry. Russian oil firms contracted with Azerbaijan for the joint exploration of Caspian deposits in contested oil fields, despite Moscow’s injunction against unilateral resource grabs. Even in the highly publicized 1997 case involving Moscow’s abrogation of the contract signed by LUKoil and Rosneft with Azerbaijan for development of the contested Kyapaz field, neither company acknowledged the legitimacy of the Russian government’s “collective ownership” rationale for termination. Instead both chose to put the contract on temporary hold for “commercial reasons” until Azerbaijan and Turkmenistan settled the dispute.86 Furthermore, LUKoil actively pursued an independent role in the construction and management of alternative pipelines for exporting Azerbaijan’s main oil via Georgia and Turkey, notwithstanding Moscow’s pressure to use the Russian route.87

Similarly, the Russian government lacked the formal authority to preempt the commercial preferences of the domestic oil industry within the fractured regulatory system. Unlike the gas sector, partial licensing and tax responsibilities were spread among multiple state agencies, regional authorities, and semiprivate entities. Successive laws on oil and gas were conspicuously vague about stipulating “joint jurisdiction” between federal and regional governments over the issuance of licenses to lease oil exploration and production rights from the state. Moreover, the Russian government did not retain discrete authority to improve the investment climate in the domestic oil sector. There were significant political costs to tapping domestic oil fields, because production-sharing agreements and transit fees had to be approved by both houses of parliament and endorsed by respective provincial administrators with their own political and
economic agendas. In addition, federal agencies shared authority with regional and municipal governments to assess a proliferating number of corporate, VAT, special, excise, export, and royalty taxes on oil revenues. This haphazard approach to taxation undermined the inducement effects of federal tax exemptions because regions and localities were under no obligation to reciprocate and were free to levy their own taxes at different rates. As only one of several independent claimants to regulatory authority in the oil sector, the Russian government lacked the political discretion needed to offset the relatively high transaction and opportunity costs associated with expanding operations at home for national oil companies and foreign investors alike.88

Moscow also possessed only modest authority to set the agenda for pricing, transport, and exports in the petroleum industry. Beginning in 1995, domestic oil prices were steadily liberalized and export quotas and duties were significantly curtailed. Yet national prices for crude were constrained by periodic gluts in the world supply, the deterioration of the national refining industry, and the limited capacity of the export infrastructure. As a result, Russian oil production was “shut in” and significantly underpriced at home. These factors insulated considerations of revenue maximizing in the domestic oil sector from the “subjective” manipulation of government protectionism.89 This, in turn, reduced the value of domestic sales and reinforced incentives among internationally engaged Russian oil firms, such as LUKoil, to increase upstream and downstream profiles abroad, irrespective of shifts in Moscow’s regulatory policies.

In addition, there were multiple government agencies charged with conflicting mandates to set throughput prices for the Russian pipeline system. There was a confused mechanism for allocating scarce access to the Russian oil pipeline system, involving the Ministry of Fuel and Energy, the Federal Energy Commission, an Inter-Departmental Commission on Access to Export Pipelines, the state transport monopoly (Transneft), the Union of Oil Exporters, and all the Russian oil companies. Accordingly, the regulatory process lacked proper oversight and was subject to intense bureaucratic competition. In practice, access to the Russian pipeline system was granted via an opaque network of ad hoc favors among rival “coordinating agencies.” This discouraged production for the domestic market and imposed stifling export bottlenecks. The overall lack of transparent access to the Russian pipeline system afforded opportunities for parochial enrichment, producing conflicting mandates among rival regulatory agencies to exploit oil shipments either to maximize short-term rents or advance the industry’s long-term international competitiveness.90 Moreover, Moscow’s ability to woo Caspian main oil exports was severely circumscribed by the instability in the North Caucasus that rendered both the trunk line through
Chechnya and the bypass via Dagestan commercially risky for Russian partners within Azerbaijan’s international consortium. Consequently, Moscow was poorly positioned to lure its companies back home by unilaterally reducing the opportunity costs of engaging in joint oil exploration and export projects with other Caspian littoral states.

Kazakhstan: A Case of Cautious Opportunism

Throughout 1991-2001, Kazakhstan represented the hydrocarbon prize of the Caspian, due to its expected energy potential. It is estimated to hold the largest energy deposits in the region, with the bulk of proven and unproven reserves located in and around the northern Caspian shelf. Like its SCCA neighbors, idle production capacity and low projected domestic consumption make Kazakhstan a potentially important energy exporter for European and Asian markets, as well as for recovering markets in the post-Soviet space. Unlike Turkmenistan and Azerbaijan, however, Kazakhstan possesses sizeable oil and gas reserves. It is the second largest oil producer among the former Soviet republics after Russia, and the twenty-sixth largest worldwide. The country is expected to produce 1.9 million barrels per day (b/d) of oil, including 750,000 b/d by 2010 from its main onshore Tengiz field, and could dramatically exceed these projections if the offshore Kashagan block meets expectations of holding reserves of up to 40 billion barrels. Kazakhstan also is predicted to assume a conspicuous presence in the global gas market for years to come due to the world-class Karachaganak field which could contain as much as 1.3 bcm of gas, 6.8 billion barrels of condensate, and some crude oil. Given the magnitude of this energy potential, oil and gas exports became the centerpiece for Kazakhstan’s early political transition and security strategies.

For the first decade after the Soviet collapse, Moscow’s leverage over Kazakhstan’s energy policies fluctuated considerably. Kazakhstan neither succumbed uniformly to Russia’s heavy-handed tactics in the Caspian contest, nor enjoyed complete autonomy. Instead, Astana pursued a nuanced strategy to capitalize on opportunities for independence, while simultaneously placating Moscow’s demands for limiting its strategic reorientation. Astana generally opposed Moscow’s preferred joint approach to ownership of Caspian Sea resources and actively solicited alternative foreign investors and options for developing and piping Kazakh oil to Asian and European markets. At the same time, it kept a distance from Azerbaijan’s conspicuous defiance, opting instead to work closely with Russia to negotiate mutually acceptable approaches for
accessing and exporting Caspian gas. As reflected by this mixed strategy, Astana’s Caspian policies were subjected to both the strengths and weaknesses of Russia’s regional energy leverage.

The inconsistencies of Russia’s leverage in this one case contradict static predictions generated by realist, asymmetric interdependence, and structural power theories. Despite obvious strategic and geographic disadvantages, as well as maintaining the highest sensitivity of trade with Moscow among SCCA states, Kazakhstan exercised considerable freedom to search out Caspian oil routes that circumvented Russia. Given that ethnic Russians comprised nearly 35 percent of the population and remained geographically concentrated in Kazakhstan, this also should have constituted an unambiguous case for Russia’s structural power. Yet Moscow’s leverage varied, notwithstanding Astana’s persistent vulnerability to Russian irredentism. In particular, the pinch of Russia’s normative projections and political geography was tempered by Kazakhstan’s dual identity as both a homeland for Kazakhs and a multinational republic.93 Moreover, as discussed below, vulnerability to Russia’s structural leverage varied across the oil and gas sectors, despite Astana’s uniform dependence on the Russian pipeline infrastructure for pumping energy to consumers and refineries or processing centers both inside and outside the country.

From an agenda control perspective, variation in Russia’s leverage over Kazakhstan is less enigmatic. Russia’s structural presence in the gas sector effectively foreclosed options for Kazakhstan. One of the paradoxes of the Soviet legacy was that Kazakhstan, despite its huge gas reserves, was left structurally dependent on Russia for both imports and exports. Gas production, which was concentrated in west Kazakhstan, was not connected to populated consuming areas in the southeast and industrial north. Rather, there were two separate pipelines that distributed gas to domestic customers but that were disconnected from Astana’s production, processing, and export capacities. Accordingly, Kazakhstan’s gas production in the west was exported to Russia’s Orenburg plant for refining and re-export, leaving Astana in the position of importing roughly 40 percent of its gas consumption, with the bulk of it coming back from Russia. Moreover, the prospects for developing indigenous gas processing facilities and alternative main domestic and export pipelines that bypass Russia (en route to markets in China, Turkey, and Europe) remained long-term propositions.94

In an effort to prolong this situation and postpone indefinitely the commercial feasibility of these alternative projects, Moscow aggressively solicited Chinese and Japanese groups to invest in the development and export of Russian gas reserves, as opposed to projects in the Caspian Basin. These offers were more