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Gulf-Central Asia Relations: Beyond the Impasse

Potential for Energy and Infrastructure Cooperation

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Executive Summary

◊ As Asia continues to globalise on the back of increasingly intricate sub-regional relations, the economic and political linkages between the Gulf Cooperation Council (GCC) and the Central Asian countries remain weak, despite their relative geographic proximity and notional economic compatibility.

◊ The empirical aim of this EDA Insight is to examine prospects that could enhance the intensity of economic ties between the six-country GCC bloc and the five republics of post-Soviet Central Asia – Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan – referred to as a 'black hole' in global Asia.

◊ It looks, first, at traditional cooperation avenues, analysing the energy partnerships connecting the Gulf and Central Asian countries.

◊ As it raises a few questions about the potential for hydrocarbon cooperation in the future, the paper highlights the following: nuclear and renewable energy as two key areas to further entrench the partnership; establishment of 'oil-plus' trade links; and opportunities that exist in light of both regions becoming global economic connectivity hubs.

◊ It particularly identifies the growing economic opportunities in post-Karimov Uzbekistan as the most promising avenue for Gulf investment in Central Asia.

◊ The Insight also focuses on the opportunities and potential hurdles associated with large-scale infrastructure development taking place under the umbrella of the Belt and Road Initiative (BRI), which is presented as a vehicle for increased cooperation.

The Issue

The intensification of linkages between the different constituents of the Asian geopolitical space is a defining marker of the Asian century. The continent is experiencing a significant rise in intra-regional trade while witnessing the progressive integration of Asia-wide markets for services and capital, with correlated increases in the number of people moving across its different sub-regions.

The GCC countries have played a central role in the advancement of these processes: the establishment of multifaceted relationships with East Asian partners, China and Japan in particular; the consolidation of strong linkages with South Asia, supported by large numbers of expatriates from the Indian Subcontinent currently living in the Gulf; and the relatively slower progress experienced by the GCC countries' presence in Southeast Asia.

There is one noticeable exception to this norm: the footprint of the GCC countries is limited when we direct our attention onto a further, yet by no means less important, Asian constituency, namely post-Soviet Central Asia.[1]

This EDA Insight showcases the results of an investigation of the Gulf-Central Asia partnership, pursuing a two-fold analytical agenda that will:

1) sketch out the factors that have impeded the development of these relations; and

2) identify potential avenues for future cooperation.

Structural economic incompatibility and political sensitivities may have trumped geographic proximity, setting apparently insurmountable obstacles to the establishment of functioning relationships between the two regions. It is the gap between these relationships' potential and their actual progress that ultimately emerges as the central determinant for the series of policy recommendations outlined in this paper's concluding section.

Central Asia's economic appeal is primarily, yet not exclusively, located in the extractive sector. The region hosts two of Eurasia's key hydrocarbon producers: Kazakhstan – with proven oil reserves that rank 11th in the world – and Turkmenistan – which is reported to be the fourth largest holder of natural gas reserves globally.[2] The possibility to collaborate in the exploration and development of such substantive reserves may represent a primary driver for the GCC interests in the region.

The commercial sector is a further area of potential convergence for GCC-Central Asia collaboration. Here, the emphasis needs not be exclusively on the development of individual trade links between the Gulf states and the Central Asian economies – which, at the end of 2018, featured a cumulative GDP of US$285.64 billion, of which more than 60% is produced in Kazakhstan[3] – but also on the development of trade infrastructure and legislation to facilitate commercial interaction between the two Asian sub-regions studied here.

Limits and Opportunities of Energy Cooperation

In his incessant efforts to address Turkmenistan's staggering energy sector, and ultimately mitigate the effects of the severe crisis that has been hitting the Turkmen economy since 2014, President Gurbanguly Berdymukhammedov has recently pursued the expansion of Turkmenistan's cooperation with the Gulf countries.

In March 2017,[4] Berdymukhammedov offered the Qatar Investment Authority (QIA) upstream stakes in the development of offshore natural gas fields, while also seeking QIA's financial support for the TAPI (Turkmenistan-Afghanistan-Pakistan-India) natural gas pipeline, an infrastructure megaproject that has been struggling financially since its formal inauguration in December 2015.[5]

In March 2018, during Berdymukhammedov's visit to the United Arab Emirates and Kuwait,[6] Türkmengaz – the state's natural gas concern – approached both the Mubadala Fund and the Kuwait Petroleum Corporation to test their willingness to participate actively in the financing of the TAPI project.

Berdymukhammedov's interest in deepening Turkmenistan's cooperation with the Gulf economies points to a contextual feature defining the wider Gulf-Central Asia partnership, namely the lack of consolidated energy relations between them.

A relatively wide range of factors need to be considered when explaining this failure. Gulf investors, to begin with, have usually showed some reluctance in pouring capital into the energy sectors of other hydrocarbon-rich countries. Their attitude towards Central Asia[7] has not openly contradicted this fundamental posture. Historically, the Gulf-Central Asia hydrocarbon partnership developed around the three key projects outlined in Box 1.

Box 1: Gulf Involvement in Central Asia Energy Projects

- The Caspian Pipeline Consortium, which saw until 2008 the involvement of the Omani government.
- The development of the N-Block in the Kazakhstani Caspian sector, an offshore project in which Mubadala holds minority (24.5%) stakes.
- The Cheleken Contract Area, which includes two major natural gas fields developed under PSA conditions by Dragonoil – the upstream unit of the Emirates National Oil Company – in the Turkmen sector of the Caspian Sea.

Notwithstanding their specific contribution to the development of local energy industries, these have to be ultimately regarded as relatively minor projects. At the time of writing this Insight, there was no Gulf company featuring amongst the operators of Central Asia's principal oil and gas fields.

The entrenchment of rigid state-controlled strategies of resource management in Central Asia's energy-rich countries represents the second factor obstructing the development of successful partnerships across the Gulf-Central Asia axis.

This proposition holds particular relevance in the case of Turkmenistan, where the government's systematic refusal to grant foreign partners upstream stakes in onshore fields greatly limited Ashgabat's cooperation prospects with Gulf natural gas companies. Despite the financial shortages that have recently come to affect the Turkmen energy sector, the self-limiting ownership structure policy enforced by the Berdymukhammedov regime is unlikely to change in the short term.

Gulf companies are therefore faced with few remaining options when pursuing greater access to Turkmen gas markets: new partnerships may either continue to focus on offshore exploration[8] or, should the Turkmen government deliver on recent policy announcements,[9] could potentially shift to assisting the development of LNG technology in the several refineries reportedly to be built across Turkmenistan.

A few minor opportunities could arise in technological support for infrastructure development, as in the case of the US$40 million worth of pipes provided in November 2018 by the Saudi Fund for Development to speed up the construction of the Turkmen sector of the TAPI pipeline.[10]

As it deployed a more flexible set of ownership structure strategies to develop its energy reserves,[11] Kazakhstan established on the other hand a greater set of successful partnerships with Gulf energy companies operating in the non-renewable sector. While the input of Gulf companies in the extraction of Kazakhstani hydrocarbons continues to be limited, bilateral cooperation in the petrochemical industry entered a positive juncture in early 2018.[12]

In this context, Kazakhstan's United Chemical Company and Borealis, which is owned in large part by the Mubadala Fund, are exploring a potential partnership with Samruk-Kazyna, the Kazakhstani oil fund, to develop a large-scale polyethylene project, integrated with an ethane cracker. A final decision on the project feasibility – establishing the plan's financing structure and determining the plant's exact location – is awaited.

It is cooperation in the nuclear energy realm that has however emerged as the most critical feature in the Gulf-Kazakhstani energy partnership. Noticeable progress in this latter area was sealed by a memorandum of understanding signed in November 2017[13] by Kazatomprom and the UAE government, in which the parties stipulated supply patterns for present and future Emirati reactors with natural and enriched uranium imported from Kazakhstan.[14]

Funding from the Gulf – particularly two US$10 million donations from the United Arab Emirates[15] and Kuwait[16] – contributed decisively to the implementation of Kazakhstan's flagship nuclear project, namely the establishment of a Low Enriched Uranium Bank managed by the International Atomic Energy Agency and hosted since 2018 in Oskemen (East Kazakhstan province).

Finally, UAE investments have played a critical role in boosting Kazakhstan's generation capacity: the Al-Falah Growth Fund, in a major investment, supported financially the Karaganda Energocenter LLP, which came into line in 2015 and, at the time of writing, continues to feature a combined installed capacity of almost 2000 MW.[17]

Beyond their partnerships with Central Asia's established producers and exporters, the Gulf energy companies may soon face new collaborative opportunities in Uzbekistan, where the process of authoritarian modernisation set into motion in late 2016 by Shavkat Mirziyoyev is slowly opening up the local economy to foreign investors.

In a recent milestone confirming the viability of Gulf-Uzbekistan energy cooperation, ADNOC finalised a partnership agreement with Uzbekneftgaz[18] to regulate the Emirati company's participation in the development of a series of upstream and downstream operations, including the expansion of the Shurtan Gas Chemical Complex in Qashqadaryo province (southeast Uzbekistan).

Despite recent progress, there is ultimately limited potential to expand further the Gulf-Central Asia energy partnership, especially if the latter is narrowly defined vis-à-vis the development and commercialisation of the partners' hydrocarbon reserves. Here, the structural persistence of economic rentierism across both regions remains the main obstacle to partnership development, inasmuch as it continues to entrench a set of energy relations that are fundamentally non-complementary.

Interestingly, the progressive integration of pan-Asian energy trade contributed to embed even further this underpinning incompatibility: any significant expansion of the export capacity of Kazakhstan and Turkmenistan may erode, directly or indirectly, the dominance that Gulf hydrocarbon exporters exert over a series of regional and sub-regional markets.

A greater deal of potential is in this sense associated with the deepening of energy cooperation in sectors that do not hold the key of the parties' ultimate economic stability. The future of the Gulf-Central Asia energy partnership does therefore hinge on collaborative projects that focus on nuclear energy, the petrochemical sector or the development of clean energy sources, as confirmed by Masdar's post-EXPO interest in the Kazakhstani market.[19]

Albeit marginal, however, Gulf-Central Asia energy linkages served a longer-term purpose: by establishing a minimal degree of familiarity between the parties, cooperation in the energy sector is acting as the launching pad for closer collaboration in other economic areas. The case of infrastructure development, which is analysed in greater detail in the next section, offers an interesting perspective to evaluate the influence that the BRI initiative is exerting on Gulf-Central Asia ties.

The BRI Factor

As negotiations for the GCC-China Free Trade Agreement continue to stall, the large-scale infrastructure development under the BRI umbrella has become an essential step towards the intensification of commercial ties between China and the GCC countries. Reportedly,[20] China-GCC linkages are expected to develop around President Xi Jinping's "1+2+3 model", which envisages a collaborative framework centred on energy, infrastructure, and nuclear cooperation. In this context, post-Soviet Central Asia has to be regarded as a natural transit point for the expansion of overland commercial flows between China and the Gulf countries and, in turn, the achievement of the second objective highlighted in Xi's model.

The construction of overland transport routes through the territory of Turkmenistan remains a significant hurdle for the development of BRI corridors connecting China and the Gulf via Central Asia and Iran. Notwithstanding official declarations,[21] the Turkmen government has continued to limit its involvement in the BRI by setting legislative hurdles to infrastructure cooperation with China[22] or by endorsing participation in a relatively limited amount of connectivity projects.

The exception to this norm has been constituted by the Kazakhstan-Turkmenistan-Iran railway. Integral to what political analyst Jacopo Pepe has labelled South-South linkages,[23] this railway, which opened in February 2016[24] and runs mostly through Turkmen territory, is designed to shorten by over 30 times the delivery of goods between Shanghai and the Iranian port of Bandar Abbas.[25]

Trade intensification effects associated with the railway's full operationalisation are to be amplified by the recent[26] inauguration of another terminal in the CSP Abu Dhabi Terminal at Khalifa Port, which is designed to elevate Abu Dhabi to a very central position in the trade links developing as part of the BRI.

This specific context points to a further facet of the Gulf-Central Asia relationship, namely seeing the Central Asian region acting as a conduit for the intensification of the multifaceted ties connecting the Gulf with East and Southeast Asia. Within this process, Gulf capital has begun to support small-scale connectivity projects based in Central Asia, as in the case of the US$25.5 million loan granted in March 2018 by the Kuwait Fund for Arab Economic Development for the funding of road maintenance works along Tajikistan's southeastern Kulyab-Kalaikhumb corridor.[27]

The UAE, according to political analyst Theodore Karasik,[28] is ideally placed to benefit from the opportunities associated with the BRI infrastructure development. The UAE government eyed the investment potential held by the Caspian ports located in Kazakhstan and Turkmenistan, in a move that could strengthen Central Asia's contribution to different supply chains emerging along the BRI route.

It is important to advance a more realistic assessment of the potential inscribed in Gulf participation in BRI projects implemented in Kazakhstan and Turkmenistan. Two key factors underpin this assessment. On a general level, the GCC countries have often failed to capitalise on specific engagement opportunities to establish wider partnerships in Central Asia. The case of Islamic banking, examined in greater detail by Central Asia expert Sébastien Peyrouse,[29] encapsulates the systematic failure to build up from promising collaborative opportunities in a focused policy area. There is no evidence to maintain that targeted infrastructure cooperation pursued under the BRI umbrella has the potential to represent an exception to the norm.

The second factor affecting Gulf contribution to infrastructure development in Central Asia relates to the regional (geo)politics of the BRI. While the prospects for further investment in the Turkmen sector of the BRI are connected to the political predicament of the government in Ashgabat, the room for further Gulf involvement in infrastructure development in Kazakhstan is in turn limited by China's overwhelming presence in the construction and the maintenance of BRI-related projects on the Kazakhstani territory.[30]

The profile of Gulf capital investment in Kazakhstan outlined in Table 1 offers further evidence to confirm this. Ultimately, the BRI expansion has not stimulated a corresponding increase in the amount of foreign direct investment originating in the GCC countries and targeting the Kazakhstani economy.

As an increasingly important component of the BRI strategy in Central Asia,[31] post-Karimov Uzbekistan may yet emerge as Central Asia's most promising destination for future Gulf investment. The process of political modernisation championed by Shavkat Mirziyoyev is

Table 1: Kazakhstan: FDI Originating in the GCC area (2006-June; million US$; selected partners)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Bahrain	0.0	0.2	0.4	8.8	-2.1	8.1	-0.6	-1.4	-0.4	0.0	0.0	0.2	0.7	0.0
Kuwait	0.0	0.0	0.4	5.5	9.9	0.6	0.9	2.0	6.3	31.2	2.1	-8.1	-0.2	4.9
Oman	4.2	6.2	12.2	21.9	21.7	15.8	20.7	43.6	67.3	39.6	0.2	0.0	0.0	0.0
Qatar	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	30.0	19.4	-2.7	-1.3
Saudi Arabia	1.2	0.2	0.8	0.2	0.0	0.0	0.0	36.2	9.8	37.6	8.3	-1.7	7.9	3.8
UAE	26.8	18.6	9.4	381.0	374.9	99.7	66.1	285.9	532.3	198.7	117.2	74.8	144.6	13.3

Source: Natsional'*nyi* Bank Respubliki Kazakhstan, '*Valovyi pritok inostrannykh pryamykh investitsii v Respubliku Kazakhstan po stranam*', accessed 14 December 2018.

essentially based on a controlled economic opening, which represents a significant change to the policies implemented by the prior regime.

A cursory look at Uzbekistan's recent commercial performance captures with greater precision the short-term impact of Mirziyoyev's reforms. In 2017, Uzbekistan's total trade turnover rose by 16.6% on the 2016 baseline.[32] Official sources, reporting on the first semester of 2018, noticed an outstanding 166.6% rise in total commercial exchanges between Uzbekistan and its top 10 partners.[33]

Uzbekistan's rising commercial profile is likely to attract the interest of the GCC countries. A look at the current state of Gulf-Uzbekistan trade relations does however paint a mixed picture.

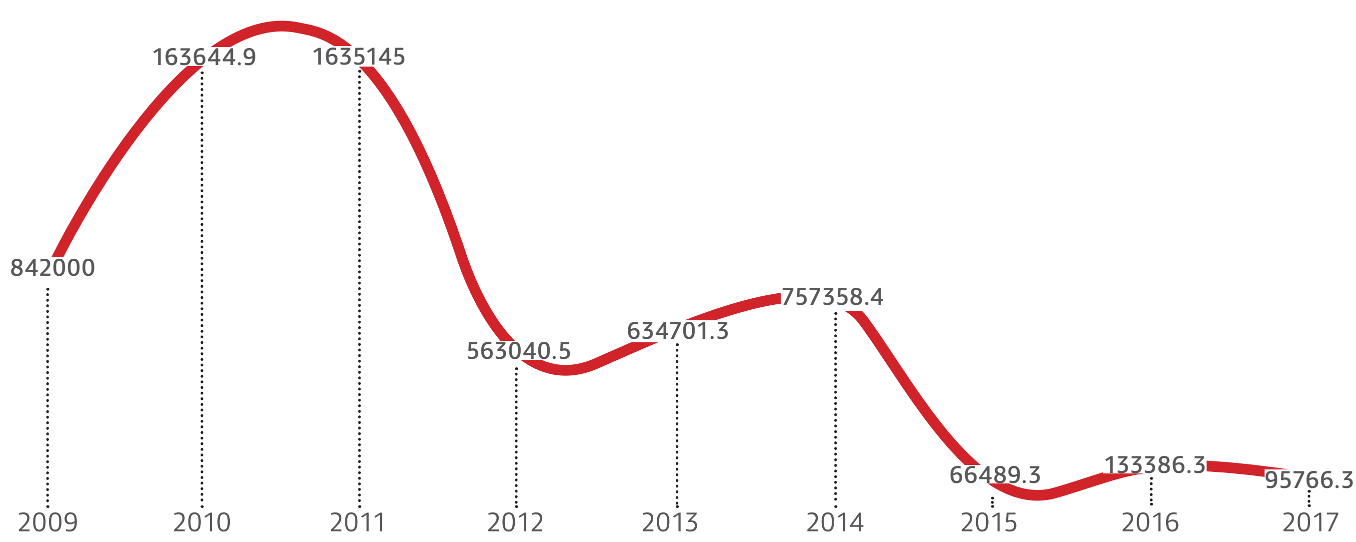
Saudi Arabia is slowly expanding its commercial activity in Uzbekistan. Saudi imports of Uzbek goods rose by 1000% across the 12 months following September 2017, and non-oil exports to Uzbekistan experienced a similar increase during the same timeframe.[34]

While remaining quantitatively more substantial than those established with Saudi Arabia, Uzbekistan's trade linkages with the UAE have recently stalled: total trade turnover for 2017 amounted to US$110.3 million,[35] a slight decrease from the 2014 baseline (US$120.2 million).[36]

Trade volumes exchanged between Uzbekistan and Kuwait are steadily growing while remaining numerically marginal, especially the export of Kuwaiti goods into the Uzbek market.[37]

An equally promising potential characterises the Uzbek investment landscape. The economic contraction of the late Karimov years had a precipitous impact on total FDI inflows, as indicated graphically in Figure 1.[38] It is to reverse this declining trend, and thus facilitate the return of foreign capital into the local economy, that the policy of economic opening implemented by the Mirziyoyev regime has devoted its core agenda.

Figure 1: Uzbekistan: Total FDI Net Inflows (2009 - 2017, BoP, current thousand US$)



Source: World Bank, accessed 20 December 2018.

As the Mirziyoyev regime continues to negotiate Uzbekistan's place in the BRI, Gulf investors are yet to formulate comprehensive investment plans to access Uzbek infrastructure projects. To date, Gulf capital investment in the Uzbek economy[39] remains confined to secondary endeavours. The recently established joint investment fund between the UAE and Uzbekistan intends to bring, in the long run, US$3 billion of Emirati FDI into the Uzbek economy. In late 2018, agro-business constituted a visibly important vehicle for the activities of this fund, considering Phoenix Agro's declared intention to enter the Uzbek agricultural market.[40]

Individual Saudi businessmen have committed to substantial capital investment into Uzbekistan's textile sector and fishing industry.[41] The Kuwait Fund for Arab Economic Development continues at the same time its assistance to Uzbek development, and, to this end, recently approved a US$30.6 million loan financing housing projects in six Uzbek regions.[42]

Conclusion

In view of the current state of Gulf-Central Asia relations, the following policy recommendations could help overcome existing hurdles, thus helping both regions tap into potential opportunities for the future.

- The GCC governments could engage directly with Central Asia's key hydrocarbon producers (Kazakhstan and Turkmenistan) to support their efforts towards economic diversification away from the energy sector.
- Identify specific avenues for energy cooperation, focusing on structured bilateral agendas for partnership development in two strategic sectors, namely nuclear energy and renewables.
- Engage directly, and through an elevated degree of consistency, with the government of Uzbekistan, advancing structured and realistic cooperation agendas to enhance the Gulf's economic presence in the Uzbek economic landscape.
- With regard to post-Karimov Uzbekistan, establish substantial bilateral investment funds, channelling Gulf capital into projects located around the Uzbek territory and not only in the capital region.
- Create a regional forum to determine a shared agenda for BRI engagement, with particular reference to the identification and, subject to funding, the eventual implementation of infrastructure projects to facilitate Gulf-Central Asia overland trade.
- Establish a structured calendar for diplomatic engagement between governments on both sides, in order to de-personalise bilateral diplomacy and include Gulf-Central Asia relations in wider foreign policy agendas carried out by trained diplomatic personnel.

Endnotes

1. This expression, to be used throughout this Insight, indicates the five post-Soviet republics of Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan.
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