Menas Caspian Focus 12/11

Politically independent monthly news and analysis of strategic developments in the Caspian region

December 2011 · Volume 7 · Number 12

POLICE FIRE TO DISPERSE PROTESTERS IN ZHANAOZEN

Western riots rattle Kazakh government

A deadly protest erupted in the western town of Zhanaozen on 16 December, leaving 14 protesters dead, apparently as a result of police gunfire. The riot between security forces and striking oil workers was a serious blot on the country's Independence Day celebrations, which were the focal point of the Zhanaozen clash.

Violence spread the following day, with protests reported in Aktau and Shetpe. Although very unlikely to challenge President **Nursultan Nazarbaev**'s regime, the unrest marks the biggest threat to Kazakhstan's political and social stability since the fall of the USSR.

The violence in Zhanaozen started when riot police moved in to clear the town square, which strikers have been occupying for months in a dispute over pay and conditions, to make way for independence day celebrations. After police cleared the square, protesters rampaged through the town itself. The local administration building, an office of **Kazmunaigas** subsidiary **OzenMunaiGas**, shops, cars and hotels were set on fire. The home of the OzenMunaiGas director was also allegedly torched, demonstrating the level of anger felt by the protesters.

On 17 December, violence broke out in the town of Shetpe when locals (whether they were exclusively strikers, or merely sympathetic to them, remains unclear) blocked the Mangyshlaq-Aqtobe railway in solidarity with the Zhanaozen demonstrators. They set fire to a train using petrol bombs and then rioted in the town. Police responded with force, killing one and wounding around a dozen.

The following day further unrest was reported in both Aktau and Zhetibai: in both towns, hundreds of strikers and supporters gathered in the main square to protest the killings in Zhanaozen. Security forces maintained a heavy presence, seeking to limit the size of the demonstrations. Tiny sympathy demonstrations were also reported in Almaty and Astana but these were immediately broken up by police.

At the time of going to press, at least 15 had been killed and around 100 injured. This is by far the most serious unrest since the collapse of the Soviet Union, and the government is seeking to nip it in the bud with a heavy response. A 20-day state of emergency has been imposed on Zhanaozen, social media has been restricted and journalists attempting to visit the area have been blocked and harassed. The region has been blanketed with hundreds of riot police, armoured vehicles, helicopters and paramilitary security forces. Interior minister **Kalmukhanbet Kasymov** has been deployed to the west as part of a commission to investigate the unrest.

Many oil workers are reported to have stayed away from work over the weekend of the 17/18 December, either out of fear for their safety or out of solidarity. However, oil output has >>>

»» Menas Associates

Caspian Focus is published monthly
Sold by subscription only
Produced by Menas Associates staff

Managing director: Charles Gurdon
Marketing manager: Judy Hubbard
Production editor: Miles Smith-Morris

ISSN 1751-4649

Menas Associates Ltd
4 Bloomsbury Square, Suite 8
London, WC1A 2RP
United Kingdom

+44 (0)20 3397 4311 Phone

info@menas.co.uk
www.menas.co.uk

been unaffected, and security has been stepped up at oil facilities in the region.

The official line is that the violence is the act of "hooligans" and "bandits" who are manipulating the striking oil workers for their own ends: the authorities have been at pains to try and distinguish between the tolerable demands of the strikers and the intolerable violence. In a further twist, Nazarbaev has also accused the exiled oppositionists **Mukhtar Ablyazov** and **Rakhat Aliev** (his former son-in-law) of fomenting the violence and seeking to provoke a civil war.

The extent of the violence and the vigour of the government response underlines how serious the situation has become. Although talk of a 'Kazakh Spring' is sensationalist, it is equally shortsighted to believe that Kazakhs are unaware of the power of crowds which this year's global protests have demonstrated. As the situations in the Middle East have repeatedly shown, excessive violence by state security forces can rapidly create a self-perpetuating cycle of anger and repression.

The oil workers' strike provides a ready-made flashpoint for social unrest, although this is likely to limit unrest to the poorer regions of western Kazakhstan, particularly Mangistau, rather than the more prosperous east. The torching of the OMG office in Zhanaozen may suggest growing anger against the institutions of the energy industry, which could intensify if protests continue.

Less directly, the unrest could increase the threat of extremism in western Kazakhstan by radicalising strikers or their supporters. This does not mean that the demonstrators will suddenly join a militant Islamist group, but it could change the local atmospherics by strengthening anti-government sentiment and making it easier for militant groups to attract recruits. In a sign of the potential symbiosis between the two anti-government forces, the militant **Jund al-Khilafah** on 18 December pledged its support for the protesters, swearing revenge for what it called the "slaughter" of civilians.

For now the government will probably be able to contain the unrest and prevent it from affecting oil output. However, further unrest will remain a possible threat and could affect the country further down the line.

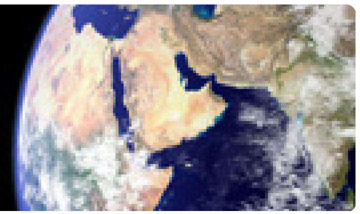
More militant violence

Kazakhstan's wave of militant violence continued this month with a shootout in a village near Almaty. On 2 December, security forces raided a house in the village of Boraldai, seeking a group believed to be responsible for the deaths of two Almaty police officers in November. In the ensuing gunfight, five militants and two members of the security forces were killed. The leader of the cell, named as **Khasen Agzhan**, was killed: his group was plotting further acts of violence, according to officials.

Boraldai is just 5km from central Almaty, and sits next to a domestic airport of the same name. The deployment and deaths of members of the elite Arystan police unit suggests that the militants were a serious threat. Grenades and assault rifles were recovered from the scene, a further indication that the group was fairly well-equipped.

The attack was claimed by the Jund al-Khilafah, which has taken responsibility for most of the attacks to hit Kazakhstan recently. The militant group, which opposes the government's supposed restrictions on Islam, said its members were "ready to be killed in the thousands in order to support this religion".

The incident fits the pattern of much of this year's violence. The authorities have generally been on the offensive against militant cells, suggesting good intelligence. However, the militants' ability to inflict casualties on elite units, and the number of successful attacks against state targets, show that the »»



government is still being caught off-balance by the attacks. The new year will probably see more of the same, and things may intensify if the situation in the west deteriorates.

Impending reshuffle sheds light on succession

It may not be official, but it seems to be close: prime minister **Karim Massimov**, a long-time ally of President **Nursultan Nazarbaev**, is not going to be Kazakhstan's next leader. The president's son-in-law, **Timur Kulibaev**, almost certainly is.

That's the implication of a mooted government reshuffle, suggested by **Yermukamet Yertysbayev**, the adviser dubbed the "president's nightingale" for his role as a sounding-board for key ideas, on 6 December.

Yertysbayev told a Kazakh newspaper that parliamentary elections in January, announced last month, would result in the formation of a new government with some serious high-level changes. Although acknowledging Massimov's achievements as premier since 2007, Yertysbayev said that the country has "substantial expectations of enormous change. A change of prime minister will be a key factor in

KULIBAEV: THE SON-IN-LAW RISES

the upcoming changes." This is a pretty damning verdict.

The president's adviser mooted Massimov's current deputy, **Umirzak Shukeyev**, as his most likely successor. Kulibaev, who now heads sovereign wealth fund **Samruk Kazyna**, will then probably become deputy. The vice-premiership will serve as a proving ground for Kulibaev, who is only 45 and has not served in any major government positions.

In other words, Massimov will be replaced by the less powerful Shukeyev, whose main role will be to keep the seat warm while Kulibaev gets to grips with high office. Shukeyev has been appointed head of the commission to investigate this month's deadly unrest in western Kazakhstan, which may be something of a test for him. The presumable next step is for Kulibaev to become prime minister as Nazarbaev heads towards retirement, and then graduate to the presidency.

It seems that, for now, Nazarbaev has no intention of going quietly. This month he gained another honorific, alongside last year's Leader of the Nation – he is now the 'People's Hero'. The proposal for the new title was made by Massimov, who declared it "probably the most important document I have ever signed in my life".

Oil Ministry to go softly on mining companies

Perhaps reflecting the labour movement's growing influence, the Oil and Gas Ministry has announced that wayward mining firms will be fined rather than have their contracts terminated, in a bid to safeguard jobs.

Announcing the decision at the end of November, ministerial secretary **Kanatbek Safinov** said that, "The termination of contracts will be used as a last measure, as in this case people will lose their jobs." Instead, the government will prioritise economic sanctions against mining firms which violate their contracts, in accordance with last year's new subsoil law. Closer monitoring of mining companies will be undertaken, according to Safinov, and the termination of contracts is held out as a last resort.

Safinov gave no indication of how the extra monitoring will be carried out, or whether the process of appealing against fines will be toughened up, which may raise a few eyebrows among mining companies. Focusing on the livelihoods of mining employees may be a genuine populist touch, but fining companies rather than terminating contracts – 28 subsoil contracts were cancelled last year – is also undoubtedly a money-spinner for the state coffers.

KMG enters Karachaganak

Kazmunaigas has finally taken its 10% stake in the Karachaganak field. After a long delay, the Kazakh state energy company has acquired the stake as part of a package deal under which the government will withdraw legal claims against the consortium, which is led by **BG** and **Eni** and also includes **Chevron** and **Lukoil**.

Specifically, 5% of the stake will be directly purchased, using $1 billion borrowed from the Karachaganak consortium members, which will be paid back over three years from KMG's oil and gas revenues. Another 5% will be granted by the government in exchange for dropping the $2.2 billion court claims, according to finance minister **Sauat Mynbaev**. The claims, which mostly concern significant sums of back >>>

taxes, have been rumbling on for some time. To make room for the newcomer, each consortium partner has transferred 10% of its rights and interest to KMG.

As well as securing KMG a stake in the project, the deal also increases the government's control over Karachaganak's scope. The state is now formally entitled to approve the budget for the project's expansion, a long-standing demand that had inhibited growth to the major third phase of production. The third phase is expected to cost around $14.5 billion, and will add 75,000 b/d of oil to production rates, an addition of around 20%. Another upside is that oil exports will be boosted through the **Caspian Pipeline Consortium** to Russia's Black Sea port of Novorossiysk.

The deal is a significant milestone for Kazakhstan in its bid to level the playing field with major oil and gas companies, which it accused of signing lopsided agreements in the tumultuous years after independence in 1991. The government now holds a stake in all of the country's major oil and gas projects and has a far more comfortable relationship with international oil companies.

Meanwhile, the deadline for the Kashagan field has slipped slightly again this month. First phase oil is now expected by June 2013, according to deputy oil minister **Lyazzat Kiinov**, the back end of a six-month window the government had outlined. Kiinov reiterated the 2018-19 window for the start of Phase Two, although reports of his comments suggest that the back end of this timeframe is prioritised.

Kiinov, speaking on 7 December, was keen to emphasise that contractual certainty was assured. "The government promises that we are not going to revise any law or any contract that is already signed, and we are not about to interfere," he said. "Everybody and every partner will continue working according to the documents we have signed."

ENRC hit by corruption allegations

Eurasian Natural Resources Corporation (ENRC), the London-listed Kazakh mining group, has been hit by rumours that the UK's **Serious Fraud Office** is gathering information for a possible investigation into corruption at the controversial company.

ENRC's shares fell nearly 8% when the news broke on 13 December. The company claims that the story is overhyped, and that it is liaising with the SFO regularly as a result of a pre-existing internal audit (the SFO also insists that there is no formal investigation).

The internal audit is looking to assess allegations of wrongdoing revealed by a whistleblower at one of its iron ore mining operations in Kazakhstan: allegedly, money was being siphoned off at the mine.

Even without a formal investigation, the SFO's interest in ENRC is yet another sign to concern investors. The company is no stranger to controversy: as the news about the SFO broke, a former ENRC executive filed a wrongful dismissal claim in London's High Court. There is no information about **Andrew Balgarnie**'s motives but it is the latest in a string of resignations and accusations at the top of the company.

This history explains why the company's shares took such a dive, even though the SFO is not formally launching an investigation. One investment analyst told the *Financial Times*: "Despite a world class asset base we feel ENRC's investment case continues to be overshadowed by governance issues, and to our mind the governance review has done little to quell a tainted image."

Regional focus

Russia hints at use of force in Trans-Caspian dispute

Russian objections to the planned Trans-Caspian Pipeline (TCP) have taken on a new dimension in recent weeks, with blunt threats of military force against Turkmenistan being made by Kremlin-linked experts and academics.

For years, Moscow has vocally opposed the construction of a pipeline to bring Turkmen gas west across the Caspian and on to Europe. Both Russia and Iran cite environmental and legal concerns, although their real objection would be the loss of commercial and political influence over transit rights to Central Asian gas.

Ever since the EU began negotiations with Azerbaijan and Turkmenistan on a TCP in September, Moscow has upped its verbal warnings. The Turkmen government has responded angrily that it has the right to build a pipeline without consulting outside states, and President **Gurbanguly Berdymuhammedov** has become more and more vocal in his determination to send Turkmen gas to Europe.

Russia has now more or less dropped the polite fiction of environmental and legal objections. President **Dmitry Medvedev** apparently discussed the issue with Russia's Security Council in October, and academics considered to reflect Kremlin thinking have insisted that >>>

Moscow is prepared to use force to block the pipeline.

Konstantin Simonov, head of the influential **National Energy Security Fund**, gave a bellicose interview to an Azerbaijani news outlet in November, stating that Moscow would not "tolerate such an outright move of disrespect". He drew an explicit parallel with Russia's last regional war, saying that, "Ashgabat understands that the situation will be the same as it was in Georgia in August 2008."

Mikhail Alexandrov, a senior Russian think-tanker, has said that he warned senior EU diplomats that Moscow would "compel Ashgabat and Baku to observe international law, probably, with the help of air strikes", citing NATO operations from Yugoslavia to Libya as a precedent.

It would seem that the costs for Russia of any military action would outweigh the benefits; these threats are almost certainly just bluster intended to rattle Baku and Ashgabat and spook foreign investors thinking of funding a TCP.

But the Georgia precedent does give pause for thought. Clearly, Moscow is not averse to using force if it feels its national interests are being directly threatened, so the question is whether the 'threat' of losing Turkmen gas is sufficient motivation to begin active preparations for military action.

Caspian states continue to lag in transparency rankings

The states of the Caspian region continue to struggle against corruption, according to the latest report by anti-graft watchdog **Transparency International**. The Corruption Perceptions Index assesses perceived levels of corruption within state services, with states ranked from 0 (extremely corrupt) to 10 (very clean).

There is a fairly strong downward trend from west to east, with Turkey leading the region in 61st place (out of 182), tied with Cuba and Latvia, with Georgia immediately behind. Kazakhstan is next in the region, but some way behind at 120th.

Next up are Armenia at 129th and Azerbaijan at 143rd – no doubt another source of irritation in Baku after its arch-rival beat it in the **World Bank**'s Ease of Doing Business Index in October. The rest of the Central Asian states bring up the rear, with Tajikistan at 152nd, Kyrgyzstan at 164th, and Turkmenistan and Uzbekistan tied at 177th. This is below Iraq and Sudan, and just above dysfunctional kleptocracies Afghanistan, Myanmar, North Korea and Somalia.

Azerbaijan, which is sensitive to international criticisms on issues of freedom and transparency, was quick to hit back. A senior official from the ruling **New Azerbaijan Party** insisted that the report was biased and subjective, and said that, "There is no corruption in Azerbaijan... At the same time, the authorities seriously operate to prevent it." States with less of a PR operation, such as Uzbekistan, made no comment.

More tanker congestion ahead in the Bosphorus

The cancellation of the planned Burgas-Alexandroupolis pipeline this month has dashed hopes for a reduction in the congestion that oil tankers face in the crowded Bosphorus.

On 7 December the Bulgarian government terminated its participation in the project, which would take Black Sea oil from Bulgaria to Greece, four years after it was formally agreed by the Russian, Bulgarian and Greek governments.

The cancellation of the project is likely to frustrate Moscow, which has long seen the pipeline as crucial for increasing oil output from Russian and Kazakh fields, which is loaded at Novorossiysk and shipped out to world markets.

The **Caspian Pipeline Consortium** (CPC), which operates the network from Tengiz to Novorossiysk, expects output to reach 48 million tons in the next two years, from 35 million tons last year, before peaking at 67 million tons by late 2014. This will put additional strain on the congested Bosphorus, which explains why Turkey – although not involved in the project – was a strong backer of the Burgas-Alexandroupolis pipeline.

Bulgaria's main reason is that the initial plan for financing the pipeline fell through, although economy and energy minister **Traicho Traikov** also said that the pipeline was a transit project, not an energy security project, and didn't provide enough benefits to make it worth the financial and environmental cost.

Russia's **Transneft** has announced that it is studying new export options for Tengiz oil, although it did not specify what those routes were. The planned Samsun-Ceyhan line, running from northern to southern Turkey, has been rejected as being "too costly" – Transneft said this month that it would cost $30 per kilometre to pump oil through the pipeline, compared to just $2 via tanker through the Bosphorus.

South Stream route altered

Gazprom's planned South Stream project, which has been fairly quiet of late, has had a change of route. The 63bcm a year gas pipeline will no longer terminate at the Central European Gas Hub (CEGH) at Baumgarten in Austria, but instead will run through the Balkans and terminate in northern Italy.

The change of route is in response to a decision by the European Commission to block Gazprom's acquisition of a 50% stake in the CEGH's gas trading platform, as part of a wider anti-monopoly crackdown by the EU against the Russian energy giant. Although a subsidiary branch will run to Austria, according to a Gazprom source quoted by **Reuters**, the bulk of the gas will go to an as-yet-unidentified location in Italy. Gazprom has not officially declared the alteration yet. >>>

MEDVEDEV: TURKEY READY TO GRANT TRANSIT RIGHTS

Gazprom CEO **Alexander Medvedev** has also said that Turkish permission for South Stream to cross its territorial waters will be granted by the end of the year. Ankara has been holding off on allowing the pipeline to enter its waters, citing the need for more data and environmental assurances. However, many analysts believe that it is stalling to gain better contract terms from Moscow or to ensure better odds for the EU's land-based Southern Corridor. Turkish officials have not confirmed Mededev's claim, and it remains unclear whether Turkey will sign off on the necessary paperwork before the end of the year.

Hopes dashed of settling Caspian legal dispute

Yet another attempt to agree on the Caspian's legal division has failed to bear fruit. A session of a special working group tasked to draw up a Caspian Convention governing the sea has failed to make a breakthrough, despite high hopes.

The meeting in Astana was the 30th held by the special working group, which serves as a regular talking shop to discuss the Caspian's status and to prepare for occasional summits of the littoral heads of state (which are intended to formalise a breakthrough but end up being fairly empty ceremonies). At the most recent, in Baku last November, the presidents were optimistic, with Russia's **Dmitry Medvedev** suggesting they became an annual fixture and Iran's **Mahmoud Ahmadinejad** proposing that the convention should be adopted in 2011.

Neither of those has panned out. In Astana at the end of November, the littoral states failed to agree on a draft text for the convention, and made no real public statements afterwards. Russia's envoy, **Alexander Golovin**, said that preparing a final text could take over a year.

Details are scarce but it seems that the group failed to make headway because of the dispute over a planned Trans-Caspian pipeline (see page 4). As at previous events, Azerbaijan and Turkmenistan insisted on their right to build it, while Russia and Iran said that a regime governing legal and environmental issues needs to be in place first. Kazakhstan has specifically linked its possible participation in a Trans-Caspian pipeline to an agreement governing the sea's legal status.

The littoral states are now firmly divided into two camps, with Baku and Ashgabat on one side, and Moscow and Tehran on the other (with Astana refusing to commit itself either way yet).

This division will stymie any further progress on resolving the issue of the Caspian's legal status and will probably contribute to a quiet increase in naval forces around the sea.

One bright spot: the littoral states have agreed on a moratorium on sturgeon fishing in the Caspian, starting next year and perhaps lasting as long as 10 years. The agreement, one of the few achievements by the littoral states in 20 years, is in response to overfishing and depleted sturgeon stocks.

Azerbaijan

Kashagan oil to cross Azerbaijan by 2013?

Energy minister **Natig Aliev** has said that oil from Kazakhstan's Kashagan field could be transported through Azerbaijan from 2013. He told local media that between 5 million and 7 million tons of Kashagan oil could be taken to Baku, where it would be fed into pipelines and rail networks running to the Mediterranean and the Black Sea.

The transit would involve a major upgrade to the Kazakhstan-Caspian Transportation System (KCTS), a grandly titled initiative agreed by the Kazakh and Azerbaijani governments several years ago and backed by IOCs working in both countries, such as **Total**.

The KCTS would involve a series of shuttle tankers running from the Kazakh port of Kuryk (linked to refining facilities by a 950km pipeline from the refinery at Eskene), and/or an undersea oil pipeline leading to the Sangachal terminal near Baku. The pipeline has never got off the drawing board and, in the current climate, is unlikely to do so; tanker transport from Tengiz is already well-established, with Azerbaijani firms **Cross Caspian** and **Caspian Shipping Company** facilitating most of the transit.

Aliev's statement suggests shippers will need to boost their tanker fleets fairly sharply – if, that is, Kashagan oil actually starts flowing by 2013.

New delay at Shah Deniz

The decision on which export pipeline Shah Deniz Phase Two gas will use has been put back again, according to foreign minister **Elmar Mammadyarov**. The Shah Deniz consortium was initially slated to pick one of its many suitors by the end of the year, but in an interview with **Bloomberg**, Mammadyarov said that a decision would be made "probably in the beginning of the next year". **Socar** boss **Rovnag Abdullaev** later clarified that the choice would be made at some point in the first quarter.

Mammadyarov also pushed back the date of the first Shah Deniz gas to reach Europe to 2018-19, "if everything will go smoothly". Phase Two gas was initially scheduled to enter the system by 2017, meaning a delay of up to two years – at least.

AGRI study goes to RFP

The Azerbaijan-Georgia-Romania Interconnector (AGRI) project, turning Azeri gas into LNG in >>>

Georgia and shipping it to Romania, has made a request for proposals to conduct a feasibility study. The call for proposals requests a consultancy company to study the economic and technical aspects of the project, and to set out the terms of the main tender.

The AGRI corporation – the shareholders are Romania's **Romgaz**, Georgia's **GOGC**, Azerbaijan's **Socar** and Hungary's **MVM**, each holding 25% - also said this month that they expect the project to be integrated into the EU's Southern Corridor alongside gas pipelines. AGRI's capacity is open for discussion, with a range of between 2bcm and 8bcm per year (costs are projected at between €1.2 billion and €4.5 billion).

Even the largest of these is small enough to be incorporated into the Southern Corridor alongside other pipelines, making AGRI a flexible addition to one of the smaller export choices for Shah Deniz.

Socar to drill Umid well in 2012

Socar will begin drilling a new well on the huge offshore Umid field next year, the third so far. It will come on the heels of the second well, which is currently due to be completed in the first quarter of 2012 and which has cost around $18.4 million.

Umid is one of the most significant offshore fields being explored, and one of the biggest projects on which Socar has acted as operator. The first exploratory well, which was completed in November 2010, suggested that the field had reserves of around 200bcm of gas and 40 million tons of gas condensate.

The field is part of a larger structure which includes the Babek field, which may be even larger than Umid. Socar estimates that Babek is around twice the size of Umid, and a technically complex field to work on. The structure will be a major test of Socar's drilling capabilities.

The state energy firm is preparing a strategic development programme which will run until 2025, it announced in late November. The programme is in response to the proliferating number of oil and gas fields being worked – 61 in total. Socar is responsible for the exploitation of 35 of these, giving it a confidence boost as it marks its 20th anniversary.

Gazprom boosts gas purchases

Russia's **Gazprom** has announced plans to boost the volume of gas it imports from Azerbaijan by up to 50%. At a meeting in Moscow between Gazprom boss **Alexei Miller** and head of **Socar Rovnag Abdullaev**, Gazprom said that the contracted level of imports would be increased to 3bcm in 2012, up from 2bcm this year. The actual figure imported is lower – 1.36bcm so far this year. That still marks a 70% increase on the 2010 figure of 0.8bcm.

Gazprom's decision to keep raising the import ceiling suggests it is seeking to make greater inroads into Azerbaijan's booming gas reserves. Although 3bcm is a fairly small amount (Baku predicts that next year's gas production will be 28.3bcm) it represents a willingness by both sides to keep the 'northern option' in Baku's gas strategy open.

BP completes platform maintenance work

BP has finished a rotating process of maintenance on its three Azeri platforms in the Caspian Sea. The routine technical work was carried out on the Eastern Azeri, Western Azeri, and Central Azeri platforms throughout November and December, with only one platform shut down at a time to minimise the impact of disruption on operations at the Azeri-Chirag-Guneshli field.

Nonetheless output did take a hit: on 9 December **Socar** posted a decline in oil production of 11% in the first 11 months of 2011, compared to the same period in 2010. Gas output fell too, by 2.6%. A rise in the next set of output figures will indicate whether the fall in production was just a temporary blip caused by the repair work or a sign of a longer-term trend.

Parliament passes 2012 budget

Azerbaijan's parliament has passed the state budget for next year, based on oil at a fairly reasonable $80 a barrel. Revenue for the year is expected to be $20.9 billion, whilst expenditures will be $21.7 billion, leaving a deficit of $806 million or 1.5% of the year's GDP forecast. That gap is an increase of 0.2% on the previous year, which is certainly manageable.

Revenues have risen fairly sharply, by 5.7%; growth in expenditure is, according to the government, almost flat (a rise of 87.6 million manats, or around $111 million). However, the headline expenditure figures are significantly higher, raising questions about what has been cut to keep expenditure growth so low.

Interestingly, healthcare and cultural facilities, which had previously been under the control of Socar, have now been transferred to the health and tourism ministries respectively. The fact that Socar had been running the facilities indicates just how powerful the national energy company is in the wider system of government.

This is also clear from the role that state oil fund **Sofaz** plays. The fund is expected to transfer about $13 billion to the state budget next year, or around 65% of revenues. The budget is balanced on a fairly conservative oil price of $80 a barrel; most predictions are around $100, so Baku will have some leeway if prices do slump (by contrast, Russia is balancing its budget for next year on $100 a barrel).

Defence spending, usually one of the headline budget items, has increased by a fairly small 1.2% this year, to $1.77 billion. Within that, law enforcement and the judiciary get a substantial injection, with their budget increasing by 20%. The overall defence budget remains extremely large, reflecting President **Ilham Aliev**'s determination to make the military budget as large as the entire state budget of arch-rival Armenia. >>>

Chinese businessmen to invest $150m in special economic zone

Georgia has announced that a group of Chinese businessmen is planning to invest $150 million in creating a special economic zone (SEZ) in Georgia, in a sign of growing (if still distant) ties between Tbilisi and Beijing.

A deal on the new SEZ was signed at the end of November between economy and sustainable development minister **Vera Kobalia** and a group of Chinese investors. No details were given on the identities of the investors, or of the benefits provided to investors in the zone.

The government wants the SEZ to be ready by 2015, when Georgia will host the European Youth Olympic Festival. The zone will be focused on tourism and commerce, with hotels and markets. It demonstrates the government's commitment to luring investors through special economic areas and incentives like low taxes.

Showcase development or Potemkin village?

In a move that has raised eyebrows among Georgians and foreign investors alike, President **Mikheil Saakashvili** has announced the construction of a brand new city on Georgia's Black Sea coast which is expected to become the country's second capital. Speaking on 4 December, Saakashvili said the new city would be called Lazika, after an ancient kingdom in the region, and would be sited halfway between Anaklia, near the border with breakaway Abkhazia, and Kulevi, site of a major oil port.

The president said that within 10 years half a million people are expected to live in the city, which "will be the major trade, commercial and economic centre in western Georgia". He claimed that the government was already in talks with European and Asian investment groups, but gave no names, and called on Georgian expatriates to return home to help build the city.

A brand-new city will be extremely controversial for a number of reasons. Firstly, the chosen area is an undeveloped wilderness; sudden urbanisation could have serious ecological effects and lead to confrontation between the government and local activists.

Secondly, and more seriously, it seems unnecessary to build a brand-new coastal city when funds are short and existing towns are already being touted as major commercial and transport hubs.

Saakashvili seems set on multiplying Georgia's capitals: splurging on modern landmarks in Tbilisi, moving the parliament to the western city of Kutaisi, and boosting Batumi as a stylish symbol of the country's development. A major new development could bleed Poti and Batumi of much-needed citizens and businesses, which they are already struggling to find despite major government investment.

The reverse is the third problem: that the city will not even be feasible. Georgia has a population of around 4.5 million, so the new city would need one in every nine Georgians to live there. This is unlikely, given concerning levels of outward migration, so Lazika could end up empty next to the more organic and successful cities of Batumi and Poti. Lazika is intended as a showcase; it may end up as a symbol of the government's grandiosity and its constant hunger for new development.

Election crisis in South Ossetia

The breakaway Georgian province of South Ossetia underwent a major electoral stand-off this month, indicating political instability in the statelet that could have wider effects for Georgia and the region.

Presidential elections in mid-November pitted anti-corruption campaigner **Alla Dzhioyeva** against **Anatoly Bibilov**, the Kremlin's favourite. Russia has maintained effective domination over South Ossetia's politics, economy and security since the province became the epicentre of the Russia-Georgia war in 2008.

Polls showed that Dzhioyeva won the 27 November election with 57% to Bibilov's 40%, but the result was annulled by the local Supreme Court, citing election violations. Dzhioyeva declared herself president and began a street protest in the middle of the *de facto* capital Tshkinvali.

As the stand-off continued the situation deteriorated, with police firing into the air to disperse crowds and an anti-tank rocket fired at the home of the statelet's chief prosecutor, a close ally of outgoing President **Eduard Kokoity**.

Kokoity resigned on 10 December in an attempt to end the crisis, as part of a deal in which Dzhioyeva would not be declared president but would be allowed to stand in a new election in March. Although Dzhioyeva was suspicious, she called off the protests. Prime minister **Vadim Brovtsev**, a Kokoity loyalist, is set to serve as interim leader until the March election.

However, the statelet's parliament – dominated by Kokoity's party - voted against the sacking of two of his leading allies, which was a key demand of Dzhioyeva's movement. >>>

The opposition now feels cheated, and may resume street protests. At the time of going to press the situation was stable, but the stand-off illustrated the fragility of the situation in South Ossetia. A more serious crisis could lead to instability on the Georgian border and escalate tensions between Tbilisi and Moscow.

Range and partners plan to spud new well

The joint venture between **Range Resources**, **Red Emperor Resources** and **Strait Oil** has announced plans to spud a second well in Georgia's Kursebi 2 prospect.

Red Emperor said on 12 December that the well is due to be spudded at the end of December or early in the new year, following additional reviews of the area's seismic data.

The decision to start on a new well follows the suspension of drilling at the earlier Mukhaini-1 well in late November. Work was halted there after re-interpretation of the seismic data suggested poor geological prospects for commercial extraction.

The Kursebi-2 prospect is estimated to hold gross undiscovered reserves of 160 million barrels. Exploration of the site is still at an early stage: reserves of this size would be a major boost for energy-poor Georgia and for the three junior companies that make up the joint venture.

Iran

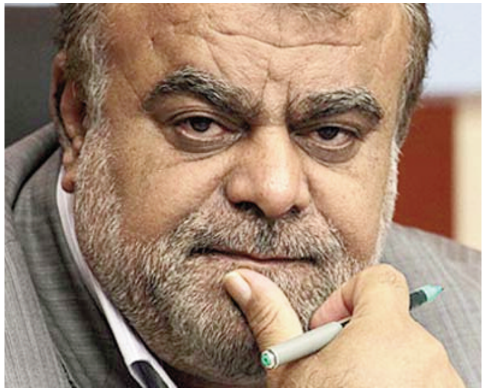
Huge Caspian gas field discovered

In a find which President **Mahmoud Ahmadinejad** said will "change the energy and political balance around the Caspian", Iran has discovered a significant gas field in its sector of the Caspian Sea.

Announced on 11 December, the field was estimated by oil minister **Rostam Qasemi** to contain up to 50tcf of gas. Iran's current proven gas reserves in the Caspian are around 36tcf.

Qasemi did not give a precise location for the field, saying that it was not in disputed waters and was an "internal affairs issue". However, he also said that it is 188km from Roudsar and 250km from Neka. If accurate, this would seem to locate it in a contentious part of the Caspian, close – or even in – Turkmenistan's waters. As Iran has held off from agreeing on a maritime boundary while it presses its claim for a larger chunk of the Caspian, there is no agreement between Tehran and Ashgabat over where their maritime boundary lies (see page 6).

The cost of developing the field could be as high as $10 billion, according to unnamed experts quoted by Iranian media. Tehran has been quick to move forward with the field; the day after its discovery, Ahmadinejad ordered the Oil Ministry to start moving ahead with full exploration as soon as possible. The urgency of drilling may be connected to the potentially disputed location.



QASEMI: FIELD'S LOCATION "AN INTERNAL AFFAIRS ISSUE"

The field will be drilled by the huge Amir Kabir semi-submersible rig, known until February 2010 as Iran Alborz, which can drill up to 20,000ft and operate in waters of 3,380ft. The rig has been conducting extensive exploratory work in Iran's Caspian waters.

A **Wikileaks** cable from the US embassy in Baku in late 2009 suggested that Norwegian, Chinese and Brazilian workers were present on the rig, which nearly caused a diplomatic incident when Azerbaijan accused it of straying into Azerbaijani waters. Given the tightening international sanctions around the Iranian energy industry, maintaining foreign expertise will become increasingly difficult, and there is scepticism over how easily Iran will be able to develop such a large, complex field without foreign investment.

If Tehran does manage to develop the as-yet-unnamed field, it could be significant for politics in the wider Caspian. It would reduce Iran's need to import gas from Turkmenistan and Azerbaijan to fuel its northern provinces, which are distant from the main gas fields in southern Iran. As well as strengthening Iran's own energy security, the quantity involved could allow increased exports to Turkey, reducing Ankara's reliance on Russian energy.

It could also spur Iran to compromise on a legal division of the Caspian, on which it is the only holdout. Despite Qasemi's claim that the field lies in Iranian waters, and despite Tehran's willingness to defend its Caspian assets, the legal and political uncertainty arising from exploration could be an incentive to agree on a formal division with the other littoral states. This is particularly true if the find is the start of a more aggressive exploration strategy in the Caspian by Tehran.

Kyrgyzstan

New government coalition faces challenges

New president **Almazbek Atambaev** was sworn in at the beginning of December, and by later in the month had managed to cobble together a disparate coalition in an attempt to bring a sense of unity to Kyrgyzstan.

His **Social Democrats** are now united with the liberal **Ata-Meken** and **Respublika** parties, as well as the conservative **Ar-Namys** – bringing together 92 of the 120 deputies in parliament. However, there are concerns that the coalition fails to address one of Kyrgyzstan's biggest problems, the division between the north >>>

ATAMBAEV: DISPARATE COALITION

and south, which was amplified by last year's overthrow of President **Kurmanbek Bakiev** and the brutal inter-ethnic violence in the south that followed.

The nationalist **Ata-Jurt** party, which has a strong following in the south, is now in political opposition, and has vowed to oppose what it sees as an illegitimate government elected through fraud.

The party received a boost recently when **Akmatbek Keldibekov**, an Ata-Jurt member serving as parliamentary speaker, was forced to step down after persistent allegations of links to drug traffickers. Some analysts believe that the accusations were political charges designed to remove Ata-Jurt from any positions of power.

He has now returned to his southern powerbase to work with Ata-Jurt leader **Kamchybek Tashiev**, who is aggrieved that he received no political post in return for suspending street protests against electoral fraud. Further demonstrations are unlikely during the cold winter, but if the current stalemate persists the opposition may launch new protests in the spring.

This could further weaken the government's already shaky control over southern Kyrgyzstan and herald further instability ahead. It will certainly deal a blow to the government's stated aim of protecting foreign investors, particularly in the mining industry, which have been under pressure from angry crowds and armed assailants. The deepening of the regional divide will make the investment climate far more uncertain.

Turkmenistan

Reshuffles afoot

The Turkmen government has undergone a bit of a reshuffle this month, although figuring out the reasons is – as ever – something of a guessing game.

Deputy interior minister **Berdimuhammet Redjepov** was fired, for the standard flaw of "serious shortcomings in his work". Vice-premier **Gurbanmurat Mezilov** was relieved of his post: the rather odd reason was that he was also head of the national **Academy of Sciences**, a task which apparently requires his full attention.

Mezilov had been appointed to run the Academy of Sciences – by President **Gurbanguly Berdymuhammedov**, naturally – as recently as February 2010. He is replaced as vice-premier by **Sapardurdy Toylyev**, formerly chairman of the **State Committee for Sports and Tourism**.

A few other officials also got a presidential rebuke, usually a first step before being shown the door. Head of the **State Service on Drugs Aman Allanurovich Garaev** was reprimanded for a "weakening of control over discipline and order on the part of personnel in the service". Health minister **Gurbanmammed Elyasov** has also been reprimanded, "for unsatisfactory performance of his duties and committing shortcomings in observing labour discipline".

Berdymuhammedov to stand again

At the national congress of the **Galkynysh** (Revival) movement on 15 December, there were no surprises when President **Gurbanguly Berdymuhammedov** was nominated the candidate for 12 February's rubber-stamp elections. Slightly more unexpected was the president's announcement that Galkynysh was to be abolished, having "fulfilled all the tasks posed before it at the current stage of state and social development of the country".

To enter the race for president, candidates need to be backed by a political party or public association, or to have gathered 50,000 signatures.

The ruling **Turkmen Democratic Party** (TDM) is the only recognised party: musings by the president about creating a second party, most recently on 16 December when he said that a multi-party system would be created "in the future" have gone nowhere so far. And government harassment makes it almost impossible for any independent candidate to gather 50,000 signatures; almost all serious opposition figures have fled the country or been jailed.

Berdymuhammedov's not-so-formidable opponents, as of 20 December, are the mayor of Halach district in Lebap province, **Myratgeldi Jumageldiyev**, the deputy head of the agricultural department in Dasoguz province **Recep Bazarov**, and, most oddly, the deputy chairman of the **Turkmen Civil Service of Maritime and River Transport**, **Rozygeldi Rozygulyev**. All three are members of the TDM and can be expected to poll in the low single figures.

It seems likely that the upcoming election is linked to the abolition of Galkynysh, although the precise thinking is unclear. Galkynysh was established by former president **Saparmurat Niyazov** in 1994 as an amorphous nationwide movement, formed of local associations and political organisations, including the TDM, and – like the TDM – headed by the president. It served little practical purpose but was a useful tool to expand the government's direct influence over public associations.

The official reason for Galkynysh's abolition is "strengthening the democratic, legal and secular state, enhancing civil society, [and] reorganising the work of public associations". This may be a sign that the government feels confident that it can relax control of these associations, providing a modicum of greater political pluralism. Alternatively it may be a signal that the TDM itself will now take on this role, cementing the influence of the more tightly organised party structure. >>>

Petronas looks to expansion

During President **Gurbanguly Berdymuhammedov**'s trip to Kuala Lumpur in early December, Malaysia's state energy firm **Petronas** announced its intention to expand operations in Turkmenistan. According to a statement released by Turkmen media, Petronas president **Shamsul Azhar Abbas** said that the company was looking to double its gas production in Turkmenistan from 500 million cubic feet to 1 billion cubic feet in three to five years. He also proposed building an oil and gas institute in Turkmenistan where Petronas will train local staff.

Doubling output in this timeframe is a fairly optimistic target, reflecting Petronas's confidence after the start-up of commercial production earlier this year in Block 1 and the start of operations at the company's onshore gas processing plant. The company has invested $4.5 billion in Turkmenistan over the past 15 years, according to statements released by the Turkmen media earlier this year.

CNPC sets up new office, processing plant

China National Petroleum Corporation (CNPC) has cemented its position in Turkmenistan this month with the opening of a new office in Ashgabat and the start of construction of a major gas processing plant in Lebap province. The new CNPC office is an impressive facility, according to Turkmen media. Located on the newly refurbished Bitarap Turkmenistan avenue, the five-storey building is large enough for 500 people and includes a sporting complex. Underlining the importance of CNPC in Turkmenistan's energy industry, President **Gurbanguly Berdymuhammedov** attended the opening, along with CNPC's CEO **Zhou Jiping**.

The processing plant is in the Bagtyyarlyk production-sharing area, to which CNPC acquired the rights in 2007. The plant will be able to process 9bcm of gas every year, which will be dedicated to supplying the Turkmenistan-China pipeline. Lack of processing capacity appears to be one of the reasons for the limited quantity of Turkmen gas now flowing to China. The plant is slated for completion in 2014, around the same time as additional production branches of the Turkmenistan-China line.

Dragon hits 2011 production target

Dragon Oil has reached a production rate of 70,000 b/d from its Cheleken contract area off the Turkmen coast, boosting confidence that the company will be able to reach its ambitious growth targets for next year.

In a press release on 19 December, Dragon said that it had reached its target for 2011 after completion and initial testing of the 28/164 well at its Dzheitune (Lam) field. Initial production at the well is 3,018 b/d, nudging Dragon's total output up to its target for the year of 70,000 b/d, an increase of 25% on last year's production.

Production is expected to rise by between 10% and 15% over the next three years to hit 100,000 b/d by 2015, from enhancing output at old wells and opening new wells. Drilling is under way at three separate wells; if they also prove productive, Dragon's confident production target looks well within its grasp.

President praises Turkish investment

Speaking at a Turkish trade expo in Ashgabat on 14 December, President **Gurbanguly Berdymuhammedov** has praised Turkey's investments in Turkmenistan and expressed his hope for intensified relations.

Around 130 Turkish businessmen attended the expo, organised by the two governments. The enthusiasm of Turkish investors for Turkmenistan does not appear to have been dented by reports, covered by ***Caspian Focus*** in July, that the Turkmen government had refused to pay numerous Turkish construction firms and had seized their assets.

That dispute was being taken to the **International Center for the Settlement of Investment Disputes** by a group of 20 Turkish companies, which accused Ashgabat of refusing to pay them $1 billion; the case is pending.

It does not seem to have disconcerted other Turkish investors from seeking a slice of Turkmenistan's economy, particularly in sectors like construction and real estate.

Uzbekistan

Gas contract with China revealed

Uzbekistan has revealed details of a major contract to supply gas to China. The deal was signed between the state gas transit company **Uztransgaz** and **China National Petroleum Corporation** subsidiary **PetroChina International Company** in October, but the Uzbek government has only revealed its existence now. Its reason for keeping the news quiet is unclear.

In line with Uzbekistan's opaque way of doing business, Uztransgaz gave no indication on prices or volumes. However, anonymous sources indicated to local media that China will buy 10bcm of Uzbek gas a year, with deliveries starting in 2012 through the existing pipeline network which takes Central Asian gas east. When the third branch of that network is up and running by 2014, a further 25bcm will be able to be exported to China.

The deal makes good economic sense for Tashkent, but also indicates growing ties with Beijing as the volatile relationship with Moscow goes through another rocky patch.

Political purge targets premier's allies

A number of ministers and high-ranking officials have been arrested or sacked from the >>>

Uzbek government, according to analysts, leading to predictions that prime minister **Shavqat Mirziyoev** is under threat.

Information about political reshuffles is almost never divulged in Uzbekistan, but rumours indicate that former presidential security adviser **Rovshan Muhiddinov**, emergencies minister **Tursunkhon Khudoibergenov**, deputy prosecutor general **Mukhiddin Kiyemov** and deputy prime minister **Botir Hojaev** have all been arrested, sacked or placed under close surveillance.

All, allegedly, are associates of Mirziyoev, a former regional governor who has served as premier since 2003. The arrests are now helping to make sense of a remarkable parliamentary session in June, when the normally quiescent rubberstamp body sharply criticised Mirziyoev. It was his first half-yearly report on the government's activities; President **Islam Karimov** shifted that responsibility to the prime minister last November.

The unprecedented criticism seems to have been an attempt to take Mirziyoev down a peg – crushing his allies in the elite seems to have taken this a step further. There is no obvious reason to do so, since the prime minister has never sought to position himself as a rival to Karimov.

One reason may be Karimov's murky plans for succession. By purging Mirziyoev's allies, the president may be making absolutely certain that he lacks a power base with which to challenge whoever is eventually anointed heir to Karimov's throne.

Karimov criticises Putin's economic integration plan

President **Islam Karimov** has taken the opportunity of the country's Constitution Day, when it adopted its first independent constitution, to attack Russian prime minister **Vladimir Putin**'s plan for a Eurasian Union (***Caspian Focus***, October 2011, page 1).

Although he welcomed the economic benefits of greater integration, Karimov warned that plans for such economic unions could "become politicised". He said that a lack of understanding about the past had led to nostalgia for the Soviet empire, which ignored its totalitarian nature and the loss of sovereignty that it entailed. In a possible reference to China or to the West, he also said that politicised unions could adversely affect relations developed with external countries.

Uzbekistan's scepticism about the Eurasian Union is quite predictable given Karimov's capricious foreign policy, which regularly flits between Russia, China and the West and refuses to align fully with any of them. Tensions regularly surface between Tashkent and Moscow over participation in multilateral groupings – Uzbekistan is constantly on the lookout for signs that Russia is seeking to reassert its control over the region.

Border tensions rise in Uzbek-Tajik dispute

Amid ongoing tensions between Uzbekistan and Tajikistan, columns of Uzbek tanks and artillery were reported to be deploying along their joint border in mid-December. The build-up, which was apparently some weeks in the making, follows several clashes in November between border guards, as well as between border guards and smugglers. Uzbekistan routinely blames the Tajik government for such incidents, and makes a habit of closing the border.

The current deterioration in relations follows a mysterious explosion on a railway bridge in Uzbekistan near the Tajik border, which occurred in November. The blast was initially blamed on terrorists, but the government's tardiness in repairing the bridge and the damage that freight backlogs have caused to Tajikistan have led to suspicions that the incident was staged to punish Tajikistan. Specifically, a spat over a Tajik hydro-electric dam, which could limit Uzbekistan's water supply, has led to a sharp decline in relations.

There is little likelihood that Uzbekistan's troop build-up is anything more than a show of force designed to intimidate Dushanbe. However, the continued tensions between them do increase the overall security risks in Central Asia and raise questions about the stability of the tense border region.

Tajikistan

Tethys secures Tajik field

Tethys Petroleum has secured its purchase of the majority of **Seven Stars Energy Corporation**, the joint venture set up in 2007 between Tethys and the Tajik investment group **Sangam**. Tethys now owns an 85% stake in the venture, up from 51%. Seven Stars owns the rights to Tajikistan's Bokhtar production-sharing contract through its subsidiary **Kulob Petroleum**.

The area covered by the 25-year PSC, on the southern border with Afghanistan and Uzbekistan, contains an estimated 1.1 billion barrels of oil equivalent. In a press release, Tethys describes it as the "jewel in the crown of the company". The press release also noted that Tethys would continue to engage prospective farm-in partners.

Also this month, Tethys announced that production testing would begin on a new Tajik well early next year. The Persea 1 exploration well has been drilled to 2,655 metres: testing will be carried out in the first half of 2012.

Free samples of Menas' Focus publications ...

Order Form

Menas Associates executive briefings are distributed in PDF format by e-mail. Corporate subscriptions can be sent to an unlimited number of individuals within your organisation, on receipt of their e-mail addresses.

Subscriptions include access via a user name and password to Menas' e-library where all of the previous issues, plus additional valuable databases, can be viewed or downloaded.

Please send me a **free** sample copy and full details of the following subscription(s):

- ☐ Algeria Focus
- ☐ Brazil Focus
- ☐ Caspian Focus
- ☐ Iran Strategic Focus
- ☐ Iraq Focus
- ☐ Libya Focus
- ☐ Nigeria Focus
- ☐ Sahara Focus (quarterly)
- ☐ Vietnam Focus
- ☐ Yemen Focus

Name

Company/Organisation

Title/Position

Business/Interest

Address

Phone

Fax

E-mail

Signature

Date

Menas Associates Ltd
4 Bloomsbury Square, Suite 8
London, WC1A 2RP
United Kingdom

+44 (0)20 3397 4311 Phone

info@menas.co.uk
www.menas.co.uk

CF1211