

Russian Direct Investments in EurAsEC and Their Role in Energy and Transport Infrastructure Development in Eurasia

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The Heads of EurAsEC member countries have stressed on many occasions that the development of investments is one of the main tasks for this integration group. This primarily concerns Russia's investment policy. In the 1990s and early 2000s, the main recipients of Russian investments were European countries. However, the portion received by EurAsEC countries has increased significantly over the last few years.

This increase in Russian investments in EurAsEC has been facilitated by a number of factors.

First, EurAsEC obviously has become a priority in Russia's economic policy in the post-Soviet space. The political convergence of Russia and other EurAsEC countries also helps to promote investments. Russia supports the political regimes of those countries that she understands well, while the West accuses them of being undemocratic and abusers of human rights, and a real threat to the national security of some EurAsEC countries.

Second, the first Russian transnational corporations have matured and built financial muscle, and now they are turning their attention to attractive assets in Central Asian countries, which are less familiar to them compared to the European members of the CIS. Small and medium-size businesses are realising their foreign trade ambitions on an increasing scale, as competition in Russia becomes tougher. These types of businesses always tend to expand to neighbouring markets, and many Russian regions border EurAsEC countries with which they have had close economic, cultural and family links since the Soviet era.

Third, EurAsEC countries possess vast deposits of oil, gas and other fossil minerals. A realistic assessment of the prospects of the world hydrocarbons market and Russia's domestic demand and export obligations urges Russian companies to develop the production of oil and gas in these countries.

Fourth, privatisation is still under way in many EurAsEC countries, and there are attractive opportunities that would be much cheaper for Russian businesses than elsewhere. Russian investors understand the mentality of the local population and the particular features of doing business in these countries.

Fifth, EurAsEC countries are a promising internal market with a rapidly growing population and gradually rising income, and this makes them attractive for Russian production and service companies. In particular, these countries may have the highest demand for Russian mechanical engineering products. This in turn will improve the general structure of Russian exports and provide new opportunities to set up assembly factories, and develop or restore cooperation in production. The region's vast labour resources allow labour-intensive production to be launched there with a view to exporting products back to Russia.

Sixth, strengthening links with EurAsEC is in line with the general trend towards the geographic diversification of Russia's external links, first of all in the direction of Asia. In doing so, EurAsEC members would become a bridge enabling Russia to establish links with remote Asian countries.

Seventh, the increasing economic expansion by Western powers, China and some CIS countries in this geopolitically important region requires an adequate economic response by Russia.

The financial and economic crisis of 2008-2009 strengthened EurAsEC countries' enthusiasm for mutual cooperation even further. As a real step towards this cooperation, the Anti-crisis Fund was established. The resources of this Fund will be disbursed in the form of stabilisation loans at arm's length basis in the event of a cash gap or a lack of funds for urgent welfare payments. To provide support to EurAsEC countries, bilateral channels will also be used. Large loans were extended by Russia to Belarus and Kyrgyzstan. For example, the main portion of the Russian loan to Kyrgyzstan (\$1.7 billion) is to be invested in the construction of the Kambar-Ata-1 hydropower plant.

This state support is very important for those Russian companies that now suffer from a lack of investment. It enables them to continue the projects they have already started and make new investments to speed up recovery after the crisis and promote economic modernisation of EurAsEC countries.

Investment volumes

It is quite difficult to assess the volume of Russian direct investment in specific EurAsEC countries, as the various ministries use different calculation methods. For instance, the Russian statistics service records only gross investments by non-financial organisations and disregards withdrawals

from foreign companies, whereas the Central Bank records real cash flows as reflected in a balance of payments.

Considerable deviations take place because the Central Bank assesses reinvested income, which makes up a major portion of the increase in investments.

This is not the point, however. Russian investments are often masked with foreign, mostly offshore names. In these cases, a foreign company located outside EurAsEC is often taken as the investment entity for statistical reporting, although the main assets of such a company are located in a EurAsEC country. This practice was exemplified by one of the major transactions by a Russian company in EurAsEC: in 2005 LUKoil via LUKoil Overseas Holding Ltd. purchased Nelson Resources Ltd., a company registered in the BVI. The new owner is Caspian Investments Resources (CIR), a 100% subsidiary of LUKoil Overseas Holding Ltd. The cost of this transaction exceeded \$2.1 billion, which is 2.5 times the cumulative direct and portfolio investment, according to the Russian statistics service, and nearly 30% of such investments according to the Central Bank¹. Another example is the purchase of the gold company Celtic Resources (Ireland) by Severstal for about \$330 million, which was completed in January 2008. The main assets of the Irish company are located in Kazakhstan (100% of the Suzdal gold mine, 75% of the Zherek gold mine, and 50% of the Shorsky molybdenum mine) and Russia (74.5% in the Tominskoye copper and gold deposit development project and 100% of the Mikheyevskoye copper and gold deposit in Chelyabinsk Oblast). There are some other notable examples.

According to the Russian statistics service, the breakdown of Russian investments in EurAsEC countries and EurAsEC investments in Russia is as follows:

| | Russia's investments in EurAsEC | | | EurAsEC investments in Russia | | |
|---------------|---------------------------------|--------|----------------------|-------------------------------|--------|----------------------|
| | 2000 | 2008 | | 2000 | 2008 | |
| | All | All | Direct and portfolio | All | All | Direct and portfolio |
| Belarus | 490.2 | 1505.0 | 1323.3 | 2.5 | 193.4 | 54.9 |
| Kazakhstan | 2.2 | 174.3 | 79.2 | 5.7 | 1064.7 | 380.0 |
| Kyrgyzstan | 0.0 | 39.8 | 0.1 | 0.1 | 66.4 | 27.3 |
| Tajikistan | 0.0 | 28.1 | 1.1 | 0.0 | 8.9 | 0.1 |
| Uzbekistan | 0.4 | 385.1 | 250.8 | 3.5 | 11.5 | 10.1 |
| Total EurAsEC | 492.8 | 2132.3 | 1654.5 | 11.6 | 1344.9 | 472.4 |
| Total CIS | 555.6 | 4084.9 | 3067.6 | 19.3 | 1758.9 | 756.3 |

Table 7. 1. Cumulative mutual investments by Russia and EurAsEC countries, as at the end of the year (\$ million)*

Note: * excluding monetary regulation bodies and commercial and savings banks.

Source: Federal State Statistics Service.

¹ In 2007, 50% of shares in CIR was sold to Mittal Investments, an Indian company owned by Lakshmi Mittal.

As can be seen from the above table, in the beginning of 2009 EurAsEC countries accounted for 53.9% of all Russian investments in the CIS (and 49.1% of direct investments). Belarus has advanced to a leading position in EurAsEC due to a single long-term transaction (Gazprom purchased 50% shares in Beltransgaz for \$2.5 billion, which will be transferred in 2007–2010 in equal installments 12.5% each, i.e. Gazprom will annually invest \$625 million). Kazakhstan with its rapidly growing economy has long ranked second, but in 2007 it was surpassed by Uzbekistan due to a number of new Russian projects.

Russia accounts for 76.5% of all investments in the CIS and 62.5% of direct cumulative investments by EurAsEC countries.

Notably, in all EurAsEC countries Russia falls significantly behind other foreign investors in terms of direct investments. For example, in Kazakhstan in the beginning of 2007, Russian investments accounted for as little as 3% of all foreign direct investment, whilst investments by the US, the Netherlands and the UK accounted for 29%, 15% and 11%, respectively. In terms of direct investments in Kazakhstan, Switzerland, France, China and Canada also surpass Russia². In Kyrgyzstan, Russian investments in 2007 accounted for 3.3% of foreign direct investments, whilst Kazakhstan's investments accounted for 46.6%.

Interestingly, the balance of investments by Russia and some EurAsEC countries is not in favour of Russia. This can be explained, first of all, by investments by Kazakhstan, which is second only to Russia in post-Soviet countries.

Investments in joint hydrocarbons production

The main targets for Russian investments in EurAsEC countries are the fuel and energy sectors. It is natural, since the region possesses vast resources, and EurAsEC countries desperately need investments. Some oil and gas production projects are closely associated with joint reconstruction of existing pipelines or construction of new ones for exporting fuel and raw materials.

One of the most active Russian players in EurAsEC is LUKoil. It has participated in eleven oil projects in Kazakhstan since 1995, when a contract for the development of the northern part of Kumkol was made. Since that time LUKoil has invested in Kazakhstan's economy over \$4.5 billion. LUKoil is a stakeholder in the Karachaganak project (15%) and has a 50% share in the Tyub-Karagan and Atashsky blocks located on the Caspian shelf (both of them are parts of the Dostyk project). LUKoil Overseas Holding Ltd. holds 54% of shares in LukArco, which in turn owns 12.5% in the Caspian Pipeline Consortium (CPC)³ and 5%

² *Exclusive, October 2007.*

³ *The other members of CPC are the Government of Russia (CPC-R, 24%) and the Government of Kazakhstan (CPC-K, 19%).*

in Tengiz, a major oil and gas deposit. In conjunction with Kazakh companies, LUKoil and Rosneft will explore and develop three more large deposits on the Caspian shelf.

In 2004, LUKoil founded the operating company LUKoil Uzbekistan Operating Company through LUKoil Overseas Holding Ltd. In June 2004, a PSA was made with the state company Uzbekneftegaz, under which LUKoil Uzbekistan Operating Company obtained the rights to commercial development of the Kandym, Khauzak and Shady deposits in southwest Uzbekistan for 35 years, and exploration of the promising Kungradsky areas in the Ustyrt plateau in west Uzbekistan, which hold about 300 billion m³ of gas and 7 million tons of gas condensate in total. LUKoil will invest about \$1 billion.

These deposits have been developed since 2007; during phase one, production will total 2.5 billion m³ annually, which will require \$200 million in investments. In 2007–2010, LUKoil will invest another \$500 million to boost annual production to 8 billion m³ starting from 2010. During the initial phase, the produced gas will be divided among the parties on an equal basis, but in the future the shares may change depending on the project's profitability. This project also includes the construction of a natural gas chemical complex with an annual capacity of 6 billion m³ (total cost \$250 million), two compressor plants and a 200 km main gas pipeline by 2010.

Jointly with KazMunaiGaz of Kazakhstan, Rosneft will develop the Kurmangazy deposit on the Caspian shelf in accordance with a PSA made for 55 years. The total cost of this project is estimated at \$23 billion. The first exploration well was drilled there in 2006.

Gazprom also seeks to expand its presence in EurAsEC countries. In Kazakhstan, this Russian gas monopoly founded the joint venture KazRosGaz. In 2006 Gazprom and the Government of Kyrgyzstan agreed to form a joint venture that will consist of the assets of Kyrgyzgaz and Kyrgyzneftegaz. In Belarus, Gazprom strives to secure safe conditions for gas transit to Europe.

A long-term strategic approach towards the development of contacts with EurAsEC countries is vital for joint investments in the production, transportation and processing of hydrocarbons. Considering this, it is important to consider the strategic agreements that Gazprom has secured with Uzbekistan, Kazakhstan, Tajikistan and Kyrgyzstan since 2000.

In December 2002, Gazprom made an agreement on strategic partnership in the gas sector with Uzbekneftegaz. It provides for long-term supplies of Uzbek gas in 2003–2012, Gazprom's participation in natural gas production projects in Uzbekistan on the terms set forth in PSAs, and cooperation in the development of Uzbekistan's gas transport infrastructure and transit of gas via the country's territory.

To further this agreement, Gazprom and Uztransgaz executed a medium-term agreement on transportation of natural gas in 2006–2010 in September 2005, and the *Agreement on the Basic Principles of Geological Exploration of Investment Blocks in the Ustyurt Region, the Republic of Uzbekistan* in January 2006. As part of this strategic partnership, Gazprom recommenced gas production at the Shakhpakhty filed on the PSA terms, and intends to produce 500 million m³ of natural gas annually. Gazprom's investments in this project totals \$21 million.

In December 2006, Uzbekneftegaz granted Gazprom licences to carry out geological exploration in seven investment blocks in the Ustyrt region: Aktumsuisky, Kuanyshsky, Agyinsky, Nasambeksky, West Uzginsky, Akchalaksky and Shakhpakhtinsky. These blocks have a total area of 38100 km², and hold about 1 trillion m³ of natural gas.

In accordance with existing agreements, Gazprom had to come up with a phased geological exploration programme for these blocks and, in the event of a commercial discovery, will have the exclusive right to negotiate with Uzbekistan the development of these reserves on the PSA terms. To implement this agreement, a Managing Committee will be established. Gazprom will have invested about \$1.5 billion in this project, including \$260 million in 2006–2008.

Geological exploration and seismic surveys by Gazprom specialists revealed insignificant hydrocarbons reserves in three blocks (Akchalaksky, Kuanyshsky and West Urginsky), and Gazprom abandoned the project. Experts comment that this decision was in line with Gazprom's efforts to reasonably reduce its investment programme in the face of the crisis. As a result, the Government of Uzbekistan ordered the State Committee on Geology and Mineral Resources and Uzbekneftegaz to revoke these licences⁴.

Gazprom and KazMunaiGaz founded a joint venture on the basis of the Orenburg Gas Processing Plant (OGPP), which will process Kazakh gas from Karachaganak and the North Caspian. Thus, additional workload will be provided to the OGPP to make up for the depletion of the Orenburg gas condensate field. Production by this facility dropped from 34.6 billion m³ in 1993 to 18.3 billion m³ in 2005, whereas its annual capacity is 28 billion m³. The proposed joint venture has been under negotiation since the mid-1990s, but positive decisions, particularly, in respect of gas prices and supply volumes in 2006, were achieved only as a result of personal agreement between President Putin and President Nazarbayev.

⁴ *Gazprom Returns Exploration Licences in Uzbekistan. Malaysians to Take Over* (http://www.newsru.com/finance/03mar2009/uzbek_gaz.html).

In 2006, Gazprom and the Government of Tajikistan executed a memorandum on cooperation in the energy sector, which creates a legal framework for the creation of a joint venture to explore, produce and sell natural gas, and other projects in this sector, including reconstruction, modernisation and construction of gas pipelines.

Transport infrastructure

Investment cooperation of EurAsEC countries on infrastructure projects has not developed on a large scale. On the other hand, there is an urgent need to rehabilitate and expand infrastructure in EurAsEC countries, which in many cases seriously impedes their economic development.

Bearing in mind the long payback periods and capital intensity of infrastructure projects, EurAsEC countries show enthusiasm for cooperation, especially for projects relating to transit infrastructure and facilities located near borders. Many EurAsEC countries are planning considerable investments in infrastructure projects. For example, investments in transport infrastructure in Russia may total \$600 billion by 2015, and government investments will account for 50%⁵.

The construction of the Caspian gas pipeline and other gas transportation facilities in the region will be critical for the development of the oil and gas sector in EurAsEC. The presidents of Russia, Kazakhstan, Turkmenistan and Uzbekistan agreed to this in May 2007. A declaration signed by the presidents will allow up to 90 billion m³ of gas to be transported via Russia. The Caspian gas pipeline will be laid along the coastline through Turkmenistan (360 km), Kazakhstan (150 km) and Russia. The pipeline will be constructed by the Kazakh party in Kazakhstan and by the Turkmen party in Turkmenistan; then it will join the old Central Asia–Centre system at Aleksandrov Gai on the Kazakh-Russian border. In addition, Russia, Kazakhstan and Turkmenistan agreed to reconstruct the existing gas transportation system and increase the annual capacity of the two old branches of the Central Asia–Centre pipeline to 12 billion m³. One more project is being discussed – to construct an East–West trans-Turkmen pipeline for transporting natural gas from northwest Turkmenistan to the Caspian pipeline system. Thus, additional workload for the Caspian pipeline will be secured. The East–West pipeline will have a length of 600 km, and the project cost will exceed \$1 billion.⁶

Cooperation in the construction of cross-border motorways is also expanding. A new motorway to Lake Issyk-Kul (Almaty–Cholpon Ata) is in the pipeline. This commercial road will be 200 km shorter than the existing one. Its length will be 88 km, including 62 km in Kazakhstan. The construction cost will be about

⁵ *Vedomosti*, 19 February 2008.

⁶ *Russia and Turkmenistan to Construct New Gas Pipeline and Transcontinental Motorway* (http://site.securities.com/doc.html?pc=RU&print=1&doc_id=214).

\$3.5 million per km, and the expected traffic intensity will be up to 10000 cars per day. This new road will provide easier access to the Kyrgyz resort facilities on the shore of Issyk-Kul, which were transferred to the Kazakhs.

Turkmenistan has invited Russian Railways to participate in a project to launch a ferry line between Turkmenbashi and Makhachkala, and also to act as general contractor in the project to construct the eastern part of the North-South transport corridor (the Kazakhstan-Turkmenistan-Iran railway). This railway will be laid along the Caspian Sea and have a length of 697 km.

The power sector

One of the largest investment projects in the CIS in which the Russian public and private sectors are participating is the completion of Sangtudinskaya Hydropower plant 1 (project capacity 670 MW). The construction of this plant started in the late 1980s, but was soon discontinued due to a lack of funds. Negotiations over completion of Sangtudinskaya between Russia and Tajikistan started in 2003, and in September 2004, Iran joined these negotiations. In January 2005, Russia, Tajikistan and Iran signed a memorandum on the completion of Sangtudinskaya HPP 1 and 2. In accordance with this document, Plant 1 will be fully completed by the Russian and Tajik parties. The Iranian party, on the other hand, will fully complete Plant 2 in conjunction with the Tajik party. To construct Plant 1, the joint stock company Sangtudinskaya HPP1 was founded, in which Russia and Tajikistan are represented by INTER RAO (75%) and the Tajik Ministry of Energy (25%), respectively.

Sangtudinskaya Hydropower plants 1 and 2 will satisfy Tajikistan's domestic demand and also export electric power to Iran, Pakistan, Afghanistan and some power-starved oblasts of Russia. In addition, these plants will play a key role in regulating the region's water balance.

In 2009, INTER RAO will commence construction of three medium-capacity hydropower plants. Total investment in these plants is estimated at \$1 billion.⁷ In the future, the programme of building small hydropower plants for remote towns in mountainous areas may be expanded, as this need exists all over Tajikistan. By 2025, over 60 small hydropower plants will be constructed in the country. There is also a project to modernise the Nurekskaya hydropower plant.

Also of note is the long-standing cooperation between INTER RAO UES and Kazakhstan in power production using coal from the Ekibastuz coal deposit in Kazakhstan (Severny and Bogatyr open pits). In 2005, on the basis of Ekibastuz GRES-2, a joint venture was founded in which INTER RAO UES received 50% of the shares. Thus, the debt of the National Electric Grids Kazakhstanenergo to INTER RAO for power supplied in 1993-1996 for a

⁷ Half of all investments in Tajikistan are Russian // *Finance*, 28 March 2009. (<http://www.finansmag.ru/news/9033>).

total of \$239 million was settled. Ekibastuz GRES-2 is a major power plant in North Kazakhstan. Its share in the total volume of power generated in Kazakhstan is 10-12%.

In the end of 2007, Rusal and the Kazakh holding company for state assets management, Samruk, founded the joint venture Bogatyr Komir through which they participated in the development of the coal and power industries in Kazakhstan. Bogatyr Komir produces coal at the Ekibastuz coal deposit (Bogatyr and Severny open pits). In accordance with the signed agreements, Rusal assigned 50% of its shares in Bogatyr and Severny to Samruk, which were received under the agreement on merging the assets of Rusal, SUAL and Glencore. Bogatyr Komir will supply coal to satisfy demand in Russia and Kazakhstan, and the parties will also consider building new power plants on the basis of supporting the development of the metal industry⁸. Notably, this cooperation has not lost momentum despite the crisis. At present, Rusal and Samruk-Energo are implementing a programme to modernise Bogatyr Komir with a total of €390 million⁹ in investments.

In February 2008, INTER RAO UES offered to buy 48% of Uzbekistan's shares in Syrdaryinskaya Thermal Power Station (which generates about 32% of all electricity in the country) and invest up to \$170 million in its modernisation. The Government of Uzbekistan will retain the controlling block of 51%. This offer indicates that INTER RAO UES has revised its strategy, as previously it considered privatising power plants in Uzbekistan to be uneconomic if the Government retains control over them¹⁰.

In the beginning of 2009, Russia and Kyrgyzstan signed an agreement which will allow their cooperation in constructing and operating Kamar-Atinskaya hydropower plants 1 and 2, and the Verkhne-Narynsky and Sary-Dzhazsky chains of hydropower plants to be optimised, and investments to be made in power distribution companies – Severelektro in particular. INTER RAO is implementing this project; this company wishes to acquire a number of assets such as Severelektro, Bishkekteploset and the Bishkek Thermal Power Plant, which are due to be privatised.

The cooperation of EurAsEC countries in the nuclear sector is of strategic importance. At present, the production of natural uranium in Russia barely satisfies 20% of the needs of Russian reactors, which, according to the Federal Agency of Subsoil Use, will increase by 1.6-1.7 times by 2020. Kazakhstan, Kyrgyzstan and Uzbekistan have large uranium deposits. Russia holds 5% of the world uranium reserves, whereas Kazakhstan holds 17%, being second only to Australia (24%).

⁸ <http://www.relcom.ru/Right?id=20071129155429>.

⁹ Y. Dorokhov. *Time to Unite Countries // Ekspert*. 2009. No.12 (30 March).

¹⁰ http://www.quote.ru/fterm_comment/index.shtml?2005/10/11/1205451.

In 2006, a programme of strategic partnership of Russia and Kazakhstan in nuclear fuel production was drawn up, and Tekhsnabeksport, Atomstroieksport and Kazatomprom executed respective memoranda. In accordance with this programme, the founding documents of three Russian-Kazakh nuclear joint ventures were signed:

- Akbastau (development of the South Zarechnoye and Budennovskoye deposits in Kazakhstan to supply nuclear fuel to Russian-built reactors);
- Uranium Enrichment Centre (isotopic enrichment);
- Atomic Plants (development of a nuclear reactor with new type VBEP-300 power generating units and its promotion in Russia, Kazakhstan and other countries).

The signed documents of these three joint ventures provide that Russian and Kazakh companies will participate in them on a parity basis.

For example, the Uranium Enrichment Centre will be created on the basis of the Angarsk Electrolysis Chemical Works. Kazatomprom and Tekhsnabeksport paid in its charter capital of 43 million roubles on a parity basis. The Uranium Enrichment Centre will supply its products to Russia, Kazakhstan and external markets. Ukraine was invited to participate in the Uranium Enrichment Centre, and other CIS countries expressed interest in its activities. In April 2007, Rosatom and the Ministry of the Environment of Armenia signed a letter of intent in respect of uranium exploration, production and processing.

Early on, the Russian-Kazakh joint venture Zarechnoye was founded to produce uranium at a deposit of the same name in the Otrarsky District, South Kazakhstan Oblast. The total reserves of this deposit are estimated at 19000 tons of uranium. Zarechnoye produced its first uranium in December 2006, and is expected to reach its design capacity of 1000 tons per annum in 2009.

In March 2009, all uranium assets of the Russian group in Kazakhstan were consolidated. The Russian uranium holding company Atomredmetzoloto, member of Rosatom, acquired a 50% share in Karatau LLP and 25% of shares in the joint venture Akbastau, which it controls via Effective Energy N.V. After completion of this transaction, Atomredmetzoloto consolidated all Russian uranium assets in three joint ventures created with Kazatomprom: Zarechnoye, Akbastau and Karatau (50% in each). This consolidation of assets by Atomredmetzoloto was part of an intergovernmental programme between Russia and Kazakhstan. The acquisition of these assets places Atomredmetzoloto second among the foreign uranium companies operating in Kazakhstan. Atomredmetzoloto announced its plan to boost uranium production by its three joint ventures to 6000 tons by

2020. At present, Atomredmetzoloto's production in Russia slightly exceeds 3000 tons.

Cooperation with Kyrgyzstan in the uranium sector has also been successful. In 2007, Ural Platina Holding, a member of Renova, won an auction for the privatisation of EurAsEC's largest uranium processing facility, the Kara-Baltinsky Ore Mining Works. Renova offered Kyrgyzstan a project to process the accumulated uranium dumps. These tailings will be used to produce valuable minerals, which could not be extracted with older technology. Technical modernisation of the facility will require \$200 million; Renova will contribute \$50 million, and \$150 million will be provided by the EDB.

Cooperation in implementing innovative alternative energy projects has also been gaining momentum. For example, the Russian research and production company Kvant and the Research Institute Gidropribor (Uralsk, Kazakhstan) plan to jointly manufacture equipment capable of producing world-class solar cells. Kvant is a leading Russian company that develops methods of direct transformation of different types of energy (chemical, solar, thermal, etc.) into electricity, self-contained power supply, and diagnostic tools that are widely used in research and production. The construction of a new Kazakh-Russian facility for manufacture of solar cells with a capacity of up to 50 MW per annum will significantly reduce the cost of solar energy, and expand its use in the economy.

Key problems

The investment cooperation of Russia and other EurAsEC countries encounters a number of problems; the most important of them are discussed below.

1. Political opposition to investment expansion

The role of political factors in the development of links between EurAsEC countries is becoming more and more important, because any significant project needs formal or informal approval at the highest level.

Sometimes Russian companies encounter the manifestations of the so-called economic nationalism, or the aspiration to tighten control over natural resources. This trend is universal, and can be observed in Russia itself. For example, the mass media may publish hostile papers or even statements by state officials aimed against Russian companies¹¹. In some cases, the situation may lead to an open conflict; this was the case with the completion of the Rogun HPP, when the Government of Tajikistan terminated the respective agreement with Rusal in August 2007.

¹¹ For example, in August 2007, Belarusian President Lukashenko, during his visit to the office of Sovetskaya Belarus, accused Russia of attempting to "privatise" his country: "Russia wants to privatise not only certain enterprises, or grab them for free. They want to privatise the whole country". (http://news.bbc.co.uk/1/hi/russian/international/newsid_6928000/6928135.stm).

EurAsEC countries often set their national interests against the goals of regional integration. They wish to pursue an independent policy and diversify their foreign trade. The policy of Western powers plays a prominent role in this game, and political investments are being readily made in order to prevent Russia's expansion in EurAsEC.

2. Lack of flexibility in Russian company policy

When acquiring assets in EurAsEC countries, Russian companies believe that control over property will secure stability and achievement of the set goals, e.g. making transit cheaper or enhancing the reliability of supplies. However, in practice, the conditions of operating an overseas asset may deteriorate (for example, raising rent for land occupied by oil and gas pipelines, introduction of new fees, taxes or duties, termination of benefits, environmental claims, etc.)¹². As a result, all the benefits of possessing an overseas asset may disappear or even turn into losses. There is also the risk of the nationalisation of assets in the event of change of power.

3. Increasing competition

Competition increases at different levels: competition with national companies, third country companies, and other Russian companies. In contrast to European members of the CIS, national elites and their affiliates in EurAsEC countries so far do not mount any significant opposition to the Russian expansion. The most serious competitors are the US, Canada, China, India, South Korea, Malaysia, the UAE and other countries which have more resources and powerful political support at their disposal, pursue a more flexible policy, and can offer better terms of cooperation. For example, when Gazprom announced its intention to abandon a number of blocks in Uzbekistan it considered unpromising, Petronas of Malaysia immediately took over, and production will commence there in 2009.

As for competition between Russian companies, it is more pronounced in sectors that can provide fast payback such as telecommunications or the food industry, rather than in the fuel and energy sector, which requires large investment. Consolidation of assets occurs more frequently in the latter sector. For example, LUKoil has acquired Soyuzneftegaz Vostok Limited, a company with Russian capital that is a party to the PSA on the Southwest Gissar and the Ustyurt region in Uzbekistan.

Recently, competition increased between Russian companies and businesses from Ukraine and other post-Soviet countries¹³.

¹² In 2007 Belarus deprived Beltransgaz of a portion of its profit by cancelling the 18% premium on sale of gas to end users. In 2008 Beltransgaz and other Russian assets in Belarus (e.g. Molyzysky Refinery) were required to pay 19% of their turnover to the Innovation Fund of the Ministry of Energy of Belarus. The amount involved is about \$70 million annually (*Nezavisimaya gazeta*, 24 March 2008).

4. There was no progress in multilateral cooperation, which would allow additional resources to be employed and new areas of common interest to be identified. Participation of non-EurAsEC countries is also possible.

5. Governmental support for the investment expansion of Russian companies and investment cooperation in EurAsEC is inadequate. Many Russian officials voiced this problem. Some positive developments in this issue were observed recently; particularly, it is planned to establish a special agency to support Russian overseas investments. This support may include provision of information, risk insurance, assistance in receiving export loans, etc. New public corporations that have considerable financial resources at their disposal will play a more active role in projects of cooperation with EurAsEC countries.

Conclusions and proposals

1. The investment cooperation of companies from Russia and other EurAsEC countries is becoming increasingly diverse, and is covering new areas of business. This is the manifestation of so-called upward integration, which is so far more successful than the formal integration projects being implemented in post-Soviet countries.

2. On the other hand, a number of problems have accumulated in this area; these are associated with increasing competition in EurAsEC markets and their particular role in modern geopolitics, and many other factors.

3. All these observations suggest that the authorities in Russia and other EurAsEC countries should pay closer attention to the private sector's efforts to expand cooperation, and formulate a sound policy of supporting these efforts. Large companies have many tools to exert pressure on governments with a view to securing political and administrative support for their investment projects. However, the governmental policies of EurAsEC countries need to be better aligned with the investment policy of large companies, which should be involved in the implementation of strategic projects in the region on a larger scale. In line with that, medium and small-size businesses and regions should also be involved actively in investment cooperation. State support is vital for capital-intensive long-term projects, especially in the energy, power and infrastructure sectors. The importance of this type of support will increase as many businesses in EurAsEC countries face major financial difficulties.

¹³ After negotiations with the Tajik President Rakhmon in March 2008, Ukrainian President Yushchenko commented that Ukraine is interested in participating in an international consortium for finalising the construction of the Rogun hydropower plant in Tajikistan: "Two Ukrainian-built turbines are already installed at this plant. It would be logical to expect that, on completion of the plant, the other six turbines will also be Ukrainian-built, provided that the Ukrainian party acts deftly". Yushchenko also stressed that 82% of all equipment installed at hydropower plants in Tajikistan was imported from Ukraine (<http://ru.proua.com/news/2008/03/07/123017.html>).

4. In this context, Russia should play a special role; it should abandon its imperial ambitions and build equal partnerships with EurAsEC countries, taking their interests into account. It should be realised that EurAsEC countries are no longer the same, and the “elder brother” approach, which can be disastrous for Russia’s interests, should be abandoned. Paradoxically, the crisis provides good opportunities for Russia to do so, and Russia has managed to preserve the major portion of its financial resources.

5. Proposals on cooperation by Russian companies should be mutually beneficial and competitive compared with other economic players’ projects. The main consideration may be the strategic importance of a project, not only its financial aspects. Russia should use and strengthen its positive image in EurAsEC – the image of a country that is always ready to come to its friends’ aid and one that imposes no political conditions. Actions by Russian companies should be well coordinated, so as to avoid unreasonable competition in EurAsEC countries, and Russian companies should be encouraged to cooperate and combine in implementing joint projects.

6. Investment cooperation can provide serious support for Russia’s policy by creating a more reliable basis for integration projects in the post-Soviet space, both economic and political. More efforts should be made to develop and implement multilateral integration initiatives relating to investment cooperation in EurAsEC. In doing so, the priority should be to enforce an agreement on encouragement and mutual protection of investments in EurAsEC countries. This agreement would be an important practical step, which would secure long-term stability and predictability of the legal framework of investments. It would also serve to improve the mutual investment climate and create a common capital market in EurAsEC, which would become a vital element of the common economic space.

7. Formulation of a common policy for EurAsEC countries towards the use of energy resources and transport services and cooperation in this area are priority economic goals for EurAsEC. It is in line with the main tasks set in the anti-crisis programmes of the EurAsEC countries. To complete these tasks and expedite development and modernisation after the crisis, it will be critical to ensure that the private sector actively participates in these processes, as it can introduce the necessary flexibility and efficiency.

| Investor company or its affiliate | Asset | First transaction year ¹ | Price of "entry ticket" ² , \$ million |
|-----------------------------------|--|-------------------------------------|---|
| Gazprom | Shakhpakhty (Uzbekistan) | 2004 | ... |
| | 50% of shares in KazRosGaz (Kazakhstan) | 2002 | ... |
| | 50% of shares in Beltransgaz (Belarus) ⁴ | 2007 | 2500 |
| Gazpromneft | Over 100 petrol stations in Kyrgyzstan | 2006 | ... |
| | Gazpromneft Tajikistan | 2007 | ... |
| | Gazpromneft Kazakhstan | 2007 | ... |
| LUKoil | 15% in the Karachaganak PSA (Kazakhstan) | 1997 | ... |
| | 50% in Kumkol (Kazakhstan) | 1995 | ... |
| | 2.7% in Tengiz (Kazakhstan) | 1997 | 129.1 |
| | 50% in Karakuduk (Kazakhstan) | 2005–2006 | ... |
| | 25% in North Buzachi (Kazakhstan) | 2005 | ... |
| | 25% in JV Arman (Kazakhstan) | 2005 | ... |
| | 25% in Kazakhoil–Aktobe | 2005 | ... |
| | 50% in the Tyub–Karagan PSA (Kazakhstan) | 2004 | ... |
| | 50% in Atashsky (Kazakhstan) | 2004 | ... |
| | 12.5% in the South Zhambai and South Zaborunye PSAs (Kazakhstan) | 2007 | ... |
| | 50% in JV Turgai Petroleum (Kazakhstan) | 2005 | ... |
| | 50% of shares in Nelson Resources (Kazakhstan) | 2005 | 2.130 |
| | 90% in the Kandym–Khauzak–Shady PSA (Uzbekistan) | 2004 | ... |
| 20% in the Aral PSA | 2006 | ... | |
| 100% in SNG Holding (Uzbekistan) | 2008 | 580 ³ | |
| Rosneft | 50% in the Adaisky area (Uzbekistan) | 2001 | ... |
| | RN Kazakhstan (Kazakhstan) | 2003–2005 | ... |
| INTER RAO UES | 50% in Ekibasruz GRES–2 (Kazakhstan) | 2003 | ... |
| | 75% of shares in Sangtudinskaya hydropower plant 1 (Tajikistan) | 2003 | ... |
| Rusal | 50% in a JV founded with Samruk (Kazakhstan) | 2007 | ... |
| Atomredmetzoloto | 50% in Karatau LLP and 25% in JV Akbastau (Kazakhstan) | 2009 | 560–580 ³ |
| Renova | Kara–Baltinsky Ore Mining Works (Kyrgyzstan) | 2007 | ... |

¹ The year of first acquisition of an overseas asset or any part of it by a Russian company.

² The volume of investments which has secured the initial acquisition of assets in a CIS country, without obligations to pay their debts (if such information is available, it is given in brackets); later on the size of these assets (shown in the second column) would increase or decrease as a result of purchase or sale of shares.

³ Estimate.

⁴ In 2007–2010, 12.5% of shares will be assigned to Gazprom annually.

Table 7. 2. Direct Russian investments in the energy sector and infrastructure in EurAsEC countries