

# Petroleum Economist



Uzbekistan aims to gradually liberalise its energy market

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## Uzbekistan lays out energy goals

The Central Asian nation seeks to attract significant foreign investment for its energy sector

*Petroleum Economist* spoke with Azim Akhmedkadjayev, the First Deputy Energy Minister of Uzbekistan, to discuss the country's near-term outlook.

The minister explains that Uzbek oil production will total an estimated 1.4mn t this year, while gas output is expected to reach 54bn m<sup>3</sup>.

**Do you have any statistics for estimated and proven oil and gas reserves? And are there any particularly promising regions?**

**Akhmedkadjayev:** The country's hydrocarbon reserves are significant: total primary energy reserves—proven and projected—amount to approximately 5.5bn t oe, including 1.5-1.6bn t oe of natural gas and 245mn t of oil.

The eight main production fields are Shurtan, Zavardy, Kokdumalak, Alan, Adamtash, Boysun, Kandym and Gissar. The reserves are mainly located in the Kashkadarya, Bukhara and Fergana regions. Overall, there are around 280 deposits of oil, gas and

liquids.

## Can you break down where Uzbekistan's oil and gas is used? How much domestically, how much is exported and to where?

**Akhmedkhadjayev:** Total final energy consumption in the Republic of Uzbekistan is over 30mn t oe/yr. The residential sector is the largest consumer, with a share of almost 40pc, while the industry, transport and services sectors are each responsible for roughly 20pc.

Domestic gas consumption is approximately 39bn m<sup>3</sup>, including LNG used by half of consumers.

Uzbekistan currently does not produce enough crude oil to cover its domestic needs and is importing oil primarily from Kazakhstan, Turkmenistan and Russia.

## How much export pipeline capacity does Uzbekistan have, where does it go and are there plans to expand?

**Akhmedkhadjayev:** Uzbekistan has already started reducing gas exports, almost all of which currently go to China, in preparation for phasing them out. This year Tashkent anticipates exporting 3.3bn m<sup>3</sup> of gas, down from 12.2bn m<sup>3</sup> in 2019.

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“Uzbekistan has already started reducing gas exports, almost all of which currently go to China, in preparation for phasing them out”

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## How much refining capacity does Uzbekistan have and does state-owned Uzbekneftegaz have plans to expand?

**Akhmedkhadjayev:** There are several oil refineries and gas processing facilities in Uzbekistan today. There are four oil refineries: Fergana, with a nameplate capacity of up to 6.5mn t/yr, Bukhara with a capacity of up to 2.5mn t/yr, Chinaz, which can process up to 110,000t/yr and Dzharkurgan, which has a 105,000t/yr capacity. In the future, there are plans to modernize the Fergana and Bukhara oil refineries.

Gas processing facilities include the 4bn m<sup>3</sup>/yr Shurtan plant, the 4.5bn m<sup>3</sup>/yr Ustyurt complex and a 3.6bn m<sup>3</sup>/yr gas-to-liquids (GTL) plant.

To date, according to the approved investment program, there are plans to expand the production capacity of Shurtan by modernising existing facilities, as well as carrying out additional processing of naphtha produced at the Uzbekistan GTL enterprise by up to 430,000t/yr and the production of an additional 275,000t/yr of polyethylene and 100,000t/yr of polypropylene.

## Does Uzbekneftegaz have plans to expand operations outside Uzbekistan? Does Uzbekneftegaz collaborate with national oil companies in any of your neighbours, such as Kazakhstan?

**Akhmedkhadjayev:** To date, Uzbekneftegaz does not produce or process hydrocarbons abroad. However, the company successfully cooperates with the national oil and gas companies of neighbouring countries—[Kazakhstan's] Kazmunaigas, [Turkmenistan's] Turkmenogas, Turkmenneft and others—in various areas, including scientific, technical, investment, trade and economic.

## Is Uzbekistan currently engaged in, or planning, any licensing rounds?

**Akhmedkhadjayev:** The government does not really carry out licensing rounds, but awards licences on a project-by-project basis to multiple companies under production sharing agreements (PSAs). State-owned Uzbekneftegaz is involved in most oil and gas exploration and production projects.

According to the decree signed by President Mirziyoyev in October last year, investors will be freed from paying any commercial discovery bonus on successful hydrocarbons finds.

Additionally, Mirziyoyev has ordered a waiver of the signature bonuses levied on exploration and production contracts offered through competitive bidding processes. The decree also simplifies the tax regime for exploration projects, with property and other minor taxes being replaced by a single annual licence payment.

Explorers will also be freed from paying customs duties on imported drilling rigs and other specialised equipment required in exploration and not available in Uzbekistan. They can also qualify for a refund of value-added taxes paid during their operations.

## Uzbekistan's oil and gas industry is unfamiliar to most of our readers. Can you describe the bidding process for blocks or assets? Specifically, does Uzbekneftegaz act as regulator, or is that handled by a ministry?

**Akhmedkhadjayev:** Uzbekneftegaz does not perform a regulatory function to provide investment blocks for exploration and production of hydrocarbons. This function, in accordance with the current legislation, is carried out by the State Committee for Geology and Mineral Resources.

## Can you describe Uzbekistan's regulatory and fiscal regime for oil and gas? What sort of contracts and royalty payment structures do you have in place?

**Akhmedkhadjayev:** The energy market is gradually being liberalised. Customs duties and permits required for the import of liquefied natural gas were abolished in February 2021. A wholesale market of electricity and natural gas is being created for manufacturers and importers and, as the first step, large enterprises were allowed to import electricity and natural gas starting from 1 August 2021.

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“The government does not really carry out licensing rounds, but awards licences on a project-by-project basis”

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The excise tax rate on export of natural gas has been reduced to zero and legal entities are exempt from customs duties on imports of natural gas. The private sector will be allowed to supply liquefied and natural gas to consumers starting from 1 October 2022.

Uzbekneftegaz has been instructed to file for an IPO by the end of 2022, and [state-owned gas transporter] Uztransgaz by 2023. The government also announced plans to halt natural gas exports by 2025 and process all domestic output into higher value-added products. The government also plans to complete several natural gas processing projects worth \$9bn by 2025. Government reports estimate that realisation of these projects will facilitate the production of \$4.1bn worth of goods, replace \$1.1bn of imports and ensure \$1.45bn of exports. Uzbekistan wants to process 20pc of its natural gas by 2026, up from 8pc currently.

Many projects are structured as joint ventures with foreign oil and gas companies, such as Russian firms Lukoil and Gazprom and China's state-controlled CNPC. Key legislation

governing the oil and gas sector includes the Foreign Investments Law, the Subsoil Law, the Investment Activity Law, the Production Sharing Agreements Law and the Law on Guarantees and Measures on Protection of Foreign Investors.

To encourage more oil and gas production, presidential decree PP-6319 – which concerns “measures for further stimulation of geological exploration and improvement of taxation for subsoil users” – was adopted in October 2021. The Subsoil Decree introduces several types of incentives, including reduced subsoil use taxes, and exemptions from corporate property tax and customs duties for equipment.

And in 2020 the government introduced a risk service agreement (RSA) to encourage production increases in hard-to-recover and mature fields. Under the RSA, operators carry out works to increase hydrocarbons production at their own expense and risk, with the right to a fixed share of the incremental output in return. The operator may sell its share of crude oil and gas condensate as a raw material in Uzbekistan, or process and sell it either in Uzbek markets or abroad, whereas natural gas can only be sold within Uzbekistan.

### **How are you hoping to encourage more foreign investment?**

**Akhmedkhadjayev:** Over the past few years the government of Uzbekistan has introduced several measures to entice foreign investors and make the Uzbek economy more attractive for international capital. One of the earlier measures was easing the process of converting Uzbek soms into foreign currencies. The liberalisation of currency became the first step on the way to several reforms aimed at opening up the country's economy and increasing transparency. Last year the country moved to 69<sup>th</sup> from 141<sup>st</sup> place in the 2015 World Bank index on ease of doing business.

With the support of the World Bank, the European Bank for Reconstruction and Development and other international agencies and organisations, the measures include: reducing taxes and simplifying taxation procedures for private enterprises, publishing budget data, the opening up trade with neighbours, measures to secure international sovereign ratings and creating free economic zones and several small industrial zones. Notably, foreign direct investment tripled since 2015 to reach \$1.7bn in 2021, with a large portion going into the development of the green economy.

### **Does Uzbekistan's landlocked position, far from key energy markets, discourage foreign investors?**

**Akhmedkhadjayev:** The geographical position of Uzbekistan has never been a strong deterrent for foreign investment and the country is more involved into global business community every year.

### **ESG considerations are increasingly important for western investors. How important are those factors in Uzbekistan and to the Uzbek authorities?**

**Akhmedkhadjayev:** Environmental and social concerns have already been addressed by companies in Uzbekistan in recent years to a relatively high degree. There is growing awareness amongst our businessmen and the general public at large about the importance of accountability and reporting at various levels.

## “The energy market is gradually being liberalised”

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Clearly, entering international financial markets and gaining access to additional financial resources brings the need to introduce modern corporate governance systems to ensure transparency and management efficiency, as well to ensure that the issues of caring for the environment and society are addressed at all levels.

In preparation for the IPO of Uzbekneftegaz on the international stock markets, work has begun with international consulting company PwC to implement a modern system of corporate governance.

Compliance inspectors have been established at various departmental levels, enterprises and oil depots. Furthermore, the international standard ISO 37001:2016 certification process is being used to help with implementing anti-corruption management systems.

### **Is Uzbekistan preparing for the energy transition? Is there a risk that Uzbek hydrocarbon resources might become stranded by the West's desire to move away from polluting energy sources?**

**Akhmedkhadjayev:** Uzbekistan’s current plans include raising the share of renewable energy (especially solar and wind) in total electricity supply from 10pc in 2020 to 25pc in 2030.

Measures to diversify energy supply, cut subsidies and increase efficiency would also help limit air pollution and greenhouse gas emissions. The government is making strong attempts to integrate energy and climate considerations into its long-term economic development and transport planning.

It is estimated that electricity demand will double by 2030. Responding to the growing demand and increasing share from variable solar and wind energy will require strengthening the power system and further modernise the existing power infrastructure, which also requires considerable investment. We believe that processing our hydrocarbons domestically will make a significant contribution towards improving the power infrastructure as well as other local needs.

## Comments

### Comments

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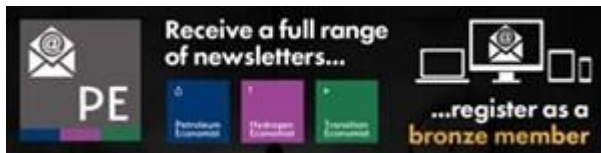
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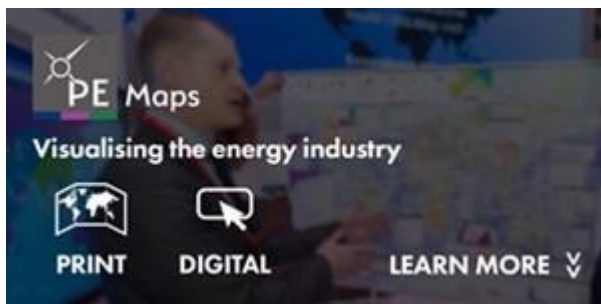
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