



## The Transportation of Caspian Oil to Western Markets: The Turkish Role

### Luncheon: Caspian Energy and the Future of U.S. - Turkish Relations

Introduction: Zeyno Baran Research Associate, CSIS

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**Zeyno Baran:** My name is Zeyno Baran, research associate at CSIS, and it is my great pleasure to introduce Ambassador Richard Morningstar. It is always a cliché to say that the person who is being introduced needs no introduction. This is inevitably the case with Ambassador Morningstar, certainly for this audience. Ever since his appointment in July 1998 as special adviser to the president and the secretary of state for Caspian Basin diplomacy, Richard Morningstar has been actively working toward finding a solution to the very complex, multidimensional problem that has brought us here today.

Ambassador Morningstar has the right background for this difficult - some would say impossible - task. He was a very successful businessman before he entered government service and therefore fully understands the commercial factor in the Caspian energy equation. From June 1993 to April 1995, he served as senior vice president for policy and investment development at the Overseas Private Investment Corporation (OPIC), where he developed and implemented strategies for new investment programs, including for Russia and the NIS [Newly Independent States]. In April 1995, he was appointed as special adviser to the president and the secretary of state on assistance to the NIS, where he oversaw all bilateral assistance, trade, and investment of the U.S. agencies involved. President Clinton then asked him to move to his current post.

If sheer effort alone could make the Baku-Ceyhan pipeline happen, the effort that Ambassador Morningstar has put in would have seen construction begin by now. Nonetheless, the impressive degree of cooperation and coordination between Turkey and the United States during his tenure has certainly helped to move the project forward to the point where the conclusion of an initial agreement in the coming days has become a distinct possibility. Actually, Ambassador Morningstar is going to make an announcement stating that it may be sooner than I was initially thinking.

I know that Ambassador Morningstar would very much like to have concrete progress before he moves on to Brussels in the summer to become the new U.S. ambassador to the EU. Even if the progress that is achieved does not fully satisfy him, however, he can be proud of his role in furthering the close cooperation between the two countries and his impact on the overall Turkish-American relationship in the post-Cold War era. Without further ado, let us welcome Ambassador Morningstar.

**Ambassador Morningstar:** Thank you very much, Zeyno. I would like to thank the Center for Strategic and International Studies for arranging this important conference. I would especially like to express my gratitude to Mr. Bulent Aliriza and Ms. Zeyno Baran of CSIS. I know that Zeyno's efforts have been tireless in assembling this distinguished audience in this beautiful setting. I would also like to thank Minister Cem, who was here this morning, Minister Aktas, and other distinguished representatives of the government of Turkey for being here today.

While I always welcome an opportunity to visit this fascinating city, I am particularly pleased to be here today. I am particularly pleased, as Zeyno mentioned, to tell you that as soon as I finish speaking, hopefully no more than 15 minutes from now, we will adjourn upstairs for a signing of a very important protocol between the government of Turkey and the

Azeri Working Group. I think it is important to note that the Azeri Working Group includes representatives of the government of Azerbaijan, SOCAR, and the AIOC, so this I think will be a very significant step forward and you'll hear more about that in a few minutes. So I started to say in my written remarks that I hoped this conference would play a constructive role in moving those discussions toward an important set of agreements. In fact, as you will witness, this conference will play a very positive role in that direction.

Practitioners and analysts of foreign policy would like to anticipate problems before they arise and employ diplomatic means to avert them. Implementing this approach, which sounds so attractive in theory, is obviously quite difficult in practice. I nevertheless believe that the United States, Turkey, and the new countries in the region, including Azerbaijan and Georgia, have had a very forward-looking, pro-active view with respect to the development of Caspian energy resources. Speaking for the United States, our policy envisions pipelines as a means for achieving several objectives that remain in the interests of the United States, Turkey, and the new states of the Caspian region for years to come. These objectives include the following:

- Ensuring the viability of the new states of the region as market-based democracies by strengthening their independence, territorial integrity, and prosperity. - Fostering cooperation among these states, thereby mitigating regional conflicts.
- Bolstering the energy security of the United States and its friends and allies, as well as the energy independence of the newly independent Caspian states by guaranteeing the free flow of Caspian oil and gas to world markets.
- Enhancing business opportunities for the United States and other countries, including all companies represented here today.

We have developed a vision of the future in which Caspian pipelines will provide an infrastructure of interdependence, as well as an insurance policy against instability in the region that is of critical importance to the United States, Turkey, and other countries. The United States' relationship with Turkey, our NATO ally, has in the past weeks, with the Kosovo conflict, been accentuated even more. Our relationship with Turkey is at the core of this vision. Turkey enjoys immense geographic significance, straddling Europe, Asia, and the Middle East, bordering directly on Syria, Iraq, Iran, Georgia, Armenia, Azerbaijan, Bulgaria, and Greece, as well as Ukraine and Russia across the Black Sea. People sometimes ask me why Turkey is so important; I simply say, "Look at the map."

Turkey is also the region's commercial locomotive, with Istanbul serving as the financial and commercial hub of the entire Caspian Basin. Moreover, modern-day Turkey enjoys a centuries-old heritage of ethnic ties to the Turkic people on both sides of the Caspian Sea. In short, Turkey serves as a geographic, commercial, and cultural bridge between the new states of the Caspian and the rest of Europe. Turkey's role in the volatile regions of the Caucasus and Central Asia is therefore important not only to pursuing the political objectives of U.S. foreign policy, but also to securing private companies' immense investments in energy and other investments as well. Turkey is critically important.

The U.S.-Turkish partnership on energy projects will be an enduring feature of both countries' foreign policies for years to come. Regardless of the realities of next Sunday's parliamentary elections, as Minister Aktas and Minister Cem have said, there is every reason to believe that Turkey's next government will fully support the Baku-Ceyhan oil and Trans-Caspian pipelines. Turkey's political leaders recognize that these pipelines are in their national security interests. Similarly, the United States government will continue its efforts to bring these projects to fruition because they are in the U.S. national interest. These pipelines will promote the development of a group of prosperous and stable countries linked to the United States and Turkey and able to export their energy resources to world markets without interference.

I must emphasize, however, that developing these countries' natural resources cannot alone ensure the new Caspian states' transitions to market democracies. We must also work to broaden economic and political reforms in this region. The process will be a lengthy and painstaking one. On the other hand, failure to develop these resources will cripple efforts to transform these countries into market democracies. Therefore, as essential tools in the development of Caspian energy resources, the Baku-Ceyhan pipeline and the TCP will remain central to our interests for decades.

We are quite pleased with the progress made on Baku-Ceyhan in recent months by the government of Turkey, SOCAR, and the companies of the AIOC. Last autumn, conventional wisdom seemed to hold that Baku-Supsa, coupled with increased tanker traffic through the Bosphorus, would become the route for the main export of oil. Since then, the

companies of the AIOC recognized clearly that the Bosphorus does not provide a long-term solution to Caspian oil exports. Turkey's concerns over the environmental and safety ramifications of a major increase in oil tanker traffic through the Bosphorus are legitimate, and all of the discussions today serve to emphasize that even more. At the same time, the government of Turkey understands that it shoulders a significant share of the responsibility for ensuring that a Baku-Ceyhan pipeline is as commercially viable as possible. The Turkish government has consequently worked hard to provide the commercial incentives required to make Baku-Ceyhan a reality.

Working in good faith, the government of Turkey and the Azerbaijani Working Group have made significant progress on the road to Baku-Ceyhan, and the protocol that will be signed in the next few minutes upstairs will be testimony to that fact. During the next few days, the parties will continue discussions in Turkey that will lead to a package consisting of an intergovernmental agreement, a host government agreement, a turnkey contract, and a guarantee from the Turkish government that construction costs on the pipeline will not exceed the agreed level. While I do not wish to prejudge the outcome of these discussions, I think it is safe to say that an agreement on the entire package is within reach. Turkey, the AIOC, and SOCAR, again as evidenced by the protocol that we will sign upstairs, are genuinely committed to reaching such an agreement. The governments of Azerbaijan and Georgia are fully supportive of this process.

Once these agreements are concluded, the companies can establish a main export pipeline company, or MEPCO, as it is sometimes called. It is the MEPCO that will conduct more detailed engineering feasibility studies and assemble the pipeline financing package. We would anticipate that the MEPCO would include companies producing oil on both sides of the Caspian. This is because aggregating oil volumes into the MEP from Kazakhstan above these volumes already committed to the CPC pipeline will be critical to ensuring Baku-Ceyhan's commercial viability. When the basic outlines of MEPCO's financing requirements become clearer, the U.S. government's trade finance agencies can fully launch their activities from our Caspian Finance Center at our embassy in Ankara. At that point, we expect the Overseas Private Investment Corporation and the U.S. Export-Import Bank to follow the lead of the Trade and Development Agency in supporting Baku-Ceyhan as creatively and as flexibly as possible.

Creativity and flexibility have been at the core of our entire effort to promote East-West pipelines such as Baku-Ceyhan. We in the United States government have consistently sought to play the role of an impartial but deeply interested facilitator, encouraging all interested parties to show maximum flexibility in pursuit of constructive compromises. Using this approach, we have worked to bridge the perceived gap between political realities and commercial viability.

At the center of this bridging effort lies the Bosphorus. Turkey's legitimate concerns over the environmental and safety consequences of a major tanker accident in the Bosphorus make Baku-Ceyhan the most politically viable route for a main export pipeline for Caspian oil, and I emphasize politically viable route. But oil companies' basic need to earn a competitive return on their investments prompts them, understandably, to seek to minimize capital expenditures. As a result, the companies have resisted committing to what they perceive as a more costly Baku-Ceyhan routing for the main export pipeline. A climate of depressed world oil prices, which are hopefully improving, and low availability of Caspian oil volumes has only stiffened the companies' inclination to reduce capital expenditures even further.

I think it is safe to say that we are getting very close to definitively establishing that there isn't necessarily an inconsistency between political realities and commercial viability with respect to the Baku-Ceyhan pipeline. Doing so has required creativity and flexibility on the part of the AIOC, SOCAR, and the governments of Turkey, Georgia, and Azerbaijan. And I think that it is a credit to all of the parties who will be signing the protocol later today that they've recognized the political realities and the commercial realities to get the project to where it is today.

We must examine the constructive alternatives and solutions to several other issues involving the Bosphorus. One key question is how we can increase the safety of navigation through the Bosphorus even as we move ahead on the Baku-Ceyhan pipeline. One of the most important steps in this regard would be for the government of Turkey to award a contract to construct a vessel traffic system (VTS). We were frankly disappointed that Turkey again deferred the VTS tender from February 26 to a later date, and we hope that a contract will be issued in the near future. That being said, Turkey cannot alone bear the full responsibility for improving the navigational safety and environmental protection of the Straits. It is also important that any discussion at the International Maritime Organization concerning a review of the existing traffic separation schemes and associated rules be technically solid and conducted in a spirit of mutual respect and cooperation.

I would not presume to have ready-made answers to all of the difficult questions surrounding the issue of Caspian oil exports and the Turkish Straits. I simply hope that the outlines of possible solutions might emerge during the remainder of our time together here in Istanbul. What I am certain of, however, is that cooperation on Caspian energy issues has brought the United States and Turkey even closer together. It will be essential for us to build upon this collaboration in coming years, to work creatively and flexibly with Russia and the other new states in the region, cooperating with interested companies to create "win-win" situations in a region that has all too often been plagued by zero-sum thinking.

**Zeyno Baran:** I think we will have about 15 minutes of questions and answers.

**Resat Ozkan:** I fully appreciate the comments you have made, but I have some difficulties understanding some points you have remarked upon. Let me start from the very end. As far as the IMO is concerned, I would point out a very crucial point. You should all realize and understand its position. It has no power and/or authority to establish rules for a region that is entirely under the jurisdiction of a sovereign state. This is a very important issue, because the IMO is not a supranational establishment; it is not even an observational platform; it is a technical agency of the United Nations. So, unless a member state agrees with such a procedure, the IMO has no power to establish rules for a member state.

I also failed to be in agreement, Mr. Morningstar, with you saying, "As a result, the companies have resisted committing to what they perceive as a more costly" - this is an important statement for me - "more costly Baku-Ceyhan routing for the main export pipeline." More costly with respect to what? If it is more costly with respect to Baku-Supsa, I think it is out of any comparison, because the main issue of the Baku-Ceyhan pipeline is commercial, whereas the traffic through the Turkish Straits is a security matter. So a safety issue and a commercial issue cannot be compared. Meanwhile, I can appreciate that Baku-Ceyhan may be more costly with respect to another pipeline, not with respect to traffic in the Turkish Straits.

**Ambassador Morningstar:** Okay, thank you. It was a very long question, but you did raise a lot of issues, which will allow me to address a lot of what may have been other people's questions as well.

First of all, in respect to the International Maritime Organization, I am not involved with those negotiations, and I don't profess to be even a novice with respect to the affairs of the IMO. So, I cannot comment effectively with respect to what its jurisdiction is or what its jurisdiction isn't. But I can say this: Turkey cannot alone determine what the regulations are going to be within the Bosphorus, and as far as I know, the International Maritime Organization is the only entity that has the ability to address these issues on a multilateral basis. So I think that it would be a serious mistake for Turkey to ignore the IMO with respect to these problems, and I know that this has not been the case. Turkey has some very legitimate issues that have been brought up this morning, and I know there will be some more discussion this afternoon; and I think that the International Maritime Organization is the place where those issues can be aired.

Second, there's one thing on which I just can't disagree with you more, and reasonable people, I understand, can disagree. I believe that there is a very strong relationship between the situation in the Bosphorus and Baku-Ceyhan. The situation in the Bosphorus makes a Baku-Supsa pipeline as a main export route politically unattainable because Turkey, Georgia, and Azerbaijan are committed to that. So, it is related; so then you have to look at other alternatives. It is my belief, and I think the belief of many others at this table, that Baku-Ceyhan is the best alternative. And it is more costly, assumedly, than a Baku-Supsa pipeline going through the Bosphorus, if you don't take into account the consequences of some of the safety issues, and so on. But my argument has always been that that's irrelevant: it doesn't matter if that route is not attainable.

At the same time we have recognized - and consistently recognized - that for Baku-Ceyhan or for any other route to be attainable, it must be commercially viable so that the companies who are making the investment can earn an appropriate return on the project. What Turkey is doing, because the Bosphorus and issues relating to the Bosphorus relate more to Turkey than to any other country, is taking the bull by the horns and saying, "We'll guarantee the cost of the pipeline in order to ensure that it will, in fact, be commercially viable." There have been several studies done, including the World Bank study, that can give Turkey some comfort that the contract can come in at an agreed-upon price. And the fact that BOTAS may be the contractor to do the project will make that easier.

One of the principal points I've been making since I've taken this job is that you cannot separate the Bosphorus from Baku-Ceyhan. There is a political context the companies and the private sector have to live with; but at the same time, the public sector has to recognize that any project has to be a commercially reasonable project.

**Bulent Aliriza:** You were a very successful businessman, and clearly your business decisions were governed by the attractiveness of the propositions that you encountered. As a businessman, would you invest in the Baku-Ceyhan pipeline?

**Ambassador Morningstar:** Sure, of course I would! Lesson number one in marketing is repetition, repetition, repetition, and if nothing else, I've repeated myself a thousand times over the last eight months. First of all, if, in fact, the incentives that are offered for this pipeline are the right incentives, given that, if I were a company I would want to get oil out of the Caspian one way or another. Assuming the incentives were the right incentives - that I could make an appropriate return - of course I would invest.

That's the whole purpose of this exercise: so that Turkey, Azerbaijan, Georgia, and the companies can come together and make a deal that will allow that appropriate rate of return. If as a result of the negotiations there's just no way to make a proper return, that's something else again. If it turns out that the total volume of oil in the Caspian is 100,000 barrels of oil a day, obviously nobody's going to invest in a Baku-Ceyhan pipeline. But that's not the case, with what is known to be in the western Caspian (with some aggregation from the eastern Caspian) and with a reasonable cost (not a \$4 billion cost, but a cost in the range of \$2.4 to \$2.5 billion). Finally, if I were assured a tariff per barrel price range that is commercially reasonable, I assume I would make that investment.

**Valekh Aleskerov:** Just a clarification. You said \$2.4 to \$2.5? Excuse me, no more than \$2.4!

**Ambassador Morningstar:** And I'm willing to take even odds right now that they'll bring it in at less than \$2.4 billion.

**Zeyno Baran:** That brings us to the end of this session. Thank you.