THE SIGNIFICANCE OF ESTABLISHING COMMON EAEU GAS, OIL AND PETROLEUM PRODUCT MARKETS FOR THE REPUBLIC OF KAZAKHSTAN

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ABSTRACT

As the migration processes gain momentum in the Central Asian region, cooperation within the Eurasian Economic Union (EAEU, established in 2014) is becoming increasingly more poignant. Currently comprising five states (Armenia, Be-
larus, Kazakhstan, Kyrgyzstan, and Russia), this regional organization has become a platform for cooperation in virtually all the economy sectors, including the power sector. Common oil, petroleum product and gas markets are being established in order for the integrative association to ensure the “free movement of goods, services, capital and labor.”

Since the Republic of Kazakhstan is currently one of the world leaders in the hydrocarbon resources, the key issue is for its energy resources to gain access to external markets. Meanwhile, with regard to the country’s geographical location and the historically determined transportation routes, the principal oil pipeline systems traverse the territory of Russian Federation. After the disintegration of the U.S.S.R., the independent countries of Central Asia, in particular, their natural resources, have attracted the attention of world powers, simultaneously becoming a place of conflict of interests. In order to preserve stability in the region, and, as a consequence, to ensure the status of a Eurasian transit traffic channel, the Central Asian republics are not only modernizing the existing communications, but are also implementing alternative infrastructure projects. Despite the foreign political interest in the Central Asian region and the Central Asian countries’ interest in cooperation with leading powers, Russia considers the independent republics to be within its influence sphere, preserving strong economic and political connections with them.

Numerous attempts at integration of post-Soviet countries have been made since the early 1990s in the framework of establishing the Commonwealth of Independent States, the Eurasian Economic Community, and the Customs Union. However, the EAEU is currently the most efficient organization, furnished with the required regulatory framework and articulated strategic goals.

The paper describes the stages and premises of the establishment of transportation routes in the Central Asian region, including Kazakhstan, their impact on gaining guaranteed access to the operating systems and route diversification, as well as the significance that cooperation in the energy sphere in the EAEU framework holds for Kazakhstan. The legal foundation being created is aimed at ensuring guaranteed access to infrastructure systems, non-discriminatory trade and access to the common energy resource market, and tariff transparency. Time will tell how the concluded agreements will be implemented, but Kazakhstan currently possesses a tangible chance of realizing its energy potential within the EAEU framework.

**KEYWORDS:** Republic of Kazakhstan, energy resources, Eurasian Economic Union, integrative processes, common oil and gas market, transport communications, gas pipelines, Central Asia.

**Introduction**

Evidently, Kazakhstan possesses significant hydrocarbon resources. According to the 2017 *Statistical Review of World Energy* conducted by BP, a British company, Kazakhstan holds the 12th and the 22nd place in world oil and gas resources, respectively, and owns 1.8% of world oil and gas resources.¹

¹ The data provided by *BP Statistical Review of World Energy 2018*, available at [www.bp.com].
According to the data provided by the JSC Oil and Gas Information-Analytical Center, 86.2 million tons (or 1.7 million barrels per day) of oil and gas condensate were mined in Kazakhstan in 2017, which is 10.5% more than in 2016.\(^2\)

Oil and gas-bearing regions comprise approximately 62% of the country’s area. There are 172 oil fields, over 80 of which are being developed. Hypothetical oil resources are estimated at 7.8 billion tons, and natural gas resources—at 7.1 billion cubic meters. Approximately 70% of these resources are located in the western regions of Kazakhstan.

Meanwhile, due to the absence of direct access to the World Ocean in Kazakhstan, 85% of Kazakhstani oil exports are conducted through Russian Federation territory via the following pipelines:

— Caspian Pipeline Consortium, total length—1,510 km, connects the Tengiz oil field in Kazakhstan and the South Ozereevka oil terminal on the Black Sea (near the Novorossiysk seaport with annual projected throughput capacity of 76 million tons of oil);

— Atyrau-Samara oil pipeline, which allows access to European markets through Russian Federation territory via the Druzhba oil pipeline, the Baltic pipeline system to the ports of Primorsk and Ust-Luga, and access to Novorossiysk through the system of JSC Transneft Novorossiysk (with annual throughput capacity for Kazakhstani oil of 15 million tons per year);

— railroad tracks.

In the course of globalization, the Republic of Kazakhstan as a full-fledged member of various organizations, both at regional and international levels, is capable of strengthening economic ties, increasing the trade turnover, and establishing full-scale foreign trade operations. However, Kazakhstan’s current infrastructural dependence on the historically determined transport communications partially limits the country’s international activity.

### Historical Premises for the Creation of Kazakhstan’s Transportation Routes

Kazakhstan’s infrastructural dependence is determined by historical premises of construction and subsequent development of transport and pipeline projects.

In the Middle Ages, the Silk Road, which connected world trade hubs, traversed Central Asia and modern Kazakhstan in particular. However, in the 19th century, the trade turnover between the Russian Empire and the associated Central Asian region was conducted via caravan routes. For instance, the Orenburg-Tashkent road was the main route connecting the Russian Empire with the region in the 1860s-1870s. Caravans that took this route were on the road for approximately three months. If Moscow was the end point of delivery, the route from Central Asia may have taken up to six months.

Simultaneously, the issue of constructing a railroad to Central Asia was discussed against the backdrop of the Industrial Revolution and development of railroads within Russia. The Trans-Caspian Railroad, built in 1881-1898, was the first railroad that allowed optimal transportation. This railroad allowed to lower the expenditures for supply and delivery of goods exported to Russia (cotton, fruit, vegetables). Immediately after the construction of the Trans-Caspian Railroad was completed, the transportation of cotton increased significantly. The railroad created the conditions for the import

\(^2\) The data provided by JSC Oil and Gas Information-Analytical Center, available at [http://www.iacng.kz].
of industrial cotton processing equipment, modern tools, gear, heavy machinery, steam and electrical engines to Central Asia.

Not only did the construction of this railroad have a huge economic significance for Central Asia, it also accelerated Russia’s industrial development and promoted the establishment of Russia’s permanent trade relations with Iran and Afghanistan. Russian goods became competitive with European products in these countries, due to which fact Russia’s economic contacts with China, India and Egypt have expanded.3

The next step in the development of transportation networks was the Orenburg-Tashkent railroad line, whose construction began in 1900 and ended in 1906. This route went through the towns of Ilets, Aktyubinsk, Kazalinsk, and Perovsk, as well as Turkestan.

As is well known, the development of the oil resources in the Central Asian region began to be conducted in the 19th century. For instance, the company owned by Nobel brothers drilled the first oil wells in western Turkmenistan in 1876. In the early 20th century, oil mining in Khazar began to be conducted on an industrial scale. There were over 20 Russian oil companies working there.5

Another oil mining site was the Urals-Embinsk district in western Kazakhstan. In 1912-1914, half of the oil fields were developed by the following companies: Western Urals Oil Company, Urals-Embinsk Oil Company and North Caspian Oil Company, owned by British capital. Cheap workforce, lack of competition and rich oil fields brought in huge revenues for their owners.5

Soviet times were particularly distinguished by a breakthrough in the construction of transport communication and oil and gas pipelines.

The Soviet government began to build new and modernize old roads in Central Asia immediately after the end of the Russian Civil War. In 1920-1922, the Petropavlovsk-Kokshetau section was constructed, in 1926-1931 it was extended to Karaganda, and in 1939-1940—to Balkhash.

The Turkestan-Siberia Railroad became the largest project. The concept of this road, which was intended to unite Turkestan, Semirechye (Zhetysu) and Siberia, emerged in 1886. In 1896, the town council of Vernyi (now Almaty) resolved to establish a commission that was to gather all the data on industry, trade and agriculture, aiming to determine the feasibility of road construction. It was presumed that the road would strengthen Russia’s military presence in the region that bordered on China and significantly simplify the transportation of cotton out of Turkestan and cheap grain out of Siberia and Semirechye to Turkestan.6

In addition, the implementation of this infrastructure project was stipulated by the need to provide the region with cheap bread from Siberia, Kazakhstan, and Kyrgyzstan, as well as increase cotton production for the U.S.S.R.’s consumer goods manufacturing. The multiplicative effect of the increase of domestic production was supposed to lower the import of cotton, which also guaranteed savings to the state budget. In turn, the development of the country’s infrastructure ensured the development of geographically remote regions via the expansion of the industrial foundation.

The total span of railroads in the U.S.S.R. in the time of its greatest prosperity (1970s-1980s) comprised 225,000 sq. km.7 The development of railroads was associated with the increase of technical parameters—the increase in movement speed, the volume of freight transportation, as well as mechanization, automation and computerization.8

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5 See: D. Tyulebekova, op. cit.
7 See: Upravlenie gruzovoi i kommercheskoi rabotoi na mezhdunarodnom transporte, ed. by A. Smekhov, Moscow, 1990, p. 13.
8 See: I. Mogilevkin, Transport i kommunikatsii, Moscow, 2005, p. 223.
Simultaneously, infrastructure development was accompanied by the implementation of energy projects. The oil pipeline system was developing rigorously. In 1940, the oil pipelines spanned only 1,700 km, while in 1945 they already amounted to 4,400 km. In the subsequent years, the speed of oil route construction began to increase in response to the demand, increasing oil extraction and its export. In the early 1960s, the 5,116-km Druzhba oil pipeline system was launched into operation; in the years that followed, it was extended to 10,000 km. High growth rate is confirmed with numbers: in 1973, the total span of oil pipelines in the U.S.S.R. was 42,900 km, in 1975—56,000 km, and in 1980—69,700 km.\footnote{See: Sovremennaya geografia mirovogo khoziaistva, ed. by M. Rozin, W. Wolf, and L. Vasilevskiy, Moscow, 1977, pp. 266-267.}

In 1967, the construction of the first 3,000-km section of the Central Asia-Center gas pipeline was completed. The gas pipeline traversed Uzbekistan, Turkmenistan, Kazakhstan and eight Russian regions. The development of this system continued until 1985, as the result of which a gas pipeline network with an 80-bcm throughput capacity was created.

| Gas Pipelines in the Soviet Republics of Central Asia in Comparison with Russia |
|---------------------------------|----------------|----------|
| Span, km                        | % of Total Span |
| All Soviet republics            | 215,196.0       | 100      |
| Russia                          | 138,421.9       | 64.4     |
| Uzbekistan                      | 10,586.0        | 4.9      |
| Kazakhstan                      | 10,501.2        | 4.9      |
| Turkmenistan                    | 7,336.9         | 3.4      |
| Tajikistan                      | 864             | 0.4      |
| Kyrgyzstan                      | 581             | 0.3      |


As the analysis and statistics demonstrate, it was precisely in the Soviet period that communication networks were established, connecting all the regions of the huge empire and ensuring the continuous trade turnover within the country.

**Infrastructural Heritage of the Soviet Period for Independent Central Asian Republics**

After the disintegration of the Soviet Union, independent republics have inherited powerful infrastructure systems, however, the railroads and auto roads ensured quick transportation primarily towards Russia. In addition, in the heavy economic crisis conditions of the early 1990s, the Central Asian republics did not have sufficient financial resources to maintain, reconstruct, or, particularly, modernize the existing infrastructure systems.
However, over time, against the backdrop of the stabilizing situation in Central Asia and the interest of world powers in accessing regional power resources, the independent republics have named the development of transport infrastructure one of the priority vectors of national policy.

Taking into account the growing competition on the world energy market, many of the economically dominant states are seeking guaranteed access to the regions that possess hydrocarbon resources, one of which is Central Asia. Such access can be guaranteed by constructing gas and oil pipelines aimed at the market of a specific state or group of states.

From this point of view, the geopolitical significance of Central Asia’s transit development potential acquires new meaning as the chance to connect Europe with the Asia-Pacific region. The countries are facing the task of creating the required infrastructure, as well as the most favorable conditions along all the sections of transportation routes that traverse a given country.

It is, however, necessary to remember the various world powers’ political interest vectors in the region, and take geopolitical aspects into account in equal measure with the national interests of Central Asian countries in forming transport strategies.

For instance, the top-priority goal for Russia is the preservation of control in the post-Soviet space, via the use of historically determined economic ties. Military interests linked to border security also play an important role. Cooperation with Central Asian countries strengthens Russia’s position in the international arena, which is why interaction across various international platforms, created with specific interests in mind (CSTO, CIS, EAEU), assumes special importance.

In turn, China had initially pursued a rather moderate policy in relations with independent Central Asian republics.

The driver of reinvigoration of bilateral contacts of the PRC with the Central Asian region was the PRC’s quickly developing economy, which determined the need to seek new market outlets and new energy sources.

Chinese enterprises are investing in projects located near the Caspian Sea, in Russia and Latin America with the aim of ensuring guaranteed access to energy resources. For instance, one of such projects was the 960-km Kazakhstani-Chinese oil pipeline Atasu-Alashankou, with a throughput of 20 million tons per year, launched into operation in 2006.

Another very important and influential player in the Central Asian region is the U.S., which is pursuing its own aims. Most certainly, besides the issue of limiting the influence of Russia and China, the U.S. aims to also ensure its access to the region’s energy resources, including through the diversification of the existing transport communications.

The Central Asian countries themselves understand the need to create new routes and the search for economic partners. With these purposes in mind, a special place in transport and infrastructure strategies of the regional countries is held by the communication infrastructure construction and reconstruction projects, which ensure both modernization of existing routes and the prospects of creating alternative ones. The Western Europe-Western China auto road project and the North South transport corridor were two of such projects for Kazakhstan.

In turn, the issue of diversifying supply routes is even more poignant in the sphere of energy resource transportation. As mentioned above, all pipelines functioning after the disintegration of the Soviet Union ensured delivery exclusively through Russian territory. When Central Asian republics gained sovereignty, this state of affairs caused the dependency on the political mood of the neighbor and its economic situation, which stipulate the tariffs for the transit and transportation of raw materials.

In order to minimize the economic risks, it would be expedient to participate in transport projects that guarantee alternative supply options. One of such projects was the construction of the Baku-Tbilisi-Ceyhan oil pipeline and the Baku-Tbilisi-Erzurum gas pipeline, in which Kazakhstan and Turkmenistan intended to participate directly.
However, due to the complexity of development of the Kashagan oil and gas field, Kazakhstan had paused its participation in the oil project. In the case of participation in the gas transportation project, the difficulty lies in the technical specifics of supplies, since oil can be transported by railway and in tankers, while gas may only be transported via a pipeline (we are not considering the issue of the possibility of LNG production and transport due to the financial and technical difficulties of such projects).

In this situation, the provisions of the Convention of the Legal Status of the Caspian Sea, signed on 12 August, 2018, are of interest. While previously it was specifically the unregulated status of the Caspian Sea that has created obstacles for the comprehensive use of all potential opportunities, now, according to Art 14 of the signed document, “the Parties may lay submarine cables and pipelines on the bed of the Caspian Sea.”

Meanwhile, a grey area emerged due to the need for the projects to comply with “environmental standards and requirements embodied in the international agreements to which they are parties, including the Framework Convention for the Protection of the Marine Environment of the Caspian Sea and its relevant protocols.”

It is, in fact, a voluntary sphere of standardization, which should not create obstacles in international cooperation; however, as experience demonstrates, it is currently one of the most efficient instruments of mutual restriction.

In any case, it is crucial to remember that Russia is one of the major exporters of energy resources to Europe, and is practically a monopolist in the sphere of oil and gas transportation. Thus, attempts to diversify the supplies and to create alternative routes contradict Russia’s crucial geopolitical interests not only in the Central Asian region, but also in the international arena as a whole.

### Directions of Cooperation in the Energy Sphere within the Framework of the Eurasian Economic Union

Russia’s geostrategic interests are precisely what establish the Central Asian region as its main sphere of influence, while the historically determined links ensure the political partnership between Moscow and Central Asian countries. Russia is one of their main foreign trade partners in the export-import operations within the regional transit framework.

On the other hand, the Russian Federation is also interested in the economic integration with the countries of the former Soviet Union, and not only the preservation, but also the strengthening of good-neighborly ties.

After the disintegration of the Soviet Union, various integration initiatives were regularly proposed as early as in the beginning of the 1990s. The Commonwealth of Independent States, established in 1993, presumed a gradual creation of free trade areas, a customs union, a common market, including a currency market, similar to the European Union.

In 1995, Belarus, Russia and Kazakhstan signed the first Agreement on the Establishment of the Customs Union. The main purposes declared were as follows: elimination of barriers in mutual trade, development of common rules for conscientious competition, coordination of member countries’ economic policy, including foreign economic policy.

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10 Convention on the Legal Status of the Caspian Sea (full text), Art 14, Point 1, 12 August, 2018, available at [http://kremlin.ru/supplement/5328].

11 Ibid., Art 14, Point 2.
This experience in establishing a customs union subsequently became the foundation for the signing of another international document, the Treaty on Promoting Integration in the Spheres of Economics and Humanities, by the presidents of Belarus, Russia, Kazakhstan and Kyrgyzstan in 1996. The parties’ arrangements provided for a gradual intensification of integration in economy, science, education, culture and social services, while promoting the respect for the participants’ sovereignty, equality, reciprocity, inviolability of borders, and non-interference in the other members’ internal affairs. In 1999, based on the preceding agreements, the Treaty on the Customs Union and Common Economic Space was signed.

The Treaty on Establishing the Eurasian Economic Community, signed in 2000, became the next stage of regional integration. The establishment of this organization aimed to foster economic integration starting with a free trade area via a customs union to a common market, where the latter presumed a unified policy in relation to third countries.

Documents that would subsequently form a solid foundation for the creation of the most sustainable and efficient union in Eurasia—a full-fledged Customs Union, which was set up on 1 July, 2011—were adopted in 2007.

In accordance with the resolution of the highest Customs Union authority, the EurAsEC Interstate Council had approved a list of agreements that form the Common Economic Space of the Republic of Belarus, Republic of Kazakhstan and the Russian Federation, which were subsequently formalized in the Treaty on the Eurasian Economic Union.

Currently, the integrative processes in the region are closely linked to the spheres of cooperation within the Eurasian Economic Union, created on the basis of the Treaty dated 29 May, 2014. According to Art 4 of the Treaty, one of the main goals of EAEU is the “striving to form a common market of goods, services, capital and labor.”

Cooperation of member states in the energy sphere is delineated in Section XX of the Treaty, according to which “in order to effectively utilize the potential of the fuel and energy complex of the Member States, as well as to provide national economies with the main types of energy resources (electricity, gas, oil, and petroleum products), the Member States shall develop long-term mutually beneficial cooperation in the energy sphere, conduct coordinated energy policy and gradually create common energy markets.”

In order to increase the possibility of oil, petroleum product and gas export using the existing infrastructure facilities (oil and gas pipelines), the Concepts of Establishing Common Oil and Petroleum Product Markets and the Common Gas Market within the EAEU were adopted by the EAEU Supreme Eurasian Economic Council on 31 May, 2016 in Astana. The Concepts were developed in accordance with the Treaty on EAEU dated 29 May, 2014.

The Concepts determine the main ideas, goals, and principles of formation of common gas, oil and petroleum product markets within the EAEU, their functional structure, interaction spheres between the entities of common markets of gas, oil and petroleum products.

**Concepts’ goals are:**

— ensuring the sustainable development of the economy, energy and environmental security of member countries, with regard to the need to prioritize satisfying the member countries’ needs for oil, petroleum products and gas;

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14 ibid., Art 79.
The aims of establishing a common oil, petroleum product and gas market are:

— establishment of conditions favorable to the economies of member states;
— development and increased efficiency of mutual trade market mechanisms (including the establishment of a market trade Union);
— unification of norms and standards for oil, petroleum products, and gas;
— raising transparency of price formation in regard to oil, petroleum products, and gas;
— increasing economic efficiency of use of oil and gas transportation systems in the common market, etc.

The concept of establishing common oil, petroleum product and gas markets stipulates that mutual trade will be conducted on the common market both in accordance with bilateral agreements, and on the exchange, via access to pipeline systems on a non-discriminatory basis.

For the purpose of implementing the Concept, the Program of Establishing a Common Oil and Petroleum Product Market in the EAEU and the Program of Formation of a Common Gas Market in the EAEU were adopted on 6 December, 2018 in St. Petersburg.

According to the adopted documents, several stages are stipulated in the establishment of a common oil and gas market:

1. the first stage entails the creation of a methodological and organizational basis for the formation of a common market (until 2021);
2. preparation and adoption of a draft international treaty (2021-2024);
3. the international treaty should come into effect no later than January 2025. 15

Common oil and petroleum product market presumes the establishment of conditions for non-discriminatory access of the Union’s common market participants to the markets of member states, and the elimination of quantitative restrictions and export customs duties in oil and petroleum product trade between associated states.

Similar goals are also behind the creation of the EAEU common gas market: organization of gas trade in the common market, while providing non-discriminatory access of the Union’s common market participants, establishing conditions for investment activities of the market participants, and transparent access to gas transportation systems of the EAEU common gas market participants.

The common market will allow to implement efficient non-discriminatory trade, ensure exchange of information on consumption, production, transportation, supply and processing of oil and petroleum products, raise price formation transparency.

The formation of a common oil and gas market in the EAEU is an integral part of economic integration within the EAEU and is aimed at establishing favorable conditions for the free movement of goods, services, technologies and capital among member countries.

In addition, Kazakhstan, like all the EAEU member states, preserves its priority right to defend its internal oil and gas market.

Thus, if a common EAEU oil and gas market is established, Kazakhstan will obtain equal access to the existing oil and gas pipelines, and may also supply its oil and gas products to the EAEU market on equal conditions.

**Conclusion**

Integration in the post-Soviet space is determined by numerous factors. One of them is the relatively low competitiveness of goods produced in the countries of the former Soviet Union compared to foreign goods, while cooperation is based primarily on building and maintaining the connections established in the Soviet era.

In addition, efficient integration requires partners’ relative economic equality for the purpose of ensuring mutual economic benefits and excluding the possibilities of influence and domination among Union participants. In the case of EAEU, judging by just the trade turnover indices, it becomes apparent that the Russian Federation is the primary partner for all participants, hence, all countries trade mainly with Russia, rather than with each other.

On the other hand, under conditions of globalization, a lack of access to open sea, and the need to preserve regional security and stability, Kazakhstan, just as other Central Asian countries, requires strategic and long-term contacts with its closest neighbors.

This is why today the Central Asian region is not only the arena for the conflict of geopolitical interests, but also a platform for cooperation in the framework of international organizations. The EAEU, which sets the tasks of ensuring a continuous flow of goods through all the member countries, creates additional opportunities for the access of Kazakhstan’s energy resources to external markets, and the efficient utilization of the country’s transport potential.

Currently, the key gas pipeline for the transportation of the Central Asian gas is the Central Asia-Center pipeline, launched into operation in 1967. It spans approximately 3,000 km, uniting Turkmen, Uzbek and Kazakhstan gas fields with the industrially developed central regions of Russia. With the main gas pipeline at the core, an expansive gas transport pipeline system was developed in the past. The main transit of Central Asian resources to Europe occurs via this gas pipeline.

Two key aspects play a very important role in the selection of the oil delivery route, namely, transportation expenditures and transportation security. From the viewpoint of both cost and security, the Russian route is the most rewarding for Kazakhstan.

Revenues from oil sales make up one-third of the Republic’s budget, and the volume of Kazakhstani oil exports is directly dependent on the functioning capacities of the Russian oil pipelines.

In addition, out of the three functioning Kazakhstani oil transportation routes (Baku-Tbilisi-Ceyhan towards Turkey; via the Caspian Pipeline Consortium; and Atasu-Alashankou to China), over 70% is exported through Russian territory.

Due to the geographic and infrastructural dependence on the Russian oil and gas pipelines, equal non-discriminatory access and transparent mechanisms of energy resource tariff formation, delineated in the Concepts of Establishing Common EAEU Oil and Gas Markets, seem quite attractive to Kazakhstan. Accordingly, the currently existing regulatory framework may become a catalyst in utilizing Kazakhstan’s energy potential. However, much will depend on the norms of the international document to be signed in 2025.