Photo: Corbis

Kazakhstan's oil projects face formidable obstacles

Kazakhstan has tremendous plans for expansion. The country aims to double its oil production within ten years, thus enabling it to develop into a formidable power in Central Asia. But there are obstacles. No access to the open sea, increasing state influence and its mighty Russian neighbour are major impediments to this plan.

by Rudolf ten Hoedt

The government of Kazakhstan is not amused. The expansion of Kashagan, the country's mammoth oil field, is fraught with delays. The Agip KCO consortium, with ENI, Royal Dutch Shell, Total, ExxonMobil and others, is labouring to get one of the largest oil fields in the world into production but announced in mid- May that despite earlier agreements, Kashagan will not be ready to produce oil and gas by 2011. That went down badly in Kazakhstan's capital, Astana.

'What do you think?' Aslar Batalov exclaims defiantly. Batalov spoke with EER in The Hague while visiting the Netherlands with a delegation from his country in June. He is the executive secretary of Kazakhstan's Ministry of Energy. 'In December last year we negotiated hard to reach an agreement. Everybody has been waiting for results. Now the consortium says it cannot meet its commitments. They are talking of a delay of two years. Of course there will be sanctions! Of course measures will be taken!' Batalov does not wish to specify what kind of sanctions and measures. 'I cannot make any comment now. Negotiations on this new delay have only just begun. We can understand there are difficulties. But we insist that everything that was promised is carried out.'

Batalov's impatience is understandable. Major national interests are at stake. Kazakhstan is the largest country in the world with no seaport. To the west, it borders the Caspian Sea, an inland sea. It is wedged between two major powers, China to the south and Russia to the north. Russia still considers the former Soviet republic of Kazakhstan to lie within its natural sphere of influence. Kazakhstan's independence in the post-Soviet era rests on two essential conditions, the development of its large oil and gas reserves and unhindered transport to the world market. The country is wrestling with both.

Increasing Production

Kazakh oil production was over 1.3 million barrels per day in 2007, according to the International Energy Agency, 1.7% of global oil production. 90% was exported. The country is aiming to double production by 2015. Kazakhstan also wants to expand downstream operations. A large petrochemical complex by the Caspian Sea is under way. Nursultan Nazarbayev, the country's powerful president, ordered its construction in 2007. The complex will stand between Atyrau and Tengiz in a triangle of oil and gas pipelines.

The explosive industrial expansion in Kazakhstan is unthinkable without the contribution of oil and gas from Kashagan. The enormous field contains reserves of an estimated nine billion barrels of crude, besides large amounts of natural gas. Production in 2015 should be 1.5 million barrels per day. But there are many obstacles. Kashagan is a technical challenge of epic proportions. It is situated offshore at a spot in the Caspian with extremely strong winds and the sea is frozen for six months of the year. Political problems also play a role. Kazakhstan pursued market reforms in Central Asia during the nineties that attracted investors. But the investment climate has become more uncertain since President Nazarbayev introduced measures aimed at greater state control over projects and maximising the government's share of revenues. In September 2007, Kazakhstan's parliament passed a law that allows the government to rewrite any contract that, as they describe it, 'threatens national interests' and to force all energy projects in Kazakhstan to have a state share of 30%.

Fear

Nazarbayev has to contend with a current account deficit that he is trying to eliminate through higher state income from the oil and mining sectors. Authorities believe that 'they can increase their share of economic rents without blunting the incentives for further development', observes think tank Oxford Analytica. By doing so, the government adds fuel to the fear that Kazakhstan is busy ditching its successful liberal framework of the nineties, which attracted more than $60 billion in foreign investments, and is replacing it with state intervention and nationalisations.

With state involvement on the rise, oil output growth has slowed down for the first time since 2004. The new delays in the Kashagan project were announced scarcely one week before the introduction of a new tax of $110 US per ton ($15 per barrel) on the export of oil.

The authorities seem willing to ease off somewhat. 'The new tax does not apply to all oil fields,' Batalov says. Large international projects, protected by stability clauses, are not subject to the new tax. He emphasises that the Nazarbayev government is seeking a balance. 'We know that the new tax has caused some unrest. Not everybody is pleased with it. But we are trying to balance the interest of the oil companies with our national interest.'

The agreement into which the Kashagan consortium of oil companies entered with the Kazakhstan authorities in December 2007 was a laborious affair. It included compensation for a previous delay of between $2.5 and $4.5 billion, depending on the oil price. Italian ENI was also sidelined as a project operator and the western oil majors had to sell a 16% share of the project to state-controlled KazMunaiGas. And the problems still do not seem to be over.

Kashagan is a technical challenge of epic proportions

The unhindered transport to the open world market is another arena in which Kazakhstan is struggling. Nazarbayev wants to sell the oil from Kashagan to the highest bidder. To this end, the country is urgently looking to expand the infrastructure. The greatest obstacle is Russia, which considers it essential that it controls the growing oil and gas flows from Kazakhstan. Russian state-owned companies have no grip on the Kazakh oil and gas industry and so Russia has little influence.

To keep Kazakhstan within its sphere of influence, the Russians tried to impede the export of Kazakh oil by increasing the price for transport via the pipeline that links Baku with the south Russian port of Novorossiysk on the Black Sea. Kazakhstan responded by setting to work with a private consortium on the construction of a pipeline from Tengiz to Novorossiysk in Russia, the Caspian Pipeline Consortium route (CPC). 50% of CPC is owned by various states: Russia has 24%, Kazakhstan has 19% and Oman has 7%. The other half is privately owned; Chevron is the largest private shareholder with 15%.

Secretary of Energy Aslar Batalov.
Photo: Roger Dohmen

The Kremlin did not give up resistance to the construction of the CPC line until Kazakhstan began a $3 billion project for the construction of port terminals in Kuryk, from where Kazakh oil and gas can be transported by tanker to Baku and from there via the Baku-Tbilisi-Ceyhan (BTC) pipeline to Ceyhan in Turkey. The BTC pipeline, in which BP has a 30.1% interest and the Azerbaijan state oil company Socar has a 25% interest, was built as an export route to Europe outside Russia. Kazakhstan now has six double haul tankers at its disposal in the Caspian Sea and in 2007 became a partner in the BTC.

Pipelines

In expectation of the enormous flow of oil from the gigantic Kashagan field, Kazakhstan now wants to extend the CPC pipeline. Negotiations with the Russians on expanding the CPC from 204 to 491 million barrels annually (from 560,000 barrels per day to 1.3 million barrels per day) have been going on for some time now. From a technical point of view, it is a simple matter of a few additional pumping-stations and a minor adjustment to the pipeline. It recently seemed that Moscow wanted to go along with the plans and that an agreement had been reached. The new Russian President Medvedev was to sign the agreement during a visit to Kazakhstan on May 22 during his first foreign tour. But there is still no formal agreement. 'There are technical problems,' says Batalov.

Kazakh oil veteran Galiaussat Keshubayev explains what he believes is going on. Keshubayev held the same position in the nineties as Batalov holds today. Now he is the Director for Management of Oil and Gas Assets of the state-owned company Samruk, which controls all state participations. He skilfully sketches pipelines and pumping-stations on hotel stationery in Scheveningen in the Netherlands. 'The shareholders of the CPC pipeline signed an agreement-in-principle,' says Keshubayev. 'At the moment, however, the Russians do not see enough commercial advantage in extending the CPC.'

70% of the 28 million tons of oil flowing through the CPC line today is Kazakh oil. The rest is Russian and joins up halfway at Krapotkin. The CPC can only be of interest to the Russians if they make more use of it. 'That won't be until a pipeline is laid between Burgas in Bulgaria and Alexandropoulos,' says Keshubayev. 'That pipeline can be fed from Novorossiysk. Russia is negotiating that with the relevant governments. The go-ahead there can set the CPC expansion in motion.'

On June 6, the US think tank Stratfor announced that Kazakh president Narzabayev has reached an agreement with Chevron for the first leg of a pipeline system from Tengiz to Karyk, from which tankers transport oil to Baku. Such a pipeline would divert much of Kazakhstan's oil exports away from Russia. True or not, the announcement will certainly add to the pressure on the Russian to expand the CPC pipeline.

For now Kazakhstan can hardly get around Russia. It still transports most of its oil via Russian territory. One of the pipelines Astana uses runs to Samara in Russia from where there are several options for transportation to Europe. And there are more strong ties between the two countries. There is a double-digit increase in trade between them, and the Kazakh defence department was reported to have signed numerous lucrative contracts with Russian arms powerhouse Rosoboronexport.

As a defensive measure, the Russians want to bring all parties in Central Asia into line and thus they are more prepared to make concessions. It was announced in March that Russia and Gazprom would buy gas at world market prices from Kazakhstan, Uzbekistan and Turkmenistan as of 2009. But Kazakhstan does not want to be pinned down by the Russians. 'Russia is one of our strategic partners,' says Batalov. 'We will use all transport possibilities through Russia. But we are considering all other politically and economically feasible transport options.' For instance, oil from Kazakhstan also reaches the Arabian Sea via swaps with Iran. The most important alternative route to date, which will make Kazakhstan more independent from Russia, was disclosed last year. As of 2007, the country has transported oil to China via the Atasu-Alashankou pipeline, a branch of an old pipeline that has transported Russian oil from Omsk via East Kazakhstan to Turkmenistan for many years. 'We have excellent relations with China,' Batalov says.

The branch to China that was installed last year has a capacity of 20 million tons. The oil the Chinese buy from Kazakhstan is actually Russian oil. Kazakhstan supplements the oil it exports to China via the Atasu-Alashankou route with its own oil via a connection to the Russian pipeline further south. This is commercially possible because the quality of West Siberian oil and that from Kazakhstan are on a par. The pipeline is too important to the Russians to close off in the event of a conflict with Kazakhstan, says Keshubayev. 'They will never do that because alternative transport is far too expensive.' He draws an arrow from Kumkol to Atasu. If the worst comes to worst, Kazakhstan can also pump its own oil from the south through the pipeline towards China. ■