Central Asia's oil and gas future

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Central Asia has tremendous potential for oil and gas development, but getting projects to run on time is no easy task. Kazakhstan is seen as the region's most mature market, yet two recent major oil and gas projects in the country have both stalled.

An LG Chem-led consortium's $5 billion petrochemical second phase project in Tengiz will remain in limbo for at least the next twelve months. The reason? A new engineering, procurement and construction (EPC) contractor has to be selected after the original choice, a Petrofac and GS Linde joint venture, lost the contract in the latter half of this year. The search for roughly $3.5 billion in debt will not resume until a new EPC contract is awarded.

French major Total, alongside ExxonMobil, Shell and INPEX all have stakes in the $48 billion Kashagan oil project, also in Kazakhstan. Like LG Chem's project, Kashagan has run into delays. Operations ceased only weeks after production in October 2013 due to faulty pipelines. The project will only start producing again in either late 2016 or 2017 – a costly delay of around four years.

Turkmenistan and Kazakhstan have the fourth and fourteenth largest gas reserves on the planet. Those resources are attracting major names like Total and LG Chem. But delays are not the only issues developers face when looking to enter Central Asia.

Multi-pronged problems

"The oil and gas potential in Central Asia is massive. The challenge is how to realise that potential. And the challenges are multi-pronged," said a lawyer working in the region.

The climate can make delays to extracting the resources nearly impossible to avoid. "The weather itself can make developing projects very difficult, with temperatures ranging from 35 Celsius during summer to minus 35 Celsius during winter" the lawyer said.

"What we find is that senior members of government are sophisticated and effective leaders and their ministries are very capable". Those international standards are attractive to investors but the knowledge pool can often be shallow.

"In terms of expertise, the further you look into company management structures, the more likely you are to reach a cliff edge where experience drops off very quickly."

Another issue is a shortage of skilled local contractors for gas and oil developments. Due to a lack of competition, those firms on offer will tend to charge an exorbitant fee, increasing project costs.

And then there is the specter of corruption.

Tajikistan, on the most recent corruption index from Transparency International, ranks 152 out of 175 countries.

Uzbekistan ranks 166th, while Kazakhstan ranks 126th. Levels of corruption in Central Asia is about the same as in Central Africa, according to the league tables.

The ADB is actively working to improve corruption in the region however. Central Asian countries are still young, and developing after the Soviet Union’s downfall. Changes are starting to happen, and it is clear there are people rising through the ranks who want to improve their country, according to a source.

The positives

The region is ideally located for oil and gas projects. Energy hungry markets surround it, with Europe to the west, China to the east and India to the south. In particular, Kazakhstan, the world’s ninth largest country by land area, is a key transit route for Europe and China.

The region’s untapped potential is attracting keen foreign eyes, including international law firms. Korean sponsors like LG Chem have been among the early entrants, while Chinese investors are now also eyeing a potential stake in Kashagan, it is rumored.

Additionally, LG International and Hyundai Engineering are set to build two gas processing plants in Turkmenistan. A provisional agreement - expected to be confirmed in early 2015 – will see the pair jointly develop the plants, which will be worth around $5.5 billion.

Sponsors are attracted to the region because it gives them a relatively cheap way to expand their operations into new markets, according to a source who works closely with Korean developers.

And the political instability in the region, particularly the sanctions levied against Russia, might actually increase the desirability of some of the region’s countries.

Not one size fits all

It is easy to view Central Asia as one geographical entity, but individual states have differing political and market conditions. Countries that are more mature – like Turkmenistan – could benefit from the political instability swirling around ex-Soviet states.

“The impact of mutual East-West sanctions on Central Asian countries with strong economic links to Russian will no doubt result in problems, but those countries that can demonstrate a stable economy during these sanctions could raise its hand as a preferred alternative for foreign investors looking to capitalise during politically challenging times,” said the lawyer.

Kazakhstan is considered the most developed in the region. And it is the country that has received most outside investment. While problems remain, the EBRD has a broad mandate to advise the government on fixing certain issues. The planned Almaty Ring Road PPP – which will feature both IFC and EBRD – is part of a plan to shape the country’s legislation.

The vast resources in relatively untouched countries offer yet more opportunities. Uzbekistan was only partly explored during Soviet times, but has vast potential reserves. It is already acting as a transit country for a gas pipeline running from Turkmenistan through to China.

Tajikistan, a mountainous country, is at an even earlier stage, but could eventually provide a huge amount of resources. The country’s Bokhtar region – which at 35,000km2 is larger than the American state of Maryland – could hold as much as 114 trillion cubic feet of gas and 8.5 billion barrels of crude oil.

Central Asia presents massive upside and downside risk, but big international firms are already staking billions of dollars on projects such as Kashagan. With governments and multilateral agencies keen to sort out legacy issues in these still relatively newly independent countries, the region appears a fair bet for those willing to take a long view.