

Oral Statement of Leonard L. Coburn
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Department of Energy
Before the Senate Foreign Relations Committee
Subcommittee on International Economic Policy
Global Energy Security
April 30, 2003

Thank you, Mr. Chairman. I am pleased to appear before you today to discuss the important role that energy plays in Russia and Central Asia and the Caspian region and the Administration's efforts to enhance our cooperation with these countries.

Introduction

On April 8, 2003, Deputy Secretary Kyle McSlarrow provided this Subcommittee with an overview of the important role that energy plays in the global economy and the Administration's efforts to enhance our energy security. Today, we will narrow our focus to concentrate on the Administration's energy cooperation with Russia and with the independent republics of Central Asia and the Caspian.

The Administration has been extremely proactive in its relations to both regions and there is a great deal of progress to report in our efforts to enhance energy cooperation. Production and

reserve figures will be discussed first and then our energy cooperation with Russia followed by Central Asia and the Caspian.

Oil Production and Reserves

Oil production in Russia has rebounded significantly over the last several years. The attached table profiles Russian oil production over the last decade. In 2003, oil production continues to increase and is approaching 8 million barrels per day. Russia is now the second largest producer and second largest exporter of crude oil behind Saudi Arabia.

In the Central Asian-Caspian region, oil production also has increased substantially over the last decade, due to the influx of foreign investment in Azerbaijan and Kazakhstan. Production in 2002 averaged about 1.5 million barrels per day.

Reserve numbers for Russia and the Central Asia-Caspian region vary widely and are difficult to pin down. In Russia, oil and gas reserve numbers remain a state secret; thus there are no official reserve numbers. Oil and Gas Journal's 2002 estimates put Russian proven oil reserves at about 50 billion barrels. Several Russian oil companies indicate that this reserve level vastly understates the actual reserves. They estimate the reserves should be in the 90 to 110 billion barrel range.

In the Central Asia-Caspian region, reserve numbers also have varied widely depending upon the source. EIA indicates that proven reserves are somewhere between 17 and 33 billion barrels. The

have been estimates of resources (not proven reserves) in excess of 100 billion barrels.

Russia

The U.S. Government's history of energy engagement with Russia dates from the early 1990's, but in the interest of time, I will focus on this Administration's energy engagement with Russia. The President recognized the importance of the United States' relationship with Russia early on in his Administration, elaborating on this relationship in the Administration's National Energy Policy, issued in May 2001.

Recommendations included in the National Energy Policy provide a guide for Russian engagement, and since the policy's creation, the Department of Energy has been active in fulfilling and expanding upon the recommendations. In the past decade, the U.S. government has been unwavering in its support of sound legal, fiscal, and regulatory environments in Russia.

The U.S. government has remained committed to supporting market reform in the energy sector. The U.S. also has been a strong supporter of oil and gas development in the region. One way in which we have sought to enhance our energy supply security is to promote Russian energy resource development and export.

We have expressed our support for the efforts of Russian oil majors to export crude to the United States and the future development of transit routes and terminals that will allow Russian resources to reach American markets.

The Administration's enhanced energy engagement with Russia developed as a result of the Summit held by Presidents Bush and Putin in May 2001 in Russia where they issued a Joint Statement on a new U.S.-Russian Energy Dialogue. It confirms the importance of energy in our bilateral relations and the Department of Energy is moving forward on the elements of this dialogue.

In order to accomplish these objectives, the Department of Energy and the Russian Ministry of Energy created a U.S.-Russia Energy Working Group. We will be concentrating on five areas:

- Global oil markets
- Investment
- Technology, including energy-efficient, environmentally friendly, clean coal technologies, and oil spill prevention and response
- Energy information exchange
- Small and Medium size enterprises

The Energy Working Group has met three times, most recently on April 7-8, 2003. There has been a great deal of progress in all five subgroups.

Last October, the Departments of Energy and Commerce organized the first U.S.-Russia Commercial Energy Summit held in Houston. The summit was co-hosted by Secretary Abraham, Commerce Secretary Evans, Energy Minister Yusufov, and Economic Development and Trade Minister Gref. The Summit was acknowledged by participants, co-chairs, and industry observers

as a great success.

At the outset of the Summit, Secretary Abraham stressed that the government's job is to create the framework of laws and rules that will allow our companies to form partnerships with confidence in the security of their arrangements... and to operate in a competitive market and free trade environment. At the summit we discussed how to facilitate investment in the Russian and American energy sectors.

Cooperation and partnerships already are underway. These include the Caspian Pipeline Consortium (CPC), Sakhalin One, Marathon Oil Corporation's recent acquisition of Khanty Mansiysk Oil Corporation, and the ConocoPhillips Polar Lights joint venture.

We will continue to promote commercial partnerships between U.S. and Russian firms in the U.S., Russia, and third countries. The Summit featured the announcement of a U.S.-Russia Commercial Energy Dialogue that will be industry led and will increase communication and cooperation. The Departments of Energy and Commerce will consult with this group to identify and help remove barriers to energy trade and investment. The Commercial Energy Dialogue provides the opportunity for Russian and Western companies to sit together to solve common problems on legislation and regulation of the Russian energy complex. The level of cooperation could not be better.

The U.S.-Russia Energy Dialogue will focus on efforts to promote energy security through discussions with Russian officials of possible technical assistance with a Russian strategic

petroleum reserve.

Technology will continue to be a focal point of the U.S.-Russia energy relationship, and energy efficiency and gas flaring elimination and reduction strategies will be given special attention in the short term.

We also have included environmental issues in our energy dialogue. When the Secretary of Energy was in Moscow six weeks ago, he signed a Statement of Intent to enter into a dialogue on oil spill prevention and response. This is an important area for both countries as we move towards the reality of increased shipments of oil from Russia to the U.S.

U.S. Department of Energy, U.S. Department of Commerce, Russian Ministry of Energy, and Russian Ministry of Economic Development and Trade officials have started planning for the next Commercial Energy Summit to take place in Russia in the fall. This next summit will include discussion of electric power in addition to oil and gas.

Lest I give you the impression that there are no concerns and problems, I would like to indicate that the path forward is not smooth and straightforward. While Russian oil production continues to increase, Russian exports are hampered by serious infrastructure problems. Today, Russian oil tankers do not have access to a deepwater port where crude oil can be transported long distances in an economically sound and environmental safe manner. Long distance markets such as the U.S., China or the Asia-Pacific are the future targets of Russian crude oil. These markets require either access to deep water ports, or new, long-distance pipelines, or some combination

of pipelines and ports. These facilities will be expensive, but are now being considered by Russia. Who will own, operate and finance these projects is under active consideration. Whether crude oil will flow directly to the U.S. and enhance U.S. energy security and supply diversification will be determined by the results of this debate and the development of these new infrastructure projects.

The opportunities for U.S. companies to invest in Russia again is not so clear and straightforward. Russia has gone through a series of changing attitudes towards western investment and its desirability and necessity. When oil prices are relatively low, or the Russian economy weak, western investment has been attractive and Russian policymakers have been active promoters of it. With a more robust Russian economy and higher oil prices, Russian policymakers have changed their tune. Regulatory, legal, and tax and other fiscal policies reflect this changing environment.

The history of Production Sharing Agreement (PSA) legislation is a good example of changing attitudes. PSAs are attractive to foreign investors because they state in one negotiated document how much a company will have to pay to the government for the right to exploit the resource, how costs will be recovered, which legal regime will be used in the event of disputes and many other rights and obligations. With a resurgent domestic oil industry in Russia and the creation of a more modern tax code, the need for PSAs has been questioned by the government and strongly opposed by some Russian companies. Recent pronouncements by the government indicate that only a relatively few projects will be permitted under the PSA regime. It is a time of uncertainty, especially for the large, high cost projects in high-risk areas.

Central Asia-Caspian

The experience in Central Asia-Caspian region is both different and similar. Most important, there have been substantial investment successes by western and U.S. companies in the region. Following the breakup of the Soviet Union in 1991, this region attracted the interest of the international energy community because of the huge oil and natural gas reserves believed to lie both on shore, but especially offshore beneath the Caspian Sea.

With independence, both Azerbaijan and Kazakhstan welcomed international investors, and big PSA contracts have been signed in both countries. These projects developed by western investors, including companies from the United States, have created thousands of jobs, provided access to improved technology including training for the labor force, invested in social infrastructure, increased commitment to environmental protection, and encouraged the establishment of many small and medium sized enterprises in these countries.

One of the major difficulties faced by Caspian states as they attempt to develop and export their energy resources has been the lack of export outlets. The Administration has consistently supported the development of new pipeline projects, especially an East-West transport corridor that would stretch from Kazakhstan through Azerbaijan, Georgia and Turkey to the Mediterranean. The Baku-Tbilisi-Ceyhan (BTC) pipeline is under construction and negotiations are underway to include Kazakhstan in this pipeline project.

A second issue inhibiting oil and gas development in the Caspian Sea is the unresolved legal status of the Sea.

As in Russia, the United States Government has consistently supported the development by Central Asian countries of sound legal, fiscal and regulatory policies to support economic growth, including energy development. The Department of Energy has maintained on-going dialogues with energy officials from Kazakhstan and Azerbaijan on market reform in the energy area. In December 2001, we established a U.S.-Kazakhstan Energy Partnership. This Partnership has met three times.

In Azerbaijan, departmental officials, including the Secretary, meet on a regular basis with representatives of the Azerbaijan government and have recently begun an initiative to expand our cooperation beyond oil and gas to energy efficiency and renewable technologies.

As with Russia there are problems. With economic growth, the government of Kazakhstan has developed ambiguous feelings about foreign investment as has happened in Russia. The investment climate has been affected by such things as changes in laws relating to domestic content and government policy on visas for expatriate workers. A recent dispute over provisions of the PSA with Tengizchevroil, while resolved, led to a government statement that future PSAs would have less favorable provisions for foreign investors.

Conclusion

This Administration has had an extremely proactive approach to energy dialogue with Russia and the Central Asia-Caspian regions. We have made good progress and have achieved some successes, but we are by no means finished with our agenda. We will continue to engage the governments of these countries to enhance our cooperation and build upon the work already underway.

Mr. Chairman, I would like to thank you for the opportunity to testify before you today, and I welcome any questions you and the Committee might have.