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Kazakhstan's 'Resource Nationalism': Its Sources and Motives

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Key Points

Kazakhstan's 'resource nationalism' is learned behavior arising from twenty years of experience of independence.

Successful administrative and financial reforms from the 1990s and early 2000s facilitate its implementation.

Its purposes are to insure (1) timely development of energy deposits through increased participation in management decision-making, (2) economic and social development outside the energy sector, and (3) public health through ecological and environmental security.

Kazakhstan's policy of 'resource nationalism' scored another win earlier this year when the North Caspian Operating Company (NCOC), which is managing the development of the offshore Kashagan deposit, declared its readiness to help KazMunayGaz (KMG) to secure a US$4 billion loan from National Fund of the Republic of Kazakhstan (NFRK). It was reported in March that the funds are to be issued in two tranches, in 2013 and 2015. The offshore Kashagan hydrocarbon deposit is the largest strike in the world since Prudhoe Bay in Alaska over four decades ago. This decision is in line with President Nursultan Nazarbayev's earlier declaration that the Fund's money should not gather interest in foreign banks but instead be put to work financing dome tic economic development.[1]

Nearly half of Kazakhstan's government revenues originate in the extraction and export of oil. KMG is the principal "national champion" through which Astana has sought, with success, to gain influence in energy resource development. It is fully state-owned and was created by presidential decree in 2002 as the successor firm bringing together the exploration and development company KazakhOil on the one hand and, on the other hand, the pipeline company Transport Nefti i Gaza. The NFRK was established in 2000 as a stabilization fund to guard the economy against external shocks. At the end of July 2012 the NFRK reported $53.5 billion in assets.[2] The March decision by NFRK follows a request to the Kazakhstani government by the NCOC consortium's participants to approve a 20 percent increase in the Kashagan project budget. The new budget estimate now reaches $46 billion. This request was approved on the understanding that the Western partners would bear the brunt of the increased costs themselves.[3]

Kazakhstan's participation in the major exploration and development consortia

Tengiz

Kazakhstan was involved in Tengiz development from the start. The first test well was drilled in 1979 and in the late 1980s the Soviet government began to develop the necessary infrastructure for systematic exploitation of the deposit. Commercial production began in 1991, and in 1992 Chevron and Kazakhstan agreed to establish a joint venture. This joint venture TengizChevrOil (TCO) was created in 1993 with Chevron and KazakhOil (an ancestor of KMG) having equal shares. Of its 50 percent share, Kazakhstan sold a 25 percent share in 1996 to the U.S. firm Mobil (which merged with Exxon in 1999 to form ExxonMobil, a subsidiary of which now manages the share), and in 1997 a 5 percent share to LukArco (a joint venture between Russia's Lukoil and the U.S. firm Atlantic Richfield, which merged in 2000 with BP, which latter took over its share in LukArco).

Kazakhstan had a history of dissatisfaction with the pace of development of the project after independence. To give just one example, Chevron slashed its 1994 investment budget in Tengiz by 90 percent when it was asked to finance most of the cost of what became the Caspian Pipeline Consortium (CPC) pipeline but was offered only a minority stake in the finished pipeline itself. The justification for such a drastic move may have been to send a signal, it only drove home to the Kazakhstani their own inability to influence in a definite way not only investment decisions but also other management affairs.

TCO also came under pressure for environmental violations at about the same time. The oil from Tengiz is very high in sulfur, which must be removed before it is put into pipes that it would otherwise corrode. A $71 million fine in 2003 for storage of sulfur in the open air was imposed, although this was reduced to $7 on appeal. In 2006 a fine of $609 million was imposed for continued failure to deal with the problem in a timely fashion.[4] Kazakhstan alleged that the sulfur was simply piled up into football-stadium sized blocks and left exposed to the elements.

In 2003, in order to prevent TCO from using accounting devices that might limit the Western partners' tax burden, the Kazakhstani government decided that TCO should take steps so that its bookkeeping practices conformed better to international standards. One other result of this move, which increased transparency of accounting, was that further delays in implementing the investment plan became more difficult to justify. TCO finally agreed to the original investment plan and its implementation after KMG also played a blocking role in preventing TCO from modifying its terms. After TCO conceded to agree to the original investment plan in 2003, Nazarbayev signed a new foreign investment law that he nevertheless promised would not affect existing investment projects.

Kashagan

The organizational development of the Kashagan consortium was even more tortuous than Tengiz's, but at least some details are important to understand Kazakhstani motivations for resource nationalism. Kazakhstan was involved in the Kashagan consortium from the start but then sold its stake only to wedge its way back in later. Yet even in the beginning when it had a stake, it was largely excluded from significant participation in decision making, partly due to a relative lack of expertise concerning the advanced technologies that were necessary and partly because it could be blocked out by a critical mass of foreign firms acting together.

In 1993 the KazakhstanCaspiiShelf (KCS) consortium was established equally among BG, a BP-Statoil joint venture, KazakhOil, Eni, Mobil, Shell, and Total. In 1997, the KCS became the Offshore Kazakhstan International Operating Company (OKIOC). In 1998 Phillips Petroleum and Inpex separately joined the OKIOC when each purchased half of the Kazakhstani company's stake. In 2001 the BP-Statoil joint venture sold its stake to the other participants. Total (by then TotalFinaElf) moved to acquire larger shares and hoped to become operator of the consortium, but complicated maneuvering and Kazakhstani government intervention led to the Italian firm Eni becoming the project operator as OKIOC acquired a new organizational form and changed its name to Agip Kazakhstan North Caspian Operating Company (Agip KCO).

In 2003 BG attempted to sell its stake to two Chinese companies but its partners in Agip KCO exercised their first-refusal privilege to pre-empt the sale. KMG had by now been created and negotiations allowed it to buy half of BG's stake while the other half was shared out among the other partners in the consortium, which exercised pre-emption rights. Eni, Shell, Total, ExxonMobil now each had slightly over 18.5 percent, ConocoPhillips (the successor to Phillips Petroleum) a little over 9.25 percent, and KMG and Inpex both had 8.33 percent. The Kazakhstani government once more had a representative in the consortium itself.

By mid-2007 the Kashagan consortium, which had continually postponed the projected date of production from 2005 to 2010 to 2012 to 2013, was saying that the original cost estimate of US$27 billion could more than double to $60 billion. The government thereupon observed the final cost could be as much as twice that again and in August that year suspended work for a minimum of three months due to environmental violations. At the end of September 2007, Nazarbayev signed legislative amendments allowing the government to amend or even annul natural-resource contracts if they were deemed contrary to national security.

Just before the three-month suspension expired, the Western members of the consortium agreed in principle to increase the share held in it by KMG, to do a better job of training Kazakh personnel at the management level, and to introduce organizational reforms increasing transparency along with KMG's oversight capacity. At the same time, shares were adjusted bringing the Western principals down in proportion and KMG up, so that KMG had the slightest symbolic plurality of shares in addition to new powers of management enforcement.[5]

Karachaganak

The Karachaganak natural gas deposit was developed during the Soviet era, Karachaganak gas was intended for treatment at a gas-processing plant run in Orenburg, just across the Russian border, run by Orenburggazprom. After 1991, Karachaganak gas had to compete with Russian gas on the Russian market. Accordingly, the Orenburg treatment plant limited quantities that it would accept from Karachaganak.[6] Even during the late Soviet period, however, technological hurdles in field development required plans for cooperation with foreign firms. Discussions began even before Kazakhstan became independent, but it took years until finally in 1997 a production-sharing agreement (PSA) for Karachaganak was signed for a 40 year term. The shares of the company called Karachaganak Petroleum Operating (KPO) were apportioned: BG and Eni each obtained 32.5 percent, Chevron got 20 percent, and Lukoil was in for 15 percent.

Following the success of its strategy of entering and exerting greater influence from within the Kashagan consortium in the middle of the last decade, Kazakhstan took aim at Karachaganak. New tax claims were laid against the non-Kazakhstani partners in late 2009 and early 2010, while KMG (which was not formally a KPO member, at least not yet) asserted that the consortium's postponement of implementation of an investment plan had almost doubled the cost of Karachaganak Phase Three from $8 billion to $14.5 billion.

In 2010, Astana accused KPO of excess oil production, i.e., beyond the amount permitted by contract. The consortium was also fined $210 million for environmental violations for the year 2008, and prosecutors revealed that further claims amounting to $136 million for back taxes and penalties were already under preparation for calendar year 2004 alone: not to mention total charges of over $1 billion in accumulated export duties. The KPO consortium began negotiations with the government to sell it a 10 percent interest in the field.

Those negotiations were successful, and the consortium's erstwhile participants ceded their stakes in proportional fashion: BG and Eni each gave up 3.25 percent from their 32.5 percent stakes, Chevron gave up 2 percent from its 20 percent, and Lukoil 1.5 percent from its 13.5 percent stake. KMG thus obtained a 10 percent share, the cost of shares being $3 billion (judged by some observers to be relatively low), "including non-cash equivalent." Of that amount, $1 billion went to the Kazakhstani state budget, and also in return Astana increased the quota for oil allowed to Karachaganak through the CPC pipeline by 500,000 tons per year with a further increase of 1.5 million tons to come later. The agreement also provided for settlement of all tax claims and any disputed customs duties.

Kazakhstan's motives and strategies

This review of relations between the government and the three largest consortia in the country reveals that the principal goals for Kazakhstan's resource nationalism appear to have been to insure the timely development of hydrocarbon energy deposits and to promote the rational use of resources and profits for the benefit of social infrastructure and social programs. Motives for realizing those goals include discontent over delays in implementing production plans, increased costs at least partly attributable to such delays, and disputes over how to cover those increased costs, as well as concerns over ecological security and violations of environmental legislation.

Possibly also Astana has not forgotten how Washington in particular, after making unspecified general promises concerning the promotion of natural-resource investment, seemed to lose official interest in Kazakhstan after the latter voluntarily agreed in 1992 to transfer its nuclear warheads to Russia and acceded two years later to the Non-Proliferation Treaty. Like all energy-rich former Soviet republics with the exception of Russia, Kazakhstan lacked, in the early and mid-1990s immediately after the USSR's disintegration, the human resources adequately to represent its interests in highly complex technical negotiations with market-oriented industrialists having wide experience on the global scale.

The Kazakhstani side's preoccupations across all three cases summarized here are similar, not difficult to understand, and not altogether illegitimate. Ecological concerns, even including fines and penalties and threats of same, are not exclusively a fig-leaf of the government for forcing foreign firms to do what they want them to do. Despite the one-party dominant political system in Kazakhstan and the unchallengeable personal (and familial) political hegemony of Nazarbayev, the ruling elite remains sensitive to public opinion about such issues and moves to take preventative action against possible discontent.

The 1985 Tengiz fire (a horrendous explosion that shot a pillar of fire 200 meters into the air and required a full year to be capped and extinguished because the inferno's gas was lethal) is not the only catastrophic ecological event in the country's recent history that is seared into the popular consciousness. The national health care delivery system is today still burdened with the effects of nuclear fallout on the population from the above-ground testing at Semipalatinsk (Semei) during the Soviet era. Indeed, Nazarbayev rode to power in the late 1980s partly on the back of the transnational civil-society organization 'Nevada-Semei' that mobilized a good proportion of Kazakhstan's population against Soviet policies in general. To this also should be added to effects of nuclear fallout blowing across the border from the Chinese testing ground in Lop Nor.

Paradoxically, or rather ironically, the much-lauded progress of Kazakhstan in the 1990s and early 2000s towards the modernization of its banking system, and increased competence of the regulatory framework in general, set the groundwork for the proposal and implementation of some of the measures now seen as 'resource nationalism'. Insistence on bookkeeping reforms at Tengiz, for example, would have been impossible in the absence of national financial and taxation reforms, including the training of Kazakhstani personnel in the pertinent international norms. Generally increased competence on the Kazakhstani side also enabled legislative reforms to be drafted with the required technical specificity and then implemented.

While Kazakhstan's redress for its past relative weakness and inequality of negotiating position hurts international investor confidence by threatening unilateral revision of contracts or imposition of new duties, its ever-deepening energy ties with China make it rather less dependent than it once was upon the industrialized West, which no longer holds a technological monopsony except in admittedly important cutting-edge technologies, without which Kazakhstan in fact cannot do. Astana does indeed require not only large capital investment to develop its resources but also those advanced technologies to which it can gain access only through cooperation with global leaders in the sector, including but not limited to re-injection of extracted gas and oil and various gas processing technologies.

Conclusion

To repeat: The principal motives of Kazakhstan's 'resource nationalism' appear to have been to insure the timely development of hydrocarbon energy deposits and the rational use of resources and profits for the benefit of social infrastructure and social programs. The Kashagan affair displays most of the legal and bureaucratic armamentarium at the disposal of Astana and also shows how Kazakhstan hesitates to take out its destructive artillery other than for the purpose of putting its existence into evidence in order to persuade. The principal explanation for what seems like the government's policy zigzags is not irrational patrimonial rent-seeking, and certainly not to the point of killing the goose that lays the golden egg, but rather the rational drive to make reality conform to the perceived need to 'level the playing-field'.

Other energy-rich, former Soviet republics in the Caspian Sea basin have manifested an evolution in their foreign energy-economic policy that is similar to Kazakhstan's. It is therefore possible to understand Kazakhstan's 'resource nationalism' on a more general basis: it is learned behavior emerging from the accretion of new experience onto past experience. The standpoint of much of scholastic Western political science makes it impossible to appreciate this fact. The North American discipline's general antipathy towards the concept of foreign policy learning, which it straitjackets by limiting the scope of application, contributes significantly to that blindness.[7]

Yet it is not even necessary to mention Russia's special and especially controversial particular situation (BP-TNK for example) to make the point. Some years after the Soviet Union fell apart, both Azerbaijan and Turkmenistan also began to move, independently of one another and of Kazakhstan, to establish the 'relative autonomy' of their national energy development and export policies.[8] The fact that Azerbaijan and Turkmenistan did this at almost the same time as Kazakhstan, just after the middle of the last decade, strengthens the case in favor of a learning-based general explanation in the context of a common international business and political environment.

[1] Miramgul Maralova, "National Fund to lend KMG NC $4bn for development of Kashagan," *Halyk Finance*, March 1, 2012, http://www.halykfinance.kz/en/site/index/research/news:80362. All URLs were verified as of August 12, 2012, unless otherwise noted.

[2] Natsional'nyi Bank Respubliki Kazakhstan, "Mezhdunarodnye rezervy i aktivy Natsional'nogo Fonda RK," *NBRK*, August 2012, http://www.nationalbank.kz/?docid=285.

[3] Nariman Gizitdinov, "Kazakhs Study Bid To Boost Kashagan Oil Cost To $46 Billion," *Bloomberg News*, January 11, 2012) http://www.bloomberg.com/news/2012-01-11/kazakhs-consider-bid-to-boost-kashagan-oil-cost-to-46-billion.html ; and Gizitdinov "Kashagan's Foreign Partners To Finance State's Share Of Costs," *Bloomberg News*, May 24, 2012, http://www.bloomberg.com/news/2012-05-24/kashagan-s-foreign-partners-to-finance-state-s-share-of-costs.html.

[4] Anthea Pitt, "Chevron hit with $609m Tengiz fine," *Upstream,* October 3, 2007, http://www.upstreamonline.com/live/article141698.ece.

[5] Robert M. Cutler, "Kazakhstan's Foreign Investment Law Changes Again," *Central Asia – Caucasus Analyst*, December 12, 2007, http://www.cacianalyst.org/?q=node/4754; also Cutler, "Kazakhstan announces new energy directions," *Asia Times Online*, February 13, 2008, http://www.atimes.com/atimes/Central_Asia/JB13Ag01.html.

[6] Richard McManus, "BG in Kazakhstan" (London: Investis, 2002), http://ir.bg-group.com/bggroupplc/presentations/2002-09-06/powerpoint.pps, slides 14–16, accessed February 4, 2003; cited in Robert M. Cutler, "The Caspian Energy Conundrum," *Journal of International Affairs* 56, no. 2 (2003): 91.

[7] For an applied treatment by the present author, see Robert M. Cutler, "Gorbachev as CEO Roadkill: Lessons for the Modern Corporation from the Soviet Foreign Policy Establishment's Failure to Manage Complexity," in M.R. Lissack and H.P. Gunz (eds), *Managing Complexity in Organizations* (New York: Quorum, 1999), pp. 352–370; for a theoretical treatment, see Cutler, "The Paradox of Intentional Emergent Coherence: Organization and Decision in a Complex World," *Journal of the Washington Academy of Sciences* 91, no. 4 (2006): 9–27. The argument of the former is being expanded for Cutler, *Why Soviet Foreign Policy Failed: What Complexity Science Tells Us That Nothing Else Can* (Litchfield Park, Ariz.: Emergent Publications, forthcoming).

[8] Robert M. Cutler, "The Central Eurasian Hydrocarbon Energy Complex: From Central Asia to Central Europe", in M.P. Amineh and Y. Guang (eds), *Secure Oil and Alternative Energy* (Leiden-Boston: Brill, forthcoming), chapter 3.

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