

The Perennial Partnership

The Global Economic Crisis and Russian-Kazakh Relations

PONARS Eurasia Policy Memo No. 71

Sergei Golunov
Durham University
September 2009

Making up nearly 90 percent of the total area of the Commonwealth of Independent States (CIS), Russia and Kazakhstan are also two of the ten largest states in the world. Both have huge oil and gas reserves, considerable industrial and agricultural potential, and developed transportation infrastructures. Their more than 7,500-kilometer common border is the world's longest unbroken international frontier. While Russia and Kazakhstan are among the main initiators of reintegration efforts in the post-Soviet space, Kazakhstan tries to conduct a balanced policy that does not rely too heavily upon any external center of power. Taking this into account, Russian-Kazakh relations are important not only for the two states but also for others seeking to solve common regional security issues, strengthen economic and political influence in Central Asia, and utilize transnational transportation networks.

This memo assesses the impact of the global financial crisis on the bilateral Russian-Kazakh relationship. It examines the developments of bilateral relations before the economic crisis of 2008 and during that crisis, through the first half of 2009.

Russian-Kazakh Relations before the Crisis

In Soviet times, the economic systems of Russia and Kazakhstan were complementary, although Kazakhstan's economy depended far more heavily upon Russia, particularly for supplies of equipment for oil and gas extraction, and food and light industry production. The disintegration of the common Soviet economic space and the resulting socioeconomic crisis negatively affected their economic ties, especially their trade turnover, which, in the 1990s, varied between \$2.5 and \$4.8 billion annually.

Potentially of greater concern were the ethno-political problems that emerged after the Soviet Union's collapse. Worsening socioeconomic conditions in Kazakhstan, combined with widespread discriminatory practices against the non-Kazakh population, particularly in education and employment, caused the large-scale emigration of "European Russophones" (Russians, Ukrainians, Germans, and others). According to official statistics, the number of European Russophones declined by more than 2.5 million (31.9 percent) between 1989 and 1999. Both countries, though particularly Russia, generally ignored the continued violation of human and minority rights by its neighbor.

Soon after gaining independence, Russia and Kazakhstan began to formulate a new basis for their relations. During the 1990s, the two sides concluded more than 300 treaties and agreements aiming to coordinate their external and defense policies, prohibit the use of territory for activities menacing to the security and stability of the other, and to move toward economic, legal, and cultural integration.

Despite some progress in reestablishing and developing bilateral ties, however, Russia and Kazakhstan did not achieve their most significant goals. They failed to create an effective customs union, preserve a common monetary and financial zone, abolish trade restrictions, or refrain from unilateral actions damaging to their partner's economic interests. One of the most serious problems in Russian-Kazakh relations in the 1990s was the poor implementation of arrangements that were easily violated by one or the other side for the sake of short-term interests. This was the case, for example, with arrangements on both preserving the common ruble zone and on abolishing customs controls on their common border.

Economic reintegration between the two states was also hindered in other ways. The sale to foreign owners of large extractive enterprises in Kazakhstan in the second half of the 1990s resulted in a certain reorientation of production toward markets other than Russia. Additionally, at the end of the 1990s, Russia began to fortify its border with Kazakhstan, creating a serious barrier not only for drug trafficking and other kinds of smuggling, but also for ordinary travel and trade.

In 2000, a new era of Russian-Kazakh relations began. Both states experienced rapid economic growth, vastly expanding the resources available for foreign trade, investment, joint electricity production projects, uranium enrichment, extraction and processing of oil and gas condensate, and space exploration. The political climate was also favorable for bilateral relations. As periodic complications arose between Russia and Belarus, Astana could claim to be Moscow's main partner in the post-Soviet space and in the Shanghai Cooperation Organization (SCO). By agreeing to jointly exploit trans-border oil and gas fields, Russia and Kazakhstan managed to solve the dual problems of delineating their common border and partitioning their respective Caspian Sea sectors. Favorable economic and political conditions, in turn, stimulated rapid growth in bilateral turnover, which increased fourfold between 2002 and 2007 to \$16.3 billion.

These trends, however, were not sufficient for real economic and, especially, political integration between the two states. Growth in trade was largely attributable to the rise in global prices for oil, gas, and metals, items that accounted for more than half

of the Russian-Kazakh turnover in 2006. Politically, Kazakhstan maintained a multivector policy, maneuvering between several centers of power (China, the European Union, Russia, and the United States) while avoiding excessive dependence on any single partner. While participating in joint pipeline projects with Russia, for example, Kazakhstan simultaneously tried to find alternative eastern and western routes that bypassed Russian territory.

Economic conditions also favored such a multivector policy. Russia's share in Kazakhstan's foreign trade decreased from 30.8 percent in 2001 to 20.2 percent in 2007. By 2005, Russia had invested \$2.2 billion in Kazakhstan (mainly in oil and gas production), while the United States had invested approximately \$12 billion. By 2006, Kazakhstan had invested roughly 3.5 times more in different sectors of the Russian economy than vice-versa due to the increasing activity of its largest banks, including Kazkommertsbank and Turanalembank.

As before, the problems of ethnic minorities did not play a significant role in bilateral relations. In recent years, Moscow has been almost entirely silent in response to campaigns initiated by Kazakh authorities to gradually oust the Russian language from official communication and to replace Russian city and street names with Kazakh ones. Neither Russian nor Kazakh authorities paid much attention to incidents involving ethnic Kazakhs in Russia, including attacks by skinheads and extortion by corrupt policemen.

During the Crisis

The global financial crisis has negatively impacted Russian-Kazakh economic relations, due to a dramatic fall in raw material prices and a crisis within both countries' banking systems. Thanks to positive dynamics in the first half of 2008, bilateral turnover still grew by almost 18 percent that year. However, in the first quarter of 2009, turnover fell by 16.4 percent compared to the same period the year before. Especially significant was a decrease in Kazakhstan's exports of wheat, metallic minerals, ferroalloys, and gas condensate, as well as Russian exports of gas condensate, oil products, and motor vehicles. Supplies of these and other items dropped by 50 percent or more (based on price). Overall, Kazakhstan's exports to Russia decreased far more than Russia's exports to Kazakhstan (down 24 percent and 11.4 percent, respectively), solidifying Russia's dominant position in their trade relationship. Indeed, while in the first quarter of 2008 Russian exports made up 68.8 percent of total turnover, in the same period of 2009 Russian exports already made up 77.1 percent.

Although far-reaching plans remain on the agenda for further cooperation in spheres like mining operations, nuclear power, space exploration, and automobile construction, progress is lagging by comparison to the pre-crisis period. This is primarily due to the banking crisis in both states, especially Kazakhstan; banks have suspended their expansion into neighboring countries. Aiming to support investment activity in its member states, the Eurasian Economic Community (Eurasec) decided in June 2009 to create an anti-crisis fund of \$10 billion, three-quarters of which was to be provided by Russia. At the same time, Russia's Sberbank was prohibited from taking control of Kazakhstan's Turanalembank, which ultimately was nationalized along with

other leading Kazakh banks.

On the other hand, the crisis likely hastened negotiations between Russia, Kazakhstan, and Belarus on creating a joint customs union to stimulate commercial interaction among the three states. According to the June 2009 intergovernmental agreement, customs controls at the Russian-Kazakh border are to be removed no later than July 2011.

Keeping in mind past failures of implementation, problems relating to the participation of Russia and Kazakhstan in the customs union are far from resolved. Certain tariffs for especially sensitive goods are to be set during a three-year transitional period. Some Kazakh specialists fear that Kazakhstan's entry into the customs union may cause a rise in prices that will allow more expensive Russian goods to replace cheaper goods from China and other states. Others believe, however, that since the conditions for small and medium-sized businesses are more favorable in Kazakhstan, many Russian businessmen will relocate there, creating new jobs.

Politically, Kazakhstan continues to position itself as one of Russia's main allies in the post-Soviet space, while not renouncing its multivector policy. Though Astana seeks to join the World Trade Organization (WTO), it seeks to do so only as a member of the customs union, not on its own. President Nazarbayev has also ratified an agreement on Kazakh participation in the construction of the Caspian pipeline that would go north from Turkmenistan through Kazakhstan and Russia. However, in August 2008, Astana remained neutral in the Russian-Georgian conflict, refraining from recognizing Abkhazian and South Ossetian independence. It has also continued to actively take part in negotiations to supply oil and gas for pipeline routes bypassing Russian territory, particularly the proposed Nabucco project through Turkey and Southeastern Europe. It appears unlikely that, in the short term, the global financial crisis will prompt Astana to abandon its multivector policy, which remains its most profitable option.

Conclusion

After the disintegration of the USSR, Kazakhstan positioned itself as one of Russia's closest partners in the post-Soviet space, while also conducting a multivector policy that balances China, Russia, and the West. Moscow and Astana managed to avoid serious ethnic and territorial conflicts, create a solid legal base for bilateral relations, and, in the 2000s, increase trade turnover, while also launching several major joint projects. These successes, however, were largely a result of the impressive rise in global prices for raw materials and their primary processing products. Unsurprisingly, Russian-Kazakh economic cooperation has been shaped by large extractive and processing enterprises. Still, Russia did not become the most important investor in the Kazakh economy, outstripped by the United States and some EU members.

The global financial crisis may have negatively influenced Russian-Kazakh relations but it has not been entirely destructive. Because of falling prices for raw materials, bilateral trade has declined significantly. Kazakh exports and the national banking system were damaged more seriously than Russia's, and, therefore, Russia has assumed a more dominant position in their bilateral trade. The Eurasec anti-crisis fund was created to support international projects within the Eurasian Economic Community.

The crisis also likely precipitated the creation of a Russian-Kazakh-Belarusian customs union, though it should be remembered that the first attempt to create such a union in the 1990s was unsuccessful. While cooperating closely with Moscow, Kazakhstan has not abandoned its multivector policy, opting to continue negotiations on Western and Chinese investment, as well as oil and gas supplies for alternative routes bypassing Russian territory.

PONARS Eurasia publications are funded through the International Program of Carnegie Corporation of New York.