

Energy focus shifts Eastward

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Straddling one of the ancient silk roads stretching from China to Constantinople, Kazakhstan could be said to hold all the aces, but dealt from a deck it knows may be marked. It has a land mass the size of Western Europe, and holds large reserves of oil and gas, deposits of bauxite, chromite, copper, iron, lead, manganese, and zinc ores, and its metallurgical sector produces metals such as beryllium, bismuth, cadmium, copper, ferroalloys, lead, magnesium, uranium and zinc.

With immediate neighbours including China and Russia, and with the Western world keen to develop access to new sources of energy and raw materials, some may feel slightly envious of a country with so many trading options. But others may argue that having two global giants feeling their own envy over such a glut of natural wealth brings its own issues. Whatever, Kazakhstan has successfully pulled off a delicate balancing act since achieving independence following the collapse of the former Soviet Union.

Development of petroleum, natural gas, and mineral extraction has attracted most of the over US\$40 billion in foreign investment in Kazakhstan since 1993 and accounts for some 57 per cent of the nation's industrial output (or approximately 13 per cent of GDP). According to some estimates, Kazakhstan has the second largest uranium, chromium, lead, and zinc reserves, the third largest manganese reserves, the fifth largest copper reserves, and ranks in the top ten for coal, iron, and gold. It is also an exporter of diamonds. Perhaps most significant for economic development, Kazakhstan also currently has the world's 11th largest proven reserves of both oil and natural gas.

In total, there are 160 deposits with over 2.7 billion tonnes of petroleum. Oil explorations have shown that the deposits on the Caspian shore are only a small part of a much larger deposit. It is said that 3.5 billion tonnes of oil and 2.5 trillion cubic metres of gas could be found in that area. Overall the estimate of Kazakhstan's oil deposits is 6.1 billion tonnes. However, there are currently only three refineries within the country, situated in Atyrau, Pavlodar, and Shymkent. These are not capable of processing the total crude output so much of it is exported to Russia. According to the US Energy Information Administration, Kazakhstan was producing approximately 1.54 million barrels (245,000 m³) of oil per day in 2009.

In a reorganisation announced in March 2010, Kazakhstan's president, Nursultan Nazarbayev, created a new oil and gas ministry and reshuffled the cabinet. Sauat Mynbayev, the former Minister of Energy and Mineral Resources, was appointed to head the new Ministry of Oil and Gas. The new ministry will take over a regulatory role of the oil and gas sector; a role which had previously been largely exercised by the national oil company KazMunaiGas.

"The ministry will relieve KazMunaiGas of inappropriate functions that create a conflict of commercial and state interests. The activities of KazMunaiGas should be purely commercial," Nazarbayev said when announcing the move. Mynbayev was instrumental in renegotiating the agreement on the development of the giant Kashagan field with a consortium of international oil companies in 2008. He is spearheading Kazakhstan's efforts to win more advantageous terms in foreign-led oil and gas projects, including the Karachaganak gas condensate field. In what could be seen as sabre-rattling, Kazakhstan accused Eni, the Italian energy group, of a US\$110 million fraud in November 2010, adding to pressure on international oil companies developing the country's vast oil resources.

Adil Abylkasymov, the head of information at Kazakhstan's financial police, said Eni was under investigation for over-representing the construction cost of an oil installation while operator of a foreign group developing the giant Kashagan field in the Caspian Sea. It remains to be seen how this situation will evolve, but many experts within the country are known to feel that Western energy companies gained access to Kazakhstan's natural resources after the fall of the Soviet Union at unfairly preferential rates, and are keen to see a realignment of contracts. It is a situation that will be monitored with interest and a degree of concern by those Western firms active in the country.

The country's economy is heavily dependent on the production of minerals. Output from Kazakhstan's mineral and natural resources sector by mid-decade (2005) accounted for 74.1 per cent of the value of industrial production, of which 43.1 per cent came from oil and gas condensate extraction. In that year, the mineral extraction sector accounted for 32 per cent of the GDP, employed 191,000 employees, and accounted for 33.1 per cent of capital investment and

64.5 per cent of direct foreign investment, of which 63.5 per cent was in the oil sector.

The economy of Kazakhstan has been growing owing to the state policy of attracting foreign investment into its extraction industries. Kazakhstan was the first CIS country assigned with investment sovereign rating, and the World Bank has listed Kazakhstan among the 20 most attractive countries for investment. As a small economy with large fuel and mineral resources, however, Kazakhstan has not been particularly attractive for investment in the manufacturing sector, which makes the country highly vulnerable to fluctuations in commodity prices.

In view of the danger of the economy not using effectively the excess profits from the extracting sectors and foreseeing a possible negative effect from a sharp downturn in oil prices, the government established the National Fund to accumulate surplus oil revenues. The revenues in the Fund are to be used for the overall development of the national economy.

Chinese investors also have a growing and significant presence in Kazakhstan's lucrative energy market – and that has aroused public concern. Late in 2010 a group of Kazakh parliamentary deputies appealed to energy minister Sauat Mynbayev, asking him to “dispel the cloud” of concern regarding China's stake in the former Soviet republic's oil sector. In a written answer, Mr Mynbayev said China held a 50-100 per cent stake in 15 companies working in Kazakhstan's energy sector. According to the Kazakh energy ministry, out of the 80 million tonnes of crude oil which Kazakhstan is expected to produce in 2010,

25.7 million will go to China.

China significantly increased its interests in energy-rich Kazakhstan in 2009, in return for providing nearly US\$13 billion in credits and loans. It was timely help for a country hit by the global financial crisis. Kazakhstan had over-borrowed and had suffered from falling oil prices. “Once energy prices fell, Kazakhstan had to find ways to borrow money and along comes China, offering favourable conditions – lending huge sums at low rates of interest,” says Sergei Smirnov, a business journalist with Kazakhstan's *Expert* magazine.

China's state energy company, China National Petroleum Corporation (CNPC), bought the Kazakh oil producer MangistauMunaiGaz for US\$2.6 billion in a joint deal with the Kazakh state energy company KazMunaiGaz. China Investment Corp (CIC) purchased 11 per cent of the KazMunaiGaz Exploration and Production company for US\$939 million. Agreements have also been reached on joint uranium production.

Separately Kazakhstan's biggest copper mining company, Kazakhmys, has agreed with China's Jinchuan Group to create a joint venture to develop Kazakhmys' major copper growth project at Aktogay. The Chinese and Kazakh Presidents opened a key gas pipeline in 2008. “What we see here in Central Asia is part of China's general strategy. Since the global financial crisis China, which is the only country with excess cash, has been actively purchasing energy assets that have fallen in price,” says Kazakh political scientist Dosym Satpayev.

Last summer also saw the expansion of oil

The Kazakh-China oil pipeline can transport up to 10 million tonnes of crude per year, and there are plans to double that capacity



Photograph courtesy of Agip KCO

Kazakhstan's Kashagan oilfield is estimated to hold commercially recoverable reserves of between 9 and 11 billion barrels

KAZAKHSTAN

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infrastructure into China from Kazakhstan. The Kazakh-China oil pipeline grew an additional 762km (472 miles) from Kazakhstan's Caspian Sea oilfields, reaching China's Xinjiang province. The pipeline is partly owned by CNPC and is the first direct oil pipeline from Central Asia to China. It can transport up to 10 million tonnes of crude oil per year, and there are plans to double that capacity. Chinese support for Kazakhstan after the global financial crisis may have been appreciated by the Kazakh government, but there has been growing public unease that the country may be selling out to its eastern neighbour.

In December President Nazarbayev said China was interested in renting one million hectares of Kazakh farmland. For the country's relatively weak political opposition this was an opportunity to mobilise support. Rare public demonstrations were held against "Chinese expansionism". In January 2010, up to 1,000 people holding banners that read "Kazakh land is not for sale" urged the government to reconsider.

For such a large country, Kazakhstan has a

comparatively small population numbering just 15.6 million. Fears were voiced that the land lease would lead to Chinese farmers beginning to settle in the country.

This came on top of existing fears about the number of Chinese energy workers in the country. But the government has sought to dismiss such concerns. At a press conference in February 2010, Kairgeldi Kabyldin, the head of KazMunaiGas, said that just 2 per cent of workers in Kazakh oil companies were Chinese. "We can't say that there is an expansion of Chinese investors, we are guided first of all by economic profitability. In our view, there are substantial advantages from our partnership with China," said Kabyldin.

So, which way to look? For Western investors this is simple – everything of interest (positive or negative) lies to the east; for China, to the west, for Russia, to the south. For Kazakhstan the silk road has become the mineral highway. While the rest of the developed and developing world continues to need access to those resources, Kazakhstan looks well positioned to enjoy continued growth. **F**
