Written Testimony of

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Geopolitical Implications of LNG Export Liberalization

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Thank you Chairman Whitfield, Ranking Member Rush, and Members of the subcommittee. I appreciate the opportunity to be here today to provide my perspective on the importance of LNG export liberalization for the Central Eastern European region. I applaud the leadership of this Committee to look at the geostrategic aspect of US natural gas exports, which along with my colleagues from the Visegrad Group (currently chaired by Hungary), the Baltics and Eastern Europe we have been long advocating.

Mr. Chairman, we are in the middle of the largest security crisis that Europe has seen since the end of the Cold War. And energy dependence, especially that of Central Eastern Europe and Ukraine, is once again on everybody’s mind. With every new Russo-Ukrainian crisis, US awareness about the strategic vulnerability of our region, and the determination to mitigate it, should only grow. Energy import dependence is one of the key factors that limit the political options available to these countries as US allies and adherents of a rules-based international order. Russian ambitions in the former post-Communist space are very clear and energy security is at the heart of this.

The European Union's dependence on external energy sources is massive. Today, Europe covers over 64% of its natural gas demand from imports. Approximately four-tenth of this import, i.e. 28% of Europe's total gas consumption, comes from Russia via three different routes – the Brotherhood pipeline via Ukraine, the Yamal pipeline via Belarus and the North Stream pipeline under the Baltic Sea. 62% of Russia's natural gas exports to the EU go through the first route, i.e. via Ukraine.

The import dependence of EU member states varies widely, in the most extreme cases reaching 100% of their total gas consumption (Baltic States, Slovakia). But there is no country on the eastern side of the EU where the share of Russian gas imports is lower than 70% of its total gas import. One can contrast these figures with the situation in the United States, which in 2007, before the onset of the shale gas revolution, imported only 16% of its natural gas needs and U.S. unconventional gas explorations could make America the largest natural gas exporter by 2015.

The popular interpretation of energy dependence, and natural gas dependence, in particular, is widely associated with supply cut-offs which wouldn't be without precedent in Central Europe. Supply cut may indeed happen again with unpredictable consequences for countries along the Eastern border of the European Union, as well as for Ukraine. Yet, if used, it would seriously hurt the supplier as well: in the short term with loss of revenue, in the mid-term with loss of its markets. Supply cut-offs are so dramatic and so obviously political that they invariably trigger actions on the receiving end to ease the dependency. Moreover, one cannot cut off the supply for one country only – everybody along the pipeline route will suffer. A supply cut-off mobilizes and unites the dependent parties and results in decreasing dependency in the medium term. It is an absolute last-resort measure that ultimately undermines the very dependence that enabled it in the first place.

The best example to illustrate this point is the natural gas crisis of 2009. Then, Russia wanted to teach a lesson to Ukraine and cut off the gas going into the country. With it, Moscow discontinued the supply to most of Central Eastern Europe, as well. The crisis itself lasted for less than two weeks, but its most important impact was the ensuing cooperation and diversification efforts among the affected countries. A new approach emerged, whereby these countries connected their pipelines' North-South direction and enhanced their storage capacities, ultimately making each of them more crisis-resistant. Even more importantly, energy security came to the forefront of security considerations and became a flagship topic within the European Union. The Hungarian Visegrad Presidency also put this on top of the group's agenda for 2013-2014. Looking back, it would be hard to deny that the 2009 supply cut off was the single most important trigger event for improving the Central Eastern European region's energy security.

It is prices that provide the best economic and political tool for the monopoly supplier. Whoever has the monopoly, calls the shots: higher prices afflict a very tangible cost on the dependent country's economy and population, while stuffing the supplier's coffers and allowing it to reap the economic rents to finance further political, economic or military actions. Hiking prices can always be presented as pure business action as opposed to a foreign policy measure. Most importantly, it can be applied in a discriminatory manner. The supplier can raise the price for the non-cooperative and lower it for the friendly. Price movements, especially price discrimination, lead to asymmetrical negotiations and side-deals as opposed to transparency and, ultimately an affordable and secure energy supply for Europe.

The example of Ukraine is the most telling of all. The country currently imports about 26 billion cubic meters, or half of its consumption, of natural gas. All of its imports come from Russia. Consequently, Moscow has been free to use price discrimination as it saw fit. Although the cost of gas grows linearly with the distance it travels, Germany pays less for the same Russian gas than any country on the route between the two. In fact, Russian gas in Germany was so much cheaper than the price paid by Ukraine that traders resold 2 billion cubic meters of this Russian-German gas to Ukraine in 2013.

In December 2013, Russia rewarded the former leaders of Ukraine with a 33% discount in natural gas prices for not signing the Association Agreement with the European Union. The new price of 268.5 dollars per thousand cubic meters is about 30% lower than the lowest price in the EU. As recent events in Ukraine have gone against the interests of Russia, Moscow is now raising the price to 400 dollars. Such a price would exact a massive toll on the already heavily indebted Ukrainian state.

The only way to limit the monopoly supplier's ability to exact damage and sow discord through the deployment of the price weapon is to establish alternative supply routes. Once they are in place, the monopoly supplier can no longer use the price discrimination tool freely, as it needs to consider how its actions affect the viability and attractiveness of alternative supply channels.

The recent deal between Gazprom and the Greek gas company DEPA is a case in point. In February this year, Gazprom agreed to a 15% price cut for Greece to be applied retroactively for about 7 months. Experts claim that Greece's LNG terminal and the recent developments in the Southern Gas Corridor, which will bring Azeri gas to Greece, among other countries, in the medium term factored into the negotiations. Simply put, the mere existence of a credible alternative supplier exerted significant downward pressure on the natural gas prices set by the dominant supplier.

We are well aware of the fact that alternative pipeline gas won't reach Europe before 2019 the earliest. Azeri gas coming in via the Southern Gas Corridor will benefit Western Europe via Italy rather than Central and South Eastern Europe. Consequently, for Central Eastern European countries, the most important task is to create a credible prospect for alternative natural gas imports.

To do that, Central Eastern Europe needs to ensure both the capacity and the volume to receive alternative gas. The first is our homework, which only we can do to build up capacities internally which allow gas-to-gas competition, create access to different supply options and create a robust internal European energy infrastructure. In Central Eastern Europe we need to overcome the dependency inherent in the traditional East-West pipeline infrastructure in the former Soviet satellite states by constructing North-South and South-North interconnectors with the aim to have a robust North-South and South-North pipeline infrastructure from the Agean to the Baltic Sea. Another important aspect is enabling the reverse flow of natural gas on these newly built, as well as older interconnections especially from the West to the East to ensure that regional markets become truly integrated.

However, Europe has been much less successful in building up the necessary volumes for alternative supply. This has been largely out of Europe's control. EU and US sanctions against Iran, the slower than expected progress in Iraq, the upheaval in North Africa postponed or put on hold indefinitely most of the potential alternative pipeline supplies. The only new supply volumes coming in from Azerbaijan as of 2019 are exactly the same quantity as the total supply from Libya which stopped entirely at the end of 2013, an annual 10 billion cubic meters.

What Central Eastern Europe and the EU in general needs right now is the additional volume of gas. The most viable option Central Eastern Europeans have today is

LNG. The LNG market has numerous advantages: many suppliers, liquidity and prices set by supply and demand with no political strings attached. Access to the LNG market would much weaken the dependence inherently present in pipeline deliveries.

Access to LNG would also assist Ukraine. During 2013, two additional capacities were opened from Hungary to Ukraine and from Poland to Ukraine, enabling the supply of natural gas to Ukraine on purely market terms. If successful, the LNG supply together with the existing and planned additional reverse flow capabilities, combined with Ukraine's own shale gas resources, could provide a reasonably sized alternative to Russian gas in Ukraine.

However, in the absence of an energy security contribution from US exports, the global supply of LNG is not at all reassuring. Among LNG exporters, terrorist and insurgent activity impacts gas operations in Yemen, Libya, Egypt, Nigeria and Algeria. Qatar has a moratorium on further exports, while in Asia, some important traditional exporters like Indonesia are now in decline. To the extent supply grows, it is locked into rigid long term contracts that can't provide flexible resilience. Without the large shale gas resources and efficient competitive markets of the United States, LNG cannot provide an adequate energy security answer.

The urgency of establishing the region's access to LNG means that the United States Congress has a potent foreign policy/energy diplomacy tool at its disposal. By clearing the way for US shale gas to reach America's Central European NATO allies would provide significant protection against the deployment of the energy/price weapon.

Today, natural gas prices in the United States are one-third to one-fourth of the gas prices in Europe, including in Central Europe. Liberalizing US LNG exports would send a signal to market actors to kick-start the development of missing infrastructure (LNG terminals, interconnectors). These developments in turn would put an immediate downward pressure on gas prices in Central Eastern Europe well before a single American gas molecule reaches the shores of our region. Energy diplomacy is not about short term fixes, we operate with long-term investments and decades long contracts, we know that the timeframe for US gas exports is 3-7 years.

But it is simply not true that lifting the natural gas export ban today would not have an immediate effect in the region. It would immediately change the business calculus of infrastructure investments and send an extremely important message of strategic reassurance to the region which currently feels more threatened than any time since the Cold War. Even with regasification, shipping and associated costs, US gas would be regarded as an important alternative. And let’s not forget that countries in our region are ready to pay a premium price for energy security.

In short, by liberalizing LNG exports, by eliminating the legal and administrative obstacles to the free trading of this vital, domestically produced commodity, the United States would provide fast and long-lasting protection for its allies against the most important dangers of natural gas dependency. Moreover, it would also enable them to act more freely in assisting Ukraine in case of an energy crisis developed there. Such a help would be in line with past US leadership in Central Eastern Europe, which many in our region have perceived to be waning in the past few years.

It is important to note that this is an elegant, yet very effective tool, which is relatively cheap to use. It incurs no threat of loss of life, not even a disruption of economic activities: it is only a removal of a self-imposed barrier. Moreover, it cannot be seen as targeting any single entity– it is only a form of help for allies, a common sense solution that helps allies and US businesses at home. It would be hard to find any other tool so obviously at hand to the US to demonstrate leadership right now, have an immediate security impact at a relatively low cost.

Hungary, as chair of the Visegrad group (Poland, Czech Republic, Slovakia, Hungary) together with several other US allies argued for LNG export liberalization even before the Ukraine crisis started. We have reached out to members of Congress and the administration to argue that the US has a historic opportunity to send a strong message of freedom to the region by simply letting the markets work. Together with my Czech colleague, Vaclav Bartuska, we have argued that "accelerating the export licensing procedure to allow increased sales to trustworthy, reliable foreign partners should be a policy that politicians on both sides of the aisle can support." This is not a partisan issue. It is an American issue that all statesmen in this country must show leadership on. Numerous Members of Congress recognized the geopolitical importance of LNG export by introducing and co-sponsoring the different bills that proposed to lift the ban on export licensing. The situation in Ukraine only underlines how timely this issue is – but also gives it additional urgency. The US should seize the opportunity and act now.

Mr. Chairman, Members of the Committee,

I believe that doing away with these export limitations would make economic sense even in better times. But there is nothing like a crisis to focus the mind. As representatives of a country that Central Europe has traditionally looked to for leadership, you know well that you do not always have the luxury of choosing the time to make some of the most necessary decisions. But with the post-Cold War settlement crumbling before our eyes, if there was ever a time for your leadership, it is now – and if there was ever an issue that would do as much good at as little cost, it is the issue at hand.