

Caspian Investment and Transportation

Remarks by Jan H. Kalicki*
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Thank you, Ambassador Kawamura [Chairman, Energy Charter Conference], for that kind introduction. It's a pleasure to join you and my fellow panelists from KMG, OMV and Edison in a discussion of risk management in the context of long-term investment decisions and policy uncertainty. I have been asked specifically to discuss Caspian investment and transportation, strategies for risk mitigation, and terms for "reciprocal" investments.

Over the past 15 years, foreign direct investment – mostly in energy – has increased greatly in the Caspian. Kazakhstan leads the way with \$32.5 billion, followed by Azerbaijan with \$13.3 billion and Turkmenistan with \$3.1 billion. In addition, Russian companies have started to develop the northern Caspian, and Iran plans the same for the south.

All major IOCs are now engaged, with BP as the leading investor in Azerbaijan and Chevron in Kazakhstan – where we operate and are half owners of TengizChevroil (TCO) and own 20 percent of the Karachaganak field, but we also own 10.3 percent of the Azeri Chiraz Guneshli (ACG) field offshore Azerbaijan. Our share of Caspian oil production is currently 270,000 b/d, and it will increase upwards to 395,000 b/d after completing the planned expansion of Tengiz in 2008. We are pursuing additional opportunities in a joint venture with Gazprom Neft in Russia, as well as opportunities both onshore and offshore Turkmenistan under a new and outward-looking government.

This large-scale investment by IOCs has been possible not only because of the substantial oil and gas sources in the region, but because of a favorable fiscal and regulatory environment in Azerbaijan and Kazakhstan. Some have questioned whether this environment is changing and may be more challenging in the future. Chevron's investment experience has been highly positive in the Caspian region – in line with our global goal of being the partner of choice for these and other countries. That is not to say that we are immune from environmental and other operating issues – but we have been successful in minimizing these as, for example, through cooperative approaches to sulfur management and focused efforts to increase sulfur exports. For example, Tengizchevroil sold 105% of sulfur production in 2006 and 122% in the first eight months of 2007.

I would attribute this progress to the early, positive role of our investments; our high level of alignment, dating back to independence, with the leaders and the economic and energy plans of the national and regional governments; and also our extensive community engagement at the federal and regional levels.

Hand in hand with investment comes the challenge of transporting the oil and gas produced to the global marketplace. This is especially important for the Caspian countries, which must depend on

* Counselor for International Strategy, Chevron Corporation, and Senior Scholar, Woodrow Wilson International Center for Scholars.

transit through their neighbors. We look to the Baku Tbilisi Ceyhan (BTC) pipeline, in which we have an 8.9 percent share, to transport ACG's production from offshore Azerbaijan through Georgia and Turkey to the Mediterranean. We look to the Caspian Pipeline Consortium (CPC) pipeline, in which we have a 15 percent share, to transport TCO's and Karachaganak's production from Kazakhstan across Russia to the Black Sea.

As more oil and gas are produced, more capacity will be required in the transportation network as a whole – by expanding BTC, CPC and the South Caucasus gas pipeline now under construction, by increasing pipeline and shipping capacity from Kazakhstan, by creating new bypasses around the congested Bosphorus, and by using other pipelines – those operated by Transneft and Gazprom in Russia, Baku-Supsa in the Caucasus, and Odessa-Brody in Ukraine extending eventually up through Poland – as well as the new Nabucco and South Stream pipelines proposed by the EU and Russia for oil and gas respectively.

On the CPC pipeline, we welcome recent progress toward aligning the private and state shareholders on expanding its capacity from 700,000 to up to 1.4 million barrels per day, as well as agreeing on tariff and interest rate issues. In turn, as CPC throughput increases, so does the economic case for the Burgas-Alexandroupolis pipeline (BAP) in which both Chevron and Kazakhstan's KMG are interested in participating on commercial terms equal to the Russian companies.

We and other companies also look to other transportation options where pipeline capacity is limited – by ship and rail, for example, through Russia and the Caucasus. At the national level, Kazakhstan and Turkmenistan expect to use not only Russian transit routes, as in the past, but also routes through China, the Caucasus, and even Afghanistan or Iran. China in particular has been proactive in committing resources not only to oil and gas development, but to transportation from Central Asia into its growing markets.

This brief overview points the way to risk mitigation in the transportation arena. The historic route for Caspian oil and gas has been Russia and, in large part, it will continue to be so. But the non-Russian pipelines also make sense – to accommodate increased production and to optimize the commercial terms through competition. In addition, at the state policy level, alternative energy routes provide substantial support for the energy, economic, and political security of Caspian states so that they, in turn, do not have to depend on the good will of any single neighbor.

Are there ways to minimize negative consequences of competition and introduce greater potential for cooperation in the Caspian? Let me identify three possible pathways – none mutually exclusive – for discussion.

First, we can increase the alignment of field and pipeline development. Assurance of adequate transportation will promote development in the more remote areas – whether these be landlocked countries or greenfields in eastern Siberia. President Putin has been personally and impressively proactive in all manner of pipelines, including the planned Nord Stream, the proposed South Stream, and the initiative for a gas pipeline around the north of the Caspian.

Similarly, expanded pipeline and transport capacity – through CPC, and across the Caspian to BTC – will facilitate vastly increased oil production at Tengiz and, in time, Kashagan. Expanded pipeline capacity – through China, Russia, and either around or across the Caspian to Azerbaijan – will facilitate increased gas production in Turkmenistan.

Leaders in Astana, Baku and now Ashgabat recognize the strategic as well as economic value of multiple pipeline links and helping these move forward, not only to the traditional northern market but to the newer western and now eastern markets. As for the latter, China is clearly doing all it can to secure more energy from these countries, by committing to *both* field and pipeline development.

The question is whether Western countries and companies are doing enough. On the one hand, CPC and BTC provide significant energy security dividends for the West and the region. On the other hand, the Nabucco pipeline project is only now advancing from drawing board to reality – though moving forward with it 10 or even 5 years ago could have created important strategic as well as economic dividends.

More can and should be done to fund timely pipeline development. For example, NOCs and IOCs can jointly invest in the phased development of new transportation infrastructure from Kazakhstan westward. Government sponsors of Nabucco, for their part, could take the lead in funding its timely development, which could then be operated commercially through gas shipments it would attract.

Second, we can encourage more reciprocal investment in Caspian and Western assets. Azerbaijan and Kazakhstan have welcomed majority Western stakes in their energy fields – and the development and broader benefits have been significant. Similarly, KMG’s interest in overseas investment should be welcomed and encouraged. Indeed, it is taking the first positive steps in acquiring an oil export terminal on the Georgian Black Sea coast, and in considering a stake in BAP from the Black Sea to the Mediterranean – stepping stones in securing the oil export route to the Western market. SOCAR’s equity interest not only in ACG but in the BTC pipeline is also a plus, with similar economic and strategic benefits.

Of course reciprocity has become a contentious issue in the EU-Russia context. In a positive move, Gazprom’s deputy chairman, Alexander Medvedev, committed to engage with Brussels on issues of access, pricing and energy security – which can only be enhanced, as President Putin suggested, by a balance between security of supply and security of demand. In turn, greater coordination of the European position will facilitate more coherent and effective energy relations with states outside the EU. Indeed, the EU’s trade commissioner, Peter Mandelson, gave a speech last month in Brussels in which he advocated “an agreement that allows Russian investment downstream and European investment upstream, anchored in a broader economic integration agreement between the EU and Russia.”

Third, we can promote a shared, cooperative legal regime for energy development. I believe this regime should promote increased investment access to the entire energy value chain, from upstream exploration all the way to downstream marketing. We need to counter growing investment

protectionism – in the West as much as in the East – with increased access and competition on a level playing field. The accession of Russia and Caspian states to the WTO, on commercially meaningful terms, and a network of trade agreements and investment treaties, both bilateral and multilateral – all fully implemented and enforced – will go far to developing a common legal space for increased investment. I also think there should be further dialogue with Russia and the United States about the Energy Charter Treaty, and the terms under which they might be prepared to join the ECT. As for the Caspian itself, Russia has shown commendable leadership in seeking multilateral agreement to its delimitation – one can hope that all five of the littoral states will ultimately join in accepting sectors proportional to their coastlines for subsea development.

Despite all the competitive pressures in the Caspian, I for one believe there is room for considerable cooperation between the regional states and external investors. Energy – long associated with competition – could become a significant vehicle for cooperation. In order for this to happen, Europe, the US and Russia should try to frame a positive rather than a zero sum dialogue with the states of the region. Such a dialogue is possible, I believe, if we better align field and pipeline development, encourage more reciprocal investment, and develop a common legal space for increased investment.

Thank you.