

# GAZPROM AS A TRANSNATIONAL CORPORATION AND CENTRAL ASIA

## *Part Two*

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## Russia's Energy Interests in Tajikistan and Kyrgyzstan

Russia is also actively cooperating in the oil and gas industry with Kyrgyzstan. This cooperation is mainly expressed in an agreement between the Kyrgyzstan government and the Russian company Gazprom on the exploration and development of gas fields over a span of 25 years.

At the beginning of 2004, Uzbekistan insisted on entering a new gas contract with Kyrgyzstan, but its conditions were tougher and less advantageous for the latter. The price of gas remained the same—42 dollars per 1,000 cubic meters, but in so doing Uzbekistan insisted on it being paid in full in hard currency, and not 50% in currency and 50% in goods as before. Taking into account its large foreign debt and state budget deficit, this contract was extremely disadvantageous for Kyrgyzstan.

Since there was no other alternative Kyrgyzstan was forced to agree to essentially any conditions Uzbekistan put forward. This situation prompted the Kyrgyz leadership to look for alternative sources of gas supplies. For example, in May 2003, an Agreement on Cooperation in the Gas Sphere between Gazprom and the Kyrgyz Government for twenty-five years was signed. Gas is delivered via the existing major gas pipelines. Apparently, Gazprom is planning to deliver some of the gas it purchases in Uzbekistan and Turkmenistan to Kyrgyzstan.

According to the same agreement, Gazprom will participate in reconstructing and building major gas pipelines, compressor stations, and other infrastructure facilities in Kyrgyzstan's gas complex. What is more, the agreement presupposes joint operation of the existing gas pipelines with the prospect of transiting gas through Kyrgyzstan to other countries. Gazprom is planning to invest in geological exploration in the republic.

In Kyrgyzstan, Gazprom plans to participate in privatizing this republic's gas-distributing networks (they are currently controlled by the state Kyrgyzgaz company). In so doing, some of the shares might be transferred to Russia for settling Bishkek's foreign debt. What is more, Kyrgyzstan, which is currently supplied with Uzbek gas, is hoping to import gas from other countries as well, relying on Gazprom's help. It should be added that the Russian gas concern is currently engaged in exploring gas fields in Kyrgyzstan itself.

It is known that Gazprom and the PRC have been working on the possibility of delivering Russian gas to China for several years now. One of the issues being discussed at the talks is the export route Russian gas should take. One alternative is for it to pass through Kyrgyzstan.

Gazprom's debut as a gas supplier to Kyrgyzstan helped Uzbekistan and Kyrgyzstan to bring their positions at the talks on delimitation of the state border between the two republics into greater balance with each other. What is more, Uzbekistan's position has become more vulnerable. Signing of the agreement between Gazprom and Kyrgyzstan led in the short term to Tashkent losing a lever of pressure on Bishkek with respect to settling territorial disputes. What is more, if Gazprom delivers gas to Kyrgyzstan, Uzbekistan might face water supply problems.<sup>1</sup>

There are several reasons why it is more advantageous for Uzbekistan to sell gas previously meant for Kyrgyzstan to Gazprom: Gazprom is a much more reliable partner than Kyrgyzstan, since it always pays for the deliveries of Uzbek gas on time and in full; and the price at which Gazprom buys Uzbek gas is the same as the price Uzbekistan sells it to Kyrgyzstan. Uzbekistan's cooperation with Gazprom is much more important for the republic, since the volume of Uzbek gas deliveries to Kyrgyzstan is insignificant—0.6 bcm annually.

Russia's position in the form of Gazprom as one of the sides of the triangle appears to be the vaguest, since the details of the agreement signed with Kyrgyzstan are not being disclosed. But it is clear that the interests of the Russian gas giant in Kyrgyzstan are not related to gas production. Gazprom has no particular illusions about the amount of gas reserves in Kyrgyzstan. According to Gazprom's data, the proved reserves of natural gas in Kyrgyzstan amount to a total of 5.7 bcm, whereby the assimilation of the republic's gas fields is complicated by the unfriendly geological characteristics and poorly developed infrastructure. In this way, Kyrgyzstan is unable to meet even its medium-term natural gas needs by means of its own fields. They can only be used for emergency purposes in the event that import deliveries are interrupted.

From the technical viewpoint, there is the Ukrainian factor: Bishkek says that Kiev is not repaying its debt, which amounts to approximately 25 million dollars. This amount "accumulated" as early as the end of the 1980s-beginning of the 1990s (when the U.S.S.R. Central Bank introduced clearing accounts), which could interfere with Ukraine joining the WTO. Kyrgyzstan is willing to accept any type of debt settlement, and Ukraine can pay by means of machine-building production for the fuel and energy complex, as well as by means of building services in this sphere.

The same applies to Gazprom's relations with Tajikistan. Gazprom has been carrying out exploration and development of fields in this country under a contract signed in 2003 and is helping local companies to build, reconstruct, and operate gas pipelines, as well as other gas complex infrastructure facilities in the republic. Proven reserves in Tajikistan are insignificant; production amounts to 24 mcm and is consumed in the south of the republic. Domestic demand is largely met by means of import, Uzbek gas is delivered to the northern part of the country (485 mcm). Proven reserves of natural gas and gas condensate in Tajikistan amount to 29.1 bcm and 1.26 million tons, respectively. In so doing, the forecasted gas resources are evaluated at more than 1 tcm, while Tajikistan's own natural gas requirements amount to only 1.2 bcm a year.

In 2004, Russia decided to try something new in Tajikistan, something it tried out in Kyrgyzstan: military bases in exchange for investments. At present, it is unprofitable to develop oil and gas, since

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<sup>1</sup> However, Uzbekistan in no way reacted to the agreement signed between Gazprom and Kyrgyzstan. Taking into account the fact that just six months earlier, in December 2003, an agreement was signed between the Uzbekneftegaz Petrochemical Company and OAO Gazprom on long-term purchases of gas in Uzbekistan for 2003-2012, joint implementation of projects in gas production (development of the Shakhpakhty field), and reconstruction and development of the republic's gas transport system, it can be presumed that the conditions of the agreement signed with Kyrgyzstan were agreed upon in advance with the Uzbek leadership.

these resources lie at great depths. A promising area is still the use of hydropower, of which the country essentially has inexhaustible reserves.

One of the topics also being discussed at the Russian-Kyrgyz talks is the problem of rehabilitating uranium tailing ponds, which, according to specialists, requires at least 50 million dollars. The Russian side expressed its willingness to assist in preparing a technical project for conserving tailing ponds (particularly the one at Kaji-Sai). Russia is also interested in creating a Russian-Kazakh-Kyrgyz joint venture for developing the Zarechnoe uranium field located in the Otrar District of the South Kazakhstan Region, the reserves of which are evaluated at 19,000 tons of uranium.

It is no accident that Kyrgyzstan has been chosen to deliver electric power to Russia: its hydro resources are estimated at 142.5 billion kW/h, and, in terms of its hydropower potential, the republic is ranked third in the CIS. This high index is due to the fact that the country's rivers have an extremely high potential per km of river bed. For example, in terms of specific hydropower capacity, the Naryn River, where a cascade of hydropower stations operates, is superior to Russia's Volga and Angara.

But the export of electric power to Russia is not the end of this project. RAO UES is suggesting that Kyrgyzstan take part in creating a Eurasian energy bridge, that is, a unified energy system for the CIS, and subsequently for Europe and Asia. Several states (France, Germany, South Korea, Iran, China, Turkey, and Japan) have already expressed their support of the idea of creating a unified Eurasian energy system. In order for Kyrgyzstan to be able to participate in this project, its potential hydro resources must be activated, in particular, two hydropower stations must be built on the Naryn River; whereby the capacity of each of them could be raised to 19 billion kW/h, which will require approximately 1.5 billion dollars.

Top priority among the main tasks of Russia's fuel and energy cooperation with Kyrgyzstan and Tajikistan goes to creating a unified water, as well as fuel and energy balance in Central Asia. These two tasks are closely interrelated, since Kyrgyzstan is participating in the water-energy exchange scheme with Kazakhstan and Uzbekistan. In this respect, Russia is offering to help Kyrgyzstan and other Central Asian states develop a new conception for an international hydropower consortium and organize the rational management of these types of resources.

Finally, we wonder about Gazprom's true purpose. We have already mentioned that the latter and Beijing have been working for several years now on the possibility of delivering Russian gas to China through Kyrgyzstan. In this respect, it is understandable why Gazprom intends to carry out major modification of Kyrgyzstan's gas transportation infrastructure.

Russia's active stance during the revolution and Askar Akaev's overthrow in 2005, particularly in the inter-Kyrgyz settlement, was motivated not only by its desire to stabilize the situation and prevent escalation of the conflict, but also by its striving to uphold its political, economic, and energy interests in Central Asia, as well as maintain its dominating influence in this region by means of Gazprom.

## Gazprom's Policy in Turkmenistan

Russian companies have begun expanding into the republic's offshore sector, while most of the Western giants and medium-sized companies found the current investment climate in Turkmenistan to be unsatisfactory. Along with the political factor, the main problem to be overcome when carrying out exploration and development in this sector is the underdeveloped petroleum infrastructure and the immense depreciation of the facilities that are available. Azerbaijan has possession of the entire set of

boring installations remaining in the Caspian after the collapse of the U.S.S.R., as well as pipe-lay-derrick barges and assembly sites for building stationary platforms, and Turkmenistan has difficult political relations with this state.

Russian oilmen and gasmen can successfully replace Western investors. The first to achieve success was Gazprom, which signed a long-term contract with Ashghabad in 2003 for the purchase of extremely large amounts of natural gas.

At present, Russian-Turkmen relations look outwardly stable, despite several crises in their recent history. The most significant of them were the events in 2003 associated with the cancellation of Russian-Turkmen citizenship.

Right up until the end of 2003, Russia repeatedly expressed its concern about the discrimination of ethnic Russians in Turkmenistan. In April 2003, Saparmurat Niyazov suddenly decided to abolish the institution of dual citizenship by asking approximately 100,000 ethnic Russians in Turkmenistan either to give up their Russian citizenship, or leave the country. Under pressure from Moscow, President Niyazov used the gas factor to achieve his end.

As a result, on 10 April, 2003, presidents Putin and Niyazov signed two documents in Moscow: an agreement on deliveries of Turkmen gas to Russia for 25 years and a protocol on the abolishment of dual citizenship. Turkmenistan is the largest producer of natural gas in Central Asia and hopes to attract foreign investments of up to 25-26 billion dollars into its oil and gas sector by 2020. Ashghabad is actively making use of this factor in its foreign policy, particularly in its relations with Russia and other CIS countries.

During this time, the Russian Federation will buy Turkmen gas at a fixed price; by 2009, purchases are to be increased to 80 bcm. Fifty percent of the gas to be purchased will be paid in cash and 50% in goods and services for the Turkmenistan gas industry. It is expected that Russia will gain a profit of 300 billion dollars, and Turkmenistan of 200 billion.<sup>2</sup>

The unresolved nature of issues regarding the building of new transnational routes, as well as the signing of an agreement in April 2003 between GTK Turkmenneftegaz and the Russian Gazek-sport company (Gazprom's subsidiary company) brought the problem of modernizing the existing pipeline system into the foreground.

Gazprom is showing an interest in solving this task, since, beginning in 2009, the annual volume of Turkmen gas deliveries to Russia will amount to 70-80 bcm a year. At present, four branches of the Central Asia-Center gas transportation system can pump 40-45 bcm of gas a year through Turkmenistan, Uzbekistan, and Kazakhstan, and approximately 70 bcm through Russia. Starting in 2009, contracted deliveries of Central Asian gas will amount to a total of approximately 100 bcm of gas a year, taking into account the 10-12 bcm of gas purchased by Gazprom in Uzbekistan under an agreement signed in December 2002. From this it follows that the capacity of the Central Asian section of the pipeline must be increased by 60 bcm, and of the Russian section by 30 bcm.

A total of 70-80 bcm of Turkmen gas will be purchased a year, and throughout the 25 years the agreement is in effect there are plans to extract approximately 1.6 tcm of gas from the Turkmen fields. From Gazprom's point of view, laying a gas pipeline within the framework of the existing route appears to be economically expedient. In this event, investments in the project will not exceed 2 billion dollars.

But there are objective and subjective difficulties hindering the implementation of these plans. The main Central Asian gas pipeline CAC (Central Asia-Center) cannot pump more than 45 bcm of gas a year (in the section that passes through Uzbekistan). Gazprombank has allotted 100 million

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<sup>2</sup> See: D. Faizullaev, "Turkmenistan: strategiia i taktika osvoeniia gazovykh resursov," *Azia i Afrika*, No. 1, 2005, pp. 21-25.

dollars, which should go to expanding the throughput capacity of CAC in Uzbekistan to 55 bcm in the next two years. What is more, a feasibility report is being prepared of a project for building a new gas pipeline branch, which will be laid within the currently operating CAC corridor. Gazprom has no intention of being the sole investor in this project. The company hopes to interest the Ukrainian side in the form of RosUkrEenergo, which is in favor of stable deliveries of Turkmen gas to Ukraine.

The main contradictions are developing around the price of the gas, the form of payment, and the transportation conditions. With respect to the latter, Turkmenistan has already managed to impose rather tough contract conditions on Gazprom: if Gazprom cannot “draw” all the gas to be delivered from this country, it will have to pay an amount equal to the cost of the “undrawn” gas. Gazprom is keeping this in mind and so is stepping up work to increase the throughput capacity of the Central Asian gas pipelines. The Turkmen leadership is insisting that, beginning in 2007, Gazprom make all of its payments in hard currency only.

Russia, like Turkmenistan, gained from the gas crisis at the end of 2004-beginning of 2005. In so doing, Gazprom not only upheld its economic interests, but also made Ashghabad understand beyond any shadow of a doubt who is holding the biggest trump cards. What is more, at this stage, Russia’s out-and-out refusal to transport and purchase Turkmen gas could have extremely serious repercussions for the Turkmenistan economy and, correspondingly, for the ruling regime there.

At present, five production sharing agreements are being executed in the country. Two of them are on dry land: the Nebit-Dag project (operator—Burren Energy) and the Hazar project with the participation of the Mitro Int company, and three are on the shelf: Cheleken (operator—an Emirates company called Dragon Oil), Block-1 (operator—Malaysian Petronas), and Blocks 11, 12 (operator—Danish Maersk Oil). The German Wintershall company is getting ready to explore the shelf, NAK Naftogaz Ukrainy obtained five contract blocks, and ZAO Zarit (a joint venture comprised of MGK Itera, OAO Rosneft, and ZAO Zarubezhneft) is planning to carry out production at three blocks on the Turkmen shelf. All of these companies intend to enter production sharing agreements.

The Turkmen side is supporting another route for the gas pipeline—from Turkmenistan along the east coast of the Caspian through Kazakhstan to Russia. In this case, its length from Turkmenistan to the Russian Federation will be reduced to 700 km, and the cost of the project will amount to no more than 1 billion dollars. But this route will not pass through Uzbekistan, which might not be entirely to Gazprom’s liking due to the large number of contracts between Russia and Uzbekistan.

Russia’s goal is obvious and consists of strengthening the position of its main partner—Turkmenistan—in the energy sector, thus retaining control over the export of Turkmen gas.

In 2004, Russia and Turkmenistan agreed that the latter would sign an important agreement “in the near future” on developing offshore oil fields in the Turkmen sector of the Caspian Sea. This transaction, which is a production sharing agreement, will be entered with the Russian oil consortium ZAO Zarit. The time-limit of the contract is 25 years and concerns the development of four blocks rich in oil and gas in the southern part of the Caspian shelf close to the border with Iran.

The Zarit joint venture was founded in May 2002 in Moscow by Rosneft and the Gazkhinvest company, which belongs to Itera (each of them possesses 37% of Zarit’s shares), as well as the Zarubezhneft company, which owns the other 26% of the shares. The consortium intends to draw Turkmen state companies Turkmenneft and Turkmenneftegaz as well as companies from Iran into cooperating with it.

In this way, the activity of Russian companies in Turkmenistan boils down to Gazprom buying large amounts of blue fuel. What is more, this company managed to “cut off” other serious consumers

of Turkmen gas, for the near future at least, and shelve for the foreseeable future such ambitious projects as building a pipeline to Afghanistan and Pakistan or laying a trans-Iranian gas pipeline with access to Turkey and Europe.

The situation was complicated at the beginning of April 2006 during President Niyazov's visit to China, where an agreement was reached on building a gas pipeline from Turkmenistan to the PRC, bypassing Kazakhstan. This demarche by Turkmenbashi looked like a risky attempt at blackmail, primarily of Russia, since this project does not have any realistic substantiation. Turkmenistan will not have enough gas to fill this pipeline even for the Pakistani and Indian markets (if the agreement with Gazprom is not broken). What is more, the military-political and geopolitical risks associated with Afghanistan still retain their significance.

## Gazprom and Foreign Markets

The main goals of Russian policy with respect to the EU consist of the following: preserving the French-German-Russian triumvirate, which has unique significance for Europe; continuing and strengthening the EU countries' energy dependence on Russia; achieving and keeping Russia's support on the part of the key European countries (Germany, France, Italy, and, possibly, Great Britain) as a counterbalance in Russia's relations with the U.S. and the Eastern European countries of the European Union; and drawing up a joint policy in geopolitical areas important to Moscow.

As Russian strategists believe, long-term, large-scale cooperation, which is counted on for decades, between two mutually complimentary economic complexes—Russia and the European Union—could lay the foundation of a new and powerful center of the multipolar world of the 21st century. In their opinion, if events develop favorably, this center could take first place in the world by the middle of this century. Moscow sees the energy resources of Kazakhstan, the Caspian Region, and Central Asia (placed under Russia's control) as a necessary and important addition to this strategy.

Ensuring energy security, which in China is a synonym for oil security, will become a top priority task. It is believed that, relying on the current structure of world oil interests, China should develop its "energy diplomacy," take active part in global and regional organizations aimed at cooperation in the energy industry, and become an effective player on the current and future markets, acquiring a discernible vote in determining oil prices and favorable game rules.

We should take note of the growing shortage of China's energy resources.<sup>3</sup> By 2010, it will satisfy half of its oil requirements by means of import. According to the estimates of specialists, the PRC economy's annual need for oil will grow from 200 million to 400 million tons, that is, essentially double, by 2020. Annual growth rates of crude oil consumption in the country have already reached 6% over ten years with a less than 2% increase in domestic production. The poor diversification of sources of oil import is arousing serious concern among experts with respect to ensuring energy security in China. Today, more than 60% of oil imports are maintained by deliveries from five countries of the Middle East and Africa, and by 2010, the share of this region could grow to 80%.<sup>4</sup>

<sup>3</sup> See: Ph. Andrews-Speed, Xuanli Liao, R. Dannreuther, "The Strategic Implications of China's Energy Needs," *Adephi Paper 34*, Oxford University Press, Oxford, New York, 2002, 115 pp.

<sup>4</sup> See: B.D. Cole, *Oil for the Lamps of China—Beijing's 21st-Century Search for Energy*, NDU, Washington, D.C., 2003.

In its Russian policy, China is pursuing a strategic goal—to implement a pipeline project from Eastern Siberia to its Pacific coast. The main problem complicating Russian-Chinese relations at the current stage is the Angarsk-Daqing pipeline.

In March 2006, Russia's energy geostrategy in the Chinese vector became extremely activated: during Vladimir Putin's official visit to the People's Republic of China, a Protocol on Deliveries of Natural Gas from Russia to the PRC was signed. The document set forth the main terms regarding time-limits, volumes, and routes (Western and Eastern) of the gas deliveries, as well as payment conditions. The Rosneft and Gazprom companies signed agreements on oil and gas deliveries and on creating joint ventures with the Chinese National Petroleum Corporation. The matter concerns building two gas systems in Western and Eastern Siberia with delivery volumes of 30-40 bcm each. The new gas pipeline from Russia to China will be built in five years.<sup>5</sup>

Essentially, signing of the memorandum on Gazprom's delivery of gas to the PRC is a serious step toward forming a global world gas market in keeping with Russia's energy geostrategy. This event will have an impact on the development of one of the three main gas markets—the Asia Pacific. One of the reasons is the Russian Federation's search for alternative markets in response to the fact that Europe has been talking a lot recently about the possibility of alternative deliveries of gas and developing alternative types of energy production. Another factor is that Russia must gain access to the Asian market as quickly as possible since there is competition between liquefied natural gas and pipeline gas.

The strategic goal of this breakthrough is Moscow's striving to intensify competition over deliveries of Russian gas in the world, particularly between the Europeans and Asians. Competition between them will ultimately lead to an increase in the cost of blue fuel. Attention is also being paid to the consideration that liquefied natural gas will be used primarily on the coast, whereas the Russian pipeline will run to China's western regions.

Another factor is important for Kazakhstan: the Russian Federation and PRC have reached a preliminary agreement on laying an export pipeline in the PRC to the Xinjiang-Uighur Autonomous Region. This will ensure additional opportunities for Astana in the future, if Moscow and Beijing can be convinced to lay the pipeline through Kazakhstan.

The LUKoil and Gazprom companies, which are closely tied to Russian state structures, have come to the forefront of Russia's energy interests in the Middle East. However, Russian companies found themselves up against tough competition from the largest Western energy corporations. Gazprom did not begin manifesting activity in the Middle Eastern vector until 2004. The concern is primarily interested in Egypt and Libya. The Russian company's main trump card is its wealth of experience in the exploration and production of blue fuel, as well as in building major gas pipelines. In recent years, both of these countries have shown immense interest in developing their gas sectors, and so the appearance of Gazprom here is entirely justified. In Egypt, the production volume of natural gas doubled in just four years, reaching 36 bcm at the end of 2004.

In November 2004, there was a meeting between Gazprom Head Alexey Miller and then Ambassador of the Arab Republic of Egypt to the Russian Federation Rauf Saad, at which the parties discussed the prospects for bilateral cooperation in the oil and gas sphere, as well as projects for the production, transportation, and processing of hydrocarbons. The details of the talks were not revealed, but two weeks later, Russian Prime Minister Mikhail Fradkov visited Egypt and stated that Gazprom might soon begin working in the country. Alexey Miller's visit to Cairo in March 2005 gave a new boost to cooperation development. The sides decided to cooperate comprehensively in several areas at once, beginning with geological exploration and ending with training Egyptian specialists for the oil and gas business at Russian higher education institutions.

<sup>5</sup> See: D. Faizullaev, "Rossiisko-kitaiskoe sotrudnichestvo v gazovoi otrasli," *Azia i Afrika*, No. 5, 2006, pp. 14-19.

It is a well-known fact that Zarubezhneftegaz, Gazprom's subsidiary company, is carrying out consultations with the Libyans regarding joint projects. What is more, even before the beginning of the official consultations, Gazprom became a co-investor of the British investment company SOCO, which in the spring of 2004 conceded to Gazprombank 54% of the shares of ODEX Exploration Ltd., which owns several licenses for developing oil and gas fields in Libya.

Israel, which has a shortage of raw minerals, could be another potential partner for Gazprom in the Middle East. Its proven gas reserves are estimated at approximately 45 bcm, and annual production does not exceed 100 mcm. So Gazprom is interested in this country as an importer of blue fuel.

For entirely understandable reasons, Israel does not want its energy industry to depend on fuel deliveries from the Arab countries. So neither Egypt, nor Libya, nor Algeria, nor Qatar (the largest liquefied natural gas exporter in the world) are suitable strategic partners for it. In the interests of energy security, it is having to expand its horizons, whereby the nearest non-Arab exporters are Russia and Norway. Russia has certain advantages, since thanks to the Blue Stream project, Russian gas is already going to Turkey.

The Israeli side offered to lay a gas pipeline from Turkey through the Mediterranean, although the possibility of delivering this fuel in liquefied form from Russia or Turkey has not been excluded. The plans to build an offshore gas pipeline are quite ambitious and do not appear to be entirely in keeping with Israel's real needs. It is possible that Gazprom will not limit itself to Israel, but will look for other potential consumers of Russian gas, Libya, Cyprus, and possibly Syria being theoretical candidates. But here the political factor again insists on its rights, which could complicate movement in this direction. It is highly likely that Israel will nevertheless prefer tanker deliveries of liquefied natural gas.

Syria, which at one time imported oil and gas technology and equipment from the U.S.S.R., might step forward as the concern's potential partner. But as of today, gas production in this country is extremely low, and exploration is being carried out by Western structures.

In the Middle East, Russian companies are coming up against two-fold competition. Western corporations are competing with them as investors, and the producing states of this region as exporters. With respect to gas, Qatar and Algeria are the main exporters. The latter recently began exporting helium manufactured from natural gas, the price of which is constantly rising. But Gazprom also has its trump cards, which are allowing it to methodologically reinforce its presence in this strategically important region for the entire world economy.

## Energy Geopolitics and Gazprom

Several significant events in international power engineering are related to Russia's active policy. One of these is President Putin's statement at the meeting of the Russian Security Council on 22 December, 2005 to the effect that Russia's strategic task is to become a leader in world power engineering and a leading exporter of oil and gas. In keeping with this, a new version of Russia's Energy Strategy until 2020 is being drawn up. The idea of uniting OAO Gazprom, RAO UES, and the Rosenergoatom state concern into a vertically integrated diversified holding company (as the nucleus of a future Eurasian transnational energy and fuel company) has been put forward.

State-civil capitalism is becoming Russia's business ideology, while top managers of state corporations own large sets of shares of the companies they head. In so doing, the tension in the conflict of interests in President Putin's administration is growing along the liberals—power-mongers line (D. Medvedev—I. Sechin, Gazprom—Rosneft), as well as in Russia's business elite.



Attention should be paid to the Russian-Ukrainian “gas war,” which was the first test for Russia’s gas and oil export forces striving for continental domination, which have already been christened “Russia’s energy weapon.” PACE came forward with an initiative to prepare a report on the use of energy resources for resolving political problems. It is also worth noting that one of the topics discussed in Davos was called “The Permissibility of Using Deliveries of Energy Resources as a Political Weapon.”

Two approaches can be traced in the political leadership and executive vertical of the Russian Federation. The first consists of placing the stakes on Russia’s affirmation as a reliable energy partner for leading nations and its “special chair in the elite club.” Vladimir Putin has spoken of this many times, and this same goal was announced as a priority of Russia’s representation in the G-8. The second approach is to use the “energy weapon” for making a new “thrust for influence,” for trying to recapture the ground lost in relations with neighbors, and for recreating a sphere of Russian domination in the post-Soviet space.

An increase in Europe’s energy dependence on foreign deliveries was designated, which became obvious with respect to the uncharacteristically cold winter, increased domestic consumption in Russia and Europe, interruptions in deliveries of Russian gas to Europe, as well as Ukraine’s “withholding” of gas intended for European consumers. Energy security was one of the main topics discussed at the G-8 summit in St. Petersburg.<sup>6</sup>

In the medium term, Europe can see no serious alternative to Russian gas. The hope of finding new fields in Denmark was not justified, supplies in the North Sea are running out, and the prospect of delivering gas from North Africa and implementing LNG projects in Europe is extremely vague.<sup>7</sup>

Gazprom’s plans also speak of much. This company is planning to buy West European gas-distributing companies and, after purchasing the SEG (North-European gas pipeline) project, Gazprom, as political scientists note, might be renamed EuroGazprom without changing its lists of shareholders and managers.

But the series of difficult talks being held between the Russian and Ukrainian leadership, Gazprom, and Naftogaz Ukrainy and the leadership of Turkmenistan and Uzbekistan shows that an increase in the role of Russian deliveries will simultaneously raise the significance and cost (both political and strictly economic) of Central Asian gas in Gazprom’s balance for Europe’s energy security.<sup>8</sup>

Gazprom’s purchase conception in Central Asian countries is aimed at diversifying the overall resource base of the Russian concern, as well as export, transit, and internal flows. Russia’s political

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<sup>6</sup> At present, the EU is importing 40% of the gas it consumes, whereby more than 25% of all the gas it imports is of Russian (to be more precise, pseudo-Russian by means of re-exporting Central Asian gas) origin. It is forecast that in the next few years, the demand for gas in the region will grow, in particular due to thermal power stations transferring to this type of energy. An increase in demand under conditions of a reduction in its own production due to the exhaustion of proven reserves of gas will lead to Europe’s dependence on gas imports significantly rising. The forecasted increase in demand in Western Europe until 2025 amounts to an average of 2.4% a year, and by 2025 demand could reach 730 bcm compared with 420 bcm in 2001. The share of import in so doing will increase from 40% to 70%. In this way, objective conditions are being created for reinforcing Gazprom’s presence on the European market. For the future, the volume of Russian gas sales under current long-term agreements is determined at 2,0 tcm, which is approximately 7% of the company’s proven reserves. Gazprom’s annual minimum contract delivery volumes to Europe (without extending the current contracts) will reach 146 bcm by 2008, and the maximum volumes could amount to 178 bcm.

<sup>7</sup> See: I. Tomberg, “Proekt Severo-Evropetskogo gazoprovoda v geopoliticheskom kontekste,” *Mezhdunarodnaia zhizn*, No. 1-2, 2006, pp. 216-224.

<sup>8</sup> Approximately 81% of Gazprom’s proven reserves are in seven gigantic fields: Urengoi, Yamburg, Zapoliarny, Astrakhan, Kharasavei, Bovanenkovskiy, and Stockman. The latter three have still not been developed, the Urengoi has been developed by 60%, and the Astrakhan has limitations for environmental reasons (the local plant cannot cope with the sulfur discharge from the gas). Independent analysts confirm the presence of a systemic problem in the monopoly due to significant exhaustion of the existing reserves. It is forecast that the ratio of production and export growth could create certain difficulties for Gazprom as early as 2006-2007, since there are no serious prerequisites for a significant increase in the rates of its own production.

leadership is objectively compelled to balance its relations with the region's states as best it can, and Gazprom is striving to reinforce its presence, including by means of investing in exploration, production, and the transportation infrastructure.

The cooperation alternative, which Gazprom and Naftogaz agreed upon, essentially envisages creating a certain prototype of a CIS gas market, but its appearance, rules, and the roles of its participants have been determined without taking the Central Asian countries into account. Signing a five-side intergovernmental agreement among Russia, Ukraine, Kazakhstan, Turkmenistan, and Uzbekistan would be a safe way to create and develop a CIS gas market, since it would bind these states together with common obligations, guarantees, and concessions. But Russia and Ukraine are striving to limit themselves to bilateral documents only, including with Kazakhstan, Turkmenistan, and Uzbekistan, which is leading to an obvious imbalance in delivery volumes and transit possibilities.

At the end of 2005, Gazprom established ultimate monopoly over the international transit of Kazakh, Turkmen, and Uzbek gas. In this way, all of KazMunayGaz's blue fuel transit potential will fully depend on Gazprom's need for Turkmen and Uzbek gas. On the whole, the export flow from Turkmenistan and Uzbekistan is limited by the capacity of their own transportation system and of Kazakhstan's. Gazprom can participate in reconstructing a section of the Central Asia-Center major gas pipeline in Uzbekistan. What is more, an increase in the overall capacity of the CAC will largely depend on Turkmenistan's difficult-to-forecast stance with respect to diversifying export gas flows, particularly on the prospects for implementing the Turkmenistan-Afghanistan-Pakistan gas pipeline project and international audit of Turkmen reserves (the Dauletabad field).

In this respect, Kazakhstan's significance as Gazprom's partner is increasing, and when making a decision on modernizing the Central Asia-Center system, KazMunayGaz must be recognized as a strategic transit partner. It is possible to find denouement of the question of expanding the CAC with an increase in the presence of Kazakhstani gas on the European and CIS markets within the framework of KazRosGaz (export quota to the Far Abroad of 50% of the total volume of deliveries and 25% for deliveries to the CIS market).

But the price policy is in need of constant adjustment. Turkmenistan has long been insisting that its gas should be sold to Gazprom at the average European price minus transportation costs and the agent's stipulated equity.<sup>9</sup>

Gazprom has also begun actively setting up a system of bilateral relations with Uzbekistan and Kyrgyzstan (later with Turkmenistan) by forming joint enterprises, which is also creating prerequisites for the active use of this factor by the Kazakh side when problems arise with Tashkent on price issues and with Bishkek on transit within the framework of KyrKazGaz.

As for Georgia the appearance of investors from Kazakhstan in the country fits in with Mikhail Saakashvili's plans, who is still looking more frequently for investment partners not in the U.S., but in the former Soviet republics. Georgia is in dire need of investments for developing its own economy, and Tbilisi is willing to consider any proposals on cooperation.<sup>10</sup>

<sup>9</sup> In 2005, Gazprom purchased around 19 bcm of gas in Turkmenistan, Uzbekistan, and Kazakhstan. In 2006, purchases were planned for 25.8 bcm. Gazprom plans to purchase 9 bcm of gas in Uzbekistan in 2006 at 60 dollars per 1,000 cubic meters and a stipulated transit price through Uzbekistan of 1.1 dollars per 1,000 cubic meters 100 km. There are plans in the future to increase the import of gas from Uzbekistan to 17-18 bcm a year by means of developing three gas fields in Uzbekistan—Urga, Kuanysh, and the group of Akchalak fields. The total volume of the company's investments in Uzbekistan is expected to be around 1.5 billion dollars. Beginning in 2007, Gazprom will purchase all the gas intended for export from Turkmenistan. The conditions of a long-term agreement envisage purchasing 60-70 bcm in 2007-2008 and 70-80 bcm in 2009-2010. But Turkmenistan's constant statements on raising prices and the five-year agreement signed with Uzbekistan make it understood that export from Turkmenistan in the next five years will remain at the previous level of up to 36 bcm.

<sup>10</sup> In October 2005, AO Tbilgazi was declared bankrupt by the city court. The enterprise is subsidized by the Tbilisi Mayor's Office, which owns 96% of the AO's shares. AO Tbilgazi's debts for natural gas consumed in past years amounts

It was presumed that Georgia would import up to 2 bcm of blue fuel from Kazakhstan every year for the next ten years. But after the price of gas delivered to Georgia went up, Gazprom prevented Kazakhstan from exporting to Tbilisi via its gas pipelines under an alternative contract. Nevertheless, Kazakhstan Prime Minister D. Akhmetov believes that such deliveries are possible if the price corresponds to the one Russia set for Georgia.<sup>11</sup>

The possible sale to Gazprom of a major pipeline belonging to the International Gas Corporation (100% share of the state) and passing through Georgia to Armenia will allow Tbilisi to replenish its budget (Gazprom is offering between 200 and 300 million dollars) and to reduce the price of gas delivered by the Russian holding company (servicing of the pipeline alone costs up to 8 million dollars a year). The country's leadership will consider this alternative in the event that Gazprom provides certain guarantees, in particular, gas deliveries for 25 years at a low price.<sup>12</sup>

Taking into account the forecasted three-fold increase in the production of Kazakh gas by 2015 from the 2005 level (from 28.7 bcm to 79.4 bcm), the Gazprom leadership must clearly recognize that most of the Kazakhstani raw material will be exported either via its pipelines and with its participation, or bypassing Russia through the Caucasus, as well as to China.

But forming a policy for exporting Kazakhstan's gas largely depends on the prospects for creating new gas-processing capacities, including gas-chemical. In the event of the successful implementation of gas-chemical projects in Tengiz and Karachaganak the expediency of building a gas pipeline to China seems dubious.

As we know, one of the main goals of the Kazakhstani authorities is to gain independent access to the end gas consumers. Of course, the matter primarily concerns Western Europe, but Georgia is also capable of becoming a precursor in this direction. The transportation of gas from Kazakhstan to this republic could be technically carried out only through Russia. Deliveries of Kazakhstani gas to the Georgian market via the KazRosGaz joint venture will make it possible for Kazakhstan to avoid Russia's discontent and opposition, which has its own gas interests in this state. What is more, Astana has serious trade arguments with Gazprom, in particular, contracts for the transit of Central Asian gas, which the Russian concern entered in Uzbekistan and Turkmenistan. In exchange for the favorable stable transit of these volumes (in 2007, they will amount to approximately 50 bcm), Astana could achieve independent export of gas to Georgia, and possibly to other CIS countries above the KazRosGaz quotas.

In this way, one of the foreign policy tasks is de-politicization of the hydrocarbon export problem and transfer to the adoption of precise and economically calculated strictly business decisions regarding the priority of export routes, which will be pragmatic regardless of the changes in the state strategy of the transit country partners (Russia, Azerbaijan, Georgia, and Ukraine).

The voluminous Chinese market deserves the keenest attention with respect to possible investment in production of the end product of refining and petrochemistry. The PRC needs Kazakhstan's oil and gas both for domestic consumption and for ensuring the export of valuable end products of refining, including to our republic. If this fact is not kept in mind, China could later become

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to approximately \$5 million to Gazprom alone. Its directors say the reason for Tbilgazi's arduous financial situation is the enormous (up to 60-70%) losses of blue fuel in the gas networks, as well as the low collection of subscriber payments due to the mass falsifications of gas meter indications. Local experts add the company's bad management and internal corruption to these reasons.

<sup>11</sup> In 2005, gas went to the population of Tbilisi for 0.265 lari (\$1 = 1.79 lari) per cm. OAO Gazprom signed a contract to deliver 920 cm of gas to AO Tbilgazi in 2006 at \$110 per 1,000 cm. According to experts' estimates, the new price will reach 0.30-0.35 lari per cm for the capital's consumers.

<sup>12</sup> At present, all gas deliveries to Georgia are carried out via the Makat-Northern Caucasus gas pipeline. Gas consumption by Georgia amounts to 4.7 mcm a day in the summer and up to 7 mcm in the winter. The share of natural gas in Georgia's energy balance amounts to approximately 24%. The country's need for gas in 2006 is estimated at 2.25 bcm.

the same “unfriendly” exporter of fuels and lubricants and other products for Kazakhstan as Russia is.<sup>13</sup>

Our attention is drawn to the fact that to augment the resource base in Kazakhstan, the Chinese are aiming to purchase already proved assets which carry out real production (PetroKazakhstan, Nations Energy). In this respect, their competition both with Russian (LUKoil) and other foreign companies is inevitable, which provides Kazakhstan with much room for maneuver.

It is obvious that coordinated Kazakhstan-Russian policy with respect to hydrocarbon and electric energy export to China (and possibly also under joint projects on the PRC domestic market) would largely promote the development of the economic component of the SCO, which the Chinese side has recently been giving great significance.

The need for and possibility of raising the status of state-private cooperation in individual oil and gas projects to the level of state-inter-corporative partnership across the board, including in national projects (from programs to develop the Caspian’s resources to the domestic fuels and lubricants market) are becoming increasingly obvious.

### *C o n c l u s i o n*

On the whole, Russia is continuing to consistently and expediently move forward in the direction it has chosen by conducting its energy policy with emphasis on the raw material sector.

At the APEC summit in Bangkok, Vladimir Putin positioned the Russian Federation as the main guarantor of energy security in the Asia-Pacific Region. Taking into account its domination in supplying the European states with energy resources and the designated contacts in this sphere with the U.S., this claim to leadership in the APR means a desire to throw open the window of opportunity that appeared as the result of the increased concern by oil importers about the stability of deliveries from traditional—Middle East and Africa—sources. The latest agreements on gas deliveries to the PRC are a new step in this direction. Russia is obviously striving to convert energy potential into greater geopolitical influence.

The Russian Federation is increasing the production of oil and gas with an essentially constant domestic demand, which is raising the question of new sales markets, particularly in the APR. By gaining access to these markets, Moscow will increasingly attract importers by raising the trade and energy dependence of consumers, which will play a certain positive role in bilateral and multilateral relations.<sup>14</sup>

But, when developing its own energy strategy, Russia is coming up against objective difficulties, which will not be that easy to resolve. Until recently, the capacities of Russia’s major pipelines ensured the pumping of 300 million tons of oil a year from Western Siberia in the westerly direction and up to 100 million tons in the southerly and easterly directions. In so doing, the throughput capacity of all the Russian Federation’s export oil pipelines amounted to 200 million tons a year. According to specialists’ estimates, the shortage of capacities (taking into account transit) amounts to no less than 40 million tons of oil a year, and by 2010 will reach 120 million.

As Russian strategists believe, the role of the CIS countries on the world oil market is rapidly increasing and, if all goes well, the leading oil-producing republics of the Commonwealth will be able to ensure 25-27% of the demand of this market by 2010. By this time, the petroleum block on the CIS base will be able to gather allies around it from among independent exporters and, along with OPEC and IEA OECD, become one of the three regulators of the world oil market. But in order to do this,

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<sup>13</sup> The main consumers of Chinese oil refining and petrochemical products at present are Korea, Japan, Taiwan, the U.S., and Saudi Arabia. Russia also belongs to the top ten importers, purchasing 753,000 tons of these products in 2004.

<sup>14</sup> In correspondence with Russia’s Energy Strategy until 2020, there are plans to increase oil production to 445-490 million tons in 2010 and to 450-520 million tons in 2020.

Moscow still has to coordinate the diverse interests of the former Union republics and form a unified energy policy for the alliance being created. What is more, the infrastructure existing within the CIS will have to be reconstructed, particularly with respect to transportation.

At the same time, all the talk about the possibility of Russia occupying a leading position on the world oil markets is still rather hypothetical. As already noted, it became a leader only in terms of the amount of oil it produces and exports. But the enormous export volumes do not allow Moscow to have an influence on oil quotas. By delivering oil almost exclusively to the Western European markets, which are extremely competitive anyway, it is impossible to set prices in other regions. In other words, the fact that Russia's energy resources are not present in the APR countries and the U.S. due to its transportation difficulties is preventing Russia from participating in the formation of world prices.

Russia's goal in Central Asia is to create a unified energy consortium under its direction, but this could have a negative effect on the ability of the Central Asian states to make independent political decisions. Gazprom's subordination of the gas transportation assets of these countries will ensure the Russian Federation full control over the industry, primarily over gas export, which will have several serious consequences. For example, Russia will become its largest importer, whereby it will use Central Asia's supplies both for its domestic purposes, and for re-export. It is possible that the Russian Federation will try to send this gas exclusively to its territory in order to maintain its own fuel and energy balance, and only partially to third countries in order to acquire profit from the transit of insignificant amounts of gas of the Central Asian republics. In so doing, Moscow will try to keep even these volumes to the minimum in order to prevent competition.

Russia's monopoly on the blue fuel market of the Central Asian republics will also have an impact on the European Union, which will be able to obtain Central Asian gas only with Gazprom's intercession. In other words, in the end, the Russian Federation will acquire the opportunity not only to dictate the price of its gas to consumers from CIS countries, but also impose beneficial conditions for it on the transit states of Russian blue fuel (Ukraine and Belarus), which are large importers of this product.

Russia's seizure of the designated gas sectors will lead to gradual ousting of other countries' companies from the region, which are carrying construction and service work as well as delivering gas and other equipment. Over time, Moscow's expansion could also spread to the oil sectors of these republics, that is, Russian companies will be able to squeeze Western oil companies out of the region's states (primarily out of Kazakhstan).

So, Moscow has come to the conclusion that the Russian Federation currently has the unique opportunity to restore its geopolitical influence in Central Asia. By joining the OCAC, Russia has recognized the legitimacy of Central Asian integration. Russia went on to achieve a merging of the OCAC and EurAsEC by essentially taking control over the integration (including energy) processes in the region. This was essentially an attempt to find an answer to China's economic expansion in the region, which means that Russia is also striving to expand its economic trade cooperation with its countries.

With respect to Gazprom's role, two aspects should be noted. First, the company is developing increasingly along the model of a classical transnational company with all the ensuing consequences for its activity on foreign markets. Second, the doctrine of Anatoli Chubais' Liberal Empire, in the spirit of which Gazprom is acting, can be surmised in the concern's policy. At present, the company is one of the most important tools of Russia's global geo-economic strategy.

Kazakhstan is still the Russian Federation's most valuable partner in its geopolitical and geo-strategic priorities in the Central Asian region. It is obvious that in the future Russia will assume an active position with respect to Kazakhstan.