

# ENERGY RESOURCES AND ENERGY POLICY

## AN OIL PIPELINE TO CHINA: AN ELEMENT OF STRUGGLE FOR CASPIAN RESOURCES

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Today, attention of many countries is riveted to the oil- and gas-rich Caspian coast. According to experts, it has a good chance of coming third (after the Gulf and Siberia) oil treasure-trove: this explains why the great powers have concentrated their geopolitical and geo-economic efforts there. The world's leading countries are shaping their policies in the local states with a view to attain control over the fuel energy sources of the Central Asian and Caspian republics and possible

transportation routes. Transnational companies, including those operating in the neighboring countries, are closely following the local developments and systematically monitor the hydrocarbon production and transportation projects.

Under these conditions Kazakhstan has to meander among the great powers, which negatively affects its policies. The situation around the oil pipeline from Western Kazakhstan to China is highly illustrative in this respect.

### China's Needs for Energy Fuels and its Strategy

In everything that they do today the Chinese leaders proceed from the conviction that the 21st century will be the century of China that is working hard to catch up with the Western countries. Even though

the figures are still low China's absolute potential is amazing (in the United States, for example, gross income is close to \$10 trillion, while in China it has topped \$5 trillion). In fact, today Chinese, not Japanese, economy is the world's second. Under certain conditions China may acquire the "critical mass" necessary for further progress toward its ambitious goal of becoming a global power and one of the key political players. This requires huge energy resources, oil and gas in the first place. The country is consuming the increasing amounts of energy mainly produced by imported energy fuels.

In 2000, the country imported 70m tonnes of oil; in 2003, about 80m tonnes; the forecasts for 2005 are 85-90m tonnes; the figure might double by 2010. Domestic production will remain basically the same (in 2003, the country produced about 136m tonnes of oil). By 2030, China is expected to consume approximately 400m tonnes of oil a year.

The mounting need for energy fuels spurred on by high economic development rates is behind China's foreign policy strategy, the most obvious manifestation of which is "the onslaught" on the energy fuel fields in Central Asia and the Caspian region. According to the Chinese press, the Chinese oil companies have concentrated their efforts in Turkmenistan, Kazakhstan, Azerbaijan, Indonesia, Iran, Iraq, Russia, Sudan, the Middle East, Africa and South America. The China National Petroleum Corporation (CNPC) that is currently producing about 13,500-14,000m tonnes a year outside the country is expected to deliver the larger part of the needed amount. Nearly half of the imported oil is produced in Kazakhstan. The China Petrochemical (Sinopec), the second largest oil company, works in Russia, Asian and Mid-eastern countries. In 2003, China started reassessing its own oil and gas reserves.

China is imperceptibly moving toward its broader presence in the oil-bearing Caspian region. Back in 2001, during his official visit to Kazakhstan Premier of the State Council of the PRC Zhu Rongji announced that his country would not only continue importing ever increasing amounts of oil from Kazakhstan but would also use its territory to move hydrocarbons to China.

The trans-China pipeline strategy follows the same logic: the West-East routes will form the core of infrastructure designed to deliver oil, gas and oil products to the industrial regions in central and eastern China. The Uighur factor has a certain role to play: by developing the Xinjiang-Uighur Autonomous Region (XUAR) Beijing hopes to defuse separatism of Eastern Turkestan, to finally quench the conflict that has been smoldering from 1997, to strengthen political stability, to establish its control over the area rich in natural resources and to use it to spread its influence to western Eurasia. Political stability is the key to China's broader economic presence in Central Asia and the Caspian that can be ensured with the help of new oil and gas pipelines, new industrial enterprises, etc. In many respects this strategy will affect the future outlines of the geopolitical triangle the U.S.-Russia-China.

Inside the country the strategy took the shape of the Great Pipeline of China project, a large-scale gas transportation infrastructure stretching from the west (the XUAR) to the east of China. The task is paramount and the need for gas is great to the extent that forced Beijing to create favorable conditions for foreign investors attracted by the prospect of developing gas fields in Western China. It looks, however, that the Tarim Basin resources in the XUAR were used as an attraction. China obviously is in no hurry to develop its own gas reserves that are not enough to ensure its growing requirements; China needs this pipeline to import gas from Russia, Turkmenistan, and Kazakhstan. These and similar projects are actively studied.

By 2006 the country plans to acquire two branch lines of an oil pipeline going from the XUAR to inland China; they are needed to realize the project of oil imports from Kazakhstan and to encourage the oil companies in the XUAR by increasing its investment attractiveness. Obviously, the pipeline will be mainly used to bring in oil from China's western neighbors. These countries in turn will acquire a market for their oil for a long time to come, even if the so-called Uighur Elephant (supposed huge oil reserves) is discovered in the near future.

At the same time, at the very beginning of this century China hoped to import Siberian oil under an agreement with YUKOS about the Angarsk-Daqing oil pipeline. In the fall of 2003 Mikhail Khodorkovskiy, head of YUKOS, was arrested, after which the project was frozen. Beijing always regarded a pipeline from Kazakhstan as another possibility for moving oil from Kazakhstan, Russia and the Caspian region to China. This pipeline is supposed to reach the northwest of China, in the SUAR.

## Potentials of Kazakhstan

The local hydrocarbon fields are mostly concentrated in the Caspian oil-and-gas province, the Iuzhno-Mangyshlak, Turgay, Ustiurt-Buzashinsky and Shu-Sarysu oil-and-gas regions. It covers 1.8m sq km, including the water surface of the Caspian and Aral seas.

Over 160 oil fields were discovered in the continental part; the richest fields are concentrated in the Atyrau Region where over 80 fields are found (their explored resources of industrial category are about 3 billion tonnes of oil). There are over 45 fields (with the total reserves of about 2.9 billion tonnes) still at the preliminary stage and at the stage of industrial development; there are over 20 fields at the stage of supplementary exploration. The largest fields are: Tengiz (over 2.26 billion tonnes), Korolevskoe with the initial recoverable resources of 30.4m tonnes; Kenbay, 30.9m tonnes.

About 70 fields were discovered in the Mangistau Region; 27 are being actively developed (the largest of them being Uzen, Zhetybay, Kalamkas, Karazhanbas). The Western Kazakhstan and Aktiubinsk regions hold good promise from the point of view of oil and gas; the Caspian shelf is the country's main hope.

The republic is consistently increasing production. In 2003, it produced 51.3m tonnes of oil (with gas condensate) and 14.04 billion c m of gas. The same year Kazakhstan increased its oil and gas condensate export as compared with 2002 by 13 percent. The export reached 44.3m tonnes of which 7m tonnes were exported to CIS countries. In terms of value, in 2003, oil and gas condensate export increased by 39 percent to reach \$7 billion. In 2004, the incremental produced oil volume is expected to be provided mainly by the Tengiz, Karachaganak and Kumkol fields. According to Minister of Energy and Mineral Resources Vladimir Shkolnik, the republic expects to produce 54m tonnes of oil in 2004; over 60m tonnes in 2005; about 100m tonnes by 2010 and 150m tonnes by 2015. Under the additional document of 25 February, 2004 to the production sharing agreement (PSA for the Northern Caspian of 18 November, 1997) the Kashagan shelf oil field alone is expected to yield up to 21m tonnes of oil every year by 2010; the figure for 2013 is up to 42m tonnes; the maximum production level of 56m will be achieved by 2016. (Geologists assess Kashagan oil reserves at 4.8 billion tonnes.)

The above says that by 2007-2008 the throughput capacity of export pipelines should be increased to 1-1.2m barrels a day (50-60m tonnes a year). As the Caspian shelf fields are developed, the throughput capacity will probably be brought up to 100-140m tonnes. Today, the export oil pipelines of Kazakhstan can carry about 310m barrels a year (42.5m tonnes); the figure for the export gas pipelines being 5 billion c m; for the transit gas pipelines, 110 billion c m.

The republic's big oil is found in the Eurasian heartland, far from the main transportation lines; its export to the world markets requires assistance of the interested states. Pipelines are the main transportation means, the capacity of which is highly strained by the country's current policies of multi-variant directions of hydrocarbon exports. The country has reached a crossroads: we do hope that our oil riches will be used for further economic development. Transportation routes are determined by the geostrategic balance of forces in the region. This explains why Kazakhstan being sucked in the vortex of geopolitical interests of the world's largest countries has practically no say about transportation routes of its own hydrocarbons in conformity with its own strategic and economic interests. Economic expediency cannot be discussed outside political collisions (both domestic and foreign). The country's strategic plans of developing its oil and gas reserves are part of the general situation.

We all know that oil supplies to the Chinese and the AP markets are highly promising, the Chinese market being the first step leading the Kazakh and transit Russian oil to the markets of East and Southeast Asia. This situation makes a Kazakhstan-China oil pipeline highly possible. It will be used to bring Kazakh and Russian oil to the AP markets across the Chinese territory or by replacing this oil with Chinese oil moved to APR from China's eastern ports. In any case the Chinese market is highly promising; the West-Center pipeline and large oil refineries are being built in the XUAR to receive and refine large amounts of Kazakh oil.

China will be able to import every year up to 50m tonnes of oil from Kazakhstan; according to the latest information, it will be no problem to load the Atasu-Druzhba-Alashankou-Dushanzi pipeline with the initial amount of 20m tonnes. At the first stage the pipeline will receive Kumkol oil; oil from Aktiubinsk brought by railway to Atasu, as well as Siberian oil exported by the Russian companies along the Omsk-Pavlodar-Atasu pipeline, including oil delivered under the replacement agreement with CNPC.

By 2007 oil production in the Aktiubinsk Region may reach 10m tonnes; in view of geographic distribution of hydrocarbons in Kazakhstan and the related political context China prefers to develop the resources of Western Kazakhstan. Since 2002 CNPC has been involved in oil prospecting in the eastern block of the Caspian region (in the south of the Atyrau Region); it has increased its share in the JV CNPC-Aktobemunaygaz to 80 percent in order to own all oil produced. (The company, however, failed to join the North Caspian Kashagan project.)

Back in June 2001 first premier of Kazakhstan D. Akhmetov speaking at the parliament of the Republic of Kazakhstan said: "The Kazakhstan-China oil pipeline may become a reality in 2006-2010. The main condition of its completion by that time is an increase in oil production by the China National Petroleum Corporation up to 20m tonnes a year. We shall work toward giving this company several small licenses so as it could increase production."

The hydrocarbons of Kazakhstan's southern regions are geographically very close to China: I refer to the oil fields of the Iuzhno-Turgay depression (Kumkol). The companies working there (PetroKazakhstan, formerly HurricaneKumkolMunay of Canada, TurgayPetroleum of Russia and Canada; Kazgermunay of Germany and Kazakhstan; Kuatamlonmunay of the U.K. and Kazakhstan, and the Oil Company KOR) find it too expensive to carry their oil by railway to Atyrau in order to transport it by the CPC pipeline. They sell oil to China, Iran and Central Asian oil refineries. According to KazMunayGaz experts, enough oil is produced in Kumkol to add annually some 4 to 5m tonnes to the Chinese pipeline.

Potentially, until 2010 Russian oil (5 to 10m tonnes every year) will be needed to load the Chinese pipeline to capacity; together with 7-10m tonnes of Aktiubinsk oil and 4-5m tonnes of Kumkol oil the pipeline will be commercially efficient at the first stage.

## China Enters the Caspian Region

I have already written that it is the deficit of energy fuels that pushes Chinese companies to Caspian shores; there they are mostly interested in the projects with proven reserves. (Earlier, it was the American and Russian oil-related interests that dominated in the Caspian region. Today, China joined them with its own interests.)

It was in 1997-2002 that Chinese money came to the region, mainly to Kazakhstan and Azerbaijan. The daily output of these oil fields is about 120,000 barrels (about 6m tonnes a year); there are hopes of even larger output. The Chinese companies working in the Caspian region normally want to minimize prospecting risks: they buy more expensive shares in the already developed extraction projects with drilling-proven reserves.

Kazakhstan was the first Caspian country where Chinese oil firms appeared: in 1997 CNPC acquired 60.3 percent of shares for \$324m of Aktobemunaygaz, its present name being CNPC-Aktobemunaygaz, and pledged itself to invest \$4 billion (\$585m of which before 2002). Its main privatization commitment is building an oil pipeline from Kazakhstan to China before 2005. The feasibility study had been ready by 1999, yet actual work did not start until 2003 because, according to the Chinese side, there was not enough oil to load the pipeline. It has become clear that it was YUKOS and its interests in the Angarsk-Daqing pipeline that were behind all this.

## Chinese Enclave in Aktobe

The Chinese have been actively developing their own self-contained full-cycle enclave (extraction, production, and infrastructure) at the Aktiubinsk oil fields to meet the needs of China. In 2000, they installed in the Zhanazhol and Kenkiyak fields drilling equipment, circulation systems, pumps and other equipment made in the PRC. In 2003, they set up repair shops and production of oil producing equipment on the basis of the Munaymashremont plant. They preferred to call the new structure a JV even though 49 percent of it belongs to the CNPC-Aktobemunaygaz Company, which is practically a Chinese business; 51 percent belongs to the China Petroleum & Technology Development Corporation.

By 2002 CNPC had completed its five-year investment program by investing \$585m; in 2003 it invested \$300m more and completed reconstruction of the Zhanazhol gas processing plant (GPP) and built another GPP (that cost \$170m) ahead of schedule. There are plans to build one more GPP in 2004 to start fine gas cleaning in conformity with the international standards for main gas pipelines. The three GPPs will cope with utilizing the ever-increasing amounts of petroleum gas from the Aktiubinsk oil fields. In 2004, CNPC-Aktobemunaygaz intends to complete construction of a gas pipeline 160 km long that will connect the Zhanazhol GPP and the KS-13 gas compressor station at the main international gas pipeline Bukhara-Urals; earlier, in 1998 it laid the Zhanazhol-Aktobe gas pipeline; in March 2004 it started building a railway between Zhanazhol and Zhem, 72 km long to be used to bring workers, equipment and materials to the fields and to deliver low-density oil, liquefied gas and granulated sulphur to international markets. Before the end of 2004 the company plans to commission more wells at Zhanazhol and Kenkiyak fields. To achieve this the company will drill sideholes (for the first time in Kazakhstan) and use state-of-the-art oil producing technologies (gas lift and hydrofrac). In the near future the CNPC plans to build two plants in Aktobe to produce high-grade oils and bitumen to completely meet Kazakhstan's needs for these products.

From time to time the Kazakh authorities make attempts to "contain" the too active Chinese by clashing their interests with those of Americans by promising, in particular, to entrust management of the part (25 percent) of the state stocks of the Aktobemunaygaz Company to Access Industries, etc. As a result, however, on 29 May, 2003 Kazakhstan had to sell the state stocks of Aktobemunaygaz (20.12 percent of the authorized capital) for \$150m. It had been bought by an anonymous buyer whose name remained secret. (The Kazakhstan government planned to sell the stocks for \$320m.) Sure enough, it turned out that the shares were bought by CNPC: today, with 80.5 percent of shares, it is practically the only owner of CNPC-Aktobemunaygaz and is even more actively realizing its strategy in Kazakhstan. Its plans are very impressive: since 2001 the company has been steadily increasing production by over 1m tonnes annually. In 2004, it will produce more than 5.5m tonnes of oil; in 2005, 7m tonnes, the plan for 2006 is 10m tonnes of oil and 1.2-1.4 billion c m of gas. So far, the produced oil is delivered to China by railways (every month more than 100,000 tonnes are transported, the maximum loading capacity being about 500,000 tonnes a month).

In April 2003, President of Kazakhstan Nursultan Nazarbaev received CNPC first vice president, chairman of the board of directors of the CNPC-Aktobemunaygaz Company Wu Yaowen and expressed his satisfaction with the level of cooperation between the company and the government of Kazakhstan.

## China: Change of Tactics

In 2003, the Chinese oil and gas companies that had already betrayed their interest in the Caspian region stepped up their activities. In Kazakhstan alone they made several attempts, mostly successful ones,

to extend their business. Early in 2003 CNPC and Sinopec tried to join the international PSA in Kashagan by buying the BG Group Plc share of 16.7 percent in the North Caspian project for \$1.23 billion. This deal might have accelerated construction of a pipeline to China. The project partners, however, used their first right of refusal to buy out the BG's share. This started a conflict between China and Shell, a British-Dutch company. The Chinese government threatened to block the company's involvement in any projects on the Chinese territory.

In May 2003 CNPC bought the stocks of 20 percent of shares of Aktobemunaygaz Company and commissioned the first line of the Kenkiyak-Atyrau oil pipeline 448 km long with an annual capacity of 6m tonnes, built on the CNPC's money. The pipeline that connected the fields of the Aktiubinsk Region and the CPC (Atyrau) began a new pipeline that would be built between Kazakhstan and China. Some months later, in August, CNPC bought the shares of ChevronTexaco (65 percent) and Nimir Petroleum Ltd of Saudi Arabia (35 percent). In this way it concentrated in its hands the entire stocks of the North Buzachi field in Mangistau with the recoverable resources of 500m barrels of oil: every day the field yields about 8,400 of barrels. At the end of 2003 the company, seemingly unexpectedly, transferred half of its shares to the Canadian Nelson Resources Ltd, behind which there were two financial-industrial groups of Kazakhstan (CAIN and ELL): the deal was accomplished in two tranches. The ChevronTexaco that had been working on the project since 1998 suddenly discovered that it became much harder to deal with the governmental structures of Kazakhstan, which refused to permit it to start large-scale development of the oil field.

Canadian and American companies are developing several other oil fields in the Caspian Lowland; the Chinese have been negotiating their purchase, or at least, the stocks, since 2003. In early 2004 it became known that Sinopec bought the leading American company of the FIOC (First International Oil Corporation) group; its daughter firms are prospecting for hydrocarbons and developing several Caspian oil fields: the Adaysky, Caspian, Sagizsky and Fedorovsky blocks and the oil fields of Chinarevskoe and Sazankurak.

In August 2003, CNPC paid \$25m for a retail network dealing in oil products in Almaty: gasoline stations, reservoirs, etc. This is strengthening the PRC's positions in its expansion in the Caspian.

## The Situation Around the Pipeline

### Political Platform

In September 1997 the government of Kazakhstan and the People's Republic of China signed an Agreement on Cooperation in the Oil and Gas Sphere. It was at that time that the Ministry of Energy and Natural Resources of Kazakhstan and CNPC signed a general agreement on developing oil fields in the Republic of Kazakhstan and on building a pipeline to China.

During the official visit to Kazakhstan on 27 July, 2000 of Deputy Chairman of the PRC Hu Jintao President of Kazakhstan Nazarbaev confirmed his intention to extend political support to this route. The expert community immediately called this oil route not only the most expensive but also the most promising for Kazakhstan. A workgroup was set up on the instructions of the premier of Kazakhstan to prepare technical documentation; there were plans to launch construction of the pipeline with an annual throughput capacity of 20m tonnes of oil in 2001.

In November China declared that it was prepared to build the pipeline; it explained its readiness by the war in Afghanistan. Earlier, despite all interstate decisions, China had been in no hurry to start building the pipeline to Xinjiang under the pretext that there was not enough oil in Kazakhstan to fill the project.

In April 2002 the heads of the CNPC-Aktobemunaygaz Company reported that it had completed the project's feasibility study and that China was resolved to continue it since it received confirmation of

the Caspian oil reserves. A month later during the visit of Kazakhstani Foreign Minister K. Tokaev to China Kazakhstan confirmed its interest in delivering its oil to the PRC; the minister discussed the pipeline's prospects.

On 4, June 2003 when President Nazarbaev and Chinese leader Hu Jintao completed their negotiations the two countries signed several important documents, an agreement on cooperation in the energy sphere among them, of strategic importance for the sides: on the oil pipeline project; on developing oil fields; on the possibility of a gas pipeline from Kazakhstan to China. Astana supported Beijing in its desire to work on the Kazakhstani Caspian shelf. The Protocol on Joint Studies and Stage-by-Stage Construction of a Pipeline from Kazakhstan to the PRC and an Agreement on Further Larger Investments in the Oil and Gas Sphere of Kazakhstan were signed by corresponding departments of the two countries. Several days later the KazMunayGaz Company and CNPC signed an agreement on joint substantiation of investments needed for the stage-by-stage construction of the Atasu-Alashankou oil pipeline, including corrected feasibility studies of the Western Kazakhstan-China oil pipeline project. In August in order to confirm the agreements the sides signed a memorandum on speeding up construction and the possibility of building a gas pipeline to China.

On 11 September, 2003 at his meeting with Premier of Kazakhstan D. Akhmetov Wu Yaowen, CNPC Vice President and Chairman of the CNPC-Aktobemunaygaz Board of Directors, reported that the Chinese firm was prepared to complete the design stage of the joint projects, including the oil pipeline to China, which could be completed late in 2005.

At a press conference in Astana in February 2004 President of KazMunayGaz U. Karabalin pointed out that if the government of Kazakhstan approved the project construction of the oil pipeline Atasu-Alashankou-Dushanzi (1,300 km long) would start in July-August 2004 to be completed two years later. Each of the countries would pay its half; the money would be loaned under oil deliveries. The project's cost was estimated at \$700-800m, the initial annual throughput capacity being about 10m tonnes of oil. It would be increased later.

On 1 April, 2004, President Nazarbaev received CNPC Vice President Wu Yaowen who informed him that the stage of preparing the feasibility study and prospecting the Atasu-Alashankou stretch of the Western Kazakhstan-China oil pipeline with an annual throughput capacity of up to 50m tonnes had been completed. On 13 April, 2004, at the talks in Beijing Vladimir Shkolnik, Minister of Energy and Mineral Resources of Kazakhstan, informed Ma Kai, Minister of the State Development and Reform Commission, that the design for the linear pipeline portion would be completed by 15 May, 2004. This was needed because President Nazarbaev's state visit to China had been scheduled to mid-May 2004, during which all corresponding documents were expected to be signed. Under this schedule the project should be started in 2004 to be completed by the end of 2005.

### ***Problems of Project Realization***

We should say here that at first a pipeline stretching from Western Kazakhstan to the sea ports in Eastern China was described as a Chinese pipeline. Its length of over 4,000 km (over half of it, 2,400 km in Kazakhstan); its cost of about \$4 billion; its annual throughput capacity of 20-25m tonnes (according to the 1999 feasibility study); and its scheduled commissioning in 2005 made it the most ambitious project among the functioning pipelines. Its realization, however, was postponed indefinitely because of its cost and because Kazakhstan had not enough oil (even if the Kumkol oil was to be sent there) to fill the line. The project triggered intrigues; since 2000 it was strongly affected by the progress YUKOS achieved in promoting its Angarsk-Daqing project.

It was decided to limit the efforts to the stretch inside Kazakhstan. Early in 2000 the feasibility study for the Atyrau-Kenkiyak-Kumkol-Atasu-Druzhba stretch was completed: the project would cost nearly \$2.7 billion; its length would be about 2,800 km; the pipeline would be economically efficient

if not less than 20m tonnes of oil were moved along it every year; the project was expected to be completed in 2-2.5 years. The KazTransOil immediately started engineering prospecting along the route, and while identifying the sources of its loading, on 24 July it opened a new oil service rack at the Atasu railway station to load 3m tonnes a year to transport the Kumkol oil to external markets, China in the first place.

In April 2001, however, President of the CNPC International Ltd Zhou Jiping announced that construction of the pipeline would not be started in the near future since Kazakhstan had not enough oil to load the line. In his turn, on 24 May in Astana Vice President of KazTransOil K. Kabyldin pointed out at a press conference that Kazakhstan was studying various export routes, while the pipeline to China was commercially justified and technically possible.

Under these conditions the Kazakh side revived designing the Western Kazakhstan-China project with the aim of completing engineering prospecting along the entire stretch by the end of 2003 and finishing construction by 2007. In this connection KazTransOil announced that it was prepared to invest \$70m in the first stage (Kenkiyak-Atyrau), 450 km long, and to open a tender for contractors in the fall of 2001. This readiness speeded up events: by December a JV Northwestern Pipeline Company MunayTas was set up to build this stretch of the line. The Kazakh side owned 51 percent and the Chinese side, 49 percent of shares. When specified, the project's cost turned out to be \$150m; the Chinese side, however, described this event as "historically and strategically important." Stroytransgaz, the Russian contractor, was ready with the first phase of the Kenkiyak-Atyrau pipeline by May 2003; it was 448 km long, with the annual throughput capacity of 6m tonnes of oil (to be increased if needed). The second phase is expected to be completed in 2004; it will bring the line's annual throughput capacity to 10m tonnes; the third phase scheduled for commissioning in 2006 will increase the loading capacity to 14m tonnes. CNPC pays for the entire project.

The Kenkiyak-Atyrau pipeline is currently used for oil exports to the West. It connects the oil fields in the Aktiubinsk and Atyrau regions with the export pipeline systems Atyrau-Samara and the CPC. The line can be reversed, therefore starting in 2005 it may become, according to the plans, the initial part of the transcontinental export pipeline Western Kazakhstan-Western China and be extended to China's sea ports.

Until 2003, it was KazMunayGaz that was working on several possible variants of feasibility study for the oil pipelines inside Kazakhstan, while China repeatedly stated that its companies would be ready to start construction as soon as Kazakhstan increased oil production to make the line economically justified (which means an annual loading of not less than 20m tonnes). This could have been reached in several ways: 10m tonnes of oil could be produced in the Aktiubinsk Region; 7m, in Kumkol; and up to 10m, in Kashagan and the Caspian shelf. These Caspian plans of the PRC at first alarmed the partners of the North Caspian Consortium Agip KCO unwilling to take into account the far reaching plans of another active player, China, which was building up its strength, besides the U.S. and European countries.

I have already written that in 2003 Beijing revised its mode of action: in the Memorandum signed by the KazMunayGaz and CNPC in August the Chinese side clearly stated its intention to actively build an oil pipeline from Western Kazakhstan to the Chinese border (the project's total cost being approximately \$2.5 billion). China suggested that the project would be realized gradually, stage-by-stage and that several options should be envisaged. For example, under the 1999 feasibility study the project (the line from Atyrau to the Chinese border, about 3,000 km long) would have repaid itself if carrying 20m tonnes of oil every year; the latest Chinese calculations, however, showed that 10m tonnes moved every year along the first phase of the line, between Atasu and Alashankou (1,100 km, its cost being \$730-907m), would have made this stretch economically efficient. The Chinese side planned to start construction in mid-2004 so as to complete the project by late 2005. (The experience of the Suez Canal says that the Chinese can work very fast.)

There were at least three reasons behind this sudden interest. First, the C.C. Communist Party of China decided to revive the project to ensure the country's energy safety; in addition, the project was



economically reasonable. I have already written that the Chinese side went as far as funding the first line itself. Second, the Russian-Chinese project of the Angarsk-Daqing main seemed to be suspended. Third, in 2005 the term of the CNPC obligations to build a pipeline to China was to expire—meanwhile, unfulfilled obligations were fraught with serious consequences for the investors. The results of oil prospecting in the Kazakhstani part of the Caspian shelf were also important. It seems, however, that the project was spurred on mainly by the American war on Iraq with obvious oil-related aims. This let China squeeze in the Caspian region.

Starting in 2003 the PRC stepped up its involvement in the pipeline project that envisaged its stage-by-stage loading, starting with 10 and 20m tonnes to finally reach 50m tonnes of oil a year. The oil sources had been identified: 6m tonnes a year would come from CNPC-Aktobemunaygaz that would increase its extraction to 10m tonnes by 2007; the North Buzachi field promised 2m tonnes a year; about 7m tonnes would come from Kumkol; part of the volume would come from Russia by the Omsk-Pavlodar-Atasu pipeline. The second phase that will bring the Atasu-Dushanzi stretch's annual throughput capacity to 20m tonnes will require Caspian oil as well. This was what Premier of Kazakhstan D. Akhmetov said on 2 March, 2004 at a meeting that discussed the construction plans.

The Atyrau-Kenkiyak and Kumkol-Atasu stretches are functioning. The Kenkiyak-Aralsk-Kumkol part with an annual throughput capacity of 10m tonnes of oil and a possibility of reversing is still being designed; the feasibility study for the entire pipeline, a long and technologically complicated project, has been taken into account.

Until recently, Kazakhstan was actively supporting China willing to complete the projects as promptly as possible. On 2 March, 2004 Premier D. Akhmetov invited the sides to speed up the procedures so as to start construction of the Atasu-Alashankou-Dushanzi stretch in 2004. It will be 1,320 km long, its preliminary cost is \$850m, it is expected to be commissioned by 2006. One month later, however, official statements grew vague.

## Special Position on Kumkol

Today, all Kumkol oil fields can yield up to 10m tonnes of low-density high quality oil; this is very important for loading the Kazakhstan-China pipeline. The interests of Kazakhstan, the U.S., Russia, and some European countries have become intertwined there. The fields attract CNPC as well: it plans to buy the PetroKazakhstan firm estimated at \$1.5 billion. It seems that other players have similar intentions.

From the very beginning the Canadian Hurricane Hydrocarbons Ltd (the PetroKazakhstan Kumkol Resources since 2003) occupied a special position on the oil routes from Kumkol and across it. This company came to the Kazakhstani market in 1996. At all times it was working on the routes independently and always wanted to be free to export oil and oil products to all countries, China included. This contradicted Kazakhstan's interests that obviously needed oil and oil products inside the country. The company ruled itself by the laws of the market and was convinced that Kazakhstan should act accordingly when it comes to domestic demands. The state structures thought differently.

The Canadians have always regarded China as the main market for the Kumkol oil; since 2000 they have been exporting it through the oil terminal Druzhba at the Chinese border; in 2003 they started using the oil terminal at the Atasu railway station and increased their exports to China.

In 2002, KazMunayGaz signed an agreement with Hurricane Hydrocarbons Ltd on cooperation in the pipeline sphere. Under it the Canadians pledged themselves to help and support the partner's plans connected with the Kumkol-Aralsk-Kenkiyak oil pipeline, 700 km long. Both companies committed themselves to work on feasibility studies. To speed up the project Hurricane Hydrocarbons promised to deliver export oil within the "deliver or pay" scheme. At the same time, the Canadians intended to be responsi-

ble for the project's smaller part if the funding was adjusted to this scheme. The design, funding and construction were expected to take 2 to 3 years. There were plans to build the line stage by stage; the first one being the Kumkol-Aralsk stretch. The main was planned to be a reversible one so as to move oil from Western Kazakhstan to the southern and eastern markets—a very important strategic decision.

Meanwhile Hurricane Hydrocarbons started laying "its own" oil pipelines. One of them connected the Aryskum pumping station (the Kyzylkia, Aryskum, and Maybulak fields in the Kumkol area) and the Zhusaly railway station at Kzyl-Orda. It is 104 km long with a daily loading capacity of 100,000 barrels (5m tonnes a year). The line completed in 2003 allowed Hurricane Hydrocarbons to decrease its transportation costs to \$2.5 per barrel. There is another line that connects its Kumkol fields and the Aryskum pump station (70 km long).

It was Hurricane's "independent ventures" that urged the State National Company KazTransOil to lobby amendments to the laws that banned any construction activities in the fuel transportation sphere without its participation. As soon as the amendments had been approved, the KazMunayGaz and Hurricane agreed to stop using the Aryskum-Zhusaly pipeline and reverse the Kumkol-Aryskum one to serve their main oil pipeline to China. Under the same agreement all oil extractors of the Turgay basin could continue using these oil pipelines and terminals of KazMunayGaz to deliver their oil to the Shymkent oil refinery or to export it.

Even though under the 2002 agreement between KazMunayGaz and Hurricane Hydrocarbons Ltd the latter's daughters were expected to fund construction of the Kumkol-Aralsk-Kenkiyak pipeline the Canadians obviously wanted to slow down the process until the prospects of the Chinese pipeline as a whole became obvious. The heads of the Canadian company offered no comment on the Chinese project.

At the same time, in 2003 PetroKazakhstan developed two new export routes. In October the TurgayPetroleum JV (in which Canadian PetroKazakhstan and Russian LUKoil had 50 percent of shares each) started using the CPC to export its oil through Novorossiisk (about 100,000 tonnes every month). In December PetroKazakhstan sent its first 26,800 barrels of oil by railway to the Tehran Oil Refinery; there were plans (using SWAP deals) to send there up to 1m tonnes of oil in 2004 in order to receive Iranian oil in the Gulf ports.

Early in 2004 it became known that the Canadian company had invited former Prime Minister of Canada Jean Chrétien as a foreign relations advisor and had incorporated Jan Bonde-Nielsen (Chairman and a shareholder of Greenoak Holdings) and Jean-Paul Bisnaire (one of the leading Canadian lawyers in the field of securities, mergers and acquisitions, and corporate funding) into its board of directors. There is an expert opinion that the company is readying for sale, or for a new issue of shares to raise its image.

It is interesting to note that the PetroKazakhstan and TurgayPetroleum companies were not included in the list of the raw material enterprises that pay to the National Fund (the list is part of the Kazakhstan's 2004 budget) because "the lower world oil prices have deprived them of superprofits in 2004" from which the companies are expected to pay to the fund. This argument looks as a warning to the Kazakhstan "purchasers" that no superprofits should be expected.

It seems that in 2004 we shall be able to watch how the Canadians are squeezed out of the oil and gas market of Kazakhstan.

## Problems of 2004

The fact that Astana insistently supported Beijing in its desire to realize the project leading from Western Kazakhstan to China means that by 2007 the republic will produce as much oil as it needed to load to capacity the third export oil pipeline (two such lines: Atyrau-Samara and CPC are functioning). There is no doubt that the Kazakhstan-China pipeline is cost efficient, which means that every year it will receive the needed 20m tonnes. When realized, the project will join together the oil pipeline systems of Kazakhstan, China and Russia to become a firm foundation of their mutually

advantageous partnership. It can strengthen their positions in Eurasia within the Shanghai Cooperation Organization.

There is another political aspect behind the oil pipeline to China: Astana's attitude to the Baku-Ceyhan project. The efforts to speed up construction of the Chinese pipeline probably mean that Kazakhstan has opted for the Eastern route as opposed to the Aktau-Baku line that was supposed to cross the Caspian. To put it mildly Russia is not enthusiastic about the Baku-Ceyhan line. On 9 January, 2004, however, speaking at the official ceremony that opened the Year of Russia in Kazakhstan, President Nazarbaev said that his country planned to move about 10m tonnes of oil a year by tankers across the sea to help load the Baku-Ceyhan line.

In addition to the factors described above the Chinese route will help develop the promising direction of Kazakhstan's oil export, will help realize the state strategy of uniting the domestic oil pipelines into a single multi-vector system equally accessible to all potential users. This fully conforms to the republic's strategic interests: energy security achieved by connecting the west and the east of Kazakhstan where two underloaded oil refineries are found. On the whole, this option will allow Kazakhstan to diversify hydrocarbon deliveries to the domestic and foreign markets.

At the same time, there are always certain forces behind the oil-and-gas scenes that run the show. Indeed, how will Kazakhstan's oil-and-gas "partners" respond to the rapid developments around the Chinese route? In February 2004 the newly elected president of Azerbaijan Ilkham Aliev during his official visit to Kazakhstan did his best to draw attention to the problem of loading the Baku-Ceyhan pipeline. The leaders of Kazakhstan limited themselves to common diplomatic comments at the prime minister level and sightseeing of Astana.

It is interesting to note that recently the top officials changed the tone of their comments. On 3 April, 2004 at the meeting between Premier D. Akhmetov and CNPC heads different dates for completion of the Kazakhstan-China project were mentioned: the first phase (Atasu-Alashankou) was postponed till 2006-2010; the second phase (Kenkiyak-Kumkol-Atasu) till 2011-2035. The prime minister pointed out that cooperation in the oil and gas sphere "should be mutually advantageous and stable." Astana was prepared to actively fund part of this important project and guarantee it. (It should be said that this means 51 percent; this is a lot: the project's total cost was estimated at no less than \$2 billion.) The new dates by which preliminary work should be completed contradict the dates mentioned earlier in the premier's instructions (first half of 2004).

At the talks with Ma Kai, Minister of the State Development and Reform Commission, that took place on 13 April, 2004 in Beijing Vladimir Shkolnik, Minister of Energy and Mineral Resources of Kazakhstan, concentrated on the fast rates of economic development of his country that have become obvious in the past five years. He also informed the Chinese side that Kazakhstan had in principle diversified the oil delivery channels to the world markets: it was decided to bring up the annual throughput capacity of the Atyrau-Novorossiisk pipeline to 67m tonnes of oil; an agreement with Russia on long-term oil transit across its territory was signed; the possibility of increasing the throughput capacity of the Atyrau-Samara oil pipeline is being discussed. This was how the government of Kazakhstan helped CNPC "transport the oil it produces on the Kazakhstani territory to the European market and get access to the CPC." With this aim in view the Kenkiyak-Atyrau pipeline was completed within the shortest time possible. The minister pointed out that by 2010-2011 the country will need another oil transportation route, its choice depending on its cost. Today, Kazakhstan is choosing between the Iranian variant and Baku-Tbilisi-Ceyhan so as to reach the Mediterranean. A new oil terminal on the Caspian with the handling capacity of 20m tonnes a year is being designed. During the meeting nothing was said about the details: about the fact that the terminal will appear in the port of Kuryk, 76 km to southeast of Aktau. It is expected to be completed in 2007-2008 in order to receive the first Kashagan oil. At the first stage, the Kuryk terminal will handle 7.5m tonnes of oil a year.

The Minister of the State Development and Reform Commission in turn expressed the desire of his government to start realizing the oil pipeline project from Kazakhstan to China late in the third-early fourth quarter of 2004 in order to complete the pipeline late in 2005 after all necessary documents had been signed (they were signed during President Nazarbaev's official visit to China in mid-May 2004).

On 20 April, 2004, it was pointed out at a cabinet meeting chaired by D. Akhmetov that the problem of funding of the Atasu-Alashankou stretch (988 km) had not been resolved; the government was instructed “to prepare all documents within the next 10 days and carry out all procedures in order to launch the project in 2005.”

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In this way the political fluctuations and altered dates of the Kazakhstan-China oil pipeline, which became obvious from what Kazakhstan’s officials have been saying recently, were probably caused by certain third forces that have managed to spoil the game of the project’s partners.