Kazakhstan wants

by Rudolf ten Hoedt

Kazakhstan is eager to create a new route for oil to Europe that bypasses Russia and thereby finally break the Kremlin's stranglehold on Kazakh oil transport. In natural gas, however, the Kazakhs remain closely tied to the Russian bear. A report from Atyrau.

Just outside Atyrau, the oil capital of Kazakhstan on the Caspian Sea, aluminum pipes glitter in the hot June sun behind barbed wire fencing. Here the strategic CPC oil pipeline emerges from the empty steppe to enter a pumping station. Subsequently the pipe disappears underground again to continue its long journey to Russia in the north.

The CPC is by far the most important export link for Kazakh oil, responsible for nearly half of its oil exports. The regional manager of the pipeline, Sarembai Murinov, gives a guided tour of the labyrinth of pipes at the pumping station and afterwards serves his guests fruit juice in the canteen. In 2009 expectations are that 682,000 barrels will flow through the pipe daily – equal to the total oil consumption of Turkey. But the pipeline's capacity is much greater. 'We're still far under the limit,' Murinov says proudly.

That's just as well. Because if there's one thing that Kazakhstan and the oil companies operating in the country need, it's more export capacity. Kazakhstan's oil industry is expected to grow strongly in the coming years, thanks especially to the development of Kashagan, the megafield in the Caspian Sea. The Kazakhs anticipate a tripling of proven oil reserves from 38.8 billion barrels to 100 or 110 billion barrels. That would push Kazakhstan up into global fourth place, behind Saudi Arabia, Iran and Iraq, in front of major oil exporters like Kuwait, Russia and Venezuela. The oil production, 1.55 million barrels per day (bpd) in 2008, is expected to double in the short term to more than 3 million bpd, outstripping for example Venezuela, Norway and Kuwait and making Kazakhstan a mainstay for energy supplies to Europe, as President Nazarbayev has said.

Currently 83% of Kazakh oil is destined for Europe, says

to break free

Caspian Pipeline Consortium pumping station in Atyrau. Photo: Rudolf ten Hoedt

Iana Dreyer, trade policy analyst at the European Centre for International Political Economy (ECIPE). With Europe importing 14 million barrels of oil a day, Kazakhstan satisfies only a modest part of European needs. But it is important for Europe to diversify its energy supply. The strategic value of Kazakh oil should therefore not be underestimated.

Power politics

A major problem for Kazakhstan is that the country's current export capacity cannot keep pace with new increased production levels. But efforts to expand this capacity have up till now been thwarted by Russian power politics.

When Kazakhstan became independent in 1991 after the disintegration of the Soviet Union, the country relied completely on infrastructure from the Soviet era. This was clearly felt by the American oil concern Chevron at the end of the 1990s. The Americans had naively overlooked the construction of a pipeline to access their newly acquired Tengiz field, the first major breakthrough for a Western oil major in Kazakhstan. It now became dependent on the Russian controlled Atyrau-Samara pipeline and paid heavily for its misjudgment. The Russians even cut off Chevron's oil transport for a month to exact a stake in the Tengiz field.

'We regard support for the Nabucco project in this phase as untenable'

In 1996 construction started of the 1580 kilometre long CPC pipeline for oil transport from Tengiz to the Russian Black Sea port of Novorossiysk. Western and Russian oil companies together took a 50% stake in the Caspian Pipeline Consortium (CPC) while the other half was in the hands of three states – Russia, Kazakhstan and Oman. At this moment, the Russian government, through state oil company Transneft, has a stake of 38.5%. Lukarco, a joint venture of Russian-based Lukoil and BP commands a 13% share. BP, however, is about to sell its stake to Lukoil. Once this transaction is finalised, Russian companies have a controlling interest in CPC. Other stakeholders are Chevron (15%), ExxonMobil (7.5%) and the state of Kazakhstan (19%).

Although the CPC meant a new export route, it did little to diminish Kazakh dependence on its dominant neighbour, because the pipeline runs through Russian territory. Russia also continues to hinder efforts to boost its capacity, in an attempt to persuade other parties to relinquish their shares. The upshot is that Kazakhstan's export capacity has not developed along with its expanding oil industry.

The recent construction of a pipeline to China signified a minor breakthrough. But this pipeline has an initial capacity of just 200,000 barrels a day. According to Julian Lee, an analyst at the Centre for Global Energy Studies in London, lack of export capacity risks affecting production growth in the Caspian Sea region. 'Some progress has been booked in the past,' he says. 'But I think these problems need resolving in the next 3-4 years and there's still a long way to go.' Earlier this year a top Chevron official warned that Kazakhstan needs to increase its pipeline capacity by one million bpd if it wants to live up to its spectacular growth forecasts.

'Most oil from Tengiz now passes through the CPC pipeline,' says Murat Munbayev, deputy general manager of Tengizchevroil ,whose shareholders besides Chevron

> *'Back then, employees sometimes took geological charts home with them'*

KazMunayGaz petrol station. Photo: Rudolf ten Hoedt

are the Kazakh national oil company KazMunayGas (20%), Exxon Mobil (25%) and Lukoil (5%). In the first half of 2009, three quarters of Tengiz oil production flowed via the CPC to the Black Sea. Most of the rest was transported by train to the Kazakh port of Aktau in the south and the Russian ports Odessa and Feodosiya on the Black Sea. 'Limited pipeline access and export capability are restricting operations', says Munbayev at his office in Atyrau, hub of the Kazakh oil industry. 'More export capacity would allow us to work more efficiently and help Kazakhstan.'

Unusual

For oil companies involved in the giant new Kashagan field, 'additional pipeline capacity' is undoubtedly a top priority. Within a few years this offshore field in the Caspian Sea will outstrip Tengiz in both production and investments. By the start of 2013, the first of 75,000 bpd must reach the surface. Production should then increase, hitting the 450,000 bpd mark in 2015 and 1.5 million bpd in 2021. Shell and KazMunayGas are currently in charge of the project which is unique in many ways. Kashagan promises to become the largest oilfield outside the Middle East with unprecedented technical challenges. Investment costs have already soared beyond initial estimates – from \$60 to \$130 billion.

But Kashagan is also the only megaproject of its kind without a pipeline. 'Export is an issue and people are worried,' says a top official of the Kashagan development corporation NCPOC, who prefers to remain anonymous. 'It's unusual to have progressed this far with such a large project without planning export infrastructure. But then again, with this project nearly everything is unique.'

The pressure on export capacity has been further increased by a new run on Kazakh oil reserves by smaller oil companies. An earlier upsurge at the start of the century nose-dived due to spiraling costs and plummeting oil prices. 'Now it's all systems go again,' says an Almaty oilman.
Roxy Petroleum, which recently teetered on the brink of bankruptcy, is a good example of the new trend. EER spoke with a very relieved Roxy chief executive, Rob Schoonbrood (ex-Shell) by telephone from London just after he had clinched a new capital injection for Roxy through the oil trading company Vitol. 'We are a typical small independent exploration company in a nontraditional new frontier market,' says Schoonbrood. 'We mainly buy fields that were discovered by the Russians during the Soviet era. Many fields have been neglected since then. The trick is getting your hands on the data of those fields. Often they are hopelessly scattered. Back then, employees sometimes took geological charts home with them. The question is how to find these. For that reason we work closely with a company that specializes in tracking down and selling Russian oil and gas data. They're not even that expensive, if you consider that our biggest field, according to a conservative estimate, has a capacity of some 250 million barrels.' It remains to be seen how the economic crisis will impact oil activities in Kazakhstan. The signs do not seem to be encouraging. Banks in Kazakhstan are having major problems and energy companies are even being asked by the government to support them with deposits, sources in the industry say.

One obvious option to increase export capacity, would be to enlarge the CPC. There are plans to increase the CPC's capacity to 1.3 million bpd in 2011, but no final decision has been made yet. Up to now, the Russian state has been more inclined to expand the capacity of the Atyrau-Samara pipeline, owned by Russian state monopoly Transneft. At the same time the Russians are trying to build up a controlling stake in CPC. According to a top Kazakh expert in the energy field who spoke to EER anonymously, the parties have already agreed to Russian demands regarding a price increase. But the oil companies involved are still deliberating a second Russian condition. The Russians want to divert 340,000 bpd from the CPC pipeline via tankers to Burgas in Bulgaria where it will continue its journey via a still to be constructed pipeline to Alexandropoulos in Greece. 'The CPC expansion is not progressing as it should,' admits the first vice president of KazMunayGas, Maksat Idenov. 'However, I cannot comment further.'

Breakout

To alleviate problems with the CPC, Chevron has for

Control centre of CPC pumping station in Atyrau. Photo: Rudolf ten Hoedt

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several years been trying to force a breakout towards the West and bypass Russia. The Americans lobbied for a route via the Caspian Sea to Baku (Azerbaijan) where oil from Kazakhstan could be transported to the Turkish coast through the BTC (Baku-Tbilisi-Ceyhan) pipeline. The transport of oil from Tengiz and Kashagan to Baku and the BTC would be a welcome alternative, reducing dependency on transport through Russia.

It was not clear initially how the oil would cross the Caspian Sea. A pipeline was a hazardous option due to the risk of earthquakes in an ecologically vulnerable region. But it seems this alternative has been abandoned, just like Chevron's lobby. The two governments involved, Kazakhstan and Azerbaijan, have taken over the initiative. KazMunayGas and the Azerbaijan state-owned company SOCAR have agreed to take a 50% stake each in the Kazakhstan Caspian Transport System (KCTS) responsible for the new export route. KCTS will employ a sea tanker shuttle system. On the Kazakh side a new oil terminal will be built in Kuryk, a Caspian port with a natural harbour. A pipeline will connect Kuryk to the oil fields of Tengiz and Kashagan. A fleet of tankers will then transport Kazakh oil to a new loading facility near Baku, which will link up with the BTC pipeline.

The new export route, which requires a $1.5 billion investment, could be operational in 2012 and should initially transport 500,000 bpd from Kazakhstan to the BTC pipeline. Plans foresee in a further increase in capacity to 1.2 and later even 1.8 million bpd which would eclipse all existing pipelines in Kazakhstan . 'We do not have a deadline, we only have a sense of urgency ,' says Maksat Idenov of KazMunayGas. 'We still have to agree with Kashagan and the Tengiz group about volumes, schedules and terminals.' Idenov recognizes the need for haste. 'KCTS must be operational when Kashagan oil and additional Tengiz oil is available for a world market.'

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Thus, it appears that Kazakhstan is wrestling to free itself from the Russian grip on its oil industry. With natural gas, it's a different matter. Kazakhstan has relatively large gas reserves and like its neighbor Turkmenistan, wants to become a major gas exporter. KazMunayGas has already established a gas business unit. Europe would very much like to see gas from Turkmenistan and later from Kazakhstan flowing to Azerbaijan via a pipeline in the Caspian Sea. It would subsequently be transported to Europe via the famous Nabucco gas pipeline. But Europe should not bank on direct gas supplies from Kazakhstan in the near future. For now, the Kazakhs have bowed to Russian pressure and promised to use the Central Asia Pipeline with its prospective extra capacity and a new, yet to be built Caspian Coastal Pipeline for its future gas export. These two pipelines connect Turkmenistan and Uzbekistan, both with important gas reserves, via Kazakh territory to Russia. State Secretary K. Safinov of the Kazakh Ministry of Energy informs EER that he doubts whether sufficient gas remains for Nabucco. 'We regard support for the Nabucco project in this phase as untenable,' he says.

On the gas front , the Russians therefore currently appear to be outmanoeuvring Europe in the battle for the Caspian region. That setback is partly the fault of the EU itself, according to trade analyst Dreyer. 'The EU set up a strategy in 2007 but it addressed issues at the wrong end. The EU talks about aid, about WTO access, about building transport routes – but sounds unconvincing. Trade, the only issue where the EU has a unified approach, does not have priority. Kazakhstan is quite competitive in metals and some agricultural products like barley towards which the EU takes a protectionist stance.' ■