

Changing the Rules in Global Resource Competition

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Thank you Chairman Rohrabacher and Ranking Member Keating for holding this hearing on the critical role natural resources play in our nation's national security and economic health. Your focus on Central Asia is important given that region's role both in energy markets and for U.S. national security concerns in neighboring Iran, Afghanistan, and Pakistan. Having served for nearly eight years as the Republican lead for energy security on the Senate Foreign Relations Committee staff, it is an honor to return to the Hill to appear before this distinguished committee.

In broad terms, Central Asian energy is the playing field for two major forces. China, in its global quest for the raw materials necessary to fuel economic growth, uses its financial clout to access Central Asia's natural gas. Russia wants power of a different type. It seeks to maintain its dominance over export routes for Central Asian oil and gas in order to maintain political influence in the region and in Europe. My friend Ed Chow will address the China question in discussing eastern export routes from the region, so I will focus on dynamics to the west and with Russia. First, however, I will give some context to changing energy market dynamics and ways in which energy translates into conflict.

Since the 1970s, Americans have been conditioned to understand their vulnerability to oil-driven threats. Energy has an imposing presence in diverse national security concerns around the globe. In the extreme, the United States can be compelled into military action to ensure steady supply lines. More commonly, energy fuels challenges ranging from Iran's nuclear program, to anti-American propaganda in Venezuela, to deepening corruption as just a few examples.

Global oil and natural gas markets have undergone fundamental structural shifts in recent years. Demand growth is primarily focused in emerging economies, especially in China, India, and the Middle East, thus leading China in particular to pursue natural resources in Central Asia and around the world. In the mid-2000's, surging global demand and struggling supply replenishment for oil shrunk global spare capacity margins, which essentially is a measure of the world's ability to increase oil production in case of man-made or weather-induced shortfalls. In that market situation, even relatively small losses in supply sent prices skyrocketing. More recently, economic recession slowed demand growth while unconventional oil and gas boosted supply. Prices remain high due to structural shift in demand, but prices are less volatile than otherwise would be expected. The current respite

for markets is likely temporary, however, absent substantial policy changes to shift demand trajectories in emerging markets when their economies regain steam. We can, therefore, expect ongoing state-backed competition for natural resources. One should bear in mind, however, that such a pursuit is also an indicator of economic activity and thus signals an opportunity for the United States to sell goods and services to growing China.

In the U.S., the rise of unconventional oil and gas, renewable, and efficiency technologies gives us the opportunity to help rebalance energy geopolitics, assert more flexibility in foreign policy, and build economic opportunities for American businesses. In oil, surging unconventional production has taken pressure off markets, and increased use of alternative fuels like ethanol and improved penetration of fuel efficiency technologies has arrested oil demand growth. That is benefiting our foreign policy as well as our economy. As one example, it has enabled much stronger enforcement of sanctions on Iranian oil than otherwise could have occurred. In natural gas, U.S. unconventional production is nothing short of revolutionary. Although trade in gas remains dominantly regional rather than global, that is changing and already foreign markets are feeling the price impacts of our production.

With that market context, potential conflicts centered on energy resources generally can emerge from at least four sources: instability due to lack of energy access, poor governance of energy resources, efforts to control energy-rich territory, and use of energy itself as a strategic tool or even as a weapon.

First, reliable access to electricity is something we take for granted in the United States, but billions of people around the world are not so fortunate, entrenching a structural barrier to economic growth. Lack of electrification is a critical threat to political stability in countries such as Pakistan, Afghanistan, and, as we have seen recently, in Egypt. With a surplus of electric generation and natural gas export potential, Central Asia can be an important source of power for Afghanistan, Pakistan, and India and thus also decrease their incentive for trade with Iran. Globally, those billions of people with no or limited electricity do have purchasing power, as we have seen in telecommunications and personal goods industries. By focusing on energy access, U.S. entrepreneurs can build markets for our goods and services, fostering mutually beneficial trade relationships rather than simply capturing raw materials. Chairman Royce has offered legislation to help spur those relationships in the African context.

Second, poor governance of energy resources can entrench corruption, authoritarianism, and be more of a curse than a cure for economic development. That not only undermines U.S. foreign policy objectives, it also can lead to internal instability and jeopardize U.S. private investments. Perhaps the most vivid example is the Niger Delta, where international oil company infrastructure is regularly attacked and oil stolen to fund violent insurgents. While Central Asian countries are currently being spared that level of conflict, control of oil and gas revenues is essential to supporting the authoritarian streaks and wasteful spending of leaders in the region. U.S. levers to influence resource governance in energy-rich regimes are limited and, in Central Asia, compete with other strategic priorities.

Information on natural resources transactions is essential to empower citizens and investors. Congress has already taken a critical step to push back on energy-fueled

authoritarianism with passage of the so-called Cardin-Lugar Amendment, which will put on public view oil, gas, and minerals payments to governments. The European Union has also now approved similar rules, which will bring more scrutiny to Russian companies in particular. The U.S. is also leading by example with the U.S. Extractive Industry Transparency Initiative process now underway in which companies, civil society groups, and administration officials are working together to disclose payments to the federal government. I encourage Congressional representatives to contribute to that process.

The final two manifestations of energy in conflict differ in that in one control over physical energy reserves is the object of conflict and in the other energy resources are being used as tools, or weapons of war, for other ends.

The drive for territorial control over energy resources remains present in the world, although it tends to be more of an internal state occurrence than inter-state. Recent examples include division of Sudan and South Sudan, jockeying for control of oil and gas in Northern Iraq, and control of mines in Congo. Fortunately, Central Asia is relatively calm on that front with delineation of the energy-rich Caspian seabed occasionally enabling unwelcome tension between littoral states. In particular, Russia objects to a proposed Trans-Caspian Pipeline to diversify Turkmen gas export options through a link to Europe outside of Russian territory. Affirmation of Congressional support for the pipeline proposal, along with continued partnership with Azerbaijan to improve maritime security capacity, would be welcome.

Regrettably, Russia's willingness to use its energy resources to assert influence over its neighbors is likely the best example we have of energy intimidation, the fourth manifestation of energy in conflict that I will mention today. On the supply side, energy-rich Central Asia depends on transit routes through Russia and Russian companies as intermediaries to get its gas to markets. On the demand side, Central and Eastern European and Baltic countries rely on Russia for up to 100% of their gas imports. If Russia simply allowed gas markets to function, this situation would still have negative pricing consequences but would not rise to the level of strategic concern for the United States and our allies. Regrettably, that is not the case. Natural gas in particular is as much a strategic tool as it is a financial boon to the Kremlin. Russia rewards its friends in Europe with low prices and penalizes its rivals with higher prices. It seeks to expand its gas empire with acquisition of infrastructure and to block alternative supply routes. In the extreme, as former Senator Richard Lugar has argued, cutting gas supplies in the middle of winter could be a more effective instrument of aggression than bombers or tanks.

In both Central Asia and Europe, over-dependence on Russia challenges the independence, economic prosperity, and political stability of afflicted countries and is detrimental to efforts to expand NATO and the European Union. With bipartisan support, the United States has worked to help rebalance energy geopolitics across the region. A core feature of U.S. engagement is to enable diversification of supply routes for exporters in Central Asia and Azerbaijan and for importers in Europe. Unlike China, which can simply pay for and build new pipelines, the U.S. relies upon private investment and rigorous diplomacy to enable that investment.

The centerpiece of our strategy is pursuit of the Southern Corridor to link Central Asian and Azerbaijani oil and natural gas to global and European markets. The oil component was completed with inauguration of the Baku-Tbilisi-Ceyhan pipeline. Natural gas has been more challenging, due to commercial hurdles, political unease, and in no small part to Russia's efforts to thwart the project. Just last month, however, a long-anticipated decision was made on which pipeline route to Europe will be utilized to carry Azerbaijani gas and in coming months the final investment decision of the gas developers in the Shah Deniz consortium will be made. To be clear, the Southern Corridor is not an anti-Russia strategy; rather, it is an attempt to bolster friends and encourage markets to work.

In addition to U.S. and EU diplomacy, U.S. unconventional natural gas is improving the bargaining position of our allies in Central and Eastern Europe. Liquefied natural gas (LNG) supplies once intended for the United States are now available on the world market, and as U.S. gas pushed down coal prices, lower-priced coal helped reduce European gas demand already stunted by slow economic growth. The fact that U.S. natural gas prices are not fixed to oil also encouraged more frequent delinking of the two in Europe where some countries have successfully bargained for lower prices from Gazprom. We should not be tempted by complacency, however. So long as physical alternatives to Russian gas are limited, our allies will remain vulnerable to resurgence of political manipulation in gas, and Central Asian countries may only have China as a viable alternative to Russia.

In December 2012, the Senate Foreign Relations Committee issued a report entitled "Energy and Security from the Caspian to Europe," in which Marik String and I elaborate on those issues in detail, and I ask that the report be entered into the record. I will share three key recommendations for the U.S. to continue rebalancing energy power dynamics.

For the first time, the United States can directly aid in the gas needs of our allies by simply allowing our markets to work through permitting LNG exports. While the physical quantities of U.S. gas moving to Central and Eastern Europe and the Baltics would likely be small, the pricing impact and political symbolism for our allies is significant. U.S. LNG exports also could help replace the approximately 20 percent of Turkish gas demand that is currently met by Iran. LNG trade will also promote economic growth at home and bolster economies of our trade partners. Congressman Mike Turner and Senator John Barrasso have offered bipartisan legislation to accomplish these goals, and many of our strategic allies are anxious for Congress to act.

At the same time, we cannot ignore the realities of pipelines -- or lack thereof -- both in Central Asia and Central Europe. High-level U.S. engagement remains vital and must be commensurate with the reality that decisions on energy are made at the highest levels of government in the region. With the failure of the Nabucco West pipeline proposal to bring gas relief directly to Central Europe, we now need to work to ensure interconnections and alternatives are pursued to bolster allies such as Hungary and Romania. Finally, U.S. advocacy for a Trans-Caspian Pipeline, which would establish a non-Russian trade route between Turkmenistan and western markets, should be rejuvenated. The pipeline would be relatively simple from a technical point of view, but it is enormously complex politically with wavering engagement from Ashgabat and opposition in Moscow. United States leadership is essential for building confidence of Turkmen leaders and helping put in place transit guarantees with Azerbaijan and Turkey.

I conclude with an observation. For decades, our nation has faced vulnerability to the whims of oil-backed regimes. In recent years, Americans have done what we do best – change the rules of the game in our favor – in this case with innovation in oil, gas, renewables, and efficiency and rigorous diplomacy. While we cannot simply divorce our economy from supply and demand decisions made in Beijing or Moscow, we now have more options for economic growth and security benefits than many people would have thought possible just a few years ago. I appreciate the Chairman, Ranking Member, and members of the subcommittee for their interest in pursuing those opportunities.

Thank you.

** The views shared herein do not necessarily reflect those of the German Marshall Fund of the United States.*

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