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Assessing Energy and Security Issues in Central Asia

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Thank you, Mr. Chairman. I am pleased to appear before you today to discuss U.S. energy interests in Central Asia and the Administration's efforts to enhance our cooperation with these countries and develop mutually beneficial relationships in this region.

Introduction

The Administration has been extremely proactive in its relations with this region. There is a great deal of progress to report in our efforts to enhance energy cooperation, but there are still challenges facing the countries in this region.

Today I will focus my remarks on the opportunity that Central Asia presents for enhancing energy security by increasing the supply of energy to world markets, adding diversity to supply options and supporting economic growth, and thus, establishing

political stability in these countries and in adjacent areas that do not have significant energy resources. I also will briefly review the energy posture of the individual countries and highlight the role of U.S. investment in the region. Then, I will focus on the Department of Energy's and the Administration's energy cooperation with the independent republics of Central Asia and the Caspian. For purposes of this testimony I am defining this region as the Caspian littoral states (minus Russia and Iran), Uzbekistan, Tajikistan, and Kyrgyzstan.

Energy Scenario

The countries in Central Asia run the gamut on energy wealth. Azerbaijan, Kazakhstan, Turkmenistan, and Uzbekistan are endowed with oil and gas resources. Tajikistan and Kyrgyzstan are faced with being resource poor except for hydropower. Oil production has increased substantially over the last decade, due to the influx of foreign investment in Azerbaijan and Kazakhstan. These countries are now providing about 2 million barrels of oil per day to the global market, and will be contributing up to 4 million barrels per day of oil in 2010. Central Asian-Caspian gas production is expected to almost double from 14 billion cubic feet per day in 2005 to 24 billion cubic feet per day in 2010.

Data on oil and gas reserves for the Central Asia-Caspian region vary widely depending on the source and are difficult to pin down. The Energy Information Administration (EIA) indicates that proven oil reserves are somewhere between 17 and 50 billion barrels.¹ There have been estimates of resources (not proven reserves) in excess of 100 billion barrels. As more exploration is done in the region and more delineation of

1) EIA cites the reserve estimates from The Oil and Gas Journal and BP's Statistical Review of World Energy

deposits is undertaken, better reserve figures will be forthcoming. Reserve numbers for gas are equally questionable. Very little exploration has been done to identify offshore reserves.

U.S. Engagement

U.S. engagement with Caspian oil and gas producers has both public and private components. Most importantly, there have been substantial investment successes by western and U.S. companies in the region. Following the breakup of the Soviet Union in 1991, this region attracted the interest of the international energy community because of the substantial oil and natural gas reserves believed to lie onshore, but especially offshore beneath the Caspian Sea. The Sea is 700 miles long and contains six separate identified hydrocarbon basins, most of which have not been developed.

With independence, both Azerbaijan and Kazakhstan welcomed international investors. In 1994 Azerbaijan signed the “Contract of the Century.” This contract is in the form of a Production Sharing Agreement with a consortium of 11 foreign companies, including three American companies--Chevron, ConocoPhillips, and Amerada Hess-- for the development of three major oil fields in the Azerbaijan sector of the Caspian Sea –the Azeri, Chirag and Gunashli (ACG) fields. Western companies anticipate investing \$12 billion dollars in this project with projected peak production of 1.1 million barrels of oil per day.

In 1993, the Chevron-led Tengizchevroil consortium was formed in Kazakhstan to develop the Tengiz oil field. The consortium (with Chevron and ExxonMobil owning the majority shares) is expected to invest more than \$20 billion in the project. In just the last three years, the consortium has purchased more than \$2 billion in goods and services from Kazakhstan companies. Oil production from Tengiz is expected to reach about 500,000 barrels per day in 2007. U.S. companies (ExxonMobil and ConocoPhillips) are also involved in the large oil deposit being developed in the offshore Kashagan block that will have peak production of 1.2 million barrels per day after 2015 and in the Karachaganak field (Chevron) where about \$4 billion has been invested to date.

In addition to oil and gas investment, AES, an independent U.S. power producer, has been involved in Kazakhstan's electric power sector. The company plans to invest about \$350 million over the next 5 years to refurbish coal and hydropower plants as well as the electricity distribution system.

These projects developed by western investors, including companies from the United States, are enhancing global competition by bringing diverse energy supplies to world markets as well as to the regional market. More importantly they have created thousands of jobs, provided access to improved technology, trained the domestic labor force, invested in social infrastructure, increased commitment to environmental protection, and encouraged the establishment of many small- and medium-sized enterprises in these countries. Thus, some of the countries in this region are now empowered with opportunities and monies to develop their economies and become more self reliant.

However, developing resources in this region is not without obstacles. Our goal is to promote regional partnerships among the producing and transit countries. It is important that the countries take responsibility for encouraging the development of new commercially viable export routes and find ways they can work together and with commercial entities in order to create a win-win situation for all involved. The U.S. government is steadfast in working with these countries to help solve their challenges.

One of the major difficulties faced by Caspian states as they attempt to develop and export their energy resources has been the lack of export outlets. During the Soviet era, all of the oil and natural gas pipelines in the Central Asian- Caspian Sea region (aside from limited capacity in northern Iran) were routed through Russia. Prior to 1997, exporters of Caspian region oil had only one major pipeline option available to them, a 240,000 barrel per day pipeline from Kazakhstan to Russia. Since independence, several new oil export pipelines have been built, including the Caspian Pipeline Consortium (CPC) pipeline that transits Russia to the Black Sea. On July 13 of this year, a ceremony was held in Ceyhan, Turkey to celebrate the lifting of first oil from the Baku-Tbilisi-Ceyhan (BTC) oil pipeline that runs from Baku, Azerbaijan through Tbilisi, Georgia to the Mediterranean Sea at Ceyhan. Negotiations were just completed to include Kazakhstan in this pipeline project. An oil pipeline from Kazakhstan to China has also been completed. The South Caucasus gas pipeline from Baku to Erzurum, Turkey will be operational later this year or in early 2007. However, the relative lack of export options continues to limit exports to markets outside the former Soviet Union. The

Administration has consistently supported the development of new pipeline projects, especially an East-West transport corridor that would stretch from Kazakhstan through Azerbaijan, Georgia, and Turkey to the Mediterranean, Europe, and other markets. In support of the Administration's commitment to multiple pipelines, the U.S. Trade and Development Agency has funded feasibility studies of several Bosphorus Bypass pipeline projects that would carry Russian and Central Asian oil from Black Sea ports to Western Europe and other markets while alleviating the congestion in the Bosphorus.

A second issue facing oil and gas development in the Caspian Sea is the unresolved legal status of the Sea. Prior to 1991, only two countries – the Soviet Union and Iran–bordered the Caspian Sea, and the legal status of the Sea was governed by bilateral treaties signed in 1921 and 1940. With independence these treaties became invalid and the ownership and development rights in the Sea have not been resolved. While only the Caspian littoral states can negotiate an agreement, the United States has provided technical legal expertise.

The United States Government also continually encourages the development by Central Asian countries of sound legal, fiscal and regulatory policies to support economic growth, including energy development. The Department of Energy has maintained on-going dialogues with energy officials from Kazakhstan on market reform in the energy area. In March, Energy Secretary Bodman visited Kazakhstan where he met with President Nazerbayev and the Energy Minister to advance our energy cooperation under the U.S.-Kazakhstan Energy Partnership. This Partnership has met five times since it was

established in 2001. In September 2005, Energy Deputy Secretary Sell and Kazakhstan's Minister of Energy and Mineral Resources signed a Work Program that commits us to cooperation in the following areas:

- Oil and gas project development;
- Realization of multiple pipeline options for export of both oil and gas;
- Improving the investment climate;
- Market reform and increased investment (including energy efficiency and renewable technologies) in the electric power sector;
- Energy-related environmental protection and regulation;
- Energy facility security; and
- Commercial nuclear technologies.

We also have conducted workshops on oil spill response policy planning, cooperation in environmentally-related marine science, and facilities security in Kazakhstan. A dialogue is under way in all of these areas.

The Department of Energy also has a bilateral forum with Azerbaijan, the U.S.-Azerbaijan Energy Dialogue. In May 2005, Energy Secretary Bodman participated in the celebration of the first fill of the BTC pipeline in Baku, Azerbaijan. He delivered a strong statement of Administration support for the efforts of the Azerbaijan government and the ACG consortium to develop additional and alternative pipeline routes for Caspian oil and gas. Departmental officials, including the Secretary, meet on a regular basis with representatives of the Azerbaijan government and, under the umbrella of the Energy Dialogue, have recently begun an initiative to expand our cooperation beyond oil and gas

to energy efficiency and renewable technologies. Use of these technologies could provide significant long-term energy savings for the Azerbaijan government as it invests in new housing for its large population of internally displaced persons as a result of the Nagorno-Karabakh conflict.

As these bilateral dialogues have matured, the primary change has been to expand the focus from primarily oil and gas issues to include a broad range of technologies, including energy efficiency, renewables and nuclear power, and an exchange of information on lessons learned, an example of which is the training we have conducted with Kazakhstan on how to assess risk to energy facilities and protect them from sabotage and terrorist attacks. We want our partners in these countries to understand that we are not just interested in the contribution they can make to world oil and gas supplies, although that is important. We want them to understand that in the long term, we share a common goal of building an energy sector in these countries that is balanced, cost effective, and secure to support vibrant, growing economies and rising standards of living.

Speaking of the long term, we encourage development of joint research projects between scientists in Central Asia and scientists at the Department's National Laboratories. We have sponsored a virtual meeting that brought together representatives of U.S.

Government funding programs and scientists in the region to explain the grant application process and to continue to support collaboration. We have supported solar scientists to work at the National Renewable Energy Laboratory to learn more about renewable

energy. We maintain a website in cooperation with the Department of Defense that encourages this cooperation and offers a tool for research facilities in these countries to allow them to demonstrate their capabilities.

As in all bilateral relationships, there are challenges. With economic growth, the Government of Kazakhstan has developed ambiguous feelings about foreign investment, as has happened in Russia. The investment climate has been affected by such things as changes in laws relating to domestic content and government policy on visas for expatriate workers. A dispute over provisions of the current Production Sharing Agreements, while resolved, led to a government statement that future Production Sharing Agreements would have less favorable provisions for foreign investors. The Kazakhstan government now concedes that the original investors assumed a higher level of risk when they entered the Kazakhstan market and are willing to grandfather agreements that had been previously negotiated. However, U.S. oil and gas companies maintain interest in investment in Kazakhstan, and we actively advocate on their behalf.

Future Plans

The United States Government, under the leadership of Secretary of State Rice, has developed a vision for this region characterized by democracy, prosperity and reform. A major tactic of this strategy is to strengthen regional trade and investment links. Whether the issue is deepening and broadening regional economic ties or supporting an individual country's economic development goals, energy is a key factor. Without strong, stable, and growing energy supplies, neither of these goals can be realized. This is why the

Department has taken an active role in engaging the countries of the region and supports interagency activities, such as the recent meeting of the U.S.-Central Asia Trade and Investment Framework Agreement.

The United States Government supports continued development of a commercially viable Central Asian oil and gas export infrastructure. We are encouraging the countries of the region and the European Union to work as rapidly as possible to develop a gas pipeline network to move Caspian gas to the European Union through Turkey. This project will promote the economic goals of the region and introduce more competition into the European gas market, benefiting both suppliers and consumers. An important step in this process is to encourage more surveys of gas reserves in the offshore regions of the Caspian in Azerbaijan to reassure potential investors and consumers that there are sufficient gas reserves to justify investment in pipeline infrastructure.

Completion of the BTC oil pipeline was a major accomplishment for the countries of the region. The next step is to bring Kazakhstan into this project. Kazakhstan and Azerbaijan recently signed the InterGovernmental Agreement that defined the terms under which Kazakhstan oil could enter BTC. The final step is completion of a Host Government Agreement with the private sector oil exporters to define the terms of their participation. We encourage all sides to complete these negotiations as quickly as possible.

While not known to possess any significant oil and gas reserves, Kyrgyzstan and Tajikistan possess enormous hydropower potential. The U.S. Government has begun working with these countries to explore the potential for exporting hydropower to the energy-poor countries of South Asia, including Afghanistan and Pakistan. The U.S Trade and Development Agency, with FREEDOM Support Act funds from the Department of State, is providing seed funding for this project. The Department of Energy, along with other government agencies, is supporting this initiative.

The Department of Energy has an active program underway to broaden and deepen cooperation with the countries of the region in the energy sector. The sixth meeting of the Energy Partnership with Kazakhstan will take place this fall in Kazakhstan. Under the Partnership, the Department is planning study tours in the United States for key Kazakhstan officials to address two major energy technologies: clean coal technologies (80 percent of Kazakhstan's electric power is fueled by coal); and nuclear power (Kazakhstan has plans to establish a nuclear power industry in the southern part of the country, which does not have oil and gas resources). Under the Energy Dialogue with Azerbaijan, we are planning a major conference to encourage the use of low-cost, energy efficient, earthquake resistant building materials. It is a major goal of Azerbaijan's government to increase living standards. Achieving this goal will require significant investment in new housing, including housing for the estimated 700,000 refugees from Nagorno Karabakh. This building technology, with its very low heat and power requirements, may eliminate the need for price subsidies over the long-run, thereby

achieving macroeconomic goals as well as raising standards of living. DOE experts have also been working with the Azerbaijanis to develop a wind power project in Nakhchivan.

I would also like to say a few words about Georgia. While not a Caspian country, it is a key link in the East-West transport corridor for Caspian oil and gas. Georgia has no significant energy resources and is almost totally dependent on Russia for gas and electricity in the winter. The political situation between Russia and Georgia does not allow for a reliable supply of gas and electricity and for more than a decade Georgians have not been able to supply heat and power to its citizens during the coldest parts of the winter. It should be noted, however, that for the first time in eight years the Georgian government headed this crisis without U.S. assistance. Under the Freedom Support Act, U.S. Government advisors have helped strategically plan Georgia's energy sector budget as well as the privatization of UEDC, Georgia's national electricity company. These measures in addition to further reforms were critical in alleviating the impact of the January crisis by facilitating the integration of emergency Azerbaijani gas and increasing the output of Georgian hydropower.

Georgia still critically needs investment in energy infrastructure and the Department has worked with the Howard H. Baker, Jr. Center for Public Policy on a proposal for a private/public initiative to work with the Georgians and the U.S. business community to discuss policy alternatives and define and eliminate barriers to investment in Georgia's energy sector. Secretary Bodman discussed this with Georgian President Saakashvili during his recent visit to Washington, D.C. The Baker Center will take the lead on this

project with support from the Department. We expect this initiative to assist Georgia in designing a long-term energy sector development strategy that will enable them to achieve an acceptable level of energy security.

Conclusion

This Administration has had a very proactive approach to developing positive and mutually beneficial relationships with the countries of Central Asia and the Caucasus. The past year has seen multiple visits to the region of high-level officials, including Vice President Cheney, Secretary Rice, and Secretary Bodman. Our energy dialogues with these countries are focused on broadening and deepening cooperation in the energy sector. The U.S. private sector also has been actively engaged in working with regional officials to achieve their national economic development goals. We have made a commitment to these countries to build a long-term partnership, including an energy partnership. As the energy sectors and needs of these countries develop and change, our relationship will also change, but the basic commitment to cooperation will continue.

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