

**THE STATUS OF INFRASTRUCTURE PROJECTS FOR
CASPIAN SEA ENERGY RESOURCES**

HEARING

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL ECONOMIC
POLICY, EXPORT AND TRADE PROMOTION

OF THE

COMMITTEE ON FOREIGN RELATIONS

UNITED STATES SENATE

ONE HUNDRED SIXTH CONGRESS

SECOND SESSION

—————
APRIL 12, 2000
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Printed for the use of the Committee on Foreign Relations



Available via the World Wide Web: <http://www.access.gpo.gov/congress/senate>

U.S. GOVERNMENT PRINTING OFFICE

69-745 CC

WASHINGTON : 2001

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WEDNESDAY, APRIL 12, 2000

U.S. SENATE,
SUBCOMMITTEE ON INTERNATIONAL ECONOMIC
POLICY AND TRADE PROMOTION,
COMMITTEE ON FOREIGN RELATIONS,
Washington, DC.

The subcommittee met, pursuant to notice, at 2 p.m., in room SD-419, Dirksen Senate Office Building, Hon. Chuck Hagel (chairman of the subcommittee) presiding.

Present: Senators Hagel, Lugar and Sarbanes.

Senator HAGEL. Good afternoon.

Let me announce before we begin the hearing that we have a vote scheduled at 2:30. And what we will most likely do is get as much done as we can in the next 45 minutes, and then probably break for a quick vote recess and come right back and pick it up from there.

I know one of our lead-off witnesses, Mr. Wolf, is delayed, so we are going to go ahead and introduce the witnesses and Secretary Goldwyn will have an opportunity to present his testimony. So, Mr. Goldwyn, if you will bear with me here for a moment, I will introduce our witnesses, and then we will get to your testimony.

Our first witness today, who is delayed as I mentioned, is Ambassador John Wolf. Mr. Wolf, is the Special Advisor to the President and Secretary of State on Caspian Basin Energy Diplomacy. Ambassador Wolf is the lead administration official on U.S. policy for energy development in the region. A career Foreign Service Officer, Ambassador Wolf has served in a variety of positions. He most recently served as Ambassador to the Asia-Pacific Economic Cooperation Forum. Before that, he served as Principal Deputy Assistant Secretary for International Organization Affairs. His other postings have included Australia, Vietnam, Greece, and Pakistan.

Do you think he would approve of that, Secretary Goldwyn?

Mr. GOLDWYN. He would be flattered.

Senator HAGEL. Now, on to you, sir.

Ambassador Wolf will be followed by the Hon. David L. Goldwyn, Assistant Secretary of Energy for International Affairs. Mr. Goldwyn has a strong background in Caspian Sea energy issues. Previous to his appointment as Assistant Secretary, he served as Counselor to Secretary Richardson on special initiatives, including Caspian Sea policy. His earlier career has been at the U.S. Mission

to the United Nations, and at the State Department, under both Bush and Clinton administrations.

We will have three distinguished private sector witnesses in our second panel. The first is Mr. Ralph Alexander, Group Vice President of BP Amoco. We are pleased to have one of BP Amoco's most senior executives here today. As a 34-percent shareholder of the Azerbaijani International Operating Company, the AIOC, BP Amoco is the most important oil company involved in the Caspian Sea region. And I note that before the merger, our first oil company witness on this issue, a couple of years ago, was Mr. Chuck Pittman, then president and CEO of Amoco Eurasia Petroleum Company.

Our second private sector witness brings a vital perspective to these issues. He is Mr. Robin West, chairman of the board of the Petroleum Finance Corporation, [PFC]. PFC consults with all the major international oil companies, as well as many national governments, on oil and gas development strategies, project financing, and other complicated aspects of today's energy industry. Before founding PFC in 1984, Mr. West served in the Reagan administration. He served as Assistant Secretary of the Interior, with responsibility for offshore oil policy. He has also worked as first vice president of Blyth, Eastman, Dillon & Company, an investment banking firm.

Our final witness, Dr. Martha Brill Olcott, is a noted scholar of the region. Dr. Olcott testified before this subcommittee 2 years ago on this subject. She is professor of Political Science at Colgate University, and also serves as senior associate at the Carnegie Endowment for International Peace. Since 1994, Dr. Olcott has served at the Central Asia-America Enterprise Fund, where she currently is vice chairman. She has worked as a consultant on Central Asian Affairs to former Secretary of State Larry Eagleburger, and has also consulted on the region with a variety of businesses. She has written widely on the region.

There have been recent dramatic developments in the Caspian Sea region, as many of you know. Recent press reports have indicated some disappointing offshore oil drilling results in the Caspian Sea. What has not been as well reported is the fact that instead of discovering significant new oil reserves, AIOC has discovered major new natural gas reserves. This has dramatically changed the calculus on the options for delivering gas to the Turkish market.

Now, Azerbaijan alone has enough gas reserves to quickly serve the Turkish market. Oil reserves have been slow to develop. However, major new exploration is underway in Kazakastani waters in the northern Caspian Sea. Exploration also continues in the southern Caspian Sea. Ultimately, there will be sufficient volumes to turn the Caspian Sea region into a major new source of petroleum.

The Caspian Sea region is estimated to have oil reserves of from 16 billion to 32 billion barrels. This compares to North Sea reserves of about 17 billion barrels, and remaining U.S. reserves of 22 billion barrels. It is well below, as most of you note, the massive reserves of the Persian Gulf.

We look forward to our witnesses' views today on what we can do to encourage Caspian Sea energy development in a way that

serves U.S. interests in supporting the independence and sovereignty of the newly emerged nations of the region.

My friend and colleague, Senator Sarbanes, will be here shortly, but in the interest of time and getting your testimony in, Secretary Goldwyn, we would ask you to go ahead and proceed with your testimony. Thank you for being here. We are grateful.

**STATEMENT OF DAVID L. GOLDWYN, ASSISTANT SECRETARY
OF ENERGY FOR INTERNATIONAL AFFAIRS, DEPARTMENT
OF ENERGY, WASHINGTON, DC**

Mr. GOLDWYN. Thank you, Mr. Chairman. I am pleased to be here. Most of the members on your panel spend a lot of time talking to each other and talking to the governments, and so we are pleased to have the opportunity to talk to you and explain what we have been up to, because we have made some progress.

I will not steal too much of Ambassador Wolf's thunder. He is going to talk about the status of the negotiations and our interests in general. So let me talk about U.S. energy interests in the Caspian and why this policy is good for America's energy security.

Our U.S. policy in the Caspian advances the administration's overall comprehensive national energy strategy. This strategy is about establishing clear, measurable objectives to help ensure that America has affordable, clean and secure energy supplies well into the 21st century. To accomplish that strategy, we work on improving the efficiency of the overall energy system, ensuring against energy supply disruptions, promoting energy production and use in ways that respect our health and environmental values, expanding future energy choices, and seeking international cooperation on global energy issues.

Our energy policy in the Caspian specifically addresses these goals. Our Caspian policy promotes the development of diverse, stable and reliable sources of energy in an important region. Developing Caspian oil and gas expands global supply. Creating multiple east-west pipelines helps ensure against national or international supply disruptions by diversifying transportation routes. Supporting investment by U.S. and Western companies in the region helps our economy, but also protects the environment they operate in by their deployment of state-of-the-art technologies and industry practices. It is also in our interest to increase non-OPEC oil supply, which contributes to the overall efficiency of a global oil market.

International cooperation and collaboration to increase and diversify world supply is crucial. By the year 2015, the world's energy consumption is expected to be 48 percent higher than it was in 1995. As much as we look at renewables and other sources of energy, we are all going to need more oil.

The intense competition for scarce energy resources makes it important for us to cooperate internationally to meet the world's growing demand for oil through stable, market-driven means. Under Secretary Richardson's leadership, the Department of Energy has taken a number of steps to strengthen domestic production and improve America's energy security for the long term.

We have been working to diversify the supply of oil for the United States, so we are not dependent on any one region. We have made some major efforts in Latin America, Africa, East Asia and

the Middle East, but we have also spent quite a bit of time in the Caspian. And we are doing this because it is important both to our national and to our economic security interests.

One question that is fair to ask is how important the Caspian is as a source of oil and gas. And, Mr. Chairman, you have given the numbers that I was going to rely on, so I will not spend a lot of time going over them. But the estimates are that regional oil and gas reserves, more or less, are on the order of magnitude of the North Sea. The proven reserves are, as you stated, between 16 billion and 32 billion barrels. But it is possible that there is up to 186 billion additional barrels, which is about a quarter of the size of the Middle East's reserves. And those remain to be discovered, and we are hopeful, any day now, to have some good news, for example, offshore in Kazakhstan.

How much the region actually produces and when it reaches peak production depends on a number of factors. And there is no question that the operating environment in the Caspian is challenging. The region lacks supporting industries and infrastructure, and there is a shortage of drilling rigs. If investments continue in the region at the current pace, and if there are sufficient export outlets, then our Energy Information Agency's high scenario projects annual oil production to reach 4.2 million barrels a day by 2010. Their low scenario, which assumes some project delays, looks at about 2.5 million barrels a day by 2010.

At the high side, these figures mean that, at best, the Caspian region could account for about 4.5 percent of total world oil supply in 2010. This represents almost half of new non-OPEC oil supply. So the development of Caspian energy resources at this order of magnitude is quite important.

The Caspian also represents an important commercial opportunity for U.S. companies and for the U.S. economy. Both the opportunities and the investments are quite large. Since 1995, multinational oil companies have entered into arrangements to explore and produce in the region, resulting in potential capital expenditures of up to \$90 billion. To date, multinationals have actually spent somewhere between \$5 billion and \$10 billion in developing these projects. And the potential, in addition to exploration and production, is engineering, construction, rehabilitation and redevelopment of onshore oil fields, which is important to a lot of our independent producers, feasibility studies, and financing.

So with this huge investment exposure, planning now for the long-term export and distribution of this oil and gas is prudent. And in the United States Department of Energy and in the administration, we want to both promote and protect those investments. And we do this in a number of ways. One is by advocacy. And we advocate for U.S. companies to win the available commercial opportunities. Our technology is unrivaled and our companies use the best environmental practices and technologies. Their involvement is going to help ensure that development in the Caspian reaches a desirable balance between maximizing production and environmental stewardship.

The other way we try and promote and protect these investments is by engaging almost all of the regions' governments in policy dialogues to foster an open, transparent and inviting investment cli-

mate. We talked about diversifying the investment of the reserves from hydrocarbons into different areas and to maximize the efficiency and safety of their energy sectors.

We recognize that there is an appropriate and, as a consequence, an inappropriate role for government in this process. And it is important, I would say, to repeat, if John was here and had started, but it is worth saying now that our Caspian policy focuses on advancing America's strategic and policy interests. But we know and will insist that the transportation regime we are supporting be commercially competitive. Because neither the private sector nor the international financing community will move forward unless it is.

So our support of specific pipelines, like Baku-Tblisi-Ceyhan and the Trans-Caspian Gas Pipeline, is not driven by a desire to intervene or interfere or to direct private commercial decisions. But it comes from our support for the governments in the region, who are either export, transit or consuming countries, and their belief, which we agree with, that they should secure transportation routes which are not dependent on their major commercial competitors. Our support is based on the belief that in advancing their interests in this case, we advance our own national economic and energy security interests.

I want to talk briefly about Russia and Turkey. On Russia, it is important to recognize that Russia has had a long and important role in Central Asia and in the Caspian. They are still the largest trading partner for each of the nations in the Caspian, and they are a littoral state of the Caspian Sea. Right now, they also have the principal transportation routes for oil and gas out of the region.

In 2001, Kazakhstani exports are expected to begin flowing through the Caspian Pipeline Consortium to the Russian Black Sea port of Novorossiysk. CPC, as that line is called, includes both U.S. and Russian companies, and will be an important new pipeline system, and we are very supportive of it. The United States has always viewed Russia as an important partner in the development of oil and gas in the Caspian, and we have encouraged Russia to participate in the development of multiple transport routes from the region. They will continue to be an important partner.

With respect to Turkey, it is important to say that we want to help Turkey as an ally in strengthening its energy security and meeting its development goals. We also share their environmental concerns about the potential increase in traffic through the Bosphorus. We do not want to see the Bosphorus become a potential choke point for a significant share of the world's oil supplies, which not only heightens environmental concerns but could possibly impede the development of Caspian energy. One of the strengths of the Baku-Tblisi-Ceyhan route that we support is that it would provide an alternative to increased flows of oil through the Bosphorus.

Development of natural gas pipelines is also important to the countries in the region. Turkey currently has a gas shortage and plans to increase its gas imports more than fivefold by 2010. Potential alternatives to reliance on Russia or Iran include purchases of gas from Turkmenistan and Azerbaijan, and export of Caspian gas to other European markets.

The U.S. Government and Secretary Richardson have spent a lot of time and effort in this region, because it is important to our interests. The Secretary has traveled to Caspian capitals three times, most recently last November, when he accompanied President Clinton to take part in signing agreements on Baku-Tblisi-Ceyhan and the Trans-Caspian Gas Pipeline. In the last year, Ambassador Wolf and I have probably had more shoshlik than we need to last us a lifetime. But we are seeing results.

We welcome an ongoing dialog with the Congress on Caspian energy development, and we really appreciate the opportunity to bring the committee up to date on the progress we have made so far. We have not had one of these hearings in a while, and we have made some progress and we are a little proud of how well we have done.

We followed with interest the numerous congressional delegations that have traveled to the region, and we look forward to working with you on this important issue. Thank you.

[The prepared statement of Mr. Goldwyn follows:]

PREPARED STATEMENT OF HON. DAVID L. GOLDWYN

Mr. Chairman and Members of the Subcommittee:

I am pleased to appear before you today. I am also pleased to appear on this panel with Amb. John Wolf, with whom our Department works very closely on issues related to Caspian energy development. Amb. Wolf has outlined the Administration's Caspian policy and presented an up-to-date status report of the specific pipeline projects. Thank you for giving me the opportunity to address U.S. Caspian policy in an energy security, energy diversity and energy policy context.

U.S. ENERGY INTERESTS IN THE CASPIAN

In support of the Administration's overall policy of promoting Caspian energy production and exports, the Department of Energy has pursued the following broad objectives:

- Ensuring global energy security in a way that adequately addresses the strategic and economic interests of the United States as well as those of our allies and regional partners;
- Promote the economic development of the countries in the region;
- Promoting energy sector reform in the Caspian countries to attract foreign investment, thereby fostering regional prosperity and stability;
- Supporting U.S. companies in their efforts to speed development of the region's energy resources;
- Fostering viable and reliable alternatives for energy export; and
- Ensuring energy development occurs in an environmentally responsible manner.

U.S. policy in the Caspian is both supported by and embodied in the Administration's National energy strategy which establishes clear, measurable objectives to help ensure that Americans will have affordable, clean and secure energy supplies into the 21st century. The goals of our energy strategy are to: (1) improve the efficiency of the overall energy system; (2) ensure against energy supply disruptions; (3) promote energy production and use in ways that respect our health and environmental values; (4) expand future energy choices, and (5) seek international cooperation of global energy issues.

Energy policy in the Caspian region specifically addresses these goals. Our Caspian policy reflects our view that the development of diverse, stable and reliable sources of energy is important to our national security and to the global economy. We can help ensure against national or international supply disruptions by diversifying sources of supply.

International cooperation and collaboration to increase and diversify world supply is crucial. The Energy Information Administration (EIA) expects world oil consumption to grow by an average annual rate of nearly two percent, reaching almost 84 million barrels in 2005 and over 103 million barrels a day in the year 2015. By the year 2015, the world's energy consumption is expected to be 48 percent higher than it was in 1995. The intense competition for scarce energy resources dictates the need

for high levels of international cooperation to meet the world's energy demands through stable, market-driven means.

Under Secretary Richardson's leadership, we have taken several steps to strengthen domestic production and improve America's energy security for the long term. We have also been working to diversify world oil supplies so we're not dependent exclusively on any one region. Our efforts have focused on maintaining strong relationships with the major oil and gas producing nations, and encouraging their continued movement toward open markets, privatization and regulatory reform; promoting the development of new sources of supply and the infrastructure to support them—in the Caspian, in Africa and in Latin America; and promoting regional integration and infrastructure linkages.

There's concrete evidence that this approach is working. Since 1974, U.S. petroleum consumption has increased 16.4% while the economy has grown nearly 110%. Our top supplier of oil varies from week to week among Canada, Venezuela, Saudi Arabia and Mexico. We are less dependent on OPEC oil, and last year imported crude oil from 40 different countries.

HOW IMPORTANT OF A RESOURCE BASE IS THE CASPIAN?

Moving Caspian energy supplies into the global market figures prominently in our national security equation. While estimates of the size of regional oil and gas reserves vary widely, most observers consider that its resources will be on the same order of magnitude as those of the North Sea. Proven reserves in the Caspian region are estimated at 16 to 32 billion barrels of oil, which are comparable to North Sea reserves. It is possible that 186 billion additional barrels, roughly equivalent to more than a quarter of the Middle East's reserves, remain to be discovered.

We believe developing these resources and facilitating their delivery to world markets will help make energy markets more competitive, transparent and market-sensitive, three prerequisites of an efficient and smoothly functioning world energy sector.

How much the Caspian region actually produces and when it reaches peak production depends upon a number of factors. For illustrative purposes, it took 25 years for oil production in the North Sea to reach 6 million barrels per day under favorable circumstances. In the Caspian region, circumstances are less favorable. The region lacks supporting industries and infrastructure, and there is a shortage of drilling rigs. If investments continue in the Caspian region at the current pace, and if sufficient export outlets are developed, the Energy Information Agency's (EIA) "high" non-OPEC supply case scenario projects annual oil production to reach 4.2 million barrels a day by 2010. In the "low" non-OPEC supply case scenario, which assumes some project delays, oil production would reach 2.5 million b/d by 2010. These figures mean that at best the Caspian region will account for about 4.5% of total world oil supply in 2010. Nevertheless, this represents almost one-half of new non-OPEC supply. By way of comparison, in recent years Middle East-OPEC has supplied over 30% of total world oil consumption, and could supply 40% by 2020. The Caspian region will never replace the Middle East as a primary source of supply, but it will limit the extent of the growth of world oil and gas dependence on the Middle East. Thus, development of Caspian energy resources at the margin will play an important role.

ENSURING A COMMERCIAL STAKE AND SUPPORTING U.S. INVESTMENTS

We continue to support worldwide trade and investments by U.S. energy companies; such investments are key to unlocking Caspian energy resources and will have a corresponding benefit of promoting regional stability and prosperity, as well as contributing to our nation's economy. U.S. technology is unrivaled and our companies employ the world's highest environmental protection practices and technologies. Their involvement will help ensure that development in the Caspian region achieves a desirable balance between maximizing production and environmental stewardship.

A fundamental thrust of our policy also relates to commerciality. That is, while we recognize the influence regional politics will play on the development of export routes, we have always maintained that commercial considerations first and foremost will determine the outcome. These massive infrastructure projects must be commercially competitive before the private sector and the international community will move forward. Our support of specific pipelines such as the Baku-Tbilisi-Ceyhan oil pipeline and trans-Caspian gas pipeline is not driven by a desire to intervene in private, commercial decisions. Rather, it derives from our belief that it is not in the commercial interests of companies operating in the Caspian states—nor in the strategic interest of the host states—to rely on a single, major competitor for transit rights. Since 1995, multinational oil companies have entered into joint arrange-

ments to explore and produce the Caspian region resources, resulting in potential capital expenditures of up to \$90 billion. To date, multinationals have actually spent anywhere from \$5 billion to \$10 billion in developing these projects. To protect these investments, we must take a sensible, long-term view of the region's development, oil demand, and price trends in the oil market. Many (actually most) of the U.S. major oil and gas firms and engineering and construction firms have invested large sums of capital in huge offshore projects in the Caspian region. There will, also be increased opportunities for American independents to invest in rehabilitating and redeveloping onshore oilfields. Feasibility studies, engineering, design, construction, and financing combine to make a protracted process. With this huge investment exposure, planning now for long-term export and domestic distribution of the region's oil and gas is only prudent. That's one reason we are so aggressive in urging these countries to forge ahead now on infrastructure development in order to plan for the future.

FOSTERING REGIONAL COOPERATION AND ENERGY DEVELOPMENT

The development of multiple pipelines and diversified infrastructure networks to transport Caspian oil and gas resources will have the additional benefit of fostering the regional cooperation needed for peace and stability. Construction of oil and gas pipelines in an "east-west energy corridor" will serve to bind all of the countries together. The development of the region's energy resources creates opportunities for these countries to cooperate in new ways for the benefit of all. The speed and depth of that regional cooperation will have a direct effect upon the future economic prosperity of the individual countries.

ROLE OF RUSSIA

Russia has had a long and important role in Central Asia and the Caspian. Russia remains an important influence in the area since Russia is still the largest trading partner for each nation, Russia is a littoral state of the Caspian Sea, and Russia has the principal transportation routes for oil and gas out of the region.

In fact, until the recent opening of an "early oil" pipeline from Baku, Azerbaijan to Supsa, Georgia, Russia provided the only pipeline transportation out of the region and most of the rail transportation from the region. Kazakhstan and Turkmenistan currently ship oil through Russia, and Azerbaijan is expected to resume shipments through Russia soon. Moreover, in 2001, Kazakhstani exports are expected to begin flowing through the Caspian Pipeline Consortium (or CPC) pipeline to the Russian Black Sea port of Novorossiysk. CPC, which includes both U.S. and Russian companies, will be an important new pipeline system. We strongly support it.

Most recently, Lukoil, the largest Russian oil company, has found a significant deposit of oil and gas in the Russian sector of the Caspian. As more wells are drilled over the next couple of years, the extent of this discovery will become clearer. If commercially viable, this oil could be used either in local refineries, or shipped in the CPC, since Lukoil has a small interest in the CPC.

The U.S. always has viewed Russia as an important partner in the development of oil and gas resources in the Caspian and has encouraged Russia to participate in the development of multiple transport routes from the region. As a littoral state, Russia has made its voice known regarding how resources should be developed in the Caspian Sea in an environmentally sound manner. Since the Caspian is an important fishery for Russia, use of the Caspian for transportation either across it or under it, can have an economic impact on Russia. As a result, its views are important to the overall development of the hydrocarbon resources around or in the Caspian Sea. We look forward to the continuation of our work with the new government in Russia to develop economic, environmentally sound transportation alternatives through and from the Caspian region.

ROLE OF TURKEY

We want to assist our European ally, Turkey, in strengthening its energy security and meet its development goals. Just two weeks ago, I had the privilege of leading the 8th session of U.S.-Turkey energy consultations. This interagency effort was established to discuss Turkey's strategy for moving forward with development of its energy sector, meeting the growing demand for electricity, diversifying its gas supplies, developing alternative fuels to diversify energy sources, and identifying further steps for development and construction of oil and gas pipelines through Turkey for Caspian resources.

In this regard, we share Turkey's environmental concerns about the potential increase in traffic through the Bosphorus. Further, we do not want to see the Bosphorus become a potential choke point for a significant share of the world's oil supplies,

which would heighten environmental concerns and possibly impede the development of Caspian energy. One of the strengths of the Baku-Tbilisi-Ceyhan route we support is that it would provide an alternative to increased flows of oil through the Bosphorus.

Development of natural gas pipelines is also important to the countries in the region. Turkey currently has gas shortages and plans to increase its gas imports more than five-fold by 2010. Potential alternatives to reliance on Russia or Iran include purchases of gas from Turkmenistan and Azerbaijan.

INTENSIFYING OUR ENGAGEMENT WITH REGIONAL GOVERNMENTS

One of the more visible ways we are implementing our Caspian policy involves the engagement of Cabinet-level and senior-level visits to the region, and the establishment of formal government-to-government dialogues. For example, Secretary Richardson has traveled to Caspian capitols three times, most recently last November with President Clinton to take part in signing agreements on Baku-Tbilisi-Ceyhan and the trans-Caspian Gas Pipeline.

As the countries in the region develop their political systems, new governmental structures and new legal frameworks, they will constantly struggle to achieve sometimes conflicting goals. They will have to formulate and implement domestic policies that create an investment friendly environment. This is not always an easy task, because as you are all keenly aware, there is sometimes tension between political and economic realities. As we establish a sound basis for trust with these countries, it will be our role to share our best advice based on our own experiences with energy development, to work with them to identify international resources, and to work in partnership with U.S. industry to resolve problems that will inevitably arise.

At the Department of Energy, we have established a dialogue with the countries of the region on issues such as climate change, energy efficiency and conservation, and environmentally sustainable energy development. We are working with them on policy issues such as energy sector liberalization and energy regulation, and establishing policies that support balance in energy development. And we are looking for new areas where we can be helpful, including developing a regional system for oil spill response. This cooperation is an integral part of our efforts to establish a positive relationship with the countries of the region that will contribute to regional development, political stability, and healthy and growing trade linkages.

The Caspian countries continue to reach out to the U.S. and to foreign investment. We are working to maintain the momentum behind our support for these governments and the private sector. We welcome an ongoing dialogue with Congress on Caspian energy development. We have followed with interest the numerous Congressional delegations that have traveled to the region. We look forward to working with you in meeting the many challenges ahead.

Senator HAGEL. Mr. Secretary, thank you.

We have been joined by the ranking Republican member and former chairman of this committee, Senator Lugar. Welcome, sir. If you would like to offer a statement and go right into your questions.

Senator LUGAR. I have a statement. I will just follow you.

Senator HAGEL. Thank you. You probably know, Senator, that we are scheduled for a vote around 2:30, and we will see how we can maybe shuttle that and we will go from there. Our other first panel witness, Ambassador Wolf, has been delayed, so we are going to just go forward with Secretary Goldwyn.

Mr. Secretary, you mentioned in your testimony that any day now you were anticipating some good news from the Kazakhstan region of the Caspian. What did you mean by that?

Mr. GOLDWYN. There is a consortium, OKOIC is the acronym for it, which is drilling for oil offshore of Kazakhstan. The expectation is that this will be an enormous oil find. But as you mentioned in your introduction, Mr. Chairman, some of the exploration in the Caspian has turned up gas rather than turned up oil. And we are kind of hoping this one is going to turn up oil.

The signs are good. I think there has been some drilling done, and the results are expected very soon. So we are hoping the results will be made public and that they will indicate that there are significant oil structures. That will not be indispensable, but it will certainly be a helpful piece of news with respect to transportation of Caspian oil.

Senator HAGEL. How much American energy firm investment do you know of that we have in that part of the Caspian in the Kazakhstani area?

Mr. GOLDWYN. In Kazakhstan specifically, I would have to submit something to break that out to you. It is sort of \$5 billion to \$10 billion in the Caspian overall. A big piece of that is in Azerbaijan. But Chevron, for example, is a major partner in CPC, and so they and other U.S. companies that are in that consortium—I believe Mobil is in that consortium also—have invested quite a bit of money in exploration and production and also in construction of the CPC pipeline.

Senator HAGEL. Thank you. You know that the Director of the Central Intelligence Agency, George Tenet, was in the Caspian region I think last month. What security issues are now part of the Energy Department's working through and dealings as we start to move into the next phase of anticipating pipelines based on anticipation of what the results will be on drilling?

I have not read Mr. Tenet's report, if he has made one. I know of the concerns he has expressed. Could you take the security dynamic of that and maybe frame that up for us in regard to the Department of Energy on this issue?

Mr. GOLDWYN. Sure, I would be happy to, Mr. Chairman.

We are concerned about security at a couple of levels. Obviously pipelines, the pipeline across Russia and the proposed pipeline which would transit Azerbaijan, Georgia and Turkey, like any pipeline, will have security concerns. They need to be protected, and we look first at the governments to fulfill their responsibilities to provide that protection.

We have seen in the last year, with respect to Chechnya, that these pipelines can be the subject of attack, as we have seen all over the world. They are favorite targets for terrorists, for guerrillas and for other people who want to get the attention of either the host government or the U.S. Government in a big hurry. And so we are concerned about that.

Part of the theory behind multiple east-west pipelines is to provide alternatives in the event that any one pipeline is interrupted. And that provides a security system. I think, with respect to the proposed pipelines, we are not yet at the stage of talking about security arrangements, but we have talked to each of the governments, and they have talked to each other as they negotiate the intergovernmental agreements and the host government agreements, a number of which contain their obligations to provide security to these pipelines, about the importance of those issues.

And as we get into the financing for these pipelines, OPIC will be having discussions with them, as an insurer of these pipelines, to make sure we have appropriate assurances that security will be provided.

Senator HAGEL. Do those security discussions include Russia?

Mr. GOLDWYN. They do with respect to CPC. I think we are sort of well along. The agreements are signed and being implemented with Russia. We talk to Russia in our bilateral dialog, through now the Gore-Putin Commission, about a host of energy issues, trade and investment, but also security.

I think, with respect to the CPC line, it is just under construction now and there has not been a problem that I am aware of that we have been asked to engage on. But the subject of the interruption of the northern line has been part of our discussions, yes, sir.

Senator HAGEL. In your testimony, of course you talked about the role of Russia. Where does the Blue Stream gas pipeline fit into your calculations?

Mr. GOLDWYN. Blue Stream is one of several competitors for the Turkish market. We support multiple lines, but our belief is that America's interests lie in ensuring that there is an east-west gas transportation route. Russia has I think now somewhere near 70 percent of the Turkish market. And President Demirel has said that he finds it in Turkey's interest to diversify their sources of supply.

Blue Stream started before the Trans-Caspian Gas Pipeline did, and it is farther ahead. From what I read in the press, they are close to reaching financing, but we have been reading that in the press for about 9 months. And every couple of months they are just around the corner. But it seems to be making good progress.

They are an economic competitor. Russia is an economic competitor both to Turkmenistan and Azerbaijan and also to Iran and to Egypt and a number of other countries that want to supply gas to the Turkish market. So, from a U.S. Government perspective, we keep an eye on that. And we are using our efforts to make sure that there is another horse in the race and that it is unfettered in its ability to compete with Blue Stream. We do not oppose Blue Stream. We do not try and set roadblocks in its way. We are trying to help the governments that are going from east to west, to enable them to have a competitor for that market.

It seems to be very important to Turkey, both because they have signed gas purchase agreements with Turkmenistan and because they have provided a number of times, and publicly and with the President and in the Ankara Declaration and the Istanbul Declaration, assurance that they view creation of this east-west line as a national priority.

Senator HAGEL. In order to ensure that we get all Senators time here on questions before we start to rotate on the votes, let me introduce the ranking Democrat on our subcommittee, Senator Sarbanes.

Senator SARBANES. Let Senator Lugar go ahead.

Senator HAGEL. All right. Senator Lugar.

Senator LUGAR. Thank you very much, Mr. Chairman and Senator Sarbanes.

Secretary Goldwyn, in some of the testimony that will follow there are suggestions that although the east-west idea is, best in terms of strategic interests of our country and our friends, that from a commercial standpoint, it may not work nearly so well. Stated another way, commercial interests have not driven this project; essentially political interests have. And that is an impor-

tant set of principles. The dilemma, however, is that it is not clear that there are proven resources that will support the Ceyhan pipeline, over the course of time, although that may come in time.

Beyond that, sometimes commercial interests have a feeling that improvement of relations with Iran might change the whole business. Given the political developments in Iran if we wait around long enough, that may be the way to go. So there is no need to hurry.

Since I visited the area—and I have not been there since the summer of 1999—this project has gone through many permutations. You have seen many more variations given your travels, including representations from Turkey and others who have come to Washington, and suggested they would be willing to bear more of the burden or that the cost would be less than we have been led to believe.

In an overall view of this situation, what is the probability that the parties involved, governmental or private, will sign all of these agreements, and that they will start construction? Or is this a project that is still a bridge too far, and we are talking about a matter of years down the trail, rather than something that you may see in the next 12- or 18-month period?

Mr. GOLDWYN. Senator, let me try and answer that in a couple of ways. First, I think the fair answer to your question is that the commerciality of this project is in the process of being tested right now.

Senator LUGAR. Being tested in what way?

Mr. GOLDWYN. In the last year, we have not only had renewed commitments by the governments of the region—which, by the way, have put their assets where their mouth is, so to speak, because they are partners in these ventures, and their income will derive from the successful transportation of this. So it is not in their interest at all to go for a politically expedient but commercially unviable transportation route because they will not earn the reserves which they need. And in these countries, as dependent as they are for oil, they need those reserves.

So they have not only made political commitments, but they have also, Azerbaijan and Turkey, have signed intergovernmental agreements committing themselves on the route and committing themselves on a number of important commitments on how this will be done. This week, Georgia is in town because Georgia is an important transit country, to settle the remaining issues. And we have every confidence that we will settle all those remaining issues, so that we can move from the next phase. And the next phase is to invite the sponsors to participate and then to look at financing.

So we are moving ahead on a commercial pace. Is there enough oil to fill this line? I think our belief is that there is. The question is, is there is enough oil produced in the region? And by the time this line would come on board, there will be more oil as more of the ventures like Azeri-Chiraz-Ganeshli and the AIOC consortium begin to produce oil.

There will be enough oil in the region to fill the line. The question will be, will the commercial provisions of the line be sufficiently attractive to attract that oil to ship through it, or will the variety of ways in which oil is transported now, by barge, by rail,

by smaller pipelines, be more economically attractive? And it is incumbent on the governments to put together a package that is going to draw that oil or this line will not happen. And we are confident that they can.

As you inferred, Turkey agreed to provide a cap on the cost of construction, which was indispensable in reaching these agreements. So the governments have stepped up and said, we are putting our money down on the table and we will take a haircut to meet our security interests. And now what will happen, once the rest of the host government and intergovernmental agreements are signed, there will be a testing in the marketplace.

And that testing will first be a meeting of sponsors, where everyone who has an interest or could have an interest in the Caspian will be invited to show up, be briefed on what these agreements are, and to commit to contributing toward design and construction. On a parallel track we will be looking at how this line is going to be financed, who will buy what share, what will their rate of return be, how will the line be managed.

And then there will be another testing, which will come maybe a year out, where they will be able to say to potential shippers, this is the deal, this is how much it is going to cost you to ship your oil. These are the guarantees that you are going to have if something goes wrong. And either they will make that attractive enough and people will commit to ship their oil or they will not and the project will fail.

But I think when you have the governments committed, you have companies like BP Amoco, which you will hear from later on today, have not only their chairman say that this is a strategic priority, but be leading the consortium to do this, they are not in the business of wasting their people or their money either. So I think there is a belief that this can be done. But it is not a done deal now. And what we will have to do over the next year is to make this attractive.

The United States, through Eximbank and OPIC and TDA, will do its part. But we are not going to bankroll this line either. It is going to have to be commercial. And we believe, with the companies, that this line is commercially viable and that if we work hard, through these steps that I have outlined, that when it comes time to have shippers commit their oil, that they will line up and we will fill this line and it will be a competitor.

Senator LUGAR. Thank you.

Thank you, Mr. Chairman.

Senator HAGEL. Senator Sarbanes.

Senator SARBANES. The first question I would like to put to you, Secretary Goldwyn, is do you expect a U.S. Government financial undertaking or commitment to develop these transportation corridors?

Mr. GOLDWYN. Only Eximbank, OPIC and TDA. There are U.S. products that are going to be used in there, and they meet the standards for Eximbank financing. Eximbank has indicated and in fact created a Caspian financing center in Istanbul to promote U.S. exports and provide traditional Eximbank financing.

OPIC, it will have to meet its requirements. No one is talking about bending the rules. But they have looked closely at this

project and is ready to step forward. And TDA has already committed substantial sums and is willing to commit more to enable this project to be completed. But that is the limit of the U.S. Government financing which the administration entertains at this time.

Senator SARBANES [presiding]. We are going to have a vote here soon and I think we are going to probably have to adjourn and then resume. I see that we have been joined by Tom Wolf. But I will just address my questions to you, because presumably we can then excuse you and we will resume with Mr. Wolf when we come back from the vote.

Is there a problem in pushing forth as many pipelines as we, the U.S., seem to be pushing? How do we sort all of that out? Presumably the finances vary considerably depending on how many different projects we are pushing. Because I assume that some undercut others or, in effect, compete with others. Is that the case or not?

Mr. GOLDWYN. Not exactly, Senator. And since we do not lead—while we support east-west lines and multiple lines, it is precisely so that we do not put ourselves in place of the companies or the countries by picking routes. We are driven by the oil or the gas, as the case may be. So Kazakhstan had huge oil. They needed an export route. And CPC, the line across Russia, was the result.

AIOC, the consortium we talked about earlier, was obliged, under its production share agreement, to select a main export pipeline route. And the Government of Azerbaijan and the other governments in that region urged that main export pipeline to be a line that would go from Baku, through Tblisi, to Ceyhan, both to deal with the Bosphorus problem and also as the best route.

That was a long and difficult negotiation, and we had interest in how it came out, and the governments had interest in how it came out. But ultimately the companies had to agree, led by the AIOC consortium, on what their route would be. So those are the only oil pipelines that are on the table right now, and we support east-west. We are not proposing a third one because we would like to have three. So we are driven by the oil.

With respect to gas, east-west is also what we are supporting. And the volume of that line and the gas that goes into it is driven by the commercial factors and by the countries, in this case, Turkmenistan and Azerbaijan, which have gas to transport. But we are not shopping lines which are disconnected from either the sources of the hydrocarbons or the commercial need to have an export route.

Senator SARBANES. And it is very clear to all the parties involved that there cannot be any expectation of a U.S. Government financial involvement other than the agencies you mentioned, and especially if they get into difficulty in carrying the projects through; is that correct?

Mr. GOLDWYN. Yes, it is crystal clear, Senator, because, as you can imagine, we have been asked more than once. The question has come up and we have hit many bumps in the road. And it is an important interest. That is why we have maintained publicly, constantly, and every opportunity we have, that it has to be commercially viable, because there is no support, no proposal—

Senator SARBANES. By commercially viable, you mean without any U.S. Government financial involvement; is that correct?

Mr. GOLDWYN. That is correct. They should go to the marketplace. That is right.

Senator SARBANES. Now, in the thinking of the Department of Energy, how much does the lack of transparency and the difficulty of governance and indeed the high factor of corruption which exists in a number of these countries, how relevant a concern is that? And how relevant a concern are the pretty dismal human rights and democracy performances in these countries? Are you simply saying, well, look, those are important but we are just putting them to one side because we have got to do this energy project? Or are they highly relevant considerations? And if so, what is it that you are doing about them?

Mr. GOLDWYN. It is a relevant concern. And it is a relevant fact that in many places, not just in the Caspian, where we rely on production of oil, there are these kinds of concerns. We deal with them in a couple of ways. With respect to transparency and corruption and general business practices, we have policy dialogues with most of the region's governments, where—I mean the governments are probably here, but not too fine a point on it—where we complain to them about the problems. But we also talk to them about policy reforms and the connection between open, transparent regimes and attracting investment.

They want the investment; they have to provide an environment where people can trust that they are going to get their money back and where they are not going to have to pay appropriate funds in order to get the deal that they want. So we talk to each of the governments. We do it bilaterally. We do it through a number of binational commissions. We have with Russia. We have with Kazakhstan. But we talk to all the governments about it.

With respect to human rights, it is a concern. And environment is also a concern. The State Department leads the dialog on human rights. But the treatment of workers, the treatment of people in these countries is a factor in the U.S. Government's willingness to engage, in the international financial community's willingness to engage, and also in the security and comfort that U.S. companies have in operating. So we do pay attention to that, Senator.

Senator SARBANES. We will pursue these other items with Mr. Wolf and the State Department since you have put at least some of them in their court, so to speak.

With that, we are going to adjourn the hearing in order to enable the Members to vote. Senator Hagel will be back shortly, and I think we will be prepared to resume.

Mr. GOLDWYN. Senator, I appreciate the committee's indulgence for my needs today. I will stay as long as I can, until it is time for me to catch my car. I will answer as many questions as I can until then.

Senator SARBANES. We are not quite clear whether Senator Hagel wants to put further questions to you or not, so you better hang on then. As far as I am concerned you could leave, but I think until we ascertain that, which should be shortly, you should stay put.

Mr. GOLDWYN. I would be happy to wait for the chairman.

Senator SARBANES. We will recess the hearing for a brief period of time, subject to the call of the chair. Thank you very much.

Mr. GOLDWYN. Thank you, Senator.

[Recess.]

Senator HAGEL [presiding]. Ladies and gentlemen, take your seats. Thank you.

Ambassador Wolf, welcome.

Ambassador WOLF. Thank you, Senator.

Senator HAGEL. We began, as you can see, without you. We knew that you would find that the most expeditious use of government time. I know you are concerned about the taxpayers getting their money's worth. And we praised you, we lauded you, we said very nice things about you. And Secretary Goldwyn said that it was acceptable.

With that, Mr. Secretary, you need to go before 3 o'clock, is that correct?

Mr. GOLDWYN. About 3 o'clock.

Senator HAGEL. Whenever you need to go, just dart out of here. We are grateful to have you come up. What we would do, since we have had an opportunity to visit with you a little bit, is take the testimony of Ambassador Wolf and then maybe, with the time remaining while you can stay with us, maybe have the two of you answer some questions jointly. So thank you.

Ambassador Wolf, we are pleased you are here. Please proceed.

**STATEMENT OF HON. JOHN S. WOLF, SPECIAL ADVISOR TO
THE PRESIDENT AND SECRETARY OF STATE FOR CASPIAN
BASIN ENERGY DIPLOMACY, WASHINGTON, DC**

Ambassador WOLF. Thank you, Mr. Chairman.

Again, I apologize for being late. We were in the basement of the Courtyard Marriott, negotiating with the Turks, Georgians and Azeris and technology is one thing but it does not reach down into those levels. So we did not hear the change from 2:30 to 2.

Senator HAGEL. A successful negotiation I hope?

Ambassador WOLF. We made an enormous amount of progress, I think. Thank you.

Senator HAGEL. Good.

Ambassador WOLF. And we have a seamless team. So I am sure that Mr. Goldwyn said all the things that I would have said, and I subscribe to them all, I am sure.

If I might, Senator, I had a brief oral statement and a just slightly longer one that I would submit for the record. But I am pleased to have a chance to testify before you today on the developments in the Caspian. We have made enormous progress in the months since my predecessor last briefed members of this committee. The President's participation in the November summit meeting in Istanbul concerning the part that they dealt with on Caspian energy underscored the continuing U.S. commitment to these projects and their importance to the United States and to our energy security interests.

But, that said, what is even more important than our participation is the message that the Istanbul Summit sent concerning the commitment of the region's governments. We have four objectives: strengthening the independence and prosperity of the new states of

the Caspian region; bolstering U.S. energy security by ensuring the free flow of new sources of hydrocarbons to world markets unfettered by regional competitors and geographic choke points. The third one is reestablishing economic linkages among the states of the Caspian. And the fourth is enhancing business opportunities. And we are making progress on all.

Some have argued that the United States policy is an attempt to impose “Made in America” solutions. We are not. This is not a great game. These energy ideas are part of the east-west energy corridor concept that was born in Tblisi, in Ankara and in Baku, not in Washington. And President after President in the region has said repeatedly that the east-west corridor is the cornerstone of his government’s foreign policy. Our role is that of facilitator.

We are encouraging partnerships among countries and companies, but the task of the actual negotiations is theirs. That is why I can be up here and they can be there negotiating in our absence, because they make the decisions. We are supporting five pipelines as part of our multiple pipeline strategy:

The Caspian Pipeline Consortium pipeline, construction is underway; the Baku-Novorossiysk early oil pipeline is operating; the Baku-Supsa pipeline, it is operating; the Baku-Tblisi-Ceyhan main oil export pipeline, which we hope will start in 2004; and the Trans-Caspian Gas Pipeline, which we hope will come into operation in 2002.

Russia was, is and will remain a major player on Caspian energy issues. We have a vision of cooperation based on a recognition that our interests are largely compatible. We work with our counterparts and we have worked in support of the CPC pipeline and Baku-Novorossiysk. We are going to continue to try to foster that cooperation among United States and Russian companies. Russia’s security, economic and other interests we believe will be better served by having strong cooperative neighbors on its borders.

I think also much has been said about U.S. policy vis-a-vis Iran. The President has taken visible steps to recognize positive developments there, but we have not changed our policy on energy cooperation with Iran. We remain opposed to investments in Iran’s energy sector and to the construction and use of pipelines to, from and through. Regardless, though, of our relations with Iran, we will continue to support the east-west energy corridor—Baku-Tblisi-Ceyhan, Trans-Caspian, among others.

We share the view of the region’s governments that the east-west corridor strengthens their security, independence and cooperation and it is good to tie them into the Western democratic nations.

I would like to take one moment to look at one other issue, an important complement to the energy issue. And that is the importance of building sustainable institutions, better legal frameworks, predictable laws, and balanced economic growth. It is important that each of the countries move in that direction in order to sustain their stability and to avoid distortions to their economic development. We all—governments, private sector and international financial institutions—need to help the countries to accomplish that task.

We do some of it through our aid programs, but restrictions on the United States’ ability to help countries like Azerbaijan directly

because of Section 907 of the Freedom Support Act do impede our ability to foster that kind of economic and political institutional development, the kind that Congress so often champions.

On the pipelines, we are making progress. This is especially true after President Aliyev's visit to Tblisi, when he and President Shevardnadze reached agreement on the level of transit fees. Their meeting made an important point, that this is not just about national gain but rather the Baku-Tblisi-Ceyhan is intended to be a regional effort. And that is an important part, the cooperating together.

As well, they made the point, and we continue to make it, that this pipeline is designed to ship oil to world markets from the entire Caspian, not just from Azerbaijan. So oil produced in Kazakhstan will be particularly important to this project. And during her upcoming visit to Kazakhstan, Secretary Albright will encourage Kazakh participation in Baku-Tblisi-Ceyhan.

The hope is to send the main export pipeline agreements to parliaments in April. That will open the way for sponsors meetings, basic and detailed engineering, and work on financial arrangements. And hopefully all of this will lead to an open season this summer. The United States will continue to help in this process.

Regarding the Trans-Caspian Gas Pipeline, the situation is more complicated. The economic case is easily demonstrated, but political differences between Ashgabat and Baku have blocked forward movement. We understand the competitive pressures that each government faces, but we believe there is a good case for why the countries of the region should cooperate, reasons that center not only on national self-interest but regional and common interests as well.

From our vantage point, the proposition is straightforward. It is time for Turkmenistan and Azerbaijan to clear away the impediments. The TCGP, the Trans-Caspian Gas Pipeline Consortium, now, finally, has an excellent offer on the table. It is not an offer that is going to get any better. There is no more room for complacency. There is no more scope for manipulation. Delay now puts this project at risk and puts at risk the benefits that would accrue to all of the parties, not just Turkmenistan and Azerbaijan, but Georgia and Turkey as well.

Mr. Chairman, I see November's decision by the region's leaders at Istanbul to sign the packet of agreements on Baku-Tblisi-Ceyhan and the Trans-Caspian Gas Pipeline as a seminal moment. I wish I had the photograph of the signing, because it is far more eloquent than I could ever be.

But the hard work is not over. Indeed, it is only beginning. Neither of these pipelines are sure things. But what is sure is the promise that these pipelines offer. The President summed this up in November by saying: "Today these countries have the freedom, they have the security, and today their leaders have shown the vision that will enable this ancient crossroads once again to light the world and brighten all our futures."

It is an enormous vision. It is an enormous undertaking. There is an enormous amount of goodwill that has been shown. We saw it again today at the meetings that are taking place on Rhode Island Avenue. It is very constructive. It represents the commitment

of the leaders of the region. And it is an effort to move this from governments into the marketplace, where the real and final decisions will have to be taken.

Thank you, Mr. Chairman. And I would be glad to answer your questions.

[The prepared statement of Ambassador Wolf follows:]

PREPARED STATEMENT OF HON. JOHN S. WOLF

I am pleased to have a chance to testify today concerning developments on Caspian energy policy. We have made enormous progress in the months since my predecessor last briefed this committee. President Clinton's participation in last November's Istanbul Summit ceremony on Caspian energy underscored the continuing U.S. commitment to these projects and their importance to the U.S. and U.S. energy security interests. That said, what is even more important is the message that the Summit sent concerning the commitment of the region's governments.

You will recall that United States policy on Caspian energy pursues four major objectives, which are to:

- Strengthen the independence and prosperity of the new states of the Caspian region;
- Bolster U.S. energy security by ensuring the free flow of new sources of hydrocarbons to world markets, unfettered by regional competitors and geographic choke-points, such as the Bosphorus and the Straits of Hormuz;
- Reestablish economic linkages among the new states of the Caspian region to mitigate regional conflicts; and
- Enhance business opportunities for companies from the U.S. and other countries.

Some have argued that the U.S. is attempting to impose made-in-America solutions on the region. We are not. This is no repeat of some "great game;" we have no territorial ambitions, and direct U.S. economic interests constitute only a fraction of total foreign investment. The idea of an east-west energy corridor was born in Tbilisi, Ankara and Baku, not in Washington. President after president has said repeatedly that the east-west corridor is a cornerstone of his government's foreign and economic policies. Several weeks ago, it was President Demirel in Ashgabat; prior to that President Aliyev and Shevardnadze in Tbilisi.

The U.S. role is that of facilitator, encouraging all parties to conclude the agreements required to ensure these pipelines' commercial viability. While we actively encourage the establishment of partnerships among countries and companies, the task of negotiating commercially viable agreements is the responsibility of the countries and companies involved in specific projects.

It is in this context that the United States has supported five specific pipelines, which we believe offer the best mix of projects for achieving the four key objectives I outlined above. These projects are:

- The Caspian Pipeline Consortium or CPC Pipeline; construction began last November;
- The Baku-Novorossiysk early oil pipeline; operations began in November 1997;
- The Baku-Supsa early oil pipeline; it became operational last April;
- The Baku-Tbilisi-Ceyhan main export pipeline; starting in 2004 it will carry oil produced on both sides of the Caspian from Baku to the Turkish port of Ceyhan on the Mediterranean Sea; and
- The Trans-Caspian Gas Pipeline (or TCGP); in three years, it can carry gas from Turkmenistan and Azerbaijan across Georgia to Turkey.

Russia was, is, and will remain a major player on Caspian energy issues. Our vision of cooperation derives from our belief that our interests here are largely compatible. We and our Russian counterparts have worked together in support of the CPC and Baku-Novorossiysk early oil pipeline projects. We will continue to seek cooperation between U.S. and Russian companies on future Caspian energy projects. We also have helped and will continue to help the energy producing countries of the Caspian region—including Russia—develop the multiple means of access to international markets that they each need and desire. We believe that Russia's security, economic and other interests will be better served by having strong, cooperative neighbors on its border.

We are delighted by the oil discovery just announced by Lukoil in the northern Caspian. Such a discovery, if commercially viable, would reinvigorate oil exploration

and reassure potential investors that there is indeed more oil to be found in the Caspian Sea. As they proceed with development of their offshore fields, we hope Lukoil officials will consider carefully the commercial benefits of participating in Baku-Tbilisi-Ceyhan; it would provide Lukoil with an economic and environmentally attractive way of reaching the Mediterranean.

Much has been said about the shifting tide of U.S. policy vis-a-vis Iran. Certainly, President Clinton has taken visible steps to recognize the positive developments that have taken place in Iran and to give impetus to the government-to-government dialogue that we proposed some time ago. But we have *not* changed our policy on energy cooperation with Iran. We remain opposed to investment in Iran's energy sector and to the construction and use of pipelines to, from, or through Iran. As one considers how the bilateral relationship will evolve, it would be wise not to underestimate the depth of U.S. concern about Iran's stance on the serious issues that still divide us, such as its support for terrorism, its active opposition to the Middle East peace process, and its efforts to develop weapons of mass destruction.

Regardless of the status of our relations with Iran, the United States will continue its strong support for Baku-Tbilisi-Ceyhan, TCGP, and the other pipelines comprising the east-west energy corridor. We share the view of the region's governments that east-west pipelines strengthen the independence, cooperation and integration of the new states of the Caspian and the community of western, democratic nations. East-west pipelines enhance their energy security and ours by diversifying sources and routes of supply. I understand that some energy companies believe their interests would be served by an early return to Iran. But, even discounting the difficulty of investment in Iran, I wonder why these companies really would want to channel large new volumes of their Caspian oil and gas holdings through a region and waterway where they are already highly exposed.

I'd like to take a moment to look at another issue that's an important complement to any sustainable energy policy. At independence, the regions' governments inherited institutions and legal systems ill-suited for today's global economy. A mad rush toward exports that neglects the need for effective institutions, transparent and predictable laws, and balanced economic growth will only undermine that country's stability and distort economic development.

We, and that means not only industrialized nations, but also private companies and international financial institutions, need to do more to encourage these countries to develop the policies and enact public sector reforms that enable them to cope with current austerity, and to prepare wisely for the increased revenue flows that will result from expanded energy exports. Restrictions on the United States' ability to help countries like Azerbaijan directly, because of Section 907 of the Freedom Support Act, clearly impede our ability to foster the kind of economic and political institutional development that this Congress so often champions.

Turning to the pipelines more specifically, I am quite upbeat about prospects for the main oil export pipeline (MEP). This is especially true after the very productive visit that President Aliyev made to Tbilisi in March, when he and President Shevardnadze agreed on the level of transit fees that each country will derive from the project. Their wisdom and foresight in concluding an agreement that places regional cooperation ahead of narrow self-interest helped underscore once again that the MEP is a regional pipeline. Those who claim that insufficient oil has been discovered in Azerbaijan to justify Baku-Tbilisi-Ceyhan miss the crucial point: namely, that this pipeline is intended to ship oil to world markets from the entire Caspian region and not only from Azerbaijan. Oil produced in Kazakhstan will be particularly important to this project. During her upcoming visit to Kazakhstan, Secretary Albright will explore ways to encourage future exports of oil from Kazakhstan via Baku-Tbilisi-Ceyhan.

Presidents Aliyev and Shevardnadze also committed to send the MEP framework agreements to their countries' respective parliaments for ratification in April. Meetings here this week are designed to put the final touches on the one outstanding document, Georgia's draft contract with potential investors. Submission of documents (Intergovernmental agreement/Host Government Agreements) to parliaments will open the way for a meeting of potential project sponsors shortly thereafter. It is these sponsors who will focus on basic and detailed engineering and financial arrangements, and hopefully this summer launch an effort to gain throughput commitments through a process known as an "open season." For our part, the U.S. Trade and Development Agency plans to organize a meeting of interested financial agencies and prospective investors in Baku-Tbilisi-Ceyhan in London shortly after the sponsors' meeting. This effort by TDA will reflect the commitment made by President Clinton last November that our export credit and trade finance agencies will remain actively engaged fostering the realization of a commercially-viable Baku-Tbilisi-Ceyhan pipeline.

Regarding the Trans Caspian Gas Pipeline (TCGP), the situation is more complicated. While the economic case for TCGP seems easily demonstrated, political differences between Ashgabat and Baku have blocked forward movement. We understand the competitive pressures each government faces, but there are good reasons why the countries of the region should cooperate, reasons that center on the individual nations' self-interest as well as common interests. From our vantage point, the proposition is straightforward. In the wake of President Demirel's late March visit, it is time for Turkmenistan and Azerbaijan to clear away the impediments. My sense is that the current TCGP consortium now, finally, has an excellent offer on the table. It's not likely the offer will get any better. There is no more room for complacency, and certainly no more scope for manipulation. It's time for all parties to agree and move forward. Delay puts this project at risk, and puts at risk the benefits that would accrue to all the parties involved.

So that's our oil and gas story. What does it all mean? I see last November's decision by the region's leaders at the Istanbul Summit to sign the packet of agreements on Baku-Tbilisi-Ceyhan and the declaration in support of TCGP as a seminal moment for the region. I wish I had the photograph here, because it speaks far more eloquently than I ever could. It shows the five regional presidents and the President of the United States joining to support commercial projects that can shape the futures of the states of the Caucasus and Caspian for decades to come.

The hard work is not over; indeed it only is beginning. Neither Baku-Tbilisi-Ceyhan nor the Trans Caspian Gas Pipeline, are sure things. But what is sure is the promise they offer to the region. In November, President Clinton summed matters up by saying: "Today (these countries) have the freedom, they have the security, and today their leaders have shown the vision that will enable this ancient crossroads once again to light the world and brighten all our futures."

Senator HAGEL. Mr. Ambassador, thank you.

As you know, coming behind you we have a panel of private sector witnesses, and we will get into some detail here after you and Secretary Goldwyn leave with that second panel on some of the more specific points that you made on timeframes and routes and how this is a new day, new freedoms, new securities and so on.

Let me start with a couple of points you made in your statement. You said the Baku-Tbilisi-Ceyhan main export pipeline is starting in 2004. It will carry oil produced on both sides of the Caspian, from Baku and so on. How realistic is that do you believe?

Ambassador WOLF. It is a stretch. The timeframe is very tight. We believe that it is possible. And we are basing that on what the companies are forecasting. We have been working closely with several of the companies that are involved in this project. I guess it is fair to say in particular with BP Amoco, that is the lead member of the Azeri International Oil Company. So they have taken a lead in a lot of this.

It is a stretch. It is important to get the framework documents to parliament this month and get them ratified. It is important to have a sponsors' meeting in the next couple of months. It is important to get on with basic and detailed engineering. We think that between November and now we have been burning up some of the surplus time that was probably built into the original timeframe. There is not a lot more time to burn.

And it is another matter, too. It is that various producing companies are looking at their prospective routes. There are other routes, particularly for the companies in Kazakhstan. And so very quickly they want to know, is there going to be a main export route to the West or do they have to search for other options?

If they search for and find other options, then their oil will not be available for Baku-Tbilisi-Ceyhan. There is a certain anxiety. There is a limit on how much oil is available, not already pledged

to existing pipelines. And so the effort is to corral all of that into Baku-Tblisi-Ceyhan. That effort cannot wait indefinitely. It needs to get on. And Azerbaijan needs to get on with the investment in its next phase of oil development. So the time is closing in on us.

Senator HAGEL. It really comes down to the economic feasibility, obviously, of the justification of building these pipelines, where we are now at that critical point. Who is going to ante up to take it the next step? And if in fact there is not enough oil, I am still somewhat at a loss to understand how this is all going to work.

Maybe you could explain it to me again. If we are not finding much oil and we need to put a lot more investment in—and I would take some issue, by the way, with security of that area, how secure it is, especially in the north. I know the Georgians would not give you, I do not think—they have not given me—a very sanguine sense of how safe they feel they are with the Russians, what they are doing in Chechnya.

I think it is not quite as rosy as you say it is, Mr. Ambassador, but maybe you can convince me otherwise. Let us take another run at it. If there is not enough oil, then how are we going to build pipelines?

Ambassador WOLF. Let us start with that question and then switch to some of the other ones then. On the, is there enough oil, the discussion has been somewhat hypothetical. And especially last year, a lot of the discussion was about whether AIOC did or did not have enough oil to build a main export pipeline. Our view has been that this is not just an Azeri or an AIOC pipeline, that this is a regional pipeline. And we believe that there are other volumes, as yet uncommitted, to export pipelines that would be available if the price is right, if the tariff is right, and if the terms are right.

So we are very close to agreements that will set a very attractive, very competitive tariff, that we hope will encourage potential producers, or producers in Kazakhstan and perhaps even Turkmenistan, to commit oil across the Caspian and into Baku-Tblisi-Ceyhan. That starts to change the balance some. And then it is a question for the consortium. They have to also look at the rate at which they will develop the Azeri-Chiraz oil structures. The rate at which they do that will also help to describe whether or not this is a financially realizable pipeline.

But we believe, with the right tariff and the right documentation, that sufficient barrels of oil will be available and pledged to make this pipeline feasible to finance commercially.

Senator HAGEL. Mr. Secretary, do you wish to add anything?

Mr. GOLDWYN. I agree with what the Ambassador has said. Just to add a clarification, there is lots of oil that goes by other routes. It goes by rail. It goes by barge. And if this line is attractive enough, then it should be safer and we hope cost competitive for them to ship. So you have got what AIOC produces. You have got volumes from other forms of shipment that you are going to draw, plus new production coming on line.

And how quickly new production comes on line is hard to predict. What they call the flow rate, the rate at which a particular structure produces oil, for AIOC so far, has proven to be better than they expected. If you have more good news than that, you may get your volumes up quicker.

We also have some flexibility, frankly, on that it is a million-barrel pipeline. But if on day one you have 995, you are still going to be able to push oil through that pipeline. So you have some flexibility. And it is without question that, given the billions of dollars that companies have invested in this area and the fact that there are more structures under exploration and expected to come on line, it is going to make sense for them to have a system in place rather than wait until they got a bunch of oil on their hands and then figure out how they are going to get it to market.

Senator HAGEL. What do you mean by "a system in place"?

Mr. GOLDWYN. A transportation system. The CPC line, that holds a million barrels, and that is pretty much that Kazakhstan is committed to that. And you have got these early oil lines, these two other lines, which are pretty close to capacity. So if you have more oil discovered, they are going to have to figure out how to ship that to market. And it can go by barge and by rail, but they probably would like an alternative.

Frankly, I think even people who are relying on rail routes across Russia would like the idea of another pipeline to ship their oil through. So there is lots more oil under exploration. And the question is a timing question, about when it is going to be ready for market and how they are going to get it there. But if we have this line under construction, I think other shippers are going to look ahead to their investment and want to have another pipeline going from east to west in place.

Senator HAGEL. We will ask the private panel and get a little more information of those coming in behind you.

Mr. Ambassador, you wanted to make a point.

Ambassador WOLF. Yes. I just wanted to say something along the same lines. There are other people with oil, with fields where they know there is oil, but they have not had a means to export the oil. Without a means to export the oil, it is difficult for them to get the capital to develop the field. If there is an export route, they can develop the field, and we believe that that will flush out, that that will enable some people to come forward who are not currently producing who might produce if the MEP is there.

Senator HAGEL. You mentioned in your statement—your words—"it is time for Turkmenistan and Azerbaijan to clear away the impediments." Would you amplify on that? Are you talking about the new natural gas that Azerbaijan found, and that has obviously put a new dynamic into the Turkmenistan natural gas, getting it across the Caspian? What did you mean when you were referring to that?

Ambassador WOLF. Mr. Chairman, these are two countries which have not had particularly congenial relations, and the importance of something like the trans-Caspian gas pipeline, part of the real benefit that comes, is by helping to encourage regional cooperation, cooperation between countries which have traditionally been competitors or adversaries.

It is our belief that it is possible for them to find a compromise on volumes that would be shipped, that would enable both Turkmenistan and Azerbaijan to benefit from the trans-Caspian pipeline. Over the course of the last months each country has had differing views depending on the day, the week, the month, about

how much of a 30 billion cubic meter pipeline needed to be reserved for it alone.

They are moving closer. Indeed, they talk about the same kinds of numbers, 16 billion cubic meters for Turkmenistan, 5 billion cubic meters the first phase of the Shah Deniz development for Azerbaijan. Now it is a question really of the leaders agreeing, this will work, we will work together, but it is also a question of coming up with a commercially attractive deal for both countries.

A lot of progress has been made there, and more discussions are taking place between the private companies that are involved in this project, and they are talking very intensely, but it has taken a while to get the suspicion and the mistrust resolved. They still will have to resolve issues like the crossing, and they will have to put aside or deal with the differences on demarkation of the Caspian, not that it is a directly related issue, but it is not an unrelated issue. It is just that they have to learn to work together. They have not done so well, but they are inching closer.

But again, it is a market solution that cannot wait. The Turks have a requirement for gas. They have a desire to diversify their gas, their sources of gas. They have a strong desire to get Caspian gas as part of that diversification. If one project does not work, they have other options, but the risk is that if the Caspian producers keep sparring with each other, that they will get shut out of the important market that Turkey is, so it is time to move forward.

Senator HAGEL. But you speak of markets. Is it not rather clear that there have been new natural gas finds in Azerbaijani waters of the Caspian? Doesn't that present a situation where you get that Azerbaijani natural gas to Turkey much cheaper and much quicker? Then where does that leave the Turkmen, realizing what you are talking about, geopolitical and other reasons to cooperate? If we are talking market forces here, explain to me how that works.

Ambassador WOLF. Well, I hesitate to speak too assertively for Turkey what I understand from a whole series of conversations from President Demirel down has suggested to me, that Turkey sees a broad strategic region for building cooperation and for helping to improve the ties throughout the South Caucasus and Caspian.

They have a sense of a Turkic identity. You will be aware that a number of the Turkic presidents met last weekend in Baku. Turkey has been trying to promote that cooperation, promote that regional dialog, and they have been prepared to pay somewhat more for the gas that they would get from Turkmenistan in order to make that happen.

That is a sovereign decision that they have made, but they also, I believe, want to ensure that the pipeline serves the interests of all of the countries, Turkmenistan and Azerbaijan and, very importantly, Georgia, because Georgia is a pivotal country for all of the energy routes through to Turkey, and for Turkey as well. I mean, this is a decision that was developed in Ankara and in the other capitals, and we have supported that effort through the use of our good offices, the President's good offices.

Senator HAGEL. Where is Iran showing up in this? I know you have referenced in your statement the administration policy on en-

ergy investment in Iran, but where do you see Iran fitting into this?

Ambassador WOLF. We have very specific legislation and administration regulations about energy cooperation with Iran. They have not changed. I frankly do not see—I do not understand the real advantages that some companies see in funneling more energy through a country that is a price hog, and through another choke point, the Strait of Hormuz, but it is not really just our view. It is—again, it is a view of the countries of the region that they are trying to promote an east-west corridor. We have supported that, and we do not see any reason to change.

And as I said in my statement, our policy notwithstanding on Iran, and we think there are good reasons to hold back on cooperation, notwithstanding that, we would still be supporting Baku-Tbilisi-Ceyhan. We would still be supporting trans-Caspian gas and east-west corridor because we believe it is in the interests of the countries involved, and it is in our interest to get those energy sources more directly to the West.

Senator HAGEL. In 1997, 1996, if I recall, China and Iran each signed agreements with Kazakhstan to move oil through Iran, and I do not know where all that stands. Maybe you could first of all give me some kind of a status as to what you understand that current situation is with the China arrangement with Kazakhstan, as well as the Iranian arrangement.

But back to the bigger picture on Iran, which is part of what I know you were taking into consideration, as you must. Iran is rather a significant player sitting there on the southern tier of the Caspian, with some interests that are not benign to play. As you suggested, there are energy companies who are at least intrigued, if not outright interested, in dealing with the Iranians, so maybe you could fill that in a little bit, and specifically talk a little bit about the Chinese arrangement with Kazakhstan.

Ambassador WOLF. Mr. Chairman, my understanding, at least of one arrangement that was there, was the idea that China would build an eastward pipeline perhaps linking the field for which they have development rights at Ouzen to another exploration in western China, and then to the east of China.

Well, it turns out, as I understand it, that what was discovered in western China was gas, not oil, and the economics of that pipeline do not seem to justify the decision to build a large and very long pipeline, so that has not moved forward, notwithstanding the continuing declarations of support for the concept.

We think there might be other ways for Kazakhstan to work swap arrangements that would end up being more efficient. It is our hope that Kazakhstan would look at the economic benefits of perhaps redirecting some of that oil, including perhaps the oil at Ouzen, to a westward route. That is a decision they are going to have to make, but the economics of it might be very good, but that is for somebody else really to decide.

I agree with your statement that some of Iran's interests in the region have not always been so benign, and I think that is another reason why the governments are leery of cooperation, but there are also some economic factors that pertain. I understand from one of our Ambassadors in the region that in a discussion between a for-

eign oil company and the Iranians about swap arrangements that the discount that Iran would insist on to do a swap arrangement make that trade, make that swap noneconomic.

This is a hard country to do business with, and I can only imagine that the more oil that were put into that market as potential swaps, the more difficult the negotiations might become, so our view is quite firm. Pipelines, swaps, sales are not a good thing and, indeed, they would trigger potential difficulties with U.S. law and U.S. regulation.

Senator HAGEL. With this administration about 8 months away from retirement, can you see any possibility that this administration would ask for any change in that Iranian relationship, specifically focused on what you just talked about, swaps, energy?

Ambassador WOLF. I think that the President has made—I mean, this is not my area, Senator, so—the President has made a very significant initiative to recognize progress that has been taking place, and to make visible some of what has been discussed privately, but I think, as I said in my written testimony, it is important for no one to underestimate the concerns about various activities—the Iranian attitude toward the Middle East, toward weapons of mass destruction, toward terrorism—and I think that it will be necessary to see concrete progress on issues like that.

This is not something where one keeps piling more and more chips out there to be enticing. The things that the President did were significant, and I would suspect that what needs to come next is a significant, substantively significant response, not just a decision to talk, but rather, actions, and not just words.

Senator HAGEL. Thank you. What is your understanding of the status of the Blue Stream Gas Pipeline?

Ambassador WOLF. There is construction taking place on both sides. The financing is not fully in place for the undersea portion, and the construction schedule is not entirely clear.

The barge, and there is really only one barge that is capable of laying pipe at that depth, is currently in the Gulf of Mexico and is expected to be staying there for a while, so that project would seem to be on a trajectory, best case, sometime in 2000, 2001, assuming that the project sponsors have the answers that will satisfy the people who provide the financing.

We have tended to try to stay out of the business of talking for or against Blue Stream. We have enough to do on trans-Caspian, but the sponsors of that pipeline have quite a lot to do to get that pipeline built and to keep it operating.

Senator HAGEL. So essentially there is not a lot of progress being made, as you understand it.

Ambassador WOLF. They are building on both sides, but the sub-Black Sea portion remains to be done. The plan was to do it this spring. That does not seem to be likely to happen.

Senator HAGEL. As you know, the Director of the CIA, Mr. Tenet, was in the Caspian Sea region last month. Have you met with Director Tenet since he has returned?

Ambassador WOLF. I have not met with him. We have regular meetings with his staff.

Senator HAGEL. Meaning—

Ambassador WOLF. We have weekly meetings that include the whole interagency interested community, and so CIA is a part of those discussions.

Senator HAGEL. Have you reviewed his trip, or talked to any of his people about sharing information with you regarding the Caspian Sea region?

Ambassador WOLF. I am not sure of the—I mean, issues come up in the course of our discussions. I am not sure I could answer them.

Senator HAGEL. Well, this is rather specific, I would say, though, if the CIA Director takes a trip to the Caspian Sea.

Ambassador WOLF. His people then feed their appraisal of the countries that are security issues, the developments in the region, in a very regular way.

Senator HAGEL. Would you not be somewhat intrigued by what the CIA Director had to say on his assessment of the Caspian Sea region, since that is your area?

Ambassador WOLF. Yes, Mr. Chairman, and I think we do see it in the publications that the CIA puts forward to the interagency group.

Senator HAGEL. Publications meaning—

Ambassador WOLF. They regularly summarize not only his visit but other sources of information as well.

Senator HAGEL. Well, I would think that that might be an interesting conversation that you might want to have with the Director.

Ambassador WOLF. I take your hint, Mr. Chairman.

Senator HAGEL. You know, information is rather important, especially in light of some of the things that you said in your testimony about the President being so assured of security over there, and how well they are all doing, and again, as I said, the Georgians do not quite share that, and some other people are a little nervous there, too.

Ambassador WOLF. Mr. Chairman, I am not sure which line it is in my statement that triggers that. I would not want to suggest that this is not a very difficult part of the region to work in, but we believe that by cooperating together, by developing this energy infrastructure, and by using the resources that would come from energy exports wisely, that these countries will both improve their cooperation with each other and their ability to provide for the needs of their citizens.

There are many ways in which development in this region could go badly, and there are a variety of issues that relate to the security of the pipeline, some of which we are discussing, for instance, with the Georgian foreign minister who is in town this week as part of the negotiating process.

We do not underestimate the difficulties of the process. I was discussing with one oil company—I have often said to the oil companies, would it not be nice if you could develop all of your needs from the Gulf of Mexico, or from the North Sea, but it turns out that energy turns up in some very difficult places. It is important for the countries of the region to recognize that they are a difficult locality, that there is a risk for that kind of investment. They need to take measures not only to agree on pipeline documents, but they need to do things to improve their laws, their transparency, to re-

move corruption, to build institutions, to create incentives for investors, and to deal with difficult security issues.

I do not think we are underestimating this, but nor are we—but we would not want to say—this is an important region. It has a significant source of energy that can help world supplies. It is not the Persian Gulf, but it is significant.

There is a reason that we have supported Turkey and the countries of the region. We do this through a variety of mechanisms, through our aid programs, some of which—some portions of our aid programs help the countries to work on their security, and their security situation. We will look at others, and in particular with regard to a country like Georgia, if that is their desire, we will look at how we might be helpful. Turkey will look at how it can be helpful. These are parts of what we are trying to accomplish.

Senator HAGEL. Well, just for the record, Mr. Ambassador, the last paragraph of your statement, what I was referring to, and I will read it back to you: “President Clinton summed matters up by saying,” quote, “today these countries have the freedom, they have the security,” and so on and so on. That is what I was referring to.

Mr. Ambassador, you have been very generous with your time, and we are grateful that you would come up. We obviously will be talking as we go along. We have a big job to do, and we are grateful for your leadership. Thank you.

Ambassador WOLF. Thank you. We appreciate the help of the Senate on this, and yours personally.

Senator HAGEL. Thank you.

If the second set of witnesses will come forward, we will take your testimony.

I see, Mr. West got two glasses of water, Mr. Alexander two, and poor Dr. Olcott only one. Now, we will remedy that, Dr. Olcott. I do not know if you were here earlier, but we said glowing things about you as well.

Dr. OLCOTT. Thank you so much, and I am sorry I was detained on the House side.

Senator HAGEL. Let us begin with Mr. Alexander, again, who is group vice president of BP Amoco Corporation, and to each of you, thank you for coming and taking your time. This is important, and we are grateful for your contribution.

Welcome, Mr. Alexander.

STATEMENT OF MR. RALPH ALEXANDER, GROUP VICE PRESIDENT FOR EXPLORATION AND PRODUCTION, BP AMOCO CORPORATION, LONDON, ENGLAND

Mr. ALEXANDER. Thank you, Chairman Hagel, for the opportunity to be here. In the introduction you mentioned that we were an investor in both the AIOC consortium, which is an oil consortia, and in the Shah Deniz Gas Project, and I just wanted to be clear coming in that we are speaking on behalf of the Amoco, not either of the consortia. They are multiple partnerships, different interests, and we can only speak for ourselves at this point, and although, for example, as we speak about Baku-to-Ceyhan and supporting that, that is not something that the AIOC partners have actually voted to do, so I just want to make that very clear.

Senator HAGEL. The record will be very clear on that, Mr. Alexander, thank you.

Mr. ALEXANDER. Thank you.

BP Amoco's experience to date has been primarily in the Azeri part of the Caspian Sea, and I thought I would take some time to give you the state of play on what has happened so far with us.

Now, what we found, much like other people exploring out there is that the area not only contains world-class oilfields, but actually contains a lot of gas, and world-class gas opportunities. In fact, to put it in context, recent industry projections would suggest that the Caspian Sea represents about 2 years of U.S. oil supply and about 8 years of U.S. gas supply, just to give you a sense of the scale of oil to gas in the Caspian.

Now, given this outcome, we are now considering development and export potential of both oil and gas out of the Caspian. Let me turn to oil first.

BP Amoco is firmly committed to the Baku-to-Ceyhan pipeline. We share many of the comments and questions and line of questioning that you raised, and other committee members did today, but the reason we do is because Azerbaijan, who is the host country who owns the resources, has expressed through international treaties a strong interest, along with Georgia, Turkey, and the United States, to build the Baku-to-Ceyhan pipeline.

We believe we must be responsive to the aspirations and goals of the Azeri Government, and are determined to do all we can to find a way to progress this project. At the same time, we also recognize an equal responsibility to both our shareholders and our partners in meeting their commercial expectations. This is the challenge that we face, and it will be very hard to do. You touched on some of the issues we have to fix.

What we are trying to do collectively will test the boundaries of doability in many areas, particularly in terms of complexity and scale. To do both the gas discovery and the Azeri initial development, including pipelines, we would estimate an investment on the order of \$16 billion. As I understand it, this is more than the entire U.S. foreign aid budget, just to give you a sense of scale here. I suspect that would put pressure on financial institutions globally to be able to come up with that sort of resource.

In addition, you have heard about the three countries representing Baku-to-Ceyhan, but within AIOC itself there are 11 companies representing seven nations, and in Shah Deniz there is a consortium that is made up of seven companies, so we have a lot of alignment issues and so forth.

On a practical level, we face unprecedented logistics and implementation challenges for the region, given the massive investment required. Our industry track record, frankly, has not been good. We have been behind schedule on delivery, costs have been higher than what we have estimated, and on the commercial front Baku-to-Ceyhan, to attract the volumes it will need, it needs to be the cost-efficient, safest, and most secure route.

If we can do this, this will stimulate development of small fields, as well as attract exploration capital to the area.

So to make this project work, we need scale in terms of barrels through the line, we will need innovative financial structures, and we will need to control the cost and deliver things on time.

Now, given what we know today, we believe about 6 billion barrels is required to make this work in terms of economics. So far, AIOC has found 4 billion barrels to date, and again there is no commitment that all those 4 billion barrels would necessarily go to Baku-to-Ceyhan.

On the financial side, we need to finish and ratify the transit agreements Ambassador Wolf spoke about. In this respect, we encourage the U.S. Government's support to get that done, and also are thankful for the U.S. Government's support to try to get more oil through the pipeline, but if we are to have any chance of making Baku-to-Ceyhan operational by 2004, we need to have confidence this project will work by the end of the summer.

Now, I would like to turn a bit to gas. In February of this year, BP Amoco confirmed the discovery of an oil world-class resource called Shah Deniz. Now, it is an interesting discovery, and it has some features that I would like to make you aware of. First of all, we believe it is likely to be the most competitive source of gas to Turkey and Georgia in the region. We believe the project can be adjusted or phased in a way that would better match the patterns of demand within Georgia and Turkey themselves, as opposed to big slugs of gas which is required to underpin big, big pipelines.

We believe we can get gas to market by the winter of 2002, 2003, and it does support the east-west corridor, and makes it a reality, and we also believe the project would be commercially viable today.

So the question is, how does this all come together? I just want to be clear that I believe, and we believe that the regional governments and the industry investors carry the majority of the burden here, but we also think the international community and the U.S. administration and Congress can help in shaping the pace and the context for the region.

Principally, the focus is on oil. We need to continue to work on the innovative financing structures. We need to encourage specific funding support by U.S. agencies, if that can happen, support energy infrastructure, and we need continuing support by—to the regional governments to coordinate and aggregate volumes of oil and gas to support the pipeline.

Mr. Chairman, the Caspian Sea presents us all with a challenge, but we believe collectively we are up to the challenge, and we are certainly going to give it our best shot.

Thank you for the opportunity to speak, and I am happy to answer any questions you may have.

[The prepared statement of Mr. Alexander follows:]

PREPARED STATEMENT OF RALPH ALEXANDER

Thank you Chairman Hagel for the opportunity to appear before this Subcommittee. My name is Ralph Alexander, I am the Group Vice President for Exploration and Production, BP Amoco corporation. Although BP Amoco is the largest shareholder and operator of the Shah Deniz Gas Condensate Project and the Azerbaijan International Operating Company, or AIOC—a consortium of companies planning the development of the largest oil field and largest oil project in the Caspian Sea, I am appearing today on behalf of BP Amoco only. I appreciate the opportunity to present an overview of BP Amoco's activities in the Caspian.

SUMMARY

Ambassador Wolf has already stated the strategic and political significance of the Caspian region. Therefore, I will focus my remarks on the commercial issues affecting the development of oil and gas reserves there.

BP Amoco plays a leading role in the development of the Caspian region's oil and gas sectors. We believe that our efforts can be a force for good by developing a world class energy resource bringing prosperity and economic growth to Azerbaijan and the neighboring transit countries through regional interdependence.

In addition to our Caspian Sea oil reserves, BP Amoco recently discovered huge gas reserves in the Shah Deniz field which will be available to supply gas to Turkey and Georgia by 2002/3. Development of Azerbaijan's presently discovered oil and gas reserves will require more than \$12 billion in field investment and more than \$4 billion to create the pipeline access to world markets.

Such large investments in this part of the world require innovative approaches to developing these resources. The challenges to be faced and in which BP Amoco is playing its full part are:

1. Work to try to make the Baku-Tbilisi-Ceyhan oil pipeline a competitive transportation option so that a world class energy resource can be developed for the benefit of the Azerbaijan and the transit countries;
2. Seek solutions that overcome the enormous complexity involved which are sustainable for all the stakeholders, and to resolve these issues quickly. Companies must make decisions today which will impact the development of these resources for the next 50 years;
3. Provide solutions for exporting early Caspian gas to Turkey thereby providing much needed energy supplies to Turkey and Georgia, and paving the way to explore for synergies between oil and gas exports; and
4. Encourage the U.S. government and the international community to provide the right environment to allow investors clear economic and competitive choices for both oil and gas development and export.

THE BAKU-TBILISI-CEYHAN PIPELINE

BP Amoco supports the concept of an energy transportation corridor from the Caspian to the Mediterranean via Turkey although this aspiration is not without its challenges. We favor a Baku-Tbilisi-Ceyhan pipeline that provides competitive transportation to world markets. At the same time, we endorse multiple export routes for oil and gas from any region to ensure competition, security of access to markets and regional interdependence.

For the Baku-Tbilisi-Ceyhan pipeline to make economic sense as currently envisioned, companies developing oil reserves in the region will need to commit to shipping approximately 6 billion barrels of oil through it. To date, the AIOC and the State Oil Company of Azerbaijan have approximately 4 billion barrels waiting for an export solution. Even if all the individual AIOC partners commit their oil to the Baku-Tbilisi-Ceyhan pipeline this is one-third short of the volumes required for the Baku-Tbilisi-Ceyhan pipeline to work. To address this shortfall, BP Amoco is:

- Encouraging producers outside of AIOC to commit specific oil volumes to the pipeline;
- Working with the State Oil Company of Azerbaijan and the U.S. Government through Ambassador Wolf, to find the additional volumes essential for progress; and
- Working with the multilateral lending institutions to find innovative ways to help finance the project.

In short, BP Amoco is making every effort to find the volumes of oil necessary and exploring new ideas to make this pipeline viable. However, no one company can make this project a reality on its own.

BP AMOCO EFFORTS TO RESOLVE COMPLEX ISSUES

The Baku-Tbilisi-Ceyhan pipeline will pass through Azerbaijan, Georgia and Turkey. In addition to BP Amoco's efforts to search for the necessary volumes for this pipeline, BP Amoco has assisted in the development and negotiation of innovative model agreements between these three countries on many government levels to provide investors with the proper legal and commercial framework and protections to undertake massive infrastructure investment.

TIMING IS CRITICAL

We are now at a critical juncture. The governments of Turkey, Georgia, and Azerbaijan have yet to finalize the agreements providing the legal and commercial terms for the pipeline. Despite the signing in November of arrangements between the three countries (which were witnessed by President Clinton) the details are still not complete. So far the delays in achieving an export solution have resulted in an approximate six month delay to the next phase of AIOC's project and production start up. Investment in offshore field development and pipelines will not go forward until these agreements are finalized.

ROLE OF THE U.S. AND INTERNATIONAL COMMUNITY

In order to make the sizable investments necessary to develop and transport Caspian oil resources to world markets, commercial loans will be necessary. However, since volumes of oil necessary to make the pipeline viable have yet to be committed, commercial lenders would have to be convinced through other means that the Baku-Tbilisi-Ceyhan pipeline is viable. Therefore, assistance from the United States Government and the international community is essential to realizing the pipeline. The U.S. Government can take the following five steps to enhance the economic viability of the project:

1. Work with international financial institutions to find innovative ways to finance the project.
2. Make specific funds from the Export-Import Bank, the Trade and Development Agency, and the Overseas Private Investment Corporation available to the project.
3. Urge direct World Bank involvement to provide a stabilizing presence in the project.
4. Provide funds to support energy infrastructure development in the region.
5. Continue to support regional governments efforts' to coordinate and aggregate oil volumes.

If the Baku-Tbilisi-Ceyhan pipeline comes to fruition, it will be a joint success by the governments of Azerbaijan, Georgia, Turkey, the United States, and the investors, bringing not only commercial and economic benefits but also regional interdependence.

EXPORT SOLUTIONS FOR GAS

What I have said today about the challenges of developing and transporting oil to market is also true for gas.

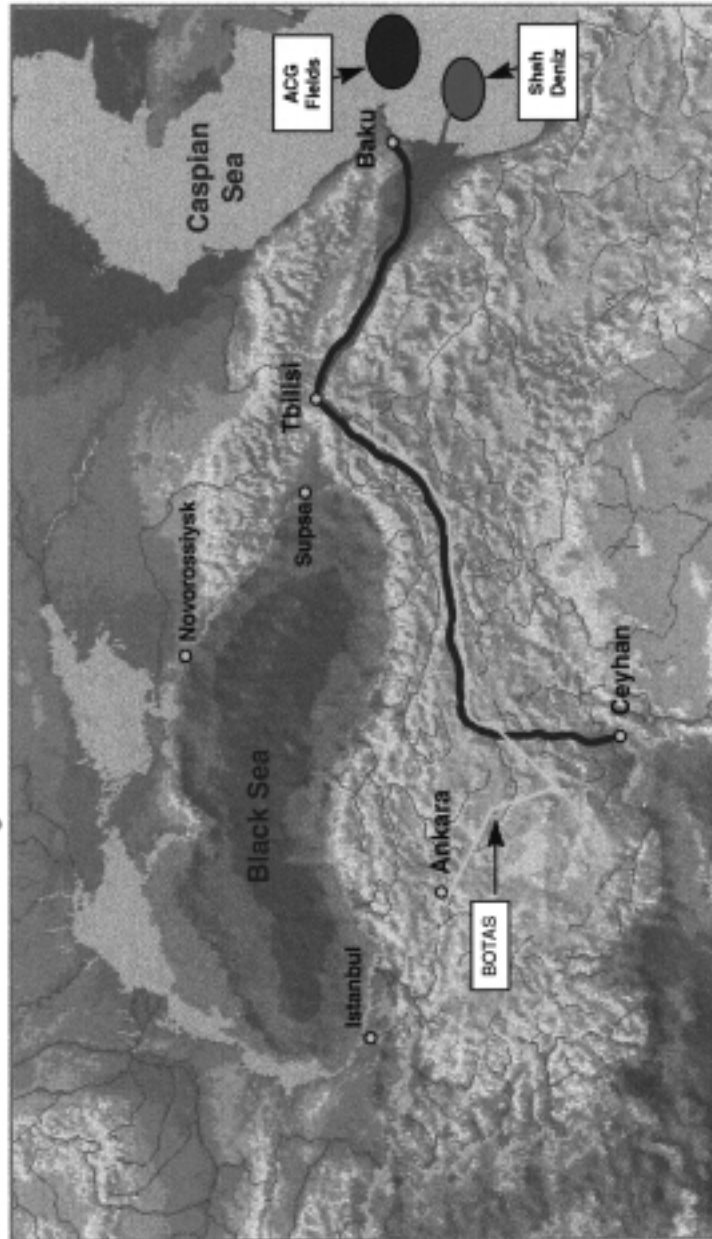
The BP Amoco led Shah Deniz partnership is currently working on an early field development scheme and securing a pipeline to deliver gas to the Georgian and Turkish energy markets by the winter of 2002-2003. This effort was supported by the gas memorandum signed between the governments of Azerbaijan, Turkey and Georgia last November. BP Amoco believes that by building a pipeline from its gas field to markets in Georgia and Turkey, it will meet the 2002/3 deadline and will provide Turkey with competitive gas sooner than other pipeline options.

Shah Deniz is a project which does not need to search for volumes and finance as a condition for realization. Early gas deliveries benefit not only the Turkish consumer but also the stability of the region, by offering a solution to the current energy crisis in Georgia. They will also underpin the economic growth of Azerbaijan and Georgia by bringing them early investment and revenues as well as gas. This project provides an outstanding opportunity for government and commercial interests to deliver on the benefits of the East-West energy transportation corridor. We should do our best to realize these benefits and not put hurdles in its way.

CONCLUDING REMARKS

In conclusion, BP Amoco will continue doing everything in our power to help make the Baku-Tbilisi-Ceyhan pipeline come to fruition. We will also strive to supply the region with a new natural gas resource. We are committed to bringing Caspian oil and gas resources to international markets. I extend my sincere thanks for the opportunity to appear before you today and to clarify BP Amoco's position to the Members of this Subcommittee. I hope that my appearance here today helps this important committee understand the challenges we face in developing and transporting Caspian resources to world markets. I look forward to any questions you might have. Thank you.

Azerbaijan - Oil and Gas to markets



Senator HAGEL. Mr. Alexander, thank you. Now let me ask Mr. Robin West, who is chairman of Petroleum Finance Company, for his testimony. Welcome. Thank you.

**STATEMENT OF MR. J. ROBINSON (ROBIN) WEST, CHAIRMAN,
PETROLEUM FINANCE COMPANY, WASHINGTON, DC**

Mr. WEST. Thank you, Mr. Chairman. I am delighted to be here. I am joined by my associate, Julia Nanay, who is a well-known expert on the region. I have a rather long statement I would submit for the record, and I just have some comments I would like to make which will summarize the statement, and frankly I would like to pick up on a few points that some of the earlier witnesses made.

The first is to put the Caspian in context. Mr. Chairman, you pointed out, and others, that the Caspian is not the Middle East. In fact, its resources are much more comparable to, for example, the North Sea, or even West Africa, but it is interesting to note that, for example, much more industry capital is flowing into West Africa than is flowing into the Caspian. This is because not only is there higher prospectivity, but there are lower risks, and people can make commercial decisions and get on with it.

In terms of the North Sea, which Secretary Goldwyn compared it to, there is a very important difference from not only just the resource issue, but the fact is that the private sector was permitted to develop this, and that infrastructure decisions such as pipelines were made on the basis of commercial decisions, not political decisions.

Now, one of the things to keep in mind also is, as you look at the industry, that companies manage their assets through portfolios, and different assets have to perform over time and under different risks, and if companies cannot get the necessary return from assets, they take their money and go elsewhere.

Now, the classic example of this was Russia. Russia has enormous resources. The risks of doing business in Russia were just prohibitive, and people could not get a return, and so they took their money and went elsewhere.

As one looks at the Caspian, there are really two critical projects. There was a discussion earlier about Kazakhstan and Tengiz. I will not go into a discussion of it except to make two points: First, that the CPC pipeline solution was the best commercial and political solution. It was a win-win for companies and Governments. It also made sense; it was a good deal, but it was a difficult deal, and it took 7 years to get done.

Second, what is important to remember is that for CPC there was proven reserves of 6 to 9 billion barrels. This is enough oil to guarantee throughput of a million barrels a day for a long period of time. The companies were then prepared to finance these projects on their own balance sheet. This was funded straight out of equity.

AIOC is a very different situation. First thing, there are several pipelines already in place, one north through Dagestan, to Novorossisk in Russia. The other is west, from Baku to Supsa. The companies have already invested close to \$1 billion in pipelines and related infrastructure. With further investment, it is possible to increase the throughput of these existing pipelines to about 450,000 barrels by 2004.

The Baku-Tbilisi-Ceyhan pipeline, this has been discussed before, requires about 6 billion barrels proven reserves to support a million barrels a day. Now, the issue being made is that there are only 4

billion barrels of reserves, but as Mr. Alexander pointed out, not all of those reserves, not all of that 4 billion barrels, will be committed to this pipeline.

For example, Lukoil, the Russian oil company which has 10 percent of this deal, they are going to take their oil north to Russia. They are not going to put it through this pipeline. Furthermore, I think the notion that one can draw on all the crude from the area is false. It is very important that the CPC pipeline and the oil that is dedicated to that remain dedicated to that.

The second point, which I think is very important, is, there is something in this called MEPCO, which is the Main Export Pipeline Company. This is actually the pipeline company. AIOC will not be the oil pipeline company, and the problem is that nobody knows yet who will be the partners in MEPCO. It is still an abstract concept, and certain companies in AIOC are trying to do their best, certainly BP Amoco is, but they are not going to do it all.

For example, SOCAR, the State oil company in Azerbaijan, wants 50 percent of MEPCO, but SOCAR has no capital and very limited credit. The government companies got equity in CPC. They did contribute rights of way, but they also contributed existing pipelines which they have, so this is a different deal. So how MEPCO—you know, what will be the structure, the financial structure of this pipeline is completely unclear.

Now, shifting a bit, Azerbaijan has been frankly a disappointment to oil companies in terms of oil prospectivities and discoveries, but has been a huge gas success, but it is important to recognize that the gas business works entirely differently than the oil business.

In the oil business the risk is essentially an exploration risk. If you can find oil in commercial amounts, at a commercial price, you can sell it into the world market. The gas business does not work like this. Essentially, the world is awash with gas, and what becomes critical in gas are markets, and there is intense competition to reach markets.

But gas markets such as the Turkish market are finite. Turkey can absorb only so much gas, but as I say, the region is awash with gas. There are enormous amounts of gas in Russia. There are enormous amounts in Turkmenistan. There are enormous amounts in Iran. There are enormous amounts in Iraq. There are enormous amounts now in Azerbaijan.

But I do not think most people realize that Turkey is even importing LNG from Nigeria now, so that the gas business, this is a different business than the oil business, and the kinds of commercial considerations are fundamentally different.

Now, the key is to be able to get gas into a market. Here, price and reliability become essential, and speed, and one of the things which I think Mr. Alexander pointed out was that there may be enough gas in Azerbaijan now to take a substantial piece of the Turkish market on a very competitive basis and use existing infrastructure. If you want an east-west corridor, energy corridor, and you want it to happen fast, gas may be the answer, not oil.

One of the things I note with interest from Mr. Wolf's testimony that, quote, "the idea of an East-West energy corridor was born in Tbilisi, Ankara, and Baku," I find this is interesting, but I would

respectfully submit that neither Tbilisi, Ankara, nor Baku are going to fund these projects. They are not making commercial decisions, they are making political decisions, and until the real source of the capital can get behind this project and are given a real commercial project, with specifics that they can act on which are competitive, this will not work.

I would like to stop there, I think, Mr. Chairman, if I may.
[The prepared statement of Mr. West follows:]

PREPARED STATEMENT OF J. ROBINSON WEST

Good afternoon. Senator Hagel and distinguished members of this Subcommittee. It is a pleasure to come before you today to address such a timely and critical issue for many companies in the oil and gas industry. My name is J. Robinson West and I am the Chairman of The Petroleum Finance Company (PFC). PFC is a strategic advisory firm, based in Washington, DC. We work with most of the companies in the petroleum industry on some aspect of their international oil and gas investment strategies. Our client base includes many of the companies active in the Caspian region.

I come before you today not to argue the policy merits of infrastructure projects in the Caspian region. Even though I have held senior policy positions in the U.S. government in the past, over the last 16 years. I have worked in the private sector and have focused solely on the commercial aspects of the petroleum business. I help companies make business decisions based on sound commercial principles. Ultimately petroleum companies, like any other business, are profit-driven entities, accountable to their shareholders. They are in the business of making money and not in the business of setting policies or achieving a government's strategic political objectives.

That's not to say that this business isn't sensitive to political agendas. It most definitely is. After all, over 90% of the world's oil and gas reserves are owned by governments, which means that accessing these reserves requires that companies be extremely attuned to what these governments' need and want in return for their participation. The petroleum industry today is in the business of partnering with many different types of governments around the world. Petroleum companies are becoming much smarter in handling what we like to call "above ground risks." Very often nowadays, the risk is not in finding the oil and gas, but in juggling the multitude of risks associated with operating in very difficult host country environments.

In addition, many of the most prospective oil and gas producing countries are off limits to the industry because they are under some form of U.S. government or multilateral sanctions. U.S. companies understand well the impact the U.S. government can have on their business. But because we are talking about a "globalized" economy, where the asset base of companies in the petroleum industry is often transnational, most international oil and gas companies of any significant size are impacted by U.S. government decisions. Clearly, the U.S. government and its policies play a sizable role in the "above ground risks" for petroleum companies.

No other region brings together so many "above ground risks" and in such a complex package, as the Caspian. When companies first entered this region in the early 1990s, they never anticipated the multitude of commercial challenges they would be faced with. These were in some measure the normal commercial challenges that could have been expected from launching into projects in difficult domestic political environments. After all, Azerbaijan, Kazakhstan and Turkmenistan were emerging from the shadows of the monolithic control of Moscow. These were new states being formed. No one thought it would be easy. But companies were willing to underwrite the commercial risks because of the huge size of the resources that could be accessed.

At the time, companies were attracted to the Caspian because of declining production in the last great oil provinces of the Alaskan North Slope and the North Sea. With the Middle East largely off limits, companies were searching for new international growth opportunities of a certain size and scale in non-sanctioned countries. The Caspian region held out the promise for companies of such opportunities.

But since 1993, when the first contract was signed by Chevron in the Tengiz field in Kazakhstan and 1994, when BP and Amoco, as members of the 11 company AIOC consortium, signed their contract in Azerbaijan, progress in these and other ventures has been limited. There have been a few small steps forward, but also many disappointments.

Managing the domestic commercial and political risks of operating in these countries turned out to be just a small part of a much bigger package of risks. This bigger package of risks involves the geostrategic agendas of an array of peripheral countries—namely Russia, Turkey and Iran—and a number of players outside the region, most importantly, the U.S.

These geostrategic agendas became reflected in a series of pipeline plans, because pipelines were a way to cement relationships between countries. Rather than being seen as commercial outlets for oil and gas, pipelines came to symbolize political dominance over the countries of the Caspian region: Russian dominance vs. Turkish dominance vs. Iranian dominance. Since 1997, as the U.S. became increasingly wedded to East-West pipeline routes, Turkish dominance also became synonymous with U.S. dominance. A new cold war of sorts was born. With the U.S. determined to keep Iran off limits as an export outlet for Caspian crudes, this cold war has pitted the U.S. against Iran. At the same time, because Iran has been largely marginalized until now, the more serious and potentially dangerous repercussion of the U.S.-Turkish geostrategic agenda has been a pipeline cold war pitting the U.S. against Russia.

Companies operating in the Caspian have gotten caught up in this “cold war,” even as they are being forced to take sides in an all or nothing game—either do it the way the U.S. wants and potentially sacrifice your business imperative of making money or don't get your resources to market. The countries of the Caspian region have eagerly embraced the U.S. geostrategic agenda because it has brought with it some explicit and implicit promised benefits from the U.S. government, both of an economic nature and military/security guarantees. In any case, the leaders of these countries feel that the U.S. through East-West pipeline routes will ensure their future independent power bases.

As the U.S. government continues to pursue this geostrategic agenda, commercial considerations have become secondary and companies are being asked to shoulder the financial burden of paying for it. The companies that operate in the Caspian are being asked to assume the role of nation-builders when, in fact, they are commercial entities accountable to their shareholders.

Let's just see where this leaves us currently. First, the claim that the Caspian region is tremendously important to U.S. interests because it will be a large new source of oil and gas needs to be examined. Some experts put the likely volume of proven and probable oil and gas reserves in the Caspian at about 60 billion barrels of oil equivalent (BOE). That's a far cry from the 674 billion barrels of oil reserves in the Middle East. It is about equal to the proven and probable oil reserves (not including gas) of West Africa (57 billion barrels).

Second, since 1993-94, the only two major oil plays in this region remain Kazakhstan's TengizChevroil (TCO) joint venture for the Tengiz field with estimated reserves of 6-9 billion barrels, which is a U.S.-led consortium (Chevron, ExxonMobil, Lukoil/ARCO and KazakhOil), and the BP Amoco-led 11 member AIOC consortium for the Azeri. Chirag and shallow water Guneshli fields also includes Unocal, ExxonMobil, Devon and Amerada Hess) with 4 billion barrels of reserves. A total of seven countries are represented in AIOC (U.K., U.S., Norway, Russia, Turkey, Saudi Arabia, and Japan). TCO currently produces about 210,000 b/d and AIOC, about half that, with 105,000 b/d.

In Kazakhstan, additional oil is available from some smaller onshore fields. The emphasis in Azerbaijan is offshore; in Kazakhstan, it is still onshore, although the drilling of the Kashagan structure offshore, if it proves up oil, will change that. Azerbaijan's total oil production is 230,000 b/d; Kazakhstan is 600,000 b/d.

AZERBAIJAN/MORE GAS THAN OIL?

During the last four years, several prospects were drilled offshore in Azerbaijan which proved up no commercial volumes of oil or gas. This changed with the recent major discovery of a huge gas field offshore Azerbaijan, in the BP Amoco-operated Shah Deniz prospect. Azerbaijan, in fact, looks increasingly like a gas play, rather than an oil play.

Other prospects in the queue for development, some by U.S. companies, are already projected to yield additional reserves of gas.

The gas aspect of Azerbaijan's future export potential is important to emphasize. Given Azerbaijan's close proximity to Turkey, gas exports from Azerbaijan to the Turkish market appear to be the best way to ensure the U.S. vision of an East-West pipeline corridor. Since a gas pipeline looks to be more feasible in the near term than an oil pipeline, it would make sense for Azerbaijan, Georgia, Turkey and the U.S. to focus first and foremost on this gas export corridor. Existing pipelines along the Azerbaijan-Georgia route could be rehabilitated at low cost and shipments of 5

billion cubic meters per year (bcm/y) of gas to the Turkish market could begin by the winter of 2002-2003.

KAZAKHSTAN/CPC

The most important U.S. commercial interest is in Kazakhstan. Tengiz is among the largest oil fields in the world today. New drilling at the Tengiz concession area could prove up even more reserves. Chevron was the first company to embark on trying to build a pipeline in the Caspian region. When Chevron signed its contract for Tengiz in April 1993, it correctly identified the Russian route for oil exports as the most commercially expedient for this crude.

Seven years later, Chevron is finally close to realizing this goal, as the construction of a 560,000 b/d, 1580 km (1,000 mile) pipeline to the Russian Black Sea port of Novorossiysk winds its way toward completion at 4 km/day, with an anticipated start-up date of June 2001. Referred to as the Caspian Pipeline Consortium (CPC) and joining a number of Western companies and Russian companies with the Russian, Kazakh and Omani governments (the government/company split is 50%/50%), this \$2.5 billion project appears to be seeing the proverbial light at the end of the tunnel.

As their 50% share of costs, the Russian and Kazakh governments agreed to contribute rights of way and existing Russian and Kazakh pipeline assets to the project. There are 740 km of existing pipes which will be used, or about half the length of the project. The companies (Chevron, Lukoil/ARCO, ExxonMobil, Rosneft/Shell, British Gas, Agip, Kerr McGee, KazakhOil/BP) are using equity financing to pay the \$2.5 billion cost of old pipe refurbishment, new pipe construction and for a new terminal in Novorossiysk. The new terminal will be comprised of a state-of-the-art offshore buoy system that will permit operation for much of the year, avoiding the shutdowns that Novorossiysk currently experiences because of bad weather. Essentially this means that each company is financing two times its share in CPC to cover the 50% cost burden that governments aren't paying. Chevron (15%) and ExxonMobil (7.5%) are contributing over \$1 billion to the construction of the CPC. Add to this the costs of developing the Tengiz field (about \$2.00/bbl), and you can say that these two companies have about \$2 billion already invested in Tengiz. In step with expansions at the Tengiz concession, Chevron is committed to carry out further expansions on the CPC pipeline, which could eventually reach a capacity of 1.3 million barrels per day (mmb/d).

While putting together the financing and construction package for CPC, TCO has worked tirelessly and with great creativity over the last six years to forge a multiplicity of interim exit routes for Tengiz crude, consisting of both rail and existing pipeline access through Russia. TCO is also barging crude to Baku and railing it to Batumi, Georgia.

When Chevron embarked on its pipeline quest through Russia (construction began in October 1998), the U.S. government still favored a close relationship between the Russian and U.S. governments, although the ties had begun to weaken. While the U.S. was and continues to be supportive of the CPC, it has simultaneously embarked on a "Silk Road Strategy," which favors the construction of East-West pipeline routes. Largely directed at the southern Caspian, namely Azerbaijan and Turkmenistan, the U.S. seeks to anchor these countries to Turkey with an oil and gas pipeline network that is envisaged as a transport corridor that will bring resources from the eastern side of the Caspian, under the sea, to Azerbaijan, Georgia and Turkey.

AZERBAIJAN AND GEORGIA/SUPSA

In November 1997, then Energy Secretary Pena went to Baku to celebrate first oil production by AIOC. While there, he spoke out in favor of non-Russian and non-Iranian routes. At that point, the northern pipeline route from Azerbaijan, that traversed Dagestan and Chechnya into Russia, was already experiencing problems. Plans were underway to build a second 830 km pipeline (just over half the length of CPC) to the Georgian port of Supsa. Taking some lessons from the vision for CPC, Supsa was going to be built on the premise that existing pipes in Azerbaijan and Georgia could be refurbished at low cost. This turned out to be a more difficult proposition for the oil pipelines in these countries, and the companies eventually found themselves having to build a new pipeline at a cost of \$560 million, almost double the original \$315 million that had been budgeted by AIOC for the Supsa connection. Supsa was completed in December 1998. Sorting out who pays for this cost overrun remains an issue between the AIOC member companies and the Azeri government. Supsa is currently transporting all of AIOC's 105,000 b/d of production and could

carry up to 150,000 b/d. The transport tariff to Supsa is \$0.43/bbl (split as \$0.17/bbl for Georgia and \$0.26/bbl for Azerbaijan).

AZERBAIJAN/NORTHERN ROUTE THROUGH RUSSIA

In early April 2000, Russian pipeline company, Transneft, announced that it had completed a \$160 million, 312 km bypass pipeline around Chechnya, heading north out of Azerbaijan via Dagestan. The entire length of the northern pipeline is probably close to 1500 km, comparable to CPC, and, according to a recent account, it can eventually carry up to 18 million tonnes/y or 360,000 b/d. Azeri company, Socar, on April 7 said it would begin shipping some of its own oil through it. Socar has committed to ship 5 million tonnes/y (mmt/y) or 100,000 b/d through the northern route.

While the northern route option is less ideal because the oil received at the other end (in the Russian Black Sea port of Novorossiysk) is priced as Urals Blend crude vs. the higher quality Azeri Light, hence the value of the barrel is \$0.30-\$0.90/bbl less, the infrastructure is not costing the companies or the Azeri government anything to build. Thus, even the \$2.15/bbl transport fee (though higher than on the Supsa route) is competitive. Moreover, having the northern route option available gives all investors in Azerbaijan a measure of comfort.

For the AIOC consortium, it makes business sense to ensure that the northern route is supplied. It also makes business sense to ensure that the western route to Supsa is supplied. These two routes provide AIOC export outlets for at least 200,000 b/d and up to 450,000 b/d with relatively inexpensive expansions. The total amount translates into 2.0-2.5 billion barrels of reserves or the amount that AIOC expects to produce starting in 2004.

AZERBAIJAN/AIOC

Today, AIOC could produce 115,000 b/d from the Chirag field, which is the only field producing oil in the ACG development scheme (Azeri, Chirag, deepwater Guneshli). In early April, AIOC began drilling in the Azeri field. By 2002, AIOC may be producing 150,000 b/d from the Azeri and Chirag fields. In order to move to the next level of development, however, which is referred to as Phase I and which would yield another 300,000 b/d by 2004. AIOC needs to have a pipeline solution available. The total production in 2004 is thus estimated at 450,000 b/d.

What are the options? Clearly, some of this oil, if not all of it, could be transported through the northern and western routes that are currently in place (and/or can be expanded).

AZERBAIJAN/BAKU-TBLISI-CEYHAN (BTC) PIPELINE

The other option being promoted by the U.S. government and now the favored option of the governments of Azerbaijan, Georgia and Turkey is the Baku-Tblisi-Ceyhan (BTC) pipeline (as opposed to a Baku-Supsa-Ceyhan or Baku-Batumi-Ceyhan pipeline). BTC would be 1,730 km in length of new pipe construction (vs. the CPC with 1,530 km and some existing pipes). BTC is estimated to cost \$2.4 billion (vs. \$2.5 billion for the CPC). BTC will traverse 3 countries (465 km in Azerbaijan, 255 km in Georgia, and 1,010 km in Turkey) and cross a mountain range in Turkey that is up to 2,500 meters high.

BTC is not an easy pipeline to build. Its technical challenges are compounded by enormous political risks particularly on the territory of Georgia, where four Russian military bases and elements of Russian troops everywhere, create an environment of insecurity and instability. A pipeline headed south from Tblisi will have to cross through or by the Armenian-populated enclave of Javekhetia, which hosts a Russian military base.

Because of the many risks involved in building BTC, any companies that participate would project finance this pipeline, and get multilateral institution investment guarantees. To the extent that financing is made available, the multilateral institutions will have the effect of providing some "political risk" insurance, but these institutions will insist on laying off most of this risk to the borrowers. This is why some companies typically do not use this type of financing. It is expensive and the risks are rarely really shifted to the financial institution.

Most troubling for the companies, however, is that there are insufficient reserves at present in Azerbaijan to commit to BTC. A 1 million barrel per day (mmb/d) pipeline would need 6 billion barrels of reserves. The maximum reserves AIOC could bring to the pipeline are 4 billion barrels, but as we will show below, less than 4 billion barrels will actually be available.

Building pipelines based on speculative reserves is not something companies like to undertake. Speculation about future exploration successes does not merit pre-

mature commitments to pipelines. This is particularly important to understand in Azerbaijan, where you currently only have two semi-submersibles available to drill and where the wells are deep and tough to drill. Committed ship-or-pay barrels for the purpose of financing a pipeline are different than “maybe” barrels. Both investors in BTC and lenders will require commercial proven reserves to back up the project. Remember that in this case, project finance and not equity finance is being used. Without commercial proven reserves as collateral, project financing will be difficult, if not impossible, to arrange. While investors and lenders will be making some forward looking judgments as to risks because any pipeline that is built will have to be sustainable for some forty plus years, the lack of commercial reserves today will be a strong negative risk factor.

BTC/RESERVES AVAILABLE

The reserves available to export pipelines out of Azerbaijan in 2004 from AIOC will be 2.0-2.5 billion barrels or about 450,000 b/d of production. This production will be split among routes. Presuming that BTC does get built, it will not all be available for BTC. No matter what happens with BTC, it would be too risky for AIOC to put all these reserves behind a single project.

Full project development of the 3 ACG fields will cost between \$10-\$12 billion and is not expected to be realized until 2007-2008. At the full development stage, 35%-40% of the 4 billion barrels of reserves will accrue to Azerbaijan’s state company, Socar. Socar’s commitment to ship-or-pay does not carry the same weight for financial institutions, as the commitment of the private companies, which could complicate financing. In addition, as was pointed out earlier, Socar is contractually committed to ship some volumes north. Other AIOC members are also likely to seek route diversification, making less than their respective reserve volumes available to BTC. What’s more, Russian company, Lukoil, which is also a member of AIOC (with 10%), is likely to commit its volumes to the northern route and the western Supsa route.

AIOC is not a monolithic entity and the member companies (representing seven countries) are contractually free to decide which direction they want to send their oil. The only impediment that exists is for U.S. companies, which currently cannot pursue a southern option through Iran, and are being asked to support BTC. U.S. companies (Unocal, ExxonMobil, Devon, Amerada Hess) carry a 24% share in AIOC. They are not the majority shareholders. These U.S. companies will have to commit to BTC and ask for U.S. Ex-Im and OPIC financing, if these institutions are to participate in the financing.

Investors also like to compare and contrast options. Azerbaijan’s location provides a series of options, which could be studied: to the north, to the west and to the south. In this sense, AIOC is better positioned than TCO in Kazakhstan. While investors like to control the pace and timing of investments, in the case of Azerbaijan, investors are being asked to study only one option—BTC—and to complete that option within an unrealistic timeframe.

BTC TIMEFRAME

Other than the need to bring more reserves to BTC, what are the steps still outstanding before construction can begin on BTC? Each government has to sign certain key agreements, which will then need to be ratified by their individual parliaments. Turkey has completed its agreements. Georgia and Azerbaijan are in the process of wrapping these up. The agreements will then have to be approved by the respective parliaments of these countries so as to ensure that the force of law is applied to the agreements in every country. While BP Amoco is negotiating these agreements on behalf of the other companies in AIOC, the BTC pipeline is outside the purview of the Production Sharing Contract (PSC) that was signed by AIOC. The PSC required AIOC to undertake detailed route negotiations, but it is not a contract that covers route construction. Hence, a new set of investors or a new “sponsor group” must be arranged for a Main Export Pipeline Company (MEPCO). At the end of the day, however, the other companies in AIOC have the option but not the obligation to join MEPCO.

MEPCO must be formed prior to carrying out preliminary engineering studies on BTC since MEPCO will fund all engineering studies. If lessons learned from CPC are any indication, the formation of MEPCO will in itself be a time-consuming process. Decisions on which company owns how many shares and on capacity rules and rights, as well as exit rules, cannot be made overnight. When it comes to members of AIOC, Russian company Lukoil, for example, may decide not to join MEPCO because it prefers to ship its volumes north through Russia or it prefers to ship its volumes west through Supsa, from where it can access its company-owned refineries

in Black Sea markets. The process of forming MEPCO could get underway parallel to the ratification of the agreements by host country parliaments.

One problem already looming is Azeri state company Socar's insistence that it have a 50% share in MEPCO. While this parallels the strategies used by governments for the construction of CPC, this is a very different project with different risks. Hammering out a "sponsor group" agreement, where the private company participants in MEPCO will have to carry the Azeri government's 50% share, will raise serious obstacles. This lends an additional complexity to an already complex set of arrangements.

After the parliaments of Azerbaijan, Georgia and Turkey ratify their countries' respective agreements, the 6 month preliminary engineering phase can begin, which will consist of scoping out the BTC route. This will lead to a 13 month detailed engineering study by the members of MEPCO to define the actual cost of the pipeline. The cost could well exceed the \$2.4 billion current estimated cost by as much as \$1 billion or more.

If BTC is to be finished by 2004, there is no time allotted for the orderly formation of MEPCO or for carrying out project finance negotiations. This is because the end of the detailed engineering phase, immediately triggers the start-up of construction. Under this "politically motivated" scenario, it is presumed that construction can begin before any money is lined up. However, private companies do not operate this way. A time period must be built in for financing arrangements to be secured. Even if MEPCO participants agree to start negotiating a financing package while engineering studies get underway, this will still require extra time. This will delay the start-up of BTC until sometime closer to 2006 (at best).

Project finance negotiations will have to depend on the pipeline costs that are defined through detailed engineering. Project finance negotiations can be protracted and it's not unreasonable to expect that it could take at least a year to secure the money (or longer). Actual construction will take 32 months. If you exclude the window for raising the money, BTC will be finished in 51 months after parliamentary ratification of the agreements (that's four years and three months). This is a very best case scenario, for completing BTC in 2004. Again, this is without the key element of financing and it is impossible to build the BTC if the money is not secured. Without full knowledge of the full cost of the system or about the source of adequate reserves, it is impossible for private companies to address where the money will come from.

SOURCES OF MONEY/THE MULTILATERALS

With project finance/private sector lending being difficult and complex to arrange, what can the multilateral institutions do? Economic intervention from the multilaterals or directly from the U.S. government may be required to offset the non-commerciality of BTC.

The International Finance Corporation (IFC) limits direct project lending to \$125 million but can arrange two to three times this amount (or up to \$375 million) in syndicated private-sector financing. U.S. Ex-Im Bank has no limit on financing but can provide loan guarantees only for the supply of U.S. goods and services at 85% of total cost, at the request of U.S. companies. OPIC has individual project limits of \$200 mn each on political risk insurance and direct financing (for U.S. companies). U.S. companies must have at least 50% for insurance and 25% equity for the project to qualify for OPIC financing. For BTC, OPIC is prepared to go over \$200 mn. The nationality of the investor at project registration can potentially play role here (i.e., U.S. Amoco's registration of Baku Ceyhan with OPIC prior to the BP Amoco merger). If the U.S. government weighs in, OPIC may be prepared to take significant exposure.

Other organizations which could be involved are the World Bank and EBRD. But the mandate of the World Bank has shifted away from lending to oil and gas projects and it may have difficulty in justifying lending for a pipeline project—except of course if strong poverty alleviation and or/environmental arguments can be made to justify BTC. Shareholders in each organization (World Bank and EBRD) could block financing if developmental (incl. environmental—Turkey/Bosporus) benefits to each country (Azerbaijan, Georgia and Turkey) are not detailed. French influence in EBRD could block Baku Cevhan. In the World Bank, France, Italy, Russia and Iran could try to block financing.

As was pointed out earlier, however, to the extent that financing is made available, the multilateral institutions will have the effect of providing some "political risk" insurance, but these institutions will insist on laying off most of this risk to the borrowers. This is why some companies typically do not use this type of financ-

ing. It is expensive and the risks are rarely really shifted to the financial institution.

STUDY OTHER ROUTE OPTIONS

In the long run, the most efficient pipeline will be the most successful. Also in the longer term, export commitments will align themselves with the lowest cost alternative. If other systems are in place that are cheaper to build and can set their costs according to the market, BTC will not attract future barrels. At the end of the day, the markets will win. If a pipeline is less economic than other alternatives, future shippers will not use it.

This also means that the end-user markets that are the most attractive will be the markets that win. Currently, Mediterranean (Med) markets are the markets of choice for Tengiz and Azeri crude sales. These crudes can command a premium in the Med, backing out Middle East crudes, because they are closer to the Med than these other crudes. However, if there is another major oil find in the Caspian, Asian markets will be preferred. The fastest rate of growth in oil demand is in Asia, and the highest netbacks for these future barrels will be in Asia. The oil will flow to those markets where the demand is greatest and where it can command the largest premiums. Another end-user market option is the domestic market in Iran.

Some non-U.S. companies have studied the option of supplying oil to Iran's northern oil refineries. Iran has four refineries in the north of the country: Tebran (230,000 b/d); Tabriz (120,000 b/d); Isfahan (290,000 b/d) and Arak (170,000 b/d). The total capacity is 810,000 b/d. These refineries are currently supplied with oil that is shipped from the south of the country. Iran would like to buy or swap Caspian crudes into these refineries and save the cost of shipping its oil north.

Iran has proposed to the Azeris that they sell 220,000 b/d under a long-term contract to its refineries. Iran would buy the oil outright from the Azeris for its Tabriz and Tehran refineries. Iran has said it would be ready to pay \$2/barrel more than the oil would earn at Ceyhan. The oil would be delivered through a new oil pipeline Iran has looked at building from Baku to Tabriz.

While this would be an outright purchase, Iran has also proposed oil swap arrangements to Caspian countries. Currently, minor amounts of oil from Turkmenistan are swapped through an existing pipeline from the northeastern Caspian port of Neka to the Tehran refinery. An equivalent volume of crude oil, with quality differentials accounted for, is then swapped out from Iran's southern export terminal at Kharg Island. Kharg Island currently handles between 2.0-2.5 million b/d of exports, but could accommodate up to 8 million b/d. Iran is about to embark on building a new 370,000 b/d oil pipeline from Neka to Tehran, with the purpose of providing an outlet for Caspian crudes.

Outright oil sales to Iran or swaps through Iran bring the oil to Iran's domestic market and/or closer to Asian markets, where the demand growth will occur. Kazakhstan and Turkmenistan, with their oil potential centered along the eastern shore of the Caspian, see the economics of a pipeline straight down to Iran as their most cost effective solution. For Azerbaijan, the choice is a Catch-22. The AIOC's production sharing contract takes transport costs into account, with the government's take directly linked to these costs—the lower the transport costs, the more revenues accruing to Baku.

What prevents the economics from prevailing in terms of the Iranian export option is U.S. sanctions on Iran. Since the issuance of two Executive Orders in 1995 by the Clinton Administration, which bar U.S. companies from trading with or investing in Iran and the passage in August 1996 of the Iran-Libya Sanctions Act (ILSA), which bars foreign companies from investing more than \$20 million a year in oil and gas developments in Iran, the U.S. has spent enormous financial and political capital on isolating Iran. The U.S. has translated this into excluding Iran at all costs from benefitting from infrastructure and pipeline projects for evacuating oil and gas from the Caspian Basin.

The U.S. rationale for sanctions is Iran's support for terrorism and its procurement of weapons of mass destruction, especially nuclear and long-range missile capabilities. Under Iran's moderate President Khatami, progress is being made to address these concerns.

A route through Turkey is definitely desirable, but private companies should be called upon to build it only if they determine that the economics warrant it. Multiple pipelines are the most politically desirable result for unlocking the resources of the Caspian—through Russia, Turkey, Georgia, Iran, China and even Afghanistan, once that option becomes available. Let the markets decide the order in which they are built. This would benefit the countries of the Caspian.

In the end, if private companies find themselves saddled with projects that are suboptimal from a commercial standpoint, they have some choices. They can shut in production and take their capital elsewhere. This is an industry that has choices. If it's not the Caspian, there is Latin America, West Africa, Asia, and for non-U.S. companies, there is even Iran.

Senator HAGEL. Thank you.

Dr. Olcott, welcome back. You were here, what, 2 years ago?

STATEMENT OF MARTHA BRILL OLCOTT, Ph.D., SENIOR ASSOCIATE, CARNEGIE ENDOWMENT FOR INTERNATIONAL PEACE, WASHINGTON, DC, AND PROFESSOR, POLITICAL SCIENCE, COLGATE UNIVERSITY

Dr. OLCOTT. Yes.

Senator HAGEL. Time flies, doesn't it? We are glad you are back. Thank you. I recall your testimony then, and it was helpful, so we are glad you are back.

Dr. OLCOTT. Thank you very much.

I was asked to talk about the politics of economic development in the Caspian region and some of the social problems of the area to bring up to date the testimony that I gave 2 years ago.

I argue at greater length in my testimony, and I am just going to highlight some of the key points, that with time the Caspian region seems almost certain to turn into more of a strategic burden to the United States than it is a strategic asset, and I would like to argue some of the ways that this is true.

There is a real question as to whether the Caspian region is, in fact, a major strategic one for the United States, despite much of the symbolic position that we have given to the region in many of the public statements of the Clinton administration.

I argue that despite the important rhetorical level that the Caspian region has assumed, the area has at best been an area of secondary security interest for the United States, and that our interest in the area is derivative of our broader security concerns, those having to do with Russia, South Asia, and a host of global issues such as terrorism, the proliferation of weapons of mass destruction, international crime, and drugs.

Moreover, as U.S. officials have come to better understand the difficulties inherent in the development of Caspian oil, our general security concerns have begun to become more of a focus of the respective bilateral U.S.-Caspian relationships. I would argue that with time they will become an even greater focus, as some of the states of the Caspian region go from being strategic assets to becoming active threats to their neighbors or the global community more generally.

Our preoccupation with energy development has led us to form a partial picture of these states. However, it is not too late to widen our visual horizons and to recognize the risks that exist in the region, and the ways in which proposed plans for energy development may be increasing some of them.

From the point of view of the administration, the United States is caught in a dilemma. As we recognize that Caspian energy reserves could make the region a strategic importance to the United States this presumes that these reserves are developed in a timely

fashion by Western firms, and that we can assure that our enemies or potential enemies are unable to cutoff the flow of oil and gas.

This is obviously why we strongly support the idea of pipelines which bypass both Russia and Iran. However, the need for such pipelines has not been considered of sufficient strategic interest for the United States to be willing to underwrite substantial costs of its construction, although we are obviously willing to provide U.S. firms with some degree of investment security.

The partial nature of our commitment to the development of Caspian reserves has led us to create the illusion of a stronger strategic relationship with these states than actually exist in fact. Given our reluctance to spend significant amounts of money, we are trying to substitute symbolic goods for material ones in order to create the illusion that our partnership with these states is stronger than, in fact, it is, and it is, indeed, in fact. Otherwise, there is no prospect that the development of the region's energy reserves will proceed in a way that advances U.S. strategic interest.

U.S. preoccupation with energy politics was such that until recently we allowed many other issues of state-building in this region to take a back seat, especially if they created the potential to undermine U.S. efforts in the energy sector. By the time we began to realize that the three most important states from the point of view of energy production, Azerbaijan, Kazakhstan, and Turkmenistan, were beginning to undermine their own long-term well-being because of the corrupt practices of their leaders, we had lost much of the leverage that we had enjoyed a few years previously.

The leaders of these countries are now rich men, and much more worldly wise. They now have a better understanding of how to evaluate the difference between symbolic offerings and firm financial commitments when offered in international negotiations. Five years ago, they had an unrealistic sense of how easy it would be to develop their reserves, and thought that talk of strategic engagement might signal a major shift in U.S. priorities, to bring in the United States as an active partner to be called on to help them out of all kinds of difficulties, both economic and security ones.

Today, the leaders of all three of the Caspian oil and gas-rich states understand the nature of the U.S. commitment quite differently. They are learning to make brilliant use of the photo ops presented to them to impress their own domestic constituencies, but they do not do much bowing in private when pressured by visiting American officials. In other words, we are becoming less and less successful with regard to influencing these societies to develop in ways that serve U.S. interests.

Let me just make a few comments about each of these countries. Turkmenistan is the state that I view as the most problematic from the point of view of its own internal security: In the first years of independence it looked like oil and gas wealth was right around the corner, and that there would be plenty of revenue to raise the general standard of living in this small overpopulated population. However—and there was greater attitude of tolerance on the part of the elites and the masses of the President's use of foreign interest in Turkmenistan's oil and gas reserve to accrue personal wealth for his family and close cronies, partly because he had granted

other leading families the ability to continue to operate fairly freely in the cotton sector.

However, the failure to engage in systematic economic reform has put the country at potential risk, and there is strong evidence that chronic unemployment is already becoming a serious problem throughout the country. The age structure of the population exacerbates this problem, and in 1997 only 37 percent of the Turkmen population were employed. That situation has gotten substantially worse.

However, instead of taking advice, the Turkmen have chosen to distance themselves from the international financial community, and today U.S.–Turkmen relations appear to be more strained than at any time in our recent history. They are also not getting on very well with their neighbors, including border problems with Uzbekistan.

One of the recent developments in Turkmenistan is that they appear to be—these economic problems contribute to the reason why Turkmenistan appears to be on the verge of returning to marketing gas via Russia. This latter will give the Turkmen much-needed cash, but it will set them back on the road to long-term dependency on Russia.

The states are grouped in the area of the severity of what I see their domestic problems.

Just a few words about Azerbaijan. By contrast with Turkmenistan, President Heydar Aliyev has made skillful use of Western firms in the region, and representatives of most Western countries are involved in at least one of the international consortia that have been formed to develop Azerbaijan's resources.

From Aliyev's point of view, the goal is to try to skillfully lead Azerbaijan through the difficult years until the pipeline can be built, and then groom his son to succeed him. Aliyev recognizes that he has problems. For example, one of the damning things about the future is that almost the entire education system in Azerbaijan, which was already failing under Soviet rule, has come into a state of near total collapse, with about 50 percent of the secondary schools in the country closed and an acute shortage of primary schools, primary education.

Aliyev is also learning first-hand what it is like to be tied to the fluctuation of the world oil prices. Low prices meant unexpected budget deficits, while high ones made it more profitable to sell oil versus refining it, one of the things which has contributed to Baku running out of oil to fuel power plants, and the recent restrictions on electricity use in Baku.

High oil prices, though, have done little to resolve Azerbaijan's security dilemma. The Armenian-Azerbaijan dispute is unsolved, and largely frozen in time. National consolidation in Georgia is still stalled, and the war in Chechnya puts them at risk.

Azerbaijan also is concerned about whether the United States will serve as a security guarantor for the region, and it is not clear how they will respond to whatever new incentives Vladimir Putin is willing to put on the table, because he is traveling through the CIS offering the Newly Independent States a host of new carrots to go along with the old set of sticks.

I will now turn for a minute or two to Kazakhstan. We see lots of evidence that the Kazakh-Russian relationship is also ripe for re-definition. Old debts are being settled, and the two States are looking for new ways to have a dialog.

Kazakhstan is the state that I am the most optimistic about in the region, despite the fact that President Nazarbayev is certainly trying to manipulate the country's political system to serve his own purposes. The 1999 elections were very questionable, both the Presidential and parliamentary, but the crackdown in Kazakhstan need not kill the prospects of the country having a democratic future, although it ensures that it will have an undemocratic present.

Kazakhstan is implicitly pluralistic, given the country's enormous size, its economic complexity, and its economic diversity, and to be sure, much of Kazakhstan's future stability depends on the success of economic reform. Economic reform, and not simply investment in the oil and gas sector. There has been an enormous amount of economic activity in Kazakhstan in recent years in terms of economic assistance and foreign direct investment, and this has created a host of new stakeholders in the Kazakh economy, and these stakeholders come most importantly outside of the oil and gas sector, for control of the oil and gas sector has remained largely in the hands of the official family.

This is a very, very positive development, because it creates an elite group that can help Kazakhstan make the transition from its current quasi-autocratic situation to a more pluralistic and a more normal-functioning economy.

The government, however, has to be able to deal with the increasingly more impoverished half to a third of the population. This means better tax collection. The growing criminalization of the economies have threatened Kazakhstan as well, although Kazakhstan is far removed from the risks of extremists or terrorist groups than either neighboring Kyrgistan or Uzbekistan.

In conclusion, for 30 seconds, the Caspian area is an area of potential wealth and potential danger. With time, the former is proving more difficult to access, and the latter more difficult to avoid. In fact, U.S. policy is already implicitly beginning to recognize this. Secretary of State Madeleine Albright's upcoming trip to the region will take her to Kazakhstan, Kyrgistan, and Uzbekistan, and will focus on the relationship between democracy and security rather than on energy issues.

In the past year or two, we have seen the cause of democracy take a hit throughout the region. Three states that were most promising with regard to their commitments to democratic values have been showing serious slippage. There were political assassinations in Armenia, the most prominent Kyrgyz opposition figure is in jail, and the recent Presidential elections in Georgia were judged to be seriously flawed.

The loss of the democratization process in one state has implication in all others. The war in Chechnya remains a major source of political instability for all three Caucasian states, adding to a serious regional refugee problem, stimulating traffic in weapons, and creating new incentives for international terrorist groups to travel to the region.

The situation in the Central Asian region, including in Kazakhstan, is destabilized by their proximity to Afghanistan and Pakistan, which has also brought terrorist groups, global terrorist networks into the region and has integrated Central Asia, unfortunately, into the growing drug trade.

Improving security measures alone will not solve these problems. The countries of the region must add to the numbers of stakeholders in their countries. This can be done in a variety of ways, through economic reforms which increase the number of medium and small entrepreneurs, by broadening the nature of political institutions and the range of topics open for public debate, and by local empowerment.

Unfortunately, the role of the United States in this process is limited. We can serve as a model, a source of investment in desirable economic projects, a training ground for young people, and even, as appropriate, a source of assistance in preventive security. However, we cannot solve their problems for them, and this is true no matter what timetable is agreed on for building new oil and gas pipelines in the region.

Thank you.

[The prepared statement of Dr. Olcott follows:]

PREPARED STATEMENT OF DR. MARTHA BRILL OLCOTT

With time the Caspian region seems certain to turn into more of a strategic burden to the U.S. than it is a strategic asset. The area is a fascinating one, with layers of different civilizations piled on top of one another, set against a background of beautiful and exotic scenery that seemingly conceal the promise of wealth. This has been enough to lure romantic adventurers to the Caspian for hundreds if not thousands of years. But does this make it an area of strategic interest to the U.S.?

When we first asked that question, at the time that these states were granted independence, we were hesitant to answer yes. The U.S. initially opened embassies in only one of these three major oil and gas producing countries, in Kazakhstan because it had nuclear weapons. We quickly moved to open embassies throughout the region, although for the first couple of years of independence we still assumed that these states would remain as part of some still ill-defined Russian orbit, and we did little to diminish the influence of Moscow in the region.

However, then the Russians began to misbehave to some of their new neighbors, and in particular to Azerbaijan and Georgia, both of which were then led by former dissidents who refused to sign on for membership in the CIS. We were disturbed by these Russian actions, in part because the U.S. is a traditional champion of vulnerable and weak states but also because we had come to be aware of the natural resources found in this region. This of course was something that the Russians were long aware of, as Soviet officials had mapped most of the strategic resources found in theft country, and had had plans to develop much of the region's oil, gas and gold reserves in the 21st century, when some of the easier to work deposits in Russia proper would already be depleted.

So the second-term Clinton administration in particular came to reevaluate the importance of the Caspian region, and began a policy of weaning these states from Russia as a means of insuring their independence and economic well-being. One of the features of this policy is to maintain, at least on a rhetorical level, that the Caspian Region is an area of strategic importance to the U.S. When witnessing the signing of the inter-state agreements that endorsed the idea of the Baku-Ceyhan pipeline, President Clinton declared that: "These agreements . . . are truly historic. They will advance the prosperity and security of a region critical to the future of the entire world." The signing ceremony took place during the Istanbul OSCE summit of November 1999, and was attended by the presidents of Turkey, Azerbaijan, Georgia, Kazakhstan, and Turkmenistan.

Yet such statements beg the question of whether the Caspian region is in fact a strategic one for the U.S. I think that the answer to this questions is no.

At best this has been an area of secondary security interest for the U.S., and even this interest is derivative of our broader security concerns, having to do with Russia, South Asia and a host of global issues such as terrorism, the proliferation of weap-

ons of mass destruction, international crime and drugs. Moreover, as U.S. officials have come to better understand the difficulties inherent in the development of Caspian oil our more general security concerns are beginning to become more of a focus of these relationships.

I would argue that with time they will become an even greater focus, as some of the states of the Caspian region go from being potential strategic assets to become active threats to their neighbors and the global community more generally. Our preoccupation with energy development has led us to form a partial picture of these states. However, it is not too late to widen our visual horizons, and recognize the risks that exist in the region, and the ways in which proposed plans for energy development may be increasing some of them.

HOW IMPORTANT ARE CASPIAN RESERVES?

The U.S. has never treated the Caspian region as if it were of primary strategic importance for the U.S. The President has never been there, and the Secretary of State will be making her first trip out to the region next week.

However, we were caught in a dilemma, as we recognize that Caspian energy reserves could make the region of strategic importance to the U.S. This presumes that these reserves are developed in a timely fashion by Western firms, and that we can insure that our enemies or potential rivals are unable to cut off the flow of the oil and the gas. This is obviously why we strongly support the idea of pipelines which by-pass both Russia and Iran. However, the need for such a pipeline is not considered to be of sufficient strategic interest to the U.S. that we will underwrite the cost of its construction by using public funds, although we will provide U.S. firms with some degree of investment security.

The partial nature of our commitment to the development of Caspian reserves has led us to create the illusion of a stronger strategic relationship with these states than exists in fact. Given our reluctance to spend significant amounts of money, we are trying to substitute symbolic goods for material ones, in order to create the illusion that our "partnership" with these states is stronger than in fact is the case. Otherwise, there is no prospect that the development of the region's energy reserves will proceed in a way that advances U.S. strategic interests.

U.S. preoccupation with energy politics was such that until recently we allowed many other issues of state-building in this region to take a back seat, especially if they created the potential to undermine U.S. efforts to gain preferential treatment in the energy sector. By the time that we began to realize that the three most important states from the point of view of energy production—Azerbaijan, Kazakhstan and Turkmenistan—were beginning to undermine their own long-term well-being because of their corrupt practices we had lost much of the leverage that we had enjoyed a few years previously.

The leaders of these countries are now rich men, and much more worldly wise. They now have a better understanding of how to evaluate the difference between symbolic offerings and firm financial commitments when offered in international negotiations. Five years ago they had an unrealistic sense of how easy it would be to develop their reserves, and thought that talk of strategic engagement might signal a major shift in U.S. priorities sufficient to bring in the U.S. as active partners to be called on to help them out of all kinds of difficulties, including security ones.

Today the leaders of all three of the Caspian states understand the nature of the U.S. commitment quite differently. They are learning to make brilliant use of the photo-ops presented to them to impress their own domestic constituencies, but don't do much bowing in private when being pressured by visiting American officials. In other words, we are becoming less and less successful with regard to influencing these societies to develop in ways that serve U.S. interests.

TURKMENISTAN

The best example is probably the case of Turkmenistan, the most opaque of the Caspian states. President Saparmurad Niyazov has taken the name Turkmenbashi (head Turkmen) in the style of Attaturk, but has constructed a cult of personality that makes him more like a space-age version of a traditional medieval Khan. A seventy-five foot gold likeness of himself sits atop the Arch of Neutrality, which rotates with the sun to cast Niyazov's shadow over most of downtown Ashgabat, the nation's capital. Most prominent institutions are named after Niyazov, his photo at just about every important intersection and on all but the most insignificant of the Turkmen currency. Media is tightly controlled, and there is no intellectual life to speak of in the country.

In the first years of independence, when it looked like oil and gas wealth was just around the corner and that there would be plenty of revenue to raise the general

standard of living of this small underpopulated nation, the peculiarities of the Turkmen political system seemed less troubling to us as well as to potential political and economic stakeholders in the country. Now with no new pipeline routes likely to rapidly materialize the situation in this increasingly more cash starved country is looking more dire. Fortunately Turkmenistan is a significant cotton producer as well, and this sector has continued to create jobs and opportunities for a part of the overwhelmingly rural population.

This country has never had a political opposition, and Niyazov's rivals from within the old communist party elite have been forced to leave the country. The President has managed to use foreign interest in Turkmenistan's oil and gas resources to accrue personal wealth for his family and close cronies. However, the other branches of the economy (especially the cotton sector) have allowed leading regional families (often powerful because of their tribal background) to continue to maintain some economic influence. Niyazov has tried to keep them at arm's length by periodically rotating the cadre close to him (which include representatives of these families), but these powerful regional families are certain to try and assert their influences in any subsequent succession struggle. Moreover, repeated rumors about Niyazov's ill-health mean that a succession struggle could be triggered at any time.

Turkmenistan is also struggling to define a distinct international identity. It recently reaffirmed its status as a internationally recognized neutral state. But Turkmenistan has not yet reached the point where it has made its neutrality work. It has not yet turned itself into a regional forum. It is unclear that it will ever be able to do this unless it moves forward with some sort of well-thought out policy of social, economic and political reform.

The failure to engage in systematic economic reform puts the country at potential risk. There is strong evidence that chronic unemployment is already becoming a serious problem throughout the region. The age structure of the population exacerbates the unemployment problem brought on by even the limited degree of economic restructuring. For example in Turkmenistan, the average population age is 23 years; 43 percent of population are children and adolescents and 10 percent of the population are retirees. As of 1997 only 37 percent of the population were employed.

However instead of taking advice the Turkmen have chosen to distance themselves from the international financial institutions. They also have more strained relations with the U.S. than any time in our shared history, and have put up a well-enforced visa regime to separate themselves from theft neighbors. The Turkmen and Uzbeks have begun discussion on formal border demarcation between the two states, and must now deal with the troubling issue of water. Also of concern is the relationship between Turkmenistan and Azerbaijan, potential rivals in the Caspian region. The two states have found it difficult to agree on terms of transit of gas along the proposed Baku-Ceyhan route, and these problems are one reason why Turkmenistan appears on the verge of returning to marketing their gas via Russia. The latter will give the Turkmen some much needed cash (even if much of the payment comes in the form of rubles and barter) but it will set them back on the road of a long-term dependency relationship with Russia.

AZERBAIJAN

By contrast with Turkmenistan, Azerbaijan seems determined to remain an independent actor in the energy world. President Heydar Aliyev has made skillful use of the interest of western firms in the region, and most western countries are involved in at least one of the international consortia that have been formed to exploit Azerbaijan's resources. Disappointments in oil exploration have revealed that Azerbaijan has huge gas reserves. Given their pivotal geographic position they should have no trouble marketing these reserves, although Azerbaijani gas could push some of the Turkmen and the Kazakh out of the markets that they had planned to serve.

From Aliyev's point of view the goal was to try to skillfully lead Azerbaijan through the difficult years until the pipelines would be built, and then groom his son to succeed him. Ilham is now first vice president of SOCAR, the Azerbaijan State Oil Company and chairs the Yeni Azerbaijan (Young Azerbaijan) Party. Thus Aliyev has tried to restrict the scope and range of independent political activities in the country, pressuring the media, and making life difficult for the many opposition figures that remain in the country.

Certainly Aliyev recognizes that he has problems. For example the education system that was already beginning to fail under Soviet rule was now in a state of virtual collapse, with teachers fleeing the profession as their salaries were roughly \$24 a month, or enough to buy 50 kilograms of potatoes.

Aliyev is also learning first hand what it is like to be tied to fluctuations in the world oil price. Low prices mean unexpected budget deficits, while high ones could also create unexpected problems. For example, rising world oil prices made it more profitable to sell oil rather than to refine it. As a result, while Azerbaijan's foreign partners in the Caspian have been exporting up to 115,000 barrels of crude oil per day, the country has run out of fuel oil to fire its power plants. In January 2000 the government of Azerbaijan introduced a schedule for the electricity supply. The official explanation for such measures was the corruption among the energy officials, but this did little to appease the Azerbaijanis, who are certainly used to the problem of corruption and familiar with the empty promises to eliminate it.

High oil prices, though, have done little to change the shape of Azerbaijan's security dilemma, and the uncertainty of their relationship with Russia as well as with their Caucasian neighbors. All that is familiar to us in the Caucasus has not changed, the Armenian and Azerbaijan dispute is unsolved and largely frozen in time, the process of national consolidation in Georgia is also stalled, and Russia's inability to secure its control of the north Caucasus combined with its refusal to withdraw means that the security of the entire region is put at risk.

Two things have changed though, Azerbaijani no longer holds out any real expectation that the U.S. will serve as some sort of security guarantor of the region. Nothing of course has come of Azerbaijan's statement of interest in having a NATO base on their territory, and there seem to be in-built constraints on the expansion of the close relationships that are developing between Georgian and various NATO forces. The second thing that has changed is the emergence of Vladimir Putin and his willingness to offer the leaders of the other post-Soviet states a new set of carrots to go along with the old set of sticks. It is too soon to know how attractive Putin's offers will seem, but like the Turkmen, if Azerbaijan gets into a serious cash crunch in the next few years, they are apt to seriously consider whatever Russia has on offer.

This is especially true because the Russians have no interest in influencing the course of political or economic institution building in these countries. Elections can be as manipulated as corrupt leaders want them to be, and economic reform as sluggish as it suits the local power-holders. After all, it is bad times that help bring back the Russians and not the good ones.

KAZAKHSTAN

The nature of the Kazakh-Russian relationship also seems ripe for redefinition, and both sides seem ready to bring a new realism to the table, as recent negotiations over Kazakhstan's long-term debt seem to suggest. These resulted in the transfer of partial ownership of Kazakhstan's state power company to Russia's UES. The Kazakhs, who now make up the majority of the population in the country that bears their name, are more self-confident about what the demographics of their country mean for national security. The border demarcation that is going on now along their border with Russia may have troubling implications for trade between the two states, but it does mean that Moscow is learning to accept the idea that Kazakhstan is a sovereign state with fixed boundaries.

Russia is also concerned about contagion from Kazakhstan. Deteriorating social conditions also feed the criminal underclass. Drug trafficking in particular is becoming more pervasive. Over 260 tons of drugs were seized in Central Asia between 1993 and 1999, most of which would have transited through Russia, and the increase in the trafficking in heroin is of particular concern. Drug enforcement estimate that only about 5 percent of drugs passing through the region are intercepted. In parts of Tajikistan and Kyrgyzstan drugs have already undermined the state. Drugs are creating a new virtual economy in parts of Kazakhstan as well. Trafficking though affects all of these states, and is aided by a political culture that tolerates an increasingly more pervasive pattern of official corruption. A culture of payoff and privilege is becoming an ever more dominant one throughout the Caspian region.

This is especially true in Kazakhstan, where there is a great deal of hypocrisy in the very public anti-corruption campaign that President Nursultan Nazarbayev has engaged in. The campaign has led to dismissals of a chief justice, a minister of economics and a minister of the interior among others. It has also led to major charges being levied against a former prime minister (Akezhan Kazhegeldin) who is President Nazarbaev's chief rival. This underscores the atmosphere of political convenience in which such charges are made. President Nazarbaev's statements about the moral purity of current appointees has done little or nothing to quash the rumors about current members of the government that are on the take, or about the growing economic power of the official family itself. Little wonder when

Nazarbayev's daughter, Dariga, controls the national television network and her husband, Rakhat Aliyev, is head of the tax police, while another son-in-law, Timur Kulidayev, is the financial director and vice president of Kazakhoil. In fact, when the Nazarbaev machine tried to generate Swiss press coverage about Kazhegeldin's secret Swiss bank-accounts they inadvertently triggered coverage about their own alleged holdings.

Nazarbayev has certainly tried to manipulate the country's political system to serve his own purposes. In 1999 Kazakhstan held very questionable parliamentary and presidential elections. Opposition was sharply limited in their participation, and the main political opponent of the president, Kazhegeldin was arrested in order to bar him from seeking office.

The current crackdown in Kazakhstan need not kill the prospects of the country having a democratic future, but it will insure that it has a non-democratic present. Kazakhstan is implicitly pluralistic, given the country's enormous size (roughly two thirds that of the continental U.S.), its economic complexity and its ethnic diversity.

This informal pluralism is not a substitute for formal pluralism, but it does help keep alive the potential for democratic development in the absence of a supportive environment. That supportive environment is no longer present in Kazakhstan. Initially, until about 1995, the government of Kazakhstan pursued a policy of encouraging the development of pluralistic institutions, or at least not actively seeking to restrict their development.

From that time on the government has been on the defensive in the political arena, although considerably increasing the scope of independent economic activity. Executive power has been strengthened, legislative power has diminished, and the judiciary serves the interests of the incumbent regime. Kazakh media is also growing less free with time. Economic reform has been episodic, but has been largely linear, and it is currently much easier for foreigners to do business in Kazakhstan than anywhere else in the region. This does not mean that investment is secure, or that the playing field a level one. Although the presidential family and "court" dominate, currency is freely tradable, property is relatively sacrosanct, and the diversity of the economy is such that independent economic stakeholders are beginning to develop throughout the country. Regional economies are also beginning to develop. As yet neither the regions, nor the independent political actors have much political influence. They are also still too cautious to actively seek it, but they are likely to be a force that will need to be reckoned with at the time that power begins to ebb away from President Nazarbayev.

Much of Kazakhstan's future stability depends upon the success of economic reform. There has been an enormous amount of economic activity in Kazakhstan in recent years, in terms of economic assistance and foreign direct investment. Kazakhstan received \$1.65 billion in World Bank loans between 1992 and 1998 and \$500 million in IMF loans between 1993 and 1998. In addition, the country has attracted the highest rate of per capita direct foreign investment in the CIS, having received more than \$7 billion by 1998.¹ In the first quarter of 1999 another \$366 million were invested. In 1998 Kazakhstan was in fourth place for FDI per capita within the CIS and CEE. Most of this money was concentrated in oil and gas sectors, which received 47.9 percent of the total FDI from 1993 and 1998 and 82.1 percent of FDI in the first quarter of 1999.

However the government has to be able to help the increasingly more impoverished lower third to half of the population maintain a minimal standard of living. The economy shows signs of real recovery, after a decline in 1998, the real GDP grew by 1.7 percent in 1999. The recovery in the oil industry helped the Kazakhs avert a large budget deficit, and they have been trying to insulate the needs of their domestic market from pressure to export oil in order to increase their foreign reserves. As is true of all the other newly independent states, Kazakhstan is coming up on a potential crisis of debt service, but as its successful Eurobond issues show, it is among the most credit-worthy of them.

The growing criminalization of the economy is a threat in Kazakhstan as well, although Kazakhstan is more removed from the risks of extremist or terrorist groups than is either Kyrgyzstan or Uzbekistan, both of which had violent incidents in 1999. Downtown Tashkent was rocked by a series of explosions in February 1999, while Uzbek terrorists held Kyrgyz (and Japanese) hostages for several months near the Tajik-Kyrgyz border. The situation in Tajikistan too remains a fragile one. Unrest in neighboring states would cast a shadow over prospects of foreign investment in Kazakhstan as well, and make the potentially diverse economy of the country more dependent upon oil and gas development, pipelines and pipeline politics. This

¹This figure represents total foreign direct investment from 1995 through the first quarter of 1995. IMF, *International Financial Statistics*, p. 916.

would be troubling, as economic development is Kazakhstan's best recipe for success and for the eventual development of a civil and pluralistic society.

THE CASPIAN AS AN AREA OF GROWING SECURITY RISK

The Caspian region is an area of potential wealth and of potential danger. With time the former is proving more difficult to access and the latter more difficult to avoid. In fact U.S. policy is already implicitly beginning to recognize this. Secretary of State Madeleine Albright's upcoming trip to region will take her to Kazakhstan, Kyrgyzstan and Uzbekistan, and will focus on the relationship between democracy and security rather than on energy issues.

The Clinton administration has regularly said that the development of Caspian energy reserves has to be driven by market forces. These market forces are already expressing themselves, and have made it clear that the pace of development in the Caspian will be a much slower one than the administration had originally projected. As it proceeds these societies are likely to continue to evolve, and to do so in ways that are not necessarily much to our liking.

In the past year or two we have seen the cause of democracy "take a hit" throughout the region. Three states that seemed most promising with regard to their commitments to democratic values have begun to show serious signs of political reversal. There have been political assassinations in Armenia, the one political figure in Kyrgyzstan who might have beaten President Akaev in upcoming elections now sits in jail, and recent presidential elections in Georgia were filled with irregularities.

The war in Chechnya is a major source of potential instability for all three Caucasian states, adding to a serious regional refugee problem, stimulating the traffic of weapons and creating new incentives for international terrorist groups to travel to the region. The situation in Central Asia is being destabilized by its proximity to Afghanistan and Pakistan. This has enabled opposition groups from Tajikistan and more recently from Uzbekistan to become linked to global terrorist networks as well as to the criminal groups that run the growing drug trade through the region.

Drugs undermine weak states, and the developing situation in Central Asia is following true to course. Deteriorating economic conditions throughout much of the region are tailor-made to the needs of the drug industry. Economic necessity makes police and border guards more receptive to bribes and ordinary citizens more willing to take the risks associated with the transport or cultivation of drugs.

The proliferation of drugs is undermining these societies. It is a blight on the economic and social environment and a threat to the traditional system of values. Drugs are wreaking particular havoc on the younger generation. The flourishing drug trade in the region enables separatist, radical religious, and terrorist movements that have already sprung up in Central Asia to become financially self-sufficient.

However, improving security measures alone will not solve these problems. The countries of the region must add to the number of stakeholders in their countries. They can do this in a variety of ways, through economic reforms that increase the number of small and medium sized entrepreneurs, by broadening the nature of national political institutions and range of topics open for public debate, or by empowering local or other forms of traditional institutions. The role of the U.S. in this process is a limited one. We can serve as a model, a source of investment in desirable economic projects, a training ground for young people, and where appropriate even as a source of assistance in the area of preventive security. However, we can't solve their problems for them, and this is true no matter what timetable is agreed on for building new oil and gas pipelines from the region.

Senator HAGEL. Dr. Olcott, thank you.

Mr. Alexander, you have sat through very cheery, glowing evaluations of your investment. Would you like to respond to some of what you heard?

Mr. ALEXANDER. Well, I think for BP Amoco the risks associated with my new-found colleagues, identified today, are risks that are part of our overall portfolio investment worldwide. I mean, clearly in this part of the world the technical risks to be faced, for example, in the deep water Gulf of Mexico versus the political risk we face are things we need to balance.

For us, we believe, as a company, that to ignore the aspirations and goals of the host countries we are in, to ignore the wishes of

our potential customers—we are a big player in Turkey today—is not something we ought to do. We also believe deeply in holding on to the basic fundamental reason for firms, around economic performance and so forth. That has to be met, too.

The real question for us is, is this a paradox, can we solve it, and we are trying like crazy to see if we can do it, but we are clear this will not be something that is fictitious. This cannot be something that is engineered, with an outcome that is not the lowest cost, most competitive outcome for us here. If it cannot be that way, then we will have to reconsider our positioning, as everybody else in the business.

So it is tough, something this firm has done for a long, long time. We have been in business around the world in a lot of different places, have faced these risks, believe we can manage them in a way that is consistent with our goals and consistent with our own internal policies, if that helps.

Senator HAGEL. The issue that Mr. West raised regarding MEPCO, can you clarify any of that, or can you enlighten your friend?

Mr. ALEXANDER. No. I think he is absolutely right. I mean, the reality is, we are sort of in what I will call data-free zone. We actually do not know how much oil will go into this pipeline, or who will be committed to it. We really do not know the tariffs yet, because it is really difficult to figure out the tariff structure not knowing through-puts.

Senator HAGEL. Without knowing, I am sorry, what?

Mr. ALEXANDER. We do not know what the through-puts are. All the tariffs that are being talked about are on some theoretical through-put, but until the host government agreements are signed, until there is a backbone framework where we can actually begin to do the work of understanding the commercial viability, what the gaps are between where we stand today and what we will need to do to be economic. I cannot sit here today and tell you this is a go, no-go. We do not know the answer to these questions. We do not know whether this will be attractive enough to entice other oil through, into the pipeline. This is the only way this will work. There has got to be the low cost sink, if you will, with an envelope wide enough to bring enough reserves into it.

So again, I think the next step for all of us is to get the host government agreements signed. Ambassador Wolf talked about his negotiations as we speak. To the extent that that is landed, we, along with our partners and other people that are interested in this, will have some data to begin to seriously subscribe, or get subscription into this pipeline. Today, we do not have that.

Senator HAGEL. Do you have any sense of how much private money has been invested over the last 2 or 3 years in the Caspian Sea, not just your consortium, but all private funding?

Mr. ALEXANDER. I do not have it handy. I know our number is around \$1 billion. I would suspect we are probably in this, the Caspian Sea, probably three or four times that amount, and that would not include anything around Tengiz and so forth.

Senator HAGEL. Mr. West.

Mr. WEST. My guess, Tengiz, that much alone or more, but there are some other—Texaco and Agip and British Gas have an interest

in a field called Karachaganek. That is a substantial field. My guess is something in the order of \$10 billion or so.

Senator HAGEL. The point that Mr. West made regarding already several pipelines in place, and having had some sense of this issue over the last 3 years here from our perspective here on the committee, and I have been to the area and visited most of the countries, I would be interested, Mr. Alexander, in having you take us through the process that you, your consortium used factoring those dynamics into the equation on whether this was a risk reward that could pay off, specifically Mr. West's point about existing pipelines, and now we have been talking all afternoon about enough oil to get it through, and where, and the instability.

But if you would, just focus a little bit on the economics of this, and the pipelines already in existence.

Mr. ALEXANDER. I want to be clear that the consortium, again, has not made any decisions on which export route will be taken. That is a matter of vote, debate, and classical commercial assessment. Where we are taking the position has been on the pipeline to the Baku-to-Ceyhan, which is a different issue, and is one that we are taking the lead to try to see if we can come to a resolution on.

Clearly, as Mr. West said, there are other pipelines available. They have less scale. They are pipelines that are unclear to me that the tariff structure long-term is any better or worse than what we might be able to do in Baku-to-Ceyhan.

It is unclear to me that any of the security issues that were raised, lines going through Russia, provide any additional security than any line going through Georgia into Turkey. It is unclear to me that as the Caspian develops, and perhaps the Lukoil announcement, which I do not know much about, or Kashagan, which is drilling, more oil going through Russia is likely to exacerbate any issues around the Bosphorus and some of the environmental issues.

So when we look at the overall package, basically where we are is saying we want to take a good, hard look at real data, real facts, and we will have to bring this forward to the AIOC. At the end of the day, if we cannot develop a competitive, commercial and economic alternative to the current pipeline systems, then I suspect AIOC will have no choice but to go that latter route, but we are not there yet.

Senator HAGEL. What is your timeframe on these kinds of decisions? I know they float, and they depend on the uncontrollables.

Mr. ALEXANDER. I think the timing is fundamentally dictated by the Azeris. To the extent we are all aiming for 2004, first of all, on the phase development, that is—to do that we are going to have to have this thing pretty well resolved by late summer.

Senator HAGEL. Late this summer?

Mr. ALEXANDER. Yes, and if you look at all the risks you have heard about, probabilistically we have got a lot of work to do very, very fast.

Senator HAGEL. Thank you.

Dr. Olcott, is there anything that you see at all that is positive about the potential of the Caspian Sea?

Dr. OLCOTT. I thought I was being upbeat.

Senator HAGEL. You thought you were being upbeat.

Dr. OLCOTT. Yes. I think that—I am trying to think of how to answer that.

Senator HAGEL. Don't strain yourself.

Dr. OLCOTT. I think that the oil resources in the Caspian will be developed. I am just not confident that there are not going to be some fairly major upheavals in the area before the newly constructed pipelines are in place, and that I think the assumption in U.S. policy that the actors that we are dealing with are going to be the actors in place—the actors that we are dealing with at the beginning of the process are going to be the actors in place at the end is probably very mistaken, and that is I think what I was trying to say about Kazakhstan.

That is the one place I feel that we are in a relatively stable situation, and the country is developing in ways in which you would expect a quasi-authoritarian former Communist state to develop. It is less democratic than we want, but slightly more democratic than he wants, and the infrastructure is being developed for economic reforms necessary to support an active oil and gas sector.

You see other kinds of industry emerging, and that is where I think the United States should be putting its influence, to try to push the Kazakhs along even faster.

The Turkmen case, I do not see anything very positive occurring, and a lot will depend upon the health of Niyazov and how quickly he passes from the scene, and that is a terrible thing to say, but I do not think that under Niyazov we will see much positive in Turkmenistan.

In the Azerbaijani case I am not as familiar with the domestic politics as I am with the five Central Asian states, but there I think the question of stability puts it some place between the two. There is more infrastructure development, more economic reform than in Turkmenistan, but I would say that the survival, stability in Azerbaijan is not as preordained as stability in Kazakhstan.

It lives in a more dangerous neighborhood, and its ruler is older, and has not made the same use of the elite, potential elite of Azerbaijan, the talent of the Azerbaijani alternative elite and the talent of the Azerbaijani population that Nazarbayev has.

Azerbaijan is a small state, and so corruption is more insidious than in a large state like Kazakhstan where it can be more dispersed across the population, so the question is, when will people be sufficiently turned off in Azerbaijan that they do not come back into the economy in the ways that we need them to. They are not at this point yet, but again I think the United States can be a more active pressure for more meaningful economic reform and keep the pressure on for political reform, because I would say Azerbaijan is far from a lost cause.

So I think that is relatively upbeat.

Senator HAGEL. So that is the best you can do here.

Thank you.

Mr. West, you referenced Iran on a couple of occasions. I would like to draw you out a little bit more on your thoughts regarding Iran. What is going on, what may go on, any potential there? Anything that you would like to offer in addition to what you talked about in your testimony?

Mr. WEST. I think there are several points. One is that, first, Iran is in a relationship with the Caspian. Obviously, it is the name that cannot be mentioned, at least to American companies or to companies that have significant interests in the United States.

But that, you know, our view is that if you want these projects to get going, irrespective of the pipelines, you want—particularly the AIOC consortium, you want to be able to have as many alternatives as possible, and I think Iran is clearly an alternative, and you know, there does not necessarily have to be investment in infrastructure by Western companies for some of this oil to flow into northern Iran and be swapped. The Iranians are actually moving crude oil from the Gulf up to northern Iran to be processed and consumed there.

The other is that obviously Iran is an area of tremendous interest. Again, in this whole portfolio issue, if you are a world-class company like BP or Exxon Mobil, or Total, or Chevron or whatever, Iran is on everybody's target. It is highly prospective. There are a lot of risks. The U.S. Government is a big risk right now, and doing business in Iran is going to be very complex.

Getting things done with the Iranians is very complex, but I think people have to recognize that Iran is a factor. It is a country with 70 million people. It has shown in the last 20 years extraordinary strength. It is not going away, and I think eventually we have to come to terms with Iran and deal with Iran. We just cannot ignore Iran.

Senator HAGEL. Mr. Alexander, any perspective on Iran?

Mr. ALEXANDER. I think it is difficult to dispute anything Mr. West has said. I mean, the geographic positioning of the nation, the resource base of the nation is something that needs to be considered.

Clearly, our position has been one where, at least in terms of the Caspian, in all our actions we have not—we do not believe that is a practical solution today, so something that we are not considering.

Senator HAGEL. How much of a realistic threat do you believe—and I would like to ask each of you this—Russia is to this specific issue of energy in the Caspian?

I know it is unpredictable, and no one can give any accurate assessment, but as you heard the give-and-take earlier this afternoon between Ambassador Wolf and myself, and Secretary Goldwyn, this is a very serious issue, and you brought it up, too, Dr. Olcott, that those people in that region are those emerging republics, and emerging market economies, using the term somewhat loosely, are very concerned.

And that has been registered with me personally by the leadership of those countries, by my colleagues, I suspect by your company, and we have to factor that in to some extent, so I would be interested in each of your three observations on that issue.

Mr. West.

Mr. WEST. From my standpoint, I think historically, one, you have to keep in mind the concept of the near-abroad, that the Russians considered this their territory, and the Russian oil industry considered some field such as Tengiz as theirs. They discovered it, and there are certain factors in Russia which are still apoplectic

that a field like Tengiz, which is really one of the largest new fields in the world, is not under their control.

With all due respect to the U.S. Government, I think that if you want to minimize the impact of the Russians commercially what you need to do is to have as many possible commercial outlets as possible.

At times, I honestly believe that by closing off Iran, and the complexities of trying to force outlets to the West, what we have done is, we have essentially eliminated a lot of negotiating leverage, and given the Russians a veto over a lot of things. I think that is a mistake, and I think the best way to get the Russians to the table on reasonable terms is to have alternatives, and at times we have not done that.

I think that the probabilities are quite high that Russia is going to try and impose as much influence as it can. The new government there is very sensitive to what they lost. These are hard currency-generating assets, and they do not have to own them to get a cut from them. I think also that frankly if you want to help the countries in this region the best thing is to get the projects going, not necessarily build a big pipeline, but to get each project going, to get hard currency generated.

Whether the hard currency is going to move to the people's pockets or to banks in Zurich is another matter, but at least to get the cash-flow moving, and at times I think U.S. policy has had the opposite effect.

Senator HAGEL. Thank you.

Mr. Alexander.

Mr. ALEXANDER. I think—I mean, just a couple of angles into this. I am not an expert on this particular area, but I think Mr. Putin is in the process of forming a position of the Russian country. I mean, internally to Russia, the level of direct foreign investment they are getting is not exactly through the roof, either. I think it meets the same test as the West Africa test and fails, so I do think there is a serious issue about how do you attract direct foreign investment, and how does that tie into foreign policy, particularly in this region?

It seems to me the Governments of Kazakhstan, Azerbaijan, one of the ways they are dealing with this is inviting large consortia into the country. I mean, despite all you heard about the risks and so forth, the reality is, AIOC and Shah Deniz have 14 different companies involved, one Russian—14 different companies are the who's who of oil and gas, and they have chosen all of us collectively to spread our risk and try to see what we can do to develop this.

So I think it seems to me there are historic issues, as Robin has pointed out, but it is unclear to me what the overall impact will be of Russia on this region.

Senator HAGEL. Obviously, your company and the consortia had to factor some of that into their thinking.

Mr. ALEXANDER. Yes. I think this situation is changing rapidly, day by day. As you know, we are the largest investor—you may know, we are the largest investor in Russia in the oil industry. We have had a much-publicized series of issues in Sidanca, and are looking in investing in major development in Siberia. Again, we remain optimistic, or stubborn, or whatever the adjective is, but at

the end of the day we believe that we can actually help our presence there and our engagement there to reshape the way this industry works in those countries.

Senator HAGEL. Well, your little company has done pretty well over the years. It is a joke, Dr. Olcott.

Dr. OLCOTT. Thank you. I think that the question is a very good one, and that we should expect to see some redefinition of Russia's relationship with the Caspian States as part of Putin's maturation process. It is hard yet to predict how successful a leader he is going to be. We have some signs I think that we can work with him. He has given two different kinds of signs, I would say.

First, he has gone back to the whole question of debt for asset swaps which was done at the beginning of independence, which was associated with Chubais and that group of performers. Now Chubais has come back with it, and recently the Russian energy company that Chubais heads took a piece of Kazakhstan's energy company as part of a swap of debts.

This is, I think, a very important development, because it can occur in other places in the region. I do not think we have to worry at any point very soon about Russia reasserting its Imperial presence, but it will try to nudge into these oil and gas projects, and may do so fairly—somewhat successfully on a limited basis.

The role of Gazprom is changing. This hearing is about oil, but their relationship to the gas industry and the CIS is important. I think we will see a lot of changes in the next couple of years and that they will grow as an actor in the CIS, or at least they will attempt to grow as an actor in the CIS, and they may well succeed.

The only other thing I would say about Putin is that energy policy does not exist in a vacuum for Russia, and he has, as I mentioned in my testimony, a host of carrots to bring to the table, and Russia's relationship to the security concerns of all of these states is really critical. As they become less democratic and more pariah-like, then Russia becomes or there is a chance that Russia will become the only dependable actor they can look to.

Now, it is not clear how dependable Russia will be, and it is not clear how much security assistance Russia will provide, but there is more of a chance that Russia will provide more security backup than we will. I mean, we are going to provide security training, but that is just it, and so in the end there is an uneven deck of cards between Russia and the United States, and the circumstances in the region will dictate how the shuffling of the cards on the Russian part works as much as the cards that Russia holds.

Senator HAGEL. Well, you all have been patient, insightful, and I am grateful. Thank you all very much.

Any last comments? Thank you.

[Whereupon, at 4:11 p.m., the subcommittee adjourned.]