

Energy Sector Transparency in OSCE Member States and U.S. Energy Security

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Mr. Chairman,

The member states of the OSCE are not only the largest consumers of energy in the world – but some of its members, almost exclusively former republics of the Soviet Union, are among the world's largest producers of oil and natural gas, as well as having the world's largest proven reserves of natural gas. These member states also own and control unique pipeline systems which transport these essential fuels throughout the world.

However, in the chain between producer-transporter-consumer there exists another link, one which has shrouded the energy sector in murkiness and threatened the energy security of consuming states – it is the lack of transparency.

Barely a day goes by without the media reporting on some suspicious and opaque deal concerning energy in an OSCE member state – be it Russia, Turkmenistan, Kazakhstan or in such a vital transit country like Ukraine.

Let me list just a few recent examples:

- Russia's state-owned Rosneft oil company announced on July 2 that it bought the remaining assets of Yukos oil company from a murky Russian company called Prana which purchased these assets in May for nearly \$4 billion, five times the starting price. The owners of Prana are unknown and the price which Rosneft paid for the Yukos assets were not reported. The chairman of Rosneft is Igor Sechin, one of Russian President Vladimir Putin's closest advisors.

- Austrian police are investigating a huge money laundering scandal involving Russian banks which worked with Austria's Raiffeisen Zentral Bank in laundering hundreds of millions of dollars. The Austrian police suspect that high level Russian officials, connected to state-owned oil companies, are involved in this scam and are laundering funds for themselves into off-shore bank accounts. And while the Russian police have stated that no officials are involved, many Russian experts believe that the police and prosecutor's office are under orders from the Kremlin to avoid investigating these officials.

- Ukrainian President Viktor Yushchenko recently asked Prime Minister Viktor Yanukovich to investigate the activities of UkrHazEnergo, a joint venture between Ukraine's state-owned oil and gas monopoly, Naftohaz Ukraine and

RosUkrEnergo, the controversial middleman company registered in Zug, Switzerland, which has the monopoly of overseeing Central Asian gas deliveries to Ukraine. RosUkrEnergo (RUE) is half owned by Russia's Gazprom and half by a Ukrainian citizen Dmytro Firtash. According to press reports and RUE officials, Firtash was paid \$364 million dollars in 2006 as his share of RUE's profits for 2005. The company, RUE, owns no assets – no gas fields, pipelines or compressor stations.

-Turkmenistan's new president, Gurbanguly Berdymukhammedov, ordered an investigation into a bank account set up by his predecessor, Saparmurat Niazov, in a German Bank. According to published reports, Niazov placed over \$1 billion in revenue from the country's gas industry into this account over which he had sole signing rights.

Reports similar to these have inundated the Internet and the press for the past 15 years – yet little has changed. If anything, the scams and opaque schemes have gotten bolder and nobody has been charged or prosecuted.

As a matter of fact, the only ones to suffer are those who have attempted to draw attention to these schemes such as U.S. citizen, William Browder, the CEO of Hermitage Capital Management, the largest private investment fund in Russia.

In November 2006 Browder was banned from entering Russia because the government claimed that he was a "threat to Russian national security." Browder had been a vocal critic of Russia's Gazprom for many years, charging that the state-owned gas monopoly was using opaque schemes to transport gas from Central Asia to Ukraine.

Efforts to encourage OSCE members into voluntarily forcing their national energy companies to adhere to international norms of transparency have met with only limited success in the states of the former Soviet Union.

For example, *The Extractive Industries Transparency Initiative* has been adopted by only three states in the region: Azerbaijan, Kazakhstan and Kyrgyzstan.

However, it is questionable if even this has made a difference in Kazakhstan, the largest oil producing country in the region. Persistent reports indicate that President Nursultan Nazarbaev and his family continue to receive kickbacks from Russian and other oil companies.

In Azerbaijan the *Initiative* seems to have been more effective, but evidence of this is hard to come by and Western monitors rely more on hearsay than on hard facts.

Russia, the largest extracting country in the OSCE is, in my opinion, by far the most opaque. Not only does opaqueness surround private deals, but the

government itself engages in shady practices when it suits its purpose – the Yukos prosecution being one such example.

The current goings-on at Rosneft, the state-owned oil company, and the gas transportation schemes from Central Asia to Ukraine by Gazprom and RosUkrEnergO are classic examples of the nexus which exists between the Russian government and its energy companies when it comes to hiding important dealings from the public eye.

What impact do Russian oil and gas opaque schemes have on the energy security of the United States?

Some Americans might be led to believe that it is not the business of the U.S. Government to police Russian corruption – as long as the pipelines are filled and vital fuels are making their way into the hands of consumers.

I believe this approach does not help either Russian business or U.S. consumers given the importance of energy in the world today. If U.S. oil and gas companies believe that their Russian partners are not playing by the rules of the game, and use non-transparent schemes to gain an advantage – then the U.S. consumer is the loser and U.S. energy security is threatened.

U.S. energy security today is threatened by a number of factors:

1. Over-consumption of energy and rapidly dwindling national resources in the U.S.
2. Inefficient use of available hydrocarbons and insufficient use of alternative energy sources.
3. Reliance on extracting nations which use their energy resources as weapons to further foreign policy or ideological agendas.
4. Opaqueness in the extraction industry which often serves as a smoke screen for government officials and clans in various self-enrichment schemes and as a means of subverting their competition.

As long as oil and gas companies in OSCE extracting countries continue to use murky pricing and barter schemes and rely on non-transparent middlemen who serve no visible function in the production-transit-consumer chain - then the energy security of the United States and all OSCE countries will be threatened.

A possible solution might be for the OSCE to adopt a set of rules governing transparency in the extraction sector. These rules would be mandatory for all members and govern the activities of oil and gas companies, coal mining concerns and uranium mining.

The energy sector in the OSCE is too vital today to permit shadowy players to dictate terms of delivery and prices for fuels and, in certain cases, be given a monopoly for supplying entire countries with vital energy resources.