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Statement before the House Foreign Affairs Subcommittee on Europe, Eurasia, and Emerging Threats

"THE DEVELOPMENT OF ENERGY RESOURCES IN CENTRAL ASIA"

A Statement by

Dr. Jeffrey Mankoff

Deputy Director and Fellow, Russia and Eurasia Program
Center for Strategic and International Studies (CSIS)

May 21, 2014

2200 Rayburn House Office Building

<u>Testimony to U.S. House of Representatives Committee on Foreign Affairs, Subcommittee on Europe, Eurasia, and Emerging Threats, 21 May 2014</u>

Dr. Jeffrey Mankoff, CSIS

Chairman Rohrabacher, Ranking Member Keating, and members of the Committee: Thank you for the opportunity to testify this afternoon on The Development of Energy Resources in Central Asia.

While the United States has viewed the Caspian Sea Basin as a potentially major new source of oil and gas for world markets for more than two decades, the region long fell short of its apparent potential. Efforts to bring Caspian energy to European markets have faced a host of geographic as well as political obstacles, especially on the east side of the Caspian, that is, in the major Central Asian energy producers: Kazakhstan, Turkmenistan, and Uzbekistan. In recent years, Central Asia has produced and exported increasing quantities of oil and gas, though it is primarily China, rather than Europe that has emerged as the region's principal customer and source of investment. While sales to China help the Central Asian producers lessen the dependence on Russian markets they inherited from the Soviet Union, they also limit prospects for transparency and political reform, and represent a potential obstacle to Western influence in the region.

Central Asia is located far from major consumers in both Europe and Asia, and is hampered by complicated geography as well as its location in a difficult geopolitical neighborhood surrounded by Russia, Iran, and China. Beginning in the early 1990s, the United States sought to develop Central Asia's energy resources and transport them to global markets. In the 1990s, the target was Europe, with plans for oil and gas pipelines across the Caspian Sea to Azerbaijan, and thence through Georgia and Turkey to Europe. Today, the United States is focused on markets in South Asia as part of its New Silk Road initiative, promoting a the construction of the so-called TAPI pipeline from Turkmenistan through Afghanistan to markets in Pakistan and India. In both the 1990s and today, U.S. efforts have faced significant hurdles, perhaps most importantly, questions about commercial viability.

At independence, the Central Asian states were saddled with colonial economies oriented almost entirely to Russia. The United States recognized that pipelines to new markets in the West would allow these countries to diversify their ties and create a new source of revenue for economies struggling with the consequences of the Soviet collapse. The United States also believed that the presence of international energy companies could help transform the region's economies by introducing Western business practices, promoting transparency, and training a new generation of specialists.

While the U.S. and its allies succeeded, with much effort, in bringing about the construction of the Baku-Tbilisi-Ceyhan (BTC) oil pipeline and the South Caucasus gas pipeline, efforts to link this corridor to the east side of the Caspian—that is, to Central Asia—have only had limited success. International energy companies including Chevron, ExxonMobil, ConocoPhillips, and others secured stakes in Kazakhstan's upstream in the early 1990s. These companies have helped Kazakhstan dramatically increase its oil production, which now exceeds 1.6 million barrels per day. They have also helped Kazakhstan access European markets, through both the privately-owned Caspian Pipeline Consortium (CPC) pipeline to the Russian port of Novorossiisk, and by barging oil across the Caspian to the BTC's terminus in Baku. The presence of these international companies in Kazakhstan's oil sector have also underpinned Kazakhstan's "multivector" foreign policy, which includes close cooperation with NATO and the European Union, alongside a strategic partnership with Russia and membership in the Russian-led Eurasian Economic Union.

Unfortunately, Kazakhstan's exports to Europe remain precarious. Russian pressure delayed expansion of the CPC pipeline for several years. Although an agreement is now in place, technical challenges continue to delay expansion. Meanwhile, high costs impeded the shipment of Kazakh oil through BTC for several years, and even now BTC is operating below capacity. International energy companies have also had less success gaining access to Kazakhstan's gas sector, which remains almost entirely state-owned, while growing state intervention in the oil sector has limited new commercial opportunities. These obstacles have proven less serious for China. Beijing opened the first phase of a new pipeline from Kazakhstan to western China (Xinjiang) in 2003, and continues expanding this pipeline's capacity, now set to reach 400,000 barrels per day.

Central Asia's other major energy producer is Turkmenistan, which is estimated to have natural gas reserves of more than 7.5 trillion cubic meters, fourth largest in the world. Far from major markets and with a very difficult investment climate, Turkmenistan struggled to attract foreign investment, especially before 2007. Unlike Azerbaijan or Kazakhstan, Turkmenistan has never granted a Western firm an equity stake in its upstream, nor entered into any production sharing agreements with them. Consequently, it remained almost entirely dependent on Soviet-era pipelines to Russia for exports. Moscow used this dependency to dictate prices and acquire a stake in Turkmenistan's gas industry. Cheap Turkmen gas also contributed to Russia's ability to exert leverage over Ukraine. Much of this gas was sold by corrupt intermediaries to Ukrainian consumers at a significant markup, contributing to Ukraine's accumulation of massive debts to Russia.

The United States has long supported construction of a gas pipeline across the Caspian Sea to bring Turkmen gas to Europe. The recent agreements to construct a Southern Gas Corridor from Baku to European markets have again raised the issue of this trans-Caspian pipeline. Thus far, Western efforts to promote a trans-Caspian pipeline have made little progress. Russia and Iran argue that no pipelines can be built until the five littoral states resolve their territorial claims in the Caspian, effectively giving Moscow and Tehran veto rights, backed up by their growing naval capabilities in the Caspian. Azerbaijan also remains reluctant to see Turkmenistan emerge as a competitor or allow Turkmen gas into its pipelines.

With the global financial crisis depressing demand, Russia attempted in 2008-09 to scale back its purchases of Turkmen gas. Particularly after a pipeline explosion in April 2009, sales to Russia plummeted. The main beneficiary proved to be China, which very quickly moved to secure Turkmenistan's resources for itself. The first branch of a new gas pipeline from Turkmenistan to China opened in late 2009, a little more than three years after the original framework agreement was signed. A second branch (Line B) opened in 2010, a third branch (Line C) is now under construction, and an agreement to build a fourth branch (Line D) was signed last autumn.

In 2013, China imported around 20 billion cubic meters of Turkmen gas, close to double what Russia imported. Once all the currently planned pipelines are in place, China aims to import 65 billion cubic meters of Turkmen gas by 2016. Of course, Russia remains a central player as well; Russian gas monopoly Gazprom took a controlling stake in Kyrgyzstan's gas industry in December (something it has long been seeking to do in Ukraine as well), and remains Kazakhstan's major outlet to global markets given the challenges facing CPC and BTC.

The reasons for China's success in Central Asia are not hard to grasp. China's state-owned energy companies do not face the same financial constraints as Western firms. Flush with cash and comparatively insulated from the need to make an immediate return on their investments, these firms are less sensitive to political and economic risk. They are also more responsive to political direction. One of the main reasons the U.S. has failed in its efforts to build a trans-Caspian pipeline, and that TAPI faces an uphill battle now, is the difficulty of convincing private sector companies to risk their shareholders' money on such complex, politically risky projects that face uncertain returns.

Chinese energy companies are also easier for the Central Asian governments to deal with, since they operate essentially as branches of the Chinese state. Rather than negotiating with a squabbling consortium of Western firms, the Central Asian leadership can simply sign a deal with its Chinese counterpart, knowing that Beijing will follow through on its commitments. Chinese companies are also less disruptive to the political status quo, and more comfortable operating in the challenging political environment some of these countries represent.

For the United States, as well as the region itself, China's emergence into the Central Asian energy game represents both an opportunity and a challenge. Chinese investment has helped bring vast new quantities of oil and gas online, especially in Turkmenistan. While the West has talked for two decades about new pipelines, China is building them, pouring significant sums of money into Central Asia in the process, and reducing Russia's hold on the region's economies. These new Chinese pipelines, moreover, promote cooperation among the Central Asian states themselves. If and when Line D is constructed, all five Central Asian states will have Chinese-built gas pipelines crossing their territory, giving the three energy producers (Kazakhstan, Turkmenistan, and Uzbekistan) access to the lucrative Chinese market, while bringing new resources to energy-deprived Kyrgyzstan and Tajikistan. Chinese-built infrastructure, including but not limited to energy pipelines, supports the United States' goals of promoting economic and political diversification in Central Asia, integrating the region into the global economy, and promoting regional cooperation.

At the same time, the rapid influx of state-directed Chinese investment does not come with the same demands for transparency and rule of law that Western investors seek, which in turn risks further entrenching Central Asia's corrupt, patrimonial political systems. It also portends greater Chinese political influence in the region, potentially complicating efforts to maintain a balanced geopolitical environment. For now, Chinese investment gives the Central Asian states an alternative to dependence on Russia, allowing them to balance more effectively between their two giant neighbors. In the future however, the danger exists that these states will end up having traded dependence on Moscow for dependence on Beijing. This prospect would be particularly worrying in the admittedly unlikely event that a true Sino-Russian strategic axis emerges.

With the United States pulling its forces out of Afghanistan, it is no secret that many in Central Asia fear the U.S. will turn its gaze away from the region, which has already seen the closure of a U.S. base in Kyrgyzstan and a reduction in U.S. foreign assistance across the board.[1] After 2014, a larger share of the United States' presence and influence in the region will have to come from the private sector; while Central Asia's governments would like to see U.S. trade and investment in fields other than energy, for the foreseeable future, energy will remain the most promising target for foreign investment. Yet the same problems that have bedeviled U.S. companies for two-plus decades are not going away either.

Under the circumstances, the U.S. has somewhat limited options. Above all, it remains important for the U.S. to emphasize its interest in remaining engaged in Central Asia even after the withdrawal of combat forces from Afghanistan, and in transitioning to a more economically driven relationship with the Central Asian states.

That said, the U.S. should acknowledge that projects requiring private investment but lacking commercial viability or facing excessive political risk are unlikely to get built. To the extent that the United States is serious about connecting Central Asian energy producers to global markets, it has an interest in the success of Chinese-built infrastructure projects, including Central Asia's new gas pipelines. While these projects need not be mutually exclusive of U.S.-supported projects such as TAPI, the reality is that Beijing is offering the Central Asian states more concrete benefits on shorter time-frame, and it would be counterproductive from the perspective of U.S. influence, not to mention the wellbeing of Central Asians themselves, for the U.S. to attempt to impede them.

Central Asia's connection to the global economy through new pipelines, railways, roads, and other infrastructure projects will also generate new opportunities for the region, and for foreign companies looking to profit from Central Asia's location at the nexus of new transcontinental trade and transit links. That said, the U.S. can help by continuing its work with the Central Asian governments to promote a more favorable investment climate, which can in

[1] http://gbk.eads.usaidallnet.gov/query/do.

time make the region more appealing to the Western firms capable of offering the region not just investment, but also modern business practices and opportunities to develop their human capital.

The U.S. should also focus on helping the Central Asian states progress towards membership in the World Trade Organization. Right now, Kyrgyzstan and Tajikistan are WTO members, while Kazakhstan is getting closer. Kazakhstan views WTO membership as a way to insulate itself against potential economic coercion by its larger neighbors, as well as a means of promoting its own domestic economic transformation.

The development of Central Asia's energy resources highlights what is perhaps the central challenge facing United States policy in the region, namely that the U.S. is far away, and has fewer direct tools available than nearby Russia and China. Nevertheless, the United States has an important role to play in ensuring that the Central Asian states remain fully sovereign and independent members of the international community. It can best do this by supporting their integration with global markets through new transportation corridors—regardless of whether these corridors run east to China, west to Europe, or south to India—and by continuing its efforts to make Central Asia a more attractive place to do business.

As the United States winds down its decade-plus of military operations in Afghanistan, it needs to place its engagement with the states of Central Asia on a new basis. Focusing on creating a more favorable economic environment can help bring more foreign investment to the region, which in the longer term will be the major factor determining the extent to which the United States and its allies believe they have a stake in Central Asia's development and prosperity.