

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

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Mr. Chairman, Senator Lugar and distinguished members of the Committee, thank you for the opportunity to appear before you today. As diversification away from Russian and Russian-controlled energy transportation across Europe and Eurasia is critically important for America's national security interests, I am honored to be able to share my views with you on this critical topic.

Top-level US engagement is essential for the establishment of the Central Asia-Europe Energy Corridor. At risk is the future of the vast space Russia considers as its backyard: the Eurasian, Black Sea and Baltic Sea regions. European Union solidarity and transatlantic unity are also in danger.

Russian Challenge to the Alliance

The most recent example of Russia's increasing influence on European foreign policy and its "divide and conquer" strategy was NATO members' inability to reach a consensus on offering a Membership Action Plan (MAP) to Georgia and Ukraine. Most from Northern, Eastern, and Central Europe agreed with the American position that the two countries should be East and Central Europeans joined the American camp, whereas many West Europeans sided with Germany, which opposed MAP extension largely due to their desire not to anger Russia. In the end, a non-NATO member Russia was able to veto *de facto* the American proposal—the first time this has happened in NATO's history.¹

While Georgia and Ukraine have been promised "eventual" NATO membership, an emboldened Moscow has since intensified its efforts to undermine Georgia's territorial integrity by its aggressive actions in separatist Abkhazia. The Russian government has also begun to challenge Ukraine's integrity by claiming sovereignty over Crimea.

The split within NATO on issues related to Georgia and Ukraine mirrors the rift that has formed on the issue of Europe's energy diversification. The European countries

¹ Both Senator Barack Obama and Senator John McCain have expressed strong support for extending MAP to Georgia and Ukraine.

that have long-term energy partnerships with Russia are often reluctant to take foreign policy stances that may irritate Moscow. It is up to the United States to support strongly the diversification of Europe's energy supply away from Russia. America's European allies need to take strategic foreign policy decisions without fear of a potential Russian backlash.²

We know that the Russian leadership wants to establish their country as an illiberal "sovereign democracy." Moscow enjoys playing by different rules than the West, particularly the United States. Former president and current Prime Minister Vladimir Putin clearly stated this vision for Russia during his speech in Munich in February, 2007. European and American failure to acknowledge the Kremlin's use of energy as its primary tool in achieving this vision has resulted in ineffective policies, which, above all, damage Russia's chances to evolve in a liberal direction.

Since Russia cut off gas supplies to Ukraine on January 1, 2006—the same day it took over the presidency of the Group of Eight (G-8)—there has been increased awareness in Europe of their dependence on Russian gas supplies. There is talk about formulating a united external energy policy within the European Union to diversify supply sources and routes, but the 27 countries have been unable to reach consensus because of conflicting priorities.

The EU has so far failed to come together as a single voice partly because the issue has not been framed correctly. The unity they need is in negotiations with Russia, and specifically its giant gas monopoly Gazprom, which serves as the Kremlin's leading foreign policy arm. There is simply no other country that poses the same political and economic challenge to the EU.

Wanted: US Strategic Engagement

European energy security and supply diversification as a concept is important, but this is not an area where direct US involvement is necessary or appropriate. US leadership is needed, however, to enable Caspian producers (mainly Azerbaijan, Kazakhstan and Turkmenistan) non-Russian controlled export options to Western markets. Europe's independent access to Caspian hydrocarbons would prevent further Russian control over their energy infrastructure, and thereby their foreign policy.

There is an excellent precedent: the Baku-Tbilisi-Ceyhan (BTC) and Baku-Tbilisi-Erzurum (BTE) pipeline projects. Even though the governments of Azerbaijan, Georgia, and Turkey backed these projects, the United States government's unequivocal support allowed these countries to proceed without fear of Russian repercussions. Similarly, it gave companies the confidence to invest in a major project like BTC or BTE that might have faltered in light of strong opposition from Moscow. In fact, even though the consortia for the BTC and BTE pipelines consisted mostly of European companies, European governments relied on US diplomacy to shield their companies from Russia.

² Germany already imports 40 percent of its gas from Russia, more than any other west European country; by 2020 this figure is expected to reach over 60 percent

Thanks to these two pipeline projects, Azerbaijan and Georgia are now free to develop their future policy without undue foreign pressure. Extending the energy corridor further east to Turkmenistan, Kazakhstan, and Uzbekistan would provide these Central Asian countries with such freedom as well. Surrounded by Russia, China, and Iran, all three have made clear their desire for a direct Western outlet in order to maximize their negotiation power and also to solidify their independence from Russian influence. As long as almost all their revenues come from Russia, they cannot feel completely independent.

Unlike in the 1990s, we have a strong and united Kremlin, currently occupied by a man who used to be the head of Gazprom. In some ways the switch from Gazprom to the Kremlin was not a major change for Mr. Medvedev because the policies of Gazprom and the Russian government have been inexorably intertwined. Gazprom is the state's largest source of revenue and the engine that has driven Russia's economic recovery. The company is primarily state-owned and many of Gazprom's corporate leadership currently hold—or previously held—high-ranking positions in the Russian government. In addition to the President himself, there is his assistant Konstantin Chuychenko, executive director of RosUkrEnerg and head of Gazprom's legal department; and the new Gazprom chairman, former Prime Minister Viktor Zubkov.

Putin has personally visited each of the relevant European and Eurasian countries, and met repeatedly with their top leaderships in order to allure them to join his energy projects. The most notable of these gas projects is the Nord Stream gas pipeline that will connect Russia and Germany. This politically divisive project is headed by Gerhard Schröder, who extended \$1.2 billion credit guarantee to this pipeline just prior to stepping down as German Chancellor.

Clearly, it is not realistic to expect the US President to micromanage these issues. Yet, it is important to make clear our strong and bipartisan commitment to the Caspian-Europe energy corridor. There is already great work done at the deputy assistant secretary level, and now, thanks to Senator Lugar's initiative, there is once again a Special Envoy for Eurasian Energy.³ Now is the time for reinforcement from the Secretary of State and the President.

Bringing non-OPEC Caspian oil to Western Markets

On oil, there is the BTC, as well as the Baku-Supsa pipeline ending in Georgia's Black Sea coast to transport Caspian (mainly Azerbaijani) oil to Western markets via non-Russian controlled routes. Baku-Novorossiysk and CPC pipelines also bring Caspian

³ President Bill Clinton created this position in 1998, and appointed Richard Morningstar as "Special Advisor to the US President and Secretary of State for Caspian Energy and Diplomacy". Following the signing of key agreements for the BTC and BTE pipeline projects, this position gradually was abolished and key responsibilities transferred to the European and Eurasian Bureau at the State Department. Mr. Morningstar served as US Ambassador to the EU following his assignment; newly appointed Special Envoy Boyden Gray is currently serving in this position concurrently with his role as US Ambassador to the EU.

oil westwards, but with Russian involvement. Russia has used its shareholder position in CPC to delay the expansion of this pipeline bringing Kazakh oil to the Black Sea, thereby hindering production.

Moreover, Moscow has conditioned the expansion to the commitment of necessary volumes of oil for its planned Burgas-Alexandroupolis (B-A) oil pipeline. The B-A pipeline will transport oil from the Black Sea via Bulgaria and Greece. In principle, the US should be supportive of such a pipeline, but Russia has 51 percent ownership and the Kremlin is using its position to urge Russian companies to invest in it. This may not be the best route for Kazakhstan or for private companies (mainly Chevron and Exxon) who may not want to submit to further control by the Russian government. The US should inquire further about the ownership and structure of this pipeline, which would be the first Russian-managed oil pipeline in the EU.

Diversification from Russian control in the western direction is a key reason for Kazakhstan to commit its oil to BTC. The Kazakh-Azeri connection is critically important to enlarge the east-west energy corridor and to reliably bring significant amount of new, non-OPEC oil to world markets.

Additional Kazakh oil will go westwards to Georgian Black Sea ports (Kulevi and Supsa). Some will reach markets via tankers crossing the Turkish Straits and some via Straits bypass routes. A portion of that oil, along with Azerbaijani oil, should be sent to European markets via the existing oil pipeline starting in Ukraine's Black Sea port Odesa and continuing onwards to Brody. Odesa-Brody was actually built for that purpose but failed to secure supply commitments from oil producers. As such, it has been operating in reverse direction ever since, transporting Russian crude from Brody to Odesa. In May, at the Kyiv conference, Azerbaijan, Georgia, Ukraine, Poland, and Lithuania not only reached consensus to switching Odesa-Brody back to its intended direction, but also to support extending the pipeline to the Polish city of Płock. From there, it would connect to the existing Polish network, enabling oil to continue to the Baltic Sea oil terminal of Gdańsk.

The US needs to ensure that Azerbaijan, Kazakhstan, and private oil companies would not once again be subverted as this project would connect Ukraine to the east-west corridor and strengthen its pro-Western orientation. Now that Ukraine has been officially promised NATO membership, it should be firmly anchored in the broad Caspian-Europe energy corridor.

Geopolitics of Gas: Nabucco vs. South Stream

On gas, the challenge is bigger due to the nature of natural gas as a tradable commodity—there is no global market, and the construction of costly pipelines effectively locks consumers into a prolonged contract with producers. This means that Moscow can more easily manipulate dependence into political and economic leverage. Natural gas is vital to the economies of many European nations—and the fuel's primacy is growing. The prospect of being forced to pay a higher price for that gas, or even having

the supply of that gas curtailed, can exert a powerful influence on a country's domestic and foreign policies.

Thanks to US support for Caspian-Europe direct gas connection, BTE has already been built, and its extension to Greece began operation in November 2007. The Turkey-Greece pipeline has enabled gas from Azerbaijan to flow all the way to the EU free from Russian control. Construction will soon begin on an extension of the Turkey-Greece connection to Italy, named the TGI pipeline.

Meanwhile, the Nabucco pipeline has become a litmus test for the ability of the EU and the US to complete a project that is a stated priority. Nabucco (named after Giuseppe Verdi's opera) is intended to have a capacity of 31 billion cubic meters that will enter Europe through Turkey. The pipeline will traverse Bulgaria, Romania and Hungary, terminating in Austria at that country's Baumgarten gas storage and distribution hub. It was originally introduced by Austria to bring mostly Iranian gas to European markets; now it is backed by the US to transport Caspian and Iraqi gas to European markets.

I will briefly discuss Iraqi gas later. Iranian gas for Nabucco is still occasionally discussed, especially by Austria, but until relations with Iran settle down, it is all but pointless to even discuss this option. Even after talks begin, it will take quite some time for Iran to develop its gas fields such that it will have sufficient gas to export—currently it is unable to produce sufficient gas for its own domestic needs.

After recognizing that Nabucco and TGI would break their monopoly of transporting Caspian gas to Europe, the Russian leadership took several steps to undermine them. At first, the Kremlin wanted Gazprom to be included as a partner to have Russian gas transported via these pipelines. However, it faced opposition since the move would have annulled the *raison d'être* of these projects. Putin was also eager for a second gas pipeline connection to be built from Russia to Turkey, called Blue Stream II, in order to reach the Turkish market first and keep Caspian gas out.

In other words, there was a race for the Turkish market. Having learned from its experience with Blue Stream I, which I will explain shortly, Turkey did not want to—once again—undermine the Central Asia-Europe gas vision by reaching another major agreement with Russia. Turkey thus made clear its continued commitment to the work with the US, EU and its Central Asian partners.

When it became clear that Nabucco could not be derailed in Turkey, Russia moved to bypass it by piping into Bulgaria directly, and from there Greece. So, in June 2007, Gazprom came up with a massive subsea pipeline project, the South Stream pipeline. Although the details of this venture are yet to be solidified, it is clear that South Stream, with a planned capacity of 30 bcm, will be one of the world's largest and most expensive pipelines ever built. Estimates of cost vary, but most analysts predict it would cost twice as much as Nabucco.

The signing of the South Stream pipeline project took place in Moscow between Greek Prime Minister Kostas Karamanlis and outgoing Russian president Vladimir Putin

on April 29. Former Italian Prime Minister Romano Prodi was offered the chairmanship of the project by Gazprom CEO Alexei Miller and Eni head Paolo Scaroni, mirroring former German chancellor Gerhard Schroeder's appointment to direct Gazprom's Nord Stream pipeline. Prodi was previously head of the European Commission, and his support would be essential for the pipeline's success, given that there is growing unease in Brussels and Washington about Gazprom's expansion into Europe. So far, he has declined to take the position.

South Stream targets the same markets and utilizes almost identical routes to Nabucco. In fact, three of the five countries along Nabucco's route are also part of South Stream's intended route. The pipeline would cross the Black Sea to Varna, Bulgaria. From there, South Stream will split into two smaller spurs: one heading West through Greece, beneath the Ionian Sea and into Southern Italy; and the second heading North through Serbia and Hungary, terminating at Austria's Baumgarten storage facility. There may also be additional lines constructed to Northern Italy via Austria and/or Slovenia.

Baumgarten is critically important in Russian strategy. Austria is involved in both Nabucco and South Stream, and both pipelines will bring gas to Baumgarten. In January, Austria's partially-state-owned energy company OMV signed a deal giving Gazprom 50 percent ownership in Baumgarten. As we know by now from other such partnerships Gazprom has formed over the years, the 50 percent would not mean equal partnership—Gazprom, and thus the Russian state, would in reality have a much bigger say. The growing OMV-Gazprom partnership is important, especially in light of OMV's desire to take over Hungarian MOL, which is the only privately owned company in the Nabucco consortium.⁴

Austria will thus become a Russian partner in Europe and serve as the clearinghouse for gas coming to Europe. Furthermore, Gazprom just last week announced that Austria and OMV would be joining South Stream and that an intergovernmental agreement will soon be signed to appoint OMV as South Stream coordinator for Austria.

Putin had previously offered Hungary the chance to become such a "hub," but the government refused—in part because of strong US opposition. Similarly, when Putin offered Chancellor Merkel such a "privileged partnership," she made clear her position to side with her EU allies.

Gazprom is making sure it has maximum flexibility in extracting the best deal for itself by having several options to get to its key markets. For example, even with strong Austrian partnership, it will construct a South Stream spur to Slovenia, and thus negate the possibility of Austrian leverage over the gas route. If problems were to emerge in Austrian-Russian relations, Gazprom could then re-route exports to northern Italy via Slovenia.

⁴ The pipeline consortium is equally owned (16.67% each) by Austria's OMV, Hungary's MOL, Turkey's Botas, Bulgaria's Bulgargaz and Romania's Transgaz and Germany's RWE

No Western company has the kind of partnership with its state as Gazprom has with the Kremlin. No Western country or company would build pipelines with such political calculations. None would undertake commercially unviable projects. We are dealing with a situation where normal competitive market principles simply do not work. It is imperative the Europeans recognize it and start taking steps accordingly; we are invariably dealing with a state-sponsored organization that has turned gas pipelines into a geopolitical tool.

Race is on: Sequencing Matters

For Russia, the main purpose of the South Stream gas pipeline project is to prevent Nabucco and TGI lines from transporting Caspian gas independent from Russian control to European markets. How? Via two interdependent moves: first, by locking up the markets and keeping out potential competition—which, as I explained earlier, is not capable of competing when Gazprom sets the rules. And second, by assuring long-term and large volume gas commitment from Turkmenistan, as well as Azerbaijan and Kazakhstan to its pipelines, thereby preventing direct Caspian-Europe connection.

Therefore, sequencing is vital. The fortunes of the two pipelines are inversely related; if South Stream is built first, it will pull Turkmen and Azerbaijani gas to its direction, leaving little reason for Nabucco to be built for Caspian gas.

From an economic perspective, it is utterly impossible to build a pipeline such as Nabucco—which will cost upwards of \$12.3 billion—unless investors are confident that the market on the consumer side will be sufficiently large. The important difference between Nabucco and South Stream is in ownership; Nabucco will be privately financed and therefore needs to be commercially viable, whereas South Stream is backed by state-owned Gazprom, which is perfectly willing to finance projects that do not make commercial sense so long as they support the strategic goals of Moscow. Unlike Western companies, Gazprom is also willing to use pipelines at minimum capacity—it loses money in the short term, but in the long term, thanks to having killed all competition, it will end up with a web of pipelines in its control. I will discuss potential implications of this shortly.

Nabucco faces a number of financing hurdles even without South Stream's competition. Investors are uncertain of Azerbaijan's ability to supply Nabucco and even more uncertain that a trans-Caspian pipeline will be constructed to bring in the Turkmen gas that many view as necessary for Nabucco to succeed. Still, the largest obstacle for Nabucco is South Stream; the potential of South Stream filling a portion of Europe's expected short- to mid-term demand will likely be enough to scare investors away from Nabucco.

So it is interesting that all the countries potentially joining South Stream speak with one voice, insisting that that Nabucco and the Russian pipeline are “complimentary not contradictory.” This brings to mind the gas race to the Turkish market in the late 1990s.

Turkey, Turkmenistan and the United States were eager to construct a trans-Caspian pipeline that would carry gas from Central Asia via the Caucasus to Turkey. Russia did not want to see its monopoly in Central Asia eroded by the construction of additional export routes and proposed a pipeline from Novorossiysk beneath the Black Sea to Turkey. Supporters of the Russian pipeline, which is now called Blue Stream, insisted that current and future Turkish gas demand was large enough to support both projects; that the two lines were, in fact, “complimentary.” Those who thought otherwise were reluctant to challenge Russia and went along—mainly because they did not think it would actually be built. They referred to this project as “Blue Dream” because of its lack of market viability and the use of never-before-used technology to construct a pipeline deep underwater. These assertions were quickly proven false. As soon as Ankara signed an agreement to build Blue Stream, interest in the trans-Caspian project dried up. Blue Stream not only prevented Turkey from having direct access to Turkmen gas, but increased its dependence on Russian gas to over two-thirds of its demand. Since its beginning, Blue Stream has operated at less than half of its 16 bcm capacity and provided the most expensive gas to Turkish consumers. Blue Stream is the product of the Gazprom-Eni strategic partnership that is now promoting South Stream.

Other Risks of South Stream

Gazprom may not have enough gas to fill Nord Stream, South Stream, and its two preexisting pipeline networks through Ukraine and Belarus. The International Energy Agency has already warned that Gazprom may be unable to meet its supply contracts by 2010. Yet from Gazprom’s perspective, this surplus capacity will have no negative effects. If both Nord Stream and South Stream are constructed in the proposed time frame, Nabucco will likely disappear. Russia’s dominant market position will be enhanced. Thus, European consumers will be left competing against each other for scarce Russian resources, driving up prices and granting Russia ever-greater leverage. Energy prices would escalate and Moscow would be able to extract political concessions from consumer countries in exchange for greater gas supplies. This leverage is typically not exercised through dramatic supply cut-offs, but instead through subtle and protracted pressure.⁵

If South Stream (and its sister Nord Stream) is constructed, Gazprom will actually enjoy a surplus of export capacity while Europe will face a deficit of supply options. This is potentially very troubling. Having a strong monopoly on transit routes into Europe, even if underutilized, still gives Russia significant influence vis-à-vis its ability to grant other producers access to these routes. Moscow may be anticipating the formation of a cartel-type organization for natural gas—with Russia assuming the leadership role—that will coordinate European supply. Reportedly, there is a plan in the works to create an international platform for elaborating a universal gas pricing formula and for discussing new gas pipelines routes and swap arrangements. From there, it will be an easy step for

⁵ However, supply cut-offs have been employed by Russia against smaller Eastern European countries like Latvia (2003) and Lithuania (2006).

members to agree to divide up markets, forming monopolies, and gaining absolute control over prices.

South Stream also poses a very real threat to Ukraine, as it would give Moscow the option to decouple the country from its gas supply exports to the EU. This would leave Ukraine exceedingly vulnerable to Russian political pressure. Ukraine's position as the transit route for around 80 percent of Russia's gas exports to Europe currently gives it a degree of leverage over Moscow. Were these supplies rerouted via South Stream, Ukraine would lose this leverage. It is no secret that Moscow does not want to see Ukraine align itself with the West, and has strongly opposed the country's efforts to do so. Ukraine is in a precarious position between East and West. There are many in its government that wish to abandon Ukraine's current political orientation and turn towards Russia—and to its corresponding political and social values. Whether or not Ukraine continues its progress towards Western values has much to do with its energy security, with South Stream as the cornerstone of the issue.

What should the US do?

The most important next step is to make credible, unequivocal, and bipartisan commitment to the Caspian-Europe energy corridor. First, the President needs to reinforce this vision by traveling to the region, namely Azerbaijan, Kazakhstan and Turkmenistan. Second, the Secretary of State needs to be engaged to the Caspian-Europe energy corridor. Third, a bipartisan congressional delegation needs to show its commitment as well. A Senate delegation led by Senator Lugar, who is highly regarded in the Caspian region, would have the best chance to make a positive impact.

If the US wants non-Russian pipelines such as Nabucco and TGI to become pipelines for Caspian gas transport to Europe, then Washington needs to provide political support to encourage exploration and development. It is important to recognize that US vision for these two pipelines, especially Nabucco, is not the same as that of Brussels—hence the lack of political backing from the EU. In September 2007 the European Commission appointed former Dutch Foreign Minister Jozias Van Aartsen as “EU Coordinator for the Caspian Sea-Middle East-European Union Gas Route”, including Nabucco, which it considers a “priority project.” Yet Mr. Van Aartsen has not yet visited Azerbaijan or Turkmenistan. As of May, he began serving as mayor of The Hague and spends only minimal time on this project. The EU cannot be taken seriously in its commitment to Nabucco (at least not in obtaining Caspian gas for it) if they leave the coordination of this project to an occasional presence because the whole Kremlin machinery is working to undermine it.

Now is not the time for hesitation but for immediate action. Russia and Russian-influenced groups argue there is not enough gas in Azerbaijan, Kazakhstan or Turkmenistan to make Nabucco viable. This is the same argument used to sow doubt in the investors and countries commitment to BTC: there was not enough oil in Azerbaijan, it was not commercial, and it was merely an American political project.

Of course, if there were indeed no large gas volumes in these countries, Mr. Medvedev's would not have chosen Kazakhstan as his first foreign visit and would not be courting his counterparts in Azerbaijan and Turkmenistan, which he plans to visit in early July. In addition to maintaining its monopoly over Kazakh and Turkmen gas export, he hopes to also begin exporting Azeri gas as well.

All three nations are able to provide more than enough gas for Nabucco and several other projects—provided action is taken now. Each nation has shown they want to send large volumes of energy resources westward, but they are increasingly under Russian pressure. They managed to resist thus far, but now they need to see political will from the West. If the US would not risk the ire of Russia, how can they be expected to do so?

Azerbaijan has already shown its strategic vision by promising gas to Nabucco. In November 2007, the Azerbaijani government and the western producers operating in its Shah Deniz offshore gas fields announced that there were significantly more reserves than initially thought—more than enough to supply the first phase of the Nabucco project. More recently, at the Caspian Oil and Gas-2008 [conference] in early June, Azerbaijan's Minister of Industry and Energy Natiq Aliyev announced that the reserves exceed 1.2 trillion cubic meters, and production could soon reach 30 bcm. Some of this gas will be consumed in Azerbaijan, Georgia and Turkey; about 15 bcm could be sent to EU markets. For that, the stage-2 of the Shah Deniz field development needs to be expedited. And that will only take place if the political risk is mitigated—which only US action can do. There are other very promising fields in Azerbaijan, development of which will also depend on the success with Nabucco development and the pace of reduction of transportation risks to EU markets.

Turkmenistan is believed to possess some of the largest gas fields in the world. In 1999 it committed 30 bcm gas westwards—16 bcm for Turkey and 14 for Europe. Now that current estimates range from 22 to 30 trillion cubic metres, that amount can easily be increased. In fact, gas from Turkmenistan will flow west directly only if the amount is large enough—otherwise western producers may not invest the billions necessary. Instead, Russian and Chinese companies will continue to increase their stakes and send gas their way.

It has been US policy since late 1990s not to engage Turkmenistan until its human rights record improves. For many years the mantra was to wait out the authoritarian president Saparmurat Niyazov and then start working on the gas project. During this time, Niyazov wanted to move away from the grip of the Kremlin (and its foreign policy instrument Gazprom), but was unable to do so given the West's reluctance to work with him. Yet he was nonetheless able to take advantage of Vice President Dick Cheney's trip to Kazakhstan in May 2006, during which Cheney advocated a trans-Caspian gas pipeline which would allow the two countries to receive a much higher price for their gas compared to what Gazprom was paying them. Armed with the prospect of diversification, Niyazov was able to negotiate a much more favorable deal, and agreed only to a three-

year deal, rather than a much longer term commitment that would harm the prospects of a trans-Caspian gas pipeline.

After Niyazov died in December 2006, US policy shifted to wait and see if the new president would be more democratic. This policy not only cost the US much valuable time and access to gas fields as the Russians moved in, but is also totally inconsistent with how Washington works with other countries with less than stellar democratic credentials on issues of mutual interest, such as Russia, Saudi Arabia, and China. Moreover, not engaging actually made democratic evolution less possible as increased engagement with Russia and China has provided Turkmenistan (and other Central Asian countries) with an alternative model: economic opening while maintaining political repression.

Once gas deals are reached and infrastructure is established, it is difficult to change course. Gazprom has already reached some long-term and large volume deals. This is time to pull the Turkmen closer—just as the Russians and Chinese are doing. Washington needs to send a clear message that the US—regardless of who is the next President—is committed to large quantities of gas reaching European markets via the proposed corridor. That means no longer sending confusing messages, such as being content with Turkmen gas going to China.

Azerbaijan and Turkmenistan had frozen relations for many years; now the two presidents recognize the importance of their partnership in realizing the Europe-Caspian vision. Despite the goodwill, there are issues that will prove difficult for them to resolve on their own; the US needs to be willing and able to serve as an honest broker and offer assistance if and when needed. **Kazakhstan** also has significant gas that can be exported, but it will not be able to do so unless there is sufficient progress with the other two.

In addition to these three nations, the US also needs to work closer with **Turkey**, which is critically important for the Europe-Caspian corridor vision. There was excellent cooperation in the realization of the BTC and BTE pipelines, the first phase of this corridor. In fact, the two sides could have used each other's talking points. Relations suffered due to the Iraq war, but are once again on an upswing. Turkish Foreign Minister Ali Babacan was in Washington last week, and energy was an important item on the agenda. Yet Ankara has not seen a clear and determined US commitment to Nabucco; this has resulted in unnecessary stalling in reaching the necessary agreements. What is needed at this point is the re-establishment of a consultative mechanism between diplomats on both sides. The Turkish foreign ministry views pipeline projects from a strategic perspective, which is precisely what is needed—and which is why US Caspian envoys have been based at the State Department.

Such a mechanism needs to be formed and begin working immediately. But that alone is not sufficient. Turkey needs to remain committed to the southern corridor vision; if it instead thinks of itself just as a transit country for gas to Europe, then there is no reason for it to say no to Russian or Iranian gas transiting its territory either—especially since many EU countries propose this. Moreover, some in Ankara do not consider South

Stream and Nabucco are competitors—and those who do consider it to be only a problem for the EU.

The US needs to recognize Turkey's fast growing energy demand and the difficulty for its leadership to say no to Iranian gas or to Blue Stream II. Rejecting Blue Stream II so far has only led to it being bypassed. The best way for the US to help those in Ankara who share the same vision for Nabucco and the gas race is to hold a trilateral working group of the US, Turkey, and Iraq to ensure timely **Iraqi** gas production and commitment to this pipeline as well as to Turkey's domestic market.

Iraqi gas is important to maintain and build increased momentum for Nabucco. The first phase of Nabucco is designed to run from Ankara to Baumgarten. The first phase is expected to become operational in 2013, with an initial capacity of up to 8 bcm a year. The second phase would be completed a year later to increase capacity to 31 bcm. Turkmen gas will be ready for the second phase; investors will want to see not only an Azerbaijani commitment but also an Iraqi commitment in order to be confident that supply will be there when the pipeline is ready. In April, the EU announced that starting 2009 it would begin receiving 10 bcm of gas annually from Iraq. The gas would come from the Akkas field in the Anbar province. Fully recognizing the importance of this gas, Gazprom has recently intensified its actions to sign a deal of its own.

US-Turkey-Iraqi cooperation on gas is also critically important for broader regional stability and cooperation. The EU has suggested that Akkas gas could reach Turkey via the Arab Gas Pipeline through Syria. But Turkey wants a direct route, and believes keeping Syria out of this project would also be in line with US policy. It is not clear what US policy is on Syrian transit; it would be important to clarify this in order not to send confusing signals to Ankara.

Another important country for the corridor is **Ukraine**. Its future is closely linked to integration with European markets for both oil and gas. The answer to corruption in Ukraine energy sector is not to leave them out but to use mechanisms to bring it under manageable control: transit pipe can be separated; borders can be metered; full transparency can be achieved—even when an American company is involved.

One project that is gaining increasing momentum, and would benefit from US support, is White Stream. White Stream would bring Caspian gas to Georgian Black Sea coast. From there, gas would flow via a pipeline with an initial yearly capacity of 8 bcm along the seabed to Romania (either through Ukraine or directly) where it would then connect with existing infrastructure. It may also connect with the Ukrainian transit system leading to Poland and Slovakia. Alternatively, gas could be liquefied and transported via LNG tanker across the Black Sea. Further studies are required to determine which method—pipeline or LNG—is more feasible. The US Trade and Development Agency (TDA) has already commissioned a study to assess the commercial viability of this option, while European Commission is co-funding the feasibility study of deep water pipeline version of White Stream through Trans European Network scheme. The project already has the status of “Project of Common Interest” in the EU and is part

of the Southern NG3 gas Corridor along with Nabucco and other projects establishing a direct gas link between EU and Caspian.

White Stream is useful not only because it represents a means for Europe to diversify its energy supply, but also by encouraging further upstream investment in the Caspian. As the Caspian region with its vast resources should become an important source of diversification for Europe's increasing supply needs (much in excess Nabucco can handle), establishment of another transportation route in the same corridor with Nabucco would contribute significantly towards needed reduction of the transportation risks. And this in turn would encourage large scale exploration production investments in Caspian gas, thereby stimulating progress on Nabucco and the trans-Caspian gas pipeline.

Finally, Washington needs to hold a strategic discussion with the EU on the long-term implications on Russian gas politics. But in the short term, it needs to impress upon key European allies that the Caspian indeed is a realistic option—provided that they do not lose focus.