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### The Kazakhstan-China Pipeline by A&A Energy Security Briefing

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## **Project Environment Analysis** **The Kazakhstan-China Pipeline**

### **Summary**

A pipeline that links the oil fields of west Kazakhstan to China's Xinjiang Province has recently completed the symbolic step of pumping crude oil its entire length. The pipeline represents a huge collaboration between China and Kazakhstan. The significance of this dimension will not be lost on Russia, which could potentially envy the revenues Kazakhstan is set to earn from the project. However, even at this early stage there are a number of questions looming, such as whether or not the pipeline will ever be able to operate at volumes that will make it a truly profitable venture. On the whole though the project should be viewed in a positive light; not only is the political risk surrounding the project entirely manageable, there is a relatively low risk of physical attack – certainly when compared to some African projects, for example.

### **The Project**

The history of the Kazakhstan-China Pipeline project stretches back as far as 1997, when an original contract was signed to construct a pipeline that would stretch from Atyrau, on the Caspian coast in western Kazakhstan, to Urumqi, in the northeast Chinese province of Xinjiang. However, economic travails put the project on hold; there was also talk of a Russian Far East pipeline. By 2002, China had begun to realise, as Russia dragged its feet about the final destination of the Taishet-Skovorodino pipeline, the folly of placing the lion's share of its energy supply requirements with Russia. The process was set in motion, with most of the initial work taking place in Kazakhstan. Phase One of the project saw the construction of a pipeline from Kenkiyak to Atyrau, which initially ran westwards, connecting the Aktobe oil fields to the Caspian hub (construction for this phase was completed in 2003). This section has been reported as being 279 miles long (approximately 450 kilometres).

The second phase of the project denotes the section running from Atasu, in central Kazakhstan, to Alashankou in Xinjiang. This has been constructed with 813 mm pipeline, a diameter critical to the pipeline supplying the requisite amount of oil, namely 400,000 barrels per day – although initially the pipeline will only be capable of pumping half that amount. The second

phase began construction in September 2004 and on 15 December 2005, Kazakh President Nursultan Nazarbaev pushed the button to begin the filling of the 613 mile (approximately 1,000 kilometres) section of pipeline. [Note: some sources indicate that this section of pipeline runs for 807 miles: this is probably due to these reports being written prior to construction. Additionally, Alashankou is often referred to by the Russian-Chinese combination of Druzhba-Alashankou, or occasionally by the name of the mountain pass where it is situated, namely the Alatau Pass.]

The question of capacity is critical to make the pipeline economically viable – although a pipeline did already exist that could have theoretically linked Kenkiyak to Atasu, it was of an insufficient diameter. The pipeline could only be an economic success if the pipeline could deliver 20 million tons of oil annually. Hence the 311 mile (approximately 500 kilometres) pipeline that existed for most of the way between Kenkiyak and Atasu had to be rebuilt.

In May 2006, the first oil pumped from the Chinese-operated oil fields in west Kazakhstan made it to the border. The pipeline is a joint venture, operated by the Kazakh-Chinese Pipeline Company, a joint venture between Chinese National Petroleum Company (CNPC) and Kaztransoil under a 30 June 2004 agreement; initially Kazakh Prime Minister Daniyal Akhmetov had said that Kazakhstan would like a 51 percent controlling share in a pipeline constructed to Russia. The total cost of the project has been estimated at US\$3-3.5 billion; phase two of the project, initially supposed to cost around US\$700 million, cost an estimated US\$850 million.

## **Political**

The political risks surrounding the pipeline are not inconsequential; both the titular nations – China and Kazakhstan – present significant risks politically, but the massive regional player, Russia, also has some value in the equation.

### *Leadership continuity*

In a nutshell, both of the nations have too much to lose by wilfully allowing the pipeline to fail, or even by deliberately sabotaging the project: there is simply too much riding on the project for this to occur. China needs the oil as much as Kazakhstan needs to sell it. The national significance of the project is such that even if there was an unexpected coup or regime change, the successor governments would probably treat the project as untouchable. It should be noted that in the current climate, neither country is likely to undergo a sudden and dramatic change in regime. There is some intrigue over the power struggles in Kazakh politics, but this relates to the successor of President Nazarbaev (currently thought to be most likely his eldest daughter, Dariga Nazarbaeva); however, the next change in power (scheduled by election) is not due until 2012.

### *Local corruption*

At a macro-level, the political capital of the project is so great as to ensure continued efforts to keep it afloat. However, there is the dimension that local politics could adversely affect the project. In both countries there are not inconsiderable problems with corruption, and the struggle between the centre and the regions could potentially be a problem. It is not inconceivable that a Chinese regional governor decide to withhold shipments of refined products to exert leverage over Beijing to resolve a relatively minor dispute.

### *Economic and transport considerations*

There are yet far more specific examples of potential political risks to the project. One major problem is the question of throughput – the amount of oil that need to be physically pumped to make the project a going concern (according to reports of 2000, when the project was still being discussed, the CNPC was ordered to make it run at a profit, despite the more overarching concern that China secure a reliable supply of oil). It was recently estimated that it would take as much as one million barrels of oil a day to flow though the pipeline to make it run profitably. At the current progress, with oil only just completing the “trudge” from west Kazakhstan to west China, it will take until mid-2007 until Chinese refineries begin to receive an estimated 100,000-200,000 barrels of oil per day. It will take up to a year after that for the Chinese refineries to be fully upgraded and expanded to be able to cope with the extra volumes. So judging by the current volumes exported and the reserves of oil, one analyst has claimed “Kazakhstan simply doesn’t have that much oil to send east”. However, his projection should be placed in the context of ever-increasing oil prices: if prices keep rising at the rate they have been, then it is highly likely that the project will become viable. Witness the change in fortunes for Canadian oil-sands deposits: once considered too expensive to develop, the rise in oil prices has left companies such as PetroCanada sitting on deposits of huge potential value. There is also the consideration that Chinese industry might be so rampant in growth that an unprofitable supply of oil is entirely mitigated by the revenues generated by the products that oil helps produce.

### *Employment*

At one point, concerns were raised about the socio-economic factors that could result in such a project being constructed. For example, there is the issue of Kazakhs becoming outraged at well-paid Chinese workers “stealing” not only their jobs, but also their women. There is no small amount of resentment felt by Kazakh labourers towards their neighbours, especially those that decide to settle in the country and take a Kazakh wife. However, hopefully such issues will have been avoided by careful preparation by both governments: not only is the cost of the pipeline to be borne equally by the two countries, construction of phase two of the project was to be completed by a 60 percent Kazakh workforce. It should also be noted that 75 percent of China’s 1,300,000 ethnic Kazakhs live in Xinjiang, representing a considerable Kazakh influence in the region.

### Powerful neighbour

But amongst all of these issues, the predominant concern is that of Russia: how will the big neighbour view this deal? Initially, there is much to suggest that Russia would strongly disfavour the project: but then Russia is notorious for thinking in zero-sum terms. One might think that Russia would assume that every Kazakh barrel of oil delivered to China is one barrel less potential revenue earned by Russia. Indeed, this is a dimension that was strongly at play during discussions over the proposed final route of the Taishet-Skovordino pipeline, and it is still not clear where the final destination will be (either Daqing – to serve the Chinese markets, or Nakhodka – to serve the Japanese; it now appears that spur pipelines might be built that could serve both destinations). While Russia is probably slightly piqued by their Kazakh neighbours beating them to it, it should also be noted that initial reports regarding the initial shipments of oil to the country claimed that both Kazakh and Russian oil would be delivered to China via the pipeline. This suggests that Russia has taken a pragmatic approach to the pipeline, namely viewing it as another potential vehicle with which it can generate revenue.



Pipeline route, (source: Energy Information Administration, <http://www.eia.doe.gov/emeu/cabs/kazak.html> )

## **Security**

The major concern facing the pipeline is that ethnic issues could proliferate to such a degree that massive infrastructure targets – of which this project is a prime example – could become attractive to minorities, separatists or fundamentalists as a tool with which to cause grief to central governments.

However, in relation to this, it should also be noted that neither China, including Xinjiang, nor Kazakhstan has had significant problems with militant, separatist or extremist attacks on oil or gas infrastructure. When comparing the threat levels to those that exist in Iraq or Nigeria, for example, it becomes apparent that there is no especial threat in this regard. However, this is not to say that such issues are non-existent in this region, and the following discussions take place at a strongly theoretical level.

### *Separatism: myths and reality?*

Regarding the issue of separatism, it is the Uighurs in Xinjiang that present the most threat in this regard. Indeed, to this Muslim Chinese ethnic group, the area is known not as Xinjiang, but as Uighurstan or East Turkestan. The major tension in the region is the Chinese government's promotion of the Han Chinese – who make up around 90 percent of China's ethnic makeup – at the expense of the Uighurs, Kazakhs and Tajiks. Whereas these ethnicities were previously dominant in the area, they are now at parity with the Han. The crackdown against the Uighurs has been intense at some times: between April and August 2001, it was claimed that 13,000 Uighurs had been arrested in the region; 30 had been executed. There were no non-Uighur executions.

Naturally, such persecution is not without consequence (or, as the Chinese would argue, vice-versa). Some believe that the threat posed by Uighur separatists is overblown by the Chinese to justify crackdowns. Some suggest that the terrorist attacks (for example the 9 September 2000 truck bomb in Urumqi) are a response to heavy-handed Chinese settlement tactics.

Muslim separatists in the remote western region of Xinjiang are increasingly being characterised by Beijing as a threat to the Central Asian region and not just China itself. No doubt this characterisation has more to do with Beijing's desire to gain international support for its counter-insurgency campaign, than any direct threat posed by these groups. Nonetheless other sources (some doubt has to be expressed about their credibility) have claimed al-Qaeda has from November 2005 established a presence in the border town of Kushi in Xinjiang province. The men are described as Afghan veterans. On 9 November 2005 Chinese police alerted the US embassy to the possibility of terrorist attack – swiftly gaining government rebuke – although no such attack occurred.

Four groups have been singled out as threats to peace: the Eastern Turkestan Islamic Movement (ETIM), Eastern Turkestan Liberation Organization (ETLO), the World Uighur Youth Congress (WUYC) and the East Turkestan Information Centre (ETIC). The last two groups operate legally from Germany. There is some evidence to suggest the ETIM and ETLO have come under the influence of al-Qaeda affiliated groups. The ETIM, a low level insurgent group, is blamed by Beijing for a series of terrorist attacks in an effort to create an independent state of East Turkistan in Xinjiang province. Unfortunately due to the nature of Chinese media control, it is impossible to tell whether the official government figures of 260 Uighur attacks in the years 1995-2005 are accurate or inflated.

#### *Motivations and capabilities*

Regarding the Uighurs' motivations and capabilities, it should also be noted that there is very little involvement of Uighur communities in the project, potentially giving them ample cause for displeasure. It should also be noted that in March 2003 a bomb attack was carried out on a bus in Kyrgyzstan, killing 21 people, that was believed to be the work of ETLO. This demonstrates preparedness and capability to strike targets outside their borders.

On a positive note, it should be remembered that Xinjiang is essentially a massive Chinese military training ground, and numerous exercises have left an infrastructure that is more than ready to produce an extremely rapid response to any nascent threat or actual physical attack.

#### *Threats in Kazakhstan*

There are at present no terrorist organisations active inside Kazakhstan itself, apart from small Kazakh Uighur elements that are seeking independence for their people from China. Like many of its neighbours, Kazakhstan must be considered vulnerable to foreign terrorist attacks, most likely from militants trained in the Ferghana Valley of Uzbekistan, since evidence of the existence of a Kazakh al-Qaeda cell is sparse. The profession of Islam, of the Sunni school followed by the majority of the Turkic peoples of the former Soviet Union, grew amongst Kazakhs throughout the '90s, rising out of the collapse of a Soviet system hostile to the religion. Mosques closed down and confiscated during the Soviet years were restored to their original purpose, and the first edition of the Koran in the Kazakh language was published in 1992.

However Islamic fervour remains restricted to the south of the country, and shows no sign of spreading to other regions, the vast majority having little more than rudimentary knowledge of the principles of Islam, and no interest in its politicisation. In the long-term, the unpopularity of the pro-government Spiritual Board for the Muslims of Kazakhstan could encourage the emergence of a politicised, militant element, but this is not at present a concern for international personnel operating in the country. Indeed, with the country presently going from strength to strength economically due to

relatively sound governance of the oil revenues, the majority of the population is largely content. The conditions are certainly nowhere near as conducive for the breeding of radical and militant Islam as in, for example, Kyrgyzstan or Uzbekistan.

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### **About A&A Energy Security Briefing**

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