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Committee on Foreign Affairs
Public Hearing**

“Towards a common European foreign policy on energy?”

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Panel I: Europe's External Energy relations: present and future challenges

**Implications for Europe: Regional Security Issues
(The Caspian and the Mediterranean regions)**

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EU Member States currently rely on Russia for over 25 percent of their oil and natural gas supplies. For many states in Central and Eastern Europe, this dependence is even more severe. Recent events, such as the gas cut-off to Ukraine and the oil cut-offs to Belarus and Lithuania, have called into question the wisdom of relying so heavily on this provider. These same events have also highlighted the failings of the EU's current energy policy—or lack thereof. Energy decisions can no longer be relegated solely to a nation's economy or energy minister, or left to the invisible hand of the market. Instead, energy security must be considered a foreign and security policy issue. At the same time, the existence of twenty-seven different energy policies is counterproductive. As many political leaders across Europe have said, it is time for the EU to speak with 'one voice' on the topic of energy security—especially given that Russia's energy policy is directed from the Kremlin and that it is a major tool in its foreign and security policy.

Together, the EU should commit to diversifying away from Russia, especially on gas, to the energy suppliers of the Caspian and Mediterranean Seas.

First, I would like to explain very briefly the dangers of dependence on Russian gas. Russia has long claimed that it is a reliable supplier to Europe. In fact, it uses this claim as justification for its refusal to sign the Energy Charter Treaty—implying that Russia is already so reliable that a formal document to enforce reliability would be redundant. However, the experience of countries in Central and Eastern Europe calls Russia's reliability into question. On numerous occasions since the fall of the Soviet Union, Poland and the Baltic states have endured politically motivated supply cut-offs and pressure tactics at the hand of Moscow. Even for Member States that have not had to contend with Russia's 'energy blackmail', there are other costs to this over-reliance—specifically the unwelcome influence it grants Moscow in European capitals. Fearful of losing needed Russian energy supplies, many European leaders feel compelled to limit their criticism of human rights violations and other unsavoury activities carried out by Russia. To enhance its bargaining power in Europe, Moscow employs a deliberate strategy of 'divide and conquer' with the EU. This has led to the creation of severe East-West tensions within the Union. Many Eastern European states have expressed concern that their

interests are being slighted. This divisiveness undermines the very foundation of the European Union.

Due to its overdependence on Russian gas, the EU also shies away from demanding more transparency of companies like gas monopoly Gazprom and its subsidiary RosUkrEnergo (RUE), which may have links to criminals. Given that 80 percent of Europe's natural gas supply from Russia flows through Ukraine (and RUE), billions of dollars are potentially being mismanaged or laundered. This means, by receiving gas supplies from RUE, the EU is a participant in a multi-billion-dollar money-laundering scheme.

While there are many other points I can make, I believe that the risks of over-reliance on Russian gas are more than clear. The good news is that the EU has realistic options to address this risk by focusing on obtaining supplies from the Caspian and Mediterranean Sea regions. Tapping these reserves will bring tremendous advantages, both to the EU and to Europe's neighbours. I will focus first on the Caspian region.

By importing from Caspian producers, the EU would secure an alternate source of energy and lessen its vulnerability to Russia. This diversification would benefit the Caspian states by granting them greater political and economic freedom from Moscow. The US has already pursued this strategy with success by supporting the Baku-Tbilisi-Ceyhan oil pipeline and the South Caspian Gas Pipeline. The construction of these pipelines and the development of the region's gas sector have substantially decreased Moscow's leverage over both Azerbaijan and Georgia. Thus, when Gazprom demanded a more than 200 percent price increase for natural gas supplies to Azerbaijan at the beginning of this year, Baku was able to decide against importing *any* Russian gas.

Although increasing a sovereign state's ability to resist foreign influence is desirable in its own right, this engagement also provided a means by which the West was able to achieve meaningful reform in Azerbaijan and Georgia. Their increased energy independence has translated into economic and political independence as well, allowing Azerbaijan and Georgia to cement their orientation towards a future in European and Euro-Atlantic institutions.

Azerbaijan's massive Shah Deniz gas field has an estimated 1 trillion cubic metres of reserves; if the upstream investment in the Shah Deniz field can be accelerated, significant quantities of gas could flow from Azerbaijan to Europe in a very short time. By 2020 Azerbaijan could produce from 30 to 70 billion cubic metres (bcm) of natural gas annually, of which up to 50 bcm could be supplied to European markets. But this capacity will simply not be developed if Azerbaijan does not have the ability to get this gas to market. Pipelines to carry Azerbaijani gas directly to Europe are needed. The EU has recognised this fact, designating the Turkey-Greece Interconnector (TGI) and Nabucco as 'European Interest Projects'. TGI is to be completed in late 2007 and, if construction on Nabucco starts in 2008 as planned, it could be completed in 2011. Together, these pipelines will have a capacity of 15 to 20 bcm per year.

However, concerted EU effort is needed to bring these various pipelines to fruition. Russia is actively attempting to undermine projects designed to bring Caspian gas directly to Europe. Moscow is keen to maintain its dominance over both European imports and Caspian

exports. In the late 1990s, it thwarted US plans to construct a trans-Caspian gas pipeline to Turkey by building Blue Stream, which effectively killed demand for additional gas from the Caspian. Now, as the EU makes plans to construct Nabucco, Russia is manoeuvring to build its own gas pipeline into Europe. Moscow has been negotiating with Hungary and Bulgaria on constructing an extension of Blue Stream into Central Europe. It would reach the same markets as Nabucco—but would supply them with Russian rather than Caspian gas.

In its quest for Caspian energy supplies, the EU needs to also work directly with the Central Asian states of Kazakhstan, Turkmenistan and even Uzbekistan. Turkmenistan in particular is important as it has one of the world's largest gas reserves. An undersea pipeline across the Caspian is feasible and needs to be supported.

On TGI, Nabucco and the trans-Caspian gas pipelines, the EU can and needs to work with the US, which is already actively engaged in supporting these projects—even though the projects are run by European companies and the gas will be for European markets.

As with the US Eurasian gas policy, a European strategy of diversification would not be anti-Russian. Instead, it would be anti-monopoly, and hence in favour of competition with Gazprom. Russian ability to continue supplying European markets 'reliably' depends *completely* on maintaining full control over the Caspian region's gas transportation. Gazprom has not made the much-needed investments into Russia's own gas development; if Central Asian gas gets to Europe via a different route, then 'Russia' would fall seriously short. This may actually be good for Russia, as it would then have to undertake much-needed reforms in its energy sector.

The EU should pursue diversification not out of fear or resentment towards Russia, but because doing so will improve its energy security and bolster its efforts to encourage reform in European neighbours. The monopolistic sway Russia holds over Caspian and Central Asian energy-producers is detrimental to their independence and prosperity. It simply does not make sense to allow the independent countries of Central Asia remain beholden to a third country—one that used to rule over them and once again would like to do so through the control over their energy and transportation networks. This is especially important in case of Turkmenistan, which has entered the post-Niyazov transition period. The window of opportunity to engage the new Turkmen leadership on long-term gas projects (and along with it, political and economic reforms) is rather limited.

The Caspian Sea region presents a number of opportunities to Europe, not the least of which is securing alternative energy supplies. Both Azerbaijan and Kazakhstan have pro-West, reform-minded leaders. Only after assuring these leaders that the EU will stand with them and not leave them vulnerable against Russian machinations, can there be the trust established at the highest levels that is necessary for these governments to undertake broader reforms.

Current EU policies, including the ENP structure, simply lack sufficient leverage or incentives to encourage Europe's energy producing neighbours to the east to change. Often, the EU is interpreted as admonishing neighbour states, calling for too much political and social reform too fast—and with too little offered in return. Leaders in the Caucasus and Central Asia are more concerned with security and stability than with political openings. Instead of lecturing

leaders on reforms that they are not in a position to make, the EU should work together with its neighbours on stability and economic development, focusing on the energy and transportation sectors. Let me state is very clearly: It is simply not possible to promote EU policies in the landlocked Caspian region without first and foremost engaging them on energy export infrastructure. If this engagement is carefully undertaken, it can create a mutual dependency that is vital to catalysing political and economic reform.

Moving to the Mediterranean, the countries of Algeria, Libya and Egypt also represent an excellent opportunity for the EU to diversify supply sources. All three have substantial natural gas reserves and well-established energy ties to the Union. In fact, Algeria has been supplying Europe with gas for decades; it was the world's first producer of LNG and is still the world's second-largest exporter of the commodity. It also is in the midst of a number of projects aimed at substantially upgrading its export capacity to Europe. These include the construction of two new gas export pipelines and two new LNG liquefaction facilities. Neighbouring Libya and Egypt, although not endowed with reserves as large as Algeria, have also proven themselves to be reliable suppliers to Europe and are increasing their gas export capacity.

However, just as in the Caspian region, the EU must move quickly to ensure that these valuable energy producers—and key European neighbours—are not drawn into the Russian sphere of influence. Moscow has been actively courting its Soviet-era clients in North Africa. Just last month, Russia and Algeria agreed to significantly deepen their cooperation on exploration and transportation in the energy sector, prompting many observers to speculate on the eventual creation of a gas cartel similar to OPEC. Moscow has made similar overtures to Libya and Egypt, signing an agreement in December 2006 on cooperation in exploration and production of oil and gas in Egypt. Without a unified effort from the EU, the energy-producing states of North Africa will drift under the influence of Russia and its policies—policies that are often in conflict with those of the EU.

Indeed, for all of the potential energy projects in the Caspian and Mediterranean region, time is of the essence. Moscow takes the energy issue very seriously and is sparing no time or effort in its manoeuvres with gas and oil producers. Although all these projects are commercially viable, given the long lead times and tremendous investment costs involved, they also require a degree of political coordination and support. The EU must express a solid commitment to proceed with vital projects such as TGI, Nabucco and the Trans-Caspian Gas Pipeline. This will spur needed development of gas fields to supply those pipelines. Gas and oil contracts are typically long-term deals; thus, with one commercial victory, Russia will be able to effectively lock the states of a region into its orbit—severely curtailing the EU's ability to press for reform and consolidating European dependence on Russian energy.