



Individual Advanced Research Opportunities Program

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Oil and the Citizenry: Changing the Resource Development Paradigm

Topic of research

Kazakhstan joined the EITI (Extractive Industries Transparency Initiative) in 2005 to improve its country's resource revenue management, and to join with other countries in improving accountability and transparency in a sector that is often associated with high levels of corruption and mismanagement of state funds from the resource sector.

The need for this type of initiative goes back to the history of extractive industries sector and its impact on transitional developing systems. Research studies clearly indicate how the management and utilization of natural resources is a key development issue with immediate implications for social and political development. Although many scholars study the political and economic impact of oil on different societies, the impact on education and civil society remain under-explored areas of research. This research, which was supported through an IREX IARO grant, examines the way in which oil as a natural resource is impacting the development of civil society in Kazakhstan. A key component of the EITI is the monitoring of the extractive industries payments by civil society and it is this area that the research focused on, and specifically, aimed answer the following questions:

- Is petroleum a blessing or a curse for the development of civil society in Kazakhstan? How much and how does the existence of oil as a natural resource shape civil society?

To answer these questions I chose to look at the key participants in the EITI (Extractive Industries Transparency Initiative), the government (Ministry of Energy and Mineral Resources, and the Ministry of Finance), the oil and gas sector (IOCs, domestic producers and Kazakhstan's NOC, KMG), and the NGO coalition representing civil society in the process. The Extractive Industries Transparency Initiative is a UK government sponsored initiative to promote the transparent reporting by governments, and companies working in the extractive industries sector to report revenues arising from mineral resource extraction. Kazakhstan first expressed its support of the process in 2003, and officially became a member of the initiative in October 2005 with the "Memorandum of Understanding on Implementation of the Extractive Industries Transparency Initiative in the Republic of Kazakhstan" which was signed at the Kazakhstan International Oil and Gas Expo (KIOGE) by the then Minister of Energy and Mineral Resources, Vladimir Skolnik (currently the Minister of Finance), four members of Parliament, and twenty-four oil and gas companies (majority IOCs, and NOC, KMG), however the NGO coalition did not sign at that time because they believed the Memorandum did not go far enough towards disclosure of revenues by the oil companies and the government.

Why Study Civil Society and the Extractive Industries Sector

Countries with substantial resources that do not invest and support a robust civil society ultimately threaten both present and future development prospects for society and pose significant possibilities for instability in the event of falling prices or new discoveries that offset current demand. Kazakhstan as a high value primary product economy is in a position to radically change the way we view the impact of natural resources on a transitional economy, but it is not clear from the history of the last decade if the government is committed to better and more ethical utilization of the country's resources.

Whether oil is a blessing or a curse depends on the management of the resource and the government's commitment to viewing oil not as a private good, but as a public good used to enhance the economy, as well as the larger society. The 1962 United Nations General Assembly declared in Article 1 of UN Assembly Resolution No. 1803, 'Permanent Sovereignty Over Natural Resources', that the 'right of peoples and nations to permanent sovereignty over their natural wealth and resources must be exercised in the interest of their national development and of the well being of the State concerned.' The 1992 Biodiversity Convention affirmed this sovereignty over natural resources (UNDP). These examples show how a country's natural resources are a public good to be used for the benefit of society, and not a private good to be squandered, misused and irresponsibly invested by only a small segment of the population. The situation in many oil rich countries is that the revenue from the sale of reserves does not go back to the people in the form of social investments, but instead is used for personal benefit and society's opportunity to benefit from the resource is neglected.

Relevance and contribution to field

Scholars continue to examine the role of oil and its impact on both economic and political development. Countries endowed with natural resources often suffer from what is referred to as the resource curse (Mehlum, et al, 2003; Karl, 1997; Torvik, 2001). What this means is that large income from extractive industries such as oil hamper economic and social development rather than enhance development, contribute to political instability, exacerbate corruption, and in some cases even fuel civil war and conflict between competing countries (Collier, 2003). Scholars argue the existence of substantial natural resources is harmful for both economic and political development because governments may make irrational investments, are more

susceptible to corruption through the high rents brought about by highly prized commodities, and that there is little incentive on the part of leaders to bring forth democratic practices or support genuine democratization of the political system. Ross (2001) argues natural resources hinder democracy because the governments of resource rich states have the power through various executive means to squelch dissent and ultimately block off oppositional forces. In another study, Ross (2001) in a report for Oxfam examined the linkages between developing countries' dependence on the export of oil and levels of poverty and found living standards to be low, high child mortality rates, low spending on health care, low enrollment rates in primary and secondary schools, and high income inequality.

Birdsall and Subramanian (2004) argue, "Oil and mineral wealth can be bad for growth and bad for democracy, since they tend to impede the development of institutions and values critical to open, market-based economies and political freedom: civil liberties, the rule of law, protection of property rights and political participation" (p. 77). Thirty-four less-developed countries boast significant oil and natural gas resources constituting 30% of their total export revenue. Ottaway (2005) in her examination of governance and oil rich countries finds "Among the top 10 oil exporters, only two (Mexico and Norway are truly democratic and only three (Nigeria, Russia and Venezuela), have even limited elements of democracy....For countries that discover large amounts of oil before their economies become diversified and their regimes democratic, oil can easily become a curse" (NYT, 2005). Reno (1998) argues the leaders use wealth as a political resource. They can disperse resource wealth to win loyalty and to control dissent. Reno also notes that public sector reforms such as the establishment of schools, health centers, and other social programs decentralize wealth and are therefore not targeted as areas of importance. The incentives to invest in institutions that do not directly support the government through increased revenues are often not invested in.

Marina Ottaway (2003) categorizes Kazakhstan as semi-authoritarian and describes such political configurations as "ambiguous systems that combine rhetorical acceptance of liberal democracy, the existence of some formal democratic institutions, and respect for a limited sphere of civil and political liberties with essentially illiberal or even authoritarian traits" (p.3). Freedom House ranks Kazakhstan 170 out of 194 countries, and categorizes the media as not free (Freedom House, 2005), and Kazakhstan ranks 107 out of 158 countries in the Corruption Perceptions Index (Transparency International 2005). Kazakhstan is a relatively new participant among oil-exporting countries. As one of the five countries surrounding the oil rich Caspian Sea, Kazakhstan has the easiest access and the largest oil supply. Petroleum scientists believe the Caspian region may contain the third largest reserves of oil and natural gas after the Gulf region and Siberia. Foreign investment into Kazakhstan's oil market is growing, and as a result government revenues from the oil and gas sectors are increasing. According to the Kazakh Energy Ministry, between 1991 and 2004 the country of 15 million people attracted more than \$30 billion in direct foreign investment. Last year alone, transnational oil companies put \$2.5 billion into three major Kazakh oil fields. Kazakhstan's natural resource exports currently account for 38 percent of foreign trade, Kazakhstan can expect crude production to triple to approximately 3 million barrels per day within the next fifteen to twenty years, making it one of the world's top ten crude oil exports (ATON Capital: Equity Research: Caspian Oils: Oil and Gas, May 12, 2004). Under the constitution of Kazakhstan land and natural resources are the property of the state, public ownership, but to date the citizenry has not been encouraged to participate in decision making over the use of natural resources, or in discussions over revenue from resources.

Research methodology

I employed qualitative research methods in this study and quantitative analysis of the revenue structure with an in-depth review of the reporting template oil and gas sector revenues. I specifically focused on governmental, private, and nongovernmental sectors. I interviewed key

players from the three sectors, and examined relevant primary source documents that provided insight into the changes taking shape impacting civil society.

While in Kazakhstan I conducted interviews with representatives from the Ministry of Energy and Mineral Resources including the Deputy Minister of Energy responsible for EITI within the ministry and facilitated focus groups with representatives from the NGO coalition. In addition I reviewed the history of EITI both from its establishment in 2002 to its launch in Kazakhstan in 2005. I also attended meetings and seminars with representatives from the Oil and Gas sectors, and the NGO coalition.

My research methodology included two focus groups with university students and representatives from the NGO coalition, interviews with 15 representatives from foreign and Kazakh owned and operated oil companies, representatives from civil society organizations involved in increasing transparency in the oil and gas sectors, the Minister of Energy, and other officials from the oil and gas sector. In addition to the interviews and focus groups I analyzed policy documents regarding Kazakhstan's National Oil Fund, documentation around the Memorandum of Understanding on Extractive Industries Transparency Initiative Implementation in the Republic of Kazakhstan.

Summary of Research findings and Preliminary Conclusions

This on-going study investigates the development of civil society in Kazakhstan, specifically examining the role of oil as both a source of possibility and as a challenge to civil society. In the last two years, there have been interesting movements in the way nongovernmental organizations, working in conjunction with oil and gas companies in Kazakhstan through the EITI initiative, have pushed the government to increase transparency around the management and utilization of oil revenues, while at the same time, oil companies are more involved in supporting community development projects as part of their societal compact with the government.

This IARO grant allowed me to explore these new collaborations, and identify the ways in which these new “transparency” and “public oversight” initiatives within the oil and gas sector affect the development of civil society in the Republic of Kazakhstan. The British Initiative on Extractive Industries Transparency (EITI) was established by order of the Minister of Energy and Mineral Resources of the Republic of Kazakhstan on April 14, 2005 and signed by the government, Parliament and twenty-four oil and gas companies in October, 2005. The EITI model of implementation in Kazakhstan comprises the following three sectors:

1. The companies, holding subsurface use rights in extractive industries (Companies) (oil and gas and mining industry) of the Republic of Kazakhstan
2. The deputies of Parliament of the Republic of Kazakhstan (Parliament of RK) and
3. The non-governmental organizations (NGOs) comprising the Coalition «Oil revenue – under the control of society!» of the Republic of Kazakhstan (Coalition of NGOs)

In addition to the above participating bodies, a National Stakeholders' Council on EITI Implementation in Kazakhstan (National Stakeholders' Council) was established to provide greater opportunity for dialogue and collaboration on the implementation of EITI. Each of the Working Groups, the Group of Companies, the Parliament of RK and the Coalition of NGOs assigned three permanent and three substitute representatives to the National Stakeholders' Council. The participating parties agreed to jointly develop and coordinate with each other regulations for the National Stakeholders' Council.

Impacts to Date

- ⊕ Symbolic “Trust”
- ⊕ International Norm Recognition
- ⊕ Changing the Dialogue/Participation – who sits at the table
- ⊕ Learning – shifting boundaries
- ⊕ Difficulty of Standardization – Hybridization of Process

Challenges

- ⊕ Participation Counts – What’s Missing from the Mix
- ⊕ The Numbers Don’t Add Up and never will unless there’s full participation on the part of all oil and gas companies working in Kazakhstan, as well as the full inclusion of domestic companies.
- ⊕ Only going So Far – Staying within Safe Boundaries
- ⊕ Education – Energy Sector
- ⊕ Supporters and Perception

The EITI, still in its early stages of development is bringing three sectors to the table which never sat together before. Representatives from the NGO coalition noted the importance of “being at the table” with the government and oil companies, and for the first time, being able to actively put forward their demands for increased public oversight over the management of resource revenues. This opportunity alone represents an important point of change and can be seen as a small opening for civil society to press its demands to the government through its demands for more openness around government and resource revenues.

Overview of the Key Issues for the NGO Coalition (based on interviews, and documents from the Coalition)

- Disaggregated information on payments by companies should be made more accessible
- Full text of the audit report, which compares payments of the extracting companies with actual revenues to the budget, should be published in its entirety;
- Within the framework of the EITI, extractive companies should also publish data on payments made to local budgets for social development;
- International EITI guidelines should be taken into account while developing the reporting templates for the Government and extracting companies;
- Civil society should be an equal partner in all discussions related to the implementation of EITI.
- Representatives of the World Bank and European Bank for Reconstruction and Development should also enter the National Council (without vote) as an intermediate party and to provide expertise when necessary;
- The Government of the Republic of Kazakhstan should be represented in the negotiations process by the Prime Minister and he should sign the Memorandum on behalf of the Government;

Since the summer some of these issues have been addressed, and companies are reporting part of their payments to local budgets, but the Coalition remains unsatisfied with the depth of reporting in this particular area. The government and oil companies have stated that they cannot move towards full disaggregation of revenue due to confidentiality clauses in contracts. Statoil did make a motion to go further with disaggregation but eventually withdrew its offer because the company did not want to act without other companies doing the same.

The results of my research to date indicate movement on the initiative, and a lot has happened since the MoU was first brought to the table in October, 2005. All participating bodies have learned about the other, and this itself is an important impact. The NGO Coalition is learning the language of the oil and gas sectors, and are better able to communicate their positions, and can also share “strategic learning about the sector” with organizations beyond the Coalition. I attended the first seminar of the Coalition in late July, 2006 and it was incredibly impressive to see the civil society sector so involved in the EITI and really strategizing about how to further develop their position and approaches to working with the government, and oil and gas companies. They also brought in the media for this seminar, and this is an effective tool for further disseminating the work of the Coalition to the larger public. Many people I spoke to indicated the importance of the media in meet the increased public oversight objective within EITI. Since it is a new initiative it is still too early to forecast its future, however, even without the full initiative in place, it is clear the Coalition will continue to challenge both the government and companies to reach the full potential of EITI, and responsibility to the citizenry.

Suggestions for future research

Kazakhstan is a rapidly emerging energy player. Many identify the country as an economic success story with GDP growth averaging 9% over the last four years and high investment ratings. The country controls 3% of the world’s oil reserves and if FDI (Foreign Direct Investment) remains strong, then the energy sector is expected to grow even further with a target daily production rate of 3 million barrels per day by 2010. The economic achievements of the country are many, but political reform lags behind, and the development of a vibrant civil society is hampered by the lack of strong support for divergent oppositional voices to exist alongside the government, and this ultimately damages the opportunities for civil society to function effectively. Corruption, specifically, has further been found to lower tax revenues as individuals and companies seek to hide income from the government (Moore, 2004). Moreover, corrupt countries tend to under-invest in education and health projects and over-invest in large, visible public infrastructure projects. (Forthcoming, Kissane, 2007)

Future research plans include the continued examination of EITI and the work of the NGO Coalition within EITI. As Kazakhstan’s oil production grows, so will its revenue from the sector. It is imperative to support increased public oversight over the country’s premier natural resource and to continue examination of the country’s management of its energy resources. In addition to the study of civil society and natural resources, it is also necessary to examine more carefully educational reform at both the secondary and tertiary levels. Will the proposed reforms include more transparency around the study and discussion of Kazakhstan’s huge resource base? The constitution grants ownership of natural resources to the citizens, but to date the amount of information shared with the public regarding management of resource revenues is limited. The education system is a great place to embark on the exploration and examination of the use of natural resources, and allows students the opportunity to actively engage in discussions regarding its country’s development.

To date, the focus of EITI in Kazakhstan is on the oil sector, and the gas sector has yet to actively engage with or in the process. This is an area of research, as are the other study of Kazakhstan’s other commodities and the revenues generated from their extraction, especially uranium.

- Kazakhstan’s challenge is to become one of the very few successful resource-rich countries in terms of promotion of diversification, and not developing an unsustainable dependency on the oil sector. The approach the country takes to managing its natural resources will continue to be a key factor in its development, and whether or not Kazakhstan can manage to alleviate high levels of corruption within the sector, and open up the government and resource sector greater transparency and public oversight.

Recommendations for the US policy community

The geopolitical situation of Kazakhstan is important to emphasize. Its location makes it a bridge between Europe and Asia, and the leading exporter of natural resources in the region. There is tremendous interest in the region on the part of the world's global powers, the United States, China, India and Russia, and all are eager to establish strategic links and are actively vying for access to the region's vast resources. Kazakhstan's resources include hydrocarbons, uranium, chromium, silver, phosphor, nickel, coal and gold. To date, the oil industry remains the most dynamic and prosperous sector of the country's economy. Of the former republics, Kazakhstan has the second-largest territory and fourth largest population.

Kazakhstan represents a stable political entity in a potentially unstable region. Nazarbayev has ambitious plans for the country: to be one of the 50 most competitive countries by 2010, accession to the WTO, and chairmanship of the OSCE in 2009. These ambitions bode well for adherence to Western operating standards, laying the possibility for alleviating the high level of corruption that exists across all sectors of society. He has made many speeches attesting to his commitment to improved living standards for the average Kazakhstani, and a National Oil Fund was established for oil revenues, indicating the need for diversification and responsibility for the needs of society.

With GDP growth holding steady at 8 to 9% per year, the Kazkhstani economy as a whole seems robust. The greatest challenge for the government is how to spread its increasing share of oil and gas wealth among a significant enough segment of the population to spur on further diversification of its economy, and not rely on oil extraction for the bulk of the government's revenues. The distribution of national wealth is extremely uneven; the bulk of the oil and gas fields are located in the west, mining and metal works are in the northeast and agriculture in the south. The rural population is approximately 42%, and there is a large rural-urban divide with extraordinary pockets of extreme wealth, and other areas of great poverty. This is a commodity based economy and the energy sector contributes significantly to GDP. The United States has taken a strong interest in Kazakhstan and this is wise because it represents a strategic region, and it is vital to forge closer ties in the region, especially as Russia seeks to play a more active and intense role in the region. Central Asian expert Ariel Cohen argues, "The Caspian region is a significant alternative source of fossil fuels" and serves America's objectives of diversifying energy sources. By 2010, Kazakhstan is expected to be producing approximately 3 million barrels per day, more than double its daily production rate in 2007. It is not the mere presence of strategic commodities that makes Kazakhstan such an important country in the region. Kazakh President, Nursultan Nazarbeyev acknowledged in May 2006, at a joint press conference with Dick Cheney, that the U.S. was the largest foreign investor in Kazakhstan, with assets reaching \$12 billion, or 33% of total FDI.

Recommendations Include:

- Continue to support Kazakhstan's efforts to participate more actively in the EITI.
- Although the EITI is a voluntary initiative, it is imperative for the United States to monitor Kazakhstan's efforts to uphold the EITI and to encourage US oil and gas companies to comply with the initiative.
- Support a broad range of civil society initiatives in Kazakhstan which highlight the resource sector, and encourage greater participation through education and openings in the media.
- Match policy talk with practice/and research. It is important to sustain a good relationship with Kazakhstan, and to support its economic reforms, but it is also critical to

highlight the country's political reforms, and to not applaud its actions in the areas of support for civil and political rights when broken.

- Kazakhstan's media is largely state-controlled, and this serves as a limitation to the full disclosure of information about the energy sector. Support for a broader mix of public and private media establishments is required.
- Bilateral assistance, and funding from US based foundations, and organizations should target civil society organizations within the coalition in order to broaden the Coalition's funding base which to date is predominantly supported by the Soros Foundation under the Revenue Watch Program.

The mismanagement of petro-rents can destabilize a political system, as well as the larger society, and it is therefore imperative for regional stability for Kazakhstan to remain committed to anti-corruption, and participation in initiatives such as the EITI that seek to bring greater public oversight over the country's substantial resource wealth. EITI is contributing to civil society development in Kazakhstan, but greater development and support are critical for the country and its development.