

London School of Economics and Political Science

China and Kazakhstan:

Economic Hierarchy, Dependency and Political Power?

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Abstract

The thesis uses a neoclassical realist framework to investigate the link between economic influence and political power in China's foreign policy, taking Kazakhstan as a case study. Over the last decades, China developed formidable relative economic capabilities that it increasingly projects externally. An in-depth look at Chinese trade, finance and investment elucidates the drivers of China's economic influence in Kazakhstan. The analysis shows that Beijing created strong economic dependencies, which in turn introduced a steep hierarchy in the bilateral relationship that leaves Astana in a subordinate and Beijing in a dominant position. This dependency is driven by the legitimacy and revenue needs of the Kazakhstani elite, on the one hand, and China's relative economic capabilities, guided by Beijing's "Go Global" and "Go West" initiatives, on the other. The thesis discusses the complex array of economic institutions that project Chinese economic power into Kazakhstan and their relationship with Beijing to determine whether Kazakhstan's economic dependence is the outcome of a deliberate policy directed by Beijing.

After establishing the extent of the hierarchy and dependency of the relationship, the thesis addresses China's ability to translate the dependency into meeting its foreign policy interests. Beijing does indeed successfully leverage this dependency to meet its political objectives, most notably in gaining access to Kazakhstani resources. Furthermore, an in-depth cases study of the Sino-Kazakhstani transboundary water dispute illustrates that Beijing can maximise its foreign policy objective of maintaining absolute sovereignty over its rivers on the back Kazakhstan's economic dependence. However, this outcome is driven largely by Kazakhstan itself, particularly by its elite. This turns China into a hydro-hegemon, undermining its foreign policy principles of "win-win" and "mutually beneficial" cooperation.

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Table of Contents

Chapter 1	Introduction.....	14
1.1	The Economic Variable in China’s Foreign Policy	14
1.1	Thesis Objectives and Methodology.....	19
Chapter 2	Theory	27
2.1	The Link between Economic Influence and Political Power	27
2.2	Hierarchy, Hegemony and Empire in IR.....	31
2.3	Operationalising Economic Dependence.....	34
2.4	Overarching Theoretical Framework: Neoclassical Realism.....	56
Chapter 3	Kazakhstan’s Political System	59
3.1	Power Consolidation	61
3.2	Emergence of the Elite Network.....	66
3.3	Concentration of State Assets and Economic Power	79
3.4	The Elite’s needs drive China’s economic influence.....	85
3.5	Chapter Conclusion.....	118
Chapter 4	The Power of Finance-China as Key Creditor	120
4.1	China’s Creditor Status in Kazakhstan	122
4.2	Kazakhstan’s Banking Crisis	122
4.3	The Impact of Chinese Finance.....	132
4.4	Chinese Conditionality	144
4.5	The Future of Chinese Loans.....	152
4.6	Chapter Conclusion: Financial Dependence	162
Chapter 5	Trade, Investment and Dependency	166
5.1	Sino-Kazakhstani Trade.....	168
5.2	Chinese FDI	193
5.3	Economic Dependence	197
Chapter 6	The Background of the Sino-Kazakhstani Water Dispute as a Case Study	224
6.1	Context of the Sino-Kazakh Water Dispute	225

6.2	Transboundary Water Regimes	227
6.3	China	230
6.4	Kazakhstan	237
6.5	The Sino-Kazakh Transboundary Water Nexus	244
6.6	China's Water Diversion	247
6.7	The Dispute Dynamics	253
6.8	Celebrated Negotiation Outcomes	264
Chapter 7	Dispute Analysis.....	269
7.1	Theoretical Framework.....	270
7.2	China's Bargaining Strategy	271
7.3	Analysis of the Sino-Kazakh Water Dispute.....	280
7.4	Dispute Outcome	316
7.5	Deliberate dispute outcomes?.....	320
7.6	The Elite also Facilitates China's Objectives	323
Chapter 8	Conclusions.....	330
8.1	Economic Dependency	330
8.2	Implications for Chinese Foreign Policy.....	337
8.3	Implications for IR Theory.....	343
8.4	Outlook	346
Bibliography	350

Table of Tables

Table 1 Kazakhstan's External Debt to GDP Ratio	124
Table 2 External Debt of Banks	129
Table 3 Chinese Credit Lines	134

Table of Figures

Figure 1 China's threat to leverage its economic and financial clout to harm Japan's economy.....	18
Figure 2 Oil Rents as Percentage of GDP	52
Figure 3 Domestic facilitators of China's economic influence.....	61
Figure 4 Key Indices on Kazakhstan's Political System	65
Figure 5 Imangali Tasmagambetov	67
Figure 6 Bulat Utemuratov.....	68
Figure 7 Vladimir Kim	70
Figure 8 Vladimir Ni.....	71
Figure 9 Chinese credit Kazakhmys.....	73
Figure 10 Adilbek Dzhaksybekov.....	73
Figure 11 Samruk-Kazyna.....	81
Figure 12 Nazarbayev White House Visit 2006.....	91
Figure 13 World Bank Corruption Rank	95
Figure 14 World Bank Voice and Accountability Ranking.....	96
Figure 15 Nurtay Abykayev	100
Figure 16 Elite Structure.....	104
Figure 17 Kayrat Kelimbetov	106
Figure 18 Vladimir Shkolnik.....	108
Figure 19 Prime Ministers	109
Figure 20 Chinese Foreign Currency Reserves.....	121
Figure 21 Kazakhstan's Annual GDP Growth	123

Figure 22 Top 6 Countries Originating Kazakhstani Debt	126
Figure 23 External Creditors of Kazakhstani Banks.....	132
Figure 24 Stimulus Package and China's Loan to KDB	137
Figure 25 New Lending to the Kazakh Economy.....	139
Figure 26 Non Performing Loans	152
Figure 27 Top 5 Trade Partners of Kazakhstan	168
Figure 28 Kazakhstan's Trade Volume with China and Russia.....	170
Figure 29 GDP growth China and Kazakhstan.....	171
Figure 30 China's Oil Demand and Supply Gap.....	175
Figure 31 Diplomacy follows Economics.....	180
Figure 32 Top 5 Trade Partners.....	183
Figure 33 Top 5 Export Partners of Kazakhstan	184
Figure 34 World Oil Prices.....	188
Figure 35 Kazakhstan's Top 5 Import Partners	189
Figure 36 Labour Productivity in Kazakhstan, 2010.....	191
Figure 37 Top 6 Source Countries of FDI Stock in Kazakhstan.....	193
Figure 38 Gross FDI Flows	194
Figure 39 Chinese FDI and GDP.....	195
Figure 40 Trade, Finance and Diplomacy.....	214
Figure 41 Chinese Crude Oil Imports	219
Figure 42 Map of Kazakhstan.....	224
Figure 43 Global Water Supply in 2008	231
Figure 44 Water demand and supply gap.....	232
Figure 45 National Leading Committee on Climate Change.....	234
Figure 46 Exploitation of River Basins.....	242
Figure 47 Regional GDP 2011.....	245
Figure 48 Project 635 in Xinjiang	247
Figure 49 Irtysh and Ili.....	250
Figure 50 Dispute Timeline	264
Figure 51 Mekong Riparians	275

Figure 52 Reputational Repercussions.....	279
Figure 53 China's First Natural Gas Pipeline	312
Figure 54 Forms of Hydro-Hegemony.....	318

Acronyms

Asian Development Bank	ADB
AktobeMunaiGas	AMG
China Development Bank	CDB
China Export Import Bank	ExIm
China Kazakhstan-Cooperation Committee	CKCC
Collective Security Treaty Organization	CSTO
Environmental Impact Assessment in a Transboundary Context	TEIA
Eurasian Economic Community	EAEC
Eurasian Natural Resources Corporation	ENRC
International Court of Justice	ICJ
International Financial Institution	IFI
International Oil Companies	IOCs
Interstate Commission for Water Coordination of Central Asia	ICWCCA
Kazakhstan China Joint Committee	KCJC
Kazakhstan Development Bank	KDB
KazMunaiGas	KMG
Mekong River Commission	MRC
Ministry of Agriculture	MoA
Ministry of Environment and Pollution	MEP
Ministry of Foreign Affairs	MFA
Ministry of Water Resources	MWR
National Bank of Kazakhstan	NBK
National Development and Reform Commission	NDRC
National Development Bank of China	NDB
National Oil Company	NOC
Samruk Kazyna	SK
Shanghai Cooperation Organization	SCO
Sovereign Wealth Fund	SWF
State Environmental Protection Agency	SEPA
State Owned Enterprises	SOE

Transboundary Environmental Impact Assessment	TEIA
United Nations	UN
UN Convention on the Protection and Use of Transboundary Watercourses and International Lakes	1997 Convention
UN Environment Programme	UNEP
UN Framework Convention on Climate Change	UNFCCC
UN General Assembly	UN GA
Water Resource Committee	WRC
Xinjiang Academy of Environmental Sciences	XAES

Chapter 1 Introduction

*“The Chinese government has money and power.
There is nothing they cannot buy.”*

(Liu Xia, wife of Liu Xiaobo)¹

This dissertation takes the People’s Republic of China’s (China) foreign policy towards the Republic of Kazakhstan (Kazakhstan) as a case study to investigate whether China can translate its economic influence into political power. It will argue that China’s growing economic capabilities enable it to create economic dependencies to pursue political ends, which is the key hypothesis of this thesis. In the case of Kazakhstan, these ends are largely geostrategic goals of ensuring resource security and maximising its claim to absolute sovereignty over shared water resources that are vital to the livelihood and prosperity of the two countries.

1.1 The Economic Variable in China’s Foreign Policy

International Relations (IR) recognises that a state’s power, as reflected in its relative position in the international system, can be broken down into different capabilities, including military, political and economic. China’s renewed rise in the modern international system occurred on the back of its dramatic economic growth, initiated by Deng Xiaoping’s open door policy in the 1970s. Yet China’s external use of its economic capabilities to facilitate its foreign policy objectives is still an understudied field, particularly in Central Asia and Kazakhstan, where it has wielded significant economic influence over the last decade. The need to understand the foreign policy implications of China’s economic rise informed the initial research interest for this thesis. Initially, the thesis set out to investigate

¹ (Tran, 2010)

these Chinese foreign policy implications for the whole of Central Asia, an area that has played a prominent role in China's past.² However, it soon became clear that such a broad perspective on several states would compromise the quality of the dissertation in favour of quantity. To narrow the scope of the thesis, Kazakhstan was chosen as a case study within Central Asia because it has a comparably well-developed economy and because of its popular scepticism of China, or even Sinophobia which should increase the threshold for Beijing³ to translate its economic influence into political power.

As a result of running a continuously high trade surplus, China has accumulated the world's largest foreign currency reserves amounting to US\$3.3 trillion, a fact that Chinese diplomats now also increasingly attempt to use as leverage for political ends. Chinese officials emphasise China's economic capabilities and influence to deter any actions or statements that may interfere with its territorial claims⁴ or domestic affairs, especially its human rights record. For example, Beijing lobbies several members of the United Nations Human Rights Council⁵ actively and threatens them with deteriorating trade relations to prevent the tabling of critical resolutions. A western diplomat interviewed by Chatham House noted recently that "China [has] pursued a very direct strategy of rewards and punishments" (Sceats & Breslin 2012:5). This strategy appears to have been effective with Germany and France, as they no longer table resolutions, anxious to maintain access to China's market for their exports (HRW 1997:4, Geinitz 2012). Such threats from China are generally also followed by diplomatic sanctions, including suspended bilateral meetings and, more frequently, trade sanctions. Liu Xia's comment above succinctly summarises this point: Beijing has the economic capabilities necessary to increasingly force foreign policy outcomes in its favour. However, Beijing does not

² Throughout Chinese histories contemporary Central Asia, along China's north-western frontier had always played a key role in China's security thinking and foreign affairs (Fairbank & Goldman, 2006).

³ The thesis uses the term "Beijing", "Chinese government" and "CPC" synonymously.

⁴ These claims primarily revolve around the status of Taiwan, Tibet and Xinjiang.

⁵ The United Nations Human Rights Council is the successor of the United Nations Commission for Human Rights (UNCHR).

always succeed. Contrary to Liu's prediction, Beijing could not deter the Nobel Committee from awarding the Nobel Peace Prize to her husband, Liu Xiaobo in 2010, most likely because of Norway's overall strong economy and relative economic independence from China. Following the award of the Noble Peace Prize, however, China refused to issue a visa to the former Norwegian Prime Minister, Kjell Magne Bondevik (Ho 2012) and Norwegian salmon exports dropped substantially because of stricter inspections by Chinese custom officials (Amland & Ritter 2011, Bardsley 2011). Similarly, the Dalai Lama presents another discernible point of contention, and engagement with the Dalai Lama has elicited Chinese sanctions in the past. In a telling example, Beijing closed the Chinese offices of the Friedrich Naumann Stiftung (FNS), a German foundation, after it co-sponsored a conference for the Dalai Lama.

Research has in fact shown that China actually makes good on its threats of economic consequences, setting a clear pattern in which bilateral trade drops for two consecutive years after a trade partner receives the Dalai Lama in an official capacity, an insight that will be elaborated upon further in this thesis and is known as the Dalai Lama Effect (Fuchs & Klann, RFI 2008). Another recent example is the significant decline in Sino-Japanese trade following the territorial dispute over the Diaoyu islands in the East China Sea.⁶ However, here Beijing leveraged its economic capabilities more saliently. In 2010, China temporarily suspended its exports of rare earth elements to Japan, an essential for its hi-tech manufacturers (Inoue2010). Interestingly, China's financial power plays an increasingly important role as well. In a China Daily op-ed, Jin Baisong, Deputy Director of the Chinese Academy of International Trade, recommended that Beijing use its financial clout. He suggested that Beijing use as leverage its position as Japan's biggest external buyer of bonds valued US\$230 billion (bn) to cut off Japanese funding (Jin 2011). China had increased its purchase of Japanese government bonds by 70% between 2010 and 2011 and is thus a significant source of financing for Japan's government and by

⁶ Known as the Senkaku islands in Japan

extension, its economy. Pang Li's cartoon that accompanied the op-ed piece candidly captures Beijing's realisation of its economic clout (See Figure 1).

Japan is not an isolated case. China is also the biggest holder of US treasuries, a fact that prompted the Congressional Research Service (CRS) to draft a report in 2008 examining the implications of US dependence on Chinese funding. The report addressed the concern voiced by policy makers and economists "that China might try to use its large holdings of US securities, including US public debt, as leverage against US policies it opposes" and concludes that "attempts by China to unload a large share of its US securities holdings could have a significant negative impact on the US economy [...]" (Morrison & Labonte 2008). However, China's economic interdependence with Japan and the US makes such a move unlikely. China's purchase of US debt indirectly finances Chinese exports and as such forms an important part of China's economy.

China's relationship with Kazakhstan diverges significantly from the type of interdependent relationship between China and the US or Japan. However, these examples do illustrate that China increasingly attempts to leverage its economic power to pursue broader foreign policy objectives, which also defines the research question of this thesis. The thesis will specifically address the causal relationship between economic influence and political ends in the context of a hierarchical⁷ economic relationship. Beijing is Kazakhstan's most important trade partner, key external creditor and an important source of Foreign Direct Investment (FDI), while Kazakhstan represents only a small fraction of Chinese trade and finance. The result is an asymmetrical relationship which Beijing exploits to further its foreign policy goals in Kazakhstan. These broader foreign goals include obtaining further access to Kazakhstani energy resources and maximising Beijing's control over shared water resources.

⁷ The term hierarchy and asymmetry will be used interchangeable throughout the thesis

Figure 1 China's threat to leverage its economic and financial clout to harm Japan's economy



The emergence of an asymmetrical relationship is not new in Chinese history. For centuries, economic variables have played a crucial role in China's engagement with the world and its periphery, including Central Asia. Up until the Qing Dynasty⁸, Chinese Dynasties conducted trade within the Tribute System (Fairbank & Goldman 2006:171), which blended economic capabilities with politics from an early stage. The system was based on conditionality: China's neighbours gained the right to trade with Beijing as long as they recognised the Chinese emperor as the son of heaven and thus China as the leading regional civilisation. The tribute system was, at least in theory, based on Confucian principles that inform a desirable, stable social order which organised relationships along hierarchical pathways. As such, the tribute system was designed to organise and maintain relationships of inequality or hierarchy. From a Chinese point of view, this often fluctuated between economic dependence and interdependencies and thus led to varied degrees of hierarchy⁹. The system also generated a number of political outcomes: it created stability along

⁸ The Qing Dynasty shaped, managed and presided over a long-lasting international order in East Asia, a distinctive international system with its own organizational principles (Zhang 2001:44). Due to its stability and longevity the system is also referred to as Pax Sinica of which the tribute system was part and parcel.

⁹ The relative strength of the Dynasty determined how hierarchical the relationship was. For a discussion on the ordering principles of the tribute system and how the system takes disorder as its starting point see Qin, 2010 (Qin 2010).

China's north-western frontier by fostering economic dependencies, and when this was not possible, by 'buying off local tribes'. The general structure that grew out of the Tribute System made Central Asia part of a Sino-centric regional system with China at its apex, gaining economically from profits generated along the Silk Road. In light of growing academic conjecture about the possibility of a return to a hierarchical system in Eastern and Central Asia (Kang 2007), a study of China's bilateral relationship with Kazakhstan will provide important insights into the implications of China's rise for international politics.

1.1 Thesis Objectives and Methodology

The immediate objective of this research is to understand how Beijing can use as leverage its economic capabilities in an asymmetrical economic relationship to pursue political ends, with Kazakhstan serving as a case study. The hypothesis that lies at the heart of this objective is that China's accumulated economic activities in Kazakhstan have generated an economic dependency of Kazakhstan on China, which China can leverage towards political ends.

This research aims to answer a number of inter-related research questions including (1) whether economic dependency is a deliberate process facilitated by Beijing (Chapter 5), (2) what economic levers drive dependency (Chapters 3-5), (3) whether China can control these levers (Chapter 5), and (4) whether and how Beijing can effectively leverage its economic influence for foreign policy objectives (Chapter 7). The first question will elucidate if Beijing is aware that economic dependencies can be instrumentalised to meet foreign policy objectives and is incentivised to deploy these. The second question will contribute to understand what economic capabilities drive dependencies. The third question will provide insights into whether Beijing can control its economic levers, such as its National Oil

Corporations (NOCs) which is a prerequisite to turning economic influence into a foreign policy instrument. Influence over the investment decisions of SWFs or NOCs should allow policy makers to condition benefits of trade and investment in negotiations. The last question investigates whether Beijing is able to leverage its economic influence and how along a conflict of interest between Kazakhstan and China.

As such the scope of the thesis is limited to understanding whether and how China can translate its economic influence into political power, by taking Sino-Kazakhstani relations as a case study. The thesis is not a comparative case study that investigates whether economic dependencies exist between China and other Central Asian states, or to what degree relations with China differ between these states.

In answering these questions, the thesis also sheds light on the specific characteristics of the bilateral relationship between China and Kazakhstan. Several different drivers that shape China's economic influence in Kazakhstan are identified, including actors involved in China's foreign policymaking, such as government agencies and the large State Owned Enterprises (SOEs). This detailed study enables an analysis of where and how China proactively facilitates economic dependencies and hierarchies and an analysis of how Kazakhstan fits into the formulation of China's foreign policy. The key hypothesis will be split into two parts which will be investigated in two main sections of this thesis.

The first part of the thesis presents a quantitative and qualitative analysis of China's economic influence in Kazakhstan to investigate the hypothesis that China's accumulated economic activities in Kazakhstan have generated an economic dependency. This section will also investigate the drivers and actors of economic dependence such as Kazakhstan's domestic political context a variable that become only salient as this research project progressed, China's National Oil Companies (NOCs) and Financial Institutions (FIs). Based on the results of this analysis, the

thesis proposes a hypothesis about the political leverage that China can derive from its economic influence in Kazakhstan which will then be tested in the second part of the thesis. The hypothesis is supported through a number of sub-hypotheses that were further refined through qualitative data such as interviews and written correspondence within and outside of Kazakhstan, newspaper articles, journals, online resources, reports and government documents. The opacity of the Chinese foreign policy-making process presented a significant obstacle to the research. As a result, the research focused primarily on the outcome of Chinese foreign policy in Kazakhstan, drawing inferences about Chinese foreign policy objectives from there. Unfortunately, this approach also has shortcomings. It is possible that policy outcomes are interpreted as the result of a deliberate choice and process when they are in reality coincidental. The precise drivers of the observed outcomes can only be established beyond doubt if more details are known about the policy-making processes in Beijing.

Interviews were conducted in English and German with officials, diplomats and experts in and outside of Kazakhstan. Most interviews were conducted under strict anonymity. Resources used are in English, Russian, Chinese and German. However, interviews in Kazakhstan were conducted in English, which may have introduced a certain bias towards opinions of a group of individuals who have been very well-educated inside and outside of Kazakhstan and whose views do not necessarily reflect those of the wider Kazakhstani population.

The second part of the thesis subsequently tests China's ability to leverage economic dependencies towards political ends, against an in-depth case study on the Sino-Kazakh water dispute. This case study was chosen for the following reasons:

1. China and Kazakhstan pursue diametrically opposing objectives. In a competitive situation where interests do not overlap, it is possible to observe whether China can maximise its objectives against Kazakhstan's

national interests. In such a competitive situation, it is possible to observe whether China can maximise its objectives against Kazakhstan's interests and determine to what extent Beijing manages to get Kazakhstan's government to make concessions against its own interest. This is in line with Robert A. Dahl's concept of power based on the idea one can affect outcomes (Dahl 1957). It is thus more suitable for this inquiry than situations in which China's and Kazakhstan's interests overlap.

2. The dispute takes place in an area of international relations that is regulated but suffers from significant enforcement weaknesses. This setting can elucidate insights into China's foreign policy because its actions are less constrained than in many other areas. This also applies to Kazakhstan's geo-strategic setting. Unlike along its south-eastern periphery, Beijing's foreign policy is less constrained in Kazakhstan through a softer presence of great powers such as the US.
3. The Sino-Kazakh water dispute has arguably been overlooked in IR research and the thesis aims to fill this academic gap.

The thesis will proceed as follows:

Part I starts with a discussion of Kazakhstan's political system to provide a wider context against which China grows its economic influence in Kazakhstan. This is not reflecting the chronological progress of this research as Kazakhstan's domestic politics became a variable only towards the end of this research project. However, the author decided to place this chapter at the beginning of the thesis to provide the reader with some context against which the following chapters will be discussed. The chapter on Kazakhstan's political landscape illustrates that Kazakhstan's political elite is an important variable that facilitates China's growing economic influence. Part I goes on to analyse Chinese finance, trade and investment in Kazakhstan based on criteria developed in the theory chapter, demonstrating that Kazakhstan has become economically dependent on China thereby introducing

a steep hierarchy in the bilateral relationship. The financial crisis of 2009 was an inflection point that accelerated China's dominance as Kazakhstan's key external creditor and top trade partner. This dependency is driven by Beijing's objectives and Kazakhstan's ruling elite, which uses Chinese investment to consolidate its power and to maintain power by meeting its revenue needs. Part I concludes with a discussion of Chinese actors involved in extending China's economic capabilities into Kazakhstan, as well as the immediate outcomes for Beijing. China's overall economic involvement in Kazakhstan implies that it has become a stakeholder in the country and Beijing is now deeply invested in Kazakhstan's political and economic stability, which also feeds into the on-going debate in China on the role of the People's Liberation Army (PLA) in protecting Chinese assets abroad.

Below is an overview of the hypothesis and sub-hypotheses that this thesis will investigate including chapter references. Some of these sub-hypotheses were adjusted whilst research progressed. An analysis into the causes of economic dependency revealed that Kazakhstan's political system is an important variable. However, an analysis into the full extent of this role is somewhat limited by the scope of this research whose primary objective is to understand whether China can leverage economic dependencies. The next chapter will provide further background on how the below hypotheses were developed.

Lead Hypothesis: China's accumulated economic activities in Kazakhstan have generated an economic dependency of Kazakhstan on China (A), which China can leverage towards political ends (B). The lead hypothesis will be split into two secondary hypotheses that are tested through Part I and Part II of the thesis.

(A) China's accumulated economic activities in Kazakhstan have created an economic dependency. This will be discussed in Chapters 3 and 4 based on the following sub-hypotheses:

1. China's financial influence in Kazakhstan has built significant dependencies especially after the Global Financial Crisis driven by the fact that China has become the lender of last resort. This will be discussed in Chapter 4
2. China is Kazakhstan's most important trading partner and a key source of foreign direct investment which further facilitates economic dependencies driven by the economic complementarity of both economies and their geographic proximity. This will be discussed in Chapter 5.
3. Before 2005, China's prominent trade and investment position was driven without significant political support from Beijing; however since 2009 Beijing's political support has become more direct. This will be discussed in Chapter 5.

(B) China can leverage these dependencies if it effectively controls the drivers of economic influence or if Kazakhstani policy makers perceive of such control

4. On the aggregate level, Beijing does not control the levers of economic influence in Kazakhstan. This will be discussed in Chapter 5
5. Chinese drivers of trade and investment are especially China's NOC which proactively enlisted Beijing's help to overcome Kazakhstan's resistance to further Chinese resource investments. This will be discussed in Chapter 5.
6. Kazakhstani decision makers perceive of China as a unitary actor in terms of economic activity and perceive it credible that Beijing can control the levers of its economic influence. This will be discussed in Chapter 5.

Part II of this thesis analyses whether China can use its economic position as leverage to meet foreign policy objectives, using an in-depth case study. Beijing extracts water from a transboundary water source over which Astana and Beijing

have been in dispute for over twenty years. A detailed analysis of the dispute reveals that Beijing can use its economic power as leverage in Kazakhstan to maximise its foreign policy goals at the expense of Kazakhstan's national interest. The Kazakhstani government deliberately decides not to challenge Beijing and thus enables China to continue with its water abstractions at the expense of Kazakhstan's access to a fresh water supply (Dahl 1957). The case study takes place in an area of international environmental cooperation, which is increasingly regulated by state practice, universally-acknowledged conventions and international environmental law. And whilst this space has seen some of the earliest forms of inter-national cooperation and even supra-national institution building, it also suffers from perceived weaknesses associated with the implementation of international environmental law that China seeks to exploit. The thesis will conclude that Kazakhstan's domestic context is a key variable that fosters China's economic influence and allows Beijing to manipulate its economic influence towards political ends. This is less the outcome of a deliberate Chinese foreign policy strategy towards Kazakhstan than a result of Kazakhstan's increased demand for revenues, driven by the elite.

Hypotheses of Part II

Secondary hypothesis: China can leverage its economic dependence in Kazakhstan to pursue political interests, especially in its water dispute with Kazakhstan, where China is able to pursue its foreign policy interests. This will be discussed in Part II of the thesis.

Sub- hypotheses that were developed as research for this thesis progressed:

1. Kazakhstani decision makers avoid antagonising Beijing and instead acquiesce with Beijing's interests because of Kazakhstan's economic dependence on China. This will be discussed in Chapter 7.

2. Kazakhstan's economic dependence can better explain its behaviour in the dispute than alternative theories, especially those that draw on Kazakhstan's Soviet legacy. This will be discussed in Chapter 7.
3. Kazakhstan undermines its own bargaining position through its reluctance to improve water consumption at home. This will be discussed in Chapter 7.
4. It is unlikely that Beijing exerts direct threats in the water dispute, rather Kazakhstani policy makers pre-emptively acquiesce Beijing to maximise future revenue opportunities through China's economic involvement in Kazakhstan. This will be discussed in Chapter 7.
5. In its water dispute with Kazakhstan, China applies lessons learnt from a similar conflict along the Mekong River. This will be discussed in Chapter 8.

Chapter 2 Theory

2.1 The Link between Economic Influence and Political Power

IR acknowledges that economics is part of a state's overall capabilities, which in turn determine its relative position in the international system. Baldwin suggests that economic means are one way to exert power in international relations by: "Augmenting or reducing the goods and services available to other countries has a long history in world politics" (Baldwin 2013: 277).¹⁰ Although the link between economic capabilities and political objectives appears intuitive at first, the subject is still under-theorised in IR and mostly focuses on security (high level politics) and sanctions (Baldwin 1985). The imposition of sanctions or trade restrictions seeks to change the behaviour of the target state, by depriving it of revenues linked to trade. For example, Economic Diplomacy, a subfield of IR analyses the role of economics in foreign policy. However, it places most emphasis on sanctions, and scrutinises multilateral economic negotiation and cooperation in a global setting, such as the G8. For example, Economic Diplomacy analyses how business actors contribute to global negotiations such as climate change (Falkner 2003, Fuchs 2005, Bayne & Woolcock 2007).

Similarly, Dependencia scholars analyse the economic relationships between states. However, although Dependencia literature would lend itself to this thesis by name, it does not support the research question at hand because of its different research objective, epistemology and premise. The origin of Dependencia scholarship is closely linked to Raul Prebisch, the Director of the United Nations Economic Commission for Latin America. The Commission observed in the second half of the twentieth century that South American economies stagnated in their development whilst others, especially the US and Europe made great strides (Ferraro 2009). This informed an ensuing academic debate with the primary objective to locate and

¹⁰ Carlsnaes, Risse and Simmons (2013): Handbook of International Relations.

understand the causes of underdevelopment in countries in the developing world, especially South America. The prevailing view was that developing countries were locked into an international capital system that curtailed their autonomy and significantly limited the ability of governments to shape their own path to economic development. Economic development is understood as producing economic growth but also industrialisation in the broadest sense. As such Dependencia scholars operate with a developmental concept of dependence. Dependencia scholars shifted the focus away from domestic factors to exogenous variables. However, as will be discussed in greater detail further on, Dependencia offers limited insight into the research question at hand, especially into questions about how economic dependencies can be defined, facilitated and operationalised to serve as political leverage. Moreover, an emerging body of research challenges Dependencia's approach to and explanatory capacity for underdevelopment, by refocusing on the importance of domestic institutions in fostering economic development and competitiveness.¹¹

IR theories have focused less on how states use their economic power to affect the economy of another state in order to further their foreign policy objectives, in a manner that falls short of or precedes outright trade sanctions. For example in their comprehensive analysis of China's economic impact on Latin America, Rhys Jenkins and Enrique Dussel Peters (eds.) narrowly focus on the economic impact that China has on this region but exclude its political consequences (Jenkins and Dussel Peters 2009).

The potential of economic influence to generate political outcomes lies at the heart of the First Great Debate in IR and has shaped the development of the discipline until today. In 'The Great Illusion', published in 1910, Norman Angell argued for the

¹¹ For examples "Why Nations Fail: The Origins of Power, Prosperity", by Acemoglu and Robinson, and "Pillars of Prosperity: The Political Economics of Development Clusters" by Besley and Persson. Both publications focus on organisational design and argue that the quality of public institutions determines economic development. These theories are geographically agnostic and propose answers beyond Latin America's historical experience

constraining effects of economic interdependence on political conflict. Using cost-benefit calculations, Angell concluded that bilateral trade made war too expensive a choice for either trade partner. His book was extremely popular among the intellectual and political elites in Europe.¹² However, the outbreak of WW1 just four years later highlighted that the relationship between trade and political outcomes can take unpredictable forms and led to E.H Carr's famous Realist response. Nevertheless, Angell laid the foundation for modern IR scholars such as Robert Keohane and Joseph Nye, who link economic interdependence to a relational concept of power and argue that "power deriv(es) from patterns of asymmetrical interdependence between actors in the issue-areas in which they are involved with one another" (Keohane & Nye 1973, 1977 and 1987). Keohane and Nye build on Albert Hirschman's work who argues that the economic relationship between two nations can generate political influence because the potential of interrupting that economic relationship (i.e. trade) increases the bargaining power of the economic partner who can more easily cope with the loss of that economic relationship (Hirschman 1945). However, like Hirschman Keohane and Nye do not define the causal mechanism by which states manage to translate that asymmetry into political power (Crescenzi, 2003).

For analytical clarity, such asymmetrical interdependence can be simply labelled as 'dependence'. The term 'interdependence' implies a mutual level of dependence, which rarely exists in relations between states. Lake makes this point clear:

"Trade has long been understood to create the potential for political influence [...]. If a state has many trade partners it is likely to have greater political autonomy and any attempt to manipulate trade for political purposes will be ineffective. If a state is highly dependent on

¹² For example Barbara Tuchman's "The Guns of August" assumed cult status within a very short period of time, and although widely read by decision makers could not stymie the dynamics leading to World War I (Tuchman 1965).

trade with another, however, it is vulnerable to the influence of that state.” (Lake 2009:47)

As exemplified in Lake’s statement above, relevant IR theories usually focus on trade which can be used for foreign policy gains, if it creates relationships of dependencies that in turn have the potential to provide political leverage (Lake 2009, Hirschman 1980, Keohane & Nye 1977, Baldwin 1985). However, because IR literature predominantly focuses on trade, it implicitly equates a country’s trade capabilities with its economic capabilities and thereby neglects other levers including finance and investment. There is no reason why a trade-related theory cannot apply to finance and investment as well. Taken together, these components can create dependencies that result in an asymmetrical relationship between two states. It is this asymmetrical or hierarchic nature of an economic relationship that connotes a “relationship of subordination” (Baldwin 1996) and which serves as the intermediary between economic influence and political power. Hierarchy creates the possibility to employ economic means towards political ends (Kahler & Kastner 2006, Lake 2007, Baldwin 1995).¹³ These asymmetrical relationships also underlie the rationale for international sanctions. The UN imposes sanctions against specific regimes in the hope of exploiting such dependencies and bringing about behavioural changes in the target country. In other words, sanctions can only be operationalised because they impose more damage on the target state than on the host state. However, as will be discussed further below, sanctions are the last resort of policy options. In the case of Kazakhstan’s dependence on China, this thesis will demonstrate that it is the fear of a reduction in overall future economic investment rather than sanctions themselves that drives the thinking of Kazakhstani decision makers.

This poses the question as to why China is interested in proactively pursuing such dependencies in the first place. Drawing on contractual theory, Lake argues that countries deliberately pursue hierarchical relationships to fend off the opportunity

¹³ The term ‘dependence’ will be operationalised further below.

costs associated with the defection of their partner. These costs in turn are determined by the degree to which their partner's assets are relationally specific, which describes how easily they can be substituted (Lake 1999:8). Lake illustrates the concept alongside the US military strategy since 1945, which involved building a forward-based defence strategy in the Pacific based on a seamless net of naval bases. However, geo-strategically the net was only effective with the participation of specific countries including the Philippines, Japan and Guam. To prevent these countries from defecting or exploiting their status, the US locked them into hierarchical relationships of dependence (Lake 1999). Although Lake has primarily developed his concept with security cooperation in mind, his underlying logic is applicable wherever cooperation and transactions take place: the more relationally specific a country's assets are, the higher the opportunity costs associated with a 'defection' for its partner. In Kazakhstan's case, Beijing has an incentive to lock Kazakhstan into such a hierarchical relationship, because it is heavily invested in Kazakhstani oil and gas resources and infrastructure on the ground. Energy resources are highly specific geographically and difficult to substitute. Energy cooperation with Kazakhstan plays an increasingly important role in Beijing's energy security and the hierarchical relationship prevents Astana from defecting from these arrangements (Chapter 4).

2.2 Hierarchy, Hegemony and Empire in IR

The Westphalian legalist concept of state sovereignty obscures our understanding of the fact that states are not equal in practice (Lake 2009, Tucker 1977). In reality, many international relations bear striking asymmetries and are thus hierarchic (Clark 1989, Tucker 1977). For example, the relationship between the US and Canada or China and Cambodia is not one of economic or political equals. This is also highlighted by the UN Security Council, where the permanent five members (P5) wield significantly more power in and beyond the organisation.

By extension, economic hierarchies are embedded in the wider debate on the nature of empire and hegemony in IR. For example, Michael Doyle, the leading authority on empire studies, defines an empire as a relationship of effective political control imposed by some societies over the effective sovereignty of other societies (Doyle 1986:12). The key indicator is the dominant metropole's direct or indirect control of the foreign and domestic policies of another country (Doyle 1986: 12). Imperialism is driven by a mix of economic, military, political, social and cultural instruments. Hegemony in contrast limits such control to a state's foreign policy (Doyle 1986:40). Both views capture extreme forms of dependency where states lose their external or internal sovereignty, or both. This perspectives also fail to recognise that sovereignty is multifaceted and divisible into different components (Lake 2007: 57); a state can lose its sovereignty in one issue area, for example, to set an independent monetary policy but maintain its sovereignty in another, such as its decisions concerning what alliances or organisations to join. Analytically, this offers a helpful framework to discern how China uses its economic influence effectively as leverage in only a selected or narrow set of issues, without comprehensively eroding Kazakhstan's internal or external sovereignty.

The thesis will argue that while China leverages its economic weight in Kazakhstan to maximise its foreign policy objectives at the expense of Kazakhstan's national interests, this falls short of attaining comprehensive control over Kazakhstan's foreign policy. Nevertheless, even if hierarchical relationships lead to the selective infringement of a state's sovereignty, they can be the precursors to hegemony and, in extreme cases, to empires. As the case study in this thesis will show, Beijing now controls the bilateral agenda and a narrow set of outcomes on certain issues in the bilateral relationship which, taken together, can be interpreted as early signs of a developing hegemony.

Lake alludes to such partial infringements when he proposes the possibility of a middle way by defining a hierarchy as a complex relationship between two actors

“[...] when one actor, the dominant state, possesses authority over another actor, the subordinate state. Authority is never total, of course, but varies in extent.” (Lake 2007:56)

However, he recognises that political power and forms of coercion are inextricably linked and often difficult to disentangle (Lake 2007:50), because authority is based on the subordinate state's recognition that the dominant state's authority is legitimate. This implies a certain willingness by the subordinate state to comply with the authority or interests of the dominant state. According to Lake, a state's failure to diversify its trade partners or by extension to change the root of its dependence is in fact an implicit acknowledgement of the dominant state's legitimate authority. Such a view of legitimate political authority draws heavily on Max Weber's acknowledgement that legitimate authority (Herrschaft) is a special sub-type of power (Macht). Indeed, this thesis will show that Kazakhstan does not diversify its economic partners away from China. However, Astana likely submits to Chinese interests not because it recognises Beijing's authority as legitimate but because it acknowledges that economic dependence on China may be the price or opportunity cost to maintaining its political power structure. This power structure refers to the particular distribution of power in Kazakhstan in the hands of small elite that turns to Chinese trade, finance and investment to stay in power (Chapter 2). Although Lake's distinction between legitimate power and coercion is difficult to apply to the Sino-Kazakh relationship, Kazakhstan's economic dependence allows Beijing to exert some form of political control. This thesis highlights several situations where Kazakhstan acquiesces to Chinese interests despite acting against its own national interests, as would be expected by Dahl's definition of relational power (Dahl 1957).¹⁴

¹⁴ Dahl defines power as getting one party to do what it would not do otherwise (Dahl 1957).

2.3 Operationalising Economic Dependence

Focusing on trade alone oversimplifies the analysis of the politics of international economic relationships between China and Kazakhstan. A comprehensive analysis must take the sum of all economic components into consideration. Finance and investment, have a big impact on the overall level of economic dependence, which can then be translated into political gains. This thesis will, therefore, analyse the weight of China's economic presence in Kazakhstan for finance, trade and investment. Such an approach can provide greater analytical insights into the actors and drivers within each of these economic levers. The following section proposes definitions for dependence that can be applied to trade, finance and investment. However, a distinctive challenge emerges in any attempt to operationalise economic dependency. The body of IR literature on the link between economic influence and political power is small and overwhelmingly concerned with trade relationships. Hence, some of the reasoning of this thesis extends the existing theory to the finance and investment fields as well.

Notions of dependence are referenced and employed across many IR paradigms. Indeed, one of the contentious points that fuel the on-going debates between Realists and Liberalists focuses on the role that dependence can play in mitigating the effects of anarchy on international cooperation.

Nye and Keohane deal extensively with the notion of complex interdependence and its positive effects on international cooperation (Nye and Keohane 2011). They posit that a specific version of dependence, namely inter-dependence, mitigates the effects of international anarchy and allows states to cooperate successfully. This is based on the premise that states seek absolute, rather than relative cooperation gains. Realists refute this assumption and maintain that interdependence has no lasting effect on systemic anarchy because of their premise that states are primarily concerned with relative and not absolute gains and thus refuse to enter a

cooperative agreement which allows the cooperation partner to benefit more in relative terms.¹⁵

Because of semantic similarities, a discussion of dependence invokes connotations of Dependencia literature, which belongs to the Marxist and Post-Modern traditions in IR. However, as briefly discussed earlier, Dependencia differs significantly from the research interest of this thesis in terms of the theory's research objective and methodology. More specifically Dependencia's structural view of historic interactions between the metropole and its periphery is not applicable to the Sino-Kazakhstani relationship. Dependencia also lacks a definition of the term dependence and applies dependence differently from the thesis. The following paragraphs will elaborate these differences and use Dependencia to illustrate that, the concept of dependence itself is still under-theorised, despite its frequent use across IR theories, which posits obstacles to its operationalisation.

Dependencia theory emerged in response to the observation that developed countries especially the USA progressed in their economic development whereas the developing economies of Latin America stagnated or even reversed. Dependencia critiqued the then predominant development theories which located the causes for economic under-development in a country's domestic setting, especially in its "soft" social factors such as religion and culture (Friedmann & Wayne 1977). Instead Dependencia scholars such as Frank (1969) and Brett (1974) broke with this view and shifted the focus to external factors by drawing on a model of the international capital system that explained various stages of economic development through exogenous historic factors (Kuhnen 1987).

The root for dependence is seen in the historic relationships between the developed world (metropolis) and the underdeveloped world (periphery), perhaps best captured in the period of Colonialism. Advanced economies such as the US or

¹⁵ For a discussion about the different assumptions of Neoliberalism and Realism on conditions for international cooperation see Hasenclever et. al. (2000)

Europe (metropolis) are at the centre of the world economy. By integrating developing economies (periphery) the metropolis constrains their economic development. For example, colonisation forced under-developed economies to integrate into the international capital system and to transfer their surplus in technological knowledge, productivity or resources to the core (developed world) through disadvantageous trade agreements. This led to the systematic exploitation of developing countries and their economic stagnation.

This historical interaction between metropole and periphery creates a structure that continually recreates and thus reaffirms the state of underdevelopment (Wayne 1977). Developing countries cannot break free from this asymmetric relationship as long as they participate in the international capital system.

Although Dependencia scholars contribute to our understanding of the causes of various levels of economic development, they do not further the research objective of this thesis which does not investigate the level of economic development in Kazakhstan or China. Instead it investigates how economic influence can be operationalised for foreign policy purposes. A Dependencia guided analysis of China's economic influence in Kazakhstan could produce paradoxical results and prescribe solutions that could further exacerbate those factors that facilitate Kazakhstan's dependence on China. Because Dependencia scholars consider the integration into the international capital system as a key inhibitor to economic development, they view an exit as the solution such as greater nationalisation and state involvement in the economy. However, as the thesis will show, it is the nationalisation of resources and centralisation of economic assets under state control that facilitate Kazakhstan's economic dependence on China. Thus liberalisation of the economy can break this dependency and limit the scope for nepotism and corruption which made Kazakhstan's economy and especially its financial system vulnerable- a vulnerability that allowed Beijing to expand its economic influence with acquiescence of the Kazakhstani regime.

A Dependencia guided analysis does not capture the Sino-Kazakhstani relationship. Accordingly, China should be conceptualised as the periphery and Kazakhstan as the metropole, given that China's level of economic development is lower than Kazakhstan's. Kazakhstan ranks 69th on the UN's 2012 Human Development Index (HDI) with "High Human Development" and China 101st as a Medium Human Development country. Thus Dependencia takes China's dependence on Kazakhstan as a point of departure. However, the thesis will demonstrate that in economic terms the reverse holds true. Similarly, if one considers income instead of development Kazakhstan and China are on par as "upper middle-income" countries (WorldBank 2013a, WorldBank 2013b) which does not accommodate a dependency relationship based on Dependencia.

Furthermore, the history of Sino-Kazakhstani relations is relatively young and lacks a colonial component. Both established diplomatic relations only in 1992. Similarly, Kazakhstan and China sought to integrate into the world capital system at a similar time given the broader historic context: Kazakhstan, following its independence from the Soviet Union in 1992 and China thirteen years earlier following Deng Xiaopeng's open door policy. A metropole-periphery view might be better suited to an analysis of Kazakhstan's relationship with Russia if conceptualised as a relationship between a former colony and colonial power. However, this view is not uncontested among Dependencia scholars.

Even if one conceptualises China as the Metropole Kazakhstan is not locked in a hierarchical relationship that leaves it with little control over its economic development. It was perhaps the most striking finding of this thesis that Kazakhstan's economic dependence on China is not so much the result of Kazakhstan's structural and historic circumstances but rather the result of intrinsic weaknesses in Kazakhstan's politico-economic structure and the foreign policy decisions of its ruling elite. In theory, Kazakhstan has the choice to diversify its foreign trade, finance and investment sources widely, however instead Astana

seeks an economic dependence on China by choice, because the regime likely views the associated opportunity costs as acceptable trade-offs. Dependencia does not account for such a voluntary submission to dependence. Instead, the author found Neoclassic Realism much better suited to produce insights into Chinese foreign policy towards Kazakhstan.

Neoclassical Realism may be limited in acknowledging the full extent to which Kazakhstan's political system drives these outcomes with China, especially its authoritarian characteristics. Field research revealed that Kazakhstan closely resembles a neopatrimonial Rentier State¹⁶, a governance structure which appears to further exacerbate Kazakhstan's growing economic dependency on China because of economic weaknesses and different cost-benefit calculations associated with such a regime. However, it is also possible that Kazakhstan concedes to Chinese interests because both nations are governed by authoritarian regimes. For example, the research for this thesis found indicators that Kazakhstani politicians have incentives to accept credit lines from China because they are disbursed in an in-transparent manner, shielded from public scrutiny, which is a common characteristic of authoritarian states. However, the potential effect of this variable falls outside the analytical lens of Neoclassical Realism. The genesis of authoritarian regimes and the role that regime consent plays between such regimes, rather than economic factors is perhaps better captured by scholarship on authoritarian diffusion¹⁷. Brinks and Coppedge for example developed a data base which shows

¹⁶Terry Lynn Karl a leading scholar on oil exporters defines a Rentier State as a "state that lives from externally generated rents rather than the surplus production of the population." (Karl 2007:2). In a neopatrimonial state the ruler directs "all political decisions through a network of personal relationships" (Pawelka, cited in Franke et al 2009). The right to rule is embodied in a person not an institution and authority is exercised through transfers of public resources. Personal loyalty and dependence relationships define the entire system. "Neopatrimonial" initially described a distinct form of governance in Sub-Saharan countries but has recently been applied to Central Asian regimes where the head of state derives authority and legitimacy from patronage networks. The right to rule is embodied in a person not an institution and authority is exercised through transfers of public resources. Personal loyalty and dependence relationships define the entire system.

¹⁷ Scholars who investigate regime diffusion in Central Asia include Tomila Lankina (2006). Thomas Ambrosio (2009) and Jeffrey Kopstein, et al. (2000), Brinks & Coppedge (2006), Kathleen Collins (2006)

that the geographic proximity of countries appears to affect the diffusion of specific regime types (Brinks and Coppedge, 2006). Students of diffusion studies may find especially Chapter 3 on Kazakhstan's political system and the case study of this thesis insightful in terms of how two authoritarian states engage with each other. However, the effects of diffusion and an analysis of whether and how the geographic proximity to China can explain why Kazakhstan features a specific regime type today, namely that of a Neopatrimonial Rentier State, rests outside the scope of this research.

Dependency

Like other theories in IR that reference dependence, Dependencia scholars rarely operationalise the term itself (Caporaso 1978). "Dependency" and "dependent" are often treated synonymously. Where scholars distinguish, "dependency" connotes the lack of a state's autonomy over its economic development goals (Caporaso 1978) and "dependence" implies reliance on others. However, "dependency" which rests at the heart of Dependencia "[...] can only be understood (i.e. it's original and intended meaning preserved) only within a certain body of historical, political, and sociological thought" (Caporaso 1978:19). Caporaso goes even further and argues that "[...] dependency is not a concept in a theory at all but a synoptic term for a body of theory" (Caporaso 1978:19). Similarly, Duvall argues: "In the Dependencia "language" tradition then, the term dependence is intended to connote a general "frame" rather than a precise data container" (Duvall 1978: 57).

Dependencia scholars are divided over the question on whether dependence should be operationalised at all. Duvall argues that "Dependencia theory can be about dependence without dependence being a central concept *in* theory [...]" (Duvall 1978:63) and a theory that is called Dependencia does not necessarily have to feature dependence as a concept. To elucidate Dependencia's specific

understanding of dependence, Duvall borrows Keohane and Nye's distinction between sensitivity dependence and vulnerability dependence, where the latter constitutes a form of subordination (Duvall 1978:62f) and implies the vulnerability of one state to an influence attempt by another state (Crescenzi: 28). However, Dependencia scholars reject this form of dependence over dependence as a conditional relationship.

“When dependence is used in the sense of a relation of support or subordination, a different orientation to measurement is called for. In particular, to measure dependence in the subordinate view is to assess an actor's costs or needs and to determine the extent to which these are affected by the actions of another actor(s). “[T]his concept is not of much relevance to dependencia theory, which is my primary concern [...]”. (Duvall 1978:67)

Consequently Dependencia does not lend itself to a positivist research methodology. Instead the thesis will draw on IPE scholarship to operationalise dependency. It will draw on a notion of dependence that necessitates subordination and explicitly incorporates costs and benefit calculations which capture the costs that any change in the relationship incurs on the dependent party (Lake2006). As such, dependence serves as the intermediary between economic influence and political power and can only work if distinctive costs are associated with breaking that dependence relationship, which incentivise the subordinate country in acquiescing with the dominant country's interests. For example, Baldwin's views dependence as an asymmetrical relationship where it is more costly for one party than the other to break the relationship (Baldwin 1980). This is comparable to a net position, where the costs for one economic partner have to be significantly higher than for the other, relative to their own economy and political system. Because it is more costly for Kazakhstan to forego its economic relationship with China, then vice-versa, China gains the necessary leverage to use this dependence to meet foreign policy objectives. The methodology and operationalization of dependence will be discussed further below.

Neoclassic Realism can accommodate a hierarchical view of international relations, where dependency connotes a form of subordination and align this view with a positivist research design that operationalises dependence in cost-benefit terms. For example, Gerry Simpson posits that

“[...]the term hierarchy is...(typically used) by International Relations scholars to describe a system in which political, economic, and social status among the actors is highly differentiated even though these actors enjoy some measure of formal sovereign equality. Hierarchy, here...simply refers to the grading of states on the basis of relative capacity”. (Simpson 2004 cited in Lake 2006:123).”

Thus hierarchies are the outcome of skewed distributions of capabilities in the international system, a view that is compatible with a Realist research design (Lake 2006). China’s relative economic capability is the most important independent variable in this thesis and is the prerequisite to building economic dependencies. However, because the term dependence is under-theorised the thesis will borrow from IPE scholars such as Katherine Barbieri (1995), John Oneal and Bruce Russett (1997), and David A Lake (2009) to operationalize dependency.

Barbieri, Orneal and Russett take the bilateral trade volume as a starting point and compare this to each trade partner’s GDP or total trade. Through additional mathematical manipulation this can be expressed along a spectrum from zero to one, where zero represents a perfect symmetrical interdependence and one an absolute asymmetrical dependence, or a perfect hierarchy. These measurements describe whether an economic relationship between two states is hierarchical. However, they do not identify the actual mechanism that can turn hierarchy into dependency.

Similarly, Lake assesses a country’s relative trade dependence on the US by taking each country’s total trade with the US, dividing it by its own GDP, and subtracting similar ratios for a peer group containing the P5 of the United Nations Security

Council (UNSC). The scale ranges from zero (no dependence) to one (highly dependent). This means a state is considered dependent if its trade with the US as a percentage of its GDP outweighs all remaining P5 members. Lake found that Canada's relationship with the US was highly dependent, especially in the mid-1990s (Lake 2009).¹⁸ However, this ignores the level of mutual economic dependency (interdependency). Although Lake found that Canadian trade was highly dependent on the US, his approach does not capture the fact that both countries are each other's largest trade partners. Thus, manipulating trade for political objectives would be a high risk strategy. The above approaches measure economic symmetry but fail to take the wider context into consideration which is essential (MacDonald 2008, Crescenzi 2005). The existence of hierarchy alone does not drive political power. Instead opportunity costs conceptualised as the costs associated with the interruption of economic relationships, are the causal mechanism that translates economic hierarchy into dependence. These opportunity costs can be located both on the systemic and domestic level and capture the context against which economic asymmetry plays out (Crescenzi 2005).

For example, if China decreases the import of Kazakhstani oil this will incur costs for Kazakhstan, in the form of decreasing revenues. However, if Kazakhstan can switch easily to an alternative export partner these opportunity costs should be low and thus Beijing's ability to leverage the asymmetrical relationship (Crescenzi 2005:31). Other contextual variables that affect Kazakhstan's opportunity costs are its landlocked geography; its proximity to China; its resource-dependent economy and its political system. A focus on opportunity costs also reflects the difference between sensitivity and vulnerability dependence:

"A state has to be affected by changes in the behaviour of another state. This is a necessary but not sufficient condition for dependence. However, if the costs associated with these changes are high because

¹⁸ Lake measures dependence along four indicators: independence, trade dependence, security dependence and alliances and recognises the cross-over effects into political issues (Lake 2007).

the state cannot substitute/find alternatives quickly, the state is economically dependent and vulnerable.” (Crescenzi 2005: 28)

Baldwin, Kastner, and Crescenzi take opportunity costs into consideration when assessing trade dependence (Lake 2009, Baldwin 1980, Kastner 2009).¹⁹ Baldwin maintains that

“The concept of cost is particularly relevant to analysing dependency, since dependency implies that the opportunity costs of foregoing the relationship are high. If state B must forego warm homes, fully employed factories, adequate transportation systems, and high living standards, when state A stops exporting oil, state B is dependent on state A for oil. If, on the other hand, state B can easily get its oil elsewhere or if it is indifferent to warm homes, etc., it is not very dependent on state A with respect to oil. “(Baldwin 1980: 499)

Based on the discussion above the thesis proposes a mix of quantitative and qualitative criteria to assess economic dependency. The thesis will investigate the absolute value of Kazakhstan’s economic relationship with China. However, this value alone is meaningless. For example understanding that Sino-Kazakhstani trade amounted to approximately US\$25bn in 2011 does not elucidate the impact on Kazakhstan’s economy. A peer group comparison with the top bilateral trade partners, as well as an analysis of how important the trade value is to the local economy and political system offers greater insight into the impact that such a trade relationship has on Kazakhstan’s economy based on the opportunity costs associated with it.

Opportunity costs capture how difficult it is for the government to switch to alternative trade partners and what impact a loss of trade would have on the local economy. A trade partner’s relative position provides a first indicator. Arguably, it

¹⁹ Kastner shows how economic integration raises the costs of war between China and Taiwan. Taiwan can in theory, exploit these transaction costs to move closer to sovereignty (Kastner 2009).

will be more difficult to substitute for declining income if the economic partner is the largest economic partner of the target country rather than if the partner ranks in the top quartile. Growth rates furthermore indicate the trajectory of the relationship. An economic relationship that has stagnated is easier to forego than an economic relationship with momentum. This also links in with the expectation of future economic benefits, another dimension that facilitates dependence (discussed below).

A qualitative assessment includes an analysis of asset specificity, market structure, and political costs. The first two criteria build on Crescenzi's work and investigate what role China's economic influence plays in Kazakhstan's wider economy (Crescenzi 2003, 2005). Market structure refers to the ability to easily substitute for decreasing economic activity from China both externally and internally by shifting the factors of the economy to other industries (Crescenzi 2005). This takes the specific structure of Kazakhstan's economy into consideration such as its reliance on commodity exports or its over-leveraged financial system. External alternatives are different economic partners. In the absence of alternatives dependency is most pronounced such as in Kazakhstan's financial sector, where China has become the lender of last resort. Geography can also be affected opportunity costs such as Kazakhstan's landlocked position, or its proximity to China which facilitates cross-border trade and an export infrastructure for oil. Asset specificity refers to how easily an asset can be shifted towards alternative uses or users (Crescenzi 2005). For example, a pipeline is an asset which is difficult to be shifted towards an alternative use or user. Political costs on the other hand assess China's economic influence on Kazakhstan's political system, especially regime legitimacy (discussed below).

Opportunity costs can be considered too high if they become unacceptable to policy makers. This is aligned with Baldwin's definition of dependence as "the ease of breaking the relationship" (Baldwin 1980:476). If it is significantly easier for one

trade partner to forego the bilateral trade relationship the dominant state can feasibly manipulate trade to achieve political objectives (Kahler & Kastner 2006: 527). Although, most of the cited research focuses on trade, it is possible to apply these criteria to the finance and investment levers as well, where dependence similarly occurs in the absence of viable alternative sources of funding, or where these alternatives are associated with high opportunity costs for Kazakhstan's economy or government (Chapter 4).

This thesis will use the criteria summarised below to assess whether Kazakhstan is economically dependent on China. Further elements will be added in the remainder of this chapter.

- The absolute value of the economic relationship to both economic partners (i.e. symmetry)
- The relative position of the economic partner, determined by China's economic weight relative to other economic partners
- The impact of China's economic influence on Kazakhstan based on market structure, asset specificity and political cost

2.3.1 Deliberation and Effectiveness

In order to leverage economic dependence, states must pursue a “policy of deliberately expanding economic ties with an adversary²⁰ in order to change the behaviour of the target state [...]” (Kahler & Kastner 2006:524). Kahler and Kastner call this a strategy of “economic engagement” which they further classify into three separate categories:

1. conditional policies that directly link economic ties to changed behaviour in the target state;
2. more passive unconditional policies where economic interdependence acts as a constraint on the behaviour of the target state;
3. unconditional policies where economic interdependence effects a transformation in the foreign policy goals of the target state (Kahler & Kastner 2006:525).

Although this fits somewhat uneasily with the Sino-Kazakhstani relationship, as both states are not adversaries but maintain good diplomatic relations, the classification helps to analytically differentiate between the different causal mechanisms that can drive political outcomes. This thesis will show that Beijing uses a combination of conditional and passive unconditional economic policies to further its political objectives in Kazakhstan. The authors’ related use of ‘deliberation’ also introduces an important element to distinguish coincidental outcomes from purposeful policy. This is especially relevant in an analysis of Kazakhstan’s acquiescence to Chinese interests, which does not always directly result from Beijing’s deliberate use of its economic influence (Chapter 5). Rather, the case study in Part II shows that Astana also proactively accommodates Chinese interests in the absence of Chinese conditionality.

²⁰ Defined as the absence of diplomatic relations

The details of the causal pathway that triggers the effectiveness of economic dependence is not entirely clear (Russett & Oneal 2001, Barbieri 1996 cited in Kahler & Kastner 2006). The causal link can be located on both the systemic and sub-systemic, or domestic, level. In the case of Kazakhstan the thesis will demonstrate that strong sub-systemic factors are at play. Economic dependence at the systemic level certainly gives the dominant state some leverage to threaten to withdraw trade or finance benefits and thus affect the target country's economic growth and in turn its overall power capabilities. This incentivises decision makers to acquiesce with the dominant state's interests in order to prevent decreases in economic influence that might be hurtful to the domestic economy. However, the causal link can also rest within the subordinate state. Kazakhstan's political system introduces high political opportunity costs. Also on the domestic level are the future expectations of trade benefits. Policy makers' expectations about the future trade relationship can determine whether they acquiesce with the trade partner's interests or not (Copeland 1996, Snyder 2009). Copeland maintains that prospects of future trade determine on how economic dependence plays out with regard to conflict or cooperation. If trade is expected to expand, policy-makers are more inclined to pursue a foreign policy that fosters cooperation with their trade partner, if not they are more conducive to conflict. In other words, depending on how important decision makers perceive the trade partner to be in the future, determines political conflict or cooperation.

Future expectations are the causal mechanism in Snyder's study on China's relationship with North and South Korea. Snyder demonstrates that expected economic gains with South Korea were the key driver in China's decision to normalize its relationship with the South, despite a close alliance with North Korea.. Although Snyder's reasoning applies to the most fundamental question in foreign policy, on whether to establish formal diplomatic relations with country, it is applicable to explain foreign policy choices in a more normalised setting. Once diplomatic relations have been normalised, economic influence can provide

substantial leverage for political influence-which is what this dissertation is concerned with.

Regarding the domestic context, Kahler and Kastner argue that economic dependencies are most effective if the target state is a democracy, based on the premise that economic performance plays an important role in the provision of public goods (Kahler & Kastner 2006). The potential loss of an important trade partner could lead to the defection of voters over concerns that the economy and their income could be negatively affected. Although Kazakhstan is not a democracy, this thesis will show that the nature of Kazakhstan's political system further underpins China's rapidly growing economic influence. The financial needs of a Rentier State facilitate economic dependence on China because the elite require external revenues to consolidate and maintain their power (Palazuelos & Fernandez 2012) (Chapters 3, 4 and 5).

In a Rentier State the redistribution of resources along political or familial loyalties (patronage) facilitates political legitimacy and a collapse or decrease of revenue may threaten the regime's legitimacy if it cannot access alternative sources. Thus a Rentier State like Kazakhstan is more susceptible to fiscal crises (e.g. oil price shocks, inability to issue bonds) as these directly affect public budgets and funds available for redistribution. This should incentivise the regime to concede to any foreign policy interest that, if left unmet could affect the fiscal position and thus legitimacy of the regime in power.

This link between fiscal crisis and regime survival is part of the wider academic discourse on the relationship between resource wealth and political instability which is approached through various angles: One posits a positive correlation between resource income and civil conflict. Accordingly, the risk of political instability increases along with oil income and oil exporters are more susceptible to political instability. Collier and Hoeffler argue that mineral wealth can foster conflict by funding rebel groups, whereas Faeron and Laitin note that oil exporters often

have weaker state institutions thereby increasing the likelihood of political instability (Fearon & Laitin 2003). Michael Ross critiques that the civil war literature suffers from limitations due to inconsistent conceptualisations of key variables such as resource wealth (Ross 2006). Nevertheless Ross concludes that on average the presence of oil and lootable resources favour violent conflict (Basedau & Lay 2009:758). However, quantitative research questions this correlation. In their large n-study Arezki and Brückner (IMF) found no conclusive evidence that an increase in oil rents is correlated with instability such as civil war (Arezki & Brückner 2009).

A different angle associated with Dutch Disease²¹ or Resource Curse literature posits that the economic structure and development of a resource rich state make it more vulnerable to instability. Resource Curse research analyses why many oil rich nations cannot translate their oil wealth into economic development. The volatility of oil prices undermines stable government budgets and economic investment, leaving governments vulnerable to public dissent during periods of depressed oil prices. Dutch Disease literature argues that overt reliance on resources undermines economic diversification and fosters underdevelopment and negative political outcomes (e.g. corruption) which in turn facilitates conflict. (Lynn Karl 1997). Demkiv summarises this as follows

“With regards to oil, the likely reason for negative economic outcomes is that the entrenched interests of petrostate bureaucrats and actors involved in the oil industry create a symbiotic relationship that stifles normal economic development. The elite’s oil interests operate outside the norms of a free-market system and the main goal is the perpetuation of this oil-dominant system.” (Demkiv 2012: 43)

²¹ Dutch Disease derives its name from the negative effect that the North Sea oil boom had on the Dutch economy. The term connotes a sudden influx of hydrocarbon wealth which increases the exchange rate and introduces relatively high salaries which together render other areas of the economy uncompetitive and undermine diversification of the economy (Lynn Karl 2009)

As the thesis will show, Kazakhstan does show signs of the Dutch Disease including corruption and an authoritarian government as well as misallocation of capital. Indeed, in Kazakhstan

“Rulers will support policies that produce personalized rents even if these policies result in lower overall social welfare and because they need to share these rents with supporters and subordinates [...]”. (Lynn Karl 2007)

Rentier State theory appears to contradict this positive correlation because Rentier States redistribute their income precisely to foster political legitimacy by buying off opposition through patronage. Thus a Rentier State should be more politically stable and less susceptible to political instability (Basedau & Lay 2009). Karl notes that Rentier States can maintain stability for extended periods, but only as long as they have the means to do so (Lynn Karl 2007: 23), because

“Oil states can buy political consensus, and their access to rents facilitates the co-optation of potential opponents or dissident voices. With basic needs met by an often generous welfare state, with the absence of taxation, and with little more than demands for quiescence and loyalty in return, populations tend to be politically inactive, relatively obedient and loyal and levels of protest remain low – *at least as long as the oil state can deliver* [emphasis added].” (Lynn Karl 2007: 21)

This suggests that external shocks to revenues have the potential to increase political instability due to decreases in subsidies, public funding and co-opting opposition. Thus Kazakhstani policy makers may be more incentivised to facilitate an economic dependence on China to secure revenues in the short and medium term- even more so if alternative sources of revenue decline.

Stephan Haggard and Robert R. Kaufman posit

“Though crises are neither necessary nor sufficient to account for authoritarian withdrawal, poor economic performance reduces the

bargaining power of authoritarian incumbents and increases the strength of oppositions” (Haggard & Kaufman, 1997: 267)

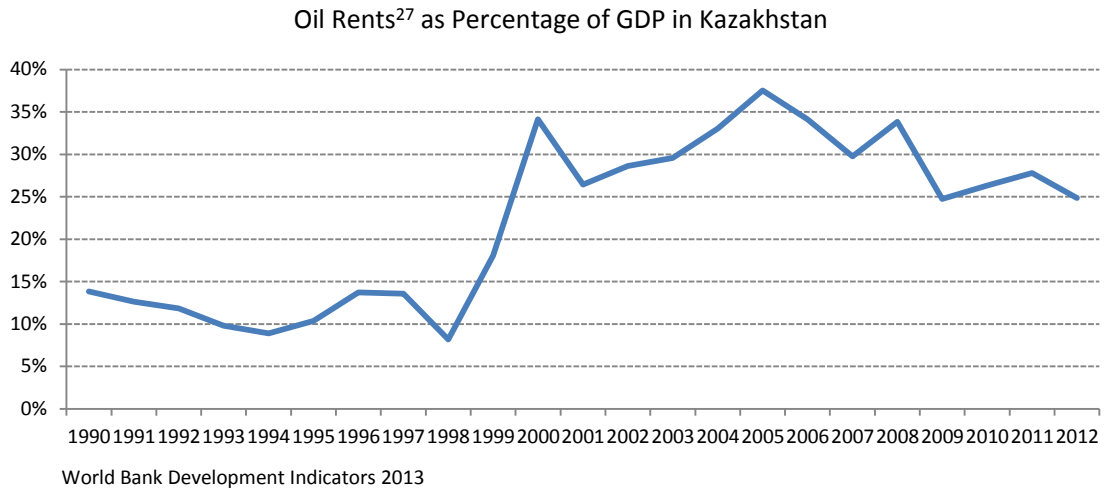
Although regime change is understood as the transition from an authoritarian to a democratic government, this highlights that fiscal crises can empower the opposition. Kazakhstani political analysts expected that Kazakhstan’s unfolding economic crisis in 2008/09 presented an opportunity for new leaders to emerge (Hoagland, 2009h).

Karl maintains that nearly all oil dependent states face “significantly higher levels of social protests when oil revenues fall, and some of these regimes collapse” (Karl 2007). In one of the most insightful studies Demkiv found a correlation between dropping oil price revenues and incidents of political instability. Demkiv conducted in-depth case studies of Type I petrostates including Algeria, Iran, Nigeria, Russia, Saudi Arabia and Venezuela covering a time period of nearly three decades (1981-2010). Type I states are defined as resource wealthy nations that produce at least 2 million barrels per day (B/D) and where oil rents contribute more than 10% of GDP (Demkiv 2012). These petrostates showed higher levels of political instability, especially demonstrations, following oil price fluctuations. Demkiv further asserts that Type II states, where oil rents contribute more than 10% to GDP but with an overall daily oil production below 2million (B/D) are the most vulnerable group to oil price fluctuations and instability. Kazakhstan is such a Type II state (Demkiv 2012)²², where oil rents constitute around one third of GDP, a higher share of oil rents in GDP than most Middle Eastern countries (World Bank 2013, Figure 2).

Arguably Rentier States attempt to mitigate any revenue risks. To this end Kazakhstan set up the National Fund (Asfaha 2007). However, the fund is young with open questions about its actual size which may play a role in the willingness of Kazakhstani policy makers to accept Chinese credit lines (Chapter 3).

²² The 10% threshold is used by several authors including Jonathan Di John (DiJohn, 2009)

Figure 2 Oil Rents as Percentage of GDP



2.3.2 Finance and Investment

The literature on how a country can use its financial capabilities as leverage for foreign policy outcomes is limited and focuses on the security implications of external debt but neglect issues that fall outside security concerns such as diplomatic, economic and resource objectives ([Drezner 2009](#), [Kirshner 2009](#)). Finance should be of particular interest because it is in this area that Beijing has developed its strongest relative capabilities, which includes the world's biggest foreign currency reserves. As a result China lent more to developing countries between 2009 and 2010 than the World Bank (Dyer, Anderlini & Sender 2011). Finance is particularly interesting, since financial streams are less tangible than traded goods and services; consumers more easily grasp China's impact by the presence of the increasing number of products labelled 'Made in China' that they encounter, but the influence wielded by external creditors on a day to day basis, however, is often invisible. More importantly, finance is a prerequisite to economic growth and thus plays a key role in any economy, an insight that the Global Financial Crisis dramatically underlined (Lipsky 2009). It was also the crisis that boosted China's role as key creditor to Kazakhstan and thus gave Beijing additional leverage. Even Daniel Drezner, an analyst who is critical of the security implications

of external debt, admits that “when targeted at small or weak states, financial statecraft can be useful [...]” (Drezner 2009:10).

Beijing’s control over its financial instruments, including policy banks and Sovereign Wealth Funds (SWFs), also allows it to use its financial power as leverage externally to further political objectives (Helleiner & Chin 2008:89 and 2009, Shih 2009). China Export-Import Bank (ExIm) and the China Development Bank (CDB) are Beijing’s main vehicles for dispensing credit abroad. Unlike funds allocated by private lenders, these are ‘policy banks’,²³ which operate directly under the state and often provide financing and investment for political purposes.

As a major creditor, Beijing uses its financial resources to project power and influence abroad and create goodwill from recipient countries (Helleiner & Chin 2008). However the positive externalities from the provision of credit extend beyond goodwill. Access to external debt is particularly important to governments that want to finance their budget without resorting to alternatives such as spending cuts or increased taxes. Avoiding such difficult and politically unpopular decisions is a point that is especially salient in an autocratic system like Kazakhstan’s, where the government’s legitimacy rests on the provision of public goods in the absence of free and fair elections (DiGiuseppe & Raymond 2012). Weiner further argues that Beijing exercises diplomatic deterrence and controls the agenda at bilateral meetings on the back of its dominant status as a creditor. As the biggest holder of US debt, Beijing was thus able to deter the US from labelling China a currency manipulator in 2009 (Weiner 2011) and effectively managed to get sensitive issues off the international agenda - including sanctions against Iran (Weiner 2011). This thesis will argue that China’s potential as a source of new funding is even more important for decision makers in Kazakhstan than the stock of its outstanding loans.

²³ In 1994 Beijing created three policy banks to raise financing for government directed programmes such as infrastructure projects. These policy banks report to the State Council. Because of their proximity to the government and their mandate to finance government projects they are often referred to as “policy banks”. Examples include the Agricultural Development Bank of China (ADBC), the China Development Bank (CDB) and China Export-Import Bank (ExIm).

IR analysis on SWFs primarily focuses on the security implications of their investments, which so far have been limited (Kirshner 2009). However, China's SWFs, including the China Investment Corporation (CIC) and the State Administration of Foreign Exchange (SAFE), have only recently become major actors in the international financial system. Despite this, by 2010 China had already become the fifth biggest provider of FDI abroad (China Daily, 2011). Like most SWFs, China's are government-controlled and invest large amounts abroad, which can force desired political outcomes (Weiner, 2011). For example, in 2007, Beijing utilised SAFE to invest US\$150m in Costa Rican government bonds. Subsequently, Costa Rica cut its official diplomatic relations with Taiwan (Anderlini 2008, Jennings 2007, Scissors 2009).

China's state control over its SWFs should also enable Beijing to enlist them into foreign policy objectives outside the security realm (Shih 2009). Victor Shih thus argues that the behaviour of Chinese SWFs can be highly unpredictable and that foreign policy objectives have top priority (Shih 2009). Elite fragmentation makes bankers highly sensitive to party politics, perhaps explaining why Chinese banks dropped out of a planned International Monetary Fund (IMF) and World Bank (WB) meeting in Japan in 2012 in protest over the Diaoyu Islands (Jones 2012). It is unclear whether Chinese banks were directly advised to do so by Beijing or whether bankers wanted to support the party line to curry favour in Beijing. Shih points out that the "devotion of a small share of the SWF's resources on foreign policy can have a significant diplomatic impact, especially in developing countries" (Shih 2009:329).

Developing countries tend to have less access to finance because of their uncertain economic growth and the investment environment that makes them open to Chinese financing. Given China's vast financing resources, a small share of these resources can still have a considerable impact on these economies. At the same time, Chinese funding is very attractive because, unlike international finance

institutions (IFI), Beijing does not link structural economic or political reforms to credit lines. SWFs can cultivate and exploit monetary dependencies especially during economic crisis, when access to capital is more difficult (Kirshner 2009). Economic crises, like the financial crisis of 2008-2009, thus generate additional opportunities for China to expand its influence by offering emergency assistance to countries in distress, including Kazakhstan – in exchange for political concessions. The European sovereign debt crisis illustrated how funding needs force governments to accept conditional bail-outs.

This chapter suggests the following approach to assess Kazakhstan's economic dependence on China. Firstly, it will provide an overview of China's trade, finance and investment activities in Kazakhstan and analyse opportunity costs in each of these levers based on:

- The absolute value of economic influence to each economic partner
- Ranking vis-à-vis other economic partners
- Relevance to the local economy
- Relevance to the political system
- Perceptions of future expectations of local decision makers

The thesis will demonstrate that, China has indeed built economic dependencies. Whether these dependencies can be translated into foreign policy objectives depends on a degree of deliberation which means China's ability to either build economic dependencies in the first place in view of their political potential or China's deliberate use towards foreign policy of the economic institutions which built these influence in the first place. This would require Beijing to control these institutions. In the absence of such control Beijing would be able to use its economic influence as leverage if local Kazakhstani decision makers perceived of Beijing to be in control of these economic institutions. The thesis will demonstrate that the latter is the case in Kazakhstan.

2.4 Overarching Theoretical Framework: Neoclassical Realism

This dissertation seeks to explain how China can transform its economic influence into political power in Kazakhstan via economic dependency. Political outcomes form the dependent variable and China's economic capabilities the independent variable. A neorealist narrative initially appeared most suitable for this thesis, given its focus on material economic power and on China's relative position vis-à-vis Kazakhstan. Neorealism puts the relative distribution of power in the international system at its centre, which also shapes the asymmetric relationship between two states. Neorealism has de-linked foreign policy behaviour from domestic variables and instead explains state behaviour through variables that are firmly placed on the system level, such as the distribution of power and structural anarchy. Waltz conceptualises states as like-units, seeking to maximise their relative power in the international system, independent of their internal political organisation (Waltz 1979). Although this approach may provide a parsimonious methodology that also complies with David Singer's level-of-analysis premise, ignoring unit level variables is problematic in China and Kazakhstan's case (Singer 1961).

During the field research, it became clear that systemic variables, such as China's relative economic power cannot alone explain the degree of China's economic influence in Kazakhstan or its ability to translate this influence into political outcomes. Instead it became evident that China's growing economic influence in Kazakhstan is also driven by unit-level variables that fall outside the lens of neorealism. The particular political system of Kazakhstan, which closely resembles that of a classic Rentier State found in the Middle East (Franke, Gawrich, & Alakbarov, 2010), facilitates the country's economic dependence on China. This is largely because of the regime's susceptibility to revenue shocks and a preference of the elite of Chinese over international investment for reasons that are outlined in Chapter 3. China's ability to use this economic influence as leverage relies on Beijing's control over the range of economic institutions that project China's

economic capabilities into Kazakhstan such as SWFs, banks and energy companies (Chapters 4 and 5).

Neoclassic Realists²⁴ on the other hand, break open the like-unit model of states and expand neorealist tenets with domestic variables (Zakaria 1998, Christensen 1996, Schweller 1998) which can modify foreign policy behaviour. Zakaria, for example, investigated why the US did not expand its power abroad following the Civil War in the late 19th century, a period that saw the ascent of US economic prosperity. Yet despite a lack of obstacles in the form of other international powers, the US did not expand its power concurrently with its economic rise. Zakaria explains this puzzle under neorealism by drawing on intervening domestic variables. The bureaucratic structure and power-sharing arrangement between the Executive and Congress left the executive with little room to pursue and implement an expansionist foreign policy agenda. Only after the Executive consolidated its power vis-à-vis Congress did the US suddenly expand its power internationally.²⁵ Although China's institutional power-sharing arrangements differ from those of the US, Beijing must overcome similar dynamics to effectively leverage its economic influence towards foreign policy ends. Neoclassical realism conjectures that to build economic dependencies, China requires the domestic structures that can effectively wield economic capabilities in the first place. A neoclassical narrative thus considers domestic variables to explain the specific set of policies that China pursues but can also explain whether Beijing can leverage its economic capabilities to further its political goals in Kazakhstan. This first and foremost depends on the relationship between Beijing and its main economic actors but also on the interests and perception of Kazakhstani decision makers.

²⁴ Relevant authors are Brown 1995, Christensen 1996, Schweller 1998, Wohlforth 1993, Zakaria 1998.

²⁵ The applicability of this theory to China is problematic: Unlike the US, power within the Chinese government is highly centralized and consolidated within the politburo of the CCP and decision making processes are significantly more opaque

As shown in Chapter 5, some of China's economic institutions, including CNPC, have become politically powerful in their own right, impeding Chinese efforts to direct CNPC's investment in Kazakhstan. Any analysis of whether Beijing can leverage its economic influence needs to take into consideration such domestic power-sharing arrangements, even if they are informal. A neoclassical perspective further reveals that the effectiveness of China's economic influence is facilitated by structural weaknesses in Kazakhstan's political system, especially driven by its elite dynamics (Chapter 2). In this way, a combination of systemic and sub-systemic variables can be used to explain the outcomes of Chinese foreign policy in an asymmetrical economic relationship. This thesis will show that elite interest in many cases overrides the national interest in Kazakhstan. These elite actors seek out Chinese investment at the expense of Kazakhstan's long-term economic development and, as a result, even facilitate Beijing's efforts to transform its economic influence into political power.

In addition to a state's bureaucratic apparatus, neoclassical realists also acknowledge that the perceptions and misperceptions of policymakers can determine a state's foreign policy behaviour (Wohlforth 1993:2, Schweller 1998). This thesis' case study highlights the fact that Kazakhstani decision makers may not appreciate the domestic power-sharing dynamics in China. Instead they appear to perceive of China and Chinese economic institutions as one unitary actor (Chapter 7) which can withdraw or extend trade, finance and investment in Kazakhstan at the will of Beijing.

Realism establishes China's relative material capabilities as the "basic parameters" of its foreign policy (Rose 1998: 145). However these parameters are not sufficient to explain how China manages to generate economic dependencies in Kazakhstan and how it can leverage these dependencies towards meeting specific foreign policy

goals.²⁶ China's rise in the international system is intricately linked to the development of its economic capabilities, which, in turn, are a prerequisite to exert economic influence in Kazakhstan. Neoclassic realism can provide a richer understanding of the complexities that allow China to translate its economic influence in Kazakhstan into political power, by taking into consideration the unit-level variables that facilitate Chinese economic influence and enable its transmission into political power. China's economic capabilities remain the independent variable and political outcomes remain the dependent variable. However, the sub-systemic variables of Beijing's control over its economic institutions and Kazakhstan's domestic context become the two intervening variables in addition to economic dependency.

Chapter 3 Kazakhstan's Political System

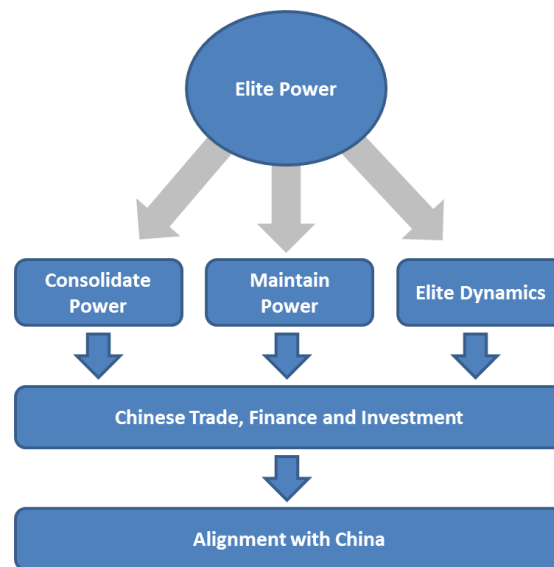
This chapter analyses Kazakhstan's political system to show how its particular structure and associated elite dynamics facilitate China's growing economic influence. These dynamics provide an important sub-systemic variable, which also affects China's ability to leverage its economic influence in its favour. This chapter will illustrate that Kazakhstan is a Rentier State where government legitimacy rests on the redistribution of revenue rents along political and economic loyalties. The subsequent discussion on Chinese trade, finance and investment will take place against this background. Chapters 3, 4 and 5 illustrate China's rapidly-emerging dominance in Kazakhstan's economy, which runs against the national and economic interests of the country. Indeed, China's growing influence, especially in the resource sector puts Kazakhstan's economic development at risk and undermines any effort to diversify the economy. Thereby China's economic influence contributes to symptoms of Dutch Disease and the Resource Curse. This is puzzling, as Kazakhstan can in theory choose from many investors and can be best

²⁶ Waltz noted that Neo-Realism is not well suited as a foreign policy theory but rather a systemic theory to predict system outcomes (Waltz 1996) and calls for, a separate theory about foreign policy that incorporates domestic politics (Waltz 1979).

explained through Kazakhstan's domestic setting, especially the existence of an elite network whose needs overrule the national interest and drive its economic dependence on China. This chapter examines the domestic context in greater detail.

The chapter shows that political and economic power in Kazakhstan is highly centralised in a small elite network that evolved and operates around President Nazarbayev. This creates three pertinent conditions that facilitate an inflow of Chinese financing and investment (Figure 3). Chinese investment assisted the elite to consolidate its power in the late 1990s and became even more important to the elite's maintaining of power throughout the financial crisis of 2008/09, when Kazakhstan's access to external funding quickly diminished (Chapter 4). As a Rentier State, Kazakhstan is particularly vulnerable to revenue shocks (Chapter 2), such as the one that was brought about through the Global Financial Crisis during which the regime had to find alternative sources of funding, one of which was China. The distribution of funds through patronage creates undesirable economic outcomes such as corruption which makes Kazakhstan more susceptible to economic stagnation and crises. Against this background the regime has to ensure that it can continuously access new funds for redistribution. Kazakhstan's political structure also creates elite dynamics that benefit Beijing in multiple ways: they create a context of personalised versus institutionalised decision making, where elite support and elite contacts are important. Beijing's economic interests are favoured through powerful facilitators such as Karim Massimov. However, these dynamics also benefit Beijing in-directly because conflicts between different elite groups primarily affect other foreign partners, especially the US and Russia and their investments, a fate that Chinese companies appear to escape.

Figure 3 Domestic facilitators of China’s economic influence



3.1 Power Consolidation

Kazakhstan’s President Nursultan Nazarbayev and a select elite²⁷ network around him hold comprehensive political and economic power in the country. This segment will discuss the emergence of the elite and its power over the political and economic process.

Nazarbayev was appointed to a leadership role in the Kazakh Communist Party (KCP) shortly before the collapse of the USSR in 1991. In 1989 he was appointed the First Secretary of the KCP, effectively making him the political head of a centralised system. In April 1990, possibly in anticipation of Kazakhstan’s independence, Nazarbayev converted his chairmanship into a presidency which was confirmed through uncontested elections in December 1991, just days before Kazakhstan was granted independence (Cummings 2005:22). From then onwards, the office of the president became increasingly powerful and now firmly controls the political

²⁷ ‘Elite’ here refers to a group of individuals who indirectly or directly play a regular and substantial part in national political outcomes and which includes political, government and economic actors (Junisbai, 2010, quoting Higley & Burton 1989; Mosca 1939; Pareto 1935, 1966; Putnam 1976).

process, effectively seizing any checks and balances. Along the way, Nazarbayev abolished the KCP, which led to the creation of his own party and also increased the threshold for political contenders and opposition parties to participate in elections (Cummings 2005; Brill-Olscott, 2010). With each challenge to his power, Nazarbayev carried out another 'reform', which invariably always encroached upon the independence of another branch of government²⁸. For example, Kazakhstan's first constitution created a parliamentary system in 1993 that divided power evenly between the parliament and President (Isaacs 2011). Nazarbayev won the ensuing power-struggle that erupted over his privatisation programme and threatened parliamentary deputies who largely owned personal stakes in State Owned Enterprises (SOE). Through shrewd negotiating tactics and backroom deals (Cummings 2005, Isaacs 2011), in 1994 Nazarbayev persuaded parliament to dissolve itself and call an election which was later annulled by the Supreme Court. He then ruled by decree until 1995 (Bertelsmann 2012), and oversaw the drafting and decreeing of the second constitution in 1995, which is in effect today (Jones Luong 2002:216). This signified the prelude to a more repressive era and spelled the end of a brief period when media and political parties operated relatively freely (Jones Luong 2002), a fact that is reflected in Kazakhstan's worsening performance on relevant indices (see Figure 4).

The second constitution gave the president extensive powers and effectively turned Kazakhstan into a presidential system (BTI, 2012). From then onwards, Nazarbayev consistently expanded his power formally and informally at the expense of an independent judiciary, legislature or press. In 1995, the President gained the right to dissolve national and regional parliaments with "little justification" (BIT), which he exercised on multiple occasions.²⁹ The President can directly appoint a quota of parliamentarians and up to nine members of the Senate, including the Senate Speaker (Cummings, 2005). Along with the seats that his party can claim in

²⁸ These branches include the Legislature (Senate and Majilis) and the Judiciary (Supreme Court).

²⁹ Article 64, Constitution of the Republic of Kazakhstan (Constitutional Council, 1995). Nazarbayev has dissolved the parliament in June 2007, November 2011

elections, this has ensured a parliamentary majority for the Presidential party, Nur Otan, which has consistently claimed more than 80% of the popular vote – enough to change the Constitution and to further expand the President’s power.³⁰ For example, in 1998 Parliament extended the President’s constitutional term from five to seven years and finally, in 2007, revoked the presidential term limit altogether, specifically for the country’s first president (FreedomHouse 2012a). This allows Nazarbayev to stay in office for life³¹ (Yermukanov 2007). As a result, the President wields enormous political power over the country’s legislature and judiciary but also provides the basis for the evolution of a strong elite-network that controls Kazakhstan key political and economic institutions and which often defines the country’s foreign policy choices and investment needs. During the remainder of the 1990s, Nazarbayev either forcibly merged ‘friendly’ opposition parties with Nur Otan or intimidated opposition candidates³² such that they fled the country. A number of opposition candidates and journalists have been killed as well.³³ Stringent requirements for party registration and representation make it virtually impossible for a genuine opposition party to emerge,³⁴ instead ‘friendly opposition’ parties are represented in parliament.

Today, Kazakhstan’s “benign dictatorship” (Henderson 2000:490) or “autocratic presidentialism” (Franke et al 2009: 109), is reflected in consistently low rankings in

³⁰ In the most recent elections of 2011, Nur Otan won 95.5% of the popular vote (Freedom House, 2012a)

³¹ Article 41, Section 1, 1995 Constitution of the Republic of Kazakhstan. (Kazakhstan Constitutional Council, 2012).

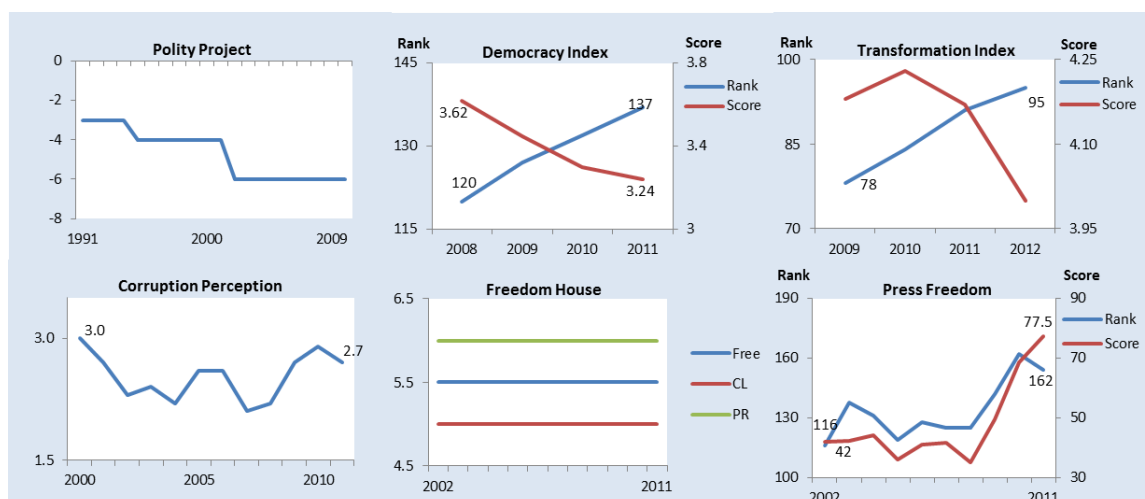
³² Vladimir Kozlov, a prominent opposition figure, was jailed in 2012 for allegedly inciting the oil strikes in Zhanaozen which ended when government forces opened fire on demonstrators. It is difficult to verify the events since media was denied access to the area. However, Aleksandr Bozhkov, one of the few witnesses, claimed that he was tortured to provide false evidence in a government trial. He was found murdered in October 2012. Kozolov appeared in front of the European Parliament (EP) and the European Commission (EC). The Kazakhstani government subsequently used these statements in a trial against him (Pilch & De Los Fayos 2012, RFERL 2012, FreedomHouse, 2012b).

³³ This includes Aleksei Pugaev (human rights activist), Nuri Muftakh (journalist), Askhat Sharipzhan (journalist), Erzhan Tatishev (BTA), Batyrkhan Darimbet (journalist), Zamanbek Nurkadilov (politician), Altynbek Sarsenbaev (politician) RFERL (2006) .

³⁴ This includes a 7% threshold for presentation and high financial requirements for parties to register.

international comparisons (Figure 4). These rankings are also in line with the literature on Rentier States which observes a strong correlation between Rentier States, corruption and media-repression (Chapter 2). Beyond today's de-facto one-party system (i.e. Nazarbayev's Nur Otan Party), the President also controls many of the country's major industries through a close-knit circle of family, friends and allies (see 3.2, below). These members of the Kazakhstani elite have benefitted from the privatisations of state owned assets particularly in the resources industry (Brill-Olcott 2010), where a boom in oil revenues turned many members into millionaires or even billionaires (Lillis 2012b). This was further exacerbated with the entry of Russian and especially Chinese oil companies, which made Kazakhstani resources more competitive (Palazuelos& Fernandez, 2012). Beyond the resources sector, Nazarbayev also has significant influence over the media and the finance industry, as some of the largest corporations and banks are controlled by his family and closest friends.

Figure 4 Key Indices on Kazakhstan's Political System³⁵



The table summarises key indices including aggregate rankings such as the Polity Project (Teorell, et al. 2012) and the Bertelsman Transformation Index (BTI, 2012). Each index captures Kazakhstan's individual score over time and where applicable, its relative global ranking. The graphs vary and higher scores often imply a worsening condition. For example, Kazakhstan's score in the Press Freedom Index increased from c.40 to nearly 80 points which meant that it dropped from the 116th to 162nd place globally and is now one of the 25 worst performing states in the world, on par with Libya. Kazakhstan's democratisation has been stagnant and even reversed in recent years. Freedom House assesses political freedom, ranging from free (1) to least free (7) (FreedomHouse 2012). Kazakhstan has consistently received low scores and the flat lines suggest that the country has made no significant improvements.

Defenders of Nazarbayev maintain that political stability during Kazakhstan's transition years took precedence over political pluralism. The Soviet Union's dissolution had significant economic repercussions. GDP shrunk by 11% in 1992 and the country suffered from hyperinflation, which reached between 300% and 1200% until 1994. Although Kazakhstan has arguably overcome these challenges, Nazarbayev created a system, the political stability of which wholly depends on him, and it is not clear whether this will survive Nazarbayev's death and/or any unplanned leadership transition – creating a problem that drives intra-elite conflicts and also worries foreign investors, including China.

³⁵ BTI, Reporter's Without Border's Press Freedom Index, Polity Project Ranking, The Economist Democracy Index, Transparency International's Corruption Ranking and Freedom House's Freedom in the World ranking.

3.2 Emergence of the Elite Network

When Kazakhstan first privatised medium-sized companies between 1993 and 1995, those loyal and close to Nazarbayev already benefited economically, a phenomenon that would become significantly stronger during the privatisation that would follow later. Whilst early privatisation waves focused on SMEs, subsequent waves gradually expanded to larger firms after 1995 and ultimately Kazakhstan's largest state owned assets in 2003, which resulted in the most corrupt phase (Olcott 2002, Pomfret 2006), where the process was "overtaken by spontaneous alienation of state assets by anybody in a position to steal them" (Pomfret 2006). This not only empowered the elite financially but also led to the emergence of new business elite capable of challenging Nazarbayev's rule.

In the first privatisation wave, Kazakhstan replicated the Czech voucher system and handed out 'coupons' to Kazakhstanis³⁶ which could be used to buy shares in Investment Privatization Funds (IPF).³⁷ Fund managers used the accumulated coupons to bid for shares in state companies. Although 200 funds existed to diversify investments, a 'mega fund' was created, Butya-Kapital, owned by Bulat Abilov, rumoured to be a Nazarbayev relative. The fund had somehow managed to accumulate 10% of the coupons that had been distributed, making it the biggest player in the privatisation process (Brill Olcott cited in Cummings 2005:30). Irrespective of whether Abilov was a relative or not, it is clear that he was very close to Nazarbayev during the privatisation process: between 1994 and 1996 he served as Presidential Advisor and by 2001 had become a member of the President's Business Council. Butya-Kapital never paid any "dividends" on the coupons that citizens had invested, however Abilov in turn had become a millionaire

³⁶ The first phase of privatisation (1991-1992) focused on the housing sector, the second on Kazakhstan's small and medium-sized SOEs (Pomfret 2006) and the third (1996-1998) on the largest state assets (Jermakowic, et al. 1996).

³⁷ IPFs were used to privatise state assets in Poland and the Czech Republic. Coupon holders could buy rights issued by IPFs. IPFs in turn uses the accumulated 'coupon capital' to buy shares in those enterprises that are being privatised (Pistor & Spicer 1996).

(Mamashuly,2012). Despite the privatisation objective, the state managed to maintain “effective control” over most enterprises at the end of the process (Jermakowicz, Kozarzewski and Pańków 1996:16).

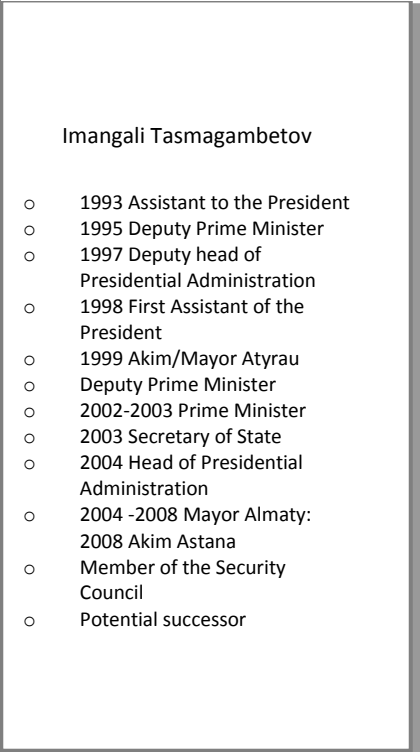
Following his consolidation of power with Kazakhstan’s 1995 Constitution, (Constitutional Council, 1995)Nazarbayev embarked on the privatisation of the country’s largest state assets and moved family, loyal friends and old allies from the Soviet era into key economic positions from which they often benefitted materially.

Nazarbayev’s role in providing access to resources was crucial to establishing and managing an elite network loyal to the President and which controls the country’s political and economic decisions and resources.

“As with political elites in the Middle East, the Kazakhstani elite exploited their position in the political sector to reinforce their social and economic position. To achieve this, Middle Eastern political elites used as their major policy mechanism nationalization; the Kazakhstani political elite by contrast, sold off state assets to foreign buyers to enrich themselves personally.” (Cummings 2005:122)

This created an elite network that controls most areas of Kazakhstan’s economic and political life. Members of this network compete for access to assets such as industries, enterprises or politically influential positions that may result in their personal financial gain. For example, Imangali Tasmagambetov (Biografia.kz 2012) a long-serving bureaucrat under Nazarbayev and widely considered to be a potential successor, has become very wealthy, even though he has never held a position in the private sector. He rose to fame through a

Figure 5 Imangali Tasmagambetov

- 
- Imangali Tasmagambetov
- 1993 Assistant to the President
 - 1995 Deputy Prime Minister
 - 1997 Deputy head of Presidential Administration
 - 1998 First Assistant of the President
 - 1999 Akim/Mayor Atyrau
 - Deputy Prime Minister
 - 2002-2003 Prime Minister
 - 2003 Secretary of State
 - 2004 Head of Presidential Administration
 - 2004 -2008 Mayor Almaty;
 - 2008 Akim Astana
 - Member of the Security Council
 - Potential successor

series of scandals³⁸ such as the ‘Baikonour Millions’ (Adilov 2005, Vlasov 2007). In 2001, Russia agreed to repay its US\$65m debt for leasing the Baikonour Space Station, through railway equipment to Kazakhstani Railways (KTZ). However, only US\$19m worth of equipment was received by KTZ but was accounted for as US\$65m, the remainder of US\$46m being allegedly siphoned off by Tasmagambetov (Safin 2004). Nazarbayev continues to support Tasmagambetov despite the scandals (Mamashuly 2012).

Bulat Utemuratov, a close confidant of Nazarbayev, is also known as the “diplomat who became a banker” (Esbergen 2011a) and is now the fourth wealthiest man in Kazakhstan (Forbes 2012) after he sold his share in ATF, Kazakhstan’s fifth biggest bank to Unicredit (Figure 6). Utemuratov likely gained a stake in the bank as a reward for his loyalty to Nazarbayev (Roberts 2008). Several of Nazarbayev’s

Figure 6 Bulat Utemuratov



Ministers have also accumulated substantial wealth: Adilbek Dzhaksybekov, the current Minister of Defence is listed on the Forbes Billionaire list as the 28th wealthiest person in Kazakhstan, with business interests in finance investment and agriculture (Lillis 2012) (see Figure 10). The Minister for the Environment is ranked as the 36th wealthiest person in Kazakhstan with business interests in oil, financial services and real estate (Lillis 2012c). These arrangements are also susceptible to corruption scandals, which can pose risks to the regime’s legitimacy and thus provide incentives

³⁸ As Akim of Atyrau Tasmagambetov monetised the fishing of caviar and sturgeon in the Caspian. He extended fishing rights to friends and set up a company, JSC Aytrau Balik, which held the monopoly on fishing at the Caspian. It is alleged that he made millions and also caused damage to the fish stock through overfishing. His friend and close business partner died under mysterious circumstances(Altyn-Orda.kz)

for the elite to choose Chinese investment over its international alternatives. However, moving elite members into business positions also ensures that the elite's political influence is projected into Kazakhstan's key economic institutions. The roles of Vladimir Ni (Figure 8) and Vladimir Kim (Figure 7) exemplify this point very well.

Until his death in 2010, Vladimir Ni was possibly Nazarbayev's closest and most influential confidante, and had already served Nazarbayev in an official capacity during Soviet times. In 1998 Ni was appointed to the executive board of Kazakhmys one of the largest copper miners in the world, where he not only personally benefitted from the company's initial public offering (IPO) in 2004 but also extended the President's power into the boardroom (Global Witness 2010). Vladimir Kim, the biggest shareholder of Kazakhmys, is also a close ally of Nazarbayev and has either received his Kazakhmys shares for his loyalty to Nazarbayev and his role in privatising the company, or, as some suspect, because he serves as Nazarbayev's frontman (Roberts 2008, Global Witness 2010). Neither Ni nor Kim has relevant industry experience that could explain their appointments from a commercial point of view. Kim holds a degree from the Almaty Institute for Architecture and Construction (Global Witness 2010) and worked as a stone mason and instructor. Ni worked for four years in coal mining before he embarked on a near 30 year career in politics and Nazarbayev's administration (Global Witness 2010:6). It is more likely that both 'owe' their appointments to their close relationship with Nazarbayev. At Kazakhmys, Kim and Ni likely act as conduits for Nazarbayev's decisions (see Case Study). The close link between these two men and the President prompted a 56-page Global Witness report investigating the true ownership and control structure of the company (Global Witness 2010). By way of a further example, Bulat Nazarbayev, the President's brother was appointed to the executive board of Kazakhmys just months before it was listed on the London Stock Exchange (LSE) (Global Witness 2010).

Since Kazakhstan's independence, Nazarbayev relied on a small group of such loyal figures who had often also served with him in the Soviet administration, such as Vladimir Shkolnik and Nazarbayev's privatisation programme was crucial to expanding the group's power into Kazakhstan's economy. This established a politico-economic elite that effectively turned Kazakhstan into a Rentier State (Franke, Gawrich et al. 2009). This is particularly relevant to this thesis, as Rentier States are more vulnerable to revenue shocks (Chapter 2) which should give any foreign partner who can extend funding or revenues under such circumstances more influence. As will be demonstrated below and in the next chapter, China took

Figure 7 Vladimir Kim

Valdimir Kim
<ul style="list-style-type: none"> • Educated architect and stone mason • 1989-1992 Cultural, Social and Scientific Development Fund, Kazakhstan • 1992-1995 CEO of JV between Samsung and ZhezKazGantsvetmet-later incorporated into Kazakhmys • 1997 CEO Kazakhmys • 2002 Political Council of Otan Party • 2006 Transferred 2.5% of his Kazakhmys shares to Vladimir Ni • Wealthiest man in Kazakhstan with net worth of US\$ 3.5bn

on this role by extending emergency credit lines to Kazakhstan.

Kazakhstan inherited state assets from Soviet times and was endowed with a wealth of natural resources which promised significant revenues. Since Nazarbayev has effectively concentrated the country's political power, he can award access to these state assets. Thus, proximity to the President, that is, membership of the elite network, is essential and provides a lucrative opportunity to benefit materially. Access to

resources are gained as a reward for loyalty towards Nazarbayev and usually these privileges are repaid by providing political support and by extending Nazarbayev's control over the decision-making processes in politics or, where applicable, in the industry or firm where he placed loyal friends. The ownership of Kazakhmys, ENRC and Brill-Olcott's example of Amalbek Tshanow serve as informative examples. When Tshanow was appointed Akim³⁹ of Zhambyl in 1995, he replaced all 140 bureaucrats of the Akimat with people from his own clan and on whose loyalty he

³⁹ The Akim (Mayor) heads of the local government. The PM suggests and the President appoints Akims.

could count (Brill-Olcott 2002). Nazarbayev extends his control into the board rooms of key companies through appointing senior executives and as a result it is widely rumoured that major companies such as the Eurasian Natural Resources

Figure 8 Vladimir Ni

Vladimir Ni
<ul style="list-style-type: none">• Close Nazarbayev confidant and advisor• 1985 Assistant to Nazarbayev• 1990-1998 Presidential Administration• 1999 Kazakhmys, Board of Directors• 2006 Received 2.5% of Kazakhmys shares from Vladimir Kim• 2010 Died in September

Corporation⁴⁰ (ENRC) or Kazakhmys refuse to make decisions without his consent. Kazakhmys' case study is especially interesting for this thesis, because China is the company's biggest customer and Astana has used Chinese credit lines to purchase a significant share in the company directly from Vladimir Kim, turning him into a billionaire. Furthermore, the company exemplifies the close inter-

linkage between politics and economics which Beijing manages to work to its advantage, perhaps more successfully than Kazakhstan's other international partners.

Case Study: Kazakhmys

Kazakhmys is listed on the LSE and has annual revenues between US\$ 3-4bn. The company's three key shareholders are all close Nazarbayev allies, such as Vladimir Kim, Vladimir Ni and Oleg Novachuck. It is widely assumed that Nazarbayev executes control over Kazakhmys through both Kim and Ni so that they make no decision without Nazarbayev (Global Witness 2010). In fact there is a close web of share transactions between Kazakhmys and Astana. In 2010 for example, Kim sold an 11% share of the company to the government which turned the government into the largest shareholder (Dawber, 2010). Kim in turn owes his shares and position in the company to Nazarbayev which explains why Kim turned over 2.5% of his own company shares, worth £135m, to Vladimir Ni in 2006. It is not clear how any of the main shareholders came into possession of the company shares, and the

⁴⁰ Kazakhmys subsidiaries are, Kazchrome, Zhairam GOK, SSGPO, Aluminium of Kazakhstan, Kazakhstan Aluminium Smelter (KAS), Eurasian Energy Corporation (EEC)

government's alleged privatisation of Kazakhmys between 1992 and 2002 was marred with irregularities (Global Witness 2010:31).⁴¹ Samsung was an early key investor in Kazakhmys, and Kim bought Samsung's 15% share in 2001 for US\$94.73m, roughly two thirds of the actual value.⁴² It is unclear how Kim managed to secure the funds to purchase these stakes in the first place. Samsung sold its shares because it was convinced that Kazakhmys could not meet the requirements for an IPO⁴³. However, soon after the sale Kim announced the IPO plans, making everyone in the company rich, including Nazarbayev's brother who had been appointed to the executive board just beforehand (Global Witness 2010). More interestingly, Kazakhmys paid Nazarbayev's hotel bill of £30,000 during a trip to the UK in 2006. The bill was paid in advance by a Kazakh bank transfer (Global Witness 2010: 30). The example highlights the close link between the company and Nazarbayev himself and his inner circle.

It is important to understand these personal relationships for this thesis, because such individuals often enter into business agreements with China or benefit from concessional Chinese loans. Kazakhmys, for example, received a number of substantial loans from China, including a US\$2.7bn credit line from the China Development Bank (CDB) to develop the Bozshakol mine (BE 2011). This was followed in 2011 by an additional loan agreement with CDB for US\$1.5bn, to develop the Aktogay mine. This brings the total loan volume to US\$4.2bn, more than Kazakhmys' annual revenues of US\$3.2bn in 2010. China in exchange bought 80% of Kazakhmys' copper (Kazakhmys 2012) (Figure 9). CDB is a policy bank (Chapter 3) with close ties to Beijing and as such it can be argued that the deal was made on a political level, in cooperation with Nazarbayev, who arguably controls

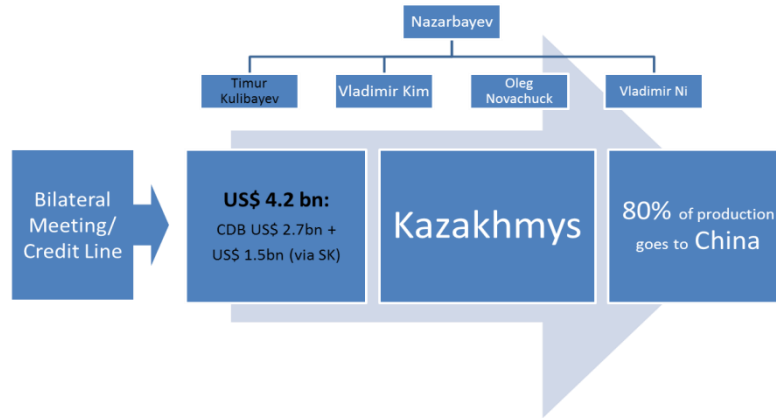
⁴¹ The Kazakhstani government sold its stake in several instalments through auctions and tenders. By 2005 the company was owned by its managers. Although employees received shares they were forced to sell before the lucrative IPO. The buyer of the biggest block of 24.65% of shares, for US\$184m, remains unknown. 11.5% of Kazakhmys shares were sold, just one week before the announcement that the company sought a listing on the LSE (Global Witness, 2010).

⁴² The company had an estimated value of over US\$1bn at the time and a 15% share should have had a value of US\$ 150m respectively.

⁴³ Samsung sold its shares in Kazakhmys because it assumed that Kazakhmys could not meet the LSE listing criteria. Kazakhmys managed to get listed within 16months.

Kazakhmys through his network. These loans also directly benefit its shareholders, including Kim, Ni and Nazarbayev’s brother.

Figure 9 Chinese credit Kazakhmys



Nazarbayev’s network also benefited directly from the country’s resource boom. The collapse of the USSR left the Kazakhstani economy in free fall and the state did not have the financial resources or necessary expertise to explore its oil and gas fields. This is why Kazakhstan invited International Oil Corporations (IOC) to invest and signed Product Sharing Agreements (PSAs) that led to significant revenue increases for the government. Elite members were well positioned on executive boards or (less visibly) as shareholders to benefit from the enormous investment

foreign investors were pouring into the country (Gorst, MacNamara et al. 2011).

Figure 10 Adilbek Dzhaksybekov

- | Adilbek Dzhaksybekov |
|--|
| <ul style="list-style-type: none"> • 1996 Deputy Akim Akmola • 1997-2003 Akim of Astana • 2004 Minister of Industry and Trade • 2004 Head of the Presidential Administration • 2008 First Deputy Chairman Nur Otan • 2008 Ambassador to Russia • 2009 Minister of Defense • 28th Wealthiest person in Kazakhstan with business interests in investment, finance and agriculture |

Throughout the 1990s, the elite consolidated its power based on the redistribution of revenues along the socio-political loyalties and Nazarbayev’s popularity. China’s growing interest in the Kazakhstani resource sector also boosted the government’s revenues and thus, perhaps inadvertently, contributed to the elite’s consolidation (Palazuelos & Fernandez, 2012).

Indeed, Chinese funding would become even more relevant to keep the elite in

power and to maintain Nazarbayev's popularity throughout the Global Financial Crisis in 2009/09 (Chapter 3).

These elite structures have turned Kazakhstan into a neopatrimonial Rentier State, similar to many in the Middle East, because power rests with the President and a small elite network that operates on patron-client relationships (Isaacs,2011;Franke, Gawrich et al. 2009). The President's power relies on personality cult, extensive patronage networks and factional elite politics. Such patronage relationships are characterised by a highly personal form of loyalty that drives an official's commitment to purpose, instead of a sense of obedience to abstract norms (Weber 1978). Thus patronage is the opposite of meritocracy, where individuals receive jobs and promotions based on their affiliation. The resulting nepotism leads to a misallocation of capital and resources that exacerbate systemic weaknesses, for example in Kazakhstan's banking sector, and thus increase the elite's revenue needs, which China is in a position to meet (Chapter 3). This hinders economic development, which is also suggested by Resource Course literature (Chapter 2) and increases the risk of political instability in the long term, especially if undesirable economic outcomes coincide with revenue shocks that are caused by volatile commodity prices. Against this background it is important for the regime to gain access to alternative source of funding. As will be seen Chinese trade and finance are such a source.

The ramifications of this neopatrimonial system extend beyond Kazakhstan's borders, as elite interests often interfere with the foreign policy process and investment decisions based on self-preservation and interest. Occasionally, international actors fall victim to these dynamics, a problem that China and Chinese SOEs have managed to avoid to date, most likely because of China's heavy investment in Kazakhstan and the fact that China has not factored in inter-elite conflicts yet.

Typically for a Rentier State, the development of massive oil revenues was crucial for the government to consolidate its power by redistributing revenues along family lines and socio-political loyalties (Franke, Gawrich and Alakbarov 2009, Isaacs 2011), from where they either trickle down directly to the remainder of society (Interview International Diplomat) or indirectly through subsidies and free public services (Palazuelos&Fernandez 2012). This redistribution lends the regime legitimacy in the absence of free and fair elections. Although definitions of a Rentier State vary slightly, they all focus on the creation of government funding through a resources rent rather than through the taxation of the population (Franke, Gawrich and Alakbarov, 2009). Rents in Kazakhstan are redistributed in terms of food subsidies, free healthcare and increased pensions and employment. For example, Astana subsidises the agricultural sector, which accommodates 30% of the national employment and has expanded state employment to 24% of the work-force (ILO 2013). As a result public sector salaries are significantly higher than productivity levels, which is also characteristic of resource-rich states (Hertog, Bodor et al. 2012). Direct taxation plays a minor role in government income and allows the government to operate somewhat autonomously from its citizens, who can only make limited accountability claims against a regime that does not primarily live off domestic tax revenues. Legitimacy is achieved through the provision of services and the redistribution of funds for which the government does not have to be held accountable, which is typical for oil exporting Rentier States (Chapter 2). This also benefits growing Chinese investment, which is very unpopular among the Kazakhstani population and it would be more difficult for a government to accept that is held more closely accountable by its electorate (Interviews Investment Expert 1, Local Investment Expert). The lack of political accountability also explains how the government was able to spend 22% of GDP on the construction of the new capital, Astana (Trofimenko 2007 in Franke et al. 2009). To generate the necessary revenues, Astana tapped extensively into its resource sector. As a result, Kazakhstan has since lost direct control over its oil and gas resources to foreign investors, who control 80% of the country's daily production (Palazuelos & Fernandez 2012).

Nazarbayev's popularity (Bertelsmann, 2012) constitutes the second pillar of legitimacy for the patronage system (Isaacs, 2011). His popularity rests on several factors. The President is closely linked to Kazakhstan's independence from a complicated relationship with the USSR and receives credit for Kazakhstan's contemporary political stability and for improving Kazakhstan's international prestige (BTI 2012:2) He is also credited for replacing the Russian elite with ethnic Kazakhstanis, thereby 'handing back' Kazakhstan to Kazakhstanis. His popularity can be attributed, in some degree, to the oil boom that resulted in segments of the population being lifted out of poverty. However, Nazarbayev's popularity is not inviolable and can be threatened by corruption scandals that reveal how the elite enrich themselves personally or by generally declining state revenues. In 2012, the regime's legitimacy was deeply shaken by violent unrest amongst western Kazakhstan's oil workers over low wages and constituted the biggest political challenge to Nazarbayev since independence. As will be shown later, Nazarbayev turned to Beijing during the financial crisis to secure loans that allowed him to save face and escape questions about his appointments in the banking sector and the true extent and whereabouts of Kazakhstan's state assets (NF discussion, below).

These configurations of legitimacy have two immediate consequences that facilitate China's economic influence: Firstly, because legitimacy is intrinsically linked to the redistribution of revenues, the government becomes susceptible to declining revenues (Chapter 2). The global financial crises, for example, depressed oil and gas prices and thus funding in Kazakhstan, which also affected the Kazakhstani banking sector (Chapter 3). Arguably this gives disproportionate influence to any foreign partner who can bridge those funding gaps. The thesis will show that China is that partner. In 2009, Astana turned to Beijing for financial help because alternative sources of funding, most notably from Russia, had fallen by the wayside (Chapter 3). Although governments seldom remain unaffected by declining economic fortunes, the negative repercussions are more pronounced in Rentier States, whose elites can come under direct threat when incomes abate - which also played a role in the Arab

Spring that brought elites across the Middle East and Africa to fall (Meija, 2012). However, even before the financial crisis, China's economic influence contributed to the power consolidation of Kazakhstan's elite (Palazuelos & Fernandez, 2012) and assisted the elite in maintaining power in the hostile economic environment of the financial crisis two decades later. Kazakhstani rent revenues experienced a significant boost when Russia and especially China developed a greater interest in the country's resources towards the end of the 1990s. China was a relative latecomer to Kazakhstani resources and entered the market several years after Chevron, ENI Agip and Royal Dutch Shell. However, following its first major investment in 1997 through CNPC's acquisition of a 60.3% stake in AktobeMunaiGas (AMG), it paid increased attention (CNPC). At the time, this was the biggest Foreign Direct Investment (FDI) by a Chinese National Oil Company (NOC). More importantly however, as part of the acquisition China committed to finance a pipeline from Kazakhstan to China. The pipeline was strategically important as it broke Russia's monopoly on Kazakhstan's export infrastructure. Until then Russia controlled Kazakhstan's export pipelines and could dictate tariffs and by extension the price of oil. Kazakhstan's landlocked position makes it vulnerable to such export dependencies (Chapter 5). The Sino-Kazakhstani pipeline gave Astana more leverage for negotiating tariffs with Russia and thus allowed the elite to tap more fully into the revenue potential of the country's hydrocarbon resources. The entry of Chinese NOCs also increased competition for Kazakhstani resources. Thus, perhaps unknowingly, China has become an important financier of the Kazakhstani elite. It may not be coincidence that Kazakhstan's GDP experienced its strongest growth rates after CNPC's investment in 1997, when GDP dipped briefly and increased from -1.9% in 1997 to 13.5% by 2001 (Figure 21). This also allowed the elite to continue to live off its energy-driven revenue stream, whilst foregoing any meaningful structural changes that would diversify its income. Instead, Kazakhstan has become even more dependent on resource revenues and hence more dependent on investment in this sector, substantially increasing the effects of the Dutch Disease (Chapter 2). Although Kazakhstani energy resources are competitive

and attract interest from IOCs from diverse geographies including India, Italy, Brazil and the US, the government has increasingly facilitated Chinese investment in this sector, although this has negative consequences for Kazakhstan's economy in the long term and is generating economic dependencies on China (Chapters 3, 4 and 5).

Secondly, the particular economic and legitimacy needs of the elite also interfere with Kazakhstan's foreign policy. Where elite and national interest conflict, the elite usually prevail in Kazakhstan, which also affects foreign relations and investment. This also positively affects China's ability to translate its economic influence into political power, a point that becomes salient in the case study in Part II. The chapter seeks to demonstrate that unlike its international alternatives, Chinese economic influence is more aligned with the elite's needs and interests. This point will be elaborated throughout this chapter and the thesis and is a significant factor in explaining why and how China has been able to increase its economic influence in Kazakhstan to the point that it has created economic dependencies that are damaging to the Kazakhstani economy in the long term. These elite dynamics are also relevant to understanding China's success in using its economic influence as leverage towards political ends and which fall outside the lens of any analytical frameworks that operate on the systemic level in IR.

Aside from benefitting the elite's consolidation of power, members of the elite likely also directly benefitted from increased Chinese investments through side-payments that accompany such resource deals (Interview International Diplomat, Astana). For example, Timur Kulibayev, married to Nazarbayev's daughter, is under investigation for allegedly having received side-payments from CNPC in conjunction with the sale of a 25% stake in KazMunaiGas (KMG) in 2003 (Chazan, 2010). Although not proven in a Kazakhstani court, a number of Kazakhstani officials (including the President himself and his relatives) are under investigation for money laundering abroad. Lawsuits against IOCs who operate in Kazakhstan revealed substantial side-payments. Italian prosecutors are considering whether ENI's

Kazakhstani subsidiary, Agip KCO should be banned from negotiating contracts in Kazakhstan as part of a corruption investigation (D'Alessandro & Jewkes 2012). The reality of side-payments and corruption is reflected in international rankings (Figure 4) and can explain how many Kazakhstani officials have managed to become billionaires (Kazakhgate, below). The elite also benefit from Chinese investment through their shares in companies. It is these companies that are often at the receiving end of concessional Chinese loans. For example, Astana's purchase of Kazakhmys shares from Vladimir Kim in 2010 was financed through concessional loans from China (Chapter 5) and turned Kim into a billionaire. Corruption scandals however, pose risks to the regime's legitimacy at home and its reputation abroad and incentivise the elite to seek out economic transactions with investments that are more discreet. In theory, any such source should be welcomed by the elite. However, whilst other investors have fallen aside in recent years, Beijing has substantial foreign currency reserves that it can invest abroad and which offer such discretion in the absence of anti-bribery laws and media-scrutiny of such transactions. This further facilitates an inflow of Chinese investments into Kazakhstan, especially in recent years.

3.3 Concentration of State Assets and Economic Power

Kazakhstan's privatisation created a new class of wealthy businessmen and oligarchs who not only extend the President's power into key industries but occasionally also openly challenge his power. Prominent examples of such oligarchs are Alexander Mashkevich, the key shareholder of the Eurasia Natural Resource Corporation (ENRC)⁴⁴, Vladimir Kim from Kazakhmys and Mukhtar Ablyazov, who made his fortune in the finance sector. Mashkevich's close link to the President is captured in the frequently-cited account of his shopping spree for the President at Versace in London (Gorst, MacNamara et al. 2011). These newly-empowered

⁴⁴ He is one of the three main shareholders of ENRC. All three were under investigation in Belgium between 1995 -2011 for money laundering which is why none of the three shareholders served on ENRC's executive board.

businessmen began to form financial–industrial elites (FIE), groups of individuals aligned through common economic and sometimes political interests (Junisbai 2010:263), who compete for access to the President and, if that fails, also oppose him. Kazakhstan’s finance sector in particular has produced a number of such challengers such as Mukhtar Ablyazov (BTA Bank)⁴⁵ Rakhat Aliev or Prime Minister Akezhan Kazhgeldyn. In order to re-gain better control over state assets but also to pre-empt further elite fragmentation and the emergence of challengers, Nazarbayev began to renationalise and centralise national assets under his control which culminated in the merger of two state-funds and his control of the National Fund (NF). These developments perhaps inadvertently benefited China’s economic influence, because it created greater demand for outside financing (Kazakhmys, above), a centralised system of economic decision making which could be targeted and an investment environment that benefitted indirectly those Chinese companies who appear to have largely escaped such renationalisation efforts.

The National Fund

The NF is said to be similar to the sovereign wealth funds (SWFs) of other resource-rich economies, such as Norway’s government pension fund or Australia’s future fund (MOF 2012). In August 2000, when oil revenue began to increase significantly, the government established the NF (NF 2000) to stabilise the economy during crises, accumulate savings to anticipate the end of the resource boom and to contribute to the government budget (SWF 2013). Such a fund can be particularly important in a Rentier State where the regime is more vulnerable to economic shocks and access to alternative funds is important to manage and pre-empt the risk of political instability. Yet it is different from Norway’s SWF in a number of aspects. First of all, the President⁴⁶, not the Parliament, controls the fund, oversees all its activities (Kalyuzhnova, 2006) and can determine any discretionary payments

⁴⁵ Formerly Bank TurAlem (BTA)

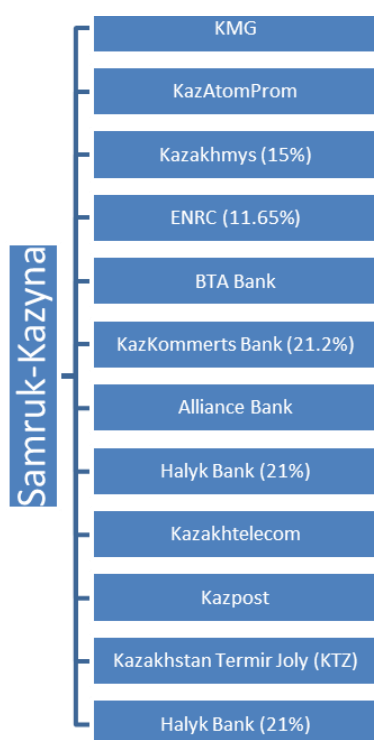
⁴⁶ He is in charge of regulation, oversight and approves external auditing.

into the fund (Kalyuzhnova, 2011)⁴⁷. The fund is inadvertently an instrument of elite consolidation as it contributes to the government budget, which can be used to facilitate political and economic loyalties.

The fund is an interesting variable in Kazakhstan’s decision to turn to Beijing for financial help at the peak of the financial crisis, which accelerated China’s economic influence in Kazakhstan (Chapter 3). Kazakhstanis interviewed by the author were puzzled why Astana turned to China for credit at that time, since the NF had substantial reserves to see the economy through the crisis (Interviews European Diplomat 2, Local Finance Expert 1, and Investment Expert 1).⁴⁸ In fact, during the crisis, Nazarbayev activated the NF for the first time in its capacity to stabilise the

economy by providing an overall stimulus package of US\$10bn, the same amount that Beijing had extended as a loan. There are indicators to suggest that this was necessary because Kazakhstan’s state assets were smaller or less liquid than commonly believed, and China’s loan not only bridged a significant funding gap, but also helped Nazarbayev to safe face and pre-empted critical questions about the true state of Kazakhstan’s finances which could undermine his popularity (Chapter 3, 4 and 5).

Figure 11 Samruk-Kazyna



Samruk-Kazyna

The financial crisis also provided an opportunity for Nazarbayev to centralise state assets and bring them under closer

⁴⁷ The fund has two accounts, one designated for savings and one stabilise the economy. A formula based on the oil price and the government budget determines how much money goes into each account.

⁴⁸ As of 2011 the joint assets of the NF and NBK are approximately US\$ 70bn.

control through the creation of Samruk-Kazyna (SK), a national holding company of all Kazakhstani state assets (Hoagland 2009g). SK was the result of a merger between Samruk, the Kazakhstan Holding for the Management of State Assets, and Kazyna, the Sustainable Development Fund of Kazakhstan. The new super fund owns wholly or partially the country's most important companies including KMG, KazAtomProm (KAP) and many financial groups including the Development Bank of Kazakhstan (KDB) (Figure 11). Its assets are roughly valued at half of Kazakhstan's GDP (Pazaluelos & Fernandez 2012). Perhaps not surprisingly, SK also holds shares in ENRC and Kazakhmys to which Nazarbayev maintains close personal links (Kazakhmys, above).

Nazarbayev appointed his son-in-law, Timur Kulibayev, at the helm of SK as the Chairman of the Board of Directors and Karim Massimov, his (trusted) Prime Minister to the Board to exert control over SK (Bnews.kz 2012). The latter is of interest because Massimov is widely considered a key facilitator of China's economic interests in Kazakhstan (discussed below). In 2012 Nazarbayev replaced Massimov with Umirzak Shukeyev, who also has close links with the President (Tengrinews 2011c): previously Shukeyev had served as the Deputy Head of the Presidential Administration and Vice Prime Minister (Samruk-Kazyna 2012). Beyond SK, Nazarbayev also nationalised Kazakhstan's then biggest bank BTA, which had run into financial difficulties (Hoagland, 2009g). Many of Nazarbayev's challengers have emerged from Kazakhstan's banking and financial sectors and the nationalisation of BTA can be viewed as a move to control the emergence of challengers (Interview International Finance Expert).

The centralisation of state assets in one entity should arguably allow Astana to exert firm control over FDI into assets under SK management. However, the centralised structure of SKs also created a single point of contact (or target) for foreign investors who want to acquire Kazakhstani assets. It appears that Beijing has understood how to work with and through these centralised structures. For

example, in the past, CNPC targeted Timur Kulibayev as the head of SK, which has come to light in an anti-corruption investigation in conjunction with the sale of oil assets to CNPC in 2003. Furthermore, Beijing initiated the creation of a joint investment fund between SK and CITIC - called the Samruk-Kazyna CITIC Investment Fund - to channel investments into Kazakhstan (Chapters 4,5). Indeed, the centralisation programme was successful and Nazarbayev exerts even more direct control over the economy. For example, in 2008, the President appointed Kaingeldy Kabyldin as the head of KMG, who has a reputation for being a strong proponent of resource nationalisation. His appointment is consistent with Nazarbayev's strategy to regain control over Kazakhstan's resources, which Kabyldin implemented effectively. Before he took charge of KMG, IOCs could acquire minority shares⁴⁹ in the Kazakhstan Caspian Transportation System (KCTS), which was no longer possible thereafter (Hoagland, 2010c). This also offers insights into China's rapidly growing economic influence even though the Kazakhstani government officially became far more critical of China's resource ownership to the point that Kazakhstan pledged to cut Chinese investment. The official rhetoric however, could not stymie Beijing's forays into Kazakhstani resource. This posits the question whether Beijing can bypass such government restrictions, possibly by targeting junior administrators. However, this is unlikely. There are indicators that the elite are indeed more firmly in control of SK than before. For example, a senior Chevron executive complained that business transactions and programme implementations have stagnated, as mid-level bureaucrats are too afraid to make decisions that are against the top of the elite (Hoagland 2009g). In view of the elite's effective control over the resource sector, it is more likely that Beijing does not bypass these restrictions but rather that it can increase its investment with elite consent. With the new degree of centralised control through SK, furthermore, it is likely that Chinese ambitions to acquire lucrative resources will be successful in the future, given that the elite controlling SK has demonstrated that it is receptive to continued investment and

⁴⁹ Initially IOCs including Chevron and ExxonMobil had approval for a 49% share of the Eskene-Kuryk Pipeline Segment from the Minister of Energy and Mineral Resources, Sauat Mynbayev. However, Kabyldin interfered unexpectedly to stop the project (Hoagland 2009f).

consents to such investment. That SK is receptive to Chinese investment was underlined by the creation of the joint sub-fund, CITIC, Kazyna Investment Fund (previous paragraph) (KCM 2008).

Nazarbayev's renationalisation programme of national resources was also motivated by the perception that Kazakhstan had sold its resource assets on unfavourable terms to foreign investors from a position of weakness in the 1990s (Interview European Diplomat 1). The government pursues a mixed strategy that involves exerting indirect pressure on companies through taxes, fines and changing regulations, and direct repurchasing programmes which are expensive to finance. This increased demand for external sources of funding, which in theory could have benefitted the economic influence of any foreign financing source. However, there is evidence that it was Chinese loans that assisted Astana with the renationalisation efforts (see Kazakhmys, above), more so because Beijing possessed the necessary financial capabilities at conditions that meet the needs of the elite. It is doubtful that Beijing's growing financial clout in Kazakhstan up until 2008/09 was the result of a deliberate foreign policy, but rather the outcome of an opportunity created by Astana's financing needs. This changed somewhat during the crisis, when private Chinese institutions, especially CNPC, likely recognised these funding needs as a strategic opportunity to gain access to Kazakhstani resources (Chapter 3). The ongoing tension between privatisation and central control also created a difficult investment climate that particularly deters private international companies. The first attempt at slowing down privatisation came in 1997, when Nazarbayev appointed the Minister of Energy, Nurlan Balgimbayev, as PM and as head of KazakhOil. Balgimbayev was famous for his stance on nationalisation and eventually created KMG. His return to Nazarbayev's administration in 2008 was widely interpreted as a sign that the President intended on reviving the renationalisation of resources, which he underlined by creating SK (Sharip 2007). The renationalisation drive, on top of prevalent rent-seeking behaviour of the elite, aimed at extracting ever greater rents (taxes or fines) to increase government and

personal revenue streams, created a difficult investment environment that is also reflected in a low ranking in the World Economic Forum's (WEF) Global Competitive Index (GCI) (Apostolou 2001). However, this environment seems to further benefit Chinese companies who appear to escape these renationalisation and rent-seeking trends, a point that will be discussed in more detail further below (Sharip 2011).

3.4 The Elite's needs drive China's economic influence

The misallocation of capital in a Rentier State like Kazakhstan creates systemic weaknesses (Chapter 2) which further facilitate economic influence from China rather than alternative sources, even though this influence generate dependencies on Beijing (Chapter 5). These weaknesses can be grouped into three areas:

- **Corruption** threatening the regime's legitimacy
- **Nepotism** leading to a misallocation of capital and funds
- **Vulnerability** to declining revenues

The centralisation of power in a small elite network also fosters corruption, which is reflected in Kazakhstan's poor performance across relevant indices (see Figure 13 and Figure 4). For example it consistently ranked in the bottom 15% in Transparency International's Corruption Index (Transparency International, 2012). From 2011 to 2012, Kazakhstan dropped from 120th place and a peer group including Ethiopia and Bangladesh, to 133th place in 2012 along with Honduras, Guyana and Russia; China in comparison ranks 80th. Personal enrichment and corruption at the elite level, although widespread, are tolerated by Nazarbayev as long as the individual does not fall out of favour and transactions remain discreet and do not damage the President's image through publicity. Although it is possible that Kazakhstanis do take the existence of small levels of corruption for granted they are susceptible to corruption scandals on a grand scale involving millions of

dollars and which are often subject to commentary on websites (Interview Legal Expert). Such revelations can threaten the legitimacy of the regime, which is why the elite exert significant control over the media (see Media Landscape, below). The author noted that this has also led to a certain degree of cynicism among Kazakhstani interviewees. Indeed, with every challenge to Nazarbayev's power, the regime has committed more resources to censor media reporting, such as after the Zhaozan Riots in 2011 (Economist, 2012).

IOCs in particular in Europe and the US have become subject to stricter anti-bribery laws, which have led to a number of high-profile investigations abroad that even involved Nazarbayev himself and his family and which reverberated into Kazakhstan and are topic of conversations on websites. Arguably this incentivises the Kazakhstani elite to become more receptive to Chinese investment because it is discreet and easily available.

The First Family

Nazarbayev's family itself takes an important position within the elite network and many key positions in the economy are filled with Nazarbayev's immediate and (distant) relatives who have benefitted significantly. Nazarbayev's three daughters are exceptionally wealthy and are married to individuals who have been installed into strategic positions and now exert control over media, security forces and key resource industries (Olscott 2002, Junisbai). For example, Dariga Nazarbayeva, Nazarbayev's eldest daughter, currently ranks as the 13th wealthiest person in Kazakhstan (Forbes 2012) with an estimated fortune of US\$600m and wields significant control over Kazakhstan's media (BBC 2012, Lillis 2012b). She also controls 36% of Nurbank, where she serves on the board of directors. Her (ex-) husband, Rakhat Aliyev, had a significant falling out with the President in 2007 and lives in Austria. Beforehand, Aliyev was deputy head of the Tax Police and Deputy Chairman of the National Security Committee (KNB), where he oversaw Kazakhstan's anti-corruption efforts. Aliyev allegedly abused his position to exert

pressure on businessmen and extort shares in their businesses, but denies these accusations. This triggered a serious inter-elite conflict and challenge to Nazarbayev's power in 2001 (Isaacs 2011). Affected businessmen, including Mukhtar Ablyazov, wrote an open letter to the President requesting to censure Aliyev. When Nazarbayev backed his son-in-law instead, these businessmen set up an opposition party, "Democratic Choice" which dissolved after some of its benefactors (including Bulat Abilov and Galymzhan Zhakiyanov) fled the country or where stripped of their assets (Junisbai 2010). However, when Aliyev announced his intention to run against Nazarbayev several years later, he had to flee the country. Aliyev lives in exile in Austria, from where he accuses Nazarbayev of corruption and occasionally releases incriminating documents (Kompromats).

Nazarbayev's second eldest daughter, Dinara Nazarbayeva, is married to Timur Kulibayev, who was viewed as gatekeeper to Kazakhstan's hydrocarbon resources until the end of 2011 and who some still consider a potential succession candidate (Hoagland, 2010d, LeVine 2010); Nazarbayev introduced Kulibayev as his successor during a state visit to Russia (Interview Finance Expert London). He is a part-time advisor to Nazarbayev and served as the Vice President of KMG, as well as KazTransOil, which transports 80% of Kazakhstan's national oil. Until 2011 he was chairman of SK before his dismissal following the Zhanaozen unrests. Kulibayev is under investigation for having received US\$166m from CNPC in conjunction with the sale of a 25% stake in KMG (AMG) in 2003, which CNPC acquired significantly below market price (Sharip 2011). Kazakhstan initially sought US\$400m for the AMG share and sold for only US\$150m in 1997. Within the same year, CNPC already generated profits of US\$240m from the oilfield, indicating that the stake was sold below market value. In 2012, Swiss authorities investigated Kulibayev on suspicion of money laundering and misappropriating funds related to his posts at KazTransOil and the CNPC case with KazMunaiGas as well as Nazarbayev himself (Hauptli, 2011). The couple has a joint net worth of US \$2.6bn (Lillis 2012b). Dinara is a main

shareholder of Halyk Bank⁵⁰ and has come under scrutiny in Switzerland, for the purchase of a US\$80m (SFr74.7m) villa in Geneva (Bradley, 2010). In Kazakhstan, where the average monthly income fluctuates around the US\$300 mark, such revelations have the potential to create resentment among the population (Mukhtarov, 2012). For example, in 2012 a rare anti-Nazarbayev demonstration took place in Almaty which drew over 1,000 protestors and demanded for the President to “(r)eturn the country’s riches to the people” (Ma-Shan-Lo, 2012).

3.4.1 Media Landscape

The threat inherent in such revelations is reflected in the regime’s efforts to control Kazakhstan’s media. The constitution provides for a free media but in practice Kazakhstan’s media landscape is characterised by censorship and self-censorship, often because the elite controls stakes in media outlets (US State Department, 2006): Six out of the seven nationwide television broadcasters are wholly or partly owned by the government and it also controls the country’s printing presses. Dariga’s Khabar monopolises national TV and heads the Committee for Social and Cultural Development, which drafts regulation on media content in the Majilis (US State Department, 2006).⁵¹ The elite own one of the country’s biggest newspapers, Karavan, and virtually abolished independent regional radio and television stations (Cummings 2005:27). Bulat Utemuratov owns Chanel 31, the Megapolis newspaper and Navigator, an online news portal (Satpaev, 2007). Media repression has increased along with the centralisation of Nazarbayev’s power and as a result, Astana now imposes some of the greatest restrictions on freedom of speech in the world (Reporters Without Borders, 2012). Reporters are regularly harassed,

⁵⁰ Halyk Bank had a market share in banking assets of 16.8% and of 21.6% in 2010. Announcement: Moody’s Disclosures on Credit Rating of Halyk Savings Bank of Kazakhstan.

⁵¹ In a 2012 debate the committee determined which channels are included in satellite receivers. It is unlikely that government critical stations were included (Ayanov 2012).

attacked and imprisoned.⁵² As a result Kazakhstan now ranks 162nd/ 179 in terms of free press (Figure 4). This is consistent with characteristics that authors of Rentier State Literature have identified. Accordingly, Rentier States divert a significant portion of their rent income to build a repressive apparatus to prevent challenges to their authority (Karl 2007)

Despite Astana's tight control several high profile scandals have been revealed in the past through western media outlets. A string of corruptions scandals were triggered by stricter anti-bribery laws in the west, combined with greater media scrutiny of IOCs, which exposed the elite and even Nazarbayev himself to a number of corruption scandals that reverberated in Kazakhstan, often helped by exiled former members of the elite who pursue their own agenda (Alexeev 2010). Online newspapers like Respublika, which moved its offices to Russia, report these scandals online. For example, in 2012 Kulibayev was subject to another investigation in Italy. Italian prosecutors threatened ENI to suspend its activities in Kazakhstan based on allegations that its subsidiary Agip KCO has paid at least US\$20m to Kulibayev for access to the prestigious Kashagan oilfield (D'Alessandro 2012). Kulibayev denies these allegations. International investigations also implicate Nazarbayev himself and threaten his popularity, one of the two pillars of legitimacy. It is likely that in response, media content is regulated through laws that prohibit journalists from writing about the wealth or health of Nazarbayev and which stipulate that no more than 20% of total television broadcasts can contain foreign programmes. Senior officials regularly file lawsuits against newspapers and journalists who report on corruption in government circles (Taukina, 2012). This is relevant to the thesis in that the elite increasingly searches for more discreet business transactions that do not shine an unfavourable light on their wealth. Russia and China, can offer such transactions. However, Russia has fallen by the

⁵² Daniyar Mokdashev, editor of Respublika a critical newspaper disappeared from his home in 2011 around the general elections. Several days later he resigned via SMS from Belarus and Respublika's website was inaccessible for much of 2011 (FreedomHouse 2012).

wayside as an investor, which has led the elite to turn increasingly to China for investment and funding (Chapters 4,5) and incentivise the elite to acquiesce with Chinese interests (Chapters 7, 8).

The most famous of these investigations is the James Giffen Affair, also known as 'Kazakhgate' which was reported in Kazakhstan's online media space (Alexeev, 2010) and even entered Kazakhstani politics. Zamanbek Nurkadilov, the former Akim of Almaty and Minister of Emergency Situations was fired from his post when he demanded an investigation into the allegations. He was found shot several days later and within weeks of an upcoming Presidential election in which he was a popular contender (Kramer 2005). The murder investigation concluded somewhat dubiously that Nurkadilov had committed suicide, first shooting himself twice in the chest and then in the head (Harris 2012). Lukpan Akhmedyarov, a regime critic and award-winning journalist who also reported on corruption, survived a murder attempt in 2012 (Lillis 2012a).

3.4.2 Case Study: Kazakhgate

The most notorious international investigation was launched inadvertently by Nazarbayev himself⁵³ and ended in a US court where he was named as co-conspirator. The ensuing scandal seriously damaged the reputation of Nazarbayev abroad and became also known at home. Since then, the President has tried to repair the damage to his reputation through enlisting a number of Washington-based PR agencies and advisors, including Tony Blair (Mendick 2011).

⁵³ Akezhan Kazhegeldyn, former Prime Minister, fell out of favour in 1998, when he ran against Nazarbayev. He fled to Switzerland and was convicted in absentia to ten years in prison for abuses of office. Kazhegeldyn made a fortune during Kazakhstan's transition. Nazarbayev decided to discredit Kazhegeldyn and contacted Swiss authorities to investigate Kazhegeldyn's Swiss funds. The strategy backfired. Swiss authorities noticed irregularities and informed their US counterparts about "a pattern of questionable transactions between Kazakhstan and American and European oil companies" which led to the indictment of James Giffen (Shelley 2000, Stodghill 2006).

Between 2003 and 2007, US authorities investigated James Giffen, an American businessman with extensive links to the former Soviet Union and Kazakhstan under the Foreign Corrupt Practices Act, which prohibits US companies and individuals from engaging in corruption abroad. Giffen was accused of channelling around US\$80m into accounts of Nazarbayev and Prime Minister Nurlan Balgimbayev, for Mobil, now ExxonMobil to acquire 25% of the Tengiz oilfield in 1996 (EurasiaNet 2003). The lawsuit was dropped for political reasons and whilst Giffen did not deny the allegations he claimed that he had acted on behalf of the CIA. Although the court acquitted Giffen, it is widely believed that these money transfers have taken place and that his acquittal was politically motivated (Alexeev, 2010). During the George W. Bush administration, the State Department pressured the prosecution to let the case fold to ensure Nazarbayev's support in Central Asia for US troop movements in the war against Afghanistan.⁵⁴

Figure 12 Nazarbayev White House Visit 2006



Source: White

The Giffen indictment initially accused two anonymous officials KO-1 and KO-2, later identified in Swiss court documents as Nazarbayev and Balgimbayev, of corruption

⁵⁴ George W. Bush received Nazarbayev in the White House in 2006, where Bush described Kazakhstan as a free nation, in order to maintain support for the logistics in Afghanistan (Draper 2006).

and money laundering and summarises its political implications (US Justice Department, 2003):

“The unlawful payments GIFFEN made to KO-1 and KO-2 ensured that GIFFEN [...] remained in a position from which they could divert large sums from oil transactions into accounts for the benefit of senior Kazakh officials and GIFFEN personally. The scheme thus defrauded the Government of Kazakhstan of funds to which it was entitled from oil transactions, and defrauded the people of Kazakhstan of the right to the honest services of their elected and appointed officials” (US Justice Department, 2003).

Accordingly, Nazarbayev allegedly received a large part of US\$80m in several instalments through a network of off-shore bank accounts (Simpson & Susan 2008). At times money was even channelled out of Kazakhstani state-owned entities such as TMG CCP when AMCO purchased an interest in the Caspian Pipeline CPC (Simpson and Susan 2008). Implicated officials in Kazakhstan deny these accusations.

In what could be interpreted as an admission of guilt, Nazarbayev subsequently enshrined his immunity against embezzlement and corruption constitutionally in 2010 (Orange 2010). Nazarbayev pressured the US government to avert the lawsuit and, when he failed, hired media consultancies in the US, which triggered the next round of scandals. The Project on Government Oversight (POGO) has approached the Attorney General’s Office with concerns that the Kazakhstani government may have “unlawfully financed sitting members of Congress” (POGO, 2011).⁵⁵ Balgimbayev has remained a close advisor to Nazarbayev and stayed in the resource sector, where he served as President of KazakhOil (KMG). In 2009, he became the President’s Special Advisor for the Caspian Sea which is home to the prestigious Kashgan Oil field that is currently developed by a consortium of IOCs, including

⁵⁵ The letter details how Astana allegedly enlisted the help of Alexander Mirtchev’s PR consultancy in D.C. to expropriate two brothers of their investment in Kazakhstan. Astana initially hired Mirtchev to repair Nazarbayev’s image abroad. Among the allegations against Mirtchev is a list of phone calls by opposition figures in the US that was handed to the Kazakhstani government (Pogo 2011).

those named in the indictment against Giffen, including ExxonMobil and ConocoPhillips. This also moves Balgimbayev into the close proximity of Beijing, since the Kashgan oil is earmarked for the Kazakhstan-China oil pipeline.

Since the Giffen trial, the situation in Kazakhstan has not improved and the World Bank's (WB) anti-corruption programme continues to rank Kazakhstan as one of the world's most corrupt countries (see Figure 13). The ranking only captures Kazakhstan's relative performance vis-à-vis other nations, which could gloss over absolute improvements. However in conjunction with country-specific indicators (Transparency International and WGI, Figure 13, 14), it is obvious that the situation has not improved and rather reversed.

These corruption scandals shine an unfavourable light on the elite at home and abroad and have the potential to threaten its power. The inexplicable wealth of government officials and Nazarbayev's family give the elite reason to worry about any future revelations. The lack of transparency, in conjunction with international corruption rankings, casts serious doubt over the legitimate income of Kazakhstan's elite. The above may simply be the small number of instances that have been exposed. The real extent of illegal transactions probably far outstrips the known volume. Although direct side-payments are not exclusive to transactions with China, as in the case of Kulibayev, Chinese funding will likely play a greater role in the minds of the Kazakhstani elite in the future. Legislative changes in the West⁵⁶, stronger anti-bribery laws and subsequent public investigations incentivise the Kazakhstani elite to conduct business with alternative sources instead of IOCs. The lack of such laws in China ensures that deals are discreet and carry little risk of becoming subject to public trials and scrutiny. Hence Chinese transactions are increasingly attractive for Kazakhstan's elite. In conversations with the author,

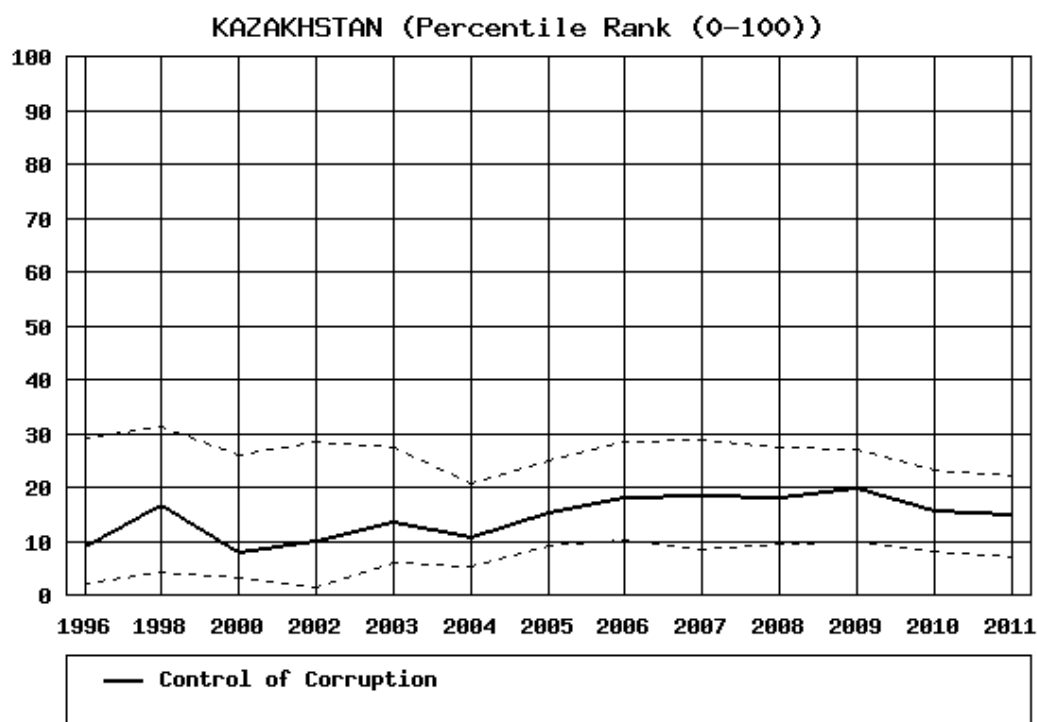
⁵⁶ Vaguely refers to international investors who are incorporated in the world's most developed nations including the EU and USA. For example under the UK Bribery Act "[i]t is an offence for UK nationals and bodies incorporated under UK law to bribe anywhere in the world". Any action that can be considered a bribe in the UK will also be a bribe when conducted abroad (UKTI 2012).

international investment advisors agreed that the stronger anti-bribery laws will benefit Chinese and Russian companies on the ground arguably because the Kazakhstani elite appears amenable to such bribes (Kazakhstan Investment Day Conference, London, 2011). This could also explain why the elite continues to welcome growing Chinese investment into Kazakhstan's resource sector despite official commitments to cap Chinese inroads, which are hugely unpopular among Kazakhstanis (Chapter 5). Consequently, elite interests in Kazakhstan are often aligned with Chinese interests, not only driving Chinese finance and investment further, but also facilitating Beijing's ability to use its economic influence as leverage towards foreign policy objectives (Chapters 6, 7 and 8). The expectation of the Kazakhstani elite on the prospects of future funding from China is also a factor that operationalises economic dependence (Chapter 2) and is thus relevant to the thesis.

However, it is possible that this particular incentive to turn to Chinese credit lines can be better captured through the dynamics of authoritarian cooperation and regime diffusion (Chapter 2). It is possible that the Kazakhstani elite prefer China's economic influence because China is, similar to Kazakhstan an authoritarian regime. However this would require further analysis which is beyond the scope of this dissertation.

Kazakhstan's worsening corruption performance further underpins this trend (see Figure 4). Maksat Idenov served as VP of KMG and was widely recognised as an able businessman who was committed to introduce international commercial standards to KMG (Ordway 2008). He resigned in order to work for ENI, after announcing that he would leave his post to work for western oil companies, as he thought that the Kazakhstani government was no longer interested in developing the oil fields along commercial principles rather than politics.

Figure 13 World Bank Corruption Rank ⁵⁷

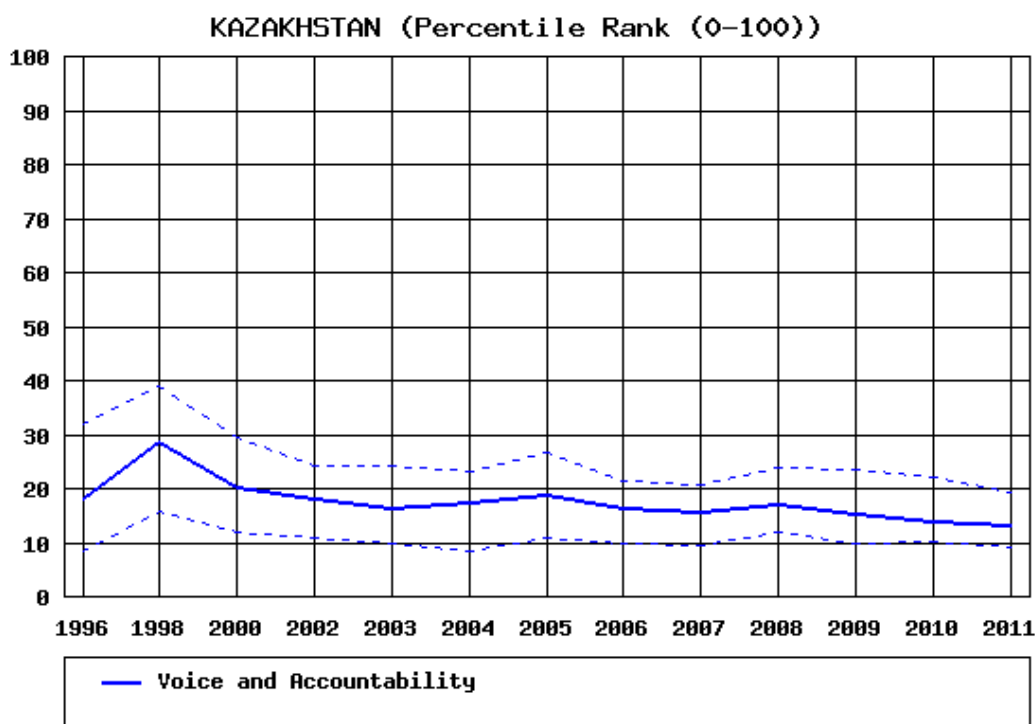


Source: Kaufmann D., A. Kraay, and M. Mastruzzi (2010), *The Worldwide Governance Indicators: Methodology and Analytical Issues*

Note: The Worldwide Governance Indicators (WGI) are a research dataset summarizing the views on the quality of governance provided by a large number of enterprise, citizen and expert survey respondents in industrial and developing countries. These data are gathered from a number of survey institutes, think tanks, non-governmental organizations, international organizations, and private sector firms. The WGI do not reflect the official views of the World Bank, its Executive Directors, or the countries they represent. The WGI are not used by the World Bank Group to allocate resources.

⁵⁷ The corruption index is an aggregate of several indices including the ADB, Global Integrity Index, Gallup World Poll, Political Risk Services International Country Risk Guide and Institute for management & development World Competitiveness Yearbook (WBI 2012). Kazakhstan's corruption is also captured in the Business Anti-Corruption Portal (Global Advice Network 2012).

Figure 14 World Bank Voice and Accountability Ranking⁵⁸



Source: Kaufmann D., A. Kraay, and M. Mastruzzi (2010), *The Worldwide Governance Indicators: Methodology and Analytical Issues*

Note: The Worldwide Governance Indicators (WGI) are a research dataset summarizing the views on the quality of governance provided by a large number of enterprise, citizen and expert survey respondents in industrial and developing countries.

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Although Kazakhstan pursues an official anti-corruption policy (OSCE) it appears that anti-corruption measures are selective and often serve as a tool to censure challengers to Nazarbayev’s authority (Economist, 2009). Nazarbayev appointed close allies or family to head the National Security Committee’s (KNB) anti-corruption department, such as Rakhat Aliyev, Nazarbayev’s former son-in-law and Kairat Satybaldy, Nazarbayev’s nephew. This view is supported by a comprehensive record of investigations into high ranking officials who have moved too close to the opposition such as Mukhtar Dzakishev, the former head of KazAtomProm (KAP), Akezhan Kazhgeldyn, the former Prime Minister, Mukhtar Ablyazov, former head of

⁵⁸ (WBI 2012).

BTA and Kazhimurat Mayermanov, the Deputy Defense Minister (Hoagland 2009e). Kazhgeldyn came under investigation after he decided to run against Nazarbayev in the presidential elections. Key witness at the trial was Vladimir Kim, who has been accused of having provided false testimony (Goodley and Hollingsworth 2012).

3.4.3 Misallocation of Capital and Talent

Another factor that facilitates Chinese investment is the embezzlement and nepotism in important economic institutions, especially banks that defaulted on their international debt during the crisis, which deterred international creditors and increased pressure to search for alternative sources of financing which Beijing provided. This is also in line with the assumptions made by the Dutch Disease and Resource Curse literature (Chapter 2). For example, these weaknesses exacerbated the effects of the financial crisis and the government's need for immediate funding (Chapter 3). Kazakhstan's neopatrimonialism misallocates resources, including funding and human capital, which creates systemic weaknesses. Positions are frequently allocated based on elite affiliation rather than merit, and elite affiliation determines business transactions which are not necessarily conducted based on commercial criteria alone.

In the 1990s, it was estimated that 50% of bureaucrats in government institutions had relatives working for the government (Henderson 2000). Perhaps the elite network is especially prevalent in Kazakhstan's lucrative hydrocarbon sector (Brill Olcott 2007), where 50% of key business figures are officially members of Nur Otan, the President's party, compared to only 12.5% in other business areas (Fjæstad & Øverland 2012). Appointments are facilitated through personal networks and less so through merit, which results in the suboptimal allocation of talent. In 2008, for example, Nazarbayev appointed Serik Burkitbayev the head of KMG despite his previous record of corruption and mismanagement. As head of Kazakhtelecom, Burkitbayev bankrupted KazPochtaBank, one of the biggest and most stable banks

in the country, by moving all of Kazakhtelecom's accounts to another bank without notice. Similarly, it was Nazarbayev who first pardoned and then agreed to appoint Mukhtar Ablyazov to the head of BTA bank, after Ablyazov had been accused of corruption and exiled to Russia. Interestingly, the elite are also concentrated in the banking sector, where they hold stakes in the country's most important banks. Dinara Nazarabayeva and Timur Kulibayev are main shareholders in Halyk Bank and Nurzhan Subkhanberdin in KazKommertsbank. Since 2009, the government owns BTA Bank.⁵⁹ Rating agencies have noted that the banking sector suffers from lax due diligence standards for lending and credit disbursements (S&P 2012). It is likely that credit lines are also disbursed along elite networks and not purely on commercial terms, which causes the sub-optimal capital allocation that is symptomatic for the low development of Kazakhstan's financial market, where it ranks comparatively low, 121st/140 globally (Sala-i-Martin, 2011). By contrast, the development of Kazakhstan's economy ranks 72nd/140 (Sala-i-Martin 2011). Arguably, the misallocation of talent and capital significantly contributed to the finance sector's structural weaknesses that saw four of Kazakhstan's biggest banks nearly default in 2009 because of a Non-Performing-Loan (NPL) ratio of 30-60% (Interview International Finance Expert)⁶⁰. A string of corruption scandals involving the senior management of banks, who allegedly embezzled the banks' capital, further eroded the confidence of international investors who fled the Kazakhstani finance sector and led Nazarbayev to turn to Beijing for help (Chapter 3) (Croft 2012). The government sued Mukhtar Ablyazov in the United Kingdom for his embezzlements at BTA Bank and a 2012 BTA audit attributed the Bank's second default in 2012 to the poor management practices by state-appointed officials (Gizitdinov 2012). The mismanagement at Kazakhstani banks continues uninterrupted after the financial crisis and analysts expect that KazKommerzBank will default by 2015/2016, when a number of key loans will be due (Interview

⁵⁹ Samruk-Kazyna holds currently 81.48 % of BTA bank. (BTA Bank, 2012)

⁶⁰ KazKommertsBank's credit rating was downgraded by Moody's in September 2012, with a share of non-performing loans that has been hovering just slightly below the 30% mark since 2009 (Kazkommertsbank 2012).

International Finance Expert). This may force the government to divert revenue to bail out its banks or to raise financing from abroad, which may very well come from China (Chapter 3).

The misallocation of capital also undermines Kazakhstan's economic diversification programme, a cornerstone of Astana's policy to reduce the economy's resource dependence and to ensure sustainable economic growth in the long-term. Energy revenues are easily accessible for the elite without making major upfront investment or structural changes. This makes the resource sector an easy revenue-generating target, which the elite fully exploits. Public revenues through oil rents alone increased from 2.2% to 44% of the state budget between 1999 and 2008 (Palazuelos & Fernandez 2012). However, because resource revenue is readily available for the government to redistribute, the elite further drive Kazakhstan's dependence in this sector instead of making the necessary investment and policy changes to favour economic growth in other areas. The state of Kazakhstan's economy is also reflected in Kazakhstan's relatively poor management expertise and business practice, where it ranks among the lowest countries internationally (GCI Business Sophistication). Businesses lack sophisticated production methods to compete internationally and rely on the input of cheap resources to compete.⁶¹ As a result, alternative industries do not emerge and the country remains trapped in a vicious cycle of dependence on resource revenues. This also translates into a dependence on those foreign partners who control the largest stake in the resource sector such as China, which in 2011 controlled nearly 30% of Kazakhstan's daily oil production (Sharip, 2011).

⁶¹ Despite government targets, reliance on oil has increased, as percentage of GDP derived from the resource sector and Kazakhstan's low rank (121st) in the GCI "Business Sophistication"/"nature of competitive advantage". The category assesses the competitive advantage of a country's companies in international markets. 1 = low-cost or natural resources; 7 = unique products and processes. Porter argues that this sub-indicator alone can explain 65 % of the variance in GDP/capita between countries and thus is a strong indicator for economic performance of the economy. (Porter, 2005)

The misallocation of talent and funding discussed above increased the revenue needs of the Kazakhstani elite for which it has increasingly turned to Beijing, especially since 2009. Foreign lenders fled the country's financial markets because of ongoing concerns of mismanagement and corruption, which created a funding problem for Kazakhstani banks. This also poses the question to what degree Beijing's growing economic influence in Kazakhstan is the result of a deliberate Chinese foreign policy, or the result of the revenue and legitimacy needs of the Kazakhstani elite. The following chapters will address this question in greater detail.

Figure 15 Nurtay Abykayev

- 1989-1990 Assistant to 1st Secretary of the Communist Party
- 1990-1995 Head of Presidential Administration
- 1995 Ambassador to the UK
- 1996 First Assistant of the President
- 1998-1999 Head of the National Security Committee
- 2000-2002 First Vice Minister of Foreign Affairs
- 2002 Head of the Presidential Administration
- 2004-2007 Chairman of the Senate
- 2007-2008 Ambassador to Russia
- 2008-2010 First Deputy Minister of Foreign Affairs
- 2010- Chairman National Security Committee

3.4.4 Elite Dynamics

Kazakhstan's specific elite dynamics can interfere with Kazakhstan's foreign policy and investment, both of which allowed Beijing to expand its overall economic influence (Chapters 3, 4 and 5). Consequences of these dynamics are a distinctively short-term view on policy, which explains why the elite are open to Chinese funding even if this is detrimental to Kazakhstan's economic interest in the long term. This short-term view also forms a consistent point of frustration expressed in interviews with international observers in Kazakhstan (interviews International Development Expert, Trade Expert, Regional Finance Expert, European Diplomat 1). Furthermore, the elite dynamics produce an informal versus institutional modus of decision making that affects private companies and which China manages to exploit. Many important investment decisions are not made in the boardrooms of Kazakhstani companies but during political, face-to-face meetings with China. Chapter 5 will

show how CNPC, for example, manipulates this setting very effectively to overcome Astana's resistance to CNPCs' acquisition interest in Kazakhstani resources (Chapter 5). At the same time elite support for investment targets is essential to successfully implement deals. As will be seen, some of the country's politically most influential elite members champion China's economic interests (Karim Massimov, below).

Uncertainty: A Kazakhstani Catch-22

Nazarbayev grants and retracts access to resources and positions of influence in exchange for loyalty. Elite members are incentivised to stay loyal, since access can be retracted at any point if an individual falls out of favour (Satpaev 2007), which can be caused by opposing Nazarbayev as in the case of Akezhan Kazhgeldin or Rakhat Aliyev or by being associated with the wrong elite group (Economist, 2009). When elite members fall out of favour, they are typically accused of corruption and embezzlement, stripped of their assets and often jailed. Since personal enrichment and access to assets make elite affiliation attractive in the first place and underpins the elite-network, investigations into corruption are powerful tools for eliminating opposition since most investigations will invariably yield results. By appointing allies to head the anti-corruption committee, the President should be able to protect or expose individuals to such investigations (Economist 2009). Former Prime Minister Akhezhan Kazhegeldyn, (1994-1997), accumulated a fortune during his time in office (Olcott, 2002). When he announced his intention to run in the presidential elections planned for 1998, he was investigated for corruption and abuse of authority and fled the country. Kazhegeldyn siphoned off resources that might otherwise have been provided to the President or his allies, something which may have further motivated the investigation (Olcott 2002: 187).

Nazarbayev also occasionally 'demotes' some of his inner circle so as to 'be seen' to react to political unrest or scandals. Following the Zhanaozen⁶² violence in 2011,

⁶² Oil workers had been on strike for months over labour conditions and pay. By December 2011 these demonstrations became violent and several people were killed. It cannot be excluded whether

Kulimbayev and Kairgeldy, both high-profile elite members served as scapegoats and were dismissed. The Zhanaozen incident constituted the biggest challenge to Nazarbayev's rule and demanded an appropriate response from the President. However, the fall of these individuals is likely symbolic. It may be possible that Nazarbayev had planned Kulibayev's dismissal over the corruption investigation involving CNPC and after it transpired that Kulibayev had an extra-marital affair with Goga Ashkenazi in London (Interview International Finance Expert; Mendick 2011). With the exile of Aliyev, Kulibayev remains the only family member who can be a feasible successor to Nazarbayev and it is possible that Kulimbayev will return to the political stage (Brill Olcott 2012) (Interview International Finance Expert). Kulibayev's case reflects the uncertainties of careers within the elite network which can come to an abrupt and unforeseen end. This might also account for the distinctive short-term view on policy taken by the elite and about which international observers frequently complain (Interview Trade Expert).

Interestingly, Nazarbayev appointed Umirzak Shukeyev as the head of Samruk-Kazyna, whose career was also accelerated through his China credentials. Shukeyev headed the China-Kazakhstan Cooperation Committee (CKCC), the main bilateral cooperation mechanism where he oversaw an agreement with China to build another gas pipeline (Meta.kz 2012). Together with Karim Massimov, this may have placed another potential facilitator of Chinese interests in a key decision-making position. Massimov was Kazakhstan's longest-serving Prime Minister and his steep political career also occurred on the back of his strong China credentials (Karim Massimov, below). Another example is Nurtay Abykayev, an old friend and long-serving assistant of Nazarbayev, who was suddenly 'demoted' to an Ambassadorship in Russia in 2007, following the murder of Altynbek Sarsenbay-uly, an opposition leader (O'Rourke, 2004). After one year, Abykayev returned to

opposition figures abroad had their hands in inciting these strikes. As one diplomat observed, the strikers were very quickly organised in a very sophisticated manner including international media attention which indicates outside involvement (Interview European Diplomat 2).

Nazarbayev's inner circle and was appointed Head of the KNB (Figure 15). These examples show that there is an element of risk involved and that access to resources or a career is only somewhat predictable in the short-term. These effects are further underpinned through the regular reshuffling of key posts.

The Rotating Chairs of Kazakhstan

Nazarbayev, his family and close allies sit at the centre of Kazakhstan's political system, from where their power radiates outward into the economic realm through personal networks.⁶³ This creates an inner circle with a small number of gatekeepers⁶⁴ and loyal supporters who also champion different elite groups, economic interests and foreign policy views and who compete against each other for access to Nazarbayev (Hoagland, 2009g). The most influential posts, after the President himself, are the head of the Presidential Administration, the Prime Minister and Deputy Heads of Administration, closely followed by individuals who are close to the President in and outside of formal structures on the level below (Cummings 2005). A core group of Nazarbayev's allies have regularly been assigned key positions in the country's most important industries creating a tight nexus between economics and politics.

⁶³ Cummings defines the political elite in terms of those who exercise "preponderant political influence" (Cummings, 2005) in a formal or informal way. However, since the elite network also controls Kazakhstan's economy the thesis will expand the definition to individuals in the economic sector who exercise preponderant influence.

⁶⁴ Gatekeepers are individuals located on the level immediately below the President. This includes the Head of Presidential Administration which, as of November 2012 was Karim Massimov who is one of the facilitators of Chinese interests in Kazakhstan (Cummings 2005: 40).

Nazarbayev also regularly reshuffles key positions among his administrators in order to prevent any individual from building a power base that could challenge the President, as has occurred in the past. Officials therefore need to be cautious of maintaining Nazarbayev's favour to avoid being assigned to an unfavourable post or shuffled out. Regular reshuffles create career uncertainty amongst officials, feed into elite-conflicts and foster short-term decision making, something which is also reflected in Kazakhstan's somewhat puzzling behaviour in a water dispute with

China and which forms the case study in the second part of the thesis (Chapter 6,7 and 8).

Figure 16 Elite Structure

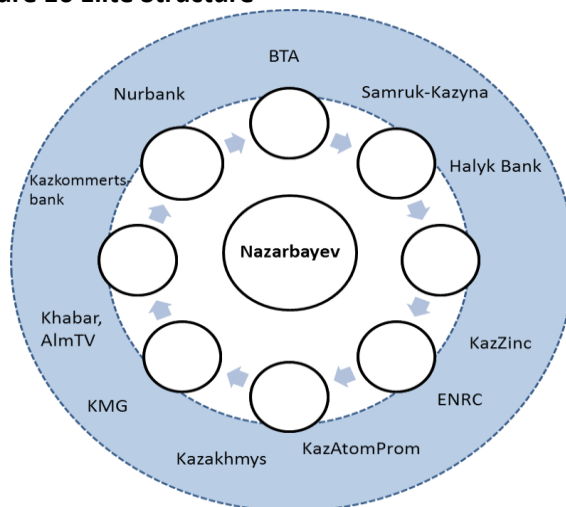


Figure 16 illustrates the elite structure graphically. The small inner circles represent officials important to Nazarbayev who have rotated through different offices, indicated by the connecting arrows. Consequently,

it is common for one person to hold several different offices both in industries and politics. For example, Vladimir Shkolnik served in all of the following positions: Minister of Energy and Mineral Resources, Deputy Prime Minister, Deputy Head of the Presidential Administration and (more recently) Head of KazAtomProm (KAP). Kairat Kelimbetov, the former chairman of SK, previously headed the Presidential Administration and was appointed Deputy Prime Minister (see Figure 17). He is also the son of Tokmukhamed Sadykov, a long-time friend and confidante of Nazarbayev - a fact that may have helped him be appointed to SK in the first place. Imangali Tasmagambetov, who some consider another potential successor to Nazarbayev, repeatedly served as assistant to the President, Deputy Prime Minister and head of the Presidential Administration (Figure 5). Similarly, Marat Tazhin has worked in Nazarbayev's administration since 1994 in various roles, including Chairman of the

National Security Committee (KNB), Deputy Head of the Presidential Administration and Minister of Foreign Affairs. Nurlan Kapparov headed KazTransOil and KazakhOil, and was Minister of Energy and Mineral Resources and Chairman of KazInvest before being appointed Minister of Environmental Protection (Government of the Republic of Kazakhstan, 2012). One interesting and notable exception to these reshuffles is former Prime Minister Karim Massimov, who has kept his position for six years (see Figure 19) for reasons that are likely linked to his strong China credentials (Karim Massimov, below).

The uncertain career prospects of elite members, as well as the regular reshuffles, may also be able to explain the somewhat short-term view that informs Kazakhstan's domestic and foreign policy decisions (Interviews Regional Finance Expert, Trade Expert, International Diplomat). This short-term view can be rooted in the uncertainties of how long an individual will stay in power and the immediate threats to the regime's overall power. Funding gaps pose such threats. It is also possible that elite members are aware that their careers can come to a premature halt and thus possibly maximise the opportunities to benefit personally from their position whilst they can. Personal enrichment in theory further benefits any foreign investor who is not bound by anti-bribery laws, such as, in Kazakhstan's case, Russia and China, which are important foreign investors along with IOCs such as Royal Dutch Shell or Total. China's growing economic capabilities in Kazakhstan come with significant opportunity costs, especially for Kazakhstan's economy in the long term (Chapter 5). The fact that the elite welcomes China's growing economic role may stem from its preoccupation with generating immediate revenue streams to ensure political self-preservation.

Informal Decision Making

Reshuffles occur within Kazakhstan's formal political institutions. Yet most of the key decisions take place in the informal realm (Issacs, 2011). Nazarbayev's closest

friends, allies and many of the country's oligarchs⁶⁵ influence the country's most important political and economic decisions without serving in an official capacity (Cummings 2005, Isaacs 2011). The political influence granted to oligarchs also further tightens the web between political and economic interests and allows Nazarbayev to project his power onto Kazakhstan's major companies (Kazakhmys, above). Relevant individuals include Valdimir Kim or Mukhtar Ablyazov and Bulat Utemuratov who served in the Presidential administration and the Council of National Security and is considered to be Nazarbayev's personal financial manager (see Figure 6). Aleksandr Mashkevich, and one of the three key stakeholders of ENRC, Nurzhan Subkhanberdin, the controlling shareholder of KazCommerzBank. He was the country's first billionaire and Kazakhstan's opposition appealed to the

Figure 17 Kayrat Kelimbetov

- 2001 First Vice Minister of Finance
- 2002-2006 Minister of Economy and Budget Planning
- 2006-2008 Kazyna Sustainable Development Fund
- 2008 Head of Presidential Administration
- 2008 Samruk Kazyna
- Father-in-law, Tokmukhamed Sadykov) was a close confidant of Nazarbayev and head of Nur Otan Almaty

LSE on the suspicion that Utemuratov's investment company Verny Capital acts as a "front for President Nazarbayev personally" (Foley 2011).

The close link between political and economic interests in Kazakhstan's elite and their informal decision-making processes means that private sector decisions are often made informally at the elite level and will be implemented in companies that are seemingly independent from the government, such as ENRC or Kazakhmys. In practical terms, this means that investment decisions are made in political meetings

between Nazarbayev or key elite members and foreign partners. This should benefit those foreign investors with support of their political leaders who negotiate on their behalf. Major investment decisions are made by Nazarbayev, especially where resources and oil and gas are concerned (Dave 2007, Franke, Gawrich et al. 2009).

⁶⁵ Interviewees in Kazakhstan referred to business magnates as oligarchs

The establishment of SK further increased the political control over commercial investments that are not made without the high-level support of Nazarbayev or his inner circle. It is thus difficult for foreign governments and investors to ignore or bypass Kazakhstan's elite structure, which determines major economic decisions. The successful implementation of a deal depends on whether it has elite support. An example from Kazakhstan's early privatisation illustrates this point; in 1993, PhilipMorris wanted to acquire Almaty Tobacco and pledged to invest US\$240m over five years (Cummings 2005:31), the biggest FDI in the former USSR at that time. The deal nearly fell apart because PhilipMorris complained about the investment conditions, context and lack of reliable tax norms. The dispute between the government and PhilipMorris could only be resolved through the intervention of Nazarbayev's family (Cummings 2005). Good personal contacts are necessary to expedite business transactions in a complicated web of bureaucratic requirements and rent-seeking strategies. Today, it takes a company on average 390 days and 38 different steps and procedures to enforce a commercial contract in Kazakhstan, which in the end costs the plaintiff on average 22% of the claim (World Bank, 2012; IFC 2012). Similarly, those surveyed by the World Economic Forum's (WEF) Global Competitive Index (GCI), have listed corruption as the biggest obstacle to conducting business in Kazakhstan (Sala-i-Martin 2011:222). Equally obstructive is a rent-seeking environment where taxes, regulations and levies change often to maximise rent extraction (Palazuelos & Fernandez 2012). Beijing and CNPC are apt at effectively using these close inter-linkages between politics and economics to their advantage (Chapter 5). Beijing benefits from this setting because key members of the elite, especially Massimov, and to a certain degree Timur Kulimbayev, facilitate Chinese interests. Furthermore, it is possible that China benefits from a low profile in elite conflicts that interfere with Kazakhstan's foreign policy, (discussed below).

It is possible that this informal and personalised way of decision making might suit Beijing, which is displayed a preference for relationship-oriented decision making

elsewhere (Interview International Water Expert 1). There is evidence that decisions to accept Chinese investment for private companies are often made through the elite network without the knowledge of senior employees or the executive board of the companies involved. In 2009, China Investment

Figure 18 Vladimir Shkolnik

Vladimir Shkolnik

- 2000-2002 Deputy Prime Minister, acting Minister of Energy
- 1999-2005 Minister of Energy and Mineral Resources
- 2005-2007 Minister of industry and trade
- 2007-2008 Deputy Head Presidential Administration
- 2008-2009 Minister of Industry and Trade
- 2009 KazAtomProm (KAP) -family connections to Russian officials. E.g. Son-in-law is a senior executive at RosAtom, Russia.

Corporation's (CIC) 11% acquisition in KMG Exploration and Production (KMG EP) for US\$993m, surprised executives at the firm, who expressed shock in conversations with diplomatic staff (Hoagland 2009a). This was a significant development for the company. The share gave CIC the right to appoint one person to the board of directors, which means that CIC will need to approve all future investment decisions of KMG EP. Similarly, in 2009, China's CNPC acquired MMG in a Joint Venture (JV) with KMG as part of a credit line. The deal was negotiated during Nazarbayev's state visit to Beijing and came after

Chinese investment faced increased opposition by the Kazakhstani public (Chapter 5). However, KMG VP Idenov was excluded from the transaction. In 2011, China also made a loan of US\$1.9bn to ENRC via SK, to expand ENRC's chrome and iron ore production. However, ENRC is a privately-held company and the loan had been negotiated during Nazarbayev's state visit to China. After the deal, ENRC's spokesperson denied any knowledge of the agreement, further highlighting high-level elite control over investment decisions and the absence of the usual corporate decision-making processes (Orange, 2011).

Karim Massimov

Within Kazakhstan's administration, Karim Massimov is considered a driving force behind China's growing economic influence and his biography features strong China credentials. As Prime Minister, Massimov was the key architect of Kazakhstan's China strategy and has become a key figure in Sino-Kazakh transactions. It has been rumoured in diplomatic circles that he has worked for either the KGB or the Chinese secret service at some point (Interview European

Diplomat 2). Massimov is an ethnic Uyghur and fluent in Chinese. After graduating from the People's Friendship University in Moscow, he applied to work for the KGB (Aliyev 2009) and subsequently studied at the Beijing Language and Culture University and Wuhan University Law School, where he graduated from in 1992 (WuhanUniversity 2007). It has been suggested that Massimov was approached and enlisted by the Chinese secret service whilst studying or working in China (Interview European Diplomat 2). Massimov has extensive work experience in China, in Urumqi as a senior trade expert at the local office of Kazakhstan's Ministry of Foreign Trade and Cooperation, as well as in Hong Kong, where he managed the Kazakhstani trading house. Based on this experience, Massimov can draw on a number of links to China which may have influenced Nazarbayev's decision to use Massimov as the primary point of contact with China. Nazarbayev has used other ethnic minorities as leverage to conduct business with their countries of origin, such as Vladimir Kim, who managed business transactions with Korea.

Massimov's exceptionally successful career in Kazakhstani politics is closely interwoven with China, his talent for attracting FDI and his ability to manoeuvre well within the Kazakhstani elite (Milas, 2007b). Indeed, Massimov was involved in the largest Sino-Kazakhstani transactions. He facilitated Beijing's decision in 2007 to

Figure 19 Prime Ministers

Prime Ministers	
• 1991-1994	Sergei Tereshchenko
• 1994-1997	Akezhan Kazhgeldi(y)n
• 1997-1999	Nurlan Balgimbaev
• 1999- 2002	Kassym-Jomart Tokayev
• 2003-2007	Daniyal Akhmetov
• 2007-2012	Karim Masimov
• 2012-	Seirk Akhmetov

finance and build the strategically important gas pipeline from western Kazakhstan to China, referred to as the “project of the century”. It is likely that this deal, for which China provided US\$5bn, propelled Massimov from the post of Deputy Prime Minister to Prime Minister within a month after the deal was announced (Sapiev & Mazhitova, 2011). Just two years later, Massimov was also involved in facilitating CNPC’s purchases of a 50% stake in MMG when Astana turned to Beijing for financial aid and in general has ‘orchestrated’ a number of high-level meetings between the Chinese and Kazakhstani heads of states (Hoagland 2009d). Massimov was the only politician who was present at the signing ceremony that established the joint CITIC-Samruk-Kazyna Investment Fund (KCM 2008). Perhaps proof of his political skill, Massimov was also the longest-serving prime minister before he resigned in 2012 (see Figure 6). Massimov’s father is a businessman who operates in the background with an “in-transparent web” of Chinese business dealings (Interview European Diplomat 2). In any case, for Chinese foreign policy makers, Massimov is an important point of contact within Kazakhstan’s administration. Analysts attest Massimov’s longevity as Prime Minister to his role in seeing Kazakhstan successfully through the global financial and economic crisis. Given China’s role in helping Kazakhstan to manage that very crisis with credit lines, as well as Massimov’s close contacts to Beijing, his success is closely interlinked with China’s increased economic significance to Kazakhstan (Chapter 3) (Hoagland 2009b). However, the ‘China Factor’ in Massimov’s career has also drawn media attention inside Kazakhstan where suspicions of all things Chinese are latent (Sapiev & Mazhitova 2011).

Following his resignation, Massimov was appointed head of the presidential administration, the equivalent of the White House Chief of Staff, one of the most influential posts in the country. A Kazakhstani study on political influence identified Massimov as the second most influential person in country after the President himself (Lillis, 2012c). The fact that he has been elevated to an even more strategic role may also be interpreted as Nazarbayev’s recognition of China as an important

foreign policy partner in the future. As head of the presidential administration, Massimov enjoys the trust of Nazarbayev, which could make him an even more effective facilitator of China's economic influence in the future.

Intra-Elite Conflicts Affect Foreign Policy and Investment

Kazakhstan's elite is not a cohesive group. Rather, over the years, sub-groups have emerged that pursue different agendas and compete with each other for access to Nazarbayev (Hoagland, 2009g). The resulting elite conflicts are typical for neopatrimonial systems (Chapter 2) and allow the President to maintain power by balancing these groups against each other (Isaacs 2011:8, Olcott 2002). Elite conflicts often occur between groups who are aligned to and promote a closer relationship with different foreign policy partners, often pitting Russia against the US. Of specific interest to this thesis is that Chinese interests appear to avoid the fate of their international counterparts and seemingly escape these elite dynamics as well as renationalisation programmes and rent-seeking behaviour. This could have a number of reasons (discussed below). However, as a result Beijing can quickly expand its economic interests in Kazakhstan.

The elite-network expanded during Kazakhstan's privatisation when it co-opted a new class of wealthy businessmen who formed financial-industrial groups (FIG), a new type of elite grouping (Junisbai 2010)⁶⁶. These groups control or own certain industries and often have champions who have served in government and are part of Nazarbayev's inner circle. The FIG resemble political parties by recruiting members into their network and serve as conduits for careers and political influence, functions that usually parties perform (Junisbai 2010). One prominent FIG is clustered around Timur Kulibayev, Karim Massimov and Kairat Kelimbetov. Bulat Utemuratov and Mukhtar Ablyazov form another group (Cummings, 2005). These groups also promote their own interests. For example, Aleksandr Mashkevich

⁶⁶ Finansovo–promyshlennyye gruppy or FPGs (Junisbai 2010). FIG is the abbreviation of the translated term.

promotes the interests of ENRC, Kazakhstan's metal energy and coal markets, the Eurasian bank and several media outlets (Junisbai 2010:244). ENRC received, concessional Chinese loans. Given Mashkevich's influential position and proximity to Nazarbayev, it cannot be excluded that ENRC benefitted from concessional financing from China because of his close relationship with Nazarbayev. ENRC's shareholders benefitted from assets that Astana seized from disputes with foreign mining companies (Gorst, MacNamara et al. 2011), which illustrates how the elite can interfere with foreign investors. ENRC also went through a much-publicized board reshuffle in London because of ownership tensions involving the Kazakhstani government (Gorst, MacNamara et al. 2011). This earned ENRC the reputation of being more "Soviet than City" (White, Mason et al. 2011). Similarly, Chinese loans financed the government's purchase of shares in Kazakhmys, discussed further above, and which turned Vladimir Kim into a billionaire.

Elite groups also promote different foreign policy partners and their associated school of thought. In foreign policy, Nazarbayev uses ethnic minorities as leverage to facilitate investment from their country of origin. Ethnicity was important in Kazakhstan's early years, when Nazarbayev replaced Russians in key positions with Kazakhstanis. Today, there are strong Korean and Uighur networks as well. Vladimir Kim is ethnically Korean with stakes in Kazakhmys where Nazarbayev used him as a facilitator for Samsung's early investment in the corporation. Two prominent Uighurs are Alican Ibragimov, one of the three main stakeholders of ENRC, and Karim Massimov, head of the Presidential Administration. It is likely that Nazarbayev deployed Massimov to deal with Beijing because of his extensive China exposure. The Uighur minority in Kazakhstan is well organized and has the potential to complicate relationships with China, because of secessionist Uighur movements in Xinjiang and the fact that many Uighurs seek refuge in Kazakhstan.

Kazakhstan's elite has been viewed as rooted in Kazakhstan's old clan structures.⁶⁷ An exhaustive analysis is beyond the scope of this dissertation. However, recent scholarship (Cummings 2005, Olcott 2002, Junisbai & Junisbai, 2005) suggests that the elite structure is a consequence of Nazarbayev's Soviet experience and an enduring Soviet legacy (Franke et. al. 2009). The first Secretary of the KCP, Kunaev established a network of patron-client ties and Nazarbayev witnessed first-hand its benefits: Kunaev's loyalty to Breshnev resulted in Kunaev's appointment and benefitted his loyal clients, including Nazarbayev who was appointed Chairman of Kazakhstan's Council of Ministers, the second most powerful post in the country (Isaacs 2011). Nazarbayev replicated the patronage system into modern Kazakhstan. Henderson notes: "Ten years after the fall of the Iron Curtain, there is growing evidence that many of the patronage networks and political controls that existed under communism are more powerful than ever" (Henderson 2000).

The Soviet Union divided Kazakhstan into administrative subunits, which developed regional identities to prevent the emergence of a powerful centre that could challenge Moscow (Jones Luong, 2002). When Nazarbayev centralised power, he also reorganised regions, which triggered conflicts with Akims and regional parliaments. Fractions can also occur between clans (Schatz and Collins 2002, 2003, 2004), a fact that older research tends to overemphasise in Kazakhstan. More recent research suggests that clan affiliation today is loosely defined and plays a subsumed role in the country's political landscape. However, the competition between different groups inadvertently drives economic and policy outcomes in Kazakhstan, depending on the interests of the group which prevails (Junisbai 2010:263).

⁶⁷ The territory of contemporary Kazakhstan was socially organised into senior, middle and junior hordes called Zhuz (translates as 100). Zhuz consisted of several tribes and clans, organised along kinship (Cummings 2005:18). Kinship was only theoretically defined. It mattered more on the top levels of the hordes. In lower levels people often lived in settlements of mixed horde lineage. Kinship became more relevant under the Soviet administration which manipulated these lineages to exercise control by creating political divisions and competition in Kazakhstan (Cummings 2005).

Elite groups are also aligned with different foreign policy partners, mainly the US and Russia, whose interests can get caught up in elite conflicts as illustrated by case studies on Anthony Sharp, Uranium One and Nation's Energy. What divides these particular groups is also a differing view on Kazakhstan's political or economic future. A useful, albeit perhaps over-simplistic division runs between 'young reformers' who promote a more liberal political climate and greater privatisation and the 'old guard' which had come of age serving in Soviet political institutions and who are in favour of a strong, centralised political system and greater national control over resources. Nazarbayev is in charge of foreign policy and the Ministry of Foreign Affairs (MFA) is located in the Presidential offices. Thus MFA officials are close to Nazarbayev, which is also reflected in his inner circle, many of which have served in an official capacity for the MFA. Based on Kazakhstan's Soviet experience, the country officially pursues a multi-vector foreign policy, that balances the great powers so that Kazakhstan will not become dependent on one country again (Nazarbayev 2006). Nevertheless, there is evidence to suggest that conflicts between these differently minded groups can interfere with Kazakhstan's foreign policy and occasionally undermine these efforts.

Nazarbayev is surrounded by a small number of gatekeepers who can influence his decisions and deny elite groups access. These gatekeepers, most prominently Karim Massimov, Vladimir Shkolnik and Kanat Saudabayev also champion different foreign policy partners (Cummings, 2005). Saudabayev, Kazakhstan's long serving ambassador to the US is widely considered the key architect of the Kazakhstani-US relationship and favours strong ties with the US. His affinity for the US is balanced by Nazarbayev's other close friend, Vladimir Shkolnik, who pursues closer ties with Russia. Shkolnik became the head of KazAtomProm (KAP) after Mukhtar Dzhakishev had been dismissed in what some view as a Russian effort to secure uranium deliveries and to prevent Kazakhstan's emancipation on the international uranium market. Shkolnik also has close personal links to Russia through his son-in-law, who is a senior executive at RosAtom, Russia's nuclear agency (Figure 18). Karim

Massimov, head of the Presidential Administration, facilitates Chinese finance and investment in Kazakhstan. These diverging foreign policy affiliations are also reflected in governmental organs. For example, the KNB, whose roots date back to the KGB and Soviet times continues to maintain a strong 'pro-Russian' outlook. Conflicts between these gate-keepers and their elite groups have affected Kazakhstani foreign policy in the past. Perhaps one of the most poignant examples of such a conflict is the Anthony Sharp Affair (below) and the mishap of Uranium One following the dismissal of KAP head Mukhtar Dzhakishev (Economist 2009).

Case Study: Anthony Sharp

The Sharp provides insight into these elite dynamics and how they detrimentally affect the relationship even with important foreign policy partners such as the US. A close partnership with the US is important for Nazarbayev, since this translates into an affiliation with the west which also helped Kazakhstan to obtain the prestigious OSCE chairmanship in 2010.

In 2008, Anthony Sharp, a Peace Corps Volunteer in Kazakhstan, was arrested for the possession of firearms after evidence was allegedly planted on him by his supervisor. The circumstances of the case are documented in a number of cables from the US Embassy in Astana (Hoagland 2009i) but are now also in the public domain (Pickens 2011a, Pickens 2011b). US diplomats considered the arrest politically motivated to harm US-Kazakhstani relations. The events that unfolded subsequent to his arrest revealed an inter-elite conflict between different governmental organs and officials, especially the pro-western grouping including (Kanat Saudabayev and his deputy Marat Tazhin) and Amangeldy Shabdarbayev, the head of Kazakhstan's KNB. Following the intervention of Ambassador Hoagland, Anthony Sharp was offered a deal in which he would stand a short trial, plead guilty and then immediately be deported to the US. Although Sharp accepted the deal, the Kazakhstani government did not live up to its end of the bargain and it took over six months and the intervention of Nazarbayev to send Sharp home. The KNB

had been in charge of bringing Rakhat Aliyev, Nazarbayev's former son-in-law, back to Kazakhstan and was frustrated "if not deeply annoyed" that the US did not support Kazakhstan's extradition request to Austria (Hoagland, 2009i). Consequently, the KNB tried to undermine the US-Kazakhstani relationship. The incident also contributed to the abrupt suspension of the Peace Corps programme in Kazakhstan in 2011 (Lillis 2011).

Case Study: Uranium One, Nation's Energy

Uranium One, a Canadian uranium producer, was pulled into the politically-motivated investigation of elite opponents. Uranium One was a joint venture partner of KAP, when Kazakhstan's KNB began to investigate the head of KAP, Mukhtar Dzhakishev, for alleged corruption. In response to media reports about the incident, Uranium One's share price fell dramatically by 40%, thereby destroying its capital base and making it a potential acquisition target (Hill 2009). It has been argued that Dzhakishev's downfall was a consequence of his close association with Rakhat Aliev and Mukhtar Ablyazov, who had both fallen out with the President.

Nations Energy exemplifies how centralised control and the elite structure allow individuals to exploit any favourable position they hold with Nazarbayev. Nations Energy, which had oil stakes in Kazakhstan, decided to sell its Kazakhstani subsidiary, Karazhambasmunai JV (Palazuelos & Fernandez 2012:7) when it became entangled in a lengthy lawsuit, instigated by members of the elite who conspired with Zoran Savicic and enlisted Kazakhstani courts to drive down the company's value. Savicic, a Serbian national, claimed a 50% share of the company based on a somewhat unrelated and nullified agreement with some of its shareholders that was made years before their involvement with Nations Energy. It was alleged that Zhakyp Marabayev, a managing director at KMG, and Askar Balzhanov, General Director at KMG EP, conspired to drive down the share price of Nations Energy to buy it and then resell it for a higher price to China's CNPC, which had been

interested in the asset. CNPC rejected the offer and instead forwarded some evidence implicating the two men to the US Embassy. It is difficult to verify the involvement of these two individuals outside of Wikileaks (Milas 2006b). However, the lawsuit initiated by Savicic is documented in a due-diligence and risk assessment report for CITIC, which was interested in acquiring the Karazhanbas oil field. The document is available online. CITIC ended up buying the company for US\$1.91bn (CITIC-Resources,2007) .

Interestingly, Chinese companies seem to have largely escaped these dynamics. This may be for several reasons. For once, interviews showed that officials consider Chinese companies generally as state-owned enterprises and fear that any aggressive move against their assets could be considered a diplomatic offence against Beijing (Interview Local Finance Expert 1), which could possibly risk future investment from China. Another explanation could be China's low profile in elite dispute, something which might be explicable through the background of Kazakhstan's contemporary political elite, which obtained their policy experience in the former Soviet Union and during the Cold War. The bi-polar world order determined which foreign partners to seek out for cooperation. As a result, it is likely that Russia still features prominently among the 'old guard', even if this does not necessarily mean that the ruling elite want to be controlled by Moscow again. Arguably, policy makers in Kazakhstan still consider the US the epitome of 'the West' which serves as the political and intellectual counterweight to Russia, as opposed to China playing this role. As 'the West' is associated with political liberalisation and privatisation, elite factions may therefore align themselves along a Russia-versus-US dichotomy. If this is the case, this will work to Beijing's advantage, in that China is not associated with any distinctive elite faction and could even be considered a compromise solution. China's rapidly growing role as key creditor and investor to Kazakhstan supports this view.

3.5 Chapter Conclusion

This chapter discussed specific factors in Kazakhstan's domestic political and economic setting that favour China's growing economic role in Kazakhstan and likely also align the elite's interest with Beijing (Chapter 6, 7 and 8). Nazarbayev's centralisation of power has led to the emergence of an elite network and established a neopatrimonial political system that operates like a Rentier State. This system creates specific revenue demands that enable the elite to consolidate and stay in power and which is further exacerbated by structural weaknesses such as weak economic institutions and vulnerability to revenue shocks (Chapter 2). In theory, these funding needs should benefit any foreign source with the economic capabilities and interest to provide such funding. However, the following chapters will show that economic capabilities of traditional sources such as the US, Russia or private international investors have significantly decreased, especially since the onset of the Global Financial Crisis, which left China as one of the few countries with the ability to invest. More importantly, however, the following chapters will show that Beijing not only has the capabilities but also offers the type of revenue that the elite are interested in: discreet and speedy transactions in conditions that may be detrimental to Kazakhstan's economy but that are beneficial to the regime (Chapters 3, 4 and 5).

Beyond the elite's revenue needs, there are a number of other variables that appear to benefit an inflow of Chinese trade, finance and investment. These include a centralised economic structure that allows foreign partners to identify and target key decision makers such as SK, a personalised and informal decision-making process and a low Chinese profile in elite conflicts. Without Kazakhstan's domestic context, it is difficult to explain why and how China manages to create economic dependencies in Kazakhstan that are the subject of analysis in the following chapters. Although China's economic capabilities are a necessary prerequisite, they do not suffice in taking account of the effectiveness of these capabilities. Thus, elite

consent is an essential sub-systemic variable that drives Chinese finance and investment. For example, during the financial crisis, Nazarbayev turned to China in order to avoid painful revenue disruptions that could undermine the regime's legitimacy. This poses the question whether Beijing's growing economic influence in Kazakhstan is the outcome of a deliberate Chinese foreign policy approach towards Kazakhstan or rather driven by opportunities presented by Kazakhstan's elite. The following chapters will try to answer this question, which is crucial for building a hypothesis on whether or not Beijing should be able to use its economic influence in Kazakhstan as leverage towards specific foreign policy objectives. As discussed in the introduction of the thesis, the deliberate use of economic capabilities is an important prerequisite to understand whether these capabilities have become a foreign policy tool of Beijing.

However, the chapter also highlighted limitations of the overarching theoretical paradigm. An alternative explanation for the willingness of Astana to foster China's economic influence could be the fact that China is an authoritarian regime.⁶⁸ Bandwagoning with China as Roy Allison puts it could serve as a means to fend off the diffusion of democratisation and good governance (Allison 2008). It is possible that this also an intervening variable that further incentivises the regime to accept China's growing economic clout. Arguably, the regime is not interested in any form of democratisation that can curtail its power. However, to what degree this fosters Astana's cooperation with authoritarian states is unclear, especially when the regime is in fiscal crisis where the primary objective is likely to access alternative sources of funding. Here the type of regime that extends funding is secondary.

⁶⁸ A detailed discussion of authoritarian cooperation and regime diffusion is beyond the scope of this thesis. For an introduction Chapter 2, footnote 17

Chapter 4 **The Power of Finance-China as Key Creditor**

Against the background of Kazakhstan's political system, this segment introduces the quantitative part of the thesis, which analyses the extent of Chinese trade, finance and investment in Kazakhstan.⁶⁹ As discussed in the introduction, China's ability to leverage its economic influence towards political ends is contingent on whether it has created an asymmetric economic relationship with Kazakhstan which informs an economic dependence (Chapter 2).

This chapter analyses the hypothesis that China's financial influence in Kazakhstan has created significant dependencies, especially following the Global Financial Crisis (Sub-hypothesis 3, Chapter 2). It shows that China has become the lender of last resort during the Crisis, and its source of new financing plays an indispensable role in Kazakhstan's economy and politics. The elite's vulnerability to funding shocks (Chapter 2) further exacerbates this development and provides incentives to gain access to more Chinese lending in the future. Unlike other alternatives, Chinese credit carries opportunity costs that are beneficial to the elite, yet detrimental to Kazakhstan's national interest. Beijing, in turn, deliberately uses as leverage Kazakhstan's financial need to meet specific foreign policy objectives.

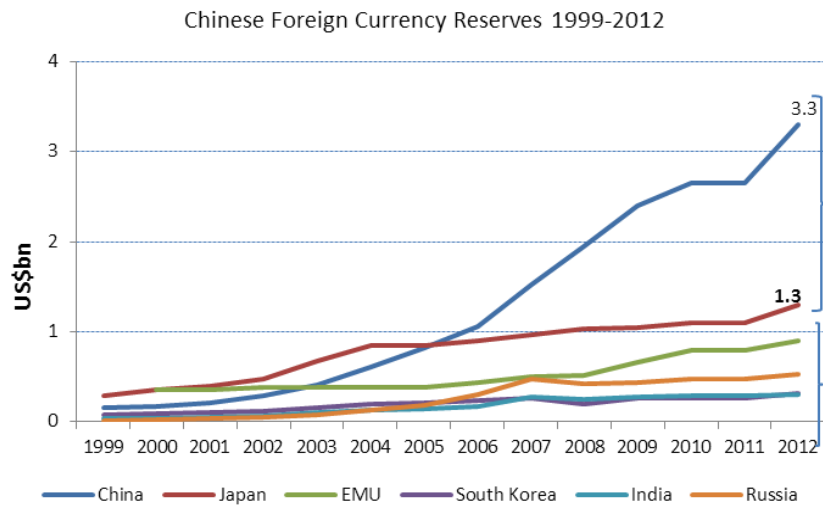
⁶⁹ FDI and finance (credit) often overlap in that Beijing provides financing in order to tap into Kazakhstan's resources. For example Beijing provides credit lines for Kazakhmys, a copper miner and also purchases 80% of Kazakhmys copper annually, possibly at concessional prices. Many of China Development Bank (CDB) loans to Kazakhstan are "loans for oil"-where interest payments are made in concessional oil deliveries. This blurs the line between finance and investment significantly. However the segment will distinguish as much as possible the two.

“When countries with external deficits run out of foreign providers of private credit, they become dependent on foreign sovereigns.”

(Martin Wolf, 2010)

Beijing’s unmatched foreign currency reserves established Beijing as a major player in the global debt market (Helleiner & Chin 2009) and a key provider of capital to emerging economies (Kaminska 2009, David 2011) (Figure 20). China’s exceptionally strong relative financial power can be used to extend credit widely and thus has the potential to contribute to building economic dependencies. Between 2009 and 2010, China lent circa US\$110bn to developing countries, more than the World Bank (WB) (Dyer & Anderlini 2011). This also allowed Beijing to become a more prominent creditor to Kazakhstan. The following segment analyses the role China plays in financing Kazakhstan’s external debt, in view of the wider research question of whether China has created economic dependencies that it can use as leverage towards specific foreign policy objectives.

Figure 20 Chinese Foreign Currency Reserves



Source: ECB, Ministry of Finance Japan, Reserve Bank of India, PBC

4.1 China's Creditor Status in Kazakhstan

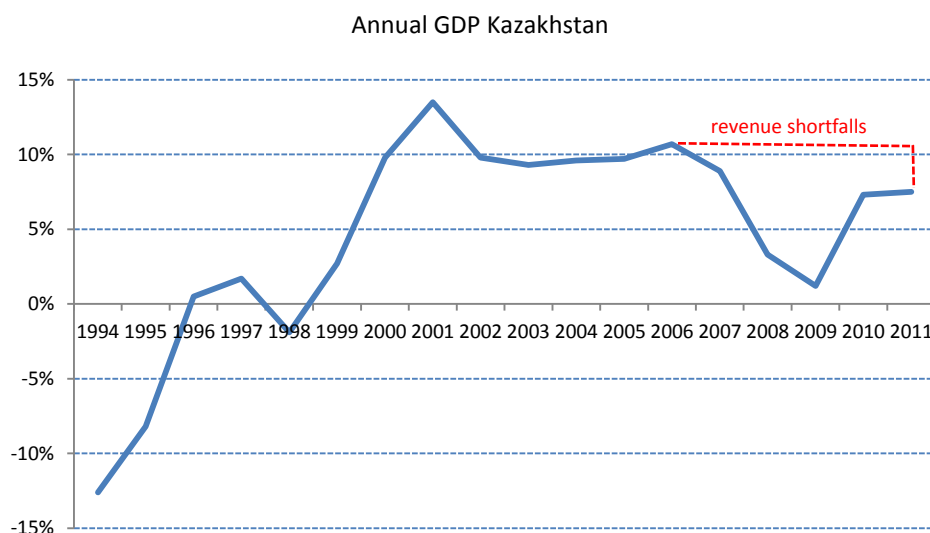
The IMF defines long-term external debt as debt that has an original or extended maturity of more than one year and that is owed to non-residents by residents of an economy and repayable in foreign currency, goods, or services (IndexMundi 2011). An analysis of Kazakhstan's debt structure provides insights on key relationships and dependencies that may arise with its external creditors. The Kazakh banking system nearly collapsed as a consequence of underlying structural weaknesses, which came to the fore during the 2008/09 financial and economic crisis. Four of Kazakhstan's biggest banks defaulted on their debt: Bank Turalem (BTA) - Kazakhstan's then biggest bank by assets; Alliance; Temir Bank; and Astana-Finance JSC. Several others ran into trouble including Halyk Bank and KazKommertsBank. The first three banks alone accounted for more than one third of the system's assets (S&P 2012). The extent of the problem is also highlighted by the fact that between 2007 and 2008, the overall profit for all 37 Kazakhstani banks dropped by 93% (Gizitdinov 2009). As the following section elaborates, a key driver of the banking sector's troubles was the relatively unstable funding structure of Kazakh banks, which relied heavily on foreign debt, along with bad management practices linked to Kazakhstan's elite structure (S&P, 2012). These structural weaknesses accelerated China's rise to Kazakhstan's most important external source of finance.

4.2 Kazakhstan's Banking Crisis

Chapter 3 briefly touched upon the concentration of elite interests and structural weaknesses in the Kazakhstani banking sector as well as the elite's vulnerability to revenue shocks, which can increase the risk of political instability, especially in a Rentier State. Kazakhstan's banking sector has a record of being unstable. In 1996, for example, Serik Burkitbaev, then head of Kazakhtelecom, was involved in the bankruptcy of KazPochtaBank, one of the biggest and most stable banks in the

country. The bankruptcy was triggered when he moved all of Kazakhtelecom's accounts to another bank without warning, consequently rendering KazPochtaBank bankrupt. However, the real test for Kazakhstan's banking system was to come over a decade later, during the Global Financial Crisis of 2008/09. Kazakhstan went through a construction boom following the discovery of large oil fields and realised an annual real GDP growth of around 10% between 2000-2007, which dramatically dropped to 3.2% in 2008 and then finally to 1.2 % in 2009 (see Figure 2) (WBI 2010). To finance the associated construction boom, domestic banks took out loans from overseas institutions at relatively low interest rates, passing on the cash to domestic borrowers. As a result, Kazakhstani banks, and therefore the Kazakhstani economy, became highly dependent on overseas credit. Consequently, foreign funding of banks reached 45% of GDP in 2007 (WorldBank,2009). This is reflected in the external debt to GDP ratio, which was extremely high when the crisis hit in 2009, particularly for a transition country (See Table 1).

Figure 21 Kazakhstan's Annual GDP Growth⁷⁰



During the Global Financial Crisis, the economy went through a downturn, driven by steeply-falling oil and commodity prices, leading many borrowers to default on their

⁷⁰ National Bank of Kazakhstan

payments (NBK 2010a, NBK 2010b). The oil price dropped from a high of US\$133.9 in July 2008 to US\$77/barrel in early 2009 and by the end of 2009, the value of Kazakhstan’s crude oil export had dropped by 46% (NBK 2010a, NBK 2010b). This constitutes a critical moment for a Rentier State where political legitimacy rests on the re-distribution of rents (Chapter 2) and revenue shocks can decrease the funds that are available for such redistribution.

External ‘over-borrowing’ combined with aggressive lending practices, weak due diligence standards and top level corruption scandals brought about the crisis (Standard and Poor’s) and Kazakhstani banks were left unable to meet their foreign interest and principal obligations. Consequently, international investors fled - scared off by recurring corruption scandals of the senior management of many banks, including BTA⁷¹. As a result, Kazakhstani banks struggled to raise financing after the restructuring. This hit the Kazakhstani economy particularly hard, as Kazakhstani banks remained the key source of financing for the real economy in the absence of developed capital markets.

Table 1 Kazakhstan’s External Debt to GDP Ratio

US\$ bn.	2005	2006	2007	2008	2009	2010	2011
GDP	57	81	105	133	115	148	186
External Debt	43	74	97	108	113	110	125
Share	76%	91%	92%	81%	98%	74%	67%

Source: World Bank, National Bank of Kazakhstan

Table 1 and Table 2 show that the Kazakhstani banking sector has deleveraged drastically with external debt falling by over half and overall debt to GDP ratios falling to 67% in 2011. However, debt in general continued to increase by 17% until 2012. This raises an interesting question: why has the overall external debt remained so high, whilst bank debt decreased drastically?

⁷¹Mukhtar Ablyazov, allegedly embezzled loans that BTA received from international lenders (Kuznetsov, 2011).

Continuous high levels of borrowing can be explained through an increase in corporate lending and alternative sources of financing that is symptomatic of Kazakhstan's uninterrupted financing needs that now need to come from a different source. Corporations have stepped in to partially compensate for the funding gap left by the banks by increasing inter-company loans (WSJ 2010). These are loans from companies or their units to affiliates in Kazakhstan which increased to 49% of Kazakhstan's external debt by mid-2012.⁷² As will be shown this also represented an opportunity for Chinese NOCs to significantly increase their lending. An example of how corporations compensated for the borrowing deficit is CNPC's agreement in 2009 to lend US\$5bn to KazMunaiGas (KMG), which was used jointly to acquire MangistauMunaiGas (MMG).⁷³ Not only is China a substantial factor in inter-company loans, it has also provided large direct loans to Kazakhstan. In particular, many of these loans have gone to the banking sector, making China the key lender to this sector that has otherwise been in deleveraging mode.

Even four years after the financial crisis, the financing structure of the Kazakhstani economy remains very vulnerable as the banking system struggles to recover and to access international capital markets. With private international lenders falling aside, Kazakhstan needed to access alternative sources of funding, a need that was particularly pronounced for Kazakhstan as a Rentier State (Chapter 2). Thus, it is feasible to assume that any new external provider of debt who fills this funding gap, wields disproportionate influence on economic growth and the elite in Kazakhstan. The following segment will show that China has adopted this role.

⁷² Jedh and Annual Report NBK.

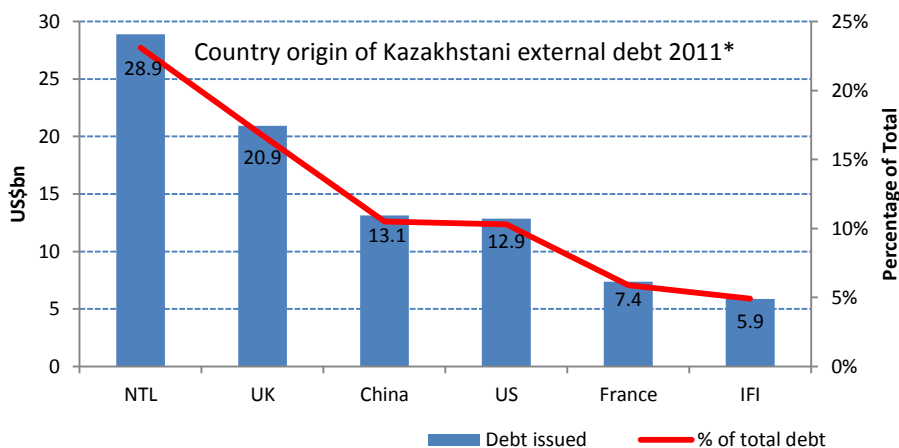
⁷³ As part of the deal, KazMunaiGas and CNPC Exploration and Development Company, a subsidiary of CNPC, agreed to jointly buy MangistauMunaiGas. The loan for the transaction came directly from CNPC. Interestingly, the right to buy a 50% stake in MangistauMunaiGas was part of the conditions for the US\$ 10bn loan package from China to Kazakhstan in 2009.

4.2.1 China as Key Creditor of Kazakhstani Banks

This section discusses China’s position as creditor to Kazakhstan relative to Kazakhstan’s other creditors, in line with criteria for dependence developed in Chapter 2.

Figure 22 shows that China was Kazakhstan’s third largest overall creditor in 2011, having provided US\$13bn. (NBK, AR 2011). However, the chart only lists the stock of outstanding loans and does not reflect the annual flow. For example, it does not take into account that UK and Dutch banks and businesses have extended only minimal or no new credit to Kazakhstan since 2009. Instead, the chart summarises the total disbursements of loans drawn by the end of 2011. However, since China is a latecomer to the creditor scene, it will take a while for Beijing to catch up with the accumulated outstanding debt of other creditor nations who have been active in Kazakhstan since the early 1990s. The UK’s top rank may be surprising but can be explained through the registration (registered trustee) of Eurobonds that are issued by banks (NBK AR 2011) and thus rather reflect an accounting principle rather than ‘real’ external credit. Controlling for this accounting principle, China can be viewed already as Kazakhstan’s second biggest lender in terms of outstanding loans.

Figure 22 Top 6 Countries Originating Kazakhstani Debt



*Source: National Bank of Kazakhstan

However, instead of looking at credit that was extended in the past, a more meaningful statistic would rank countries according to their credit disbursement within a given year. While an exact breakdown of this data could not be retrieved, the National Bank of Kazakhstan's (NBK) annual report identified China as the second biggest lender to Kazakhstan in 2010 and 2011 with US\$13bn in new loans (NBK 2010a). These loans were earmarked to finance segments of the Kazakhstan-China pipeline. China may very well be on its way to surpassing the UK and the Netherlands as the single biggest financier of Kazakhstan, given that in the first two months of 2011 alone, China has pledged roughly US\$7bn in new loans⁷⁴ to Kazakhstan. Thus, on an annual basis, China is now the second biggest lender of new credit to Kazakhstan after the Netherlands and ahead of the US and the UK. New credit is a more meaningful indicator in understanding how important Chinese financing is for Kazakhstani politics and economics. Although outstanding credit needs to be serviced, this also hinges on the availability of new credit lines that finance the elite's current revenue needs (Chapter 3). Figure 21 illustrates that these funding needs were especially acute immediately before and after the financial crisis, when Kazakhstan's annual GDP growth contracted from around 10% to nearly 0%. To avoid exposure to declining revenue and the associated possibility of political instability (Demkiv 2012), the government will look towards current and future sources of lending, such as China, more so than towards old lenders. Within a very short period of time, Beijing has become a key financier of Kazakhstan's overall external debt and has replaced the US. This trend is even more pronounced in the Kazakhstani banking sector which will be discussed below.

A more detailed breakdown of Kazakhstan's external debt shows that Kazakhstani banks, along resource exploration⁷⁵, was the biggest beneficiary and thus key driver

⁷⁴ The Kazakh government identified 30 important industrial projects for which it wanted financing from China (Orange 2011). However, it is unclear whether ENRC was consulted prior to Nazarbayev's visit or not. Zaure Zaurbekova, head of the financial department at ENRC, stated in an interview with the Daily Telegraph that ENRC had not participated in the preparation leading to these loans and has not given its official approval yet (Orange 2011).

⁷⁵ The destination of loans will be discussed in more detail.

of foreign lending until 2007, taking up 47% of Kazakhstan's total external debt (NBK 2010a). China's financing of this sector is crucial because of its importance to Kazakhstan's current and future economic growth. In view of still under-developed capital markets banks remain the most important creditors to the Kazakhstani economy.

Table 2 External Debt of Banks

US\$ bn.	2004	2005	2006	2007	2008	2009	2010	2011	2012*
Total Debt	33	43	74	97	108	113	119	125	132
Banks	8	15	33	46	39	30	20	15	15
Share	23%	35%	45%	47%	36%	27%	17%	12%	11%

Source: <http://www.jedh.org>; Joint External Debt Hub, *1st half 2012.

The relative and absolute decrease in bank debt after 2007 is due to the defaulting of four major Kazakhstani banks during the financial crises. The restructuring, in conjunction with general risk aversion during the crisis, deterred investors, making it more difficult for Kazakhstani banks to tap international loan markets. This is reflected in the fact that the volume of external bank debt decreased dramatically, from a pre-crisis peak of US\$46bn to US\$15bn in 2011. Also, the banking system's maturity term structure changed significantly. Whereas long-term loans constituted 78% of bank debt before 2008 this share more than halved to 37% in 2010.⁷⁶ Instead, the proportion of generally shorter-dated credit lines like bonds and certificates of deposits (CDs) increased to 55% of external debt. This shift to shorter maturities implies a riskier banking system, as Kazakhstani banks have to access the notoriously unstable international investor base⁷⁷ more frequently to re-finance their debt. Rather, the banks, along with the Kazakhstani government are interested in long-term credit lines that provide a degree of certainty and thus, financial stability. However, in the aftermath of the crisis, Kazakhstani banks had to re-approach international investors continuously to raise the funds to finance their long-term assets, thus frequently putting themselves at risk of a crisis in investor confidence and as a consequence, worse terms and conditions. This is also a direct consequence of structural weaknesses in the finance sector that are reflected in Kazakhstan's bad credit rating (S&P 2012).

⁷⁶ In 2007 external debt of Kazakh banks amounted to US\$ 46bn, of which US\$ 35.9bn were long-term loans (NBK, 2011b).

⁷⁷ Investors have greater faith in their domestic institutions and are often willing to provide them with more beneficial loan terms. International investors in turn tend to be stricter.

The next section discusses the role of Chinese credit lines in Kazakhstan's banking system, the structure of which increases the opportunity costs for Kazakhstan to forego Beijing's credit lines (Crescenzi 2005).

China as key lender to Kazakhstani Banks

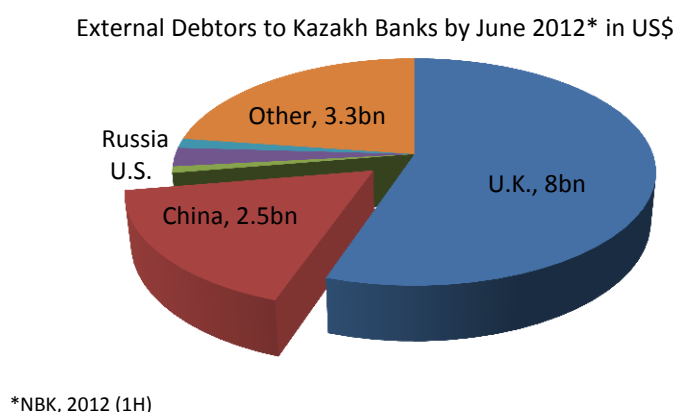
Kazakhstani banks showed signs of structural weaknesses as early as June 2007 when the share prices of BTA and KazKommertsBank began a continuous decline and thereby preceded the Global Financial Crisis by several months. The earliest signs of the sub-prime crisis occurred on 9 August 2007, when BNP Paribas suspended trading in three mortgage-related funds. But the crisis would only come to a head over one year later with the bankruptcy of Lehman Brothers in September 2009. It seems that international investors were sensitive to the (Chapter 2) structural weaknesses⁷⁸ in the Kazakhstani banking sector and withdrew their money more quickly from markets that were perceived as less safe (Interview Finance Expert, London). International rating agencies generally criticised lax lending standards and a bad repayment culture in Kazakhstani banks. Perhaps, then, the near collapse of key Kazakhstani banks during the peak of the financial crisis was not surprising. However, years later, these weaknesses continue to persist. They have further eroded international confidence in the banking system and leave Kazakhstani banks struggling to access international markets. In the aftermath of the Global Financial Crisis, this left China as the only key creditor along with the UK from which Kazakhstani banks could borrow (Figure 23).

China's role in the banking system cannot be underestimated, given that banks are the key source for financing economic growth in the absence of capital markets (WorldBank 2012c). Although banks have somewhat recovered from the crisis and increased their capital ratio, new credit lines to Kazakhstan's economy remain subdued with little signs of changing (ADB 2011). Intercompany loans substitute for

⁷⁸ Standard and Poor describes Kazakhstani banks as "aggressive", with "relaxed lending practices" and "underwriting standards" in a "weak payment culture" (S&P 2012).

these shortfalls, however, only multinational companies and thus larger firms benefit from access to funding through their affiliates abroad. Small and medium sized businesses, on the other hand, find it difficult to access financing, which further hinders the development of alternative industries in Kazakhstan and thus puts Kazakhstan on a course towards the Dutch Disease (Chapter 2). It is difficult to conclude whether Beijing could have taken such a prominent role in Kazakhstani debt without the financial crisis. Few examples of Chinese loans before 2009 can be found in the public domain. However, the overall lack of transparency makes it difficult to say conclusively how much money Beijing has extended to Astana. What is certain, however, is that both the volume and frequency of Chinese loans has increased significantly since 2009. This would also be in line with the observation that China began to provide external financing more assertively, based on the insight that the financial crisis offered a number of critical opportunities for Beijing to invest its foreign currency reserves abroad, at a time when investments were generally less competitive. The Global Financial Crisis significantly decreased the number of available creditors for Kazakhstan which simultaneously increased the opportunity costs for Astana to turn down external credit from China (Crescenzi 2005, Chapter 2). China's role in Kazakhstani debt may not only be driven by Kazakhstan's financial needs but also by China's determination to seize finance and investment opportunities abroad. This point will be discussed in greater detail towards the end of Part I of the thesis.

Figure 23 External Creditors of Kazakhstani Banks



4.3 The Impact of Chinese Finance

China has extended sizable loans to Kazakhstani banks since at least 2006, when the China Development Bank (CDB) and Kazyna Sustainable Development Fund created a joint fund with a volume of US\$5bn to finance infrastructure projects (Trend.Kz 2006). During the subsequent financial crises, China was the only country to consistently expand its loan volume while other international investors withdrew credit. In particular, China's importance grew when four Kazakhstani banks (BTA Bank, Alliance Bank, Temirbank and Astana Finance) defaulted on their international debt, thus writing off 85% of their obligations. The subsequent restructuring especially affected Dutch special purpose entities, which had extended large credit lines to Kazakhstani banks. As a result, loans provided by Dutch investors, such as ABNAmro and ING were wiped out and the Netherlands dropped from the list of top foreign bank loan providers. However, while the Netherlands and other investors fled, China provided an instant lifeline to Kazakhstan through loan commitments. For example, in April 2009 the Chinese Government extended a US\$10bn loan package to help the country manage the impact of the financial crisis. In September 2009, China Exim Bank extended a US\$1.5bn loan to the Kazakhstani Development Bank (KDB) as part of an individual credit agreement. The NBK further noted in its 2009 annual report that due to

improved bilateral relations between China and Kazakhstan, the KDB and the National Wealth Fund (NWF) Samruk-Kazyna could raise about US\$4.2bn from China's Exim and CDB (NBK 2010a). This money was earmarked for investment projects in various industries and infrastructure development as part of the anti-crisis programme. However, it is likely that a large part of this loan was either directly or indirectly used as working capital by cash-strapped Kazakhstani banks, thereby helping them through the crisis (Figure 24). Table 3 summarises publicly-reported loans from China and shows how the frequency of such loans increased dramatically after 2009.⁷⁹ Curiously, this is similar to the forays of China's energy companies in Kazakhstan, who made a first initial investment, followed by increased investment. Perhaps this is indicative of a strategy of testing the waters with an initial investment or credit-line that is then quickly followed. Alternatively, this could simply mean that China has discovered its resource and financing interests in Kazakhstan, on which it followed up with more activity. The table also shows that whereas the first credit line of 2006 was directed at joint investment into infrastructure projects, nearly all subsequent credit lines had a distinctive resource focus.

More importantly, China is the only creditor to continue to lend high volumes to the banking sector. By the end of 2011, China had lent more than US\$2.5bn directly to Kazakhstani banks, compared to US\$51m by the UK and US\$149m by the US. The Netherlands stopped lending to Kazakhstani banks all together (NBK 2011). Kazakhstan's only alternative to Chinese credit lines then is to provide funding for its banks through domestic sources. This, as will be discussed is either not feasible or comes at substantial opportunity costs, especially for the ruling elite (Crescenzi 2005, Chapter 2).

⁷⁹ The table excludes loans that closely resemble FDI in connection with Chinese investments in Kazakhstan such as CITIC, CIC (Chapter 4). Sources include: KDB 2011, Paxton 2011, Hook &Gorst 2011, Orange 2011 and KIP 2008.

Table 3 Chinese Credit Lines

Public Record of Chinese Credit to Kazakhstan			
<i>Year</i>	<i>Originator</i>	<i>Value (US\$bn)</i>	<i>Description</i>
2006	CDB	5.00	Joint Kazyna Investment Fund
2008	CDB	0.30	KDB
2009	CDB	5.00	Samruk-Kazyna
2009	China ExIm	5.00	Samruk-Kazyna /KMG
2009	China ExIm	0.87	ENRC
2009	China ExIm	1.50	KDB
2009	CDB	2.70	Samruk-Kazyna /Kazakhmys
2011	China ExIm	0.50	Samruk Energo
2011	CDB	1.50	Samruk-Kazyna /Kazakhmys
2011	? ⁸⁰	5.00	Petrochemical Complex
2011	CDB	1.70	Samruk-Kazyna
2011	CDB	1.90	ENRC
2012	China ExIm	1.13	KMG/ Refinery
2012	China ExIm	10.00	SCO Members

China's fast rise as key creditor is reflected in the annual reports of the NBK, which only mentioned Chinese credit sporadically before 2009. In 2009, the Netherlands accounted for 50.3% of outstanding external bank loans, followed by the UK (11.6%), Germany (4.7%) and international organisations (2.4%). However, halfway through 2012, China was already the second largest lender to Kazakhstani banks. The dramatic shift in Kazakhstan's external debt structure shows that western creditors have abandoned the Kazakhstani banking system. These drastic changes are largely a reflection of the restructuring efforts of Kazakhstani banks with their foreign lenders, which amounted to over US\$15bn in write-offs by the end of 2011 (WorldBank 2012c). Whether Beijing's financial clout is strong enough to create dependencies is subject to an analysis into opportunity costs and alternative sources of finance at the end of the chapter. Beyond its immediate implications for Kazakhstan's finance sector, Chinese loans are highly relevant to the Kazakhstani

⁸⁰ This loan could not be verified independently

economy and politics which increases the cost of foregoing Chinese finance significantly.

Economic Relevance

The previous segment discussed the effects of the financial crisis on the Kazakhstani banking sector and thus the relevance of Chinese credit lines. However, access to external financing from China was crucial to alleviate inflationary pressure and maintain systemic stability. When the financial crisis began to affect the Kazakhstani economy, Astana initially attempted to prevent a devaluation of the Tenge. By February 2009, however, the pressure to devalue had taken its financial toll. After substantial efforts that had depleted Kazakhstan's foreign currency reserves by US\$3.5bn (16%), the NBK decided to let the Tenge depreciate against the US Dollar. On 4 February 2009, the currency depreciated by 18% in one single day (Bloomberg 2009). This was a difficult decision given the government's investment in stabilising the currency. Crucially, however, a lower Tenge exchange rate made it even more difficult for Kazakhstani banks to service their external debts held in foreign currencies. The inability to service external debt was a key driver to Kazakhstan's financial problems. Kazakhstan's relatively high inflation rate, which fluctuated between 18.7% in 2007, 9.5% in 2008 and 6% in 2009 added to these systemic pressures and turned external financing into the best solution. Raising external credit allowed Astana to alleviate inflationary pressures at home, whilst gaining access to the necessary funds that would allow it to bail out banks and stabilised the finance sector. Astana suddenly required substantial additional funds to bail out BTA. In 2009, SK initially purchased 78% of BTA's shares for Tenge 251bn (US\$1.6bn) which it later increased to 100%. In search of external funding, Arman Dunayev, chairman at BTA, predicted that the Government would turn to Russia for access to finance since Kazakhstan "doesn't have any extra money to invest" (Gizitdinov, 2009). As the former deputy head of SK and former Finance Minister, Dunayev should be well-placed to know Kazakhstan's overall financial position (see Controversy of Chinese Loans). Indeed, Kazakhstan turned to Russia in the hopes

that Moscow would provide direct help or that Sberbank would buy BTA. Although Sberbank showed initial interest, it has since declined. The alternative to external funding would have been a substantial internal stimulus package through monetary easing (i.e. printing of money) which the government did deliver in the end, but which was likely smaller because of Astana's access to Chinese credit. Quantitative easing on the other hand carried the risks of significantly increasing Kazakhstan's underlying inflation pressures and consequently impede Kazakhstan's rebound from the crisis.

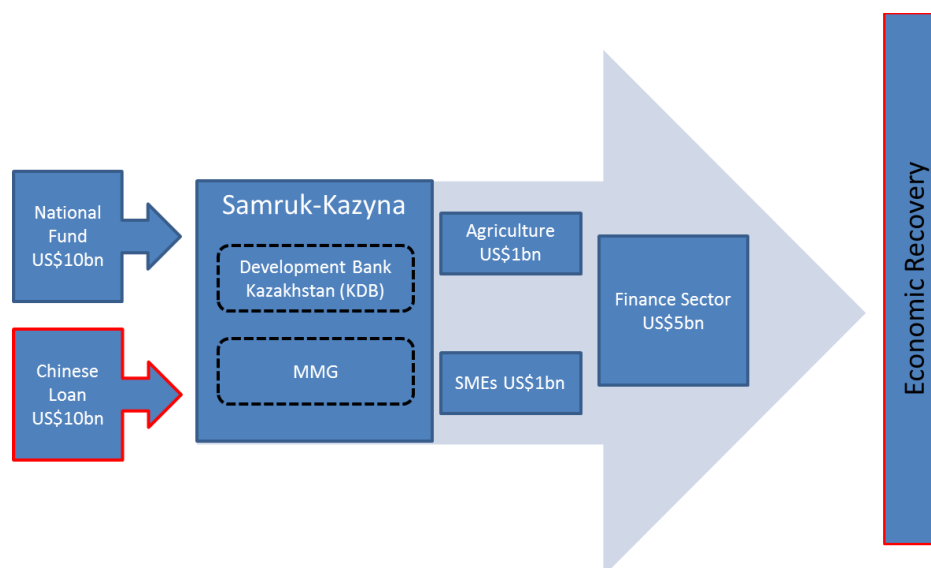
Having failed to secure financial help from Russia in 2009, Nazarbayev turned to China. During his state visit several weeks later, Beijing extended an immediate credit package of US\$10bn to Kazakhstan, the size and timing of which was crucial to help Astana to mitigate the impact of the financial crisis. Further analysis of the impact of China's loan on the Kazakhstani economy supports this view.

The severity of the situation was further highlighted by Astana's decision to inject an US\$10bn stimulus package into the economy and to finance this package by drawing on its National Savings Fund (NF) for the first time. Remarkably, the value of this package matches the volume of China's 2009 credit line, which poses some interesting questions. Interviewees in Kazakhstan were puzzled by Astana's decision to take financing from China because the NF's accumulated savings, together with Kazakhstan's state assets, put Kazakhstan into a strong enough position to easily cover such sums by itself (Interviews European Diplomat 2, Investment Expert 2, Local Finance Expert1). The chapter will revisit this point further below.

However, lack of insight into the NF in conjunction with the timely proximity of the credit line and questions raised by interviewees warrant further analysis (discussed below). Furthermore, China's credit line and the stimulus package were channelled through the same institution. US\$9bn of the NF package went to SK from where it was disbursed to the finance sector, which received US\$5bn alone, SMEs and agriculture received US\$1bn respectively (Figure 24) and although the remainder

(US\$3bn) was earmarked for construction and infrastructure projects it had not been disbursed by the end of 2010 (Kalyuzhnova, 2011: 6656).⁸¹ It is possible that alternative investment into these sectors rendered it unnecessary for the Government to fully disburse the stimulus. For example, CITIC Kazyna Investment Fund I (CITIC 2012b), a US\$200m joint Sino-Kazakhstani investment fund focusing solely on infrastructure investments in Kazakhstan may have filled the gap (Chapter 3). This has important implications for the Rentier State as Astana did not have to draw these funds from its budget, which left the regime with more funds available for patronage to mitigate the potential risks of political instability that are associated with sudden revenue decline (Demkiv 2012).

Figure 24 Stimulus Package and China's Loan to KDB



The Development Bank of Kazakhstan (KDB) received half of Beijing’s credit line (US\$5bn), whereas MMG received the other half. Both are embedded in the holding structure of SK and thus under government control (Figure 24).⁸² SK was also in charge of redistributing the stimulus package and thus received the respective

⁸¹This includes refinancing of mortgages which were listed separately.

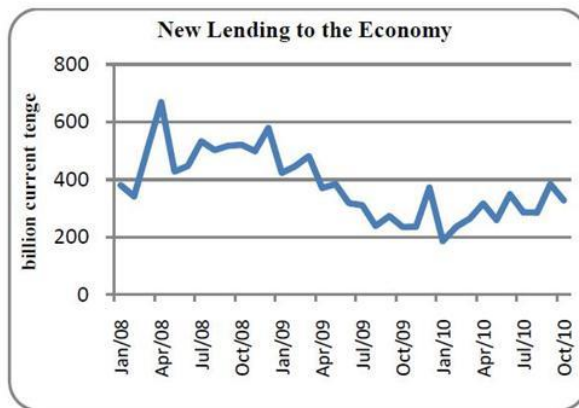
⁸² A breakdown of China’s credit line into the direct loan to KDB and KMG for the acquisition of MMG is macro-economically irrelevant. KMG is state owned and as such both ‘individual’ credit lines were injected into the Kazakhstani economy during the financial crisis in 2009.

funds from NF as well. Within SK, it is difficult to track the flow of both cash injections. However, it is possible that both the NF stimulus and parts or all of the Chinese credit line went into a single point from where they were redistributed. Interviewees at SK confirmed that it was not known where China's credit went exactly (Local Finance Expert 2) and Kazakhstani analysts also voiced concern that Chinese credit lines were largely destined for companies closely linked with the elite (Costello quoted in Hoagland, 2009b). These concerns were likely fuelled by the fact that Timur Kulibayev, Nazarbayev's son-in-law, headed SK at the time, thereby enabling Nazarbayev or the elite to determine the recipients of China's credit line as well as the stimulus (Chapter 3). This suggests that Chinese credit lines were used directly for patronage.

It is possible that Beijing provided some of the necessary cash that was supposed to be with the NF and which for some reason, was tied up. Alternatively, the stimulus package could have included both the NF and Chinese loan volume together, which would bring the total volume to around US\$20bn, which would in turn indicate that the crisis was much more acute than the government had publicised. In any case, the volume of the government stimulus also provides a suitable context in which to gauge the importance of China's credit. Yelena Kalyuzhnova attributes Kazakhstan's economic recovery to the NF stimulus package, which served as a "risk buffer and collateral for the economy during the crisis." (Kalyuzhnova, 2011: 6655). It is thus possible to conclude that, based on the size of China's credit in relation to the size of the NF funded stimulus, that China's credit was an important factor in allowing the Kazakhstani economy to weather the effects of the financial crisis. Several other yardsticks further support this conclusion. In 2008, the banking sector made accumulated profits of roughly Tenge 15bn (circa US\$100m) and overall, new lending to the Kazakhstani economy totalled US\$9bn in 2010 (Figure 25) (Gizitdinov 2009). The volume of China's 2009 credit line alone dwarfs these figures and relays what impact its credit line had in relation to the size and performance of Kazakhstan's banking sector. Thus Chinese loans played an important role in

Kazakhstan’s economic recovery. It is very likely that without these loans Kazakhstan’s economic recovery would have dragged on. A prolonged recovery period in turn also poses risks for political instability especially in a resource dependent Rentier State (Demkiv 2012).

Figure 25 New Lending to the Kazakh Economy



Source: World Bank

Chinese credit continues to be critical even beyond the financial crisis, not just because of the terms and volumes involved but because China is the only remaining external creditor to provide large-scale credit directly to Kazakhstani banks. This further adds to the opportunity costs for Kazakhstan if it were to break off from Chinese funding.

Political Relevance

The above discussion put the volume and timing of China’s credit into context to examine the relevance of Beijing’s financing for the Kazakhstani economy. However, the political implications of China’s credit line may be even greater, especially because the regime is vulnerable to revenue shocks (Chapter 2). This significantly increases the opportunity costs associated with an exit from Chinese funding. Chinese funding allowed the elite to overcome declining revenues and allowed Nazarbayev to preserve his popularity. The regime’s legitimacy rests on both of

these pillars. Figure 21 captures the dramatic decline in Kazakhstani GDP during the crisis. Dropping oil prices amidst a contracting global economy and depressed demand for energy also caused a decline in tax revenues for the government. Although the volume of these declines is not on the public record, it can be assumed that a decline in oil production drives declining government revenues, particularly in an economy that primarily depends on the resource sector. Chapter 2 argued that a neopatrimonial system is particularly susceptible to declining revenues because they affect the elite's ability to redistribute funds that underpin its legitimacy. Kazakhstan's GDP dropped significantly from the end of 2006 and has still not recovered to pre-crisis levels. Within this context, it is important for the elite to access additional sources of funding to avoid government cuts or alternatively raise domestic taxes, both of which can undermine its legitimacy. Chinese credit lines, which have dramatically increased in frequency, very likely provided such funding (Table 3).

After Moscow failed to provide the hoped-for financing, President Nazarbayev turned to Beijing. China's emergency credit line may have helped the President to save face in view of government mismanagement and a number of top-level corruption scandals in the banking sector. BTA's collapse was also brought about by a narrower capital base than assumed, which impeded the bank's ability to service its debt. This led to allegations of embezzlement against BTA's senior management, in particular BTA's CEO, Mukhtar, who now lives in exile. Nazarbayev and Ablyazov share a tumultuous past, which also moves Nazarbayev closer to the BTA default. Ablyazov was fired from previous posts, jailed for counts of corruption and moved to Moscow into exile, from where he was pardoned and rehabilitated by Nazarbayev himself, who agreed with his subsequent appointment as head of BTA. Thus, the embezzlement charges against Ablyazov are at best, embarrassing for Nazarbayev and at worst, illustrate a serious error in the President's judgement. However, even after BTA was nationalised, gross mismanagement continued under government oversight, which caused the bank to default yet again in 2012

(Gizitdinov 2012). Corruption among senior management is widespread in Kazakhstan (Standard & Poor's), however, the close links between the Government and BTA are a huge embarrassment. After the news broke that BTA defaulted in 2009, returning from Beijing with US\$10bn for the Kazakhstani economy must have been a personal success. However, any reputational damage over appointments pales in comparison to the problems that the President can face over questions about Kazakhstan's state assets.

The Puzzle of Kazakhstani Assets

Individuals interviewed in Kazakhstan were puzzled as to why their government turned to China for credit lines because Kazakhstan had accumulated significant assets and funds through the NF (European Diplomat 2, Investment Expert 3 and Local Finance Expert 1). Because of increasing oil and gas revenues, the government decided to invest these revenues in the NF from 2002 onwards (Chapter 3). The NF's purpose is to stabilise the economy and to save for when resources might be exhausted in the future (Chapter 2). By the time the financial crisis hit, the fund and central bank had joint reserves of at least US\$60bn - enough to bail out failing banks and to stimulate the economy.⁸³ Thus, taking credit lines from China during the crisis was not reconcilable with the general understanding that the fund had substantial reserves or with the observation that Chinese credit is directed at Kazakhstan's resources through provisions in the credit agreement.

Interviewees pointed out that resource investments are highly lucrative because of the low risks involved for China and a guaranteed return on investment. In their view, the Government is handing out Kazakhstan's assets to foreign investors. Given the opaque management nature at the NF (Chapter 2) it is possible that the funds were not available or not as liquid as widely held. The financial crisis, especially the quick collapse of key banks that followed, caught the Government by surprise. To prevent any further destabilisation of the finance sector, it was

⁸³ As of 2011 the joint assets of the NF and NBK are approximately US\$70bn.

important to act as quickly as possible. The general lack of transparency surrounding the fund makes it difficult to find a definite answer. However, there are further indicators to support the hypothesis that when the financial crisis hit, the funds were not available:

Already before the financial crisis, incongruity had emerged between Astana's ambition to renationalise state assets and its ability to do so. This view is supported by the more difficult investment climate in Kazakhstan, which saw increases in taxes, environmental fines, levies and regulation aimed at extracting greater rents to boost government revenues. Kazakhstan's financial commitment to oil fields, where it has reclaimed shares from international investors, also casts doubt on the state of its asset and revenue position. IOC partners in these oil fields often complained about the delays that the government caused by its inability to meet the finance and investment obligations that it took on with its respective share. As a result, the next phases of key oil and gas projects have been delayed several times (Interview Energy Expert). Currently, this is epitomised in the prestigious Kashgan oil field, which had been the largest find of its kind in the last six decades and has proven notoriously difficult to develop (Paxton and Gordeyeva 2012). Up until now, it required a total investment of US\$46bn, nearly twice the initial estimate of US\$24bn, while production is facing frequent delays. One of the reasons for these delays was KMG's reluctance or inability to provide funding. The North Caspian Operating Company (NCOC) a consortium of IOCs, including Exxon Mobil, Royal Dutch Shell, ConocoPhillips and KMG, currently operates the field, however,⁸⁴ ConocoPhillips recently announced its exit. Although KMG has eyed an expansion of its share in the project, which is also in line with the government's renationalisation ambitions, the government-owned company may not have the necessary funds:

⁸⁴ The consortium consists of eight oil companies: Exxon Mobile, Royal Dutch Shell, Eni, Total, INPEX, ConocoPhillips and KMG. Each of the IOCs has a 16.85% stake in the field except for ConocoPhillips (8.49%) and INPEX (7.56%).

“we, as the national company, wouldn't refuse the idea of increasing our share. How we might finance this is another question” (Daniyar Berlibayev quoted in (Paxton and Gordeyeva 2012)).

The oil field is one of Kazakhstan's most prestigious projects and KMG's concern highlights Kazakhstan's strained finances further. Instead, CNPC has engaged CITIC to explore purchasing options of ConocoPhillips' share.

Arman Dunayev's comment about Kazakhstan's assets in view of the BTA bailout further supports this view. Here it is worth noting that Kazakhstan also used Chinese credit in the past to pursue its renationalisation programme (Chapter 3) and although Chinese credit lines are attractive, they are not unconditional, and it should be preferable for the Government to finance the renationalisation programme itself. The fact that it has not, supports the view that the Government lacks the necessary funds.

From the above observation, it is possible to conclude that President Nazarbayev may have turned to Beijing to access external sources of financing because Kazakhstani assets are not as vast or as accessible as widely believed. Chapter 3 showed that Nazarbayev directly controls the NF and thus is also accountable for its assets. Beijing's extension of credit during the crisis provided enough funding to finance the stimulus package, which should have been financed through the NF in the first place. The opaque nature of the fund makes it difficult to draw any conclusions beyond any doubt however, in view of the facts Beijing's financial credit line may have very direct implications for the elite and politics in Kazakhstan (Chapter 2). Accepting Chinese credit lines comes with a different set of opportunity costs that are detrimental to the sustainability of Kazakhstan's economy in the long-term and thus detrimental to the Kazakhstani national interest. That Kazakhstan turns to Chinese credit nevertheless and even more so since 2009 can be explained through the elite's revenue interests, which override the national interests, as well as the fact that Beijing offers credit lines at conditions that meet the elite's needs.

Put bluntly, the terms of Chinese credit are favourable to the elite and unfavourable to Kazakhstan's long-term development. This also weighs into the assessment of alternative sources of funding at the end of the chapter.

Concessional Long-Term Loans

The terms and size of Chinese loans are especially attractive for Kazakhstan. Beijing provides medium to long-term loans with a maturity of around 13-15 years at concessional interest (1-3%) (Development Bank of Kazakhstan(DBK) 2009). As other investors prefer more liquid, shorter-dated bonds and CDs, access to long-term loans have become even more critical for Kazakhstani banks to avoid exposure to market volatility (see China as Key Creditor of Kazakhstani Banks, above). Given its vast financial capabilities, Beijing can quickly disperse loans which do not come with the political conditionality of International Financial Institutions (IFIs). Beyond the financial terms, however, Chinese loans are discreet and not subject to the media scrutiny that may question whether such loans benefit the elite (Chapter 3). Foregoing Chinese credit lines would thus incur significant opportunity costs, especially for the regime.

4.4 Chinese Conditionality

Chinese loans are generally perceived to contain fewer conditions than those from other sources such as IFIs, which condition credit on political and/or economic reforms. Nevertheless, Chinese credit to Astana features a different set of conditions that reflect China's foreign policy objectives.

In line with Beijing's other economic partners, Kazakhstan has to adhere to the One-China policy (一个中国政策) and acknowledge that Taiwan is part of China, in order to engage in any meaningful form of economic activity with Beijing. In conjunction with Beijing's extension of the US\$10bn credit line, in April 2009, Kazakhstan signed a joint communiqué in which it not only reiterated its support for the One-China

policy but declared its outright opposition to Taiwan's independence (FMPRC 2009). However, Chinese conditions go beyond diplomatic statements of support and there are indicators that at least in the financial realm, Beijing recognises the potential to link more tangible foreign policy objectives to its credit lines. Interestingly, Chinese credit lines to Kazakhstan are not emitted by the private sector but directly by the sovereign through China's policy banks, such as China ExIm and CDB who are under direct state control. These loans agreements are usually made during bilateral meetings between senior Chinese and Kazakhstani politicians, mostly Nazarbayev himself or Karim Massimov, a key facilitator of Chinese interests (Chapter 3). This setting stands in stark contrast with Kazakhstan's other creditors, most prominently the Netherlands, Kazakhstan's biggest lender. Here loans are directly issued by corporate banks, such as ING and ABNAMro, or corporations in the form of intercompany loans. In some cases, investment is also channelled through Special Purpose Vehicles (SPV).⁸⁵ Notably, this means that credit is issued without political fanfare in the absence of summits or other diplomatic occasions, and that these creditors do not receive the same degree of government support, if any. This underlines the strictly private, for-profit character of Dutch loans. SPVs in particular are likely to be far removed from state influence. These vehicles are owned by a range of investors, often from different jurisdictions and nationalities. SPVs incorporated in the Netherlands are among the largest creditors to Kazakhstan (NBK 2010a). Thus, unlike the Chinese loans issued by state policy banks, Dutch loans have a distinctly apolitical character.

This specific type of bank and setting firmly embeds China's credit to Kazakhstan in a political framework and thus should allow Beijing, in theory, to use as leverage its financial capabilities towards foreign policy objectives. Securing the relevant energy resources to keep China's economic development on course became one of these

⁸⁵ SPVs are subsidiaries of companies with a specific liability structure which ensures that the SPV will survive the parent company's bankruptcy and vice-versa. Companies use SPVs to finance large projects without putting the parent company at risk. SPVs constitute a large part of Kazakhstani debt that originates in the Netherlands, presumably in the Netherlands Antilles where SPVs enjoy a beneficial tax regime.

objectives in 2008, which takes on particular relevance in transactions with resource-endowed Kazakhstan (Hsiao 2008).⁸⁶ Perhaps unsurprisingly, Beijing facilitates access to Kazakhstan's lucrative resource sector by injecting credit, with elite consent, directly into major Kazakhstani resource companies such as Kazakhmys and ENRC, which are cited throughout this thesis (Chapter 2). However, it may not be coincidence that just one year after China elevated energy security to a foreign policy objective, Beijing conditioned credit lines to Kazakhstan for the first time. The much-discussed credit line of 2009 marks the first time that Beijing linked the provision of an emergency loan to the acquisition of Kazakhstani resource assets. This differs from the provision of credit into resource companies and instead takes direct ownership of resource assets. This conditioning occurs through package deals, where China bundles a number of distinctive loans into one package, to which it then adds explicit resource objectives. The package setting in theory should enable China to increase its bargaining power, and creates strong cross-over effects between its financial instruments and political gains.

For example, China's much-discussed US\$10bn emergency loan contained two lines of credit (KCM 2010): US\$5bn from China ExIm for CNPC to acquire 50% of MangistauMunaiGas (MMG), a Joint Venture (JV) with KMG and US\$5bn for KDB (Chapter 4). MMG is one of Kazakhstan's largest oil companies and owns exploration rights for 36 oil and gas fields.⁸⁷ Its acquisition marked a coup for CNPC because it beat India's ONGC and Gazprom and had encountered significant resistance from Astana: between 1997 and 2005, CNPC had quickly expanded into Kazakhstan's oil sector, a trend that Astana intended to cap (Konirova 2006). This also caused CITIC's tumultuous acquisition of Nations Energy's Karazhanbas oil field,⁸⁸ which Astana wanted to prevent. To prevent the CITIC acquisition, Prime Minister

⁸⁶ For a discussion on the role of Energy Security in China's Foreign Policy, see Charles Ziegler (Ziegler 2006).

⁸⁷ The most important of these oil fields are: Asar, Burmasha, Kalamkas, East Zhetybai, Alatobe, North Asar, Zhetybai, Oimasha, South Zhetybai.

⁸⁸ Part of the deal was also Argymak Trans Service LLP Tulpar Munai Services LLP which provides transportation and drilling services (Xinhua 2006).

Massimov tried to set up a deal between Nation Energy and Vladimir Kim, the head of Kazakhmys and a close friend of Nazarbayev (see Political System) (Milas 2006b). Ultimately, CITIC's acquisition went through shortly after CNPC's 2005 acquisition of PetroKazakhstan, which triggered a heated debate in Kazakhstan's lower house (Peyrouse 2008). To block further investment, the Government passed a law prohibiting companies in the hydrocarbon sector from selling exploration licenses to third parties without government consent, and another law giving KMG priority in acquiring any stakes up for sale in the hydrocarbon sector (Peyrouse 2008). Nevertheless, Beijing has expanded its ownership of Kazakhstani resources.

MMG's acquisition was also remarkable for its timing at the peak of the financial crisis and thus when international oil prices were at an all-time low - which is likely to have affected the acquisition price. This was a lucrative transaction for CNPC, since MMG was already producing oil and therefore did not require any upfront investment (Costello, 2009). For Astana, the timing of the sale amidst falling oil prices was disadvantageous and the decision to go forward with the transaction likely reflects Nazarbayev's need for external finance at the time. The credit package pushed Astana to go even further and officially retract its intentions to cap Chinese investment in the resource sector. Astana pledged to Beijing that it would welcome Chinese involvement in its Darkhan oil and gas field and further vowed full support to expedite the implementation of the project and enter into principled agreement at an early date (FMPRC 2009). In 2005, CNOOC and CNPC signed a MOU with the Kazakhstani Government to develop the prestigious oil field in the Caspian Sea, which holds around 11 billion barrels of oil reserves.⁸⁹ However, subsequently Astana stalled any progress. Just months earlier, on 31 October 2008, Wen Jiabao,

⁸⁹ KazMunaiGas states that "By now, the Parties have discussed main commercial, technical and economic conditions of the project implementation and working at the Draft of Agreement on cooperation principles on «Darkhan» project" (KMG 2012)

had pressed Karim Massimov to speed up the implementation of the project during his visit in Astana (ChinaDaily 2008, Nurshayeva 2008).

Closely following the April 2009 loan, China Investment Corporation (CIC) acquired 11% in KMG Exploration and Production (KMG EP) which was also agreed in a bilateral meeting without any input from the company itself (Chapter 2). KMG EP specialises in drilling and distribution but also holds stakes in Kazakhstani oil and gas fields, including Uzenmunaigas and Embamunaigas, thus further expanding Chinese ownership.

Since April 2009, China has extended a string of credit lines that target Kazakhstan's resource sector (Table 3). This reflects Kazakhstan's ongoing demand for external financing in view of a banking system that has not recovered from the crisis (see The Future of Chinese Loans, below), as well as Beijing's growing interest in extending such loans. Beijing's positive experience and the effectiveness of its conditional loans in meeting its foreign policy objectives may also have played a role. Based on a conservative calculation, China has provided US\$22bn of new credit since 2009 targeted at Kazakhstani resources.⁹⁰ Already within the same year (2009), Beijing lent US\$2.7bn to Kazakhmys,⁹¹ of which the company has drawn at least US\$700m by 2011 (Mundy 2011). At a bilateral meeting in February 2011, Hu Jintao again extended a number of credit lines bundled into one package. This included a US\$1.7bn loan directly to Samruk-Kazyna and a US\$5bn loan for a petrochemical facility.⁹² Again, that loan bundle included a conditional resource component: an agreement from Nazarbayev to deliver 55 metric tonnes of uranium to China (Hook, 2011). In June of the same year, CDB extended a pre-existing credit

⁹⁰ The calculation is based on the table below and excludes China's SCO loan and the US\$5bn loan from 2011 since it could not be verified through other sources.

⁹¹ Kazakhmys PLC is an international natural resources company, listed in the UK, principal operations in Kazakhstan and Central Asia. The core business is the production and sale of copper. The copper division also produces significant volumes of other metals as by-products, including zinc, silver and gold. Kazakhmys' biggest stakeholder is Samruk-Kazyna which holds 28% of its shares. Its copper division operates sites across Kazakhstan with 17 open pit and underground mines, 10 concentrators and 2 smelting and refining complexes (Kazakhmys 2012).

⁹² This loan could not be verified and will thus be excluded from any further calculations.

facility for Kazakhmys by an additional US\$1.5bn to increase its copper production, 80% of which China purchases annually (BBC 2011). Furthermore, it is widely believed that Kazakhstan also repays these loans through concessional oil and gas deliveries to China (Interview European Diplomat 1), which benefits China's objective to secure energy in the long term. This is especially beneficial because Beijing, as a relative latecomer to the international oil and gas markets, struggles to access low-priced resources.

It is possible to observe other forms of conditionality beyond resource access. Projects that receive Chinese credit are executed partially or completely by Chinese contractors, thereby adding little value to the Kazakhstani economy. For example, the joint Sino-Kazakhstani pipeline which Beijing co-financed was built by the China Petroleum Pipeline Bureau. At the beginning of 2012, China's Exim Bank extended a loan of US\$1.1bn to Kazakhstan to upgrade its Atyrau refinery, and Sinopec Engineering will execute the project (Maralove 2012, Paxton 2012). Kazakhmys' US\$1.5bn loan will develop a new mine in Aktogay, the equipment for the development will come from China (Xinhua 2011b). It is widely known that Chinese oil and gas investors also import their own workers and subcontractors (Interview European Diplomat 1). Although this violates Kazakhstan's local content laws, CNPC has escaped any fines so far, a point that the thesis will revisit again. As such, Beijing's creditor behaviour bears similarities to that of western countries in the 1980s, which provided concessional loans, also known as development loans, often on the proviso that recipient countries ordered equipment from the creditor in return.

Chapter 5 will discuss the dynamics behind China's credit lines in greater detail. However the conditionality of the 2009 finance package for Astana indicates that policy makers in Beijing understood the investment opportunities that the financial crisis presented and thus pushed its financial institutions to 'go global' and invest. This also confirms Kirshner's argument that economic crises generate opportunities

for well-funded states to offer emergency assistance to those in distress – in exchange for some political concessions (Kirshner 1997).

As indicated in the introduction, these conditions also have significant economic disadvantages. The loan for resources approach is detrimental to sustainable economic growth and undermines any meaningful diversification of the economy (i.e. Dutch Disease), which is firmly anchored in Kazakhstan's national strategy 'Kazakhstan 2030: Prosperity, Security and Ever Growing Welfare of All the Kazakhstanis'- a key government blueprint for Kazakhstan's economic development until 2030. Nevertheless, between 1999 and 2012, Kazakhstan's dependence on its resource sector grew dramatically and now constitutes 85% of export revenues or 40% of GDP (Palazuelos and Fernandez 2012). This also leaves other areas of the economy under-developed (Chapter 2) and creates a macro-economic trap otherwise known as the Dutch Disease: High revenue inflows through the resource sector increase price levels, especially labour costs, which renders manufacturing, as an industry, uncompetitive (Interview Trade Expert).

Through loan maturities of around 13-15 years, China will drive this trend in the long-term and strategically commit Astana to resource exports during that time, thereby allowing Beijing to meet its energy security objectives. Beijing's pipeline construction further added to these complicated dynamics: in a single pipeline setting the end-consumer, namely China, has significant leverage over the producer to determine the "price" of these loan-for-oil deliveries (Interview European Diplomat 1). One of the outcomes of these credit arrangements is that China now effectively controls between 25-30% of Kazakhstan's oil production (Sharip 2011). Despite Beijing's pledge to increase finance in Kazakhstan's non-resource sector, resources continue to be the main destination of Chinese loans. As a matter of fact, research for this thesis could not find any meaningful loans that were directed to the non-resource sector. Not surprisingly, these credit facilities stir up controversy in Kazakhstan and create the sense that the country is selling out on its resources,

which also increases the opportunity costs for the Government to accept financing from Beijing. Through its 'loan for oil' conditionality, China is able to link credit to further resource commitments and locks Kazakhstan into long-term debt. This is in line with David Lake's theory about relationally specific assets driving China to seek out a hierarchical relationship with Kazakhstan, based on economic dependence (Lake 2009).

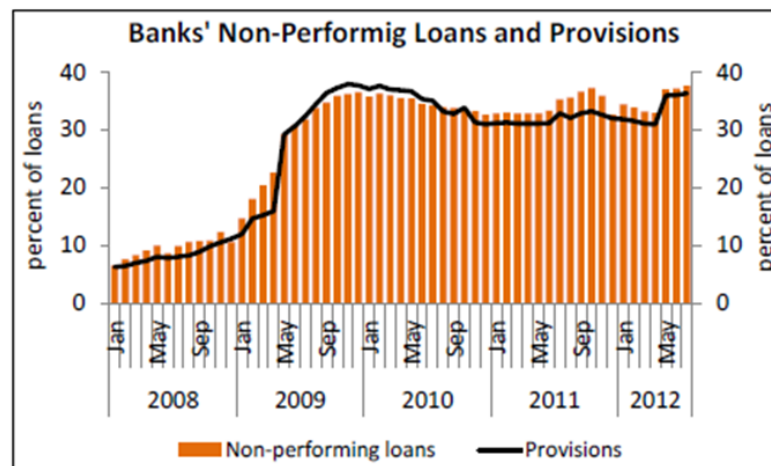
It can be concluded that Chinese loans are beneficial to the Kazakhstani elite, but not to Kazakhstan's economic development. The reasons why the elite is so receptive to accepting Chinese investment, even though it undermines economic diversification and commits Kazakhstan to resource deliveries at concessional prices, may be rooted in the elite's distinctive short-term funding needs and as such a short-term view on decision making that is symptomatic of its immediate concern for self-preservation (Chapter 3). Chinese loans also offer a certain degree of discretion, which may provide further incentive to turn to China for funding in the future, especially in view of a number of corruption scandals that could threaten the regime's legitimacy. The financial crisis left China as an available source of credit. Although alternatives are difficult to come by, corruption and mismanagement in the banking sector, in conjunction with the elite's rent-seeking behaviour created a complex investment environment that deterred international private investors.

The chapter concludes with an analysis of whether China has achieved a creditor status that creates or contributes towards economic dependencies. Any such assessment will analyse alternative sources of finance, as well as the perception of decision makers on the future of Chinese credit (Chapter 2).

4.5 The Future of Chinese Loans

The financial crisis and its aftermath eroded investor confidence in Kazakhstan's banking sector and the government, which restricts access to international capital markets until the sector has recovered. The sector has struggled with an official Non-Performing-Loan (NPL) ratio of officially 30%-40% since the beginning of 2009 (See Figure 26), which finance experts put at 60% (Interview Finance Expert London). Figure 26 also shows that Kazakhstan's banking crisis is still ongoing and is indicative of serious structural problems, for which Kazakhstan's neopatrimonial form of governance is partially responsible (Chapter 2). Standard and Poor's risk assessment points to "lax lending standards" and a culture where loans are disbursed against weak due diligence standards, possibly because the creditor is linked to the bank through the web of patron-client relationships. This is further reflected in the NBK's assessment that the stability of Kazakhstan's financial system continues to be at significant risk of low profitability and capital adequacy and thus low levels of investment activity in the economy (NBK 2011).

Figure 26 Non Performing Loans



This will significantly impede the ability of Kazakhstani banks to raise funds at reasonable conditions on international markets. The consequences are observable

in the field of export-import guarantees, which are important to Kazakhstan's economic diversification. In 2009, Euler-Hermes, a German export credit agency was heavily invested in BTA and exposed to roughly US\$500m or half of the outstanding export credits in Kazakhstan's banking sector. Euler-Hermes participated in the settlement negotiations with BTA in September 2009. However, the conduct of BTA and the Kazakhstani Government concerned Euler-Hermes to the point that it feared BTA's immediate collapse and enlisted the German government, which promptly accused Astana of a lack of effort in the matter (Hoagland 2009d). BTA's renewed default in 2012 confirmed these fears. Moreover, the 2012 default occurred over the relatively small amount of US\$160m and under full government ownership and oversight. An audit found that the bank had breached regulations, including sections of the recovery plan that was approved in 2009, because of inadequate control of BTA executives (Gizitdinov, 2012).

Consequently, international Exim Banks now demand greater guarantees from the government (see Private Lenders). In a 2010 transaction involving General Electric's plans to build locomotives in Kazakhstan, the US Exim Bank asked directly for a sovereign guarantee to finance the deal. This was not welcomed by Samruk-Kazyna's Kairat Kelimbetov, who maintained that "our word should be good enough" (Spratlen 2010). The deal in question had a volume of US\$150m, reflecting how low confidence in Kazakhstan's financial capabilities had dropped. Euler-Hermes concluded in January 2012 that

"The latest default may also adversely affect the sovereign's credibility in international financial markets. Nominally, Kazakhstan has ample reserves [...]" (Euler-Hermes,2012).

International ratings agencies resonate with this view and consider the banking sector an "extremely high credit risk" (S&P 2012). The share prices of most Kazakhstani banks continue to decline, indicating that investor confidence remains eroded. In view of international scepticism against Kazakhstani banks and the

Kazakhstani Government, access to alternative sources of funding will thus remain crucial.

There seems to be consensus, at least among economists and analysts in Kazakhstan, that Chinese loans will increase in the future (Interview Local Finance Expert 1). The perception of future economic benefits further operationalises economic dependencies as discussed in Chapter 2. In fact, the belief is that China already constitutes a viable alternative to loans from IFIs, such as the IMF or EBRD that are generally dependent on political and fiscal reform, opportunity costs which the ruling elite likely considers higher than those associated with Chinese loans. In Kazakhstan's neopatrimonial system, both types of loans result in different trade-offs. Conditional loans from IFIs will diminish the elite's control over the corporate sector and thus lead to a loss in power. Chinese loans are detrimental to Kazakhstan's economic development and may lead to a loss of independence. However, they strengthen the elite's position domestically in the medium term by providing revenue incomes and assisting elite consolidation (Chapter 2). Keirat Umarov, Deputy Foreign Minister, underlines this view when arguing that Kazakhstan refused to cooperate with the U.S. Congressional human rights certification process to receive financial assistance and instead would rather pass on these funds (Hoagland, 2010a).

Furthermore, Chinese loans are processed and disbursed much faster than those from IFIs and thus are a suitable source for unforeseen declines in revenues⁹³ This is was also a consensus opinion emerging from interviews and various personal conversations in Kazakhstan (Interview Regional Finance Expert, Conversation Local

⁹³ In "Beijing Consensus" Stefan Halper quotes the Senegalese President Adboulaye as saying that "[...] a contract that would take five years to discuss, negotiate and sign with the World Bank takes three months from inception to conclusion with Chinese authorities" (Halper 2010).

Investor). For China, in turn, this presents an opportunity to secure energy whilst also investing and diversifying⁹⁴ some of its massive foreign currency surplus.

It appears the Kazakhstani Government expects China to continue committing large loans in the future and is keenly aware of China's financial capabilities in this respect. As one interviewee put it, "we are peanuts for Chinese investment" (Interview Local Finance Expert 1), and experts see the recent currency swap agreements with Beijing in this light. Accordingly, the swaps are directly linked to increased Chinese credit in the future, which Kazakhstan can now service in Yuan. Kazakhstani officials have high hopes that China will provide more credit in the future, a view also expressed by the head of SK, Kairat Kelimbetov (Kazinform 2010). This view on China as future source of credit is a pertinent criterion that operationalises economic dependence towards political ends (Chapter 1). Copeland maintains it is such prospects that will drive Kazakhstan's cooperation with China's interests (Copeland 1996). However, critical voices in Kazakhstan recognise that the country is on its way to becoming debt-dependent on China (Atabayev 2010).

Besides the commitment to resource deliveries that come with Chinese loans, there has also been a rumour that China expects to lease 1m hectares of arable land from Kazakhstan to plant soybeans as a favour. Rakhat Alyiev, accused the President in 2010 of having signed a secret pact leasing the land for 99 years (Mamai 2010). Aliyev's personal motives aside, the rumour has persisted and a diplomat in Astana confirmed that the request had been debated in the Kazakhstani parliament (Interview European Diplomat 2). This plays to the latent Sinophobia amongst Kazakhstanis and can turn into a political problem for the government (Interview European Diplomat 2). Given that China is the most populous country in the world with comparatively little arable land, Kazakhstanis are suspicious about policies tying the neighbouring countries too closely together. In particular, Kazakhs fear an influx of Chinese labour driving out Kazakh workers, in the worst case, transforming

⁹⁴ Most of China's foreign currency reserves are invested in US Treasuries making China susceptible to quantitative easing in the US and the devaluation of the US Dollar.

them into yet another minority in their country, similarly to Soviet times. Above all, these developments invoke historic fears of a Chinese annexation of Kazakh territory. The public's distrust of China and the government's reliance on China's economic investment pose a conflict that can increase the opportunity costs associated with Chinese investment, especially for the ruling elite. In contrast, Kazakhstani politicians seek to benefit from China's abundant surplus that allows Beijing to invest freely, and therefore have an incentive to keep this information from reaching the public domain. Research on China is therefore viewed sceptically in Kazakhstan and interviewees only agreed to conversations if they were kept anonymous.

Alternatives Sources of Finance

This chapter has already touched on opportunity costs in its discussion of the role that Chinese lending played in Kazakhstan's banks, economy and political elite. The following segment examines the relationship between China and Kazakhstan against alternatives (Crescenzi 2005) and discusses the associated opportunity costs in greater detail to determine whether Beijing has created dependencies through this economic lever (Chapter 2). Baldwin defined this as "the ease of breaking the relationship" (Baldwin 1980:476). If the Kazakhstani Government were to forego Chinese credit, what are the alternatives and costs associated with them? This takes into consideration the quantitative and qualitative aspects of external credit and builds on the previous discussion on the significance of Chinese credit to Kazakhstan's economy and political system.⁹⁵ The availability of alternative sources of financing affects opportunity costs (Crescenzi 2005) for a country to exit or forego the economic benefits associated with an economic partner. In terms of credit lines, alternatives for Kazakhstan are foremost Russia, the US, private investors and International Financial Institutions (IFIs).

⁹⁵ These are the indicators discussed in the introduction. They are slightly adjusted to the finance sector.

With regard to the overall external debt, the picture appears mixed at first. Here China 'only' ranks as the third biggest lender in terms of outstanding loan stocks, behind the Netherlands and the UK. In terms of newly provided loans, however, China has ranked second since 2010. What is critical is that Beijing has managed become a top lender in a very short period of time and this momentum is unlikely to abate, given Kazakhstan's need for external debt, ongoing systemic problems in the banking sector and China's vast foreign currency reserves coupled with its demand for resources. In fact, new loan originations matter most to Kazakhstan's finance needs. Outstanding loan volumes are loans that creditors have already provided to Kazakhstan in the past, with no guarantee that these creditors will refinance these loans in the future. When it comes to future loan expectations, the evidence presented here suggests that the Kazakhstani Government looks primarily to China. After all, China emerged as the second biggest lender in 2010 and will likely become number one in the near future, simply because it has the financial funds and is willing to extend concessionary loans. This has important implications for Kazakhstan's decision makers and, consequently, for Chinese influence: to tap into these future expected loans, Kazakhstan must keep China happy. This means that Kazakhstan, and more specifically, the elite is incentivised to promote policies that are in line with China's interests, thus giving China political leverage, as this dissertation aims to show. On the other hand, China is the only one of Kazakhstan's top creditors still providing loans to the struggling banking system that provides loans to SMEs, driving economic growth. This last point cannot be overemphasised, given that banks are the primary source of funding for the economy in the absence of capital markets.

The following section discusses whether Kazakhstan has any alternatives and the associated opportunity costs associated with these. One alternative would be a deleveraging of the Kazakhstani banking system by foregoing international loans altogether. However, these costs in terms of economic growth and the implication for the elite's legitimacy based on income redistribution are likely too high to make

this politically feasible. The second option would be to substitute a different creditor for China. This depends on whether a substitute exists and whether the loan conditions are acceptable to Kazakhstani decision makers. Potential substitutes include Russia, the US, private sources, or IFIs.⁹⁶

Russia

Russia is a natural candidate. As part of the former USSR, Kazakhstan still maintains close ties to Moscow; and Russia considers the former Soviet Central Asian Republic within its sphere of influence. In the short and medium term, however, Russia is unlikely to be a viable source of financing and so far has rejected Kazakhstan's bid for financial help. Russia therefore sends a message that although it considers Kazakhstan its 'Near Abroad', it is not willing to extend its financial power. Because Russia's economy is similarly resource-dependent, both countries go through analogous revenue changes based on the fluctuations of global energy prices. However, when commodity prices drop, like during the financial crisis, Kazakhstan arguably has a greater need for credit than in times of oil windfalls. Yet, this is when the Russian economy has less money to spend. The Chinese economy depends less on resources and China's vast foreign currency reserves allow Beijing to spend even in times of an economic downturn.

Even prior to 2009, Russian loan commitments to Kazakhstan were minimal and Moscow does not feature in the NBK's annual reporting. Secondly, Russia's economic importance to Kazakhstan is only likely to decrease further, as it has yet to recover to pre-crisis levels after being significantly affected by the global financial downturn. Evidence for this can be found by the stalling negotiations between SK and Russia's Sberbank in the sale of BTA Bank. Even if Russia were to commit the financing, it may come at high political cost to Kazakhstan. As part of the Kazakh

⁹⁶ The calculations include the Netherlands and the UK because their companies extend private debt to Kazakhstan not sovereign debt like China. Both have little geo-strategic interest in Kazakhstan that would justify increased state funding for Kazakhstan that would make up for a drop out of Chinese credit.

multi-vector foreign policy, it seeks to maintain a healthy distance from its former oppressor. The Kazakh public is also suspicious of Russia and memories of Soviet times are still fresh.⁹⁷ Russia's lack of financial commitment may have constituted an inflection point for Kazakhstani policy makers, who realised that Russia's pledge towards Central Asia and Kazakhstan is more military and political than economic.

The US

The US had geostrategic interests in Kazakhstan because of its troops in Afghanistan and its proximity to China and Russia. Kyrgyzstan's decision to close down its US air base in favour of a Russian might incentivise the US to search for closer ties with Kazakhstan. However, US troops are scheduled to leave Afghanistan soon and the current US administration's pivot to Asia may shift the foreign policy focus towards other sub-regions, including South East Asia and Japan. Any financing to Kazakhstan, therefore, might not win political and public support. From an economic point of view, the US is running a current account deficit and as of 2013, is on a tentative road of economic recovery. It is thus unlikely to be in a position to commit large resources abroad. In view of the recent recession and two costly wars, policy makers have become extremely cautious when it comes to spending for political purposes abroad - an issue highlighted during the most recent presidential election. This thinking is also reflected in the US Exim Bank, which, unlike its Chinese counterparts, insists on collateral or sovereign guarantees from Kazakhstan to finance projects, even in conjunction with Samruk-Kazyna, the welfare fund (Spratlen 2010).

Private Lenders

In the long term, private sources such as Morgan Stanley or Deutsche Bank could potentially replace China as key lenders. However, given that private, for-profit sources originate loans priced at free market value, the cost for Kazakhstan will be

⁹⁷ Impression of author from conversations in Kazakhstan

high, as Chinese loans are concessional. While Morgan Stanley appeared as a creditor in the 2009 NBK reports, the company's involvement was later heavily criticised when it was revealed it had hedged its stake, generating a windfall profit when BTA defaulted. It is therefore likely that these investment banks mainly lend in situations of distress. During a normalised market environment, it is unlikely they can meet their return expectations at interest rates that would also be attractive to Kazakhstan. Furthermore, the recent experience with recurring bank restructurings has already driven away some of the existing lenders, including Italian and French banks, who have decreased their financing in conjunction with ENI's and Total's investment interests in Kazakhstan (NBK, 2010). Even policy banks in the west, such as export credit agencies are only willing to provide financing against collateral. This became especially relevant in 2010, in conjunction with the Kazakhstan Caspian Transportation System (KCTS), where KMG was surprised when the French export credit agency demanded collateral for project financing. A leading oil executive concluded that "KMG is slowly beginning to understand that they must treat us as investors and partners, not just paying customers" (John Dabbar quoted in (Hoagland, 2010c)).

The prospect of raising external debt depends primarily on the reputation of a government to service and repay that debt, and Kazakhstan is no different. In his study spanning 300 years of international debt dynamics, Michael Tomz identified a government's reputation as the single biggest driver in lenders' decisions to extend credit (Tomz 2007). Given the past performance of government-owned BTA, it will be exceptionally difficult for the Government to raise debt in the near or medium term. This does not apply to Beijing in equal terms because of China's vast foreign currency reserves and the fact that its loans advance Beijing's regional interests (Chapter 4). As such, Beijing will be the most approachable lender in the short and medium term.

International Financial Institutions (IFIs)

This leaves IFIs such as the IMF, ADB and EBRD as substitute candidates. However, although these institutions aim to provide fiscal assistance, especially to transition countries, their funds are exhausted in the aftermath of the financial crisis. While international development banks may be able to provide loans at favourable interest rates like China, it is unlikely they can provide the volume required. For example, the entire loan volume ADB committed to Kazakhstan between 1994 and 2010 totalled US\$1.7bn (ADB 2011). One third (US\$500m) of this amount was committed in 2008 as a one-off countercyclical anti-crisis programme. Arguably, more would have been needed during the financial crisis but the ADB was stretched to its limits. Similarly the WB has disbursed US\$3bn in loans to Kazakhstan since the country joined in 1992.⁹⁸ As a reminder, China committed over three times that amount during just in 2009. Most importantly, the loans of international financial organisations are bureaucratic and conditional with expectations for the debtor country to implement economic and political reforms. This involves political and economic opportunity costs that the Kazakhstani elite likely aims to avoid. Economic liberalisation undermines the elite's attempt to centralise control over the economy and conflicts with the power structure of the neopatrimonial system. Moreover, IFI loans require lengthy processing, something which makes China's quickly-disbursed loans even more attractive. Chinese conditionality is more acceptable to Kazakhstan's government than its alternatives, and by the end of June 2012, Kazakhstan consequently had five times more debt outstanding to China than to IFIs.

The above shows how entrenched China already is as a creditor to Kazakhstan. It can be concluded that its replacement comes with substantial economic and political costs for the government. Given the fragile recovery of Kazakhstan's economy, the government may seek to avoid any disruption that results from

⁹⁸ The total volume of credit lines runs to US\$5.5bn in the period of 1992-2010 (World Bank 2012).

changing creditors. China emerged as the biggest new source of credit to Kazakhstan's cash-strapped banking sector, keeping the system liquid and demonstrating to Kazakhstan its reliability as a partner. Politically, Beijing's credit allows the elite to pursue the status quo without having to undertake any structural changes, including diversifying the economy. As discussed in the previous chapter, Astana pursues a distinctively short-term view of the country, which is further facilitated through incoming revenues from China. Because Chinese loans are accompanied by little media scrutiny, unlike western counterparts, it is easier for the Government to keep China's financial influence out of public view and use Chinese funds to save face in view of questions surrounding BTA and the NF. Moreover, it is a distinct possibility that Chinese credit lines enrich the elite directly (Costelo 2009).

Developments since 2009 have further eroded international investor confidence especially BTA's second restructuring in 2012 also significantly eroded the credibility of the sovereign itself. Conversely, the significance of access to Chinese credit lines has increased. Kazakhstan's failure to sell BTA is indicative of how unattractive the banking system has become for foreign investment and lending at the moment. This also generates a big problem for the government, which initially only planned to prop up the bank in the short-term but now is only more deeply tied-up in BTA. Kazakhstan may soon find itself turning to China for help with BTA, as an analyst covering the region has suggested⁹⁹ (EBRD 2010). However it is likely that Chinese investors will steer clear of Kazakhstani banks because they are problematic.

4.6 Chapter Conclusion: Financial Dependence

This chapter analysed whether China's financial influence in Kazakhstan has built significant dependencies in Kazakhstan, especially after the Global Financial Crisis

⁹⁹ Conversation with an analyst at the EBRD

and found evidence to support this hypothesis based on a discussion of criteria developed in Chapter 2.

Whilst research for this thesis could identify a number of substantial credit lines from China to Kazakhstan, it could not find any evidence for the reverse. During the period under analysis, no evidence could be found for Kazakhstani credit lines to China. This is not surprising, given the state of Kazakhstan's financial system after the Global Financial Crisis which was over-leveraged. This suggests a steep asymmetry between both countries concerning the issuance of debt. A discussion of the qualitative context of this asymmetry has shown that Astana faces significant opportunity costs if it would forego Chinese credit lines. This is based on the structure of Kazakhstan's financial sector and the role that Chinese credit lines play in it as well the availability and trade-offs associated with alternative sources of debt. Furthermore, Kazakhstani decision makers perceive of more Chinese credit lines in the future. The above criteria suggest that Kazakhstan's dependence on Chinese credit lines is significant.

The financial crisis turned China into Kazakhstan's dominant external creditor through the provision of large loan volumes; the second biggest creditor of Kazakh banks; and most importantly, the key source of new credit lines. It is unlikely that Kazakhstani banks could obtain the long-term loans often provided at below-market interest rates elsewhere without facing some form of political conditionality. As noted above, the defaults in the Kazakhstani banking system meant Kazakhstani banks have had less access to long-term loans and have had to shift to bonds and CDs as a means to raise cash. These, however, are less attractive due to their shorter maturity and are less stable, creating bigger uncertainties. As such, long-term loans are preferable for ensuring a stable banking system. Thus, China effectively assists Kazakhstani banks in bridging the time until international investors have regained confidence in the Kazakhstani government and its banking system. Until this point, the availability of alternative sources of external credit is

highly restricted for Astana. Arguably, China was “the lender of last resort”, the only source of financing available that could provide the volume of funds required at the time. More importantly, Kazakhstan’s domestic politics render alternatives to China unfeasible: Although loans from IFIs and private investors might be better for the economy in the long term, they are not attractive to Kazakhstan’s government. To access alternative loans, the Government has to make significant changes in the finance sector and break the tight inter-linkage with the elite nexus to win back investor confidence. This would mean, however, that the elite cease its influence over the sector - an opportunity cost it is not yet willing to pay. Until that happens or until international investors return, China has an opportunity to further expand on its position as main creditor. Returning to Martin Wolf’s observation that “when countries with external deficits run out of foreign providers of private credit, they become dependent on foreign sovereigns” (Wolf, 2010), Kazakhstan has become financially dependent on China in the absence of feasible alternatives. The size and maturity of Chinese loans mean that Beijing will find itself in a creditor-debtor relationship with Kazakhstan for the foreseeable future. This chapter highlighted how China exploits this relationship politically, by committing Kazakhstan to deliver resources as part of its “energy-for-loans” approach. Binding Kazakhstan to China economically and financially fits well with Beijing’s energy security strategy.

China’s role in the banking sector, combined with its role in Kazakhstan’s overall external debt, means the financial relationship between both countries is highly skewed towards the dependence of Kazakhstan. This dependence can be further operationalised through government perception: interviewees in Kazakhstan expected more loans from China in the future, and Kairat Kelimbetov, the head of Samruk-Kazyna, expressed his hopes in 2010 that China will increase its credit volumes further (Kazinform 2010). In the absence of feasible alternatives, Kazakhstan is financially dependent on China. The next segment will analyse

Chinese trade and investment to see whether Kazakhstan's financial dependence on China is further reinforced through trade and investment dependencies.

This also poses further questions about whether these dependencies are the result of a deliberate Chinese foreign policy. The predominant driver of this hierarchical finance relationship is Kazakhstani demand for external financing based on specific elite needs and structural weaknesses in the banking sector that have driven away international investors. However, the facts presented in this chapter show that Beijing made the deliberate decision to extend such funding and understood the opportunities inherent in the financial crisis, which allowed Beijing to condition its finance package to resource acquisitions. The following chapters will discuss the Chinese actors involved in these credit lines in greater detail, in order to answer this question and show that Kazakhstan fits in well with a number of Chinese objectives beyond energy security, such as diversifying its currency reserves, market access for goods, and regional economic and political security (Chapter 5 and 6).

Chapter 5 **Trade, Investment and Dependency**

The chapter examines China's trade and investment (FDI) status in Kazakhstan and shows that China has become Kazakhstan's most important trade partner and is a key source of foreign direct investment. Together with finance these economic levers create significant economic dependencies in Kazakhstan (Chapter 2). Concerning trade, this is driven by the bi-lateral trade and FDI asymmetry between Kazakhstan and China, as well as the opportunity costs associated with Kazakhstan's market structure, asset specificity of trade and geographic proximity to China (Chapter 2). Compared to finance and trade, China's FDI status is weaker in relative terms. Nevertheless its FDI status is still significant for Kazakhstan's economic growth, especially the momentum of China's FDI.

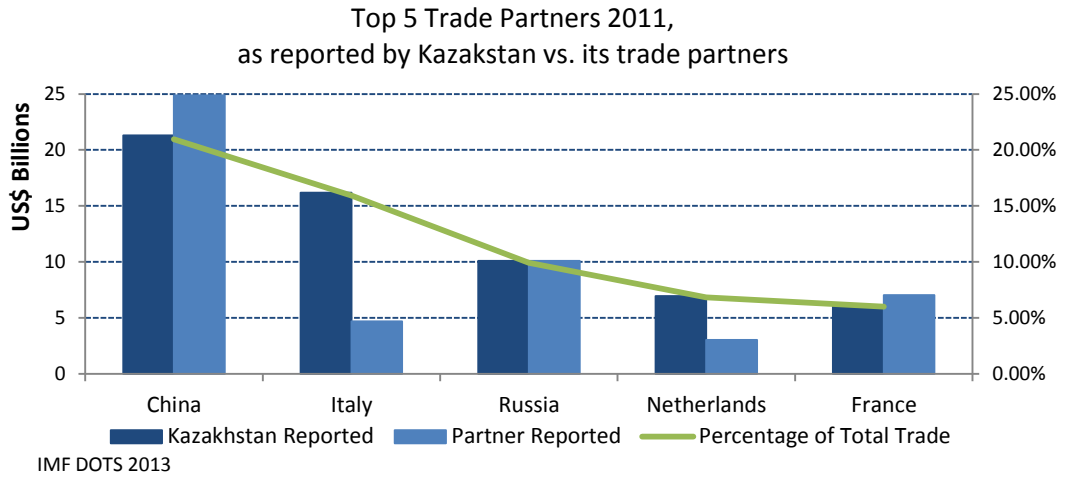
The remainder of this chapter analyses whether Beijing can leverage this economic dependency towards political ends and investigates if economic dependency is the outcome of a deliberate policy process in Beijing. This addresses a research question and criterion identified in Chapter 2, which should allow Beijing to leverage economic influence in political power (Kahler & Kastner, 2006). The chapter supports the hypothesis that Beijing's political support for projecting economic influence into Kazakhstan has become more direct, especially after 2009. The chapter also analyses the key drivers behind China's economic influence in Kazakhstan and shows that Beijing is not in control of the aggregate economic drivers. This chapter argues that although most of China's economic activity in Kazakhstan appears to fall within the government's 'Go Global' framework, Beijing can exert such control only selectively and where mutual interests overlap. Rather the chapter will substantiate the sub-hypothesis that Chinese drivers of trade and investment are especially China's NOC which proactively enlist Beijing's help to overcome Kazakhstan's resistance to Chinese resource investments. CNPC for example, successfully enlists Beijing's support to meet Astana's resistance to Chinese investment in its resource sector. Nevertheless Kazakhstani decision

makers perceive of China as a unitary actor in terms of economic activity and perceive it credible that Beijing can control the levers of its economic influence which should allow Beijing to leverage economic dependencies.

The chapter closes with an overview of the immediate outcomes of Kazakhstan's economic dependence which will be analysed in greater detail in the case study of Part II.

5.1 Sino-Kazakhstani Trade

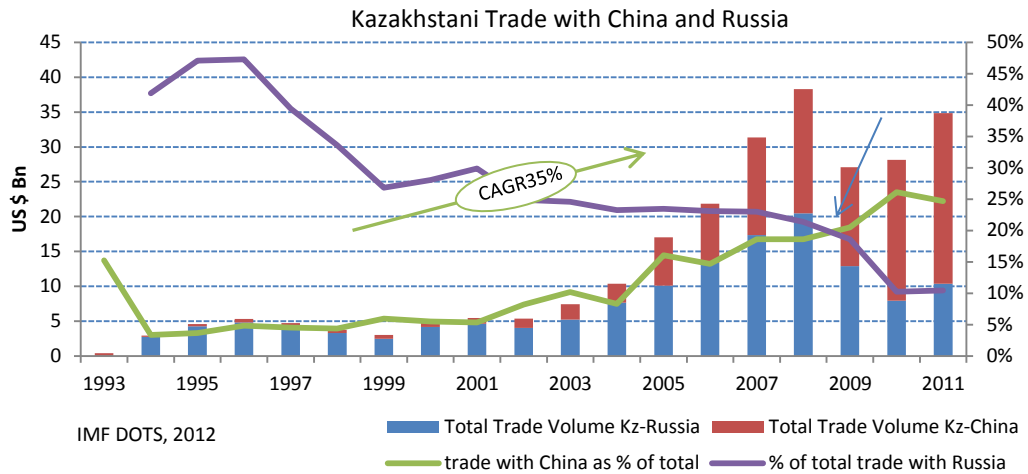
Figure 27 Top 5 Trade Partners of Kazakhstan



China replaced Russia as Kazakhstan’s most important trade partner in 2009. Although the Financial Crisis constituted an important inflection point this is the result of a much longer trend that had already started around 2001 (see Figure 28) and was consolidated after the Financial Crisis, even when trade with Kazakhstan’s other trade partners recovered. This trend is likely to continue in the foreseeable future. By the end of 2011, Kazakhstan reported a Sino-Kazakhstani trade volume of c. US\$21bn, or c. US\$25bn based on figures reported by China (Figure 27). There are discrepancies between Kazakhstan’s overall reporting to the IMF and that of its trade partners. For Sino-Kazakhstani trade China reports a higher volume of exports than Kazakhstan. The most significant variance occurs in trade reporting with Italy for which Kazakhstan reports a total trade volume of c.US\$16bn and Italy reports only c. US\$5bn. With the exception of China, variance in reporting does not affect who Kazakhstan’s top 5 trade partners are, however it does change how these countries rank vis-à-vis each other. For example, based on Kazakhstani numbers Italy would be Kazakhstan’s second most important trade partner after China, based on Italian numbers this would be Russia. The reason for these reporting differences could not be established conclusively. However, the IMF noted in its review of

reporting standards that Kazakhstan's data reporting evidenced inconsistencies, inaccuracy and general weaknesses (IMF 2008). Italian, Dutch and French reporting on the other hand is in line with international standards and thus should bear more weight in an economic analysis. Similarly, analysts from international banks and investors such as ING also draw on China's reported numbers in their commercial reports about Kazakhstan (ING 2012). Going forward the chapter will draw on variances in reporting where this leads to different conclusions. For example, when investigating the sub-components of trade the chapter will draw on Chinese trade figures, which are more reliable (Peyrouse 2008) to draw conclusions about the drivers for trade. However, in terms of symmetry for example, the difference matters little. Depending on the source Sino-Kazakhstani trade constituted either 21% (US\$21bn) or 24% (US\$25bn) of Kazakhstan's overall trade in 2011 whilst it constituted barely 0.6% (US\$21bn) or 0.7% (US\$25bn) in China's overall trade volume which totalled c. US\$6.3tr in the same period (IMF DOTS 2012). This suggests a steep asymmetry in the Sino-Kazakhstani trade relationship. The following sections analyse whether this asymmetry is associated with opportunity costs that create economic dependencies.

Figure 28 Kazakhstan's Trade Volume with China and Russia



Initially, Sino-Kazakhstani trade was driven by small traders who crossed the border from China into Kazakhstan (Interview European Diplomat 1) and received a significant boost through China’s growing energy needs. Figure 28 illustrates how bilateral trade expanded even throughout the economic crisis, when China replaced Russia as Kazakhstan’s most important trade partner. This is all the more significant in view of Kazakhstan’s close economic integration with the Soviet Union and Russia after 1991. The decline in Kazakhstani-Russian trade since 1997 saw, with a four-year time lag, the concurrent increase of the Sino-Kazakhstani trade volume. It is noteworthy that Sino-Kazakhstani trade has expanded at an extraordinary pace. In 1993 China accounted for only 3.4% of Kazakhstani trade and by 2011 for a quarter, or the equivalent of around 13% of the country’s GDP. This translates into a compounded annual growth rate (CAGR) of 35% which outpaced both Kazakhstan’s and China’s economic growth during the same period which at its peak never exceeded 14% for China and 13% for Kazakhstan (Figure 29). The CAGR suggests significant momentum which magnifies the opportunity costs for Kazakhstan especially since this momentum is associated with its most important trade partner. By way of comparison, France is the only other trade partner who experienced a similar growth rate during the same period; however, bilateral trade with France only constitutes 6% of overall Kazakhstani trade.

Figure 29 GDP growth China and Kazakhstan



Even though this pace has slowed over the last few years, the underlying drivers and the overall trade structure will, with everything else being equal, further cement China's status as Kazakhstan's most important trade partner in the future. The particular context of Sino-Kazakhstani trade significantly increases the economic and political opportunity costs for Astana based on:

- Overall trade volume
- Peer-group comparison
- Economic complementarity
- China's resource demand
- Cross-border trade
- Asset specificity
- Political support
- Lack of alternatives

Economic Complementarity

By the end of 2011, Sino-Kazakhstani trade had reached c.US\$25bn, followed by trade with Russia at around US\$10bn, and the France with US\$7bn. Of the US\$25bn in total, exports to China constituted the biggest component with c.US\$15bn,

compared to imports valued c.US\$10bn (IMF DOTS).¹⁰⁰ As such, China runs a trade deficit with Kazakhstan. Perhaps unsurprisingly 69% of Kazakhstani exports and Chinese imports are mineral fuels (IMF DOTS): Mineral fuels, of which China imported US\$9.6bn in 2011, more than quadrupled since 2006 (US\$1.4bn) and were merely US\$0.34bn in 2003. This was followed by ores (US\$2.0bn) and copper (US\$1.6bn), which nearly doubled from (0.7bn) in 2009, followed by rare earth elements and radioactive elements (US \$1.3bn) which doubled since 2009 (0.6bn) and iron and steel (US\$ 0.9bn).

Beijing, in turn, primarily exports processed products to Kazakhstan, including: machinery and appliances (US\$1.2bn); followed by electronics (US\$1bn), processed iron and steel articles (0.3), cars (0.3) and railway equipment (0.3). The latter import reflects China's growing role in Kazakhstan's infrastructure development, whereby Kazakhstan's south eastern railway nexus is increasingly integrated with China because of the change from Russian to Chinese gauges (Muzalevsky, 2010). This break-down also reveals the complementary structure of both economies which also strengthens the overall prospects of Sino-Kazakhstani trade in the future, especially vis-à-vis Russia. This complementary structure of both economies also increases the opportunity costs for Kazakhstan if it were to decrease trade with China in order to counter any trade dependencies. Indeed, it is possible that Astana has tried to counter the rapidly growing trade volume with China by joining a Customs Union with Russia (discussed, below).

The complementarity of both economies is captured by the fact that China exports processed consumer goods to Kazakhstan, which Kazakhstan's economy either cannot produce, or cannot produce competitively due to a lack in economic diversification (Chapter 2). China in turn imports resources that are necessary to fuel its economic growth. Both governments also acknowledge the economic

¹⁰⁰ Kazakhstan tends to underreport trade numbers with China which is why the statistics used China as the reported country, where numbers are more reliable (Peyrouse 2008). Differences in total values are due to rounding

potential of this complementarity and are thus committed to expanding trade in the future. In December 2012, Wang Qishan and President Nazarbayev set a target to nearly double bilateral trade to US\$40bn annually by 2015 (FMPRC 2012). This suggests that Kazakhstani leaders perceive trade with China to increase in the future, a key criterion for operationalising economic dependence (Chapter 2). The Kazakhstani-Russian trade-structure, on the other hand, is competitive because of the congruent nature of their economies. Both economies predominantly export hydrocarbon resources and are thus naturally in a more competitive relationship - which may also explain why Kazakhstani-Russian trade has dropped steadily since Kazakhstan's independence.

This complementarity introduces significant opportunity costs for Astana and makes it more difficult to mitigate decreases in Sino-Kazakhstani trade. Kazakhstan's market structure and the factors of its economy are heavily skewed towards the export of resources and import of consumer goods. Mitigating decreasing trade volumes with China is only possible by changing the factors of the economy (i.e. diversification) or finding alternative trade partners in the short-term (Crescenzi 2005). The following section discusses Kazakhstan's market structure, whereas alternative trade partners will be discussed towards the end of this segment.

The complementary nature of Sino-Kazakhstani trade rests in the lack of a diversified economy and creating dependencies on trade partners who have a complementary profile, unless Astana manages to develop a competitive manufacturing industry. The current price level in Kazakhstan combined with the close proximity of China, where workers' salaries are a fraction of their Kazakhstani counterparts, casts doubt on such prospects, at least in the short and medium term (Interview Trade Expert). In 2011, the average salary in Xinjiang was 1,000 Yuan/month (~US\$160) compared to Tenge 90,000 (~US\$600) in Kazakhstan (Tengrinews 2011a, MOFCOM 2012). Building different industries aside from the hydrocarbon sector will require structural reforms to bring down wages and to

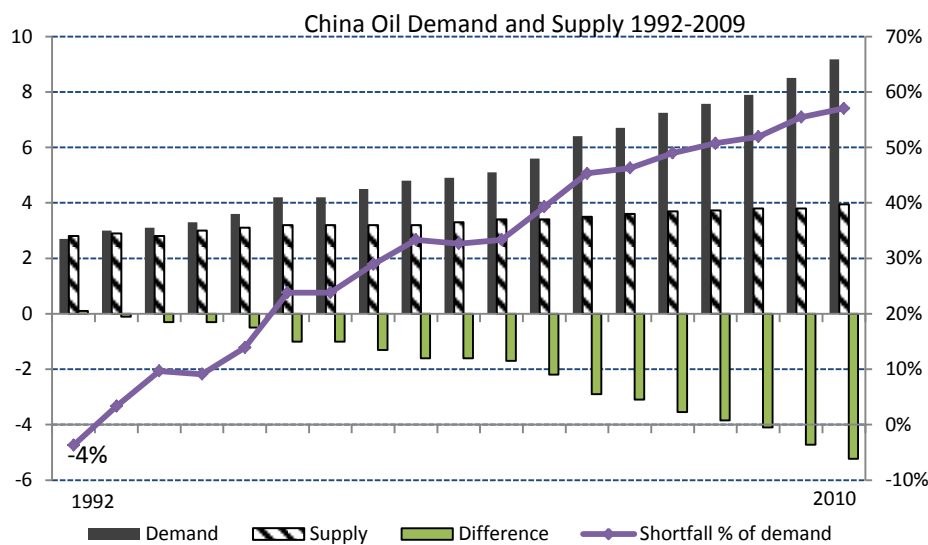
provide an environment in which small businesses have access to funding and talent. This, however, necessitates the political will to carry out reforms, loosen the elite's grip over the economy and to make greater investments in these sectors. However, decreasing labour costs will likely suppress incomes and living standards, which in turn pose a legitimacy risk to the government (Chapter 2) The financial crisis also significantly decreased bank lending to the economy, something which particularly affects smaller businesses without alternative options, such as intra-company loans (OECD, 2010). However, there are few signs that the elite are incentivised to undertake the necessary reforms to diversify the economy (Chapter 2). An economic downturn could be an inflection point to provide such an incentive. However, as the previous chapter demonstrated, instead of widespread reforms the elite preferred to increase Chinese financing which has allowed the elite to maintain the status quo.

Resources

Chinese resource demand and the specialisation of Kazakhstan's economy in the resource sector will likely continue in the future, drive bilateral trade and strengthen Beijing's clout in Kazakhstan's economy. At the same time this makes Kazakhstan's economy more vulnerable to declining trade with China. Figure 30 depicts China's 50-60% gap between oil and gas demand and supply, which also informs Beijing's decision to elevate energy security to a foreign policy objective. Beijing has recognised Kazakhstan's role as a reliable provider of these energy commodities which is reflected in joint statements and communiqués. It is thus invested in the construction of oil and gas pipelines, which allow Beijing to import these commodities via land and not via sea lanes, which are susceptible to supply chain disruptions. Pipelines are a long-term investment and further underline the fact that oil and gas exports from Kazakhstan to China are set to increase in the future and make Kazakhstan a firm variable in China's national security strategy. At the same time hydrocarbons are a highly specific asset which is less fungible than consumer goods especially its transportation which increases Astana's opportunity

costs. Besides China's high economic growth rate, China's resource demand is also driven by its rapid urbanisation. Forty-five percent of Chinese people are now living in urban areas, which has increased demand for the construction of property and raw materials to support the accompanied construction and infrastructure boom. This will continue into the future, and it is estimated that another 300-400m Chinese will be urbanised. Experts within Kazakhstan consider this a key driver for China's increasing demand in Kazakh commodities, primarily raw materials and energy in the future (Esbergen 2011b). As a point of reference, the construction of a 90sqm apartment requires six tonnes of steel, which, in turn, requires roughly 10 tonnes of iron ore (Regan 2011). Besides classic commodities, China has begun to import rare earth elements and uranium, for which Kazakhstan is a key source (discussed below).

Figure 30 China's Oil Demand and Supply Gap



Cross-Border Trade

A point that is often overseen in discussions of Sino-Kazakhstan trade is a flourishing cross-border trade and which initially drove the Sino-Kazakhstani trade relationship. However, today it is still an important component in the bi-lateral

trade structure and source of employment and living standards in Kazakhstan. The effects of cross-border trade also increase the opportunity costs associated with alternative trade partners, even though this type of trade is more difficult to instrumentalise towards political ends.¹⁰¹

Chinese consumer goods fuel local and regional markets and thus employment in Kazakhstan. A flourishing cross-border trade is vital to economic growth and employment in South East Kazakhstan and, at the same time, functions as a gateway for Chinese consumer goods into Kazakhstan and into wider Central Asia. Cross-border trade is trade which takes place within 30km of the border and involves individual traders who carry up to 50kg of cargo. The Korgas/Horgos border point handles around 150,000 traders annually and is considered a best practice example for bilateral cooperation in the region (Mitra & Kaminski 2008). A simplified visa regime allows Chinese traders to import goods valued < US\$1,000 duty free and large amounts are subject to simplified customs and visa regimes. Chinese goods, typically appliances and apparel, valued US\$3.1bn in 2006, supply bazaars throughout Kazakhstan (Mitra & Kaminski 2008). The value of these goods easily exceeds that of US-Kazakhstani trade, which amounted to US\$2.6bn in 2011 (IMF DOTS). Almaty has the country's biggest bazaars (Barakholka, Altyn Orda, Karkara and Sary-Arka), because of their proximity to the Chinese border and turn around US\$ of 1.8bn annually (Mitra & Kaminski 2008:65). The author's visit to these bazaars and conversations with Kazakhstanis confirmed that the majority of goods sold there originate in China. Bazaars are also important sources of employment. Experts estimate that the Barakholka bazaar alone indirectly employs 250,000 people (Mitra & Kaminski 2008) and arguably, trade with Chinese goods contributes to this employment. However, Chinese consumer goods also raised living standards in Kazakhstan and in recognition of the benefits of cross-border trade, China and

¹⁰¹ It seems infeasible for China to "control" private, small scale traders that largely operate "below" the radar. Although not impossible, the CCP runs the risk of provoking a backlash from traders in the border region and in consequence unrest, in an area that Beijing struggles to keep stable. The CCP's trade off costs would be potentially very high-serving as a deterrent.

Kazakhstan decided to expand cross-border trade in the future (Tinibai 2010). In November 2011, the Horgos International Border Cooperation Centre was inaugurated, which expands tariff free border trade to the point that China will be able to import copper and other resources tariff free from deposits near the border (Weitz 2012).

Economic Impact and Trade Resilience

Sino-Kazakhstani trade has increased dramatically since 1997, driven by Kazakhstan's market structure and its economic complementarity with China. The asset specificity of oil as well as a thriving cross border trade further increases the opportunity costs for Astana. However, the thriving trade relationship with Beijing has a negative impact on the local economy because it further facilitates Kazakhstan's economic dependence on the resource sector and undermines economic diversification. The Kazakhstani regime likely accepts this as a trade-off to access short-term revenue streams that can be redistributed (Chapter 2) and that do not require any economic reforms or significant upfront investment from the Kazakhstani government.

The Global Financial Crisis further underlined the resilience of bilateral trade, when trade with Kazakhstan's other partners dropped significantly. For example, whereas exports to China dropped by 19% between 2008 and 2009, Italian exports dropped by 44%, Dutch exports by 52% and Russian exports by 43% (IMF DOTS 2012). The Kazakhstani government pursues a multi-vector foreign policy, which aims to create amicable ties with the region's great powers and to balance these powers economically and politically against each other. Trade with China was important for Kazakhstan to help emancipate the economy from Russia. However, by 2009, China had replaced Russia as Kazakhstan's most important trade partner, and it is possible that the momentum of Sino-Kazakhstani trade may have caused scepticism in Astana becoming too dependent on Chinese trade. This may explain why Astana entered into a Customs Union with Russia and Belarus in January 2010, in order to

keep Russia economically involved and to prevent Kazakhstan developing a greater trade dependence on China. The negative consequences of the Customs Union outweigh its economic benefits which would support the view that Astana entered it primarily for political and not economic reasons.

The Customs Union raised prices for goods imported from third parties, predominantly China, and stifled Kazakhstan's accession process to the WTO, which had been well underway beforehand, whilst providing few macro-economic benefits. The WTO estimates that Kazakhstan was losing c.0.2% in real income per year as a result of joining the Union (WTO 2012). Before joining the Union Kazakhstan already had free trade arrangements in place with Belarus and Russia which poses the question why Kazakhstan decided to join. The only difference of the Customs Union is the implementation of a common external tariff (WorldBank 2012) which affects Kazakhstan's external trade partners, foremost China. The Custom Union effectively doubled tariffs from an average of 6.16% (MFN tariff) to 11.5% and Astana had to raise tariffs on 45% of its imported items, mainly originating in China, to which the Customs Union applies a standard 17% tariff (ADB 2011, WorldBanka 2012). However these tariff revenues are unequally divided among the union members: 87.97% goes to Russia, 7.33% to Kazakhstan and 4.7% to Belarus. Within the first three months of the Customs Union, prices on cars and consumer goods increased by 40% in Kazakhstan. In the absence of Russian substitutes, consumers have no choice but to absorb these increases (Weisskopf 2011). Where Russian alternatives are available they are more costly than and of inferior quality to their Chinese counterparts, which has led to complaints, demonstrations and petitions that also raise the political costs for Astana (Volkov 2010, Weitz 2012). Among Kazakhstanis, the Customs Union stirs historic anxieties about a deeper re-incorporation with Russia that begins economically but may end politically (RFERL 2011). Indeed, Moscow already tried to instrumentalise the Customs Union for its foreign policy agenda. In 2011, amidst ongoing tensions between Russia and Georgia, Moscow pressured Kazakhstan to suspend the import

of Georgian wine, Georgia's primary export commodity (Sharip, 2011). Georgia is Kazakhstan's second biggest source of wine imports after Ukraine, and an import embargo would significantly hurt Georgia's exports. Astana also hoped the union would attract more FDI because of Kazakhstan's access to a bigger market. However, so far these effects are not discernible. Instead, Kazakhstanis are worried that the Customs Union will undermine the diversification of Kazakhstan's economy even further because local producers cannot compete with relatively better Russian products and lower production costs. Perhaps most significantly, Kazakhstan's Customs Union entry impedes its accession to the WTO for which negotiations had been underway. It will now have to re-negotiate most agreements. These trade-offs go beyond procedural setbacks. According to the WB, Kazakhstan's WTO accession would have resulted in income gains, equivalent to 6.7% of consumption, and are four to five times higher than the WB's most optimistic projection model for the Customs Union could produce (WorldBank 2012a) .

Not surprisingly, the Union is widely criticised by Kazakhstani analysts and entrepreneurs.¹⁰² Because of the economic downsides, it is difficult to explain the decision to join the Customs Union from a purely economic perspective. Rather, the decision was politically motivated, with the aim of keeping Russia involved in Kazakhstan's economy to balance China's rise, to avoid the political and economic vulnerabilities that a dominant trade partner can cause (Lake, 2009). However, so far the Customs Union has had little effect on China's momentum, thereby underlining the robustness or resilience of Sino-Kazakhstani trade. In view of the trade facilitators discussed above, it is likely that bilateral trade will continue to grow in the future. The Customs Union may have the opposite effect. China can integrate Kazakhstan further into its own resource network because of arguments between Russia and Kazakhstan over import/export tariffs of Kazakhstani oil that is

¹⁰² Outspoken critics include Gennady Shestakov (Chairman of the Association of Customs Brokers), Timur Nazhanov (Vice-President of the Independent Association of Entrepreneurs), Derya Atabay (Economic commentator for radio Azattyk), Ualikhan Kaisarov (former MP and former presidential candidate (Park, 2011).

being refined in Russia. Kazakhstan just announced that it will refine crude oil in China in the future, starting with 500,000 tonnes in 2013 (Shustow, 2013).

Trade and Chinese Foreign Policy

Trade data also provides insights into how Kazakhstan fits into the thinking of Chinese policy makers. Research for this thesis raised the question of whether Beijing was the driving force behind the Sino-Kazakhstani relationship, or whether this role is played by Chinese corporations, as suggested by one interviewee (Interview European Diplomat 1). Although this point will be discussed in greater detail, Sino-Kazakhstani trade data can provide some interesting insights in this respect. Indeed, there are indicators that good Sino-Kazakhstani trade relations not only preceded good political relations but were the driver of the political relationship, at least until 2005, when Beijing upgraded the bi-lateral relationship to a strategic partnership. However, since then, especially since 2009, Beijing appears to be more in control of shaping the development of bilateral trade.

Figure 31 summarises the Sino-Kazakh trade volume between 1998 and 2010 and the arrow marks the strategic partnership in June 2005.

Figure 31 Diplomacy follows Economics



Between 1992 and 2002, trade developed steadily to around US\$1bn. However, from then onwards it accelerated steeply, especially between 2004 and 2006, when it more than doubled from 2.7bn to 7bn. Within this segment in turn, trade had grown the fastest with a y-o-y increase of 154% from 2004 to 2005, which thus marks the fastest expansion of growth. Although bilateral trade continued to grow afterwards, the pace never matched the 2004 and 2005 rate again. Yet only toward the end of that phase of peak growth did Chinese policy makers upgrade their bilateral relationship. After the 2005 Strategic Partnership, trade continued to grow quickly, something which may have been facilitated by the strategic partnership. In any case, Beijing significantly stepped up its financial involvement in Kazakhstan after 2008 through the extension of loans during bilateral meetings (Chapter 4). This leads to the following sub-hypothesis (Chapter 2): Before 2005, Chinese enterprises shaped the relationship between Kazakhstan and China and policy makers followed the facts on the ground, by retrospectively sanctioning these developments. However, in the period following 2005 and especially since 2009, Beijing has taken a more proactive stance politically trying to shape Chinese economic interest through the extension of conditional credit lines.

Although Beijing has become more proactive, there are signs that commercial interests still drive the relationship. China upgraded the bilateral relationship again in June 2012 to a Comprehensive Strategic Partnership (CSP), which also includes the institutionalisation of regular bilateral visits (Xinhua 2012a). However, the CSP came about only after China had become even further involved in Kazakhstan's economy following the financial crisis. The document itself contains agreements that seem to have already been met beforehand, including the initiation of "cooperation in new areas, including nuclear energy, solar energy and wind energy" (Xinhua 2012a). However, cooperation in nuclear energy had already skyrocketed in 2011, when Nazarbayev agreed to become China's key supplier for uranium and for which KAP will increase its deliveries 100-fold by 2013/2014.

5.1.1 Alternative Trade Partners

The chapter has established that China has quickly become Kazakhstan's most important trade partner and that the trade relationship features a significant asymmetry where overall Sino-Kazakhstani trade constitutes between 21-24% of Kazakhstan's total trade volume and between 0.6-0.7% of China's. This suggests that it might be easier for China to break off the relationship than vice-versa (Baldwin 1980). Further analysis into the momentum, complementarity (i.e. market structure) and asset specificity of the primary export commodity (oil) suggests that significant opportunity costs for Kazakhstan are associated with this bilateral trade relationship which in turn implies that China has created a dependency with this economic lever. The following section discusses whether Kazakhstan can draw on alternative economic partners to substitute for shortfalls of Chinese trade and the associated economic and political opportunity costs. Alternatives have low opportunity costs if they are easily available (Crescenzi 2005) and could be European economic partners or Russia with which Kazakhstan participates in a Customs Union. This section argues that Kazakhstan can diversify its trade relationships in the long-term but is unable to do so in the short-term, as this requires reforming the economic and political sector which is not in the interest of the elite.

Figure 32 illustrates the relative difference in trade volume between Kazakhstan's five biggest trade partners. Based on Kazakhstani data Italy is Kazakhstan second biggest trade partner and would need to increase its current trade volume from US\$15bn to US\$25bn (China's trade volume of US\$20bn plus the difference between both countries, US\$5bn in 2011). Based on data reported by trade partners, Russia is the second biggest trade partner and would have to increase its bilateral trade volume by US\$40bn. This illustrates the magnitude of substitution required by one or several trade partners together if Chinese trade were to cease completely.

Figure 32 Top 5 Trade Partners



Trade in goods and services, especially hydrocarbons, is less fungible than finance and geographic factors affect the competitiveness of products more strongly because of transportation costs. This is especially pronounced in a landlocked country like Kazakhstan. Alternative trade partners to China create significant economic and especially political opportunity costs for Astana - a fact that should highlight the urgency for Astana to diversify its economy in the long term. The following segments primarily analyses exports because they constitute Kazakhstan's most important source of revenue especially so as the country is a Rentier State where the ruling elite relies on the redistribution of external rents (Chapters 2,3).

Although China is Kazakhstan's biggest export market, Figure 33 shows that alternatives exist. Depending on the source of reporting, Italy is currently Kazakhstan's second biggest export destination due to ENI's 32.5% share in the Karachaganak oil field or France. Similarly, either Switzerland or Russia is the fifth biggest trade partner. However, in both cases, France and Italy, each trade partner would have to more than double their imports from Kazakhstan to substitute for trade losses with China. In the aftermath of the financial crisis, it is difficult to identify a single substitute market that would absorb the volume of oil and gas

exports to China, especially not in geographically removed regions such as Europe. France, Italy and the Netherlands all have experienced subdued economic growth in the period observed. Moreover since 2000 Kazakhstan's export structure has become more concentrated. The number of its export partners has dropped during the crisis (World Bank 2013). Thus it is more difficult to substitute for decreases in export revenues through existing trade partners as they become fewer. This implies that opportunity costs associated with foregoing existing trade partners have become higher since 2009.

Figure 33 Top 5 Export Partners of Kazakhstan



Future Chinese Demand

Even though Italy is Kazakhstan's second biggest export destination, it is not a realistic substitute for China. Ignoring the transportation logistics that were discussed previously, China's demand, driven by its socio-economic development, will increase faster than Italy's in the near and medium term. China's economic growth is mainly fuelled by industrialisation and urbanisation, especially in its western province, Xinjiang, which is the first import point for oil and gas from Kazakhstan. Italy's economy, on the other hand, has been suppressed since the

financial crisis and the short and medium term outlook is also unclear in view of the current European sovereign debt crisis. By mid-2012, Italy had turned to the ECB for aid. However, even if Italy's economy were to rebound it is unlikely to grow at a similar pace to China's, simply because of a more mature economy and greater energy efficiencies. A similar argument can be made for the French and Dutch economies. The resilience of Chinese demand was underlined during the financial crisis. Although exports to China dropped they only declined by 19% between 2008 and 2009, whereas Italian exports dropped by 44%, Dutch exports by 52% and Russian exports by 43% (IMF DOTS).

Geography

The geographic distance to Italy and Kazakhstan's landlocked position make oil exports more cumbersome and expensive than to China or Russia where Kazakhstan already has a pipeline system in place. China's proximity facilitates trade, because it reduces transport costs and times for commodities to be physically moved. Oil and gas especially require a particular transport infrastructure either through pipelines, shipments or via railway. Currently, Kazakhstan exports liquid fuels through pipelines via Russia to the Black Sea or to China, by a mix of boat and pipeline to Azerbaijan and Turkey and by boat and train to Georgia (EIA 2012). Yet pipelines are the most cost efficient mode of transporting oil. By 2012, the vast majority of Kazakhstani oil was transported through Russian pipelines (ibid) (Chapter 2). Without Chinese pipelines, Kazakhstan faces a problematic choice. A loss of the Sino-Kazakhstani pipeline would hand the export monopoly back to Russian which poses the risk of higher transit tariffs - because Russia can dictate tariffs for oil destined for European markets but also political risks (see below). Similarly, exporting via the Caspian Sea will incur additional transit fees through third countries such as Azerbaijan potentially rendering oil production in Kazakhstan less competitive. Any cost increases reduce the profit margins of major oil corporations, especially during extended periods of subdued oil prices such as in the aftermath of the Global Financial Crisis. As a result these producers may revise their

production and investment plans in Kazakhstan. This affects Kazakhstan's budget directly as it has signed revenue sharing agreements with many IOCs.

Alternative export partners, such as Italy and France, already import large oil and gas volumes from Russia, which may add competitive pressure to an increase of Kazakhstani oil supplies and bring down oil prices and thus revenues for Astana. Both France and the Netherlands are equally affected by low growth and subdued demand for energy in the short and medium term, which calls into question the feasibility of accessing alternative markets quickly. Although the EU is interested in alternative resource imports from Russia, these are difficult, something which was highlighted by the Nabucco Pipeline which, if realised, will import oil from Central Asia via Turkey. However, the different foreign policies and political dynamics in these transition countries have effectively put the project on hold. In Kazakhstan, geographic variables also affect the opportunity costs of shifting or increasing oil exports which is a highlight specified asset.

The export of oil requires a complex infrastructure on land or by sea. As a landlocked country Kazakhstan has to rely on land infrastructure such as railways or pipelines whereas pipelines are significantly more efficient than railways in terms of cost/bb and capacity. At the same time pipelines require significant upfront investments and cannot be shifted to alternative use or users, should China decrease its import of Kazakhstani oil. This specificity of oil further increases Kazakhstan's opportunity costs associated with any export partner for which it has export infrastructure in place. For example, if oil exports to China were to decline significantly, Kazakhstan in theory should be able to find alternative export markets such as Italy or Japan. However, to export to Japan Kazakhstan has to transit oil through a third country for a fee or put new infrastructure in place to facilitate such exports. Once in place, export infrastructure, especially pipelines, increase opportunity costs that are associated with decreasing imports (e.g. from China) and make it difficult to shift to alternatives in the short-term.

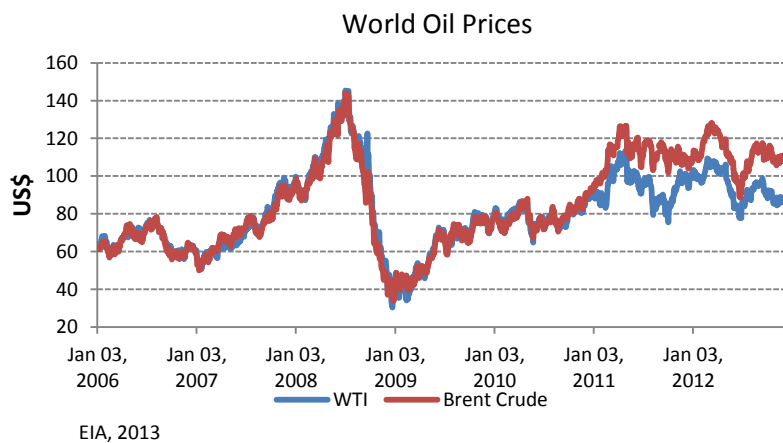
Political opportunity costs

Export alternatives also have significant political opportunity costs. Increased exports to European alternatives may increase political and media scrutiny of Kazakhstan's political system, also because of stronger anti-bribery legislation. The European Parliament is already critical of Kazakhstan's government and its human rights record and this may stir more controversy. However, media attention abroad has the potential to threaten the regime at home. After the Libyan revolution, the current atmosphere in Italy is even more sensitive to what partners Italy seeks abroad (Dejevsky 2012). ENI has been under investigation by Italian prosecutors since 2011 for corruption in Kazakhstan and prosecutors have asked the court to place ENI's subsidiary, Agip KCO under special administration (D'Alessandro 2012). In 2006, Nazarbayev visited the Netherlands to discuss Shell's involvement in the Kashgan oilfield, which triggered demonstrations against him in Den Haag (Interview European Diplomat 1).

It is not clear how much room for manoeuvre Astana has to choose alternative export partners. Recent developments in shale gas have the potential to dramatically diminish the attractiveness of Kazakhstani oil, which, by international comparison, is already more difficult and expensive to export. The Tengiz oil field, for example, has already doubled the initial cost forecast for its oil consortium from US\$20bn to US\$48bn in 2012. Similarly development costs for Kashagan Kazakhstan's biggest oil have more than tripled to c.US\$40bn by 2012 and oil production has been delayed by more than eight years. It is estimated to come online in 2016. This makes Kazakhstan's economy very susceptible even to minor changes in the international oil market that may drive down prices and thus the profitability of oil exploration and production (Dejevsky 2012). The complexities in the production and transport of oil render it difficult to shift to alternative export partners in the short-term. For example, negotiations for a pipeline to export oil from the Tengiz oilfield via the Russian port of Novorossiysk took over six years and involved complex political negotiations over tariffs (Yergin 2011:67). This also

increased Russia’s grip over Kazakhstan’s export infrastructure and led to the dilution of profits from Kazakhstani oil. Light crude exported via Russia “is mixed with lower quality oil from Russia before it is exported, decreasing its sale price” (Kennedy 2011:10). At the same time changes in the export volume of oil lead to declining government revenue in the short or medium term, until alternatives are in place. However, as discussed in Chapter 2, Kazakhstan’s regime is vulnerable to such revenue shocks, especially in a period of economic crises and subdued economic activity such as following 2009 where alternatives are difficult to access in the short-term. In the aftermath of the Global Financial Crisis, oil prices dropped significantly (Figure 34) and have not recovered to their pre-crisis level. Lower oil prices directly translate into lower income for Kazakhstan’s regime which poses the risk for political instability (Demkiv 2012). This should significantly increase the opportunity costs associated with decreasing bilateral trade volumes, especially from the biggest trade partner. These costs are further magnified during times of low economic growth.

Figure 34 World Oil Prices



Any analysis beyond the immediate timeframe is necessarily also guesswork and contingent on little change. Such change in Kazakhstan could easily be brought about by Nazarbayev’s death and an unresolved succession question, which could

lead to a complete restructuring of the political and economic landscape. However, the above analysis aimed to convey that it is relatively difficult to forego trade with a specific trade partner in the short or medium term. Unlike finance, trade, especially of commodities, relies on a physical infrastructure for export via third countries.

Imports

Figure 35 Kazakhstan's Top 5 Import Partners



Declining import volumes also have opportunity costs for Kazakhstan; although not to the same extent than exports as these directly contribute to the elite's budget and its ability to redistribute income to maintain political legitimacy and loyalty (Chapters 2 and 3). China and Russia are the only top 5 trade partners with a significant import presence. As previously mentioned, Kazakhstan's import figures are US\$5bn lower than China's (Figure 35). Russia is Kazakhstan's second biggest source of imports after China, which is mainly due to the re-import of refined Kazakhstani oil (Shustow, 2013).

The complementarity of Kazakhstan's market structure also increases the opportunity costs associated with decreasing imports. This is illustrated by the CU

with Russia: Cheap Chinese consumer goods have increased the living standards of Kazakhstanis. However, after joining the CU Kazakhstanis have to pay more for goods of less quality, which in turn affects their living standards. This has led to complaints, demonstrations and petitions. The CU conveyed how difficult it is to substitute for Chinese imports. This may also explain why Chinese trade continued to increase nevertheless after 2010.

It is difficult to see how Kazakhstan can seek out alternative trade partners, especially in view of its geographic position, the complementary structure of its economy, and the economic political opportunity costs associated with decreases in Chinese revenue and alternative trade partners. Astana recognises these benefits, which is why it supports the expansion of bilateral trade and its petition of the Chinese government to participate in technology transfers to boost economic development (FMPRC 2009).

5.1.2 Segment conclusion: Trade Dependence

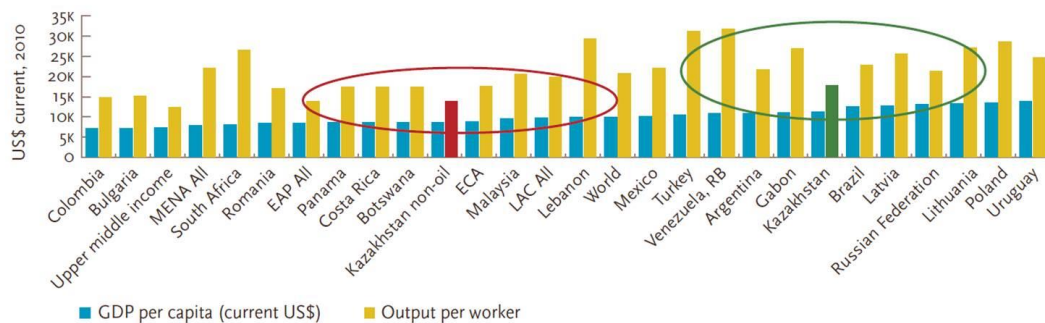
This segment established a stark asymmetry in the bilateral trade relationship, similar in magnitude to the asymmetry in the finance (Chapter 4). By 2009 China has become Kazakhstan's most important trade partner, the complementarity of both economies facilitates the momentum and volume of bilateral trade. Kazakhstan's market structure on the other hand and its political system associate significant opportunity costs with declining Sino-Kazakhstani trade volumes or alternative trade partners. It is unlikely that Kazakhstan can increase resource exports to these partners in the short or medium term. Moreover, the factors of Kazakhstan's economy are largely resource concentrated and cannot be shifted to alternative industries pending significant economic reforms. International comparisons indicate that Kazakhstan has among the lowest labour productivity across its economy both in the oil and non-oil sectors (Figure 36). As previously mentioned this renders Kazakhstan's non-resource uncompetitive and creates additional obstacles to

economic diversification. This diversification in turn is a prerequisite to tap into alternative export sources. As a result Kazakhstan cannot substitute for decreases in Chinese exports by focusing on exporting alternatives such as manufactured goods.

A discussion of alternative trade partners showed that these are only feasible under economic and, more significantly, opportunity costs, which the elite might not be willing to take. Thus, it can be argued that Kazakhstan depends on Chinese trade in the short-term, unless it is willing to forego Chinese revenues of US\$15bn in exports. Given the regime’s susceptibility to revenue disruptions this is unlikely, particularly so in an overall subdued economic climate where government revenues are already under pressure.

Figure 36 Labour Productivity in Kazakhstan, 2010¹⁰³

Figure 3.6: International comparison of labor productivity in Kazakhstan



Lake argues that a failure to diversify trade away from one dominant trade partner like China can be interpreted as the “tacit acceptance of the dominant state’s potential influence and therefore its legitimacy and authority” (Lake 2009). Whether this is the case in Kazakhstan depends on how much effort Astana undertakes into the diversification of its trade partners. Astana tried to balance its growing trade volume with China through joining a Customs Union with Belarus and Russia. However, so far this has not produced the intended effect and to the

¹⁰³ World Bank 2013c

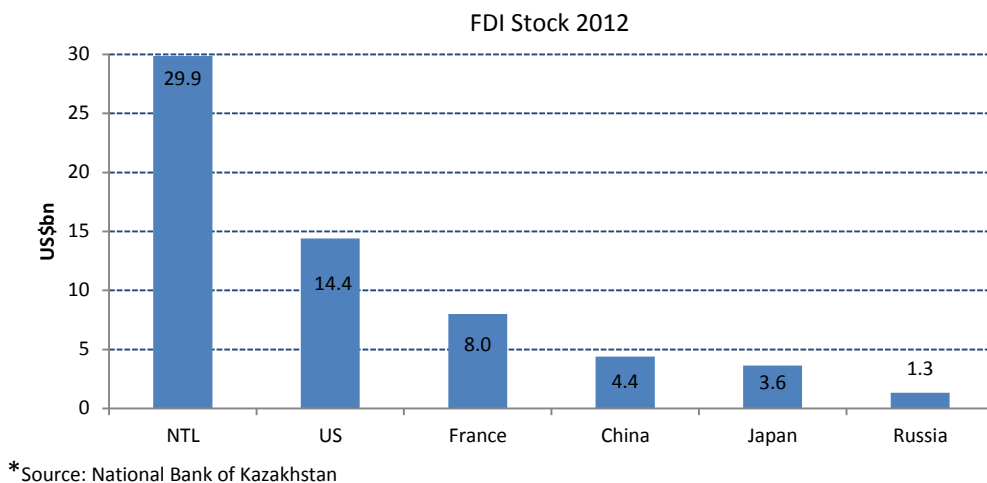
contrary, led to Kazakhstan's decision to refine its oil in China in the future. However, the real problem in Kazakhstan impeding any diversification of trade partners or the economy is structural. The economy is highly resource-dependent, which makes it difficult for the government to choose its trade partners more freely. These structural weaknesses, however, are intricately linked to the neopatrimonial setting. Although officially the diversification of the economy is a national goal, the actions of the elite contradict this, which instead facilitates revenue generation in this sector as well as Chinese credit lines that deepen its resource dependence even further (Chapter 2,3). Any structural changes in the economy are intricately linked to dissolving neopatrimonial structures, which facilitate the status quo and create a difficult climate for alternative international investors. Thus, it can be argued that as long as the government does not undertake the necessary structural political and economic reforms that are the key driver to Kazakhstan's trade and finance situation, it promotes the status quo and thus acknowledges the legitimacy of Chinese dominance or at least accepts China's dominance as an acceptable trade-off.

China's role as Kazakhstan's most important trade partner is likely to persist in the short to medium term, also backed by substantial Chinese financing, which not only benefits the elite but also ensures increased resource exports to China in the long run. This introduces an asymmetrical relationship where China is a key export market and thus revenue stream for Kazakhstani goods. The fact that China imports more from Kazakhstan than it exports further underlines this argument. As such, Kazakhstan is more dependent on access to China than the other way around, which generates political leverage for China. Sino-Kazakhstani trade constitutes 25% of Kazakhstan's overall trade; however, for China, this constitutes only 0.7% (IMF DOTS). Thus, it is significantly easier for China to break the relationship than for Kazakhstan, at least from a mere quantitative point of view. This introduces a steep hierarchy (Baldwin, 1996) and Kazakhstan's high dependence on trade with China makes it vulnerable to the influence of China (Lake 2009: 47).

5.2 Chinese FDI

Foreign Direct Investment into Kazakhstan is perhaps China's weakest economic capability, which may be the result of its relatively late entry into the Kazakhstani economy or because Beijing's credit lines mimic FDI and thus may not be captured in FDI accounts. Although initially a modest FDI volume compared to the Netherlands, for example, China's investment was strategically and politically important. This thesis has touched upon the strategic significance of the Chinese-Kazakhstani pipeline at various points. Nevertheless, Chinese FDI has increased gradually and China is now the fourth biggest provider of FDI stock (see Figure 37).

Figure 37 Top 6 Source Countries of FDI Stock in Kazakhstan

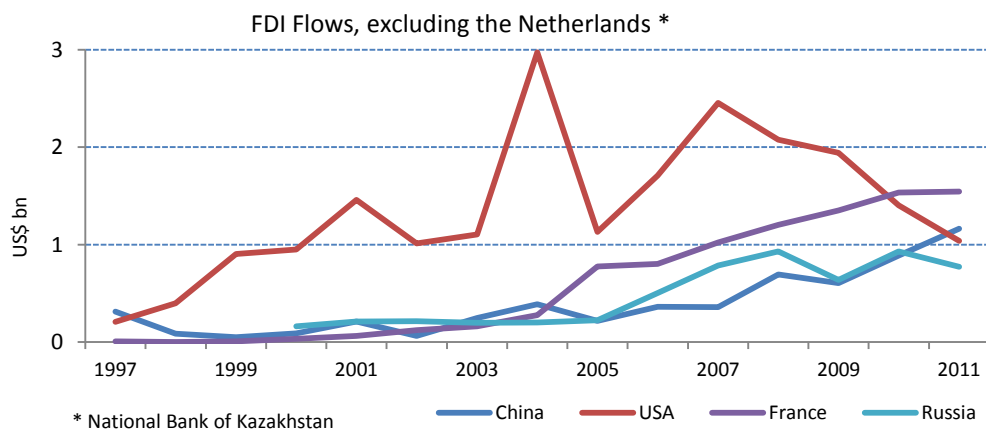


However, FDI stock can be misleading, because it only measures the accumulated sum of all FDI provided to date and thus benefits early entrants into Kazakhstan's economy, such as the Netherlands and the US. As such, FDI stock does not capture new FDI flows or recent trends, including changes. FDI flows, on the other hand, capture new investments on an annual basis and thus capture changes. For example, Figure 38 illustrates that Beijing has increased its FDI commitment to Kazakhstan in recent years, whereas investment from other states has stagnated.

The UK, for example, featured prominently among the list of top contributors in

previous years, but divested from Kazakhstan in 2011. As a result, China is now the third biggest FDI provider on an annual basis behind the Netherlands and France. It lags behind in overall accumulated FDI stocks because it is a latecomer (See Figure 37). However, low Chinese FDI figures may be the result of China's provision of large loans, which serve similar purposes to FDI: Beijing provides loans to access resources, to secure long-term deliveries or to get resources at concessional prices. For example, China's loan to Kazakhmys helps the company to expand its production capacity. As Kazakhmys' biggest customer, Beijing already buys 80% of the company's copper. Through the loan it thus ensures the company can meet its greater production capacity, which also benefits Beijing, perhaps even at concessional prices. As such, the loan closely resembles FDI. Interestingly, the Kazakhstani Ministry for Economics and Industry also refers to FDI stock, where China relatively underperforms to alleviate public fears about China's economic expansion (Tengrinews 2011b).

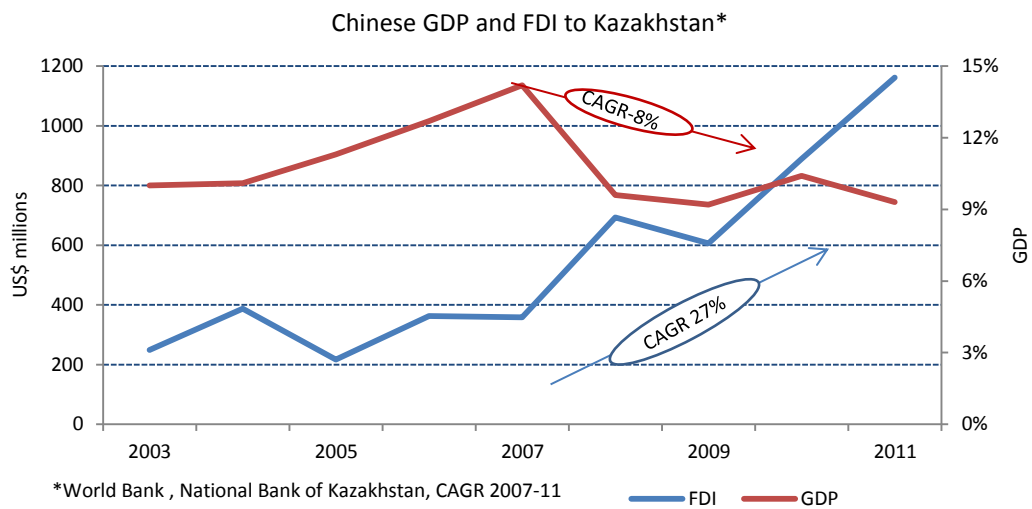
Figure 38 Gross FDI Flows



Similarly to Chinese finance and trade, China's FDI status was accelerated through the Financial Crisis. This is all the more noteworthy because China itself experienced a declining GDP but continued to invest in Kazakhstan nevertheless. This may indicate that China recognised the investment opportunities for commodities

during the global economic down-turn and by investing throughout, proved itself a reliable partner for Kazakhstan even in times of economic crisis (see Figure 39).

Figure 39 Chinese FDI and GDP



In line with Chinese trade and finance, Chinese FDI is overwhelmingly concentrated in Kazakhstan’s resource sector and as such is part and parcel of Beijing’s search for resources abroad.

5.2.1 Alternatives

Figure 37 illustrates that there are feasible alternative sources to Chinese FDI, foremost the Netherlands, France and the US. In the aftermath of the financial crisis and with the outcome of the European sovereign debt crisis uncertain, FDI around the world has generally stagnated or dropped. US, French and Russian FDI flows slowed significantly, leaving China as one of the few countries on an upward trend to continuously expand their FDI in Kazakhstan. Nevertheless, the overall volume of

China's annual FDI is not out of reach. The Netherlands, for example, provides US\$ 7.9bn of FDI, seven times more than Beijing. Thus, it is possible to argue that the Netherlands could step in for China if Kazakhstan were to block Chinese FDI to counter the risk of economic dependence and/or political leverage. Also, the gap to the next biggest FDI provider is relatively modest. The US ranks fourth and provided only US\$ 200m less in FDI in 2011 than China, which could increase subject to a recovery of the US economy. China's FDI makes up less than 9% of Kazakhstan's annual FDI flows-with 91% provided by other sources. Kazakhstan can likely turn to these sources for increased FDI at a low opportunity cost.

5.2.2 Segment Conclusion: FDI

China's FDI entry into Kazakhstan has been relatively late compared to its international counterparts, especially the Netherlands and France. This is directly linked to the fact that China is an emerging economy and the late entry of Chinese oil companies into the Kazakhstani market, which is the primary destination of Chinese FDI. Consequently, China only ranks fourth in accumulated FDI stock. However, it is catching up quickly and is already the third biggest contributor of annual FDI inflows into Kazakhstan, behind the Netherlands and France. This is thus China's weakest economic capability in Kazakhstan by relative ranking. By relative volume and ranking, the opportunity costs for Kazakhstan are not too high to replace Chinese FDI and there are feasible alternative partners who have the resources to step in, especially the Netherlands and the US. However, as the third biggest provider and given the momentum of Chinese FDI, China plays an important role in Kazakhstan's economic growth, especially when taken together with Beijing's provision of financing (credit), which sometimes overlaps with FDI. Although Kazakhstan is not dependent on Chinese FDI, it adds to China's overall economic influence and thus dependence on Kazakhstan.

5.3 Economic Dependence

The preceding sections have shown how quickly China has increased its economic capabilities in Kazakhstan and that it has created economic dependencies in trade and finance based on the opportunity costs that the regime might face if Chinese credit lines or trade decreased.

It is now the second most important source of new credit to Kazakhstani banks, acted as creditor of last resort and has become Kazakhstan's most important trade partner. This has propelled China into a key role in Kazakhstan's economic growth. These economic levers can be weighted differently in their significance to economic growth. Finance is especially relevant because it is the prerequisite of economic growth (McKinnon 1973).¹⁰⁴ Kazakhstan's underdeveloped financial sector is a key reason affecting the growth of the private sector (World Bank 2013). Here China's role in Kazakhstan is even more pronounced considering that banks are the most important source of funding for businesses in the absence of strong capital markets. This overt reliance on bank funding also drives inefficiencies and "a tendency towards instability and crisis" (Lipsky 2009), which could be witnessed during the financial crises in 2009 (Lipsky 2009). Thus, a strong financial sector is the prerequisite for economic diversification and growth in the long term. Trade, on the other hand, provides short and medium term revenues for the elite and thus a means to facilitate legitimacy domestically. Thus Beijing's role has a more immediate effect. Arguably FDI flows rank second to trade and finance as FDI drives economic growth in the long term. China's dominant position in both trade and finance, and the opportunity costs of alternatives, foster Kazakhstan's economic dependency on China. Although it is difficult to quantify the degree of the resulting economic hierarchy, it is possible to conclude that it is highly asymmetrical, based

¹⁰⁴ McKinnon argued that capital markets are a prerequisite to the efficient allocation of money and thus effective growth, especially in developing economies.

on the fact that Kazakhstan is a net debtor to China, that Sino-Kazakhstani trade generates a quarter of Kazakhstan's income from trade, whereas, conversely, it constitutes not even one per cent of China's trade volume. However, Kazakhstan's position is significantly better where China's overall resource strategy is concerned, which presents a feasible opportunity to level the bilateral hierarchy and increase opportunity costs for China. However, as will be seen in the case study, Kazakhstani policy makers do not seize this opportunity. The resulting dependency relationship was further confirmed by interviewees in Kazakhstan, who assumed that China could afford to lose access to the Kazakhstani market, whereas Kazakhstan could not afford to lose access to the Chinese market (Interviews Local Finance Expert 1). Although the author somewhat disagrees with this statement, especially in view of China's energy strategy, it is an important recognition of how China and China's economic influence is perceived by decision makers on the ground, which further operationalises the link between economic dependence and political power.

5.3.1 Coordinating Foreign Policy Goals and Actors

The following segment addresses the key research questions of the thesis. It examines the actors that drive China's economic influence in Kazakhstan and their relationship with Beijing to understand whether Beijing can influence the drivers of its economic growth and whether Kazakhstan's economic dependence is the outcome of a purposeful policy. The preceding analysis of bilateral trade already suggested that Chinese companies initially shaped the trade relationship until 2005, when Beijing became more proactive in diplomatic terms. This section argues that Kazakhstan's economic dependence cannot be traced back to a coherent purposeful Chinese foreign policy (sub-hypothesis), that on the aggregate level, Beijing does not control the levers of economic influence in Kazakhstan (sub-hypothesis) as there is evidence that China's NOCs proactively enlist Beijing to further their economic interest (sub-hypothesis).

Leveraging economic capabilities towards foreign policy objectives requires the combination of different factors. The economic dependency has to be the outcome of purposeful policy (Kahler & Kastner, 2006). Thus Beijing would foremost have to direct its economic activity towards Kazakhstan in full knowledge of its implications, or, alternatively, recognise what role it plays in Kazakhstan's economy and perhaps even more importantly its elite. However, this thesis could not detect a coherent Chinese policy towards Kazakhstan, or any policy at all for that matter rather Kazakhstan is viewed as part of Central Asia. At the Ministry of Foreign Affairs, Kazakhstan is subsumed under diplomatic relations with Eurasia and Chinese academics tend to view Kazakhstan through a Russian lens (SIIS 2013). Rather, it appears that Kazakhstan's economic dependency is an unintended outcome of Beijing's broader foreign policy to benefit from the investment climate during the global economic crisis within its Go Global framework, which focused more on its financial institutions after 2009. Arguably, in the financial realm, Beijing must acknowledge Kazakhstani financing needs, in order to perceive credit conditionality as an option. This occurs mainly from a perception of strength. It is however, not clear whether Beijing is aware of Kazakhstan's specific finance needs or whether Chinese foreign policy makers perceive the country through the broader context of the Global Financial Crisis, which created financial shortfalls in many countries. Although a point could be made that Beijing may have understood Kazakhstan's finance needs, there are no indicators that Beijing is aware of the economic and political implications of its trade relationship with Astana. This, however, would be necessary if its economic capabilities were to be used to work towards specific objectives. Although Beijing and Astana can quantify this relationship in bilateral meetings where they aim to double Sino-Kazakhstani trade, Beijing may not be aware of the political implications. As noted beforehand, Chinese academics view Kazakhstan from a Russian perspective and thereby perhaps indirectly acknowledge that Russia is the dominant power in Kazakhstan. However, this no longer holds true, at least in economic terms.

A deliberate policy of fostering and using economic dependencies also rests on Beijing's ability to exert control over its economic capabilities (Kahler & Kastner 2006:524) or at least direct their investment behaviour. The dynamics between Beijing and its economic actors also determine whether Beijing can use its economic influence as leverage for political ends (Chapter 2). This is also analogous to Zakaria's analysis of the power-sharing arrangements between Congress and the President over US foreign policy (Zakaria, 1998) which affected the ability of the US to project its power abroad. Arguably, Beijing can use its economic clout as leverage most effectively if it is credible for Kazakhstan that Beijing can cut its economic investment, in order to pursue the Kazakhstani government to comply with its interests. This segment argues that the activities of China's policy banks are directed by the Go Global initiative and thus serve directly as instruments to realise Chinese objectives abroad, although these objectives are not targeted at an individual country. With Chinese SOEs however, especially CNPC, the picture is mixed, and SOEs have in fact become active foreign policy actors in their own right who enlist Beijing for their investment purposes abroad. This works well where the interests of Beijing and the SOEs overlap. Although a number of economic actors pursue Chinese objectives in Kazakhstan by acquiring stakes in resources, however, they do not act jointly but tend to compete against each other instead. Nevertheless, and perhaps surprisingly, interviews confirmed that Astana does not recognise the fragmentation of Chinese investors, creditors and the government. Instead it perceives China as unitary actor, which only further magnifies the political effects of Kazakhstan's economic dependence on China. This also explains why Chinese companies seem less affected by the rent-seeking behaviour of the Kazakhstani elite, which perceives Chinese companies to be affiliated with the Chinese government, thus risking a diplomatic fall out (Interview Local Finance Expert 1, Investment Expert 1).

Financial Institutions

China's credit lines towards Astana are primarily disbursed by policy banks, including China ExIm and CDB, whereas Chinese investment is conducted through SWFs including CITIC and CIC. Amongst these, Beijing can arguably exert most control over its policy banks. China ExIm and CDB are the most prominent originators of Chinese loans to Kazakhstan (Chapter 3). Both are state-owned, report to the State Council and are tasked to implement government policy. China ExIm struggled with a high NPL ratio until mid-2005, as loans were allocated solely to meet political rather than commercial objectives and against little due diligence. Although the bank now provides loans under stricter economic principles it is still following Beijing's instructions. Initially, the bank was responsible for financing Chinese exports, however, Beijing increasingly uses China ExIm to develop its foreign policy abroad or "cujin duiwai guanxi fazhan" (facilitate the development of foreign relations) (ExIm 2012), and analysts estimate that ExIm disbursed US\$80bn in loans abroad in 2011, thus lending China's economic capabilities substantial clout (Minto 2011).

Against a widening resource supply gap, China ExIm turned away from simple trade finance and instead acts as an international creditor of concessional loans similar to the ADB and WB to secure Beijing's resource security in the medium to long term. This has drawn criticism, especially of China ExIm's activities in Africa, where it directs 25% of its annual lending (Minto, 2012). This increased outward activity is in line with Beijing's Going Out/Go Global (走出去) strategy, which encourages Chinese enterprises to invest abroad to access international technology and expertise and to modernise Chinese companies (Tenth Five Year Plan 2001-2005). Although Chinese banks and, increasingly, SWFs play a role in this strategy, their mandate was extended during the financial crisis. Politicians, bankers and businesses (Ding 2010) recognised that the crisis presented opportunities to invest in a less competitive environment when China also became a key lender to Kazakhstan (Xinhua 2009). It is thus likely that Beijing extended credit lines to

Kazakhstan as a result of this general perception to seek investment opportunities abroad, rather than as a deliberate foreign policy strategy towards Astana. Ma Weihua, head of China Merchant's bank, captured this new perspective in his call for Chinese banks to learn to "swim", instead of standing around the water's edge (Xinhua 2009). However, it was not just bankers but also politicians like Li Lianzhong (李连仲), CPC Central Committee Secretary for Economic Policy Research, who challenged China's financial institutions to go global and target resources, especially oil, gas, iron and copper, on the back of China's formidable foreign currency reserves and to turn China into a global financial power (Finance.gg.com 2009).¹⁰⁵ Part and parcel of the latter is the internationalisation of the RMB, especially at Beijing's periphery where the People's Bank of China (PBC) also signed bilateral agreements with Kazakhstan (discussed below) (Wang and Zhang 2011).

Kazakhstan also fits into one other prominent Chinese objective, namely the diversification of its foreign currency reserves (Finance.gg.com 2009). The financial crisis brought about a greater focus on diversifying China's foreign reserves into commodity investments abroad (Weiner 2011:89). Therefore, Kazakhstan's banking crisis provided an ideal opportunity to channel investment into relatively conservative, low-risk assets that are also important to sustained Chinese economic growth. Walter argues that this is best explained by China's as yet under-developed investment capabilities which result in a focus on less risky assets, particularly commodities (Walter 2010). The volume of US\$3.3tr currency reserves put pressure on SAFE and CIC to invest otherwise China risks losses in value through currency fluctuations or inflation. However, investing these reserves domestically can lead to a substantial inflow of money into China's economy and thus exert inflationary pressure (Howie & Walter 2011). This poses a widely underestimated challenge for Beijing: US\$3.3tr cannot be easily absorbed globally and there may not be enough projects available for Chinese funding. Interviewees argued that

¹⁰⁵For example Renim University organised a forum in 2010 to discuss the opportunities of the financial crisis "Big country, big country finance and economics -exploring the road for China's financial rise" (da guo jing ji yu da guo jin rong— tan xun zhong guo jin rong jue qi zhi lu).

Kazakhstan did not have enough commercial projects in view of Chinese finance commitments (Interviews Local Finance Expert 1 and Local Finance Expert 2). Consequently Walter argues that “[The reserves are] not worth anything, because they [CCP] can’t use it” (Walter 2010). What is left is the search for international investment opportunities and in Kazakhstan these investment opportunities overlap with a number of items on China’s “agenda of vulnerability” (Kerr 2010: 150), namely China’s key strategic interest to maintain energy security, water security and regional stability.

Beijing’s efforts to internationalise its currency and to build a regional financial infrastructure can be read in this light as well. There are early signs that Beijing integrates Kazakhstan’s financial infrastructure more closely with its own. In 2004, both established a joint financial committee which meets annually to discuss closer financial cooperation, including monetary policy coordination (NBK 2012) such as integrated payment systems, knowledge transfer from China on its experience with taxing financial instruments, the establishment of a special SCO account and currency swap agreements (NBK, 2012). Beijing offered Kazakhstan a currency swap agreement in early 2011, which has led to closer integration of the Kazakhstani and Chinese banking system: Kazakhstan’s central bank can sell Chinese Yuan to domestic traders and commercial buyers of Chinese goods. Beijing has pushed a number of high volume currency swaps, which has been interpreted as an attempt to diversify away from its dollar surplus. Indeed, it is hoped that the Yuan will become an important regional currency by 2020 and Chinese policy makers have understood that the current financial climate is conducive to initiate these steps (Wang & Zhang 2011). On a practical level, this allows trade partners in Kazakhstan to conduct transactions in Yuan. As of June 2012, BTA has opened a Yuan account with the Industrial and Commercial Bank of China (ICBC), which allows Chinese and Kazakhstani customers to settle directly in Yuan (Xinhua 2012b) and should facilitate cross-border trade, where transactions are in small amounts, making currency exchanges less cumbersome. Currency swaps also have political benefits

and allow Kazakhstan to secure cheaper debt or to hedge against exchange rate fluctuations in the long term. Exchange rate shocks have greater impact on emerging economies such as Kazakhstan's (Isakova, 2008).¹⁰⁶ The swap agreement gradually decreases Kazakhstan's level of dollarisation, by replacing transactions in US Dollars with Chinese Yuan which decreases the structural power of the US and increases China's. However, interviewees pointed out that the currency swap agreement is indicative of more Chinese loans in the future that can be repaid and serviced in Yuan (Interview Local Finance Expert 1).

It is not clear whether 'Going Global' aims at creating financial dependencies or whether these dependencies are merely the result of an increased focus on investments and trade in Kazakhstani commodities. In any case, Go Global, along with China's SCO strategy and RMB internationalisation, is creating economic and financial dependencies, at least in Kazakhstan. Although Beijing understood and acted upon the global opportunities of the financial crisis, this research could find little evidence of a specific foreign strategy towards Kazakhstan; rather, China's growing economic capabilities in Kazakhstan can be viewed through China's broader foreign policy objectives, which are not exclusive to Kazakhstan.

Whereas a case can be made for Beijing's strategic use of its policy banks, the picture is more mixed where SWFs are concerned, such as CIC, CITIC and SAFE. SWFs in general do not report their activity and the only publicly-known investments in Kazakhstan were conducted by CIC and CITIC, whose resource acquisition is in line with their global investment focus. As such, their investment appears in line with Beijing's Go Global strategy, however, it cannot be answered conclusively if this is coincidental or whether Beijing instrumentalises these vehicles directly. CIC has closer government ties and US\$200bn of assets under management (AuM), which could turn it into an effective foreign policy tool. However, unlike SAFE, which is

¹⁰⁶ For a discussion of exchange rate shocks and the impact of high levels of dollarization in Kazakhstan and Central Asia see Asel Isakova (Isakova, 2008).

overseen by the PBC, CIC reports directly to the State Council and has a number of representatives from different ministries on its board, which brings it in close proximity of the policy-making process (Helleiner & Chin 2008: 90). Victor Shih's extensive research of CIC concluded that in China's fragmented political system, foreign policy objectives gain priority to which fund managers are sensitive (Shih 2009:328) and which may explain their recent boycott of an IMF meeting in Japan (Chapter 1). This implies that the political use of SWFs in China, similarly to policy banks, is a realistic option. Although Shih shows how China's SWFs are predominantly subject to domestic objectives, he notes that the "devotion of a small share of the SWF's resources on foreign policy can have a significant diplomatic impact, especially in developing countries" (Shih 2009:329), which captures the impact of Chinese loans in Kazakhstan very well (Chapter 3).

More indicators move CIC in proximity of Beijing's foreign policy process and raise questions about its role in China's foreign policy. In 2009 CIC¹⁰⁷ acquired a US\$940m stake in KazMunaiGas Exploration Production (KMG EP) (Duce 2009), a deal which stirred controversy among KMG EP executives because it was negotiated on the political level without the consultation of the company's senior management (Chapter 2). It is not clear whether Beijing was involved in the deal or whether CIC sought out Kazakhstani officials themselves. The fact that its acquisition of KMG EP was decided in a political meeting implies that CIC must have had political support on either side. The acquisition was particularly meaningful because CIC gained a personal representation on the executive board of KMG EP and will have a say in KMG EP decisions in the future. In any case, CIC proved that it knows how to acquire assets in Kazakhstan through the elite. CIC also acquired the China International Trust and Investment Corporation (CITIC)¹⁰⁸ Capital, which in turn set

¹⁰⁷ Through Fullbloom Investment Corp

¹⁰⁸ CITIC is a large Chinese state owned Investment Company with approximately 44 subsidiaries such as China CITIC Bank, CITIC Holdings, CITIC Trust Co. and CITIC Merchant Co., Ltd. (Carecinstitute.org)

up a bilateral investment fund with Samruk-Kazyna (discussed below) that systematically channels Chinese investment into Kazakhstan.

CITIC has US\$4.4bn AUM and a strong resource focus. CITIC acquired the Karazhanbas Oilfield in 2006 for US\$1.91bn against substantial Kazakhstani opposition that included Baktykozha Izmukhambetov, the Minister for Oil and Gas, who rallied that "we must take extreme measures to stop the agreement on the Karazhanbas" (AP 2007). It is unclear how CITIC managed to overcome Kazakhstani resistance, especially from such a prominent figure like the Minister for Oil and Gas, however, CITIC must have had elite support (Chapter 3). The incident underlines two issues: it confirms that many decisions in Kazakhstan's political system take place in the informal realm. In theory, the Minister of Oil and Gas should be in charge of energy acquisitions, yet in the case at hand he was overruled by other interests. Moreover, CITIC managed to somehow enlist the support of the relevant decision maker in the elite structure to conclude the deal, which illustrates that it can also navigate the intricacies of Kazakhstani decision making. It is also possible that CITIC enlisted Beijing's support in order to succeed. Although CITIC mission is primarily commercial, it is not clear what links it maintains with the Chinese leadership (discussed below). It is possible that CITIC's oil acquisition accidentally coincided with Beijing's increased focus on resources or that CITIC sought out Kazakhstani energy assets because they are commercially lucrative. However, this distinction is not necessarily relevant. In Kazakhstan, Chinese SWFs and SOEs are misperceived as a unitary actor, a view that does not distinguish between Beijing, its economic players and their respective dynamics, and thus can create political leverage for Beijing in Kazakhstani eyes (Interview Local Finance Expert 1). This is a distinctive disadvantage for Kazakhstani politicians since they are likely to overestimate the control of the Chinese government over its economic institutions and the CPC's ability to enlist them in its foreign policy. Yet many Chinese economic institutions lack coherence and instead of serving as entities that extend China's

economic capabilities, they often compete with each other and thus produce a rather fragmented picture in reality (Interview European Diplomat 1).

For example, CITIC and CNPC have a competitive relationship, at least in Kazakhstan, and it is thus unlikely that either one or both of these firms act under a unified government mandate. Both funds competed for the Karazhanbas Oilfield (Wilson 2007) and although they pursue the national interest through the acquisition of resources, they seek support from Beijing individually (Interview European Diplomat 1). Interestingly, Beijing also benefits from Nazarbayev's centralisation of the economy by establishing the CITIC Kazyna Investment Fund, a joint investment fund with Samruk-Kazyna in 2009 (Chapter 3). SK manages Kazakhstan's state assets, especially its resources, under a single holding and management structure and the CITIC-Kazyna Investment Fund institutionalises a direct link between SK and China's financial capabilities, which provides for Chinese direct access to SK and its assets. The fund was created by Nazarbayev and the chairman of the Chinese State Council¹⁰⁹ and thus originated on the highest political level. It is not clear whether CITIC followed Beijing's initiative or whether CITIC enlisted Beijing's support to pursue this opportunity; what is certain, however, is that there are points of contact. The fund (KCM 2009) is run by Fanglu Wang, who also raised capital for the Ministry of Finance and likely has likely close contacts in the ministry (CITIC 2012a). CITIC's initial aim was to attract foreign capital and know-how into China, however with the joint venture, it has reversed this role and directs finance activities abroad. Due to its history, the fund and its assets are closely linked to politics. In any case, CITIC's activities increase China's financial clout in Kazakhstan. The fund also further blurs the line between finance (credit) and direct investment (FDI). With an initial capitalisation of US\$200m, it set out to finance infrastructure and non-resource related projects in both countries. However, so far, it has primarily invested in Kazakhstan. Despite its emphasis on the

¹⁰⁹ The Fund was established based on an Executive Order President Nazarbayev following a meeting with the Chairman of the State Council of China in Kazakhstan on August 17-18, 2007 (KCM 2009).

non-resource sector, it currently promotes a sub-fund, CKFI, with an exclusive resource focus¹¹⁰. The fund provides credit lines between US\$5m-30m with a maturity of at least 10 years, with the goal to invest in good companies with 'impaired liquidity' to take advantage of the credit crisis (CITIC 2010). Two additional funds are already planned with a capitalisation of US\$400m each bringing the total investment clout of all CITIC funds to US\$1bn.

Chinese State Owned Companies

Whilst China's SWF presented a mixed picture in their relationship with Beijing and its foreign policy towards Kazakhstan, the picture is more pronounced where Chinese SOEs are concerned, especially CNPC and China Guangdong Nuclear Power Group (CGNP). There is evidence that these companies do not execute Chinese foreign policy, but to the contrary, actively enlist Beijing to pursue their objectives in Kazakhstan. This may be effective because Beijing's and CNPC's interests are aligned and it is questionable whether CNPC could enlist Beijing, or vice-versa, in areas where their interests diverge.

An anti-Chinese investment climate gained momentum in Kazakhstan after CNPC's acquisition of PetroKazakhstan in 2005 and CITIC's intention one year later to acquire Nations Energy. PetroKazakhstan constituted the most substantial addition to CNPC's portfolio at that point and unlike CNPC's other overseas assets, was a key contributor to CNPC's reserves and profits (Pala 2006). Prior to this, CNPC had accumulated an "unwieldy collection of small assets" (Downs, 2008), which were not of interest to other IOCs because of their low potential and profitability, and thus meant that CNPC operated in an uncompetitive space. PetroKazakhstan's revenue stream likely drove CNPC's determination to acquire more oil fields in Kazakhstan with a strategy that even Chinese diplomats call "aggressive" (Hoagland, 2009c). However CITIC acquisitions of Nation's Energy in 2006 interfered with these

¹¹⁰ According to the Kazyna Investment Fund brochure, CKIF targets the following industries: "Chemical and Metallurgy, Petrochemical, Oil and Gas Equipment and Services, Construction Materials, Food Processing, Machinery.

plans. Even Nur Otan members openly criticised China's aggressive expansion into Kazakhstan's hydrocarbon sector (Peyrouse, 2008) and Majilis deputies accused the government of risking Kazakhstan's energy independence. This played into deep-seated fears that a newly independent Kazakhstan was on its way to become yet another resource appendage, this time to China. Despite Energy Minister Izmukhambetov's pronouncement in November 2006 that he would block CITIC's acquisition (KASE 2006) it was completed on 31 December 2006 (Xinhua 2006) and according to Majilis' deputy, this increased China's share in Kazakhstan's oil production from 28% to 40% (KASE 2006, Konirova 2006).

Kazakhstani researchers also highlighted the political implications. Murat Auezov suspected in later interviews that CNPC's acquisition of smaller oil fields before 2005 was less driven by profitability concerns than by a strategy to "develop a network in Kazakh territory that will legitimise [Beijing's] right of inspection over Astana in the event of political tension" (Peyrouse, 2008). A string of legislation followed aimed at curbing Chinese expansion, including a 2007 law that required KMG's consent in the sale of any Kazakhstani oil and gas stake. Further, amendments to Kazakhstan's subsoil law permitting the abrogation of resource contracts on security concerns were actually aimed at Chinese investment (Hoagland 2009c, Kynge, McGregor et al. 2011). Nevertheless, in 2009, and in conjunction with Beijing's credit line, CNPC announced that it had successfully acquired MMG in a joint venture with MMG (CNPC 2009) which led Konstantin Syroezhkin, Kazakhstan's eminent China scholar to claim that Kazakhstan had become a de-facto resource appendage of China (Syroezhkin 2011:20). CNPC's eventual success, against Kazakhstani opposition and amidst China's key credit line in 2009, leads to the following hypothesis: CNPC enlisted Beijing's help to overcome Kazakhstan resistance and acquire further oil and gas assets. Several points substantiate this: Based on the experience that their international acquisition success was not driven by money alone, subsidiaries of Chinese NOCs began to involve their parent companies because of their closer ties to Beijing, in recognition

of the fact that Beijing's political influence could be helpful (Downs 2008). It then follows that PetroChina, CNPC's subsidiary, was likely aware of the additional leverage that it could create with the Kazakhstani government by involving CNPC, its parent, and Beijing, in order to overcome Kazakhstani reluctance. CNPC thus involved Beijing to include its US\$5bn loan for a joint venture with MMG into the emergency credit package for Kazakhstan, at a time when Astana was in critical need of financing. This brought the loan to US\$10bn. A second point focuses on the personal links between CNPC and Beijing, especially Jiang Jiemin (蒋洁敏), the Chairman of CNPC and head of PetroChina which acquired MMG. Jiang signed the agreement with KMG president Kairgeldy Kabyldin on 17 April 2009 in Beijing, only one day after Nazarbayev had received the credit line in a meeting with Hu Jintao (CNPC 2009).

Jiang Jiemin is closely associated with China's aggressive international energy expansion also in Kazakhstan and thus likely mobilised all available political and economic options to conclude the MMG transaction. More importantly, however, as member of the CPC central committee, Jiang is embedded in Beijing's decision-making process, giving him access to China's government and the possibility to enlist Beijing's help, especially when Kazakhstan's financial crisis presented an opportunity. Through the CPC Central Committee, Jiang could also access those high-level political figures in Kazakhstan that would be helpful to CNPC's acquisition plans. As such, Jiang met with the Kazakhstani Foreign Minister, Kanat Saudabayev, in February 2010, to discuss further gas and oil exploration. One year later, Hu Jintao and Nazarbayev signed an agreement for a joint venture project between KMG and CNPC to develop the Urikhtau gas field, which will feed into the Sino-Kazakhstani gas pipeline (CNPC 2011). Jiang also has access to Nazarbayev himself. Both met on the side-lines of a 2012 SCO summit in Beijing (Oil&Gas-Eurasia 2012).

These personal links are further reinforced through Su Shulin (苏树林), who was appointed Senior Vice President of CNPC in 2002 and remained in senior positions

with CNPC and then Sinopec until 2011 (ChinaVitae 2012). Su has extensive links to the government as an alternate member of the 16th and 17th CPC, Central Committee and as Governor of Fujian Province. At CNPC, Su facilitated CNPC's ground-breaking investment in Kazakhstan in 1997 and the construction of the Sino-Kazakh pipeline (Downs 2008:125). Like CIC and CITIC, CNPC has shown that it can navigate Kazakhstan's elite structure well. Where market rules apply, CNPC channels its bid through the executive board but adjusts its strategy when necessary as it has in Kazakhstan (See *Political System/Kazakhmys*). In view of the above, CNPC can be considered an active foreign policy actor in China which lobbies the government for support. This finding is in line with recent research into the relationship between Chinese SOEs and the CPC. The CEOs of China's NOCs today bear striking similarities with the corporate lobby groups encountered in western democracies (Downs 2008: 137) and influence Beijing's policy-making process. As a result, Chinese NOCs have turned into increasingly powerful elements vis-à-vis the state and are subjecting the CPC to their own agenda.¹¹¹

It is possible to make a similar point for the Guangdong Nuclear Power Company (CGNPC). Although data on China's nuclear deal with Kazakhstan is at best indicative, it can be included into a wider pattern of economic and political transactions. CGNPC approached KazAtomProm (KAP) as early as 2006 and signed a strategic partnership with KAP in the same year. However, the deal received political backing in 2007, through a Memorandum of Understanding (MOU) signed between Hu Jintao and Nazarbayev that allowed CGNP to buy stakes in KAPs' uranium mines. Based on the chronological order of events, it is possible that GNPC discovered Kazakhstan as potentially important supplier of uranium in 2006 and then received the necessary high-level political support one year later.

¹¹¹ Chinese SOEs turned into more powerful actors following their privatization in the 1990s. Industrial ministries such as the ministry for mobile communication, steel, railways, etc. were abolished and their staff including their membership in the central party committee, transferred into these new corporates (McGregor 2010, Howie & Walter 2011, Walter 2011).

Another, yet less direct vehicle that facilitates China's economic influence in Kazakhstan is the Shanghai Cooperation Organisation (SCO). Beijing pledged US\$10bn through China ExIm in loans for SCO members who struggled with the recession in 2009. Kazakhstan itself aimed to attract US\$3bn of these funds in 2010, however, it is unclear if it was successful (Kazinform 2010). Astana did at least benefit from a known US\$400m credit line to finance the modernisation of two border crossings, including Horgos. Within the SCO Banking Consortium, China promotes the creation of a development bank similar to the WB to disperse loans to its member-states. Although in its early stages, Beijing already announced its plans to commit US\$8bn out of US\$10bn to the bank, which would enable it to extend more financing into Central Asia, including Kazakhstan, within a multilateral umbrella (Shodon 2011). That China is interested in these opportunities was underlined at the 2012 SCO summit where Hu Jintao pledged another US\$10bn to the SCO to finance joint projects in the region (Tengrinews 2012a). However, although the SCO offers further opportunities to raise China's creditor status in the region, its multilateral setting also inhibits possibilities to use these credit lines as leverage politically.

This segment discussed the different actors and objectives that drive China's economic capabilities in Kazakhstan and their relationship with the Chinese government. Beijing's ability to control the drivers of its economic influence is mixed. Beijing can employ its policy banks to invest abroad within the framework of 'Go Global' and thus also advance its resource interests in Kazakhstan. Policy banks are thus a firm part of Chinese foreign policy. Although CITIC and CIC invest in Kazakhstan in line with the Go Global strategy, it is more difficult to prove whether Beijing actively enlists its SWFs or whether these SWFs seek out investment in Kazakhstan because of its promise of returns. However, both CIC and CITIC have shown that they understand and manage Kazakhstan's decision-making process and made successful acquisitions against high level political opposition which was facilitated through close government contacts, either between these SWFs and

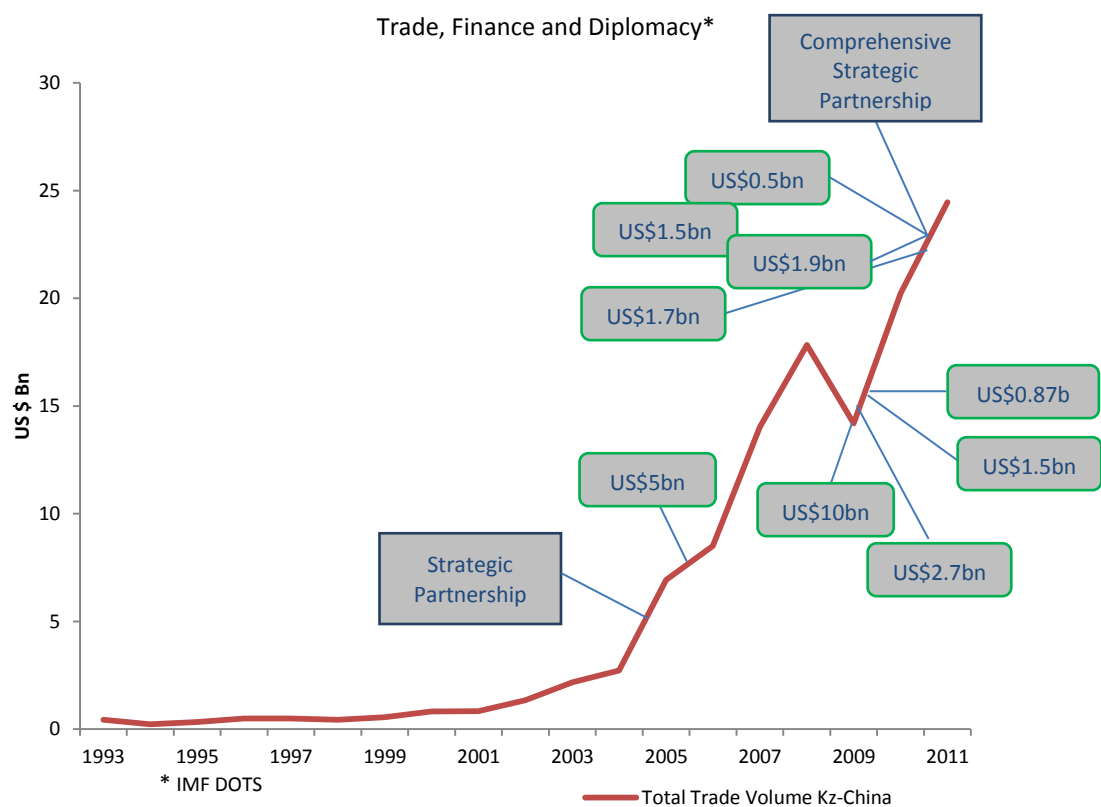
Beijing or these SWFS and Kazakhstani elite contacts. CNPC's investments also fall in line with China's drive for resource acquisitions abroad. However, as this segment has shown, it proactively enlists Beijing to overcome investment obstacles in Kazakhstan. As such, Beijing's control over its economic institutions varies greatly and it is questionable whether Beijing could force its SOEs or SWFs to divest assets in Kazakhstan in order to pursue a political agenda, especially where interests may diverge. The research showed that China can leverage its economic influence where the interest of NOCs and Beijing align. It was possible for CNPC to gain Beijing's political support, however it is unclear whether Beijing can in turn control CNPC's investment. Given the political and economic power of CNPC in China this is unlikely. This applies especially to Kazakhstan, where CNPC has made some of its most profitable investments (Downs 2008). This should impede Beijing's ability to use its economic influence to meet foreign policy objectives. Nevertheless, for the time being, this distinction may be of greater analytical than practical value as Astana likely perceives these different actors as simply state owned and thus part and parcel of Chinese government interests and policies (Interview Local Finance Expert 1; Chapter 7). Hence, the accumulated economic activity of China's economic institutions drives China's overall economic power in Kazakhstan, at least in the view of the Kazakhstani elite.

5.3.2 Political Leverage

The previous segment discussed Beijing's control over its economic institutions as a prerequisite to deliberately deploying its economic capabilities, which are mixed. Whereas CNPC has turned into a powerful actor vis-à-vis Beijing, there is greater opportunity for the government to exert control in the financial sector, at least where its policy banks are concerned. The finance segment has shown that Beijing already links specific resource objectives to its credit lines to Kazakhstan, a move that can be viewed as a deliberate strategy in recognition of Kazakhstan's financial needs (Chapter 3). Although Beijing recognises such opportunities, it is less clear

whether it has driven Kazakhstan’s financial or trade dependencies as part of a specific foreign policy. However, Beijing has become more proactive both in financial and diplomatic terms in Kazakhstan, as indicated by the string of credit lines and agreements that followed Kazakhstan’s financial crisis in 2009. This implies that Beijing is taking a greater economic and perhaps political interest in its neighbour.

Figure 40 Trade, Finance and Diplomacy



Perhaps this distinction primarily matters analytically, yet less so in view of its practical applicability. Beijing’s Go Global initiative, in conjunction with the objective to exploit financial opportunities, can invariably lead to economic dependencies, especially in times where alternative sources of funding are limited. In addition to Chinese trade and investment, this has de-facto created an overall economic dependency of Kazakhstan. Rather, it is Kazakhstan’s domestic

circumstances that create ongoing demand for external finance, which Beijing is able to meet with its vast foreign currency reserves. The revenue needs of the elite further facilitate the inflow of Chinese trade and investment which increases the political opportunity costs of alternative sources of funding and underpins Kazakhstan's economic dependencies (Chapters 3 and 4).

Nevertheless, Beijing did recognise the opportunities inherent in the financial crisis, which left it as one of the few countries with the ability to invest. Based on the effectiveness of such financial conditionality, Beijing may draw on these more often in the future, thereby creating a stronger link between its financial capabilities and foreign policy objectives. The picture is less clear where trade is concerned. Initially, Sino-Kazakhstani trade was driven by small traders and subsequently taken over by Chinese SOEs, especially in the resource sector (Interview European Diplomat 1). This is why until 2005 Beijing did not shape but rather retrospectively acknowledged the economic realities on the ground through closer diplomatic relations. Following China's recognition of Kazakhstan as a strategic asset in Beijing's quest to meet its energy demand, China became more proactive politically, by embedding energy commodities into bilateral agreements and conditioning energy access to loans, at least since 2009. Beijing's more proactive role in facilitating trade is also reflected in its decision to establish the China Kazakhstan Cooperation Committee (CKCC) to better organise, guide and control the development of bilateral trade (Chapter 6), as well as its political leadership in developing cross-border trade, where it initiated the creation of a free trade area along with Kazakhstan.

In summary, China's deliberate economic strategy rather than a deliberate foreign policy strategy facilitated Kazakhstan's economic dependence. China's economic strategy, roughly subsumed under its Go Global programme, aimed at benefitting from investment opportunities of the financial crisis and at investing and diversifying its foreign policy holdings whilst meeting its overall increasing energy

demand. Yet, at least in the financial realm, there are already some overlaps between China's economic and foreign policy strategies, as its financial conditionality has shown. This should open further possibilities for the twain of politics and economics to meet in the future and thus, for Beijing to draw on its full economic capabilities as part of its foreign policy. Independent of the strategic considerations (or lack thereof) behind China's economic capabilities in Kazakhstan, these capabilities have created an economic dependence.

However, to what degree Beijing should be able to leverage that dependence in its favour. The preceding discussion supported the first part of the lead hypothesis that *China's accumulated economic activities have generated a considerable economic dependency of Kazakhstan* (lead hypothesis). However, the fact that the research could not identify a specific foreign policy towards Kazakhstan necessitates a modification of the second part: *Beijing can leverage this economic dependence politically, if it is aware of these dependencies and if it can control the economic activities of its institutions and/or if Kazakhstani policy makers perceive of China as a unitary actor that can control its economic institutions.*

It is unclear if Beijing is aware of the extent of its economic influence in Kazakhstan, which is a prerequisite to leverage these dependencies for specific political goals. However, Beijing is aware of and deliberately uses its economic capabilities in general. This is particularly salient in its creditor approach where it links loans to resource commitments. Arguably, the experience also demonstrated to Beijing that these linkages are effective, thereby confirming China's creditor status indirectly. The thesis already discussed that Kazakhstani decision makers misperceive the relationship between Beijing and its economic institutions in Beijing's favour which should incentivise decision makers to acquiesce with Chinese interests, in view of China's accumulated economic power in the country and Kazakhstan's dependence as well as elite expectations on future economic benefits.

Economic dependence can be translated into political influence because of the opportunity costs associated with the loss or decrease in activity of the economic partner which make it too costly for the sub-ordinate economic partner to forego the economic relationship. As a result the dependent state is vulnerable to the political influence or conditioning of the dominant state. Kahler and Kastner maintain that democracies should be particularly susceptible to such political influence as overall economic performance plays a role in elections. However, this should also apply to elites in a Rentier State. These elites are rational actors who base their decisions on cost-benefit calculations with the goal "[t]o come to power, to stay in power and, to the extent that they can, to keep control over money" (Bueno de Mesquita & Smith 2011). In Kazakhstan political and economic opportunity costs operationalise dependence into political influence via the risk of legitimacy losses and political instability linked to declining income (Demkiv 2012). Part I elucidated that Kazakhstan is vulnerable to external revenue shocks such as those experienced in the period following the Global Financial Crisis. During this period of subdued growth the opportunity costs associated with China increased significantly as China has become the lender of last resort and the largest trade partner. This incentivises the regime to avoid any conflict of interest with China that can put future trade, finance or investment benefits at risk. As such the regime should support Chinese foreign policy interests, accede to conditional requests or indirectly acquiesce to Chinese interests pre-emptively to create strong/friendly ties that may facilitate future investment. This strengthens China's bargaining power vis-à-vis Kazakhstan (Hirschman 1945).

Before moving on to the second part of the thesis which will test this hypothesis along a case study, the following segment will discuss some immediate outcomes for Beijing and how Kazakhstan fits into China's overall strategy.

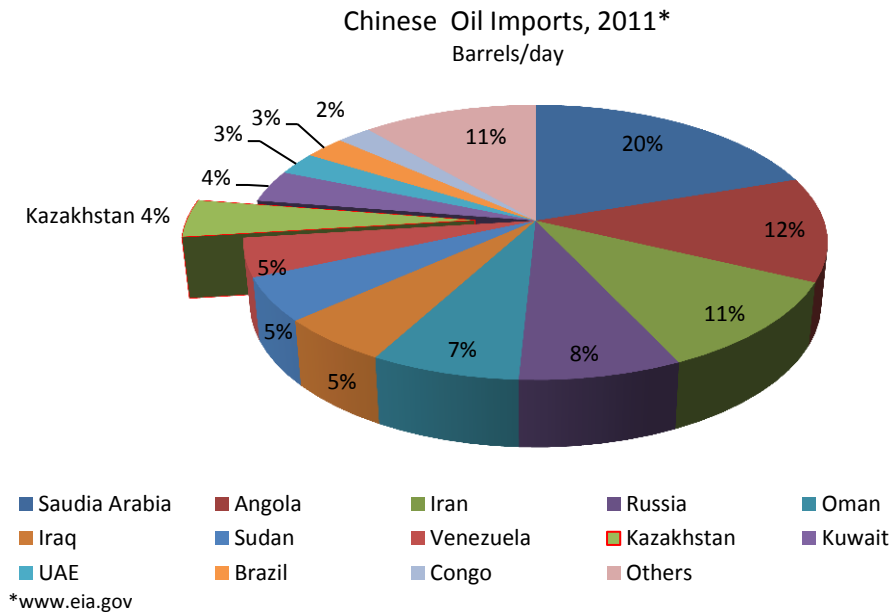
This thesis showed that China controls between 25-30% of Kazakhstan's daily oil production, based on its accumulated ownership in Kazakhstan's oil fields. In June

1997, CNPC outbid Amoco, Unocal and Petronas for a 60.3% share in AktobeMunaiGas for which it paid a signing bonus of US\$320m and made an investment promise of US\$4.3bn (Strecker Downs 2000:15). In 2003, CNPC expanded that share to 85.42% and bought PetroKazakhstan for US\$4.18bn in 2005. PetroKazakhstan owns 12 oil fields and licenses for six oil exploration blocks (ATimes 2005). In 2006, CITIC bought Nation's Energy for US\$1.9bn. In 2009, CNPC acquired 50% of MMG and CIC bought an 11% stake in KMG EP. In view of the fact that 80% of Kazakhstani oil resources are under foreign ownership (Palzuelos & Fernandez, 2012), China's 30% share turned it into the second most important foreign player in Kazakhstan's oil and gas fields after the US, a status it achieved within a short period of time, given that it only arrived in Kazakhstan in 1997.¹¹² However, Kazakhstani oil deliveries currently only constitute 4% of Chinese imports but this is set to double by 2020, with CNPC's plan to build a second oil pipeline to source more Kazakhstani oil for China's domestic market (EIA 2012). Figure 41 illustrates China's diversified import portfolio, which would allow it to substitute Kazakhstan for other oil exporters and which seems to extend the economic asymmetry between Kazakhstan in China. Beijing could arguably break the oil relationship more easily than Kazakhstan. However, Kazakhstani resources have distinct advantages for Beijing: Kazakhstani oil is relatively cheap because China financed the transportation infra-structure and because the consumer at the end of the pipeline determines the prices (Interview European Diplomat 1). Beijing's loans-for-resources approach further ensures concessional prices that Beijing can lock in because of the medium-term maturity of these loans (Rasov 2012). Because Kazakhstan neighbours China, Beijing can import resources via landlines -which protect it against supply chain disruptions. The proximity of Kazakhstan and its SCO membership facilitate China's ability to protect its assets on the ground. The Arab Spring has moved the latter point to the forefront of Chinese priorities, where political developments forced Beijing to abandon US\$18bn worth of projects and to

¹¹² This calculation excludes the Kashgan Oil Field, which will only come online next year and which is developed by a consortium of foreign firms without Chinese presence.

evacuate 36,000 Chinese, the biggest evacuation in modern Chinese history (Xinhuanet, 2011).¹¹³ The incident sparked a broader debate about how Beijing can protect its investment abroad and what role the PLA should take in this (Brautigam 2011).

Figure 41 Chinese Crude Oil Imports



CNPC's acquisitions in Kazakhstan allowed CNPC to diversify its upstream and downstream portfolio so that it can balance and swap reserves as necessary. In addition to its shares in Kazakhstani oilfields, CNPC acquired valuable downstream, processing and transportation assets, thereby possessing the entire oil production cycle: Kazakhstan only has three domestic refineries, which constrains its processing capacity and thus exports oil to Russia for refining, which has led to recent disagreements over tariffs in conjunction with the new Customs Union. Kazakhstan sought financing from China to expand and modernise its refinery capacity and Chinese companies now have stakes in two out of three of these refineries, Atyrau and Shymkent (PetroKazakhstan), both of which add valuable processing assets.

¹¹³35,860 Chinese evacuated from unrest-torn Libya(Xinhua 2011a).

Most recently, Kazakhstan has started refining crude oil in China at the Dushanzi Refinery near the Kazakhstani border, which is an opportunity for Beijing to further lock in Kazakhstani oil by integrating it with its own processing network (WKT 2012). Through its stake in KMG EP and in the Sino-Kazkh Pipeline, it added distribution capacity that can bring refined products to market. From a global perspective, CNPC is immune to oil price fluctuations, especially from rising oil prices, in that it can balance and swap reserves around the world (Hoagland, 2009c).

Besides the implications of Kazakhstani assets to CNPC, natural gas imports from Kazakhstan are even more important in Beijing's goal to diversify its energy mix and to boost cleaner sources. The Central Asian Gas Pipeline (CAGP) connects gas from Turkmenistan and Uzbekistan as well Kazakhstan. It is the first and, to date, only pipeline through which Beijing imports natural gas and thus plays a key role in Beijing's plans to diversify its energy supply by 2020. Currently, the country meets 68% of its energy demand through coal, which is a high pollutant energy source, whereas only 4% of its energy mix is natural gas (EIA 2012). Beijing aims to increase the gas share to 10% by 2020. Once completed at the end of 2012, the pipeline has a capacity of 40bn meters³/a, which will double China's natural gas imports and thus plays a key role in China's energy diversification. The CAGP is crucial because it feeds directly into China's West-East pipeline, which is currently under expansion to accommodate more imports from Central Asia in the future, including Kazakhstan (CNPC 2012).

This role is even further pronounced regarding nuclear power, where Beijing turned to Astana to provide 40% of its uranium needs in the next years. China plans to increase the share of electricity generated from nuclear power from 1% (11.3 Gigawatt [GW]) to 6% (86GW) by 2020 requiring an additional 122 nuclear power plants (Hotter 2011). Kazakhstan produced 36% of global uranium in 2011, and is the world's biggest producer, producing twice as much as the second biggest producer, Canada (WNA 2012). Kazakhstan also possesses the second biggest

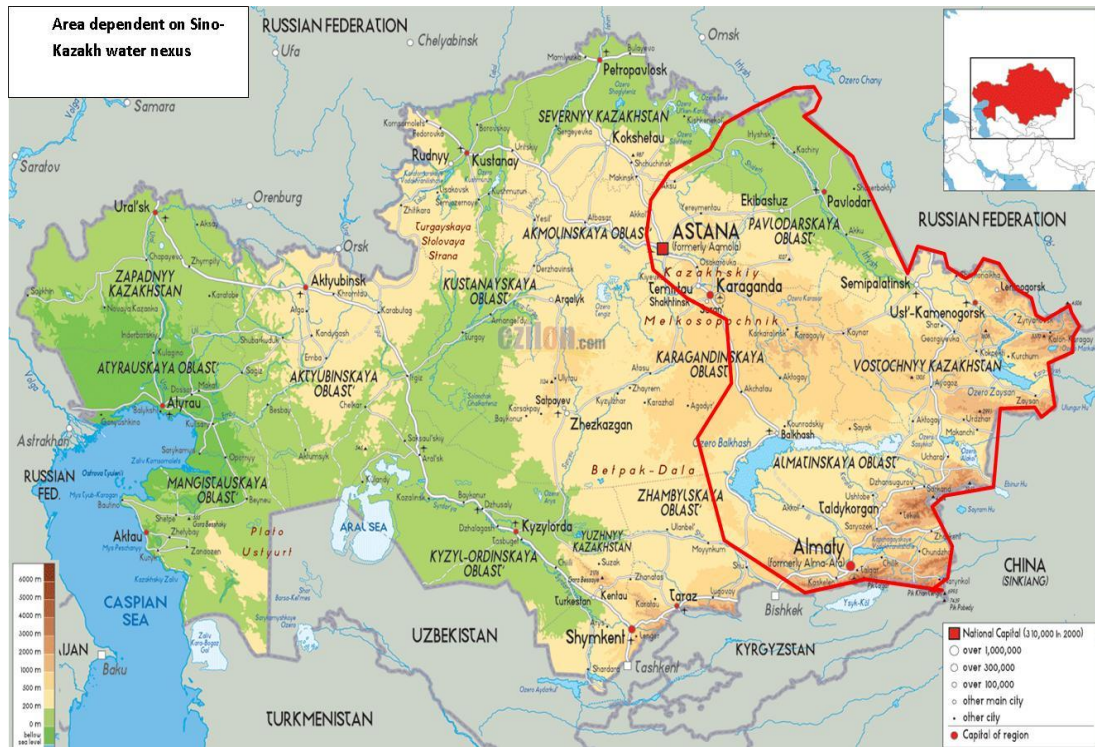
uranium deposits in the world and this, combined with its geographic proximity, makes it the most suitable supplier for China's Nuclear Energy Strategy (Chapter 6). Beijing recognised Kazakhstan as the key to its nuclear energy plans as early as 2006, when CGNP and KAP signed a strategic cooperation agreement and CGNP bought stakes in KAPs' uranium mines. KAP has now become CGNP's main uranium supplier. In 2008, CGNP's subsidiary Sino-Kazakhstan Uranium Resources Investment and KAP created a joint venture (Semizbai-U LLP) to finance uranium mines (WNA 2012). Both China National Nuclear Corporation (CNNC) and CGNPC hold 49% shares in several uranium mines and purchase at least 20% of KAP's annual uranium output (CGNPC 2009). Interestingly, KAP and CGNPC entered into an agreement to establish a company for the construction of nuclear power plants in China, after KAP's initial plans to work with Russia's Atomstroyexport fell through. This is interesting, as KAP was also subject to intra-elite struggles, in which Russian interests played a role. Atomstroyexport's refusal to enter into a commercial relationship with KAP further reaffirms the trend that Moscow does not compete commercially but rather politically in Kazakhstan (Chapter 2 and 3). Beijing's 2009 loan coincided with Kazakhstan becoming the world's biggest uranium producer (WNA 2012) and since then, uranium purchases from China have accelerated dramatically, turning Kazakhstan into China's key supplier. In June 2010, Hu Jintao and Nazarbayev signed an agreement to import 24 metric tons of uranium to China by 2012 (Weitz 2011). A year later, in 2011, Nazarbayev agreed to supply China with 55 metric tonnes of uranium and promised to meet 40% of China's uranium demand in the future (Hotter 2011), which translated into a 100-fold increase of uranium pallet deliveries to China. KAP expects Chinese imports of uranium pallets to increase from 2 metric tonnes annually to 220 metric tonnes by 2013/2014 (Gizitdinov 2011), which also more than doubled KAP's profits in the first half of 2012.

Astana's position in meeting Chinese gas and especially uranium needs should allow it to level the economic hierarchy with China. However, most puzzlingly, Astana does not seize on this opportunity, as the following case study will demonstrate.

PART II

Chapter 6 The Background of the Sino-Kazakhstani Water Dispute as a Case Study

Figure 42 Map of Kazakhstan



Source: ezilon maps

Part II of the PhD addresses the question whether China, in line with the findings of Part I, can effectively leverage Kazakhstan's economic dependence to maximise its foreign policy objectives and how, by looking at the ongoing Sino-Kazakh water dispute. This case study will focus on the dispute dynamics between China and Kazakhstan and argue that Beijing has managed to meet its foreign policy interests at the expense of Kazakhstan's national interests over the last twenty years. The water dispute shows that China can leverage its economic influence to maximise its bargaining power which also translates economic influence into political influence (Hirschman 1945).

The water dispute is suitable because both China and Kazakhstan have conflicting foreign policy interests and a political outcome is most visible if Kazakhstan acts against its own interests based on its dependency on China, whilst Beijing pursues a policy of deliberately exploiting that economic dependency.

The following chapter provides a background and overview of the dispute. It argues that the dispute takes place in the context of environmental cooperation, more specifically, international water regimes, an area in international relations that although increasingly well regulated, suffers from implementation weaknesses. The chapter will discuss the domestic contexts in China and Kazakhstan that shape their foreign policy objectives in the dispute but also the dispute outcomes. Kazakhstan is interested in restricting China's abstraction of water from the joint water nexus. It is in Beijing's interest, in turn, to maximise control over its water resources. Beijing can realise these objectives fully because of Kazakhstan's economic dependence and the acquiescence of its elite with Chinese interests, which maximises Beijing's bargaining power in the conflict.

6.1 Context of the Sino-Kazakh Water Dispute

IR literature discusses increasingly how non-traditional security threats, such as freshwater conflicts, shape the foreign policy objectives of nations (Westing, 1989) and international organisations such as the United Nations (UN) have put water security onto their agenda (Cosgrove 2003). Regionally, the Asia Society in New York focuses on the conflict potential of water shortages and the June 2009 Asia Europe Meeting dedicated an entire session to non-traditional security threats, where water security featured prominently. IR literature also recognises the link between a nation's domestic water context and its foreign policy stance (Trolldalen, 1992), which will be seen in China's and Kazakhstan's case. Water security should be considered from a global angle as a challenge affecting the majority of the planet's population. A joint study by the International Finance Corporation, McKinsey and

the private sector found that without efficiency gains, the gap between demand and supply of fresh water will reach at least 40% by 2030 (Water 2030). Potential global problems are foreshadowed on a regional level in areas that are more arid and dryer than the global average. Both Kazakhstan, with its arid and dry climate, and the northwest of China face prominent water shortages, while competing over a shared fresh water nexus made up of 23 transboundary rivers.

While IR recognises that water disputes can spiral into open conflicts, historically such escalations have been limited (Homer-Dixon, 1999). However, the absence of violence in a conflict does not necessarily equate to an absence of conflict (Zeitoun & Warner 2006). The ongoing dispute between Kazakhstan and China over a set of shared transboundary rivers falls into this category. The dispute takes place in an increasingly well-regulated field, which experiences effective supranational cooperation that transforms the anarchic space of IR. Theoretically, cooperation on shared international rivers takes place along a spectrum, from violent conflict at one end to international customary law and supranational institutionalisation at the other. Common practices among states have led to important changes in international customary law, which now stipulates the rules states should follow in their activities along shared rivers. While the international legal system still has some way to go, transboundary rivers are also home to some of the world's most cooperative and effective institutions (Rhine Agreement, below). Today the frequency of cooperation far outweighs the record of conflict (Wolf 2007). Actual state practice frequently goes beyond the prescriptions of customary environmental law, especially in transboundary river basins.¹¹⁴ For example, Wolf has shown that over 3,600 treaties on water related issues exist (Wolf 1998, Wolf 2007). Over the years, many international basin councils have been created to

¹¹⁴ "River basins are defined as the area that contributes hydrologically [...] to a first order stream which, in turn, is defined by its outlet to the ocean or to a terminal (closed) lake or inland sea". River Basins are watersheds (US) or catchments (UK), and include lakes and shallow, unconfined groundwater units. (Wolf, 2007).

govern river basins and successfully transform conflict into cooperation (EECCA-NBO 2012).

China's foreign policy stance in the Sino-Kazakh water dispute ignores these developments, thus exploiting weaknesses in the implementation of international law. As a consequence, China maximises its objective of maintaining unhindered access and use over its transboundary rivers, at the expense of Kazakhstan's national interest. This thesis argues that Beijing can only proceed in this manner because Kazakhstan's economic dependence prevents Kazakhstani officials from taking a firmer stance against Beijing.

6.2 Transboundary Water Regimes

With approximately 260 transboundary river basins globally (Wolf, 2007), there exists a clear need for norms to regulate access to transboundary freshwater. International environmental cooperation is often depicted as one of the least progressive areas of international relations. However, with more than 400 fresh water-related agreements signed between 1820 and 2007 (TFDD 2012), this area is actually densely regulated. The majority of these agreements are bilateral, and, unsurprisingly, their density is highest in Europe and North America. For example, the EU Water Framework Directive (WFD) is the most far-reaching piece of transboundary legislation (EC 2000) regulating the joint control of shared water resources across member states and mandating the creation of River Basin Districts (RBD) along the geographic river basin across borders. As a result, international RBD have been set up for monitoring, planning and the implementation of policies that control pollution (quality) and water levels (quantity).

Perhaps surprisingly, international environmental cooperation has witnessed some of the earliest and most effective supranational institution building. For example, the Rhine River Treaty of 1804 constitutes one of the first examples of effective

supranational cooperation, which mitigated the anarchic dynamics in the international system. By the end of the 18th century, commerce along the Rhine had become cumbersome. Each city state along the river imposed its own tax system and often forced cargo to be transferred onto its own boats. These policies inhibited trade and rendered maintenance work and monitoring along the river impossible. Spearheaded by France, the hegemonic power of the time, the Rhine River Treaty established regulations and harmonised commerce between riparians. France and the Holy Roman Empire created an international administrative body in Mainz, which oversaw the river's maintenance taxation and acted as tribunal in case of conflicts and disagreements (ZKR 2011). It effectively established a single transit tax regime, and eliminated cargo-transfers at each city port. In 1815, that body was transformed into the *Zentralkommission fuer die Rheinschiffahrt/Commission Centrale pour la Navigation du Rhin*, to which France and Germany conferred sovereign rights and which was headed by an independent official¹¹⁵. The commission drafted future regulations on the Rhine, independent from their principals Germany and France (Spaulding 2000).

In contrast, Asia is one of the least regulated geographies in this respect. In the absence of regional agreements, river basins and transboundary rivers fall under the wider framework of international conventions and water law, which has made significant strides in recent years. A number of international agreements regulate transboundary rivers, including the 1992 *UN Convention on the Protection and Use of Transboundary Watercourses and International Lakes* (UNECE 1992), which contains a chapter on Environmental Impact Assessment in a Transboundary Context (TEIA), as well as the 1997 *UN Convention on the Law of the Non-Navigational Uses of International Watercourses* (1997 Convention) (UN 1997). These agreements primarily regulate the planning and execution of projects that affect transboundary rivers. Unsurprisingly, Kazakhstan became party to both

¹¹⁵ Modern Europe's first supranational official who pledged allegiance to the commission instead of his country of origin. Similarly to the EU today, he was not paid by states but rather by the commission itself through funds that it generated along the Rhine (Spaulding, 2000).

conventions in January 2001, likely driven by the necessity of its unfavourable geographic position. As a downstream riparian to most of its transboundary rivers, Kazakhstan is vulnerable to projects conducted upstream.

To maintain absolute sovereignty over water resources, China has pursued the opposite strategy. Beijing was one of only three countries to vote against the 1997 UN Convention. Gao Feng¹¹⁶, China's representative to the UN General Assembly (UNGA) at the time, argued that the convention infringed on a state's indisputable sovereignty over watercourses that flow through its territory (UN 1997). Westad argues that China's reiteration of the sovereignty principle in international affairs has historic roots in China's concept of justice (Westad 2012). This thesis will show that this principle is especially pronounced in China's foreign policy approach to Kazakhstan. In relation to transboundary waters, the sovereignty argument was first developed by Attorney General Judson Harmon in 1895 in response to Mexican claims at the Rio Grande.¹¹⁷ However, the US quickly retracted its own principle and went on to sign several treaties with Canada and Mexico in 1909 and 1906, which reflected today's commonly accepted principle of "equitable utilization" (McIntyre 2011b:61). The fact that Beijing reverts to the sovereign principle today indicates that China's approach to transboundary water rights is increasingly at odds with international developments. In essence, the 1997 Convention acknowledges that sovereignty cannot be absolute where shared water resources are concerned and that downstream riparians have a right to be protected from random and unilateral actions of their upstream riparians. This basic principle is shared by the overwhelming majority of states who voted in its favour. In recognition of the widespread norm, a recent International Court of Justice (ICJ) ruling in 2010¹¹⁸ has incorporated some of these principles into customary international law (Chapter 7), moving China's stance even further out of touch with common international

¹¹⁶ Acting Director-General of the Treaty and Law Department, MOFA.

¹¹⁷ He argued that restrictions on the use of the river denies the US the right to exercise full sovereignty over its natural territory and imposes restrictors on something that nature had endowed to the country (McIntyre 2011b:61).

¹¹⁸ ICJ Ruling in Uruguay vs. Argentina 2010

practice and the realities of international regimes. The next segment analyses how China's water and development situation has caused it to adopt this foreign policy stance in the dispute (Trolldalen, 1992).

6.3 China

Water Supply as National and Foreign Policy Objective

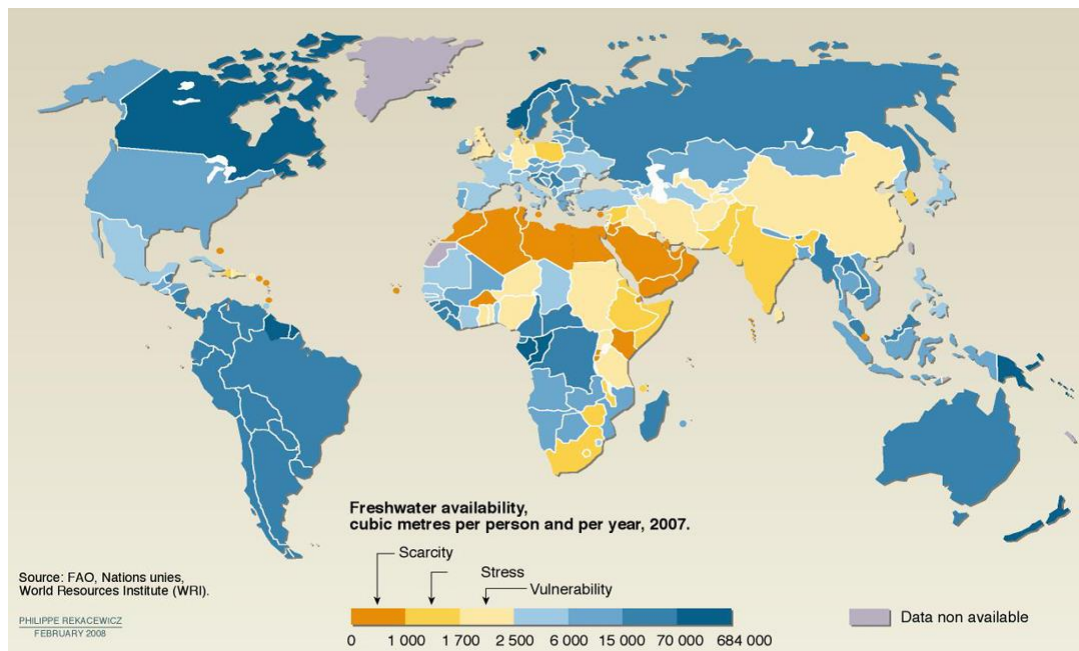
China's foreign policy objectives and its 'absolute sovereignty' stance are first and foremost rooted in the fact that large parts of China suffer from a dry climate. The United Nations Environment Programme (UNEP) systematically assesses the water situation of countries (Figure 43). For example, Canada's water supply of more than 684,000 meters³ per person and year exceeds its water demand, whereas the Saudi Arabic peninsula suffers from acute water scarcity which occurs when

“the amount of water withdrawn from lakes, rivers or groundwater is so great that water supplies are no longer adequate to satisfy all human or ecosystem requirements, resulting in increased competition between water users and other demands “(UNEP).

Along this spectrum, China's water supply is under stress, with less than 2,500 meters³ per person and year (UNEP 2008). However, China is in the advantageous position that most sources of freshwater originate within its borders, so that its dependency ratio is zero, whereas it is 50% in Kazakhstan (UNEP)¹¹⁹.

¹¹⁹ 50% of Kazakhstan's sources of freshwater originate outside its borders (UNEP 2008).

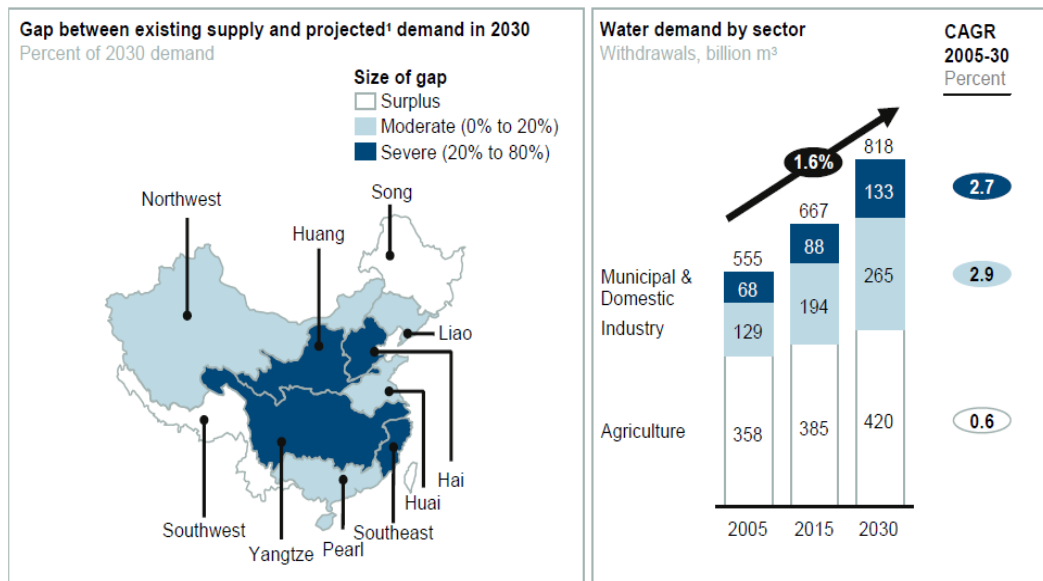
Figure 43 Global Water Supply in 2008



Source: UNEP (2008).

Not surprisingly, the key drivers for China's water demand include rapid industrialisation and urbanisation, high electricity and power demand and a policy goal of agricultural self-sufficiency, in conjunction with water mismanagement. Together, these drivers lead to an acute shortage in fresh water, especially in China's North West, which is set to increase further in the coming years. The Water Resources Group predicts that if the status quo is maintained, China will suffer from a demand-supply gap of 30% by 2030 (Figure 44).

Figure 44 Water demand and supply gap



¹ The unconstrained projection of water requirements under a static policy regime and at existing levels of productivity and efficiency
SOURCE: China Environment Situation Fact Book; China Agriculture Annual book; Study of China water resources strategy; China grain security planning; basin annual bulletin; press search; 2030 Water Resources Group

Source: 2030 Water Resources Group, Addams et al. 2009

Approximately 30% of China’s surface area is susceptible to drought conditions (Figure 44). Even before the country embarked on a period of rapid economic growth, China was regularly affected by droughts (Wu, Lu et al. 2011). Over its 2,000 year history, China has recorded over 1,000 droughts of varying intensity, making them a bi-annual occurrence (ibid.). The challenges of China’s geography are magnified by human intervention including industrialisation, massive power projects such as the Three Gorges Dam and general water mismanagement. Thus, droughts have become more severe in the recent past with experts estimating that an additional 13 million tonnes of grain (sufficient to feed 85 million people) will be lost each year. Signs of deterioration are already appearing: as of January 2012, the Poyang, China’s biggest freshwater lake, had shrunk to roughly 5% of its original size (Thibault 2012, Verkhoturov 2009). Just as recently as 2011, Hunei province and some Northern Provinces experienced their worst drought in decades. In 2012, another draught hit the Yellow River and Huai River regions, disrupting agriculture and leaving at least 4 million people with insufficient drinking water (XinhuaNet

2012). Greater problems may lie ahead, especially in northern China, where glacier melts that currently feed up to 40% of China's northern rivers will decrease in the long term due to warmer climate conditions. A dry climate and rapid industrialisation exacerbated by manmade water shortages, as shown in the following section, together inform China's foreign policy stance.

Water Policy in China

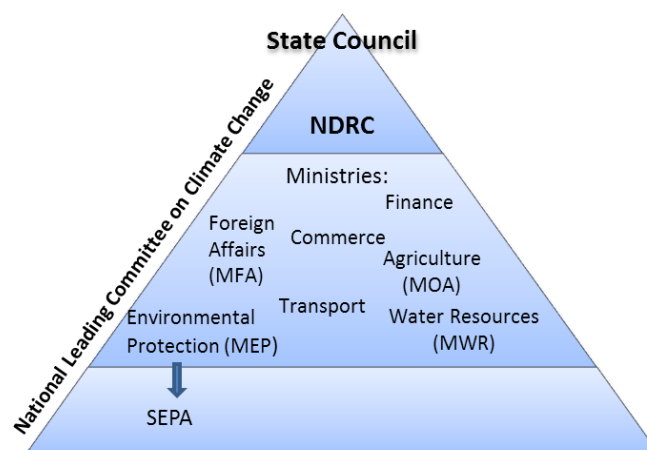
The water situation in China is exacerbated by institutional weaknesses, inadequate environmental protection mechanisms and conflicting policy priorities, similar to Kazakhstan. Beijing is aware of the environmental costs of its extensive industrialisation and urbanisation and is committed, on the surface, to promoting 'Green Growth'. However, when environmental concerns conflict with economic growth, China prioritises economic growth.

Institutional weakness in environmental protection leads to a further neglect of environmental issues. The State Environmental Protection Agency (SEPA), which was granted ministerial status in 1998, and incorporated into the Ministry of Environmental Protection (MEP), is in charge of monitoring water, together with the Ministry of Water Resources (MWR). In the past, water-related issues fell under the auspices of other ministries, including the ministries of finance, agriculture and construction. In 1998, the State Council established the National Coordination Committee on Climate Change (NCCCC), an inter-agency committee that brings representatives from these ministries under one umbrella. In 2007, the NCCCC received an institutional upgrade and became the National Leading Committee on Climate Change (NLCCC), chaired by Wen Jiabao (Figure 45).

However, the National Development and Reform Commission (NDRC) is in charge of the committee, whose priority is economic growth. As a result of the NDRC's status and political power, the commercially-oriented commission naturally dominates SEPA and, by extension, economic policy trumps environmental and water policy.

SEPA is understaffed and must rely on local authorities for implementation, leading to misaligned incentives and fragmentation (Chen 2009). Local SEPA offices rely on funding from the local government, which are incentivised to prioritise growth over environmental concerns, since growth is the source of government income and a key benchmark for career progression within the CPC (Economy 2007). This may explain why, despite stricter regulation and environmental targets, the number of companies that discharge waste water illegally into rivers and lakes continues to increase, going from 2,500 in 2006 to 60,000 in 2011 (Meng 2012). Arguably, replacement costs for water and pollution fines remain too low, making it more economical to pay fines in the short-term than to modernise. Industry and agriculture are not the only culprits. It is estimated that 20% of the country’s water consumption can be attributed to leaky pipes alone. This mismanagement occurs in a context where 600 cities in China have insufficient access to water, while over 100 cities experience severe shortages (Economy 2007). However, pollution poses the most significant problem. In 2006, 60% of drinking water was not safe and around 30% of water was so polluted that it could not be used for industrial purposes, threatening the health of around 80m people (Qiu and Li 2009)

Figure 45 National Leading Committee on Climate Change



Mismanagement also extends into water monitoring and research. Accurate data on water usage is missing, with experts agreeing that numbers are indicative at best

(Chen 2012). Similarly to Kazakhstan, China's river and data collecting practices are highly fragmented and prone to manipulation and bureaucratic turf battles. This also affects the Sino-Kazakhstani dispute. The problems in data reporting are well documented and result from misaligned incentives on the local level, combined with a lack of checks and balances customary to the Chinese political system. For example, pollution is known to be under-reported as some local offices supplement their income by taking pollution fines. The infractions leading to these side-payments are then not disclosed to the central government, leading to chronic under-reporting (Gang Cheng 2009: 25). Moreover, data on these rivers, which has to be communicated internationally, has to be channelled from the local to the regional, provincial and national level where it becomes subject to negotiations between administrative departments. These obstacles to data collection also mean that it is unclear how much water China abstracts from transboundary rivers. In fact, this research has shown that signs of scientific activity on transboundary rivers were only detectable in 2011 (Sizixun.com 2011, XAES 2011) .

Despite the water mismanagement at the local level, Beijing is aware of the potential security implications resulting from water stress. China's poor, rural households spend 50% of their income on food, making them particularly vulnerable to droughts that push food prices upward, accelerated by an underlying high inflation rate. This can cause social instability and may even intensify underlying ethnic tensions over land and access to water, especially in regions such as China's North West. These tensions may be relevant in Xinjiang, where a huge influx of Han Chinese benefits disproportionately from economic growth and marginalises the indigenous Uyghur population. In any case, drier weather would impede the successful socio-economic development of China's western regions and undermine Beijing's 'Go West' programme. As freshwater resources cease to sustain economic growth in agriculture, mining and oil exploration, closing the gap between China's wealthy coastal regions and its poorer west becomes more difficult. The potential security implications become salient when tracking the number of

spontaneous mass incidents (SMI) triggered by environmental concerns, from general pollution to access to safe drinking water. Such SMIs have increased in the recent past and have even become the subject of a special hearing of the US China Economic and Security Review Commission in 2011 (Economy 2011). Observers estimate the number of such incidents with environmental causes at around 90,000 (Genasci 2012). Historical parallels can be drawn with China's man-made and natural famines sparking revolutions. Access to water has often been at the forefront of rebellions against Emperors (Turner 2009) and remains a factor of conflict between villages, especially in China's arid north. This also affects the government's budget. Beijing is forced to import the harvest shortfall at a relatively high cost, given that the Yuan is pegged against the US dollar and considered undervalued. Beijing's purchasing power is thus constrained whilst draughts push up grain prices not only locally but also globally.

6.3.1 National and Foreign Policy Priority

Beijing is aware that water and resulting food shortages constitute non-traditional security threats, which can precipitate social instability. The leadership has discussed water supply in a number of high-level policy documents, turning it into a national security priority. For example, China's strategy for the country's food security (2008-2020) identifies water shortages as a key challenge (Xinhua 2008). Food security has always played a key role in China's economic development and the CPC Central Committee considers it crucial to national self-reliance, preventing conflict and building a harmonious society (China 2008). In 2009, the standing committee of the State Council acknowledged that climate change exacerbates water shortages. Chapter 3 of China's 12th Five Year Plan focuses on tackling these shortages, by setting targets to reduce industrial water consumption by 30% (EU-China 2011). Beijing's concerns over domestic water stability inform an international policy that prioritises maximum control of its water supply. China's foreign policy aims to ensure unconstrained use of and access to its transboundary

rivers and is firmly rooted in China's sovereignty concept. China's Water Law from 1988 further emphasises China's absolute water sovereignty. In Chapter VII, Articles 51¹²⁰ and 52¹²¹ stipulate that it is Beijing's prerogative to decide whether international treaties are applicable to its transboundary rivers. Moreover, it is up to the State Council or Provincial People's Congresses to formulate rules for the implementation of such international treaties (Lehman 2012). The resulting foreign policies on transboundary waters directly conflict with China's neighbours, including Kazakhstan, the security implications of which are recognised by Chinese academics (Li 2011).

6.4 Kazakhstan

Kazakhstan is landlocked and its topographic location naturally predisposes it to water shortages and droughts. About 80% of Kazakhstan's topography consists of deserts and steppes, the result of a strong continental climate with limited precipitation (Aquastat 2011). While Kazakhstan's geography certainly presents water challenges, the natural situation is not as severe as in China. The UNEP classifies Kazakhstan as water *stressed*, a lot less severe than China, which is water *scarce*.

However, the impact of Kazakhstan's natural geography is sharply exacerbated by poor past and present water management practices, which lead to an overall water situation that is arguably more problematic than the *stressed* classification suggests. This section elaborates on the government's lacklustre attitude to tackling the issue

¹²⁰ Article 51: Where any international treaty or agreement relating to international or border rivers or lakes, concluded or acceded to by the People's Republic of China, contains provisions differing from those in the laws of the People's Republic of China, the provisions of the international treaty or agreement shall prevail, except those provisions on which the People's Republic of China has declared reservations (Lehman 2012).

¹²¹ Article 52: The State Council may, in accordance with this Law, formulate rules for its implementation. The standing committees of the people's congresses of provinces, autonomous regions and municipalities directly under the Central Government may, in accordance with this Law, formulate measures for its implementation (ibid).

by building proper legislative, monitoring and implementation capabilities. The historic burden of an aged Soviet water infrastructure is exacerbated by slow policy reform, a fragmented bureaucracy a lack of investment and poor human resource capacities (Interview Russell Frost). Similarly to China, Kazakhstan's foreign policy needs to be understood with regard to this domestic context.

Manmade Water Shortages

Kazakhstan has inherited a number of manmade ecological disasters. Under Moscow's rule, it was a key testing site for radioactive and chemical weapons, as epitomised by Semipalatinsk, an area that is radioactively contaminated. Additionally, Moscow attempted to turn Kazakhstan into its food and resource 'appendage' with mega agricultural projects such as the Virgin Lands Campaign¹²², which converted 350,000 km² of steppe into farm land (Seguillon et al 2010:38). The resulting over-irrigation has left today's Kazakhstan with high saline levels in rivers and seas. Some of the better known Soviet environmental disasters abroad that Kazakhstan inherited include the Aral Sea and Lake Balkash. The Aral Sea, which straddles Kazakhstan and Uzbekistan, has shrunk by 90%. As a result of Soviet economic policies, the newly independent Kazakhstan inherited high pollution levels (OECD Report) in its ground water together with a centralised but dated irrigation system in urgent need of overhaul (Interview Russell Frost).

The state of Kazakhstan's hydrological infrastructure makes it difficult to collect reliable data on its water situation. In 2012 only 20 stations took measurements in the entire Ili-Balkhash basin, an area of about 500,000 km², and were sub-optimally distributed (TACIS, 2010). To complicate matters further, information on Kazakhstan's surface water flows collected prior to independence is stored in a centralised Soviet database, which is not digitised and hence is cumbersome to access. However, the current situation cannot be blamed on the Soviet legacy

¹²² Khrushchev's campaign to turn the steppe into farmland for large scale grain production to alleviate the food shortages in the USSR. At its peak in 1960 Kazakhstan turned 17,000 km² of steppe into farm land.

alone. Kazakhstan had an uninterrupted record of data from the Irtys River from the 1950s to 1995, when data monitoring began to deteriorate. Monitoring broken down completely in 2000, just as Xinjiang's accelerated development led to increased water abstractions along transboundary rivers. Given the fact that the lack of data comes at a high opportunity cost, it is curious that Astana has not placed more resources and emphasis on upgrading its hydrometric network. Currently, Astana cannot produce data in negotiations with Beijing that quantify China's water abstraction and cannot prove that shallower water levels are the result of Chinese intake, rather than normal cyclical variation. International experts note that the poor state of Kazakhstan's water infrastructure is the result of underinvestment and neglect by the government (Interview Tim Hannan). The government has been slow to undertake the necessary policy reforms that provide incentives for more efficient water use and to make the investments to overhaul the infrastructure and equipment that allows for adequate data monitoring. Kazhydromet operates Kazakhstan's hydrological stations and is in charge of measuring water quantities. Under its auspices, the number of working hydrological stations has dropped by more than half, from 506 in Soviet times, to 206 in 2004 (Berik Baymagambetov Kazakhstan, UNEP, 2005).¹²³ Although the situation had improved slightly by 2012, when 291 hydrological sites regularly took samples (Kazhydromet 2012), many stations still do not produce reliable data because of insufficient, dated and undependable equipment. Moreover, technical station staff often lacks the necessary training, leading to transmissions of inaccurate data and inadequate accounting of real water usage (UNESCO Course 2011). Experts suggest that it would cost KZT 200million (US \$ 1.4m) to update and rehabilitate the entire system (EU TACIS 2010). Given this sum is a miniscule fraction of Kazakhstan's GDP, the lack of action must be attributed to a lack of political will rather than of financial options (Tim Hannan). This lack of political will is a recurring theme in the

¹²³ This number was presented by Berik Baymagambetov, Kazhydromet at an international workshop in 2004. As of 2012 Kazhydromet claims on its website that there are 291 hydrological sites from which it takes samples. This could not be verified. Even if true, it indicates slow progress in repairing hydrological stations (WMO 2005).

negotiation process and undermines Kazakhstan's credibility in Chinese eyes, negatively affecting the bilateral negotiation process (Chapter 6, 7.3.4)

Dysfunctional equipment is also a key problem in the agricultural sector, where an inability to measure irrigation flows leads to waste water (TACIS 2010). In general, the country has failed to implement a cost structure on fresh water use that drives more efficient consumption, especially in the industrial sector (Russell Frost). This pervasive water mismanagement means Kazakhstan suffers from widespread water pollution, affecting both ground and surface water. In addition to inheriting pollution from Soviet times, present-day heavy mineral resource extraction, an under-regulated petro-chemical and manufacturing sector, heavy irrigation and fertilisation of agricultural land and inadequate waste water treatment facilities add to the problem. In 2005, only 60% of the country had reliable access to safe water and sanitation (UNDP Kazakhstan). Only Astana, Almaty and Atyrau have proper municipal waste water treatment facilities, whereas sewage is untreated in the rest of Kazakhstan, accounting for 70% of the population. Ironically, Kazakhstan's waste water facilities functioned significantly better during Soviet times and have only begun to deteriorate since independence (Interview Tim Hannan).

As in China, further challenges may lie ahead, with rapid demographic growth predicted to increase water demand. With a birth rate of 22.4 per 1,000 women, Kazakhstan is growing relatively fast, especially in urban areas. Moreover, 25% of Kazakhstan's GDP is directly derived from resources and is thus extremely water consumptive, further increasing demand. As a result, Kazakhstani experts and academics widely recognise that access to water constitutes a key component in the country's environmental security and to Kazakhstan's long-term socioeconomic development (Nysanbek 2005). Worries about excessive pollution are exemplified in a recent report by the Asia Pacific Water Forum (APWF), which noted that Kazakhstan is not only off-track but regressing in meeting its water-related Millennium Development Goals (MDG) and Index of Drinking Water Adequacy

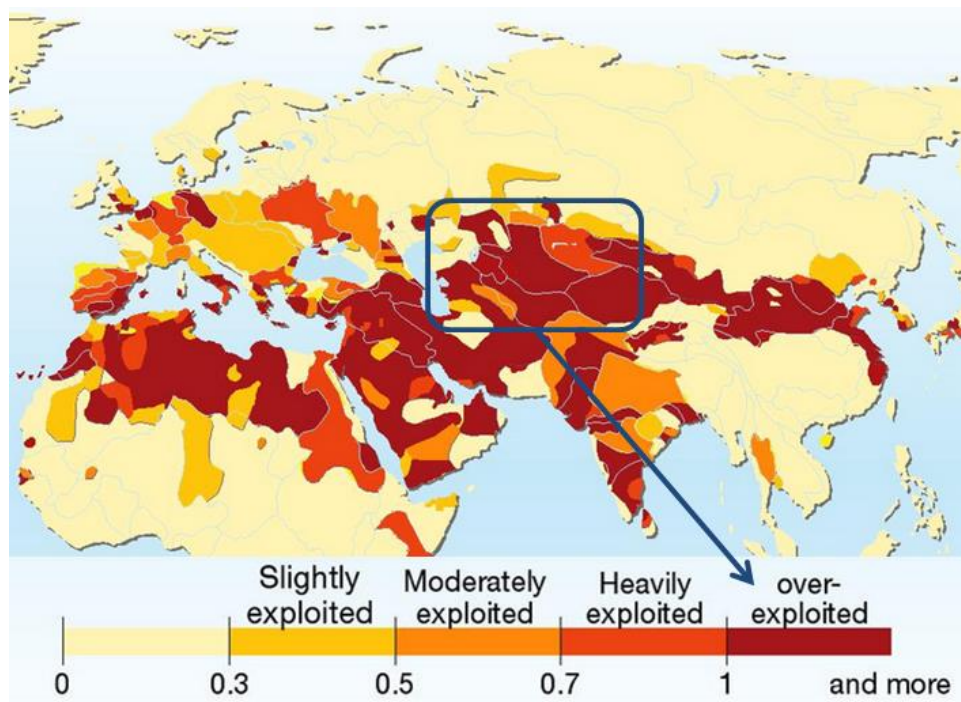
(IDWA) targets (ADB 2007). In fact, Kazakhstan was the only of 12 Asian countries off-track in all categories, which span from urban and rural water to sanitation (ADB 2007). This and other studies demonstrate the water situation is primarily caused by bad management practices which have not shown any sign of improvement. This lack of advancement is likely reflective of a lack of political will rather than a lack of economic means.

6.4.1 Water Security: Rhetoric and Domestic Regulatory Framework

While Kazakhstan's water situation is by no means secure, local politicians tend to exaggerate the situation and focus on external factors rather than internal mismanagement. On his official website, former PM Massimov claims that Kazakhstan suffers from water scarcity (Arystanov 2012). Anatoliy Ryabtsev, head of the Committee on Water Resources (CWR) at the Ministry of Agriculture (MOA) also speaks of "severe water scarcity" both in terms of drinking water and economic development. The usage of these technical terms suggests the water situation in Kazakhstan is level with that of Saudi Arabia (Ryabtsev 2011). However, in contrast to government language, IOs such as UNEP and the Stockholm International Water Institute (Granit, Jägerskog et al. 2010) do not consider Kazakhstan water scarce, although UNEP classifies Kazakhstan's overall water situation as vulnerable. The elite may be attempting to enlist domestic and international support for Kazakhstan's water cause with such dramatic rhetoric. A recent OECD report by Struan Stevenson, Member of the European Parliament (MEP), adopts the elite's official language, showing some signs of success of this strategy. This may also explain why the Kazakhstani government publishes its water numbers per m² and not per capita. As the world's ninth biggest country, this necessarily produces a more dramatic result that implies acute water shortages. In contrast, research published by UNDP calculates freshwater availability per person, producing a more realistic picture of the implications for the local population.

More recently, in 2012, Nurlan Kapparov, the Minister for Environmental Protection, told the Kazakhstani parliament that the country already faced a fresh water deficit of more than 20% (OOSKAnews 2012). Perhaps unsurprisingly, politicians have compensated for inadequate domestic practices by turning to easily accessible fresh water sources such as rivers and lakes, thus taking a distinctive short-term view of the problem. This also explains why UNEP considers Kazakhstan a country that practises excessive water use (Rekacewicz 2002) and whose water indicators show highly overexploited river basins (Rekacewicz 2002, UNEP 2008) (Figure 46). Consequently, the Kazakhstani government has shifted its focus to ensuring the unimpeded flow of fresh water along its transboundary rivers.

Figure 46 Exploitation of River Basins



Source: UNDP, Rekacewicz. Modified by author.

The Kazakhstani government has supplemented its rhetoric with new regulation, to halt the steady deterioration of water management capabilities. In 2003, Kazakhstan issued a New Water Code, which establishes qualitative and

quantitative targets and, more importantly, delineates clear administrative competencies, rights and responsibilities for water management on the national and local level. However, rather than streamlining responsibilities, the implementation of the New Water Code has, in practice, split them, leading to a slow and cumbersome implementation of water policies. Today, overall management and oversight of water resources falls within the Ministry of Agriculture (MoA). The New Water Code further partitions responsibility for regulatory policy to the Water Resource Committee (WRC) under the MoA and for monitoring to the Ministry of Environment and Protection (MinEP). The MoA is responsible, among other things, for ensuring sufficient irrigation for farming, arguably making water efficiency a conflicting priority. As the WRC reports to the MoA, the power balance clearly falls in the water-consumptive MoA's favour. Other Central Asian states, including China, have established water ministries on equal footing, so that they can hold other ministries responsible on compliance.

Besides conflicts of interests, the division of responsibilities undermines effective water management. While the WRC is in charge of the maintenance of water infrastructure and the allocation of water resources to different users, the Tax Committee within the Ministry of Finance charges fees for usage, and the MinEP oversees the quality of water discharges. Further fragmentation occurs as the MinEP itself works as a dispersed administration, with branch offices in oblasts and cities. The bureaucratic fragmentation also extends to the management of river basins, causing administrative tension, competition and turf battles (UNESCO 2011). With the help of UNDP and the WB, nine river basin levels were established in 2004 to enable their comprehensive management. In practice, the River Basin Councils (RBCs) work with varying degrees of effectiveness and interviewees assume that only one third of RBCs actually work (Interview Tim Hannan). Another factor which hampers data monitoring may be that RBCs only have advisory status, despite having the best understanding of the situation due to direct stakeholder participation and proximity to the river basin. RBCs lack an organisational structure

and operate without a secretariat. Meetings are organised by word of mouth, which is why in practice they only take place with the support of IOs (Interview Russel Frost). With little travel required, these meetings are not costly to organise. The fact that the government does not provide more support reveals a lack of political will, an issue discussed in depth in the analysis in the next chapter. Similarly, little progress has been made on the implementation of pollution targets. The majority of Kazakhstan's waste water continues to go untreated as non-compliance is possible by bribing the local officials (Tim Hannan) in charge of oversight.

6.5 The Sino-Kazakh Transboundary Water Nexus

With a dependency ratio of 50%¹²⁴ half of Kazakhstan's water supply originates outside the country, and in particular, in China. China and Kazakhstan share a water nexus of 23 cross-boundary rivers, which originate in China's *Tianshan* and *Altay Mountains*. Given Kazakhstan's disproportional reliance and overexploitation of water resources, these transboundary rivers have become extremely important, politically and socio-economically (UNEP 2008). As the red circle in Figure 42 illustrates, large parts of Eastern and Northern Kazakhstan depend on the Sino-Kazakh water nexus to meet both human and industrial demand. These areas encompass more than 25% of Kazakhstan's population, including Almaty, East Kazakhstan, Pavlodar and Astana City (see Figure 42) and more than 35% of GDP (see Figure 47).

¹²⁴Kazakhstan has a total of 100.5 km³/year of freshwater at its disposal, of which only slightly more than half (56.5km/year) are derived from Kazakhstani territory.

Figure 47 Regional GDP 2011



2011	Population	% Total	GDP	% Total
Pavlodar	747,055	4%	1,527,256	6%
East Kazakhstan	1,395,059	8%	1,553,741	6%
Almaty	3,359,689	20%	6,151,809	23%

* Source: National Bank of Kazakhstan

In view of Kazakhstan’s susceptible position, it is unsurprising that water policy is reflected in Astana’s objectives. While the New Water Code of 2003 and the Law on Environmental Protection focuses on domestic water management, Kazakhstan’s foreign policy approach towards water management are better laid out in the ‘Development Strategy 2030’ and the ‘Kazakhstan 2050’ strategy (Nazarbayev 2012) as well as the ‘National Plan for Integrated Water Resource Management and Water Efficiency 2009/2015’, which turns water availability and joint management of transboundary rivers into long-term government priorities (Massimov 2009). In 1999, the government amended its 30-year action plan to include “the attainment of acceptable agreements on transboundary watercourses” as a national security priority until 2002. In March 2012, in his first meeting of the year with his Security Council President, Nazarbayev placed water security at the top of the agenda (tengrinews 2012b). In his address to parliament in the same month, Nazarbayev identified water security, especially water allocation of transboundary rivers with China and Russia as a burning issue for Kazakhstan because of “a fearful deficit of

drinking water” (OOSKAnews 2012). According to the Kazakhstani Ministry of Foreign Affairs (MFA), the management of the transboundary water issue with China is an explicit foreign policy priority because of the implications it has for Kazakhstan’s economic and environmental security (MFA 2012a, MFA 2012b). The Kazakhstani military also recognises that the distribution of transboundary water will increase the potential for conflict in the future (McDermott 2011).

The perceived and actual water scarcity in both China and Kazakhstan feeds a mutually competitive approach to maximise access to transboundary water resources (Mirumachi 2007:14,(Mirumachi and Allan 2007). This is a zero-sum competition, with Beijing determined to maximise control and use of all water sources that originate on its territory, whilst Kazakhstan aims to restrict China’s water usage to maximise its own access. In other words, every cubic meter gained by China is a cubic meter lost by Kazakhstan. For Kazakhstani foreign policy makers, this puts a water-sharing agreement with China at the forefront of their foreign policy objectives. China’s rapidly increasing freshwater needs, on the other hand, lead to bigger water abstractions from its transboundary rivers, leading to a net loss of water for Kazakhstan. This has set the stage for a dispute between both countries over finding an agreement to set limits on China’s water diversion. The dispute has been underway for nearly 20 years and centres, among others, around a considerable irrigation project in Xinjiang, called Project 635.

6.6 China's Water Diversion

Figure 48 Project 635 in Xinjiang



Project 635 and China's Go West Strategy

The transboundary water dispute between China and Kazakhstan dates to the 1970s, when Kazakhstan, then still part of the Soviet Union, complained about China's increased water intake along the Ili (伊犁河) and Irtysh (额尔齐斯河). However, the issue never received priority under the Soviet leadership in Moscow, most likely because the Kazakh Soviet Republic did not feature high on the agenda. Today, a large-scale Chinese canal network project, known as Project 635, lies at the heart of the Sino-Kazakhstani water dispute. Project 635, technically also known as the Long Distance Inter-Basin Transfer Project, begins in the Altay region 56km east of Fuhai County, at the Irtysh's mid-stream. It then crosses through the Mongolian Autonomous County all the way to Karamay City to provide drinking water and irrigation to support agriculture and industrialisation, especially Karamay's oil and gas fields (Baidu 2012, Wen 2012). The decision to build this canal is an integral component of Beijing's Go West strategy, aimed at boosting the economic development of its western provinces. Although the strategy was firmly incorporated in China's Tenth Five Year Plan (2001-2005), the government had already begun to discuss initiatives to develop its western provinces in the early

1990 (CDG 2010)¹²⁵. Against this backdrop, the project was proposed to the State Development Planning Commission in September 1996 and then quickly approved by MWR in October 1996.

The Kazakhstani government has been accused of moving into action too slowly, but the exact point at which policy makers became aware of Chinese plans to build a canal is unclear. Some analysts, including Kazakhstan's first Ambassador to China, Murat Auezov¹²⁶, claim that the government had knowledge of construction plans already in the early 1990s, during the planning phase of the project. Others claim that Astana only knew of the plans in 1998 (Sievers 2002: 2), when Beijing began with the actual construction. Given that Kazakhstan submitted a draft agreement to Beijing in 1992, it is likely that Kazakhstan had early knowledge of the project already. In China, references to the project can be found as early as 1992, in an article that analyses the tendering process of the project¹²⁷. However, Beijing formally notified Kazakhstan of its plans for the Xinjiang diversion project only in 1998, two years after the MWR approved the project. The original 1996 plan foresaw a total length of the main canal of 324km at a width of 22m, with a power generation capacity of 32,000 kilowatts. However, more recent reports suggest the canal will span a network of 890km, including five reservoirs and three power plants, with China maintaining flexibility to expand the canal network according to need (Liu 2007). Once in use, the canal will divert at least 840 million m³ to transform 70,000-140,000 hectares (700-1,400km²) of desert into arable land, primarily for cotton production and the development of oil fields. The plan also

¹²⁵ The CCP already recognised the development needs of China's western provinces in the late 1990s, when Jiang Zemin toured the western regions. The notion to develop China's west appeared in the Chinese media around 1999 (Onishi 2001).

¹²⁶ Murat Auezov was Kazakhstan's first Ambassador to China between 1992 and 1995. After his return to Kazakhstan he co-organised an opposition movement called 'Azamat' in response to the 1995 new constitution and the suspension of parliament. All cofounders were dismissed and Auezov had not been offered another diplomatic post (Cummings 2005). Auezov went on to head the George Soros Institute in Kazakhstan before setting up the Mukhtar Auezov Foundation to commemorate his fathers, who used to be a famous Kazakhstani writer.

¹²⁷ References to the project can be found in academic publications as early as 1992 (Zhen 1992).

foresees a 5-10% diversion of the Irtysh River into Lake Ulungur. Lake Ulungur itself exemplifies the pressures exerted by Xinjiang's development on the fresh water supply. Over the last three decades, Lake Ulungur shrunk by nearly 60 km² (World Lakes, 2012). Concurrently, a second project is under construction, linking the Irtysh with Urumqi to provide more water for the Tarim Basin. The Ili River has also seen increased construction of reservoirs and hydropower stations in the last years to win more arable land in Xinjiang. There are as many as thirteen reservoirs and more than 30 hydro-power stations under construction along the Ili. These developments have triggered ever greater water run-offs also along transboundary rivers, which the net water loss felt in Kazakhstan.

Implications for Kazakhstan

The Irtysh and Ili are by far the two biggest rivers and as such any changes along these rivers have a great impact on Kazakhstan's water supply and ecology. The Irtysh originates in the Altay Mountains in Xinjiang's north east, where it is known as the Black-Irtysh. From there, it feeds Lake Zaysan, one of Kazakhstan's biggest lakes, and crosses through Kazakhstan's Eastern Province and Pavlodar before it merges with the river Ob, whose main tributary is in Russian Siberia. This makes Russia the second downstream co-riparian and hence a potential stakeholder in any pollution or water diversion of its upstream riparian. The Ili originates in the Tianshan mountains further west, where it is formed by the tributaries Tekes and Kunges. In Kazakhstan, the Ili constitutes the main tributary of Lake Balkhash, where the river creates a huge, fertile Delta also known as the 'Seven Rivers' (Figure 49).

Figure 49 Irtys and Ili



Canal projects and generally greater water intakes from the Ili lead to a net loss of water for Kazakhstan, exacerbating the already vulnerable situation for the 7.4m Kazakhstani, or 43% of population, who rely on these rivers and lakes as a key source of fresh water and who generate >40% GDP. Precise numbers on Chinese water abstraction are impossible to ascertain because of Kazakhstan's weak institutional capabilities (see Data Exchange). As a result, this segment must rely on expert estimates. The Ili is the main tributary to Lake Balkhash, which, with a size of 16,000 km² and a volume of 106 km³, is one of the biggest lakes in the world and the key source of fresh water for the 3.4 million people of Almaty Province. The lake has already come under stress with the Soviet construction of the 140km long Kapchagay Reservoir in the 1970s (Lakenet). After independence, Kazakhstan continued to fill the Reservoir, further adding stress to Lake Balkhash. As of now, the reservoir is half full (15km³) and, once reaching full capacity, will reach a total volume of around 30 km³. Recent and greater Chinese extractions along the Ili have put Lake Balkhash's water levels under further strain. Analysts estimate that Xinjiang's annual water abstraction from the Ili has reached between 3.5 km³-5 km³ in 2009 and 2010 (EuropeanDialogueXXI 2011) and expect this to increase to 7km³ in the next few years, which translates into an increase of between 43% and 100%

(Malkovsky¹²⁸ quoted in Carino 2008). In June 2012, officials in Kazakhstan noticed an increase in Chinese construction activity with an estimated 13 new reservoirs and up to 39 hydropower stations under construction along the Ili and its tributaries (Wang 2012). While the hydropower stations will only affect the timing of water flows, the reservoirs will lead to a net loss of water. Conversely, the shallower waters have also significantly increased the Lake's overall salinity, because the concentration of pollutants is increasing. China itself also contributes to these pollution levels by feeding untreated waste water into the river at levels which appear to be beyond China's control. In view of these developments, Kazakhstani experts and the media have sounded alarm bells. At the end of 2010, Kuanysh Isbekov, Director of the Committee of Fisheries and Research at the Ministry of Agriculture, warned that China's water intake along the Ili will see Lake Balkhash follow the same fate as the Aral Lake and disappear in the future (Sorokoumova 2010), a comparison that resurfaces regularly in Kazakhstan.¹²⁹ The shallower waters have also significantly increased the lake's overall salinity (ILEC 2012) as the concentration of pollutants increases. China itself contributes to these pollution levels by feeding untreated waste water into the river at levels which appear to be beyond China's control, due to the institutional weaknesses discussed above.¹³⁰ The Irtysh feeds into Lake Zayasan, which is East Kazakhstan's biggest fresh water lake with a surface area of 2,000 km².¹³¹ From there, the river flows through the provinces of Eastern Kazakhstan and Pavlodar before it crosses into Russia (see Figure 42) (Chinamap 2012). The Irtysh provides fresh water for four of Kazakhstan's biggest cities including Astana, Karaganda, Semipalatinsk and Pavlodar, where approximately 4m Kazakhstanis depend on the river for fresh water (Weinthal 2006).

¹²⁸ Head of Kazakhstan's Institute of Geography.

¹²⁹ The same dynamics that led to the demise of the Aral Sea are at work at Lake Balkhash: large hydropower projects disrupt the regular water flow, excessive diversion takes place to irrigate agricultural land, whose pesticides and fertilizers get then re-inserted into an ever smaller water volume, leading to rapidly increasing pollution levels and salinity.

¹³⁰ Although this was in 2007 it is questionable whether Beijing has managed to bring the pollution levels under control by now because of the institutional weaknesses of SEPA (Milas 2007).

¹³¹ The lake is over 100km long and 20-40 km wide

Kazakhstan's inadequate monitoring capabilities make it difficult to quantify precisely the declining water run-off associated with the canal network (see data discussion, below) but current estimates range from 20% to 40% (Weinthal 2006). The latter number was provided by Zhou Xiaopei, the former Chinese Ambassador to Kazakhstan, who probably intended to reassure that China would not divert the entire river. However, the number instead caused outrage in the media and panic among environmentalists and is still frequently quoted today. Others estimate that Chinese abstractions will reduce the overall water resources in the Irtys Basin by 8 km³ in 2030 and by 11.4km³ in 2050, far exceeding declines that experts consider dangerous. Moreover, navigation in parts to the Irtys will become difficult or impossible (Mamyrayymov 2012). Experts note that even a 5-10% decrease in water levels, as communicated initially by Beijing, will render some hydropower projects along the Kazakhstani part of the river infeasible (Sievers 2002:3) while severely decreasing the output of the remaining ones (Mamyrayymov 2012). The Russian agency for water resources estimates that Kazakhstan currently takes 3.8 km³ annually from the river. By comparison, the Chinese intake has nearly tripled from 1.5 km³ to 5 km³ annually since Project 635 entered into use.¹³² Net water losses for Kazakhstan along both the Ili and the Irtys are likely to significantly worsen in the future. Researchers at the Xinjiang Academy of Environmental Sciences (XAESb), which conducts all EIA assessments in Xinjiang and has been investigating both rivers closely since 2011, point out that the region's 'leapfrog' economic and social development will put further strains on the Ili (XAES 2011b). With Project 635 coming fully on-stream in the next couple of years, increasing net water losses are expected to exacerbate Kazakhstan's water supply shortages and ecological problems (5izixun.com 2011).

Besides the obvious socio-economic implications, China's increased water intake also affects Kazakhstan's electricity generation capacity. The country already suffers

¹³² These are estimates made by the Federal Agency for Water Resources of the Russian Federation and the precise number is generally unknown (FWRA).

from power shortages because of an aged Soviet electricity grid (Peyrouse 2007). This grid is split into incompatible northern and southern parts that cannot transfer power between each other. As a result, the northern grid exports electricity to Russia while the southern grid, which is prone to particularly severe shortfalls, imports electricity from Kyrgyzstan (Peyrouse 2007). Overall, the electricity infrastructure has not kept pace with growing demand, leading to a demand and supply gap of 200MW in 2009 (2013). Decreasing surface water flows of the Ili and Irtysh affect the power output of hydropower stations and exacerbate Kazakhstan's existing electricity problem. For example, the AES Ust-Kamenogorskaya GES LLP and the Kapchagaiskaya GES Balkhash hydropower stations along the Irtysh and Ili, provide 5% of Kazakhstan's overall energy supply and are vulnerable to water abstractions. Experts predict that China's water diversion will lead to an incremental 25% reduction of hydropower generation along the Irtysh by 2030 and a 40% reduction by 2050 (Mamyrayymov 2012). In summary, it can be concluded that despite the lack of quantitative measurement data, greater water demand and extraction in Xinjiang leads to a net loss of water in Kazakhstan. This magnifies Kazakhstan's already significant environmental problems, from fisheries and power generation to water quality and agricultural irrigation.

6.7 The Dispute Dynamics

The next segment provides an overview of the dispute and the bilateral negotiations. Both China and Kazakhstan pursue a resource-maximising strategy. While China attempts to retain unfettered control and access to its transboundary rivers, Kazakhstan attempts to maximise the water flow in order to retain access to fresh water. The next section provides a chronological summary of the Sino-Kazakh negotiations and shows in the subsequent analysis that China thwarts any attempts of Kazakhstani policy makers to flatten the asymmetry in their bargaining power. The analysis draws parallels with China's water conflicts with its other neighbours,

so as to identify indicators of a systematic Chinese strategy towards transboundary water conflicts.

6.7.1 A Chronology of Negotiations

First Decade: 1992-2001

Kazakhstan and China establish formal negotiations over the transboundary rivers. Figure 50 illustrates the negotiation timeline. Beijing appears as an active negotiation partner who willingly extends cooperation on a wide range of water-related issues. However, it employs long delays to prioritise economic issues over environmental ones and avoids the definite resolution that Kazakhstan seeks, an agreement that limits China's water intake.

Kazakhstan establishes diplomatic relations with China on 3 January **1992**, only several weeks after declaring independence. The Kazakh government soon notices suspicious activity across the border in Xinjiang, indicating the planning stages of what would turn out to be the Project 635 canal. Already in February **1992**, President Nazarbayev instructs Murat Auezov, Kazakhstan's first Ambassador to China (1992-1995), to submit a draft agreement to Beijing on the mutual use of transboundary rivers along with a request to discuss the matter. Common diplomatic etiquette stipulates a written response within two months, but Beijing delayed a response until after 1995, when it 'verbally' assured Kazakhstan it was studying the issue¹³³. The 1992 draft agreement was signed nine years later, in 2001, as the Agreement on Cooperation in the Use and Protection of Transboundary rivers (Mamyrayymov, 2012). However, the Xinjiang Ministry for Water Resources had approved Project 635 years before, in October 1996.

¹³³ This is based on Murat Auezov's account. Auezov returned to Kazakhshtan in 1995 when a response of Beijing was still outstanding.

In **1997**, CNPC acquires large stakes in AMG and the Uzen oil field and pledges to build an oil pipeline, a crucial step for Kazakhstan in breaking Russia's export monopoly on oil. The deal is hailed the 'contract of the century' with an estimated value of US\$9.5bn (Bluth 1998). In what is unlikely to be a coincidence, a year later, in **April 1998**, both sides sign a border demarcation agreement, where Kazakhstan concedes approximately 100-200 km² of land (Interview Local Expert) to China along the Black Irtysh. Later that year, Beijing commences with the construction of the 300km Irtysh Karamay Canal.

In **March 1999**, President *Jiang Zemin* receives a private letter from President Nazarbayev, asking China to take urgent measures to resolve the question of joint water usage. Jiang invites a Kazakhstani expert group to Beijing for the first round of official consultations, which take place in **May 1999**¹³⁴. Kazakhstani officials present a pre-drafted agreement on the use and conservation of transboundary rivers, which Beijing rejects. Instead, China emphasises that it is committed to a fair and reasonable use of transboundary rivers, drawing on international legal language also anchored in the 1997 Convention and thus implying that Beijing is aware of changes in international environmental law. Beijing assures Kazakhstan that it will take its interests into full consideration when planning and executing projects along the Irtysh-Karamay Canal. China informs Kazakhstan for the first time about its construction plans and quantifies its intention to divert 450 meters³ through the canal in 2000 and 1 km³ by 2020. At the second meeting in Almaty in **October**, both sides agree to regularly exchange information about the Ili and Irtysh. The verbal agreement does not specify what data should be exchanged and is not formalised and signed until 2006. Several more years pass, until in 2011, early signs emerge that China is conducting the research necessary to comply with the agreement.

¹³⁴ Eric Sievers account is the most authoritative source on these negotiations (Sievers 2002). The following discussion closely follows his narrative until 2001. This author expands the narrative through supplementary sources where indicated.

In **June 2000**, at the third round of meetings in Beijing, China and Kazakhstan agree to establish a joint expert group to explore and exchange data on transboundary pollution. Facing increased criticism from the media, NGOs and opposition at home, the Kazakhstani government claims to have scored significant concessions from China upon its return home. These concessions include a binding agreement that caps China's water diversion from the Irtysh at 1 km³ of water, prohibits Chinese diversions from the Ili and pledges to include Russia in future negotiations.

In **2001**, China completes the first part of the Irtysh canal. Before commencing the fourth round of negotiations, Astana retracts all of the alleged "concessions" from previous meetings, probably in recognition that this was necessary step if it wanted to host Beijing in Astana in **March**. The government concedes that no agreement had been reached on Russia's participation as a negotiating partner and that no guarantees on water diversions from the Ili River had been given. In fact, from now on, Kazakhstan refers to the meetings as 'consultations' rather than 'negotiations' (Sievers 2002:6), underlining its powerless position. At this stage, the dispute becomes highly politicised, with Murat Auezov publicly accusing the Kazakhstani government of incompetence and collaboration with China and alleging outright disregard of national interests (Borisov 1999). Arguably to save face, the Kazakhstani government now changes its **strategy** by drastically downplaying the seriousness of the problem. The government now claims that the canal does not constitute a threat to its water supply and ecology, directly contradicting its previous claims that water diversion of as little as 6% would have disastrous effects on Kazakhstan's water supply, hydropower projects and ecology. Instead, it now blames NGOs and the media for wildly exaggerating the situation. Furthermore Astana turns the status-quo into a major foreign policy achievement: In **June**, Amanbek Ramazanov, the chair of the CWR, visits Beijing and claims that China agreed to significantly decrease water diversions from the Irtysh from 3-5 km³ to 1 km³. However, China had indicated the 1 km³ cap all along. In any case, as observers noted, 1 km³ corresponds to 10% of the flow from China and exceeds the 6% mark

previously identified as disastrous by the Kazakh government (Sievers 2002:6). Ramanzanov continued to downplay China's activities (Pilip'juk 2002). Ramanzanov's claims are based on documents the Chinese government presented to him in Beijing as during this period, Beijing denied Kazakhstani officials access to the canal (Pilip'juk 2002). In **September**, Zhu Rongji and Nazarbayev sign the 'Agreement on Cooperation in the Use and Protection of Transboundary rivers' in Astana and set up a Joint Commission for the Use and Protection of Transboundary rivers (Russian.China.Org.Cn 2010), alongside the expert group in charge of the implementation of the agreement (Article 8) (KazakhstaniGovernment 2001). The Joint Commission is only staffed with one representative and two deputies from each side (Article 8). In the agreement, China makes no commitment to limit its water intake and, crucially, the agreement stipulates that Kazakhstan cannot veto any Chinese construction plans (Article 4) (Carino 2008). Again, it takes two years for the first meeting of the Joint Commission to occur. Cooperation efforts continue to focus on water management and pollution, rather than the more important issue of extraction. The lack of progress leads international observer Stuart Horsman to conclude that

it is evident that China is unwilling to engage in meaningful cooperation or compromise [in] the pursuit of its water demands (Horsman 2001:76).

By the end of 2001, responsibility for the WRC is moved out of the MFA and into the Ministry of Agriculture, reducing the Committee's political power. Eric Sievers argues that the Committee was moved to help the MFA to save face in the absence of progress (Sievers 2002).

Second Decade: 2002-2012

The dominant themes of the first decade continue into the second. China and Kazakhstan further institutionalise the dispute but Beijing successfully sidesteps any water allocation agreement. Cooperation between both countries expands greatly,

culminating with the construction of a joint hydropower station in *Khorgos* and technical exchanges on pollution, as well as emergency response and warning systems. Yet China maintains control of the negotiation process and continues to stall progress on water allocation agreements.

In **2002**, China and Kazakhstan sign a friendship and cooperation agreement, which includes a mutual commitment to take practical measures to prevent environmental pollution and use of natural resources, in line with international treaties. Ten years into the negotiation process, this marks the first explicit reference to international treaties.

The signing of the Five-Year Sino-Kazakh Cooperation Programme (2003-2008) follows in **2003**. The agreement includes a provision to conduct friendly consultations on the protection of transboundary rivers. During 2003, the first meeting of the '*China-Kazakhstan Joint Commission on the Use and Protection of Transboundary Rivers*' (Joint Commission) takes place, as stipulated in Article 4 of the joint agreement (see 2001).

In **May 2004**, both sides establish the **China Kazakhstan-Cooperation Committee** (CKCC), which coordinates all bilateral activities underneath one umbrella, with the respective deputy heads of government serving as chairs (Russian.China.Org.Cn 2010). Also the Committee on Transboundary Water Management (CTWM) falls under the remit of the CKCC, however, it would take until 2008 before the first CTWM meeting took place under the CKCC umbrella. In **July 2004**, the first CKCC meeting takes place in Beijing, under the auspices of Vice Premier *Wu Yi* and Kazakhstani Deputy Prime Minister *Akhmetzhan Yesimov*. In **October**, the second meeting of the *Joint Commission on the Use and Protection of Transboundary rivers* takes place in Almaty. The meeting sees the signing of a memorandum on natural disasters, which subsequently leads to an agreement to immediately notify each other in case of a natural disaster or emergency along the river (UNECE, 2010).

In **July 2005**, Beijing upgrades its relationship with Kazakhstan to a “Strategic Partnership”(FMPRC 2005). The second meeting of the CKCC takes place in Astana, again co-chaired by *Wu Yi* and *Akhmetzhan Yesimov*. Among the sub-committees mentioned in the Chinese press release, transboundary water is not listed, indicating China’s lack of prioritisation of the issue.

In **October 2006**, the fourth meeting of the *Kazakhstan-China Joint Commission on the Use and Protection of Transboundary rivers* takes place in Almaty (gazeta.kz 2006). In **November**, the third CKCC meeting takes place in Beijing, co-chaired by Vice Premier *Wu Yi* and Deputy Prime Minister *Karim Massimov*. In Wu’s view, the CKCC has “actively pushed for mutually beneficial cooperation in all areas and [...] made positive contributions to the development of bilateral ties” (Xinhua). At the same time Kazakhstan pledges continued support China’s security strategy in the region to combat the ‘three evils’. The joint Wu and *Massimov* summary of the CKCC activities omits transboundary rivers.¹³⁵ During *Nazarbayev*’s **December** visit to Beijing both sides sign ‘*The strategy for cooperation in the 21st century and the development of economic cooperation*’ (Kazakhstani Embassy 2007). A Chinese press statement lists the sub-committee’s meetings but no mention of the *Joint Commission* is made. In **December**, Kazakhstan and China sign an agreement to conduct scientific research, which is hailed as a breakthrough by the Kazakhstani government (Kazakhstani Embassy in Beijing). The Chinese Ministry of Water Resources agrees with the Kazakhstani Ministry of Environment to exchange hydrological data on major transboundary rivers, and also signs an agreement with the Kazakhstani Ministry of Agriculture on the development of research cooperation on transboundary rivers (Kenshimov 2010). The US embassy dedicates an entire cable to the meeting, noting that *Nazarbayev* again returned home without any progress toward a water allocation agreement with China. It further

¹³⁵ Wu and Massimov summarised the CKCC achievements in the following fields: economy, trade, transportation, ports, science, technology, finance, energy, mineral resources, humanities, security and railway(English.Xinhuanet.com 2010).

quotes Nazarbayev, referring to his failure to make any progress at the meeting: “we cannot say that Kazakhstani-Chinese cooperation is developing in a completely positive way” (Milas 2006a). During this time, the increased water outtake of the Ili River becomes noticeable in Kazakhstan’s Lake Balkhash.

The following March (**2007**) Astana hosts a meeting with Chinese and Kyrgyz officials to discuss a framework for Integrated Water Resource Management (IWRM) along the Ili. In a sign of weakness, Kazakhstan tries to buy off China and offers China subsidised food deliveries for ten years in exchange for a binding commitment to let the Ili flow unimpeded into Lake Balkhash. By demanding to let the river flow uninhibited, Astana pursues a strategy of absolute river integrity (Wolf, 2007). China rejects the offer and talks break down (Milas 2007a). In the first half of 2007, the Kazakhstani government becomes aware of a new Chinese project along the Ili River and increases the number of water facilities along the transboundary rivers (ibid). *Anatoliy Ryabtsev*, Chairman of the Committee for Water Resources, claims that Beijing admitted that its industrial growth surpasses “its ability to prevent the Ili’s pollution” (Milas 2007a). Later that year, in **August** Hu Jintao visits Kazakhstan with *Wu Yi*, where he meets Nazarbayev and Karim Massimov. In the joint communiqué from the meeting, Hu lauds the progress in bilateral relations in the areas of trade, transport, security, humanities and energy resources, and identifies priority areas for future cooperation, including the expansion of mutually beneficial collaboration in trade, the economy, infrastructure and energy, followed by the deepening of security ties and closer cooperation with international organisations. Again, transboundary rivers are not mentioned (FMPRC 2007a). In **November**, the fourth meeting of the CKCC takes place in Astana and is again co-chaired by Wu Yi and Kazakhstan’s First Vice Prime Minister, Umirzak Shukeyev, who would later become the head of Samruk-Kazyna (Samruk-Kazyna 2012). By the end of 2007, there is still no evidence that China and Kazakhstan exchanged water data, as already agreed in 2001.

In **August 2008**, Hu Jintao meets Nazarbayev on the side-lines of the Olympic Games in Beijing. Hu agrees to incorporate the Joint Water Committee (JWC) into the CKCC mechanism and to study the technical requirements for a water-allocation agreement. Nazarbayev considered this a turning point (Russian.News.Cn 2010), as it marks the first detailed discussion on water quality, pollution prevention and water allocation (Gazeta.kz 2008). However, although the JWC falls within the responsibilities of higher policy levels at the CKCC, the deputy heads of government do not attend water resource meetings in person. Several weeks later in **October**, PM Massimov invites Wen Jiabao to Astana. Wen and Nazarbayev issue a joint communiqué from the SCO meeting in Astana, identifying three priority areas for bilateral cooperation: energy, non-resource areas and trade. Furthermore, in reference to the Global Financial Crisis, Beijing assures Kazakhstan close financial cooperation (Article 11).¹³⁶ Despite the supposed progress, water is not mentioned in the communiqué and the year concludes without a meeting of the CKCC.

In **March 2009**, the Kazakhstani financial police, the *Economic Crimes and Anti-Corruption Agency*, targets the WRC and MinEP with corruption charges. Anatoliy Ryabtsev¹³⁷, then Deputy Chairman of the Water Resource Committee and *Nurlan Iskakov*, Minister for Environmental Protection, are dismissed along with two deputies (Asanow 2009). Simultaneously, the financial crisis unfolds, with two of Kazakhstan's biggest lenders, BTA Bank and Alliance, defaulting in **April**. On **16 April**, during a visit to Beijing, Nazarbayev receives a US\$10bn credit line to prop up Kazakhstan's financial system (see China as Kazakhstan's Creditor). Both sides sign a *Sino-Kazakh Joint Communiqué*, reiterating basic principles of trade and energy cooperation (FMPRC 2009). Astana-Finance defaults in May, followed by Temir Bank in October. In **December**, the sixth meeting of the JWC finally takes place as part of the fifth meeting of the CKCC. During this set of meetings, the Kazakhstan Institute

¹³⁶Both sides agreed that during the subdued economic situation it is important to continue the close financial cooperation between the two countries, to strengthen control in the financial sector, to share experiences and information exchange to improve the joint opposition to financial risks (FMPRC 2008b).

¹³⁷Ryabtsev pleaded guilty.

for Strategic Studies (KISS) hosts a roundtable with the Chinese Academy of Social Sciences (CASS), which focuses on economic cooperation. KISS presents its concerns on transboundary rivers to CASS, which rebuffs them, instead reiterating that bilateral negotiations have yielded significant progress already (KISI 2009).

Hu visits Astana in **June 2010**, where he and Nazarbayev praise the achievements made since the establishment of the JWC. The two leaders highlight the spirit of the “win-win negotiations”. In **November**, the eighth meeting of the JWC takes place in Karaganda, Kazakhstan (MWR 2010). Negotiations focus on further necessary technical work before talks about water sharing can commence (Mashin 2010). Both sides agree on the joint construction of the Dostyk hydropower station at Khorgos.

In **February 2011**, China and Kazakhstan issue a joint communiqué, in which transboundary water issues feature as number 13 and 14 out of 18 topics. Highlighting the low priority of the issue for Beijing, China’s congratulatory note on Kazakhstan’s success in the Asian Winter Games appears on the agenda beforehand, as item 12. In the same year, Kazakhstan and China sign the ‘Agreement on the Protection of Water Quality of Transboundary Rivers’, but again, this agreement fails to address the crucial issue of water allocation (Gazeta.kz 2011). The JWC expresses its intention to promote the ‘Plan for the Technical Implementation of Water Allocation of the Sino-Kazakhstani Transboundary Rivers’ (Gazeta.kz 2011). Anarbek Oman, Chairman of the Kazakh CWR within the MoA, claims that a water allocation agreement will be signed before the end of 2014¹³⁸. Both sides reiterate their appreciation for the work of the JWC and their *intention* to promote the implementation of the Dostyk Hydropower Project. Construction

¹³⁸ There is no indication that this might actually happen. Research has not been able to get a version of the agreement or any kind of insights into the substance of the agreement. Moreover during the meeting both sides praised the achievements of the joint Commission the use and protection of transboundary rivers which had been established as far back as in 2001. Again any documentation with details on these achievements, is not available in the public domain. Beijing, however mentioned that it was willing to consider the technical conditions for negotiations on water allocation.

commences shortly thereafter, in **April 2011**. During this time, the promised research activity into transboundary rivers finally commences. The Yili Department of Environmental Protection in Xinjiang commissions XAES to conduct an impact assessment of local river basins, including the Ili and Irtysh, with the goal of improving the monitoring of water quality and building an emergency response system (XAES 2011a, XAES 2011b). In **June 2011**, on the side-lines of the SCO meeting in Astana, Hu and Nazarbayev sign a 'comprehensive strategic partnership, an upgrade from the previous 'strategic partnership'.

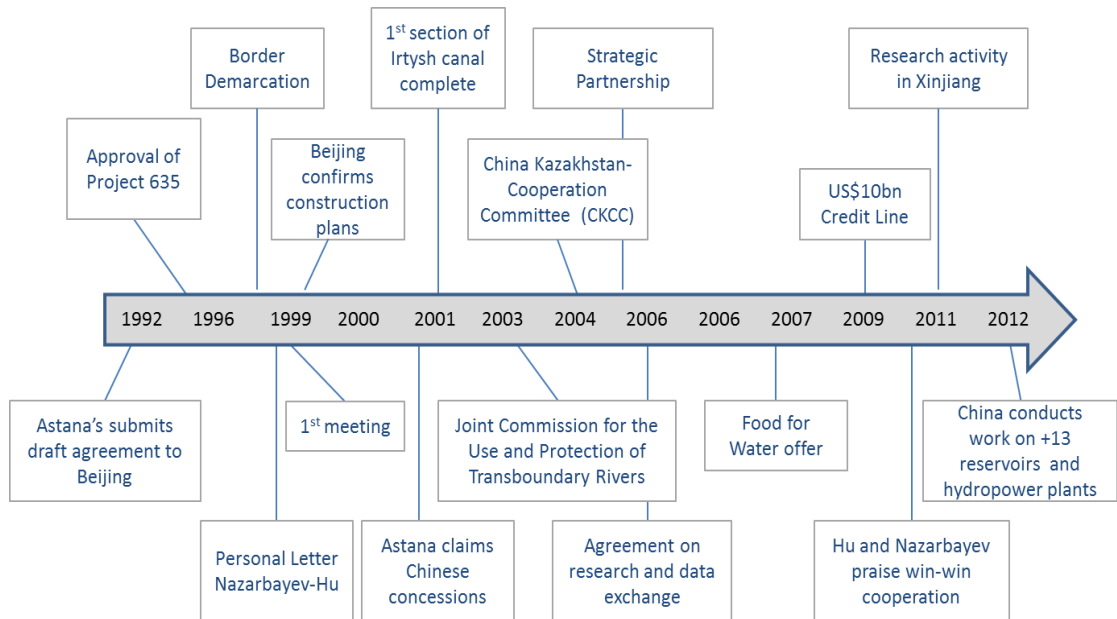
By mid-**2012**, Talgat Mamyrayymov, Vice President at Kazakhstan's Centre for Humanities and Political Science and other Kazakhstani scientists claim that China has started work on thirteen additional reservoirs and hydropower plants along the Ili River (Mamyrayymov 2012). In July **2012**, the JWC meets in Beijing alongside the CKCC to discuss the technical work required for water allocation and to exchange views on flood prevention. The meeting renews irritation in Kazakhstan about China's allocation proposals: Beijing initially proposed to base the split of water volumes on the population of each country. Given the vastly different population sizes of the two countries, this split implies a 98.7% allocation to China. A proposal based on the populations of Xinjiang (20m inhabitants) and the Kazakhstanis living along these rivers (6m)¹³⁹ would have been more legitimate.

Beijing did change its allocation approach slightly in 2012, now insisting on a division based on each country's current water demand. This strategy of 'who will consume more, gets more' is beneficial to China, which, after years of stalling, has in the meantime brought numerous canals and reservoirs online. Further increases in demand are predicted, since the central government is committed to boosting economic and social development in Xinjiang. Other Chinese negotiation techniques include counting the Ishim and Tobol tributaries, which originate in the north of Kazakhstan, and joining the Irtysh in Siberia before flowing into the Ob.

¹³⁹ Including Astana City

Unsurprisingly, this negotiation approach led to frustration on the Kazakhstani side, which argued that rights to **historic** water use should be upheld, given that Kazakhstani water demand has remained relatively stable over the years. In particular, Islam Abishev, chairman of the CWR, aired his displeasure at China’s maximisation of its self-interest in the media (KazTag 2012).

Figure 50 Dispute Timeline



6.8 Celebrated Negotiation Outcomes

Judging by the number of meetings, China and Kazakhstan are engaged in an active negotiation dialogue on the rights to their transboundary rivers. However, the length and progress of this dialogue is symptomatic of China’s reluctance to compromise its sovereignty. A string of technical studies were commissioned to buy time for China to continue its building activity. The bilateral nature of the negotiations is also noteworthy. As discussed in the introduction to this chapter, water cooperation is home to some of the most developed international institutions. Furthermore, Russia is a co-riparian to the Irtysch and Ili and thus, is equally affected by China’s diversions. Despite these setbacks, however, both sides

have found several negotiation outcomes to celebrate and have frequently congratulated each other on supposed progress, such as the 2010 praise for the 'win-win' negotiations. Kazakhstani policy makers often highlight the institutionalisation of the conflict and the exchange of data as significant accomplishments. However, after nearly two decades of consultations, no progress has been made towards finding a binding agreement on water allocation. Instead, Beijing has proceeded with its resource capture strategy, unilaterally changing the distribution of water in its favour (Zeitoun and Warner 2006): 444) through increased water abstraction, on the back of numerous canal and hydropower projects. China's success has come directly at the expense of Kazakhstan's national interests. In a sign that Beijing recognises that Astana's bargaining power is greater than that actually employed, Chinese academics have hailed Beijing's ability to contain the dispute and prevent it from spilling over to other interest areas (Wang and Hu 2011).

One area frequently hailed as a major achievement is the agreement to swap data. Initial talks on information and data exchanged began in October 1999, but were only definitively specified in 2006. Only in 2011 did tentative signs of research activity begin to appear in Xinjiang, where XAES had been authorised by the local government to research the province's transboundary rivers. The long delays for the acclaimed progress is merely a public relations vehicle to justify decades of talks by at best, inflating small successes or at worst, inventing them. Experts claim that institutional weaknesses, especially in Kazakhstan (see *China and Kazakhstan*, above) cast doubt on the effectiveness of these data exchanges (Interview Russell Frost). Moreover, data exchanges have been limited to pollution data rather than quantitative information on water flows and abstraction, which lay the foundation of any water allocation agreement. An earlier portion of this chapter (see *Kazakhstan*, above) discusses the shortcomings in Kazakhstan's data collections capabilities in more detail. These shortcomings undermine Kazakhstan's position in

the bilateral negotiations, thus lending a helping hand in Beijing's pursuit of its own interests (Chapter 6, 7.3.4).

Kazakhstan cannot rely on Chinese data either, as this is equally prone to misreporting. Data collection challenges in both countries pose an important question: what kind of data is actually exchanged (Interview Russell Frost)? If data exchanges do in fact take place, their value is likely symbolic rather than practical. This puts any workable water allocation agreement further into the future, since any such agreement must necessarily be based on a quantitative understanding of water abstractions.

Data exchanges and more generally, negotiation progress, is also delayed by the lack of a permanent institutional structure of the CKCC or JWC (Chapter 6). It is also unclear which institutions are involved in the data swaps. For example, in 2006, the Chinese MWR signed agreements with both MinEP and MoA (see Chronology 2006), who have overlapping responsibilities on water in Kazakhstan. But numerous other Kazakhstani organisations, with varying reporting structures, carry out research on the ground. The Committee for Fisheries and Research, which reports to the MoA, examines Kazakhstan's lakes and rivers. Additionally, Kazhydromet operates hydrological stations, yet its reporting structure is unclear. Kazhydromet signed one bilateral agreement with China in 1995, which included provisions to exchange meteorological but not hydrological data (Kazhydromet 2012). Most likely, data from Kazhydromet is channelled through different ministries, if it is exchanged at all.

Crucially, this research did not uncover any signs of data-generating research in Xinjiang until 2011, when the XEAS was commissioned to carry out research along Xinjiang's transboundary water nexus. This implies that no data was exchanged beforehand, or that the data swaps were based on estimates or at best, weak data. Poor data quality is not only an obstacle exclusive to the Sino-Kazakh water nexus. China was also criticised for the poor data it provided in the Mekong water dispute

(Cronin and Hamlin 2012:32). It is international practice to facilitate the direct exchange of data between different countries by setting up Joint River Basin Councils (JRBCs). Contrary to common international practice, Beijing has prevented the institutionalisation of the CKCC and rejected proposals to set up a bottom-up IWRM (UN) mechanism or JRBC (see *Second Decade: 2002-2012*; 2007).¹⁴⁰ Interestingly, Kazakhstan has managed to set-up such JRBCs with Russia to manage water along the Irtys and, more prominently, with Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan, to organise the water management of the Aral Sea (EECCA-NBO 2012).

In summary, it can be concluded that negotiations between Kazakhstan and China remain stagnant in the 'adversarial stage', with China still defending its right to absolute sovereignty over its transboundary rivers (Rothman cited in Wolf, 2007). As demonstrated in this chapter, China's stance comes at the expense of Kazakhstan's national interest. In general, institutionalisation and closer cooperation are associated with a better conflict resolution in IR paradigms, such as liberalism and constructivism. However, it is against the background of more intense bilateral cooperation that negotiations between Kazakhstan and China have not made meaningful progress, further lending applicability to a realist narrative. This outcome is particularly surprising given that in June 2011, China upgraded its relationship with Kazakhstan to a 'comprehensive strategic partnership', thereby establishing regular meetings on the prime minister level.

While Beijing emphasises 'mutual benefit' (互利共), 'win-win negotiations' (共赢的) and the 'spirit of great responsibility' (高度负责), this chapter highlights that Beijing unilaterally controls the negotiations. In fact, reports generally describe the conflict in terms of *David vs. Goliath* often depicting Beijing as a regional bully (Blank 2009). While Kazakhstan's position as downstream riparian certainly lowers its bargaining position (Zeitoun and Warner 2006), the analysis in the next chapter will show that

¹⁴⁰ see International Commission for the Protection of the River Danube (ICPDR).

the situation is far more complex than the *David vs. Goliath* analogy implies. Astana does in fact have recourse to a number of feasible policy options that would significantly increase its bargaining power and which the previous chapter briefly delineated (Chapter 5). It will be argued that, contrary to the view of Sievers et al, Kazakhstan by choice does not pursue an assertive water policy towards Beijing (Sievers, 2002). Instead, it allows Beijing to control the negotiations counter to its national interest and thus appears complicit in China's successes.

This apparent puzzle is best explained through Kazakhstan's economic dependence on China that is driven by the elite's perception and interests, as well as Beijing's related ability to manipulate Kazakhstani elite interests in its favour. As such, the explanatory variables for Kazakhstan's behaviour are located both on the systemic level (economic hierarchy and dependence) as well as on the sub-systemic level in Kazakhstan's elite dynamics. This implies that China can maintain its water sovereignty with limited interference from Kazakhstan. Astana's failure to object may preserve its economic and elite interests in the short-term, including Chinese investment, but lock Kazakhstan more firmly into China's hierarchical power structure in the long-term. The next section will provide a detailed analysis of how China applies this hierarchical relationship as leverage in its favour.

Chapter 7 **Dispute Analysis**

The previous chapter showed that Beijing has successfully maintained absolute sovereignty over its water resources, even though this approach is increasingly out of touch with developments in international environmental cooperation. This chapter investigates whether these outcomes are the result of Beijing effectively leveraging Kazakhstan's economic dependence and how. To this end the chapter analyses the bargaining strategy that China employs to achieve this outcome. Beijing controls the agenda and setting of the dispute negotiations, frequently stalling them. However, as informative as Beijing's strategy, is Astana's response. Astana's decision makers appear to undertake no meaningful efforts to level the hierarchical relationship in order to improve their negotiation position. This can only be partially explained by Kazakhstan's economic dependence. Antagonising Beijing could threaten future economic benefits and jeopardise Chinese investment in Kazakhstan on which the elite relies (Chapter 5). From Kazakhstan's overall perspective, it could be argued that the cost of water access and quality are balanced against the benefits of China's economic influence. However, the cost-benefit analysis is much more skewed towards benefits when Kazakhstan's real decision makers, the elite, are considered in isolation. The elite in particular benefits from Chinese investment, both structurally and personally but will only be indirectly affected by its short-sighted water policy in the dispute. This also highlights what appears as the elite's short-term view on decision making. This short-sightedness is linked to the different rational and cost-benefit calculations in a Rentier State, where the elite's immediate and primary concern is maintaining power even if this negates the national interest (Chapter 2 and 5). As a result Beijing can pursue its interests and firmly lock Kazakhstan into a hierarchical relationship, adding 'water hegemony' to magnify Kazakhstan's subordinate position.

The chapter also draws parallels with the Mekong, where China faces another transboundary water dispute. Patterns emerge that suggest China may have studied its experiences to develop an overall strategy for dealing with water disputes.

7.1 Theoretical Framework

IR literature on conflict and cooperation often applies game theory to elucidate the different policy preferences of states in a conflict situation. This exposes problems inherent in the dispute structure which can inhibit cooperation, such as insufficient communication or risks of defection. Although the water conflict would neatly fit into a two-by-two matrix¹⁴¹ with China's default preference for defection and Kazakhstan's for cooperation, it provides little guidance for analysing the ongoing negotiation process between both states. Fearon's model of dispute bargaining, as well as Zeitoun and Warner's framework of hydro-hegemony inform a more fruitful analysis (Fearon 1998, Zeitoun & Warner 2006). By breaking down the cooperation process into bargaining and implementation stages, the former, under which Kazakhstan and China currently negotiate, can be analysed independently of the later implementation stage (Fearon 1998). Fearon's framework is applied to the Sino-Kazakh water dispute. In this dispute, the interests of the two sides are opposed. Beijing aims to maximise its use of transboundary rivers and pursues absolute sovereignty over its water resources, while Kazakhstan tries to minimise Chinese water abstractions and thus pursues a strategy of absolute river integrity (Wolf 2007) (Chapter 5). Nevertheless, cooperation can be beneficial for both parties. Without cooperation, Kazakhstan runs the risk of losing large if not all water volume, along those shared rivers, as China can maximise its abstractions. Beijing's preference for an agreement is less straightforward but still significant. In the absence of an agreement, Kazakhstan may turn towards the international community for help, thus depicting Beijing as an uncooperative

¹⁴¹ Game theory usually depicts a situation along a two by two matrix that captures the different default preferences of two cooperation partners.

regional hegemon. More significantly, Beijing runs the risks that Kazakhstan will seek an external solution to the dispute, either in a legal forum or in an international or regional organisation which reduces China's ability to influence the outcome to its benefit.

7.2 China's Bargaining Strategy

China implements a range of bargaining strategies, many of which are cited in Fearon's model (Fearon 1998):

- Information secrecy
- Bilateral negotiations: Beijing controls the agenda and excludes third parties
- Stalling for time
- Exploitation of institutional weaknesses inside Kazakhstan
- Preventing external dispute resolution
- Isolation of the water dispute

In theory, Astana could offset each of these strategies, thus mitigating the effects of Kazakhstan's economic dependence. The Kazakhstani government could:

- Enlist domestic and international public opinion to shame Beijing
- Multilateralise negotiations through regional and international organisations
- Speed up dispute resolution
- Seek external dispute resolution by mounting legal challenges
- Link other issue areas that are more important to China, such as non-water resources and security cooperation
- Improve water management and monitoring capabilities
- Diversify the economy to trade in virtual water

However, Kazakhstan only pursues these options sparingly. This thesis argues that this is the result of Kazakhstan's economic dependency on China. Given China's key role in Kazakhstan's economy, Astana, and particularly its elite, worry that antagonising Beijing risks future economic and political benefits associated with China. Beijing's strategy along the Sino-Kazakhstani water dispute is similar to its strategy along other water conflicts from which it has possibly learnt. In particular, the Mekong conflict is studied in more detail below. China's strategy is remarkably similar to that applied in Kazakhstan and includes some of the six negotiation strategies listed above. While parallels between the two water conflicts emerge, the opaque nature of Beijing's foreign policy process makes it difficult to conclude that these are the result of a coherent foreign policy strategy of Beijing. Negotiations take place behind closed doors and are treated as state secrets, also inside Kazakhstan. As a result, the question of causality is difficult to answer. These are questions on whether Beijing directly uses as leverage Kazakhstan's economic dependence by issuing threats or linking future trade and investment prospects to Kazakhstan's compliance. Or, does the Kazakhstani government deliberately fail to level the playing field in anticipation of losing economic benefits in the future? As a lack of disclosure makes a direct analysis impossible, this chapter will study the outcomes and the policy tools selected by Kazakhstani officials to shed light on the dispute dynamics. By excluding alternative explanations, it becomes apparent that the interests of the ruling elite inside Kazakhstan drive the water negotiations, thus also further facilitating the hierarchical relationship with Beijing.

7.2.1 The Mekong Conflict: Emergence of a Chinese Water Strategy?

China faces a well-documented water dispute along the Mekong, also known as the Lancang in China. Research into this dispute reveals interesting similarities to the Sino-Kazakh transboundary water conflict, and it is likely that Beijing applies lessons learned at the Mekong in Kazakhstan. The opaque nature makes conclusive proof of China's strategy in either water dispute difficult, but there are a number of

indicators that support the view: The Mekong dispute predates the transboundary conflict with Kazakhstan, and an overlap between the Chinese ministries involved in both disputes suggests that likely some institutional learning has occurred. Initiatives to set up a committee of riparians along the Mekong stretch back to the late 1950. Both the Mekong River Commission (MRC) and the Chinese Ministry of Water Resources (MRW) were established in 1958 and have existed continuously, albeit in slightly different shape. For over half a century, the MRW accumulated expertise along the Mekong, forming many contact points with the MRC and individual riparians, at least on a technical level. In addition, the MWR signed a number of data-sharing agreements with the MRC (Shi 2010). Interestingly, the MWR is also a key contact point in the Sino-Kazakhstani Water dispute, having signed agreements with the MinEP and MoA in Kazakhstan. It participates in the China-Kazakhstan Joint Commission on the Use and Protection of Transboundary Rivers, the main body discussing transboundary water issues. The overlap between these two disputes extends to individuals such as Jiao Yong, the vice minister of the MWR, who co-chaired the meeting of the joint committee in Karaganda, Kazakhstan in 2010. The institutional continuity suggests that, at a minimum, Chinese actors in the Kazakhstani dispute are aware of issues that arose previously at the Mekong.

Information awareness between the two conflicts likely extends beyond technical committees. Policy questions involving the Mekong are handled through China's MFA, via the Chinese embassy in Bangkok, and it is common diplomatic practice to share cables not just to the MFA but also with other relevant embassies. Therefore, it is likely that Beijing shares this information with other embassies involved in water-sharing disputes, including the one in Kazakhstan. This shared information likely includes media commentary. Given the critical press coverage received on the Mekong, Beijing has actively followed media commentary on the Mekong dispute (Interview International Water Expert). As in Kazakhstan, China is deeply involved economically in Laos and Cambodia, two Mekong co-riparians, especially in Laos' hydropower projects. Chinese state-owned hydropower companies, such as

Sinohydro, are active in the region and will build four to five of eleven planned dams. China ExIm Bank (ExIm), which has emerged as one of the world's biggest financiers of dam projects (International Rivers),¹⁴² is funding the construction of the Kamchay Dam in Cambodia. Given the economic importance, Beijing is incentivised to closely monitor developments at the MRC, as negative press coverage could jeopardise lucrative projects. Any lessons learned along the Mekong are likely carried over, as the same Chinese companies involved in the financing and construction of hydropower dams along the Mekong are also active in Kazakhstan, such as China Datang and Sinohydro, both SOEs involved in projects in Kazakhstan (Aizhu 2008, Sinohydro 2008, Guo 2011). Especially given the proximity of the CEOs to the state council (SASAC), it is possible to assume that the institutional knowledge gained along the Mekong is shared and preserved. These institutional, political and economic links in the two water conflicts suggest that any parallels found may not be coincidental and are perhaps indicative of a comprehensive Chinese strategy on transboundary water disputes. As pointed out by Backer the Mekong is not a unique case for Beijing with its many transboundary rivers. It is thus concerned that its behaviour or concessions along the MRC may trigger similar demands by other downstream riparians (Backer 2007). This suggests that Beijing may take a common approach to its transboundary water disputes.

¹⁴² China ExIm appears in foreign policy records as well and its governor frequently meets with Finance Ministers abroad. For example in 2005 Li Ruogu met with Siniora Ben, the State Secretary of Finance in Cambodia to discuss projects. This further underlines ExIm's growing role in Chinese Foreign Policy (Exim 2005).

Figure 51 Mekong Riparians



Source: <http://www.asiawebdirect.com/maps/mekong/index.htm>

The Mekong Dispute

The Mekong originates in the Himalayas, traverses China and then crosses from Yunnan into Burma, Laos, Thailand, Cambodia and Vietnam (see Figure 51). In China, the Mekong is known as the Lancang River, which China emphasises to communicate its uncompromising sovereignty and control over the river. The Mekong conflict originated from the construction of hydropower dams in China, which contributed to decreasing water levels and changes in water cycles. These changes interfere with local communities and their agricultural planning (Wolf, 2007), thus creating tensions with downstream riparians including Thailand, Laos, Cambodia and Vietnam (McCartan 2010). In response to China's dam projects, these states established a multi-lateral body, the MRC, in 1958 to manage the dispute. Although China chose not to join the MRC, perhaps because it sought to

maximise its bargaining power in bilateral negotiations, it enjoys observer status and participates in meetings. Although, the MRC has limited powers, it facilitates knowledge generation and consultations on the use and future of the Mekong. It has registered some noticeable successes in this respect, such as pushing Laos to suspend the construction of the iconic Xayaburi Dam, a lucrative hydro-dam project, in 2011. The Xayaburi Dam is an iconic project, not only because of its size and position along the main stream of the Mekong, but also because of the controversy and media attention that it has drawn (Interview Kurt Mørck Jensen). Today, Vietnam, and to a lesser degree Cambodia, are pushing for a moratorium on further dam construction, supported by research and impact studies published by the MRC (Interview Kurt Mørck Jensen). The MRC's ability to draw in civil society has contributed to its effectiveness. For example, information published by the MRC mobilised Thai civil society, which has become a key opponent to dam projects. These developments culminated with Thai environmentalists suing one of the banks that provided financing for the Xayaburi Dam, by alleging that the conducted environmental impact assessment (EIA) was inadequate. While MRC decisions are not binding on China, Beijing has been very susceptible to the mobilisation of public opinion. In fact, Chinese hydropower companies have suspended the submission of project plans, which were finalised two years ago, to see if Laos will revoke the moratorium (Interview International Water Expert 1).

7.2.2 Lessons Learned

These developments along the Mekong likely make Beijing nervous, especially since the publicity extends beyond the region and has motivated civil society to suspend key projects. The stakes in the Kazakhstani water conflict may even be higher, as water abstractions there lead to a net loss of water rather than hydropower projects leading to a change in water flows. The discussion below illustrates some factors that explain why the outcomes for co-riparians along the Mekong were more favourable. Interestingly, China has avoided many of these factors in the

Kazakhstani conflict, suggesting it is applying the lessons learned at the Mekong. One immediate consequence of the multilateral setting at the Mekong is the inadvertent internationalisation of the dispute. The MRC has close links to the UN, international environmental institutions such as the Environmental Law Institute (ELI)¹⁴³ and a large number of donor countries, including the US, Australia and Denmark¹⁴⁴. As a consequence, both the US Congress and the Australian Parliament have discussed the Xayaburi Dam officially in parliamentary sessions and in 2011, the US Senate introduced the following resolution, “Calling for the protection of the Mekong River Basin and increased US support for delaying the construction of mainstream dams along the Mekong River” (USSenate 2011). This may keep the US engaged in the Mekong or even draw the country further into the Mekong dispute, which may have geopolitical implications for China. Parliamentary debates on China’s actions along the Mekong generate publicity and are not in Beijing’s interest.

The multinational setting along the Mekong also increases transparency, better access to data and thus opportunities for research. Because of the international setting, protocols are available in the English language, making the dispute accessible to a wider, global audience, and which in turn attracts greater academic coverage. For example, an active network of experts and professionals called M-Power¹⁴⁵ provides analyses and reports on the Mekong in English. Much of this academic and media attention has depicted Beijing in an unfavourable light (MRC 2010)¹⁴⁶, undermining its efforts to cultivate the image of a peaceful, cooperative and responsible power. Discontent over China along the Mekong is barely concealed, with Thai Senator Prasarn Marukpitak publicly voicing his frustrations in

¹⁴³ The Institute runs a China programme that provides training and expertise to Chinese universities, lawyers and judiciary (ELI 2008).

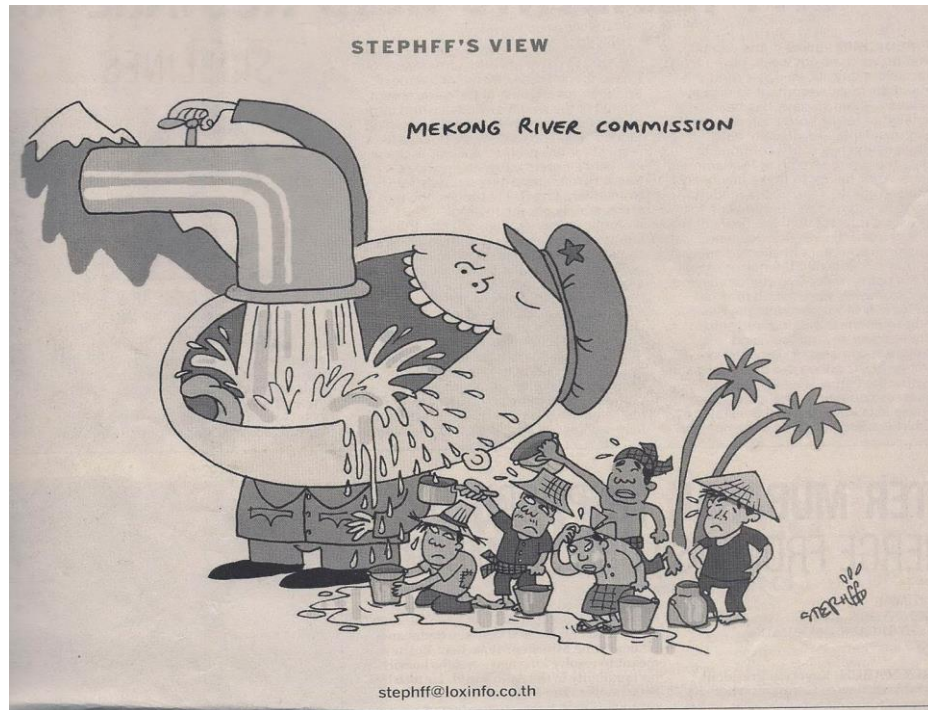
¹⁴⁴ Since its inception in 1958 a number of countries have provided technical and financial assistance including France, Great Britain, Germany, Belgium, Netherlands, Canada, Australia, The Philippines and Japan (Delli Priscolli & Wolf 2009).

¹⁴⁵ Mekong Program on Water, Environment and Resilience (M-Power)

¹⁴⁶ Relevant publications Hamlin & Cronin 2012, Hirsch & Mørck Jensen 2006

2009 that “China considers itself a big country that doesn’t have to listen to the opinions of the people downstream”(RFAUnplugged 2010). Beijing received especially negative press coverage in 2008 and 2010, when the region experienced a severe drought. Interestingly, much of the criticism was likely unfounded. MRC studies have shown that Beijing’s dams were not to blame for either of these dramatic droughts. On the contrary, in January and February of 2010, Beijing released water from its reservoirs to counter the adverse effects of the ongoing draught and to keep the Mekong navigable for boats. When Chinese reservoirs were exhausted and water levels suddenly dropped, the lower Mekong riparians assumed China had just ‘closed the tap’. In fact, China itself was probably worse affected by the draught than its downstream riparians, as around 30 Chinese vessels were stranded along the Mekong (Interview International Water Expert). However, because of China’s reluctance to share information, media and Thai civil society blamed Beijing’s dam construction for the droughts. A cartoon that ran in the Bangkok Post in April 2010 candidly summarised the general attitude at the time (see Figure 52). The cartoon depicts China as the greedy water consumer who leaves only a few drops for its co-riparians, Vietnam, Cambodia, Burma and Laos.

Figure 52 Reputational Repercussions



Kindly provided by International Water Expert

The negative media backlash is at least partially linked to the opaqueness of China's foreign policy and hence a self-inflicted problem (Chong 2012). Experts believe that Beijing now actively follows and manages commentary regarding the Mekong to limit media and civil society exposure (Interview International Water Expert 1). In any case, it is clear that the MRC has increased the pressure on Beijing to act responsibly. The experience along the Mekong has also created awareness in Chinese ministries about the reputational implications related to data secrecy, or a lack of transparency and to be viewed as "someone who doesn't care" (Hirsch & Jensen et al 2006). This could both inform Kazakhstani officials how to use transparency and internationalisation of the conflict to strengthen their bargaining position as well as teaching Beijing how to avoid these pitfalls in future situations.

Better conflict outcomes at the Mekong are linked to the multilateral institutionalisation and transparency of the dispute. However, it is possible that differences in the systemic and sub-systemic variables of these coriparians may

affect better outcomes as well. This could be related to greater economic independence of these states or different types of governments and stronger civil societies. An analysis of different regime types and variance in foreign policy outcomes warrants further research but is beyond the scope of this thesis and needs to be addressed elsewhere.

7.3 Analysis of the Sino-Kazakh Water Dispute

The remainder of this chapter analyses the different Chinese negotiation strategies and the Kazakhstani response in detail. In summary, China's approach along the Ili and Irtysh suggests that Beijing does in fact apply many of the lessons learned along the Mekong.

7.3.1 Information Secrecy

China's foreign policy processes take place out of the public eye. This undermines Beijing's aim to build a reputation as a benign and responsible power, because it prefers to keep conflicts that could jeopardise this away from international public attention (Chong 2012). With increasing global awareness on climate change, transboundary water has become one such controversial issue. China's position as upstream riparian puts it naturally into a more powerful position, which, combined with maintaining absolute sovereignty, invokes the image of China as a regional bully (Zeitoun & Warner 2006, Zeitoun & Allan 2008). While it is in Beijing's interest to avoid the negative press it has experienced at the Mekong, Kazakhstan could conversely exert pressure on China by introducing more transparency to garner international support. Such transparency would demonstrate that Beijing has compromised little over the last decades. However, rather than improving transparency, the Kazakhstani government appears to undertake great efforts to keep the negotiation process out of the public eye, even classifying information on transboundary rivers as a state secret. Kazakhstan's behaviour appears puzzling at

first, but can be explained by resorting to Kazakhstan's economic dependence on China and the legitimacy concerns of the elite in Astana (Chapter 2, 3). Therefore, the government has a strong incentive not to antagonise Beijing by drawing international attention to China's continuing water abstraction. This might risk future economic benefits (Copeland 1996). Chinese academics agree that Kazakhstan is hesitant to confront Beijing, in order to preserve the friendly relationship between both countries, presumably because of the benefits inherent in such a friendly relationship (Wang & Hu 2011). Kazakhstan's position is not unique. Concerns around decreasing Chinese economic activity are also thought to be a key driver of the Laotian government's actions along the Mekong. Because China is a key investor in Laos, Laotian officials have requested a review of MRC correspondence with China to ensure that China will not perceive Laos to be tarnishing Beijing's image and will not retaliate by curtailing future investment (Interview International Water Expert).¹⁴⁷ In addition to fears about alienating Beijing, there are likely also strong domestic reasons for the Kazakhstani government to keep the water conflict 'under wraps'. Despite nearly 20 years of negotiations, the government has failed to make any meaningful progress in protecting its national interests. Open public knowledge of this failure may expose the elite to criticism and even throw into question the elite's legitimacy. Additionally, the issue bears domestic risks to Nazarbayev himself. Given the strong undercurrent of Sinophobia among the Kazakhstani population, any perceived China-friendly actions could pose critical questions about the motivation and incentives of Kazakhstani policy makers. Murat Auezov the former Ambassador to China, has repeatedly attacked the government over its failure to exert pressure on Beijing and downright accused it of 'collaborating' with the Chinese. Previous events have demonstrated that Chinese issues have the power to mobilise society even against Nazarbayev himself, despite his overwhelming popularity. Kazakhstanis took to the streets in 2009 after media reported that China was

¹⁴⁷ The question to what degree this is driven by China's economic influence in Laos is beyond the scope of this thesis

interested in leasing swaths of arable land inside Kazakhstan (Hoagland, 2010b). Sinophobia may have increased further, with rumours circulating about illegal Chinese immigrants and the exploitation practices of Chinese oil and gas companies (Interview Investment Fund).

Sinophobia, combined with increasing public criticism of fabricated success stories of the early negotiations with China, may have caused the Kazakhstani government to change strategy in 2002. At that point, the government began to downplay the significance of transboundary water issues. For example, the then Prime Minister Kassym-Jomart Tokayev issued statements claiming that China's diversion of the Irtysh does not pose any economic or environmental threats. The government went further and accused the media and NGOs of widely exaggerating the issue (Sievers 2002:4). Today, the Kazakhstani government pushes its negotiations with Beijing into a "world of disappeared hydro politics" (Allan & Mirumachi 2011:25), treating the ongoing dispute as a strict secret by imposing an information embargo on the general public.¹⁴⁸ The author's enquiries about the current state of the negotiations or China's position were widely met with the response that this information was too sensitive for sharing and discussing. Perhaps the government's decision to demote the Committee on Transboundary Water from the MFA via the Ministry of Natural Resources and Protection to the MoA was part of its strategy to push the dispute further into the background. This move not only de-prioritised the issue, but also de-politicised the process by giving it a more technical colouring. It also allowed the MFA to offload responsibility for the stagnant negotiation process (Sievers 2002). The result is that a less influential MoA with weaker capabilities does not have the resources or ministerial support to cope with the dispute, certainly not with its foreign policy dimensions (Kuanysh Baybolatovich & Cummings, 2005).¹⁴⁹ However,

¹⁴⁸ The interviewer's questions about the state of negotiations between China and Kazakhstan were immediately blocked and referred to as "state secret".

¹⁴⁹ Cummings ranked the political influence of Kazakhstani ministries from into hierarchies from most influential (1) to least influential (7). Accordingly, the MoA only ranks (6) (Cummings 2005:40).

relocating the committee into the MoA also has lasting effects beyond the negotiation table (discussed below).

The elite's preference to mute the dispute is aligned with Beijing's, because of sensitivities around Kazakhstan's economic dependence and intrinsically linked to this the elite's immediate legitimacy concerns. Although it is not possible to weigh both factors precisely, the regime's survival is likely a more immediate concern. Thus, keeping the dispute away from domestic attention prevails over the more long-term threat of Chinese retaliations in trade and investment. By acceding to Beijing's preferences, the Kazakhstani government takes a distinctively short-term view. One could also argue that water security is an important prerequisite to Kazakhstan's economic growth in the long term, and thus more important than the future of Chinese investment. Lending the dispute a higher profile would also be in line with its status as a national security objective and explicit foreign policy goal, both of which are contradicted by the government's actual actions. Interviewees in Kazakhstan also consistently criticised the distinctively short-term view of the government across different issue areas (Interviews Trade Expert, International Finance Expert).

Beijing's strategy has paid off, and the Sino-Kazakhstani water conflict now unfolds inside the "shadow state" (Mirumachi and Allan 2010:22). Until recently, the water conflict has escaped closer academic scrutiny and wider international attention, thus leaving the reputation of both governments widely intact. Literature on China's water disputes overwhelmingly focuses on the Mekong and almost completely neglects the Sino-Kazakhstani disputes. For example, Yoffe et al. identify the Mekong as a future area of conflict but fail to discuss the transboundary dispute with Kazakhstan, which, by the time of their publication had been underway for nearly ten years (Yoffe, Wolf et al. 2003). Eric Sievers' 2001 treatment of the dispute is still the most comprehensive source and a more recent article by Richard Stone (Stone 2012) are improving information about the dispute abroad. In China,

the dispute does not receive much attention outside policy-making circles. A search in the CNKI database only produces a handful of results, nearly exclusively published by Xinjiang University (CNKI, 2012). As a result, Beijing can keep the dispute in a bilateral setting, supporting its aim of preserving absolute sovereignty over its transboundary rivers.

7.3.2 Bilateral Negotiations

It appears to be China's default position to engage in negotiations on a bilateral basis. By avoiding multi-lateralised foreign policy discussions, China can use its relative size and economic weight to its advantage, a fact also recognised by Neoclassical Realists.¹⁵⁰ Despite this preference and perhaps by necessity, Chinese foreign policy has become more multilateral in recent years, with Beijing now taking a more proactive approach towards established IOs such as the UN and even spearheading the foundation of the SCO. Nonetheless, the preference for bilateral negotiations remains, especially when territorial claims or resources are at stake. This is true in the Mekong conflict, when China declined to join the MRC and likely also experienced first-hand how effectively IOs can mitigate hierarchical relationships. In 2000, a number of MRC states and China signed the 'Agreement on Commercial Navigation on the Lancang' to facilitate commercial navigation along the Chinese section of the Mekong by authorising the necessary construction to enable bigger ships to navigate the waters. Despite the commercial focus, the contractual parties have since used vague articles of the agreement to exert pressure on China to release information about its dams along the river (International Water Expert 2)¹⁵¹. Similarly, Burma, Thailand and Laos also enlisted

¹⁵⁰ Accordingly states always strive to maximize their relative position vis-à-vis other states in the international system based on the premise that competition for security is a zero sum game. Thus a state must always try to seek a favourable security position vis-à-vis other states.

¹⁵¹ Relevant articles are Art 21 states that [...] representatives of the Contracting Parties [...] consult and [to] promote cooperation in the following matters inter alia: (b) measures to increase safety for navigation and protection of environment; (f) for the purpose of safe and smooth navigation, especially in dry season, to cooperate to a possible extent in the provision of water flow and the relevant data [...].

the MRC's help to question an EIA conducted by Beijing, which an independent report found "substantively inadequate and in many places fundamentally flawed" (Hirsch et al 2006:155). This diplomatic 'embarrassment' likely reaffirmed China's preference to conduct discussions in a more controllable bilateral setting.

The Sino-Kazakhstani water dispute, on the other hand, has produced more favourable outcomes for China, likely because Beijing can use Kazakhstan's subordinate position as leverage to control the agenda by keeping the negotiations bilateral. It is not necessarily Beijing that uses this hierarchy as leverage, but rather Astana's willingness to do it for Beijing. In contrast, for Kazakhstan, resorting to international involvement presents a feasible policy option and should be at the forefront of Astana's FP. Interestingly, Astana has complied with Beijing's preference for a bilateral setting, thereby weakening its own bargaining position and puzzling international and domestic observers alike (Sievers 2002). Astana's economic dependence and 'short-term view' can explain the reluctance to confront Beijing through a regional or global institution. As a result, Astana makes FP choices that may be sub-optimal for the country as a whole.

Third Party Participation

Zeitoun and Warner argue that "having powerful friends can [itself] be a very efficient source of power" (Zeitoun and Warner: 449). At the beginning of the dispute, Kazakhstan turned to co-riparian Russia and also Kyrgyzstan for support (Sievers 2002). However, Moscow declined to get involved because the Irtysh was not a foreign priority at the time. Astana also hoped Kyrgyzstan would use its position as an upstream riparian to China to blackmail Beijing into a cooperative stance, by threatening to divert its own rivers (Sievers, 2003). This crude strategy, failed. While Astana did initially attempt to open the dispute to other countries, potential candidates such as Russia or Kyrgyzstan were unwilling to get involved. However, since then Astana has not reached out to other countries such as the US, another prominent regional power. Rather, since 2001, Astana only half-heartedly

and unsuccessfully attempted to include other nations in the conflict, which was consistently blocked by Beijing. Today, officials in Kazakhstan, including Serik Akhmetov at the MinEP, consider the inclusion of Russia a viable strategy (Kenshimov 2010). However, Beijing has rejected these requests without offering Kazakhstani negotiators any concessions in return (Ryabtsev 2011). This also reflects the complex geostrategic context of Central Asia, where closer intra-regional cooperation and integration has largely failed (Allison 2004), and Russia and China exert influence in different ways whilst also seeking closer relations with each other. Attempts to balance Russian and Chinese interests are thus becoming more difficult for Kazakhstan. An analysis of the geo-strategic implications of Kazakhstan's economic dependence on China, which initially "provide[d] an alternative to the excessive dependence on Russia [...]" (Kerr 2010) is beyond the scope of this thesis.

International Forums

Beijing's outstanding response to Kazakhstan's 1992 request to discuss transboundary waters indicated that the issue did not rank high on Beijing's agenda (see Chronology of Negotiations) and the vague response in 1995 to 'study' the issue further underlined this. Shortly thereafter the 'Shanghai Five' held its first meeting in April 1996, which would have provided an ideal platform (Analitika 2007) to address the water dispute (People'sDaily 2000). Yet, interestingly, Nazarbayev did not raise the issue (Sievers 2002). Perhaps Kazakhstan's diplomatic corps was too inexperienced and overwhelmed to raise the issue only five years after independence. However, this explanation is unsatisfactory given Kazakhstan's otherwise proactive and multilateral foreign policy within the same issue area during that period. Earlier in 1992, the government initiated a meeting of the water ministries of Central Asian countries in Almaty to set up the Interstate Commission for Water Coordination (ICWC) to facilitate the joint use and management of water resources. The ICWC has since been supported by a wide range of international organisations and NGOs including USAID, ESCAP, GEPF, NATO, GTZ, EU, the Asia-

Pacific Water Forum and the International Network for Basin Organizations (ICWCCA 2009, ICWCCA 2012). This demonstrates that Astana acknowledged water supply as a strategic challenge early on and successfully conducted a pro-active and multilateral foreign policy in response. A more promising explanation is Astana's acquiescence to Chinese interests to facilitate future investments. Interestingly, the Shanghai Five meeting occurred only one year before CNPC made its investment in Kazakhstan with strategic implications for Astana. It acquired a 60.3% stake in AkotbeMunaiGas (AMG) and, more importantly, offered to construct the export pipeline that broke Russia's monopoly. It is likely Kazakhstan was aware of CNPC's interest already in April 1996, as oil companies generally undertake multi-year feasibility studies before bidding. Moreover, this acquisition constituted CNPC's biggest overseas investment at that point and included financing for a complex infrastructure project. Therefore, CNPC likely conducted an investment feasibility study and was in talks with the Kazakhstani elite, which controlled AMG. It is thus conceivable that Nazarbayev did address the water dispute more visibly at the Shanghai Five to avoid jeopardising the imminent CNPC investment. Chapter 3 discussed the strategic value of CNPC's pipeline project to Kazakhstan.

Several years later, Kazakhstan did table the water issue twice at the SCO, first in Tashkent in June 2004 and again in 2012, where Kazakhstan proposed the establishment of a water and food committee (Baigarin 2012). With its focus on traditional and non-traditional security threats, the 2004 summit was an ideal platform, as water security is a central issue to most SCO member states. However, in its Tashkent Declaration, the SCO subsumed 'water management' under the lower-profile topic of 'cooperation in general environmental protection', possibly because of China's opposition, given that the interests of the remaining SCO members were aligned on the issue. Member states agreed vaguely that effective regional water resource management should be addressed together, but did not specify in more detail (SCO 2004). In 2012, Beijing also blocked the discussion of its dispute with Kazakhstan (Ryabov 2012). In view of Beijing's preference to negotiate

on a bilateral basis, its efforts to suppress discussion of the dispute within the SCO may not be surprising. The SCO's multilateral setting mitigates the hierarchical relationship with Kazakhstan in Astana's favour. Beijing's ability, in turn, to exclude discussions on water allocation at the SCO, likely attests to Beijing's economic and financial clout in the organisation (Ryabov 2012). However, by suppressing any substantial discussion of the issue at the SCO, Beijing undermines its commitment to the SCO in particular and to multilateralism in general. Less than a month after the 2004 SCO summit Qian Qichen, the former Vice Premier, dedicated an entire speech at a global conference to China's belief in multilateralism as the best way to manage challenges and security threats in the future (Qian 2004).

Other International Institutions

Given Kazakhstan's failure to raise the profile of transboundary water issues at the SCO, it could resort to a number of other regional and global bodies, such as the Eurasian Economic Community (EAEC), ADB, OECE, CIS or UN ESCAP. The EAEC has a strong investment focus. Its core activities include the improvement of common hydro-energy complexes and the Central Asian water supply and thus would provide a suitable forum, particularly to address the implications for Kazakhstan's hydropower stations (EurAsEC). Furthermore, the membership, which includes co-riparian Russia but not China, makes it more likely that Astana would garner support. Given that EAEC also has observer status at the UNGA, it could serve as a platform to discuss the dispute more widely. However, Kazakhstan has not raised the issue at the EAEC or at any of the other IOs identified by the Chairman of the CWR as ideal institutions to develop a regional dialogue to solve transboundary water issues with China, such as the UN, SPECA, IFAS, ESCAP and ICWC (Ryabtsev 2011). Nevertheless, in the end, the government ignored the advice and criticism of some of its own officials and solely opted for the low-key and behind-the-scenes involvement of UNDP, which assists Kazakhstani negotiators through technical expertise and preparatory briefings for meetings with their Chinese counterparts (Interview Local Expert). Consequently, Kazakhstani officials go out of their way to

avoid antagonising Beijing (Stone 2012). This can be explained through Kazakhstan's economic dependence on China as the discussion of alternative explanations will show. However, this dependence is most effective because of Kazakhstan's domestic context: raising the profile of the dispute through IOs could shine an unfavourable light on the government's achievements so far.

Alternative Explanations

In his assessment of the first decade of Sino-Kazakh negotiations, Eric Sievers concluded that Kazakhstan's reluctance to engage international organisations was the result of a lingering Soviet legacy of conducting foreign affairs, which prefers power politics over multilateralism (Sievers, 2002). A lack of data and insight into this early period makes it difficult to categorically reject this argument. Arguably, Kazakhstani diplomats had no faith in international regimes at that stage. Astana's early achievements in multilateralism including the ICWC, however, call this argument into question. Even if the Soviet legacy drove Kazakhstan's early foreign policy behaviour, this certainly is no longer the case today. Kazakhstan is now an active participant in regional and international multilateral organisations, especially in the environmental realm, where it has managed to garner significant support for its Green Bridge Initiative in ESCAP and at the UN. Astana became a proactive proponent of environmental cooperation in general. It has acceded to a number of global environmental initiatives, including the UN Framework Convention on Climate Change (UNFCCC) and the Kyoto Protocol in 2009 and has offered to host a sub-regional Central Asian office of UNEP (UNPM). Beyond environmental initiatives, Astana has also used IOs to boost its image abroad. In a considerable diplomatic achievement, Kazakhstan chaired the OSCE in 2011, the first former Soviet Republic to do so. Similarly, it also founded the Conference on Interaction and Confidence Building Measures in Asia (CICA), which has a permanent secretariat in Almaty and annually brings together its 24 member states, eight observer states and three observer organisations including the UN, the Arab League

and OSCE.¹⁵² Summit participants include heads of states, such as Vladimir Putin and Iran's President Mahmoud Ahmadinejad. Not only does Kazakhstan's active involvement in other IOs contradict the hypothesis on Soviet style politics, it is also inconsistent with Kazakhstan's conduct in its other transboundary water disputes, including along the Chu and Talas rivers, which originate in Kyrgyzstan and to which Kazakhstan is also a downstream riparian. The water dispute centres on reservoirs, dams and canals in Kyrgyzstan and has been resolved in a mutually beneficial way. UN ESCAP and UNESCE assisted with the establishment of the Chu-Talas Water Commission in 2006, which has a permanent secretariat and expert working groups, headed by government officials from both countries (Chu-Talas-Commission 2012). A range of IOs provide technical and managerial support and the secretariat fully institutionalised the dispute. Kazakhstan agreed in 2000¹⁵³ to share maintenance and operating costs of dams and reservoirs in Kyrgyzstan, in accordance with how much water it receives (OSCE et al. 2006, Chu-Talas-Commission 2012). These examples illustrate that Kazakhstan does not in general shy away from IOs but rather recognises their efficacy, yet in practice decides against using them in the dispute. The bilateral negotiation setting is at odds with Astana's otherwise proactive engagement of IOs. Hence the at best indirect multilateralism practised by the Kazakhstani government, where UNDP provides support mainly through information sharing, is not the result of inexperience, reluctance or capacity constraints regarding IOs. A more satisfactory explanation is Kazakhstan's economic dependence on China and Astana's concern that the involvement of an IO would introduce transparency that could also feed criticism at home. As a result, China can successfully keep the dispute bilateral and institutionally weak (no permanent secretariat), thus maximising the inherent power asymmetry between both states, which is also reflected in its control of the agenda.

¹⁵² An overview of recent activities can be found on the CICA website (CICA 2010).

¹⁵³ Agreement on Utilization of the Water Facilities of Interstate Use on the Chu and Talas

Beijing has prioritised oil and energy interests over the transboundary water dispute, consistently relegating the topic to the bottom of the agenda. In joint statements and communiqués of bilateral meetings since 2002, transboundary rivers are sometimes omitted and only once appear in the top third of the agenda (FMPRC 2002). In the 2004 meeting, transboundary rivers are at best alluded to in a segment where both sides commit to the responsible use of resources (FMPRC 2004). Rather than outlining a potential solution to the transboundary water conflict, the strategic partnership of 2005 only notes the achievements of the JWC and a commitment for continued cooperation (FMPRC 2005). The 2006 communiqué constitutes an outlier in this regard and mentions the water conflict in the top third of bilateral issues, where both sides underline their willingness to further strengthen cooperation (FMPRC 2006). However, from 2007 onwards, the issue dropped but could still be found in the top half of the joint communiqué (FMPRC 2007a,2007b). In 2008, the conflict was again relegated to the bottom quarter of the agenda, after the Beijing Olympics and agricultural cooperation (FMPRC 2008a, 2008b). The issue has remained towards the bottom in joint communiqués in subsequent years (FMPRC 2009, FMPRC 2010, FMPRC 2011a, 2011b). In 2012 the water dispute was discussed as the last item in section three out of seven. Both sides agreed that they will promote the implementation of the technical work necessary for water allocation (FMPRC 2012). However, it is unclear whether the agreement has any effect.

The reason for the apparent uptick in importance of the transboundary water issue in 2006 is unclear. At this point in time, CNPC was tendering for the Uzen field, a deal which CNPC successfully closed one year later. Around 2005, the investment climate in Kazakhstan had turned more anti-Chinese and perhaps Beijing assigned greater importance to garner some goodwill. Aside from 2006, however, Beijing seemed in control of the bilateral setting and the agenda of this water dispute. China's ability to set the agenda and to continuously prioritise its economic interests in Kazakhstan can be explained either through Kazakhstan's inability or

disinterest to push the transboundary water dispute higher up on the agenda. However, although analytically helpful, both explanations are based on the same key variable: Kazakhstan's economic dependence on China.

In parallel to the negotiation process, China has become more important to Kazakhstan's economic growth, but also to Kazakhstan's elite, which relies on rents and stable revenues to stay in power. It is thus possible to assume that Kazakhstani officials did not attempt to get the water dispute higher up on the bilateral agenda to avoid antagonising Beijing, which could risk crucial economic benefits. Weiner, for example, showed how Beijing's used its financial influence to set the agenda in its bilateral meetings with the US. Thus, it is likely that Beijing's financial clout over Kazakhstan can exert a similar effect (Weiner, 2011). Despite its unfavourable position, Kazakhstan has the ability to significantly increase its agenda-setting power (discussed below). However, it deliberately decides not to use this ability, which further corroborates the hypothesis.

7.3.3 Stalling for Time

Throughout the dispute, Beijing has withheld information about its construction plans, refused to grant Kazakhstani officials access to construction sites¹⁵⁴ and generally stalled the negotiations as long as possible without appearing outright obstructive. In Fearon's terms, China led a war of attrition (Fearon 1998). Already in 1992, the Kazakhstani Ambassador Murat Auezov delivered a water-sharing proposal request to Beijing (see Chronology of Negotiations). Breaking with diplomatic etiquette, Beijing delayed a reply until 1995, when it verbally ensured it would study the issue. In another example, both sides agreed to regularly exchange

¹⁵⁴ In 2001, during his visit to Beijing, Ramazanov was only granted access to documents and data about the canal but he was denied access to the building site itself. Nevertheless, Ramazanov considered this a success and claimed that the canal didn't pose a threat. At least until 2001 Kazakhstani officials had not been granted access to the site in Xinjiang.

data in 1999, but only twelve years later, in 2011, did tentative signs emerge that the relevant research is underway in Xinjiang.

China's stalling strategy serves two purposes. Firstly, it delays any binding agreement that restricts China's water intake. Secondly, it buys time for China to proceed with its construction plans, thus creating a new negotiation reality on the ground. For example, concurrently with Beijing assuring Kazakhstan that it was studying the transboundary water issue, it drafted plans to build the Karamay Canal (Chapter 5). Part and parcel of this strategy is China's demand for time to conduct its own technical studies (Interview Local Expert) and its refusal to share data with Kazakhstan that could facilitate the negotiations. The lack of political will in Kazakhstan to improve hydrological data collection plays into the hands of Beijing, by providing the pretext on which Beijing can request scientific studies. Again, the Kazakhstani government does not object and plays further into the hands of Beijing. This hydrological situation can be viewed as a typical outcome of Rentier State dynamics, where capital often gets misallocated, which in turn introduces institutional weaknesses from which China can benefit (Chapters 2, 3 and 4)

The MRC Experience

The MRC experience also demonstrated to Beijing to question and to verify claims made by negotiation parties and/or their civil societies but also illustrated that these technical studies draw out negotiations. Beijing also saw that a lack of data transparency can create unwanted and perhaps unwarranted criticism where civil society is actively involved in the dispute; NGOs claimed that China's dams along the Mekong caused bad flooding in 2008 and worsening draughts in 2010. In response, Beijing published its own study, to contradict these claims (Xinhua 2010) by drawing on the global context of climate change and a higher frequency of more severe droughts that occur 'naturally'. Similarly, an independent study commissioned by the MRC later confirmed that Chinese dams were not to blame for the draughts (Interview International Water Expert 1). However, instead of

exchanging more data following the Mekong example, Beijing appears to have stalled the negotiations by requesting further studies. International observers in the Sino-Kazakh dispute accuse Beijing of turning these technical studies into a deliberate strategy to “purposefully drag its feet” (Interview Local Expert). While the studies are ongoing, Beijing can finish its construction projects, which “create new facts on the ground that are irreversible” (Interview Local Expert). When after the completion of yet another technical study both parties return to the table, Beijing, has de-facto changed the realities on the ground and thus created a new basis from which to negotiate. Analogously along the Mekong, Beijing considered MRC membership only after it had already completed four dams and thus created irreversible facts. Now it is approaching the MRC to better manage these dams.

Beijing also combines the stalling approach with a policy of ‘don’t ask, don’t tell’ (Interview, Kurt Mørck Jensen). China does not share its plans, data or impact assessments and does not ask other states for permission with respect to works and plans that affect the flow of transboundary water. As a result, other states, including Kazakhstan, cannot anticipate changes to their water flows or address these plans in negotiations before construction commences. Once projects have been executed, it is difficult to reverse them. Furthermore, co-riparians do not have access to data points that could allow them to push negotiations forward (Kenshimov 2010). ‘Don’t ask’ captures Beijing’s reluctance to ask for data or impact assessments from its co-riparians, which might force Beijing to act upon this information. China’s stalling strategy is so effective because the studies it carries out do not concern themselves with the core problem of the dispute, the allocation of water. Instead, Chinese studies deal with all other areas of transboundary water management such as pollution, hydropower and emergency systems. These studies often lead to subsequent follow-on studies, buying more time for Beijing. The string of studies is so long-winded because Beijing refuses to set a timeline for the dispute resolution. It seems that this strategy is clearly recognised by Chinese scholars, who

urge the government to continue to avoid setting a deadline for the resolution of the dispute (Wang and Hu, 2011).

When Beijing does address transboundary water allocation in its studies, it does so in issue areas which are not as relevant to the dispute resolution, which naturally prolongs the negotiations further. The chronology of negotiations in the previous segment showed that Beijing agreed to swap data where pollution is concerned, or where data is necessary to create an early warning emergency system along transboundary rivers (Chapter 5). These numerous technical studies provide the further advantage of shifting the focus from the political aspects of the conflict to technical and scientific elements, which thus de-politicise the dispute and give it a technocratic colouring instead. Kazakhstani negotiators point out that the scientific and technical angle also generally better suits Beijing's technocrats and their mind sets (Nurgali Ashimov, Kazakhstani Minister of Environmental Protection).¹⁵⁵ IR literature considers the de-politicising of a dispute a feasible step towards finding a solution, especially when arguments get heated and easily spill over into civil society. For example, in the Mekong dispute, the technical cooperation between the MRC and China has worked well (Interview International Water Expert 1). However, this may be primarily because along the MRC, Chinese hydropower dams only affect flooding cycles but do not lead to a net loss of water as in Kazakhstan's case. In other words, the relatively smooth technical cooperation along the Mekong works well because the stakes are lower. In the Sino-Kazakh dispute, by contrast, de-politicising the issue has simply led to the pushing the dispute further into the background and down the political agenda, which seriously impedes progress (see (1) Information Secrecy, above). So far, Beijing has successfully managed to stall the negotiations and delay any measures or meaningful data input that could lead to a water allocation agreement in the conflict. Astana is aware of China's strategy which one analyst candidly summarises as follows:

¹⁵⁵ Ahimov was quoted in the media as saying: "negotiations between [my] country and China [...]were moving forward "with great difficulty" (OOSKAnews,2011)

“China is not set up to find a speedy resolution to the problem, perhaps this is why China approaches the use and protection on transboundary rivers through technical positions at the interagency level” and “It seems China’s position on the allocation and protection of transboundary rivers was informed by their desire to delay the time and implement water development projects in Xinjiang” ((Talgat Mamyraymov cited in (Bachische 2012)).

It is easy for Beijing to stall the negotiations because the dispute parties have not set a timeline or road map to arrive at a dispute solution. Kazakhstan’s inability to speed up the negotiation process lies in its avoidance of challenging China more aggressively, which is rooted in Kazakhstan’s economic dependence on China and decision makers’ anxieties of risking Chinese revenues. Interviewees in Kazakhstan confirmed that Astana considers China a key source of future revenues (Interview NBK) and that there is an understanding that it would be easy for Beijing to forego its investments in Kazakhstan (see Part I) . One interviewee summed it up in his assessment that “we are peanuts” (Local Finance Expert1).

However, Kazakhstan’s domestic context, especially the elite’s lack of political will, further facilitates Beijing’s efforts to stall any progress that would lead to a commitment to restrict its water intake. Kazakhstan’s own weak water management capabilities provide China with the pretext to conduct further studies before an agreement can be reached, and to question Astana’s motivation. The next segment discusses how Astana is complicit in China’s negotiation success.

7.3.4 Exploitation of Institutional Weaknesses

Kazakhstan’s weak water management capabilities, especially its dated hydrometric system, give Beijing a pretext to doubt Kazakhstani data and deny water allocation demands (discussed below). Even Kazakhstani officials themselves occasionally acknowledge that this critically undermines their negotiation position in two ways (Sorokoumova 2010): Firstly, Beijing can argue that it should not bear the responsibility and compensate for Kazakhstani water inefficiencies and

mismanagement by providing it greater access to its own water resources (Interview Russell Frost). Failing to improve water management and efficiencies at home raises suspicions in China that Kazakhstan seeks a free ride off Chinese resources (Interview *ibid.*). This also extends to any discussions on pollutants. Kazakhstan complains about high levels of untreated waste water that enter the Ili and Irtysh in China but the government “has no leg to stand on” given the dire state of waste water facilities in Kazakhstan (Interview, Tim Hannan).

Secondly, although Chinese activities lead to a net loss of water, Astana cannot quantify this loss which must form the basis of an allocation agreement (Russell Frost). Thus, Astana cannot credibly put forth demands. Experts agree that convincing Beijing to sign a water allocation agreement requires Kazakhstan to credibly demonstrate by what volumes China abstracts. Other issue areas have shown that Beijing takes data quality seriously and that negotiation partners with inadequate or partial data lose credibility in Beijing’s eyes.¹⁵⁶ China is likely aware of Kazakhstan’s poor data-monitoring practices because of multiple contact points exist between Chinese and Kazakhstani experts. For example, a high-level workshop in Almaty jointly organised by the World Meteorological Organization (WMO) and UNDP was attended by both Chinese officials including Renhe Zhang, President of the Chinese Academy of Meteorological Sciences (CAMS),¹⁵⁷ and Chao Qingchen, from the China Meteorological Administration (CMA) as well as their Kazakhstani counterparts. At the workshop, Berik Baymagambetov, director at Kazhydromet, reported frankly about the state of hydrometric stations inside Kazakhstan (WMO 2005). Not only does Astana lose credibility, but Kazakhstan’s weak institutions provide a legitimate pretext for Beijing to question Kazakhstan’s position and demand further studies, thus buying more time.

¹⁵⁶ Conversation with a EC Diplomat in Beijing, 2004

¹⁵⁷ CAMS is the research arm of the China Meteorological Administration.

Political Will

What is perhaps most surprising is that Astana has the ability to rectify both issues to lend its demands the necessary credibility, yet does not act accordingly. Deteriorating waste water practices in Kazakhstan are indicative of political mismanagement, rather than the Soviet legacy or a lack of economic means (Chapter 6). The government's reluctance to implement recommendations from IOs further supports the view that a lack of political will is the cause. What appears as lack of political will can be explained through the different cost-benefit calculations that inform decisions in a Rentier State, where the elite's immediate concern is the preservation of power in the short-term (Chapters 2,5). In the past, several IOs have attempted to help Kazakhstan improve its water management capacity, to gain credibility in negotiations with China. The EU alone has supported more than 300 projects worth €140m to provide policy advice and technical assistance to various ministries, including the MinEP (EU 2012). For instance, the EU's River Basin Management project under the Technical Aid to the Commonwealth of Independent States (TACIS)¹⁵⁸ initiative¹⁵⁹ is one of the biggest programmes underway in Kazakhstan. In its scope and objectives, the project also refers to its benefits regarding Kazakhstan's negotiations with China.

“Although the transboundary management issue lies outside the remit of the EU funded project, the external threat provides a strategic backdrop to the pilot project. The pilot project presents an opportunity to develop a core of knowledge and management tools that could contribute to Kazakhstan's strategic negotiations with China on transboundary water management” (EU Doc 1 2006:1).¹⁶⁰

¹⁵⁸ Technical Assistance to the Commonwealth of Independent States (TACIS), was the first cooperation framework guiding EU programmes for the CIS region. In 2006 it was replaced with the European Neighbourhood and Partnership Instrument (ENPI) whose guiding principles are the EU's Development Cooperation Instruments (DCI).

¹⁵⁹ In 2002 EU TACIS was replaced with the EU's Development Cooperation Instrument (DCI)

¹⁶⁰ “The European Union's Tacis Central Asia Action Programme 2006 for “Republic of Kazakhstan”. Development and Improvement of Policy Instruments for Environmental Protection, Republic of Kazakhstan, Result 3.1:Ili-Balkhash LEAP”.

Given that external institutions recognise the damaging effect that Kazakhstan's poor water management record has on the negotiations with China, it is almost inconceivable that the Kazakhstani government is not aware itself. Within TACIS the EU has extended its project focus on river basin management, explicitly identifying the core objective to "[...] systematically collect information and create a database on the river basin in the Ili-Balkhash Basin", (UNDP 2012) thus explicitly aiming at improving Kazakhstan's data capabilities. Although the programme has made recommendations, Astana has so far shown little interest in their implementation (Interview Russel Frost). Astana's lacklustre attitude towards improving its negotiation position permeates the negotiations. For example, in 2010, the EU project suggested Kazakhstan create urgently a unified water management body (UWMB) to overcome the conflicts of interests between different ministries currently sharing responsibility and to facilitate better monitoring and water usage along the river basins. The project found that the cost of establishing such a body to be marginal, since it would simply combine functions already carried out by different ministries (TACIS 2010)(EuropeAid 2006). Astana failed to follow the EU's advice and further, has not undertaken any other significant steps to improve its water management capabilities, further illustrating a lack of political will rather than a lack of funds. This is particularly puzzling in view of the negative consequences for the transboundary dispute.

By exploiting Kazakhstan's weak water institutions, Beijing can both successfully rebuff Kazakhstani demands for water-sharing agreements and delay any agreement by insisting on further scientific studies. On the other hand, Beijing can control the negotiations because it is not sharing its data, which could facilitate progress (Cascao & Zeitoun 2010). This is also consistent with its behaviour along the Mekong. While Kazakhstan's economic dependence on China can explain both the government's lack of motivation for challenging Beijing and its unwillingness to push for a resolution timeline, it does not explain its reluctance to improve the country's own water management capabilities. Improving water institutions would

have positive ramifications beyond the water conflict including improved water access in Kazakhstan and thus, less pressure to find a solution with China. As it stands right now, Astana actually runs the risk of antagonising Beijing over water diversion claims, which Kazakhstan can inflate disproportionately without hard data. That this possibility is also reality is frequently seen in the official depiction of the water supply situation in Kazakhstan, with claims that the country suffers from water scarcity, whilst the UN considers Kazakhstan only water stressed (Chapter 6). Instead, the lack of motivation to undertake the necessary changes reflects the short-term view on policy that this thesis discussed in the beginning and that is inherent to Kazakhstan's neopatrimonial political system (See Chapter 3).

7.3.5 Preventing External Dispute Resolution

China pursues absolute sovereignty over its rivers also beyond the dispute (UN 1997). For example, when the ADB moved to endorse the Convention on the Law of the Non-Navigational Use of Transboundary Watercourses and International Lakes (1997 Convention), China dispatched a large delegation to the ADB conference in Manila. At the conference, Beijing strategically broke up the attendees into smaller sub-groups in order to communicate its strong opposition to the 1997 Convention (Interview Kurt Mørck Jensen). Nonetheless, Chinese attempts to exploit legal weaknesses associated with the implementation of international environmental regimes are increasingly at odds with developments of customary international environmental law, common state practice and public opinion, none of which consider absolute sovereignty to be unlimited, especially where state actions negatively effects another state. That sovereignty stance also undermines its commitment to the Sino-Kazakhstani Good-Neighbourly Treaty of Friendship and Principle 2 of the Rio Declaration of 1992 which it co-authored

“States have, in accordance with the Charter of the United Nations and the principles of international law, the sovereign right to exploit their own resources pursuant to their own environmental and developmental

policies, and the responsibility to ensure that activities within their jurisdiction or control do not cause damage to the environment of other States or of areas beyond the limits of national jurisdiction. “ (Chee Yoke 2012).

Although China opposed the 1997 Convention, a recent ICJ ruling transferred key elements into customary international law in acknowledgement of the fact that they reflect customary practice among states. Whether its principles find enforceable application to Beijing’s conduct along the Irtys and Ili rivers depends on whether *jus cogens*¹⁶¹ applies, which remains subject to debate. Either way, the implications are considerable for China. In Article 2 of its 2001 agreement with Kazakhstan, China committed to finding a solution based on the *equitable* and *reasonable* utilisation of the rivers (Government 2001), thereby referring to the two cardinal principles of international environmental law (McIntyre, 2011), based on the understanding that transboundary rivers are “shared resources” (McIntyre, Jägerskog et al. 2010), an interpretation already widely accepted before the ICJ ruling in 2010. Accordingly, agreements between states should reflect these principles, which include an obligation not to cause significant harm and a duty to notify and exchange information (Raadgever, Mostert et al. 2008). The ICJ confirmed that states violate these principles “if the interests of the other riparian State in the shared resource and the environmental protection of the latter were not taken into account” (ICJ 2010):

“[a] practice, which in recent years has gained so much acceptance among States that it may now be considered a requirement under general international law to undertake an environmental impact assessment where there is a risk that the proposed industrial activity may have a significant adverse impact in a transboundary context, in particular, on a shared resource. Moreover, due diligence, and the duty of vigilance and prevention which it implies, would not be considered to have been exercised, if a party planning works liable to affect the regime of the river or the quality of its waters did not undertake an

¹⁶¹ Jus cogens describes an absolute, peremptory legal norm which cannot be violated under any circumstances and thus has applicability throughout the world.

environmental impact assessment on the potential effects of such works.”

It further defined the due diligence¹⁶² process necessary to prevent significant harm to the co-riparian. Accordingly, states have the duty to notify, consult, exchange information and conduct a transboundary environmental impact assessment (TEIA) prior to commencing construction, particularly when proposed industrial activities are expected to have a significant adverse impact on the co-riparian (McIntyre 2011, ICJ 201). Advanced notification and EIAs are now customary practice among states and, with the ICJ ruling, part of international law, demonstrating that the sovereignty approach [is] “at best an anachronism that has no place in today’s interdependent, water scarce world” (McIntyre, Jägerskog et al. 2010:62). China’s violation of customary international practice brings Beijing’s commitment to mutually beneficial cooperation into question. After all, Beijing did not notify Kazakhstan about future projects along the transboundary water nexus, including the recent building of reservoirs and hydropower dams (Kenshimov 2010), but rather leaves it to Kazakhstani officials to ‘detect’ such activity (Chapter 5,). Furthermore, Beijing has not conducted any TEIAs before executing its projects, again violating customary international law and practice.¹⁶³

Despite the advances in international environmental regulation, questions remain around enforceability and jurisdiction remain and the ICJ only has jurisdiction if both parties consent. Beijing’s consent to an external dispute resolution is unlikely and enforceability depends on whether the international community will interpret these norms as *ius cogens*. In the meantime, Beijing can exploit these legal uncertainties. Nevertheless, Beijing must still consider international common

¹⁶² States have to inform a riparian as soon as possible of any project that might have transboundary effects which means as soon as it is in possession of plans, this includes “reasonable efforts by a state to inform itself of factual and legal components that relate foreseeably to a contemplated procedure and to take appropriate measures in timely fashion to address them. Thus, states are under an obligation to take unilateral measures to prevent significant transboundary harm or minimise the risks (McIntyre 2011:140).

¹⁶³ Also confirmed in an email conversation with an International Legal Expert who specialises in International Environmental Law and Transboundary Environmental Impact Assessments (TEIA).

practice, as non-compliant behaviour can generate a reputational problem, similar to the one China experienced along the Mekong. Beijing may consider this especially risky in Central Asia, where such behaviour may feed into underlying suspicions about China's expansion and abuse of power. Interestingly, the official language used by China in the water dispute with Kazakhstan seems to pay homage to these recent changes in international law. In meetings, both parties hold that the principles of 'equitable' and 'reasonable' use of the water should inform the dispute (Chapter 5). However, instead of applying them, these principles appear to be rhetoric at best. A lack of substantive actions on Beijing's part indicates that perhaps China merely wants to create the impression that it is complying with international standards.¹⁶⁴

Despite the weaknesses of international environmental law, Beijing does take these developments seriously enough to build capabilities in international water law, to prepare for potential legal challenges that might arise from its transboundary rivers. Beijing's circumvention of customary international environmental law provides Astana with a number of opportunities to challenge Beijing in front of an international body. Although enforceability of international environmental law remains weak, Astana may gain concessions from Beijing by simply threatening with a legal challenge. Independent of the prospects of such a law case, the resulting publicity would lift the dispute to a global level, increasing attention from academics and the media. Despite an awareness of the international legal situation, this research has not uncovered a single Kazakhstani initiative to resort to international law. In fact, the government has come under pressure domestically for missing these opportunities (Borisov, 1999).

China's line of action in the conflict also violated pre-existing legal agreements, such as the Sino-Soviet Treaty of 1957, to which Kazakhstan succeeded after the dissolution of the USSR (Sievers, 2003). This treaty covers the 'Regime of

¹⁶⁴ This is not an isolated case. China turns to adopt legal international language, such as 'freedom of religion' or 'human rights', however giving them a completely different interpretation.

Commercial Navigation on Border Waterways and Tributary Streams and Lakes' (Slusser & Triska 1959:395), and both parties agree not to interfere with the navigability of their transboundary rivers. However, Beijing's water diversion lowers the water levels of the Irtysh and Ili, thus risking their navigability (Sievers 2003: 184). China has violated not only the Sino-Soviet treaty in substance, but also more recent agreements in spirit. China has signed an agreement with Kazakhstan and committed to find an "equitable and reasonable" solution to the transboundary water dispute (Article 2, Joint Agreement), but ongoing construction activity appears to undermine this promise.

As sceptics on international environmental law frequently note, even bilateral environmental agreements are difficult to enforce, because they often lack clearly defined obligations, based on which a case could be built. Nevertheless, and as stated above, Kazakhstan could initiate a legal discussion on the international level to shift public opinion in its favour, thus putting Beijing under pressure as the MRC did. Especially since international law now enshrines the concept of equitable use of transboundary rivers, Astana should be confident that public opinion would be receptive to its case. It could be expected that at a minimum, Beijing would need to demonstrate that it has taken Kazakhstan's interests into consideration when planning and constructing its reservoirs, canals and hydropower dams. However, beyond international water law and the Sino-Soviet Treaty, legal scholars have identified a number of alternative legal options that Kazakhstan could pursue. These include conventions signed by both China and Kazakhstan that indirectly touch on water issues. For example, Astana could submit challenges under the "Convention to Combat Desertification in Countries Experiencing Serious Drought and/or Desertification, Particularly in Africa" (UNCCD 1994) the UN "Convention on Biological Diversity" (CBD 1992) or the UNESCO "Convention Concerning the Protection of the World Cultural and Natural Heritage (UNESCO 1972). These conventions would allow Kazakhstan to make the case that China's water abstraction threatens biological diversity along its south-eastern water nexus, which

is fed by the Irtysh and Ili (Sievers 2003). This might be a feasible strategy, given that Lake Balkhash and Lake Zaysan have been widely recognised for their unique biodiversity. Some experts believe the lake was created over 65 million years ago, potentially making it the world's oldest lake. Lake Balkhash, on the other hand, is home to over 120 bird species, twelve of which are officially endangered. Yet another possibility rests with private Kazakhstani citizens, who can sue China or Chinese companies over any transboundary harm caused by China's water abstraction. For example, the fishing industry in Lake Balkhash is adversely affected by shallower waters, which affect spawning cycles. In theory, any affected person could litigate either against the company who built the canal or against the Chinese state under whose jurisdiction the harm has occurred (Nollkaemper et al 2008:5). Such litigation could be brought forward against China in Kazakhstani courts. However, this has not occurred thus far and it is questionable whether Kazakhstani courts would cooperate in such litigation, given their lack of independence and the possible implications this may have for the Sino-Kazakhstani relationship.

Despite these favourable developments, Kazakhstan has not resorted to the international legal system to address deadlock with China. This decision undoubtedly comes with costs for Kazakhstan, especially in the long run. As time passes, the provision of international law for the equitable and reasonable use of transboundary waters will work in China's favour, because it takes population needs into consideration. The rapid socio-economic development in Xinjiang will likely continue to increase Xinjiang's population also through an influx of Han Chinese. Given that Kazakhstan's population growth has been slower in comparison, China will be entitled to a greater share of water intake going forward (Sievers, 2003). Especially in the early stages of the conflict, Astana was questioned for not resorting to the international legal system. Today, criticism has become more muted, perhaps because the government has managed to push the dispute out of the public eye. Interestingly, calls for reverting to international law are more prominently coming from Chinese academics, who recommend that China consult international law,

specifically the 1997 Convention, to solve the dispute (Wang and Hu, 2011). This might stem from China's positive experiences of international settlement mechanisms such as the WTO, which settled several high-profile trade disputes against the US and the EU in Beijing's favour (Miller 2011).

Kazakhstan's economic dependence as well as the elite's reluctance to challenge Beijing can also account for Astana's reluctance to resort to IOs and international law. This can be further substantiated by ruling out alternative explanations. One often cited explanation for Kazakhstan's behaviour is the relative lack of expertise of Kazakhstan's diplomatic corps. After independence, Kazakhstan did lack an "indigenous foreign policy elite" (Cummings 2003: 139) and thus the relevant expertise in international environmental law. The matter was further complicated by the fact that international environmental law only made significant achievements later, following the 1992 Rio Declaration and the 1997 Convention. A lack of expertise may also explain why Kazakhstan did not manage to nudge Beijing to the negotiation table earlier. However, over the last ten years, Kazakhstan built significant expertise in international law, with a large number of Kazakhstani students studying law abroad. The popular Bolashak scholarship programme sends up to 1,000 students abroad annually, all of whom are committed to return home and work in Kazakhstan for several years. Former US Ambassador Hoagland summaries the impact of the programme as follows:

"The so-called BOLASHAK Generation is apparent now throughout the public and private sectors -- bright, globalized, young people, almost all speaking English, who are in positions just a level or two away from decision-making authority "(Hoagland, 2009j).

Today, Kazakhstan is home to several reputable international law firms with qualified local staff. Perhaps most tellingly, some legal experts demonstrated early on that Beijing was in violation of international customary law (Sievers 2002). In addition, Kazakhstan is actively involved in a number of legal frameworks at the UN. For example, it has been an active member of the UN Committee on the Peaceful

Uses of Outer Space (UNCOPOUS) since 1994, even serving as an annual co-sponsor and an outspoken proponent of drafting legislation to regulate outer space rights (UN 2010). Having served as the USSR launching pad for space flights, including the first manned space flight under Yuri Gagarin, Kazakhstan recognises the prestigious aspects of its historic link to questions of outer space. Here Kazakhstani involvement also extends to water issues with Kazakhstan, advocating the benefits of using space technology for water management on the ground (UN 2010).¹⁶⁵ Kazakhstan also has significant diplomatic representation at IOs beyond the UN, such as UNESCO and OSCE. There are currently 73 Kazakhstani embassies and consulates abroad. As for staffing on specifically international environmental issues, there appears to be no lack of enthusiasm or man power.¹⁶⁶ Kazakhstan actively encourages fellow Central Asian countries to accede to the Helsinki convention, even making “concerted efforts to engage China” (UN 2008: 27). In fact, Nazarbayev’s Greenbridge initiative epitomises Astana’s explicit priority to become a leader in international environmental cooperation. This initiative aims to link the environmental efforts of Asia and Europe, spanning 95 countries and two thirds of the world population (UNECE 2011). Nazarbayev launched the initiative at the UNGA, and his diplomatic corps has successfully lobbied ESACP, as well as United Nations Economic Commission for Europe (UNECE) for full support. In this case, Kazakhstani diplomats certainly demonstrated the expertise to successfully navigate IOs to enlist international support. The active and successful involvement of Astana contradicts the lack of actions taken in the Sino-Kazakh water dispute. However, the very personal nature of the Greenbridge Initiative, which is a key effort by Nazarbayev to build his legacy, suggests that Kazakhstan mobilises its resources where the elite interests are the strongest and where they additionally overlap with the national interest. Here it is also in Astana’s interest to keep the faltering

¹⁶⁵ Statement of Byrganym Aitimova.

¹⁶⁶ For example a UN report states that “Kazakhstan also is active in developing bilateral and regional cooperation in environmental protection, as well as in a greater role in international organizations and forums. Many of its efforts are focused on the particular importance of transboundary water issues to regional cooperation” (UN 2008).

negotiations with China out of public view, as this would cast doubt on Kazakhstan's leadership qualities in the field of effective international environmental cooperation, possibly revealing double standards.

Kazakhstan has also demonstrated that it has the legal expertise to defend its interests in a host of international litigation cases, and is considered the most experienced CIS country in international investment arbitration (Usoskin 2012). Four cases involving Kazakhstan are currently pending at the International Centre for Settlement of Investment Disputes (ICSID) at the WB alone (WorldBank 2012b). In 2010, Kazakhstan won a complaint against a previous tribunal decision concerning a bilateral investment agreement with Turkey.¹⁶⁷ The current case against Mukhtar Ablyazov¹⁶⁸, the former head of BTA, shows best how effectively Kazakhstan can mobilise legal capabilities in a foreign jurisdiction if elite and national interests are aligned.

Another possible explanation for Astana's lack of recourse to IOs is that the government is put off by the burden of proof in environmental cases, which currently rests with the affected states. Kazakhstan would have to present detailed data showing how China's water diversion affects Kazakhstan's access to fresh water. As previously discussed, Kazakhstan is not in the position to provide this data. However, this problem is not insurmountable, as the government could undertake the necessary policy changes and investments in the hydrological sector. Nonetheless, Kazakhstan has not drawn on any legal regimes, institutions or conventions at its disposal. This is even more telling as international law seems to be moving in Kazakhstan's favour, with attempts to shift the burden of proof from the affected states gaining traction (Sands 2003:273). Although China may soon

¹⁶⁷ Republic of Kazakhstan vs. Rumeli Telekom A.S. and Telsim Mobil Telekomunikasyon Hizmetleri A.S. (ICSID Case No ARB/05/16).

¹⁶⁸ Mukhtar Ablyazov had been Energy Minister and head of Temirbank before being embroiled in the opposition and exiled to Russia, from where he returned to head BTA bank. During the credit crunch, BTA defaulted which the Kazakhstani government blamed on large scale embezzlement of the bank's funds by Ablyazov, who is currently standing trial in the UK.

find itself in a position where it must prove that its irrigation projects do not cause significant harm to Kazakhstan, there are no signs Astana's strategy is about to change.

The above examples illustrate that Kazakhstan does not lack the capabilities or staffing to pursue legal avenues. It has, in the past, garnered international support for its environmental and other initiatives, making the alternative explanations presented unsatisfactory. The differentiating factor between the issue areas successfully pursued via IOs and the Sino-Kazakhstani water dispute is the elite interest (discussed below). Only when the issue is very close to the Kazakhstani leadership's interests does Astana operate effectively in international regimes, as strongly exemplified along Astana's Greenbridge Initiative. The Sino-Kazakhstani water dispute, on the other hand, is driven by Kazakhstan's economic dependence on China and Kazakhstani anxieties around endangering future benefits, as well as Kazakhstan's elite, which lacks the political will to even undertake the domestic changes necessary to improve the country's water management capabilities and hence, its position in the dispute.

The most obvious outcome for the water dispute is that Beijing successfully averts any legal challenge and the risk of internationalising the dispute. By refusing to address the deadlocked dispute through a broader international mechanism, Kazakhstan plays into the interests of Beijing and re-affirms the hierarchic relationship with China. However, given the wider context of changes in international environmental law, the tide of global public opinion on the subject may shift to Beijing's disadvantage. China may soon find itself in a position, where it will be asked to justify the effects of its water abstraction on downstream riparians. This has in fact already happened along the Mekong.

Beijing is aware of the changing international legal framework and is actively preparing to mitigate the effects by developing the relevant expertise in international water law. For example, Professor Patricia Wouters, from the UNESCO

Centre for Water Law, Policy and Science at Dundee University, has been invited as a returning scholar by Xiamen University to lecture specifically on these issues (Dundee University 2011). By stalling the negotiations as long as possible, Beijing has actually bought itself time to develop the legal capabilities necessary should Kazakhstan decide to address the dispute in a legal context.

7.3.6 Isolation of the Water Dispute

Perhaps most strikingly, China also manages to isolate the water dispute from other areas of bilateral cooperation, such as access to resources and security cooperation. Here Kazakhstan's elite possibly plays the most prominent role in facilitating China's interests. In these areas, the Sino-Kazakhstani relationship should be less hierarchical (Chapter 4) and by isolating the water dispute, China maximises the effectiveness of Kazakhstan's economic dependence which increases the opportunity costs for Astana. This may be one reason why the JWC was excluded from the CKCC structure until 2009 to prevent any issue linkages. Technocrats in particular in Kazakhstan highlight Kazakhstan's lack of leverage in negotiations with Beijing and call on the government to improve its bargaining power (Stone 2012)¹⁶⁹. A viable option, and one successfully practised by other states, is to link the dispute to other issues where Kazakhstan might have advantages vis-à-vis China (Daoudy 2009:365): this could be areas that are important to Beijing, such as supply of non-water resources and regional security cooperation, where the power relationship is reversed or at least one of interdependence. Kazakhstan's non-water resources, especially uranium and gas and to a certain extent oil, play an important role in China's medium and long-term energy strategy. This thesis has discussed Kazakhstan's role in Beijing's attempts to diversify its energy mix and to seek energy imports through more reliable overland supply chains (Chapter 4), as well as Beijing's uranium needs. As a result, Chinese NOCs have heavily invested in pipeline infrastructure in Kazakhstan, which should increase Astana's role and bargaining

¹⁶⁹ Igor Malkovsky, Deputy Director of the Institute for Geography in Almaty.

power vis-à-vis Beijing, in line with Lake's theory on relationally specific assets (Lake, 1998). This applies even more to nuclear power. As the world's second biggest producer, Kazakhstan is in a unique position to be the key supplier to Chinese demand (WNA 2012). Beijing cemented that relationship in 2011, when Nazarbayev agreed to supply China with 55,000 tonnes of uranium and promised to meet 40% of China's uranium demand in the future (Hotter 2011). This provides Kazakhstani policy makers with an opportunity to level the playing field, by linking the terms of the long-term uranium supplies to concessions in the water dispute. This strategy could be successful as alternative uranium suppliers are limited. Other options for China include Australia, Canada and Niger, but Kazakhstan produces as much uranium as these countries combined (WNA 2012).

Astana has a strong position in gas exports. The Central Asian Gas Pipeline (CAGP) for example, delivers gas from Turkmenistan and Uzbekistan but must transit to large parts of Kazakhstan (See Figure 53). It is currently the only natural gas pipeline into China, and is thus a key part in Beijing's plans to diversify its energy supply away from its heavy reliance on coal. Completed at the end of 2012, the pipeline has a capacity of 40bn meters³/annually and has doubled China's natural gas imports. Beyond the immediate energy benefits, China is heavily invested in both the oil and gas pipeline project, which costs around US\$7bn. By far the longest part of the pipeline, 1115km or 60% of its length, runs through Kazakhstani territory, giving Astana a prominent role in its management and security, thus creating opportunities for Kazakhstan to use it as a bargaining chip (Figure 53).

In 2007, Kazakhstan launched one tentative attempt to link the water issue to food deliveries. At a meeting with Chinese and Kyrgyz officials on the Ili Basin Integrated Water Resource Management (IWRM), Astana proposed to deliver subsidised food to China for ten years, in return for Beijing's commitment to allow free flow of water along the Ili (Milas 2007a). However, Beijing flatly rejected the offer. It is possible that Beijing did not want to be perceived as being bought off in the

presence of a third party (Kyrgyzstan). Food items, on the other hand, are likely not persuasive enough, since food imports are not as hard to come by for Beijing as other resources, such as uranium, oil and gas - which are more suitable for levelling the playing field. Energy resources in particular may be a powerful bargaining chip. Chinese NOCs are interesting in tapping into more Kazakhstani energy resources in the future, as underlined by CNPC's plan to build another pipeline to access the energy resources farther away in the Caspian (Interview Energy Expert). Linking further resource agreements, such as a Caspian pipeline to progress in the water negotiations, is arguably a low-risk strategy for Astana. Having established the CKCC as meta-structure to coordinate various components of the bilateral relationship, should facilitate efforts to link different issues.

Figure 53 China's First Natural Gas Pipeline



Astana can link regional security issues. Beijing highlighted on numerous occasions that it values Kazakhstan's support in fighting the Three Evils, terrorism, extremism and separatism (Xinhuanet 2009), which affect Xinjiang, because of its intertwined history with Central Asia and China's "weak constitutionality" (Kerr 2008) in this

region. As a consequence, political instability caused by the Three Evils in Central Asia may spill over into Xinjiang.

China managed to broaden support for this fight throughout Central Asia because Kazakhstan and other SCO member states have adopted Beijing's rhetoric (SCO 2012). Perhaps as a result, SCO member states have agreed to extradite foreigners if they are accused of one of the Three Evils (HRIC 2011). However, Astana's security cooperation has domestic and international costs. Kazakhstan is home to a large Chinese Uighur population, which is also represented in the elite (Karim Massimov). Beijing is concerned that this exile group can organise resistance at home and has frequently asked Astana to extradite Uighurs. However, these Uighurs are sometimes recognised as refugees by UNHCR, and thus receive a minimum level of legal protection against extradition. Astana has come under strong criticism domestically and internationally for its refoulement of ethnic Uighurs back to China, where they often face prosecution if not execution (Amnesty 1998). While the Kazakhstani population sometimes associates Uighurs with illegal Chinese labour, Uighurs are in general very well integrated. Over 300,000 strong, ethnic Uighurs constitute one of Kazakhstan's largest and fastest growing ethnic minorities. They are politically very well organised and have, for example, staged protests against China in Almaty, following the 2009 riots in Xinjiang. Given the Sinophobia already present in Kazakhstan, the Uighurs put Astana under further pressure by highlighting its cooperation and involvement with Beijing. Given the domestic and international costs associated with this practice, it is interesting that Astana has not asked for concessions in return, at least not publically. By not pursuing this option, Astana misses an important opportunity to improve its negotiation position with Beijing and to level the playing field. There is a precedent of successfully linking water issues to security cooperation. In its dispute over Turkish dam projects along the Euphrates and Tigres, Syrian negotiators linked Turkey's Kurdish security concerns to the dispute, which led to a water allocation agreement in 1987 (Daoudy

2009: 375). Prior to the agreement, Syria had supported the PKK and its operations in Turkey.

Kazakhstan also has one of the longest borders with China and Astana's security cooperation is paramount for Beijing. For example, the spread of Islam through Central Asia to Xinjiang is a further concern for Beijing, and Kazakhstan's cooperation is thus a potential negotiation point. Cheng Guoping, the former Chinese Ambassador to Kazakhstan, emphasised in conversation with the US Ambassador, Richard E. Hoagland:

"Kazakhstan's role and importance is growing daily and is of great significance to China for political, economic, and security reasons."
(Guoping quoted in Hoagland, 2010e)

This sums up a number of options for Kazakhstan to level the playing field. Astana could peg its security cooperation, both bilaterally and within the SCO, to progress in the dispute. However, instead, Astana pledges to support China's diplomatic initiatives within IOs, such as the UN, CICA and SCO, in bilateral communiqués. For example, Kazakhstan supported China's boycott of the Nobel Peace Prize ceremony for Liu Xiaobo in 2010. Similarly, Nazarbayev echoed Beijing's calls to replace the US Dollar as the global reserve currency within two weeks of China's high-level criticism. Nazarbayev called for a replacement of the US Dollar as the world's reserve currency in March 2009 (Muzalevsky 2009) and again during the OSCE's annual international economic forum in Astana in 2010¹⁷⁰. This closely followed Beijing's initiative. On 23 March 2009, Zhou Xiao Chuan (Zhou 2009), the governor of the People's Bank of China (PBC) called for the creation of a new international reserve currency and the de-facto abolishment of the US Dollar, which cause much international attention (Anderlini 2010). The proximity of both public statements is interesting. Nazarbayev floated the idea on 10 March 2009, just two weeks earlier. This poses the question as to whether both statements were co-ordinated, or

¹⁷⁰ Nazarbayev first went on record with regard to replacing the U.S. Dollar on 10 March 2009, just two weeks before Zhou Xiaochuan floated the idea publically

whether Beijing and Kazakhstan had discussed the issue previously, for example in the SCO.

Some scholars attribute Astana's success in getting Beijing to the negotiation table at all to Kazakhstan's resources and their value to Beijing (Economy quoted in Stone 2012). There is no direct evidence that Astana actually generates such issue linkages, for which it also has been criticised domestically. An alternative explanation for Beijing's willingness to sit at the negotiation table is China's concern both for reputational risks in the region and the risks of losing control over the dispute to a third party or international regime. This was highlighted by Mang's testimony before the US Congress where she demonstrated that Beijing is keenly aware of how negative overseas environmental impact caused by its SOEs damages its public diplomacy and soft power.¹⁷¹ This concern is also reflected in China's stance at the MRC, where an attitude of "we don't want to look like someone who doesn't care" (Hirsch & Jensen et al 2006) has increased ministerial interest to comply with demands for data transparency. While the reputational concerns of Beijing can explain the fact that negotiations are taking place, this research has not uncovered any instances where Astana proactively linked diplomatic collaboration and support for the transboundary water dispute with other issues, where it is in a much stronger position vis-à-vis Beijing. Chinese scholars rightly celebrate this as a foreign policy success, as the water dispute has not spilled over to other issue areas, affecting the broader scope of Sino-Kazakh "good neighbourly" relations (Wang and Hu, 2011).

This section has illustrated that there are numerous issue areas, spanning energy resources to security interests, where Kazakhstan's strategic role results in significant opportunity costs for Beijing if Kazakhstan were to defect. These issue

¹⁷¹ Grace Mang discussed how the Ministry of Commerce and Environmental Protection drafted guidelines that oversee SOEs environmental impact and stressed that this "goes well beyond efforts of other governments including the U.S" (US Congress 2012).

areas also explain why Beijing may be interested in fostering dependencies with Kazakhstan (Lake 1999:9). By default, this means that Kazakhstan has bargaining power and could link these issues to the water dispute, yet Astana has continuously failed to include any of these elements in its conversations with Beijing, aside from a half-hearted attempt in 2007. China's success in isolating the water issue is demonstrated by the fact that 19 years of negotiations have yielded no binding water allocation agreement. By refusing to level the playing field, Beijing has managed to lock Kazakhstan into the hierarchical relationship, which will also prevent Astana's costly defections in issue areas where Astana, can increase China's opportunity costs and mitigate the effects of economic dependence. Oil, gas and uranium are difficult and costly to substitute given their specificity (Crescenzi 2005), role in China's energy security, and the late arrival of NOCs on the international resource stage. More so uranium, as Kazakhstan is not bound to a complex export infrastructure like in oil and gas (Chapter 5). Chinese NOCs must compete with IOCs established in resource-rich geographies for a share of the remaining non-nationalised hydrocarbon assets. Limiting competition for Kazakhstani energy resources by locking Kazakhstan into a hierarchical relationship is an effective strategy for China and its NOCs (Lake 1999).

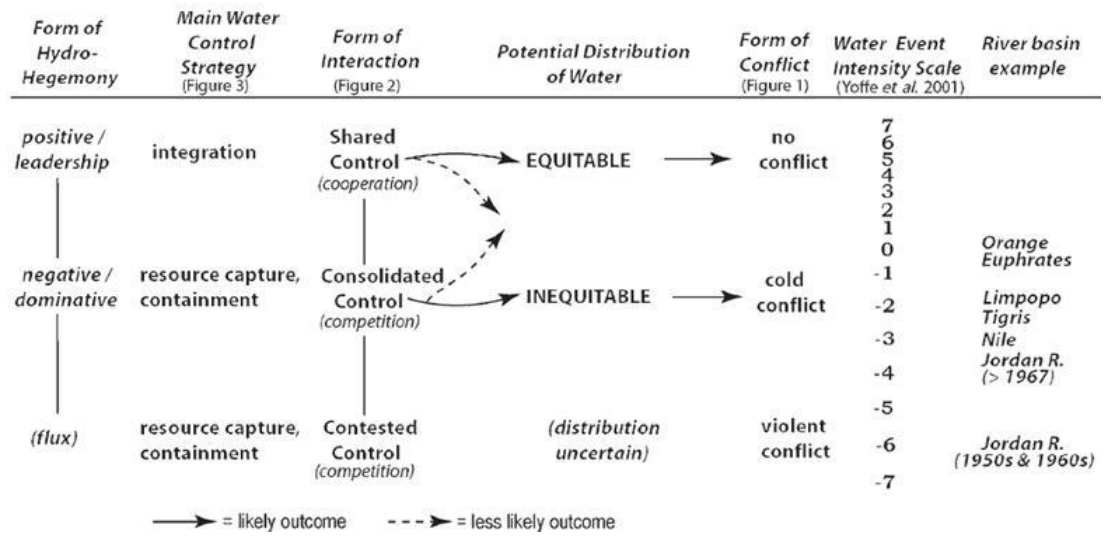
7.4 Dispute Outcome

China has consolidated its control over water resources outside the realm of military power. In effect, Beijing has translated its economic power into political objectives, such as maintaining absolute sovereignty over transboundary waters, turning China into a hydro-hegemon which itself further magnifies the asymmetrical relationship (Cascao & Zeitoun 2011). Hydro-hegemony describes the domination of a co-riparian over disputed water resources, a status often achieved through exploiting existing power asymmetries between co-riparians (Zeitoun & Warner

2006). Figure 54 depicts the different forms of hegemony that a co-riparian can exert over transboundary waters. In the positive form a benevolent hegemon provides public goods, such as infrastructure for cooperation (Zeitoun & Warner 2006), which corresponds to a liberal interpretation of the hegemonic stability theory (Kindleberger, 1973).

China exercises a negative form of hydro-hegemony (Zeitoun & Warner 2006), whereby it unilaterally captures water resources without meaningful concessions. By doing so, Beijing exploits weaknesses in the enforceability of international environmental law and the absence of significant resistance from Kazakhstan. In theory, China can further its hydro-hegemony as leverage to exert pressure on Kazakhstan in other areas (Zeitoun & Warner 2006). For example, Beijing can condition a water-allocation agreement to Kazakhstani concessions in other areas, such as further access to Kazakhstan's resource sector, especially in the Caspian, which Beijing has failed to access to date (Interview European Diplomat 2) or other foreign policy objectives such as support in the fight against the Three Evils. By creating links to other issues, such as uranium deliveries, Astana could stymie Beijing's ability to maintain absolute sovereignty over its rivers. However, in its current position as hydro-hegemon, Astana risks Beijing 'turning the tables' to exploit Kazakhstan's water vulnerabilities by demanding additional concessions from Astana itself.

Figure 54 Forms of Hydro-Hegemony



(Zeitoun & Warner 2006)

China's behaviour is a missed opportunity to transform the dispute into a positive form of hegemony, similarly to France's role in developing the Commission for Rhine Navigation (Chapter 6). China could facilitate cooperation along the Irtysh and the Ili and act as positive hydro-hegemon by shaping and retaining the monopoly on the rules of the game (Warner & Zeitoun 2006) whilst promoting regional cooperation. This would lend its win-win diplomacy (hezuogongying) real weight. Whilst China appears cooperational (Biba 2007) on the surface, it has made not actionable and binding commitment to restricting its own water intake and allocating water with Kazakhstan. Similarly Beijing's reputation can be at stake if it continues with the status quo. In case of a transfer of power, a more transparent political system in Kazakhstan may reveal China's uncompromising stance at the expense of Kazakhstan's national interest. An expert from the China Institute for International Strategic Studies (CIIS) summed this up as follows: "how to properly deal with and solve this dilemma [of conflicting water needs with Kazakhstan] will test China's diplomatic acumen and its ability to govern" (Han, 2011). Kazakhstan's economic dependency can explain why decision makers "show no inclination to antagonize China" (Stone 2012: 407) in order to secure the goodwill of Beijing and benefit from the perceived economic opportunities. However, these calculations

may not necessarily pay off. Here the Mekong serves as an informative example. The parties to the Agreement on Commercial Navigation on the Lancang-Mekong River¹⁷² acceded in the hope this would increase trade with China. However, there is now a suspicion, at least in Thailand, that the agreement disproportionately benefits Chinese exports to Thailand, whilst China refuses to facilitate imports from Thailand in return (Hirsch 2006). This may serve as an important lesson to Kazakhstan.

Beijing seemingly appreciates the hierarchical setting with Kazakhstan and its benefits. This is most obvious in China's preference for a bilateral negotiation setting, which allows Beijing to maximise the hierarchical relationship and China's reluctance to advance the negotiations. If water inefficiencies in both countries remain unchanged, this will further fuel the conflict potential of the dispute in the future as China and Kazakhstan may not have the resources to trade in virtual water (Allan, 1992), to depoliticise the dispute.

The next section investigates whether these dispute outcomes are the result of direct threats from Beijing and are related to the research question of how China

can leverage Kazakhstan's economic dependence.

¹⁷² Copy with the author.

7.5 Deliberate dispute outcomes?

The dispute outcome depicts China as a hydro-hegemon, which is the result of its foreign policy objective to maximise sovereignty over its transboundary rivers. Although Beijing pursues a number of negotiation strategies the degree of intent or the causality in generating these successes is less clear. Meeting minutes or protocols do not exist in the public domain, save for officially released statements which could be aimed at manipulating public opinion by exaggerating any progress. Limited press freedom in both countries further suppresses a public debate and critical analysis of the negotiations. Consequently, it is difficult to dissect the decision-making process and assess where the causal link is located: does Beijing issue threats to Kazakhstan in meetings or does Kazakhstan pre-emptively comply with Beijing's agenda to ensure it can maximise perceived future economic benefits? Given the lack of direct data, the thesis is limited to the observation of outcomes on the ground to infer Chinese objectives. Unless the processes within the MFA are known in greater detail, any such analysis necessarily relies on circumstantial evidence. Nonetheless, this thesis argues that outcomes are likely driven by the pre-emptive acquiescence of Kazakhstan's elite to Chinese interest or what Baldwin has termed "the rule of anticipated reactions", where

"one actor, B, shapes his behavior to conform to what he believes are the desires of another actor, A, without having received explicit messages about A's wants or intentions from A or A's agents." (Baldwin 1980: 499)

Although the causal pathway differs from direct intent or threats, the outcome remains unchanged: China can pursue and maximise its foreign policy interests, at least in the water dispute with Kazakhstan. It is unlikely that China issues any direct threats in the dispute because the reputational risks associated with direct threats are likely too high.

Reputational Risks

Economic threats, once they become known, carry reputational risks for Beijing, which are most likely only worth taking in cases where sensitive interests, such as its national security, are at stake. Beijing is determined to develop a reputation as a peaceful rising power in the region and cannot afford to be seen as a regional bully. This concern came to light when, in response to Kazakhstani media criticism of China's water abstractions, Chinese academics complained that Beijing is misunderstood and that critics conveniently abuse the China threat theory (Wang & Hu, 2011). Threatening stances could set off a wave of Central Asian countries seeking assurances from Russia or inviting the US deeper into Central Asia which would contradict Chinese intentions to detach the US from the region (Kerr 2008).

The detrimental effects of perception as a more assertive power were observable in the aftermath of the Global Crisis of 2008. Driven by a newfound self-confidence, China sharpened its rhetoric and territorial claims of the Spratly and Diaoyu Islands with the issuance of economic threats and increased military activity. This prompted a renewed US commitment to Asia, possibly by invitation of regional countries. While Beijing certainly considers a strengthened US presence in Asia undesirable, perhaps the sensitive security issues at stake more than compensate for the sub-optimal outcome. In other words, threats to China's territorial integrity are likely worth the opportunity costs of damaging its reputation. Transboundary water, on the other hand, does not rank as highly on China's agenda, making it unlikely that Beijing would use explicit economic threats if that risked increased Russian and US interference and its perceived sphere of influence.

Similarly, Beijing has made direct economic threats against states that have critiqued China's human rights record, received the Dalai Lama or awarded the Nobel Peace Prize to Liu Xiaobo (Chapter 1). Such threats have proven effective in the past and analysts point toward Beijing's increasingly sophisticated carrot and stick strategy (Chapter 1). At the time of writing China successfully averted an anti-

dumping case initiated by the EU solar industry, using the “lure of commercial contracts and the threat of retaliation” (Chaffin and Wiesmann 2012).

Fuchs and Klann demonstrated in a regression model of 159 states that received the Dalai Lama that exports from the host country to China drop by 8.1-16.9% on average in the two years following a high-level reception. It takes typically two years for trade to rebound (Fuchs and Klann 2010:4). Interestingly, this correlation is only statistically significant between 2002 and 2008, the period of Hu Jintao’s leadership, and exclusively affects machinery exports. This particularly affects machinery exports. However, it is unclear whether exports drop because Beijing instructs SOEs to order their machinery from alternative sources or whether Chinese companies and consumers themselves boycott these goods in the wake of changing political sentiment at home. Yet Kazakhstan should be less susceptible to this effect because it predominantly exports resources which are essential to China’s economic development. While machinery imports are easy to substitute, the high specificity of resources makes it harder for Beijing to seek out alternatives without opportunity costs (David A Lake, 1998). Uranium, oil and gas are only available in a limited number of countries and difficult to substitute. Additionally, Beijing’s existing investment in Kazakhstan’s energy sector means it sunk costs, which it would forfeit through decreasing imports. CNPC made a significant investment in a US\$7bn oil pipeline, which will only be recouped through its long-term usage and deliveries. While it is likely that the Dalai Lama effect is not credible when resource imports are at stake, it is also possible that the Kazakhstani government has not grasped its immunity yet (Fuchs and Klann 2011).

7.6 The Elite also Facilitates China's Objectives

'Energy resources are a much higher priority in Astana's psyche than water'
(Tim Hannan)

Kazakhstan's behaviour in the dispute can be explained through its economic dependence on China. Kazakhstan likely fears antagonising Beijing over the water dispute, thereby risking future economic trade-offs such as decreased revenue streams to which it is particularly vulnerable as a Rentier State even more so during economic crises (Chapter 2).

However, Astana also displays an astonishing unwillingness to shore up its own water management capabilities to improve its bargaining power vis-à-vis China (Mirumachi & Allen 2010) which suggests a complete lack of political will (Borisov 1999) and leaves Kazakhstan in an exceptionally weak bargaining position for which its economic dependency cannot fully account for. This not only allows Beijing to fully leverage Kazakhstan's economic dependency, but also facilitates and further consolidates the hierarchical dynamics, undermining Kazakhstan's national interest in the short and long term (hydro-hegemony). This puzzle cannot be fully understood without taking Kazakhstan's elite into consideration.

In the water dispute elite interest conflict with and negate the national interest and water sovereignty. The elite's short-term concern for economic and political survival which are in line with Rentier State dynamics (Chapters 2 and 5) not only disincentives decision makers from a more aggressive negotiation stance, but also invariably aligns the elite interest with China. The link between revenues and elite legitimacy should give economic and political influence to any foreign economic actor who can provide such revenues (Chapter 2), especially after 2008. Chinese trade, finance and investment helped the elite to consolidate and maintain its power by providing it with discreet and easily accessible revenues and which gave China significant influence in Kazakhstan's economy and politics (Chapters 2 and 3).

This can also explain why the Kazakhstani government “abnormally” favours Chinese investment (Alida Ashimbaeva, cited in Peyrouse, 2008).

The lack of political will to overhaul its hydrological infrastructure and thus maintain the status quo instead, which may be due to the misallocation of capital that is typical in a Rentier State strengthens China’s bargaining position. Because the patronage system creates looser accountability links with the constituency and suppresses free media reporting, Kazakhstan’s elite can take these decisions without consequence. As a result of the elite structure, Kazakhstan cannot draw on many of the bargaining options discussed above. For example, the government cannot introduce greater transparency into the dispute to enlist public support, without facing embarrassment over how little progress has been made in the negotiations. This is especially acute given the underlying Sinophobia of Kazakhstanis.

Beijing also indirectly benefits from Kazakhstani elite dynamics. In 2009, the MinEP and the Water Resource Committee (WRC) became the target of the government’s new anti-corruption efforts. The Economic Crimes and Anti-Corruption Agency, better known as the financial police, carried out a high profile corruption campaign, which also targeted Anatoliy Ryabtsev (Asanow 2009)¹⁷³, the Chairman of the WRC, Nurlan Iskakov, Minister for Environmental Protection and his two deputies. Both institutions are key partners in the Sino-Kazakhstani negotiation process and the dismissal of their leadership likely affected their effectiveness. Chinese negotiators prefer to build relationships with individuals and not institutions. Thus a change in personnel slows down cooperation until a new relationship of trust is established (Interview International Water Expert 1). This is observable at the MRC. After every CEO change, Beijing deploys a cautious approach to the organisation where “not much happens” and cooperates more actively further along in the CEO’s term if the candidate has been found as trustworthy or unbiased (Interview International

¹⁷³ Ryabtsev pleaded guilty.

Water Expert 1). It is unclear why the anti-corruption campaign targeted these individuals, as none of them are known to be critics of the President. However, analysts argue that the anti-corruption campaign was politically motivated and symptomatic of an ongoing inter-elite struggle (Economist 2009). These officials may have been made scapegoats to help the government save face amidst an unfolding string of embezzlement scandals at the time (Chapter 3). As officials in institutions with relatively little policy power, they were possibly considered 'disposable'. The timing of the anti-corruption campaign further supports this view. The campaign was launched in 2009, when the financial crisis peaked and a string of corruption scandals at the country's biggest banks forced the government into action.

Decision making often takes place in the informal realm in Kazakhstan, favouring personal vs. institutional decision making processes (Chapter 3). It is possible, then, that personal contacts facilitate China's interests more directly to delay any water-allocation agreement. Previous chapters have shown that economic players such as CNPC, CITIC and CIC are apt at working along and through the Kazakhstani elite and its decision-making process to close deals (Chapter 5). Unfortunately, the water dispute takes place behind closed doors and it is difficult to draw any further conclusions about elite contacts. However, there are indicators for personalised decision making in the dispute as well. Nazarbayev sent a personal letter to Jiang Zemin in 1999 to bring Beijing to the negotiation table in the first place. By doing so, Nazarbayev shifted the dispute to a personal level, which, judging by the outcome, was successful. The personalised approach is also reflected in the CKCC, which is now in charge of the JWC. Media and analysts in Kazakhstan criticise the CKCC and suspect that its lack of transparency allows China to directly buy decisions and decision makers (Peyrouse, 2008). High-level elite alignment can also explain why dispute management and strategy have not received a higher profile and remained on a low-technical level, embedded in government institutions with little policy power, such as the MoA. Transboundary water management and water

supply are officially national and foreign policy priorities and should thus be dealt with at much higher government levels. This would also explain why it is only lower-ranking officials and technocrats, located at the periphery of the elite network, who criticise the negotiations. Murat Auezov is the notable exception. Instead the task falls with officials from the MoA who express their frustrations:

"The [JWC] meets every year without results." (Dostay, Zhakybay, Kazakh Institute of Geology and Geography, quoted in Ryabtsev 2011)

IR research shows that successful strategies for solving ongoing water disputes lie beyond the river basin itself, in the political economy of the subordinate riparian. A diversified economy allows water-scarce states to trade in virtual water as the most effective way to overcome water scarcity and thus, the driver for water disputes (Mirumachi & Allan 2010). Singapore, for example, has to import 95% of its water needs. To achieve water security, Singapore signed long-term treaties with Malaysia to import water via Johor, where it invested in shared water-treatment plants. A strong and diversified economy allows water-scarce countries to trade in such virtual water (Allan 2002). A highly-skilled labour force is, in turn, the precondition for a diversified economy and allows states to seek viable alternatives to meet its water security demands (Allan & Mirumachi 2011:17). Yet, here, Kazakhstan relies disproportionately on foreign investors to provide training for the local labour force. Kazakhstan's local content law enforces a quota on international investors to employ at least 80% local staff. The law has caused much discontent among ICOs, less because of their unwillingness to employ local staff but more because of the widespread lack of qualified labour.¹⁷⁴ This is an interesting difference to Azerbaijan, which is a similarly resource-driven economy, however invests heavily in the education of its work force and thus has managed to maintain a more diverse economy, according to an expert (Interview Regional Expert).

¹⁷⁴ Conversations of the author at the Kazakhstani Investment Day in London, 2011.

As a result the elite is incentivised to facilitate Chinese interests or, at a minimum, not to antagonise Beijing over the water dispute. This may explain Kazakhstan's reluctance to pursue meaningful options to improve its negotiation power. If a state is economically dependent, it should be in the national interests to mitigate these dependencies. The thesis has shown that Kazakhstan is in a position to level the asymmetry with China by recourse to its energy and security cooperation. By failing to do so, Kazakhstan's bargaining position is much weaker than can be explained by the country's economic dependence alone. The sub-systemic context provides an additional lever that facilitates the effectiveness of Kazakhstan's economic dependence. In the absence of a discrete Chinese foreign policy towards Kazakhstan, it is possible that this effectiveness is entirely driven by the Kazakhstani elite and its perception of Beijing.

Instead of challenging Beijing to pursue national interests, Kazakhstani policy makers go out of their way to support China's interests. In 1998, Kazakhstan conceded 100-200 km² of land to China along the Black Irtysh, amidst Beijing's refusal to start a conversation with Kazakhstan over Transboundary Rivers (Interview Local Expert). In May 2000, Nazarbayev wrote a letter to President Jiang Zemin, suggesting that the next meeting of the Shanghai Five would take place in Shanghai the following year. The meeting was diplomatically significant because the SCO would take the significant step of becoming firmly institutionalised. Nazarbayev's suggestion to have this founding/key meeting in Shanghai could have been aimed at appeasing Beijing. Moreover, Nazarbayev suggested the summit focused on economic themes, thereby taking the option to discuss transboundary water issues in a multi-lateral setting off the table.¹⁷⁵

An alternative explanation for the slow negotiation process could be a lack of awareness in Beijing of how important the dispute is for Kazakhstan. The lacklustre motivation of Kazakhstan's elite to confront Beijing more strategically could raise

¹⁷⁵ Chronology of bi-lateral meetings (CCTV 2012).

the impression in Beijing that this is not a key issue for Kazakhstan and thus, they have decided to ignore it. However, this explanation does not hold. Academics in China write about the dispute and draw an accurate picture of the negative consequences of China's water abstractions for Kazakhstan and acknowledge openly that this poses a security threat for Astana (Wang and Hu 2011). Moreover, commentary can be found on Chinese micro blogs, which describe problems that Project 635 causes Kazakhstan (Baidu 2011). Kazakhstani and Chinese experts have regular points of contact outside bi-lateral settings of the dispute, such as in expert working groups, which are organised by international institutions such as the World Meteorological Organization (WMO 2005) or the UN to discuss the overall water situation in the region more generally. The ongoing attempts of Kazakh negotiators to table the issue at SCO meetings and to get Russia involved should have signalled clearly to Beijing that the issue is of national importance.

On the surface, China's negotiation strategy has been successful. It has managed to maximise its foreign policy objectives to maintain absolute sovereignty over its water resources, whilst Astana, conversely, loses access to water. Beijing controls the agenda and has prevented the multi-lateralisation, externalisation and cross-linkage of the dispute. Moreover, by exploiting Kazakhstan's institutional weaknesses, Beijing has been able to stall for time, which shifts the legal situation in Beijing's favour in view of Xinjiang's socio-economic developments. Concurrently, building activity has continued unhindered, which has allowed Beijing to create a more advantageous starting point to any water allocation agreement in the future (Zeitoun & Warner 2006:44). Astana is likely deterred by China's economic dominance, fearing that exerting pressure on Beijing in the water dispute could risk current and future revenues (Weiner, 2011; Copeland, 1996 and Snyder, 2006). While economic dependency is one explanatory variable, it cannot explain why Astana has not undertaken any domestic steps to improve its water management capabilities, especially monitoring. This thesis has demonstrated that elite interests are an intervening variable, something which can explain the lack of will to

challenge Beijing and the short-term focus of Kazakhstani policy making (Chapter 3). The elite's lack of motivation to challenge China is likely rooted in its indirect and direct benefits from China's growing economic involvement in the country, which allows the elite to maintain the status quo and aligns its interest with China, thus creating a conflict with Kazakhstan's national interest.

Chapter 8 **Conclusions**

The thesis investigated whether China can translate its economic influence into political power and used Sino-Kazakhstani relations as a case study. The mechanism that translates/operationalises economic influence into political influence is the presence economic dependencies of one state on another, in this thesis, Kazakhstan's economic dependence on China. Economic dependencies in turn are the outcome of bilateral economic asymmetries that create significant opportunity costs for the subordinate economic partner (Kazakhstan). The thesis found that China has indeed created economic dependencies in Kazakhstan which it can leverage towards foreign policy objectives. The second part of the thesis illustrated this along a transboundary water conflict between both countries where China can maximise its bargaining position and thus foreign policy objectives. However, the causal pathway that facilitates China's ability to translate Kazakhstan's economic dependency into foreign policy gains appears more indirect. It is unlikely that Beijing issues direct threats in the dispute but rather the Kazakhstan pre-emptively acquiesces with Chinese interests.

Kazakhstan's particularly political context as a Rentier State is an important intervening variable that both facilitates China's growing economic influence in Kazakhstan and China's ability to leverage that dependency towards its foreign policy objectives.

8.1 Economic Dependency

This thesis has found evidence for the hypothesis that China's accumulated economic activities have created an economic dependency in Kazakhstan as well as its sub-hypotheses. However this is only partially the result of a deliberate process. China's rapidly-growing economic involvement in Kazakhstan has been accelerated in the aftermath of the Global Financial Crisis. The stark asymmetry and associated

opportunity costs have created strong economic dependencies in Kazakhstan. China's influence is most clearly pronounced in its role as Kazakhstan's number one trade partner and creditor of last resort. On the other hand, Kazakhstan's presence in China's economy is barely discernible, introducing a stark asymmetry. However, raw numbers may underestimate Kazakhstan's influence, given the elevated role it plays in China's overall energy strategy. While trade, finance and investment data demonstrates the existence of an economic dependency, the degree of Beijing's deliberateness in establishing this dependency was more difficult to establish. In fact, this thesis could not uncover a comprehensive Chinese foreign policy strategy towards Kazakhstan, or Beijing's control over its economic institutions that would be required to deliberately pursue economic dependencies on the aggregate level. While central government control does appear to be present in some sectors, such as Chinese policy banks, whose credit lines directly link the provision of finance to resource access, Beijing's control over other Chinese economic institutions in Kazakhstan, such as SOEs, appears to be more tenuous. Instead, Kazakhstan's economic dependency is the outcome of a confluence of factors in both China and Kazakhstan. While China's relative economic capabilities and its shifting foreign policy priorities may have incentivised Chinese trade, finance and investment abroad, it is Kazakhstan's domestic political system, especially its status as a Rentier State that further engrained Beijing's presence. Over the course of this research, the elite has emerged as an important intervening variable which facilitates Kazakhstan's economic dependence on China as well as China's ability to leverage that dependence towards political ends. The political dynamics and legitimacy considerations in a Rentier State increase the opportunity costs associated with decreasing Chinese economic activity (see below).

Beijing's 'Go West' and 'Go Global' frameworks, coupled with China's energy security requirements, desire to diversify its foreign currency reserves and interest in regional stability, led Chinese actors to pursue investment opportunities in Kazakhstan. Chinese politicians and bankers grasped the opportunities presented by

the retrenchment of western sovereigns and banks in the wake of the Global Financial Crisis and encouraged their financial institutions to go out and 'swim' (Xinhua, 2009). Given Kazakhstan's immense resource endowment and proximity to western China, it was a natural destination, and the volume of credit lines to Kazakhstan increased significantly after 2008 (Chapter 4). The Kazakhstani elite welcomed increased Chinese investment. Kazakhstan's neopatrimonial political system facilitates China's economic dominance, as the elite relies on external revenues to both legitimise its own power and possibly to enrich itself. Beijing's relative economic capabilities allowed it to make available its deep coffers in 2008, when alternative sources of finance fell sideways and Kazakhstani mismanagement exposed revenue gaps. This effectively turned China into the lender of last resort (Sub-hypothesis 1). Interviewees noted Astana's repeated over-optimism in its budget forecasts, which incorporated revenues from the Kashgan Oilfield (Interview European Diplomat 1) that did not materialise due to years of delays. Production and associated revenues may finally come online in 2013. Astana's financial mismanagement extended to structural weaknesses in the banking sector, Nazarbayev's renationalisation programme and questions on the true size of Kazakhstani savings (Chapter 2 and 3). China's economic interests in the resource sector allowed Astana to make up for these shortfalls without cutting spending or increasing taxation, thus allowing the elite to maintain the status quo without risking political reforms.

Another factor that facilitated the emergence of Kazakhstan's economic dependency on China was the emergence of more stringent anti-corruption laws in the west. Chinese finance and investment, by contrast, is more discrete and less likely to become the subject of corruption scandals (Chapter 2). In Kazakhstan's neopatrimonial system, investment decisions are frequently made in the informal realm of personal elite contacts rather than in the corporate boardroom (Chapters 2 and 4). While foreign investors had difficulties navigating the centralised economic structures of Samruk-Kazyna and the elite power dynamics (Chapter 2),

CIC, CITIC and CNPC successfully managed Kazakhstan's complex power structure (Chapter 4) to advance their investment objectives and thus China's aggregate economic power. After all, Chinese economic institutions likely enjoyed Astana's consent and they aided the elite in consolidating and maintaining its power (Chapters 2, 3 and 4). In addition, China benefits from a prominent supporter in Karim Massimov, who built his steep political career on his ability to channel Chinese investment into Kazakhstan. It is possible that the personal and opaque nature of decision making in Kazakhstan suits China better than western democracies (Interview International Water Expert 1).

As discussed in Chapter 5, Kazakhstan's economic dependence is only partially the result of a deliberate process. Whilst Beijing's macro-economic policies created incentives to seek investment abroad, these were not targeted at Kazakhstan specifically. Until 2005 Beijing's economic influence in Kazakhstan was mainly driven by small traders and NOCs. However, there are signs that Beijing has become more proactive in facilitating its economic influence in Kazakhstan after the financial crisis, especially in finance (Sub-hypothesis 3). While China's economic dominance in Kazakhstan may not be the result of a deliberate Chinese foreign policy, the discernible fit between Beijing's desire for energy security and diversification of foreign currency reserves and Astana's need for additional revenues allowed that dependency to develop more spontaneously. In fact, it is interesting that China's role in Kazakhstan's economy is not yet more pronounced (Interview Local Finance Expert 1). One interviewee suggested that Russia's "invisible hand" counterbalanced Chinese economy forays into Kazakhstan rather than Astana (Interview, European Diplomat 2). China is now deeply involved in Kazakhstan's economic and by extension its political life. This necessarily also has implications for

Kazakhstan's and China's respective relationship with Russia. However, a detailed analysis of the geopolitical consequences is beyond the scope of this thesis.¹⁷⁶

Although Beijing may not have deliberately created economic dependencies in Kazakhstan, it may nevertheless deliberately leverage the existing dependency for political gain. However, Beijing's ability to exert this leverage critically hinges on both its credible control over the economic institutions that drive this dependency and its grasp of Astana's revenue needs. Another research question of this thesis was whether China can control the economic levers that underpin its economic influence in Kazakhstan. Chapter 5 found evidence that China's economic capabilities are fragmented between various economic institutions where Beijing's level of control varies significantly. As a result it is unlikely that Beijing control the levers of economic influence in Kazakhstan, which was identified as a criterion for the ability to translate economic influence into political power (Chapter 5, Sub-hypothesis 4).

Moreover, the depth of Beijing's understanding of Kazakhstan's specific revenue needs is unclear. China's call for its financial institutions to seek out investment opportunities abroad may reflect a broad understanding of finance needs in a world of stretched public budgets post-2008 rather than an in-depth understanding of the revenue intricacies in Kazakhstan. This thesis observed two cases of political leverage, Chinese credit lines conditioned on resource deliveries and the Sino-Kazakhstani transboundary water conflict. In the former case, Chinese policy banks China ExIm and CDB acted in close links with Beijing's interests, demonstrating that China does indeed leverage Kazakhstan's dependence towards immediate outcomes, including access to resources. On the other hand, Beijing's control over its SWFs and SOEs is less certain. These actors have shown that they can enlist Beijing's political support to overcome obstacles to their investment objectives. Both CNPC and CITIC have used Beijing to overcome the anti-Chinese investment

¹⁷⁶ For an introduction see David Kerr, *Central Asian and Russian perspectives on China's strategic emergence*. *International Affairs* 86(1).

climate in Kazakhstan (Sub-hypothesis 5). This strategy was successful, but perhaps only because the interest of Beijing and its economic institutions overlapped. However, Beijing's reach over these institutions is less clear if, for example, it were to instruct these entities to abandon planned projects in Kazakhstan. While this would not be in the interests of Chinese SWFs and SOEs, it would be necessary if Beijing were to credibly seek to use its economic capabilities as leverage for political gain. However, as the case study on the Sino-Kazakhstani transboundary water dispute has shown, China's actual control over its economic institutions may not be as relevant as Astana's perception of such control. Indeed, it became clear through interviews in Kazakhstan that Astana perceives China and its economic institutions as a unitary actor and believe that Beijing can indeed exert control over its economic institutions (Sub-hypothesis 6). This led to a modification of the lead hypothesis: China can leverage these dependencies if it effectively controls the drivers of economic influence or if Kazakhstani policy makers perceive of such control (Chapter 1).

In the latter case, Beijing manages to leverage Kazakhstan's economic dependency to pursue absolute sovereignty over its transboundary rivers and reinforce the existing hierarchy between both countries. Beijing actively pursues negotiation strategies that allow it to maintain the hierarchy and block Kazakhstani attempts to level the playing field. For example, Beijing opposes multilateralising the negotiations by including Russia, who as a down-stream riparian is equally affected by Chinese water abstractions. Instead, Beijing cooperates only enough to prevent Kazakhstan from abandoning the negotiations and seeking an external dispute resolution. At odds with developments in international environmental cooperation, Beijing exploits weaknesses in the enforcement of transboundary water regimes to exert absolute control over its transboundary rivers, establishing Beijing as a hydro-hegemon (Zeitoun & Warner, 2006) and further facilitating the bi-lateral hierarchy. Although Beijing leverages Kazakhstan's economic dependency in the transboundary water conflict, Astana has shown little inclination to challenge

Beijing or to conduct the domestic changes necessary to improve Kazakhstan's negotiating position (Chapter 6). This thesis presented circumstantial evidence that China's ability to leverage the economic dependency is further facilitated by Kazakhstan's elite, as many of its interests are aligned with Beijing.¹⁷⁷ As Chapter 3 discussed, the elite frequently consents to China's increased economic involvement in the country, due to Beijing's role in assisting the elite to consolidate and maintain power at home. The associated conditionality of Chinese economic activity is more acceptable to the elite than those of alternative sources of investment (Chapter 3). The elite are susceptible to revenue disruptions especially severe shocks brought about by an economic crisis such as 2008. Because of uncertainties inherent in the Kazakhstani political system (Chapter 2), immediate revenues take priority over long-term revenues which can explain the "lack of political will" to challenge Beijing more forcefully along its transboundary rivers. The elite also lend a helping hand to Beijing in the water conflict by failing to acknowledge China's fragmented power dynamics and by failing to improve the domestic variables that weaken its bargaining position vis-à-vis China. By presenting Chinese corporations and Beijing as a unitary actor, Astana provides greater leverage for Beijing than likely exists in reality. However, the perception in Astana could change in the future and would likely allow Kazakhstan to exploit the increasingly fragmented political dynamics that are emerging in China. The failure to improve domestic variables such as Kazakhstan's poor hydrological framework as well as general water inefficiencies is likely the result of misallocated capital which is typical for a Rentier State (Chapter 2 and 3).

Kazakhstan's economic dependence can account for the success of China's bargaining strategy over the disputed transboundary water resources. However, interestingly research suggested that this unlikely due to direct Chinese threats but

¹⁷⁷ It might be of interest for a future research project to investigate to what degree elite alignment with China is driven by the fact that both regimes are authoritarian. However, this is beyond the scope of this thesis.

rather due to the pre-emptive acquiescence of the elite with Chinese interests or what Baldwin calls the “rule of anticipated reactions” (Baldwin 1980).

Although China uses its relative economic power to its advantage in the water conflict and in obtaining resources at concessional prices, Beijing does not appear as yet to ‘maximise’ its aggregate economic leverage over Kazakhstan. At least, this thesis could not find evidence in the public domain. This may be due to Beijing’s unawareness of the extent of its economic influence or the absence of a comprehensive foreign policy towards Kazakhstan to take advantage of it. However, the preconditions to use this economic hierarchy as leverage in the future are in place. Past successes, for example in obtaining resources, may hasten Beijing’s interest in doing so.

Whether deliberately established or not, the current environment of growing Chinese involvement in Kazakhstan’s economy provides Beijing with increasingly powerful levers to promote its interests, even at the expense of Kazakhstan’s overall development and national security. Similar situations are seen in other countries, such as Cambodia and further afield in Africa, where Beijing combines close relationships with the local elite and its deep financial pockets to exploit resources on the ground. China’s behaviour in the transboundary water dispute with Kazakhstan is thus an interesting testing ground for Beijing’s foreign policy and leadership ability, even beyond Kazakhstan or Central Asia.

8.2 Implications for Chinese Foreign Policy

The establishment of an economic hierarchy implies that China has become a crucial stakeholder in Kazakhstan’s economic, and by extension its political landscape, with Chinese investment exposed to domestic changes in Kazakhstan. Nazarbayev is currently the sole guarantor of political stability, and uncertainties around his succession persist (Chapter 3). The open succession question and

ongoing inter-elite conflicts may lead to a prolonged leadership transition accompanied by open competition for power, which is likely to affect international investment on the ground (Interview Finance Expert). While this does not necessarily mean that violent incident will erupt, it is possible that political changes may destabilise Kazakhstan's biggest companies. Given the elite frequently has a stake in corporations, even including the LSE-listed ENRC and Kazakhmys, political turmoil in Kazakhstan is likely to lead to changes in shareholders and board representatives. Even now, international investors are occasionally pulled into the elite conflict, as Uranium One and Nation's Energy demonstrated (Chapter 2). This uncertainty presents a challenge to China's foreign policy approach and links into the ongoing debate on non-interference versus interference in sovereign nations.

A vital part of the debate on the merits of interference to protect Chinese assets abroad, in case of a regime collapse or conflict, is the military's role. The Arab Spring and events in Libya leading to the mass-evacuation of Chinese nationals (Xinhua 2011a) reinvigorated this debate and proponents of a more 'assertive foreign policy' argue that improvement of PLA capabilities would be in China's economic interest. Chen Xiangyang from the Chinese Institute of Contemporary International Relations suggested that China should develop a "Large Periphery" strategy to safeguard stability along its borders (Lin 2011). However, calls for military readiness now extend beyond China's border to protecting its interests abroad. Chinese military leaders now discuss the possibility of intervening in Central Asia, should a conflict threaten Chinese investment (Lin 2011). Chinese newspapers argue that Beijing should consider the military significance of railway exports in enhancing China's military power projection (Lin 2011). In fact, during a SCO Peace mission in 2009, China moved troops into Kazakhstan using the same railway infrastructure that it helped to finance and build. China's ability to refit its economic investments for military purposes has also been recognised on the other side of the border. Konstantin Syroyezhkinan, an influential China expert at Kazakhstan's Institute of Strategic Studies (KISS), has raised concerns that China

could use its infrastructure investments to deploy troops to Kazakhstan should its investment and interest be seriously threatened through a crisis or unforeseen regime change (Syroezhkin 2010)¹⁷⁸. International analysts, such as Robert McDermott, observed that during the SCO Peace Mission China already demonstrated these capabilities, and surmised that this could extend to a unilateral intervention by Beijing, in case its assets might be at risk (Kucera 2010).

However, since the Arab Spring, this debate is no longer confined to military circles. Members of China's resource industry increasingly call for the protection of Chinese energy resources abroad. There is now widespread recognition in China that its oil and energy investments are often in countries that are susceptible to conflict, competing interests and unstable regimes, making it crucial for China to be able to defend its interests. (Wu 2011). The conflict in Libya highlighted the risks of China's energy security strategy, and the parallels with Kazakhstan are obvious. At a minimum, businessmen and legal scholars demand that Beijing develop early warning systems and political risk assessments for China's overseas' investments (Wen 2011). Kazakhstan and China signed a number of military agreements, which could also be driven by Beijing's desire to stay close to political and military developments within Kazakhstan. On the back of these agreements, there is regular contact between special service and law enforcement agencies. A number of Kazakhstani officers undergo training courses at China's elite military schools. A protocol on the provision of military assistance between the defence ministries of Kazakhstan and China is in place, and both sides cooperate to protect the Central Asia-China Pipeline (Kazinform 2011). Although Beijing does not directly protect its assets in Kazakhstan, it arguably is closely enough involved to step in and protect its assets directly should the need arise. China holds regular consultations with the security departments of Kazakhstan, Uzbekistan and Turkmenistan, trains security

¹⁷⁸ Lin also shows how the PLA's General Logistics Department is involved in the planning and execution of railways and railway stations in China to facilitate the deployment of Chinese troops.

personnel and provides equipment and weapons including to Kazakhstan's KNB to protect its pipelines (Hoagland, 2010e).

Nevertheless, this thesis also reveals an interesting gap between China's actual economic and political influence in Kazakhstan and its limited official foreign policy towards Kazakhstan. Perhaps Beijing assumes that in the case of a political crisis, Russia will maintain stability in Kazakhstan. Yet recent events across Central Asia cast doubt on Russia's commitment and ability to intervene or to provide the financial support necessary to keep the Kazakhstani regime in power. In 2010, during the Kyrgyz civil war, Rosa Otunbayeva, Kyrgyzstan's interim President, appealed to Russia for military help, which Moscow declined. Similarly, when Nazarbayev turned to Russia for help during the financial crisis, Moscow was not forthcoming (Chapter 3). These events question Russia's commitment to the region.

Beijing's lack of a coherent, communicated foreign policy for Kazakhstan stands in stark contrast to the deep economic ties between the two nations. It seems Beijing is unable to match its policy making to the rapid growth of its economic actors' involvement in Kazakhstan's economy and political system. Beijing is undoubtedly a dominant economic force in Kazakhstan, and its presence helps to keep the local elite in power. However, the absence of a comprehensive foreign strategy is striking and carries economic and potentially political risks. It is possible that China may decide to rely instead on other foreign powers to maintain a stable economic and political environment conducive to its own interests. Yet, this can put Chinese investment at risk if such a third party rescue is not forthcoming in a crisis. Beyond jeopardising Beijing's ability to protect its assets in Kazakhstan in a potential crisis, any political instability may spill over into Xinjiang and feed into Uighur secessionism. Moreover, Beijing's failure to acknowledge the true extent of its influence in Kazakhstan implies that it may not be aware of the implications of the actions of its economic institutions. This disconnection could increase Kazakhstanis' perception of a China as a threat.

As such China's growing economic influence in Kazakhstan falls in line with its wider foreign policy objectives which include foremost maintaining political stability and securing energy resources. Political stability refers to combating the Three Evils, terrorism, separatism and extremism which have repercussions for the political stability of Xinjiang , its most western province. By providing economic investment to a Rentier State and acting as lender of last resort Beijing invariably also props up Kazakhstan's elite and the political system itself which may pre-empt the risks of regime change (democratisation) at its borders. To what degree Beijing deliberately contributes to the diffusion of authoritarian regimes along its borders through its economic influence should be addressed in another research project.

Absolute Sovereignty

This thesis also provides insight into China's general approach to international relations and disputes, particularly into the Chinese principle of *absolute sovereignty*. The Sino-Kazakhstani transboundary water dispute exemplifies China's stand on upholding absolute sovereignty. However, the conflict also illustrates that this stance is increasingly at odds with international developments, such as the recognition that transboundary rivers are shared resources. Although the principle of non-interference has marginally softened in recent years under pressure from the UN, China continues to block or abstain when it comes to votes on sanctions and military interventions. This view may be rooted in China's own territorial challenges and its concern that it could find itself at the receiving end of such interventions. However, the non-interference principle also has strong historical roots in China's concept of justice (Westad, 2012 page?), the idea that states in the international system interact along a certain order and obey certain rules. Irrespective of its roots, the non-interference policy increasingly clashes with China's desire to safeguard its economic investments abroad. The recent experience in Libya turned this apparent contradiction into a reality for China. Kazakhstan has

the potential to provide challenges for Beijing that are greater than those in Libya. In Kazakhstan's case, a number of Chinese security concerns coincide, ranging from energy security to territorial security concerns involving separatist activity in Xinjiang.

The reality of China's desire to maintain absolute sovereignty in the Sino-Kazakhstani transboundary water dispute and in its foreign policy more broadly, stands in stark contrast to China's rhetoric. It is difficult to reconcile Beijing's foreign policy with its principles of 'hu li' mutually beneficial (互利) or 'gong ying' win-win (共赢) cooperation. In the water conflict, Beijing has missed opportunities to proactively foster cooperation and provide benign leadership as a regional hegemon who provides public goods (Chapter 7). Instead of levelling hierarchies, Beijing insists on keeping negotiations in a setting where it can maximise Kazakhstan's subordinate position. Its 'don't ask, don't tell' approach further questions its commitment to driving the negotiations towards a solution. By providing Kazakhstan's elite the means to consolidate its power, China has become not only a stakeholder on the ground but an accomplice in the corruption and rentierism in Kazakhstan's domestic politics. This may pose a reputational problem in the long term, especially if a new generation of politicians takes the helm of Kazakhstani politics. Judging by its outcome of resource extraction, China's foreign policy towards Kazakhstan resembles that of a traditional colonial power. Beijing exploits Kazakhstan's institutional weaknesses and elite dynamics to foster economic dependencies that can be leveraged for political gain, even to the detriment of Kazakhstan's national interest. Its conditional credit lines lock Astana into oil and gas deliveries at concessional prices in the medium to long-term. Today, former colonial powers appear more committed to bringing about political and economic improvements on the ground through a variety of means, including foreign aid, lower tariffs (African Growth and Opportunity Act), and technical assistance. Yet China appears to do little to benefit Kazakhstan's political and economic development. Rather, it exploits the dysfunctional economic and political

context it encounters. China's involvement in Kazakhstan further exacerbates the "resource curse" (Auty 1993), and undermines Astana's efforts to diversify its economy, hardly a 'win-win' scenario.

8.3 Implications for IR Theory

A Neoclassical Realist perspective allowed the thesis to elucidate variables on the systemic and sub-systemic level, which can explain how China could create an economic dependency with Kazakhstan. The asymmetry in the Sino-Kazakhstani relationship is the result of the specific revenue needs of the Kazakhstani elite and its consent to Chinese investment, which was made possible thanks to China's relative economic capabilities. These dynamics are also important for understanding how Beijing benefits from Kazakhstan's economic dependence across different foreign policy objectives. These range from access to energy resources to exercising absolute control over its water resources. Other IR paradigms overlook these factors and cannot provide a similarly satisfying explanation.

Since Kazakhstan's independence, Beijing and Astana have built an ever closer relationship, marked by such milestones as the comprehensive strategic partnership, regular parliamentary level visits, military exchanges and joint military missions under the umbrella of the SCO. The two parties also institutionalised the transboundary water dispute through annual meetings. In a neo-liberal or constructivist framework, this institutionalisation should help enable dispute resolution. However, the lack of any relevant agreement after twenty years is puzzling and can be better explained through a neoclassical realist narrative.

Shortcomings are also apparent under a realist framework. Chinese foreign policy interests in the region, such as the maintenance of resource security, would lend themselves naturally to a realist analysis. However the 'means' and 'manner' with

which China pursues its political goals, by fostering economic dependencies and manipulating elite interests in Kazakhstan fall outside the Realist lens. In the water dispute, for example, the conflict dynamics do not only reflect existing economic and power asymmetries in international relations, but are also the result of structural weaknesses inside Kazakhstan (Chapter 6). Increased Chinese investment in Kazakhstan's hydrocarbon industry directly benefits the ruling elite in two ways: firstly, it allows the elite to consolidate and maintain power in the absence of free and fair elections and, secondly, it contributes to the accumulation of personal wealth. Sino-Kazakhstani negotiation outcomes cannot be explained through classic realist frameworks that consider all states like-units (Kenneth Waltz). Rather, Beijing can exploit Kazakhstan's economic dependency because of the behaviour and interests of Kazakhstan's ruling elite. This invariably creates a situation where elite interests shape Kazakhstan's foreign policy behaviour. For example, Kazakhstan does not follow the usual power-maximising positions, but rather foregoes opportunities to improve its bargaining position with China because Kazakhstan's foreign policy is shaped to a certain degree by the elite interest. As such, Kazakhstan's behaviour can be better compared to that of a Middle Eastern Rentier State or a Petro State (Yergin 2011). The thesis elucidated how the context of a Rentier State creates specific revenue needs but also introduces vulnerabilities to external revenue shocks (Karl Lynn 1997, Demkiv 2012). The vulnerabilities increase the opportunity costs associated with revenue shortfalls from a key economic partner, especially during a period of economic crisis such as following 2008. Kazakhstan's banking system was particularly vulnerable during this time which is also the result of misallocated capital which is typical for a Rentier. As such the thesis demonstrated that economic dependencies are not only effective in democracies (Kahler and Kastner 1996) but can be equally and perhaps even more effective in a non-democratic setting such as a Rentier State.

Neoclassical Realism captures these sub-systemic variables, which are not only relevant for understanding how China established the economic dependency, but

also for comprehending how China can use these dependencies to advance its foreign policy goals. Economic dependence remains at the centre of the analysis as a form of fungible power (Guzzini 1998:137), linked to a state's overall relative material capabilities (Rose 1998). Thus, the central tenet of the analysis remains the distribution of power in the international system. China's rise in the international system is intricately linked to the development of its economic capabilities, which in turn are a prerequisite for exerting economic influence in Kazakhstan. It is China's relative material capabilities that establish the 'basic parameters' of its foreign policy (Rose 1998:145). On the unit level, neoclassical realism distinguishes between different power capabilities and foreign policy preferences and interests (Rose 1998:146). China's foreign currency reserves and strong economic growth enabled it to expand economic trade and investment, while Kazakhstan's historic economic partners withdrew. However, neoclassical realism also captures the elite's favouritism of China and the discreet nature of its investments. After an economic dependence has been established, neoclassical realism elucidates the domestic factors that inhibit or facilitate Beijing's ability to operationalise the dependency. The incorporation of domestic factors enhances analytical clarity and shows that when Beijing exerts direct control over its economic institutions, such as its policy banks, it can effectively advance its overall energy objectives. Neoclassical realism further takes into account the perception of policy makers in Kazakhstan, who do not distinguish between China's economic institutions and Beijing and who perceive of China as a future source of revenue. Both factors facilitate China's ability to operationalise Kazakhstan's economic dependence towards foreign policy objectives. By adding sub-systemic factors to the classic systemic factors such as the distribution of power, neoclassical realism can better explain why Beijing can leverage Kazakhstan's economic dependence effectively in the water conflict. The thesis has shown that a neoclassical realist framework is most suitable in addressing the question of whether China can enlist its economic capabilities to advance foreign policy objectives.

This thesis has shown that the independent variables that inform the economic hierarchy between Kazakhstan and China can be located both in China and in Kazakhstan. It is difficult to assess which weighs more heavily towards a satisfactory explanation of Kazakhstan's economic dependence. A discussion of Kazakhstan's domestic context establishes that the neopatrimonial system generates revenue needs, which in theory should benefit any external source able to extend such revenue. However, Beijing's relative economic capabilities, particularly the world's biggest foreign currency reserves, have enabled it to increase these revenues even throughout the Global Financial Crisis when alternative sources disappeared, whilst offering opportunity costs that are acceptable to the Kazakhstani elite.

8.4 Outlook

While China derives resources and geopolitical interests from the Sino-Kazakhstani relationship, the long-term benefits for Kazakhstan are less clear-cut. The Kazakhstani elite's preference for easily-generated revenue from Chinese resource investment has left the country resource dependent (Palazuelos & Fernandez 2012) and undermines any diversification of the economy. Officially, the government aims to diversify its economic partners by 2020, when no single economic partner should enjoy a share of greater than 5% in Kazakhstan's economy (Interview Investment Expert 1). Economic diversification is essential for generating sustainable long-term growth and for de-linking Kazakhstan's economic success from the price and availability of energy. The potential successful exploration of shale gas in the US and, going forward, in China, which is home to reserves, could exert downward pressure on Kazakhstani resource revenues. Moreover, diversification would improve Kazakhstan's ability to trade in virtual water, as discussed in Chapter 6, and thus become less dependent on a positive outcome in the Sino-Kazakhstani water dispute (Mirumachi, 2010).

The economic dependency on China also undermines Kazakhstan's multi-vector foreign policy, which strives to balance the interests of the major powers against each other. Currently, China has replaced Russia along all economic indicators. This thesis has demonstrated that China's economic weight in Kazakhstan is exacerbated by the short-term view and rent-seeking behaviour of elite. The power structure in Kazakhstan incentivises elites to be more concerned with their short- and medium-term survival than long-term sustainable policies (Interview Trade Expert, International Development Expert). The elite's desire for self-enrichment has led it to extract money from investors through frequent and intransparent tax changes and fines. The government's renationalisation programme further alienated western IOCs and, perhaps as a result, CONOCO Philips abandoned the Kashagan oil field in 2012. Chinese companies appear to have enjoyed some immunity from these threats to foreign businesses (Interview Trade Expert). Since Kazakhstani decision makers perceive Chinese IOCs, such as CNPC, as more closely linked to their government, they have been hesitant to subject them to fines and other forms of interference. This disparate treatment of foreign IOCs further increases China's economic dominance in Kazakhstan.

In parallel to this thesis' argument that the elite structure in Kazakhstan facilitates the country's economic dependence, the solution to Kazakhstan's economic challenges lies in the reform of this elite structure. Given the absence of an obvious succession, Nazarbayev's death may provide an opportunity for a new generation of leaders to introduce greater economic and political liberalisation. The field research for this thesis has shown that a generation of talented Kazakhstanis has entered the political and economic system, a generation who are determined to succeed based on their abilities rather than elite affiliation. A leadership transition can provide the necessary inflection point for these individuals to move into key decision-making positions and transfer Kazakhstan's economy into a post-resource era. However, other analysts are more sceptical and foresee a distinct possibility that the next leadership in Kazakhstan will continue with the same policies (Conversation Risk

Analyst). Yet, even under the current leadership it is feasible to imagine a reform of the private sector, as long as the political power of the elite is kept intact. Meritocracy in the private sector, particularly better managerial oversight over Kazakhstan's banks, would reinstall investor confidence in Kazakhstan's banking sector and potentially open up alternative sources of finance besides China. Limiting rent-seeking behaviour may make the overall investment climate less volatile and attract western IOCs, thus counteracting Chinese influence in Kazakhstan.

Another outcome of China's economic influence is Kazakhstan's invariably closer integration with China's economic and financial infrastructure. Chinese infrastructure, especially the railway system, has undone the historically close integration with Moscow and will thus support trade and people links with Beijing in the future. Kazakhstan's financial sector is now better integrated with China because of closer bilateral cooperation, currency swap agreements and Chinese efforts to build a financial infrastructure throughout Central Asia via the SCO. The construction of a number of pipelines from Kazakhstan to China combined with medium-term financing integrates Kazakhstani resources increasingly into China's infrastructure, especially the West-East pipeline. The recent fallout between Russia and Kazakhstan, over tariffs for Kazakhstani oil refined in Russia, has led Astana to decide to refine oil in China (Chapter 4). Militarily, Kazakhstan cooperates closely with China under the SCO umbrella but also increasingly bilaterally, with China providing security training and equipment to Kazakhstan to protect its pipelines. This may exert a greater pull for security integration with China as well. As a result, economic ties between the two nations are increasingly expanding to the spheres of infrastructure, finance and also security.

The thesis demonstrated that the complementary nature of both economies drives growing bilateral trade and investment. One potential obstacle to further integration is the role of Russia. The Customs Union between Kazakhstan and Russia

is still relatively young and it remains to be seen whether Russia will regain trade share at the expense of China. Moreover, there are uncertainties about China's economic growth, which may have peaked by 2012 and is likely to continue at slower rates in the future, which may also slow down Sino-Kazakhstani trade and hamper China's ability to invest abroad. Equally, changes in Kazakhstan's political landscape could bring about the necessary structural changes to create a more sustainable economy, where no a single foreign country plays a predominant role. Alternatively, Astana may attempt to link different issues in its engagement of Beijing, such as uranium deliveries or security cooperation, to dispute concessions, thus mitigating the hierarchal relationship.

The introduction of this thesis discussed the historic precedent of China's trade-centred foreign policy, which also created a hierarchical system along its periphery with China at its apex (Chapter 1). During the Qing Dynasty, China projected economic power into Central Asia and integrated the area firmly into its tribute system, which established China as a regional hegemon. There may be similarities between China's renewed economic dominance in Kazakhstan today. To what extent such historic parallels are coincidental or reflect the continuation of an underlying Chinese way of conducting foreign affairs is a topic that needs to be addressed elsewhere.

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