



**Statement before the Senate Foreign Relations  
Subcommittee on European Affairs**

***“TRANSATLANTIC SECURITY  
CHALLENGES: CENTRAL AND EASTERN  
EUROPE”***

A Statement by

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Mr. Chairman, Members of the Committee:

It is an honor for me to return to the European subcommittee two years after I testified before you on the serious and growing energy vulnerability of Ukraine, which is much in the news today.

My fellow panelists have already covered very well the various security challenges for Central and Eastern Europe. Since my own competence is limited to energy, I will focus on the threats and opportunities that sector presents to countries in this region.

More than twenty years after the fall of the Iron Curtain and the transition from a command economy to a market economy, the energy economy of this region depends on three primary factors for each individual country:

1. Geography and the availability of indigenous energy sources
2. The state of modernization of the energy sector
3. European integration

The legacy of the Warsaw Pact and Comecon left most of these countries reliant on Russia for its oil, gas, and nuclear fuel supplies, which were conducted under barter and other non-market trading terms, when they regained their full political independence. Transforming a highly inefficient and polluting energy economy necessitated a painful transition, along with overall economic restructuring. Historical suspicion and actual use of energy as a political tool by Russia gave further impetus to the drive for modernization of the energy economy.

In general, the countries that chose a speedier path for transition – full privatization of previously state-owned energy assets, introduction of market competition and transparent regulation by independent commissions, adoption of European standards and business practices – are in better conditions today than those countries with state-controlled companies that retain old business practices with their traditional supplier of imported fuels. These state companies continue to dominate the energy sector so that politics rather than market forces determine outcomes.

Countries that have a coastline and therefore better access to crude oil and petroleum imports from the international market and countries with significant indigenous energy production, such as Poland with coal and Romania with oil and gas, are less vulnerable to supply cutoffs.

Preemptive action also mitigated vulnerability to cutoffs. The Czech Republic's courageous decision to build an oil pipeline from Bavaria (Ingolstadt-Kralupy-Litvinov) in the mid-1990s in midst of its breakup with Slovakia is an example of an inland country which invested early on to reduce the risk of supply cutoffs. Until then, Czech refineries were totally dependent on crude oil supplies from the Soviet-era Southern Druzhba pipeline from Russia and Ukraine. Poland and Lithuania's decision to commission liquefied natural gas (LNG) receiving terminals are more recent examples of committed action to diversify energy supplies.

The potential for shale gas from a geological trend, which extends from southern Lithuania, across Poland, Ukraine, Romania to Bulgaria, offers good prospects to develop in the medium term indigenous energy supply that is affordable and environmentally beneficial.

European integration offers the best opportunity for energy modernization. The pathway to the European Union includes funds to assist much-needed reform and restructuring of the sector, and to remove corruption by adopting European standards and business practices. The E.U. also offers funds for important infrastructural improvements, such as interconnector pipelines capable of reverse flows.

Market integration is critical for smaller countries in this region to achieve better diversity of energy supply. The energy industry relies on economy of scale to justify multi-billion dollar investments. The entire population of the Balkans is smaller than the population of Turkey. Therefore, it is difficult for individual countries in southeastern Europe to economically justify diversification projects on their own without being connected to the energy markets of their neighbors with pipeline infrastructure, shared storage facilities, connected electricity grids, and sound commercial arrangements.

Unfortunately, the process of energy market integration in this region has been painfully slow and results have been mixed at best for the free flow of gas and electricity. Without market integration, the region simply cannot afford the energy supply diversity it says it wants. Bulgaria is a prime example of a country which has not taken full advantage of its excellent geographic location to connect with its neighbors in energy, failed to fully utilize E.U. accession funds for this purpose, stalled development of its shale gas potential, and is today not much better off in terms of supply vulnerability from a gas cutoff between Russia and Ukraine than it was in 2006 and 2009.

Since I testified previously before this Subcommittee about the sorry state of the Ukrainian energy economy and this topic came up in my testimony before the Senate Energy and Natural Resource Committee two weeks ago, I will not spend much time talking about Ukraine here and leave this subject to the question period if Senators are interested.

Suffice it to say that Ukraine and its long-troubled gas relations with Russia remain the biggest supply vulnerability for the region. Half of Russian gas sales to all of Europe still transits Ukraine, in spite of Russia's continuing efforts to bypass Ukraine. Ukraine is the dominant and, in some cases, the exclusive route for gas imports to most central and southeastern European countries.

The potential benefits of energy sector reform in Ukraine remains enormous and it is now more urgent than ever. There is much that countries from Central and Eastern Europe, which have gone through successful transition to a modern energy economy, can offer Ukraine in terms of sharing lessons learned and assisting in capacity building. They are

also the countries which will be most affected by the possible collapse of the Ukrainian state.

In many of these areas, it is natural for Europe to take the lead given its proximity and shared interests. However, the urgency and seriousness of the crisis in Ukraine demand American leadership and for us to coordinate our efforts with our European friends and international financial institutions, while enforcing strict compliance on the current and future governments of Ukraine to meet commitments to reform its critical energy sector as a condition for Western aid.

I thank the Committee for your attention.