

ENERGY AND DEMOCRACY: OIL AND WATER?

HEARING BEFORE THE COMMISSION ON SECURITY AND COOPERATION IN EUROPE ONE HUNDRED TENTH CONGRESS

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ENERGY AND DEMOCRACY: OIL AND WATER?

July 23, 2007

COMMISSION ON SECURITY AND COOPERATION IN EUROPE
WASHINGTON, DC

The hearing was held at 3:00 p.m. in room 419 Dirksen Senate Office Building, Washington, DC, Hon. Alcee L. Hastings, Chairman, Commission on Security and Cooperation in Europe, presiding.

Commissioners present: Hon. Alcee L. Hastings, Chairman, Commission on Security and Cooperation in Europe and Hon. Benjamin L. Cardin, Co-Chairman, Commission on Security and Cooperation in Europe.

Witnesses present: Simon Taylor, Director, Global Witness and Roman Kupchinsky, Regional Analyst, Radio Free Europe/Radio Liberty.

HON. ALCEE L. HASTINGS, CHAIRMAN, COMMISSION ON SECURITY AND COOPERATION IN EUROPE

Mr. HASTINGS. This hearing series is designed to give the Commission a comprehensive picture of this complex issue and highlight areas where the Commission, the U.S. Government, and the OSCE can take effective action.

The first hearing took place on June 25 and focused on conflict prevention and the security of supply and transit of oil and gas. The third hearing will address the nexus of energy security and environmental security, focusing on the diversification of energy supply and sustainable technologies, namely, how we can decrease dependence on foreign sources and address environmental concerns at the same time.

At today's hearing, we are going to hear from our distinguished panelists about the development of democracy and civil society in countries with abundant energy resources and why that matters to U.S. energy security.

I mentioned at the last hearing the remarkable fact that only 2 of the world's top 10 oil exporters are established democracies—Norway and Mexico. Something seems to be a bit wrong with this picture. But when we look at countries that are situated on oil and natural gas reserves, we think these are countries that won the global version of the economic lottery.

They've built a built-in revenue stream that can fuel not only their own economy, but also be an export commodity. But what economists have found by studying these resource-rich countries is

that they often do worse or as poor as resource poor neighbors, both economically and politically.

This problem is sometimes referred to as the resource curse.

Each of the countries we are focusing on today—Russia, Kazakhstan, Turkmenistan, Uzbekistan, and Azerbaijan—face some aspect of this resource curse and while the situation in each country is unique, we can generalize and say that the lack of transparency in politics and in oil/gas deals is at the root of the problem.

It's a well known and well bemoaned fact that the United States is becoming more and more reliant on imported oil to fuel our economy. We are the world's largest consumer of oil. We account for an astonishing 25 percent of global daily demand, despite having less than 3 percent of the world's proven reserves, and we source that oil from some unstable sometimes and unfriendly sometimes places in the world, such as Nigeria and Venezuela.

In the context of today's hearing, some of you may wonder why the United States should care what's happening in Turkmenistan or Kazakhstan, when we actually don't rely on these countries for a significant portion of our energy supplies.

Russia is only No. 9 on our list of oil suppliers and Kazakhstan and Turkmenistan, Uzbekistan, and Azerbaijan don't even make it into the top 20.

The answer is that unlike natural gas, oil is a commodity. So regardless of where we source our oil, what happens in other oil-rich countries impacts the stability of our price and our supply, as well.

As the National Petroleum Council reported last week, and I particularly think this is a poignant quote, "There can be no U.S. energy security without global energy security." Oil is the tie that binds us all and threatens to choke us at the same time.

So take a minute to think about how drastically different our interactions with these countries would be if we did not rely so heavily on these countries' resources. I think it goes without saying that we could have more leverage to promote democracy and civil society.

Clearly, oil constrains, if not drives portions of our foreign policy. So while it is imperative that we work to limit our dependence on foreign oil and change the dynamic of supply and demand, it is just as important to create more stable and reliable sources of energy.

One of the key ways the international community has sought to counteract the political and economic instability inherent in the resource curse is through programs that seek to instill transparency and accountability into the resource payment system.

I'm very pleased that we have with us today Mr. Simon Taylor, one of the founders of and now the Director of Global Witness, an organization that has led the charge in not only exposing corruption and kleptocracy, but also finding workable solutions to these problems.

Also joining us today is Mr. Roman Kupchinsky, regional analyst for "Radio Free Europe" and "Radio Liberty."

Senator, I don't know whether I had a chance to discuss this with you, but in an effort to be creative, and I said to Mr. Taylor earlier, from my perspective, sometimes hearings on Capitol Hill are sterile and in an effort to infuse them with a bit more enthu-

siasm, today, for the very first time, we are inviting our audience members to submit questions.

We'd like to take advantage of the expertise we have here. So please hand your questions to our staff and if we have time, and I suspect we will today, we will ask our panelists if they will indulge us and answer some of them.

The point that I'm making is I decried the fact that we sit and very occasionally in the audience are a substantial number of people who have a wealth of information that come in, listen to the hearing and go out and we don't benefit from it. So I'm trying to at least reach out in that regard.

You should all have copies of the full biographical information of our distinguished witnesses. So before I turn to Mr. Taylor for his testimony, I would like to recognize my good friend and co-chairman, the distinguished Senator from Maryland, and ask for any opening remarks you may make, Senator Cardin.

**HON. BENJAMIN L. CARDIN, CO-CHAIRMAN, COMMISSION ON
SECURITY AND COOPERATION IN EUROPE**

Mr. CARDIN. Well, first of all, Mr. Chairman, thank you very much for making this a priority of the Helsinki Commission, energy security, and I thank you for convening this hearing and I appreciate both the witnesses that are with us today.

Audience participation—that sounds a little bit like what the Presidential debates are trying to—so maybe next we'll do it by web. But I think it's important that we focus on the subject of energy security and I appreciate it very much.

We just came back from the Ukraine. Our Parliamentary Assembly meeting had its annual meeting in the Ukraine, which, of course, the issues in that part of Europe, energy is a critical issue and the relationship among the OSCE states.

We had a chance to go up to Chernobyl and see firsthand the problems of a nuclear facility that was built inappropriately and what that accident has caused.

So every opportunity we get, Mr. Chairman, we try to advance our understanding and appreciation of the challenges facing us globally on reaching energy independence. We know how important it is to our economy. We know how important it is to our security. We know how important it is to our environment. And I think the OSCE states have a particular opportunity to be the leaders in the world on moving forward with energy independence and energy security.

I'm going to ask permission to put my full statement in the record.

Mr. HASTINGS. Without objection.

Mr. CARDIN. And let me just make a couple preliminary comments. It is extremely troublesome when you look at the oil-rich, energy-rich states and see so many of them are autocratic and non-democratic and have serious issues of transparency and corruption, because you know that it's not a reliable source of energy if the country cannot develop the type of economy, the type of social institutions and governmental institutions that promote the development of its country.

And just according to Transparency International, 6 of the top 10 oil exporting countries to the United States are among the most corrupt countries in the world. So it is affecting the energy supply right here in the United States.

Another troubling part is that, to many respects, these states are resource-rich and, yet, their people are living in poverty. So when you have a corrupt government and you may have resources, those resources don't get fairly distributed and the people of their own country don't benefit from the wealth of their own state.

So there's many reasons why I think we should be concerned about the relationship between having energy resources and the type of government that is in place in these countries.

We have been working very hard, the U.S. Helsinki Commission, to raise the issue of transparency, to raise the issue of fighting corruption. At the OSCE Parliamentary Assembly meeting a year ago, I authored a resolution on behalf of the U.S. delegation urging parliamentarians to look at the issues of immunity, because immunity is being imposed to block corruption investigations in many of the states in the OSCE, and that's wrong. We've got to do something about that.

So this is an important issue. I was looking at the Transparency International, which rates the countries. I didn't know you did that until I read this information for this hearing. You rate the countries as far as how corrupt they are, 1 to 163.

It's good to be a low number, not a high number. And one country which is a high number is trying to do something about it. Azerbaijan, which is tied for 130th place, which is nothing to brag about, but it's implemented the EITI recommendations in 2003 and, since that time, the country has experienced an increase in GDP, growth in foreign direct investment, and has the world's 12th most improved business environment score.

So you can see that when you make progress to improve, it helps the country itself.

Now, some of the other countries, such as Russia is tied for 121st place and they're not making much improvement. Kazakhstan is tied for 111th place. Turkmenistan is in 142nd place and Uzbekistan is in 151st place. And I think that's part of the problem and, yes, it does affect the United States, because it affects our ability to have reliable energy policies, on which we want to help lead for energy independence in the United States, as well as energy independence in the entire OSCE region, so that we can, in fact, control our own destiny.

So for all these reasons, I'm very pleased that our two witnesses are here today to try to help us sort this out and see what policies we can advance in OSCE to help our region be responsible states and regions to advance energy security for the world.

Mr. HASTINGS. Thank you very much, Senator.

Just for purposes of the record, when the Senator referred to EITI, that's the Extractive Industries Transparency Initiative.

Mr. Taylor?

As I indicated, ladies and gentlemen, the biography of Mr. Taylor is available for all of you. But just as a reminder, he is one of the three founders and Directors of Global Witness.

And I'll leave you to your testimony at this time, Mr. Taylor. Thank you for being with us.

SIMON TAYLOR, DIRECTOR, GLOBAL WITNESS

Mr. TAYLOR. I should start by also thanking you for having us. I think it's a great privilege to be here and I hope I can make a few concise and succinct points that would add to the presentation that we've submitted, and, at the same time, I'd like to pick up on some of the points that you have both referred to just now.

Just a brief thing about us—Global Witness—was the, how should I put it, the conceiver and one of the co-founders of the Publish What You Pay Coalition back in 2002—the Publish What You Pay Coalition is now Pan-global, with 380-plus organizations—civil society organizations, a community, if you like, representing basically everywhere in the world, I think, today.

And it was the launch of the Publish What You Pay call, which led to the U.K. Government launching this thing called EITI, or the Extractive Industry Transparency Initiative.

Now, the Brits may have launched that process, but it's now really a much bigger thing. The United States is now properly engaged, although we have some concerns about things that could be enhanced, which is something I'll come back to.

EITI, though, has lots of good points and it has some points that are less good. So there are issues around areas that we have some concern about which could be addressed through additional measures. I'll come back to those, as well.

But, essentially, through EITI, we have governments at the table, we have both producer and consumer governments. We've got companies at the table. Pretty much all the key oil, gas and mining companies are now at the table. And we have civil society, including representation through the Publish What You Pay Coalition and beyond.

And there are two issues we're really looking at here. One is energy security from the consumer side. Obviously, you can't plan economies and move things forward and have a functioning economy without security of supply of energy. But simultaneously, from the producer side, I think you can't have a functioning society without accountability, and I'm talking here about accountability over the stewardship of the revenues derived from a state's assets.

And in a lot of the countries we are looking at, we're talking a vast percentage of the state income in relatively non-diversified economies comes from oil and gas, and mining, of course, is another issue.

And so this discussion really depends which side of the fence you sit on. If you're on the consumer side, you're worried about getting your ready supplies. If you're living in a place like Equatorial Guinea or Kazakhstan or Uzbekistan, or in Angola, you're interested in accountability over the management of those revenues. And that's really where we hope EITI will deliver.

And I'd like to just sort of refer to some of the key points that we were making. Senator Cardin was saying that—he mentioned the Transparency International Comment about 6 of the top 10 sources of U.S. supplies are in the bottom third of the world's most corrupt countries—I think that's quite a salient point. Kazakhstan,

in the area we're talking about here, Turkmenistan, Uzbekistan rank right on the bottom, in the bottom section.

There are a number of other issues we've come across looking at the region we are concerned about in the hearing today. For example, gas supplies from Turkmenistan, I don't know the extent to which members of the commission have gone through our report from a couple of years ago, "It's a Gas"—see www.globalwitness.org, looking at these very strange corporate structures that were established to govern—"govern" is the wrong choice of words here—but to manage gas reserves coming out of Turkmenistan and through Ukraine.

They have really no founding rationale for being there. There's all sorts of very strange corporate structures. There doesn't seem to be much of a purpose and they are not at all transparent.

If you look at Turkmenistan, a vast percentage of the state's income was stashed in accounts in Frankfurt, essentially managed by the president, before he died, and the money is still there. There's been no real kind of progress on why this money was sitting there. Nobody knew how much was there. There was no oversight and control.

So this is an issue that isn't just about the production of oil and gas. It's also about the management of banking—how banking is another function that allows assets to be diverted overseas. We need to address these things, as well. That's not going to be addressed through the EITI process, but we, as an organization, are now thinking about some of these issues.

And I mentioned Ukraine and I mentioned Turkmenistan in Europe and I think one of you made the comment about global energy security—which is something, of course, which is of interest to the United States, because there's a sort of fungibility to this. If you look at gas coming through to Western Europe from Russia, about 80 or 90 percent of it comes through Ukraine, which didn't work too well a couple of years ago when the tap was turned off.

I think you've just been, you said, to Ukraine. So you've seen firsthand what the implication of that [the cutoff gas supplies] was. So needless to say, it's created a real sense of panic, I think, in Europe as to how can anyone rely on any of the current arrangements.

And to some extent, that has increased the political interest in EITI, for example, as a structure—but we have to get EITI right and we have to get it functioning.

And perhaps I should just briefly mention some of the key areas that we think there needs to be some other work done:

We think it would be useful to have a reporting requirement on transparency created. To some extent, that's what we were calling for through the launch of the Publish What You Pay campaign, although, at the time when we launched it, we were focusing on the mechanism of listing authorities requiring companies listed—and there are good things about that and there are things missing in terms of what you could achieve.

We think we need something more comprehensive than just that. And so one of the things we are looking for is to see later on this year some work on Capitol Hill, we hope, to address this problem, to look at it more comprehensively, to see whether we can get com-

panies that are associated with the United States—either registered in the United States or listed in the United States to be simply required to disclose the revenues they pay in each country.

In part, such a move illustrates where some of the weak points are in the EITI process. In EITI, we are relying on governments to voluntarily come to the table and at the point when they voluntarily come to the table and say, “Yes, we will perform,” then there’s the matter of whether, in fact, they do perform and, at the point when they do perform, then the companies that are located in that country will have to disclose the revenues they pay.

So there’s a kind of an arrangement that will come together as a consequence of performance.

The problem with that is, though, if you’re a kleptocratic president or member of the kleptocratic elite, why on earth would you come forward and volunteer to have yourself held accountable? And this is a problem we face with countries like Equatorial Guinea, like Kazakhstan, like Angola, and so on and so forth.

So where we’re at with EITI right now is we have, as was mentioned before, Azerbaijan is performing. We have also Nigeria performing. But really we don’t have anybody else really delivering at the moment. And so we need to have a drive to help ensure, both diplomatic outreach-wise and funding and supporting the EITI structure to make that function and make it work.

We need to see the United States use the leverage it’s got to bring countries to the table and deliver, because otherwise they sit on a list and they’re going to get to the stage where, when we get to verification in September, which is the next big issue on the agenda for EITI, that if verification functions properly, they will be kicked off and when they get kicked off, it’s going to be very politically embarrassing.

So we need to keep them in, but we need to keep them in and the cost of keeping them in is performance. So these are very difficult issues, but ones where we need help basically from Capitol Hill, from the administration, to make it happen in a way that we haven’t seen so far.

So that’s one side. The reality though is that we are never going to get some countries to the table—I think we have to face that—not in the immediate future anyway, and short of regime change or some enlightenment happening, I can’t see it happening in some countries at all. And very often these are the key countries for which we have had greatest concern and which inspired all this work in the first place.

So do we accept EITI and its limitations or do we go as far as we can with EITI and think of alternatives and additional mechanisms to help bring about transparency by default, if you like, and, at the same time, by protecting the companies that are working in these jurisdictions by simply requiring their disclosure. I think we have to do both, and if we can make progress on both these fronts, then we’ll improve things quite a lot.

So I have now referred to a reporting requirement. We need to see progress on that. We can talk to people further about that after this. EITI is something I’ve mentioned, as well.

In addition, we need to see budgetary transparency. I think from the producer government or a producer country side, this is an-

other area where there is a great need for progress. It's all very well seeing transparency in the revenue streams coming in like we've seen now in Nigeria, but it's the next stages down where very often the money disappears.

How do you know then what happens to it? This all takes place in the nexus between central governments and where it gets disbursed and how it's getting disbursed and whether, in fact, transferences of funds actually do equate to the budgets and any kind of reality. I think those are very important things. So we need to see some progress on that side, as well.

The real cornerstone of all of this is the capacity of civil society to function in this kind of environment and I was struck by the Freedom House submission which I saw. And on the one hand, from the Publish What You Pay/EITI side, we see progress in delivery from Azerbaijan and, yet, what I read in the Freedom House statement, I'm not an Azerbaijan expert, but I see a retraction, if you like, a retrenchment of—what's the right term—a real backlash, if you like, against freedom of the press and so on and so forth.

I personally feel that that's an inconsistency. You cannot have civil society able to hold government accountable for the deployment of state resources and have the press completely close down. It just doesn't work.

And so although we may be saying, from an accountant's point of view, "Here's the figure on the table, well done, Azerbaijan," if they are beating up civil society, then come the verification process, civil society is going to be—I'm talking about the whole global network here—is basically going to be calling on verification processes to come into play.

And that really means that Azerbaijan needs to come off the list of properly performing and be considered in some kind of—I don't know, what's the right term? They need to be put in the doghouse until they stop beating up on civil society, and I include the press in that regard, because the whole point of this is not just to deliver data that sits collecting dust—we need to create a mechanism whereby such data can be used and deployed to create accountability around the sound management of these resources, and the capacity of civil society to play that questioning role without backlash is an essential prerequisite.

Transparency is an essential precursor. It's one small bit. We have to have it, but without the rest, it's, frankly, meaningless. It's like having an election and then winning 99 percent of the vote and nobody's able to ask why. Then someone stands up and says, "Yes, they held an election." Well, do we give that credibility? I think we have to question those things.

So these are the sort of key areas that we are looking at at the moment and we would like to talk to you more about the sort of frameworks around which we could see enhancement of delivery from EITI, but also about this more comprehensive requirement to enable companies to disclose. So we'd really like to look at that with you.

If you wouldn't mind, indulge me for 1 second. I'd just like to chart one last thing that didn't appear in the submission and just refer people to a paper that we copied and left outside.

I'm not the author of that paper. I have nothing to do with its production. But it's an author who's an editor of a journal called "The Petroleum Review," who is a quite respectable author in his field.

And it's to do with something that was referred to by the chief economist of the International Energy Agency, Dr. Fatih Birol, a couple of weeks. It appeared, I think, in the "Financial Times." And it's reference to—well, they kind of wobbled—reference to the sustainability of oil and gas production, principally oil at this stage—I am referring here to something known as the peaking of gas and oil production, gas, of course, coming later.

There are credible commentators on the stage with a lot of experience coming at this not from the economist's perspective, which seems to be more about raise the price, the assumption then being, OK, it becomes more sustainable to put more money and investment in—and magically wave the wand and out comes more oil.

Instead, the issues raised in this document are issues of physics, chemistry and geology around the structure of oilfields and we have got to a critical stage. This author has provided a piece-by-piece survey of every single project down to 40,000 barrels a day—which is peanuts. We're consuming 85 million a day globally now. So 40,000 is nothing. All the ones in the pipeline for the next 10 years, something like that.

If you were to produce a graph of oil supply coming onstream—from those already existing projects, together with these new projects discussed in the paper—versus a graph of global demand—the lines cross roughly around 2010, 2011. So we're right around the corner at the point where increase in oil demand is going to exceed capacity of the sector to supply. And when we get to that stage, then we're going to go right through \$100 a barrel, we're going to go through \$150 a barrel. Who knows where we go to next, but the price can only go up, and that has massive economic implications, I would say, for political decisionmaking reasons, for global economic panic reasons, for economic security reasons, and especially for significant increased risk of conflict over dwindling essential supplies reasons—we simply do not want to go there.

So I guess what I'm saying here is—if we are serious about the whole problem of security of supply of basic essential energy needs, this issue adds a critical additional weight, I think, to what I think you were calling for at the beginning—the need for diversification of energy supplies.

Depending on who you talk to, the transition into an alternative energy economy is not a 5-minute affair. It's 10–20 years and we'd better start sticking money into such a transformation with Apollo Programme style resources and leadership and we'd better start doing that now. We do not want to see the alternative.

So half of my message is let's try and create the accountability mechanisms to deliver benefit out of these revenue streams, because these will hugely benefit the populations in those countries. Let's create the accountability and enable people to have a voice in these countries, to hold their governments accountable at the same time, because I think we can do it.

There are mechanisms we've started to create which we can use to do this, but we all have to pull it the same way. We have to also

add in these additional mechanisms—such a process should help in the meantime with energy security, because more stable places have got to be better than unstable ones.

But we cannot forget the peaking of oil and later gas supplies, because that will stomp all over us, creating all sorts of problems.

Maybe the document I refer to has missed something—maybe the timing is out by 5 years, but I don't think so. We have to address these issues as a priority.

Thank you.

Mr. HASTINGS. Thank you very much, Mr. Taylor. Your full statement will be included in the record.

And without mentioning the author's name, has that been made available for publication?

Mr. TAYLOR. This was published in February this year. It's a public document.

Mr. HASTINGS. All right. So do we have copies?

Mr. TAYLOR. Yes, and I can send you an e-mail version, if you like.

Mr. HASTINGS. But do we have copies here today.

Mr. TAYLOR. Twenty copies we left outside.

Mr. HASTINGS. Thank you very much. I just wanted to make sure that I had it.

Mr. TAYLOR. I can give it to you. I can give it to you after.

Mr. HASTINGS. I'm worried about \$12 a gallon for my gasoline.

Mr. TAYLOR. It'll be paying real soon.

Mr. HASTINGS. Mr. Kupchinsky, you heard Senator Cardin mention that he and I and others were in Ukraine recently and I note from your bio that you spent a rather considerable portion of your career in Ukraine. But, of course, today, as regional analyst for "Radio Free Europe" and "Radio Liberty," we are honored to have you here with us and we invite you to submit your full statement in the record and go forward in any manner you see fit.

Thank you.

ROMAN KUPCHINSKY, REGIONAL ANALYST, RADIO FREE EUROPE/RADIO LIBERTY

Mr. KUPCHINSKY. Thank you, Mr. Chairman. Thank you for inviting me to this hearing.

For the first time in the history of the United States, the United States is on the verge of becoming partially dependent upon natural gas from Russia. Canada, the traditional supplier of natural gas to the U.S. market is running out of exportable gas, as is, Mexico.

In the near future, the United States, which is the world's largest consumer of natural gas, will become dependent on gas, in the form of Liquid Natural Gas or LNG, not only from Trinidad and Tobago, Qatar, and Algeria, but from Russia.

The International Energy Agency, as my colleague just mentioned, recently predicted by the end of the decade, gas supplies will be very tight, as will be oil supplies. The United States uses over 600 billion cubic meters of gas yearly and the gas that will be arriving will be in the form of liquefied natural gas, LNG, which will create a can of worms in terms of security of refasification ter-

minals in the Gulf of Mexico, on the east and west coasts, the security of energy tankers bringing LNG.

Now, the question is what does this mean for the national security of this country.

Most analysts will agree that Russia's natural gas industry is the most opaque sector of the Russian economy and that Gazprom, the Russian state gas monopoly, is a secretive corporation reporting only to the Kremlin.

Gazprom, according to its spokesmen, intends to control 10 percent of the U.S. gas market in 2, 3 years and 20 percent by the end of the decade.

If the United States is going to be dependent on Russian LNG for 20 percent of its consumption, then we need to look at this very carefully and do something about it before we become overly dependent.

If the United States is going to be dependent on Russian LNG for 20 percent of its consumption, then we need to look at this very carefully and do something about it before we become dependent.

Russia is not Saudi Arabia in that it is a country which is able and is willing to project its hydrocarbon clout around the world. We've seen this in the countries of the former Soviet Union and I believe that that's one of the fears we have to examine.

One of the reasons for the opaqueness in Russia is that Russia does not have a foreign corrupt practices act. Russian company executives, especially Gazprom executives, are not bound by any legal restraints when it comes to their business practices abroad, and this is mostly evident in central Asia, as my colleague pointed out, a region where top officials have regularly been suspected of funneling money from oil and gas deals, above all, gas deals, into their hidden offshore accounts.

This lack of transparency has helped Russia gain control over the central Asian energy market and has been instrumental in keeping Western countries at bay, out of the Central Asian energy sector.

It's far more profitable for key officials in these countries as Turkmenistan, Kazakhstan, Azerbaijan, to deal with Russia. Russian companies are far more amenable to giving kickbacks than an American company which is prohibited by law from doing so.

The result of these types of activities, the result has been to sabotage Western efforts to diversify its supply of natural gas. Russia has been buying central Asian gas, has practically created a monopoly on central Asian gas, and this has made western Europe even more dependent upon Russian supplies.

I believe it's a mistake to believe that Russia's efforts in central Asia to control central Asian pipelines is being conducted merely for commercial ends. The greater strategy, I believe, is to prevent alternative supplies from reaching Western Europe in the event of a crisis.

In other words, by monopolizing gas supplies and their transport routes, Russia is better prepared to use gas as a weapon to further its foreign policy ends.

Let me give you one example. Ukraine for years bought natural gas directly from Turkmenistan. But then Russia came in and they gave bigger kickbacks and signed a contract with Turkmenistan, at

25-year contact, to buy practically all of Turkmenistan's gas production.

Ukraine was in effect forbidden from dealing directly with the producer, with Turkmenistan, and had to buy all Turkmen gas initially through Russia and then through a middleman company, RosUkrEnergo, which nobody really understood what its role really was. Ukrainian President Viktor Yushchenko has often stated that there is no reason for RosUkrEnergo's existence.

The current President of Turkmenistan has ordered an investigation into the private bank accounts of his predecessor, Saparmurat Niyazov, which are allegedly kept in German banks. How serious these efforts are to track down Niyazov's bank accounts only time will tell. In the meantime Global Witness is trying to track them down.

However, this middleman company, within a span of a few years, has evolved into a tremendous empire. Now, 50 percent of this middleman company is owned by Gazprom and Gazprom refuses to explain how and what it is doing with this middleman company.

The other 50 percent is owned by a Ukrainian businessman without any links to the Ukrainian Government.

We have to remember that Gazprom's lack of transparency prevents information about these deals from reaching the Russian or the Ukrainian public.

Gazprom Media, a subsidiary of Gazprom, controls the main Russian newspapers and radio stations and these media outlets refuse to provide information about these suspicious deals.

And I have to add, as an aside, look at the president and the former president of the Turkmenistan. The current president of Turkmenistan has now ordered or begun an investigation into the private bank accounts of his predecessor, which are allegedly kept in German banks. Now, how serious these efforts to track down Niyazov's bank accounts are, I think Global Witness is doing an excellent job in trying to track them down.

So as a result of these deals, Ukraine is now totally reliant on Gazprom for its vital energy supplies. In fact, a country vital to the security of Europe, can be blackmailed at any time into doing what the Kremlin wants.

I mentioned that Gazprom wants to control up to 20 percent of the U.S. natural gas market. If Russia, by the end of this decade, is to supply over 60 or 120 billion cubic meters of liquefied natural gas, LNG, to the U.S. market and a crisis were to erupt in United States-Russian relations, the problems can become very intense.

The one solution I would offer, in addition to what my colleague mentioned, is that the OSCE should insist that member states adopt legislation similar to the Foreign Corrupt Practices Act we have in the United States.

When the world becomes much more reliant on liquefied natural gas, LNG, competition will become very fierce between us and our allies, as well as with China, India, Japan and South Korea for limited supplies.

I believe that it is in the interest of the national security of the United States to try to bring some order into this emerging market for LNG and realize the dangers which are inherent in it.

Thank you very much, sir.

Mr. HASTINGS. I thank you both. You both have enlightened our testimony and rang some alarm bells that I'm sure should set our continuing concerns.

I'd like to turn to the co-chairman for any questions that he may have and then I invite the audience, if you received one of our slips, if you would submit your questions, I'm sure somebody will be picking them up, the staffers over on this side.

All right, thank you.

Senator Cardin?

Mr. CARDIN. Thank you, Mr. Chairman. I appreciate the courtesy of allowing me to question first.

You got my attention on the LNG security issue, since there is now application to put another LNG terminal in Baltimore, in a populous area, that our Governor is opposed to for security reasons and the regulatory process here is unclear as to how it will proceed on those types of applications.

I just mention that as just one of the side effects of our greater dependency upon LNG.

You also mention that OSCE should take a more aggressive stance and the member states enacting anticorruption, kickback type legislation, such as we've enacted in the United States. The United Nations has been working on such an effort internationally.

In the OSCE, our delegation did author an amendment to our annual document, I think, 2 years ago or last year, where we did encourage the states to enact legislation similar to what we've enacted in the United States.

The problem, of course, is there's no monitoring of that and there's little desire in a corrupt state to enact that type of legislation. The problem we find is that it's so engrained in their culture, kickbacks and payments, it's almost a way in which you get governmental services is by paying kickbacks.

I guess you have brought up very serious problems in these energy-rich states and I'm not sure yet we have a game plan for how to deal with it. Reporting laws would be great. If we could get more transparency, I'm for that. I think that makes a good deal of sense and I think we should work for that and perhaps we would get accurate information, but I'm not sure.

So I guess I'm looking for some more far-reaching proposals that we should be looking at to try to deal with the transparency issues.

Of course, one option is we're so dependent on these energy sources. If we weren't as dependent on these energy sources, then we would be in a much stronger position to say that unless certain reforms are done, we have other alternatives. But we don't have that many other alternatives today and it just makes even more imperative the greater conservation of energy and the greater development of alternative renewable energy sources, so we're not as dependent upon the fossil fuel energy sources that are generally produced in states that lack basic transparency in the way that they do business.

But I think we've got to be bolder. I think we've got to look for a more aggressive stance, in addition to an energy policy that gives us the opportunity to have options that we don't today.

Any thoughts?

Mr. HASTINGS. Please, Mr. Taylor?

Mr. TAYLOR. I think one of the things I was trying to stress when referring to—I basically agree with exactly what you just said. I think collectively, and I’m not just talking about the United States here, but the Europeans have, as well, the same problem, and let’s bring in some others.

China, we’re collectively referring to this great worry about China’s increasing consumption, but per capita-wise, China’s consumption is minimal compared to ours. And so if we expect, as we have done, to export a lot of our manufacturing into China, then we’re partly responsible for the expanded energy consumption in China. That is a fact of globalization, it would seem to me, and that is only going to get worse, not better.

So these whole constraints we’re talking about are going to get worse in a climate when the supplies are getting worse.

You mentioned, rightly, before, the issue of gas in Russia. If you think of the near neighbor, Canada, we’re now at the stage with gas in Canada where it’s either gas to keep the Tar Sands projects going or it’s gas for the U.S. gas market. It’s not both. There isn’t enough. That’s where we’re at.

So a lot of the people who are saying, “Oh, yes, Tar Sands will come and rescue us from our oil depletion problem don’t take that into account, leaving aside the fact that oil development from Canada isn’t really going to replace that much, given the depletion rate.

So the situation’s going to get worse, not better, and it’s not going to get any better in terms of price at all. In fact, that’s going to get much worse. Quite how and when? Well, we’ll have to see.

I think we have to have many more things. Transparency is simply a tool. If you don’t have it, you can’t ask the questions. You’re absolutely right. Do they do it right? But that’s why EITI is interesting, because in September, we get to the stage where we have a verification agency properly functioning. That’s very important.

If the verifying process for political expediency, because of people on the board or not, let’s say if it doesn’t, because there will be a big rile about that. But if the verification process is solid, then those who don’t perform are going to get kicked off.

Now, if it would cost you a lot to get kicked out of EITI and the incentive for joining was quite a high value for joining, well, that might change the dynamic a little bit.

If you then include reporting requirements along the lines of that which I’ve just referred to, you could create the scenario where the vast bulk of the world’s oil and gas companies, and I include the three biggest Chinese companies in that ticket, as well, because they are in the United States, they have a presence here, so they’d have to do the same thing, you would, by default, force transparency around the payments they make in every country of operation.

And at that point, you then go out in the public domain, data, this is what came in. Then you’ve got nasty people like us, nicer people like you guys in the Senate, in the House, wherever it happens to be, other jurisdictions able to stand up and say, “Hang on a minute. You know, so-and-so wants to come and see the President this week.” It’s a great prestige opportunity.

I'll give you an example. It's not to do with the area we're talking about, but, for example, the President, we thought, in a very good initiative, launched the kleptocracy initiative a couple of years ago now. I can't remember the timing now, I think 2006 or 2005.

And whilst this is a great initiative, very shortly after the announcements that I picked up, we had President Obiang essentially getting the red carpet treatment here in Washington. President Obiang stashed \$750 million in Riggs Bank, which is the reason why, along with a couple of other reasons, as well, but one of the main reasons why Riggs doesn't exist anymore.

And, yet, for sovereignty reasons, that money was not held. Now, this was stolen money. It was in, they claimed, state accounts. But de facto, Obiang had personal control over those accounts. How can that be a state account? There's a farce.

But sovereignty always seems to be the point where we all stop and we can't touch sovereignty. But I would counter that by saying who gave the sovereign rights to President Obiang to basically have sole control, at his discretion, over an account with \$700 million in it, all coming from state oil money, in this example.

We could probably repeat the same about Nazarbayev, I would imagine, if you think of the Swiss account. So the parallels are there.

So to me, sovereignty simply doesn't stretch there, whether you're elected or otherwise, and Obiang, frankly, if anyone thinks he was elected with 99 percent of the vote, well, that's [inaudible].

So these are options to have assets frozen.

Mr. CARDIN. Mr. Kupchinsky, let me give you a response to respond to my concerns. But let me add just one more thing to it, and that is EITI.

Is that, as a voluntary organization, effective in trying to deal with some of these issues or should we be looking at a stronger mechanism?

Mr. TAYLOR. EITI is the international game in town right now. It is functioning by virtue of the fact that various states are participating, including the United States, in a way that's meaningful now as opposed to before, but we'd like to see more.

It is the only game in town. It is going to deliver in some countries. We still have doubts about its capacity, because of its voluntary nature, in countries where you have kleptocratic elites who have no intention of moving. That's why we need a mandatory mechanism to create the conditions why there would be disclosure.

So it's good insofar as it goes. It is not necessarily the whole picture and it is still only going to deliver this small component.

Mr. CARDIN. Mr. Kupchinsky?

Mr. KUPCHINSKY. One solution which comes to mind is that the member states of the OSCE, that they adopt national legislation and make their companies—along the lines of the Foreign Corrupt Practices Act and make sure that their companies, their energy companies abide by their law.

For example, in Germany, the head of Ruhrgas, the largest German gas company, also sits on the board of Gazprom and this is a very cozy relationship, where Gazprom is the biggest supplier of gas and he's sitting on the board. He's obviously not going to rock the boat.

Former Chancellor Schroeder is sitting on the board of the North Stream Pipeline. He obviously is also not going to rock the boat. When the cost overrides on the construction of the north pipeline, the Russian costs are going to be phenomenal and you know where the overruns are going to go.

This is a big problem. Let me give you just a brief thing of how it looks internally. The person in charge, RosUkrEnergo, the middleman company bringing Turkmen gas to Ukraine, is a member of the board of Gazprom. He's also a former KGB agent.

The person in charge of Gazprom sales of gas to Ukraine, Belarus, the Baltic countries and what is a former KGB agent. The head of Rosneft, one of the largest Russian oil companies today, is a former GOU, former military intelligence agent.

It seems that, all of a sudden, intelligence agents have become energy dealers, energy traders. It's an amazing transformation. And they're responsible for their controller in the Kremlin, another former KGB agent.

I don't believe in coincidences like this, that they happen. Don't forget that the guy's also in charge of this middleman company bringing gas from Turkmenistan to Ukraine, he's also on the board and the head of the board of Gazprom Media, in charge of the newspapers, the media outlets that Gazprom owns.

So here you have—I mean, I'm not paranoid, I hope I'm not, but this is beginning to look very suspicious.

So, again, I repeat, I think one possible approach is to make the companies responsible for the implementation of this. The Russian companies will find out pretty soon, though, not only the Russians, but the central Asians, that if Conoco Phillips, BP, Shell come in and they see that something is not right, they're going to make it public and they're going to demand that if the Russians want to deal—the Russians want to sell as well as we want to buy and if we're telling them we're not going to buy and if we can force the Chinese and the Indians to do the same, I think we have a very strong weapon here.

The question is getting the Chinese to go along with it and corruption in China is not a fly by night thing. I mean, it's deeply embedded in the system today. And now and then, an official gets shot, which is better than in Trinidad and Tobago, where they use the cat-o-nine tails to whip them.

And Trinidad and Tobago, as a matter of fact, is the largest supplier of LNG to the United States.

Mr. CARDIN. I thank you both for your answers and your testimony. I think working for transparency at the company level makes some sense and that might be a way that we can get around some of the corruption issues within countries. If we can establish a standard for international business among the major countries, that may be a way of trying to get at that.

Thank you. Thank you, Mr. Chairman.

Mr. HASTINGS. Thank you very much, Senator.

Several things come to mind and one is a process issue and it has to do with the OSCE, which is obviously the commission's principal concern, how we might be able to impact the matters that we have discussed here today.

The implementation, for example, Mr. Kupchinsky, of a corrupt practices act of sorts would require consensus in the OSCE and one of the significant players in the OSCE is Russia, who likely would never agree.

It leaves me puzzled how we gain transparency with countries who do not wish to be transparent and what leverage, if any, we have.

I don't believe personally in too many exercises in futility. And while it may very well be something that we pursue, and I think rightly so, I believe when you get to Vienna, the end result will be that it will stall there and such an enlightened corrupt practices act might very well not come to fruition.

Traveling along the same lines, there are certain things that at least we know Russia, as a country, is projecting and it is in our face. For example, if we were to turn to the Caspian Pipeline Consortium and their attempts at takeover there and the use of retroactive tax claims, that's happening in our face and it leads me to wonder, aside—there's been something in my mind about America, quote-unquote.

There is America and then there are American companies that are thought of as America and when you think about policy, to what extent does Exxon operate, for example, outside the scope of what the State Department or anybody else might think when they're dealing with this commodity and when they have a board that has a bottom line?

And even though we have transparency, their profits have risen. We know ostensibly that their profits go to their shareholders and we know that the bad countries' profits go to bank accounts unknown, but at the very same time, all of them seem to be playing in the same oilfield, no pun intended.

And how do we separate that? How do we control, how do we manage policy that will cause big companies to comply with EITI or with a corrupt practices act?

In short, what I'm saying is that it's rather troubling that we don't have as much leverage as would like to have. And where, if any, leverage do you see that we might project?

And I might add, gentlemen, I heard both your testimonies loud and clear, but following along with Senator Cardin said, maybe just to expound a little further as to how we might get a—we meaning OSCE, we meaning the U.S. Government, might have a greater impact on this process than we have now?

Are we trying and failing, as another way of putting it, or if we were to exert diplomatic efforts, to what extent will they be successful? What type of diplomatic efforts, regional? When you say get China and India to do something, it's a little larger order than us sitting in the comfort of room 415 in the Russell Building and saying it ought be done.

How? How can we do these things? And if I have a kernel of a question in there, I'd invite responses from either or both of you.

Mr. Kupchinsky?

Mr. KUPCHINSKY. You're a hard task-maker. I mentioned one thing—putting the onus on the companies, on the energy companies, let them try to bring order into their own house. That's one possibility.

One of the levers we have, I think, on Russia, not only us, but overall the other members of the OSCE, as well, is the question of banking, which my colleague brought up. It's extremely important.

Most Russian energy money, illegal money is laundered out of Russia. The U.S. State Department believes there are like \$7 billion a year. Other organizations, including the Russian internal ministry, believes it's more on the order of \$10 billion to \$15 billion a year that's laundered out of Russia into Western accounts.

Unfortunately—

Mr. HASTINGS. And/or Western businesses.

Mr. KUPCHINSKY. And/or Western businesses, yes.

Mr. HASTINGS. Including in South Beach, Miami. But go ahead. Most people don't know about it.

Mr. KUPCHINSKY. You've got to give me the address there. This laundering activity is an Achilles heel for them, except that banks like Austria's Raiffeisen Bank, which has been involved in a number of very sleazy deals in Russia, in Ukraine, in other places, in Austria itself, are just as responsible, because they refuse to abide by the rules of the game. It's the German banks, as well, and others.

The Financial Action Task Force in Paris was probably very good in terms of controlling and decreasing terrorist financing. They did an excellent job, I believe, as far as it could.

But the question of this type of laundering from the energy businesses, from Russia, as well, Russia was not financing terrorism. Russia was financing its own children who were stealing its money.

Now, I think that's a very strong possible approach we can use is to force these Western banks to report and open up who these accounts are held by, who are the principals of these companies and force these companies. When they open an account, they have to put down the name of the principal.

Cyprus, for example, has done a lot to stop money laundering. But, yet, when you go through the different websites, the principals of these companies are never mentioned. They're hidden and their national legislation allows them to hide it.

Once this is gone, this creates a problem for the corruption in Russia. That's one possible way of decreasing it. We won't stop it. I'm very pessimistic about stopping it all, but I think there are levers of controlling it and decreasing it.

Mr. TAYLOR. I think, for me, this is really why we come back to this kind of need of a cocktail of mechanisms. So we should see transparency as simply a component. It's actually quite a small component, but we're not even there in a lot of these different states we're talking about.

So the oil and gas companies, using this example, are one vehicle to get transparency, because they, after all, are responsible for large percentages of the revenue streams. And so requiring revenue transparency is a way of putting the information in the public domain and let's see how those mechanisms can work.

They will vary depending on the country and the opportunities and the extent to which it's possible to lean on them, if that's not an inappropriate term. That's one part of it.

Now, that kind of brings me back to EITI, in a way, I think, and the whole energy security issue, which is really quite [inaudible],

and, that is, the lion's bulk of the energy resources are still being consumed by, as we've mentioned before, those wealthy principally Western, but including Japan and a couple of others, industrialized nations.

China, a captor anyway, is only just coming up and the fact is that there's such a crunch, there's such a pinch, there isn't much slack in the system. China is going around scrabbling to pick up what's left and there isn't that much left.

In addition to that, if you go to, say, offshore Angola, a lot of the places are frontier places. They're very difficult and offshore Angola, it's frontier because it's 3,000 meters of water, and you come down to really only five companies that can drill and that's Exxon, Chevron, BP, Shell, Total, the Norwegians, but even they can't do it very easily because they don't have the finance to do it.

So one of China's main companies has now got a significant slice, which block is now 18, I think, it's a deepwater block, but actually the operator is Total. They can't do it.

Now, of course, it will not stay like that. In a decade, we'll be talking about a different situation. But for the time being, China is very, very dependent on the existing arrangements. That means China is vulnerable. That means there's an opportunity to bring China into a process like EITI.

So this is an area where I know the State Department did make overtures. They didn't get much of a response yet. But let's see something revamped and reinvigorated. Get China into EITI, it starts to look very difficult for certain countries that currently who go in the Chinese camp [inaudible] have to go.

If you then add the reporting requirements, I'm afraid the Chinese companies are registered here and listed here and otherwise. They rely upon this country and in Europe, as well, for raising finance for the projects they're involved in.

Of course, they can go back home, but, there, there is an element of credibility and respectability they are looking for. So you have an angle to pull them in in a way that they can't even stand up and say, "You're aiming this at us," because we're not. This is about everybody. This is about leveling the playing field. That's one bit.

And I've talked all about transparency in the context of addressing despotic elites, if you like, and creating transparency. I just want to stress, when we launched Publish What You Pay and even before that, this was as much an issue of bad behavior by different companies in the field, whichever field we're talking about, as it was about kleptocratic elites.

It is simply not true to say that the worst excesses of the Elf regime, for example, we've all heard about the Elf trials and what came out about Congo-Brazzaville. Angola was in there, as well. I spent nearly 3 years investigating theirs and other companies' activities in Angola, for example.

And I found an invisible subsidiary of Elf which did not exist on the books, which was shipping arms from an Israeli state arms factory. What the hell is an oil company shipping on through a subsidiary that doesn't physically exist? I mean, it was completely farcical.

Elf was not the only one. If you want to find out what happened in Angola, you have to ask how was it that the three big corporations managed to get Blocks 31, 32, and 33 in Angola at that time and the way that they could do it was only through middlemen and the middlemen were effectively the Russian mafia or at least the Russian mafia is a very broad term, but they were represented in that equation.

These were people who operated at the very highest levels, who talked to presidents, who arranged bank accounts and facilities. Nothing has ever come out about that. There's no discussion about that.

So these companies, we've seen in the Giffen indictment, all of them, at various stages, in different jurisdictions, have done things. And so there is a reason for creating revenue transparency, I think, in every jurisdiction for all countries, for each of the companies, because it becomes a lot harder to run slush funds in offshore centers when you have to account for every penny in every country you operate in.

So I think we have to see it in this double direction. And, again, that's still only one bit. We have to address this issue of banking, which is perhaps another subject of discussion.

Mr. HASTINGS. We do have several questions from the audience, but you piqued my interest when you mentioned Angola and I'd just share my personal experience in a limited way in going to Angola and arriving at the airport and taking a ride to the president's residence, Mr. Dos Santos.

And I'll never forget the images along the way of that roughly three U.S. miles, I would think, maybe 2.5 miles to his residence, with people, particularly children, standing in pools of filth and then me arriving at his residence and seeing the ostentatiousness of same.

But on the way, there was something else that I noticed and I asked the driver what were those walls along the line and there were a variety of oil companies behind those walls and you could see occasionally through them the swimming pools and the tennis courts and they were companies from different areas of the world, including the United States.

And it struck me interesting. I know that because of other concerns that we had coming into Angola, that I certainly did not leave the president with a favorable impression from me as a person, for I mentioned the things that I just said. And I might add, if any of you see him, tell him he didn't leave a favorable impression upon me either. So that cuts a lot across the countries.

Let me just read the questions that we did have come to us, only because I want this to be a practice in the future.

Gentlemen, I don't know whether either of them will pique your interest. I do believe that one or two of them you may have answered.

But one says, "Economic and political development over the past several years have demonstrated the effectiveness with which Russia has used bilateral ties with European governments and energy companies to disrupt development of alternative energy transit infrastructure and a common energy policy. What needs to be done

to counter these tactics and how can the EU countries pool their economic weight to effectively fight Russian monopolistic power?"

Another I believe you may have answered, in part, Mr. Taylor. It was directed to you, "Can you please elaborate on the point you raised about Azerbaijan and Nigeria being expelled from the EITI?" I think you did mention that in your previous comments.

Another, "What should the OSCE adopt as a standard for resource revenue transparency? Should EITI be mandatory for OSCE countries or should there be higher standards? Would you recommend that all OSCE countries sign onto EITI?" And I believe that reauthorization process is ongoing and upcoming soon and hopefully many of the OSCE countries, in my view, should be encouraged to join.

And this one is—and I guess it was more for me and for Senator Cardin, "Why will the U.S. Congress not cap the price of oil? The idea that demand determines the price of a necessity for Americans is destroying our Nation's people. We need an economic recovery based on technological improvements in nuclear power and VAE systems," and, in parentheses, it reads, "is leading corruption regarding oil and aerial space today."

And the final one, and then I will allow each of you to respond as you see fit, the final one that was just handed me, "The most recent report on Russia in Freedom House's 'Nation's in Transit' study shows across the board decline in Russia's democratic performance. How does Russia's energy wealth factor into that country's critical upcoming elections?"

Several of which are very good questions. If you will permit me, the question directed to those of us, Senator Cardin and myself and other representatives, I think America's energy policy is a work in progress. And I was put the question earlier by "Bloomberg" reports—a reporter that spoke with me earlier today and I didn't want to predict what the ultimate energy legislation will look like.

But what I did say is I do not believe that it will happen this week or next week and I do believe personally that it's going to take a bit longer for the various undertakings.

The Senate has passed a measure, as many of you know. The House is undertaking its own reviews in a variety of ways. But when you talk about a cap on oil, you have to recognize the immense complexity that is involved and I do and, therefore, I don't like to make snap judgments with reference to where we go with our energy policy.

But, ladies and gentlemen, particularly this audience, most of you, other than Mr. Kupchinsky and myself, and I only reference him because we have the most gray hair in the room, but most of you will be here 30–40 years from now. The things that these gentlemen have talked about today are going to be tremendous intersections in your lives.

I ran for office for the first time in 1964, in the State of Florida, for the Florida legislature, and I advocated at that time desalination and I advocated that Florida should be a laboratory with the sun that we have for us to develop alternative energy sources based on the use of solar energy.

Later, I ran for office and then became concerned about water, the missing link in this hearing, but something that is critical, as

well, and many of you likely will see as many world disputes and local disputes about water as you are likely to see about energy.

What I want to say to you is to have a real sufficient alternative energy production in place technologically is going to take another 15 or 20 years, no matter the legislation, no matter what anybody tells you or thinks, and I want you to know that much of that technology, much of the invention, much of the patent resources that are out there, the kinds of things that you are likely to see in your future have already been in the works, but you're not talking about something.

I listened to people the other day talk about how simple it will be to meet CAFE standards. Well, I'm not so sure that people understand that meeting the CAFE standards means an increase in the price of the automobile. And when you start weighing all of these things, then you do have to be particularly careful and legislators who are more careful than am I are themselves on these kinds of questions until you ultimately will see the results.

I believe we will get a new direction in energy policy, but I don't think that we are going to get it in one lump sum and there's going to be some magic wand waved out there and all of these things are going to come together. It's going to take time. It's going to take a lot of legislation. It's going to take a lot of cooperation.

And, as usual, what will wind up happening is the business community worldwide, globally and otherwise, will be ahead of all governments. Governments limp along with policy, but businesses will look for the best solutions that they can make money off of. And so in the energy field, a lot is going on.

I'll give you one final, and I apologize for taking so long, but in Ukraine, Senator Cardin and I and nine other of our colleagues met with President Yushchenko and it had never occurred to me, when he began his discussion about black soil and what he was talking about was the residual damage that had occurred as a result of Chernobyl, and he was asking for the Academy of Sciences to give some thought to the possibility of growing something on that soil, even though it's radiated, for energy production, but not so much for human consumption.

And it's certainly something that needs to be addressed and looked at, because they have this vast field of, perhaps the second or third largest, black soil in the world and it's fertile and perhaps corn or whatever could be grown there for something to get us away from the fossil fuel.

I apologize to both of you. I took a long time. I'll allow you to take as long as either of you wish to answer our questions and then we will be concluded.

You want to start, Mr. Kupchinsky?

Mr. KUPCHINSKY. The question which intrigues me the most, which I've given a lot of thought to in the past, is the problem between Russia and the European Union and the question of a common policy, how Russia is dealing with individual countries in the EU to try to win them over to their side, to sign long-term or short-term contracts for gas and oil deliveries and to split the EU from a common policy on energy.

One of the problems, one of the reasons I think that the EU is faced with a rather severe and increasing energy problem is the

United States. The United States, nobody really wants to mention these, but the United States is, in a way, very, very much responsible for what's going to happen in the next 10 to 20 years.

If we look at the facts, we have 3 percent of the world's population and we use 25 percent of the world's oil supplies, over 20 million barrels of oil a day. This is more than China, Russia, and most of Europe uses in a day combined. California consumes more gasoline than China.

Now, these are very frightening statistics. Not only are they frightening in the sense of the over-consumption of energy in the United States, it's the image it projects around the world.

I mean, we've been getting bad press on the Arab, on the Middle Eastern street for many, many years and this is one of the considerations, where Americans are seen driving around in monster cars, living in an air-conditioned environment their entire lives, wasting energy constantly. It creates not only sort of hatred, it creates the problem of others are not getting enough.

Now, if we can't learn—it's not only a question of how many miles per gallon your Hummer is going to get, 8 or 12 miles a gallon, or your SUV, and Detroit is screaming that the U.S. auto industry will collapse if the mileage goes up to 35 miles a gallon in, what, 10 years from now.

That's nonsense. That's total nonsense. But I think we have to see ourselves as being responsible and if we want to help the Europeans and others, we have to cut back. I mean, there's no way. We use more gasoline for air-conditioned automobiles than Indonesia uses as a country, and this is ridiculous. This is nonsense and this cannot continue, but it will.

I forget who did a study. What do Americans look for when they buy automobiles? In 2005, mileage was number, like, 15 or 20 on the list of things that are more important. This year, it's only No. 12. What's more important is the audio system on the car.

Now, this is crazy, of course. I think you're absolutely right in saying that it's a process. We're not going to change the buying habits of the American consumer very quickly or the habits of Detroit first creating a demand for SUVs and then saying that Americans want SUVs. First, they create it with the advertising and people think that they're driving in the Australian outback when they're actually going to CVS to buy Viagra or something. This is nonsense.

So I think it's a very serious problem. The European Union is suffering in many ways because of our over-consumption. Russia, of course, is playing a game with everybody, trying to divide and conquer, and they're going to continue doing this. Whether Putin remains in office or whether he leaves, it doesn't really make much of a difference.

It's not a question of who will be the president. Gazprom will continue to be the Presidential maker in Russia and we have to find a way of dealing with that.

Thank you.

Mr. HASTINGS. Thank you very much.

Mr. Taylor, I said you could have as much time as you need and inside 5 minutes, I mean that.

Mr. TAYLOR. Here we go then. Yes, I recognize your description of Angola. I could add a few like that, too. It's a very distressing place to go to at that time.

I might also say I think Mr. Dos Santos and his cronies probably, between them, are Africa's and possibly even the world's biggest kleptocrats right now and we certainly are interested in seeing what assets are out there and where they might be. So we might have more to say on that at some point.

And somebody mentioned, I think you mentioned, and I just thought I'd try and correct that, maybe it's the wording of the question, about me suggesting Azerbaijan should be expelled. My comment was more to do with the fact I think we've been pleased Azerbaijan is performing on the delivery of data.

They're doing EITI. Everyone kind of recognizes that. I think there may be still some shortcomings in the delivery, as is still for Nigeria, as well, but they're the two examples where we've got delivery going on.

My point really relates to the inconsistency between jumping all over civil society and suppressing freedom of expression, stroke freedom of the press, and EITI being seen as an accessory, because the whole point of EITI is the cornerstone being the capacity of civil society to hold government accountable and part of that surely is public domain debate and discussion in and outside of the media.

And if you suppress and beat up the media, then there's a schism there. There's an inconsistency there.

So all I'm saying is for a proper verification process, a validation process to be effective, then things like locking up your press or having them bumped off, frankly, in my opinion, should get you bumped off of the list again. It might not get you bumped off the list as far as Equatorial Guinea that hasn't done anything at all, but there should be a shot across the bows there and we need to see that EITI can help deliver a more sustained capacity of civil society to do things.

So in my opinion, they're right on there at the moment, but let's see what happens. They have to pass these tests and the validator needs to be good and that's an area I think where the United States could play a very effective role as its board member to ensure that validation actually means something, because otherwise we'll have another wishy-washy process.

And talking of wishy-washy processes, you mentioned earlier where the money from Turkmenistan was. We have had this concern by BaFin, the German regulator for banks, and also Deutsche Bank themselves, they are concerned what we knew, what we thought we knew to be the case, the accounts, the Turkmen accounts in Deutsche Bank in Frankfurt.

So I think one thing, if I may be so bold, that you and the committee could do would be to seek to obtain out of BaFin and Deutsche Bank why it was possible to effectively have accounts under the sole control of President Niyazov, because I, frankly, can't see much difference between that and the sole control exercised over the money in Riggs Bank, and that was enough to kill Riggs Bank off.

Now, lots of people say, "Well, there's a difference between the regulatory requirements in Germany and the regulatory require-

ments here," but that's precisely the point. Someone needs to be jumping all over the Germans and saying, "This isn't good enough," because I think there's no other way of looking at it. But Deutsche Bank offered facilities for effectively an offshore account with \$2 billion in it, where there was no control and oversight by the state government structure or anything.

It was, de facto, his account and I think that's a problem. So that is a good example.

And someone mentioned BAE Systems. I can put my hands up and say I think the Brits' suspension of the BAE Systems investigation was probably one of the more shameful acts we've done in recent times and some of us have some aspirations to see that challenged. There's a legal challenge going on at the moment to see if the investigation should continue or could be reopened.

I believe the Department of Justice here is interested, which I fully commend them to continue with their digging.

Oil well factoring in the Russian election, I think you very beautifully, eloquently said something about that. I'd be interested to hear more about the Senate energy bill, but maybe we can talk about that.

Thank you.

Mr. HASTINGS. Gentlemen, thank you both. And, ladies and gentlemen, thank you all for your patience.

I assure you that the full transcript will be made available to the other members of the Commission. You certainly have given us a great deal of food for thought and useful information, I believe, that will help us both in the Helsinki process and in our legislative responsibilities to try to produce some positive results for everybody.

Thank you so much. That concludes the hearing.

[Whereupon, at 4:33 p.m., the hearing was adjourned.]

APPENDICES

PREPARED STATEMENT OF HON. ALCEE L. HASTINGS, CHAIRMAN, COMMISSION ON SECURITY AND COOPERATION IN EUROPE

Good afternoon. I want to welcome you all to this hearing of the Commission on Security and Cooperation in Europe.

Today's hearing is the second of three hearings the Commission is holding on the topic of energy security, an issue that spans the security, economic and environmental, and human dimensions of the Helsinki process. This hearing series is designed to give the Commission a comprehensive picture of this complex issue and highlight areas where the Commission, the U.S. Government and the OSCE can take effective action.

The first hearing took place on June 25 and focused on conflict prevention and the security of supply and transit of oil and gas. The third hearing will address the nexus of energy security and environmental security, focusing on the diversification of energy supply and sustainable technologies—namely how we can decrease dependence on foreign sources and address environmental concerns at the same time.

At today's hearing we are going to hear from our distinguished panelists about the development of democracy and civil society in countries with abundant energy resources—and why that matters to U.S. energy security. I mentioned at the last hearing the remarkable fact that only two of the world's top 10 oil exporters are established democracies—Norway and Mexico. What is wrong with this picture?

Top World Oil Net Exporters 2006

- 1 Saudi Arabia
- 2 Russia
- 3 Norway
- 4 Iran
- 5 United Arab Emirates
- 6 Venezuela
- 7 Kuwait
- 8 Nigeria
- 9 Algeria
- 10 Mexico

Source: EIA: International Energy Annual (2000–2004), International Petroleum Monthly (2005–2006).

When we look at countries that are situated on oil and natural gas reserves, we think these countries have won the global version of the economic lottery. They have a built-in revenue stream that can fuel not only their own economy but also be an export commodity. But what economists have found by studying these resource-rich countries is that they often do worse than their resource-poor neighbors, both economically and politically. This problem is often referred to as the “resource curse.”

Each of the countries we are focusing on today—Russia, Kazakhstan, Turkmenistan, Uzbekistan and Azerbaijan—face some

aspect of this resource curse. And while the situation in each country is unique, we can generalize and say that the lack of transparency in politics, and in oil and gas deals, is at the root of the problem.

It's a well-known, and well-bemoaned, fact that the United States is becoming more and more reliant on imported energy to fuel our economy. We are the world's largest consumer of oil—we account for an astounding 25 percent of global daily oil demand—despite having less than 3 percent of the world's proven reserves. And we source that oil from some unstable and unfriendly places in the world such as Nigeria and Venezuela.

In the context of today's hearing some of you may wonder why the United States should care what is happening in Turkmenistan or Kazakhstan, when we actually don't rely on these countries for a significant portion of our energy supplies. Russia is only number nine on our list of oil suppliers and Kazakhstan, Turkmenistan, Uzbekistan and Azerbaijan don't even make it into the top twenty.

The answer is that unlike natural gas, oil is a commodity, so regardless of where we source our oil, what happens in other oil-rich countries impacts the stability of our price and our supply as well. As the National Petroleum Council reported last week, "There can be no U.S. energy security without global energy security."

Oil is the tie that binds us all and threatens to choke us at the same time.

So take a minute to think about how drastically different our interactions with these countries would be if we did not rely so heavily on these countries' resources. I think it goes without saying that we would have more leverage to promote democracy and civil society. Clearly oil constrains, if not drives, our foreign policy.

So while it is imperative that we work to limit our dependence on foreign oil and change the dynamic of supply and demand, it is just as important to create more stable and reliable sources of energy. One of the key ways the international community has sought to counteract the political and economic instability inherent in the resource curse is through programs that seek to instill transparency and accountability into the resource payment system.

I am pleased that we have with us today Mr. Simon Taylor, one of the founders of—and now the director of—Global Witness, an organization that has led the charge in not only exposing corruption and kleptocracy, but also finding workable solutions to these problems. Also joining us today is Mr. Roman Kupchinsky, regional analyst for Radio Free Europe/Radio Liberty.

I mentioned in the last hearing that I would like to incorporate some of the expertise and knowledge that is represented in our audience. So today we are offering you the opportunity to ask questions of today's panel. We have forms available for you to write your brief question, which you can then hand to one of our staff. Then as time permits, we will ask our panelists to answer some of those questions. I look forward to your participation.

You should all have copies of the full bios of the witnesses, so before I turn to Mr. Taylor for his testimony, I would like to recognize my Co-Chairman, the distinguished Senator from Maryland, to see if he has any opening remarks. Senator Cardin?

PREPARED STATEMENT OF HON. BENJAMIN L. CARDIN, CO-CHAIRMAN, COMMISSION ON SECURITY AND COOPERATION IN EUROPE

Thank you, Mr. Chairman. I am pleased that the Commission is now turning its focus to the nexus of energy and democracy. As the States of the Organization for Security and Cooperation in Europe (OSCE) pursue energy security, we must address why it is that so many of the resource-rich countries in the world are not democratic and whether development of both democracy and energy resources is an incompatible goal.

In the search for energy security in the OSCE region and beyond, democracy is an important contributing factor. Endemic corruption is an impediment to democracy. Last year the OSCE Parliamentary Assembly adopted a resolution I authored on limiting immunity for parliamentarians in order to strengthen good governance, public integrity and the rule of law in the OSCE region. Just recently Chairman Hastings and I met with the President of Ukraine who told us that this was one of the first things he would like to see accomplished once a new parliament is elected this September. This is an important step forward for Ukraine.

Broad immunity for parliamentarians can serve as a cover for corruption. I believe that good governance is the key to a properly functioning democracy. In many of the oil-exporting states, corruption and kleptocracy have become the norm and prevent democratic ideals from flourishing. The United States must consider the impact of its dependence on these types of states for energy security.

Countries that are mired in corruption are not reliable sources of energy. According to Transparency International, six of the top ten oil-exporting countries to the United States are among the most corrupt countries in the world. A lack of transparency within governments and the energy sector poses both a threat to energy exports and the ability of governments to properly manage revenue for their citizens. These governments are not accountable to their citizens and have taken advantage of the resources of the nation in pursuit of the self-interest of a few corrupt leaders. The result has been increasing political instability, and in some cases violent attacks on pipelines and refineries.

Not only does political instability threaten the physical ability to export oil and gas, but it also has created a poor investment climate. If we are to support development of energy resources, U.S. policy should certainly take into account the investment incentives in these countries. Corruption not only weakens those incentives, but also prevents those investments from producing real results in terms of security of supply. There is clearly a positive link between development of democracy and development of energy resources, which can be seen in some of the recent improvements to both in countries such as Azerbaijan. Additional steps are absolutely necessary to increase transparency in oil-exporting governments, but initiatives such as the "Extractive Industries Transparency Initiative," and "Publish What You Pay," are moves in the right direction and need U.S. support.

In order to achieve energy security, not only must we work towards our own energy independence, for which I have introduced legislation, but we must also ensure that the countries from which

we import oil and gas are reliable sources. Combating corruption and increasing transparency are part of the process of democratic development and must be supported by U.S. policy if we are to attain long term energy security.

**PREPARED STATEMENT OF SIMON TAYLOR, DIRECTOR,
GLOBAL WITNESS**

Thank you, Mr. Chairman and members of this esteemed Commission, for the opportunity to share my views on the critical issue of oil and corruption and how we can put a stop to it. This is not a remote problem, but one that affects us squarely here at home. For when a kleptocrat in a region like Central Asia decides to exact higher bribes, angers the local population, kicks out Western companies, cuts off energy supplies, and provokes local insurgencies, oil prices jump up and U.S. energy security is suddenly threatened.

When I started working on this issue over ten years ago, oil-related corruption seemed like a problem that we would never solve. After all, real thieves will find a way around any system of safeguards—particularly if the payoff is hundreds of millions of dollars in oil revenues. But in those ten years, I have been surprised at how many steps forward we’ve actually taken—from criminal bribery investigations to transparency of payments schemes. But the problem is far from solved, Mr. Chairman, particularly at a time when oil prices are at an all-time high, and political leaders in autocratic and energy-rich nations are using their windfall profits to consolidate power and undermine democracy. We need to inject new lifeblood into solutions now, and the key is transparency.

My testimony will outline the key problems of oil and corruption, how it affects us in the U.S., what solutions have been tried to combat it, and what the U.S. role should be in preventing it.

1. THE FACTS

Mr. Chairman, the reality is that energy-related corruption involves huge sums of money, is bad for the people in oil-rich countries, and is worse for U.S. energy security. Let me present three key facts that illustrate this point.

Fact One: Six of the top ten sources of U.S. crude oil imports rank in the bottom third of the world’s most corrupt countries, according to Transparency International’s latest global survey.

This is a very disturbing development, and three major energy suppliers in Central Asia: Kazakhstan, Turkmenistan, and Uzbekistan rank as three of the most corrupt. All three fall in the bottom third of the ‘most corrupt’ list. Corruption in these nations not only affects the citizens of those countries, but it comes back to us squarely here in the U.S. and Europe in terms of energy security. The linkage works along the following lines: corruption and kleptocracy in resource-rich countries lead to political instability, drive up oil prices, and present significant risks to U.S. investments. As citizens in oil-producing countries become disgruntled with governments and foreign investors whom they believe to be corrupt, such citizens can foster political unrest and threaten oil supplies.

Energy security mainly refers to the security of supply—a stable, reliable energy supply at affordable prices. As such, the insecure political climate described above has led to disruptions of energy supply in several nations. Gas from one of Europe’s main suppliers—Turkmenistan—was shut off twice over the past two years because of non-transparent squabbles and dealings with inter-

mediary companies, including the Russian-Ukrainian RosUkrEnergo. Or to take an example from outside the OSCE, between 500-800,000 barrels of oil a day are lost from Nigeria alone—the U.S.’ fifth largest importer of crude oil—due to attacks by rebel groups angry at the corruption of oil revenues and the secrecy of government budgets, made up mainly of oil revenues.

As President Bush stated in 2006, “Some of the nations we rely on for oil have unstable governments, or agendas that are hostile to the United States. These countries know we need their oil, and that reduces our influence, our ability to keep the peace in some areas. And so energy supply is a matter of national security. It’s also a matter of economic security.” Simply put, non-transparent, unaccountable, autocratic governments are unreliable sources of oil over the long term.

Fact Two: Turkmenistan is Central Asia’s main exporter of gas, which flows through Russia to Ukraine and on to Europe. In Turkmenistan 75% of the gas revenues are kept off-budget, and Deutsche Bank still keeps a \$2 billion Turkmen bank account which ex-Turkmen leader Saparmurat Niyazov maintained personal control over.

Turkmenistan holds the 6th largest natural gas reserves in the world but has a track record of bad governance, poverty, and mismanagement of public assets. These factors make it an unreliable energy supplier. Nearly 60 percent of its population lives below the poverty line despite \$2 billion in annual gas revenues, freedom of the press is ranked as the 3rd lowest in the world, just behind North Korea; and it has been labeled as “one of the worst totalitarian systems in the world”. Under President Saparmurat Niyazov, who passed away last December, schooling was actually cut by a year, while Niyazov ordered a multi-million dollar ice rink to be built in the desert and constructed a number of golden statues of himself across the country, one of which rotates with the direction of the sun.

Between two and three billion US dollars of Turkmenistan’s public funds are currently held by the Turkmen Central Bank at Deutsche Bank in Frankfurt. The existence of these bank accounts was confirmed to Global Witness by Germany’s banking regulator Bafin and later, by Deutsche Bank itself. Further billion-dollar foreign reserve funds of oil, gas, and cotton revenues, which were under the sole control of Niyazov, are also believed to be held at Deutsche Bank. Evidence suggests that many of Niyazov’s bizarre prestige projects, including golden statues and palaces, were paid for out of these funds.

Deutsche Bank claims it is living up to the anti-corruption and pro-human rights principles of the UN Global Compact. But without a proper system for checking what its members like Deutsche Bank are doing in places like Turkmenistan, the Global Compact is little more than a marketing tool. Its members may only be paying lip-service to the principles they claim to support. I call on the Helsinki Commission to write to Deutsche Bank to explain its dealings with the former Turkmen regime and to Germany’s banking regulatory office, the Bafin, to explain how such a situation can happen in the first place.

Fact three: 80–90% of Russian and Central Asian gas transits through Ukraine, but these supplies were cut off in 2006 because of a pricing dispute between Russia and Ukraine. The solution—the involvement of mysterious intermediary company RosUkrEnergo—raises alarming questions of transparency and good governance.

On New Year's Day 2006, Russia cut off gas supplies to Ukraine, demanding an increase in the price Ukraine was paying. The solution involved a new private company, RosUkrEnergo (RUE), who agreed to supply gas to Ukraine at a lower price than what Gazprom was demanding from Ukraine. However, it was unclear why RosUkrEnergo was needed in the first place: Gazprom delivers Turkmenistan's gas to the Ukrainian border. Why did Gazprom not simply hand it over to Ukraine's state oil and gas state Naftohaz Ukrainy? Defenders of the scheme state that RUE was needed because it paid on time, unlike Naftohaz, and could maintain relations between the two sides, while keeping the gas relatively price low for Ukraine. However, for the first two years of existence, the owners of 50% of the company were not disclosed, raising concerns that RUE had ties to the ruling elites of Russia and Ukraine. The then-U.S. Ambassador to Ukraine, Carlos Pascual, highlighted news reports that linked the company to figures in Russian organized crime. Though RUE has denied all such links, the U.S. Department of Justice is now investigating RUE.

Recent revelations show a close personal friendship between Ukraine's current energy minister Yuri Boiko and RUE's 45% private shareholder Dmitri Firtash. Boiko was even for a time on a key RUE committee at the behest of Firtash. Boiko has yet to explain this apparent conflict of interest. I would urge the Commission to pursue this matter further.

Fact four: Kazakhstan is a major energy exporter with over 1.2 million barrels of oil per day, but it ranks in the bottom third of the world's most corrupt countries (111/163) and is implicated in a \$78 million Foreign Corrupt Practices Act legal case in New York.

Lack of energy transparency has led to corruption scandals in a number of oil-producing countries in recent years, both tainting energy companies and seriously retarding economic development. Kazakhstan, which produces over 1.2 million barrels of oil per day, is a case in point. In 2003, the largest-ever foreign corruption investigation in U.S. legal history uncovered a major international corruption scandal that "defrauded the Government of Kazakhstan of funds to which it was entitled from oil transactions and defrauded the people of Kazakhstan of the right to the honest services of their elected and appointed officials". The scheme was based around Kazakh President Nursultan Nazarbayev and Oil Minister Nurlan Balgimbayev demanding that international oil companies such as Chevron (now Chevron-Texaco) and Mobil (now ExxonMobil) pay a series of fees to middleman James Giffen on behalf of the Republic of Kazakhstan. This arrangement, the indictment alleges, helped Giffen to skim money from the deals and send some US\$78 million in kickbacks to President Nazarbayev and others through dozens of overseas bank accounts in Switzerland, Liechtenstein and the British Virgin Islands. The case is currently awaiting trial in New York.

Another \$1 billion of Kazakh oil money has also been uncovered offshore and out-of-sight under Nazarbayev's direct control in a secret fund in Switzerland. Despite the country's vast oil wealth, Kazakhstan's economy grew an average of only 0.3% from 2000-2005. Today, 19% of the population lives below the poverty line and one in three people die before age 60. The corruption scandals have tainted not only the Kazakh government, but also U.S. oil companies trying to foster a better global business reputation.

2. SOLUTIONS

With energy security growing in significance over the coming years, fostering better, more transparent investment climates in oil-producing countries is quickly assuming a new, more prominent role. The foremost step in promoting such an environment and combating corruption is through energy revenue transparency. Energy revenue transparency works through four main measures, but the progress made to date on this issue has in reality only been drops in the bucket rather than a glass that is half full.

A. A Reporting requirement on transparency

The most significant of these measures would be through a reporting requirement for corporations to regularly report payments made to all foreign governments for oil, gas, and mineral extraction on an annual and quarterly basis. Setting up such a requirement is a critical role the U.S. should play, and I will go into this in more detail shortly.

B. The Extractive Industries Transparency Initiative (EITI)

A second transparency policy measure is the Extractive Industries Transparency Initiative (EITI), which serves to improve investment climates through the audited disclosure of revenue payments. In this process, all oil companies operating in an EITI implementing country, including state-owned companies and non-western companies, first disclose all payments to governments, including production sharing agreement payments, taxes, royalties, and signature bonuses. Then governments disclose the revenues they receive, and the two sets of figures are independently audited by an auditing company and publicly examined by civil society.

Launched in September 2002, EITI has produced concrete results in two countries (Azerbaijan and Nigeria), where independently audited and reconciled reports have been published. In Azerbaijan, GDP growth per capita increased from 10.4% in 2000 to 25% in 2005, and following its participation in EITI, Azerbaijan has had the world's 12th most improved business environment score from 2001 to 2006, according to the Economist magazine.

But much remains to be done in the other 51 resource-rich countries. Of the 27 countries that have signed on to EITI, only ten have formulated a work plan, and a further eight have not taken the first step of appointing an official to lead the EITI process. Moreover, 33 resource-rich countries—including all OPEC members excluding Nigeria—have not signed up to EITI.

C. Budget transparency

The next step, once there is transparency about revenues flowing into the public finances, is transparency about how the money is spent. Civil society groups in developing countries are often most concerned about transparency in spending, because they can see the oil money that is meant to go to schools and healthcare being drained away by vested interests. For example, despite progress on the revenue transparency side with EITI, civil society groups in Azerbaijan cite continued corruption despite the EITI process. They have called for budget expenditure transparency as a means to significantly further reduce poverty and eliminate corruption. Oil-producer governments and donors can partner to establish transparency of budgets, either through special aid arrangements or the conditioning of aid on progress in budget transparency.

D. Accountability through civil society

Transparency alone will not solve the oil-corruption problem. Critically, it also requires accountability, which is a longer term process but one which we can influence. In other words, getting the revenue and budget numbers out in the public is a key first step. But if citizens do not understand these numbers, or civil society groups and the media do not have the capacity to analyze the figures and put pressure on the government to come clean on any discrepancies, then the revenue numbers alone will not combat corruption. Likewise, if there are not a key group of reformers in the government—a critical mass who can influence policy—then the voices of civil society groups will go unheard. So we also need to influence these figures, the policy decision makers within the governments of the oil-rich countries.

For example, the Kazakhstan coalition of Publish What You Pay, comprised of many Kazakh civil society groups and led by the Open Society Institute of Kazakhstan, has achieved a number of advocacy successes over the past several years. Most recently, the coalition convinced the government to sign the EITI decree in December 2006, in which the government obligated all extractive companies to endorse EITI and made endorsement of EITI a condition for awarding of any future energy contracts. We need to ramp up support for these type of watchdog civil society groups, to ensure they have the capacity they need to promote accountability.

3. THE U.S. ROLE

Now is the time for the U.S. to make transparency a key element of a reinvigorated energy policy. The U.S. should play a lead role in this policy drive, given the U.S. nationality of many of the largest international oil companies, and join other governments such as Norway and the UK who have taken a number of lead initiatives already. Doing so would save U.S. taxpayer money by making resource-rich countries use their oil, gas, and mining revenues for development, and make them less dependent on foreign aid.

Two targeted policy measures should make up the U.S. energy revenue transparency strategy.

- First and foremost, we call on Congress to pass legislation on the statistical reporting of oil, gas, and mining revenue payments.

And when I say we here, I represent the voice of the entire Publish What You Pay coalition, made up of over 300 nongovernmental organizations worldwide dedicated to energy revenue transparency. The legislation should require extractive industry companies to publicly disclose payments to all governments on a country-by-country basis, as a small additional element to the information that is already routinely disclosed by these companies through SEC filings and their foreign equivalents. The U.S. should take the lead on this issue, but other major securities market regulators should follow suit, including the U.K., Hong Kong, Japan, and India, so as to level the playing field for all companies.

Companies often disclose revenue payments to governments but these payments are not reported by country. This would be a simple addition to existing disclosure, which should not be unduly burdensome since companies need country-by-country financial data for their own internal accounting purposes. Nonetheless, this form of disclosure would be a powerful tool for increasing transparency because even the most opaque of oil-producing countries, which may impose strict confidentiality requirements on U.S. oil companies, typically waive these requirements for disclosures that are required by regulators in a company's home jurisdiction.

More than any other measure, this would introduce transparency as an international standard to be practiced widely. While EITI covers a small handful of oil-producing countries, a legislative statistical reporting requirement and the other relevant regulation bodies would be comprehensive—able to capture all payments made to all governments by every major oil and gas company listed in the U.S. and other global securities exchanges. Full revenue payment disclosure is already normal guideline practice in the Alternative Investment Market in the U.K., as well as among several oil and mining companies, including Talisman Energy and Newmont Mining.

- Second, the U.S. should ramp up with a much more significant diplomatic push for EITI. This should involve three separate components.

First, EITI is coming up to a crucial moment in September. Since the end of last year, there has been a new validation mechanism in place which determines whether or not a country is truly making its revenues more transparent. This system was agreed by governments, civil society and oil companies, so it has consensus support. To qualify as an EITI member, a country has to take four basic steps which show its commitment to the process, including talking to industry and civil society, appointing a government official to steer the process and drawing up a workplan.

This September is the deadline for countries that claim to be in EITI to show that they have completed these four basic steps. A number have not. If EITI does not get rid of the free-riders, those countries who sign up with no real intention of reform, its credibility will collapse. These countries will have to be firmly told that they are not in EITI, and the U.S. should play an especially key role in this. I'm optimistic that together all of us in EITI will make the right decisions.

Second, it is vital that the U.S. more actively support EITI implementation in Kazakhstan. Kazakhstan will soon become a top

ten oil producer with geopolitical importance. Yet a number of companies have not signed up or publishing their payments under EITI, particularly TengizChevroil, a Joint Venture between Chevron, ExxonMobil, Kazakhstan's state oil concern. For EITI to prove itself a truly global initiative that improves transparency and reduces corruption, it has to be shown to be working in Kazakhstan. Kazakhstan's current bid for OSCE chairmanship provides just such an opportunity. The U.S. should require commitments and significant progress on EITI from Kazakhstan in exchange for any consideration to chair the OSCE in 2009.

Third, the U.S. should increase financial support to EITI focused on enabling civil society to interpret revenue data and to be protected in the case of civil harassments. This is the other diplomatic push—to work out a mechanism whereby civil society can participate. Journalists and civil society representatives have been threatened, arrested, and beaten across Central Asia for merely being interested in oil revenue issues. But this cannot go on. There is no point in delivering revenue transparency in order to create accountability of governance if civil society doesn't have the space or protection to monitor accountability. The EITI is a key mechanism for getting this civil society protection right, and the U.S. has to be more fully behind it.

Overall, Mr. Chairman, we ignore the close link between oil and corruption at our own peril. Gone is the day when we could simply look the other way when foreign leaders ask for bribes, and it would not come back around to us. Global oil is in shorter supply by the day, Mr. Chairman, so we cannot afford to play games with our energy security. While alternative energy may be the future, transparency is the key to both helping secure our energy for the present and ensure that oil actually benefits the people of energy-rich countries. Thank you.

**PREPARED STATEMENT OF ROMAN KUPCHINSKY, REGIONAL
ANALYST, RADIO FREE EUROPE/RADIO LIBERTY**

Mr. Chairman,

The member states of the OSCE are not only the largest consumers of energy in the world—but some of its members, almost exclusively former republics of the Soviet Union, are among the world's largest producers of oil and natural gas, as well as having the world's largest proven reserves of natural gas. These member states also own and control unique pipeline systems which transport these essential fuels throughout the world.

However, in the chain between producer-transporter-consumer there exists another link, one which has shrouded the energy sector in murkiness and threatened the energy security of consuming states—it is the lack of transparency.

Barely a day goes by without the media reporting on some suspicious and opaque deal concerning energy in an OSCE member state—be it Russia, Turkmenistan, Kazakhstan or in such a vital transit country like Ukraine.

Let me list just a few recent examples:

- Russia's state-owned Rosneft oil company announced on July 2 that it bought the remaining assets of Yukos oil company from a murky Russian company called Prana which purchased these assets in May for nearly \$4 billion, five times the starting price. The owners of Prana are unknown and the price which Rosneft paid for the Yukos assets were not reported. The chairman of Rosneft is Igor Sechin, one of Russian President Vladimir Putin's closest advisors.

- Austrian police are investigating a huge money laundering scandal involving Russian banks which worked with Austria's Raiffeisen Zentral Bank in laundering hundreds of millions of dollars. The Austrian police suspect that high level Russian officials, connected to state-owned oil companies, are involved in this scam and are laundering funds for themselves into off-shore bank accounts. And while the Russian police have stated that no officials are involved, many Russian experts believe that the police and prosecutor's office are under orders from the Kremlin to avoid investigating these officials.

- Ukrainian President Viktor Yushchenko recently asked Prime Minister Viktor Yanukovich to investigate the activities of UkrHazEnergo, a joint venture between Ukraine's state-owned oil and gas monopoly, Naftohaz Ukraine and RosUkrEnergo, the controversial middleman company registered in Zug, Switzerland, which has the monopoly of overseeing Central Asian gas deliveries to Ukraine. RosUkrEnergo (RUE) is half owned by Russia's Gazprom and half by a Ukrainian citizen Dmytro Firtash. According to press reports and RUE officials, Firtash was paid \$364 million dollars in 2006 as his share of RUE's profits for 2005. The company, RUE, owns no assets—no gas fields, pipelines or compressor stations.

- Turkmenistan's new president, Gurbanguly Berdimukhammedov, ordered an investigation into a bank account set up by his predecessor, Saparmurat Niazov, in a German Bank. According to published reports, Niazov placed over \$1 billion in

revenue from the country's gas industry into this account over which he had sole signing rights.

Reports similar to these have inundated the Internet and the press for the past 15 years—yet little has changed. If anything, the scams and opaque schemes have gotten bolder and nobody has been charged or prosecuted.

As a matter of fact, the only ones to suffer are those who have attempted to draw attention to these schemes such as U.S. citizen, William Browder, the CEO of Hermitage Capital Management, the largest private investment fund in Russia.

In November 2006 Browder was banned from entering Russia because the government claimed that he was a “threat to Russian national security.” Browder had been a vocal critic of Russian's Gazprom for many years, charging that the state-owned gas monopoly was using opaque schemes to transport gas from Central Asia to Ukraine.

Efforts to encourage OSCE members into voluntarily forcing their national energy companies to adhere to international norms of transparency have met with only limited success in the states of the former Soviet Union.

For example, The Extractive Industries Transparency Initiative has been adopted by only three states in the region: Azerbaijan, Kazakhstan and Kyrgyzstan.

However, it is questionable if even this has made a difference in Kazakhstan, the largest oil producing country in the region. Persistent reports indicate that President Nursultan Nazarbaev and his family continue to receive kickbacks from Russian and other oil companies.

In Azerbaijan the Initiative seems to have been more effective, but evidence of this is hard to come by and Western monitors rely more on hearsay than on hard facts.

Russia, the largest extracting country in the OSCE is, in my opinion, by far the most opaque. Not only does opaqueness surround private deals, but the government itself engages in shady practices when it suits its purpose—the Yukos prosecution being one such example.

The current goings-on at Rosneft, the state-owned oil company, and the gas transportation schemes from Central Asia to Ukraine by Gazprom and RosUkrEnergo are classic examples of the nexus which exists between the Russian government and its energy companies when it comes to hiding important dealings from the public eye.

What impact do Russian oil and gas opaque schemes have on the energy security of the United States?

Some Americans might be led to believe that it is not the business of the U.S. Government to police Russian corruption—as long as the pipelines are filled and vital fuels are making their way into the hands of consumers.

I believe this approach does not help either Russian business or U.S. consumers given the importance of energy in the world today. If U.S. oil and gas companies believe that their Russian partners are not playing by the rules of the game, and use non-transparent schemes to gain an advantage—then the U.S. consumer is the loser and U.S. energy security is threatened.

U.S. energy security today is threatened by a number of factors:

1. Over-consumption of energy and rapidly dwindling national resources in the U.S.
2. Inefficient use of available hydrocarbons and insufficient use of alternative energy sources.
3. Reliance on extracting nations which use their energy resources as weapons to further foreign policy or ideological agendas.
4. Opaqueness in the extraction industry which often serves as a smoke screen for government officials and clans in various self-enrichment schemes and as a means of subverting their competition.

As long as oil and gas companies in OSCE extracting countries continue to use murky pricing and barter schemes and rely on non-transparent middlemen who serve no visible function in the production-transit-consumer chain - then the energy security of the United States and all OSCE countries will be threatened.

A possible solution might be for the OSCE to adopt a set of rules governing transparency in the extraction sector. These rules would be mandatory for all members and govern the activities of oil and gas companies, coal mining concerns and uranium mining.

The energy sector in the OSCE is too vital today to permit shadowy players to dictate terms of delivery and prices for fuels and, in certain cases, be given a monopoly for supplying entire countries with vital energy resources.

**MATERIAL SUBMITTED FOR THE RECORD BY ROBERT
AMSTERDAM, PARTNER, AMSTERDAM & PEROFF LLP**

Esteemed Commissioners and Colleagues,

It is a great privilege to have the opportunity to submit for the record the following testimony on such an important issue, and I sincerely regret not having been able to attend the hearing in person.

My biographical details will be available to all of you in separate documentation, but to just briefly establish my background and provide necessary disclosure, here are some basic facts: I am a U.S. citizen, and a Canadian citizen as well. I have practiced international law for the past 27 years in a number of emerging economies in Latin America, Africa, and Eastern Europe. In 2003, I was retained by Mikhail Khodorkovsky, the former CEO of the Yukos Oil Company. I have represented Mr. Khodorkovsky in a series of politically motivated trials that brought significant international attention to the relationship between energy and politics in Russia and beyond.

Prior to its expropriation by the Russian government, Yukos was widely recognized as the most successful and transparent private company in post-Soviet Russia. Mr. Khodorkovsky had opened the company's books, adopting modern scientific, technical and corporate governance standards at the level of the most sophisticated U.S. and Western European energy companies, and thus achieving record levels of efficiency, production and public accountability. As a result, Yukos was perceived by some to be an economic competitor of the Russian state. Moreover, Mr. Khodorkovsky himself became a prominent advocate of democratization, rule of law, and economic transparency in Russia.

Following a show trial that violated fundamental rights guaranteed under the Russian Constitution¹ and basic principles of due process under law, Mr. Khodorkovsky was sentenced to an (eight) year prison term in Siberia. He has been serving this term, under appalling conditions, thousands of miles from his family in Moscow. According to a 2005 Resolution of the Parliamentary Assembly of the Council of Europe (PACE),

(t)he circumstances of the arrest and prosecution of leading Yukos executives suggest that the interest of the State's action in these cases goes beyond the mere pursuit of criminal justice, to include such elements as to weaken an outspoken political opponent, to intimidate other wealthy individuals and to regain control of strategic economic assets.²

Mr. Khodorkovsky had been eligible for parole in October 2007. However, in February 2007, the Russian Procuracy brought an entirely new series of charges against him. Last week, referring to Mr. Khodorkovsky as "one of Russia's best-known political prisoners", a July 20, 2007 Washington Post editorial described the

¹These violations are documented independently by the Council of Europe Rapporteur Sabine Leutheusser-Schnarrenberger.

²Resolution 1418 of the Parliamentary Assembly of the Council of Europe, adopted on 25 January 2005, para 1-14.

Kremlin's new charges against him as "magnificently implausible."³

I have briefly outlined the situation of my client not to focus on one man's unjust persecution but to highlight a prominent example of a much larger problem that continues to have disturbing implications for Western governments and companies, and that impacts directly upon the purposes and obligations of the U.S. Helsinki Commission as they pertain to the question at issue at this hearing: the relationship between energy, natural resources and democracy.

The larger meaning of the Khodorkovsky case was powerfully recognized by Anna Politkovskaya, the exceptionally courageous and important Russian investigative journalist who was assassinated in the elevator of her Moscow apartment complex on October 7, 2006. An English language translation of her last work has just been published in the United States as *A Russian Diary: A Journalist's Final Account of Life, Corruption, and Death in Putin's Russia*, and I urge the distinguished commissioners to read it for further information.

Reflecting on the appointment by Russian President Vladimir Putin of his deputy Igor Sechin as chairman of the board of directors of the state oil company Rosneft, Politkovskaya writes:

Sechin personally oversaw the dismemberment and destruction of Yukos and the arrest of Khodorkovsky. His appointment to head Rosneft, which claims the choicest parts of Yukos, proves the Kremlin destroyed Yukos for its own benefit. Its ideology requires the formation of a "state economy," supposedly run of behalf of the people. In reality, it is bureaucratic economy whose principle oligarch is the government official. The higher the official, the bigger the oligarch.⁴

This Commission has been assigned an immensely important responsibility: to monitor and encourage compliance with the Helsinki Final Act and other OSCE commitments assumed by participating states. Specifically, the U.S. Helsinki Commission has been directed by Congress "to monitor the acts of the signatories which reflect compliance with or violation of the articles of the Final Act . . ." Congress asked the Commissioners to pay particular attention to the human rights provisions of the Final Act. These include requirements that signatory states "promote and encourage the effective exercise of civil, political, economic, social, cultural and other rights and freedoms all of which derive from the inherent dignity of the human person and are essential for his free and full development."

As a signatory to the Helsinki Final Act and an OSCE member state, the Russian Federation has assumed obligations to adhere to these provisions. In the context of today's hearing on energy and democracy, I wish to suggest two ideas that might usefully guide the Commissions' assessment of Russia's (or indeed any member state's) compliance with or violations of the Act's provisions.

³ Editorial "Throwing the Books at Them," Washington Post, (July 20, 2007, pp. A18) <http://www.washingtonpost.com/wp-dyn/content/article/2007/07/19/AR2007071902310.html>

⁴ Anna Politkovskaya, *A Russian Diary: A Journalist's Final Account of Life, Corruption, and Death in Putin's Russia* (New York: Random House, 2007), p. 153 (from diary entry dated July 27, 2004).

The first idea is that resource nationalism, combined with the corruption of democratic process and rule of law, results in violations of human rights guaranteed under the Final Act.

In this regard I want to highlight the OSCE's monitoring in each participating state of the freedom of the media, the freedom of assembly and association, and the right to liberty and a fair trial. In this regard, I am very pleased to praise this Commission for its May 24, 2007 hearing on "Russia: In Transition or Intransigent?" Chairman Hastings introduced that hearing with the recognition that

"particularly over the last seven years, the Kremlin has moved to recentralize authority and power that it had seen slip away in the wake of glasnost and perestroika. The result has been a significant limitation on the civil liberties that many of us associate with a legitimately open society. Despite President Putin's lip service in support of democratic institutions and civil society, we now see a political agenda centrally planned in Moscow."⁵

In this context, I also recognize Senator Smith's authorship of H.Con.Res. 151, calling upon President Putin to seek competent outside law enforcement assistance in the investigation of the unresolved murders of dozens of independent Russian journalists over the past decade, including the murder of Anna Politkovskaya.

The second idea, on which I will focus attention on in the remainder of my submission, is that resource nationalism, and the corruption of democracy and rule of law at home, results in violations of the rights of other sovereign states guaranteed by the Final Act.

Most significantly for purposes of this hearing today, the Final Act requires participating States "[t]o refrain from any act of economic coercion designed to subordinate to their own interest the exercise by another participating State of the rights inherent in its sovereignty and thus to secure advantages of any kind." Unfortunately, having achieved a near monopolistic control of oil, gas and other core natural resources, by methods including illegal expropriation of assets owned by private shareholders, the Russian Federation has effectively utilized its control of these resources to initiate acts of economic coercion prohibited by the Final Act.

As this Commission is well aware, the Kremlin temporarily cut off the supply of Russian natural gas to the Ukraine (and subsequently to Europe) in an effort to coerce the government to accept an increased price—but with the ultimate goal of gaining control over transit states. Russia used its control over energy supplies in similar ways in effort to intimidate Belarus and Georgia. The OSCE membership of Ukraine, Belarus and Georgia was of no consequence to Russia in carrying out these acts of economic coercion.

The intended recipients of this coercive economic diplomacy extended far beyond the boundaries of states that formerly belonged to the Soviet Union. Western European governmental and business leaders have come to understand very well that their economies have become largely dependent on Russian state-controlled oil and gas, and therefore increasingly vulnerable to direct and indirect co-

⁵ The unofficial transcript of the May 24 hearing can be read here: <http://www.csce.gov>

ercion by Gazprom and the Kremlin itself. Unfortunately, some European governments have acted to facilitate and legitimize Russian energy coercion in an effort to minimize political risk in maintaining their dependence on Russian energy sources.

The mandate of this Commission is to monitor the actions of government signatories to the Final Act. However, in analyzing the operation of economic coercion in violation of the Act, it is also necessary to shine a light on the role of multinational corporations with investments, ventures and interests in Russia today.

In addition, a number of Western bank and international oil companies have carried out a “foreign policy” of their own, seeking to ingratiate themselves to the Kremlin in an effort to secure transactions that could potentially enable them to reap significant profits from Russia’s enormous oil and gas wealth. Egregious cases include actions by BP, the German bank Dresdner Kleinwort, the Italian energy company ENI, and the Italian government itself, to help the Kremlin facilitate illegal sham auctions of assets belonging to Yukos shareholders. In another recent case, aggressive harassment by the Russian government of the accounting firm PricewaterhouseCoopers, including the initiation of criminal tax prosecutions and illegal police raids, ceased promptly after the firm agreed to the Kremlin’s demand that it withdraw years of audits it had prepared documenting the clean financial due diligence review of Yukos Company.

The bitter irony is that such efforts by multinational firms to carry out “corporate foreign policy” to appease the Kremlin, and thus protect their company’s economic interests in Russia, have failed—over and over again.

Following the consolidation of state power over the energy sector in Russia which included the Yukos Affair and the monopolization of pipeline infrastructure, the Kremlin embarked on an multinational “energy diplomacy” strategy to build close relations with other exporters and coordinate the markets they sell to. One of the most notable developments of the coordination strategy was Gazprom’s landmark swap agreement last year with the Algerian state gas supplier (the deal included debt forgiveness and a major arms purchase), which overnight put 69% of Italy’s natural gas supply under Russian control.⁶ Following this decision, Italian energy firm ENI found itself coerced into signing Russia’s largest gas supply agreement in all of Europe, and then later became the first foreign firm to purchase controversial assets in liquidation auctions, only to later hand them over to Gazprom.⁷

In sum, we are faced with an activist Russian government with an established pattern of using energy supply to achieve economic coercion, and political objectives in violation of Russia’s obligations under the Helsinki Final Act. As Mr. Roman Kupchinsky describes in his testimony to this record, “Russia is a country which is able and is willing to project its hydrocarbon power around the world.”

⁶Italian Industry Minister Pierluigi Bersani diplomatically pointed out that this agreement could eventually lead to economic pressures on European gas prices;” which was another way of warning that Italy is about to submit itself to the whims of a foreign oligopoly. (http://www.jamestown.org/publications_details.php?volume_id=414&issue_id=3832)

⁷See Times of London article, “Eni wins auction for Yukos, then hands it to Gazprom,” (April 5, 2007), http://business.timesonline.co.uk/tol/business/industry_sectors/natural_resources/article1615107.ece

The tactics through which this is accomplished can be viewed in three categories: cooperation, cooptation and disaggregation, all of which carry serious ramifications for other energy exporters in areas such as Central Asia, and it will especially affect importers in Europe and North America.

Cooperation. Following the formalized market coordination with Algeria, Russia also extended its increasingly close contacts with Iran, Turkmenistan, and Qatar—shortly thereafter the Financial Times published news of a report circulated around NATO warning that the alliance “needs to guard against any attempt by Russia to set up an ‘OPEC for gas’ that would strengthen Moscow’s leverage over Europe.”⁸ By the time the gas exporters group decided to form an official committee to study coordination, it was clear that the “Gas OPEC” represented the greatest threat posed by Russia coordination efforts. At the time, Representative Ileana Ros-Lehtinen said that “[t]he creation of this cartel would pose a major and long-term threat to the world’s energy supply. We must vigorously oppose the establishment of this global extortion racket.”⁹

Dr. Ariel Cohen of the Heritage Foundation has further argued that Russia’s efforts to coordinate a gas cartel represent three central characteristics of their maneuvering: it will be a gradualist process, it will be stealthy, and they will make great efforts to appear reasonable at all times.¹⁰

Cooptation. Here I refer to Russia’s impressive ability to consistently outflank the West in reaching alternative supply sources in a concerted effort to diminish competition and increase dependence. One need look no further than the recent signing of a memorandum of understanding between ENI and Gazprom to build the South Stream pipeline under the Black Sea—an initiative that many argue is nothing more than a political gesture to scare investors away from a non-Russian owned alternatives, such as the Nabucco and Baku-Tsibils extensions. Observer Vladimir Socor of the Eurasia Daily Monitor of the Jamestown Foundation said the following of the deal: “By putting a multiplicity of options on the table, Russia can pressure countries it regards as ‘recalcitrant’ into transportation deals favorable to Moscow.”¹¹ All of this is in addition to Russia’s state-ordained monopoly over transport routes from Central Asian countries such as Turkmenistan, Kazakstan, and Uzbekistan.

Perhaps the most flagrant example of the Kremlin’s cooptation strategy is its success in recruiting former German Chancellor Gerhard Schroder as an ally in government—and an employee after stepping down from his post. Shortly before his term ended, Schroder signed a German-Russian agreement to build the Nord Stream pipeline under the Baltic Sea to supply Russian gas directly to Germany, bypassing Poland, Ukraine and the Baltic countries. Promptly upon leaving office, Schroder accepted a post as the head of the Gazprom-affiliated shareholders’ committee of the Rus-

⁸Financial Times, “Nato fears Russian plans for ‘gas OPEC’”, (Nov. 13, 2006), <http://www.ft.com/cms/s/af125540-7358-11db-9bac-0000779e2340.html>

⁹UPI, “Ros-Lehtinen blasts proposed gas cartel,” (April 2, 2007), <http://www.carthtimes.org/articles/show/46891.html>

¹⁰Ariel Cohen, “Gas OPEC: A Stealthy Cartel Emerges,” Heritage Foundation, Web Memo #1423, <http://www.heritage.org/Research/EnergyandEnvironment/wm1423.cfm>

¹¹http://jamestown.org/edm/article.php?article_id=2372249

sian-led consortium building that very pipeline. Before leaving office, Schroder had also worked to ensure preferential financing for the project.

The third element of the Russian energy methodology is disaggregation—the process by which bilateral deals are sought and promoted in order to disaggregate, or cause divisions, among importers—a trend that is discussed earlier in the record by Mr. Kupchinsky. Not to belabor the point with a laundry list of examples, here I share a comment from Dr. Janusz Bugajski of the Center for Strategic and International Studies: “The Kremlin not only manipulates divisions between older and newer members. It also aims to forestall any common policy among EU newcomers. Hungary and Bulgaria have become the primary targets among former Soviet satellites. The Kremlin is capitalizing on long-standing personal connections with Socialist officials in these countries to construct pipelines and distribution points that will pre-empt Europe’s energy diversification.”¹²

All of this is worrying. Worrying for anyone who cares about democracy and freedom in states like Russia. Worrying both for consumers of energy and for anyone who cares about the future of the producing countries themselves or our relations with them. For one thing, resource nationalism continues to put upwards pressure on the price of oil. That has long-term implications for the world’s biggest energy consumers and, by extension, the world’s economy. But resource nationalism is also sowing problem seeds in the countries that practice it. Rising energy demand is not being met by equivalent growth in production and supply of energy. In that scenario, higher prices should mean increased investment in the upstream. Yet the resource nationalists are working to prevent the kind of companies that have capital and know-how to invest from doing so. In the short and medium term, that will hurt those companies and the consumers that rely on them. In the long-term, it will also undermine the demand for the product (oil and gas) that the resource-rich countries can offer. Their economies increasingly reliant on the resources they produce, will suffer.

In conclusion, how should governments and companies in OECD countries respond to the abuses of resource nationalism in countries such as Russia? We have identified the harm these abuses generate domestically in the deterioration of human rights necessary for a democratic society, and we have identified as well the harm these abuses generate internationally in the form of economic coercion in violation of the Helsinki Final Act. We need to dedicate ourselves to monitoring, identifying and redressing these abuses. Our objective should be to de-politicize the energy trade and promote competitive, market-based relationships with exporters which respect international rules, norms, and treaties.

Certainly I believe there is wide agreement that policy efforts must focus on transparency and accountability among Western businesses in the effort to improve energy security and democracy. But we must also recognize the new reality that powerful state corporatism in Russia, and in other states with a government-con-

¹²Janusz Bugajski, “Influence Far Abroad,” *Moscow Times*, (March 23 2007), <http://www.moscowtimes.ru/stories/2007/03/23/006.html>

trolled energy resource based economy, has weakened our ability to exert influence.

Moreover, there exist today unprecedented diplomatic relationships among these resource autocracies.¹³ Within recent months we have seen Ayatollah Khamenei pledge energy cooperation with Moscow, and then Hugo Chavez making yet another state visit to Russia to sign a major arms deal—just days before the Kennebunkport Summit between George W. Bush and Vladimir Putin. Various regional instabilities are being provoked and exploited by these activist and cooperative policies among pariah states.

The engagement of United States and European states with these authoritarian and quasi-authoritarian governments must be predicated upon an adherence to strictly defined rules and norms. The EITI is an excellent mechanism that we must continue to pursue, as well as the promotion of various corollaries of the Foreign Corrupt Practices Act, but these efforts should be made part and parcel of a broader effort to deal with resource nationalism.

A newly strong Russia can and should have a major role in global stability and prosperity but to engage with them on an equitable basis, we need to see reciprocity, coherence, and consistency in our responses. For example it is clear that Russian companies have been very successful raising money among investors in the West. However, such privileged economic relations should be conditioned upon a constructive attempt by authorities to cooperate, and, above all, to adhere to the rule of law.

Resource nationalist states such as today's Russia have been extended undeserved privileges by foreign governments fearful of coercive reprisals—and multinational corporations eager to profit from perceived opportunities to trade their technical expertise and managerial capacity for access to tremendous oil and gas wealth. But we should remind these governments and firms that such a strategy exposes citizens and shareholders to extraordinarily high and potentially punishing risks. The presumption of regularity is a dangerous foreign policy for states and corporations alike. In the face of economic coercion, and with the prospect of profitable opportunities business as usual¹⁴ can be a seductive but potentially catastrophic approach.

And there are other steps we can take. Russia's successful manipulation of Europe's energy security dilemma has put it and its company Gazprom in the ascendancy. In part, this has been the result of brilliant strategic thinking by the Russian government and Gazprom. But it has also been caused by the deficiencies of the EU's policy with Russia. While Gazprom presents a monolithic position vis-à-vis the EU, Europe's member states present a fractious, disunited assembly, each eager to deal with Gazprom even at the

¹³For further information, please consult Joshua Kurlantzie's, "Crude Awakening," *The New Republic*, (October 2 2006). <https://ssl.tnr.com/p/docsub.mhtml?i=20061002&s=kurlantzick100206>

¹⁴Right in the midst of an aggressive and bitter dispute between the United States and Russia on the missile defense shield, and while the United Kingdom continued to receive no cooperation from Moscow in its investigation of the murder of Alexander Litvinenko, several leaders of energy companies made a public call to continue "business as usual" with Russia. See the May 23, 2007 article in the *International Herald Tribune* (<http://www.ihf.com/articles/2007/05/23/business/rusoil.php>).

expense of other European neighbours or the EU's wider strategic goals.

Symbolic of this have been the energy embargoes Russia has perpetuated against the Baltic States. As members of the EU, these countries deserve—morally and legally the assistance of other member states. Yet such crises in those countries was scarcely acknowledged by governments of the larger European states. Brussels must realize—or be made to realize—that such disunity undermines its very *raison d'être* and serves only to encourage more aggressive treatment from Gazprom.

Another example of the EU's failure in this regard has been the Nabucco project. As a pipeline that could help to loosen Russia's increasingly strong grip over gas imports into Europe, that project ought to be given strategic priority by Brussels—in the same way that Moscow gives priority to projects it considers strategic. Instead, it has been left directionless and at the mercy of Gazprom, which has been able to pick off members of the Nabucco consortium in an effort to render the project defunct. Future projects must not repeat these mistakes.

What else can be done? More broadly, there is a crisis of confidence among consumers of energy vis-à-vis producers, who are considered to be in the ascendancy. Yet consumers have the one commodity that producers need: demand. If consumer governments wish to regain momentum in securing energy supplies, they need to look at solutions to this on the demand side of the equation. This includes pursuing alternative energies, diversifying sources and fuels, building spare infrastructure capacity (pipelines storage, LNG terminals, refineries) and working to reduce wastage.

Such proposals are broad. But the crisis in energy we face is serious and demands serious answers. Aggressive resource nationalism threatens to damage the world's economy in a profound way. But the success of resource nationalism relies fundamentally on demand patterns. Managing demand effectively could, therefore, be crucial to ending this damaging period of resource nationalism which has brought so many human rights abuses in its wake; to restoring balance to energy markets; and to ensuring the security of energy supplies to consumers.

This year, at the thirtieth anniversary of the founding of the Charter 77 movement we remember the courage of so many Russian and Eastern European dissidents, like Vaclav Havel, who suffered imprisonment rather than give up their vision of freedom and human rights. Those of us who are now citizens of the fifty-six participating OECD states are fortunate to enjoy the protections of the Helsinki Final Act. We are grateful to this Commission for your monitoring of states' adherence to their obligations under this immensely important treaty. I am also fully available to the Commission to answer any questions on the record.

**MATERIAL SUBMITTED FOR THE RECORD BY HOUSTON
AZERBAIJANIS, HOUSTON, TX**

Chairman Hastings, Chairman Cardin, Distinguished Members of the Commission,

Thank you very much for this opportunity to raise our voice and inform the Commission members on how the development of the Republic of Azerbaijan's vast energy resources has worked to improve the development of democracy in the nation and the region.

Houston Azerbaijanis is a non-profit organization dedicated to the promotion of friendship between the United States and Azerbaijan through cultural, educational, social and charitable activities in the Houston metropolitan area. Preservation of cultural heritage and work with young generation are primary goals of our organization. Being a part of Houston community, energy is a very important topic for us. It builds a significant link between Azerbaijan and the largest energy-rich region of the United States, the state of Texas.

As you know, the Republic of Azerbaijan is a pro-western, secular Muslim State located at the crossroads of Eastern Europe and Southwest Asia. Bordering the Caspian Sea in the East, Russia to the north, Georgia to the northwest, Armenia to the west, and Iran to the south, it is the largest country in the South Caucasus with a population of over 8 million.

The Republic of Azerbaijan has aimed to meet all criteria for transparency and accountability, fulfill its social obligations, and safeguard its resources for future generations.

Soon after the development of its energy resources, Azerbaijan was resolute not to repeat the mistakes of other energy-rich nations and squander the revenues from these resources.

In order to avoid what is known as the "Dutch Disease," Azerbaijan established the State Oil Fund (SOFAZ) in 1999 to ensure macroeconomic stability, manage oil revenue in a transparent fashion, fund social and infrastructure projects, and manage resources for future generations. As of June 2005, the State Oil Fund's assets were AZM 5,098 billion. Domestic investment and outlays are strictly regulated to guarantee a steady growth of the Fund's assets.

The State Oil Fund supports the diversification of the economy, investments in education, poverty reduction, and other social projects such as housing for Azerbaijani refugees and internally displaced persons from Nagorno-Karabakh and seven surrounding regions currently occupied by Armenia.

The State Oil Fund is internationally recognized for its excellence in public service. The United Nations granted the Fund its 2007 Public Service Award for Improving Transparency, Accountability and Responsiveness in the Public Service. The State Oil Fund is the first government agency ever to be awarded the UN Public Service Award among those of Eastern Europe and the Commonwealth of Independent States. Azerbaijan has reached out to international organizations to achieve its goals. In 2003, Azerbaijan announced its decision to pilot the Extractive Industries Transparency Initiative (EITI) by the United Kingdom. The EITI "supports improved governance in resource-rich countries through the verification and full publication of company payments and govern-

ment revenues from oil, gas, and mining.” Azerbaijan’s agreement with the EITI is recognition of the importance of good governance and recognition of the need to convert petrodollars into “economic growth and poverty reduction.”

The State Oil Fund is responsible for the implementation of the EITI Initiative through the National Committee on the EITI which was also established in 2003. More recently Azerbaijan was selected to the Management Board of the EITI.

Formal steps were taken through the EITI to bring in local and foreign companies into the transparency and accountability process. In November 2004, the government of Azerbaijan, local and foreign companies, and a coalition of non-governmental organizations signed a MOU defining the rules for the EITI process and disclosure of payments by oil and gas companies, and receipt of allocations from extractive industries to the Government of Azerbaijan. The MOU also set up an annual audit by an internationally recognized company.

Azerbaijani non-governmental organizations (NGO) are also a part of the EITI Initiative in Azerbaijan. The NGOs organized as the Council of Coalition of the NGOs of Azerbaijan with the express purpose of “Improving Transparency in Extractive Industries.” As many as 32 NGO leaders and organizations signed onto the Coalitions memorandum announcing its establishment. In a true expression of the freedom of speech and organization these NGOs provided a critique of the fifth annual EITI report in Azerbaijan which offered that there had been improvements since the report from the year before.

In conclusion, our organization strongly believes that Azerbaijan has put into place necessary mechanisms to ensure that all of its citizens benefit from its natural resources, and to secure the sustainability of its economy, and has done so in a transparent manner. Azerbaijan continues to emerge within the region and the world as a unique actor—a democratic, secular, state with a predominantly Shiite population. The Azerbaijani Diaspora in the United States supports US-Azerbaijan relations and Azerbaijan’s contributions to the energy security of not only the United States, but also the western countries. We believe that if Azerbaijan continues on the current path, it will steer clear of the minefields of the “Dutch disease.”

Thank you very much for your time.

Sincerely,

NATALIE M. KASSENIEVA,
President.

**MATERIAL SUBMITTED FOR THE RECORD BY CHRISTOPHER
WALKER, DIRECTOR OF STUDIES, FREEDOM HOUSE**

Chairman Hastings, Senator Cardin, members of the Commission and staff, thank you for calling this important hearing today and for inviting Freedom House to comment. This hearing could not be timelier. With oil prices reaching \$80 per barrel—and the possibility that they will climb still higher—there is an urgent need for attention to the implications of this profound price shift on the democratic trajectory of key states in whose fate US interests are intertwined.

Today, given the strong global demand for energy, the likelihood that this demand will keep prices at high levels for the foreseeable future and the troubling governance profile of the states on which we must rely for supply, there is in essence a “perfect storm” of factors that should raise bright flags for the international policy and business communities.

Indeed, one of the major byproducts of the skyrocketing price of energy is the emergence of a group of energy-rich, but democracy-poor countries in the former Soviet Union that are wielding newfound clout in ways that are posing difficult challenges for the United States, as well as the European Union and wider community of democratic states. Drawing on significant energy windfalls, these post-Soviet petrostates—among them Azerbaijan, Kazakhstan and Russia—are becoming increasingly repressive at home. In the case of Russia, petrofinanced democratic pushback is not confined to domestic affairs. The Kremlin is applying the tactics that have come to define domestic politics under the leadership of President Vladimir Putin to challenge democratic institutions beyond Russia’s borders, including the OSCE.

With oil prices spiking in recent years, the petrostates’ windfall is staggering. This sort of wealth should be a godsend for impoverished, post-Soviet countries. However, such positive impact is by no means certain in unaccountable governing systems where a small group of elites tend to control a large part of the resources. Other than Norway, which enjoyed the advantage of having accountable institutions in place when it came into its energy wealth, the track record of countries rich in energy resources is quite poor.

PETROSTATES’ POOR TRACK RECORD ON DEMOCRACY

Much of the study concerning energy rich states and democratic accountability has historically focused on the Middle East and resource rich lands in other regions. However, the recent spike in the price of oil has brought into sharper relief a number of issues relevant to countries of the former Soviet Union that enjoy an abundance of energy resources. The earlier research conducted on this issue may help in providing a window of sorts into the governance performance to be expected in newly emerging energy rich countries.

Among the key features often identified with states falling prey to the resource curse—that is to say the negative development and growth outcomes associated with hydrocarbon-led development—include:

- The growth of state bureaucracy and transformation of state institutions toward greater seeking of rents;
- A crackdown on the news media in an effort to limit access to independent information;
- Poor and opaque mechanisms for policy development—and policy failure; and
- “Fiscal pacification” enabled by energy wealth, used among other things to mask underlying societal problems and to co-opt would-be political opposition or movements not acting in conformance with the regime.

Whether the post-Soviet petrostates can escape the poor development outcomes of the earlier generation of countries that relied on oil and gas as their principal economic engine remains a significant question. No less important, and indeed directly linked to domestic development issues, is how these countries choose to exert growing influence internationally.

While there is no iron-clad definition of a resource-based economy, a frame of reference is those in which natural resources account for more than 10 percent of GDP and 40 percent of exports (OECD). This threshold is easily met in the cases of Azerbaijan, Kazakhstan and Russia. More than half of Azerbaijan’s current GDP and 90 percent of exports come from oil and gas. In the Kazakh case, GDP is 30 percent and nearly 60 percent of exports come from oil. Oil and gas exports account for about 60 percent of Russia’s federal budget revenues and two-thirds of its exports.

THE “RESOURCE CURSE”: ALREADY REARING ITS HEAD

The “resource curse”—along with associated pathologies of energy-led development—may in fact already be rearing its head. In each of these post-Soviet countries, there is an increasing dependence on energy as the chief economic driver, as well as growth of state bureaucracy and the corruption that accompanies it.

I would prefer that my assessment were not so gloomy. But the fact is that in many respects institutional reform has actually regressed in recent years in Azerbaijan, Kazakhstan and Russia, suggesting that the resource curse may already be growing roots. In all three of these cases the countries have been stuck or are moving in the wrong direction on the fundamental indicators that Freedom House evaluates that represent the brick and mortar of sound and accountable systems. Whether we speak of political parties, the media, non-governmental organizations and even the independent business community, all have come under growing pressure by the authorities over the past several years.

All three of these countries are categorized as “Not Free” in Freedom House’s annual survey of political rights and civil liberties, *Freedom in the World*, and in the annual survey of media independence, *Freedom of the Press*, indicating that basic safeguards and guarantees are absent in these systems.

In the Russian case, for example, today there are no domestic challenges to President Putin. This means no real public discussion, or serious debate that should serve as a catalyst for policy innovation or economic diversification. In Russia, as in Azerbaijan and Kazakhstan, corruption remains a festering sore that creates severe obstacles to further political and economic development.

With so much money flowing into these countries the stakes are raised for powerful elites who dominate these systems and control these formidable resources. To protect their lucrative positions they seek to limit scrutiny of their activities by silencing the press, political opposition, civil society and other independent institutions.

PETROSTATES AND CRACKDOWN ON PRESS FREEDOM

The crackdown on the press has been particularly systematic. Journalists' murders, increasing media takeovers by regime-friendly concerns and domination of broadcast news in order to manage what ordinary citizens can and cannot see have become standard operating procedure.

In Azerbaijan, the government's attempt to increase its control of independent information sources is cause for particular concern. In recent years, the Azerbaijani government has faced heightened international criticism over entrenched corruption and a lack of transparency. Under existing conditions, an independent press would seem a critical component in avoiding poor outcomes associated with states rich in resources, but with poorly developed institutions. Analysis produced by the OECD identifies the lack of press freedom as one of the key factors enabling corruption to flourish in resource-based economies. The authorities' recent ratcheting up of pressure on selected media outlets, therefore, raises concerns about Azerbaijan's ability to take the steps needed to avoid the "resource curse."

Freedom House findings identify a host of obstacles for independent media in Azerbaijan's legal, political, and economic spheres. Freedom of the Press, Freedom House's annual survey of global press freedom, places Azerbaijan in the "Not Free" category. Another annual Freedom House publication, Nations in Transit, reports that "Azerbaijan's media sector encounters numerous obstacles to conducting its work and maintaining independence." Among the issues highlighted in the report was the fact that media "continue to operate under governmental and legal pressure, with most opposition outlets facing substantial financial hardship in the face of unreasonably high libel penalties." The increase in defamation suits in 2006 led the Organization for Security and Cooperation in Europe (OSCE) Media Freedom Representative, Miklos Haraszti, to urge President Aliyev to decriminalize defamation, a proposal Freedom House strongly endorses.

Russia has seen the most precipitous press freedom decline in recent years. Today, all of the major national television channels (Channel One, RTR, and NTV), from which most Russians get their news and information, have come under state control and are effectively censored. Control of national television news broadcasting is, however, only one piece of a broad and comprehensive campaign to bring independent media under the sway of the authorities. The energy industry has had a significant hand in the pacification of independent news media. Gazprom-Media, an arm of the state-controlled gas behemoth, has acquired control of a number of previously independent news outlets and either closed their doors or drained them of independent reporting. In July 2006, President Putin signed a law that expanded the definition of extremist activity to include public slander of a government official related to his

or her duties, using or threatening violence against a government official or his family, and publicly justifying or excusing terrorism. The definition of extremism in this new law is so broad that it allows the authorities to use unchecked power against their critics, including in the media.

In Kazakhstan, broadcast media have been taken into the hands of members of the presidential family and those with close ties to it. Meanwhile, the screws have been tightened on journalists who take an independent line. A campaign to silence critics who reported on official corruption caught in its web journalists such as Sergei Duvanov and Nuri Muftakh. In 2006, Kazakh President Nursultan Nazarbayev signed into law media legislation that increased government control over news media by imposing costly registration fees for journalists, expanding criteria for denying registration to media outlets, and requiring news outlets to reregister in the event of a change of address.

The battering of the independent news sector is no idle issue in these resource rich environments. As the economic windfall from high oil prices rockets upward and the temptations of oil money grow, it is all the more important to have a vibrant and independent news media sector, along with other critical independent institutions capable of placing basic checks on rents, runaway patronage and other variants of corruption.

THE KREMLIN'S AUTOCRATIC PRACTICES PROJECTED ABROAD

The Kremlin, meanwhile, having already effectively constrained independent organizations and voices at home is now pursuing an international dimension to its anti-democratic campaign. Russia's leadership has apparently set its sights on limiting the ability of important international organizations to scrutinize its conduct.

Institutions in which Russia enjoys membership such as the Council of Europe and the OSCE have become the objects of Moscow-inspired obstructionist campaigns. The Kremlin, for instance, is determined to limit the election monitoring capacity of the OSCE, whose Office of Democracy and Human Rights (ODIHR) has set the standard for evaluating the conduct of elections in the Europe and Eurasia region. Russia is apparently pursuing this strategy to limit these organizations' ability to effectively monitor upcoming elections in Russia (in 2007 and 2008) and in Kremlin-friendly autocratic states.

In its immediate neighborhood, Russia's leadership has also played the energy card to exert pressure on countries that represent the critical test cases for democratic reform in the former Soviet Union—such as Georgia and Ukraine—as well as on supposed allies including Armenia and Belarus.

The energy stakes are particularly high for Europe. EU imports of Russian energy are expected to grow from 50 percent to 70 percent over the next decade and a half.

However, with these petrostates' coffers already swollen with cash and no significant shrinking in energy prices in sight, the countries within the Commission's purview are likely to confront increasingly assertive petrodplomacy for the foreseeable future. These factors suggest that the community of democratic states

should devise a coordinated response to the challenge, including the pursuit of a serious policy of energy independence.

I would note that Russia, Kazakhstan and Azerbaijan all have ambitions of more deeply integrating into the global economy, doing business with the EU and western community and being accepted as normal countries. They seek the prestige and benefits of membership in western, rules-based organizations, while typically offering up only the trappings of accountable democratic institutions. Russia is poised to join the WTO and is already a member of organizations such as the Council of Europe and the OSCE, as is Azerbaijan. Kazakhstan is eager to obtain the OSCE chairmanship, as well as admission into the WTO.

This suggests that these countries should at a minimum be required to live up to the commitments they've made to these rules-based organizations, where they not only enjoy the prestige these institutions confer, but also should adhere to rather than lower their standards.

I would like to thank you again for the opportunity to present these remarks.



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