



LUND UNIVERSITY

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From Natural Resource Windfalls to Curse?

The Resource Curse Paradox and Economic Diversification in Kazakhstan

EKHK18 Bachelor Thesis

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Thesis Defense: 18th of August, 2017, 11: 00
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Lund, Sweden

Abstract

The evidence pointing to a fundamental link between abundance in natural resources and unsustainable development processes in developing countries has caught attention lately, one aspect of this being the ‘resource curse’.

This paper aims to demonstrate the extent to which the resource abundance can explain the unsustainable economic development process of Kazakhstan. It aims to answer the overarching research question: *How does the dependence on natural resources affect the economic development in Kazakhstan?* with sub questions: a) *Is economic development deficient due to poor political institutions?*, b) *If poor political institutions are present, shall the case of Kazakhstan be defined by the resource curse or the rentier state theory?*

The analysis is carried out through applying theories of natural resource curse and rentier state on the case of Kazakhstan, thereby assessing how both theoretical models and exceptional country factors shape the developmental outcome in Kazakhstan altogether with its economic, political and social progresses. However, it is observed that resource curse theory alone is not able to explain Kazakhstan’s inability to be engaged in significant steps towards proper governance of sustainable economic diversification. Both low economic diversification and neopatrimonial structures combined with the Post Soviet legacies consolidate rentierism effects in the country. Thus, the study demonstrates that the rentier state approach seems to be applicable in Kazakhstan.

Keywords: *natural resources, resource curse, Kazakhstan, rentier state, Soviet legacy, economic diversification*

Acknowledgments

First and foremost, I would like to express my sincere gratitude for my academic supervisor, Ellen Hillbom, for her time, practical advice and constant support while writing this thesis.

I also would like to express my eternal gratitude to my family for their constant support and love. Assel, Maria, Natassjha, Samina and Sophie - thank you for introducing me to the beauty of Scandinavian friendship and culture. Lastly, I am very grateful for the Lund University Global Scholarship Fund for providing me with the incredible opportunity to come to study in Sweden, conduct this research and obtain my bachelor degree.

Abbreviations and acronyms

CIS	Commonwealth of Independent States
GDP	Gross Domestic Product
HHI	Herfindahl-Hirschman Index
IMF	International Monetary Fund
KZT	Kazakhstani Tenge
NGO	Non-governmental Organisation
NRGI	Natural Resource Governance Institute
OECD	Organisation for Economic Cooperation Development
OSCE	Organisation for Security and Cooperation in Europe
SITC	Standard International Trade Classification
SPAID	State Program for Accelerated Industrial and Innovative Development
SWF	Sovereign Welfare Fund
NF	National Fund
UN	United Nations
WB	World Bank
WGI	World Governance Indicators
WDI	World Development Indicators

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1. Introduction

The former Soviet Union countries that are rich in oil and gas tend to have low levels of economic diversification and their governments are becoming more and more authoritarian (Gelman 2010). This particularly applies to the transitional, newly emerged economy of Kazakhstan. This section consists of research background and problem, significance of the study, research question and aims, definitions of resource curse and rentier state and thesis outline.

1.1 Research background and problem

In the aftermath of Soviet Union dissolution, the Central Asian region has reemerged as an area of increasing importance, particularly due to its natural resources. Kazakhstan, is a post Soviet transitional economy in Central Asia, located between the two global powers of Russia and China, neighboring with Uzbekistan, Kyrgyzstan and the Caspian Sea (see Figure 1).

Kazakhstan gained independence from the Soviet Union in 1991 and began to rely on the extraction of natural resources in the early twentieth century, following the upturn in both oil prices and proven oil reserves (Pomfret 2005: 680). Since its independence the country has been transitioning from a Soviet framework into ‘*something else*’. However this ‘*something*

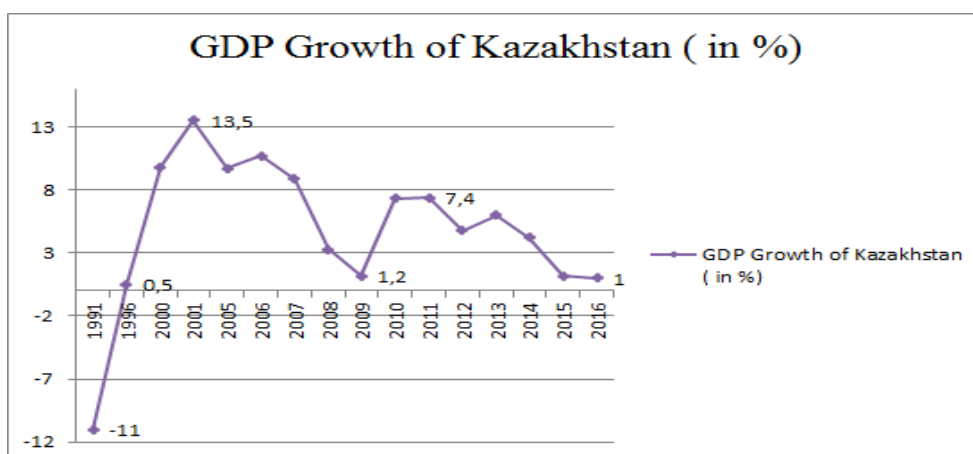
Figure 1. Main resources exported by the Post Soviet Countries, M. Zagozina 2014



else` does not possess a proper definition yet (Rumer 1996: 15). Indeed, the transition towards a new societal structure that would possess both elements of market economy and capitalist society has not happened in economic history before (ibid.). It cannot be argued that

Kazakhstan is transitioning towards the liberal democracy of a Western type either. The resource curse phenomenon which has been broadly addressed in the fields of political science, economics and development, is especially relevant to the former Soviet Union bloc. Former Soviet Union states are functioning according to autocratic regime types that highly rely on revenues from their natural resources. These states have been transforming into a new type of regime called the rentier state regime. Moreover, the connection between the post-communist regimes, resource abundance and rentierism has been scarcely examined up until now (Esanov et al. 2001; Franke et al 2009: 110).

Figure 2, GDP Growth of Kazakhstan (in %), 1991-2016, WB Data 2017



A high dependency on natural resources becomes very harmful for the economy when world primary goods markets tend to be volatile (Auty 2001). In the case of Kazakhstan, the move towards a floating exchange rate regime that happened in August 2015 has driven the abrupt depreciation of national currency Kazakhstani tenge (KZT). Moreover, this also resulted in sharp increase of the inflation rate: from approximately 3.8 percent annually before August 2015 up to 16,7 percent as of May 2016. This altogether eroded consumer purchasing power and real wages in the country. Particularly, low income households became the most vulnerable to the increase in prices, decline in wages and narrowing employment opportunities (World Bank Group 2016: 1-3). The GDP growth dynamics continued to slow down (1 % as of 2016, Figure 2) across all sectors in the economy as oil prices fell on the international market. Consequently, both external and internal demands have been experiencing a weakening downward trend (World Bank Group 2016: 2-3), which suggests

the potential dominance of extractive sectors, as well as vulnerability of the economy of Kazakhstan.

Furthermore, resource dependent economies have a tendency to have lower governance quality and they are found to experience a number of negative political-economic distributive patterns (Barma 2014:257). They are also more likely to have authoritarian governing structures (Dunning 2008, Ross 2012). These tendencies have also been observed in the case of Kazakhstan: Kazakhstan has been functioning with hyper centralized political system since independence and lately demonstrated a tendency towards even greater authoritarianism (Freedom House 2017). A crucial element which will be analyzed in this study is how the resource dependent state of Kazakhstan generates and distributes income windfalls from the rents, and how that links these various side effects of its economic development and determines its outcome today.

1.1.1 Political economy of Traditional and Contemporary Kazakhstan

Clans concept

The peculiarity of the Kazakh political system, both traditional and contemporary has to do with the dominance of the clans. Clans in traditional Kazakhstan were based on family ties, and were the basis of the economy and governance of the Kazakh nomadic society. When referred to the clan as a particular unit of political organization, it implies a group of people around an individual with power, thus, those individuals share interests of businesses and lobbies via decision of state authorities. It is the contemporary clan system of Kazakhstan that rules the political economy of the country (Dorozhkin and Igbayev 2009: 136). Although the Soviet system was based purely on communist ideology by discouraging the aristocratic classes from the ruling positions, clan mentality persisted and has been the base of independent Kazakhstani political ideology up to now (Dorozhkin and Igbayev 2009: 135-137; Ibadildin 2012: 54).

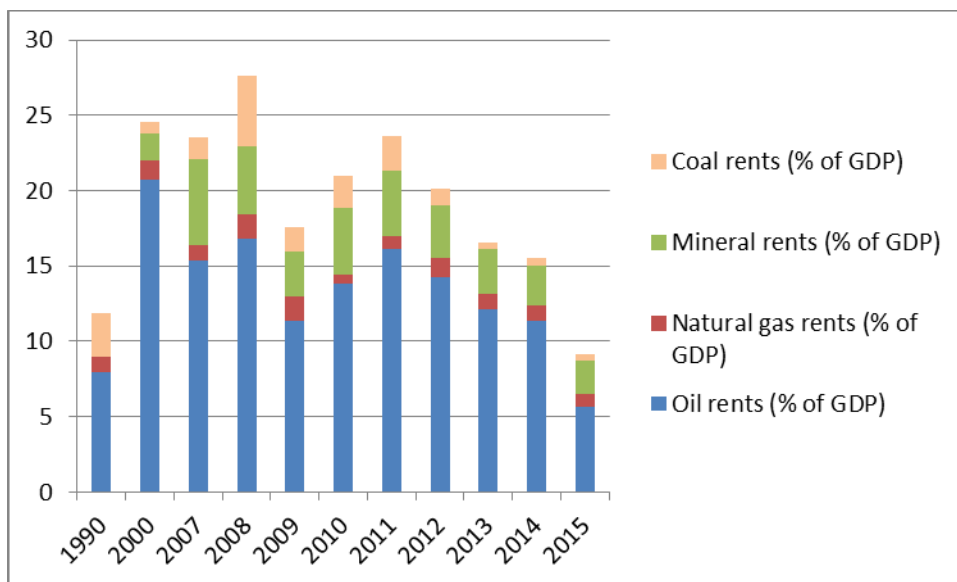
Kazakhstan under Soviet Rule

The Soviet system at its core has always been portrayed as suffering from weak institutional quality (Zagozina 2014: 19). In the 1920s, Soviet authorities abolished large estates, administered the forced collectivization and removed the sources of traditional authority in Kazakhstan. The inheritance of the weak state and the institutional quality from Soviet rule established the platform for significant economic uncertainty to occur in the country (Pomfret 2005: 859). With regard to the drastic ideological switch after the Soviet Union dissolution, today's ruling elite does not differ much from one of the Soviet period, both in terms of composition and administrative governance methods. The most feasible explanation of that lies in disorganisation (Pomfret 2005: 861), the consequences of which will be explained further in this study.

Kazakhstan after Soviet Rule

Scholars consider the independence of Central Asia states as a Russian political default, because Kazakhstan's independence did not happen due to any national liberation movement, it was a result of Moscow's decision to withdraw its maintenance of the Soviet Doctrine (Cummings 2002: 1). As Olcott (2010) put it, Kazakhstan was 'catapulted' into independence.

Figure 3, Total Natural Resource Rents in Kazakhstan (% of GDP), WB 2017



By looking at figure 3, it is observed that contemporary Kazakhstan possesses rents from a variety of natural resources, that is natural gas, minerals and coal; the share of rents from resources in GDP tends to be quite high in the country – 27, 6 % in 2008 and 20 % in 2012 (WB 2017). This evidence points to the potential absence of meaningful economic diversification and heavy dependence of the Kazakh economy on resources to generate its revenues and GDP, which in turn are signs of the presence of a resource curse.

When the government moved towards price liberalisation in January 1992, the institutions required for a well-functioning market economy were not in place (Pomfret 2005: 860). By the 1990s the privatisation process in Kazakhstan was characterized by asset sales mainly, so by the 1997 majority of the most valuable state enterprises were sold (ibid). At that time the attention of Kazakh government shifted towards oil sector development, which was more and more characterized by the elite's wealth accumulation. The economy was hit by several negative exogenous shocks in the late 1990s, and in the early 2000s Kazakhstan entered the oil boom period (ibid). Since then the country enjoyed rapid economic growth up until 2014 (refer to Figure 2). The state has been gaining more favorable oil transportation opportunities and even larger discoveries of resources in the country. The proven reserves ensure a substantial oil flow until the mid of the twenty first century at the least (Pomfret 2005: 863).

1.2 Significance of the study

As Laruelle (2016: 10) states, Kazakhstan has been in the spotlight in terms of policy making, while the scholarship focused on other aspects of the development process of Kazakhstan and its society is very modest. Moreover, the 'resource curse' as a decisive factor in development of the Post Soviet Caspian region has not been universally accepted among scholars up to now (Meissner 2010: 7). So far, no study could do justice to the state building complexity of the country as ethnically diverse, as large and as resource rich as Kazakhstan (Olcott 2010: 2). Therefore, it is essential that "*future research should henceforth apply comprehensive, country-specific, and in-depth context analyses*" which have been previously neglected in academia (Meissner 2010: 8). This paper studies if any of the side effects from

resource abundance in Kazakhstan depend on its internal conditions, which is where this study fills the gap and makes its contribution to overall research.

1.3 Research question and aims

This case study aims to analyze the degree to which resource curse could account for the absence of economic diversification and sustainable economic development in Kazakhstan. This is done through applying both resource curse and rentier state theory on the case of Kazakhstan. Therefore, the research will answer its main overarching question: *How does dependence on natural resources affect the economic development in Kazakhstan?* with the sub questions:

- a) *Is economic development deficient due to poor political institutions?*
- b) *If poor political institutions are present, shall the case of Kazakhstan be defined by the resource curse or the rentier state theory?*

This will be done by, first, assessing the dominance of the oil industry in the economy by analyzing recent diversification trends in the country; second, by applying the resource curse and rentier state theories on the Kazakh case. The study will base its analysis within the 1990-2017 time framework, mainly focusing on the 2000-2017 timespan, as the year of 2000 is the benchmark of Kazakhstan's entering the oil boom period.

1.4 Definitions: Resource Curse and Rentier State

The natural resource curse, often referred to as the 'paradox of plenty' relates to the failure of resource dominant states to fully benefit from the resource windfalls by having worse economic performance, as well as the failure "*for governments in these countries to respond effectively to public welfare needs*" (NRGI 2015: 1).

The rentier state concept comes from the subcategory of research on the resource curse phenomenon. Thus the implication of the rentier state as one of the curse manifestations is

appropriate, although it is a separate research field in its own right. Mahdavy (1970) in his study on oil rich states in Middle East, defined the rentier state as the state receiving rents from foreign actors, be it enterprises, governments or individuals; in relation to its importance in economic situations when “*oil revenues received by the governments of the oil exporting countries have very little to do with the production processes of their domestic economies*” (1970: 429). In the rentier state, oil and mineral abundance is assumed to spawn growth restricting state intervention together with extraordinarily levels of rent-seeking, where rent-seeking competition is negative in terms of the developmental results it generates (Di John 2011: 3).

1.5 Thesis outline

The next section of this study is the previous studies section, which observes the literature research done on Kazakhstan and its relation to the resource curse. Further on, there is a methods section which includes the research design, data quality and limitations of this study. Thereafter, the following section is the theoretical framework, which explores the resource curse, particularly its two sub models: Dutch disease and institutional quality; and a rentier state theory. Then the analysis of empirical findings follows; this section is divided into subsections that analyze stated theories and theoretical concepts. At the end of the thesis, there is a conclusion.

2. Previous studies

The existing literature, both empirical and theoretical, on the resource curse and rentierism in Kazakhstan varies largely in every regard. The research is rarely up-to-date with the current academic debate on the resource curse topic (Meissner 2010: 18).

Yessengali Oskembayev (2015) in his study called ‘*International analyses of natural resource curse and Kazakhstan’s related economic performance with special attention to its wheat and energy sectors*’, examined the role of natural resource abundance for economic development

and quality of institutions focusing on Kazakhstan and the rest of the CIS countries. By comparing two subsamples (1990-2000; 2001-2010), the author found that the impact of direct resource curse might disappear, while indirect impact (that is through the quality of institutions) is constant for both periods observed. This implies that resource curse via institutional quality established important linkages between economic growth and natural resources. Furthermore, the analysis shows the significant impact of the agricultural sector on institutional quality and concludes that in Post Soviet countries agricultural sectors are dependant on the state. The study provides a broad overview of the evidence of state companies' dominance having a negative influence on reform progresses in the countries (Oskenbayev 2015).

Eger and Leonard (2007) in their research '*Dutch Disease scare in Kazakhstan: Is it real?*' shed light on Dutch Disease as a theoretical aspect of the resource curse, and its negative impact on the economy of Kazakhstan. The authors (2007) assessed the mechanism by which oil prices fluctuations on the world market could harm the non-oil manufacturing. They found that in the open sector real exchange rate appreciated because of the nominal exchange rate appreciation. Their econometric evidence has shown that the rising trend in oil prices and oil revenues may be linked to the U.S dollar exchange rate of both non-oil and oil sectors; however, this appreciation is limited only to the oil sectors' real effective exchange rate. It is not significant statistically for the non-oil manufacturing. Therefore, Eger and Leonard (2007) came to conclusion that Kazakhstan has not been affected by the Dutch Disease.

Finally, Akram Esanov (Revenue Watch Institute, 2009) in his study '*Economic Diversification - The case for Kazakhstan*' examined the Kazakh diversification experience by assessing the efficiency of Kazakh government policies in promoting economic diversification. The study (2009) pointed to the weak regulation of the financial sector in the country, weaknesses in economic and political institutions and geographical location of the country to be decisive for the absence of sustainable economic development. Esanov (2009) writes that given weak regulations, Kazakh banking sector borrowed heavily from the international capital markets and instead of loaning to the manufacturing sector, loans were

provided to the sector of construction and durable goods consumption (Esanov 2009: 21-22). Esanov concludes that “*The uneven path of economic and institutional reforms has led to unbalanced growth across different sectors*” (Esanov 2009: 32), and the absence of proper economic and democratic institutions hamper the accountability and responsiveness of the government.

To conclude this section, although the approaches taken by Oskenbayev (2015), Eger and Leonard (2007) and Esanov (2009) tend to vary largely in both their findings and scope, they do not disclaim each other. Each study is estimating some specific factors, at the same time being neglectful of others. Having revealed that, it is possible that there is a significant connection between historical and cultural legacy, institutional framework and abundance in resources in Kazakhstan. Thus, a new approach that would combine the analysis of the stated above factors is needed if all the regional dynamics are to be understood and recognized. This study aims to take a closer look at resource related conditions and authorities’ behavior responsible for the peculiarities of Kazakh developmental outcomes by bringing out previous empirical data. Moreover, there is a gap in current research in terms of looking at such factors altogether.

3. Research Design and Methods

This section includes the research design and methodology chosen for this study as well as its limitations.

The research question determined both the choice of research design and methodology for conducting this study. This thesis will carry out the case study design, as it is about extensive examination/analysis of a single case (Bryman 2011: 67), which is contemporary Kazakhstan. The case study research accounts for the particular nature and complexity of the case (Bryman 2008: 66), which will provide an in-depth understanding of how dependence from natural resources has affected economic development of Kazakhstan. Both theories of resource curse and rentier state are tested in this study. In order to ensure the quality of

empirical findings, the thesis refers to data from reliable databases such as World Bank, IMF, UN, OECD, OSCE, Freedom House, Transparency International and Statistical Agency of Kazakhstan. It also focuses on the findings of both local and international researchers such as Esanov, Konkakov, Satpayev and Umbetaliyeva, Ross and others.

This case study is a mixed-methods research that integrates both qualitative and quantitative data in the analysis in order to bring out holistic, more complete answer to the research question (Bryman 2008: 637). The quantitative indicators are employed in the thesis with the aim to analyze structural changes within the economy of Kazakhstan since its independence. However, since focusing primarily on measurements tends to describe only one side of the process, this study will employ qualitative findings too (Bryman 2008: 178).

3.1 Limitations

This approach has limitations: Firstly, Kazakhstan has been independent only for two and a half decades. As a consequence, data/research done on the effects of its resources over this period of time is scarce. Secondly, Kazakhstan, as a state with authoritarian tendencies, allows limited access to transparent, in-depth data and information. This is especially an issue related to the study of institutions and social structures - academic scholarship regarding these subjects is very limited. For these reasons, the contextual research of this thesis is based on empirical reporting and articles.

4. Theoretical framework

The theoretical framework of this study will be focused on both the resource curse with its two sub models: Dutch Disease and Institutions; and on the rentier state theory, the latter concerning the effect of natural resource rents on the political economy of Kazakhstan. This is done for two reasons: first, regarding the chosen sub models of the resource curse theory - not all the aspects of happenings in Kazakhstan would fit them, because the literature and

theories of the curse are based on the experience of Middle East and North Africa (Meissner 2010: 9), and not on Central Asia. Second, the application of the rentier state theory will contribute significantly as it comes to emphasize other causal links between low levels of economic governance and rents, as well as it would cover the autocratic nature's presence (Ross 2001: 328).

4.1 Dutch Disease

With regards to resource curse, Dutch Disease is one of the earliest concepts that appeared to link abundance in resources with lower economic growth (Corden 1984). Dutch Disease describes how effects from the resource windfalls as well as following appreciation of the exchange rate are detrimental for the rest of the economy. For example, the appreciation in exchange rate harms the so called 'non-oil tradable sectors', like manufacturing. This, in turn, generates deindustrialisation (Di John 2010: 2). The logic of a simple Dutch Disease theoretical concept could be described as: in the economy that is in full employment equilibrium, continuous increase in the external income inflow results in a relative prices change, benefiting services and construction (non-traded goods), and against the manufacturing and agriculture (non-oil traded goods). Consequently, non-oil tradeables are crowded out by the non-tradeables. Furthermore, production, employment and competitiveness of the traded goods sector declines (Di John 2010: 2).

However, there are particular criticisms to this model. For instance, Ross (1999: 306) states that the model poorly fits the frameworks of developing states, since it assumes that capital and labor supplies are employed and fixed before the oil boom. Yet, developing states usually have labor surpluses and their booms attract foreign labor and capital. Furthermore, Gelb (1989) in his study on seven oil exporters during 1971-83 showed that only four had their labor shifted from manufacturing and agriculture sectors, in others manufacturing sectors were not harmed by export booms, although agriculture suffers.

4.2. Institutional quality

Previously this study described how economic effects from possessing resources generate hardships for resource exporters. However, in order to explain why these hardships account for slower or unsustainable growth, we must be able to explain why governments and other institutions in the country fail to conduct reformative and efficient policies. Michael Ross (1999: 307) states that governments take an exceptionally large part in sustaining resource sectors in the economies of developing countries, which means institutions are decisive for the curse to occur and analysing them is essential, something that this study aims to do.

In particular, this study will be referring to the model developed by Mehlum and Torvik (2006), who examined the impact of institutional quality on the resource curse. These authors investigated how “*growth winners and growth losers differ*” (2006: 1), relating to the type of institutions the state acquires. Particularly, institutions in their model were divided into two types: *grabber friendly and producer friendly*; they tend to push the aggregate income down or up, accordingly. When it comes to grabber friendly type, they promote gains from specialization in unproductive activities, due to, for example, a weak rule of law and corruption. Moreover, grabber friendly institutions are connected with the rent seeking activities that harm economic growth (Mehlum and Torvik 2006).

4.3 Rentier State theory

“Wherever a rent is to be found, a rent seeker will be there trying to get it” -
Mueller (1989: 241)

The model of the rentier state, introduced by Mahdavy (1970) aims to explain why the decision makers of resource dependent states create and strive to sustain growth-restricting policies (Di John 2011: 171). It explains the circumstances when the state starts to be more involved within the economy, it tends to grab more rents in order to reinforce its position in power as well as to further access to rents. Then institutional quality deteriorates, and that does not establish sustainable, long term economic diversification and democratization (ibid.). Applying the rentier state matters for this study, because unlike economic

explanations, political economy explanations of the curse are not tested oftentimes, “*either quantitatively or with well selected qualitative case studies*” (Ross 1999: 308).

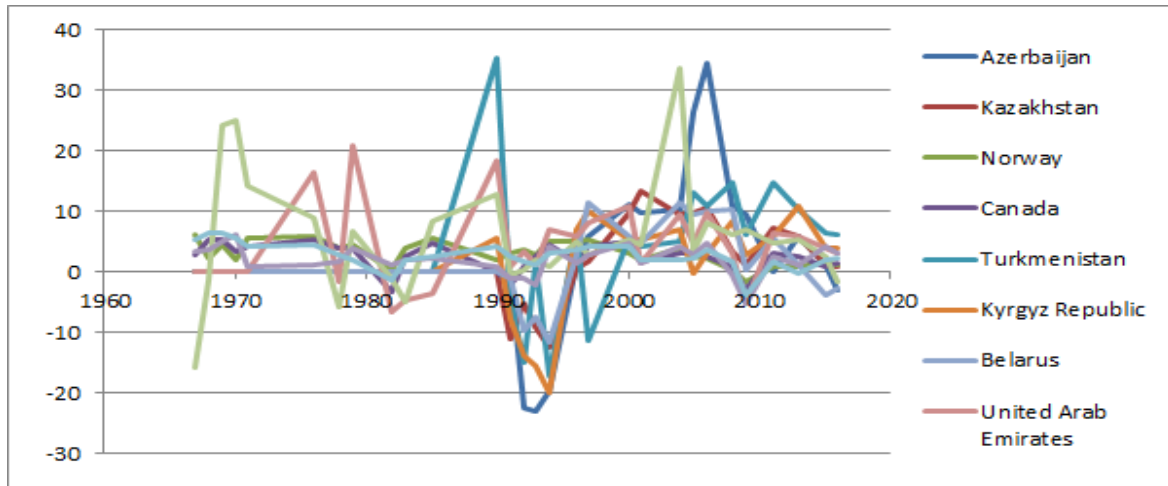
Michael Ross (2001) uses three explanations for this rentier state pattern: a) the ‘*rentier effect*’, which suggests that resource abundant economies are using low tax rates and patronage to damp down the democracy; b) the ‘*repression effect*’, which explains that wealth gained from resources allows governments to repress social movements because their internal security becomes strengthened; c) the ‘*modernization effect*’, which indicates that resource driven economic growth does not bring about cultural and social changes (Ross 2001: 337), which generate democratic government. Both ‘*rentier*’ and ‘*repression*’ effects will be applied on Kazakstan in this thesis except for the ‘*modernization*’ one as Ross himself did not find the causal relationship between urbanization and higher education levels and democracy (Ross 2001).

4.3.1 Rent-Seeking and Corruption

Both indicators of corruption and rent seeking form a significant basis of the rentier state theoretical framework. *Rent-seeking activities* are defined as activities aiming at creating, sustaining as well changing both rents related rights and institutions (Milgrom and Roberts 1990: 269; Di John 2011: 171-172). What happens is that with regards to resource allocation and economic regulations the extent of discretion from the state inclines. Therefore, oil economies become more vulnerable subject towards larger levels of corruption and rent-seeking, compared to non-oil economies (Di John 2011: 172). Further on, this thesis integrates resource curse and rentier state theories in the analysis, the latter being a separate focus on the political economy of Kazakhstan.

5. Analysis of empirical findings

Figure 4, GDP Growth, WB 2017

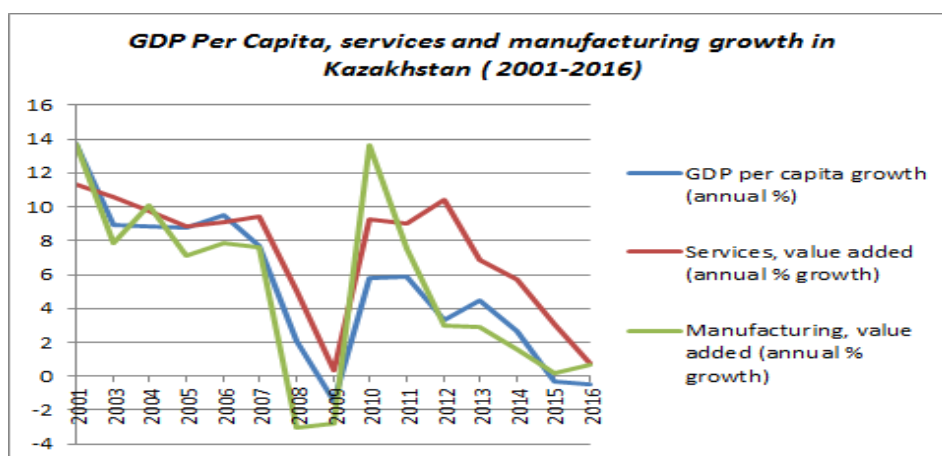


At the beginning of this study, it was revealed that Kazakhstan heavily depends on natural resources. Before examining other sectors of the Kazakh economy from the perspective of its ability to host sustainable economic diversification, let us look at Figure 4, which portrays GDP growth dynamics in different countries. The list includes former Soviet Union Countries characterized by unsustainable economic growth, which do and do not depend upon natural resources; as well as countries like Canada, Norway and United Arab Emirates. While the Resource Curse theory states that abundance of natural resources lead to poor economic development, the graph above makes it clear that the relationship between possessing resource and economic growth should not be regarded as a clear cut: it can be both negative and positive. Thus, it seems to point to the presence of both growth retarding and enhancing factors that make the resource prevalence a curse or a blessing. Further on, the paper is going to investigate other sectors of the economy and factors at work in order to assess Kazakhstan's economic prospects in the light of its oil welfare and the institutional heritage.

5.1 Diversification trends

Figure 5 shows annual growth dynamics in service sector, manufacturing and GDP per capita in Kazakhstan from 2001 up to 2016.

Figure 5, GDP per Capita, services and manufacturing growth (2001 - 2016), WB 2017



As seen in Figure 5, Periods of global economic downturns (2008-2009) and of sharp decline in oil prices on the global market in 2014 suggest that Kazakhstan remains vulnerable to fluctuations in commodity prices and other outer shocks, which is a sign of resource curse. Furthermore, by looking at Figure 6 `Structural composition of Kazakhstan's GDP`, one can observe that the structure of GDP since independence has not gone through significant changes with industry, construction and other services activity remaining comparably or expanding at higher rates throughout 1991-2015 and agriculture reduced to half after the oil boom, from 2001 - 2015. One can conclude that there is a direct link between the boom in the primary sector and excessive growth in secondary sectors of the economy. Now, going back to Figure 5, the growth in manufacturing seems to be low as of 2016 (0.8 percent), which might point on the fact that natural resources sector is crowding manufacturing.

Figure 6, Structural Composition of Kazakhstan's GDP (1991-2015), Ministry of National Economy

Year	Agriculture	Industry	Construction	Trade	Transport and communication	Other services activities	Total
1991	29,5	27,2	9,2	12,0	10,2	11,9	100,0
1994	15,0	29,2	9,6	12,1	10,2	19,9	100,0
2001	9,8	34,6	6,2	13,6	12,6	23,3	100,0
2002	9,0	33,2	7,1	13,7	13,1	24,0	100,0
2003	8,8	32,4	6,7	13,0	13,8	25,4	100,0
2004	8,8	34,4	6,6	12,6	13,5	24,2	100,0
2010	4,5	28,4	7,7	13,0	11,1	35,3	100,0
2013	4,6	32,9	6,1	15,4	10,5	30,5	100,0
2014	4,2	27,6	6,1	16,2	10,4	35,5	100,0
2015	4,7	27,8	19,0	12,5	10,7	25,3	100,0

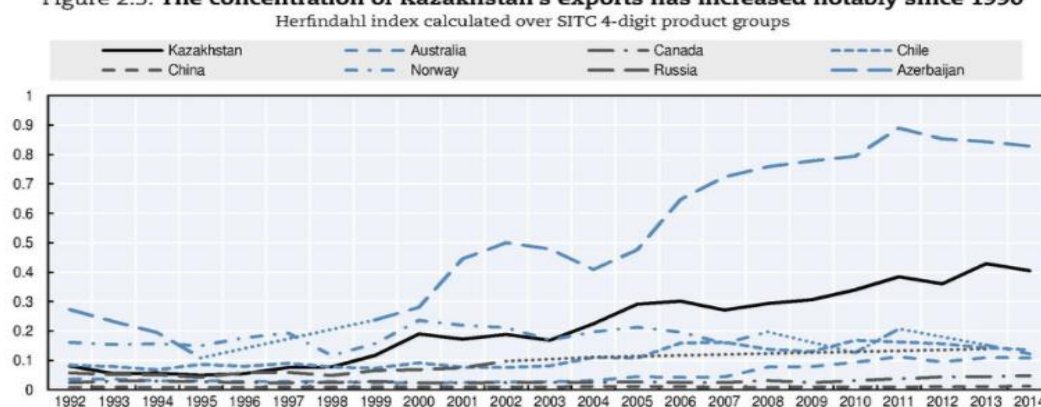
Source: Statistics of Ministry of National Economy, Republic of Kazakhstan. Journal of Economics and Statistics 3/2016*

5.1.2 Export Diversification Index

So far, the empirical evidence of Kazakhstan suggests a weak and vulnerable economy, given large natural resource windfalls. Both the heavy reliance on a restricted production base and, thereafter, an export base highly concentrated in fuels, e.g 61 % as of 2016 (OECD 2017), might be the reason for such an unsustainable economic development.

Figure 7, The concentration of Kazakhstan's exports (1992-2014), UN 2016

Figure 2.3. The concentration of Kazakhstan's exports has increased notably since 1990



Note: dotted lines indicate that data coverage is below 80% of total exports.

Source: Calculations based on UN COMTRADE (database), UN (2016).

StatLink <http://dx.doi.org/10.1787/888933445347>

Empirical evidence based on cross country regressions indicate that the curse works through export basket concentration, not through abundance in resources (Lederman and Maloney 2008). The increasing concentration rates can be traced through the *Herfindahl-Hirschman*

Product Concentration index (HHI) - a measure of diffusion of the trade value across the products of exporter, which is portrayed on the figure 7 above. The country which exports only one type of commodity will possess a value of '1', while a country that has perfectly diversified her export portfolio, would have a '0' score (World Bank 2015). Based on the data from Figure 7, the concentration of exports on the basis of SITC 4 digit product groups went up to 0.41 in 2014, from 0.06 in 1993, which suggests that there is a lack of export diversification in Kazakhstan. Furthermore, one can observe that it is the increase in oil prices, which drives the greater concentration of exports. Given the large share of crude oil in exports, any concentration index would be defined by that share of oil out of total exports, be it in nominal or in deflated terms (OECD 2017: 54). In the case of Kazakhstan, the production was most concentrated during 1998-2009, due to increased importance of extractive sectors in the economy, and after that the trend has been reversed.

Overall, it is concluded from the analysis of Kazakh economy that it can be portrayed as heavily dependent on oil and mining export, which consequently explains the high exposure of Kazakh economy's top sectors to price fluctuations on the world market and indicates its large propensity of being cursed by natural resources. So far, Kazakhstan has developed under a conservative economic policy by relying on earnings from the exports of raw materials. The previous analyses in this study has shown that the weaknesses here lie in underinvestment in the other economic sectors and the clear instability of growth rates due to heavy dependence on changes in an external environment. The next chapter of this thesis will determine if the condition of Kazakhstan could be explained by resource curse by applying theoretical sub models on the case.

5.2 Resource Curse in Kazakhstan

5.2.1 Dutch Disease in Kazakhstan

Figure 8, Structure of Production, 1993, 1998 and 2002 (in %)

STRUCTURE OF PRODUCTION, 1993, 1998 AND 2002 (%)			
	1993	1998	2002
<i>Share of GDP</i>			
Industry	28.7	24.4	29.3
Agriculture	16.4	8.6	7.9
Construction	8.3	4.9	6.1
Transport and communication	10.0	13.8	11.5
Trade and catering	7.9	15.2	12.0
Other (mainly services)	28.8	33.2	33.1
<i>Share of industry</i>			
Manufacturing		55.1	44.5
— ag. processing	(11.4)	(20.6)	(13.4)
— metallurgy	(23.9)	(18.7)	(17.3)
Mining	15.7	24.3	46.5
— coal		(3.3)	(1.4)
— petroleum		(14.6)	(38.2)
Electricity, gas and water	14.4	20.7	8.7

Note: Industrial categories are not identical for 1993 — 11.4% = food industry, 15.7% = fuel industry, 14.4% = electric power. Nevertheless, 'manufacturing' as defined for the later years was clearly larger in 1993 than in 1998.

Source: International Monetary Fund (1997), pp. 87–88; International Monetary Fund (2003), pp. 70–71.

The effects of Dutch Disease have been observed largely in international trade literature, especially in connection with resource dependent economies (Corden 1984). As was stated in the theoretical framework section,

the increase in resource driven exports leads to currency appreciation and declines incentives aimed at developing production of other goods, which harms the non-oil sectors in economy in the long run. Such linkage seems to resemble current conditions of the Kazakh economy, however, it is unlikely to be of great significance in Kazakhstan because of non-oil sectors atrophy in the economy already in existence before the oil boom period, during the 1990s (see Figure 8). The experience of the industrial production structure has been quite dramatic since then: though its share of GDP was about 29 % in 1993 and 2002, in 1993 less than 1/3 of industrial output accounted for petroleum, while in 2002 the share of petroleum was more than 1/3 and had an upward trend (Pomfret 2005: 870). Pomfret observed that the “*agricultural processing industries' share of manufacturing output fell by a third between 1998 and 2002*” (2005: 870), and the share of agriculture was reduced to half between 1993 and 1998. This means that the light industry was in significant decline before the oil boom (Kalyuzhnova et al 2004: 257-259, Pomfret 2005).

However, it is interesting that the rising oil sector in Kazakhstan has actually increased the competitiveness of the Kazakh economy (IMF 2014), which suggests us that the case of Kazakhstan might not be fully explained by resource curse; there are other important structural factors at play.

5.2.2 Institutional quality

Natural resource curse theory states that resource wealth tends to initiate a fight over revenues from resources, which consequently results in poor quality of institutions and lower growth. This study is using the model of Mehlum and Torvik (2006), which divides institutions into grabber friendly and producer friendly types to indicate their impact on economic development in the country. For the analysis of institutional quality in Kazakhstan, the World Governance Indicators (WGI) for 2000-2015 were derived for 2000-2017. WGI focus on six important dimensions such as Voice and Accountability, Rule of Law, Regulatory Quality, Corruption Control, Government Effectiveness and Political Stability/Absence of Terrorism within percentile ranks. They range from 0 to 100, where 0 indicates the lowest quality rank and 100 the highest (WGI 2017). Figure 9 below indicates the following dynamics:

Figure 9, WGI Indicators, 2017

World Governance Indicators for Kazakhstan (2000, 2015)



It can be observed that while still possessing quite low indicators of institutional quality, Kazakhstan has actually achieved some improvements since independence. These were observed in such governance indicators as rule of law, regulatory quality, control of corruption and effectiveness of the government. However, Kazakhstan failed to make a progress in other very important aspects of governance, such as political stability and voice and accountability. For instance, while in 2000-2015, the percentile of government effectiveness increased almost twofold, from 26.0 to 51.0, the voice and accountability indicator percentile decreased from 21.0 to 17.0 (WGI 2017). Additionally, the efforts of the government to reduce levels of corruption brought somewhat limited results - 25.0 as of 2015 (WGI 2017), but still this indicator remains within the lower percentile. Referring back to Mehlum and Torvik (2006: 1), the weak rule of law and corruption imply the presence of grabber friendly institutions in Kazakhstan, which is the sign of negative resource curse presence through institutional channels in the country.

5.2.2.1 Sovereign Welfare and National Funds in Kazakhstan

In order to foster diversification of its economy, the country adopted a specific industrialization program - the '*State Program for Accelerated Industrial and Innovative Development*' (SPAIID) for the period of 2010-2014. The aim was to form a proper institutional and legislative basis, as well as develop the infrastructure across the country for the sake of economic diversification. While 770 projects have been implemented creating 75,000 jobs, which in turn led to production of 400 types of new products (Konkakov 2016: 14), the economy has remained heavily dependent from resources revenues. Lack of transparency in checks and balances is a major issue that considerably reduces the efficiency of such government programs, and, as a result, regardless of how well the program was designed, the outcomes were below the target level (OECD 2017, Konkakov 2016).

In order to manage the income from the natural resources, Kazakhstan has created the National Fund (NF) in the year of 2000. The mission of the Fund has been "*to save financial resources for future generations and to reduce the country's dependence on international raw*

material markets” (Satpayev and Umbetaliyeva 2015: 123). In order to execute NF’s savings function, the maximum savings amount was defined as unlimited, the minimum, however, has been defined. The stabilization function has been secured by guaranteed transfers to the state; the funds assets totalled US \$65 bln in 2013. Furthermore, the monitoring system is tightly linked to the president (ibid.).

The performance of economic institutions of Sovereign Welfare Fund ‘Samruk Kazyna’ (SWF), which was created to facilitate diversification, has not achieved the targets either. The Fund is an exclusive shareholder of Kazakhstan Development Fund and keeps hold of interests in gas, oil energy, finance, construction, property and transportation sectors (Esanov 2009: 16). While it is challenging to distinguish between social and commercial goals of the fund, both the lack of transparency and dependence from excessive government support are some of the biggest issues within the Fund. Esanov (2009: 17) stated that the governing board does not have any NGOs representatives and that the sharing power principle is violated as well, since decision making power is in the hands of one agency.

As was stated before in this study, resource abundance in a rentier state is a basis for low quality and predatory state institutions. The empirical evidence described in this section suggests that Kazakhstan could be regarded as a rentier state. The establishment of such funds in the country is a clear example of low transparency levels in the extractive sector, as well as in the whole distribution of the income from resource exports (Satpayev and Umbetaliyeva 2015: 123- 124).

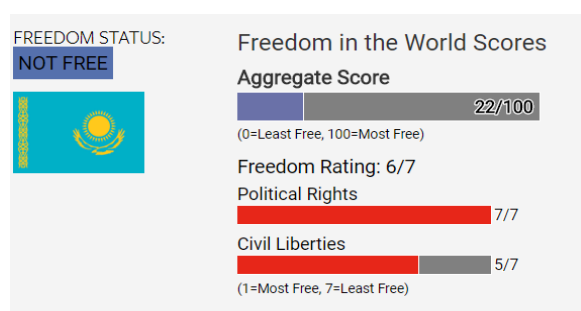
5.3 Kazakhstan as a Rentier State

The rentier state is associated with the high level of corruption (Di John 2011: 172); thus, Kazakhstan had a score of 29 out of 100 of the corruption perception Index, where 0 stands for “highly corrupt” and 100 for “very clean” (Transparency International 2015). The corruption issue, which is mainly attributed to post Soviet features such as informal and neopatrimonial structures, so far remains too complex to solve. Thus, almost all political

levels in the country have been formed by informal structures and corruption (Satpayev 2006).

Second, a high level of corruption in combination with a weak system of state management culminates in the opaque management of natural resources by a narrow circle of government officials (Satpayev 2006). The Freedom House states that the democracy levels failed to strengthen in Kazakhstan - the country possesses the aggregate score of 22 out of 100 regarding the freedom status, where 0 indicates the least democratic state (refer to Figure 10).

Figure 10, Kazakhstan Profile: Freedom in the World Scores, Freedom House 2017



According to Freedom House, in 2010-2017, the freedom score deteriorated from 5.5 to 6.0, 6.0 being the least free, and democracy level has a score of 6.64/7 where 7.0 indicates the complete absence of democracy, which reflects on the worsening processes of elections, non-existence of independent media and civil society in Kazakhstan recently (Freedom House 2017).

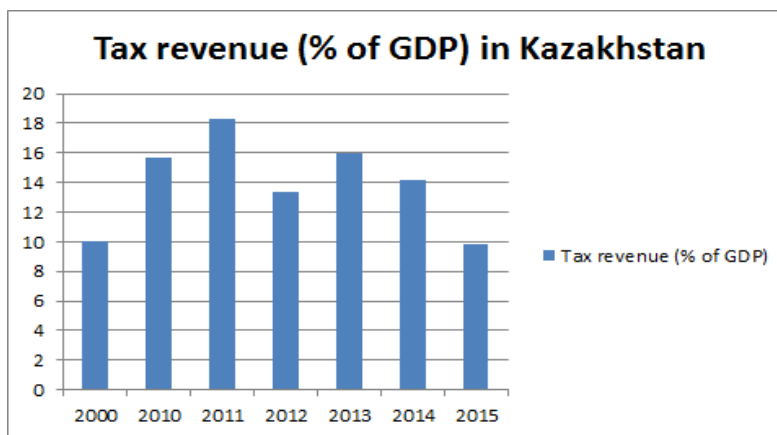
As mentioned previously, there are certain specific characteristics that characterize state a ‘rentier’: significant domination of rents in the economy, few people engaged in rents generation, as well as rents externality (Beblawi 1987). Despite the popular motto of the country’s authorities “*First the economy, then politics*” (Satpayev and Umbetaliyeva 2015: 124), stating that economic development, being a priority, can be separated from political reforms, the rentier state approach seems to be appropriate for Kazakhstan. Here a specific cultural factor puzzle, responsible for such development outcomes, falls into place: the aforementioned clans concept laid out the basis for the neopatrimonial system, which is

grounded on kinship and trust, extending on both vertical and horizontal levels of the Kazakh political system (Satpayev 2006: 95). Hereby, there is a hierarchically structured elite pyramid in Kazakhstan with serious ethnocentric policy of recruitment (Dave 2007), where elites depend on the natural resource income, coming from sales on foreign markets with volatile prices dependent upon external circumstances (Satpayev 2015: 123).

The last part of this study will elaborate on the rentier and repression effects of the rentier state by applying the framework articulated by Ross (2011).

5.3.1 Taxation effect

Figure 11, Tax revenue (% of GDP) in Kazakhstan, WB 2017

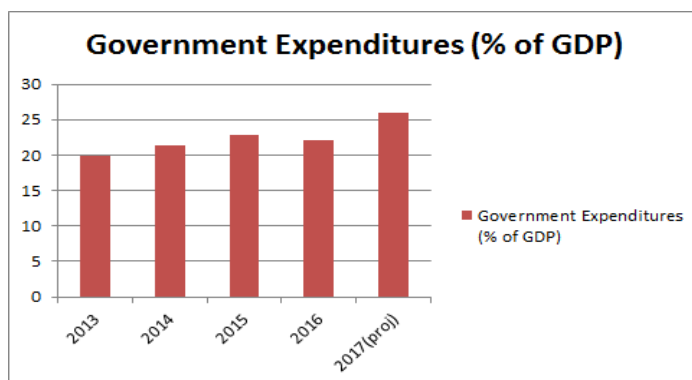


Based on Ross's framework, there are three parts comprising the rentier effect, such as *taxation, group formation and spending* effects. Particularly, the absence of an efficient tax system is one of the features that portrays rentier states

(Ross 2001: 333). The reason why the government tends to tax less, or sometimes not at all, is because taxation gives the ground for citizens to demand democracy, proper political participation and liability (ibid). If we look at the Figure 11, we can see that the rate was fluctuating from 10 to 18 percent in 2000-2015, which suggests that taxation in Kazakhstan does not hold a significant share in its GDP (WB 2017). Thus, since most of the state income is coming from resource exports, one could affirm that the taxation system in the country is not a significant concern for the authorities to maintain and develop, as of now.

5.3.2 Spending effect

Figure 12, Government Expenditures (% of GDP), WB 2017



The second effect, referred to as a ‘spending effect’ describes the way governments tend to maintain their power in rentier states.

It states that governments are using rents towards miscellaneous development programs, as well as

subsidies of particular sectors in the economy - to put it simply, rentier states pursue considerable fiscal spending in order to make their power legitimate (Ross 2001: 333-334; Meissner 2010: 11). Interestingly enough in Kazakhstan the government expenditure was 22.1 % as of 2016 (IMF 2017), which is much lower than that of OECD countries (OECD 2014: 61) and of other resource rich economies (WB 2017). However, if looking at the efficiency of this spending, the modernization plan “SPAIID” and creation of welfare funds (thesis’ section 5.2.2.1), are perfect examples of a spending effect on patronage (Ross 2001: 333). Indeed, Kazakhstan has achieved significant success in combating the poverty and rising living standards of its population; however this is not the outcome of its industrialization plans, but rather a consequence of a rentier economy (OSCE 2013).

5.3.3 Group Formation Effect

Finally, there is a third constituent of a rentier effect - the ‘group formation’ effect, stating that rentier states tend to suppress opposition, or any kind of independent social groups, to the status quo since they are seen as a threat for existence of the state. It has been mentioned before that the freedom of speech is restricted in the country, and that the opposition has been marginalized (Freedom House 2017). That describes how the rentier behavior in Kazakhstan destabilizes civil society - the necessary precondition for a democratic state. Kazakh civil

society groups lack any significant support from within and outside of society, although international NGOs have somehow managed to establish a more influential dialogue with the state than other parties in the country (Franke et al. 2009: 131).

5.3.4 Repression effect

Table 13. Military expenditure (% of GDP) in Kazakhstan - WB 2017

year	2013	2014	2015	2016
rate	0,9	1,0	1,1	0,8

The repression effect entails that the rentier governments are inclined to spend state income on security matters so as to strengthen their authority and retard democratization. Regarding Kazakhstan, it spends on average 1 percent of its GDP on its security apparatus (see the table above), which contradicts this spending aspect of the theory's repression effect. However, the repression effect also states that government spending goes for the sake of preserving ruling elites, as well as for the continuing integrity of the government by suppressing domestic mass unrests, aspirations and protests (Ross 2001: 335), which is exactly what happened in the Kazakh oil town Zhanaozen, where major mass unrest and protests happened in 2011 (Satpayev and Umbetaliyeva 2015: 125). Therefore, having a military apparatus is important with regards to protection of country's energy resources and related facilities which tend to be situated in unstable territories (Ross 2001).

The well-known labor conflict in the oil town of Zhanaozen in Western Kazakhstan in December 2011 clearly demonstrates the linkages between the rentier state, social tensions and oil industry in the country. The mass unrest resulted from unfair distribution of dividends from the natural resource rents between the oil companies and the local workers (Freedom House 2017). Kazakh workers demanded equal rights and pay with foreign workers and abolished the restrictions imposed on independent labor unions activity (Satpayev and Umbetaliyeva 2015: 126). The conflict escalated on the 16th of December, 2011 on the central square of the city, where: "... hundreds of protesters had set up their tents for more

than six months, at least 16 people were killed and more than 100 injured” (Satpayev and Umbetaliyeva 2015: 126; Kourmanova 2012). The shooting happened as the police was trying to clear out the area for celebrations of the Independence Day of Kazakhstan (ibid.). To sum this up, it has been observed that the country follows the framework of Ross’ repression effect: although the military spending does not tend to be high, it aims to protect the infrastructure of oil producing industries, which are exposed to security threats around the highly charged borders of Caspian Sea.

6. Conclusion

Through the extensive analysis of empirical findings, this study answers its main overarching question: *How does dependence on natural resources affect the economic development in Kazakhstan?* with two sub questions: a) *Is economic development deficient due to poor political institutions?* b) *If poor political institutions are present, shall the case of Kazakhstan be defined by the resource curse or the rentier state theory?*

This was done through applying two theories: the natural resource curse and the rentier state on the case of Kazakhstan since independence. First, the study revealed a large dominance of rents from natural resources in the Kazakh economy and as a consequence of that deficient economic development in Kazakhstan. Neither the economy structure, nor the export basket displayed noteworthy changes. The analysis indicated the presence of weak institutions in the country, both economic and political, that have negatively affected the process of economic development. Furthermore, the absence of strong institutions has formed a system vacuum, giving clans and shadow economy an opportunity to grow strong. Thus, the post Soviet neo-patrimonial regime in Kazakhstan has strengthened the effects of rentierism, which was proved by testing the second theory of a rentier state against the experience of Kazakhstan. To conclude, it shall be contested that resource curse theory alone is not able to justify Kazakhstan’s inability to be engaged in significant steps towards proper governance of sustainable economic diversification. However, Kazakhstan can be defined as a rentier state,

particularly a Post Soviet rentier state with miscellaneous cultural, historical and specific structural preconditions at work.

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