

## COMPETING FOR MARKETS AND INFLUENCE: ASIAN NATIONAL OIL COMPANIES IN EURASIA\*

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*This article discusses the asset acquisitions of Asian national oil companies (NOCs) in the energy-rich states of Russia and Central Asia, and considers the implications for economic and geopolitical stability. Asian NOC investment in these countries is analyzed in terms of state-level political and economic relations, as well as the regional and local impact of NOC activity on the host country. Asian NOCs, and the governments that support them, face few political obstacles in dealing with Eurasia's authoritarian regimes. Asian companies operate in business cultures similar to those in Eurasia, and have fewer reservations about engaging in bribery or corruption than their Western counterparts. These advantages are offset by the entrenched position of Western and Russian oil companies, and a strong commitment of the host states to political and economic independence.*

**Key words:** economic development in Asia, foreign investment in East Asia, Russian Far East, Central Asia

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## Introduction

Asia's dynamic but largely energy-poor countries need secure supplies of oil and natural gas to meet the needs of their rapidly expanding economies. Wary of the volatility of international energy markets, Asian nations have pursued energy policies that can arguably be described as neomercantilist, accepting elements of the globalized market while retaining significant state influence over energy exploration, production, and transportation. A key goal has been to acquire upstream assets in the few remaining areas of the world not dominated by Western international oil companies (IOCs). A strategic commodity, oil is critical to modernization, and is perceived as too vital to be left entirely to market forces. Chinese and Indian national oil companies (NOCs), and to a lesser extent those from Japan and Korea, have worked closely with their governments to compete for energy assets in Latin America, Africa, the Middle East, and—the specific focus of this article—Russia and Central Asia.

This article addresses the following questions. First, to what extent have Asian national oil companies succeeded in acquiring energy assets in Eurasia, defined as Russia and Central Asia? Second, has political influence accompanied Asian NOC activities in this region? Third, how welcoming is the Eurasian business environment for Asian investment in the energy sector? Finally, what are the major obstacles to penetration of the region by Asian national oil companies?

The central focus is on Eurasia's economic and political interactions with Asian national oil companies and their home government's support for their asset acquisition strategy. The major findings are that Chinese companies have had greater success than Indian or other Asian NOCs in securing regional energy assets, although their efforts have been constrained by strong competition from an increasingly nationalistic Russian energy policy, the established position of Western oil firms, and by energy nationalism within Central Asia itself.

## Neomercantilism, National Oil Companies, and Foreign-Policy Influence

### *A Profile of the NOCs*

Ensuring a stable supply of oil at reasonable prices is critically important for the rapidly growing Asian economies. This growth is a relatively recent development for China and India, however, brought about by the abandonment of autarkic socialist policies and their subsequent integration into the global economy. In the post-World War II era, Japan pursued neomercantilist policies to protect certain industrial sectors and enhance their international competitiveness, with remarkable success.<sup>1</sup> Once Japan had reached a high level of post-industrial development, and the 1980s bubble burst, the economy stagnated and policy makers began to rethink the state-dominated approach.<sup>2</sup> China and India, as late developers, seek to protect their vital national interests by mobilizing the resources of the state to support national oil companies' strategies of going abroad in search of equity. The result is an oil-driven form of neomercantilism.<sup>3</sup>

National oil companies are, by definition, representatives of the state in which they are situated. While NOCs vary considerably in their autonomy from the state, they need to balance the economic demands of the international market with the political needs of their governments. Asian NOCs are actively seeking upstream assets around the world, to secure energy supplies crucial for internal development. While these companies are competing vigorously with each other, with non-Asian NOCs,

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1. Robert Gilpin, *Global Political Economy: Understanding the International Economic Order* (Princeton, N.J.: Princeton University Press, 2001), pp. 156-68.
  2. Japan dissolved its national oil company in 2001, creating three new, mostly publicly traded companies that are supposed to be responsive to state energy needs.
  3. Neomercantilism, as I am using it here, is a form of economic nationalism that does not reject the market, but seeks to protect state interests from uncontrolled global market forces. The prefix distinguishes the concept from the older forms of European mercantilism. See Bjorn Hettne, "The Concept of Neomercantilism," in Lars Magnussen, ed., *Mercantilist Economics* (Boston: Kluwer, 1993), pp. 31-34.

and with IOCs for assets in energy-rich regions around the world, they also occasionally find opportunities for cooperation.

National oil companies are often larger and more powerful than international oil majors, and may have significant influence on the economies or political systems of host states, particularly smaller ones. This has become apparent as Chinese NOCs acquire properties in North America, the Middle East, Africa, and Central Asia. The most important Asian NOCs are the Chinese National Petroleum Company (CNPC), the Chinese National Offshore Oil Company (CNOOC), Sinopec, India's Oil and Gas Company (IOGC), and Korea's National Oil Company (KNOC).<sup>4</sup> Asian NOC investment has been concentrated in Eurasian states holding significant hydrocarbon reserves—Russia, Azerbaijan, Kazakhstan, Uzbekistan, and Turkmenistan. This article assesses the impact of Asian NOC investment in these countries in terms of state-level political and economic relations, as well as the regional or local impact of NOC activity on the host country.

Large-scale NOC investments may develop resources, generate employment, and promote greater prosperity, but they may also generate excess pollution, skew income distributions, encourage corruption, provide support for human rights violations, and stimulate unplanned flows of migrant labor. Much depends upon the international behavior of the NOC and of the home country. The national interests of home states, combined with the economic priorities of NOCs, can undermine international efforts to address internal repression or international conflicts. Similarly, governments eager to secure energy resources may frustrate efforts of international aid agencies to mandate improved economic and political performance.

Asian NOC investments in Eurasia may affect the competition for political influence in the region, since neomercantilist energy policies are likely to generate conflict over scarce hydrocarbons.<sup>5</sup>

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4. NOCs may vary considerably in the extent of state ownership. Sinopec is 75 percent owned by the Chinese government, CNOOC is 70 percent state-owned, CNPC is 90 percent state-owned, and ONGC is approximately 84 percent state-owned. KNOC is wholly owned by the South Korean government. The publicly-traded subsidiaries tend to be far more profitable and less labor intensive than their state-owned parent companies.

5. Heinrich Kreft makes this argument in "China's Quest for Energy," *Policy*

The United States and Europe have significant interests in Central Eurasia that include enhancing stability and preventing terrorism, developing diverse sources of energy, and promoting democracy and market reforms. Russia and China are cooperating on security and are seeking to limit United States and NATO influence in the region, but they compete for access to energy resources in Central Asia.<sup>6</sup> Both Russia and China are using their national oil and gas companies to enhance their political influence regionally and globally. The relatively late entrance of Asian national oil companies into these markets introduces a new dynamic into a complex and politically unstable region.

National oil companies face a different set of expectations and constraints than do international oil companies. NOCs must operate in the highly competitive environment of international energy markets, while staying responsive and accountable to the national governments that own controlling shares in the company. NOCs in energy-exporting states, such as Saudi Arabia, Algeria, or Iran, are primarily concerned with the upstream side of the business. Policy considerations for these NOCs are mostly domestic. The state's goals are focused around seeking economic rents from national reserves of oil and gas, to provide a (usually the) major source of revenue for the government, and maintaining domestic employment.

The relationship between NOCs in oil-importing countries and their respective governments is similar to that of state-NOC relationships in oil exporting states. The state has a set of goals and expectations for the NOC that may support the company's operations, or at times may clash with the market imperatives of the business's commercial operations. Yet importing NOCs are different in several respects. First, importing NOCs seek to acquire reserves and invest in properties abroad, to supplement inadequate domestic supplies (as in the case of Chinese and Indian NOCs), or because domestic supplies are largely nonexistent (as in

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*Review* (October/November, 2006), online at [www.hoover.org/publications/policyreview/4824886.html](http://www.hoover.org/publications/policyreview/4824886.html).

6. Due to limited space, this article will focus on the energy nexus rather than the broader security concerns of China and Russia. For a discussion of the latter, see Charles E. Ziegler, "Putin Comes to Shove in Asia," *Far Eastern Economic Review*, vol. 171, No. 1 (January-February, 2008), pp. 20-24.

South Korea or Japan). NOCs are expected to conduct business in support of broader state goals, including employment and social welfare programs. In turn, governments may provide subsidies for poorly performing state companies, and may grant low-interest loans for the purchase of foreign assets.<sup>7</sup>

### *Chinese, Indian, and Other Asian NOCs*

Foreign operations of Asian NOCs must be viewed within the broader context of state goals and priorities. Asia's national oil companies reflect their country's priorities for securing ownership of upstream assets, in the belief that this strategy positions them better to survive price or supply fluctuations. A purely *laissez faire* approach to the international oil market is too risky, given the high stakes for these developing economies. China's goals include ensuring domestic stability, maintaining high economic growth rates, creating jobs, reducing differential growth rates across regions, and reducing energy vulnerability. These goals are inter-related. China cannot maintain its high growth rates, generate employment, or reduce the widening income disparities between urban and rural areas or between eastern and western China if adequate supplies of oil are not available.

Oil is vital for China's rapidly expanding economy. The People's Republic of China (PRC) has significant reserves of crude oil—about 18.3 billion barrels of proven reserves—but domestic production supplies only 55 percent of China's needs.<sup>8</sup> China's energy policy calls for maximizing domestic production (rather than moderating demand), while acknowledging that NOCs must acquire energy assets abroad to cover the deficit. Moreover, China's energy strategy seeks suppliers other than

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7. In CNOOC's failed bid for Unocal, for example, the Chinese government reportedly was willing to grant the company a low-cost \$7 billion loan, nearly 40 percent of the premium purchase price. Peter Parry, John McCreery, and Adrian Del Maestro, "CNOOC's Bid for Unocal Went Awry," *Petroleum Economist*, vol. 73 (April, 2006), online at <http://proquest.umi.com/pqdlink?index=30&did=1032003101&SrchMode=3&sid=1&Fmt=3&VInst=PROD&VType=PQD&RQT=309&VName=PQD&TS=1202491174&clientId=9580&aid=1>.

8. Energy Information Administration Country Analysis Brief—China (August, 2006), online at [www.eia.doe.gov/emeu/cabs/China/pdf.pdf](http://www.eia.doe.gov/emeu/cabs/China/pdf.pdf).

the Persian Gulf states, and the Chinese prefer supply routes that avoid the vulnerable Straits of Malacca.<sup>9</sup>

In China, state-owned companies have the advantage that their efforts to acquire assets are actively supported by government diplomacy. High-ranking officials, up to the president, have facilitated NOC investments by offering aid packages to host countries, providing subsidized loans to NOCs, and encouraging them to bid competitively for energy properties. This neomercantilist strategy for acquiring raw materials is vigorous and coherent, although the actual gains have been limited.<sup>10</sup> China has offered political side benefits to energy producers, such as supporting Kazakhstan's bid to join the World Trade Organization, or endorsing the Uzbek crackdown on Andijan protestors. This does not mean, however, that the Chinese energy community is unified on either its foreign or domestic energy strategies. Erica Downs has argued persuasively that a "fragmented authoritarianism" model best captures the diverse forces that influence energy policy making.<sup>11</sup>

Chinese NOCs have in the past been willing to pay more for assets than IOCs, presumably because losses would be underwritten by the state, or because foreign ventures are more lucrative than domestic operations. Domestic retail fuel prices are capped by the government to avoid shocks that might spike inflation or slow economic growth; to compensate for domestic retail losses, Chinese NOCs then profit from foreign upstream acquisitions or government subsidies.

In terms of foreign acquisitions, China has invested considerably more in international oil properties than other Asian NOCs, although the official figures for foreign direct investment are modest.<sup>12</sup> China's NOCs have the advantage that they are a

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9. For a more extended discussion, see Charles E. Ziegler, "The Energy Factor in China's Foreign Policy," *Journal of Chinese Political Science*, vol. 11, No. 1 (Spring, 2006), pp. 1-23.

10. Jonathan Holslag, "China's New Mercantilism in Central Africa," *Asian and African Studies*, vol. 5, No. 2 (2006), pp. 134-69.

11. Erica Downs, "The Chinese Energy Security Debate," *The China Quarterly*, vol. 177 (March, 2004), pp. 21-41.

12. In the four-year period from 2003 to 2006, overall Chinese investment flows into Eurasia totaled \$992 million, with Russia accounting for over three-fourths. 2006 *Statistical Bulletin of China's Outward Foreign Direct*

major component of the country's energy strategy. While the government may not direct the NOCs to conclude specific deals, top government leaders facilitate business transactions through diplomacy and by arranging concessionary loans. The Chinese government can also draw on its huge reserves to provide side payments to clinch deals. Indian companies have increasing freedom to invest abroad, but India's NOCs are frequently subjected to political interference in securing foreign investments.<sup>13</sup>

India is more dependent on energy imports than China. In 2006, India produced 846,000 barrels per day (bbl/d) of crude oil, but consumed a total of 2.63 million bbl/d. Imports, therefore, accounted for about 68 percent of the country's petroleum needs, and some 60 percent of these imports come from four countries: Saudi Arabia, Nigeria, Kuwait, and Iran.<sup>14</sup> India's state companies, primarily the Oil and Natural Gas Company (ONGC), have been emulating their Chinese counterparts in recent years. Indian companies have also followed a strategy of acquiring upstream assets in order to guarantee energy supplies to domestic markets. India's plans to build excess refinery capacity for exporting high-quality refined products, however, differ from China's strategy. Projected growth rates in the consumption of refined oil products are much lower for India than for China. Chinese growth is driven more by industry and manufacturing, while India's growth is driven by information technologies and less energy-intensive services.

India's geographic position between the major Middle East producers of crude and the East Asian consumers confers an advantage. Domestic fuel prices are still subsidized by the government, thus making exports of refined products (to Iran, Indonesia, and other countries in Asia) more attractive than selling on the internal market. ONGC is the largest company in India by market capitalization, and is dominant in upstream

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*Investment*, online at <http://preview.hzs2.mofcom.gov.cn/accessory/200710/1192783779118.pdf>. These figures do not include financial investments.

13. Sumit Ganguly, "The ONGC: Charting a New Course?" Baker Institute Energy Forum (March, 2007), online at [www.rice.edu/energy/publications/nocs.html](http://www.rice.edu/energy/publications/nocs.html); and Herberg, *Energy Security Survey 2007*, pp. 10-12.
14. Energy Information Administration Country Analysis Brief-India (January, 2007), online at [www.eia.doe.gov/emeu/cabs/India/pdf.pdf](http://www.eia.doe.gov/emeu/cabs/India/pdf.pdf).

production, accounting for about three-fourths of India's oil output. Like its Chinese competitors, ONGC has been willing to pay premium prices for upstream assets, largely in the form of bonuses.<sup>15</sup>

Although India is a democracy, its pressing need for energy has led New Delhi to adopt a pragmatic policy toward authoritarian oil and gas states. In relations with Burma, for example, India's energy needs led the Bharatiya Janata Party government to mute its criticism of the repressive military regime in Rangoon. Relations between India and Burma have improved markedly over the past decade, although Burma remains closely aligned with China.<sup>16</sup> ONGC has Indian government approval to acquire assets throughout the world, and the company has the resources to make significant purchases. As of July 2006 ONGC had an \$11-billion cash reserve and no outstanding debts.<sup>17</sup>

China and India have, on occasion, cooperated in acquiring foreign oil and gas assets, in addition to engaging in fierce competition. Oil minister Mani Shankar Aiyar visited Beijing in January 2006 to discuss energy cooperation, and in December 2005, ONGC and CNPC jointly bid for a 38 percent stake in Syria's Al Furat Petroleum.<sup>18</sup> In 2006 ONGC Videsh and Sinopec combined to buy a 50 percent stake in Ominex de Columbia, an \$800 million deal. But Chinese-Indian cooperation on oil has been limited to smaller projects; they remain competitive in bidding for larger properties.

In Central Asia, India has demonstrated a willingness to work with the most repressive regimes, and has for the most part refused to follow the U.S. example of criticizing these states' violations of civil rights. India's position of noninterference in the internal affairs of countries is closer to China's than to that of the United States. The Indian government did not support Tashkent's repressive actions in Andijan as vociferously as did the Chinese or Russians, but they refrained from making

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15. Ganguly, "The ONGC."

16. Marie Lall, "Indo-Myanmar Relations in the Era of Pipeline Diplomacy," *Contemporary Southeast Asia*, vol. 28 (2006), pp. 424-46.

17. *Asianmoney* (July, 2006).

18. Indrajit Basu, "India, China Pin Down \$573m Syria Deal," *Asia Times*, December 22, 2005, online at [www.atimes.com/atimes/China\\_Business/GL22Cb06.html](http://www.atimes.com/atimes/China_Business/GL22Cb06.html).

harsh statements comparable to those heard in Washington or European capitals.<sup>19</sup> Uzbek President Islam Karimov has been welcome in India: He visited four times since Uzbekistan gained independence, and relations are described by both sides as close and friendly.

Japanese companies are involved in some dozen projects in Russia, Azerbaijan, and Kazakhstan, but aside from the Sakhalin ventures, most of these are small-scale. And Japanese companies are only partially owned by the government. The Japanese National Oil Corporation (JNOC) was broken up starting in 2001 as part of a planned reform by the Koizumi Junichiro government. Some of JNOC's activities were absorbed into the Japan Oil, Gas, and Metals National Corporation (JOGMEC); two other major companies formed were Inpex and the Japan Petroleum Exploration Company. Still, Tokyo's foreign energy policy may be characterized as neomercantilist, since the Japanese government maintains equity stakes in all these companies, and they, in turn, are expected to further Japan's national interests by diversifying energy supplies.

South Korea, the world's fourth largest importer of crude oil, has no domestic supplies of oil or natural gas and therefore is highly vulnerable to price fluctuation and supply disruptions. Like the other Asian oil importing countries, South Korea is using state-owned companies to acquire equity stakes in oil properties around the world to improve its energy security. At present, Korea supplies only four percent of its oil requirements from domestically owned overseas assets, through the Korean National Oil Company (KNOC) and Korean Gas Company (KOGAS). While these companies are state-owned, the Korean government plans to privatize both. Like China and India, South Korea seeks to diversify oil supplies and reduce its dependence on Middle East oil, an unhealthy 78 percent in 2004. The country has developed a strategic petroleum reserve as a cushion against supply disruptions. However, Korea's KNOC has very limited investments in Eurasia.

The following section focuses on Chinese, Indian, Japanese, and Korean neomercantilist activities in Eurasia, to assess the economic and political influence on the host nations.

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19. A former foreign secretary, Salman Haidar, did publish a highly critical article in *The Statesman*, May 24, 2005.

## **Influence on Host Countries**

The potential impact of a national oil company's investments and activities in a host country depend on several factors relating to NOC business practices, the extent of home country support for NOCs, and various features of the host country. First is the question of the size and scope of the NOC investment. Is it a major investment, with the NOC holding a controlling or blocking equity share in the project? Is it a fairly minor equity share? Or is it an exploration, service, or transportation contract that does not suppose a permanent presence in the industry? Does the project involve a large number of NOC employees at various levels, or are there simply a few NOC employees, with the bulk of the labor and managerial force indigenous to the host country?

Other factors are related more to the economic strength and sectoral distribution of the host country—for example, the percentage of a host country's oil or gas exports taken by one or a few NOCs may vary considerably.<sup>20</sup> An additional factor is the relative strength of a host country's economy, the extent of its diversification, and its reliance on oil exports. Healthy, diversified economies will tend to be less subject to influence from NOC participation.

Finally, the potential for NOC influence depends on the political stability and capabilities of the host state and the international alignment of forces in the region. Logically, weak and unstable states would be more heavily impacted by NOC activities, particularly those backed by a powerful neomercantilist government, than would strong, stable states. Likewise, states that have powerful international actors as friends or allies should be less susceptible to the influence of NOCs. Many states, however, not just the smaller and more vulnerable, seek to control the extent of foreign participation in their energy security.

Oil is a strategic commodity. Even the leading champions of market forces in the United States are reluctant to allow certain competitors to control the nation's oil supply.<sup>21</sup> Eurasian host

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20. In Sudan, for example, Chinese companies absorbed fully half of the country's oil exports in 2006.

21. Perception is often more relevant than reality. A good example is the Chinese National Offshore Oil Company's bid to acquire Unocal in 2005.

countries have shorter historical experience with market forces; they prefer neomercantilist strategies, keeping the commanding heights of the economy under central state control. Asian NOCs, driven by a complicated mix of profit motives and national mandates from their governments, engage in competitive and cooperative relations with energy-rich states equally determined to advance their state interests through resource nationalism. The following section assesses the potential impact of Asian national oil companies, both positive and negative, on four Eurasian countries that hold significant hydrocarbon resources: Russia, Kazakhstan, Turkmenistan, and Uzbekistan.<sup>22</sup>

### *Russia*

Vladimir Putin's resource nationalist policies limit foreign ownership of the oil and gas sector, enhance the clout of state-controlled firms, and ensure that private energy companies reflect the policy priorities of the Russian government. The policies have proved immensely popular, and are likely to be followed by his successors.<sup>23</sup> Under Putin's leadership the Russian state dissolved Mikhail Khodorkovsky's Yukos oil company, dividing its assets among state-owned firms. The Russian gov-

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The proposed deal was hardly a threat to the United States economy, its political power, or its energy security. CNOOC offered a premium price of \$18.5 billion for Unocal, two billion dollars above Chevron's offer, to acquire 1.75 billion barrels of reserves located mostly in Indonesia and Thailand. Unocal also held a 10.3 percent share in the Azeri-Chirag-Gunashli PSA, operating a field in Azerbaijan's sectors of the Caspian. Unocal was ranked fortieth among the world's oil companies, and its annual production of one percent of total U.S. oil and gas consumption was not likely to affect U.S. security. However, the chairman of the U.S. China Commission was called before the House Armed Services Committee to testify on the strategic implications of the proposed sale, and members of Congress voiced strong opposition to the sale, leading CNOOC to withdraw its bid. See Alexei Barrionuevo, "China Bid for Unocal Creating Unusual Stir," *International Herald Tribune*, July 2, 2005.

22. Asian NOC investments in Azerbaijan are minimal, and so have been excluded from this discussion.
23. For a recent review of Russian political developments and the transition, see Charles E. Ziegler, "Russia and the CIS in 2007: Putin's Final Year?" *Asian Survey*, vol. 48, No. 1 (January-February, 2008), pp. 133-43.

ernment also forced Royal Dutch Shell to relinquish half of its share in the Sakhalin II project. Putin made it clear that strategic resources are too important to remain fully under the control of foreign owners or Russia's private entrepreneurs.

Russia is particularly attractive to Asian NOCs because it holds approximately five to six percent of the world's oil reserves, has about one-third of the world's total gas reserves, and is geographically connected to Asia via the Russian Far East. Russia is easily the strongest economy of those discussed in this section, with overall GDP for 2007 estimated at \$1.375 trillion.<sup>24</sup> The oil and gas sector dominates the economy, accounting for between 25 and 40 percent of GDP, with diversification proceeding slowly. Since 2003 the government has moved to restrict equity holdings in key sectors of the economy, especially strategic natural resources, with the goal of extending Russian state control over these vital sectors of the economy.

Asian NOC investments in Russia are modest. The big players in Russian energy have been the international oil companies—Shell, ExxonMobil, Chevron/Texaco, and British Petroleum—and the Russian state-owned companies, Gazprom, Rosneft, and Transneft. Chinese investments have been small in scale, and are concentrated in the period from 2003 to 2007. The largest projects—the oil and gas pipelines from Siberia to China and the Pacific coast—are in the planning or early implementation stages, and in any case are Russian-owned and controlled. The largest Chinese investment to date in Russia was the purchase in 2006 of Udmurtneft by Sinopec. The Chinese company reportedly paid BP-TNK \$3.5 billion for Udmurtneft, or about forty percent above its book value. The Russian company, with an estimated 550 million barrels of reserves, was reportedly valued at only \$2.5 billion. In keeping with Russian policy of restricting foreign ownership to a minority share, state-owned Rosneft retained a controlling 51 percent of the company.<sup>25</sup>

The next largest Chinese venture into Russian oil was CNPC's purchase of \$500 million in shares of Rosneft, concluded in July 2006. CNPC had originally sought to purchase \$3 billion (a five-

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24. Federal'naya Sluzhba Gosudarstvennoi Statistiki, online at [www.gks.ru/bgd/free/B04\\_03/IssWWW.exe/Stg/d040/13vvp31.htm](http://www.gks.ru/bgd/free/B04_03/IssWWW.exe/Stg/d040/13vvp31.htm).

25. *Financial Times*, June 21, 2006.

percent stake) when Rosneft made its initial public offering on the London and Moscow stock exchanges, but the company was allowed to purchase only a fraction of that. By contrast, BP was allocated \$1 billion in shares, and Malaysia's Petronas acquired \$1.1 billion. CNPC was disappointed in the results of the IPO, but reasserted its intent to expand long-term cooperation with Rosneft.<sup>26</sup> Earlier, CNPC had been excluded from bidding for Slavneft during a privatization auction in 2002 (by the Russian Duma), and was not allowed to participate in bidding for Yukos' main subsidiary, Yuganskneftegaz, which was acquired by Rosneft (in part with a Chinese loan). Rosneft did pledge in 2004 to supply China by rail with 4.8 million tons of oil per year as a condition of the loan.<sup>27</sup>

The proposed construction of one oil and two gas pipelines from Siberia eastward would significantly change the Russia-China energy relationship, but plans have proceeded slowly, and on Russia's terms. The prospect of a privately owned oil pipeline disappeared with the attack on Yukos, and Putin decided to route the pipeline to the Pacific Ocean rather than to China. In an attempt to limit the political damage, the Chinese were virtually assured that a spur would be constructed to Daqing, although experts differ on whether reserves are sufficient to fill both lines. CNPC officials are upbeat on the pipeline's prospects, which would significantly expand deliveries of crude.<sup>28</sup> But Russian officials are clearly wary of tying their country to one East Asian consumer, preferring instead the option of marketing to other Pacific Rim countries. And they are determined to maintain as much control as possible over transportation networks.<sup>29</sup>

Natural gas pipelines to China present somewhat different issues. One of the planned routes would carry natural gas from the

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26. "CNPC Invests \$500m in Rosneft's IPO," *China Daily*, July 19, 2006; Breffni O'Rourke, "China/Russia: CNPC Denied Intended Stake in Rosneft," *Radio Free Europe/Radio Liberty*, July 19, 2006.

27. *Petroleum Economist*, vol. 73 (May, 2006).

28. See the remarks by CNPC General Director Chen Geng, *Interfax China: China Business Daily*, March 20, 2006, online at [www.interfax.cn/displayarticle.asp?aid=11195&slug=PIPELINE](http://www.interfax.cn/displayarticle.asp?aid=11195&slug=PIPELINE).

29. Among the various factors that led to the arrest of Mikhail Khodorkovsky and the assault on Yukos, a major factor was certainly Yukos' attempt to circumvent Transneft's pipeline monopoly.

Kovykta field in eastern Siberia to coastal China and on to South Korea. The second would pipe natural gas from the Sakhalin I project across the Tatar Strait to DeKastri on the Russian coast and then on to Komsomolsk. Additional liquefied natural gas (LNG) would be produced at the Sakhalin II terminal on the south of the island, and could then be exported throughout the Asia-Pacific region and to the western United States. The main problem with China in building the gas pipelines would not appear to be one of monopsony, but rather disputes over pricing.

India is a major investor in the Sakhalin I project, participating in the consortium led by ExxonMobil and including Japan's SODECO and affiliates of Rosneft. ONGC's \$2 billion investment in Sakhalin was the company's largest foreign acquisition through July 2006, giving it a 20 percent share in the project. Sakhalin I provided India with 33,000 barrels per day of crude oil in late 2006, with the prospect of reaching 50,000 bpd at peak production. India is interested in acquiring additional equity in Russian energy projects; one likely prospect would involve participation by ONGC Videsh in Sakhalin III.<sup>30</sup>

Outside of ONGC's large share in the Sakhalin I project, India has not been able to acquire equities in Russian oil and gas projects. ONGC had bid for a \$3 billion stake in Rosneft during the IPO in June 2006, but was unsuccessful. The Indian company also lost out to CNPC in its bid to acquire a 49 percent share in Udmurtneft (in 2006) and in its attempt to secure a 20 percent share in Yuganskneftegaz. However, Russia and India have declared they intend to expand energy cooperation. Following a meeting at Gazprom headquarters in April 2006, ONGC Videsh and Gazprom set up working groups to study cooperation in exploration and research.<sup>31</sup> Russia is currently constructing two nuclear reactors to supply India's growing demand for electricity. During Putin's January 2007 visit to India, ONGC and Rosneft signed an agreement on joint exploration and refining in Russia

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30. Statement by India's petroleum minister Murli Deora, in Richa Mishra, "India Keen on Stake in Sakhalin III Project," *Hindu Business Line*, December 3, 2006, online at [www.blonnet.com/2006/12/03/stories/2006120303460100.htm](http://www.blonnet.com/2006/12/03/stories/2006120303460100.htm).

31. Allister Maunk "The Great Indian Chessboard," *Monthly Review* (April, 2006), online at [www.axisglobe.com/article.asp?article=827](http://www.axisglobe.com/article.asp?article=827).

and India, as well as other countries. Putin also assured his hosts that he supported ONGC's bid to acquire a 20 percent stake in the Sakhalin III project.<sup>32</sup>

Russia, India, and China have in recent years explored the possibility of developing stronger trilateral relations, drawing on former prime minister Yevgeniy Primakov's vision of creating a strategic triangle to counterbalance U.S. power. Rhetorical support for a triangular relationship may be strong, especially in Moscow and Beijing, but suspicions between China and India run deep. In economics, especially energy, prospects for cooperation are even more limited, since India and China compete for Russian oil. Bilateral energy ties have greater potential economically, and are more feasible politically. India, for example, has proposed partnering with Russia to expand its refining industry (which is largely state-owned), in order to handle greater volumes of Middle East and Southeast Asian crude.<sup>33</sup>

Japanese and Korean energy firms have focused their efforts in the Russian Far East. Japan's links with the Russian oil and gas industry go back well into Soviet times, and Japanese companies were among the first to invest in Sakhalin. Private companies—Mitsui and Mitsubishi—have been active in the Sakhalin II project since the early 1990s, and the Sakhalin Oil Development Corporation (SODECO, a joint stock company) holds a 30 percent share in Sakhalin I.<sup>34</sup> JOGMEC, created to support the country's private companies in their search for energy assets, provides loan guarantees to SODECO in connection with the Sakhalin I project.<sup>35</sup>

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32. Agence France-Presse, January 25, 2007.

33. India's oil secretary, M. S. Srinivasan, proposed to Russia in October 2006 that Russian companies work with the state-owned Indian Oil Company in expanding India's refining capacity. In exchange, he proposed that Indian companies partner with Gazprom for joint bidding on exploration blocks and joint participation in exploration projects in Russia. *World Refining & Fuels Today*, vol. 31 (October, 2006).

34. Sodeco includes state-owned Japan Oil, Gas & Metals National Corporation, Inpex Corporation, Japan Petroleum Exploration Co., Itochu Corporation, Marubeni Corporation, and Teikoku Oil Co. Bloomberg.com, online at [www.bloomberg.com/apps/news?pid=10000101&sid=aW0PXzFAgo\\_s&refer=japan](http://www.bloomberg.com/apps/news?pid=10000101&sid=aW0PXzFAgo_s&refer=japan).

35. See [www.jogmec.go.jp/english/activities/financial\\_oil/index.html](http://www.jogmec.go.jp/english/activities/financial_oil/index.html).

Korea is seeking to diversify its oil supplies away from the Middle East, and while Southeast Asia is KNOC's core area of interest, the state-owned company is seeking upstream assets in Russia and the Caspian Sea region. According to KNOC's vice president for overseas exploration and production, Korea wants to secure imports from Sakhalin. In December 2005 a consortium of South Korean companies led by KNOC (together with Korean Gas, and private companies SK Corporation, Daewoo International, Hyundai, GS Caltex, and Kumho Petrochemical) acquired a 40 percent stake in a project to develop the offshore West Kamchatka Shelf. Estimates are that this area may hold nearly four billion barrels of oil equivalent. Korea is keenly interested in the prospect of a Siberia-China-Korea natural gas pipeline, as the country currently relies on imported LNG for its gas needs. KNOC has set aside about \$7 billion for acquisitions in Russia, the Caspian Sea, and other regions over the next five years, but the Koreans are well behind the Chinese, Japanese, and Indians in this strategy.<sup>36</sup>

### *Kazakhstan*

Kazakhstan has followed a neomercantilist policy in the energy sector, encouraging foreign investment and permitting extensive private ownership, while securing majority control over large projects for state-owned KazMunaiGaz. In recent years the government has renegotiated the terms of investment to "correct" perceived inequities from the early independence era. Kazakhstan was heavily reliant on foreign direct investment in the early years, in part to develop the economic system, but also in large part to prolong Nursultan Nazarbayev's personal rule as president.<sup>37</sup> As in Russia, growing Kazakh nationalism has bred popular resentment against foreign oil companies, which are viewed as exploitative.

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36. *Petroleum Economist*, vol. 73 (February, 2006), online at <http://proquest.umi.com/pqdlink?index=13&did=999214891&SrchMode=3&sid=1&Fmt=3&VInst=PROD&VType=PQD&RQT=309&VName=PQD&TS=1202497268&clientId=9580&aid=2>.

37. E. K. Dosmukhamedov, *Foreign Direct Investment in Kazakhstan: Politico-Legal Aspects of Post-Communist Transition* (London: Palgrave/MacMillan, 2002), pp. 161-65.

Kazakhstan's approach to the oil and gas business reflects its geopolitical strategy. Kazakhstan has pursued a "multi-vec-tored" foreign policy that skillfully balances the major powers with interests in the region: Russia, China, and the United States. Nazarbayev appears determined to spread investment around among a number of foreign companies, while pressuring them to cooperate with state-owned KazMunaiGaz, to minimize the potential influence of any one company on Kazakhstan's economy or politics.

To expand state control over energy, Kazakhstan in 2003 adopted a new investment law that removed some of the incentives and protections granted in 1994 legislation. The government limited tax concessions for foreign investors to five years, in order to ensure equal access for both domestic and foreign companies. Additional legislation enacted in 2004 gave the state preemptive rights to shares of oil projects being sold by foreign investors, and raised the government's share of oil income from 65 to 85 percent. A 2005 law on production sharing agreements required the local purchase of goods and services and the hiring of Kazakh nationals in oil and gas projects, and mandated that KazMunaiGaz have a minimum 50 percent share in offshore projects. These moves were designed to give state-owned KazMunaiGaz a stronger position in the oil and gas sector, and to give Kazakhstan a more lucrative share in the large Kashagan field.<sup>38</sup>

China's first acquisition in Kazakhstan was the Aktobe field, in the northwest. CNPC's international branch acquired a 60.7 percent stake in the field in 1997, and planned to construct a pipeline eastward to Xinjiang. The project languished for several years, in large part because of low oil prices, but by the middle of 2006 the pipeline had been completed and in early 2007 the Aktobe field was producing 120,000 bpd. In August 2003 CNPC bought 35 percent of the North Buzachi oil and gas field, in northwest Kazakhstan, and acquired the remaining 65 percent from Chevron two months later.

The single largest Chinese purchase of Kazakh assets took place in August 2005, when CNPC acquired the Kazakh holdings

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38. *International Financial Law Review*, vol. 22, No. 4 (April, 2003), pp. 70-76; *FSU Energy*, vol. 8 (January 17, 2003); *FSU Energy*, vol. 9 (December 10, 2004); *New York Times*, October 27, 2004.

of the Canadian firm PetroKazakhstan. CNPC paid a premium price for PetroKazakhstan: \$55 a share, or approximately \$10.26 per barrel of reserves (compared with PetroChina's trades at \$8.09 per barrel, and ONGC's at \$8.63 per barrel). India's ONGC sought to acquire PetroKazakhstan, as did Russia's Lukoil, but both were outbid by the Chinese state company.<sup>39</sup> This purchase was especially useful for China's energy strategy, since it will provide oil to the newly finished Atasu-Xinjiang pipeline (PetroKazakhstan's output in 2005 was about 128,000 bpd). ONGC had approached the bid in partnership with Mittal Group. Indian businessman Lakshmi Mittal has close ties to Kazakh government and business leaders, and his steel, mining and construction companies are prominent in Kazakhstan's economy. ONGC initially offered \$3.9 billion for PetroKazakhstan, with CNPC proposing \$3.6 billion, but CNPC subsequently raised its bid. Indian critics accused their leaders of not adequately supporting ONGC in its bid for the Canadian company.<sup>40</sup>

Some analysts have suggested that Kazakhstan is trying to ease out Western investors in favor of Asian partners more amenable to Kazakhstan's style of doing business.<sup>41</sup> However, China's efforts to acquire Kazakh assets have not always proved successful. CNPC and Sinopec failed in their 2005 bid for British Gas's 16.67-percent stake in the rich Kashagan offshore field. In July 2005 Chinese President Hu Jintao had visited Kazakhstan for a meeting with Nazarbayev, apparently seeking to pave the way for a CNPC acquisition. In the end, the other five majors exercised their right to buy out BG's share, and Kazakhstan convinced the partners to concede 50 percent of BG's share to KazMunaiGaz. Shortly after CNPC purchased PetroKazakhstan, the Kazakh government forced the Chinese to sell one third of the company to KazMunaiGaz, with the proviso that the shares be paid for out of future revenues. These developments illustrate

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39. N. J. Watson, "China Beats India to PetroKazakhstan," *Petroleum Economist* (October, 2005), online at <http://proquest.umi.com/pqdlink?index=4&did=919185321&SrchMode=3&sid=2&Fmt=3&VInst=PROD&VType=PQD&RQT=309&VName=PQD&TS=1202498004&clientId=9580&aid=3>.

40. Laxman Kumar Behera, "China Deals a Blow to India's Aspirations in Kazakhstan," *Energy Security*, January 10, 2006, online at [www.iags.org/n0119064.htm](http://www.iags.org/n0119064.htm).

41. Watson, "China Beats India to PetroKazakhstan."

the limits to Chinese influence in the Kazakh oil sector.

While oil is central to Chinese operations in Kazakhstan, long-term plans for supplying natural gas are also being developed, with KazMunaiGaz and CNPC agreeing to draft a feasibility study for construction of a gas pipeline from Kazakhstan to China. The first phase of the pipeline would go into operation in 2009 and would have an annual capacity of ten billion cubic meters (bcm). When the second phase is completed, in 2012, annual deliveries are expected to reach 30 bcm.<sup>42</sup>

While working closely with Chinese companies, Kazakhstan also welcomes cooperation with India in the energy sector. Negotiations between ONGC Videsh and KazMunaiGaz to develop oil and gas blocks in the Caspian region began in 2005. In 2006 Kazakhstan offered the Indian joint venture company ONGC-Mittal Energy Ltd. a 25 percent stake in the Satpaev offshore exploration block in the Caspian Sea, with the possibility of increasing the company's share to 50 percent once the block begins producing oil.<sup>43</sup> However, Kazakh-Indian cooperation on energy is limited by geography. Kazakhstan is landlocked, and pipelines would need to go through Afghanistan, Pakistan, or Iran to reach India. Each of the possible routes would face serious, though not insurmountable, economic and political obstacles.

For Kazakhstan, there are both economic and political advantages to dealing with Indian companies. India can provide capital and technology for the energy sector, as well as a ready (albeit distant) market. Kazakh officials are also eager to have Indian companies develop the information technology sector of the economy. Kazakhstan is currently India's largest trading partner in Central Asia, although with total turnover at \$210 million in 2006, there is great potential for expansion. Indian officials also hope to realize economic and political benefits from the developing relationship. The Kazakh government has publicly supported full membership for India in the Shanghai Coop-

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42. Sergei Blagov, "Nazarbaev Reassures Russians on Energy Cooperation," Eurasianet.org, March 20, 2007, online at [www.eurasianet.org/departments/insight/articles/eav032007a.shtml](http://www.eurasianet.org/departments/insight/articles/eav032007a.shtml).

43. Himendra Kuma, "Kazakhstan Offers 25% Stake to ONGC-Mittal JV in Oil Block," Dow Jones Newswires, October 13, 2006, online at [www.rigzone.com/news/article.asp?a\\_id=37095](http://www.rigzone.com/news/article.asp?a_id=37095).

eration Organization, and has endorsed Delhi's bid for a permanent seat on the United Nations Security Council.<sup>44</sup>

Kazakhstan's policy of diversifying investors suggests that potential influence from Asian NOCs backed by government diplomacy will be limited. Kazakhstan's oil and gas sector has profited from a range of foreign investors—American, Italian, British, Russian, and Chinese. American companies alone hold about 27 percent of foreign direct investment in Kazakhstan, approximately \$11.8 billion from 1993 through 2006.<sup>45</sup> Kazakhstan's leaders have been fairly successful, at least to this point, of balancing off companies from the major powers, whether national oil companies or international majors, and securing lucrative deals for Kazakhstan.

State policy focuses almost exclusively on the positive aspects of oil and gas cooperation with foreign investors, which are considerable, so Kazakh media seldom criticize either Asian or Western companies. However, "non-official" sources report poor treatment of Kazakh workers by foreign companies. For example, CNPC managers have been accused of discriminating against Kazakh workers at the Aktobezmunaigaz joint venture in Aktobe, origin of the Kazakh-China pipeline. The facility employs a mix of Chinese and Kazakh workers, and the latter complain they are forced to live in substandard housing, eat in a separate, inferior cafeteria, and are paid only a fraction of what Chinese workers receive. The workers also complained about poor safety records and frequent injuries. Local government officials in Aktyubinsk oblast investigated the alleged abuses, the oblast governor threatened strict sanctions, and in response Chinese executives promised to improve conditions at the enterprise.<sup>46</sup>

Chinese and Indian companies operating in Kazakhstan have

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44. "Kazakhstan Wants India to Join Shanghai Cooperation Organization," PTI Indian News Agency (in BBC Monitoring South Asia-Political), March 8, 2007, online at [www.lexisnexis.com/us/lnacademic/results/docview/docview.do?risb=21\\_T3009979503&format=GNBFI&sort=RELEVANCE&startDocNo=1&resultsUrlKey=29\\_T3009979508&cisb=22\\_T3009979507&treeMax=true&treeWidth=0&csi=10962&docNo=1](http://www.lexisnexis.com/us/lnacademic/results/docview/docview.do?risb=21_T3009979503&format=GNBFI&sort=RELEVANCE&startDocNo=1&resultsUrlKey=29_T3009979508&cisb=22_T3009979507&treeMax=true&treeWidth=0&csi=10962&docNo=1).

45. U.S. Department of State Background Note, "Kazakhstan" (February, 2007), online at [www.state.gov/r/pa/ei/bgn/5487.htm](http://www.state.gov/r/pa/ei/bgn/5487.htm).

46. Alina Pak, "Vplot' do deportatsii . . .," *Gazeta 'Megapolis,'* n.d., online at [www.megapolis.kz](http://www.megapolis.kz).

been known to violate work permit rules, bringing in construction workers, mechanical specialists, and cooks instead of employing Kazakh labor as required by Kazakh investment law.<sup>47</sup> Foreign energy companies may register as Kazakh firms in order to avoid local content rules, and they often use subcontractors who fail to observe labor or environmental standards. Workers at facilities operated by Western companies tend to leave if the companies are sold to Chinese owners. Chinese managers promise to abide by international standards, but then fail to fulfill their commitments. And while foreign oil companies are required to provide “social responsibility” funds (for environmental restoration, education, and local infrastructure), regional and district *akims* (governors) are authorized to spend the funds at their discretion.<sup>48</sup>

In cultural terms, Chinese and Indian companies are more adept than their western counterparts in functioning within the corrupt Central Asian business environment. Publicly, Central Asian governments welcome Asian NOC investment, and tend to downplay or cover up problems. Privately, Central Asians worry that China, with its huge population, could flood their small countries with Chinese workers and alter the demographic balance. While good statistics are not available, several reliable sources told this author that approximately 500,000 Chinese workers now live in Kazakhstan. Most of these are men working as contract laborers, and many return to China as scheduled; but Kazakhs still tend to view Chinese migration as a potential threat.<sup>49</sup>

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47. Within a few months after China’s CITIC purchased Nations Energy, Kazakhstan’s energy minister took the company to task for violating environmental standards and for not using Kazakh labor or goods, as required by law; “CITIC Receives Environmental Warning,” Korean Oil & Gas Industry Group, online at [www.kogiguk.com/News/Archive/2007/Mar/Article3246.htm](http://www.kogiguk.com/News/Archive/2007/Mar/Article3246.htm).

48. Personal communication from a specialist in the Kazakh oil and gas sector, April 2007; Interview with Kazakh energy specialists, Almaty, June 2007. Chinese oil companies in Central Asia try to portray themselves as good corporate citizens. CNPC-International Aktobe Petroleum, for example, devotes much of its website to explaining how the company protects worker safety and preserves the environment. See [www.cnpc-amg.kz/english/index.php?p=hse](http://www.cnpc-amg.kz/english/index.php?p=hse).

49. Personal communication with a member of the Karaganda Maslikhat (legislature), April 2007; interview with Nur-Otan official, Astana, May 2007.

Japanese and South Korean companies are fairly minor players in Kazakhstan, although both are exploring the possibility of securing Caspian Sea oil. In Central Asia, JOGMEC provides financial support to Inpex for its North Caspian Sea operation in the huge Kashagan field, which also includes EniAgip, ExxonMobil, Shell, TOTAL, ConocoPhillips, and KazMunaiGaz. JOGMEC also provides equity financing and loan guarantees to Inpex and Itochu for their participation in the Azeri-Chirag-Gunashli project in the south Caspian.<sup>50</sup>

South Korea has an advantage over Japan in that approximately 100,000 ethnic Koreans live in Kazakhstan, and many of these assimilated Koreans have been successful entrepreneurs. South Korea has interest in four Kazakhstan projects. One is offshore—the Zhambyl field in the north Caspian, where a consortium comprised of KNOC and four private Korean companies holds 27 percent of the block, with KazMunaiGaz controlling 73 percent. The field is estimated to hold between 600 and 800 million barrels of crude, and KNOC will operate the project jointly with KazMunaiGaz. Another consortium headed by KNOC acquired 50 percent of the South Karpovskiy gas field in 2005, jointly operated with a Kazakh company, Meridian Petroleum. KNOC also sought to purchase the ADA and Egizkara fields in Kazakhstan, which were partly controlled by the Korean firm LG, but negotiations for this deal have proceeded slowly.<sup>51</sup>

### *Turkmenistan*

Turkmenistan is gradually emerging from the totalitarian dictatorship of Saparmurat Niyazov, who died in December 2006. The country's internal political dynamics and foreign policy orientation, however, are only marginally different under his successor. Under Niyazov, Turkmenistan had maintained a state of permanent neutrality, which translated into virtual isolationism.

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50. Inpex has an 8.33-percent share in the Kashagan field and a 10 percent share in Azeri-Chirag-Gunashli. Itochu holds a 3.92 percent share in the latter project. See [www.jogmec.go.jp/english/activities/financial\\_oil/index.html](http://www.jogmec.go.jp/english/activities/financial_oil/index.html).

51. *Korea Times*, April 19, 2005; interview with KNOC General Director Gwak Jung Il, *Oil Review* (Kazakhstan), online at [www.oilreview.kz/pages/free\\_eng2.html](http://www.oilreview.kz/pages/free_eng2.html).

From the start of independence in 1991, Niyazov rejected ideas of Islamism and Panturkism, creating instead his own unique ideology of a paternalistic state led by an infallible figure, and legitimated through his spiritual guidebook, the *Rukhnama*. Ideology under Niyazov was nationalistic and anti-Russian; Turkmenistan's weakened position was blamed on repressive Russian and Soviet colonial history.<sup>52</sup>

Relations with the United States were problematic, given the country's abysmal human rights record. China and Iran, however, constituted potential markets for Turkmen gas, and neither country was troubled by Niyazov's repressive policies. Export routes through China and Iran would lessen Turkmenistan's dependency on Russia, and so were attractive to Turkmenistan's leadership. In April 2006 Niyazov and Chinese President Hu Jintao signed a deal to construct a natural gas pipeline to Guangdong. The plans for this pipeline, which would deliver thirty billion cubic meters of gas per year over a thirty-year period, were deemed unrealistic by some experts. However, the project was reaffirmed by Turkmenistan's newly-elected president, Gurbanguli Berdimukhammedov, in spring 2007, and CNPC plans to start work in 2008 on a 6,500 kilometer pipeline to deliver Turkmen and Kazakh gas to Xinjiang. President Berdimukhammedov has praised China as a close friend and reliable partner, while asserting Turkmenistan's determination to maintain a foreign policy of permanent neutrality.<sup>53</sup>

With Niyazov gone, the United States and Europe are exploring the potential for a new relationship with Turkmenistan, based heavily on an interest in energy. Washington is encouraging Turkmenistan's new leaders to diversify their gas export strategy in order to avoid the near-monopoly control over pipelines exercised by Gazprom.<sup>54</sup> Berdimukhammedov has welcomed the

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52. For a discussion of Turkmen ideology under Niyazov, see Horak, "The Ideology of the Turkmenbashi Regime," pp. 305-19.

53. Turkmen Radio, as reported in *Global News Wire—Asia Africa Intelligence Wire* (March 26, 2007); *Xinhua News Agency*, (February 16, 2007); *Xinhua Financial News*, (April 5, 2007).

54. U.S. Assistant Secretary of State for South and Central Asia Richard Boucher attended Niyazov's funeral and met with senior Turkmen officials. Stephen Mann, principal deputy assistant secretary of state for South and Central Asia, met with Berdimukhammedov and the Turkmen

attention from Washington, and has negotiated with the European Union in an attempt to diversify his country's gas customers. But the United States and Europe face competition from China and India, which have ratcheted up their diplomacy. At the same time, Russia is working assiduously to preserve and strengthen its hegemonic position in Turkmenistan.<sup>55</sup>

With American and Chinese officials and oil companies pursuing Turkmenistan's gas, this relatively weak Central Asian nation has a great deal more leverage in international business and political affairs than it would otherwise have. The greatest threat to Central Asian economic independence is the power of Russia's national gas and oil companies, particularly Gazprom and Transneft. Gazprom, one of the largest corporations in the world, monopolizes all gas pipelines running from Central Asia through Russia; Transneft controls the oil pipelines. Turkmenistan needs foreign investment and technology to develop its gas resources. China's NOCs and Western majors can offer deals that give the Central Asian states alternatives to Russia, and the competition will tend to drive oil and gas prices higher. New deals on gas and oil can also undermine Gazprom's strategy of covering Russia's local market with cheap Turkmen imports, while exporting Russian gas to Europe at world market prices. Deals with China, the United States, and Europe erode Moscow's influence over Turkmenistan, and raise fears about Washington's strategic intentions in the region.<sup>56</sup>

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energy minister in March 2007. A former National Security Agency official, David A. Merkel, has expressed hopes that Turkmenistan would supply gas to a Trans-Caspian pipeline that would bypass Russia. Joshua Kucera, "West Should Take Action to Check Gazprom's Influence in Turkmenistan-Expert," Eurasianet.org, March 21, 2007, online at [www.eurasianet.org/departments/business/articles/eav032107.shtml](http://www.eurasianet.org/departments/business/articles/eav032107.shtml); U.S. Embassy in Turkmenistan, <http://turkmenistan.usembassy.gov/pr/20070305.html>.

55. Russian Prime Minister Mikhail Fradkov and Gazprom CEO Aleksei Miller attended Niyazov's funeral. China was represented by State Councilor Tang Jiaxuan, a special envoy of President Hu Jintao, and India sent Saifuddin Soz, the Minister of Water Resources.
56. A recent article by a Russian analyst referred to Washington's "assault on Ashgabad" and warned that the United States was not only seeking energy resources but was also attempting to surround Iran in preparation for a military assault. Aleksandr Zhelenin, "Brosok na Ashgabad:

Turkmenistan's existing projects with Asian national oil companies are relatively small, and involve minimal foreign investment. Petronas, the Malaysian state-owned oil company, has operated three blocks in Turkmenistan's Caspian waters since 1996, and has invested \$386 million from 2002 to 2005.<sup>57</sup> CNPC has two projects dating from 1998 to service and overhaul old wells. In late 2006 the company signed a three-year agreement to explore the South Yoloten gas field in a joint venture with Turkmengeologiya. But Turkmenistan's secretive government still refuses to allow outsiders to evaluate its gas reserves, casting doubt on the viability of these agreements.<sup>58</sup>

However, there are several major proposed projects that could radically alter Turkmenistan's energy industry. The first would be a natural gas pipeline to western China, a joint venture between Turkmenistan and CNPC announced in April 2006. This pipeline, planned to deliver 30 bcm annually to China over thirty years (starting in 2009), would cost at least \$5 billion. Experts are divided on whether Turkmenistan's reserves are sufficient to supply the pipeline, and in any case the discovery of several huge fields in China, and that country's slower than anticipated shift to natural gas in its energy balance, make the project questionable.<sup>59</sup>

Western leaders promote transportation plans that bypass Russia and Asia. The United States is promoting a gas pipeline from the southern Caspian Sea through Azerbaijan and on to Turkey—the Trans-Caspian Pipeline (TCP). This pipeline (with an annual capacity of 30 bcm, at a cost of \$5 billion) would ship Turkmen and Kazakh gas westward through Baku, bypassing Russian territory. Azerbaijan's government has supported the project, urging Kazakhstan and Turkmenistan to sign on.<sup>60</sup> The

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sotrudnichestvo SShA i Turkmenii mozhnet pererasti ekonomicheskii ramki," *Nezavisimaya gazeta*, March 12, 2007.

57. U.S. State Department Investment Climate Report 2006: Turkmenistan, online at [http://turkmenistan.usembassy.gov/ic\\_report06.html](http://turkmenistan.usembassy.gov/ic_report06.html).

58. Vladimir Socor, "Turkmenistan-China Gas Agreements Still a Very Long Shot," *Eurasia Daily Monitor*, July 20, 2007, online at [www.jamestown.org/edm/article.php?article\\_id=2372306](http://www.jamestown.org/edm/article.php?article_id=2372306).

59. "Natural Gas: Putting the Cart Before the Horse," *Petroleum Economist* (December, 2006).

60. Vladimir Socor, "Azerbaijan Spearheading Initiative on Trans-Caspian

European Union has explored the prospect of routing Turkmen, Iranian, and Azeri gas through Turkey and on to Europe through the 2,000-mile long Nabucco pipeline. Russia has sought to block both projects.

India is interested in the longer Trans-Afghan Pipeline (or Turkmenistan-Afghanistan-Pakistan pipeline, TAP). The Asian Development Bank completed a feasibility of the 1,700-kilometer Trans-Afghan pipeline in 2005, and India's parliament passed a resolution supporting Indian participation in the project. But security concerns and the lack of investors, along with uncertainties about the size of Turkmenistan's reserves, have delayed implementation of the project. The Trans-Caspian Pipeline is probably more feasible, since it is shorter and much of the infrastructure is already in place on the western side of the Caspian. But there are also political problems with the TCP, related to territorial disputes among the littoral states over the Caspian Sea.

Prospects for the Trans-Caspian and Nabucco pipelines declined when, in May 2007, the presidents of Russia, Turkmenistan, and Kazakhstan agreed to upgrade the Prikaspiiski natural gas pipeline running northward from Turkmenistan to Russia. That deal, when added to proposed Uzbek gas exports, would increase annual Russian imports from Central Asia from 50 million to 90 million bcm. The agreement, when finalized, will strengthen Moscow's control over the region's energy exports, weaken Washington and Europe's efforts to diversify energy supplies, and make it more difficult for Asian companies to compete with Gazprom.<sup>61</sup>

Putin's energy diplomacy aims to preserve Gazprom's near-monopoly over Central Asian gas exports and strengthen his country's position as the major export route for oil.<sup>62</sup> However,

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Gas Pipeline," *Eurasian Daily Monitor*, March 30, 2006, online at [www.jamestown.org/edm/article.php?article\\_id=2370929](http://www.jamestown.org/edm/article.php?article_id=2370929).

61. Sergei Blagov, "Russia Celebrates its Central Asian Energy Coup," *Eurasianet.org*, May 16, 2007.

62. Russia's intentions were clear when, in April 2007, Berdymukhammedov made his first official visit as president to Moscow. Berdymukhammedov met with President Putin and the heads of Russia's major corporations and reaffirmed his country's commitment to the twenty-five-year gas contract signed in 2003. Putin emphasized Russia's interest in a security partnership with Turkmenistan to address terrorism and narcotics traf-

there have been continual disputes between Russia and Turkmenistan over natural gas pricing. Given suspicions about Moscow's neoimperial policies in the border regions, the new leadership in Ashgabad will likely continue Niyazov's efforts to diversify export routes. The proposed pipeline to China, the Trans-Afghan pipeline to India, the Nabucco pipeline to Europe, and the Trans-Caspian Pipeline favored by Azerbaijan and the United States all provide Turkmenistan with alternatives to Russian export routes and enhance its bargaining position.

As in the case of Kazakhstan, Turkmenistan is a small, relatively weak state that is in many respects highly vulnerable. The abject poverty in the countryside and the potential for social unrest during liberalization are possible sources of instability. The country is landlocked, and is located in a highly volatile region. Assuming the Turkmen leadership can pull off a skillful balancing act similar to that of their counterparts in Kazakhstan, the country may be able to absorb investment from all the major powers without being dominated by any one of them. Chinese proposals in particular offer Turkmenistan a means to contain Russia's heavy-handed energy diplomacy.

### *Uzbekistan*

Uzbekistan has only modest oil reserves (about 600 million barrels), but substantial reserves of natural gas (about 66 trillion cubic feet). It is the second largest gas producer in the former Soviet Union, after Russia. Chinese, Indian, and South Korean national oil companies have concluded deals with Uzbekistan in recent years, although these are all relatively small operations.

Uzbekistan and China first signed energy agreements during President Hu Jintao's June 2004 visit, when CNPC concluded a number of oil and gas contracts with Uzbekneftegaz, the

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ficking. Although Putin reassured his guest that Russia respected Turkmenistan's neutrality, Russian observers agreed that Putin was extending an invitation to strategic cooperation. "Turkmeniya-Rossiya: Kaspii, gaz i filial MGU v Ashkhabade," Ferghana.ru, online at [www.ferghana.ru/article.php?id=5082](http://www.ferghana.ru/article.php?id=5082). While the trip to Moscow was Berdymukhammedov's first state visit, it was his second trip abroad as president. The first was to make the hajj to Mecca. Anatoly Medetsky, "Energy Tops Turkmen Agenda," *Moscow Times*, April 24, 2007.

Uzbek state oil company. In June 2006 Uzbekneftegaz and the China National Oil and Gas Exploration and Development Corporation, a subsidiary of CNPC, concluded a \$210-million deal to undertake exploratory onshore drilling. Later that year CNPC entered into two contracts with Uzbekneftegaz, including a production sharing agreement (PSA) that also included Lukoil, Petronas, and the Korea National Oil Corporation, to explore and develop natural gas deposits in the Aral Sea. Each of the partners received a 20-percent share in the project.<sup>63</sup>

Although Uzbekistan's energy relations with China are in the early developmental stages, they provide political and diplomatic support for the regime's repressive domestic policies and for participation in world economic forums such as the WTO. China also provides technology and investment for Uzbekistan's oil and gas sector. However, it is not clear that the economic benefits are sufficient to keep Chinese companies interested. In April 2007 Sinopec's Shengli announced it was withdrawing from a 2003 agreement with Uzbekneftegaz to develop oilfields, contending that Uzbekistan's resource taxes (20 percent for crude oil and 30 percent for natural gas) were too high.<sup>64</sup> Shortly thereafter, the head of China's National Development and Reform Commission, Ma Kai, and Uzbek Deputy Prime Minister Rustam Azimov agreed to build a 530-kilometer gas pipeline with an annual throughput of 30 bcm.<sup>65</sup> These developments suggest a lack of coordination between Chinese political officials and the country's national oil companies.

India is following in China's footsteps, but without great success. After the ouster of U.S. troops from Uzbekistan, India was cited by President Karimov as one of his country's close friends, together with China, South Korea, and Pakistan.<sup>66</sup> Prime Minister Manmohan Singh visited Tashkent in April 2006 to discuss security issues, including military training and education, containing Muslim extremism, and cooperation in the oil and gas sectors.

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63. Reuters, June 13, 2006; Xinhua, September 3, 2006; *China Daily*, September 5, 2006, online at [www.chinadaily.com.cn/bizchina/2006-09/05/content\\_681542.htm](http://www.chinadaily.com.cn/bizchina/2006-09/05/content_681542.htm).

64. *Xinhua Economic News*, April 17, 2007.

65. *Moscow Times*, May 2, 2007.

66. RFE/RL Central Asia Report, May 26, 2006, online at [www.rferl.org/reports/aspfiles/printonly.asp?po=y](http://www.rferl.org/reports/aspfiles/printonly.asp?po=y).

One project discussed during Singh's visit was a production sharing agreement between ONGC Videsh and Uzbekneftegaz, but it appears the agreement has not been finalized.<sup>67</sup>

Korean firms were active in Uzbekistan in the 1990s, with major joint ventures in the automobile, telecommunications, and textile industries. Building on the ethnic Korean tie (there are about 250,000 ethnic Koreans in Uzbekistan, the largest Korean population in Central Asia), Koreans became prime investors in the Uzbek economy, at about \$1 billion. However, the absence of clear business and tax laws, and high levels of corruption, led to disillusionment among Korean investors. President Karimov's March 2006 visit to Seoul was part of a strategy of winning new friends in East Asia, and was specifically targeted at attracting Korean investment in Uzbekistan's hydrocarbon and minerals sectors, beyond the Aral Sea operation. During Karimov's visit, KNOC and Kogas signed a memorandum of understanding with Uzbekneftegaz to explore the possibility of developing two oil and two gas fields in eastern Uzbekistan, but apparently the contracts were never issued.<sup>68</sup>

Like Kazakhstan and Turkmenistan, Uzbekistan has utilized its geopolitical position and energy resources to balance off the larger powers. In the 1990s Uzbekistan's foreign policy leaned westward in an attempt to preserve the country's newly acquired independence. When U.S. criticism of Tashkent's human rights record strained relations, Karimov found support for withdrawal of U.S. forces in the 2005 Shanghai Cooperation Organization resolution. China and Russia, in contrast to the United States, have endorsed the Karimov regime's brutal tactics against its critics, and Tashkent has moved closer to both countries since 2005. Beijing welcomed President Islam Karimov for a state visit just two

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67. ONGC Videsh's website does not list any projects in Uzbekistan; see at [www.ongcvides.com/](http://www.ongcvides.com/).

68. Gulnoza Saidazimova, "Uzbekistan: Karimov in South Korea Looking for Investment," Radio Free Europe/Radio Liberty, March 29, 2006, online at [www.rferl.org/featuresarticle/2006/03/5f2219c2-413c-4c27-b04f-2b6df81daf67.html](http://www.rferl.org/featuresarticle/2006/03/5f2219c2-413c-4c27-b04f-2b6df81daf67.html); Lee Joo-hee, "Korea, Uzbekistan Agree on Joint Oil, Gas Development," Ferghana.ru (March 29, 2006), <http://enews.ferghana.ru/article.php?id=1348>. A search of KNOC and Kogas websites found no indication that the contracts had been finalized as of February 2008.

weeks after the Uzbek government put down the popular uprising in Andijan, and President Hu Jintao signed a treaty of friendship and cooperation with his Uzbek counterpart. Hu assured Karimov that China “honored” Uzbekistan’s efforts to preserve its independence, sovereignty, and territorial integrity. The Chinese foreign ministry reiterated China’s firm support for Uzbekistan’s right to preserve domestic and regional stability by cracking down on terrorism, separatism, and extremism.<sup>69</sup>

### Discussion and Conclusions

Asian national oil companies have a mixed record in Eurasia. Although Japanese oil and gas corporations were the first to establish a presence in Russia, Japan’s equity investments in the region have been fairly limited. Of the few new projects that have been undertaken in recent years, most are small in scale. Japan no longer has wholly state-owned energy companies, but instead has opted for state-owned financing of primarily publicly traded companies. Still, the government works closely with oil and gas firms to diversify supply, with a primary focus in Russia’s Sakhalin projects and the proposed Siberian oil and gas pipelines.

China and India have pursued a more overtly neomercantilist strategy of state support for national oil companies seeking energy assets. China’s investments in Eurasia have been the largest and most significant in geopolitical terms. However, Chinese investments in Russia have been limited by political reactions from nationalist politicians, and by executive decisions barring foreign firms from holding majority shares in strategic sectors. Political relations between Russia and China are officially described as excellent, and the strategic partnership between Moscow and Beijing serves as an important counterweight to perceived U.S. hegemony and unilateralism. But Russians are deeply suspicious of China’s long-term intentions toward their country, and they are clearly nervous about the enormous demographic

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69. Qin Jize, “China, Uzbekistan Sign \$600m Oil Agreement,” *China Daily*, May 26, 2005, online at [www.chinadaily.com.cn/english/doc/2005-05/26/content\\_445707.htm](http://www.chinadaily.com.cn/english/doc/2005-05/26/content_445707.htm).

imbalance, particularly in the Russian Far East.

In Central Asia, Chinese firms have pursued an aggressive strategy of acquiring oil and gas assets, with the greatest successes coming in Kazakhstan. Although Kazakhstan is small, militarily weak, and landlocked, its energy wealth and central geopolitical location have conferred a unique ability to balance off the major powers, both politically and economically. Kazakh legislation now requires controlling shares in major oil and gas ventures to be held by state-owned KazMunaiGaz, limiting foreign penetration. Finally, as in Russia, there is considerable suspicion of China's intentions, and fears the country could be swamped by migrant labor. These factors combine to limit the potential impact of Chinese and other Asian NOCs in Kazakhstan's economy.

Uzbekistan has proved a more difficult place for Asian NOCs to do business, not so much because of nationalism and legislation directed against foreign investment as because of corruption, arbitrary and repressive leadership, and economic inefficiency. In this environment, Chinese firms appear to have an advantage over international oil companies, and firms from Japan or Korea.

India's presence in Central Asia has been limited, in part because longstanding tensions with Pakistan have made access to the region difficult. Indian NOCs are now making a concerted effort to compete with Chinese firms in Central Asia, but results to date have been modest. However, India has some advantages in the region. There are no historic tensions with Russia or Central Asia; indeed, during the Soviet period there were close military and economic ties, Indian films and culture were popular, and India was relatively easy to visit. But India is geographically further removed from the region than China, and Indian firms have been less aggressive than Chinese in pursuing oil and gas assets. It also appears that India's state-owned companies have not enjoyed the same level of political support that Chinese firms have received from their government.

Korea, like India, has adopted China's strategy of seeking oil and gas assets abroad through its state-owned oil and gas companies. Korea is late to the game, and its investments to date have been modest. However, as a medium power Korea is much less threatening than China, and the presence of substantial ethnic Korean populations in Uzbekistan, Kazakhstan, and Russia

confers a business edge.

Of the oil- and gas-rich Eurasian states, Turkmenistan is probably the most vulnerable to external influence, whether in the form of NOC investment or great-power machinations. A totalitarian state in the process of transition and possible reform, Turkmenistan is fragile and much less able than Russia, Kazakhstan, or Uzbekistan to engage in a balancing act to protect its sovereignty and develop its natural resource base. Turkmenistan's new leaders appear willing to engage with the world, and they need foreign technology and investment to develop the natural gas sector. Asian NOCs will move quickly to fill the vacuum if Western companies and governments do not.

In Eurasia, Asian NOCs face the greatest competition neither from each other nor from the oil majors, but instead from Russia. Russia's state-owned firms—Gazprom, Rosneft, and Transneft—are key elements of Putin's successful strategy of rebuilding Russian power based on state control of strategic resources. These companies have been used with typical Russian ruthlessness to restore Moscow's influence in Central Asia, and Putin's successors are likely to continue this policy. Asia's national oil and gas companies have made some modest inroads in the region over the past decade, but Russia's energy hegemony, combined with national resource strategies of the Eurasian states and balance-of-power politics, limit their influence.

There are four major implications of Asian NOC activities for broader economic and geopolitical competition in Eurasia. First, the Asian NOCs, and the governments that support them, are far more tolerant of Eurasia's authoritarian regimes and human rights violations than American or European policy makers. This tendency to separate business from politics holds for Asia's democratic governments as well as the authoritarian states. This may confer a slight business edge on the Asian NOCs, although Western companies have successfully pursued projects in authoritarian states, in Eurasia, and elsewhere.

Second, Asian NOC investments are driven by a neomercantilist mix of economic and political factors, not solely market forces. These factors generate tension between company and state priorities. Asian political leaders often voice support for major projects, such as long-distance pipelines, that may not be economically attractive to the national energy companies. China's frag-

mented authoritarianism suggests that oil company executives and government officials may work at cross purposes. Asian NOCs, particularly the Chinese, have in the past paid above-market value for upstream oil and gas assets. Their global operations are highly profitable, and Chinese leaders expect them to subsidize domestic operations, where retail prices are controlled by the government. India's Oil and Natural Gas Company experiences similar conflicting pressures. National oil company efforts to acquire upstream assets abroad mesh closely with national government goals of diversifying energy supplies and extending political influence regionally and globally, but the relationship between Asian governments and their NOCs appears to be one of symbiosis rather than control.

Third, Asian companies operate in business cultures similar to those in Eurasia, and tend to have fewer restrictions (either legal or moral) about engaging in bribery and corruption. But the "corruption advantage" of Asian NOCs may be offset by Western oil majors' reputation for paying high wages and treating workers well. European firms also tend to invest large sums in local infrastructure and goodwill projects, and they respect the environment to a greater extent than do Asian NOCs or indigenous firms. Asian NOCs, especially the Chinese companies, are viewed as exploiting the workforce and evading host country laws. Chinese investments also generate fears of massive in-migration.

Finally, energy-rich Eurasian states have used their own form of neomercantilism to develop their resource base, attract diversified foreign investment, preserve national sovereignty, and maintain good relations with all the major powers. All Eurasian states vigorously guard their political and economic independence and resist infringements on their sovereignty by any outside force, whether Eastern or Western, private state-owned entities. The pattern, whether in Russia or Central Asia, is for these politically and militarily weak but energy-rich states to use their oil and gas resources to leverage stronger geopolitical positions.

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