

# **Global Energy Security Issues**

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First, let me thank you for the opportunity to testify.

It is always an honor to appear before this committee. But it is a particular honor being asked to speak at the current hearings, coming as they do at so critical a time in our nation's history.

The US led war to liberate the people of Iraq is certain to be a watershed event, one whose full impact on the post-Cold War international security system we will not be able to accurately describe or fully comprehend for at least several years. Many of the reverberations of this action will not even begin to form or be felt until the culmination of the war, and others until military occupation makes way for Iraqi self-rule.

The events in Iraq will pose a lingering risk to US energy security, irrespective of the fact that the war is being undertaken to meet a set of broader security concerns. Although the speed with which increased amounts of Iraqi oil can be brought to market will be difficult to calculate until a careful survey of the Iraqi oil industry is done, the end of the war will mean the resumption and expansion of Iraqi oil production.

Increasing Iraqi oil production only addresses one small part of the energy security problem. Much more important to the long run energy security of US and its closest allies is the success with which the US goes about the post-war reconstruction in Iraq. For here the US is sailing in far more uncharted waters than it did throughout the phase of military operation.

It is likely to be several years before the democracy-building experiment that the US will engage in the aftermath of this war can be judged as a success, until an Iraqi civilian government is able to demonstrate its capacity to govern the state with public approval. Until that time the risk of instability in other oil-producing states in the Persian Gulf is likely to remain quite high, and if US led democracy building efforts are successful in Iraq the risk to many of these regimes

may well be intensified. No matter what, the relationship of the US to other oil-producing states has been redefined, as have the relationships of the leaders of many of the neighboring countries to their populations.

There are other threats to the energy security of the US and its allies that bear little relationship to the War in Iraq. Two other oil-producing states have also been frequently in the news in recent months, whose reserves figure importantly on the US market, Venezuela and Nigeria. Industries in both countries have been temporarily shut down, the first because of a national strike, and in the second case because of ethnic disturbances. In both cases American held assets have been directly affected, and the work-stoppages have affected the supply of oil to US markets.

These developments too could be a harbinger for problems that may lie ahead, for other small producers in Africa, and more importantly, in Russia and in the new producers of the Caspian region, whose production is set to increase dramatically over the next 5-10 years. The kind of risks that are posed to US energy security in these states will not be minimized by US success in war in Iraq, or by a smooth process of nation-building in its aftermath.

My testimony will look at the energy security threats that could originate from these "new" oil producing states that lie outside of the Persian Gulf. I will then talk about the possible threats to energy security that could come from the Persian Gulf region in the aftermath of the current war for the liberation of Iraq. Finally, I will conclude with a discussion of the "hidden" security costs for the US of crises in the oil industry and energy sector more generally.

### **Threats to Energy Security in "New Producing" States**

The recent crises in Nigeria and Venezuela may well be harbingers of the kind of problems that will develop in the Caspian region, as the Soviet-era rulers make way for a new generation of rulers.

Of the five states of the Caspian region, only Iran does not in some way qualify as a new producer. Turkmenistan, Kazakhstan and Azerbaijan all achieved their independence in late 1991. The situation in Russia is somewhat different, as it is a case of statehood restored. However, the economic revolution that has accompanied the fall of communism means that Russia should be viewed as a kind of new producer as well. Russia's reserves are vast, larger than the other new Caspian states, and foreigners as well as Russians have been entertaining hopes of developing these assets.

All of these states have also experienced enormous political changes, going from constituent units of a highly centralized ideologically driven political system to self-administering political units each with its own evolving national identity. Probably nowhere have these changes been greater than in Russia, which has already experienced a peaceful political transition, with Boris Yeltsin's choice of political successor being ratified by a popular election process.

The other three new Caspian oil and gas producers have yet to undergo this same transition. Octogenarian Heydar Aliyev who rules Azerbaijan is not nearly as sickly as his much younger former Russian colleague was. He hopes to serve out both his current, and one additional term of office. If Aliyev's health holds, the outcome of the 2003 presidential election is not in doubt, But although Aliyev has been one of the greatest political survivors of the last fifty years, even he cannot cheat death indefinitely, and when construction is complete and "big"

oil begins to flow through the much debated Baku-Tbilisi-Ceyhan pipeline, Azerbaijan could find itself going through a difficult political transition..

Saparmurad Niyazov of Turkmenistan and Nursultan Nazarbayev are in their early sixties. The latter seems quite fit, and the former has both had serious health problems and is the more unhealthy and more unpopular of the two. Niyazov, has been responsible for the development of an increasingly more despotic cult of personality, and has grown so unpopular with the Turkmen elite in recent years that in November 2002 there was a failed political coup effort against him. In the aftermath of the failed coup, the Turkmen leader has moved even closer to Russia than previously was the case, and negotiations awarding Russia long-term control over the export of Turkmen gas are coming to a conclusion.

For all his much publicized praise of the special relationship between the US and Kazakhstan, in recent months Nursultan Nazarbayev has also become more closely associated with Russia's president Vladimir Putin on a number of key issues, including almost mirroring Russia's position on the war in Iraq. The Kazakh president has not required the same bailing out as his Turkmen counterpart. Nazarbayev has not been guilty of the same political excesses as his Turkmen colleague, but he too has been responsible for a sharp restriction of political competition in his country. Increased pressure on political opposition groups in Kazakhstan has come at a time when stories of his personal corruption, accentuated by an ongoing grand jury investigation in New York's southern district, are increasing. While developments in Kazakhstan have led to periodic rebukes of the Kazakh leader by reasonably low-level administration officials, even as the drama in NYC has continued to unfold, the leader of oil-rich Kazakhstan has remained a welcome visitor in Washington.

The deteriorating political situation in Kazakhstan is not wholly dissimilar to that of Nigeria, although the level of corruption in the landlocked Caspian state is still not as all pervasive as it was in Nigeria under military rule. It is often said, in my opinion with great justice, that the US is too generous in the treatment of dictators of oil-rich states. In tolerating the foibles of these men policy-makers in Washington often help create the very outcomes that their support is designed to avoid, that is to make access to oil less rather than more dependable. As estimates of the size of Kazakhstan's unexploited oil reserves began to grow, so too it seemed to Washington's degree of tolerance for Nazarbayev's "bad" behavior.

We are already seeing what this kind of outcomes such a strategy can lead in Nigeria, where the damage done in the years of corrupt military dictatorship left the economy of the country in ruins, creating hard-to-fulfill popular expectations of the civilian rulers who took power four years ago.

When the government of Nigeria was returned to civilian rule four years ago it was already too late to introduce relatively easy fixes for the country's growing economic crisis. Nor were there any ready solutions for reversing decades of deteriorating social conditions in many parts of the nation. In a country as ethnically diverse as Nigeria, the introduction of a participatory form of government with the backdrop of social and economic crises was a recipe for ethnic conflict, much like we have seen in recent weeks in the Nigerian Delta region, where US and other foreign producers have recently suspended oil production.

The trigger for the most recent violence is Nigeria's current election cycle, which culminates with presidential elections in mid-April. The real cause, though, is the decades of neglect by Nigeria's rulers. While the military dictators were in power the thrust of US policy was to support US businesses involved in the country, and provide only minimal assistance to the

regime in power. Since the return of civilian rule, the US has made a substantial increase in assistance money available to the Nigerian government, and non-governmental agencies working in the country. But this assistance money is unlikely to lead to rapid solutions in Nigeria. A slow improvement in the country's economic and social situation could develop, but this is not guaranteed. Civilian government could be abandoned in favor of a military or even other form of dictatorship, and the country could devolve into further chaos or a civil war on ethnic and regional lines. As bad as the recent level of ethnic violence has been, and there have been over ten thousand deaths in four years, under a dictatorship or during a civil war things could grow much worse, with full-scale genocide resulting.

Although one should not generalize too far from the situation in Nigeria, many features of this African country's crisis could be duplicated in Kazakhstan, albeit in somewhat muted forms. In any political succession, elite groups from Kazakhstan's oil-producing regions (found largely in Western Kazakhstan) are certain to demand greater representation and a greater share of the spoils (both in terms of personal wealth and as investment in the economy of their region).

The demographic mosaic of Kazakhstan is not nearly as complex as that of Nigeria, but ethnic and sub-ethnic divisions are critical there too. Should political succession fail to meet the expectations of the prominent families of the Small Horde (from Western Kazakhstan) and solely reward those from the Great Horde (which is the group that President Nazarbayev is from), or those of the Middle Horde (in northern and eastern Kazakhstan, whose prominent families have generally favored close ties with Russia) then the threat of territorial secession could become more than a hypothetical one.

One of the complaints that helped set off the current protests in Nigeria's Delta region has been the shortage of petrol as well as problems with energy supply more generally. This has

been a recurrent problem in Kazakhstan and Azerbaijan both, and in both places there has been a sharp differentiation in the standards of living between the urban rich and the rural poor, and the percentage of the population falling into the latter category is an increasing one.

The situation in Venezuela while different from that of Nigeria, is in many ways equally disturbing, proving the case of what scholars have called "the Dutch disease." Oil is the principle source of income in Venezuela, and the state oil company is that country's largest employer, and economists have been warning that Kazakhstan, Azerbaijan and Russia could all fall victim to "the Dutch disease."

Venezuela's crisis was caused by the mismanagement of the oil industry, by a sharp turnover in management as well as bad choices in how income from foreign investments was used. Added to the mix was a controversial and unpopular president, and you get a situation that developed into a nation-wide strike in both the oil extraction and petroleum refining industries.

It is not difficult to imagine variants of the Venezuelan crises potentially developing in either Azerbaijan or in Kazakhstan, especially if the newly organized National Oil Funds do not receive or properly distribute the amount of money in oil revenues that most of the populations of these countries are counting on. This is especially true because the next group of presidents could be less popular and more controversial than the current group. This is very likely to be the case in Azerbaijan, but could also be true in Kazakhstan, as in both countries the new leaders will have to create the foundations for their political legitimacy.

Moreover, despite Washington's long-time support for these less than popular regimes, the presidents of Kazakhstan and Turkmenistan remain likely to turn to Moscow instead to bolster their regimes. The Kazakh oil and gas industry is becoming more intertwined with Russian interests than was previously the case. At the same time relations between the Kazakh



government and leading US and other western energy companies are becoming more strained, and the Kazakh government seeks to redefine terms of existing contracts, and to insure that the Kazakh national oil firm gets majority ownership stakes in all new projects that are let.

The conditions of political succession are likely to put new and more serious pressures on foreign investors in Kazakhstan, who even if they back the winning side are likely to find the ground-rules of doing business increasingly more set in sand. What makes this most unfortunate, from the US point of view, is that these developments are likely to occur in the period (2005-2010) when Kazakhstan's new large oil fields begin to become significant producers. Russian elite groups are already working closely with competing economic and political forces within Kazakhstan, determined to ensure that the outcome of a political succession struggle is to their benefit. And unlike US groups, that are also interested in protecting themselves against unfavorable outcomes, the lack of transparency of the playing field works much more to their advantage.

The relationship between Baku and Moscow is more complex, given the enmity on the Azerbaijani side that dates from the Karabakh crisis and Moscow's tacit support of the Armenian position. But the realist camp in Azerbaijan, of whom Heydar Aliyev is certainly the most prominent representative, is well aware of the critical role that Moscow can play to help secure the position of the country's next president. Azerbaijan is the only one of these oil-producing states to have joined the current coalition in the war to liberate Iraq, but in the past few years President Aliyev has also sought to improve relations with Russia.

### **Can Russia be a stabilizer in neighboring states?**

In the first year of the War on Terrorism there was reason for US policy-makers to be optimistic that improved US-Russian energy cooperation could advance the cause of US energy

security as well as US security interests more generally. Putin had great hopes for a strong US-Russian energy partnership, and had hoped that it would stimulate foreign investment in Russia's oil industry as well as advance the cause of Russia's geopolitical interests more generally by creating a new and strengthened international role for Russia.

From the onset, there has been a strong element of press-hype to the Russian-American energy partnership, hype generated by the two states involved rather than by the media. From the US side, talk of enduring cooperation with Russia put Saudi Arabia and other Gulf producers on notice, that there were new energy sources becoming available to the US, and that if they wanted to preserve their privileged place in the US market they had to be more forthcoming with their oil reserves.

From Russia's point of view the partnership gave Putin's presidency a seeming international success, at a time when US policies were marginalizing Russia in Europe and in the international community more generally. It also seemed to give the Russians a reward for participating in the War on Terrorism, and for quietly standing aside when the US opened military bases in Uzbekistan and Kyrgyzstan.

Developments in the last few months are making clear that Russia's sense of national interest diverges in many key ways from that of the U.S. At the same time, Russia's energy resources are real and considerable, and their oil reserves in particular can be developed in ways that if coordinated with the development of Azerbaijani, Kazakh and Turkmen reserves can be to everyone's advantage. Moreover, the changing nature of Russia's relationship to the other former Soviet republics also makes it seem less imperative for the US to take great pains to "protect" these states from Russian bullying in oil, gas, and other commercial sectors. This is especially true, if being partisan in this way would restrict US access to Russia's own reserves.

Although conditions have improved for western firms doing business in Russia under Vladimir Putin, they are still far from problem free. In part they reflect the unstable relationship between Russia's oil industry and the economy more generally. The health of the Russian budget is directly linked to the current high price of oil, and when the price of oil drops Russia's leaders look to other forms of income, which include the sale of arms, weapons systems and various forms of military technology by state monopolies. The oil industry is not the major employer in the same way that it is in Venezuela or in the Gulf states, and there is real debate among Russian economists as to how rapidly Russia should expand the oil and gas sectors of its economy.

While Russia is unlikely to have a Venezuelan style economic crisis, it is still not clear how large or how stable a force Russia will be in the international energy market. Russia's oil industry is still evolving, and the divide between private and state-owned companies is still not a fixed one. Moreover, it is unclear whether the Russian government will ever give up full ownership of its assets, nor regularize the terms for foreign investors' participation in their development. Russians' investing in their own in the oil and gas sector has also faced serious road-blocks, not the least of which is the difficulties posed by the continuing state monopoly on the transit of oil and gas.

All of these problems affect US and Russian cooperation in the energy sector, and make it unlikely that this is going to turn into a real "partnership" anytime soon. While changes in Russian policy, not the least of which is a growing western-style corporate culture among some of the large Russian firms, make projects in Russia seem more desirable, very few firms seem eager to leap into the Russian market with both feet at least until they evaluate projects in other parts of the world that may become available to them in the near future.

BP's acquisition of a 25 percent stake in the Russian TNK oil company is a major development, and the first real show of western confidence in the Russian oil industry in quite a long time. But it is less clear what kind of harbinger it is, whether western firms will want to buy large stakes in Russian oil companies, and whether other Russian firms will sell stakes large enough to give western companies the managerial role necessary for them to make such an investment. For all of Putin's interest in attracting western investment, the rules of political engagement in Russia have been fixed to insure that westerner firms don't have "unfair" advantage over Russian firms, but little is being done to make the world of "insider" transparent to those from without.

The increased tensions between US and Russia owe their origin to the different stances of the two countries on the need for a war to liberate Iraq, but the idea of a close US-Russian energy partnership was based on a confluence of interests that for many other reasons was not likely to develop. The fact that Russian and US national interests sometimes overlap does not mean that their core values have much in common.

### **Looking Ahead in the Persian Gulf**

While most of the non-Arab oil producing states outside of the Persian Gulf region will be able to minimize the impact of the current war in Iraq on energy and other security issues, the same is not true of those within the Gulf region. There is no way that the states of the Persian Gulf and the nations of the Arab world more generally can insulate themselves from developments in Iraq. The fighting in Iraq also could lead to security problems in Indonesia, another oil-producing state in which radical Islamic groups enjoy popularity.

The fact that the U.S. enjoyed rapid military success in Iraq is a very hopeful sign, but as the reconstruction and nation-building stages in Iraq have yet to begin in earnest means only

those analysts who enjoy second sight have much sense of how developments are going to play out.

The period of U.S. military occupation will be a time of real stress in the Persian Gulf and in the Muslim world more generally, where many will see the U.S. military presence as a form of thinly disguised twenty-first century-style colonialism. U. S. policy-makers are now gearing for a massive humanitarian assistance and nation-building effort to "win the hearts and minds" of the Iraqi population. But the protection of U.S. national security, of which energy security is only one element, really demands that the Bush administration launch a successful public relations battle in the rest of the Arab and Muslim world.

As is so often the case with tyrannical figures, Saddam Hussein was a much greater hero outside of his country than within it, and even Iraqi public opinion may remain divided over just how Saddam Hussein was removed. In much of the Arab and Muslim world the evil one knows often seems preferable to the risks of the unknown, especially if the unknown is to be delivered by as problematic a force as the US military. The discovery of weapons of mass destruction in Iraq, would go a long way to repairing relations with US allies in Europe, but this will not have the same impact in the Islamic world, where strong leaders are expected to take strong steps to protect their populations.

Public opinion outside of Iraq has been heavily against the US led war effort. Protests in both the Arab and the Muslim world more generally are likely to continue throughout the period of US military occupation and this kind of public reaction will make the regimes that have supported the US effort more vulnerable from their critics. When one adds up active and inactive supporters, the regimes in Kuwait, Qatar, Saudi Arabia and Jordan have all been put at greater risk, and the last two were already quite vulnerable.

The long-term security of all of these regimes is dependent upon the success of reform movements within each of these states. But U.S. policy in the region can serve to further destabilize these regimes in the short-run, and could serve to undermine the political security of the states that provide so much of our energy needs.

It is also hard to imagine that the US can devise successful public relations efforts in the Arab world in the absence of a comprehensive peace settlement for the Arab-Israeli conflict. It is bad news for the Saudi regime in particular, if the US image in the Arab world becomes increasingly more tarnished in the coming weeks and months, for they are probably the most fragile of the states upon which US energy security depends. In time, the Saudi regime could experience its own version of the Venezuelan oil crisis. The country faces a demographic bulge, with growing numbers of young people being rendered virtually unemployable by the religiously dominated education system that all but the most privileged elite children pass through. In recent months the regime has at least making the right noises that it recognizes the need for economic and political reforms (although the role of religion in Saudi Arabia will at best only be tinkered with a bit). But the reform process is certain to produce change slowly, at best, in leave the regime with serious opposition for the foreseeable future.

US policy-makers should also make sure that they have drawn all the appropriate lessons from our military engagement in Iraq before challenging the regime in Iran by military means. First there is the question of international support for such an operation, which is certain to be even more difficult to obtain than for the current operations in Iraq. But even if US policy-makers were convinced that we could successfully overcome the international diplomatic fall-out of proceeding militarily with a small coalition of allies, there is the question of how the Iranian military and Iranian people would each respond in the face of a military incursion. While it is

certainly the case that the Iranian political and religious establishment are in an uneasy alliance at best, Iranian nationalism is a much more formidable and deeply rooted force than Iraqi nationalism, and there is little or no evidence to suggest that outside forces would be welcomed by any significant sector of the population as the source of moving the Iranian polity toward a more secular and pro-western form of government.

US energy security in the Persian Gulf will be very heavily influenced by how the US exercises its authority in Iraq, once Saddam Hussein is ousted from office. The less the transition authority seems like an occupation force, and the less the transitional regime can be accused of being a puppet for US interests the less anti-American sentiment will be further stimulated in other oil-producing states and the Arab and Islamic world more generally.

Most outside observers will be closely watching how the Iraqi oil industry is managed, whether oil income goes to help support military occupation and administrative costs, or if it is solely directed for the purchase of food and other humanitarian assistance for the Iraqi people. There will also be a lot of attention to how the contracts are let for rehabilitating Iraq's oil-wells and repairing the country's infrastructure, with the question being whether the process is a transparent one in which non-US firms are offered a level-playing field from which to tender their offers. It will be critical how decisions are made about the ownership Iraq's still undeveloped oil reserves, as well as how the choices will be made as to how and by whom they will be developed.

It is one thing for the Bush administration to insist that the war for the liberation of Iraq is not about oil, but their claims will not dissuade US and foreign critics until such time that US policies give evidence to the contrary. The way that the US goes about the reconstruction of the

Iraqi oil industry will either dispell these rumors, or insure that they are never able to be dispelled.

### **Security and Oil Dependency**

The fact that the US and virtually all of our principal allies consume more oil resources than they produce insures that the question of energy security will remain a vital one until such time that new sources of energy or new patterns of consumption emerge. That time is not imminent, although estimates of when it may occur vary dramatically.

This means that the US and its allies will continue to depend upon all of the existing producers to meet their energy needs, no matter how problematic the stability of some of these states may be. Many new oil producers could come on line whose domestic political stability could be even more problematic than those states described in this testimony.

Forecasting the course of international developments is never easy, but it is never more difficult than in a period of rapid international change. Modifications in how the international oil market operates that began to be introduced in the aftermath of the 1973 Yom Kippur War have done a lot to cushion the US and other major oil consumers from sudden changes in the international oil market. But all the industrialized and rapidly industrializing nations remain vulnerable both to cataclysmic changes in oil supply and to dislocation provided by several producing nations simultaneously reducing their exports.

The US and its allies are also vulnerable to the subtle impact of policies that are designed to increase energy security, but that oftentimes have a long-term effect that is quite opposite to their intended purposes. US policies that offer support of non-democratic leaders in oil-



producing states may maximize the supply of oil in the short-run, but often have exactly the opposite effect in the long-term.

While the US and most of our closest allies have the economic means to insulate ourselves from paying too big a price for such mistakes, as we are generally able to absorb sharp increases in costs that are caused by the vagaries of uncertain supply and a fluctuating price structure other states have less flexibility. Uncertainties in the oil market have great impact on less developed states, as well as those that are in the midst of rapid industrialization. Both groups of states have difficulties paying high spot prices for oil when oil supplies that they counted on are no longer available at the price that they expected to pay.

For this reason, uncertainties in the international oil market can cause all sorts of seemingly unrelated security problems for the US, even when steady supply to the US markets is maintained. High prices of oil, especially unexpectedly high prices, disrupt the economic plans of less developed states, making fragile states even more fragile, destabilizing whole sub-regions of the world.

Rapidly industrializing states with growing energy needs are also highly vulnerable to changes in the price and supply of oil in particular. One state worthy of mention in this regard is China, a country whose need for energy resources is growing and whose economy can not easily absorb sharp jumps in price or shortages in availability. For that reason China's leaders are looking for stable partners who in partnership with leading Chinese firms will insure that China's long-term energy needs are met. More than most any other country, China's search to protect its own security interests could create unexpected security challenges for other states.

And as China is looking to Russia, Iran and the Caspian for some of these new partnerships, US interests are sure to be affected in the process. If the war in Iraq does not

produce any major dislocations in world oil supply China is apt to move reasonably slowly to better protect its economy from future dislocations. But if the war does at some point produce even temporary major shortages, then the Chinese will certainly rethink their strategy and be more aggressive about asserting their national interests in the energy field.

It is still too early to predict the impact that this war will have on the oil industry in Iraq, not to mention the political climate in neighboring oil producing countries and in the Middle East region more generally. The fact that there are certain to be long-term and unpredictable outcomes of the War in Iraq on energy security highlights the way in which oil specifically, and energy more generally, is intertwined with a host of other security factors.