

## KAZAKHSTAN: CONTINUOUS IMPROVEMENT OR STALEMATE IN ITS RELATIONS WITH CHINA?

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**Abstract:** Over the last two decades Kazakhstan has implemented foreign policies aimed at improving relations with many new geopolitical actors, as well as longstanding common partners such as Russia, on which it was formerly heavily dependent. By utilising its huge hydrocarbon production potential, Kazakhstan has managed to surpass all other Central Asian states in political and economic importance. Kazakhstan has now turned its eyes to China, seeing it as an important and powerful partner in the economic, political and security spheres. This article deals with fundamental issues in Kazakhstan's relations with China.

Kazakhstan has become an important player in Central Asia's regional relations in recent years. International observers have underscored the many positive changes made by the country. Kazakhstan has achieved higher levels of real economic and social development than other regional states. In macroeconomic terms, Kazakhstan has the largest economy in Central Asia and has recorded impressive growth levels since it gained independence in 1991. It quickly recovered from the depths of the 2008/2009 world economic crisis.<sup>1</sup> Kazakhstan's success is worth underscoring, as it is the only Central Asian country that appears in the list of countries with a high level of human development.<sup>2</sup> However, it seems that a well-coordinated effort is being made by Astana and European Union members to overestimate the country's achievements, while conscientiously ignoring its problems.<sup>3</sup> Western pundits also sometimes seem unwilling to criticise the

'Kazakhstani path'<sup>4</sup> of development, although the country still has serious infrastructure problems,<sup>5</sup> an authoritarian political system and an insufficient diverse economic base.<sup>6</sup> It should be apparent to all stakeholders that, regardless of how impressive Kazakhstan's economic performance might appear at first glance, there is room for further improvement. The country is still largely dependent on its neighbours in various economic sectors and is continuously seeking opportunities to sustain its growth through regional and global economic cooperation. In that sense, China–Kazakhstan relations are especially important, not only in terms of overall trade turnover between the two countries, but because of the sustainability of both the 'Kazakhstani path' and Central Asia's stability.

### Kazakhstan–China relations

Political relations between Kazakhstan and China have been cordial since 1991, the year Kazakhstan achieved independence. Old disputes over their common border have been settled and closer political contacts established. Chinese and Kazakhstani officials often meet to discuss bilateral issues and, according to Astana, '... developing and maintaining good neighborly relations with China is a top priority'.<sup>7</sup> Both countries are members of the Shanghai Cooperation Organisation (SCO) and other regional and sub-regional groupings committed to promoting political cooperation, economic development and security. This strong reciprocal support is deemed essential to achieve some of their most important mutual foreign policy goals. For instance, Kazakhstan supports Beijing's 'One China' policy, thus supporting Beijing's official position on Taiwan and Tibet,<sup>8</sup> while China backs Kazakhstan's almost two-decade-long bid to become a member of the World Trade Organisation (WTO).<sup>9</sup>

Equally positive are their bilateral economic relations, which have been intensifying for many years. China's willingness and ability to invest in Kazakhstan has been the main factor driving continual improvement in their trade relations.<sup>10</sup> Impressive figures support these economic relations. In early 2011, for example, Beijing made a loan worth \$1.7 billion to the Kazakhstani National Welfare Fund (Samruk-Kazyna) and another worth \$5 billion to the Kazakhstani petrochemical industry, in addition to pledging to buy Kazakhstani uranium for an estimated \$8 billion.<sup>11</sup>

Astana welcomes this uptick in the Chinese influence, as it contributes to diversifying the country's

economy. Mutual trade relations were for many years concentrated in gas and oil exports from Kazakhstan to China. However, they have now entered into a process of diversification, and positive outcomes are expected from further economic integration between the two countries, especially in the border regions.<sup>12</sup>

Improved bilateral relations underscore these beneficial developments and might in the midterm help Kazakhstan consolidate its achievements. Since 2011 Kazakhstani and Chinese state officials have come together several times to discuss economic, political, cultural and security issues. In June 2011, Chinese President Hu Jintao and Kazakhstani President Nursultan Nazarbayev discussed the specifics of their security partnership, signed in 2005, and affixed their signatures on a document on 'Development of an All-Round Strategic Partnership', which stipulates a commitment to enhance bilateral trade and increase the frequency of meetings between top officials.<sup>13</sup> Since the beginning of the 2000s Kazakhstan–China relations have been put on a strong footing. Nazarbayev and Hu Jintao, when they meet, leave the impression of sharing a deep understanding. Kazakhstan's presidency of the SCO in the second half of 2011 provided many opportunities for the two heads of state to discuss face-to-face various aspects of bilateral cooperation. Chinese officials have repeatedly expressed satisfaction with the evolution of bilateral trade relations in recent times and strongly supported the opening of the Khorghos International Centre of Boundary Cooperation, a transnational free trade centre on the border of Kazakhstan and China, spanning a 3.36 million m<sup>2</sup> area of Chinese territory and 1.6 million m<sup>2</sup> area of Kazakhstani land.<sup>14</sup>

Kazakhstani and Chinese officials have ample reason to be content with the trade volumes between the two countries. In 2011, the bilateral trade volume amounted to \$20 billion, up from a disappointing \$8.3 billion in 2006. This is a significantly larger volume than the trade turnover between Kazakhstan and Russia, two countries that are trying to boost their trade through a customs union.<sup>15</sup> Initially, Astana and Beijing set the goal of reaching a trade volume of \$15 billion by 2015. Fortunately, the value of bilateral trade is already, in the first quarter of 2012, \$5 billion above the planned level.<sup>16</sup> In addition to trade, Kazakhstan's friendship is also essential for China since it is a major transit country. For instance, the improvement of the railway connection between north-west China and south-east Kazakhstan and onward into Russia and Western Europe was at the top of the agenda in their bilateral discussion.

These developments indicate that Kazakhstan is an increasingly important player in China's strategy in the Central Asia region, while Russia's influence in that region is steadily declining in relative terms. China, Turkey and, to a much lesser extent, Iran are making rapid gains at the expense of Russia. This trend is evidenced both by data, as noted above, and by changes observable in both domestic markets and traditional bazaars across the region. The increasing Chinese presence is even changing the lifestyles of ordinary people. The flood of cheap and affordable Chinese goods has allowed Central Asians, even in the smallest and most remote villages, to buy products that

they previously had never dreamed of seeing. In all probability, Russia will become progressively less able to hinder China's penetration into the region. Commercially, the future does not look enviable for Moscow as by 2015 the bilateral trade between China and Kazakhstan is expected to reach \$40 billion,<sup>17</sup> an increase that will further strengthen China's foothold in Central Asia.

Much to Moscow's dismay, improvements in Kazakhstani–Chinese economic relations are expected to increase even further in the years to come. At the end of September 2011, Chinese and Kazakhstani business people met to discuss investment projects between the two countries. The chairman of the Standing Committee of China's National People's Congress, Wu Bangguo, who attended the meeting, focused the talks on future cooperation possibilities in energy, mineral extraction, metallurgy, road and railway construction, telecommunications and agriculture. He also drew attention to the need to improve cooperation between Kazakhstani and Chinese firms and augment the volume of investments.<sup>18</sup> Perhaps more importantly, Bangguo insisted that there are many opportunities for cooperation in manufacturing and service sectors.

Since independence, Kazakhstan's president has been adamant about the necessity to diversify the Kazakhstani economy away from energy production and export, as this makes the country too dependent on fluctuating oil and gas prices. A rapidly developing partner like China would certainly help President Nazarbayev achieve this objective. However, one can only be doubtful whether Chinese investments and cooperation will actually bring about economic diversification in Kazakhstan. The Kazakhstani elite, on which this process of diversification depends heavily, may not actually have a strong enough interest in altering the present economic structure. Kazakhstan's historical experience has demonstrated that poorly diversified economies, which rely heavily on natural resources for generating revenues, are the best models political and economic elites can use to indulge in kleptocracy.<sup>19</sup> It remains to be seen whether the Kazakhstan–China economic partnership will serve the interests of ordinary Kazakhstanis or merely the members of the president's circle.

### Energy cooperation

Energy development and export largely dominates Kazakhstani–Chinese relations. Beijing considers Central Asia, especially Kazakhstan and Turkmenistan, a crucial element in its energy equation and has geared its policy in such a way as to secure as many resources as possible from this region.<sup>20</sup> Central Asia can play a major role in helping Beijing diversify its energy suppliers. It can also reduce, by the same token, China's reliance on Middle East oil exporters, who exported to China more than two million barrels/day in 2010.<sup>21</sup> Beijing keeps a close eye on the current political events in the Middle East, and the instability that comes with them. Chinese policy planners develop alternative policies which could be implemented in the event that the United States decides to close, or at least filter, the Strait of Malacca, through which oil cargoes

from the Middle East must pass.<sup>22</sup> Under these circumstances, China's oil and gas imports from Central Asia will probably continue over the next few years—even potentially for decades—prompting the expansion of the energy sectors of the Central Asian hydrocarbon-rich states. Furthermore, Chinese imports of Central Asian oil and gas will divert a massive amount of revenue from China to Central Asia, in addition to providing a powerful alternative buyer to Russia.<sup>23</sup> This will in turn give Central Asian governments more political leeway in their international relations. Kazakhstan seems quite conscious of this situation, and is accordingly currying favour with China, knowing the many benefits it could potentially reap.

The spectacular economic growth in the People's Republic of China (PRC) in the last 20 years has generated intensive use of primary energy resources. Since the first half of the 1990s, China has not been able to meet all its energy needs from its own production and has thus become a net importer of oil and gas. The country became a net importer of natural gas in 2008 as the gap between supply and demand approached five billion cubic metres. Meanwhile, Kazakhstan and Turkmenistan, and to a lesser extent Uzbekistan, have abundant reserves of oil and are export-oriented economies. Therefore, the Chinese authorities have progressively made energy a priority issue on their Central Asian agenda. This development has important implications and can be analysed from various angles. Firstly, China's own perspective on its present boom and how Beijing's involvement in the Central Asian republics' development is perceived need to be taken into consideration. Secondly, the growing role of Central Asian energy issues in China's policy has important geopolitical implications, specifically on the relations between Moscow and Beijing. Energy is one of the strategic issues where the interests of Beijing and Moscow are clearly divergent and it has the potential to complicate the cooperative atmosphere the two powers have enjoyed in recent years. Moreover, it is necessary to contextualise the Caspian Basin's place within the overall energy strategy of the PRC.

Kazakhstan has become one of China's main energy suppliers. In 2011, 11 million tons of oil flowed to China through the Kazakhstan–China oil pipeline, which runs from Kazakhstan's Caspian shore to Xinjiang in China.<sup>24</sup> During a September 2011 visit to Central Asia, Chinese officials expressed their desire to expand energy trade with oil-rich Kazakhstan.<sup>25</sup> The latter's oil exports are set to swell over the next few years. Astana is expecting a 50 per cent increase by 2020,<sup>26</sup> and China will receive the lion's share of this, as its domestic demand is increasing dramatically. Kazakhstan plans to export 22 million tons/year of oil to China by 2020, up from 12.1 million tons in 2011.<sup>27</sup> To achieve this, it is currently boosting the export capacity of the Kazakhstan–China pipeline and constructing a parallel gas pipeline scheduled for completion by 2014.<sup>28</sup> This additional pipeline will also enable Kazakhstan to transport gas extracted in the western part of the country, where most of the deposits are located, to the more industrialised southern regions,

reducing by the same token their reliance on Uzbek gas imports.<sup>29</sup>

As in other areas, the purchase of oil deposits and the signing of long-term energy supply contracts are the main instruments used by China to influence the energy sector of Central Asian states. In 1997, after three years of negotiations, the China National Petroleum Corporation (CNPC) began operating in Kazakhstan. Other major Chinese firms soon followed. In addition, Beijing and Astana signed in that year an agreement to construct a pipeline of almost 4,800 km connecting the Caspian Sea and the Xinjiang region in north-west China.

The construction of the Kazakhstan–China oil pipeline was divided into three sections. The first section, linking Atyrau (north Caspian) with Aktobe region oil fields (western Kazakhstan) was completed in March 2003. This section also carries oil to the west, towards the Caspian Pipeline Consortium (CPC) pipeline, which connects the Tengiz oil field in Kazakhstan with the Russian port of Novorossiysk on the Black Sea, through Atyrau. The second 1,000-km section was built between September 2004 and December 2005 and links Atasu in central Kazakhstan to the border town of Alashankou in China's Xinjiang Uygur Autonomous Region. Like all other milestones in China's Central Asian energy development, the opening of this section of nearly 1,000 miles generated much debate and some stridency. However, the Atasu–Alashankou section, the most important of the Kazakhstan–China oil pipeline, is able to deliver only 10 million tons of crude oil a year to China, a modest amount considering China's oil needs. The third and final section, which connects Kenkiyak with Kumpol, was as per an agreement between Kazakhstan and China on 18 August 2007 and completed on 11 July 2009. This pipeline makes it possible to pump oil directly from the northern Caspian to the Dushanzi refinery in Xinjiang.

To feed the pipeline, China has acquired, through various companies, exploitation rights to various oil fields in Kazakhstan. In the process Chinese companies have had to cope with both the suspicion their presence arouses and the relative delay in getting anything done, thus harming their position in the coveted Kazakh Caspian offshore fields. The exception is the Darkhan deposit, which they exploit under an agreement signed in October 2008. However, making a virtue of necessity and following a consistent business strategy, China has invested in oil fields located in the Aktobe region and in other more isolated sites along the route of the Sino-Kazakh oil pipeline (Buzachi North, Karazhanbas and Kumkol in the Kyzyl-Orda region).<sup>30</sup>

These, along with the aforementioned Atasu connection to the pipeline going to Russia, make the Sino-Kazakh oil pipeline an alternative route for exporting Russian oil from western Siberia to China. As a result, Beijing has virtually assured sources of supply for a pipeline which currently has a maximum annual capacity of 20 million tons of crude that could be expanded to 30. The most significant Chinese investments in the Kazakh hydrocarbon sector have been the \$4.2 takeover of PetroKazakhstan, a Canadian-based

company, by the Chinese oil company CNPC in August 2005 and the purchase for US\$1.91 billion of the Kazakhstan oil assets of Canada's Nations Energy Company Ltd by the China International Trust and Investment Corporation (CITIC) in December 2006. Through these two acquisitions Beijing acquired an important position in the Kazakh oil market and although the figures available vary substantially and are difficult to compute, it is estimated that in 2006 China was responsible for about 25 per cent of all oil extraction in Kazakhstan.<sup>31</sup>

This increase in China's presence in the Kazakh oil sector generated an animated public debate led by those who see in Beijing's policy a growing threat to Kazakhstan's economic sovereignty and autonomous development prospects. While some local analysts are known to dissent from the majority view and point out, for example, that contracts signed with Chinese companies are more beneficial to Kazakhstan than those signed with large Western companies, the controversy over the Chinese acquisitions has more particularly culminated in the Majlis, the parliament of Kazakhstan, which approved in September 2007 the introduction of a series of amendments to the law 'on subsurface and the use of the subsurface' dated 27 January 1996. The law expanded Astana's ability to revise or annul contracts concerning the exploitation of subsurface resources and posing a threat to 'national economic security interests'.<sup>32</sup> As a response to the \$1.9 billion sale of the Karazhanbas oil field by Canada-based Nations Energy to CITIC, the Kazakh government passed a law preventing foreign investors from selling stakes in Kazakhstan's assets to third parties. Also, the 2005 sale of PetroKazakhstan Inc. to CNPC illustrated the need for the new law giving Kazakhstan the first right of refusal to buy assets in any proposed transfer of oil assets between foreign companies. Also, KasMunaiGas became a stakeholder in PetroKazakhstan in 2005, and following the passage of this amendment, KasMunaiGas executed an agreement with CITIC to purchase 50 per cent of Karazhanbas. It is interesting to note that the above PetroKazakhstan purchase created a similar reaction in Russia, especially among companies active in Kazakhstan, which share these misgivings about the progressive Chinese encroachment.

The purchase of the Canadian firm by CNPC led to the Russian company Lukoil, which owns 25 per cent of the rights to the North Kumkol deposit, to go to both the Court of International Arbitration in Stockholm and the Kazakh courts to claim a preferential right to acquire the deposit. Through this action, Lukoil, which won the lawsuit, secured the rights to the entire reservoir. Lukoil is officially a private oil company but its actions, as is well known in the energy industry, are often in line with the wishes of the Kremlin. Therefore, some authors believe that this action shows that 'Russia is unwilling to allow China to have direct access to Central Asian energy resources'.<sup>33</sup>

Within the SCO, which is paying increasing attention to energy issues, the approaches of Kazakhstan and Russia coincide. Despite the fear of potential dominance, Kazakhstan estimates that China's presence in its oil sector is of strategic importance in the long term. The

Kazakhstan–China oil pipeline has already reduced Kazakhstan's dependence on the old Soviet pipeline network through which the majority of Kazakh oil exports still flow. The new pipeline allows direct access to the global economy, with its ever expanding oil consumption. Moreover, the weight of Chinese companies in the sector, though increasing, is still small in relative terms and barring new purchases of large deposits, their share in total Kazakh production will decrease significantly when the extraction of oil from the offshore Kashagan field, situated in the northern part of the Caspian Sea, begins.<sup>34</sup>

While energy will undoubtedly remain the nucleus of China–Kazakhstan cooperation, Chinese officials hope that in future this cooperation will not remain limited to oil and gas; they believe that it should be extended to clean and renewable energy as well.<sup>35</sup> In that regard, Beijing has singled out nuclear energy as a potentially important sector for bilateral cooperation. In 2011 Kazakhstan, which is well endowed with uranium ore, began exporting the indispensable resource for producing nuclear energy to China.<sup>36</sup>

These developments can only benefit Kazakhstan, as it requires new trading partners if it is to become one of the top five oil producers in the world.<sup>37</sup> President Nazarbayev has also committed his country to diversifying the economy, which can be achieved through major investment in the renewable energy sector.

#### Notes

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(This article will be continued in the next issue of *Khazar Review*)