CHINA-KAZAKHSTAN ENERGY RELATIONS BETWEEN 1997 AND 2012

by César B. Martínez Álvarez

While China's interest in securing energy resources has garnered much attention in the media lately, its approach to energy security is nothing new, at least in regards to its Central Asian neighbors. The People's Republic of China (PRC) has always had several interests in common with these Central Asian neighbors, especially dealing with migration, trade, and ideological extremism. Still, its focus on developing stronger energy relationships with these neighbors has gathered momentum over the last two decades, especially as the economy has liberalized and emphasis has shifted away from self-reliance to ensuring affordable and stable supply of energy to meet China's burgeoning demand. In particular, since 1997 China has given increasingly focused support to its national oil companies to develop strong linkages with their counterparts in Kazakhstan, bolstered by elevated government-to-government ties between the two countries. Chinese expansion into Kazakh oil fields reflects not only the PRC's interest in maintaining energy security but also its desire to strengthen relations between China's western regions and Kazakhstan as well as to tighten the economic linkages between China's Xianjiang region and its own coast. In so doing, the PRC is attempting to strike a delicate balance between coordination with Russia on strategic and security issues and competing with Putin's new Russia for influence in Central Asia.

Part One: Introduction

Most of the media attention on Chinese foreign policy focuses on the relations between Beijing and its Eastern neighbors (Tokyo, Seoul, Taipei, and Pyongyang), as well as on the dynamics of Chinese-American interactions: territorial claims (Senkaku/Diaoyudao, and Takeshima Dokdo Islands), tensions on the straits, the North Korean nuclear program, human rights issues, and occasional political clashes between Washington and Beijing (for example in 2001), represent the most visible elements of Chinese contemporary diplomacy. Much less academic and policy attention has been devoted to the links between the People's Republic

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of China and its western neighbors in Central Asia: Kazakhstan, Tajikistan, Kyrgyzstan, Turkmenistan, and Uzbekistan.

The former Soviet Central Asian space has become an increasingly relevant region to fulfill Beijing's foreign policy and grand strategy.[1] On the one hand, the Xinjiang Uyghur Autonomous Region is closely linked to its western neighbors, and both China and the Central Asian countries share common security threats and challenges: Islamic extremism, terrorism, illegal migration, drug trafficking, and others.[2] Additionally, since the mid-nineteenth century —the time of the Great Game between the British Raj and the Czarist Empire —the region has been a geopolitical battleground, whose strategic situation has deeply changed after the fall of the Soviet Union. In other words, domestic security and great power politics are two key interests for China.[3]

> For several years after the Maoist victory in the civil war in 1949, the domestic petroleum sector was strongly associated with the strength of China, the need for self-reliance, and the resistance against the aggression of the superpowers

In 1993, China became a net oil-importing country for the first time in its history.[4] The Central Asian territory is a keystone in Beijing's energy security strategy: first, there has been a shift in the center of gravity for the Chinese hydrocarbons industry, from the Heilongjang province (where the plethoric Daqing Oilfield is located) to the Ordos and Tarim basins in Xinjiang; the geological similarities between the westernmost Chinese basins and Kazakh oil plays represent a crucial economic interest for China. Second, Central Asia, and Kazakhstan in particular, has become a very attractive place for Chinese direct investment, both in exploration and development of petroleum as well as in the construction of oil and gas pipelines.

Given the extraordinary relevance and complexity of this region, I will focus on China-Kazakhstan energy links. What are the most salient interests of the Chinese energy security strategy in Central Asia, particularly in Kazakhstan? Which tools has Beijing used in order to fulfill those goals? Have they been successful? What are the overall diplomatic and geostrategic consequences of China's recent interest in Central Asia in terms of hydrocarbons development?

The main argument of this essay is that security of energy supplies has gradually become a central issue in the Chinese-Kazakh economic and political agenda, along with other topics like migration, ideological extremism, and trade. Beijing's strategy has been two-fold: on the one hand, Chinese National

Oil Companies (NOCs), in particular China National Petroleum Corporation (CNPC), were—somewhat autonomously —pioneers in dabbling in the capital-thirsty Kazakh hydrocarbons sector and establishing corporate links with their Kazakh counterparts. Over time, they have been able to participate in increasingly attractive oil plays. On the one hand, these Kazakh counterparts have received relevant direct and indirect support from the Chinese government in terms of financial resources and diplomatic initiatives.

In the first part of the paper, I will briefly describe the overall framework of Chinese energy policy since 1993, focusing on the mounting petroleum needs of the country as well as on the institutional reform that resulted in the creation of three national oil companies that have recently become global economic players. In the next three sections, I will analyze the different moments of Beijing's energy security strategy in Central Asia, with a particular emphasis on the Kazakh case: 1997-2001, 2002-2008, and 2009 onwards. Finally, the paper concludes with some remarks about the overall geostrategic consequences of this diplomatic and business activity.

Part Two: From the Maoist Hydrocarbons Industry to the Modern Chinese National Oil Firms

For several years after the Maoist victory in the civil war in 1949, the domestic petroleum sector was strongly associated with the strength of China, the need for self-reliance, and the resistance against the aggression of the superpowers (including the Soviet Union after the Sino-Soviet split).[5] Daqing became synonymous with the industrial potential of the new regime.[6] After a few months of a mass campaign in 1959, oil output increased from 0.79 million metric tons per year by 1960 to 4.40 million in 1963.[7] From then onward, oil revenues were a crucial source of foreign currency for China (some authors claim that they represented nearly 20 percent of the country's international trade).[8]

Nonetheless, after the implementation of economic liberalization in the country, the impressive growth of coal, petroleum, and natural gas consumption revealed the supply deficiencies of the Maoist Chinese energy industry; therefore, illegal and uncontrolled coal mining activity, electricity shortages, and substantial decreases in oil output, especially in Daqing, motivated policymakers in the 1980s to reform the energy governance model of China.[9] In the context of a transformation in the role of the Chinese state in the economy, and as a result of the reorganization of the old Maoist Ministries of Petroleum Industry and of Chemical Industry, three national oil companies emerged: the China National Petroleum Corporation (CNPC), the China Petroleum & Chemical Corporation (better known as Sinopec), and later on, the China National Offshore Oil

Company (CNOOC).[10]

In the 1990s, amidst the liberal reform of the economic czar Zhu Rongji, the new firms experienced a process of corporatization and became vertically integrated companies, with business units in exploration, production, and refining.[11] The Ninth and Tenth Five-Year Plans (1996-2006) aimed at creating competitive and modern actors in many different economic sectors of the country.[12] The official support for overseas corporate activities from Chinese State-Owned Enterprises (SOEs) and their partial privatization complemented the hydrocarbons sector reform in the People's Republic of China.[13]

The implicit mandate of the new "National Champions"—China's National Oil Companies (NOCs)—was to ensure the supply of affordable and reliable energy resources for the country, whose demand for petroleum and natural gas has remarkably increased in the last 25 years.[14] Contrary to what many authors and analysts argue, the main strategy of CNPC, Sinopec, and CNOOC has not been the acquisition of foreign equity oil to be exported to China under conditions of exclusivity. Interestingly, the approach of the Chinese government and its NOCs has been much closer to the market than commonly assumed.[15] Most of the capital expenditures and new investments have been devoted to exploration and production within China, and domestic energy resources constitute the lion's share of the three NOCs reserves.[16] However, they have increasingly looked for overseas expansion opportunities in Sudan, Russia, Central Asia, and South America.

> To the government in Astana and the rest of the Central Asian governments, the gas pipeline to China is the cornerstone of a strategy to reduce Russian influence on their energy sectors.

Part Three: The First Period of Expansion 1997 - 2003

What has been the role of Central Asia, in particular Kazakhstan, in the overall energy security strategy of the People's Republic? The nature of the Chinese interest in Kazakh energy resources is intrinsically different from the situation in other regions, as it is linked to the development of the domestic hydrocarbon industry in China. For almost 30 years, the heart of the Chinese oil sector was the Daqing Oilfield—along with Shengli, Huabei and Liaohe.[17] According to Höök and his colleagues, all of those hydrocarbon plays reached their peak of output between 1979 and 1999.[18] Additionally, they are expected to decline at very fast rates.[19] In contrast, the most promising regions are located in the Tarim and Ordos basins in Xinjiang, which share geological conditions with

Kazakhstan.[20] Therefore, the western border of China became a region of crucial interest for Beijing.[21]

The first stage of the Chinese energy strategy in Kazakhstan began in 1997; the Chinese firms were considered newcomers, and the most prolific and productive assets of the country were administered by the Western supermajors (for example, the supergiant Kashagan and Tengiz in the Caspian Sea). The largest transportation infrastructure, the Caspian Pipeline Consortium, was in control of North American, European, and Russian mid-stream firms.[22] Therefore, the only viable alternative for CNPC was to focus on smaller and marginal oilfields.

For Kazakhstan's government in Almaty (which was relocated to Astana in 1997), the potential inflow of Chinese capital represented a counterbalance vis-à-vis the dominant influence of Russia in the energy sector of the country.[23] As a consequence of these shared interests between the two parties, in June 1997 CNPC acquired 60.3 percent of rights to explore and exploit the Zhanazhol Oilfield as well as other oilfields (from AktobeMunaiGaz), the first foreign operation of a Chinese oil company.[24] A few months later, CNPC agreed with a Kazakh firm and another Chinese corporation on the establishment of a mid-stream company called Kazakhstan-China Pipeline LLP, which built a pipeline from the Aktobe and Atyrau Oilfields, to be connected to the West-East Pipeline in 2002.[25] The next year, the company dabbled in richer and more challenging fields (North Buzachi and Bars) as well as additional mid-stream projects (Kenkiyak-Atyrau).[26]

During this first period of expansion, Beijing devoted limited diplomatic and political resources to support Chinese firms in Kazakhstan as an element of its grand strategy in the region. Energy was simply not at the top the bilateral relations in the beginning: financial loans to the newly independent country, migration, border security, control of the separatists in Xinjiang, and trade were (and continue to be) very relevant items in the Kazakh-Chinese agenda.[27]

The first petroleum agreement was not signed until September 1997 (after CNPC became involved in the country).[28] Even within the largest Chinese multilateral initiative in the region—the Shanghai Cooperation Organization—security of energy supply was not among the main elements in the negotiations.[29] In fact, the fight against transnational terrorism was the glue that kept the institution together during its first years of existence, according to Saurbek and Fravel.[30]

In other words, the projection of Chinese petroleum and natural gas interests in Central Asia, particularly in Kazakhstan, was driven mainly by the corporate activities of CNPC rather than by a conscious and formal diplomatic strategy, as Beijing was much more interested in establishing a stable framework to resolve the initial challenges in its relations with a new neighbor. This first period demonstrated that energy is not the only interest of the Chinese leadership in Kazakhstan, as border security and social stability in Xinjiang are also crucial.

Part Four: The Second Period of Expansion 2004 - 2009

By 2004, Sinopec and CNOOC had joined CNPC-PetroChina as international investors in Africa and Australia, respectively.[31] The companies were now doing business in risky locations (for example, offshore fields) and were becoming credible partners and competitors for international oil companies. During this second period of expansion, CNPC consolidated its presence in Kazakhstan and in fact took advantage of its privileged position to enter into other Central Asian countries. In 2005, PetroChina and CNPC Exploration and Development Company acquired the Canadian firm PetroKaz, the third largest corporate player in the country after the Kazakh KazMunaiGaz and the American Tenghizchevroil.[32] Additionally, in December 2005 CNPC inaugurated the Xinjiang oil pipeline, which is 962 kilometers, is capable of transporting up to 15 percent of the Chinese imports.[33] Finally, CNPC continued exploiting the prolific Zhanazhol Oilfield.

After the consolidation of its Central Asian upstream base—with operations in Kazakhstan, Uzbekistan, and Turkmenistan—in 2008, CNPC began to negotiate the construction of the China-Central Asia pipeline, which connects these hydrocarbon-rich areas to the West-East II pipeline, from the Caspian Turkmen and Kazakh coast up to Hong Kong and Shanghai.[34] In December 2009, the heads of state of China, Kazakhstan, Uzbekistan and Turkmenistan inaugurated this $20 billion investment project, which transports up to 40 billion cubic meters of natural gas.[35]

The interests of the two parties (China and the Central Asian states) were very clear: to Beijing, the development of mid-stream infrastructure represented an alternative to mitigate the dependence of the country on the Malacca Strait.[36] Additionally, it would increase the security of natural gas supplies to the wealthy coastal provinces, which are increasingly dependent on this particular hydrocarbon.[37] To the government in Astana and the rest of the Central Asian governments, the gas pipeline to China is the cornerstone of a strategy to reduce Russian influence on their energy sectors; being landlocked countries, their only strategy at the time of independence to commercialize their energy resources was using Gazprom and Rosneft infrastructure.[38] The new project represented an alternative way to reach foreign markets and, therefore, increased the geopolitical autonomy of the countries.[39]

The official diplomatic support from Beijing to CNPC in Kazakhstan shifted from the inchoate and episodic approach of the previous period towards a formal and strong strategy, similar to the Chinese position in Angola and other African countries. In his first international trip in 2003, Chinese President Hu Jintao met his Kazakh counterpart in Astana and signed an agreement of cooperation between CNPC and KazMunaiGaz; in the official statement for the visit, energy-related projects occupied a key discursive role.[40] The implementation of joint strategies to take full advantage of the economic complementarities in the energy sector of China and Kazakhstan also became a relevant issue in the yearly meetings of the Shanghai Cooperation Organization.[41]

In 2005, a few months after the takeover of PetroKaz by CNPC, the heads of state of both countries decided to upgrade the bilateral relation to a "strategic partnership." In the official statement, the "geological complementarity" between the two countries was cited as one of the reasons for this initiative and energy became a top issue.[42] However, according to the same document, it is clear that Sino-Kazakh interactions are also driven by internal security concerns (mainly the common interest in fighting separatism and terrorism) and overall economic considerations.

In other words, during the second stage of expansion, it is possible to observe a closer interaction among the different branches of the Chinese state, with the goal of developing a more successful energy security strategy in Central Asia. On the one hand, CNPC became more assertive and entered bigger fields. It even pursued a strategy of mergers and acquisitions of relevant corporate actors in the Kazakh energy industry. On the one hand, the Chinese politicians gradually recognized the need to support their companies abroad with a more coherent diplomatic strategy and consequently took advantage of their leverage vis-à-vis Central Asian authorities.

Part Five: The Third Period of Expansion 2009 - 2012

The third and current phase of Chinese expansion regarding its western neighborhood dovetails with a new overall international strategy of the three largest Chinese oil corporations, from the outset of the 2008 financial crisis onwards. The two leading features of Beijing's energy initiatives in Kazakhstan have been: 1) the consolidation of CNPC as the dominant non-Russian and non-Western economic player in the country (and a source of balance for the Kazakh government), through the extension of long-term financial deals, and 2) the decision of the Chinese political leadership to decisively support its firms abroad with capital resources.

According to several authors, such as Julie Jiang from the International Energy Agency, the financial crisis of 2008 set the stage for a new mechanism of foreign energy policy: the loans-for-oil agreements.[43] As a result of the immense economic losses of several countries and the remarkable availability of capital in China (a country enjoying the largest current account surplus in the world), Chinese political leaders were able to secure the inflow of hydrocarbons (natural gas in Central Asia) in exchange for multibillion dollar loans.[44] In the region, almost all the hydrocarbon-producing countries benefitted from this innovative formula.

So far, the interactions between the two great powers in the region have been more cooperative than competitive.

As Erica Downs argues, the establishment of closer collaborations between the commercial interest of the Chinese state (in this case, CNPC) and the national state banking institutions (significantly the Export-Import Bank of China and China Development Bank) has been a necessary condition to solidify the bids of the Chinese NOCs abroad.[45] In Kazakhstan, KazMunaiGaz received nearly $10 billion from the Export-Import Bank of China, $3.3 billion of which would be devoted to acquire MangistauMunaiGaz, from the Indonesian conglomerate Central Asian Petroleum.[46] This company owns the right to explore and develop 35 gas and oil fields, including Kalamkas and Zhetybai, some of the largest in the country. Additionally, CNPC continued to strengthen its dominance in the Kazakh upstream industry. Astana and Beijing agreed to jointly develop the Urikhtau natural gas area, one of the last mega-fields in the region, in order to ensure the supply of the China-Kazakhstan gas pipeline.[47] After these initiatives, according to Downs, the former Soviet Republic became the main supplier of equity oil for the largest energy corporation of China.[48]

Julie Jiang and colleagues assert that from 2009 to 2010 Kazakhstan, along with Turkmenistan and the Russian Federation, received the largest share of foreign loans from Chinese state-owned banks: $39 billion or 58.21 percent of China Development Bank and Export Import Bank of China international investments.[49] In other words, the flagship oil corporation of the People's Republic has built a very dense and complex network of upstream hydrocarbon projects, subsidiary companies, pipelines, and joint international ventures across the northern and eastern borders of the country.

As argued at the beginning of the paper, it is crucial to analyze the strategy of CNPC and the support from the political leadership and the financial institutions of the country in the light of the domestic developments in the People's Republic. The geological similarities between the Ordos/Tarim basins and Kazakhstan oil plays, as well as their economic complementarities, help to explain the relevance of the country for China. October 2012 saw the initiation of construction of the West-East III pipeline, which will connect Fuzhou, the blooming capital of the Fujian province, with the natural gas fields of Horgos, in Xinjiang.[50] For the first time in the economic history of the country, the transportation of hydrocarbons will be open to foreign direct investment.

From a geopolitical perspective, this colossal network will be linked to the China-Central Asian pipeline; out of the 30 billion cubic feet that could annually be distributed through it, 25 billion will come from Kazakhstan, Turkmenistan, and Uzbekistan, while the remaining 5 billion will be produced domestically in the Xinjiang Uyghur Autonomous Region.[51] In other words, the domestic and overseas strategies of the Chinese NOCs are deeply integrated.

Part Six: Strategic and Geopolitical Challenges of the Chinese Strategy in Kazakhstan

The history of Chinese national oil companies operating in Central Asia has not been exclusively driven by cooperative approaches and positive developments. Even though there is a clear energy economics complementarity between the former Soviet Union republics (including the Russian Federation) and the People's Republic of China, military and security considerations are also essential elements in the foreign policy decisionmaking of Beijing, Moscow and the Central Asian capitals. Therefore, it is crucial to understand the expansion of the Chinese energy interest in Kazakhstan in the light of the general strategic dynamics of the region.

The region has been a political battleground between great powers. Much of the nineteenth century witnessed the consolidation of the Czarist Russian dominance over Central Asia, as well as the tensions between Moscow and London for the control of the territory between Siberia and the Raj in what has been described as "The Great Game." Since then and until the fall of the Soviet Union, Kazakhstan, Uzbekistan, and the other now independent Republics belonged to the Russian sphere of influence; during the Communist years, the region developed following the needs and constraints imposed by the leadership in distant Moscow.

After the arrival of Vladimir Putin to power in Russia in 2000, one of the most explicit interests of Moscow's new foreign policy has been to recover the lost clout over the former Soviet Union and thus regain its status as a great power. Recognizing the new balance of economic, demographic and military capabilities in the region, the Kremlin has pursued a mixed strategy of bilateral rapprochements with the Central Asian republics (for example, the Eurasian Economic Union) and multilateral cooperation with China (the Shanghai

Cooperation Organization).

So far, the interactions between the two great powers in the region have been more cooperative than competitive, especially as they share common strategic interests elsewhere (to balance what they consider unilateral actions from the United States).[52] However, certain tensions remain: the role of Chinese international trade and investment in the Central Asian countries, which has outpaced by far the economic links with Russia; the issues of illegal Chinese migration both in the Central Asian countries as well as in Russia; and the potential consequences of the Chinese influence in the energy sector of Kazakhstan, Turkmenistan and Uzbekistan (in this sense, the availability of alternative transportation routes would certainly undermine Russian influence on the former Soviet Republics, which had been dependent on Moscow).

In other words, in a strict realist sense, in pursuing the expansion of Chinese energy interests in Kazakhstan, Beijing's leaders must necessarily maintain a fragile balance between fostering deep and valuable interactions between both countries that fully take advantage of the economic and geological complementarities, and the need to take into account Russian interests. Additionally, it is crucial to remember that the need to supply affordable and reliable hydrocarbons is not the only economic reason for Chinese interest in Kazakhstan; the construction of multi-billion dollars of energy-related projects is expected to have positive spillovers in Xinjiang; for Beijing, the development of the Western provinces of the country represents a crucial mechanism to curb separatist movements and promote social stability in the province. In this sense, the business and diplomatic initiatives in Kazakhstan not only facilitate and strengthen the potential for bilateral cooperation in border and security issues; but also represent a key mechanism to economically link the Xianjiang region with the coastal areas of China.

NOTES

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