

## KAZAKHSTAN AT TWENTY-FIVE: STABLE BUT TENSE

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Kazakhstan is at a political and economic crossroads. The country saw impressive growth from 2000 to 2015 due to high oil prices, but it failed to diversify the economy away from extracting and exporting raw materials. The country's post-Soviet trajectory has been dominated by one political figure, President Nursultan Nazarbayev, but the government is only now trying to put into place institutional building blocks that could help safeguard stability for the post-Nazarbayev era.

With economic problems in its three main trade and investment partners (China, the European Union, and Russia) and low oil prices, the Kazakh economy has been in a downward spiral since 2014. The outlook for 2016 is equally bleak, with the Economist Intelligence Unit predicting the country's GDP will contract for the first time since 1998. This economic uncertainty led to rushed decisions to call early elections—a presidential vote held in April 2015 and a parliamentary election to be held in March 2016. Nazarbayev, who is seventy-five and has run the country since the late Soviet era, won the April election with an implausible 97 percent of the vote—once again postponing the inevitable leadership change. The early elections should be seen as preventative measures to ensure the safe return of Nazarbayev and the political system he stewards to office before the country's growing economic crisis leads to greater socioeconomic discontent—something that now appears to be starting. The government is particularly concerned about the falling value of the Kazakh currency, the tenge. The currency declined significantly

after summer 2015 and was, according to Bloomberg, the second worst performing currency in the world that year.

Kazakhstan's political system has long prevented the emergence of any credible political rival to Nazarbayev, either from the opposition or the established ruling elite. For years, this lack of a viable alternative was seen internally as an asset that protected Kazakhstan from Kyrgyz- or Ukrainian-style political instability. However, Kazakhstan's political system now looks increasingly brittle, which raises concerns about what happens to the country after the Nazarbayev era.

Political openness, independent media, and civil society remain stunted in Kazakhstan, once again by design. There is more civil society space in Kazakhstan than in neighboring Azerbaijan, Turkmenistan, or Uzbekistan, but those countries are a low bar for comparison. Independent civil society activists and journalists in Kazakhstan often get into trouble with the law enforcement and tax authorities. Public statements, including those made via social media,

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on what are considered sensitive topics such as the currency devaluation, corruption allegations against senior officials or the security services, or comments deemed by law enforcement to be ethnically chauvinistic or extremist are closely monitored by the government.

This lack of vibrant public debate and legitimate outlets for the public to convey information back to the state does not seem to have been much of a problem during the boom years, but could be down the road as the Kazakh state's and corporate entities' budgets become increasingly stretched. The economic crunch that Kazakhstan experienced throughout 2015 and that continues into 2016 will hamper the Nazarbayev system's ability to keep up with popular expectations for raised living standards after so many years of high growth. Following its devaluation of the currency in August 2015, the government faced small-scale economic protests. In response, several prominent financial figures were dismissed, including the head of the central bank and the chairman of the Kazakhstan Stock Exchange's Management Board. The economic crunch also impacts intra-elite dynamics as Nazarbayev has fewer resources to divide among powerful elite groups and clans.

Kazakhstan's economic growth was, for a long time, extraordinary. Per capita GDP, for example, rose from \$1,647 in 1991 to \$13,172 in 2013, transforming Kazakhstan from a post-Soviet basket case to a middle-income country in just two decades. This is one of the main reasons for Nazarbayev's continued popularity. Nevertheless, Kazakhstan's economic prosperity was lopsided. There remains a wealth gap in the country as a whole and divergent standards of living between different parts of the country. Economic discontent is increasing, particularly among those who have not benefited from the country's fast growth—much of which has been centered around the capital of Astana and the commercial center of Almaty.

## **NEW REGIONAL REALITIES**

Kazakhstan's much lauded stability is concurrently threatened by a confluence of events outside the country and over which Astana has limited control. To outsiders, the Kazakh

leadership presents the country as an island of stability and prosperity in an increasingly troubled Eurasian landmass. To an extent, these claims are true, but the bar for stability and prosperity in the region is quite low. Countries to which Kazakhstan is compared include an increasingly assertive but economically drained Russia, an ultra-authoritarian Uzbekistan, a hermetically sealed Turkmenistan, and frequently unstable Kyrgyzstan and Tajikistan. They also include a potentially unstable Azerbaijan that is turning away from the West and an Afghanistan that is facing resurgent extremist threats.

Kazakhstan's largest challenge is managing an increasingly bellicose Russia, officially its closest ally and a country whose economy—for better or worse—is intertwined with Kazakhstan's. Moscow, however, has proven itself to be an unpredictable regional actor with its policies on Ukraine and Syria. Astana seems to be trying to distance itself from Russia's war with Ukraine and intervention in Syria. Astana is also concerned that Moscow is eager to take advantage of real and manufactured ethnic grievances—a problem for Kazakhstan, where about 23 percent of the population is ethnic Russian. A secondary challenge for Kazakhstan is how to engage the West during a time of heightened East-West tension. Furthermore, Europe, NATO, and the United States—once keenly interested in Central Asia as the staging ground for the war in Afghanistan—have largely pulled out of the region and are refocusing their attention elsewhere. The West's refocus away from Afghanistan and Central Asia is occurring at a time when Kazakhstan is wary of Russian intentions, concerned about Islamic extremism in the region, and worried about the political stability of many of its neighbors. For Kazakhstan, the West's waning interest in Central Asia is a troubling development.

Although Kazakhstan, like other Central Asian states, has legitimate fears about Islamic extremism, it is also the case that the extremist threat is hyped by Kazakh security officials to justify the state's tight control over civil society, religion, and information space and to gain Chinese, Russian, and Western security assistance. Unfortunately, the state's frequent use of "extremism" as a moniker to tarnish any

Islamic-oriented political or social movements or religious-oriented texts that the government feels to be threatening makes it hard to gauge the true strength and appeal of extremist ideologies in Kazakhstan. The same holds true for the 2014 legislation that simplified procedures the state uses to designate groups as extremist and shut them down and for the gradual tightening of state control over the Internet in the country.

Extremist groups will likely have difficulty truly gaining ground in Kazakhstan and elsewhere in Central Asia, but the lack of transparency in the country and the absence of public debate in the region over extremist threats (and their causes, including socioeconomic inequality) muddies the picture. The authorities' tight grip at home could very well impede their ability to detect and respond to transnational extremism.

Meanwhile, China continues to increase its economic influence in the region, eager to use Kazakhstan to realize its ambitions to create new trade and transportation links to the region and beyond. Kazakhstan, seeking to jump-start its economy through infrastructure projects and to create employment opportunities, sees itself as the key transit state for the Chinese-inspired One Belt, One Road (OBOR) initiative linking both east–west and north–south trade routes. Despite its recent economic troubles, China—Kazakhstan's top trading partner—still appears to possess the intent, capacity, and institutional infrastructure to push this project forward. By contrast, the competing U.S.-proposed New Silk Road initiative to promote links between Central and South Asia remains largely stillborn due to a lack of dedicated resources, waning interest among regional actors, and instability in Afghanistan and Pakistan.

The Iran nuclear deal could lead to the slow reintroduction of Tehran—welcomed as an economic partner, but often feared because of its political agenda—as a more active regional player, potentially opening up new transportation routes for Kazakh hydrocarbons. The prospect of Iran serving as a non-Russian and non-Chinese transit corridor to the Persian Gulf is an intriguing one and could provide Astana with leverage over the two major outside powers that dominate Central Asia and the region's access to the wider world.

These geopolitical changes are occurring at a time when Kazakh elites are realizing—perhaps too late—the need to diversify the economy away from its dependence on oil exports and the need to reform the country's political institutions, which are weak and too dependent on the president himself. Nazarbayev's centrality to Kazakhstan's post-Soviet transformation could turn out to be one of the country's most acute problems.

Moving into the future, Kazakhstan may simultaneously face geopolitical insecurity outside its borders, economic trouble due to prolonged low oil prices, and political uncertainty at home.

## **INCREASINGLY DIFFICULT MULTIVECTOR FOREIGN POLICY**

For years, Astana promoted with success a multivector foreign policy in which Kazakhstan sought to balance its relations with China, Russia, the United States, and, to a lesser extent, the European Union.

Astana also actively engages regional powers in East Asia, the Persian Gulf, and elsewhere. In particular, it sees wealthy authoritarian states like Singapore as both potential partners and models to emulate. There are, of course, significant differences between Kazakhstan and these states. Compared to Kazakhstan, Singapore faces much less of a corruption problem, is not landlocked, and has a more diversified economy, thanks in large part to the city-state's scarcity of natural resources. Singapore also does a better job of providing a broad-based social safety net for its citizens, making the wealth gap between rich and poor Singaporeans less prominent than the one in Kazakhstan. Nonetheless, Kazakh reformers are convinced that their country can learn from and replicate some of Singapore's success. The Lee Kuan Yew School of Public Policy at the National University of Singapore, for example, is a top destination for Kazakh students who receive the prestigious Bolashak scholarship, an all-expense-paid study abroad program financed by the government to bring international expertise back to Kazakhstan. Recent civil service reform proposals to increase civil service pay, introduce greater accountability, and ensure

merit-based promotions are loosely modeled after Singapore's successful efforts to reduce corruption in the bureaucracy. Even if implemented, however, these proposals likely would do little to combat corruption at more senior levels of the ruling elite.

Kazakhstan likewise has had long-standing ambitions to cultivate closer relations with the Gulf states, which represent another model of development for Kazakhstan. However, the international isolation of Iran—the geographic link between Central Asia and the Gulf—has complicated these efforts. The sanctions regime against Iran has prevented the development of the essential transportation, trade, and communications infrastructure to facilitate closer economic ties between Kazakhstan and the Gulf, although the new Kazakhstan–Turkmenistan–Iran railway and the rolling back of sanctions on Iran could change that.

Kazakh political elites see the country as a potential bridge between East and West—a role that has become increasingly important as relations between Russia and the United States (and Europe) have deteriorated to new lows. Aware of growing threats to Kazakh security, Nazarbayev has offered himself and his country up as mediators for international conflicts ranging from Ukraine to Syria. Sadly, however, Nazarbayev's mediation efforts have not been successful, nor have they been taken seriously by most outside powers.

Nazarbayev sees himself as an elder statesman who has guided his country through a tumultuous transition from the Soviet era and partnered with the United States to safeguard and work to eliminate the Soviet-era nuclear and bioweapons facilities based in Kazakhstan. Nazarbayev is rightly proud of his role in removing the stockpile of nuclear weapons from Kazakhstan and making his country a non-nuclear-weapon state. However, that decision is slightly more controversial after Russia's intervention in Ukraine. Both Kazakhstan and Ukraine received security assurances in the 1994 Budapest Memorandum from Russia, the United Kingdom, and the United States for their decisions to give up nuclear weapons. Russia's disregard of these assurances to Ukraine in 2014 and

the West's impotence to do much about it worry Kazakhstan's political elites and raise questions among them about Russia's long-term reliability as an ally, neighbor, and trading partner.

Kazakhstan has tried to avoid taking sides in the Ukraine conflict. Likely under Russian pressure, it abstained from the 2014 United Nations General Assembly Resolution 68/262, which declared Russia's annexation of Crimea invalid, but it put more distance between itself and Moscow as the Ukraine conflict devolved into war. As Moscow's efforts to destabilize Ukraine intensified and became more evident, Kazakh officials appeared to grow increasingly concerned that Astana's close relationship with Moscow would tarnish its reputation internationally.

With Ukraine in constant turmoil and on the verge of economic collapse, few in the West pay enough attention to how the conflict in Ukraine and the collapse in East-West relations are impacting Kazakhstan. The Eastern Partnership (EaP) project is essentially stillborn, but the EU still talks about its hopes for greater integration of the European countries of the former Soviet Union. By contrast, the EU still lacks a clear vision for its relationship with Kazakhstan, despite the fact that the EU is Kazakhstan's largest source of foreign direct investment. Although the EU and Kazakhstan signed an Enhanced Partnership and Cooperation Agreement in December 2015, it took almost a year to do so after concluding negotiations on this vaguely worded diplomatic agreement that relegates Kazakhstan to a much lower relationship with the EU than the EaP states. This could change, as the EU indicated in June 2015 that it is reviewing its Central Asia strategy. However, the EU is preoccupied with other issues closer to home, some of which are internal (terrorism, Greece, and the future of the EU) and others are external (Ukraine, Syria, and the refugee crisis). It is unlikely that a new EU strategy for Central Asia would bring any greater focus on the part of Brussels to the region.

In Washington, senior U.S. leaders have even less bandwidth or incentive to focus on the region than they did during the height of the Afghanistan war in the late George W. Bush

and early Barack Obama presidencies when the efficient movement of war matériel through the Northern Distribution Network via Central Asia was an administration priority. Central Asia is now crowded out by bigger, more pressing national security and legacy issues: Iran, Syria, the self-proclaimed Islamic State, the refugee crisis, the Ukraine crisis, Cuba, Greece, and the threat of infectious diseases, among many other issues. While concerns about Russia are already playing a large and public role in the 2016 U.S. presidential election campaign, it is unlikely that the candidates will focus on the former Soviet space beyond Ukraine and the Baltic states.

For its part, NATO once thought strategically about Central Asia during the war in Afghanistan, albeit mainly as a backdoor to that conflict. While NATO documents and officials still refer to Kazakhstan and other Central Asian states as “partners,” the alliance is focused primarily on planning to defend against Russian aggression toward its easternmost members with much less regard to distant regions in Central or South Asia. Nobody in Astana has any illusions that the West will be of much assistance should Russia decide to meddle in Kazakhstan’s domestic affairs at some point in the future or should Islamic extremism spillover from South Asia into Central Asia.

## **RUSSIAN AND DOMESTIC THREATS**

Kazakhstan would be a place where the Kremlin could easily replicate the Ukraine scenario if it chose to. The bulk of Kazakhstan’s ethnic Russian population lives in the country’s north, an area that Russian nationalists claim was historically part of Siberia. Russia has a legacy of stoking interethnic tensions in northern Kazakhstan, although not in recent years. Back in 1999, however, the Kazakh government uncovered a plot involving over twenty ethnic Russians (including twelve Russian citizens) to promote separatism in the north. All were prosecuted by the Kazakh authorities. However, Russia demanded that its citizens involved in the plot be extradited, causing many to speculate that Moscow at least was aware of and possibly had a role in efforts to break northern Kazakhstan away from the rest of the country.

Fear of Russian separatism is a major reason why Nazarbayev has tried to put a Kazakh stamp on the country’s north. In 1997, he moved the government from Almaty in the south to Astana, building the country’s glitzy new capital there and encouraging the migration of ethnic Kazakhs—both from other regions of the country and neighboring states—toxresettle in the north. Particularly in the early post-Soviet era, his government also quietly encouraged emigration of ethnic Russians from Kazakhstan, although government officials are careful to avoid overtly playing to any extreme notions of ethnic Kazakh nationalism.

The Kazakh government remains sensitive to any manifestations of separatism and Russian ethnic chauvinism—either at home or across the border. Kazakh courts have convicted and sentenced to jail several ethnic Russians who are Kazakh citizens for fighting alongside the separatists in Ukraine and inciting “ethnic hatred”—a catch-all legal justification to criminalize extreme forms of Russian nationalism in Kazakhstan, public mockery of the Kazakh nation, or calls by Kazakh citizens for Russian intervention in Kazakhstan.

Russian President Vladimir Putin exacerbated concerns about separatism in 2014 when he publicly stated that Kazakhstan was an artificial state, created by Nazarbayev, on “territory where no state ever existed previously.” By highlighting Nazarbayev’s role in sustaining Kazakhstan as a state, Putin’s statement underscored Nazarbayev’s essential role as the creator and guarantor of Kazakh sovereignty. It also called attention to a major flaw in the Kazakh political system: the lack of political and cultural institutions to ground the country in the post-Nazarbayev era. So long as Nazarbayev remains in power, it is unlikely that Russia would actively try to destabilize Kazakhstan. After all, Kazakhstan is one of the few friends it has in the region and the only one with potential global standing, given its size and wealth. But Moscow certainly is doing all it can to make sure that a decisively pro-Russian leader is installed in Astana once Nazarbayev leaves the scene.

## COMPLICATED ECONOMIC ENVIRONMENT

The country saw unprecedented growth after 2000, riding largely on high oil prices and giving rise to an emerging middle class. To its credit and unlike some of its neighbors, Kazakhstan has begun to invest in that new middle class by sending some of its young citizens to study overseas—many of them on their own merit as opposed to due to their connections to the political or economic elite. It also is establishing Western-oriented institutions of higher education to create skilled cadres for the government and a capable next generation workforce. However, those skilled young professionals are not widely dispersed across all sectors of the Kazakh economy, and corruption remains a problem in Kazakh educational institutions, including some of the most elite ones.

Energy makes up about one-quarter of Kazakhstan's GDP, but low oil prices caused the government to slash its GDP growth forecast for 2015 from 4.8 percent first to 1.5 percent and later to 1.0 percent. According to the Asian Development Bank, GDP growth in the first half of 2015 was estimated at 1.7 percent, down from 3.9 percent a year earlier. Exports from the country—mostly hydrocarbons—declined by 73 percent in the first half of 2015.

The government has had ambitious plans to diversify the economy away from natural resource extraction, but little progress was made during the years of high energy prices. The manufacturing sector, for example, accounts for 11 percent of GDP, while the agricultural sector constitutes 5 percent. Both are inefficient. According to the World Bank, a Kazakh agricultural worker, on average, produces only \$3,000 worth of crops per year, which is seventeen to 23 times less than the average yearly output of a farmer in a developed country (\$50,000–\$70,000).

Several large companies in Kazakhstan cut salaries and production over the course of 2015. The authorities appear particularly concerned about layoffs in the country's west—the center of Kazakhstan's oil industry, but a place where oil profits do not trickle down and a wealth gap is clearly evident.

The region has a track record of political and economic protest, and the population there in the past has appeared more susceptible to extremist messages than in other parts of the country.

In 2011, a months-long strike in the town of Zhanaozen ended with at least sixteen people killed after security services broke it up. Although the protest was clearly economically driven, the government had long tried to cast the demonstrators and their supporters as being “extremist.” The violence helped fuel both domestic and international backlashes against the country's leadership. The Kazakh authorities closely monitor the population there for any signs of political protest.

The economic slowdown is also impacting elite dynamics. When economic growth was strong, Nazarbayev was able to distribute resources and assets among powerful elite groups and clans, creating a power-sharing consensus between the powerful groups. There are three main clan divisions in the country—Uly Zhuz (Great Horde), Orta Zhuz (Middle Horde), and Kisis Zhuz (Small Horde)—which compete for economic and political influence. As the economic prospects for the country decline, competition for political power and the perks that come with it increase. This appears to be occurring both on the individual level as well as on the intra-clan level. There have been reports that some members of the Small Horde, which dominates the west of the country, where the major oil fields are located, want more posts on the national level and greater autonomy on the local level. How these dynamics will play out in the post-Nazarbayev era remain unclear.

The government responded to growing economic difficulties over the past year by launching a stimulus package in November 2014, announced in Nazarbayev's Nurly Zhol (Path to the Future) address to the nation that focused mainly on new infrastructure and transportation projects. Yet, the Kazakh budget is stretched, which forced the government to revise the oil price assumption on which its budget is based from \$80 to \$50 per barrel in 2015. Nazarbayev in August 2015 said that Kazakhstan must prepare economic policies to

deal with oil prices fluctuating between \$30 and \$40 per barrel for the foreseeable future, and some analysts predicted that the price could fall below \$20. According to Minister of Economy Yerbolat Dossayev, the 2016 budget will be revised downward once again with an oil price assumption of \$40 barrel.

The Kazakh central bank's decision in late August 2015 to stop propping up the tenge and let it float freely was a long-delayed and long-feared—after the 2014 devaluation provoked widespread anger and protests—move. Before the August decision to float the currency, the government reportedly took money from the oil reserve fund. That fund, however, is not transparent, and there is no reliable information about how much money was actually expended from it. But the potential that government spending will deplete the oil fund is clearly a concern and prompted Nazarbayev to reiterate that new fiscal policies must be adopted to prevent that. In addition to floating the tenge, the government will likely slash the salaries of state employees, as Russia has already done. Astana appears to be belatedly following the Moscow playbook for managing an economic crisis.

Aware of what occurred after the 2014 devaluation, the authorities refrained from describing it as a devaluation, likely an indication the regime remains fearful of popular discontent. However, since the August 2015 decision to cease shoring up the currency, the tenge's value has declined by around one-half and continues on a downward spiral, which prompted Nazarbayev to replace the head of the central bank in November of that year in a move that probably had as much to do with optics as with monetary policy. The currency's devaluation has hit particularly hard those in the retail sector and Kazakh citizens holding dollar-denominated mortgages and loans.

Many aspects of Russia's economic troubles impact Kazakhstan. Western sanctions on the Russian financial sector are hurting Kazakhstan, in part because of the close ties between Russian and Kazakh companies and the fact that some Kazakh businesses take out loans from Russian

banks, which now have more limited resources and ability to lend to Russian companies, not to mention those in other former Soviet states.

Finally, Russian aggression undermined the long-term prospects of the Eurasian Economic Union (EEU), of which Russia and Kazakhstan are founding members. Symbolically, the organization is important for Nazarbayev since he was the one who first proposed it. But Kazakhstan (along with Belarus) stripped out most of the political aspects of the EEU during the final negotiations in spring 2014 and bucked Russian pressure again in summer 2015 to impose countersanctions on U.S. and European agricultural products—a move seemingly in line with Nazarbayev's multivector approach to foreign affairs.

Nazarbayev repeatedly has made clear Kazakhstan's intention to leave the organization if it is used by Russia to undermine Kazakhstan's independence. In light of the ruble's weakness, cheap Russian imports now are flooding across the border into Kazakhstan, hurting Kazakh manufacturers and agricultural producers. In March 2015, Kazakhstan began pulling some Russian food products (butter, candy, and meat, among other items) off the shelves of supermarkets. The Kazakh government cited health concerns, but the real reason was because cheap Russian products undercut those produced in Kazakhstan. Russia's food safety regulator Rospotrebnadzor—an agency the Kremlin regularly uses to block imports from the United States and Western-oriented former Soviet states—in turn blocked Kazakh dairy products and some produce in April 2015 for similar reasons. In effect, the economic relationship between the two most important EEU members devolved into a trade dispute. This is likely one of the reasons Nazarbayev rarely discusses the EEU. His comments at a youth forum during his spring 2015 election campaign focused not on that organization but on his aspirations for Kazakhstan to join the ranks of the top 30 richest economies in the world, such as Japan, Singapore, South Korea, and the United Arab Emirates. Furthermore, since joining the EEU, Kazakhstan's trade with fellow EEU members Belarus and Armenia has declined dramatically.

Another example of the Kazakh officials souring on the EEU can be seen in their approach to China's OBOR project. Although Putin and Chinese President Xi Jinping in May 2015 signed a declaration agreeing to coordinate the OBOR's activities with the EEU, Nazarbayev clearly prefers direct bilateral coordination between Kazakhstan and China over granting the EEU a say in how China's Silk Road vision evolves. In August 2015, he signed an alternate declaration pledging coordination between the OBOR and Nurly Zhol. This decision has raised suspicion in Moscow that Kazakhstan plans to proceed with the Chinese on a bilateral basis, cutting out Russia and Russian influence over the future development of Silk Road projects and—probably equally worrying for Moscow—creating Eurasian transit routes that compete directly with Russia.

### TOO LATE FOR TRANSITION PLANNING?

Kazakhstan will face numerous political and economic challenges in the coming years. Many Kazakh elites (not to mention foreign investors) see Nazarbayev as the man who can steer Kazakhstan through these challenges and ensure the country's stability. However, that attitude may turn out to be shortsighted because the most pressing threat to Kazakhstan's stability might be Nazarbayev himself.

After his reelection, Nazarbayev pledged to undertake political reform, including moving the country away from its hyperstrong presidential rule toward a system that gives more power to the parliament and the state bureaucracy. In May 2015, he announced his National Plan, which included 100 concrete steps to implement five institutional reforms, geared toward developing and professionalizing the state bureaucracy, reforming the judicial system to ensure greater rule of law, creating a state that is accountable to its people, promoting economic growth by diversifying the economy, and attracting international investors in new sectors. It is an ambitious program that could lay the groundwork for the post-Nazarbayev era.

This is not the first time the Kazakh authorities have made promises about undertaking political or economic reform, so skeptics are wary that the authorities will move beyond the rhetoric. However, even if they do, it is unclear how much of this ambitious agenda can actually be implemented before Nazarbayev leaves the scene and whether the country's next president will be as skilled in balancing the country's competing domestic and foreign policy interests. Kazakhstan faces multiple geopolitical and economic problems over which it has limited control. However, the country's greatest upcoming challenge—the transition to the post-Nazarbayev era—is one of its own making.

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