

## Oil transport through the Caucasus is a top priority issue in Kazakh oil export policy

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Kazakhstan has recently intensified its efforts to increase the volume of Kazakh oil transported through the Southern Caucasus to Europe, via – among other routes – the Baku–Tbilisi–Ceyhan pipeline. Talks on signing additional detailed contracts for oil transport *via* the BTC have started, and an agreement on using this pipeline to transport Kazakh oil has been ratified. Astana’s activity is an indication of a change in the country’s export policy; Kazakhstan has made it clear to Russia that it is ready to develop oil export routes to Europe alternative to the Russian ones. Action taken by Kazakhstan fits in with the strategy of the diversification of oil transport routes which have been in place for several years. The intention is not to withdraw from oil transit through Russian territory but rather to develop alternative routes.

Astana has intensified its efforts mainly as a consequence of the failure to reach a compromise with Moscow on developing the Tengiz–Novorossiysk pipeline, which runs through Russian territory and is the main route for oil export from Kazakhstan. The lack of any real prospect of increasing the pipeline’s capacity and using other export routes to their maximum extent is preventing Astana from increasing oil production. Astana wants to strengthen its position in contacts with the Russian Federation and to improve the security of Kazakh oil exports.

Astana’s plans may be thwarted by Azerbaijan, which is not currently interested in the transit of large amounts of Kazakh oil. At present, Baku grants high priority to exports of its own oil *via* the Baku–Tbilisi–Ceyhan pipeline, which is being used to almost full capacity. However, Azerbaijan will be more willing to offer attractive export conditions to Kazakhstan in the future, when Azeri oil production is expected to drop. This will fit in with Azerbaijan’s strategy of changing its role from that of an oil exporter into an oil and gas transit country.

## The lack of export possibilities hinders oil production growth

Kazakhstan is the largest producer and exporter of oil in the Caspian region and has the greatest potential in terms of both production and export. In 2007, the country produced nearly 67 million tons of oil, most of which (55 million tons) was exported. According to government forecasts, production and export volumes will be doubled by 2015 to reach 130 million tons and 110 million tons respectively. The existing oil transport infrastructure is insufficient and restricts Kazakh export possibilities, which forces Astana to impose temporary limitations on production growth. On 19 May, the government reduced the oil production forecast for 2008 from 70 million to 67.6 million tons, the lack of transport possibilities being one of the reasons. Worsening problems with oil export have led Astana to intensify its efforts either to find new transport routes or expand existing ones.

## The directions of oil export

The key transport routes run through Russian territory (first of all, the Tengiz–Novorossiysk and Atyrau–Samara pipelines; see map), *via* which a major part of Kazakh oil is exported (nearly 80% in 2007). Other, less significant, possibilities include the sea & railway connection from Aktau port through the Southern Caucasus to the Georgian port of Batumi (nearly 10%) and *via* the pipeline running to China and then by sea to Iran (in total, nearly 10%).

Pursuant to the strategy of diversification of oil export routes, which was adopted several years ago, Kazakhstan is interested in further development of export routes in the following

**The project for the development of oil transport through the Caspian Sea envisages increasing the throughput capacity of Aktau port and building a new port in Kuryk and an oil pipeline from Eskene to provide a connection between Kuryk and the oilfields (Tengiz and Kashagan) located in the northern (shallow) part of the Caspian Sea. The pipeline's annual throughput capacity will be at least 25 million tons of oil at the beginning and to reach eventually even 56 million tons.**

directions: to the West (including the options of oil transport through Russia or the Southern Caucasus), to the East (China) and to the South (Persian Gulf through Iran). For economic and strategic reasons, the West is the most attractive direction of oil export for Astana. The Western market is the place where Kazakhstan has reliable customers who are ready to pay very high prices for oil and where the country can be offered the possibility of both improving the profitability and broadening the range of its activity by investing in the oil processing and fuel distribution sector<sup>1</sup>. Some European countries which want to reduce their dependence on oil supplies from Russia are especially interested in the expansion of Kazakh capital<sup>2</sup>.

<sup>1</sup> Astana is also interested in obtaining know-how in oil refining and special conditions existing in fuel retail market.

<sup>2</sup> For example, Romania; in September 2007, KazMunaiGaz bought a 75% stake in the Romanian refiner – Rompetrol.

## Problems with developing the Russian routes

Kazakhstan may use two routes to increase its oil transport to Europe, the Northern corridor (running through the territory of the Russian Federation) and the Southern corridor (running through the Caspian Sea and the Caucasus). Astana has been making attempts to increase the transport possibilities via both corridors for several years now.

The option of oil transport through Russian territory requires increasing the capacity of either the Atyrau–Samara pipeline (from 16 to 20 or 30 million tons) or the Tengiz–Novorossiysk

pipeline (from 32 to 67 million tons). The first route is has not been expanded due to Russia's failure to present an offer acceptable to Kazakhstan. Moscow has probably demanded guarantees of long-term supplies of Kazakh oil *via* the enhanced pipeline, without assuring on its part that the oil will then be delivered through the Russian network of pipelines to the Baltic Sea ports, which are preferred by Kazakhstan. Recently, the Russian Federation has modified its standpoint and invited Astana to participate in the Baltic Pipeline System 2<sup>3</sup>. According to the plans of Transneft, the Russian pipeline operator, Kazakhstan could send nearly 10 million tons annually by this route.

**The project of building a railway connection between Kazakhstan and Iran envisages building a line running along the Caspian Sea coastline to the Iranian city of Gorgan. The annual oil transport capacity of this route will be 15 million tons. Kazakhstan and Iran are likely to effect swap transactions; Kazakhstan will receive oil in the Persian Gulf in exchange for oil delivered to Northern Iran.**

The deadlock over increasing the transport capacity of the Tengiz–Novorossiysk pipeline, which has lasted since the beginning of the route's existence, is also a result of Russia's unwillingness to compromise. Moscow makes its consent for pipeline development dependent on a number of conditions which the CPC consortium will have to meet<sup>4</sup>. *Inter alia*, it requires repayment of the CPC consortium's debts and a guarantee of financial backing for the project from the incomes generated by oil transported *via* the pipeline running from Kazakhstan before it decides to

increase the throughput capacity of that pipeline. Moreover, it wants to co-ordinate the project with the construction of the Turkish Straits bypass, the Burgas–Alexandroupolis oil pipeline, which is planned and supported by Russia (running through Bulgaria and Greece). It also cannot be ruled out that Moscow has been attempting to get a long-term commitment from Kazakh oil producers to send their oil via the enlarged route in the future.

Actions taken by Russia, mainly efforts to obtain guarantees of oil transport through Russian pipelines, are – from Moscow's point of view - intended to help it retain control over exports of Kazakh oil. On the other hand, Russia has been delaying its decision to increase the throughput capacities of existing routes because it is unwilling to face competition with Kazakh oil on the European market and problems with exporting Russian oil through from congested Turkish Straits (Bosphorous and Dardanelles).

## Kazakhstan vs. the Caucasian routes

Kazakhstan, in parallel with its attempts to boost exports via the Russian Federation, has been taking actions to increase the volume of its oil transported via the Caucasian routes (cf. the map). An agreement which provided for a connection between Kazakhstan and the Baku–Tbilisi–Ceyhan (BTC) pipeline was signed as early as June 2006. In January 2007 Astana signed a memorandum with foreign investors on building infrastructure for oil transport *via* the Caspian Sea to the BTC using the Kazakhstan Caspian Transport System (KCTS).

However, as a consequence of the long-standing deadlock over the increase of the Tengiz–Novorossiysk route's throughput capacity, Astana has, over recent months, intensified its actions to develop oil transport through the Southern Caucasus. An intergovernmental agreement on the transport of Kazakh oil by the BTC pipeline, which had been delayed for nearly two years, was ratified this March and April by both houses of the Kazakh parliament and finally approved by the president on 29 May. Additionally, Kazakhstan has intensified talks with Azerbaijan (this April) and companies operating in Kazakhstan (June) in order to set the rules for building the KCTS.

<sup>3</sup> The project is aimed at increasing the throughput capacity of the Russian oil export pipeline by using a Russian terminal on the Baltic Sea and building a pipeline connection from Unecha to Ust-Luga.

<sup>4</sup> Caspian Pipeline Consortium, the owner and operator of Tengiz–Novorossiysk oil pipeline.

Actions taken by the Kazakh government match the offensive launched by Chevron, the US company which is very strongly interested in new possibilities of oil transport because of forecasted growth in the company's oil production<sup>5</sup>. Chevron initiated talks with Azeri partners concerning oil transport through the Southern Caucasus as early as 2007, thus sending a clear message to Russia that it was ready to develop that route.

## Kluczem Azerbejdżan?

However, there are problems with increasing the quantity of Kazakh oil transported via the Southern Caucasus mainly due to the attitude of Azerbaijan. Baku uses the existing transport routes to transport its own oil as a first priority, leaving significantly less capacity for transit of oil from the other Caspian states (including Kazakhstan). Ensuring optimal conditions for transport of its own oil is the highest priority for Azerbaijan, which leads to discrimination against Kazakh oil. At the same time, Baku – in an attempt to maximise its profits from transit of Kazakh oil – has been sending it *via* routes which are mainly beneficial to the transit country. The priorities of Azerbaijan's export policy are sometimes in conflict with the interests of Kazakhstan, and each of the countries has a different opinion on the optimal method of Kazakh oil transit through the Caucasus.

From Astana's point of view, the best way to export oil through the Southern Caucasus is to take it by railway from Baku to the terminal owned by the Kazakh oil & gas firm, KazMunaiGaz, which is located in the Georgian port of Batumi on the Black Sea. Meanwhile, Azerbaijan wants the largest possible amounts of oil (including Kazakh oil) to be sent by railway to the competing terminal in another Georgian port, Kulevi (operational since 16 May), which is controlled by the Azeri state-owned oil enterprise SOCAR.

It is also important for Kazakhstan to have the possibility to export oil via the BTC, the pipeline which passes through the overcrowded Turkish Straits and offers direct access to the Mediterranean Sea. In turn, Azerbaijan is not interested in feeding Kazakh oil to this pipeline in the near future because it is almost entirely filled with Azeri oil (it will start running at full capacity at the end of this year). At the same time, Kazakh oil could compete with Azeri in the Mediterranean Sea region and impair the quality of exported Azeri oil due to differences in the chemical composition. It seems that Baku would rather provide Kazakhstan with access to the Baku–Supsa oil pipeline, in which it is least interested<sup>6</sup>.

According to forecasts, the production of Azeri oil will decrease in the future and more throughput capacity in Azerbaijan's main export pipe (BTC) will be available. Then Baku will become significantly more interested in the transit of Kazakh oil and, to fill existing pipelines, it will be more prepared to present a more attractive offer for transport of Kazakh oil to Astana.

## Astana becomes more interested in supplies to China and Iran?

Problems with increasing oil exports in the Westerward direction, via routes running through the Caucasus and Russia alike, have made Astana more inclined to accelerate work on oil transport routes in alternative directions. In December 2007, construction of the middle section of the oil pipeline running to China started. Following its completion (2010), the transport capacity to China will double (reaching 20 million tons of oil annually). Further increases in exports in this direction are rather unlikely, considering Kazakhstan's fear of Chinese domination. Consequently, this direction does not offer a serious alternative to export routes to Europe.

Furthermore, in autumn 2007, work was initiated on building a railway connection from Kazakhstan through Turkmenistan to Iran, which will enable transport of up to 15 million

<sup>5</sup> Chevron is the major shareholder of the huge Kazakh Tengiz oilfield, where production is expected to grow from approximately 13 million tons in 2007 to 26 million tons in 2009.

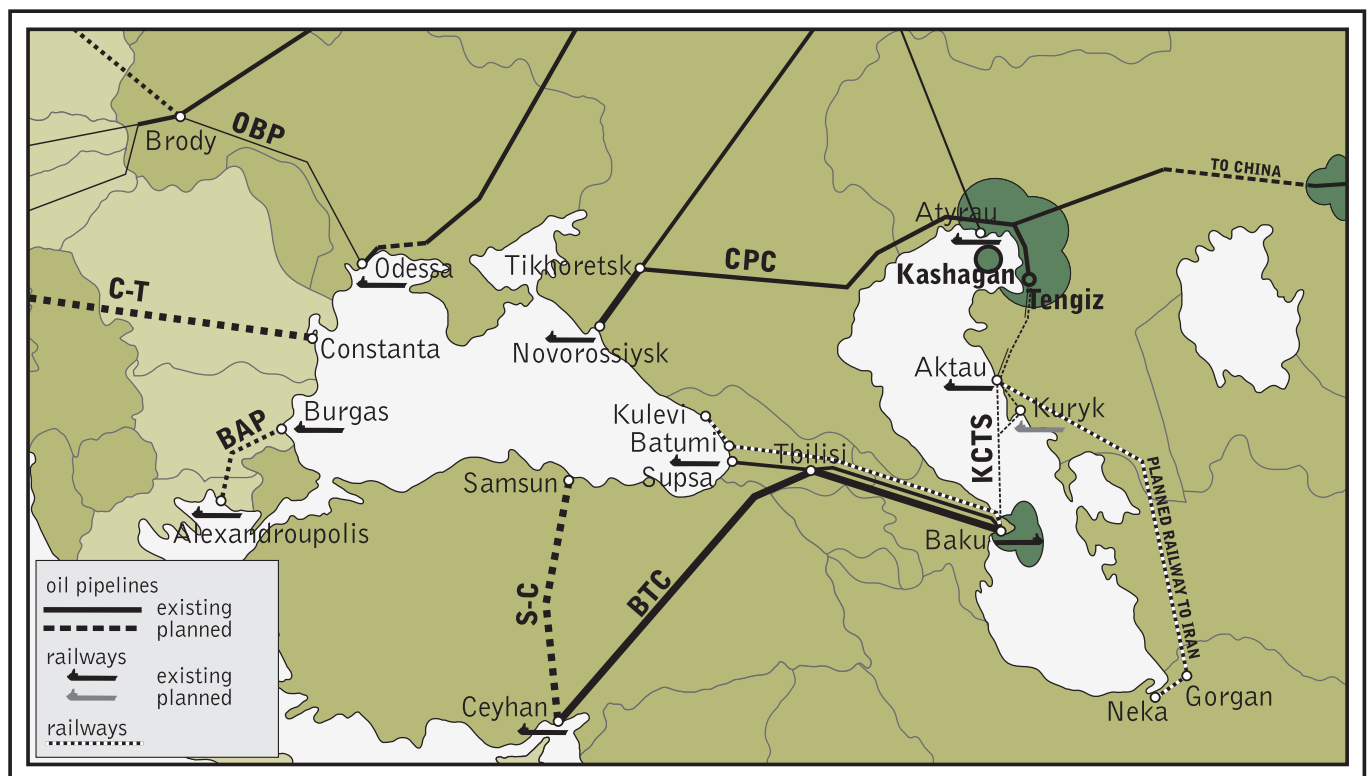
<sup>6</sup> SOCAR is very likely to take over control of this route by the end of this year. Oil transport *via* this pipeline will start in the nearest months.

tons of oil annually. Increasing transport capacity in the Southern and Eastern directions fits with Astana's energy strategy of diversifying oil export routes. However, the latter two directions are not seen as high priority by Kazakhstan.

## Conclusions

- Kazakh oil can be exported to the West only through Russia and Azerbaijan, countries which in fact are Kazakhstan's competitors on the oil market.
- Actions taken by Kazakhstan indicate that Astana is determined to increase transport of oil via routes running through the Southern Caucasus. However, this does not mean withdrawal from transit through Russian territory. Relations with Moscow are of strategic significance for Astana, and no moves aimed at limiting the previous level of co-operation should be expected.
- Problems with increasing the throughput capacity in Russian territory provide a convenient excuse for Astana to become more engaged in developing the Caucasian routes. At the same time, by making efforts to launch oil transport routes via Caucasus, Kazakhstan presses on Russia to unblock the projects aimed at increasing the volume of oil transit through Russian territory.
- Baku's stance is essential for the success of Kazakh plans to transport oil through the Caucasus. At present, Azerbaijan is mainly interested in exporting its own oil. However, in the future, when its oil production will be reduced as forecast, it will want to change its role of an oil producer into that of a transit county. Then co-operation with Kazakhstan will be especially valuable.

## Map. Existing and planned routes for export of Caspian oil



**OBP - Odessa-Brody-Płock**

**C-T - Constanta-Trieste**

**BAP - Burgas-Alexandroupolis**

**BTC - Baku-Tbilisi-Ceyhan**

**CPC - Tengiz-Novorossiysk pipeline**

**KKST - Kazakhstan Caspian Transport System**

## APPENDIX

### Existing key routes for oil transport from Kazakhstan

Name	Capacity (million tons annually)	Sent in 2007 (million tons)	Possibility of extension (million tons annually)	Comments
Tengiz–Novorossiysk	32	25.5 this quota has been granted to producers from Kazakhstan)	67	Russia has prevented development of those routes so far
Atyrau–Samara	16	16	up to 30	
Kazakhstan–China (Atasu–Alashankou section)	10	4.8 due to the lack of infrastructure which could provide a connection to the fields by the Caspian Sea (the middle section)	20 (potentially even 50)	Fears of Chinese domination do not contribute to increasing exports in this direction
Kazakhstan–Caspian Sea (Neka, Baku, Makhachkala)	10.5	8.9	20	Oil is sent to Baku, Neka and Makhachkala

Developed by CES on the basis of media releases (including Argus)

### The main routes of oil transport via the Southern Caucasus

Name	Capacity (million tons annually)	Sent in 2007	Possibility of extension (million tons annually)	Comments
Baku–Tbilisi–Ceyhan	50	27.5	60–80	
Baku–Supsa	8	0	approx. 20	The pipeline was being repaired and did not operate in 2007.
Baku–Batumi/Kulevi railway line	14.4 (estimates)	9.5	n/a	

Developed by CES on the basis of media releases (including Argus)

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