OIL, OLIGARCHS, AND OPPORTUNITY: ENERGY FROM CENTRAL ASIA TO EUROPE

Committee on Foreign Relations
The United States Senate

June 12, 2008

Dr. LEON FUERTH
Research Professor
The Elliot School of International Affairs
The George Washington University

The Committee has asked me to provide background on how the Clinton-Gore administration recognized the significance of Caspian energy, and how it then organized itself to deal with this subject. As I understand it, however, the Committee's interest is prospective rather than historical. It wants to know what elements of this experience may be valid, as the United State turns to face the accelerating and multiple strategic challenges arising from energy. This testimony will therefore be structured as an historical account, interspersed with markers to indicate what may be lessons of continuing importance, and ending with a brief set of recommendations.

Caspian energy policy was formed during the second Clinton-Gore administration, but it cannot be understood outside the context of events and innovations of the first four years. Those earlier developments conditioned how we came to recognize the importance of Caspian energy, how we formed a policy to deal with it, and how we organized internally to manage that policy and to conduct a diplomacy constructed upon it.

The narrative actually begins two years before the Clinton-Gore administration began its existence, as a consequence of the implosion of the Soviet empire, which destroyed Russia's control of the Caspian region.

The Clinton –Gore Administration took office as the wreckage of the old world order was still settling. Our predecessors had handled the collapse of the Soviet Union and the Warsaw Pact with great skill, but it was up to us to deal with the aftermath. The Russian Federation was on the edge of free-fall. Its economy was devastated, and its new political institutions were extremely fragile. There were early signs of hyper-inflation. Public suffering was considerable. There was deep moral dislocation. The military was broken. The Communist Party apparatus was the only nationally organized political force in the country, and it was intent on recapturing power. Other political forces representing extreme nationalism hovered at the edges. One could not exclude a complete societal collapse in a state which still possessed the largest nuclear arsenal on the planet.

We – meaning the senior tier of national security officials in the new administration —also believed that there was a huge opportunity in these circumstances. The government of the Russian Federation was in the hands of reformers, whose agenda

was to create a society based on the rule of law and driven by market economics. We recognized that the United States was the only government able to marshal a positive international response, on a scale anywhere near what would be needed. We understood that our chances of success were not particularly high, but we also believed that what was at stake was a millennial chance to create a post-Cold War world organized around a collaborative US-Russian relationship.

President Boris Yeltsin had serious personal and political weaknesses, and we recognized them. But we also saw in him and in his government a serious interest in moving beyond the Soviet experience, domestically and internationally. After a period of deliberation at the outset of the new administration, the decision was made for the United States to present itself to the Russians as a potential partner in what we hoped would be the birth of a new society. That kind of effort demanded not just moral but organizational and material support. It carried substantial political risks. But the risks of inaction were assessed as much greater.

That is why the United States accepted President Yeltsin's suggestion, made at the April 1993 Summit in Vancouver, that we needed a new form of bilateral organization to operate at the highest political levels. This was the point of origin of the US-Russia Bi-national Commission, aka the Gore-Chernomyrdin Commission. It was also the point of origin of the Russia Policy Group under the leadership of (then-ambassador, and later Deputy Secretary of State Strobe Talbot. The objective of the Commission was to make sure that high-level agreements would actually be converted into material change on the ground. The objective of the Policy Group was to create a venue for coordination that would embrace every major stake-holder in the Executive Branch, and super-charge the NSC inter-agency process. Together, the Commission and the panel were designed to assure constant orchestration and follow-through, working across traditional bureaucratic boundaries in both governments.

The Bi-national Panel began its operations in September 1993. Its first mutually agreed goals were to develop new forms of cooperation in two important areas: space flight and energy. There were no precedents for the level of collaboration we had in mind. They would intrude almost in equal measure upon areas of policy that both we and the Russians would previously never have opened up to each other. The Russians accepted joint work in space in the hopes of preventing the dissolution of their space industries. We embraced this work, partly to augment US capabilities, and partly because we feared that Russian technology would otherwise be up for sale to the highest bidder: notably, Iran. The Russians accepted cooperation in energy because the output of their oil and gas fields was plummeting, and could only be restored with infusions of outside capital and technical skill. We viewed the potential collapse of Russian energy production as a threat to the political stability of the Federation, and a threat to the stability of the global energy market. We also believed that Russian extraction procedures were technologically backward, and were causing avoidable environmental damage locally in the form of massive spills, and globally through the emission of green house gases.

Over time, the Commission expanded to include committees in defense conversion; energy; environment; health; science and technology; along with various task forces on issues ranging from tax law to safe storage of plutonium from Soviet warheads.

There was also a side agenda in which the Commission's two principals acted to clear the way for what would become a series of summit meetings at the level of presidents. The story of how these processes worked is as much a matter of attitude as of substance. Success depended upon going out of the way to build relationships based on parity of respect, and to look for ways to handle inevitable differences in a manner which would support basic American and Russian interests, yet not rupture underlying forms of cooperation.

The expansion of NATO in (date) is a prime example of such a challenge. Caspian energy was another. Both cases involved strong objective and psychological challenges to core Russian conceptions of territoriality and security. The expansion of NATO marked the permanent liquidation of the Soviet empire in Eastern Europe; and the assertion of American economic and strategic interests in the development of Caspian energy, drove home to Russian leaders their loss of dominion over a region that had been an integral part of the Soviet Union. Both processes represented objectives that the Clinton-Gore administration regarded as vital to the design of a stable post-Soviet world, yet each also put at risk the kind of US-Russian relationship that would be central if the design were to become a reality.

The difference is that the future role of NATO in central and Eastern Europe was recognized as a crucial issue from the beginning of the Administration, and was dealt with by well-established processes within the national security apparatus: whereas the question of Caspian energy was not recognized for several years, and had to be addressed by an improvised system for which there was no precedent. The fact that we were able to succeed owed much to the Gore-Chernomyrdin experiment and to the consultative procedures that had evolved to support it. It also depended upon extensive operational experience within the US government, for handling policy and organizational issues generated not only by Gore-Chernomyrdin, but by a series of other bi-national commissions: US-Egypt (chaired by Gore and President Mubarak), established in September 1994; US-Kazakstan (chaired by Gore and President Nazerbaev) established in November 1994; US-South Africa (chaired by Gore and then-Deputy President Mbeki), established in March 1995; and US-Ukraine (chaired by Gore-and President Kuchma), established in September 1996.

The Caspian chapter began in the winter of 1995, when a National Security Council office director named Sheila Heslin came to see me to say that she believed that US government was not alert to the energy potential of the region, and that there was no policy for dealing with it. In the absence of such a policy, there was a growing risk that Russia and Iran would succeed in making themselves the gate –keepers to what already was established to be an immense new reserve of oil and gas. Both governments were already developing juridical claims by which they would in effect assert dual rights to sea-bed drilling, and both were moving towards an arrangement whereby oil and gas would exit the region either by way of GAZPROM's pipeline system transiting Russia to Europe, or by way of a north-south pipeline that would run south through Iran, to exit that country by way of coastal terminals. Were this plan to succeed, Russia and Iran would acquire tremendous geo-strategic leverage, including the ability to strangle Turkey's economic growth.

I had the latitude to explore these assertions, for which purpose I drew upon the knowledge of an ad hoc interagency group that included all pertinent agencies, including the CIA. It was not unusual for the Office of the Vice President to function in this manner, as the precedents for it were already established because of the bi-national commissions. The vice president, moreover, had by this time established personal links to every president in the region, and was in a position to draw upon these connections to help establish a new policy designed for region-wide application. In this capacity, he provided a political link trusted by the bureaucracy to operate accurately and effectively within the bounds of national policy, as established by the President. His engagement made US operations more continuous than would otherwise have been possible, given that presidents are intermittently available.

At a certain moment in my exploratory discussions the basic elements of a potential US strategy took form:

- The United States would favor multiple pipelines to carry oil and gas out of the Caspian into world markets.
- United States policy would welcome a Russian role in this system, to be organized along normal commercial patterns.
- The United States would oppose Iranian involvement in this process, until and unless Iran took convincing steps to repair its relationship with the United States – notably, to meet our concerns about their nuclear program and intentions.
- In support of these policies, the United States would follow the commercial logic of private sector enterprises which were then considering various pipeline concepts. We would be prepared to apply US diplomatic influence in the region to help consolidate support of governments controlling rights of way.
- The United States government would seek to bring to bear the resources of the Export-Import Bank, OPIC, and the Trade Administration Agency (TDA), but would take care to do this through consultation, and not by means that would abridge their legal independence.
- The stated basic objectives of the policy were to: prevent Russia and Iran from successfully imposing a dual-key lock on exploration and transport of oil and gas reserves from the Caspian; buttress the independence of the newly emerged states in the Caucasus/Caspian region; protect the economic/political stability of Turkey ; and to contribute to the long-term stability of the global energy system. A co-equal priority would be to find ways to do this without fracturing the larger US-Russian relationship, by making it clear that the objective was not to exclude Russian commercial activities.

It remained to convert this general framework into official policy, and to construct a more formal process for managing its many elements in government. Conversion to formal policy was a relatively straightforward process, involving a blending of well-established informal and formal systems. There already existed multiple informal levels of communication among cabinet level officers and deputies. These informal systems did not make policy, but simply provided a way to identify new issues and to initiate early thinking. The next step was to schedule a discussion of Caspian energy policy at a

meeting of the Deputies Committee; and having done that to move it – with the imprimatur of the deputies – to the first available Principles Committee meeting.

The Principles Committee rapidly endorsed the need for a policy and supported the proposal I have outlined above. By coincidence, then –Secretary of Energy Peña was scheduled to have a series of routine meetings with leaders in the region. We decided to capitalize on this by making it the occasion to unveil US policy and to seek the endorsement of these leaders for it. Their reactions were very supportive. The vice president opened a dialog with the Russian government in the margins of a Gore-Chernomyrdin meeting. Chernomyrdin's response was polite and not confrontational, but showed us that Russian leaders continued to feel a proprietary interest in Caspian energy, despite their loss of control over the region.

The first accomplishment of this policy and its related diplomacy was to bring about agreement, in September 1995, on construction of a relatively low-capacity pipeline for the transport of oil from Baku to the port of Supsa, in Georgia. From there, the oil would be loaded onto barges and ultimately shipped to markets via the Bosporus. Although small in scale, this agreement created all the basic precedents needed to reach agreement on a full-scale pipeline for oil, to run from Baku to the Turkish port of Ceyhan (announced at a region-wide meeting in Istanbul, in June 1998.

The Caspian policy could not properly be managed from within any one executive branch agency, or in any single directorate of the National Security Council, or in the National Economic Council. Conventional placement of the policy always seemed to be at serious cost to one or more of its objectives. Instead, we decided to convert the improvised mechanism used during the policy's formation, into a hybrid management system to coordinate its execution.

The plenary group of this body was large enough to permit all interested agencies to engage. It met more or less monthly, but in any event, as needed in the Old Executive Office Building. It was co-chaired by myself and by a senior NSC department head. External diplomatic actions were coordinated by the Department of State through an individual of ambassadorial rank: initially Dick Morningstar, and then John Wolf.

The senior cabinet lead was held by the Secretary of Energy: first Frederico Peña, and then Bill Richardson. The vice president could be engaged at the request of the group, through me. The president could be engaged at the request of the group, through the National Security Adviser. The system fed smoothly into the formal policy system as needed, and it fed into the formal interagency on a constant basis. It generated very good situational awareness. There were no rogue actors.

The Caspian energy policy had many ways to fail. There could be no guarantee that concerned governments would find it in their interests to cooperate, that US energy companies would pick routes for economic reasons that would overlap the strategic interests of the US government, or that US lending agencies that had legal independence in lending decisions, would be convinced of the soundness of any resulting proposals. But the policy did succeed, and the Baku-Tbilisi -Ceyhan oil pipeline is in operation

today as a consequence. We also succeeded in bringing this project to fruition without a confrontation with the Russian Federation.

What lessons, if any, does this history offer for the future? As you know, since leaving government in 2000, I have been a research professor at the George Washington University. My subject has been an effort to find ways for democratic forms of governance, such as ours, to handle the increasing pace of change that characterizes the modern world.

I have come to understand that the United States is having to confront policy challenges that are not merely complicated but complex in the theoretical meaning of that term: they involve the interaction of systems of events within other systems of events; they resist permanent resolution because solutions to old problems mutate into new challenges; they do not display linear or predictable relationships between cause and effect, so that seemingly minor changes of input produce abrupt, and even discontinuous changes of output.

I have also come to believe that the best approach our government can use in its efforts to manage complex issues will be based on networked forms of organization. Networks handle complexity by dispersing authority to act in a structure where the distance between "the field" and "headquarters" has been shortened by eliminating middle layers of management, and by substituting sophisticated information systems. These systems maintain coherence by using feed-back channels to measure performance against expectations, and to generate corrective responses based on learning.

The Caspian energy issue was a complexity phenomenon, although we certainly did not recognize it as such at the time. The methods that we improvised to run our policy, like the systems that we developed to run the bi-national commissions, were in fact examples of networked organization. In hindsight, I see that my colleagues and I were dealing with complexity, without realizing the full implications of that fact, and we were experimenting with networked organization without understanding the theory. We were able to do both of these things because the administration offered us the latitude to ask unorthodox questions and to put into place equally unorthodox responses.

The administration was open to new thinking across normal bureaucratic limits. It was open to bureaucratic improvisation in ways that strengthened the underlying interagency machinery. It was inclusive and unusually transparent to its participants. Decisions were developed by open processes. Once established, policy reliably guided practice. Where practice suggested deficiencies in existing policy, changes could be made rapidly within the system rather than outside it. The intelligence system was employed continuously and purposefully. Intelligence personnel did not advocate policy, but were present as it was debated and knew what its information requirements were.

We made sure the process was buffered against political end-runs, or even the appearance of political influence. We were ready to solicit information and insight from the private sector, but we did not fine-tune our policies to match their commercial interests. We developed comprehensive, all-points relationship with other governments, such that energy could be approached in terms of even broader concerns. We developed

and used high level contacts for the most stubborn or urgent of our bilateral problems, but used these relationships sparingly and only if normal government to government contacts were stalemated. Most importantly, we were consciously redefining the scope of national security to include major economic issues, and we redesigned the policy-making machinery to better express priorities and trade-offs between traditional and new conceptualizations of national security.

I believe that these are attitudes and concepts lessons that will be helpful as we deal with energy issues of exponentially increasing difficulty. Over the last eight years, the United States has fared less well in terms of routes for the transport of gas out of the Caspian. Early on, it became apparent that Gazprom intended to make a stand on winning this prize, and that to accomplish this, the Russian Federation was prepared to fully mobilize its resources. The United States has not done likewise, and the results are evident.

There is of course, the South Caucasus Pipeline, which connects gas from Azerbaijan's fields in the Caspian to Turkey. But, in general, my impression is that the United States is not doing well in terms of Caspian gas. Under Putin, the Russian state has re-established dominance over the decision-making of its oil and gas enterprises, and has effectively merged with Gazprom . We have already seen efforts to use that power for blunt political objectives in Eastern Europe. The European Union – after ignoring its energy dependency on Russia for a generation, is alert at last, but is not responding very effectively. The so-called Nabucco gas pipeline – to move gas into Europe through Austria, using routes through Bulgaria and Romania, is apparently being overtaken by Russian efforts to block any access except by way of the Russian pipeline system.

As best I can determine, the US government has lost focus. Other matters consume the attention of our highest officials, and that is understandable. But political freedom is still what we are all about, and since colonial times, American statesmen have understood that political independence cannot co-exist with economic servitude. Whoever wins the next election for President, will need to broaden the focus of national security, and proceed accordingly.

Leon Fuerth

June 11, 2008