

**IMPLEMENTATION OF U.S. POLICY ON CASPIAN
SEA OIL EXPORTS**

HEARING

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL ECONOMIC
POLICY, EXPORT AND TRADE PROMOTION

OF THE

COMMITTEE ON FOREIGN RELATIONS
UNITED STATES SENATE

ONE HUNDRED FIFTH CONGRESS

SECOND SESSION

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IMPLEMENTATION OF U.S. POLICY ON CASPIAN SEA OIL EXPORTS

WEDNESDAY, JULY 8, 1998

U.S. SENATE,
SUBCOMMITTEE ON INTERNATIONAL ECONOMIC
POLICY, EXPORT AND TRADE PROMOTION,
OF THE COMMITTEE ON FOREIGN RELATIONS,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:06 a.m., in room SD-419, Dirksen Senate Office Building, Hon. Chuck Hagel, [chairman of the subcommittee] presiding.

Present: Senators Hagel and Sarbanes.

Senator HAGEL. Good morning. This is the subcommittee's third hearing on the Caspian Sea region. Our first hearing last year dealt with general economic and political developments in this region. Our second hearing, last February, focused on our new policy supporting a western main export pipeline. The hearing today will look at the implementation of that policy.

There is little time left before the October 1998 deadline for deciding the route for the main export pipeline. I support the U.S. policy in this region. I support the administration's position. I support the construction of a main export pipeline through Azerbaijan, Georgia, Turkey to the Mediterranean. But a policy is not enough without a clear, forceful plan for carrying it out.

The development of the western pipeline project will support the sovereignty, independence, and cooperation among these emerging free market nations. These nations need to understand that they have a common future. They need to get beyond the past and look to the future. They need to understand that through the free market system a gain for one nation does not mean a loss for another. They can all benefit.

A month ago I returned from a trip to the Caspian Sea region. In Istanbul, Turkey, I delivered a keynote address at the Crossroads of the World Trade and Investment Conference hosted by our government's Trade and Development Agency. I was in the region for 9 days and visited 5 countries—Turkey, Georgia, Armenia, Azerbaijan, and Turkmenistan.

I came away from the trip hopeful, but concerned. There are tremendous opportunities for all of the nations of this region. However, the nations of this region and the region's leaders need to display the vision and bold leadership necessary for their people to enjoy the unlimited future of economic opportunity and national independence that will be available to all of these nations and to

all peoples in this region if they understand and address their mutual interests.

Strong visionary American leadership is also required. America is the one country that can help bring these nations together. As a distant power, the United States has no imperial designs on this region. Our own national interests coincide with the national interests of the countries of this region: respect for national sovereignty, independence, and economic growth.

Decisions made this year will set the geopolitical and economic course of this region for the next century. The United States must help these nations realize that potential. If we do not, others will surely fill the leadership void.

Now I would like to welcome our distinguished witnesses this morning. We will hear from a variety of viewpoints. We will first be hearing from Ambassador Marc Grossman, Assistant Secretary of State for European Affairs, which encompasses the Caspian Sea region.

Also on the first panel is Ambassador Stephen Sestanovich, Special Advisor to the Secretary of State for the New Independent States, the former Soviet republics. Ambassador Sestanovich visited the region the week after I was there.

On the second panel is one of our Nation's most respected strategic and foreign policy thinkers, Dr. Zbigniew Brzezinski. Dr. Brzezinski also visited the region during my recent trip to this area.

Our final panel will be made up of the respected scholar, Dr. Martha Brill Olcott, who has testified before on this region, and Mr. Van Krikorian, Chairman of the Armenian Assembly. We look forward to your views as well.

The Ranking Minority Member, my distinguished colleague Senator Sarbanes, will be here shortly and he has indicated that we should proceed. So with that, we will proceed. Again, I welcome our witnesses and am most appreciative of your time this morning. So with that, may I ask Secretary Grossman to begin.

STATEMENT OF HON. MARC GROSSMAN, ASSISTANT SECRETARY OF STATE FOR EUROPEAN AND CANADIAN AFFAIRS

Mr. GROSSMAN. Senator, thank you very much, and thank you for that introduction.

Ambassador Sestanovich and I this morning will make statements to you that I hope will further your efforts in this regard, because I think the relationship between the Congress and the administration in this area is going to be crucial to the kind of success that you seek and we seek as well. So I very much appreciate the opportunity to appear before you today to talk about America's interests in Caspian Basin energy.

Senator, you referred to your trip to the region and your statement at the Istanbul conference on May the 27th. One of the things that I took from that statement was your sentence that said that Caspian energy had fired the imagination of the entire world. I think that is absolutely right. Your visit to the region helped people focus on the importance of developing a western route for Caspian gas and oil.

As I said, establishing the right dialog with the Congress I think is going to be vital to our future success. Secretary Pena, Under Secretary of State Eizenstadt, Strobe Talbott and others have led such a dialog from our side, and your hearings and our consultations from time to time I believe have made a major contribution to our policy. As part of our dialog with the Congress, it is clear that we also support the passage of the Silk Road Strategy Act and the repeal of section 907 of the Freedom Support Act.

Senator, if you would allow me, I would like to just step back for a moment and review why these Caspian energy issues are important to the United States. Bringing Caspian energy on line could be one of, as you say, the most significant developments of this decade. Done correctly—and that is what we hope we are trying to do—bringing Caspian energy to world markets can contribute to diversifying energy markets, which would obviously benefit our European allies and, as you say, benefit Turkey, provide major commercial opportunities for American companies, and help develop the emerging market economies of both the supplying and the transit states.

As you just said in your introduction, this is not a zero sum proposition. Everybody can win if we do this right. That is why in early 1995 we announced a policy to support multiple pipelines to bring Caspian energy resources to world markets. Our objectives then and our objectives now were: to diversify world energy supplies, increasing energy security for the United States and for our European allies; to eliminate traditional energy monopolies on which many of the countries in the region were dependent; avoid the emergence of choke points, such as the Bosphorus, as the Caspian Sea is developed; and, very importantly, to advance opportunities for American business and to provide support for the new nations of central Asia and the Caucasus, as well as Turkey.

Deputy Secretary Talbott described our approach to the region on the 21st of July last year in a speech over at Johns Hopkins as “co-operative and inclusive,” one that tries to break down barriers and foster regional cooperation.

We pursue this east-west energy corridor because it serves the interests of the regional states and our policy objectives. Ambassador Sestanovich will talk about the ties the United States is establishing with the emerging states of the Caucasus and Central Asia. Let me say at this point that the key to our success will be our work with Europe and with Turkey.

We think that development of Caspian Energy supplies will support stable European energy markets and enhance the security and the prosperity of Europe, which is a goal obviously in the interest of the United States. I think this is especially true for Turkey, which represents a natural transit route and where a growing economy is creating energy shortages and demand for natural gas growing at 14 percent a year.

Mr. Chairman, I can report that we have made progress toward achieving our goals and advancing U.S. interests. Secretary Pena’s announcement in Istanbul at the same conference at which you spoke of a new Caspian Sea initiative which will bring together the heads of EXIM, OPIC, and TDA to coordinate development and support of projects in the Caspian Basin is, we believe, a step for-

ward in realizing our goals. As a result of our diplomacy, which Secretary Pena and others have led through their engagement, states in the region have begun to leave distrust and competition behind, at least on this issue, and cooperate more closely. I would say this has been especially true in the last 3 months.

I would also say that Turkey, with much to gain from our mutual success, has taken a lead here. Let me give you some examples. Turkey successfully solicited Kazakhstan's and Azerbaijan's cooperation in committing to transport oil through an east-west pipeline and is continuing to work in that direction. Turkey organized a conference of foreign ministers of the key regional states in March, a very important outcome of which was that they endorsed our pipeline strategy.

Turkey's cooperation is important if we are to accomplish our objectives, and that is why President Clinton identified energy cooperation as a key element of our bilateral relations with Turkey when Prime Minister Yilmaz visited the United States last December. Since last December we have conducted regular high level meetings to move our agenda forward.

Our purpose in all of this is to encourage Turkey to facilitate the construction of a Baku-Ceyhan pipeline as a commercially attractive alternative for transporting Caspian oil. Turkey is nearing completion of a feasibility study on Baku-Ceyhan that will provide a catalyst for American and other investors to initiate Caspian investments.

This Eurasian transport corridor, including oil and gas pipelines across the Caspian to Baku and then the Caucasus to Ceyhan, would help us achieve our objectives. It would establish Turkey as an important economic bridge between Central Asia, the Caucasus, and world markets, improve Turkish and European energy security, generate revenue further to develop Turkey's energy infrastructure, provide a commercially attractive alternative to transport through Iran, and help relieve traffic congestion through the Turkish straits.

We have also worked closely with our allies on our pipeline strategy. I think a very important development took place on the 18th of May, when at the U.S.-EU summit in London we issued a joint statement that highlights the importance of multiple pipelines for the secure delivery of Caspian Basin gas and oil to world markets. The European Union is supporting two assistance projects on its own to help overcome obstacles to the construction of transport systems, with the goal of facilitating the flow of natural resources westward toward Europe. We are working with our European allies on how we can best complement each other's efforts to promote pipeline projects. Caspian energy will be a major topic at the July 15 U.S.-EU Senior Level Group meeting at which both Under Secretaries Eizenstadt and Pickering will participate in Vienna, and in my own consultations with the EU troika now that the Austrians are in the presidency of the European Union on July the 17th.

There are some real challenges. We want the regional states, as you do, to work more closely with one another. There are significant disincentives to doing business in the area. There are competing visions on what pipeline routes are right.

But we will stay engaged and we will work with our European allies and we will work with the Turkish government to strengthen its leadership and, with Turkey and the countries of the Caucasus and Central Asia, pursue east-west energy transport routes, to reform internal economic and energy policies, and to finish with, shake off, unnecessary regulatory and bureaucratic burdens. We think that these reforms will facilitate private sector investment to reap the economic benefits of the region's oil and gas resources.

One other point, if I could. That is we will also continue our active efforts to dissuade countries from considering Iran as an acceptable route for transporting their energy reserves. As Secretary Albright said on May 18, we remain "strongly opposed to oil and gas pipelines which transit Iran and as a policy matter we will continue to encourage alternative routes for the transport of Caspian energy resources." In her Asia Society speech in the middle of June, she reiterated that "our economic policies, including with respect to export pipelines for Caspian oil and gas, remain unchanged."

Iran is not only risky as a route for energy; it also keeps control of the region's energy reserves in fewer hands, and we do not believe that that is in anyone's interest.

As the Secretary also said, we will examine carefully, under the Iran-Libya Sanctions Act and other relevant authorities, any new proposals for the construction of pipelines and take action appropriate to the circumstances.

Our goal, Senator, is to advance America's interests in the region, promote development, increase trade, strengthen market economies, and avoid conflict. We have the determination, we have a plan for engagement, and we hope we have the imagination to make a good policy succeed.

After Ambassador Sestanovich's statements, I certainly look forward to your questions, to your comments, and very much also to your suggestions. Thank you.

[The prepared statement of Mr. Grossman follows:]

PREPARED STATEMENT OF HON. MARC GROSSMAN

Mr. CHAIRMAN.

Thank you for the chance to appear before you today to talk about America's interests in Caspian basin energy.

Senator Hagel, as you said in your speech in Istanbul on May 27, Caspian energy has fired the imagination of the entire world. Your visit to the region helped people focus on the importance of developing a western route for Caspian gas and oil.

Establishing the right dialogue with Congress is vital to developing a successful policy. Secretary Pena and Under Secretary of State Eizenstat have led such a dialogue from our side, and your hearings and our consultations have made major contributions to our policy. As part of our dialogue with Congress, it is clear that we support passage of the Silk Road Strategy Act and the repeal of Section 907 of the Freedom Support Act.

Let me step back for a moment and review why Caspian energy issues are important to the U.S. national interest.

Bringing Caspian energy "on line" could be one of the most significant developments of this decade. Done correctly, bringing Caspian energy to world markets can simultaneously contribute to diversifying energy markets (which benefits our European allies including Turkey), provide major commercial opportunities for American companies, and help develop the emerging market economies of the supplying and transit states.

This is not a zero sum proposition.

That is why, in early 1995, we announced a policy to support multiple pipelines to bring Caspian energy resources to world markets.

Our objectives were then, and remain, to:

- diversify world energy supplies, increasing energy security for us and our European allies;
- eliminate traditional energy monopolies on which many of the countries in the region were dependent;
- avoid the emergence of choke points such as the Bosphorus as the Caspian is developed;
- advance opportunities for American business; and
- provide support for the new nations of Central Asia and the Caucasus, as well as our NATO ally Turkey.

Deputy Secretary Talbott described our approach to the region on July 21 last year in a speech at SAIS as "cooperative and inclusive," one that tries to break down barriers and foster regional cooperation.

We pursue an East-West energy corridor because it serves the interests of the regional states and advances our policy objectives. Ambassador Sestanovich will talk about the ties the U.S. is establishing with the emerging states of the Caucasus and Central Asia. Let me say at this point that the key to our success is our work with Europe and Turkey.

Development of Caspian energy supplies will support stable European energy markets and enhance the security and prosperity of Europe, a goal very much in U.S. interests.

This is especially true for Turkey, which represents a natural transit route and where a growing economy is creating energy shortages and demand for natural gas growing at 14% per year.

Mr. Chairman, I can report that we have made progress toward achieving our goals and advancing U.S. interests.

Secretary Pena's announcement in Istanbul on May 27 of a new Caspian Sea initiative, which brings together the heads of EXIM, OPIC, and TDA to coordinate development and support of concrete projects in the Caspian Basin, is a step forward in realizing our goals in this region. And, as a result of our diplomacy, which Secretary Pena and others have led through their engagement, states in the region have begun to leave mutual distrust and competition behind on this issue and to cooperate more closely. This has been especially true in the last three months.

Turkey, with much to gain from our mutual success, has taken a lead. Turkey successfully solicited Kazakhstan's and Azerbaijan's cooperation in committing to transport oil through an east-west pipeline, and is continuing to work in that direction. Turkey organized a conference of foreign ministers of the key regional states in March, which endorsed our pipeline strategy. We are working right now with Turkey to develop a joint approach to Turkmenistan and Azerbaijan to bring them into closer cooperation with our efforts.

Turkey's cooperation is important if we are to accomplish our objectives. That is why President Clinton identified energy cooperation as a key element of our bilateral relations with Turkey when Prime Minister Yilmaz visited in December. And, since last December, we have conducted regular high-level meetings to move our agenda forward. We encourage Turkey to facilitate the construction of the Baku-Ceyhan pipeline as a commercially attractive alternative for transporting Caspian oil. Turkey is nearing completion of a feasibility study on Baku-Ceyhan that will provide a catalyst for American and other investors to initiate Caspian investments.

The Eurasian transport corridor, including oil and gas pipelines across the Caspian to Baku and then the Caucasus to Ceyhan, would help us achieve our objectives.

It would establish Turkey as an important economic bridge between Central Asia, the Caucasus, and world markets; improve Turkish and European energy security; generate revenue to develop Turkey's energy infrastructure, provide a commercially attractive alternative to transport through Iran; and help relieve traffic congestion in the Turkish straits.

We have worked closely with our allies in Europe on our strategy.

At the U.S.-EU Summit on May 18 in London, we issued a joint statement that highlights the importance of multiple pipelines for the secure delivery of Caspian Basin gas and oil to world markets. The EU is supporting two assistance programs to help overcome obstacles to the construction of transportation systems, with the goal of facilitating the flow of energy resources westward toward Europe. We are working with our European allies on how we can best complement each other's efforts to promote multiple pipelines. Caspian energy will be a topic at the July 15 U.S.-EU Senior Level Group meeting with Under Secretaries Pickering and Eizenstat, and in my own consultations with the EU troika on July 17.

Real challenges remain. We want the regional states to work more closely with one another. There are significant disincentives to doing business in the area. There are competing visions on which routes are the most commercially viable.

The United States will stay engaged. We will work with our European allies. We will work with the Turkish government to strengthen its regional leadership, and with Turkey and the countries of the Caucasus and Central Asia to pursue east-west energy transport routes, to reform internal economic and energy policies, and to shake off unnecessary regulatory and bureaucratic burdens. These reforms will facilitate private sector investment to reap the economic benefits of the region's oil and gas potential.

We will also continue our active efforts to dissuade countries from considering Iran as an acceptable route for transporting their energy reserves. As Secretary Albright on May 18, we remain "strongly opposed to oil and gas pipelines which transit Iran and as a policy matter, we will continue to encourage alternative routes for the transport of Caspian energy resources." In her Asia Society speech on June 17, she reiterated that "your economic policies, including with respect to the export pipelines for Caspian oil and gas, remain unchanged."

Iran is not only risky as a route for energy; it also keeps control of the region's energy reserves in fewer hands. And that is in no one's interest.

As the Secretary also said, we will examine carefully, under ILSA and other relevant authorities, any new proposals for the construction of such pipelines and take action appropriate to the circumstances.

Our goal is to advance America's interests in the region—promoting development, increasing trade, strengthening market economies, and avoiding conflicts. We have the determination, engagement, and imagination to make a good policy succeed.

I look forward to hearing your questions, comments and suggestions.

Senator HAGEL. Mr. Secretary, thank you. Mr. Ambassador.

STATEMENT OF HON. STEPHEN R. SESTANOVICH, SPECIAL ADVISOR TO THE SECRETARY OF STATE FOR THE NEW INDEPENDENT STATES

Mr. SESTANOVICH. Senator, I want to thank you also for the opportunity to review our policy toward the Caspian Basin. As you noted, you and I and other witnesses were in the region last week, so this is a particularly opportune moment to look at where we stand. I might note that your visit reflects increased Congressional attention to this region, which is certainly an important ingredient of a successful policy.

I am sure you have heard it said, as I have, that American interest in the Caspian is exclusively about energy. It is not. If there were no oil or gas there at all, the United States would still have important interests in the region. They are: to advance the sovereignty, prosperity, and democratic development of the countries; to promote regional cooperation among them; and to support their integration into international institutions and the international economy.

These are ambitious goals. They reflect the enormity of the transformation that began with the breakup of the Soviet Union in 1991.

To serve these goals, the United States is expanding its relations with all the states of the Caspian Basin. Thanks to the active support of the Congress, we are carrying out aid programs worth \$372 million in fiscal year 1998. We promote democracy, respect for fundamental human rights, the rule of law, and open and sound investment and trading regimes. We are helping these countries create the legal infrastructures of market economies, prepare themselves for accession to WTO. We work on issues ranging from non-proliferation to resolving U.S. investor problems, from Caspian sea-

bed delimitation to counternarcotics, women's issues, environmental protection.

Regional cooperation and conflict resolution are important elements in our strategy toward the Caucasus. We are leaders in the group known as the UN's Friends of the Secretary General, which addresses the Abkhaz conflict in Georgia. The United States is also one of the three co-chairs of the OSCE Minsk Group, which is charged with resolving the Nagorno-Karabakh conflict. Our efforts on Nagorno-Karabakh and our Caspian diplomacy as a whole would be better off without section 907 of the Freedom Support Act and I want to take this opportunity, Mr. Chairman, to urge its repeal.

The U.S. is expanding its security cooperation with the states of the Caucasus and Central Asia. As members of the Partnership for Peace, some of them participated in numerous PFP exercises. The countries that formed CENTRASBAT are gaining the ability to police peace settlements in this region and beyond.

We have initiated security dialogs with the Caucasus states, will soon have similar dialogs with Turkmenistan and Kyrgyzstan, and have made security and nonproliferation key agenda items of our binational commissions with Uzbekistan and Kazakhstan. We are providing assistance, equipment, and training to Georgia that will help it to take control of its borders as Russian units depart.

Mr. Chairman, our interest in the Caspian is not defined simply by the region's energy resources, but no one doubts their significance. Energy could become a source of conflict, a lever of control, or an obstacle to progress. Or for the states of this region it could become a ticket to prosperity and peace, a secure link to the outside world.

Our multiple pipeline strategy aims to promote these positive results. We believe that a commercially viable east-west corridor ought to consist of a Baku-Ceyhan oil pipeline, a parallel gas pipeline to Turkish markets and beyond, and trans-Caspian gas and oil pipelines. Support for multiple pipeline routes, including the Caspian Pipeline Consortium route through Georgia, is as important as any other aspect of our policy for securing the economic sovereignty and independence of the Caspian Basin states.

As Ambassador Grossman has said, we have made some real progress. Each month this spring has brought significant steps forward. In March, as Marc noted, regional foreign ministers met in Istanbul to coordinate energy transport policies. In April in Washington Turkmen President Niyazov signed a grant agreement with the Trade and Development Agency to fund a feasibility study for a trans-Caspian gas pipeline. In May Secretary Pena and the heads of the three U.S. trade finance agencies announced an unprecedented new Caspian Sea initiative to facilitate financing of east-west routes.

In June the Azerbaijan International Operating Company began negotiations with potential transit states for the main export pipeline, and the CPC obtained land allocation permits from Novorossiysk and Krasnodar. This week Russia and Kazakhstan signed an agreement dividing the north Caspian seabed into national sectors. These are all important steps forward.

Our multiple pipeline strategy is a long-term policy initiative. Ultimately, the number and the routes of these pipelines will be based on the attractiveness of the markets, on the size of supply, commercial viability, and strategic calculations. Three pipelines are currently in development: one for early oil out of Baku north through Russia, a second for early oil west from Baku through Georgia, and the CPC line from Kazakhstan through Russia.

The big question now is what major pipeline comes next. We strongly believe that the right answer is to build pipelines along an east-west corridor.

Mr. Chairman, I would like to comment on one issue of particular importance to our Caspian Sea policy. As you know, Secretary Albright in May issued a national interest waiver under the Iran-Libya Sanctions Act in connection with investment in South Pars by TOTAL, Gazprom, and Petronas. This decision did not and does not change our Caspian energy policy. We continue to oppose trans-Iran pipelines for Caspian energy exports in the strongest terms. We will carefully examine new pipeline construction proposals under ILSA and other relevant authorities and take appropriate action.

Secretary Albright was clear about this in her Asia Society speech on June 17th when she said: "Our economic policies, including with respect to export pipelines for Caspian oil and gas, remain unchanged." Ambassador Grossman quoted this statement. We cannot quote it enough.

In the coming months we will pay particular attention to three areas of regional energy cooperation. First, we and the Georgians have pursued the idea of an intergovernmental framework agreement to strengthen the legal basis for an east-west energy transport corridor and reduce investment risks.

Second, we are trying to facilitate an agreement between Azerbaijan and Turkmenistan that would ease the way for trans-Caspian pipeline development.

Third, we are encouraging Russian companies to work cooperatively with other investors, particularly in the Caspian Pipeline Consortium project. Russia's role will be crucial to the development of Caspian resources and transportation routes.

Mr. Chairman, as you have said, the challenges of Caspian energy development, political, economic, commercial, and technical, are great. So are the payoffs. We have in place an integrated strategy that takes account of the American interest at stake. With the support of the Congress, we feel we can succeed.

Thank you. I look forward to the discussion on these issues with you.

[The prepared statement of Mr. Sestanovich follows:]

PREPARED STATEMENT OF HON. STEPHEN SESTANOVICH

Thank you, Senator Hagel, for the opportunity to review our policy toward the Caspian Basin. As you know, I was in Tbilisi, Yerevan, Baku and Ashgabat last month, so this is a particularly opportune time for me to meet with you and your colleagues.

I'm sure you have heard it said that American interest in the Caspian is exclusively about energy. It's not. If there were no oil or gas there, the United States would still have important interests in the region. They are to:

- advance the sovereignty, prosperity and democratic development of these countries;

- promote regional cooperation among them; and
- support their integration into international institutions and the international economy.

These ambitious goals reflect the enormity of the transformation that began with the break-up of the Soviet Union in 1991 and that, in this region, involves the emergence of new institutions in every realm of life.

To serve these goals, the United States is expanding its relations with all the states of the Caspian Basin. Thanks to the active support of the Congress, we are carrying out aid programs worth \$372 million in Fiscal Year 98. We promote democracy, respect for fundamental human rights, the rule of law, and open and sound investment and trading regimes. We are helping these countries create the legal infrastructure of market economies and prepare themselves for accession to the World Trade organization. We work on issues ranging from non-proliferation to resolving U.S. investor problems, from Caspian seabed delimitation to counternarcotics, women's issues and environmental protection.

Regional cooperation and conflict resolution are important, indeed vital elements in our strategy toward the Caucasus. We are leaders in the group known as the UN's Friends of the Secretary General, which addresses the Abkhaz conflict. The United States is also one of three co-chairs of the OSCE Minsk Group, charged with resolving the Nagorno-Karabakh conflict. The co-chairs visited the region in May and are planning another trip later this month. Our efforts on Nagorno-Karabakh, and our Caspian diplomacy as a whole would be better off without section 907 of the Freedom Support Act, and I want to take this opportunity, Mr. Chairman, to urge its repeal.

The U.S. is expanding its security cooperation with the states of the Caucasus and Central Asia. As members of the Partnership for Peace, some of them have participated in numerous PFP exercises. The countries that formed the Central Asia Peacekeeping Battalion (CENTRASBAT) are gaining the ability to police peace settlements in this region and beyond. We have initiated security dialogues with the Caucasus states, will soon have similar dialogues with Turkmenistan and Kyrgyzstan, and have made security and non-proliferation key agenda items of our bi-national commissions with Uzbekistan and Kazakhstan. We are providing assistance, equipment, and training to Georgia that will help it to take over control of its borders as Russian units depart. President Shevardnadze has contributed enormously to the stability of this region and to the progress of Georgia, and we will continue to support what he is trying to do.

Mr. Chairman, our interest in the Caspian is not defined simply by the region's energy resources, but no one doubts their significance. Energy could become a source of conflict, a lever of control or an obstacle to progress. Or it could become a ticket to prosperity and peace, a secure link to the outside world.

Our multiple-pipelines strategy aims to promote these positive results. We believe that a commercially viable east-west corridor ought to consist of a Baku-Ceyhan oil pipeline; a parallel gas pipeline to Turkish markets and beyond; and trans-Caspian gas and oil pipelines. Support for multiple pipeline routes, including the Caspian Pipeline Consortium route through Russia, is as important as any other aspect of our strategy for securing the economic sovereignty and independence of the Caspian Basin states.

We have made real progress. Each month this spring has brought significant steps forward.

- In March, regional foreign ministers met in Istanbul to coordinate energy transport policies.
- In April in Washington Turkmen President Niyazov signed a grant agreement with the Trade and Development Agency (TDA) to fund a feasibility study for a trans-Caspian gas pipeline.
- In May Secretary Pena and the heads of the three U.S. trade finance agencies announced an unprecedented new Caspian Sea Initiative to facilitate financing of east-west routes.
- In June the Azerbaijan International Operating Company. (AIOC) began negotiations with potential transit states for the main export pipeline, and the Caspian Pipeline Consortium (CPC) obtained land allocation permits from Novorossiysk and Krasnodar.
- And this week Russia and Kazakhstan signed an agreement dividing the north Caspian seabed into national sectors.

Our multiple pipeline strategy is a long-term policy initiative. Ultimately, the number and routing of these pipelines will be based on the attractiveness of markets, size of supply, commercial viability and strategic calculations. Three pipelines are currently in development. early oil out of Baku north through Russia, early oil

west from Baku through Georgia, and the CPC line from Kazakhstan through Russia. The big question now is what major pipeline route comes next. We strongly believe that the right answer is to build pipelines along an east-west corridor.

Mr. Chairman, I'd like to comment on one issue of particular importance to our Caspian Basin policy. As you know, Secretary Albright in May issued a national interest waiver under the Iran and Libya Sanctions Act in connection with investment in South Pars by TOTAL, Gazprom, and Petronas. This decision did not and does not change our Caspian energy policy. We continue to oppose trans-Iran pipelines for Caspian energy exports in the strongest terms. We will carefully examine new pipeline construction proposals under ILSA and other relevant authorities and take appropriate action. Secretary Albright was clear about this in her Asia Society speech on June 17 when she said, "Our economic policies, including with respect to export pipelines for Caspian oil and gas, remain unchanged."

In the coming months we will pay particular attention to three areas of regional energy cooperation.

First, we and the Georgians have pursued the idea of an intergovernmental framework agreement to strengthen the legal basis for an east-west energy transport corridor and reduce investment risks.

Second, we're trying to facilitate agreement between Azerbaijan and Turkmenistan that would ease the way for trans-Caspian pipeline development.

Third, we're encouraging Russian companies to work cooperatively with other investors, particularly in the Caspian Pipeline Consortium (CPC) project. Russia's role will be crucial to the development of Caspian resources and transportation routes.

Mr. Chairman, the challenges of Caspian energy development—political, economic, commercial and technical—are great. We have in place an integrated strategy that takes account of the American interests at stake. With the support of the Congress, we can succeed.

Thank you.

Senator HAGEL. Mr. Ambassador, thank you. I again add my thanks to each of you for your efforts.

Since it is just the three of us here, it will be a little cozier and I will jump around here a little bit on some questions.

If I could begin with you, Mr. Secretary, and pull up a piece of your testimony when you referenced Secretary Pena's announcement in Istanbul, and I was there. That was good news, bringing the heads of EXIM, OPIC, and TDA together to coordinate development in this area in this policy. Take us through where we are with that. How does that work? Do we have a coordinator? Do they have an office? What happens? What are we doing?

Mr. GROSSMAN. We have followed up on Secretary Pena's announcement, obviously, because it got the right kind of publicity, we think, certainly among the governments and in commercial areas. There is a Caspian finance working group which meets every week. We are taking in now the possibilities of American companies interested in using some of the facility.

We have repeated to everybody one of the most important things about that statement, that there is no dollar limit on the amount of money that we would be prepared to use in terms of EXIM, OPIC, and TDA. We have used this certainly in our conversations with the Turks to encourage them to move forward on their ability to, as I said in here, facilitate this Baku- Ceyhan line.

So we have stayed very focused on the fact that Secretary Pena's announcement gave us, anyway, at the working level a very big opportunity and we have tried to make the best of it.

Mr. SESTANOVICH. Could I add one point to that, Senator?

Senator HAGEL. Yes.

Mr. SESTANOVICH. U.S. companies have already registered with OPIC eight projects valued at \$10 billion. So the response from the corporate sector to this initiative has been extremely positive, and

I think they particularly, like regional governments, appreciate the fact that the U.S. Government is putting resources behind a policy that we have said is in our interest, that they feel is in their interest. Those resources will help the policy work.

Senator HAGEL. Now, is there a coordinator? I know we have talked about this before and I know, at least as of yesterday, there was not a final decision. But take us through that. The coordinator then will be appointed, it is my understanding, to coordinate this piece of strategy and the plan and the policy, as well as the complete policy; is the that way it is going to work?

Mr. SESTANOVICH. Well, what we would at this stage, Senator, want to make sure happens is that the enhanced coordination among all the agencies that are involved in this effort, but not simply in the area of financing—there is an important diplomatic component to this. Ambassador Grossman spoke of the importance of regional cooperation among the Caspian Basin states to facilitate an east-west transportation corridor.

That means, as I mentioned, for example, working with the Georgian government on their proposal for an intergovernmental framework agreement that will create a legal basis here. We want to look at enhanced coordination within our government and with regional governments across a variety of fronts, because it is not just financing that needs to be addressed in order to make this corridor a reality. There are many other elements.

Senator HAGEL. Will they be meeting monthly, weekly, for example, these three groups that are in at least the finance piece of this, OPIC, TDA, EXIM? What I am trying to get at is how does this work? This is an interesting concept, a good concept, positive, but who is running the train? Is anybody driving this?

Mr. SESTANOVICH. I met with Jim Harman of EXIM last week to talk about this issue. They are enhancing the coordination among these three agencies, which have not always acted closely together. They are—I cannot tell you the frequency of it, but they now have a common project which will require just the kind of regular coordination you describe, but not just amongst themselves. I want to emphasize that. Coordination with the Departments that handle our policy toward the region is going to be essential.

To be frank, from the State Department's point of view, we see the availability of resources here as a significant extra lever, making our policy—giving it an extra chance of success.

Mr. GROSSMAN. If I could just add, I think our object is to take the point that you made in your initial statement, which is we need a clear, forceful plan here. This plan so far I think has been laid out for us anyway—the President is involved in it, the Vice President, the Vice President's office, the Secretary of State, the Secretary of Energy. I know that Steve and I agree on this. As both of your testimony talked about, as we now move closer and closer to getting pipelines built, getting contracts signed, American companies coming in and saying that they want projects, we want to make sure that we enhance our coordination all across the government, not just in the finance area, to support what you want, which is a clear, forceful plan.

Senator HAGEL. It appears to me that at this point we still have not really pulled it together. We do not have a coordinator. Is that right, yet?

Mr. GROSSMAN. That is right.

Mr. SESTANOVICH. We are definitely looking at that possibility as one way of enhancing coordination, and I think there is a recognition at sort of all levels of the government of the advantages that that would offer.

Senator HAGEL. Well, you all understand that these announcements are positive and good, but if we cannot implement them, if we cannot maximize the power and the focus and the effort and the talent, then we do not have much.

Mr. SESTANOVICH. Can I add one thing here, Senator. I think we had very impressive coordination among the agencies on this issue. I have sometimes heard it said in conversations up here that it is a real drawback that you cannot go to one person that is in charge of this policy. But my response to that is that really high level policies and issues that involve very, very high priority of the United States generally involve the participation—you can tell that they are high priorities because they involve the participation of more than one agency.

If you take our relations with NATO, look at the number of arms of the U.S. Government that are involved there, or with the EU. I think it is a sign of the priority that so many different agencies are involved. Now our task is to make sure that at this particular stage, with the new task that Ambassador Grossman has referred to, we keep that coordination at a high level.

Senator HAGEL. Well, it is like everything else. Somebody has to be accountable. Somebody has to be responsible. We can make announcements and go to meetings and tomorrow it is tomorrow.

What I would like to do—and I know you do not have all the answers here and it is not your area of final responsibility, but I would like very much if you could provide for the record, give us some sense of a process here, what is in the planning stages. Could you tell us how we are going to utilize the Secretary of Energy's announcement bringing those together?

To your point, Mr. Ambassador, it is bigger than just financing. We understand that. But how is this all going to come together and who is in charge after that decision is made? We will have more hearings and we will have an opportunity to bring up if a coordinator is selected. If a coordinator is not selected, then who is going to be in charge? Do we call you up, Mr. Ambassador, and you are the one that is going to answer the questions?

So you see what the point is. Thank you.

Georgia. You mentioned Georgia. Where are we with Georgia's problems with Abkhazia? Making progress? Problems? A stumbling block?

Dr. Schneider: One important thing we have been able to do with the rapid action by the Foreign Relations Committee just last week, Senator, is to get a new Ambassador out to Georgia. We were very glad to be able to do that on a fast track, and thank you for it. It gave us an opportunity to make sure that our communication with the Georgian government was at a high level.

When I was in Georgia last month, I talked about the Abkhaz problem with the foreign minister and with President Shevardnadze and continue our discussion. We have tried to show our support in a number of ways for the Georgian government as it deals with this conflict, by making available enhanced relief to help them deal with the refugee problem, by offering substantial support for their efforts to improve their control over their own borders. They are acquiring control this month from the Russians over their maritime boundary and will acquire control over the coming year over part of their land boundary with Turkey.

We are also working closely with them on energy issues, which they consider to be a substantial factor of strengthening their own long-term stability. We have on the diplomatic front tried to re-energize the effort within what is known as the Geneva process under the so-called Friends of the Secretary General, to bring the parties together to find a settlement to this problem.

We are rather active on a number of fronts to support the Georgian government.

Senator HAGEL. Explain to me what you mean when you refer to helping the Georgians control their own borders?

Mr. SESTANOVICH. Well, Russian border troops have had responsibility for guarding the border. They have agreed with the Georgians to turn over that responsibility, as I mentioned, this month for the maritime border. To support that, we have made available patrol boats, just as one instance.

Senator HAGEL. I saw one boat when I was there.

Mr. SESTANOVICH. There will be another soon.

Senator HAGEL. OK.

Mr. SESTANOVICH. I used the plural prematurely, Senator.

Senator HAGEL. It is a very precise business, you know, Mr. Ambassador.

Mr. SESTANOVICH. And they have asked for other equipment to help them make effective use of the boats.

With respect to the land border, they have asked for equipment and training which are made available by a variety of cooperative programs that the Defense Department, Customs Service help them with. We have provided equipment as well. This is an important part of establishing sovereignty and we want to help the Georgians do it. It is a big task and a new one for them.

Senator HAGEL. How many Russian troops are still there?

Mr. SESTANOVICH. In Georgia, I cannot give you the number right now. Let me get back to you on that. It is a few thousand.

Senator HAGEL. And they are drawing them down?

Mr. SESTANOVICH. Let me add. There are several different categories. There are border troops, there are regular troops at, for example, an air base in the north, and then there is a contingent of peacekeeping forces under the CIS that has a regularly renewed mandate, stationed between the Georgian forces and Abkhaz forces.

Senator HAGEL. The Abkhazia issue itself, aside from the border guards and other factors, how is that to be resolved? Are the Abkhazians convinced that they should be an independent entity?

Mr. SESTANOVICH. They are—I do not think they speak with a single voice on this. The issue to be addressed really is what kinds of political relations and economic relations are established be-

tween them and the central government at Tbilisi. It is a matter that is on the agenda, but in discussions between the Tbilisi government and the forces that are led by Mr. Ardzimba. It is on the agenda of the Geneva process.

The way in which it can be resolved is by negotiation, we hope, and not by force.

Senator HAGEL. Have the Abkhazians given up any land since the cease-fire? When I was there—if you recall, you were right behind me.

Mr. SESTANOVICH. Yes.

Senator HAGEL. I was there right at the beginning of that, and it was my understanding—I was very close to the border. It was my understanding that the Abkhazians were making some significant advances, and my question is again have they pulled back or are they still in place where they ended when the cease-fire began?

Mr. SESTANOVICH. I need to check on that for you, Senator. The May 25th protocol established a cease-fire and there has been discussions since then of refugee movements. I do not know whether the lines have shifted since May 25th. Let me get you an answer.

Senator HAGEL. Thank you.

Mr. Secretary, you obviously weigh in on these as you see fit.

You mentioned Nagorno-Karabakh, which is a huge issue, as you know, and you both referenced that. I would be interested in each of your analysis on where we are. Are we making progress on Nagorno-Karabakh?

Mr. SESTANOVICH. Not a lot of progress.

Senator HAGEL. Mr. Ambassador, would you pull that microphone a little closer? Thank you.

Mr. SESTANOVICH. Yes. Sorry.

We have, as you know, the OSCE Minsk Group, which is a group chaired by the U.S., France, and Russia, with representatives that periodically travel through the region in order to establish whether there is a basis for negotiation among the parties. We have had extremely good cooperation among the three, among the three parties, that is among the three co-chairs.

But recently there has been a reassessment of Armenia's position, which we are digesting, to be honest.

Senator HAGEL. Excuse me. Would you say that again? A reassessment of Armenia's?

Mr. SESTANOVICH. A reassessment of their approach to the diplomatic formula that was worked out by the Minsk Group co-chairs last fall.

Senator HAGEL. Was this part of the result of the new president?

Mr. SESTANOVICH. Well, they have a new president, who has done two things: said that he wants the Minsk Group process to continue. There had been some people who opposed the continuation of the process. He said and told me last month that he believes it needs to continue and, not only that, believes it can achieve results more rapidly than we had thought in the past. We will have to see whether that is true.

One of the changes that Armenia has argued for in reassessing the diplomatic formula worked out by the Minsk Group co-chairs last year is to try to put more issues up front. They want to front-load an agreement so as to address the questions of the status of

Nagorno-Karabakh. Azerbaijan has said it is prepared to look at such a comprehensive formula, but the issue really is going to be whether by front-loading we make it easier or harder to get agreement among the parties.

I would have to say we have not made any progress yet in addressing that, but the co-chairs are very active and will have another trip through the region at the end of this month. I would be very glad to keep you apprised of the results of their trip, perhaps after their return.

Senator HAGEL. Mr. Secretary?

Mr. GROSSMAN. I do not have anything to add.

Senator HAGEL. Is it not realistic to assume until we get some kind of resolution that it is unlikely that the oil companies are going to continue to invest in that part of the area, or not? Give me, if you would, each of you, your thoughts on this. You each have referenced this as a problem. It is a problem. We understand that.

But when I was over there I met with a lot of the oil company representatives and I got a very uncertain tone on how much further they want to go, for a lot of reasons. Obviously, is there enough volume to carry a new pipeline and all the economic consequences and factors that have to be played into this. But also the stability issue.

Mr. SESTANOVICH. Senator, I agree with you that the political stability of the region is important to the stability of any energy transportation arrangements that are made and has to be part of the calculation that companies make, that governments make. Moreover, that is not simply restricted to Nagorno-Karabakh. The Abkhaz conflict that we talked about is part of the overall assessment that one would make.

I do not generally hear companies saying that they do not think an east-west transportation corridor can work without a resolution of the Nagorno-Karabakh problem. I think a resolution of the conflict would certainly enhance the prospects of the region as a whole. I think it would also enhance Armenia's ability to benefit from the development of the region as a whole, and that is an important consideration for Armenia as it weighs its policies.

Obviously, it wants to benefit from and be part of the region's development, rather than isolating itself.

Mr. GROSSMAN. If I could just add, just to return to the point that you made in your opening statement, that is why we see this, and I think you see it as well, as a win-win situation. This is not a zero sum game. There are a whole series of challenges that we have got to take care of.

Both of us referred in our testimony to internal regulations, and you and I talked about this, in a country like Turkey. You have got relations between Turkey and its neighbors. We hope that in all of these areas that what we are doing by, as you say, having a clear, forceful plan, is we will change people's perceptions of what it is to be a success and move people forward in this regard.

That is one of the reasons, as Steve said in his testimony, this is not just about energy. It is about our whole approach to the area.

Senator HAGEL. Thank you.

We have been joined by our distinguished ranking minority member, Senator Sarbanes. Welcome.

Senator SARBANES. Well, thank you very much, Mr. Chairman.

First before I direct some questions, I just want to make a short opening statement. First of all, I appreciate this opportunity to examine further the issue of U.S. policy in the Caucasus and Central Asia. This is the third such hearing and, while I consider this to be an important matter that deserves our close attention, I have some concern about what I perceive to be an excessive focus on the issue of oil and gas interests as the driving force behind this attention.

This is not to suggest that we ignore the strategic importance of maintaining adequate supplies of energy at reasonable prices from diverse sources. But I have considerable concern whether pipeline politics should overshadow some of the larger issues and concerns that we have in any region of the world, whether it is Central Asia or the Middle East or elsewhere.

It seems to me the United States has a fundamental interest in promoting basic American values and principles, such as respect for human rights, democracy, and the rule of law. If you are unwilling to subscribe to that as a basic fundamental concept, then I would just go on to suggest that the long-term goals of peace and stability, security and prosperity, which are essentially really to developing these strategic concerns on the energy resources, are often unobtainable or meaningless.

If you are not convinced just on the basic principle, then as a pragmatic or practical argument I say to you that, unless you can develop a situation that gives you some stability and peace and the area, why, it may be a vain exercise.

So I think it is important that as we develop a strategy to gain access to energy supplies from this or any other region we proceed from these values and principles as a starting point and not as an afterthought. Not only is that the only way we can be assured of protecting U.S. interests over the long term, it is the best way of ensuring peace, stability, and prosperity for the people of the region.

Now I want to address some questions to our administration witnesses. First, and this is moving a little off the subject, it is my understanding that one of the most serious security concerns for the countries of Central Asia is the threat of Islamic fundamentalism. Do you all agree to that? Would you share that view, just generally speaking?

Mr. SESTANOVICH. I think extremist political movements under an Islamic banner can be very destabilizing in the region, sure.

Senator SARBANES. Now, I am receiving reports that the concern in the area is not Islamic fundamentalism so much as promoted by Iran, which tends to get a lot of attention in this country, but as promoted by the Taliban in Afghanistan. I gather so that raises the concern that the U.S., through its military support of the mujahedin and of Pakistan has in some measure contributed to that threat.

What has the U.S. done to make clear its abhorrence of the Taliban regime in Afghanistan and to ensure that no U.S. weapons are supplied to it by Saudi Arabia or Pakistan?

Mr. SESTANOVICH. Senator, you catch Ambassador Grossman and myself with a question outside our spheres of responsibility, but let

me answer it in this way. We have, the administration, Secretary Albright in particular, has spoken frequently about our concerns that policies of the Taliban violate basic human rights, just the way that you have said it creates a fundamental problem for American policy.

We do not believe that our policies have supported the Taliban in any way. We do not do that. But you are absolutely right that the conflict in Afghanistan can be a source of instability elsewhere in the region. For that reason, we have promoted an effort to bring the parties together, and we have been particularly attentive to the issue of the spread of arms from the Taliban.

There are some elements of that that I can get for you after the hearing and in particular in closed session.

Senator SARBANES. Did you want to add to that, Marc?

Mr. GROSSMAN. Just simply in terms of an example. Senator Sarbanes, I know that there has been a lot of concern, even in the last couple of weeks, about the Taliban, especially their treatment of women and young girl children—closing schools, not providing the ability for people to go to school. I think that both Assistant Secretary Indefurth, Jamie Rubin, and our AID people have tried to make as clear as possible along the lines that Steve has talked about our fundamental opposition to the Taliban's human rights policies and very specifically over these past couple of weeks their truly abhorrent way that they treat women and young children.

Senator SARBANES. Now, we are headed fairly obviously, I think, here for a major fight over the so-called Silk Road bill. I mean, one important amendment would probably be to change its name to the Oil and Gas Interests bill. But leaving that aside, to go to the substance of it for a minute, what would repeal of 907 authorize you to do that you cannot do already?

What is it that you want to do, since already there has been a loosening of 907 to permit aid to nongovernmental organizations, aid to support certain kinds of important activities, a whole range of activities—humanitarian, rule of law, democracy building, and so forth and so on. What is it you want to do that you cannot do right now?

Mr. SESTANOVICH. Senator, let me answer you in this way. I put this question that you raise to our Ambassador in Baku just last month. We have been very grateful to the Congress for creating these opportunities to enhance our activities in Azerbaijan because we think they are part of creating in Azerbaijan, helping the Azerbaijanis create modern political and economic institutions.

That is why all the opposition parties in Azerbaijan have recently issued a statement calling for the repeal of section 907. They too see it as part of enhancing democracy in Azerbaijan.

Our ability to provide democracy assistance would have been greater if we had had full freedom to do so earlier. Our ability to work with democratic parties would have been greater. But we now have the chance to do so and that will play an important part in our assistance programs in Azerbaijan this year during the Presidential election campaign.

Let me give you an example of one thing that I always use and that Ambassador Escodero talks about when we look at kinds of programs that we think help create a modern democratic state.

Senator SARBANES. Let me just interrupt for a second. There is nothing now that prevents the National Endowment for Democracy or the various sub-organizations that it helps to fund from engaging in efforts in Azerbaijan to foster the growth of democracy, is there?

Mr. SESTANOVICH. There is not and they are very active, and we support what they are doing.

Senator SARBANES. Let me ask you this question. I want to get a little bit of an understanding about Mr. Aliyev. He, of course, received a royal welcome not long ago when he came here. First of all, I understand he overthrew the democratically elected president in order to assume power. Is that correct?

Mr. SESTANOVICH. The government of—well, there was sort of violence throughout the country and President Aliyev was returned to power and Elchibey, who was the previous president, resigned. You are right about that.

Senator SARBANES. Now, Aliyev is the former Politburo member, is that correct?

Mr. SESTANOVICH. Yes.

Senator SARBANES. Was he a KGB general at one point; is that correct?

Mr. SESTANOVICH. I am not sure what his rank was, Senator.

Senator SARBANES. So it is only a difference on the rank, not the balance of the characterization?

Mr. SESTANOVICH. I believe he was the minister for internal affairs in Azerbaijan.

Senator SARBANES. Now, I gather Deputy Secretary Talbott about a year ago underscored shortcomings in the conduct of parliamentary elections in Azerbaijan; is that correct?

Mr. SESTANOVICH. We have had questions about elections in Azerbaijan and other countries in the region, Senator.

Senator SARBANES. And how much concern is there in the Department about how valid the Presidential elections scheduled for this fall are likely to be?

Mr. SESTANOVICH. We have talked to President Aliyev about that. I have mentioned it directly myself to him last month. We have had or participated in efforts to shape the election law that was developed, recently passed by the Azerbaijani parliament. We have been working on that with the OSCE and European and international NGO's to provide an election law that would create fair rules of the road for the elections.

I think we have made a good deal of progress here, but there are still some concerns about how the election commission, which plays the crucial role in elections, will be constituted.

We are, more generally, actively encouraging NDI and other organizations, as you know, to work with democratic movements and parties in Azerbaijan.

Senator SARBANES. Why would we repeal 907 in advance of the election, over which there is a very large question mark as to whether it is going to be open, fair, and honest, as opposed to at a minimum at least withholding, to use it as a lever to help gain an open, fair, and honest election?

Mr. SESTANOVICH. Well, Senator—

Senator SARBANES. Will it not be perceived as a major victory for the Aliyev government in advance of a very important election?

Mr. SESTANOVICH. I think it will be perceived as a sign of the kind of interest in Azerbaijan that the United States wants to show.

Senator SARBANES. Well, we have shown a lot of interest. I do not think we have a problem in showing interest. That has been kind of manifest.

When did Aliyev visit here?

Mr. SESTANOVICH. Last summer, 1997.

Senator SARBANES. And who did he see?

Mr. SESTANOVICH. The President, and I assume he was here on the Hill seeing Senators.

Senator SARBANES. Who else did he see in the executive branch besides the President?

Mr. SESTANOVICH. I cannot tell you, Senator. I was not working in the government at the time. I will get you the whole list of meetings if you would like.

Senator SARBANES. Secretary Grossman, do you know who he saw, besides the President?

Mr. GROSSMAN. Steve and I did our confirmation hearings the same day about a year ago. I would be glad to get you that list.

Mr. SESTANOVICH. After his visit.

Senator SARBANES. Well, anyhow, he started at the top and I assume he saw a lot of other people as well. That is a pretty royal reception, is it not?

Mr. SESTANOVICH. It is a good visit.

Senator SARBANES. Now what about this assertion that I understand that Azerbaijan has been ranked as the third most corrupt developing country? Do you have a comment on that?

Mr. SESTANOVICH. I have not seen that. My guess is there are a lot of Caspian vying for the honor, sir.

Senator SARBANES. Well, let me read from the State Department's own human rights report: "The government's human rights record continues to be poor and the government continued to commit serious abuses." Then, further on: "The entire judiciary is corrupt, inefficient, and subject to executive influence."

Mr. SESTANOVICH. Senator, I do not think there is any doubt about those reports. Section 907 keeps us from undertaking projects in Azerbaijan of the kind that we have undertaken in other countries of the former Soviet Union to deal with problems of that kind. We want to be able to get on top of those.

I mentioned a moment ago some of the things we would like to do. I will give you an example. In other countries of the former Soviet Union we have worked with them to create a securities exchange commission like our own, to make sure that the privatization of state properties actually results in a functioning market economy. That is the sort of project that we would be eager to undertake, but that is not yet currently one of the carve-outs of section 907 that the government—that the Congress has allowed us.

So if your concern is about corruption, I hope you will see the new possibilities created for us by repeal of 907.

Senator SARBANES. Well, it would seem to me that before we even begin to consider that we ought to have a significant improve-

ment in the human rights situation and the conduct of an honest election. Otherwise you are going to continue to have an unstable situation in the country.

The Human Rights Watch says—let me just quote them: “Azerbaijan’s human rights record in 1997 continued to be dismal, but had no perceptible impact on the unprecedented level of involvement by the international community and international business in the country. International investment activity in the petroleum sector was feverish. The international community largely glossed over Azerbaijan’s poor human rights record in order to protect oil interests.” Mr.

SESTANOVICH. Senator, I am with you on this issue. Investment alone, money alone, will not create the kind of institutions that will make for a modern Azerbaijan, a democratic Azerbaijan, or one that we will have a successful long-term relationship with. We are in favor of projects that will help us to create, to move toward those goals in the way that I have referred to.

I might note that section 907 is not actually linked to the issues that you have talked about, but to the relations between Armenia—

Senator SARBANES. The blockade of Armenia.

Mr. SESTANOVICH. [continuing.] and Azerbaijan.

Senator SARBANES. You do not suggest that the repeal of it would not send a message about the human rights situation as well, do you?

Mr. SESTANOVICH. I do not think it would, actually, because it will help us to deal with a lot of these issues that you have expressed concern about.

Senator SARBANES. Suppose we change the basis for 907, keep it but just shift its basis, or add to the basis besides the blockade the human rights situation. Would you accept that?

Mr. SESTANOVICH. I do not think that further restrictions on our ability to conduct our relations with Azerbaijan would be positive, any more than I would want further restrictions on our relations with Armenia, Senator.

Senator SARBANES. Well, Mr. Chairman, I see we are not getting very far. I did want to put in the record two editorials, one from the *Washington Post* on June 11th, “White House pledge”—let me just quote from it briefly: “When President Clinton invited Azerbaijan’s strongman ruler to the White House last summer, he opened himself to criticism that he was overlooking that nation’s lack of democracy in deference to its oil wealth. Perhaps to deflect such criticism, the two presidents, Mr. Clinton and Azerbaijan’s Heidar Aliyev, issued a joint statement in which Mr. Aliyev committed himself to political pluralism and the holding of free and fair elections.

“Now, with the approval of a flawed election law back home, that commitment is open to question. Now, how will Mr. Clinton respond?”

It goes on to say: “Mr. Aliyev, who was Azerbaijan’s communist party boss in Soviet days, has kept a tight rein on politics, television broadcasting, and other aspects of society. Now, at age 75, he is expected to run for reelection in October. Opposition groups charge that the election law his supporters have approved will

allow another unfair vote in what is becoming an Azeri tradition. The opposition argues that the biggest concern is with the election commission, which will be dominated by Aliyev backers. The opposition argues that in such circumstances even the best law could be subverted and a fair vote cannot be guaranteed. "If no changes are made, the opposition now proposes to boycott the election."

[The information referred to follows:]

WHITE HOUSE PLEDGE

(FROM THE WASHINGTON POST, 6/11/98)

When President Clinton invited Azerbaijan's strongman ruler to the White House last summer, he opened himself to criticism that he was overlooking that nation's lack of democracy in deference to its oil wealth. Perhaps to deflect such criticism, the two presidents—Mr. Clinton and Azerbaijan's Heydar Aliyev—issued a joint statement in which Mr. Aliyev committed himself to "political pluralism" and "the holding of free and fair elections." Now, with the approval of a flawed election law back home, that commitment is open to question. How will Mr. Clinton respond?

Azerbaijan is one of three small countries that emerged from the Soviet Union in the Caucasus region, wedged between the Black and Caspian Seas and among Russia, Turkey and Iran. All three have made their claims on U.S. attention: Armenia, because of its large diaspora population here; Georgia, because of its respected president, Eduard Shevardnadze, and its strides toward democratic development; and Azerbaijan, because its Caspian Sea reserves have sparked a modern-day oil rush. Unfortunately, neither free-market reform nor political development has kept pace with the establishment of oil company branch offices in Baku.

Mr. Aliyev, who was Azerbaijan's Communist Party boss in Soviet days, has kept a fairly tight reign on politics, television broadcasting and other aspects of society. Now, at age 75, he is expected to run for reelection in October. Opposition groups charge that the election law his supporters have approved will allow another unfair vote in what is becoming an Azeri tradition. The biggest concern is with the election commission, which will be dominated by Aliyev backers. The opposition argues that in such circumstances, even the best law could be subverted, and a fair vote cannot be guaranteed. If no changes are made, the opposition now proposes to boycott the election.

As the two presidents agreed last summer, "democracy, economic reform and other observance of human rights play an essential role in ensuring Azerbaijan's continued stability." Oil wealth without governmental accountability is likely to lead to massive corruption and an embittered and impoverished population—not circumstances likely to further America's strategic goals in the region. Opposition politicians believe that Mr. Aliyev still could be persuaded to uphold his August promise if Mr. Clinton makes clear to him that good relations with the United States are at stake—and that the August statement was not just intended to save face.

SECOND WORST IN AZERBAIJAN

(FROM THE WASHINGTON POST, 6/30/93)

The worst that could happen in the old Soviet empire is that Russian nationalists would conspire to restore the old order. Second worst is what is conceivably happening in Azerbaijan. The democratically elected president is on the run, under political pressure from an old discredited Communist and under military pressure from a young discredited adventurer. As for the Russians, something uncertain but distinctly unhelpful, though perhaps more a matter of negligence than of conspiracy, is going on: The battle against the elected president has been conducted with Russian arms. The unraveling is alarming both for its effect on Azerbaijan and as a precedent for other parts of the former Soviet Union.

The crisis arises from Azerbaijan's struggle against a secession campaign opened up by ethnic Armenians in Azerbaijan's Nagorno-Karabakh enclave. In that bitter war, the president, a former dissident nationalist floundered; finally he fled Baku. The old Communist party and KGB boss Gaidar Aliyev moved in as acting leader. But a warlord who had equipped a personal army (partly from weapons somehow

left behind by departing Russian army units) to fight in Karabakh, turned that army into an instrument of his own ambition. First he took on the president, and now he is maneuvering against (or is it with?) Mr. Aliyev. Cascading domestic as well as foreign frustrations seem to have made peaceful democratic development less appealing to many citizens on Azerbaijan at the moment than the promise of strong leadership.

The transition from an authoritarian past has been particularly rocky in the old Soviet Muslim and Caucasus republics. Azerbaijan, which fits under both labels, has a considerable potential in its oil riches and its notable secularism, but these resources have yet to be tapped by wise leadership to serve the nation's growth. Before the latest interruption caused by the power struggle in Baku. European and American diplomats were laboring to bring Azerbaijan and Armenia—as well as the Armenians of Karabakh—to the negotiating table. This effort remains vital. But so is restoration of leaders legitimated by democratic choice. The Yeltsin government is under its own difficult but unavoidable obligation to see that no elements of the Russian army contribute to the chaos.

Senator SARBANES. Is that correct?

Mr. SESTANOVICH. That has been discussed.

Senator, if I might interject here, you will not find us hesitant to raise concerns about the conduct of this election. We have discussed the election commission and other details of this election law repeatedly with the government of Azerbaijan. I believe we have had some substantial success in improving the law that was passed by the parliament. We are going to keep on this case. You need not worry about that.

I think we have established this year in our comments on other elections in this region our credibility on this issue.

Senator SARBANES. Is the administration willing to withhold action on this legislation until we see what kind of an election we have, whether in fact there is an honest shake out there?

Mr. SESTANOVICH. We are for repeal of section 907, Senator, and feel we would have had flexibility to serve our interests better had it been repealed earlier.

Senator SARBANES. Do you think that Armenia should be included, should be a possible candidate for a pipeline route, east-west pipeline route?

Mr. SESTANOVICH. Multiple pipelines means multiple pipelines, Senator. If there were a peace settlement, I think President Aliyev himself has mentioned the possibility.

Senator SARBANES. Do you think—so you include Armenia, then, as a pipeline candidate?

Mr. SESTANOVICH. Sure.

Senator SARBANES. Now, how is that going to happen if Azerbaijan has a blockade? A blockade would stop a pipeline, would it not, I assume?

Mr. SESTANOVICH. Well, Senator, there is no question that the absence of a peace settlement will prevent a pipeline, no question about it.

Senator SARBANES. Thank you, Mr. Chairman.

Senator HAGEL. Senator Sarbanes, thank you.

Mr. Secretary, you have had an easy ride this morning. That is very unfair.

Mr. GROSSMAN. You are about to change that.

Senator SARBANES. Actually, I did not direct my questions to Mr. Sestanovich. I just put them out there openly and the Secretary just seemed to have taken a pass. I did not purposely give him an easy ride. He seemed to have availed himself of the opportunity.

Mr. GROSSMAN. No, no. Besides the difference in this table, there is the difference in responsibility. I actually thought, Senator, that some of the points you made in the beginning about the kinds of principles that one needs to subscribe to were sort of leading to a conversation that you and I have had on a number of occasions.

Senator HAGEL. Well, maybe we can balance this a little bit, Mr. Secretary. Staying a little bit with the theme of Senator Sarbanes' last couple of questions regarding pipelines, what is the status of the cost overrun as you understand it, either of you, from Baku to Poti? When I was there that was a very big issue and the oil company representatives were in a position not to go much further until that issue had been resolved.

Where are we with that?

Mr. SESTANOVICH. I do not think it has been resolved. It is a lot of money and affects the calculations that they make about going forward with the entire project. It is part of the project that needs to be clarified.

Senator HAGEL. Mr. Secretary, anything?

[No response.]

Senator HAGEL. Then that obviously affects the October 1998 pipeline decision deadline. Would it not have some impact on what we are going to do here about that? Well, let me phrase it another way. Do you think that October 1998 deadline will be met on a decision?

Mr. SESTANOVICH. I would not want to venture a prediction on that. There are a number of uncertainties that have to be addressed, including, as you mentioned, volumes. One of the big questions that companies and governments have is what kinds of volumes are we looking at that would make different kinds of pipelines viable.

Mr. GROSSMAN. And that is of course a deadline that has moved over the years. As I said in my testimony, there is still a feasibility study to be had on the Turkish side. It seems to me all of these pieces, at least as the information as you can have it at the time, needs to be in place.

The other thing that has always struck me in dealing with this issue is, not only is there a set of deadlines constantly, but of course there is a negotiation going on all of the time. Moving the deadlines and studies, of course, are useful back and forth on the negotiating track as well.

Senator HAGEL. You do not, either of you, have a sense of how this cost overrun is going to be resolved?

Mr. SESTANOVICH. Let me get you an answer, a better answer on that.

Senator HAGEL. Well, that obviously impacts that route going through Poti and the Black Sea, because if they cannot finish that and connect that then that too will then play into where is the volume.

Let me go to another point. Senator Sarbanes mentioned Iran, and there has been some rumbling certainly immediately after the ILSA decision: This is a signal that maybe the administration is pulling back a little bit on this issue. Both of you hit this directly. Secretary Albright has hit it directly. Any possibility that you see of a weakening by the Caspian Sea region countries, oil companies?

Well, maybe it would not be all bad to bring that down through Iran?

Mr. GROSSMAN. We do not see that. Of course, we have to speak for, obviously, what we believe and what our policy is. I think you very correctly picked up from our testimony that there is not a change in our opposition to the whole question of pipelines across Iran. I think it is worth noting, and both of us tried to do this in testimony, that, to step back here, I think we have had some considerable success by using the Iran-Libya Sanctions Act to focus more attention as we have with Europeans and the states in the region, and I would say Iran as well, on issues of concern to us—weapons of mass destruction, terrorism.

So we tried very hard to use the Iran-Libya Sanctions Act as a way to promote our interests.

The other thing that is very interesting to me, Senator, and I guess there is lots of conversation yet to be had about this, which goes exactly to your question, is in Secretary Pena's speech there in Istanbul I thought the section where he talked about the whole issue of commercial viability and whether there are not in fact economic and commercial reasons to continue to support Baku-Ceyhan and make it a better route than Iran—these are not lost on countries, states in the region. They are not lost on the companies.

As he said, you have got capital costs. It is not only a matter of capital costs up front, it is a matter of moving oil to the Persian Gulf, environmental issues, taxation issues, tariff issues. So we think that a combination of strong statements by us about what our policy is, our support as we have tried to make clear today for an east-west corridor, for Caspian oil, and the fact that the economics do not all argue for a route south keep us very much inside of this game, and people ought to be reaching the conclusion that when we say east-west, Baku-Ceyhan as an alternative, that we mean it.

Mr. SESTANOVICH. If I could add something to that, Senator. I find when I talk to leaders in the region complete agreement when I say that letting any country monopolize the transportation of energy out of the region is bad for the Caspian Basin states. There is no difficulty with that proposition whatever. Having Iran dominate it would be particularly negative.

So that is an area where we have got no disagreement with these states and where they are not just looking for the excuse to do it. They see it as a drawback, a problem. One of the advantages of an east-west transportation corridor for them is the independence that it offers them over the long term.

So we are working with governments that share our perspective about the advantages here.

If I could just say an extra word about the cost overrun issue that I think may have been a bit confused. A moment ago we may have been confusing two different pipelines. The cost overruns have to do with the line from Baku to the Georgian coast, and the construction of that line continues even while the cost overruns are being addressed, I mean who is going to bear the burden of those costs.

That is separate from the long-term decision which needs to be made about the main export pipeline in October 1998. That deci-

sion could be complicated by difficulties in addressing a number of cost questions as well as the other issues that I mentioned, particularly volumes.

Senator HAGEL. Yes, because they all connect.

Mr. SESTANOVICH. Yes. But right now the cost question, the cost overrun question, is not stopping the progress of the pipeline.

Senator HAGEL. Thank you.

One last question. Mr. Secretary, you mentioned a couple of times just recently, and I am going to read back from your testimony, you mentioned Turkey and the feasibility study. From your testimony: "We encourage Turkey to facilitate the construction of the Baku-Ceyhan pipeline as a commercially attractive alternative for transporting Caspian oil. Turkey is nearing completion of a feasibility study on the Baku-Ceyhan that will provide a catalyst for American and other investors to initiate Caspian investments."

Mr. GROSSMAN. Right.

Senator HAGEL. Could you explain that?

Mr. GROSSMAN. Sure. One of the things that I think makes the most sense in all this is for American investors to have some kind of a baseline. That is why from the very beginning of this process, from 1995 and 1996, we encouraged the World Bank and the Turks to bring about a feasibility study.

One of the things that I know that you and I have talked about in the past is that the Turks over the years have gone through a series of ideas about how this pipeline would be built and how it would be financed, but now they are coming up with actually putting money on the line, people making big decisions.

We felt that it was the most important thing for the international companies, the international community, to have a real feasibility study to open up, look at, and debate and decide what was reality. We have been encouraging this to be completed. We were hoping actually it might be done a couple weeks ago and I was hoping to by my testimony catch people's attention that we would like this to be done and be done quickly.

Obviously, it has to be right, and I know one of the conversations between the company that did it and Turkey at the moment is to make sure that it forms this baseline. But we think this will be a huge piece of assistance to American companies in their own deliberations about what the right thing to do is and how to make this route a reality.

Senator HAGEL. Who is paying for that study?

Mr. GROSSMAN. It is a World Bank study.

Senator HAGEL. A World Bank study, and it is being done with the cooperation and involvement of Turkey and outside consulting companies?

Mr. GROSSMAN. That is exactly right. It is a European, a German company, as I understand it. They got this contract and have done this. They are in a conversation with the government of Turkey about the final status of the report. But we want this report to come out.

I was not there. I understand that the Turkish government was talking about some of the preliminary findings there in Istanbul. But I think, for all the reasons that I have outlined, it is very important that this come out to be a baseline.

Senator HAGEL. Thank you.

Senator Sarbanes, we have Dr. Brzezinski in the wings here. Any further questions you would like to ask?

Senator SARBANES. I have one question I want to put. Understanding the rationale between multiple transit corridors for the movement of oil and gas, is one of the administration's objectives to exclude Russia as one such corridor?

Mr. SESTANOVICH. No, Senator. The CPC line, which would bring oil from Kazakhstan to Russia, should be considered part of an east-west transportation corridor, and the Russians understand that. We have made clear our support for that line and, more broadly, our view that this does not involve a conflict between Russian and American interests in energy exploitation.

Senator HAGEL. Gentlemen, thank you. We appreciate it. If there is anything that you wish to add for the record, please do. We will keep the record open for a couple of days, so if any of our colleagues wish to submit questions or if Senator Sarbanes or I have followup questions we will have the record continue open.

Thank you all very much.

Mr. GROSSMAN. Thank you very much.

Senator HAGEL. Dr. Brzezinski, welcome. We said very glowing things about you earlier and I know there is no point in repeating it. You would just be flattered.

Dr. Brzezinski: I would love to hear it. Senator HAGEL. Well, on behalf of this committee, we are grateful to have you with us this morning, and thank you for taking the time, and we will get right to your testimony.

Senator Sarbanes, any additional comments? Senator SARBANES. No.

**STATEMENT OF HON. ZBIGNIEW BRZEZINSKI, COUNSELOR,
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Dr. Brzezinski: Mr. Chairman, Senator Sarbanes, thank you for having me. I will make just some brief introductory comments.

First of all, pertaining to my own interest in this area, it goes back quite a few years. Even when I was a graduate student, I became intensely interested in the national problem that I felt was confronting the Soviet Union with increasingly insoluble dilemmas, that eventually the aspirations for national independence from the non-Russian nations would become a very serious problem.

I first traveled to the Caspian Sea area and to Central Asia back in the fifties and I was quite impressed by the depth of national feelings among some of the intellectuals and about the strength of national traditions within the peoples at large. That reinforced my original academic interest in the area.

When I served as Director of the National Security Council, I pushed for active U.S. support for the national aspirations of the various Soviet peoples on the basis of the view that such aspirations could in time create an altogether new political situation in the space of the former Soviet Union.

After the fall of the Soviet Union, I traveled to the newly independent countries and I became increasingly convinced that their stability and the promotion of some form of regional cooperation

among them was in fact in the U.S. national interest, that this would help to stabilize as well as to transform the area occupied previously by the Soviet Union.

That was the advice I gave to the U.S. Government, and in the fall of 1995 I was asked by President Clinton to go to Baku to talk to President Aliyev at a time when the initial decisions were being made about the export pipelines from Azerbaijan. The burden of the message was that the United States favored not a single route—we were not seeking monopoly for the West—but we also did not wish that there would be a monopolistic arrangement by anyone else, and therefore the United States favored two pipelines, one to the West, to the Black Sea through Georgia to Turkey, and one north, to Novorossiysk through Russia. That was the point of view that prevailed, with President Aliyev endorsing that.

In addition to these activities, I have also addressed business groups on the subject of the importance of the area. I have spoken to boards of directors. I have consulted with business firms that are interested in the area, giving them advice on the geopolitical conditions that prevail, on sources of stability and instability in the region, on the prospects for its evolution.

Let me add tangentially that I do not lobby for any business company, I do not represent its commercial interests. But I do offer my views on the geopolitical importance of the region and the likely role of the United States in it and the role of other powers.

My overall approach is that the United States has a basic geostrategic interest in the promotion of stability in the region, which stems very much from the importance that the region has in terms of potential source of energy, of minerals, and this is a perfectly legitimate American interest.

The United States also has an equally legitimate negative interest, namely that the region should not become unstable, that the region should not degenerate into what I sometimes call the Eurasian Balkans, namely a region of internal weakness, internal instability, internal ethnic, national, or religious conflicts, all of which can have a suction effect on the aspirations of larger powers around the region, such as Russia, Iran, Turkey, China, and in a more distant way the West, particularly the United States, as well.

Hence, both the positive and the negative interests of the United States requires the need for a reasoned long-term strategy toward the region, the purpose of which is to promote regional stabilization, regional cooperation, and access to the region by the international community, access politically, access financially. The best way to achieve that is by a multiplicity of access, so that no single power controls access in a monopolistic fashion.

I believe some of the same points were made by you, Senator, Mr. Chairman, when you spoke in Istanbul on May 27, where you emphasized: "Regional development and cooperation brings regional security and prosperity. We must build on the common denominators of mutual interests. Trade and investment are building blocks for the world's mutual interests."

Then you went on to say: "The United States must put forward a clear, comprehensive, and effective U.S. policy for this region, particularly for the development of a western route for Caspian Sea oil."

I personally feel that in the longer run a major outlet from the Caspian Sea Basin through Georgia, through Turkey, and through Turkey to Ceyhan on the Mediterranean seacoast, would be the best geostrategic outcome. It would be the best, but it may not be the only desirable solution. There may be others which may to some extent fulfil the same geostrategic as well as commercial need. I have in mind a multiplicity of individual outlets, namely, in addition to the one to Novorossiysk, through Russia, in addition through Georgia to Supca and from Supca either through Turkey or additionally north to Ukraine or to Romania and thence to Western Europe.

If there is a peaceful settlement between Azerbaijan and Armenia, a pipeline through Armenia directly to Turkey would enhance the Armenians' stake also in accommodation. But I would also not exclude, nor would I oppose—and I know this is controversial—a pipeline from the region south through Iran, for it seems to me that it is also in our interest to give Iran a stake in regional cooperation. Short of such a stake, we are likely to increase the temptation both for Iran and for Russia to try to play exclusionary politics in the region, to the disadvantage of the region's stability, to the disadvantage of the kind of objectives which I believe are in the American interest and more generally in the interest of the region and of international stability.

So these, in brief, are some of my introductory comments. Obviously, much more specific issues can be addressed. There is the problem of internal stability in the region. Georgia has recently been the object of some attempts at destabilization, including attempts to assassinate the president of Georgia. Democratic development in the region is falling short. The elections in Armenia were not perfect, indeed far from perfect. The democratic situation in Armenia is far from positive. Very much the same can be said about Azerbaijan. Very much the same can be said about some of the Central Asian countries.

The process of nation-building and of advancing democratization is a very difficult process, given the region's history, its experience both with Soviet communism and with imperial domination in the past. Hence we are confronted here with a region that presents us with many difficulties, but it is an important region politically and economically and hence one deserving of American strategic attention.

Thank you very much.

Senator HAGEL. Dr. Brzezinski, thank you.

Senator Sarbanes, would you like to go first? Go ahead.

Senator SARBANES. Well, Mr. Chairman, first let me say to Dr. Brzezinski that we are pleased to have him back before the committee. Over many years he has given us wise counsel and advice. On occasions I differ with him, but whatever he gives us is worth serious thought, and we very much appreciate him coming here this morning.

Dr. Brzezinski: Thank you.

Senator SARBANES. I want to ask a question that is somewhat off in terms of being directly on focus, but I would just like to get your thoughts on this. I understand why the international community has said that these various borders that were established in Soviet

communist times are not to be altered, because you do not want to throw all the borders up for grabs and that would lead to lots of problems. On the other hand, it is my perception that many of these arrangements were done by Stalin or even by Tito in Yugoslavia to accomplish a kind of a divide and rule purpose within the particular country.

Nagorno-Karabakh as I understand it was brought into Azerbaijan by Stalin. Of course, that then gave him counter-tensions within these countries that increased the ability to control, it seems to me, control the situation from the center. It is my perception that much the same was done in Yugoslavia. So you set up these borders, but you included within them a different ethnic minority group, and that set up a tension. The center could play against that tension in order to increase its control.

Now, when these republics which were formerly part of a country become independent and you take the borders that were established largely for internal reasons, to maximize, as I perceive it at least, control from the center, you then are confronted with these very enhanced ethnic tensions.

First of all, do you see any merit in that analysis? And if so, what if anything can be done about it?

Dr. Brzezinski: Well, you have raised a very difficult and perplexing issue and you have done so in a very thoughtful manner. This is a very difficult legacy of the past. We confront it not only in the former Soviet Union, not only in Yugoslavia, as you have also mentioned; we confront it, for example, in Africa, where the borders were drawn by the colonial powers and many of these borders were drawn in a very arbitrary fashion and in some cases, as you have stated, even for the purpose of dividing opponents so that one can rule them more effectively. The old maximum, *divida et impella*.

I would not be at all surprised if that was the case with some of the borders drawn in Central Asia and in the Caucasus by the Soviet rulers in the twenties, early thirties in some cases. But once this has been said, the question arises can this be altered in any reasonable fashion without promoting massive turmoil and conflict?

A number of the borders, for example, between the Central Asian countries are also very arbitrary. We have seen the outbreaks of truly bloody ethnic conflict, for example in the Fergana Valley in Central Asia. The war between Armenia and Azerbaijan has clearly been destructive for both countries and has inhibited the development of stable nations, the creation of stable political institutions, the emergence of democracy in both countries.

I do not have any magic solution for it. But what I do feel quite strongly is that we should not open the floodgates to changes in these borders by force, because if we do then we are likely to see an epidemic, an epidemic of national and ethnic conflicts.

I do have to share—I do have to say that I share the view of the administration spokesmen that addressed you before this part of our discussion and, at the risk of disagreeing with you, Senator Sarbanes, I do think that 907 is not helpful, because it pits the United States in effect objectively on the one side of what is a very complicated and a very difficult issue, an issue which I hope can be resolved over time in a constructive fashion.

But it is more likely to be resolved in a constructive fashion if we have the flexibility for dealing with both parties and if we can promote regional accommodation from which both parties can benefit. I think that is the only way we can address these issues.

Senator SARBANES. Well, let me just make this observation. Then I will move on to another question. You know, 907 was amended by the Congress to move from a fairly rigid cutoff to allow assistance to move for supporting democracy, Trade and Development Agency, the Foreign Commercial Service, for the NGO's, and so forth. So it does provide an opening to try to accomplish some of those purposes.

Now, it is true that the rationale for it is the blockade, and I think that is a valid rationale. But also I think now there is an important rationale that is associated with the internal political developments in Azerbaijan, particularly the elections coming up.

Let me ask you this general question. As a matter of promoting stability in the region, would you agree that being able to have an internal situation that puts in place the rule of law, respect for human rights, and a political system that allows the opposition to be heard and so forth and to have an opportunity to gain power would contribute to stability?

It is the perennial question, you know. We can go with a strong-arm dictator and in a sense that gives us stability, but in so many instances in the past that stability has turned out to be short-lived. Beneath the apparent stability is breeding an intense instability which eventually breaks out, and so we are not really building a long-term permanent basis of stability.

Dr. Brzezinski: As a general proposition, what you say is absolutely true. I would only add that this is a long-term difficult process involving societies that for 70 years were dominated by a totalitarian system ruled by one party machinery, political machines, intimidated by terror. Political opposition was suppressed, whether it is in Azerbaijan or Georgia or Armenia or elsewhere in the former Soviet Union.

So the last seven decades were not exactly schools of democracy. Then all of a sudden the system collapses, independence is gained. It is rather difficult in these conditions to expect quick emergence of a relatively stable, well-functioning democratic system. That is why we really have not seen that very much in the space of the former Soviet Union.

Georgia I would say is somewhat better than either Azerbaijan or Armenia, and better than, I would say, every country in Central Asia. Ukraine probably is the only former Soviet republic in which you have had a transfer of power from one president to another through free elections. I have to add, Moldova recently did that, so you have only two out of some dozen. But it has not happened anywhere.

I think it is desirable for the United States to have the maximum degree of flexibility in dealing with protagonists such as Armenia and Azerbaijan in order to influence their internal development. This is why I do feel that we are somewhat constrained, though not as much as in the past—you are absolutely right in saying that there has been a change—by 907.

I would hope that as the process of regional development develops some degree of momentum, Armenia can be drawn into it so that it also sees a stake in regional development, because that seems to me to be the basis for trying to resolve some of the problems that you have identified, both the internal political problem and the external territorial problem. I see no other way. The other way is force, war, and it is going to be destructive for the region. Indeed, some of the leaders of the region suspect that conflict between them is being abetted from the outside deliberately in order to make the new states more vulnerable.

Senator SARBANES. Do you have any view on this—we are getting reports that there is a perception in Central Asia of in effect U.S. support for the Taliban through the military support we have provided to the mujahedin and so forth, and that we have not been able to sort of get across the notion that there is somehow not an indirect underlying connection there.

Have you received reports of that sort and what is your response to that?

Dr. Brzezinski: No, I have not. I frankly do not think such reports would be accurate. For one thing, the Taliban were not a major force in the resistance to the Soviets. They are an outgrowth of the situation that developed after the eviction of the Soviets. They are a fundamentalist extremist group, but they were not supported by the United States. They are an offshoot of one of the resistance groups that the Pakistanis favored and there is truth in that.

But I do not have a sense from my contacts with the administration that we are in any way actively supporting the Taliban. We have recently tried to promote a dialog between the different parties to the conflict in Afghanistan.

I would also add this. While fundamentalism may be a potential threat in Central Asia, it is not likely to come that much from Afghanistan as such. Afghanistan, given its national mosaic, may have some influence on Tajikistan, to some extent in Uzbekistan, but less on the others.

In fact, in addition to Iran, which obviously is openly fundamentalist, Saudi Arabia and particularly Wihabism, which is a phenomenon of fundamentalist Islam, seems to be also playing here an active role and seems to be emerging more as a challenge to the Central Asian governments, secular governments, postSoviet governments, than the Taliban. At least that is my reading of the situation.

Senator HAGEL. Dr. Brzezinski, thank you again for being with us this morning.

I want to pick up on a point that you made in your comments about the danger of unintended or intended exclusionary policy specifically regarding Iran and Russia. Would you embroider around that point that you made when you suggested that maybe we should construct some scenario here where Iran could be part of this Caspian Sea outlet, and how would that happen and how would we work that through the current situation?

Dr. Brzezinski: Well, the bottom line is that ILSA greatly restricts our freedom of action. The paradox currently is that we are in effect, and for good reason, not enforcing ILSA vis a vis our

friends, foreign businesses particularly, but restricting ourselves. So we are right now, I think, in the worst of all worlds. We are not able to impose an effective embargo, but we are sustaining it against our own corporate interests to the benefit of foreign corporate interests.

My view is that in the longer run, if we want a stable Persian Gulf region and a stable Central Asia, some gradual accommodation between the United States and Iran is in our mutual interest. I think we can carefully promote it by engaging in a dialog, by gradually permitting business corporations to engage in trade and investment, and in the meantime thereby giving the Iranians some stake in a stable and increasingly prosperous Central Asia from which they can also benefit.

I think such a policy is more likely to be productive than an essentially ineffective attempt at an embargo, which at the same time gives both the Iranians and the Russians more of a stake in pursuing a policy of joint collaboration directed against western presence in the region.

I was just reading the other day a rather lengthy study of the situation in the region, published in the *Diplomategis Digesnik*, which is the Russian Diplomatic Journal, by a Soviet, a Russian scholar, on the subject of Russia, the trans-Caucasus, and Caspian oil. He quite explicitly addresses the question of Russian-Iranian cooperation and of the joint interest of these two countries in opposing western influence in the region.

Senator HAGEL. Would you focus a little bit on the Russian dynamic of this? Well, obviously we are much, much further along in our relationships and the dynamics of those relationships with Russia than we are with Iran, but if you could take us through the Russian scenario a little bit and then maybe link those two, the Iran-Russian piece that you referred to.

Dr. Brzezinski: I sense that Russian policy toward the region is torn between two basic orientations, and obviously I am greatly oversimplifying. One perspective realizes that there is a Russian stake in cooperation, that Russia has neither the technology nor the capital to really preempt the West in the region, given the interest of the countries of the region in development, which requires technology and capital. Therefore, in that perspective it makes more sense for Russia to collaborate, to be a partner, to have a share, a share in the pipelines, to have a share in the access, also to provide some of the outlets such as through Novorissiysk. I believe that some of the Russian energy companies favor that policy, which I think is more enlightened, more realistic, more in tune with the times.

There is a second orientation, which is much more traditional, and which simply takes the view that if the West can be kept out of the region it would be to Russia's benefit and hence would like to see only one outlet, through Novorissiysk, would like to prevent the stabilization of these countries. It might be even inclined and tempted to foster internal instability, such as in Georgia, to promote the Armenian-Azerbaijani conflict, to stimulate some of the ethnic and religious passions of Central Asia.

This second orientation seems to me to be really against the spirit of the times and rooted in a mind set which is well summarized

by a well-known Russian joke. God comes to a very poor peasant and says to him: My dear son, I love you, I want to do something for you. What can I do for you?

This poor peasant says to him: Oh God, my neighbor has four cows. I do not have any cows. He has ten sheep. I do not have any sheep. He has 12 pigs. I do not have any pigs. God, please do me a favor: Kill all of his sheep and pigs and cows.

Well, that is the attitude of those who say: Keep the West out; let us maintain monopoly. I hope it is a losing attitude. I think it gradually is the losing attitude, because I sense in Russia a change in leadership, which involves also a change in mind set. Younger leaders are coming to the fore, more open-minded leaders, leaders who I hope and suspect sense that Russia's future is in international cooperation as a national state, and it can be a partner in the development of this region, a partner, a participant, and thus a beneficiary.

But it is still an unresolved issue, because Russian politics are very unstable currently, and therefore you also see negative manifestations: the insistence on troop bases, the insistence on monopolistic exclusionary control over access, some temptation to play the ethnic game. Certainly the Georgians seem to be convinced that it was someone from Russia who was involved in the Abkhazian stir-up recently.

So the issue is still wide open, and I think our policy here has to be persistent, patient, but open-minded. We are not trying to keep them out. We are trying to create a framework of regional cooperation that will stabilize the region to the benefit of the local community particularly, of the global economy, and to the benefit of negating the tendencies toward conflict which otherwise can become dominant in the region.

Senator HAGEL. If I might just followup on this, do you believe the administration's approach to Iran is the correct approach?

Dr. Brzezinski: Yes, I think that its careful prudent movement away from dual containment is eminently sensible, because dual containment I think really locked us into a policy in which we were just freezing ourselves out of the game, so to speak. But it has to be pursued carefully. I think Secretary Albright addressed it exactly in the right tones of prudent, but positive, inclination to engage in a dialog if the other side is serious. I think we should persist in that position.

Senator HAGEL. Thank you.

Senator SARBANES. You can keep Mr. Brzezinski at the witness table all day and get the benefit, but I know we have another important panel coming up, so I will desist, Mr. Chairman.

Senator HAGEL. Dr. Brzezinski, thank you.

Dr. Brzezinski: You are welcome very much.

Senator HAGEL. You are, as always, generous with your time and we appreciate it.

Senator SARBANES. Thank you.

Senator HAGEL. If the third panel will come forward, we will begin. Thank you.

Dr. Olcott, Mr. Krikorian, thank you. It has only been 2 hours, but I know you have benefited from this insightful exchange. So thank you so much for being so patient. We appreciate your both

being here and look forward to your testimony. Dr. Olcott, would you like to begin?

**STATEMENT OF MARTHA BRILL OLCOTT, SENIOR ASSOCIATE,
CARNEGIE ENDOWMENT FOR INTERNATIONAL PEACE,
WASHINGTON, D.C.**

Dr. OLCOTT. Thank you very much. It is an honor to be invited to testify before you today on U.S. policy toward the Caspian region and to have the opportunity to make comments on S. 1344. My brief oral presentation and more extensive written testimony both offer a more sober view of U.S. opportunities for influencing events in this region than many other speakers have today and at other Congressional hearings recently.

My comments—I cannot compete with Professor Brzezinski, but my comments are based on some 25 years of experience studying the region, frequent travel. In this period I have gotten to know many of the region's leaders, its businessmen, journalists, professional analysts, as well as hundreds of ordinary citizens. I have also gotten to know the region through working as a corporate consultant and as a member of the board of directors of the Central Asian-American Enterprise Fund.

I have traveled nearly the length and breadth of six of the eight countries under discussion and have generally done so overland and not simply by air. I visited oil and gas projects, new and abandoned factories, and have seen first-hand the declining standards of living, health care, and education that many in the region are experiencing.

There is a growing sense of helplessness taking hold among the masses in these countries and it is one that an ever more insulated elite is generally losing touch with. I, unlike many of the other speakers today, am much more confident about the prospects of building democratic societies here than we have heard.

It is important to note that the first 5 years of transition to independence have generally gone more smoothly than was predicted. This relative success, however, is not in itself a reason for great comfort. Countries are little different from automobiles or airplanes. They will run only so long when maintenance is deferred. Moreover, not every defective part can be repaired once it is discovered.

I am afraid that over the next 5 years we will find this image all too applicable to developments in these eight states, and the proposed legislation as currently written will neither press these countries to seriously attack their deferred maintenance problems nor will it address in any serious way what to do about the defective parts.

For the remainder of my testimony I would like to touch on some of the most serious issues that I see facing these eight states, and I will try to do so briefly.

One, energy and other natural resource income is coming in much more slowly than anticipated, and the problems of developing these oil and gas deposits are proving to be technically much more difficult than earlier assumed. I am not talking simply about the pipeline issue, but the actual physical problems of developing the oil and gas.

Over the next 5 to 10 years, none of the predictions, no matter how optimistic, of the oil income show the amount of wealth coming into the area as sufficient to meet the deferred social welfare needs of this region. Moreover, few of these states have clear plans to convert this income into projects designed to provide for sustainable economic development.

Two, in this interim period most of these states are likely to face a succession struggle. Few of these states have any real preparation for a democratic transfer of power, although, as I said before, they are capable of developing in democratic ways. As detailed in my written testimony, the situation in some states is more precarious than in others. But it is nonetheless worth noting that for the moment Turkmenistan's future depends on the weakened cardiovascular system of one man, Sapamirad Niyazov, with no real alternative successors identified.

Three, the crisis in Georgia, on which I am far more pessimistic than the other speakers have been today. The crisis in Georgia could lead to even greater instability in that already deeply divided society. For all the talk of the need for peace in Karabakh, the major challenge to a western pipeline route is the unconsolidated nature of the Georgian nation and state, which is currently held together by a fragmenting series of political bargains.

Four, at the moment there seems little chance of finding an acceptable solution to the Abkhaz crisis. While Russia may have exacerbated this crisis, it did not—the recent crisis—it did not cause it and, unfortunately, it can no longer solve it. Greater international mediation is unlikely to solve this problem any time soon, given the nature of the gulf which currently separates the two parties. It is unlikely to diminish Abkhaz interest in anything approaching full independence or motivate the Georgians to accept this independence, given how many other ethnic communities in Georgia might later pose similar claims.

Five, ironically, the Russian pipeline routes are beset by similar problems, as Dagestan, the alternative route to Chechnya, is becoming an increasingly more factionalized and unstable region.

Six, while there is increasing talk of regional cooperation, including between the Georgians, Azerbaijanis, and the various north Caucasian governments, leaders in poor control of their own societies generally do not do well at addressing regional problems in concert.

Seven Central Asian regional cooperation has gone a little bit further than that in the Caucasian states. There is greater cooperation here on water and energy issues, but the bigger problems—how to come with the region's integration with the broader Muslim world and with its growing narcotics crisis—are still not being tackled in any effective way.

Eight, if these problems are not addressed quickly, then over the medium term the states of this region will begin to destabilize one another rather than be mutually supportive of each other's future development.

Nine, Central Asian leaders are still confused about how to deal with their Islamic heritage, and the recent concern about Wihabism is a good case in point. There are certainly radical Islamic movements in the region, although they are not Wihabis,

even if some may receive Saudi funding. Islam is part of Central Asia's heritage and this is especially true of the Uzbekhs, and its inevitable role in the region must be better appreciated by the region's secular rulers.

Ten, Islamic movements feed on poverty, declining educational opportunity, bad health care, and unemployed youth, and all of these are in increasingly evidence in Central Asia.

Eleven, and I am getting to the end: postSoviet Central Asia is one of the few places in the postWorld War Two world where universal literacy is declining and universal health care has been withdrawn. Since this is coupled with the region's growing problem of official corruption, which in most countries reaches from the highest level of the government down to the lowest, the end result is a sure-fire recipe for public cynicism.

Twelve, cynicism is what makes the region's leaders fearful of holding free and fair elections. They already know that scoundrels get voted out, and this fear will not be mediated by the U.S. Government allocating more money for civic education.

Thirteen, my penultimate point, what makes the situation more frightening is that few of these nations have developed an effective state-managed monopoly of force. This makes them unlikely candidates to successfully police their borders, let alone the internal problems they face within them, any time soon or to be able to put down movements of mass popular protest. Foreign partners, including the kinds of programs suggested in the proposed legislation, foreign partners who offer only minimal assistance in these tasks are unlikely to be successful in bridging these gaps.

Finally, fourteen, it also means that they are currently incapable of managing or even successfully assisting an effective narcotics traffic prevention program. Over the past few years, opium growing, heroin processing, and drug trafficking play an even greater role in the economy of Central Asia and the north Caucasian republics than previously, and this is becoming a difficult problem to reverse and will fully undermine further moves to democracy if we do not move toward it quickly.

Thank you.

[The prepared statement of Dr. Olcott follows:]

PREPARED STATEMENT OF DR. MARTHA BRILL OLCOTT

The West has discovered the Caspian, and the billions of dollars of oil and gas reserves which lie beneath its sea as well as below its near and distant shores. The value of these resources has made Western businessmen and politicians keenly interested in the fate of the three states that contain most of the region's oil and gas—Kazakhstan, Turkmenistan, and Azerbaijan—as well as the other newly independent nations through which these resources will need to transit on the way to Western markets.

Now most large western oil companies are hoping to secure a "piece" of the Caspian, to help them supply markets in Europe and Asia through the first quarter of the twenty-first century. This has meant that in six short years "conventional wisdom" in western policy circles concerning these states has shifted 180 degrees. Azerbaijan and the Central Asian states have gone from being seen as inconvenient additions to the international scene to being seen as potential strategic assets.

The souring of US-Russian relations combined with the heightened attention given to the region's vast energy reserves has led to a new set of priorities in the Caspian region. US policy-makers are now strongly committed to these states freeing themselves from dependency on Russia, and doing this without growing closer to neighboring Iran, the other logical but underutilized outlet to global markets. We also are encouraging these states to develop alternative security arrangements to

complement the Russian-dominated CIS military agreements as well as to concentrate on developing ties with the global economy, even if for now these come at the expense of good trade relations with CIS partner states.

If the leaders of the Caspian states follow all this advice, US policymakers maintain, they will be serving their countries' best interests. But it is far from clear that this is the case, or even that this change in policy orientation is in the best interests of the US, or the long-term interests of the western firms so eager to do business in the Caspian region.

This change in US and western attitudes is likely to affect the kinds of states which emerge in the region, and not necessarily for the better. In the short-run it makes these states more likely to survive, as Russia has effectively been put on warning to not become the neighborhood bully. Yet Russia's influence in this region may have been exaggerated. The greatest sources of instability seem certain to lie within these states themselves, and seem certain to be further stimulated if the income from energy sales does not manage to trickle down from the elite to the masses. The Caspian states would certainly not be the first place where leaders use the national wealth for their own personal benefit and then expect the west to help buffer them from the actions of angry masses as well as from the intervention of neighbors who seek to serve as patrons for disgruntled elements in the population.

The sharply declining standards of living throughout the region, the increasing levels of corruption, the refusal of almost all of the region's leaders to prepare for a stable and democratic transfer of power all speak to the risks ahead. US policymakers are not taking adequate stock of these challenges, at least if we intend for the Caspian to be an area of vital national interest. All this suggests that current US interest in the region may be little more than diplomatic posturing, that we will "fold our tents and depart" if the investment climate sours, leaving the people of the Caspian states to cope on their own with the consequences of their leaders actions.

Reassessing the Caspian States

Initially there was very little optimism in western policy circles about what the collapse of Soviet rule in this part of the world brings. The new states of Central Asia and the Caucasus seemed rife for being overtaken by that fatal combination of drugs, guns, and Islamic extremism. Even at birth the neighborhood was already a deadly one; the Armenians and Azerbaijanis were fighting over Karabakh, the Georgians and the Abkhaz had clashed over the boundaries and definition of the Georgian state, and the Tajiks were beginning to fight between themselves over who should rule and whether the state should be a strictly secular one.

The presence of so many contested theaters helped contribute to a western predisposition to look to Moscow to guide these states into more stable and democratic futures, and play the role of policeman if good guidance failed. The situation in Tajikistan was particularly disturbing. Its porous border with Afghanistan raised the specter of the fighting in the two states somehow becoming conjoined and threatening the stability of the other Central Asian states. So when Russia decided to intervene in autumn 1992 to try and restore order they did so with tacit US support. All this, of course, was before Chechnya, and the very partisan way in which Russia tilted the balance toward the Abkhaz in Georgia, threatening the survival of that nation and newly elected President Eduard Shevernadze's physical survival as well.

These latter actions led US and other western leaders to begin wondering whether Russia was demanding too great a role, and whether Moscow sought to reap the benefits of an empire without sustaining most of the costs of maintaining it. The numerous bottlenecks that Chevron encountered in trying to negotiate a pipeline across Russia to ship Tengiz oil to market began to look to outside observers like key figures in Russia's political establishment were more concerned to cripple Kazakhstan economically than to extract fair transit fees. This impression was further strengthened when Russian leaders began to challenge contracts signed between western firms in both Azerbaijan and Kazakhstan, saying that the Caspian wasn't these nations' to develop; Caspian Sea reserves had to be divided and developed through agreements made by all the littoral states. Russia's hold over transit routes made their objections more than mere idle threats.

These developments led to a reassessment in US policy to the region. While the rhetoric of US policy is still much the same, the interpretation of the policy has changed substantially. While the US is committed to these states preserving their independence, introducing market economies and developing democratic institutions, the initial fire a fairly tentative hold on power, and Armenian President Lev Ter-Petrosian felt pressured to resign in February 1998, in part because his irregularity

filled 1996 election made it harder for him to rebuff criticism of his conciliatory policy on the Karabakh dispute.

The Emergence Of The Caspian States

Certainly the Caspian leaders have done a far better of securing the independence of these states than most observers thought possible four or five years ago, but this does not mean that they will be as successful with the challenges that lie ahead. One of the problems, though, is that there is no agreed on formula for evaluating developments in this region, or for predicting with much assurance what problems sustaining independence over the mid-term is likely to create.

For all the talk of throwing off the Russian "imperial yoke" the Caspian states are not going through a traditional decolonization experience. The Soviet Union was not simply the "heir" to the Russian Empire, but a transformed version of it, simultaneously a quasi-empire and a deformed multinational state twisted by the ruling ideology and the dominating role of the communist party. The Caspian states are all creations of the Soviet experience, and their current elites are the explicit products of it. Some of these states have better established mythologies of nationhood than others do, but unlike the Baltic nations or the countries of Central Europe, all of the Caspian states lack a history of independent statehood.

At the time of independence the Soviet republics had become weak quasi-states, a kind of imitation states, each with a president, a Prime Minister, a council of ministers, and quasi-democratically elected national and local legislatures. They also had a locally administered and highly developed network of social services, including a school system which was sufficient to sustain universal literacy and offered free secondary and higher education, as well as a virtually free health-care system which penetrated (albeit unevenly) to the most remote rural regions.

While the Soviet republic structure had been set up to facilitate Moscow's administration of these regions, it made the institutional transformation from republic hood to statehood smoother than was initially expected. Added to this was the effect of the changing politics of the late Soviet era, which created new nationalist-oriented mind sets among masses and elites alike, giving powerful incentives for the governing elite of the Caspian republics to transform themselves into national figures. Those who had "blood on their hands" from doing Moscow's bidding—such as the communist bosses in Georgia, Armenia and Azerbaijan—were driven from power at the very time when the elites were getting strong new economic incentives to hold on to it.

Talk of economic reform had stimulated both public and private claims of ownership to the Caspian states enormous economic potential. Oil and gas reserves are only a part of this region's great wealth. Kazakhstan has vast reserves of aluminum, copper and chrome, while collectively Uzbekistan, Kazakhstan, and Kyrgyzstan account for some 40 percent of the USSR's vast proven gold deposits and Uzbekistan and thrust of our policy is that time is on our side, that direct foreign investment is generally coming in quickly enough to enable these states to make a successful transition to independence.

The hope is that revenues will be used in ways that serve the long-term economic interests of these states and that governments will use their royalties and profits to create a diversified economy, a sound tax base, and a responsible social policy. True, there is increasing concern about the growing problems of corruption in the region, but there is little anxiety that the situation might somehow become one which is beyond fixing, where disorder in one or more countries undermines regional security more generally.

Even if US policy-makers still express concerns to the various Caspian leaders in private, and it seems certain that they do, there is relatively little reason to think that their advice is being heeded. Over time the region's leaders have gotten more adept at rebuffing the implied conditionality of early US policy in the region. The shift in US policy has not made these men less democratic, it simply has made them less apologetic about their behavior. At the same time too, one gets the sense that many US policy-makers may also be coming to accept one of the basic premises of at least the Central Asian rulers, that their Asian peoples are little suited to democracy by tradition or temperament.

Now many in the west seem to find these arguments more attractive than they did several years ago, as the attraction of a "strong hand" applied in Islamic societies has grown in the face of violence in Algeria, the Taliban advance in Afghanistan, and the continued simmering of Islamic extremist-inspired violence throughout the Middle East, the former Soviet Union, and now even in parts of Europe and the US. After all, a large part of the reason why the US continues to press for the isolation of Iran is because of Teheran's continuing support for these kinds of groups.

So US leaders seem to have become comfortable dealing with the former communist leaders turned nationalist types that still run virtually all these societies, and to see them as more predictable and hence preferable to the alternative elites who are trying to bubble up from economic, political, and social forces that were released by the Gorbachev reforms as much as by independence. Some of these presidents have always been highly attractive figures to western audiences, such as former USSR foreign minister Eduard Shevernadze, or Kyrgyzstan's Jefferson-spouting physicist turned politician Askar Akaev. Over time, most of the others have also evolved into more worldly-wise political leaders, supported in part by advice from Western advisors and their own increasingly more sophisticated diplomatic representatives.

Certainly, it is also the case that virtually all the leaders of the Caspian states seem firmly entrenched in their Presidential offices. Presidents Karimov and Nazarbaev, who chose to have their mandates extended through referendum the last time around, are now talking about participating in competitive elections in 2000, and President Aliev will face reelection in September 1998. Of course, President Rakhmonov of Tajikistan still retains behind these words has all but disappeared. Six years ago, we treated these states differentially based on their progress in achieving a democratic transition. While we rushed to recognize all these states, Kyrgyzstan, Kazalistan and Armenia got US embassies first, in a measure designed to nudge the other five toward embracing democratic principles more enthusiastically. While no one would deny that practical politics also played a role in this decision—Kazakhstan had nuclear weapons and Armenian Americans are a potent lobbying force—the US government did continue to send out clear signals that the newly independent states would be treated differentially. Presidents Karimov and Niyazov were denied access to President Clinton during their earliest trips to the US, because of their lack of progress in human rights in particular.

Now the behavior of US policy makers sends a different message. Presidents of the energy-rich states are now welcome official visitors in Washington, regardless of how undemocratic their regimes are. Pipeline politics has come to eclipse concerns over sustaining macroeconomic reforms, and fear of political instability has begun to clearly overshadow our commitment to the cause of popular political empowerment.

This does not mean that we have abandoned our earlier commitments, just that we don't hold leaders accountable when they backslide or make little headway in implementing democratic reforms.

US and most other forms of international assistance is still targeted toward projects designed to promote structural economic reforms, as well as the legal environment necessary for a rule of law and the protection of private property. Kyrgyzstan, Kazakhstan, Georgia, and Armenia have received the disproportionate share of this aid, as the commitment to a radical restructuring of society remained greatest in these countries.

The US also continues to help all these states (except Azerbaijan which is still covered by Congressional Resolution 907 B) overhaul their education and social welfare systems. Here too the emphasis is on redesigning these systems to increase their long-term viability, by transforming them from state-sector to private-sector funded and managed activities. This aid is not primarily designed to help them meet existing social welfare needs. But the amounts of money devoted to these projects remain pitifully small, and no matter how much congressional interest in these areas is increasing, the sums available for allocation will inevitably be a fraction of the funds necessary to help these societies cope with the task of successfully educating and economically integrating their overwhelmingly young and rural population while still providing for their pension-age citizens.

The economic crises and social welfare challenges that all these states face are severe but there is nothing in the US policy to convey a sense of panic. In the official US view none of the Caspian states are seen as beyond saving, including war-torn Tajikistan, which is now showing signs of possibly emerging from five years of sporadic fighting with an increasingly more factionalized polity than the one which led to the war. The Turkmenistan are major international cotton producers. Powerful nationalist movements developed in Armenia, Azerbaijan, and Georgia and even in the politically more passive Central Asian republics the state leaders began to stake out a direct claim to manage the resources in their domain.

The speed with which independence came may have been unexpected, but whatever their lack of international experience, the new heads of state were quick to grasp what an extraordinary opportunity independence meant for them personally and for those they chose to empower as they directed the privatization process in their now sovereign states. At the same time, it was not intuitively obvious to them how to capitalize on this new advantage. For all their political shrewdness and administrative acumen, the Caspian leaders lacked the kind of basic knowledge of

what the world beyond their borders looked like and how it functioned. Victims of the ideological system which had produced them, the first post-Soviet heads of state were far less worldly than the post-colonial leaders of the 1940s, 1950s, and 1960s had been. Most had little knowledge of the most elementary questions of finance and trade, not to mention the more complex ones of how the global market functioned in the energy sector, in precious metals, or in most other commodities. All these questions had been handled by specialists in Moscow, people with whom most of the new Caspian leaders and their close associates generally had little direct contact.

It is not surprising then that the first few years of independence were characterized by a number of false starts in attracting foreign economic investment. The leaders of most of these countries began to get advice from a variety of sources, ranging from prominent Western businessmen and politicians, to friends and acquaintances who had emigrated and then “made” it in the west, including advisors and technicians sent from Moscow.

Accepting International Direction

Progress was erratic in the first few years, as the coming undone of the Soviet Union was not a seamless process and required that each of these states come to terms with Russia as well as with each other. In Tajikistan, Georgia, and Azerbaijan it sharply exacerbated protracted and violent struggles between competing elite groups for control, while normal state-building in Armenia was suspended due to the ongoing conflict over Karabakh and the accompanying blockade by Azerbaijan.

Russia did not appear as a disinterested party in any of these disputes, which only made the other Caspian states more nervous in their dealings with Moscow. The other Central Asian states were concerned that the Tajik crisis might be a harbinger to similar struggles in their own country, which made Russian security guarantees all the more necessary. At the same time though, none of these states wanted to accept Russian economic domination as the price for these guarantees.

So the first few years were dominated by a testing process between Moscow and the “good” Caspian states (Georgia and Azerbaijan were not active members of the CIS during that period). The international community was still a rather passive actor in the newly independent states. Diplomatic recognition was offered but substantial assistance was largely deferred while the international financial institutions and various aid agencies of western democracies studied the situation to figure out the most effective ways to intervene.

The parameters of the economic autonomy of the Caspian states began to be increasingly clear after the collapse of the ruble zone in late 1993. By then the international community was also mobilizing for action. Kyrgyzstan was the first of these states to accept an economic recovery program designed by the international financial institutions and donor nations, and introduced its own currency in May 1993. Kazakhstan followed quickly thereafter, but international recovery programs were not made available to Uzbekistan until 1995, to Armenia and Georgia until 1996, and to Azerbaijan and Tajikistan in 1997. By that time the Kyrgyz were already on their second three year program, but the Uzbek program was in suspension, and the Turkmen were still struggling to get their economy in a state of sufficient readiness to be assisted.

The timing of international intervention reflected the receptivity of the various states to macroeconomic reforms. Kyrgyzstan has been the test case for international intervention. It was the first to embrace the case of privatization and moved quickly to create legal guarantees for local and private property owners. Kyrgyzstan was moved quickly to establish a banking system, to reform the tax structure, and to limit government spending to what it could raise from investment, tax, and foreign assistance. A similar reform package was introduced in Kazakhstan, where the government has gone even further to try and meet the expectations of the international community, engaging in a systematic overhaul of social welfare delivery systems as well.

Kazakhstan’s new pension system is being hailed by many as the model for other newly independent states, as over a 45 year period it will gradually replace the current pay-as-you-go system with private pension funds that will be supported through investments on the new Kazakh securities exchange. All this assumes a dynamic and fully privatized Kazakh economy, stimulated by foreign investment and sustained over time by the burgeoning Kazakh investors themselves.

The Georgians only began to pay serious attention to questions of economic restructuring after Eduard Shevernadze took over as President, and the Azerbaijanis whose oil income has been used to fund their economic restructuring—have accepted

far more international guidance under Geidar Aliev's rule than during that of his predecessors. The Uzbeks and the Turkmen have been the slowest to accept international guidance on these questions. Initially both thought that they had enough resources to do it "their way," and both introduced their new currencies without benefit of IMF stabilization programs.

The Uzbeks, who were using the sale of gold reserves to bolster their failing som, gave up and invited the IMF in, only to abandon the agreed on strategy a year later when they sharply restricted the convertibility of the som, even for most foreign investors. The Uzbek government maintains that it is still eager to attract foreign capital and promises to sharply reduce the currency restrictions by late 1998 or early 1999. The Tashkent government has made no secret of its contempt for the "wildness" of the privatization process in Russia and even in neighboring Kazakhstan, so their go slow policy suggests a desire to strongly influence the makeup of the winners and losers in the process.

The Turkmen are still in the process of negotiating with the IMP, and like the Uzbeks, they have long favored subsidized prices over freely convertible currencies. Like Azerbaijan, gas-rich Turkmenistan was an energy producer in the Soviet period. As such, the Turkmen government intuitively turned to the Russians, and looked to their long-term partner Oazprom to help them develop their reserves and market their products in the west. But the two quickly clashed over terms, as Russia wanted the Turkmen to provide gas to the cash poor CIS states, and leave the more solvent European markets to Oazprom. This is what pushed the Turkmen government to try to integrate directly in the global markets, and to invite in the international financial institutions to help them with the process. Here too there is little enthusiasm for transparency, but the economy of Turkmenistan is so much more fragile than that of Uzbekistan and the elite with capital for investment so much narrower that they still remain fully within the government's control.

Concerns about transparency have regularly surfaced in all the Caspian states. It has been a particular problem in Kazakhstan, whose press has been granted some discretion in discussing such matters. The privatization process is furthest along in Kazakhstan, with over three quarters of all enterprises in the country in private hands by late 1997, including over half the nation's large enterprises. The more valuable the commodity, the less transparent the process has been. While Kazakhstan has been more conscientious about putting valuable resources up for development through tender, the results of these tenders have sometimes seemed inexplicable. While there have never been serious allegations about inappropriate behavior on the part of major western oil firms, there is no shortage of rumors concerning powerful middlemen who transport suitcases of currency to leading political figures. Kazakhstan metallurgy industry has been scandal-ridden as well. Contrary to the advice of foreign economic experts, several large processing plants were transferred to management companies, which turned them over for privatization only after their stockpiles of valuable resources were sold off.

Relying On Foreign Investment In Energy

Foreign economic investment is intended to be the cornerstone of the Caspian states' economic recovery, and the lack of transparency in the region rightfully continues to make many potential investors wary, while the promise of large potential rewards clearly is bringing many others in. For all the negative publicity about corruption in Kazakhstan, the government's two Eurobond offers were quickly oversubscribed. Overall, the Caspian states have made steady progress in attracting direct foreign investment. Not surprisingly this investment is going disproportionately into the three oil and gas rich states, and Kazakhstan leads all the newly independent states in the amount of investment on a per capita basis. However these investment figures can be somewhat misleading as a measure of the long-term economic prospects in the region. They are a better indicator of western interest in developing the Caspian oil and gas reserves than they are a measure of the ability of western firms to do so.

There are enormous hurdles which must be met before the "oil dollars" begin rolling in, and much can change in these states in the interim period. Some earlier problems have begun to fade as Russia seems to be accepting the idea that the undersea resources of the Caspian will be divided into national sectors. However, the most critical issue constructing additional pipelines to move oil and gas from these states is moving forward only slowly.

Russia is trying to maintain its monopolist advantage in transit, and is against routes which bring competing sources of oil and gas to Russia's export markets. At the same time though, Russia's own political and economic fragmentation has made it difficult for Moscow to "deliver" on Russian transit routes. Russia's republic and

oblast leaders want to maximize transit fees. The Russian oil and gas industry, with its powerful semi-privatized firms, Gazprom, Lukoil, not to mention, Transneft—which still has a monopoly over the pipelines themselves—all have their own corporate interests to protect. When all these competing forces come together you get an almost insolvable problem. While everyone seems sure that oil and gas will eventually flow from the region, no one can say with much certainty how soon and at what cost.

Although the Azerbaijani International Oil Consortium (AIOC) that is developing the 510-million-ton-rich Azerbaijani Chirag, Azeri, and Gunashli fields seems committed to a western transport route through Georgia and Turkey, the route is a costly one, could require subsidies from either the US or Turkish governments, and will not be developed if it passes through or borders on a zone of constant conflict. While the Georgian government may ask for NATO security guarantees for the proposed pipeline across its territory, it is hard to imagine that NATO member states will provide them to Tbilisi.

For now the only firm route for “big” oil is the Caspian Pipeline Consortium (CPC) a pipeline across Russia. Moreover, there is little in the history of that project to reassure western investors. The negotiations over the CPC became so bogged down that for a while it looked like Chevron might even pull out of the Tengiz project, despite the enormous size of the deposit and Chevron’s nearly decade long negotiations to secure it. Mobil’s entry into the transaction in 1996 injected more capital into the deal and allowed the pipeline consortium to be redefined to the satisfaction of both the Russians and the Kazakhs. Even now, though, the final transit terms are still not resolved, and the project has experienced continual delays, with Chevron relying on a series of costly stopgap measures to keep some oil flowing and some revenues coming into Kazakhstan’s coffers.

While it is clear that alternative pipelines will eventually emerge, it is still not fully clear how much new oil the existing markets will bear. Until the actual investment in extraction is made, western firms are free to pay the appropriate fees and back away from their promised investments. While this is unlikely to happen throughout the Caspian region, it is certainly possible that some of the more costly to exploit deposits could be abandoned if the price of oil continues to drop and new markets come on line more slowly than anticipated.

It is important to remember that the pipeline issue will not be decided in a vacuum. If financing a major pipeline through Iran becomes politically feasible, so would be developing Iranian oil and gas. In the next decade Iraqi oil might also become available for development, and it will be cheaper and easier to develop and market than much of the resources in the Caspian region. For now Saddam Hussein seems an intractable and immortal force, but it is unclear which will come first, his departure or peace in Afghanistan. The latter is a prerequisite for shipping oil and gas from Central Asia on to Pakistan and India. Moreover for this southwest route to be financially attractive there must be access to the Indian and Pakistani markets, which adds another difficult to obtain condition to that of peace in Afghanistan.

A Population Under Stress

For now, income from the energy sector remains below projected levels. In 1997 Kazakhstan experienced the first substantial increase in oil production since independence, and Azerbaijan experienced increases as well, while Turkmenistan’s gas industry remained seriously depressed, although production increased somewhat. Turkmenistan’s crisis is certainly the most severe. They have been forced to accept a barter arrangement for partial payment with Ukraine rather than see their market for natural gas collapse entirely, and their new pipeline across Iran requires them to cost-share construction through payment in kind, which effectively sharply limits the income from current exports.

The partial recovery in the oil and gas industry is part of a more general economic recovery. The GDP’s of all of these countries, except for Tajikistan, finally began to increase in 1996. Many including Kazakhstan in particular experienced even larger increases in 1997. However, some caution is warranted in looking at these increases, as they oftentimes do not speak to the scale of the recovery which is necessary before these countries begin to experience any sort of meaningful economic recovery.

Take the case of Georgia, whose 11 percent increase in the GDP is being trumpeted as a sign that the Shevernadze government is turning this country around, an argument which is critical to the defense of Georgia as an ideal and stable transit point for Azerbaijani oil. Such an argument ignores the near totality of Georgia’s economic collapse in the years of the Gamsakhurdia government and subsequent war with the Abkhaz separatists. Even marginal improvements in the Georgian economy produce enormous increases in the GDP. Although the lights and heat

may be on again in Tbilisi and the return to energy production is part of what is included in this figure these recent increases are not realistic indicators of a sustainable economic recovery.

Industrial production must be restored, agricultural exports reestablished, and new jobs created for this turnaround to be sustained, and on all those counts the situation in Georgia is still problematic. It is clearly for this reason that Georgia is campaigning so hard to be the main transit point for the AIOC's "big oil" for without this guaranteed source of income it is hard to imagine Georgia being in a position to repay its mounting international obligations. Even with the assistance that Georgia has received, the standard of living has dropped precipitously in what was previously considered one of the better places to live in the USSR, because the climate was mild and food was generally abundant by Soviet standards. However, since independence the per capita food consumption of meat, milk and eggs has dropped dramatically in Georgia; only the populations of Armenia and Tajikistan seem to have fared worse than the Georgians have.

Diets appear to be deteriorating across the Caspian region, even in the more affluent states of the region such as Kazakhstan, which has had the strongest combined foreign investment and internationally funded economic reconstruction program. Kazakhstan's population was always better nourished than that of the other Caspian states, which was a reflection of the generally higher standards of living that the more industrialized areas of the Soviet Union enjoyed. Even now with their deteriorating diets, an average Kazakh still eats better than people did in most parts of the USSR at the time of its collapse. The Kazakh population though still has a strong feeling of relative deprivation, as the Kazakhs, like everyone else in the Caspian region are consuming significantly less meat, milk and eggs, and more grain products than previously. In addition, the Kazakhs are spending a far greater percent of their disposable income on food—up to two thirds now, or twice the previous level. The pricing structure in Kazakhstan is closest to world standard, but the salaries are higher there as well. The relative expenditures on food have risen even more quickly in some other countries—Azerbaijanis and Tajiks now pay on average almost eighty percent of their income on food.

Given that the Soviet press was filled with articles in the late 1980s on how precariously balanced were the lives of most rural Central Asians—their bad diets, despoiled environment and declining health care—it is clear that their lives have only further deteriorated. It is difficult to get reliable information on the percent of the population that currently lives in poverty. In the late Soviet-era the Tajiks and Turkmen were considered the poorest in the region, and while there are no official statistics which bear this out, first-hand accounts from the region suggest that this is still the case. Proportion of the population that lives below the poverty line is certain to be dangerously high, given the better statistical reporting from more affluent neighboring countries. In Kyrgyzstan, approximately sixty percent of the population live in poverty, which is defined as living at under a \$1 per day, while the International Red Cross reports that 73 percent of all Kazakhs live on less than \$50 per month, which is the Kazakhstan government definition of poverty.

The worsening of the diet of most people has helped speed the deterioration in public health. The population has become more rundown at the very time that public health services and sanitation are deteriorating. Here the evidence is more anecdotal than systematic, but over the past several years there have been reports of epidemics of typhus, cholera, hepatitis, polio, and now tuberculosis. The latter is especially serious in Kazakhstan where a virulent strain has become entrenched among the population, and the government was recently forced to close a major tuberculosis facility because of financial problems. The national pharmaceutical industry was in serious decline just prior to the collapse of the USSR. However, after one country split into twelve, routine childhood immunizations became more difficult to obtain for the countries that lacked pharmaceutical production facilities, had nothing to barter with their neighbors, and were forced to use scarce currency reserves to keep protect the health of their populations.

In the last few years some international assistance has been targeted to address this issue, but as remote health care facilities close down in part due to growing shortages of doctors and parents keep ill-clad children home from unheated schools, the increased prevalence of long-eradicated childhood diseases will not be easily reversed. The Kazakh government recently announced a free inoculation program for children up to age five, but it remains to be seen how fully it will be funded.

Diseases among livestock have also become more prevalent because of the high cost of inoculations, and brucellosis has spread. Deteriorating sanitary conditions have speeded up the spread of typhus, cholera, and hepatitis especially in rural areas where the rising entrance fees at public bath houses (as well as inflated soap prices) have put weekly baths out of the reach of many with large families. There

have also been cases of bubonic plague reported in parts of northern Kazakhstan, and there are fears that Almaty may be vulnerable because of the city's large rat population.

Energy shortages have compounded many of the health and sanitation problems. Uzbekistan has periodically cut off gas supplies to southern Kazakhstan and much of Kyrgyzstan for non-payment, while northern Kazakhstan has experienced severe electricity shortages due to disputes with Russian providers. Turkmenistan has regular brown-outs in much of the country. These shortages affect homes and schools as well as factories in the Caucasus as well.

One of the last publicized aspects of the economic crisis that these states are in is the deteriorating state of public education. Although there is little reference to this on the public record, Kazakh and Kyrgyz officials estimate that about a third of all school age children simply don't attend school anymore in winter. This figure is probably even higher in countries where fuel shortages are more severe. It is undoubtedly far higher in Tajikistan, where the education system in the parts of the country most affected by the civil war is reported to be in near complete disarray. It is somewhat lower in Uzbekistan where authorities have made a concerted effort to provide subsidized school lunches and targeted schools to meet broader public health needs.

Secondary education is in an even more serious trouble, for here curricular issues are no less important than those associated with the deteriorating physical plant. In all the newly independent states there has been a shift to expanded and improved education in the local language, at the expense of education in Russian, which had previously been the favored language for advanced and specialized education.

This switch in language of instruction, and the move away from Russian history and culture, is one reason for the steady exodus of Russians and other Europeans from these countries over the last several years. This can help in the process of national consolidation of these states, as it makes the states more mono-ethnic, and creates new opportunities for upward mobility among previously disadvantaged groups.

None of these states, though, have the financial resources for a complete overhaul of their educational systems and in many places it has been easier to quietly close schools than to revamp them. One of the first victims was the old Soviet vocational-technical education system, which was almost exclusively a Russian language one. The severity of the crisis in secondary education varies substantially from country to country; Georgia and Armenia had relatively comprehensive secondary and higher education systems in their national languages, while Kazakhstan and Kyrgyzstan have tried hardest to keep the existing Russian language education system most intact. Overall, though, there is a growing tendency to transform the old 12 grade system into a 9 grade one.

The end result is that tens of thousands of undereducated fifteen year olds are being dumped into a saturated unskilled workforce annually. Uzbek authorities have begun openly talking about the long-term risk that this poses for the state, but the dangers are as real in those countries whose governments are silent about the problem. The population of these eight states is disproportionately young, according to the 1989 census over half of the titular nationalities were under 21, 50 this problem is not one which is going away anytime soon.

Higher and advanced specialized education is faring better in many of these countries, especially since this is an area in which these states are receiving targeted international assistance. While all of the states of the region are pressing their seriously belabored school systems to introduce universal English language curriculum to enable future generations to receive "international" education, Kazakhstan and Kyrgyzstan appear to be serving the current generation best, with merit based scholarship programs for foreign study and state as well as foreign funding of new institutions offering western style advanced education in business and economics.

At the other extreme is Turkmenistan, which recently closed the Academy of Sciences to concentrate all the state's education resources in the state university. But as with so much else in the country, educational reform has had to bear the direct imprint of Turkmenbashi (head Turkmen), as President Niyazov prefers to be called, who seems more concerned with the size and grandeur of university buildings than with the educational curriculum.

In fact, grandiose public building projects have been a particular attraction for Central Asia's leaders, arguing that their people need new symbols of independence to be proud of. Only Kyrgyzstan's President Akaev has eschewed the region's trend, adding some modest new memorials to victims of Soviet and Russian rule to supplement the old Soviet monuments. By contrast President Karimov spent millions of

dollars building a massive museum of Timur in Taslikent, which touts his philosophy of state craft as appropriate for the "reborn" Uzbek state.

Karimov's efforts though are modest by comparison to the massive mosques, museums and palaces being built in Ashgabat. Many of these new structures form part of the orchestrated cult of personality around President Niyazov, whose face is on the various denominations of the Turkmen manat, save for the smallest ones, which were deemed unworthy of this honor.

President Naaarbaev has engaged in the most ambitious public construction of all, moving Kazakhstan's capital to Akmola, now called Astana. Billions of dollars are eventually to be spent turning this windswept small provincial city into a model twenty-first century capital, and the government transfer was made with break-neck speed, less than three years after the original decision. While Kazkh authorities justify the decision as necessary to maintaining the internal cohesion or this land giant of a state, and have managed to raise much of the costs of new construction from firms eager to win government favor, the budget is little able to stand the cost of a government which shuttles back and forth between the two capitals, or the expense of lodging legislators and ministries officials in dorms, service apartments and hotels in Astana. The new capital city also puts a severe strain on the north's overcommitted energy resources, and leaving local provincial officials searching for ways to heat and light their own less essential public buildings.

Kazakhs may take pride over the fact that President Nazarbaev now has 2 presidential palaces and 2 state-built vacation homes, and that as a tennis buff he has seen to their as well as his own needs by sponsoring the creation of a new world-class public tennis courts in Astana. But they probably also find it distressing that coverage of the dedication of the new capital went on against a background of simultaneous press accounts of pregnant strikers collapsing during protests over unpaid wages in a failing phosphorous factory in southern Kazakhstan.

The Coming Threats

The "shock" of transition is the next challenge which each of these states must withstand, for only Armenia has undergone a peaceful and quasi-democratic political transition. The principle of choosing leaders through competitive elections seems better established in the Caucasus than in Central Asia, but this in itself does not make the region a stable one. The boundaries of all three states are still contested and those who are challenging these boundaries are unlikely to be appeased through the incentives of pipeline politics or foreign economic investment more generally.

Regional initiatives are doomed to defeat as long as the status of the Karabakh remains unresolved and the progress of Minsk negotiating group of the OSCE seems sure to be slowed by Karabakh leader Robert Kocharian's victory in Armenia's presidential election. Fortunately though, the internal political problems of each of these three states generally have little impact on their neighbors.

Georgia seems certain to have the most difficult transition in the region. In many ways it is not yet a consolidated nation, but a collection of semi-sovereign enclaves, whose leaders have generally accepted the authority of President Eduard Shevernadze. The status of Abkhazia remains unresolved, and will remain difficult to entangle as long as the north Caucasian republics of the Russian federation including Chechnya are still working out their status with Moscow. Most of these disputes have become mutually reinforcing, with arms supply lines cutting across national boundaries. The routing of pipelines across these territories will only increase the value of political autonomy for the leaders of these various national communities. The ongoing Abkhaz crisis makes the government in Thilisi more vulnerable to pressure from other ethnic and regional groups; the recent unsanctioned clashes between Georgian insurgents and Abkhaz fighters only serve to highlight the difficulties that President Shevernadze has controlling his own population. Even a democratically elected successor to Shevemadze will still have to come to terms anew with the leaders of Ajaria and Southern Ossetia, and try to appease the frustrated ambitions of rival Georgian groups.

Geidar Aliev's successor in Azerbaijan should face a somewhat easier problem, if he is chosen in even a quasi-democratic way. However, if Aliev holds an undemocratic presidential election in 1998 and then tries to put his son in charge, then Azerbaijan could once again degenerate into the kind of civil disorder that helped bring Aliev back to power in 1993. Azerbaijan is no less complex a society than Georgia is, and too potentially wealthy a state to become the exclusive hereditary preserve of a single elite group. Moreover, as long as Azerbaijan has multiple exits to market through Russia, through Georgia and Turkey, and possibly someday through Iran it will be able to continue to benefit from its vast oil reserves.

The five states of Central Asia are potentially more interdependent than those of the Caucasus. Here the greatest risk is the states imploding from within, and the "fallout" crossing national boundaries. We have already seen some of this in Tajikistan. Although the war in Tajikistan did not create the domino effect that many feared, Kyrgyzstan and Uzbekistan have had to cope with an unwelcome refugee burden (generally their own conationals) generated by the crisis.

Even more serious is the growing drug trade across the region, particularly problematic in southern Kyrgyzstan, which most attribute to the porousness of the Tajik-Afghan border. Heroin as well as opium is now both transiting and being produced in Central Asia. Poorly paid border guards and policemen are easy prey for those interested in moving this deadly cargo.

Serious social unrest in Uzbekistan, even if of a much smaller scale than the civil disorder in Tajikistan, would pose a risk to all the other Central Asian states. The situation in Uzbekistan seems stable enough today, but the society will come under great stress at the time of political succession. Karimov's putative heirs will be the ones who pay if the Uzbek president guessed wrong when he opted for economic stabilization over the macroeconomic reform program suggested by the IMF and World Bank experts. There is virtually no institutional preparation for a democratic transition in Uzbekistan, which raises the prospect of a free-for-all developing as Karimov's strength diminishes. Given that Uzbekistan is the center of Central Asia's religious revival, religious themes will be invoked as groups jockey for support. Secular political elites may also choose to make common cause with radical Islamic activists who remain very powerful in the densely populated Fergana Valley even after years of government efforts to reduce their influence.

Uzbekistan's government has created the most pervasive and effective security force in the region and is clearly able to deal summarily with small pockets of resistance, but is unlikely to be able to deal effectively with mass resistance, or with the kind of disorder that would accompany a shift in drug routes through Uzbekistan. Efforts to control widespread unrest would inevitably lead to "spill-over" of the opposition into Kyrgyzstan and Tajikistan and possibly into neighboring Kazakhstan as well. If Islamic groups should take power in Uzbekistan or even if a secular regime should opt for visible religious coloration, there is sure to be impact in all three of these neighboring states.

Southern Kazakhstan and southern Kyrgyzstan would both be strongly affected, and deepest latent anger at deteriorating economic conditions could turn into widespread and potentially violent public protest in a very short period of time. Kazakhstan's former Prime Minister Akezhan Kazhegeldin publicly warned of this possibility in March 1998, and although there was an element of political posturing on the part of this possible presidential candidate, the same point is being made with increasing frequency by local political observers.

Kazakhstan could and should have an orderly political transition, but the opportunity for personal enrichment that is afforded those who hold power is an enormous temptation for those close to President Nazarbaev. Over the past several years, Kazakhstan has become a steadily less democratic state, with a far weaker legislature and far stronger presidency than Kyrgyzstan or the Russian Federation has, although it is still a far more pluralistic society than either Uzbekistan or Turkmenistan. Kazakhstan is roughly as democratic as Azerbaijan, but it is less immune from outside influences. Kazakhstan's large Russian population and long border with Russia means that Moscow will never be a disinterested observer with regard to developments here. The pace of economic recovery is sure to effect the nature of the transition which occurs, for if government efforts to sponsor the development of small and medium size businesses succeed, there should be a large enough middle class to support a stable transfer of power regardless of how undemocratically it is orchestrated.

Barring major unrest in neighboring Uzbekistan, there should be a relatively smooth transition from President Akaev to his successor. The small country's elite has shown relative skill at sorting things out behind closed doors which has helped make Kyrgyzstan's elections the freest in the region. Turmoil here would have relatively little consequence on neighboring states. The Kyrgyz do however, control much of the water supply to neighboring countries, and thus have some leverage to exert in regional affairs.

Turkmenistan is the most unpredictable of the Central Asian states, and in the short-run potentially the most unstable. President Niyazov's health is uncertain, and the problem of succession is one which cannot even be discussed let alone planned for in this extremely tightly controlled state. The elite here is quite small, and mirrors the clan cleavages of Turkmen society, but they have been allowed very little room for economic development and political maneuvering. Those from the larger and more powerful clans would be able to make effective use of popular dis-

affection. A protracted political struggle here could focus on plans for foreign development of Turkmenistan's resources, with existing contracts proving as long- or as short-lived as the reputation of a deceased leader in a lawless state.

What If Things Go Sour

It is hard to know just how effective a force western governments are likely to be in influencing the outcome of events in the Caspian region. Obviously we have a capacity for military intervention should we choose to do this. The US took pains to demonstrate this when the 82nd Airborne organized jump that took them from Georgia to Kazakhstan in September 1997 as part of the training process for CENTBAT, the joint Uzbek, Kazakh, and Kyrgyz conflict peacemaking force which is being sponsored by NATO's Partnership for Peace.

However, the reluctance with which the US and other western nations have committed to the use of force in recent years is testimony to how great a gap must be bridged for military capacity to become military engagement. The Caspian region is Russia's back-yard, and Western leaders have taken pains to convince the Russians that the competition over development of Caspian energy is a commercial competition. As eager as we are to see the region's various inter-state and internal conflicts be resolved, in order to help facilitate the rapid flow of oil and gas, the OSCE states have moved cautiously toward internationalizing the various ongoing negotiations, and have yet to press for peacemaking or peacekeeping forces to be expanded beyond the confines of the CIS states. Any formal use of force by a western power, even in the cause of protecting western investments, would be interpreted by Russia as a hostile act, and would have grave consequences for the future of NATO and evolving European security relations.

At the same time Russia is also no longer free to use force with impunity in the Caspian region. The various Caspian states are still bound to Russia through a variety of bilateral and multi-lateral security agreements, but any Russian intervention that was not at the explicit request of the state involved would have potential consequence for Moscow's evolving relationship with the west.

Russia's policy-makers, though, might still choose to intervene in the Caspian, even at the risk of suffering the wrath of the west. Nonetheless, they are likely to be increasingly more reluctant to do so. Intervention would have to bring with it the prospect of enormous commercial gain, such as the compensation for helping one Turkmen group come to power over another. Alternatively, Moscow would have to be confident that their failure to intervene would in and of itself constitute a threat to Russian security.

A variety of situations could lead them to the latter conclusion, including inter-ethnic violence in northern Kazakhstan, serious fighting between the Georgians and the Abkhaz, or even the prospect of radical Islamic groups taking power in Uzbekistan. It is also possible that Russia might decide that none of these scenarios pose a direct threat to their own national security, and they would opt to more tightly seal their own borders instead. While Russia originally scoffed at the cost of turning their former inter-republic boundaries into secured international ones, they have now begun the slow and expensive process of trying to do this.

With each passing year the likelihood grows that the Caspian states will have to assume full responsibility for their own security needs before too long. The US, Turkey, and other western states have been willing to provide some officer training and other limited military assistance designed to gradually wean these states away from exclusive dependence on Russian assistance or Russian compatible command and control systems. But none of these countries are anywhere near ready to defend themselves against a formidable external enemy and most seem ill-prepared for prolonged engagement with a determined internal enemy.

This "security gap" will certainly restrict the options available to western powers interested in maintaining friendly regimes in the Caspian, regimes that will guarantee the security and be willing to continue to service their western loans. Despite the current US public posture, should it become an all-or-nothing choice between military intervention and writing off these debts and investments, the arguments against military intervention are almost certain to prevail over the impulse to protect our assets.

In fact, it seems that the west has made an even more callous choice about the Caspian region, although there is little in the public rhetoric to suggest that this might be the case. While western policy-makers may talk about the Caspian region as one of new and real strategic importance, we see this area as little more than a back-up for the potentially much vaster reserves in the more strategically located Persian Gulf region. In an energy hungry world, the Caspian resources are certainly

worth trying to “snare,” but the west will only help develop them if we can do so at a reasonable cost.

Loans for economic restructuring are on offer as well as grants to help them develop the legal infrastructure necessary to secure property and some limited humanitarian assistance to help them get over the worst shocks of funding their own social welfare systems. We are even willing to provide money for “civic education,” although we are not necessarily interested in holding these states to the standards of developing democracies. But the impetus for economic change must come from within these societies themselves, as must the internal fortitude necessary to make the transition to even quasi-western and quasi-democratic states. If it does not then the strategic importance of the Caspian will soon become yesterday’s news as everyone knows that these same resources will once again be available for development when a more enlightened set of rulers come around.

NOTE: Some of the material in this testimony appeared in modified form in my article “The Caspian’s False Promise,” *Foreign Policy*, Summer 1998, pp.94-113.

Senator HAGEL. Dr. Olcott, thank you. Mr. Krikorian.

STATEMENT OF VAN KRIKORIAN, CHAIRMAN, BOARD OF DIRECTORS, ARMENIAN ASSEMBLY OF AMERICA, NEW YORK, N.Y.

Mr. KRIKORIAN. Thank you, Senator Hagel, Senator Sarbanes. I guess I can say good afternoon at this point.

If Dr. Olcott characterized her testimony as optimistic, I guess the best—

Dr. OLCOTT. Sober.

Mr. KRIKORIAN. Sober, or not as pessimistic. I would like to characterize mine hopefully as realistic, and I will hit just the highlights of what is in my written testimony and try not to read what has been spoken before.

I am testifying as the Chairman of the Board of Directors of the Armenian Assembly. I would like to thank you for the opportunity to be heard and for your attention to this part of the world.

There is no question that U.S. policy has been derailed in our national objectives of establishing democracy, the rule of law, open economies, and civil society in the countries of the Caspian region. That derailment should be corrected, and I want to be very clear here. We have no question that commercial entities ought to be able to pursue their economic interests on legal and commercial bases and the U.S. Government must support U.S. businesses seeking fair treatment in foreign countries. But the U.S. Government should not be in the business of pushing bad deals or in the business of compromising U.S. principles every time a foreign government, especially the kind of foreign governments that we are talking about, decides to politicize a commercial issue or a commercial interest.

Confusion over what the U.S. Government should be pursuing was initially caused, apparently is still being caused, by reports that we now know were grossly exaggerated, about the Caspian’s oil reserves constituting a strategic alternative to the Persian Gulf and elsewhere. Based on that faulty premise, the U.S. crossed the line from promoting our principles to promoting misguided parties and misguided principles.

From new reports that have been publicly available out of Houston by the Baker Institute, London by the International Institute for Strategic Studies, and Geneva by Petro Consulting, we now

know that, instead of the 200 billion barrels of oil in the Caspian, a figure which has been loosely used, and valued at \$4 trillion, including by the State Department, we are really talking about between 15 and 30 billion barrels of proven reserves, maybe. I say maybe because that characterization of those barrels of oil as proven comes from the Soviet period, which political analysts, I am sure like Dr. Brzezinski and his associates, and natural resource companies who have been involved in the region are confirming were inflated, and they were inflated for political purposes, to tell the world that the Soviet Union had a lot more resources than it really did.

The most recent drilling results in offshore Azerbaijan are actually showing no oil. Interesting. One of those sets of drilling results was in part of an area touted as having four billion barrels of oil. The projections of potential reserves will have to be adjusted downward as well, and this is occurring in a period of reduced oil prices.

The designated markets for south Caspian oil are in Asia and parts of Europe, but not the United States. While there is a lot of natural gas, especially in Turkmenistan, markets are as big a problem as pipelines. In addition, there are the environmental, political, and legal issues that many others have raised, as well as the budget problems that the early oil pipeline from Baku to Supca is having.

Problems like that are going to continue and make these investments uneconomic. But all in all, the cold truth today is that no one can guarantee that the storied Caspian will reduce U.S. gasoline prices or have any effect on our strategic need to ensure multiple sources of oil.

Based on promoters' hype, however—and I am not saying that everyone talking about those figures is a promoter or is hyping it, but the truth is that, based on promoters' hype, the primacy of the goals for which the cold war was fought and won have dramatically been replaced by the primacy of the goals of those promoters' individual financial gains, and the influence of U.S. principles and the perception of the U.S. as an honest broker are lower now than at any point since the breakup of the Soviet Union.

That is most evident with respect to our policy toward Azerbaijan. U.S. companies, the State Department, and other government officials have actually, hopefully not intentionally, but have actually entrenched institutionalized corruption in Azerbaijan and elsewhere. They have also helped to grow and perversely promoted as a form of democracy the revolving door of U.S. Government officials involved in the region and sanctioned the kind of behavior that shocks most Americans, and I can cite a few examples.

You will recall that when Armenians in Nagorno-Karabakh were taking the spears for challenging the Soviet system that put them under foreign domination, they had not only the support but also the encouragement of the U.S. Government. So when the U.S. was able to increase its role, the potential to act as an honest broker was highly appreciated. When the President appointed a special Ambassador, Jack Maresca, to mediate the conflict, there was a profound sense of hope.

Imagine the reaction, then, when upon leaving government service Ambassador Maresca went to work for one of the major oil com-

panies, lobbying Washington to ingratiate itself with Azerbaijan. That sent a message about U.S. rhetoric and reality.

You may also recall that when Congress passed section 907 it did so with the explicit support, not the opposition but the support, of the Bush Administration. I can say that definitively because I negotiated the final language of section 907 with Ambassador Armitage in 1992. The compromise, the agreement that we reached, included the administration's support for that legislation, and at the House committee meeting on September 21, 1992, which adopted what became the final version, in an explicit exchange with Congressman Broomfield Ambassador Armitage was asked whether the administration supported this legislation, specifically section 907, and he said yes.

The Bush Administration and a bipartisan Congress supported 907 because it was and is a reasonable, principled response to outrageous behavior. Upon leaving government service, though, Ambassador Armitage joined so many other former Bush Administration officials by enthusiastically lobbying for repeal of section 907. Instead of observing the law, prior and present administration officials have been at work to circumvent it, while promising Azerbaijan that Congress would repeal it. That sends a message about rhetoric and reality as well, and in the whole debate about whether the law has worked or not frankly is a controlling issue as far as I am concerned, because the law was never really enforced.

There are examples of others in government who have acted similarly, but the point is that U.S. principles and U.S. law with respect to Azerbaijan are not being implemented consistently with the stated policies or national interests of the U.S. The proof is in the results.

We have heard talk about corruption and in fact the newspaper accounts and U.S. diplomats will acknowledge that corruption is a problem. We know that the president runs the country basically as a private syndicate. We know that upon assuming office following a coup, he initiated a massive offensive against Armenia and Nagorno-Karabakh. We know about his political record. In fact, I can summarize it by saying that he was one of the guys we fought in the cold war.

What I would hope would be as troubling as anything to the Members of Congress, though, is his personal behavior, and that was recounted in David Remnick's book, "Lenin's Tomb." Accused of sexual assault, he was shielded from prosecution essentially by a decision by the communist party. To my mind, that always gives one pause when one thinks about exactly who one is dealing with.

You know that a leading opposition candidate for this fall's Presidential election is living in exile. He is afraid to return because he thinks he will be killed, and he is probably right. In the meantime, President Aliyev was honored by luminaries and supplicants from the U.S., promoted as a democrat, and even welcomed in the White House, without mention of coming to terms with his past or present crimes.

It was also noted, and I will not go into it again, that supporting this kind of a regime is exactly what tends to get the United States in trouble, what tends to get our commercial interests in trouble over the long term; that no one can predict what the future will

bring, but political succession is inevitable. Considering that the oil contracts were renegotiated not only after President Elchibey took power, but also after President Aliyev took power, it is reasonable to expect that when political succession occurs in Azerbaijan there will be a new call for renegotiating contracts. As a taxpayer, I can say that I believe that Congress and the administration ought to be a little more careful with taxpayers' money before allowing agencies like OPIC, EXIM Bank, and other agencies to take risks there.

The bottom line legal conclusion on exploitation and transit use of the Caspian is that all five littoral countries have to conclude a treaty. Each of those countries has different limitation and different problems. It is perfectly foreseeable to see that a treaty that may make sense for Azerbaijan and Kazakhstan may not make sense in Russia, and who knows where Iran will end up.

It is also constructive to realize that demanding sectoral division of the Caspian will not change the law or that legal reality. Investments being made on that assumption, that sectoral division will occur, are at risk, and companies are making those investments with their eyes wide open.

This pipeline debate actually brings home the point that so many people in our opinion have been getting backward. Development of the Caspian's energy potential, whatever it is, is not going to lead to democratization, stability, and regional integration. Those things have to start first, and it is in the U.S.' primary interest to see that they take hold in this continuing period of transition from the Soviet era.

We can start by taking down the "For Sale" sign that private interests have put in front of the U.S., by setting a better example when dealing with regional problems, and by not buying romanticized notions of what the region is or what it holds. Each of the countries that emerged from the Soviet Union is different in increasingly important ways. Regional groupings for development of energy environmental matters do not correspond to regional groupings for development or other political matters. The differences in national and regional developments ought to be better appreciated if the U.S. as a nation is going to do what we set out to do.

Finally, I want to use this opportunity, which I do appreciate, to correct a perception about Armenia that is commonly accepted and repeated. Specifically, the President, Robert Kocharian, is often misquoted as stating at a public event that Armenians would sabotage pipelines. I spoke with someone who was present when the quote was purportedly made and is a definitive source on what was said. The quote was totally incorrect, categorically incorrect.

Armenians are, however, suffering from the absence of common sense and fair dealing being applied to the region. We know from the experts that the Baku-Ceyhan pipeline through Armenia saves at least \$600 million off of what was estimated as the \$2.3 billion price tag and is the most stable long-term route, with the added benefit of encouraging Turkey to be a better neighbor.

We hear that U.S. policy is to encourage decisions based on commercial principles, regional integration, stability, and such, but no one has put a real proposal on the table. Instead, Armenians are

consistently criticized for not embracing solutions to the Nagorno-Karabakh conflict that we know from bitter experience, in most of our cases bitter personal experience, put us at risk of another genocide.

Thank you.

[The prepared statement of Mr. Krikorian follows:]

PREPARED STATEMENT OF VAN Z. KRİKORIAN

I am testifying as the Chairman of the Board of Directors of the Armenian Assembly of America, and I would like to start by thanking you for this opportunity and for your attention to this part of the world. There is no question that U.S. policy has been derailed from our national objectives of establishing democracy, the rule of law, open economies, and civil society in the countries of the Caspian region. It is now time to wake up from the pipe dreams purveyed by special interests. Commercial entities should be able to pursue their economic interests on legal and commercial bases and the United States government must support U.S. businesses seeking fair treatment in foreign countries. However, the government should not be in the business of pushing bad deals or in the business of compromising U.S. principles every time a foreign government decides to politicize a commercial issue.

The Difference Between 15 and 200 Billion Barrels of Oil Is Not Insignificant—Especially in the Caspian

The confusion over what the U.S. government should be pursuing was initially caused by reports that we now know were grossly exaggerated about the Caspian's oil reserves constituting a strategic alternative to established resources in the Persian Gulf and elsewhere. Based on that faulty premise, the U.S. crossed the line from promoting our principles to promoting misguided parties. Now, we must try to get on the right track.

From new reports out of Houston by the Baker Institute, London by the International Institute for Strategic Studies, and Geneva by Petro Consultants, we now know that instead of the 200 billion barrels of oil in the Caspian, a figure which has been used loosely and which was valued at four trillion dollars (\$20 price per barrel) by the State Department, we are really talking about between fifteen and thirty billion barrels of proven reserves, with a real oil price of fifteen dollars per barrel or less. We also know that even those figures on proven reserves are from the Soviet period which political analysts had suspected and now natural resource companies are confirming were inflated.

The most recent drilling results in offshore Azerbaijan are actually showing no oil—just gas condensate; interestingly, one of these sets of drilling results was in part of an area touted as having four billion barrels of oil. The projections of potential reserves will have to be adjusted downward as well, and this is occurring in a period of reduced oil prices. Well over 50 percent of what oil there is appears to be in Kazakhstan. The designated markets for South Caspian oil are in Asia and parts of Europe but not the United States, and while there is a significant amount of natural gas, especially in Turkmenistan, markets are as much a problem as pipelines.

In addition, environmental and political pitfalls with regard to getting the oil to markets are becoming a bigger problem. The recent earthquake in Ceyhan serves as a reminder that the entire Caspian and Caucasus region is earthquake prone. The early oil pipeline from Baku to Supsa is significantly over budget and there is a dispute over who will pay for the overrun which is in the range of hundreds of millions of dollars. The Baku-Ceyhan pipeline which has been most actively promoted for strategic reasons already appears to be too expensive of a proposition unless it can also be used for oil from Kazakhstan. Trans-Caspian underwater pipeline proposals as well as the particularities of the Caspian's environment and water level trigger even more sensitivities. All in all, the cold truth today is that no one can guarantee that the storied Caspian will reduce U.S. gasoline prices.

Taking the United States on a Dangerous Ride

Based on promoters' hype, however, the primacy of the goals for which the Cold War was fought and won have dramatically been replaced by the primacy of the goals of the promoters' individual financial gains. Considering the stakes, this transformation must be reversed. The influence of United States principles and the perception of the U.S. as an honest broker are lower now than at any point since the break up of the Soviet Union. This is most evident with respect to our policy toward Azerbaijan.

United States companies, the State Department, and other government officials have not only entrenched institutionalized corruption in Azerbaijan and elsewhere, but have also helped it grow and actually promoted it as a form of democracy. Indeed, the revolving door of U.S. government officials involved in the region has sanctioned the kind of behavior that shocks most Americans. Let me cite specific examples.

The United States plays an important role in resolving the Nagorno Karabagh conflict through the OSCE, which itself is being tested in the process. You will recall that when the Armenians in Nagorno Karabagh were taking the spears for challenging the Soviet system that put them under foreign domination, they had not only the support but also the encouragement of the U.S. government. So, when the U.S. was able to increase its role, its potential to act as an honest broker was highly appreciated.

When the President appointed a special ambassador, Jack Maresca, to mediate the conflict, there was a sense of hope among many that the American style of fair play would make a positive contribution. Proposals which were unacceptable in light of the region's realities were nevertheless accepted as they were made in good faith because they came from a U.S. ambassador. Imagine the reaction in the region, then, when Ambassador Maresca upon leaving government service went to work for one of the major oil companies lobbying Washington to ingratiate itself with Azerbaijan. This sent a message to every country in the region about U.S. rhetoric and reality.

You should also recall that when Congress passed Section 907 of the Freedom Support Act in 1992, it did so with the explicit support of the Bush Administration. I can say that definitively, because I negotiated the final language of Section 907 with Ambassador Richard Armitage. The agreement we reached included the Administration's support for the legislation, and, sure enough, at the House Committee meeting on September 21, 1992 which adopted the final version of Section 907, in an explicit exchange with Congressman Broomfield, Ambassador Armitage told the world that the Administration supported Section 907. The Bush Administration and a bipartisan Congress supported 907 because it was and is a reasonable, principled response to outrageous behavior. Upon leaving government service, Ambassador Armitage joined so many other Administration officials by enthusiastically lobbying for repeal of Section 907. Instead of observing the law, prior and present Administration officials have been at work to circumvent it, while promising Azerbaijan that Congress would repeal it. This too sent a message about rhetoric versus reality and also makes charges that the law has not worked ring hollow.

There are examples of others in government who have acted similarly, but the point is that stated U.S. principles and indeed U.S. law, in particular with respect to Azerbaijan, are not being implemented consistently with the stated policies or the national interests of the United States. The proof is in the results.

Control Risks Group has ranked Azerbaijan as the third most corrupt developing country. Off-the-record or anonymously in the press, diplomats and company officials acknowledge that corruption abounds in foreign investment deals. Yet the Justice Department allows the Foreign Corrupt Practices Act to lay dormant, securities regulators do not act, and, as we learn more that investors were misled on the amount of oil in the Caspian, Congress is now considering legislation, namely the Silk Road Strategy Act, that accepts the faulty and inflated numbers on Caspian reserves.

The president of Azerbaijan essentially runs the country as a private syndicate. Upon assuming office, he immediately initiated a massive offensive against Armenia and Nagorno Karabagh. He was a KGB general and rose to be a Soviet Politburo member; he is responsible for ethnic cleansing, political repression, and major atrocities. Had it not been for the vote of the Communist Party, as David Remnick recounted in his book *Lenin's Tomb*, he would have been appropriately punished for sexual assault. A cult of personality right out of the Soviet manual has been imposed on the people of Azerbaijan who will not see the economic benefits of any oil rush, and a leading opposition candidate for this fall's presidential election is living in exile with a legitimate fear for his life if he returns. Other opposition candidates for this fall's elections have stated they will not compete because of Aliyev's rigged election law, and Azerbaijan has been in gross violation of the CFE treaty without any consequences. Yet, Heydar Aliyev is honored by luminaries and supplicants from the U.S., promoted as a democrat, and even welcomed in the White House without a mention of coming to terms with past or present crimes.

The U.S. has substantial experience in dealing with strongmen like Heydar Aliyev. The experience shows that whatever short-term benefits a particular company or U.S. diplomacy may gain, there is a public backlash that follows. U.S. political and economic interests can end up paying a fairly high price for compromising

American principles which value clean government, fair play, and respect for human rights. Let's not be surprised when the backlash hits if the U.S. continues to repeat the mistakes of the past. If U.S. policy aims at establishing secure, independent, democratic and economically viable countries in the region, sadly implementation is missing the mark. Even though many people do not want think about it, political succession is inevitable. In Azerbaijan, no one can predict what that will bring, but considering that Aliyev renegotiated oil contracts when he took over through a coup and one of the current candidates is calling for canceling existing contracts if he wins, Congress and the Administration ought to be more careful with taxpayers' money before allowing OPIC, ExIm Bank and other agencies to take risks there.

Bootstraps May Not Work in the Caspian

The bottom line legal conclusion on exploitation and transit use of the Caspian Sea is that all five littoral countries—Russia, Azerbaijan, Kazakhstan, Iran, and Turkmenistan—must conclude a treaty. Each of the five countries has different interests and different limitations. For example, both houses of the Russian legislature must ratify any treaty on the Caspian, and it is easy to see how that could be a problem, even if campaigning for the next round of elections in Russia had not already begun. Iran presents a special case, where different policies collide and implementation is impossible to predict. But simply recognizing that it is a wild card reaffirms that unilateral action in the Caspian could well set off conflicts that neither the United States nor the region needs.

It is also constructive to realize that demanding sectoral division of the Caspian will not change the law or the reality. Investments made based on the assumption that sectoral division will occur are at risk, and the pipeline and other options on the table today for resolving the issues and removing the risk are obviously not enough to bring all the parties together.

Pipeline routes similarly implicate legal, political, economic, security, and other issues, with no easy way out. The existing northern route through Russia was always subject to sabotage for political reasons and simple theft to feed the illegal refineries in Chechnya. Those risks were recently supplemented when the Chechen government threatened to stop the flow of oil unless Russian war reparations are paid and when conflict heated up in Dagestan. In fact, security and stability are significant issues whether pipelines go north, south, west, or east. Instead of spending time and money pushing alternative pipeline routes, it should be clear that the U.S. would be better off remaining above that debate and focusing on resolving the conflicts and building the foundations for democratic structures in which the types of impediments pipelines now face would be eliminated.

The pipelines debate actually brings home the point that so many people have been getting backwards. Development of the Caspian's energy potential is not going to lead to democratization, stability, and regional integration; those things have to start first, and it is in the U.S. primary interest to see that they take hold in this period of continuing transition from the Soviet era.

Honesty is the Best Policy

We can start by taking down the "For Sale" sign that private interests have put in front of the United States, by setting a better example when dealing with regional problems, and by not buying romanticized notions of what the region is or what it holds. Each of the countries that emerged from the Soviet Union is different in increasingly important ways. Regional groupings for the development of energy or environmental matters do not correspond to regional groupings for development of other matters. The differences in national and regional developments ought to be better appreciated if the U.S. as a nation is going to do what we set out to do.

Finally, I want to use this opportunity to correct a perception about Armenia that is commonly accepted and repeated. Specifically, the President, Robert Kocharian, is often misquoted as stating at a public event that Armenians would sabotage pipelines. I spoke with someone who was present when the quote was purportedly made and is a definitive source on what was said. The quote was totally incorrect. Armenians, however, are suffering from the absence of common-sense and fair dealing being applied to the region. We know from the experts that the Baku-Ceyhan pipeline through Armenia saves \$600 million off a an estimated \$2.3 billion price tag and is the most stable longterm route with the added benefit of encouraging Turkey to be a better neighbor. We hear that U.S. policy is to encourage decisions based on commercial principles, regional integration, stability, and such, but no one has put a proposal on the table. Instead, Armenians are criticized for not embracing solutions to the Nagorno Karabagh conflict that we know from experience put us at risk of another Genocide.

Thank you.

Senator HAGEL. To each of you, thank you very much.

Dr. Olcott, if I could begin the questioning with you. Your testimony was not particularly uplifting in any way you measure the dynamics of that area, and I would like to give you an opportunity to, if you can, tell this committee what would be your policy? Should we not develop the energy resources, or should those resources be developed there?

How would you go at this? Give us some of your sense. You told us all the things wrong, but what is right, if anything? But more importantly, how would you come at it or what should we be doing?

Dr. OLCOTT. Thank you for the opportunity. I obviously think the region is one of great potential. I am just a realist, and I think we should go into it knowing more about the region we are going into.

I think the energy resources have to be developed. I support the idea of multiple pipelines, but I think that the notion of cutting Russia out is a foolish one. I think that the region's long-term stability depends on having some outlet through Iran. This might not be the right time for it, but ultimately I think that that is an important outlet for the region. It cuts transport to Europe significantly, not just for oil, but for all sorts of other goods.

I am very uncomfortable with the western pipeline because I think that it depends inordinately on the stability of Georgia, which I see as a highly unstable state. I think that we have to do more for democracy-building. We have to do—I am very much in favor of the push for privatization in the region, and Kazakhstan and Kyrgyzstan have gone much further than the other states in this way.

But the way we are coping with the social welfare benefits in these societies is with western style deferred maintenance projects. We are now focusing U.S. aid on a Kazakh pension program that is designed to make it self-sufficient in 40 years, but we are not coping with the deferred health costs of the—the deferred costs of the pension—helping them cope with the deferred pension payments today and the deferred health costs.

So we are building up this social pressure in the society. I think if we are going to be serious about acting in the region we have to act—if I use the word “aggressively” that sounds neo-imperialistic, but I think we have to have a more concerted, well thought out strategy that is more than simply developing the oil of the region.

We have to work with these states to develop good projects for sustainable economic development. The problem of dropping education—President Krimov talked about it: In Uzbekistan, about 100,000 young people a year at age 15 are being thrown out of schools with no possibilities of employment. We are building up proto-revolutionary situations in this part of the world. This is happening in Kazakhstan, this is happening in Kyrgyzstan.

So I am all for the development of oil, but I think that we have to be—if we say we are going to be strategic or quasi-strategic partners of these states, we have to go in and really help them think—work with them more aggressively thinking through the long-term security problems, the long-term internal security problems that they face, improving education systems, and not be afraid of tackling the problem of corruption.

What we are pussyfooting with a bunch of very corrupt leaders, because we do not want to risk them getting angry at us and giving America—

Senator HAGEL. Let me please interrupt just for a moment. That is all interesting, but give me two or three examples of how we would change our policy, tangible programs focus. How would we start to get at this? You said a number of things about all the problems in each of the countries and so on, but give me some examples of how we get at this.

I do not think anybody disagrees with your general points here.

Dr. OLCOTT. Funding for secondary education in some of these countries.

Senator HAGEL. Where does the money come from?

Dr. OLCOTT. Well, we should be working with them to use their oil income to work toward it.

Senator HAGEL. That means they have to develop energy resources, if we are going to be working with them to get income.

Dr. OLCOTT. Or even more equitable tax systems.

Senator HAGEL. But they do not have any money to tax.

Dr. OLCOTT. They do have money to tax, and we are not really pressing on the corruption issue in these societies.

Senator HAGEL. How do we get at the corruption issue?

Dr. OLCOTT. In 3 minutes?

Senator HAGEL. Take as much time as you like.

Dr. OLCOTT. The problem is we do not know nearly as much about these societies as we pretend we know, and we have not done—in Kazakhstan alone, which is the country that I know the best of the whole region, we have allowed whole hosts of major privatization of mineral resource deals to go forward under very corrupt conditions, with very little of the money going into the public treasury.

There has been no, to the best of my knowledge, no pressure on the government to go out and collect this money and put it back into the budgetary process. That is one very small example.

I am uncomfortable in a public hearing listing the list of corrupt transactions that I know have occurred in the region where there has been no followup. But there are millions of dollars of money being stolen in each of these countries that could go into public funding, that could go into the education system, the health care system, that are now escaping into the pockets of the officials.

It is not just Azerbaijan, as was pointed out. It is all throughout. It is throughout almost all of the region. There is very little—because of the politics being dominated by energy at this point, there is very little pressure right now on these regimes to clean up their act. You hear way too much that 70 years of communism makes them incapable of understanding democracy and there is just very little follow-through of the paper trail of these bad privatizations.

It would be embarrassing to list to you the government officials in these countries who have profited from these transactions, who have made vast personal fortunes. Many of them are outside of the country, and stolen from their own population, the money that could be going to solve some of these problems.

Senator HAGEL. Thank you, thank you.

Senator Sarbanes.

Senator SARBANES. Well, thank you, Mr. Chairman.

Dr. Olcott, are you all right on time? I understood you had something.

Dr. OLCOTT. I had a lunch, but they will wait for me.

Senator SARBANES. Fair enough.

First of all, let me say Dr. Olcott has been a student of this area for many, many years. In fact, we have a lot of sort of instant experts on the region now, and I do want to acknowledge the fact that long before all of these various importances attached to this region she was doing some very careful and thoughtful analysis and commentary about it.

This is a diversion, but I am just kind of curious. Is there any rationale at all for shifting the capital of Kazakhstan to Istana?

Dr. OLCOTT. There are three reasons for it, I would say. One was that it really does consolidate the position of the Kazakh population. The other was there really were ecology problems of growing and making Almati grow.

But the third one I think was a classic corruption issue, that what Nazarbayev did was transfer enormous amounts of leverage in giving out contracts to people who then became enormously personally loyal to him. So fortunes were made on the transfer of that capital as well.

How you would rate the three factors I think depends upon your degree of cynicism. But I think that all three really played a role in the transfer of that capital.

Senator SARBANES. Do any of them have enough validity to justify the kind of expenditure and the diversion of resources that is being devoted to that purpose?

Dr. OLCOTT. Personally, I think it is the worst decision he made as president. I think it created a growing sense of disillusionment even among ethnic Kazakhs about what their independence was about. It did not make them anti-independence, but it made them much less loyal to Nazarbayev, and they are very loyal to Nazarbayev.

That move to Istana is one with a lot of hidden figures. There has been a lot of talk about how it has only been built with foreign money. But all the costs of moving the legislators back and forth to Istana—and they go back and forth every week and they are housed in Istana at government expense, and this is a government that has a very strained budget right now.

It is not a government that is doing everything wrong. It is trying to make pensions even, it is trying to improve health care to some degree. But it is taking money away from social needs that are much more pressing. Kazakhstan has one of the highest tuberculosis rates in the world right now. It has near-epidemic tuberculosis. All this at a time when you have these singing and dancing ladies glorifying the new Kazakh state and the what will ultimately be billions of dollars of money spent to move a capital faster than any capital has been moved in a developed society.

Senator SARBANES. Now, I have a perception that one of the things that is happening in the region is being absolutely oblivious to any other important calculations other than access to oil and gas and therefore tolerating practices that in the developed world have obviously been ruled out of hand, so that in a sense the govern-

ment policy is to indulge the private interests that are seeking to gain this access, even though it then results—it may result in high levels of corruption, internal development that is truly not long-range in terms of putting the country on a stable and prosperous basis.

Do you share that perception?

Dr. OLCOTT. I share that perception, and I would argue it is not even good for American business, that American business is being pushed into an unstable region faster than we are able to ensure the stability of the business community; that if what we want is American oil and gas companies to play an active role in development of Caspian reserves, which I think is something we should want, then we should want the American business community to be going in under conditions of greater stability, with a government that is more aware of the causes of instability and more able to address that instability.

I am all for American involvement there, and I am not implying that American firms have behaved in inappropriate ways. But I do not think they are going to stay the long course as the region shows itself to be unstable. So I see it as sort of an empty policy in two ways. We do not appreciate the difficulties of stability in the region. The businesses that are trying to work in the region have a much greater sense of the instability of the region and they are not going to dump good money after bad as projects begin to fail and as governments begin to go down.

Senator SARBANES. Now, taking the immediate short-run outlook and picking up on the chairman's question about, well, what can be done sort of practically, how important do you consider it to be that the Presidential election to be held in Azerbaijan this fall be an open, fair, and honest election, in terms of how conditions in that country are going to develop thereafter?

Dr. OLCOTT. I think it is critical that it be a free and fair election. What concerns me most is that if the election is not free and fair, then President Aliyev will try to have his son replace him, and that will be a long-term scenario for disaster in Azerbaijan.

I think all the elections that are held in the region we should push to be free and fair, but I think that is one, since it is coming up first, that is one where we get to show our backbone, particularly because the implications of not having a free and fair election I think are very dangerous for the long-term consequences of the stability of the state.

Senator SARBANES. What can the U.S. do to underscore the importance of this and to move the situation toward a free and fair election?

Dr. OLCOTT. I think we should be working with the opposition groups to urge them to run regardless. I think that we should continue to pressure for improving the election law. We should continue to pressure for changing the composition of the electoral commission. I think we really should make it—we should help create an atmosphere where it is safe for opposition figures to return to the country. We should make it clear to Aliyev that if these people die in mysterious car crashes or their houses blow up by accident from natural gas, that we will view him with great suspicion, that

accidents happen but it is hard to believe that accidents happen so fortuitously.

So I think that the opposition should be urged to contest the election. I think it is always good when the opposition can agree on one candidate or two among themselves. But I think a free and fair election is what is needed in Azerbaijan.

Senator SARBANES. Could I just put one question to Mr. Krikorian?

Senator HAGEL. Yes.

Senator SARBANES. Some have suggested that the new president of Armenia, Mr. Kucharian, is not open to or anxious to arrive at a resolution of the disputes with Azerbaijan, and I wonder how you would respond to that criticism?

Mr. KRİKORIAN. Totally incorrect. I have spoken with him myself directly about it. He has a different style than probably diplomats are used to, though. He is putting all of his cards face up on the table and he is saying: Here is what I will give you and here is what I will not give you; if you want to talk seriously about resolving this dispute, I am ready to do it this year.

He is saying: You know what? In every other conflict in every other part of the world, the people that are actually fighting with each other are talking with one another. In this conflict, however, Azerbaijan refuses to directly negotiate with Nagorno-Karabakh without preconditions. Certainly they have said that, well, if Nagorno-Karabakh officials accept all of our conditions, then we will negotiate with them, which is hardly a way to start.

It is hard to imagine meeting a more serious or honest guy. His foreign minister is in line with that. I hope that you have had a chance to meet with him. I think that virtually everyone who has met with him has come back with that same impression, of frankly not playing games. The president came out of a war zone, defended his house, his family's houses, from what would be devastation, and is a straight shooter among straight shooters.

If I could also just take a quick opportunity to respond to Senator Hagel's question, what should the U.S. be doing, I think it is frankly to start depoliticizing some of these business issues. I do not think that oil companies ought to be carrying the U.S. Government so tightly with it when it goes to pursue some of these things that it wants to pursue, and that was the example that frankly worked, that was used in the Middle East, and allowed oil to be extracted from there. The U.S. Government was not brought in until fairly late in the game. The decisions were made on commercial bases, where people knew what the risks were going to be, and they made their business decision.

If they are being treated unfairly, it is a different story. They should be protected. But in terms of carrying all of the baggage of the sins of this government or the problems of this country or that country, I think we should take a step back from politicizing issues a little bit.

Thank you.

Senator HAGEL. Mr. Krikorian, may I pick up on your point. Do you really believe that our American energy companies are interested in developing resources in the Caspian Sea as a front person for the American Government, in fact that the American Govern-

ment is dictating their presence their? Is that what you implied or said?

Mr. KRIKORIAN. No, no, that was not.

Senator HAGEL. What did you mean by that?

Mr. KRIKORIAN. What I was saying was that I believe that the oil companies are bringing the U.S. Government with them, that their interests—they are tying the U.S. Government to their interests more than they ought to be, not that they were working on behalf of the U.S. Government. I have no question that they are working on behalf of their own commercial interests. But the extent to which they have drawn the U.S. Government, the entire U.S. Government, into that is the problem.

Senator HAGEL. Do you not believe that those oil companies, as some would suggest, being mercantilists or capitalist mercenaries, would have their own self-interest in mind first? And that leads me into the next question, if you could answer as well. Your numbers that you cited, interesting numbers—I had not heard of these, the Houston Baker Institute—essentially really questioning what the oil companies' numbers show.

I guess the other part of that question is, if the oil and gas and the volumes and all the other dynamics that go into exploration to develop profit are not there, why would our oil companies be there?

Mr. KRIKORIAN. I think that is what you are seeing. I think you are seeing and you are going to go into a period where they muddle through.

Senator HAGEL. They are investing billions of dollars. Oil companies, no company, can do that without some pretty significant cost benefit analysis and risk assessment analysis.

Mr. KRIKORIAN. Well, we could take a look at exactly what they are investing versus what they promised to invest. I think if we take a look at exactly what they are investing, we will see that you are not quite up to billions of dollars yet. I think they have promised—

Senator HAGEL. Have you looked at the books? Have you seen what they have invested?

Mr. KRIKORIAN. I have just seen the general statistics on it and I know the terms of their contracts.

Senator HAGEL. You know, these are public companies, so you can get that information.

Mr. KRIKORIAN. I know that. I would be surprised if they are in the billions of dollars.

Senator HAGEL. Well, they are.

But let me go back to the first question I asked—

Mr. KRIKORIAN. I guess we should also distinguish between the different parts, investment in Kazakhstan, investment in Turkmenistan, are we talking about offshore or onshore? If we are talking about offshore Azerbaijan, you have this very clear example of two drill holes and no oil.

Senator HAGEL. But they are continuing to build pipelines and invest money there. My question is do you really believe they would do that if they felt that there was not much return or potential return? Or what would be their motive?

Mr. KRIKORIAN. I do not think they are doing it as quickly as everyone thinks. I think—I do not think they are doing it as quickly

as everyone thinks. I think before they can justify to their shareholders investing anything close to billions of dollars they are going to have to have a lot more in their proven reserves categories, and not proven based on what old Soviet statistics showed. Actually, those statistics are in the State Department's report to Congress last year. They are going to wait and prove them up themselves if they can, and so far it has not happened.

Senator HAGEL. Thank you.

Let me ask you a question, Dr. Olcott. You had mentioned in your testimony and then in response to some questions about corruption being rampant in all countries.

Dr. OLCOTT. Virtually.

Senator HAGEL. Virtually. Which countries would you exclude, where there is no corruption in the Caspian Sea area, the Caucasus?

Dr. OLCOTT. I would say that there is different levels of corruption. Probably Kyrgyzstan would be the least corrupt. In the three where there are vast reserves—Kazakhstan, Azerbaijan, and Turkmenistan—the level of corruption is the highest. Uzbekistan is the trickiest to talk about because of the long-existing second economy, so it is hard to know what is continuing patterns of corruption and what is new corruption.

Senator HAGEL. Is there corruption in Armenia?

Dr. OLCOTT. In the Armenian case you do not have the same reserves and I do not have the same data base.

Senator HAGEL. No, I am not asking—

Dr. OLCOTT. So I just do not have that same information.

Senator HAGEL. But would you say, just offhand? You have been extolled as an expert in this area.

Dr. OLCOTT. But I am not extolled on—you can extol me on the six countries that I have worked with for 35 years.

Senator HAGEL. But you do not know about Armenia?

Dr. OLCOTT. But I cannot talk about the levels of corruption in Armenia.

Senator HAGEL. Levels of corruption or no corruption? There are levels of corruption in the Armenian government?

Dr. OLCOTT. There are levels of corruption everywhere in the former CIS. But whether it touches the kinds of corruption that you find in the Caspian states, that I just cannot say.

Senator HAGEL. So it is a matter of degrees of corruption?

Dr. OLCOTT. Yes, but when you have poverty levels rising at almost the same level, at almost the same speed, in states that are being touted as enormously rich, the social upheaval factor that you are creating in those states is much greater than in states, like Armenia and Georgia, which are not being touted as states that are on the verge of great wealth. So the three that are touted on the verge of great wealth have much greater social risk because of the growing poverty.

Senator HAGEL. Thank you.

Senator Sarbanes.

Senator SARBANES. Mr. Chairman, I just want to make one observation. This Baker Institute policy study, which I think is an important study, I just want to quote from it. It says: "In short, the Caspian Basin is not going to be the ace in the hole for inter-

national energy security. The region is by no means the only major oil and gas province in play that can help diversify world oil supplies and reduce reliance on the Persian Gulf. Substantial reserves remain to be exploited in Africa, South America, and offshore Asia, and particularly the payoff in terms of magnitude of incremental supply to global markets would be much higher if greater efforts were applied to unlock the significant resources lying in Mexico and Russian Siberia, rather than similar efforts in Central Asia and the Caucasus.”

They make the point that the huge distance from Central Asian and Caucasus hydrocarbon reserves from the world’s major energy-consuming regions requires a considerable financial investment to bring them to market. The countries of the region are landlocked, and it goes along with that analysis and it is developed.

But I think it is important to put this whole thing in context. There has been a kind of a fixation, I think, and I am all for developing additional alternative energy resources and figuring out how to bring them to market, but I think we ought to maintain some sense of perspective in this matter, as I said in the outset.

Let me close. I again want to thank—this is a very thorough, comprehensive statement Dr. Olcott has submitted to the committee and which she quickly summarized. I do want to thank you very much for the obvious time and effort that went into this prepared statement.

Senator HAGEL. We both, on behalf of the committee, are grateful for your testimony and thank you for your patience. We are grateful.

[Whereupon, at 12:41 p.m., the subcommittee was adjourned, subject to the call of the Chair.]

APPENDIX

ARMITAGE ASSOCIATES L.C.,
ARLINGTON, VA 22209,
July 31, 1998.

THE HON. CHUCK HAGEL,
346 Senate Russell Office Building,
Washington, DC 20510.

DEAR SENATOR HAGEL: Let me begin by thanking you for sending me various floor speeches and remarks that you have recently delivered regarding U.S. foreign policy. It is very refreshing to hear unapologetic statements regarding the need for strong U.S. leadership in the international community. I applaud your efforts.

The purpose of my letter is to respond to testimony given on July 8, 1998 before the International Economic Policy, Export and Trade Promotion Subcommittee regarding Caspian Sea Oil Exports. I felt compelled to respond in writing to you because I fear that an incorrect statement given by Mr. Van Krikorian, if left unchallenged, may be taken as fact. It is my hope that you will share this information with your colleagues to remove any doubts on the position of the Bush Administration in 1992 regarding Section 907 of the FREEDOM Support Act.

In his testimony, Mr. Krikorian stated that,

You may recall, that when Congress passed Section 907, it did so with the explicit support—not the opposition, but the support of the Bush Administration. I can say that definitively because I negotiated the final language of section 907 with Ambassador Armitage, in 1992. The compromise—the agreement that we reached, included the Administration's support for that legislation. And at the House Committee meeting on September 21st, 1992 which adopted what became the final version, in an explicit exchange with Congressman Broomfield, Ambassador Armitage was asked whether the administration supported this legislation, specifically, Section 907, and he said yes. And upon leaving government service, though, Ambassador Armitage joined so many other former Bush Administration officials, by enthusiastically lobbying for repeal of section 907.

My reaction to Mr. Krikorian's statement was both a 'yes' and a 'no.' The 'yes' is in response to the fact that Mr. Krikorian, then Director of Government and Legal Affairs for the Armenian Assembly, and I did work together to develop language regarding the prohibition of U.S. Government assistance to Azerbaijan which would eventually become Section 907. Although I cannot cite the reported exchange with Congressman Broomfield on September 21, 1992 which Mr. Krikorian notes in his testimony, the 'no' is in response to Mr. Krikorian's statement that the Bush Administration supported this legislation.

As I recall, in May 1992, the Senate Foreign Relations Committee passed an amendment which severely restricted U.S. assistance and trade with Azerbaijan until Azerbaijan lifted all blockades against Armenia. As the point-man for the Administration however, I fought against the amendment, apparently to the surprise and perhaps chagrin of the Armenian Assembly.

Recognizing that some form of aid restriction would be imposed regardless of the State Department's efforts and further recognizing that the White House was unable to lend its leadership to this issue amid a presidential campaign, I negotiated with the Armenian Assembly, as a collective representative of over 14 American-Armenian organizations, in order to craft the least offensive language that the Administration could obtain at the time. Hence, my comment (at a June 1992 hearing at a House Foreign Relations Committee) that the Bush Administration did not object to the 907 language was partly correct—we did not object to the language that we helped to negotiate—but we certainly did strenuously object to any provision which prohibited the U.S. Government from addressing the Armenian-Azerbaijani conflict as an even-handed mediator and impeded the Administration from conducting U.S.

foreign policy in an unfettered manner. Any person representing the President would also object, of course, to any fetters on Presidential prerogative.

To this day, I personally regret that the Bush Administration was unable to fight Section 907 effectively. Had I known that Section 907 would still exist in 1998, perhaps more persuasive arguments could have been made to combat this provision. However, given the circumstances in 1992, I was only able to mitigate the damage that has been done to the role of the U.S. Government in this vital region.

Finally, regarding Mr. Krikorian's final comment about my apparent reversal on Section 907 now that I am in the private sector, I can only say that my position continues to be remarkably consistent in both public and private sector capacities: I strongly oppose Section 907. I have testified regarding this matter as a private citizen well before any clients had engaged me regarding Caspian Basin activities.

As President of Armitage Associates, one of my firm's principal activities is help develop private sector humanitarian assistance programs to assist the most vulnerable and needy citizens of Azerbaijan which, ironically, Section 907 has prohibited. For example, I have been honored to be involved with the Texaco Corporation in a program to purchase medical supplies and equipment and provide technical assistance in order to create a regional blood bank in Baku something which, in better circumstances, could also benefit the citizens of Armenia. Indeed, many other U.S. companies, such as Unocal, Amoco, Exxon and others, also have stepped forward to provide urgently needed aid. While these companies should be commended for their efforts, in no way should it be a substitute for U.S. Government leadership in this area.

It is my sincere hope that this letter has provided some additional clarity on this controversial subject. If you have any questions or comments regarding this letter, please do not hesitate to contact me. Although I am traveling to Baku next week, I would be very happy to discuss this issue with you at greater length upon my return. With very best wishes,

Sincerely,

RICHARD L. ARMITAGE,
PRESIDENT.

July 22, 1998.

SENATOR CHUCK HAGEL
Chairman,
Subcommittee on International Economic Policy, Export and Trade Promotion,
Foreign Relations Committee,
United States Senate,
Washington, DC.

DEAR SENATOR HAGEL: I am writing with regard to the hearing on Caspian Oil Exports which was conducted by your Subcommittee on July 8, 1998. During that hearing one of the witnesses, Mr. Van Krikorian of the Armenian Assembly, attacked me by name. This letter is intended to correct the record.

Mr. Krikorian used innuendo to imply that my role as the first American mediator of the conflict over Nagorno-Karabakh was somehow not impartial because of the fact that after leaving government service I joined an oil company. His remarks, and their implications, are totally unjustified, and are damaging to my reputation. The facts are as follows:

I spent more than thirty years as a United States Foreign Service Officer. In 1991-92, as the Soviet Union broke up, I was the United States Ambassador to the Conference on Security and Cooperation in Europe (CSCE—now called the OSCE). I immediately took action to bring the newly-independent states of the former USSR into the CSCE, and personally resolved the last obstacles to membership for Armenia. I made several dangerous trips to Nagorno-Karabakh and its region, where a bloody conflict was already raging. I subsequently was instrumental in creating a negotiation aimed at resolving that conflict. This negotiation, called the Minsk Group, had the initial success of bringing all the parties to that conflict to the negotiating table.

I put a lot of effort into finding a solution to the conflict, as any participant in those negotiations would confirm. I was scrupulously impartial in identifying possible compromises, using my best judgment as a neutral mediator. I also tried mightily to get the U.S. Government more interested in the areas of the Caucasus and Central Asia. However, when I realized that the parties to the conflict were not

prepared to make the compromises necessary for a peaceful settlement, and that the U.S. Government, still very much focused on its policy toward Russia, was unwilling to take a leadership role in the Caucasus, I asked to be relieved of this assignment and left government service.

As a private citizen I have fostered a number of conflict-resolution organizations, and was President of a research institute focused on the former Communist countries. About a year ago I accepted appointment as Vice President for International Relations of a major energy development company. In this position I have worldwide responsibilities for the company's relations with foreign governments. However, I am not a lobbyist with the U.S. Government, and am not even resident in the United States. My views on the Caucasus and Central Asia, and in particular on the conflict over Nagorno-Karabakh, have not changed.

I believe attacks like the one Mr. Krikorian made on me have the unfortunate effect of discouraging people to undertake the role of mediator in conflicts like the one over Nagorno-Karabakh. Such work is by its nature difficult, dangerous, obscure and often thankless. If the United States is to carry out its responsibilities as the World's leading power, however, it must be prepared to use its influence for mediation of the many conflicts in remote areas, which produce misery and desolation for the peoples involved. The American diplomats who carry out such efforts should be encouraged, not criticized.

I believe Mr. Krikorian owes me, and the many American diplomats who have carried out such difficult assignments, a public apology.

The effort of your Subcommittee to focus public attention on the Caucasus and Central Asia is laudable, and I hope you will continue it. Fortunately there is a growing realization of the importance of these regions, for the United States, and for the World.

With best personal regards.

Sincerely,

JOHN J. MARESCA,
UNITED STATES AMBASSADOR (RETIRED).

U.S. DEPARTMENT OF STATE,
WASHINGTON, DC 20520,
July 29, 1998.

HON. JESSE HELMS, CHAIRMAN,
Foreign Relations Committee
U.S. Senate.

DEAR MR. CHAIRMAN: Following the July 8, 1998 hearing at which Ambassador Stephen Sestanovich testified, additional questions were submitted for the record. Please find enclosed the responses to those questions.

If we can be of further assistance to you, please do not hesitate to contact us.

Sincerely,

BARBARA LARKIN,
ASSISTANT SECRETARY,
Legislative Affairs.

Enclosure: As stated.

RESPONSES OF AMBASSADOR-AT-LARGE STEPHEN SESTANOVICH TO QUESTIONS ASKED
BY SENATOR SARBANES

Question. What can't we do under section 907 of the FREEDOM Support Act?

Answer. The following are some, but not all, examples of the types of assistance we cannot provide to Azerbaijan due to section 907 of the FREEDOM Support Act:

- Anti-corruption assistance
- Counter-narcotics programs
- Economic reform assistance, including tax reform, development of rational and transparent budgeting procedures, development of a commercial code and tariff regulations and other regulations aimed at improving the economic life for all Azerbaijanis as well as encouraging investment
- Programs to enhance environmental protection and clean up devastated areas

- Programs that promote membership and participation in international organizations such as the World Trade Organization and Partnership for Peace
- Programs that promote regional cooperation among governments; USAID's Caspian environment program is one example.

Our ability to work in areas such as these will help us pursue our security, energy and commercial interests in Azerbaijan, but assistance programs are not the only area hindered by section 907.

Section 907 serves as a disincentive to a peaceful settlement of the Nagorno-Karabakh conflict

It plays into the "zero-sum" thinking in the Nagorno-Karabakh conflict, a counter-productive view that the U.S. has been working hard to dispel.

Question. Is the USC aware of any U.S. arms being supplied via Pakistan and Saudi Arabia to support the Taliban?

Answer. No. The USC is not supplying arms to support the Taliban through either of these countries or through any other country. Question Submitted for the Record

Question. How are cost overruns on Baku-Poti pipeline going to be resolved?

Answer. The commercial dispute between the Azerbaijan state oil company SOCAR and the Azerbaijan International Operating Company (AIOC) over responsibility for cost overruns on construction of the western early oil pipeline from Baku to Supsa will be resolved through ongoing negotiations between SOCAR and AIOC.

The United States has encouraged both parties to resolve this commercial dispute through negotiation and to proceed with plans to build a main export pipeline. In the meantime, construction continues on the western pipeline. The western route should be operational in early 1999.

Question. Has Abkhazia given back territory to Georgia that it took in recent fighting?

Answer. The territory in the Gali region of Abkhazia is part of the region claimed by the authorities of Abkhazia. It remains a part of the security zone monitored by the CIS Peacekeeping Force and UNOMIG. Internally displaced persons who had returned to this territory in recent years fled once again as a result of the May hostilities. The status of this territory remains an issue of contention between the parties.

Question. How many Russian troops are in Georgia?

Answer. There are three different categories of Russian troops in Georgia:

- Russian border troops—somewhat less than 4,000
- Defense Ministry troops stationed at four Russian bases on Georgian territory - about 9,000
- Peacekeeping troops:
 - CIS Peacekeepers in Abkhazia - 1500
 - Russian peacekeepers in South Ossetia - 500

A treaty on Russian military bases on Georgian territory was signed by President Shevardnadze and then Russian Prime Minister Chernomyrdin in 1995. Although the two countries' parliaments have not ratified the treaty, as recently as April 30, President Shevardnadze said that the Russian military bases "exist on the basis of an agreement between the two countries and their future fate will depend on how the agreements are fulfilled." Russia is supposed to assist Georgia in building a national army and to support the restoration of Georgia's territorial integrity. Russian bases are located at Tbilisi, Batumi, Akhalkalaki, and Gudauta—the latter in territory controlled by separatist Abkhazia.

Currently an Agreement of 1994 for the Stay of Russian Frontier Forces in Georgia provides for the Russian Border Troops in Georgia. There is a signed agreement for Georgian assumption of Coast Guard responsibility on its Black Sea Coast as of July 1, 1998; Russia has already sharply reduced its maritime presence in Georgia. Both Georgia and Russia have said there is agreement in principle on the phased total withdrawal of Russian border guards. The Head of the Georgian Border Guards, Gen. Chkeidze, has stated that this May the frontier agencies of Georgia and Russia will consider a draft of a Treaty on Border Cooperation. This will draw on the ongoing talks between Georgia and Russia relating to the further presence of Russian border troops in Georgia and their functions.

At the April 29 CIS Summit, the CIS leaders, including President Shevardnadze, agreed to extend the CIS peacekeepers in Georgia until July 31, 1998 and appointed Maj. Gen. Sergey Korobko as Commander of the CIS PKF.

In Georgia there are approximately 15,000 Russian troops, including about 9,000 Defense Ministry troops there pursuant to a 1995 basing and air defense agreement (signed by the Georgian president and Russian prime minister but not yet ratified

by the two parliaments). This is a subject of ongoing negotiations between the Russian and Georgian governments.

Somewhat less than 4,000 of these are border guards, stationed there under a 1994 agreement on border guards. Georgia will assume its own coast guard responsibility effective July 1, 1998 under a separate agreement.

There are also about 1,500 Russian CIS peacekeeping troops in Abkhazia and another 500 in South Ossetia included under another agreement.

“TRADE AND INVESTMENT—A KEY TO OUR GLOBAL COMMUNITY”

REMARKS BY U.S. SENATOR CHUCK HAGEL

Crossroads of the World Conference Istanbul, Turkey May 27, 1998

I am grateful for the opportunity to speak to you today on an issue that is vital not only to the United States, and this region of the world, but to all of the world as we prepare to enter the next century—trade and investment. Trade and investment are the keys to the next century.

It is most appropriate that the name of this conference is, “The Crossroads of the World”—a crossroad being the place where roads meet and decisions are made. But this region is more than a crossroads in geography. We are at a crossroads of history and human endeavor.

Central Asia, the Caucasus and Caspian Sea region have risen on the world stage at a most unique time. Never in the history of man have we had a world so full of opportunity. With the collapse of Communism and the rise of vibrant new nations in this region, we have an opportunity to transcend centuries of conflict. The nations of this region will build new opportunities for their people through commerce, trade, joint projects, free markets, and respect for their neighbors. The magic of the free market is that a gain of one country does not mean a loss for another. We can all gain and thrive by working together.

One project has fired the imagination of the entire region—indeed the entire world. And rightly so! The Caspian Sea basin contains the world’s greatest reserves of oil and gas outside of the Persian Gulf. But unlike every other major petroleum discovery, the resources have no easy access to the sea, and therefore no easy access to world markets. It is a testament to the people and nations of this region that they are working to solve this problem in a way that will turn disadvantage into an economic opportunity. But a westward export corridor will do more than create economic growth in the region. It will also help build peace, stability, security, strengthen national independence, provide more opportunities for all nations of this region, and connect this region to the world. It will help further develop what President Shevardnadze has called the Eurasia Corridor.

I want to stress the importance of understanding the dynamics of the “big picture”—the realization that the world is interconnected. The nations of the world are living in a global community—underpinned by a global economy. Economic and political stability in this region of the world is connected to the rest of the world. Farmers and ranchers in my state of Nebraska are directly affected by the development and growth of markets in this area and around the world. Economics, markets, communications, trade, investments, and politics are all interconnected.

Taking advantage of the opportunities of this brave new world will require vision and leadership. Bold leadership—bold leadership with the vision to see through the haze of the present and into the possibilities of the future. Nations must not be held captive to the past. This will require leadership that is wise enough to seize the moment and move nations forward. Nations of today are not the nations of yesterday. We must rise above past differences and old conflicts. This is not without risk. But the risk must be taken.

International trade connects the crossroads. Trade binds nations together in strategic and political alliances. Throughout history trade and commerce have been key instruments that have helped break down totalitarian governments, dictatorships and opened the doors to democracy and higher standards of living for all people. Trade and international investment have helped pave the way for peace in many areas of the world. Democracies do not go to war with other democracies. Last week we witnessed the referendum for peace in Northern Ireland ending 29 years of bloodshed. The prospects of economic growth and investment in the region played a significant role in this historic vote. The countries of Eastern Europe opened the

doors to free markets which guided the move towards democracy and freedom. Trade and democracy are interconnected. And China reminds us that freedom does not grow in isolation—trade leads to more open societies. Trade and investment lead to political and economic stability.

The need to build stability, sovereignty and territorial integrity in Central Asia is essential. We have a unique opportunity in this part of the world to build regional economic cooperation. Let us not squander this opportunity. We have the chance to make the world more stable, more secure, more democratic—a world safer for our children and grandchildren.

Regional development and cooperation brings regional security and prosperity. We must build on the common denominations of mutual interests. Trade and investment are building blocks for the world's mutual interests.

This important conference gives us the forum to share common visions, exchange ideas and common goals, and move forward in strengthening our global community.

As Chairman of the United States Senate Foreign Relations Subcommittee on International Economic Policy, Export and Trade Promotion, I have held a number of hearings on the Caspian Sea oil pipeline. This area of the world is continuing to offer more and more opportunities to American companies. The growth and development of this area's infrastructure along with the economic and political stability of the region are important to U.S. interests. The United States must put forward a clear, comprehensive and effective U.S. policy for the region, particularly for the development of a western route for Caspian Sea oil. Another piece of that was put into place by Secretary Pena's announcement. But this is more than just an infrastructure project—this is about building and strengthening regional economic cooperation and understanding. We have the ability to build and strengthen international cooperation on all levels. The stability of the region will benefit not only those in the area but around the world.

The nations of the world are truly interdependent. We must work together—toward achieving our common goals—toward achieving a world that is economically and politically stable—where free trade and democracy flourish, but not at the expense of national sovereignty.

National identity and sovereignty must not be sacrificed in the process. And it need not be. Peoples and nations are anchored by their cultures. There will never be peace and stability with artificial nations and compromised cultures. We must be careful as we pursue the trade and investment which will allow all nations to prosper in this crossroads. For this crossroads sits atop the fault line of civilization.

We face unlimited horizons. We are all up to the task. We are up to the challenge. For they represent the best of our cultures, our peoples, our technologies, our spirit and our mutual interests.

Ladies and gentlemen, thank you.

Existing and Potential Oil and Gas Export Routes From the Caspian Basin

