GAZPROM AS A TRANSNATIONAL CORPORATION AND CENTRAL ASIA

Part One

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Russia occupies third place in terms of world oil supplies: it accounts for approximately 10% of the world reserves, or 27% of the oil supplies outside OPEC. In terms of oil production, the Russian Federation is on a par with Saudi Arabia, the world leader, and in terms of oil export volumes, it is securely in second place. Russia is the absolute leader in the gas

sector: it accounts for approximately one third of the world's total reserves, one quarter of world production, and approximately 30% of world export, while its main gas transportation system has no analogies in terms of length and complexity.

The unprecedented trends on the oil markets are having a decisive influence on the nature and rates of Russia's economic growth: oil and gas export is responsible for more than one third of the revenue going into the state treasury. In 2004, the Russian Federation accounted for 10.97% of the entire world oil production. According to the forecasts of the country's government, the export of Russian oil will reach 253 million tons in 2006 and 260 million in 2007.

As a major fuel and electric energy exporter, on the deliveries of which the economy of several neighboring countries largely depends, Russia has a good opportunity to strengthen its own economic and political positions.

The main feature of Russia's foreign policy lies in the fact that Moscow is using the economy (to be more precise, energy cooperation) as a powerful tool to reach its foreign policy goals. This concerns both Russia's relations with the West and with Asian countries (China and Japan). But Russia's energy strategy is making itself known to an even greater extent in relations with the CIS countries. This factor—energy policy as a geopolitical tool—directly affects the national, economic, and energy interests of the Central Asian countries.

Russia's energy geostrategy is evolving in three main areas: Western Europe, Central Asia, and the Far East. The European vector is the central one, since it is ensuring the main inflow of revenues and forms the foundation of Russia's economic relations with the EU, giving Moscow geopolitical clout and international influence.

Central Asia, as a source of transit energy resources, occupied a subordinate position in the European vector of Russia's geostrategy. But in recent years, Gazprom's activity in the region and Moscow's aggressive energy cooperation strategy have begun to turn Central Asia into a special target of Russia's energy, economic, and geopolitical expansion.

The Far Eastern (Asian) vector is relatively new to Russia's geostrategy. This vector has not yet been sufficiently developed for geographic, financial and economic, technological, and political reasons. Nevertheless, in the future, it could occupy an independent and important place in Russia's energy strategy. It is already clear today that the Eastern vector will be a significant component of Russia's Central Asian strategy. What is more, Gazprom and other major Russian energy companies are becoming more active on markets new to them, particularly in the Middle East.

During implementation of Russia's strategy, large oil- and gas-producing companies controlled by or closely related to the state have been called upon to play the role of agents in carrying out the country's geopolitical plans. The events that unfolded in 2005 with respect to building the North European gas pipeline and relations with Ukraine showed that gas policy, and Gazprom in particular as its tool, has become one of the main factors in Russia's foreign policy strategy.

Since the beginning of the new millennium, the situation began to improve for the Russian Federation. The abrupt increase in world hydrocarbon prices and the first positive results of the structural reforms in the Russian economy began to yield their fruit. This made it possible not only to begin resolving domestic socioeconomic problems, but also think of Russia once more in its role as a great nation.

Along with the demand structure, the supply structure, which has become more diversified in the past decade, is also changing. In addition to the traditional centers of oil export, new ones have appeared: Russia, Central Asia, and West Africa. As an exporter only, the Russian Federation is rapidly exhausting its supplies, the exploration of which is being carried out at an extremely slow rate. The Ministry of Natural Resources has already sounded the alarm: according to its estimates, the supplies at most of the fields will run out in the next few years, and Russia could encounter a shortage of hydrocarbons.

This prompted the current Russian leadership to draw up a new energy resource strate-

gy, which has not been officially publicized, but has been functioning for several years now. Its gist lies in the fact that the Russian Federation is taking up the position of developed countries and beginning to make a name for itself on the planet's raw material markets by carrying out an economic expansion policy in less developed countries.

Gazprom's Role in Russian Strategy

As mentioned above, large oil- and gas-producing companies controlled by or closely related to the state have been called upon to play the role of agents in the country's geopolitical strategy. The events that took place in 2005 involving construction of the North European gas pipeline and relations with Ukraine showed that gas policy, and Gazprom in particular as its tool, is one of the main elements in Russia's foreign policy strategy.[1]

OAO Gazprom is the largest gas company in the world and a monopolist in the production and transportation of Russian gas. For the past few years, the Kremlin administration has been significantly increasing its control over Gazprom, permitting the gas concern, in turn, to reclaim part of the core assets and increase the financial opportunities necessary for resolving the designated strategic tasks.

Within the framework of Vladimir Putin's strategy, Gazprom has noticeably stepped up its activity on the foreign markets in recent years and has been steadily enlarging its presence geographically on the planet. The gas concern (and the Russian leadership on its behalf) has been showing a clear inclination toward a transfer from spontaneous and one-time undertakings to a targeted strategy on the foreign economic front. What is more, this strategy is distinguished by perceptible diversity of the actions undertaken depending on the specifics of the particular region. But the goal is the same—to carve out a niche for the Russian company in this region.

The new strategy also presupposes a new geographic vector in Gazprom's foreign policy. In addition to traditional cooperation with European structures, it is gaining increasing access to the markets of the Asian and African countries.

Gazprom's main achievement as of today is that it is the sole operator of all the gas flows from the Central Asian states. The economic benefits of this are obvious. The main principle Russia is upholding in its gas-export policy is that of sole exporter. By assuming full control over the transportation and export of Central Asian blue fuel, Gazprom has significantly expanded its export potential while keeping in mind the interests of its Central Asian neighbors.

A new vector in Russia's strategy is its striving to make use of Central Asia's hydropower potential. This is seen in Russia's (and its business's) active participation in joint water development projects.

Kazakhstan is still Russia's most valuable partner in its geopolitical and geostrategic priority system in the Central Asian Region. It goes without saying that the Russian Federation will continue to take an active and offensive stance with respect to Kazakhstan in the future.

At present, Moscow's policy in the Caspian is being carried out in the spirit of Vladimir Putin's strategic Caspian initiative. It is aimed at achieving several goals: military-political (ensuring Russia's military domination in the region), transportation and communication (implementing the South-

[1] See: I. Tomberg, "New Realities on the Oil Market and Russia's Energy Policy," *Central Asia and the Caucasus*, No. 4 (28), 2004, pp. 116-127.

North project involving India and Iran), and energy (retaining Russia's control over the transportation of energy resources).

As Russian strategists believe, due to the increasing dependence of the Caspian states on foreign capital, primarily American, and in light of the extremely limited financial resources, Russia needs to act simultaneously in three areas to protect its interests in the Caspian:

1) to achieve priority use of the Russian export infrastructure already in operation;

2) to promote Russian oil and gas companies in the region and encourage their maximum participation in the corresponding projects;

3) to block, wherever possible, projects that are unprofitable for Russia, taking advantage, among other things, of non-settlement of the Caspian's legal status.

According to Moscow, militarization might be delayed by the inclusion in the Convention on the Legal Status of the Caspian Sea currently being discussed by the Caspian states of the principle of the inadmissible presence of the armed forces of third countries in the region.

So while the U.S. was embroiled in its Caspian oil and Iraq affairs, and the EU in enlargement, Russia was building its Liberal Empire in a certain branch of the CIS—the gas industry. In order to fully set up this empire, Moscow needed Gazprom to carry out several intermediary tasks: acquire the Ukrainian gas transportation system on concession (for 30 years), create (under Russian conditions) a Russian-Belorussian joint venture based on the Beltransgaz Company, and sign a 25-year agreement with Kazakhstan on strategic cooperation in the gas sphere.

Russia is essentially striving to complete monopolization of the gas sectors in the Central Asian republics and then move from a "gas caliphate" to building a "gas U.S.S.R.," after fully taking over Ukraine and Belarus, a process which has already begun. Under the present conditions, these two countries can only rely on themselves, and to ensure reliable gas supplies they must maintain control over the transit of Russian blue fuel through their territory.

Gazprom's Efficiency

In June 2005, the state established its absolute power in the monopoly: its share in the capital rose to the control level. By December, a set of laws on liberalization of the company's shares was passed through the Duma in two readings. Due to these two undertakings alone, capitalization more than doubled, from 60 billion dollars to over 160 billion. At the end of September 2005, it became known that Gazprom had purchased the Sibneft oil company. Then Gazprom began implementing two extremely large investment projects—building the North European gas pipeline and preparing the Stockman field for development. Last year, Gazprom gained direct access to the Italian market and began establishing closer ties with ENI, as well as becoming involved in the Sakhalin projects.

The fact that Alexei Miller and Dmitri Medvedev are in charge of management is immensely conducive to Gazprom's successful activity. The latter factor is an embodiment of strategic support and a manifestation of the government's will in the company's policy and forms a balance between its interests and the state's interests, while also acting as Gazprom's lobbyist at the top level and its authorized presidential representative. Without this support, it would have been impossible to initiate the liberalization of the monopolist's shares or carry out absorption of Sibneft in less than a year. It stands to reason that Dmitri Medvedev's "patronage" of Gazprom is not widely promulgated, while

its importance for the company is inestimable. Gazprom's highest leadership is striving to remain aboveboard when conducting its affairs, particularly with respect to asset transactions and economically transparent non-politicized motives in forming the company's business strategy.

On the other hand, all of Gazprom's recent major achievements would have been impossible without daily efficient work: talks with bankers about credit loans for new projects, with customers about new contracts for the purchase of gas, and with new business partners on the world markets. Nor would they have been possible without ensuring negotiations on "absorption" transactions. This is Alexei Miller's sphere of responsibility as Gazprom's chairman of the board.

But Western experts warn about Gazprom's problems. For example, the concern's fancied role as Russia's "geopolitical ice-breaker" relieves it of the need to engage in profitable management and justifies its lack of transparency. According to small stockholders, billions of dollars disappear every year without a trace. The fact that this fuel giant does not subordinate itself to the laws of the market economy is also confirmed by its restrained investment policy. Old fields are being exhausted, while new ones are being developed very slowly. Since the state began supervising the concern, oil production has risen by only 2%.

Diversification of Gazprom's Interests: Liquefied Natural Gas

The fact that Russia's significance on the world liquefied natural gas (LNG) market is currently close to zero draws attention to itself: it is not producing or consuming liquefied gas in noticeable amounts, although it has an enormous resource potential. Russian companies were either not interested in this vector or it was not pertinent for them. Russia's main producer—Gazprom—placed its stakes exclusively on developing its own gas-pipeline system, the largest in the world. Small gas-producing companies were unable to implement multi-billion projects on their own, and oil producers, also leading gas producers, did not see the point in investing vast funds in marginal business. Gazprom has been exporting its gas quite successfully via pipelines, while its appearance on the LNG market would have violated one of the company's key trading principles: Gazprom's gas deliveries should not compete with each other.

In so doing, Russia has several competitive advantages, which could have long made it, if not the leading, at least a very large LNG producer. The country has access to all the key consumers: liquefied gas can be conveniently delivered from the fields in Yamal and on the shelf of the Artic seas to North Europe and the U.S., and the hydrocarbon supplies of Sakhalin and East Siberia are located close to Japan and Korea, the largest markets in the world. In Russia, the production of so-called combination gas is growing. This gas contains valuable admixtures, so is more expensive. Paradoxically, the harsh climate also provides perceptible advantages. In the winter, when demand for energy resources is at its highest, the processing of LNG at liquefying plants in northern regions can be 30% higher than at similar production units in equatorial regions.

But Gazprom has still been unable to gain independent access to the liquefied gas market. The difficulties are largely related to the lack of experience both in working on a competitive market, and in creating LNG production plants in general. Gazprom is making persistent efforts to join the consortium for implementing the Sakhalin project and has already reached agreements with the largest stockholder—the Shell Company—on exchanging part of its share in the project for its assets in other regions.

Gazprom also has its own project for building an LNG plant—the only realistic mid-term prospect for Russia is setting up an LNG production unit at the Stockman gas field (its supplies would be

sufficient to satisfy Europe's entire gas demand for seven years). Earlier, Gazprom suggested pumping the gas produced there via the North European gas pipeline, but delays in developing the field interfered with these plans. Now, with its help, the Russian company is hoping to find a niche for itself on the Atlantic LNG market. Total investments in the project should amount to around 20 billion dollars and the capacity of the liquefaction plant to 7.5 million tons a year. The first deliveries are planned to start in 2010-2012.

In mid-2005, the project began to take specific shape, and in the fall of 2005, Gazprom had already compiled a so-called short list of five potential foreign participants to join the consortium for developing the field. Two key partners are in the offing: one will fulfill the function of technology supplier (Norway's Norsk Hydro or Statoil could fill this role, since they have experience in building LNG facilities in Arctic conditions), and the other will be a U.S. company, which will ensure access to the North American market, the second closest after the European.

Gazprom will soon publicize the list of foreign companies to engage in the Stockman project with it. According to American analysts, the matter concerns the creation of a so-called "world gas OPEC"—GOPEC. So U.S. energy circles are beginning to put pressure on the White House to join this project.

Ukrainian-Russian Gas Crisis

After the disintegration of the U.S.S.R., Ukraine and Russia became country-symbionts in the gas sphere. Most of Russia's gas export to the Far Abroad was transited through Ukraine.

With the government's support, Gazprom began insisting on monetary payments and on a more than three-fold increase in the price of gas beginning in 2006, from 50 to 160 dollars. What is more, it has recently been talking about a price of 230 dollars and saying that in the future the price will fully correspond to the world level. Ukraine received another blow from its main partner, Turkmenistan (the percentage of gas from this country in Ukraine's total consumption amounts to approximately 45%), which announced that privileged conditions for Ukraine would be cancelled beginning in 2006. This meant that taking into account "European" transportation fees (Turkmen gas is transited via major Russian gas pipelines), the cost of Central Asian gas for Ukraine would increase approximately 1.5-fold.[2]

On the whole, Ukraine would have to bear the brunt of several billion dollars in additional expenses a year. The liberalization of gas relations with Ukraine promises Russia an impressive economic profit. The direct effect alone from raising gas prices, even with a significant increase in Ukrainian transportation fees, will amount to 1.3-3.2 billion dollars. At present, since gas is so cheap, the Ukrainian nitrogen fertilizer industry, which is competing directly with Russian plants, is operating at full capacity: after all, gas accounts for up to 70% of the prime cost at these plants. By using cheap Russian gas, Ukraine was able to earn money on exporting electric power to Europe and even managed to find a way to deliver excess gas there. Under the new conditions, the huge jump in price for previously cheap fuel will deprive the energy-intensive Ukrainian economy of this competitive advantage forever and free up part of the market for Russian business.

Gazprom saw creating a joint gas transportation consortium as an effective way to overcome the disagreements. This was to be a structure in which Russia, Ukraine, and possibly Germany could manage

[2] See: *Ekspert* No. 45 (491), 28 November, 2005; No. 47 (493), 12 December, 2005; No. 49 (495), 26 December, 2005.

Ukraine's gas pipelines on parity terms. A similar model operates in Gazprom's relations with Belarus. But, for political considerations, in January of this year, a compromise agreement was reached that was more advantageous for Kiev. All the same, Gazprom emerged from the Ukrainian crisis with a stronger reputation in the eyes of its European partners, which can be evaluated as a strategic achievement.

Gazprom achieved its main goals during the crisis: ensuring deliveries of gas to the West European market and control over financial flows (including by means of Turkmen gas). This was the main reason for the compromise with the Ukrainian side. As early as April 2006, similar methods were used with respect to Belarus.

Gazprom and Central Asia

Gazprom's actions (with the support of the Kremlin) looked different in Central Asia, which is a potential resource base for Moscow's energy strategy.[3]

In recent years, Russia's largest oil and gas companies have had a keen eye on Central Asia and been developing cooperation with the region's republics in different formats and with different degrees of success.

In April-May 2003, Russia signed several strategic long-term energy agreements with Turkmenistan, Uzbekistan, Kyrgyzstan, and Tajikistan. All four transactions signed were intended for 25 years and envisaged resolving a wide range of problems, in particular: gas export, joint development of oil and gas fields, laying pipelines, and modernizing outmoded equipment in the region's republics.

The top priority task in Russia's fuel and energy expansion is to create an integrated water and fuel-energy complex in Central Asia (under Russian management). One of the possible ways to carry out this task is to include Tajikistan in the water-energy consortium being created. The Rogun Hydropower Plant—the most powerful in the region—is currently being built in this country. Gazprom will participate in reconstructing and building major gas pipelines, compressor stations, and other infrastructure facilities for Kyrgyzstan's gas complex. It is very possible that Gazprom's main activity in this undertaking will be transiting gas to other countries (China).

Russia's goal is clear: it wants to strengthen its position as Turkmenistan's main partner in the energy sector and, in so doing, maintain control over the export of Turkmen gas. Ideally, Russia would like to control Turkmen gas in order to guarantee large-scale investments. Today, Turkmenistan is Russia's private ward. Russian-Turkmen relations are being built on Russia's management of Turkmen gas assets through Gazprom.

The most striking example of Russia's strategy is Gazprom's actions in the region. This company is trying to establish control over the gas flows between Uzbekistan and Kyrgyzstan, as well as between them and foreign markets. In so doing, it is more advantageous for Uzbekistan to sell gas previously intended for Kyrgyzstan to Gazprom. Even though the details of the agreement signed with Kyrgyzstan are not being revealed, it is obvious that the interests of the Russian gas giant in this republic are not related to gas production. The transit of gas through Kyrgyzstan to other countries will become an important factor, since this republic directly borders on China. It is known that Gazprom

[3] See: M. Karayianni, "Russia's Foreign Policy for Central Asia," *Central Asia and the Caucasus*, No. 4 (22), 2003, pp. 90-96.

and the PRC have been considering the possibility of delivering Russian gas to China for several years now. One of the main issues at these talks is the export route for Russian gas. One option is for it to pass through Kyrgyzstan, so it is clear why Gazprom intends to carry out major modernization of the republic's gas transportation infrastructure.

Today, the growth rates of production, which means of gas export as well, from the Central Asian countries is much higher than the rates of modernizing and developing their gas transportation systems. But the main gas artery from the region's states to Russia—the major gas Central Asia-Center pipeline—is currently operating to its limit. This relates to all three gas transportation countries: Turkmenistan, Uzbekistan, and Kazakhstan.

Kazakhstan: Rival or Partner?

Russian strategists have an ambiguous view of the expansion of energy cooperation between the Republic of Kazakhstan and China. According to Russian experts, the appearance of a new player—Kazakhstan—is introducing a certain intrigue into the situation, but they say this development of events should not be evaluated as negative.

As we know, Astana is hoping to become one of the world's largest producers of "black gold" in the next ten years. By 2010, it intends to reach a production level of 100 million tons, and by 2015 of 150 million. These ambitious plans are based on Kazakhstan's high potential in this sphere. According to Russian data, our total hydrocarbon resources are officially estimated at 25 billion tons of oil equivalent, 8 billion of which can be considered recoverable resources: confirmed oil reserves amount to 3.6 billion tons.

An increase in the throughput capacity of the Atyrau-Samara pipeline and export of oil through Russia is opening up a promising sales market for Kazakhstan, which Europe is for the country. According to experts' forecasts, by 2010, Central and Eastern Europe will import around 80 million tons of oil a year. The total length of the Caspian Pipeline Consortium (CPC) pipeline is 1,580 km and its initial throughput capacity amounts to 28 million tons a year. In so doing, a maximum throughput capacity of 67 million tons of oil a year is achieved (45 million of this amount goes to Kazakhstani oil producers).

In the next forty years, the CPC will be a stable source of revenue for stockholders. According to the estimates, during operation of the pipeline, approximately 23.3 million dollars will go into Russia's federal and regional budgets in the form of revenue and profit; Kazakhstan will receive approximately 8.2 billion.

Russian analysts pointed out that the KazMunaiGaz Company was initially willing to finance the construction of a third stage in the Atasu-Alashankou section of approximately 1,300 km in length.

Russian experts believe that the oil pipeline to China will only be economically profitable, if at least 20 million tons of raw material are pumped through it a year (at present, the new section of the pipeline can only pump 6 million tons). So Chinese companies are stepping up their efforts to obtain new fields in Kazakhstan. If experts' forecasts regarding the deposits in Kazakhstan's part of the Caspian are confirmed, this oil could be used "to fill the Chinese route;" then the throughput capacity of the pipeline would also increase.

Russian experts believe that Beijing's willingness to finance the laying of a pipeline from Kazakhstan was to show that there was an alternative and was a way of responding to the Russian government's tardiness in choosing a route for the pipeline.

When discussing the competition coming from Kazakhstan, Russian experts could not help but raise an important practical question: does the country have enough oil to "fill the Chinese route," if we keep in mind Astana's involvement in transporting oil via other pipelines (the CPC, Atyrau-Samara, and BTC)? When analyzing the republic's export potential, that is, keeping in mind domestic oil consumption (in the next decade it will fluctuate at around 10 million tons a year), it transpires that in 2010, Kazakhstan will be able to export no more than 100 million tons. According to Russian experts, this is not enough to fill the existing pipelines, never mind those still under construction. In the next ten years, Kazakhstan will not need to create new transportation capacities, since in 2010, it will have a surplus of about 10 million tons a year.

So Russian analysts came to the conclusion that if we ignore its political ambitions, Kazakhstan does not have the economic feasibility (or need) to compete with Russia in the Chinese vector. What is more, Russia has the prospect of transferring energy cooperation between Astana and Moscow into the channel of strategic cooperation. Pipeline branches to China will make it possible to "open up" an additional alternative for pumping oil to China: first via the currently idle Omsk-Pavlodar-Chimkent pipeline, and then via the Kazakhstan-China route.

During President Nursultan Nazarbaev's visit to Moscow (in April 2006), this logic was affirmed: the Russian side confirmed its participation in the Kazakhstan-Chinese pipeline.

Kazakhstan and Gazprom

Resource-rich Kazakhstan, which is steering a course toward attracting as many investors as possible and is considered one of Russia's main partners in the post-Soviet space, is still the most attractive Central Asian republic for Russian companies.

Foreign companies that planned to participate in tenders in 2004 under new projects in the Kazakhstan sector of the Caspian Sea expressed their concern about the tougher tax conditions in the industry. Rosneft was one of the dissatisfied companies, which planned to begin implementing a joint Caspian project with Astana called Kurmangazy as early as 2004. Despite the objective difficulties, Russian companies are still hoping to find a niche for themselves on Kazakhstan's promising energy market.

Since 2004, Gazprom has been showing greater interest in the Karachaganak project and clearly does not want to let such large volumes of natural gas slip through its fingers. Gazprom suggested that Kazakhstan create a joint venture with it based on the capacities of the Orenburg Gas Processing Plant, after expressing its willingness to transfer several units capable of processing 8-10 bcm of gas a year, two pipelines already extended from the field to the Orenburg GPP, and other necessary technical equipment to this joint venture. It was presumed that Gazprom was also willing to offer Kazakhstan parity participation in the joint venture. However, all that is needed to develop the necessary volumes of Karachaganak gas and condensate at the Orenburg GPP is to increase its capacity slightly, while construction of a new plant on the field itself will cost much more and take much more time. According to the estimates of Gazprom's specialists, this construction would require around 1.3 billion dollars, while only 300 million are needed to increase the capacities at the Orenburg GPP.

Nevertheless, Gazprom is planning to become a stockholder of Kazakhstan's gas transportation system (if it is sold). According to the company's deputy chairman of the board, A. Ryazanov, this is advantageous not only to Moscow (which means to Gazprom as well), but also to Astana.

So, strategically, the views of the Russian monopolist and Kazakhstan coincide. Like Astana, Gazprom is interested in increasing the throughput capacity of the Central Asia-Center route (45-50 bcm a year), since, in 2003, the concern entered a long-term contract with Ashghabad, planning to bring purchases of Turkmen gas up to 70 bcm by 2007. In 2004, Gazprom announced that it intends to invest more than 1 billion dollars in developing Uzbekistan's fields.

Gazprom's strategists are mainly concerned that if Kazakhstan really does greatly increase its gas production volume, Astana will again raise the question of having to make room for Gazprom at the export pipeline to Europe. At present, the export of Kazakhstani blue fuel abroad is limited to around 6.5 bcm a year, whereby only part of this gas goes to Europe (the rest goes to the Omsk Gas Processing Plant).

Gazprom holds that this system is entirely workable, and Russia will hardly agree to increase the export of Kazakhstani gas via Russian gas pipelines, since this could be detrimental to the export of Russian blue fuel.

Uzbekistan's Oil and Gas Complex and Russia

The Republic of Uzbekistan has well-developed and sufficiently powerful flowline and main gas pipelines, which make it possible to transport fuel to consumers within the republic and abroad. The total length of the main gas pipelines is 12,660 km, and they are served by 25 compressor stations. In the northwest, separate sections of powerful gas transportation systems were laid intended mainly for transit gas deliveries: these are the Central Asia-Center and Bukhara-Ural lines. A distinguishing feature of Uzbekistan's gas transportation system is that it is of interstate significance. Neighboring republics—Kazakhstan (the southern part), Kyrgyzstan, and Tajikistan—are supplied with Uzbek gas. What is more, Turkmenistan uses it for exporting its gas. It is presumed that by 2010, the total volume of commercial gas deliveries via the Uzbekistan gas transportation system will increase to 70 bcm.[4]

Uzbekistan occupies third place among the East European states and CIS countries in terms of explored supplies of natural gas, and fourth in terms of liquid hydrocarbons. Its total potential resources amount to more than 5,300 million tons of oil, 480 million tons of condensate, and 5,095 bcm of gas. At present, oil production is being carried out at 51 fields, gas production at 27 fields, and condensate production at 17 fields. A total of 123.9 km of main gas pipelines have been put into operation by Uzbekneftegaz enterprises. They include the Gazli-Kagan gas pipeline of 68.6 km and a gas pipeline-shunt from the Syr Darya State Regional Power Station of 18.4 km in length. Production drilling has been carried out and 22 and 17 wells for oil, and 16 and 11 wells for gas have been linked to these pipelines, respectively.

The Uzbekneftegaz National Holding Company (NHC) is carrying out modernization of gas-filling stations within its structure at a total cost of approximately 100 million dollars. There are plans to reconstruct the existing and build new gas-filling stations operating on liquefied gas and belonging to the Uznefteprodukt Joint-Stock Company.

Uzbekistan's strategic task is to actively attract foreign investments not only into geological exploration and gas production, but also into gas processing. The main project in this area is the Shurtan chemical gas complex, construction of which began in 1998. It is based on the Shurtan group of low-sulfur gas fields recently put into operation—South Tandyrcha, Adamtash, and Gumbulak, the

[4] See: D. Faizullaev, "Gazovyi potentsial Uzbekistana i Turkmenistana," *Azia i Afrika,* No. 9, 2004, pp. 13-18.

gas from which is characterized by a higher concentration of valuable light hydrocarbons—ethane, propane, and butane, as well as so-called aromatics—a valuable raw material for obtaining many petrochemical products. When this complex went into operation in 2002, the opportunity arose for purifying all the gas extracted at the Shurtan and neighboring fields and pump it through the Shurtan-Syr Darya-Tashkent gas pipeline. In terms of polyethylene production, the complex reached the planned level of 125,000 tons a year in 2002.

Oil and gas condensate production in Uzbekistan dropped to 6 million tons in 2005 compared with 7.3 million tons in 2002, and gasoline and diesel fuel production to 3.2 million tons compared with 3.5 million tons. But the demand for gasoline and diesel fuel has been increasing by approximately 5% every year and, by 2005, there was shortage of almost 700,000 tons of gasoline and 600,000 tons of diesel fuel. The decrease in oil and petroleum product production is related primarily to depletion of the fields in use, as well as to a slowdown in the rise in technical level of geological survey production.

Russian analysts note that in isolation from neighboring countries—Turkmenistan and Kazakhstan—capital investment in Uzbekistan's gas industry might be inefficient due to the republic's distance from the sales markets. Nevertheless, Russia is establishing economic cooperation with Uzbekistan: the Russian Federation occupies first place in the Uzbek economy in terms of trade turnover, which amounted to more than 1 billion dollars in 2003. There are more than 200 joint enterprises operating in the republic, and such large concerns as Gazprom, LUKoil, Wimm-Bill-Dann, the Cherkizov Agroindustrial Complex, and others are successfully carrying out business.

In July 2001, the project participants signed a contract on the Main Principles and Provisions of the Production Sharing Agreement at the Bukhara-Khiva and Gissar Fields of the Oil and Gas Regions. According to the contract, LUKoil and Itera will receive 45% of the produced gas each, and Uzbekneftegaz will receive 10%. Russia is confident that Uzbekistan will be its reliable economic partner for at least the next 30-35 years. This is the term of a long-term gas contract signed in June 2004. A consortium of investors is being created: 90%—LUKoil and 10%—the Uzbekneftegaz National Holding Company, which is carrying out exploration and production of hydrocarbon supplies in southwest Uzbekistan under production sharing conditions. Capital spending (LUKoil will bear the main brunt) comes to around 1 billion dollars and, in the future, production volume will amount to 8.8 bcm of gas a year. Most of this amount will be purchased by Gazprom's structures.

The Final Production Sharing Agreement under the Kandym-Khauzak-Shady Project was signed in June 2004 during Vladimir Putin's visit to Uzbekistan. LUKoil and Uzbekneftegaz joined the consortium in its final form. It was decided not to involve the Itera Company, which specializes in the transportation of gas and oil, in the project, since in 2002, another Russian company, Gazprom, acquired the right of system operator of the main Central Asia-Center gas pipelines in Uzbekistan.

In December 2002, the Uzbekneftegaz and Gazprom companies signed an Agreement on Strategic Cooperation until 2012. In keeping with this document, Uzbekneftegaz and the Zarubezhneftegaz closed joint-stock company (created in September 1998, 60.1% of the shares belong to Gazprom, 24.9% to Zarubezhneft, and 15% to Stroi-transgaz) signed a Production Sharing Agreement in Tashkent on 14 April, 2004 on an investment project called Development Completion of the Shakhpakhty Field in the Ustiurt Oil and Gas Region. It was opened in 1962, and its supplies are estimated at 39.9 bcm of gas. At present, the recoverable deposits amount to some 8 bcm. But in February 2002, production had to be halted due to high wear-and-tear of the equipment.

According to the conditions of the mentioned agreement, Zarubezhneftegaz is investing more than 15 million dollars in modernizing the field's infrastructure. Profit from the sale of gas will be distributed evenly between the project participants. Production was to be renewed during the second

half of 2004, the field finally set up by the end of the year, and its development was to be completed over the next 13 years. What is more, the investor completed construction of a booster compressor station. All of these measures made it possible to produce 200 million cubic meters of natural gas at that time and send it to the Karakalpakia compressor station of the Central Asia-Center main gas pipeline for export. Beginning in 2005, the annual production and export of blue fuel amounted to 400 million cubic meters.

It is obvious that in the current situation, a potential investor showing its interest in Uzbek gas will need a single strategy for the three countries of the region, which Gazprom has been actively engaged in for the past two years. The agreement it signed with Tashkent in 2003 until 2012 envisages joint development of the fields and deliveries of Uzbek gas (5 bcm a year until 2005 and 10 bcm a year after 2010). What is more, Gazprom's strategic interest in Uzbekistan is aroused by the fact that the Central Asia-Center main gas pipeline linking Turkmenistan and Russia runs through the republic's territory.

In this way, the Russian company has entered its first contract in Central Asia envisaging the exclusive production of gas. In the mid-term, this will allow Gazprom to switch from reselling gas to its production, that is, to begin a new stage of business in the region, and also restore the former Soviet chain of geological, commercial, and transportation assets, which will give this structure the opportunity to increase its export potential and strengthen economic relations with its Central Asian partners.

The agreement on cooperation in gas production and transportation signed with Uzbekistan at the end of 2002 envisaged three main areas of partnership.

- *First*. The main principles of Russia purchasing Uzbek gas until 2012 were set forth. In keeping with this agreement, Uzbekistan has already delivered 5 bcm of gas to Russia between June 2003 and May 2004, and beginning in 2005 planned to reach a level of 10 bcm a year at a price of around 40 dollars per 1,000 cubic meters.
- *Second.* A program for implementing joint gas production projects was drawn up. As the agreement envisages, beginning in April 2004, Gazprom's subsidiaries—Zarubezhneft and Switzerland's Gas Project Development Central—became participants in the project for producing gas condensate at the Shakhpakhty field in the Ustiurt Region under production sharing conditions. The term of the agreement was 15 years. It was presumed that in 2004-2007, investments in field development will reach 15 million dollars. These funds will be invested in developing the latest gas production technology and constructing a new booster compressor station. Every year, 0.5 bcm of gas will be produced at the Shakhpakhty field; it will be distributed between the Russian and Uzbek participants in the project on a 50:50 basis.
- *Third*. There were plans to reconstruct and develop the existing Uzbek gas transportation system. Now its throughput capacity amounts to 130 million cubic meters of gas a day, or 48 bcm a year. This capacity is hardly sufficient for meeting the obligations to transit 36 bcm of Turkmen gas to Ukraine, 4 bcm of which are purchased by Tazeksport in Ashghabad, as well as the mentioned Uzbek gas purchased by Gazprom. The latter planned to gradually increase the capacity of Uzbekistan's gas transportation system to 51-52 bcm in 2005 and 56 bcm in 2006. Gazprom intended to provide approximately 100 million dollars in investments for this purpose.

In this way, the Russian giants on the oil and gas market gained access to new Asian fields, thanks to which Russia, in the form of its companies, has now become Uzbekistan's leading investment partner in the gas industry and economy in general.

It is worth noting that Itera was the first Russian company to gain access to Uzbekistan. Along with LUKoil, it held talks lasting for many months on entering a production sharing agreement regarding the Kandym-Khauzak-Shady block, which is located in the south of the country. The volume of confirmed geological supplies of blue fuel in the contract territory amounted to 283 bcm. The largest field is Kandym; and its supplies amount to more than 150 bcm. But in 2003, Itera curtailed its activity in Uzbekistan and even closed down its office in Tashkent, unable to deal with the tough competition coming from Gazprom, which essentially monopolized the export deliveries not only of Uzbek, but also of all Central Asian gas.

As for LUKoil, the company carried out talks with Uzbekistan on the Kandym-Khauzak-Shady block on its own, and on 16 June, 2004, during Russian President Vladimir Putin's visit to Tashkent, this Russian oil giant and the Uzbekneftegaz Company entered a production sharing agreement envisaging gas production in the Bukhara-Khiva Region (in the southwest of the republic). In order to implement the project, a joint venture will be created, in which the share of the Russian company will amount to 90%, and Uzbekneftegaz's share to 10%. In so doing, LUKoil increased its share to 90% (from 70%) six days before signing the contract. The term of the agreement is 35 years; the volume of investments in the project is approximately 1 billion dollars; industrial gas production will begin in 2007. In this way, LUKoil became the second Russian company executing a production sharing agreement in Uzbekistan's oil and gas industry.

Within the framework of this project, the maximum level of annual production is drawing close to 9 bcm, and the total accumulated production volume could increase to 207 bcm. What is more, the project envisages the construction of a contemporary chemical gas complex with a capacity of 6 bcm of gas a year, the first stage of which will be put into operation in 2010. There are plans to drill 240 production wells and lay more than 1,500 km of pipelines. In addition to this, there are plans to build two compressor stations, headers, and RV sites, put up high-voltage electric transmission lines, lay a separate rail branch of around 40 kilometers in length, and build roads and access ways. Incidentally, blue fuel will be pumped via Gazprom's main transportation networks, so the Russian monopolist will be taking indirect part in this project too. A feasibility study of the project was carried out by the UzLITIneftegaz Institute, a subsidiary of Uzbekneftegaz, and an American law firm, Baker and MacKenzy, prepared the production sharing agreement. The feasibility study and text of the production sharing agreement were approved by the republic's Special State Commission entrusted with drawing up conditions for using sections of the subsoil and reviewing production sharing agreements.

The active stance of Russia's largest oil and gas companies has made it possible for them to occupy a dominating position in Uzbekistan's heat and fuel complex, which not one foreign investor has been able to do so far. In contrast to Kazakhstan, where Russian companies have to deal with tough competition from the world's largest companies, a different situation has developed in Uzbekistan. The coordinated actions of the Russian companies and their control over the transportation supply lines (the same "production-transportation" blend in the form of Gazprom and LUKoil) are making it possible for Moscow to establish more efficient geopolitical relations with Tashkent. In addition to everything else, Uzbekistan is the only Central Asian country where Russian oil and gas producers have not yet encountered objective difficulties in implementing their projects.

(Concluded in the next installment)