

Energizing the Future: Local Content in the Age of AI

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Dear members, this month I would like to talk again about Local content, i.e. the program to develop and help localize services and manufacturing in Kazakhstan. In reality this type of support for local industry exists in every country where there are enormous interests linked to raw materials, in an attempt for the countries where these resources are found to escape from the vicious circle of a country supplying raw materials (and consumer of products finished) It is obviously a topic of extreme importance for a country like Kazakhstan, with an economy largely dominated by extractive activities, and with a population that is not enormous in absolute terms.

To give an idea of the difficulty of the local content development process, which I will call localization from here on, I would like to point out the growth of the Kazakh GDP in the last 20 years, just to focus attention on the macro numbers before going into the detail. In figure 1, you can see how the country went from producing, according to Western standards (coming from a socialist economy, talking about GDP was impossible) as a small Italian region until today, where we arrive at GDP



of my region, Emilia Romagna. Let's leave aside considerations on GDP per capita, which we don't need today, and let's focus on the composition of Kazakhstan's GDP.

Now enough with the graphs, let's move on to the considerations that matter to us: is localization working? And are we generating industrial production through localization? And what could be the prospect of a further push towards localisation?

The intentions of the Kazakh President are very clear, the push and the impulse to look for new localization opportunities are on the table of the Kazakh Government and of all the major companies in Kazakhstan, perhaps first and foremost the international capital companies which are asked for a particular attention to this topic. But from what we can read from the graphs I wanted to propose, GDP growth is driven by the growth of services, more than by industry or even by agriculture.

2018	\$179,340,000,000	\$202,016,000,000	4.10%	\$10,897	1.22 %	18,538,099
2017	\$166,806,000,000	\$194,060,000,000	4.10%	\$10,596	1.31 %	18,314,814
2016	\$137,278,000,000	\$186,417,000,000	1.10%	\$10,312	1.36 %	18,078,553
2015	\$184,388,000,000	\$184,388,000,000	1.20%	\$10,338	1.38 %	17,835,909
2014	\$221,416,000,000	\$182,202,000,000	4.20%	\$10,357	1.42 %	17,592,298
2013	\$236,635,000,000	\$174,858,000,000	6.00%	\$10,081	1.42 %	17,345,732
2012	\$207,999,000,000	\$164,960,000,000	4.80%	\$9,645	1.41 %	17,102,864
2011	\$192,626,000,000	\$157,405,000,000	7.40%	\$9,333	1.43 %	16,864,917
2010	\$148,047,000,000	\$146,559,000,000	7.30%	\$8,814	1.37 %	16,627,837
2009	\$115,309,000,000	\$136,589,000,000	1.20%	\$8,327	1.27 %	16,402,369
2008	\$133,442,000,000	\$134,969,000,000	3.30%	\$8,333	1.19 %	16,196,517
2007	\$104,850,000,000	\$130,657,000,000	8.90%	\$8,163	1.16 %	16,006,136
2006	\$81,003,864,916	\$119,979,000,000	10.70%	\$7,583	1.06 %	15,822,748
2005	\$57,123,671,734	\$108,382,000,000	9.70%	\$6,923	0.87 %	15,656,248
2004	\$43,151,647,003	\$98,798,707,088	9.60%	\$6,365	0.68 %	15,521,923
2003	\$30,833,692,831	\$90,144,805,736	9.30%	\$5,847	0.51 %	15,416,712
2002	\$24,636,598,581	\$82,474,662,156	9.80%	\$5,377	0.38 %	15,338,963
2001	\$22,152,689,130	\$75,113,535,661	13.50%	\$4,915	0.30 %	15,281,285
2000	\$18,291,990,619	\$66,179,326,575	9.80%	\$4,344	-0.13 %	15,236,253

And here I come to the point, which I would like to submit for your reflection. The development of the industry subservient to extractive activities, which we have known so well in Italy so much so that when it comes to a development plan the name of Enrico Mattei still remains an unattainable symbol, is the number one opportunity for Kazakhstan.

While the mining activity has relied on the Russian and Chinese markets, with little positive effects both for the performance of the sector and unfortunately for the well-being and safety of the



employees, the activity linked to Oil and Gas, on the other hand, is largely led by international companies.

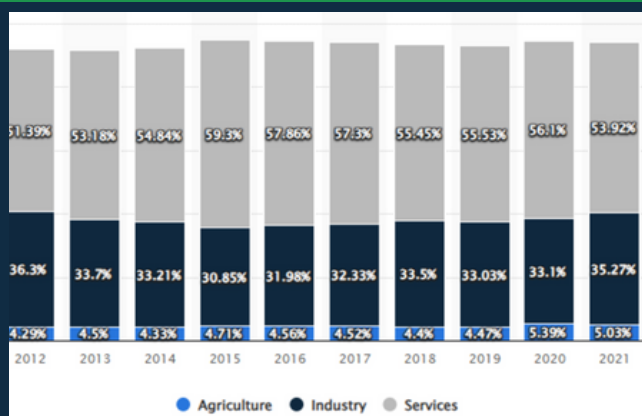
These initiatives have alone generated much of the hard currency that allows Kazakhstan to continue to grow towards European-like living standards. Now they are rightly or wrongly considered the engine of the development of a Kazakh industry at least in support of this industrial sector.

The premises are all there, but we have already spoken about this on other occasions as an opportunity not fully exploited either by international investors or even by the Kazakh authorities.

The international panorama tells us a lot, especially about what will happen in the world of oil and gas in the coming years. The first signal that I want to bring to support my thesis, namely that there is no time to waste, is offered to us by the largest oil company in the world, Saudi Aramco. It has been news for a few weeks that the latest auction on the market for 0.64% of company shares saw the entire package put up for sale being purchased. However, there are two considerations: the first, the price, unlike in the past, has settled on the minimum limit set by the seller. The second, contrary to previous indications, over 120 Western brokers were also authorized to purchase.

Are we perhaps witnessing a decline in Saudi Aramco's appeal? Maybe it's just a not particularly lucky auction, but we definitely weren't used to it. If we add the second signal, which comes from OPEC, where Angola's exit has certainly left some consequences, given that despite the production cut imposed by OPEC (and only partially actually implemented), the price of crude oil has not had no upward impetus, just a jolt. Considering the crises in Ukraine and Gaza, it almost seems that the leverage power of crude oil producers is diminishing.

In figure 2 we see where this wealth of Kazakhstan comes from



Returning therefore to Kazakhstan, and to localization, there is no doubt that the model that will be increasingly sustainable will have to be linked to competitiveness. Modern industry, and in particular the oil and gas industry, is based on skills and technologies that require significant investments and consolidation times that cannot be eliminated in any way. Accompanying this localization process is not at all simple.

As Confindustria we would like to point out in this overall picture what could be an innovative approach. Always with the aim in mind of moving those indices in figure 2 towards the industrial sector.

Therefore, as regards the yardstick that the operators of the fields in the west of Kazakhstan and the Ministry of Energy, holder of this "mission" for Kazakhstan, have set themselves, there is probably a lack of attention to the evolution of the market of so-called engineered products, therefore not off the shelf but specifically designed for use in the oil and gas industry. The famous certificate which confirms the localization of the product, today has a composition linked in an anachronistic way to mechanical processes. Paradoxically, if tomorrow Mr. Apple decided to locate the production of a tablet or a telephone in Kazakhstan, he would struggle to obtain this certificate, given that it is manufacturing linked to the assembly of parts produced around the world and therefore he would not reach the requirement to have some component "produced" in Kazakhstan. It seems like the vision of industry in the days of the craftsman's workshop, where the more one manages to make his own components at home, the more "producer" he is. This vision that lies between Vasari's workshop in Renaissance Florence and the wheat fields that someone wanted to cultivate at all costs in the courtyards of houses at unbearable costs for the economy must be eliminated from the table of good intentions as soon as possible. If we want to develop an industry in Kazakhstan, it must necessarily be able to compete with the world market, there is no way we can think of having a product in Atyrau that is not competitive with a product of equal quality produced in China. Of course, the price dumping that is sometimes seen appearing on the Kazakh market, to the detriment of quality, sometimes in an embarrassing way, must at the same time be fought without hesitation, because it hurts both those who buy and those who find products in warehouses that will remain there for life and those who produce honestly and find themselves forced to charge starvation prices to survive and therefore do not invest in innovation, preparing to leave the market sooner or later.

The growth of industrial workers, a growth that has not occurred in Kazakhstan for many years, (figure 3) tells us that in reality we are not doing this localization well. We still cannot generate enough appetite among generations of Kazakh entrepreneurs to invest in technology, in research, as companies do all over the world. Again the vision is only linked to the supply of products to the market

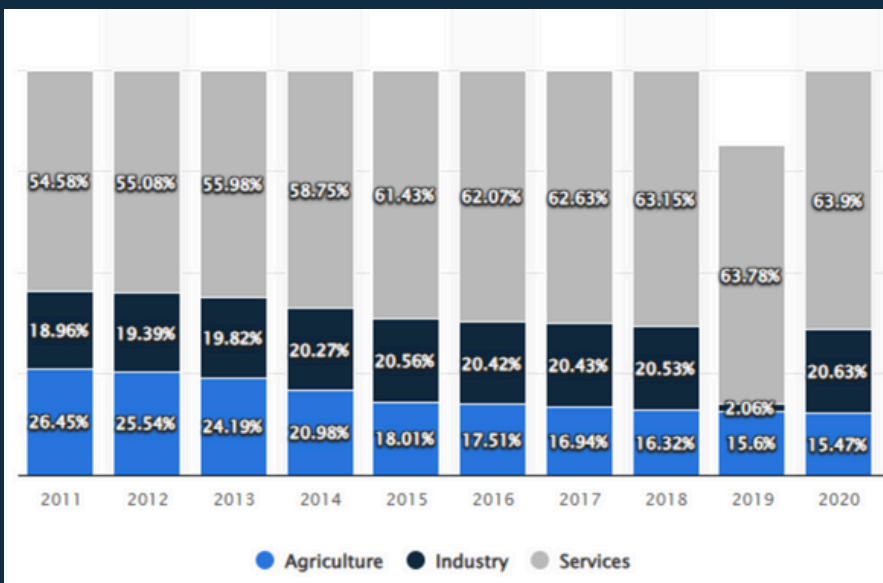


figure 3. Who produces the wealth

Kazakh, which is spectacularly behind the times. Considering the international outlook of the customers of these potential Kazakh entrepreneurs, it should be of great interest to produce for example components that this company buys for its plant in Kazakhstan, but also offers an opportunity to present the same product on other investments of the same company.

During a recent visit to an African country, during a negotiation for a renewable energy project, one of the bystanders told me in complete confidence that my "ace" up the sleeve for the success of the negotiation was the high consideration of the user final and therefore customer had for Kazakh products. This left me speechless. Kazakh products? Yet, despite myself, thinking back, although the product in question was not assembled in Kazakhstan, its design, the concept itself, the technical office that defined the materials to be used, in short the entire part linked to what can be considered the heart and model of the product is made in Kazakhstan by Kazakh engineers. So I did a test to see if this product, an electromechanical component, met the requirements for the famous CT-KZ. And the result says no. Maybe the consultant who reviewed the file forgot something, I thought. And then I understood. We returned to Vasari's workshop. The question comes naturally to our Kazakh friends. But you really want to pass

through industrialization done to the detriment of the environment, with starvation wages having to compete with countries with immensely superior manpower available, and so on. Or isn't it better to skip this step, taking advantage of what Europe has already done, and much of Italy, and move directly to industry 4.0, to new materials technologies and sustainable industry?

It's about thinking about Kazakhstan's future in a radically opposite way, from a labor intensive economy to a technology intensive one. I'll throw it out there, as a reflection at the end of the article. Perhaps Kazakhstan has more interest in entering the era of Artificial Intelligence than trying to defeat the Chinese and Indians on steel products... I hope that some concept has found an appropriate expression to spark a discussion from these lines, we are always available to bring examples and solutions to help this country become an industrialized nation in all respects.

In the coming months we will dedicate some attention every month to the topic of localization, in relation to the great challenges of our times, energy, water, environmental sustainability, globalization and so on.

I therefore ask forgiveness for the unappealing beginning of this note, for the next few months no more graphs and a few more virtuous examples.