Chapter Four

ENERGY AND DEVELOPMENT IN KAZAKHSTAN: PRESSING CONCERNS
Outline

This chapter discusses the steps and policies taken by Kazakh Government in energy sector, especially pertaining to hydrocarbons, since independence. It also discusses the impacts of such policies on energy sector and overall socio-economic system.

4.1 The Beginning

Kazakhstan's leaders and government officials embraced the international community's faith in its immense energy wealth without giving it the necessary thought. With the full confidence of energy abundance behind him, Nursultan Nazarbaev, President of the Republic of Kazakhstan, wrote in the fall of 1997: “I am convinced that by 2030 Kazakhstan will become a Central Asian snow leopard and will serve as an ex-ample to other developing states...”.

Energy sector, especially the promised wealth of oil and reserves, was assumed as the engine for future growth and solution to most social and economic problems. The reasons were not surprising.

- The reserves in the Tengiz field were initially estimated to hold up to 10 billion barrels of oil, while the other two large onshore oil fields in Western Kazakhstan (Uzen and Karachaganak) were estimated to hold approximately one-third of this amount each. Domestic

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politicians and western investors alike quickly accepted these figures, predicted output and income accordingly, and minimized problems associated with improving production and securing viable export routes. The Tengizchevroil joint venture, established in April 1993 as the first of its kind in Kazakhstan, was a direct result of these optimistic expectations.

- The widespread enthusiasm for Kazakhstan's on-shore reserves was minuscule compared to the excitement generated by the potential of its offshore reserves in the Caspian Sea. In June 1996, Kazakhstan presented official estimates of 10 billion metric tons of crude oil and 2 trillion cubic meters of natural gas, based on a series of seismic tests conducted by the Caspian Sea Consortium. This meant that the Caspian Sea held reserves "ten times bigger than those of its onshore Tengiz oilfield and much larger than Russia's entire oil reserves of 6.7 billion tons." 3

- This pervasive attitude was not surprising, considering the emphasis placed on Kazakhstan's energy sector by foreign governments, especially the United States, and investors, international lending organizations, and development agencies.

As a result, the Kazakhstani government has pursued several policies based on an overly optimistic estimation of their future income from developing and exporting oil and gas reserves. However, so far, this optimism has not proved true. For example, Chevron believed that it could eventually produce over 700,000 barrels per day (BL/d) for

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3 OMRI Daily Digest, No. 125, Part I, June 27, 1996.
export. Yet, although production has indeed increased every year since 1993, as of 1998 it had still failed to reach this level and remained constrained by limited export access. Similarly, the US$150 billion that President Nazarbaev claimed his country would earn in just a few years from Tengiz exports has not yet materialized.

In the case of Kazakhstan's offshore reserves, political and structural difficulties were minimized in the face of exaggerated potential. Kazakhstan's Oil and Gas Minister Nuralyn Balgimbayev declared at the end of 1996 that drilling would begin the following year and the revenue flow to the central budget shortly thereafter. Likewise, Baltabek M. Kuandykov, president of Kazakhstancaspishelf, announced that the government expected "the Caspian oil quantity to be enormous compared with the Tengiz reserves" and, by the year 2015, to supply "60 million tons of oil per year." More recent estimates of the Caspian reserves, however, are as low as 7.7 billion barrels for the entire region.

4.2 Issues in Hydrocarbon Sector

With independence, Kazakhstan inherited a structure designed to cater to the needs of erstwhile Soviet Union. A number of geographic and political obstacles hindered the need to expand exports and increase

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5 Bhary V. Shenoy, S. Gurcan Gulin, and Michelle Michot Foss, 'Caspian Oil Export Choices Clouded by Geopolitics, Project Economics,' Oil and Gas Journal Online, vol. 97, no. 16 (April 19, 1999), p.3
foreign direct investment. According to the World Bank\textsuperscript{6}, following key issues to be addressed in the oil and gas sector.

- Outmoded exploration and production technologies, poor production practices causing pollution (examples being flaring of gas and inadequately capped wells)
- Limited access to foreign markets
- An inadequate legal and regulatory framework hampering inflow of foreign capital and know-how
- Low prices, difficulty in collection of payments and lack of transparency

Future prospects of the country depended on the capability to produce large surpluses (after meeting domestic needs) for exports. Kazakhstan has traditionally been the net exporter of energy, which is expected to expand with new investments in infrastructure. In this respect, energy demand (oil and gas) expectations are worth mentioning.

\textit{Energy Demand}

The energy demand has been expected to fall during the economic restructuring process, initially due to contraction and in the medium term due to higher relative prices, restructuring of enterprises and an

increase in energy efficiency. The World Bank\(^7\) has estimated energy
demand till 2005 based on three scenarios of reform (Rapid, Slow and
Gridlock). The table 4.1 gives the details.

**Table 4.1: Fuel Projection in Kazakhstan (MTOE)**

<table>
<thead>
<tr>
<th>Fuel</th>
<th>1991</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>I</td>
<td>II</td>
</tr>
<tr>
<td>Oil</td>
<td>19</td>
<td>12</td>
</tr>
<tr>
<td>Gas</td>
<td>11</td>
<td>14</td>
</tr>
<tr>
<td>Total (incl. Coal)</td>
<td>67</td>
<td>47</td>
</tr>
</tbody>
</table>

Lower domestic demand increases the export potential of the republic,
which also played on the minds of policy makers. Entire emphasis, as a
result, has been on increasing availability as discussed in the section
below.

### 4.3 Policies and Steps Taken

In 1992, Kazakhstan's First Deputy Minister of Fuels and Electric
Power, Uzakbay Bekobosynov, outlined the government's long-term
plans for the oil and gas sector.\(^8\) The Kazakhstan government
approved following targets (Table 4.2). The envisaged expansion of
hydrocarbon production was largely based upon the 160 or so already
discovered fields, estimated to contain 6.2 billion tons of oil and 2.4

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\(^7\) Dale Gray, "Reforming the Energy Sector in Transition Economies: Selected Experience
1995, p.77

\(^8\) Interfax Petroleum Report, November 6-13, 1992, p.12

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trillion cubic meter of natural gas. The plan also called for a considerable increase in exploration efforts as well, to find new reserves in the western, central and southern portions of the country.

The new plan, despite over capacity condition in FSU, called for a huge expansion of refining capacity to 40 million ton annually by the year 2000. To support the expansion of production and to eliminate the need for imports of fuels from neighboring republics, it was planned to build nearly 4000 km of oil and gas pipelines by the year 2000. Another key infrastructure project was the refurbishment and expansion of the port at Aktau to facilitate expanded oil exports across the Caspian Sea.

**Table 4.2: Targets for Long-term Plans**

<table>
<thead>
<tr>
<th>Year</th>
<th>Crude Oil Production* (million tons)</th>
<th>Natural Gas Production (billion cubic meters)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995</td>
<td>38.5</td>
<td>16</td>
</tr>
<tr>
<td>2000</td>
<td>42</td>
<td>22</td>
</tr>
<tr>
<td>2010</td>
<td>75</td>
<td>28</td>
</tr>
</tbody>
</table>

*includes condensate

*Source: News Notes, Post-Soviet Geography, January 1993*

The long-term program also envisaged a substantial role for foreign companies. The Kazakh Prime Minister, Sergey Tereschenko stated that a major goal of Kazakhstan's energy policy was to end the republic's dependence upon oil imports from Russia⁹.

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⁹ Summary of World Broadcasts (SWB), October 9, 1992, pp11
**Privatization of Energy Sector**

In short, the Republic of Kazakhstan’s energy sector development strategy has consisted of attracting as much foreign investment and as many foreign investors as quickly as possible. This was an expressed goal of former Prime Minister Akezhan Kazhegeldin, the steward of the country’s privatization program, who was able to secure US$1.2 billion in direct investment in the first year alone. Under his leadership, the Kazakhstani government sold off the bulk of its shares in oil and gas enterprises to a variety of foreign companies between July 1996 and July 1997 (See Table 4.3 below for details). Thus, by 1998, Kazakhstan was already “the largest recipient of foreign direct investment in per capita terms among the CIS countries,” most of which is heavily concentrated in the energy sector[^10].

The central government viewed the rapid sale of oil and gas enterprises as an opportune way to bring in sorely needed funds and accelerate efforts to expand and modernize the production, refining, and transportation industries. Accordingly, their expectations for the amount of revenue that would accrue via privatization were also much higher than the actual amount received. Many government officials, for example, were dissatisfied with the prices obtained by Kazhegeldin in the first few rounds of privatization. In fact, this was a major reason for his forced resignation in October 1997.

[^10]: Asipov, 'Kazakhstan: Living Standards during the Transition', Focus Central Asia, No.3, Feb 15, 1998, p.4
Table 4.3: Energy Sector Privatization in Kazakhstan

<table>
<thead>
<tr>
<th>Date</th>
<th>Foreign Company</th>
<th>Fields or Enterprise</th>
<th>% Shares</th>
<th>Official Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>July 1996</td>
<td>Vitol Munay Shymkent</td>
<td>Oil Refinery</td>
<td>85%</td>
<td>$230 million a</td>
</tr>
<tr>
<td>August 1996</td>
<td>Hurricane Hydrocarbons</td>
<td>Yuzhneftegas JSC</td>
<td>90%</td>
<td>$400 million b</td>
</tr>
<tr>
<td>August 1996</td>
<td>Tractebel</td>
<td>Almatyenergo Karazhanbasmunai</td>
<td>100%</td>
<td>$275-698 million c</td>
</tr>
<tr>
<td>March 1997</td>
<td>Triton-Vuko Energy Group</td>
<td>Hydrocarbons</td>
<td>94.5%</td>
<td>$90 million</td>
</tr>
<tr>
<td>May 1997</td>
<td>Medco Energy Corporation</td>
<td>Mangistaumunaigaz JSC</td>
<td>85%</td>
<td>N/A</td>
</tr>
<tr>
<td>June 1997</td>
<td>Chinese National Petroleum Co.</td>
<td>Aktyubinskunaigaz JSC</td>
<td>60%</td>
<td>$4 billion</td>
</tr>
<tr>
<td>July 1997</td>
<td>Chinese National Petroleum Co.</td>
<td>Uzen Oil Fields</td>
<td>60%</td>
<td>$9.5 billion d</td>
</tr>
<tr>
<td>January 1998</td>
<td>Central Asia Petroleum</td>
<td>Mangistaumunaigaz JSC e</td>
<td>65%</td>
<td>$248 million</td>
</tr>
</tbody>
</table>


a This figure consists of US$80 million in direct payments over the three next years and another US$150 million in investments over five years to upgrade the plant. Vitol (a Dutch company) backed out of the deal in early 1997, and the contract came under the supervision of a former Vitol subsidiary, Kazvit.

b This contract includes a pledge to invest $280 million in the enterprise over six years.

c Of this estimated range, the lower figure includes $270 million pledged to upgrade several power stations, the electricity grid, and pipeline system; the higher figure is based on $340 million in actual payments and $358 million in direct investments, including a pipeline in southern Kazakhstan that will bypass Kyrgyzstan.

d Approximately half of this amount is pledged investment in building a pipeline from these fields to eastern China.

e Mangistaumunaigaz JSC was resold to an Indonesian company after Kazakhstan established its own stock-holding company, Kazakhoil, in March 1997.

Tenders handled after his departure by the newly appointed Prime Minister (and former Oil and Gas Minister) Nurlan Balgimbayev thus aimed for much higher numbers and more money up front. For
example, in a sell-off of state shares in the Offshore Kazakhstan International Operating Company (OKIOC) to Phillips Petroleum of the United States and Inpex of Japan, Balgimbaev declared that Kazakhstan would receive "immediately ... around US$500 million" and eventually would "reap US$700 billion in revenues from its offshore oil and gas fields." Most foreign experts and oil and gas company representatives working on the ground, however, insist that a much more modest amount of revenue will accrue directly to the Kazakhstani Government.

The Kazakhstani government also had high expectations concerning the level of tax revenues it would eventually receive from foreign companies. For example, Kazakhstani government officials anticipated that they would "earn more than US$2 billion in taxes and royalties over the next 20 years"—in addition to the initial purchase price—from the sale of a controlling stake in Yuzhneftegaz alone.

Ironically, most contracts with foreign companies included exemptions from tariffs and taxes. In lieu of taxes, many foreign companies agreed to make huge capital investments in technology and infrastructure, as well as to pay back wages, contribute to pension funds, and build roads, schools, apartments, and hospitals. Hurricane Hydrocarbons, the company that eventually won the tender for Yuzhneftegaz, is a case in point. Written into the contract was a provision requiring

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11 Energy and Politics (Formerly Pipeline News), No.32, Part II (Sep 28, 1998)
12 Pipeline News, No.46, Feb 1-6, 1997.
Hurricane to assume all the social obligations and economic costs of the company and surrounding area, including US$4 million a month in local salaries for workers.

Recent Developments in Privatization

In November 2000, Kazakhstan announced it was considering selling shares in two oil companies:

- a 30% holding in oil Mangistaumunaigaz, located in western Kazakhstan, produced 85,000 BL/d in 2000, up from 60,000 BL/d in 1999. Indonesia's Central Asia Petroleum owns 60% of the company, and

- a 25.12% holding in Aktyubinskmanaigaz also in the west of the country where most of Kazakhstan's oil is located, is controlled by the China's National Petroleum Company (CNPC), which bought 60.3% of the company in June 1997. Aktyubinskmanaigaz produced 50,000 BL/d in 2000, up from 45,000 BL/d in 1999.

In mid-1998, Kazakhstan transferred public stakes in its remaining production and refining companies to state oil and gas company Kazakhoil in preparation for a possible privatization. However, Kazakh President Nursultan Nazarbayev signed a law mandating that Kazakhoil would be a closed, joint-stock company, with 100% of its shares under government control. The law also made Kazakhoil responsible for monitoring foreign oil company activities in Kazakhstan, as well as mandating that Kazakh companies buy Kazakh equipment.
and services whenever possible. In addition, Kazakhstan's Prime Minister Kasymzhomart Tokayev told Parliament that Kazakhstan would strengthen state control over the fuel and energy sector, including the production and sale of oil products.

As part of its purchase of Aktyubinskmlunaigaz, CNPC is expected to invest $4.1 billion over the next 20 years to develop three fields. In addition, CNPC proposed building an oil pipeline to China. However, work on the feasibility study on the pipeline was halted because Kazakhstan was not able to commit the minimum flows needed to make the pipeline viable for at least 10 years. CNPC also won a tender in 1997 to develop jointly the Uzen field, but CNPC has since pulled out of the project, leaving development of the Uzen field to Uzenmunaigaz. CNPC's other involvement in Kazakhstan is a proposed project to build an oil pipeline from Kazakhstan to Iran.

Since the takeover of operation of the Kumkol oilfield in 1996, Hurricane Hydrocarbons (Canada) has been engaged in a dispute over pricing with the Shymkent Refinery, which is the only outlet for this oil. Hurricane plans to invest $280 million over the next six years in this project.

In refining, The Atyrau refinery became 29.5% owned by Fixoil as Switzerland's Telf AG reduced its holdings in the refinery. The Atyrau refinery will undergo an upgrade by Japanese firms led by Marubeni.
Marubeni plans to invest $400 million for what Kazakh officials termed a 80% rebuilding to begin in 2003.

The Shymkent refinery (now Shymkentnefteorgsintez, or Shnos) was purchased by Vitol (Switzerland) in August 1996, but was sold to Kazakommertsbank in July 1998. The refinery plans to invest $150 million for modernisation over the next five years, including a new catalytic cracking unit. Shnos signed a protocol in April 1999 for a merger with Hurricane Kumkol Munai (HKM), a subsidiary of Hurricane Hydrocarbons Limited, that would give Shnos guaranteed supplies from HKM's Kumkol field, and give HKM a guaranteed customer. However, HKM has had disputes with the refinery, and stopped shipping oil to the refinery in September 1999 before resuming shipments later in the fall.

The American company CCL has managed the Pavlodar refinery since 1997. An interdepartmental commission recommended that legal action be taken to terminate the contract and transfer it to KazakhOil because of allegations that the contract was illegally awarded, and that CCL did not comply with contractual provisions. On May 27, 1999, the Supreme Court of Kazakhstan ruled that the property should be transferred, and the rest of the property should go to other companies. Mangistaumunaigaz, which is 60% owned by Indonesia's Central Asian Petroleum, acquired part of the refinery's assets from CCL. However, CCL is appealing the decision because of the contract that
Mangistaumunaigaz signed with the refinery, and the government will make a final decision on the transfer of the refinery.

In Natural Gas, Kazakhstan’s privatization of the gas market has gone in reverse after moving quickly in the years after independence. Kazakhstan originally granted Tractebel (Belgium) a concession to the gas distribution system in Almaty in 1996. In July 1997, Kazakhstan awarded Tractebel a 15-year contract to manage the western Kazakhgaz and southern Aulaugaz distribution systems, with Tractebel pledging to invest up to $1.5 billion in Kazakhstan on repair, construction, and planning costs, including a $150 million gas line in southern Kazakhstan to bypass Kyrgyzstan.

However, Tractebel was investigated for a payment of 50 million euros ($54 million) to three Kazakh businessmen. The Kazakh government planned to review the terms of the company’s concessions for the gas distribution networks. In the spring of 2000, Tractebel decided to leave the Kazakh gas market, selling its assets to KazTransGaz, which was set up by resolution of the Kazakh government in February 2000, for $100 million.

KazTransGaz, which is wholly-owned by the state, owns over 9,000 kilometers (5,400 miles) of main pipelines and 26 compressor stations with 308 gas transportation units. In April 2001, KazTransGaz was given the task of starting a project to manage Kazakhstan’s regional gas networks and to implement the programs on modernizing gas
pipelines. First Deputy Prime Minister Daniyal Akhmetov has proposed that the government set up an inter-departmental commission to study the ownership of the gas infrastructure in Almaty, as well as in the Zhambyl, west Kazakhstan, and Aktyubinsk regions, each of which has been privatized partially but none of which is exhibiting strong financial health.

Akhmetov has said that the regional gas distribution networks in the above regions should be transferred to KazTranGaz. After the regional networks become suitable for sale and attractive for potential buyers, Akhmetov said, then the Kazakh government should make a decision on their further ownership.

4.4 Effects of Privatization

Short Term
As discussed above, the common practice of foreign companies assuming social costs was adopted as

- a means of temporarily relieving the government of its fiscal burdens in the regions, and
- a way of overcoming the initial opposition to privatization from managers of oil and gas enterprises.

Indeed, central authorities continually reassured both regional governors and factory managers that they would benefit directly from privatization, promising that the foreign companies would invest in the
necessary technologies to increase production, pay social costs, and in many cases guarantee employment and the payment of back wages.

The principal consequence of the privatization scheme, therefore, has been to place both the responsibility and blame for local socio-economic conditions on foreign investors, rather than on government officials.

The Kazakhstani government (local and central) has increasingly held foreign investors accountable for the social and economic well-being of their employees. Some instances are given below:

- Tengizchevroil as crucial to the region's economy, since it employs over 3,000 workers in the region and provides more than a quarter of its tax revenues. However, when Tengizchevroil attempted to reduce the number of its employees through a reorganization program, the regional government was quick to side with regional labor union leaders against this move. Union leaders and workers alike have also come to hold the foreign owners responsible for their social and economic well-being, even though their respective enterprises were in dire straits well before privatization began.

- Since the Belgian company Tractebel acquired the former state energy company Almatyenergo in August 1996, for example, it has repeatedly been held accountable for employee grievances, and general resentment toward the privatization's failure to solve the company's deep-seated economic and technical problems. Tractebel attempted several times to increase Almatyenergo's
efficiency by reducing its enormous labor costs and raising rates, but instead had to appease local authorities and union leaders by agreeing to maintain its bloated workforce and pay wage arrears.\textsuperscript{13}

The Kazakhstani government has in fact deliberately encouraged the tendency to blame foreign investors. For example, when 1,000 workers who had not received their wages for over a year began a hunger strike in the Fall of 1997, central and local authorities claimed that they were not responsible for back wages, but the new owners (Lukoil-Utek joint stock company). Their proposed solution, thus, to this problem was to “try to find a ‘more respectable’ investor.”\textsuperscript{14}

A secondary consequence of Kazakhstan’s policies is that the mere speed of privatization has led to the undervaluing of Kazakhstan’s natural resources, that is why foreign companies continue to invest in Kazakhstan despite problems with tax laws, corruption, and the lack of transparency in tender bids. Undervalued assets, together with the promise of large royalties and hidden “side-payments” (or bribes) from the sale of Kazakhstan’s most valuable resources to foreign owners, have increased competition between governing elites. Competition for control over the privatization process itself has been particularly fierce among sectoral and non-sectoral elites, or between those who work within and those who work outside of the oil and gas sector.

\textsuperscript{13} Tractebel to Promote a New Prime Minister?’ Focus Central Asia, No.4, p.7-10.
\textsuperscript{14} Sharipzhan, ‘Kazakhstan: Workers’ protest Reveals Flaws in Privatization’, RFE/RL Newsline.
The greatest opposition to privatization initially came from the so-called oil barons in western Kazakhstan who were unwilling to surrender their long held monopoly over the country's oil wells and gas pipelines. In fact, they were initially successful in delaying the oil and gas tender process. In Spring 1997 the central authorities eventually responded by dissolving the stronghold of the oil barons' authority—Kazakhstanmunaigaz, the state holding company that controlled the country's oil and gas sector—and continuing with privatization as planned. However, the government was subsequently forced to make some concessions to energy sector elites when promised revenue from oil and gas enterprise sales failed to materialize. Thus, in October 1997, Nazarbaev put one of the most prominent energy sector leaders, Nurlan Balgimbaev, in charge of slowing down the privatization process and reconsidering pending contracts.

Among these other problems, the anticipation of additional revenue generated via privatization has also fostered corruption among both central and regional elites. Foreign companies must first negotiate contracts with central authorities—most notably, the president and Prime Minister—to whom they often offer funds as a way of sealing the deal. They must then contend with the regional governors (or akims), with whom they engage in ongoing negotiations. Not only do they need the akims' approval for the initial purchase, they also have to keep the governors involved in subsequent decision-making. Otherwise, the akims make operations difficult for the foreign
companies by causing delays in projects or sending over the tax inspectorate. Local officials are not opposed to accepting personal cash payments in exchange for helping a project run smoothly or ignoring contract violations and environmental regulations.

This corruption, in turn, has contributed to growing popular distrust of government officials. The popular Almaty-based newspaper Karavan, for example, accused the government of simply stealing money generated from privatization, including "[h]alf a billion U.S. dollars paid by Mobil for the right to develop the Tengiz oilfields."\(^{15}\) Opinion polls taken in 1997 and 1998 indicate that this was a widely shared view and that, as a result, public trust in the Kazakhstani government has been at an all-time low.

Finally, the drive to attract foreign investment in the energy sector has encouraged Kazakhstan's trend toward the centralization and concentration of power. In March 1995, Nazarbaev dissolved a parliament that had become increasingly hesitant to endorse his economic reform agenda. This move was followed by a series of presidential actions, including a referendum to extend Nazarbaev's term to the year 2000 and decrees aimed at augmenting the power of the presidency over all economic and foreign policy matters. These events laid the groundwork for another wave of economic reforms in March 1997, which were intended to facilitate foreign investment, particularly for newcomers. The sum result of these reforms was to

\(^{15}\) Karavan, April 10, 1998, p.1

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establish a “one-stop shopping center” for foreign investors in all areas of the economy, but particularly in the energy sector. Similar to the relationship between SOCAR and western oil companies in Azerbaijan, foreign investors have welcomed the centralization of political and economic decision-making to expedite their business transactions.

**Long Term**

Several long-term consequences stemming from privatization also arise from Kazakhstan’s increased reliance on foreign companies for regional socio-economic welfare. In the short-term, this strategy has undoubtedly alleviated some of the country’s most pressing socio-economic problems, especially in regions like KzylOrda, which were hit hardest by lost subsidies after the Soviet Union’s demise.

Over the next decade, however, Kazakhstan’s privatization program is likely to increase the distance between central authorities and the local population, exacerbate regional socio-economic differentiation, and, ultimately, decrease the capacity of the state.

There is already a growing sense in Kazakhstan that central leaders are becoming detached from the realities of everyday life. The gulf between central authorities and citizens has grown. The leadership of the republic feels euphoria because of achieved economic successes, which are not at all clear. If foreign companies continue to assume responsibility and bear the blame for Kazakhstan’s social and economic condition, the central government will become increasingly
removed from the daily social and economic problems that its citizens face. Perhaps this may also coincide with the erosion of institutional mechanisms for transforming societal demands into policy outcomes, such as fully contested elections and active political parties with a strong popular support base. The presence of such factors would contribute to more responsive and effective governance in Kazakhstan; their absence will promote precisely the opposite result.

Moreover, so called “economic successes” of central leadership are felt differently across Kazakhstan’s regions. There are already striking differences in the poverty rates between the southern, eastern, and the northern parts of the country. The poverty rate in the south of the country (69 percent) is nearly twice the national average, while that in the north (9 percent) is many times lower. In terms of the number of poor, nearly two out of three poor people live in the south or east of the country. Similarly, levels of consumption vary across regions. They are “highest in the west and lowest in the north.”

Such stark differences in regional economic development are especially alarming because they are likely to exacerbate tensions stemming from Kazakhstan’s overlapping ethnic and territorial divisions. Kazakhs and Russians have each made up approximately 40 percent of the population. Owing to both historical and political factors, over time, Kazakhstan became geographically divided between

16 Asimov,”Kazakhstan: Living Standards during the Transition”, p.15
17 Ibid., p.17
Russians and Kazakhs. Russians became a majority in most of the northern and eastern parts of the republic, while Kazakhs remained numerically strong in the south and west. These overlapping ethnic and territorial divisions have been an important source of social and political tensions in present-day Kazakhstan.

Indeed, shortly before independence, Russian nationalist movements emerged in the northern and eastern oblasts to demand greater autonomy or outright secession, while Kazakh groups in the southern and western oblasts rallied around elevating Kazakh to the official state language and appointing more Kazakhs to government positions. Several years later, Russian and Kazakh nationalist organizations continued to draw their primary support base from the northern or eastern oblasts and southern or western oblasts, respectively.

Kazakhstan has witnessed growing levels of social unrest since 1996. Workers and union leaders, in particular, have become increasingly skeptical about privatization. Some foreign companies have not fulfilled their expectations by paying back wages and maintaining full employment, as the government promised. Labor has thus begun to unite, not only to protest this situation, but also to demand that the government actually remedy it. In this sense, privatization has generated something positive—organized collective action. Between 1995-98, there were over 20 public demonstrations and strikes in Kazakhstan. Yet, to date, such popular demands for redress have not produced a positive government response. So far, the government has
primarily either ignored or repressed public protests. However, it seems unlikely that the government will be able to continue its current approach, and this deadlock constitutes yet another source of potential future conflict.

Even if foreign companies are willing and able to meet the costs of the socio-economic burden that contracts with the Kazakhstani government have bestowed upon them, this situation will create more problems rather than provide a solution. Over time, the state itself will become unable to meet the basic needs and demands of its population because it will not have developed the institutional capacity to do so. An increased reliance on foreign companies to perform state functions will thus undermine the state itself. State-societal relations will not be mediated directly through domestic institutions (as in democracies), but rather, indirectly via international actors and organizations. In short, Kazakhstan will become a state that essentially governs by proxy\textsuperscript{18}.

The attitude of elites toward privatization in general and foreign investors in particular will also generate some serious long-term political and economic consequences for Kazakhstan.

- First of all, as revenue from oil and gas privatization decreases over time, elite competition over private and public funding sources is likely to intensify. This will manifest itself, for example, in increasing

battles between central and regional authorities over the supervision of foreign companies operating in the oil and gas regions of Western Kazakhstan and over shares in the proceeds from foreign investment.

- Secondly, corruption is also likely to continue and intensify because of the competition among elite groups. Over the long-run, this will serve to both impede democratization and hinder economic growth. In the post-Soviet context, however, corruption is likely to be used to justify the continued use of anti-democratic measures and the centralization of power.

- Finally, the concentration of power in the central government will both continue to increase tensions between central and regional elites and impede the development of more decentralized forms of political and economic decision-making. Such centralization is also strongly associated with low levels of economic growth.

4.5 Flawed Basis

By most estimates, Kazakhstan's level of expected wealth from oil and gas development and export alone was simply unrealistic. The actual income generated from Kazakhstan's energy wealth will be much smaller than expected due to several factors.

- first, the high costs of transporting oil from a landlocked state to world markets;

- second, the quality of the oil reserves themselves, some of which are high in sulphur; and
• third, the overall downward trend in world oil prices since the 1980s.

Some experts has predicted that the most likely scenario for Kazakhstan’s projected oil rents, which estimates the world price of oil at $18 per barrel and Kazakhstan’s output capacity at 1.5 million b/d, would produce only a “modest rent stream,” or approximately 1.8 percent of its GDP.¹⁹ This is much lower than the “windfalls” that other petroleum-rich countries, such as Venezuela, Indonesia, and Nigeria, experienced in the 1970s. In addition, based on this scenario for projected rents, Kazakhstan’s actual revenue from oil export “would boost public revenues by only 10 percent, if the level of public expenditures is assumed to stabilize at 16 percent of GDP.”²⁰

4.6 Consequences of Over-reliance

Kazakhstani government’s never say die optimism was not affected even with the continued decline in oil prices from mid-1997 to mid-1999. In early 1999, Prime Minister Nurlan Balgimbaev declared that by the following year the Republic of Kazakhstan intended to produce 40 million tons of oil annually, 28 of which would be reserved for export, and to more than triple this amount by the year 2015.²¹ This is an even more optimistic estimate of Kazakhstan’s oil export capacity

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²⁰ Aunty, ‘Does Kazakhstan Oil Wealth Help or Hinder the Transition?’ p.20
than that of most international oil experts.\textsuperscript{22} This perspective has had several negative social, political, and economic effects.

- First of all, grandiose visions of oil wealth have raised popular expectations that oil and gas reserves can serve as the panacea for all that ails Kazakhstan. Government officials, most notably the president himself, have not hesitated to share their overly optimistic expectations with the public. In connection with his official visit to the United States in the fall of 1997, Nazarbaev publicly acknowledged his own expectations that the latest oil agreements signed in Washington envisage a long-term investment of US$28 billion in Kazakhstan from which Kazakhstan would receive up to US$550 billion in oil revenues over the next forty years. He later declared during a visit to Pavlodar as part of his presidential re-election campaign in November 1998 that his country would be a major oil and gas exporter in the next century.

- Secondly, the overly optimistic view of future oil revenues has promoted a strong tendency toward borrowing and overspending, particularly for discretionary purposes. By 1997, Kazakhstan was already “the third largest borrower after Russia and Ukraine among the former Soviet states,” having accepted 13 loans from the World Bank “totaling about $960 million” since independence.\textsuperscript{23} A large portion of this was initially directed toward macroeconomic

\textsuperscript{22} For example, the International Energy Agency’s most optimistic estimate is 1.54-2.34 million b/d by 2015, whereas Kazakhstani officials claimed they would export 2.6 million b/d by 2015.

stabilization and then was re-directed toward the rehabilitation of oil fields and the reorganization of state-owned enterprises to attract foreign investment. Meanwhile, more direct income from the export of oil created an extra-budgetary source of discretionary funds. The creation of Kazakhoil in particular made this possible, since it provided a legal means for the government to set aside a portion of the company's account acquired through oil exports to satisfy its own aims. Financing for the construction of new buildings and infrastructure in the new capital (Astana) is a case in point. Kazakhoil is estimated to have spent $25-30 million on improvements in Astana. Over the next several years, the transfer of the capital to Astana is likely to "cost at least $500m and—with a shortage of power and drinking water—will eventually run up a still larger tab."24 The government expects that these funds will come from oil dollars.

- The third negative consequence of the Kazakhstani government's strong emphasis on the energy sector is that it has shifted official attention away from the development of other sectors, most notably manufacturing and agriculture. The investment priority of the government since independence has clearly been in revitalizing its oil and gas fields and building pipelines. Between 1990 and 1995, the oil industry alone accounted for 40 percent of all sectoral investment; the energy sector (including electric power generation and coal) comprised 60 percent of total sectoral investment.25

By 1998, while "[c]apital investments in the national economy [had] shrunk by 89 percent compared to 1991, nine out of every ten industrial enterprises [had] stopped work, and livestock numbers [were] half of what they used to be in 1991,"\textsuperscript{26} investment in the energy sector continued to grow by comparison. This, in turn, has led to a significant rise in unemployment, along with the out-migration of skilled labor, and a growing sense among the population that the government is simply ignoring its plight. The government's prioritization of its extractive industries has not only contributed to the collapse of food, light, petrochemical, machine-building and other industries but also left large groups of the skilled personnel and members of their families without the means to make a living or prospects for doing so. The direct result of this, he argues, is mass out-migration by skilled laborers in search of employment opportunities elsewhere.

- Finally, the expectation that the country can rely primarily on oil and gas revenue has diminished the government's efforts to develop a reliable system of tax collection. In fact, when revenues fell to only 20% of GDP by 1995 and continued to drop by another 6 percentage points in 1996, government officials still believed that prospective oil revenue presented an easier solution to the public deficit than did improved tax collection or faster economic growth. Although the government

acknowledged its failure to collect taxes effectively during 1997, it has done little to correct this problem aside from creating a new State Revenues Ministry in October responsible for “defining fiscal policy and regulating taxation and customs.”

Tax revenues as a percentage of GDP continued to decline in 1998.

To conclude, Kazakhstan, with its obsession with oil and gas wealth (consequences summarised in table overleaf), might devolve into a quasi-state that is internationally recognised but able neither to meet the basic social needs of its population nor to achieve even minimum levels of economic growth.

27 RFE/RL Newsline, July 23, 1997
Table 4.4: Energy Wealth Related Effects in Kazakhstan

<table>
<thead>
<tr>
<th>Short-Term Effects</th>
<th>Long-Term Effects</th>
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<tbody>
<tr>
<td><strong>Over-Optimistic Expectations</strong></td>
<td></td>
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<tr>
<td>1. increases popular expectations</td>
<td>1. will exacerbate popular discontent and further the erosion of support for reform</td>
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<tr>
<td>2. promotes over-spending and borrowing;</td>
<td>2. will impede economic growth and undermine state capacity</td>
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<tr>
<td>increases discretionary spending</td>
<td>3. will promote Dutch Disease and increase poverty</td>
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<tr>
<td>3. decreases attention to the development of other economic sectors; increases unemployment</td>
<td>4. will impede state capacity to generate revenue and hinder democratization</td>
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<tr>
<td>4. decreases emphasis on tax collection</td>
<td></td>
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<tr>
<td><strong>Form and Pace of Privatization</strong></td>
<td></td>
</tr>
<tr>
<td>1. foreign companies take responsibility and blame for local socio-economic conditions</td>
<td>1. will increase distance between central government and local population, promote state incapacity, and exacerbate regional socio-economic differentiation</td>
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<tr>
<td>2. quick sell undervalues natural resources; large royalties provide quick revenue and increase intra-elite competition</td>
<td>2. as revenues decrease over time, elite competition will intensify</td>
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<tr>
<td>3. fosters corruption at the central and regional levels and popular distrust of government officials</td>
<td>3. increased central-regional tensions and impeded democratization will hinder growth</td>
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<td>4. encourages trend toward centralization and concentration of power</td>
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<tr>
<td><strong>Combined Outcomes</strong></td>
<td></td>
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<tr>
<td>1. decreases state commitment to direct social spending</td>
<td>1. will exacerbate growing regional economic differentiation</td>
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<tr>
<td>2. increases poverty and health risks</td>
<td>2. greater poverty and health risks</td>
</tr>
<tr>
<td>3. creates repeated &quot;cycles&quot; of protest, crackdown, and co-optation</td>
<td>3. may lead to the radicalization and regionalization of the opposition</td>
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