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KAZAKHSTAN – BUSINESS ENVIRONMENT IN A BOOMING ECONOMY

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Kazakhstan

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Foreword

The Northern Dimension Research Centre (NORDI) is a research institute run by Lappeenranta University of Technology (LUT). NORDI was established in the spring of 2003 in order to co-ordinate research into Russia.

NORDI's mission is to conduct research into Russia and issues related to Russia's relations with the EU with the aim of providing up-to-date information on different fields of technology and economics. NORDI's core research areas are Russian business and economy, energy and environment, the forest cluster, the ICT sector, as well as logistics and transport infrastructure. The most outstanding characteristic of NORDI's research activities is the way in which it integrates technology and economics.

LUT has a long tradition in conducting research and educating students in the field of communist and post-communist economies. From the point of view of these studies, LUT is ideally located in the Eastern part of Finland near the border between EU and Russia.

This book aims to provide readers with an overview of Kazakhstan's economy and discuss the business environment and investment climate in Kazakhstan. The study deals with various issues faced by foreign companies when doing business in a transitional economy under ongoing series of reforms. In this context, qualitative as well as quantitative indicators have been used.

Lappeenranta, December 2007

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1 Introduction

1.1 Background

Many Western companies find that their established markets are stagnating or even declining. Emerging market economies can therefore provide an attractive market which may offer enduring route for corporate growth. This study focuses on Kazakhstan.

Kazakhstan was the last of the former Soviet republics to declare independence in December 1991. Its population of 15 million people is ethically very heterogeneous, comprising some 130 different nationalities. Nevertheless, it has been extremely successful since the collapse of the Soviet Union in maintaining political stability and harmonious interethnic relations. (European Commission, 2007)

Kazakhstan has sustained very strong macroeconomic performance since the start of the decade. Annual real GDP growth has averaged about 10 percent. Employment has expanded steadily and social indicators have improved. The fiscal position has remained very strong, permitting substantial increases in public expenditures, especially social and infrastructure spending, as well as an accumulation of large savings in the National Fund (NFRK) for future generations. (IMF, 2007b)

The Kazakhstan market is dynamic and changing. Since the independence from the Soviet Union in 1991 the market has been engaged in still ongoing series of reforms. Wage increases and substantial expansion of bank credit have fuelled private consumption spending (ADB, 2007). Local markets are of growing interest as consumption and buying habits change.

Today Kazakhstan is responsible for four per cent of world's oil and gas reserves and energy exports are the main reason for high economic growth rates. Kazakhstan's major trading partners include Russia, Italy, Switzerland and China. Trade with Finland, although still quite modest, is increasing. The Kazakhstan market attracts FDI mainly to the oil and natural gas sector, but also a wide range of other activities, such as transport, services, infrastructure equipment and engineering.

1.2 Focus of the study

The purpose of this report is to present an overview of the present state of the general market conditions and more specifically the investment climate in Kazakhstan and the potential business opportunities in the market from the point of view of foreign companies.

The aim of the study is: (1) *to provide* an overall analysis of the Kazakh market conditions and industrial structure through statistical data, (2) *to identify and describe* the prominent trends, phenomena, and agents in the market, and (3) *to identify and describe* the factors affecting foreign companies' potential in the market.

Chapter 2 gives an overview of the general economic situation in Kazakhstan. It also discusses the prevailing economic trends.

Kazakhstan's natural resources and industrial structure is discussed in Chapter 3. The abundance of oil and gas reserves in Kazakhstan is the main reason for its high economic growth. The Kazakhstan climate is favourable for agricultural production, and thus, the country is one of the largest grain exporters in the world.

Chapter 4 deals with the foreign trade structure. Chapter 5 focuses on the international credit worthiness of Kazakhstan. Some qualitative indexes are also discussed.

Business environment and investment climate of the country are analysed in Chapter 6. Several international studies and reports rank countries each year and their development is monitored from various points of view.

Chapter 7 focuses on the foreign direct investment in Kazakhstan. Investment inflows and stock are analysed as well as the country's investment potential and performance. At the end of the chapter, also motivation and opportunities for foreign investors are discussed briefly.

Chapter 8 concludes.

2 Kazakhstan's national economy

2.1 General economic development

Kazakhstan's economic performance over the past half a decade has been impressive. Economic and social indicators show major gains due to a rapid expansion in hydrocarbon production. Real GDP has grown over 9 percent a year on average and per capita income has risen sharply. There has been a steady decline in unemployment. In addition, inflation has moderated to single digits, and confidence in the banking system has strengthened. Sizable share of the rapidly expanding public spending is going to social services. At the same time, increased government revenues, especially from oil, have kept the overall fiscal position in surplus and substantial assets have been accumulated in the National Fund. (IMF, 2006, p. 2)

Recently, Kazakhstan's economy has had rapid growth as a result of dynamism in its energy sector, but also because of economic reforms, good harvests, and foreign investments. (Djalankuzov et al., 2004) Growth has been sustained through strong domestic demand that is underpinned by higher oil prices, increased fiscal expenditure and an easing of credit conditions. The economy remained robust in 2006 with real GDP growing by 10.6%, mainly driven by activity in the non-oil sectors such as construction and financial services. (EBRD, 2007, p.28)

Compared to Estonia, Russia and Ukraine, Kazakhstan's growth measured by real GDP has been steadier and remained above the other countries' growth with some exceptions in the first years of the 21st century. (See table 1)

Table 1. Growth in real GDP in per cent.

	2000	**2001**	**2002**	**2003**	**2004**	**2005**	**2006[1)]**	**2007[2)]**
Kazakhstan	9,8	13,5	9,8	9,2	9,4	9,7	10,6	9,0
Estonia	10,8	7,7	8,0	7,1	8,1	10,5	11,4	8,5
Russia	10,0	5,1	4,7	7,3	7,1	6,4	6,7	6,9
Ukraine	5,9	9,2	5,2	9,6	12,1	2,6	7,1	5,8

[1)] Estimate, [2)] Projection
Source: EBRD (2007)

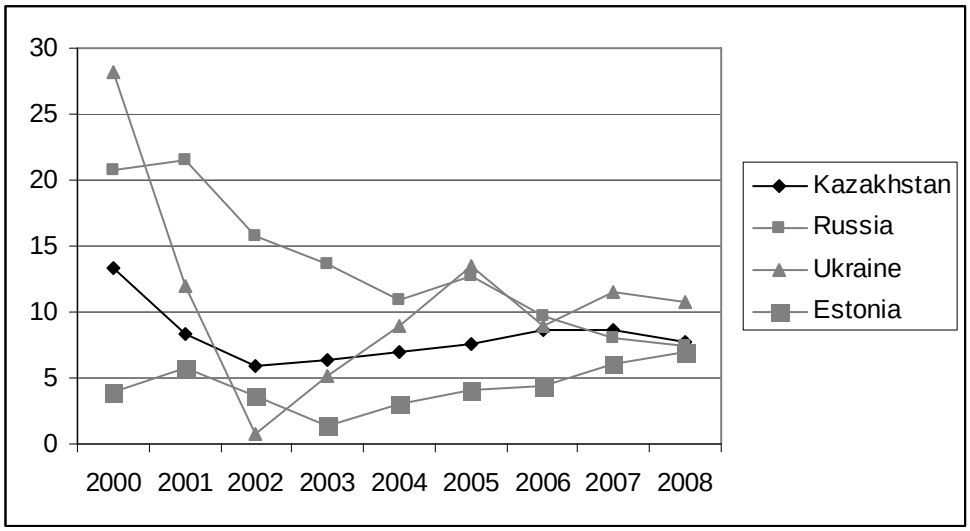
The Kazakh GDP has grown in real terms by an annual rate of approximately 10% during the last 5 years. Thus, the oil boom is very real. At the same time, there are cumulative effects of "petro-dollars": the economy has rather broadly-based dynamism. Inflation has annually been over 8% in the same period of time. Obviously, the oil-related boom has triggered inflationary pressure, which is likely to continue. However, inflation rates of 5-8% a year are rather usual

in emerging markets with strong economic growth. Double-digit inflation rates would be harmful from the point of view of investment. (Tiusanen & Kinnunen, 2005, p. 25)

It can be said that Kazakhstan's economy is in relatively good shape with no rampant inflation. Inflation picked up from 6.9 percent in 2004 to 7.6 percent in 2005 (period averages) and jumped to almost 9 percent in February–April 2006 (year-on-year) as credit growth accelerated to over 70 percent and external borrowing by banks surged. A 30 percent increase in pensions and public sector salaries implemented in mid-2005 also contributed to inflationary pressure. (IMF, 2006) Inflation reached 9 percent (y/y) in May 2006. During February–April 2007, CPI inflation eased to just below 8 percent because of slower food price increases. (IMF, 2007b)

Comparisons between Kazakhstan, Russia, Estonia and Ukraine show that during the early years of the 21st century the inflation has fluctuated the least in Kazakhstan. Until the recent estimates, the inflation rate in Kazakhstan has been lower than in Russia while clearly higher than in Estonia. (See figure 1)

Figure 1. Inflation, average consumer prices, annual percent changes.



Note: 2007-2008 estimates.
Source: IMF (2007a)

The structure of the GDP formation in Kazakhstan has changed during the past ten years. The share of agriculture has declined from 12.8% to 6% in 1995-20006. The share of industry (including mining) of GDP has increased from 27% to 42% in 1996-2006 (see table 2). One of the main sectors contributing to dynamic GDP growth has been exploitation and export of oil (ICEG, 2007).

Table 2. Structure of GDP.

(% of GDP)	1996	2005	2006
Agriculture	12,8	6,8	5,9
Industry	27,4	40,1	42,1
Manufacturing	13,9	12,8	12,4
Services	59,8	53,1	52,0

Source: World Bank (2007)

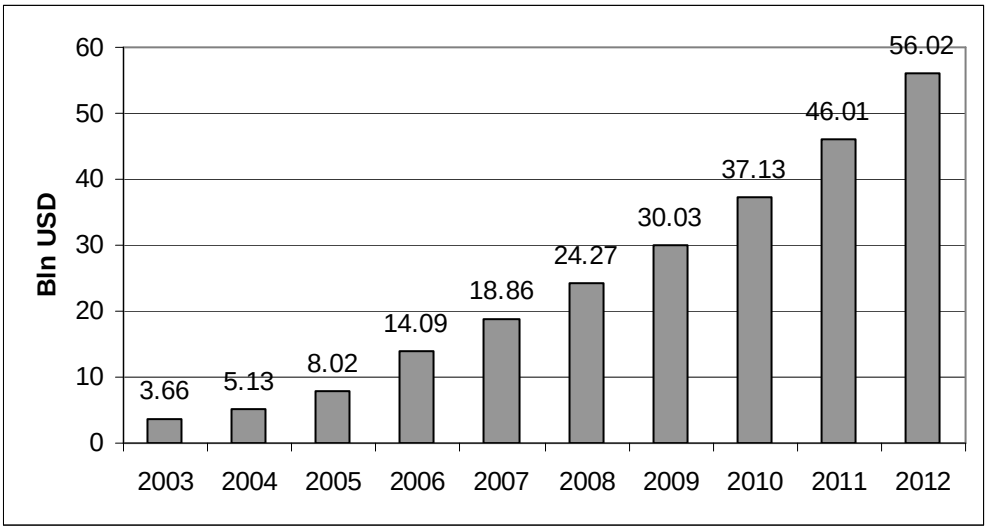
The break-up of the Soviet Union in December 1991 and the collapse in demand for Kazakhstan's traditional heavy industry products resulted in a short-term contraction of the economy, with the steepest annual decline occurring in 1994. In 1995-1997, the pace of the government program of economic reform and privatization quickened, resulting in a substantial shifting of assets into the private sector.

Kazakhstan's monetary policy has been well managed. Because of its strong macroeconomic performance and financial health, Kazakhstan became the first former Soviet republic to repay all of its debt to the International Monetary Fund (IMF) in 2000, 7 years ahead of schedule. (U.S. Department of State, 2007)

Emerging markets often suffer of capital shortage. Therefore, there is the temptation that the best natural riches are sold to foreigners who repatriate their profits. The local economy enters a vicious circle of underdevelopment. (Tiusanen & Kinnunen, 2005, p. 23)

The post-Soviet Kazakhstan decided to avoid this poverty trap by establishing a National Fund in 2000 to invest a part of the export income in global financial market for the benefit of future generations. The Fund's capital was over 14 billion $ in 2006 (IMF, 2007b) It has been estimated that Fund's capital would increase at least by $ 1 billion a year, (Tiusanen & Kinnunen, 2005, p. 23) and the IMF estimates are even larger (see figure 2).

Figure 2. National Fund, end of period stock, billion USD.



Note: 2006-2012 projections.
Source: IMF (2007b)

In March 2002, the U.S. Department of Commerce gave a market economy status under U.S. trade law to Kazakhstan. The change of status recognized substantive market economy reforms in the areas of currency convertibility, wage rate determination, openness to foreign investment, and allocation of resources. (U.S. Department of State, 2007)

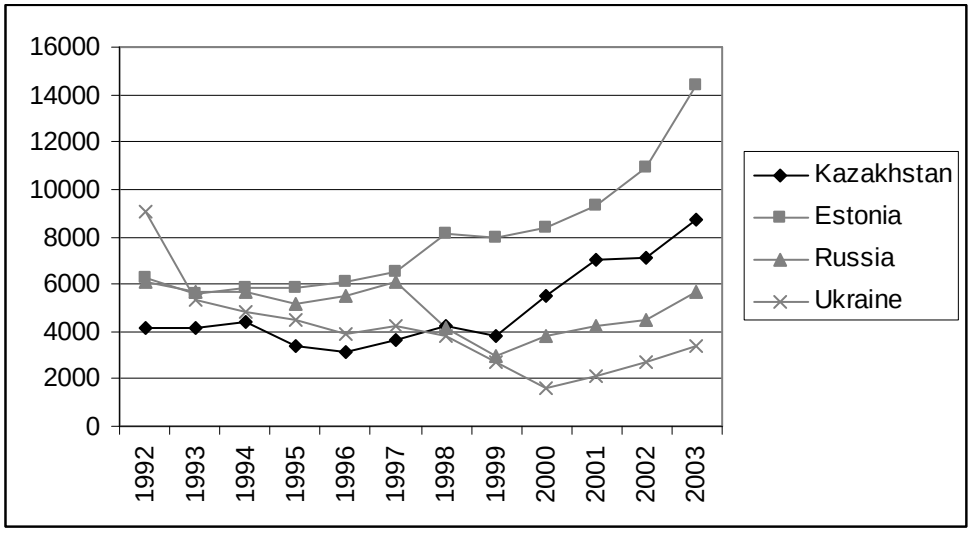
Kazakhstan has embarked upon an industrial policy designed to diversify the economy away from overdependence on the oil sector by developing light industry. The policy aims to reduce the influence of foreign investment and foreign personnel. Upward pressure on the local currency continued in 2006 due to massive oil-related foreign-exchange inflows. Aided by strong growth and foreign exchange earnings, Kazakhstan aspires to become a regional financial centre and has created a banking system comparable to those in Central Europe. (CIA, 2007)

2.2 Productivity, labour force and employment

According to the World Bank (2005), Kazakhstan's labour productivity, measured as dollar value added per worker, in manufacturing improved between 2000 and 2003.

Kazakhstan’s labour productivity was stagnant in manufacturing during the 1990s, relative to Ukraine, and Estonia. Growth in labour productivity in manufacturing from 2000 to 2003 was more impressive in Estonia than in Kazakhstan. However, the latter has performed better than Russia and Ukraine. (See figure 3)

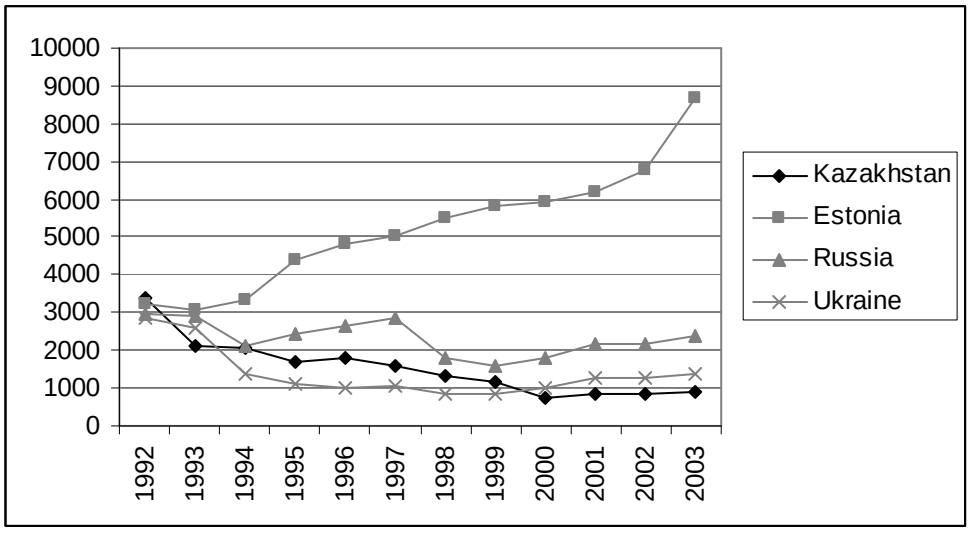
Figure 3. Manufacturing labour productivity, USD per worker per year 1992-2003.



Source: World Bank (2005)

In agriculture, which generates the livelihood for a significant part of the population in countries under review, the productivity picture is worse than in manufacturing. The agricultural productivity trend is very similar in Kazakhstan, Ukraine and Russia. There was decline in the 1990s, but some recovery after the turn of the century. In Estonia the situation is excellent compared to the three other countries. Estonian agricultural productivity has almost three-folded over the period of 1992-2003. (See figure 4)

Figure 4. Agricultural labour productivity, USD per worker per year 1992-2003.



Source: World Bank (2005)

Productivity growth is a key issue in long-term development. Permanent gains in competitiveness will only be made if the county improves its human capital base. Kazakhstan needs to develop a productive labour force, at all skill levels, which is more difficult than just creating an educated elite. This endeavour will require sustained efforts with an extended

period before pay-off is clearly observed. The quality of the health and educational systems in Kazakhstan may not be contributing as much as they could to enhance labour productivity (World Bank, 2005, p. iv)

Oil money inflow is likely to lead to real exchange rate appreciation over time, which is likely to hurt competitiveness in sectors that have no direct link to the oil industry. Thus, unless labour productivity increases, it will be too costly to produce goods without any link to the oil industry in Kazakhstan. (World Bank, 2005, p. 4)

There are difficulties in finding highly skilled local labour in Kazakhstan, particularly those with engineering and management skills. This hurts local companies in two ways. On the one hand, they may have difficulty finding local engineers who are qualified in the technical disciplines needed to supply the oil and gas sector. On the other hand, it raises the price of skilled labour. When a particular skill is in short demand, workers with this skill will demand higher wages and are more likely to be poached by firms looking for that skill. Training workers would be very expensive for firms, because they may have difficultly retaining these workers. (World Bank, 2005, p. 50-51)

According to the International Labour Organization (ILO, 2007), unemployment rate in Kazakhstan is lower than reported in Ukraine or Estonia. The latest figure (2006) is 7.8% in Kazakhstan.

Table 3. Unemployment rates in 2004.

	Labour force survey, total unemployment
Kazakhstan	8.4
Estonia	9.7
Russia	7.8
Ukraine	8.6

Source: ILO (2007)

2.3 Living standard

Rapid economic growth has helped raise the living standard in Kazakhstan. Currently, the annual per capita GDP and monthly wages in Kazakhstan are among the highest in the former Soviet republics. (Macleod Dixon Lawyers, 2007)

Living standard in Kazakhstan has experienced a relatively steady growth recently. In 2006 it was about 50% of that reached in Estonia and about 80% in Russia. Kazakhstan's living

standard exceeds that of Ukraine measured by GDP per capita in current purchasing power parity in USD. It is estimated that the living standard in Kazakhstan will grow by about 10% per year in 2006-2008 (IMF, 2007a).

Table 4. GDP per capita at current PPP (USD).

	2004	2005	2006	2007	2008
Kazakhstan	7414	8387	9568	10658	11672
Russia	9975	11010	12178	13432	14625
Ukraine	6597	7046	7832	8624	9308
Estonia	15027	17133	19692	21860	23606
CIS (12) average	4498	5047	5710	6430	7112

Source: IMF (2007a)

In 2006 the average living standard in the 12 CIS countries was about 60% of that in Kazakhstan. However, at the same time in 2006, the average living standard in EU(15) countries (37004 USD) was almost 4 times higher than in Kazakhstan.

Regional disparities in per capita gross regional product (GRP) are high and rising (see table 5). Measured in USD, per capita GRP in the oil-extracting oblasts (Aktobe, Atyrau, West Kazakhstan, Kyzylorda and Mangistau) and the metropolitan areas (Astana and Almaty) amounted at almost twice the national level in 2004 (97.0 per cent and 995.3 per cent higher, respectively). The average indicator for the non-oil industrial oblasts (East Kazakhstan, Karagandy and Pavlodar) was virtually the same as the national average. For the agricultural oblasts (Akmola, Almaty, Zhambyl, Kostanai, North Kazakhstan and South Kazakhstan), however, per capita GRP was barely half the national level. (USAID, 2006a)[1]

[1] Regional classification is based on production structure. (See USAID, 2006a, p. 3)

Table 5. GRP per capita in PPP (USD) in 2004.

1.	Akmola oblast	4190
2.	Aktobe oblast	8734
3.	Almaty oblast	3037
4.	Atyrau oblast	30467
5.	East Kazakhstan oblast	5341
6.	Zhambyl oblast	2522
7.	West Kazakhsatn oblast	9274
8.	Karagandy oblast	7550
9.	Kostanai oblast	5814
10.	Kyzylorda oblast	5849
11.	Mangistau oblast	17479
12.	Pavlodar oblast	8864
13.	North Kazakhstan oblast	4220
14.	South Kazakhstan oblast	2780
15.	Astana city	13835
16.	Almaty city	14861
Total	Kazakhstan	6562

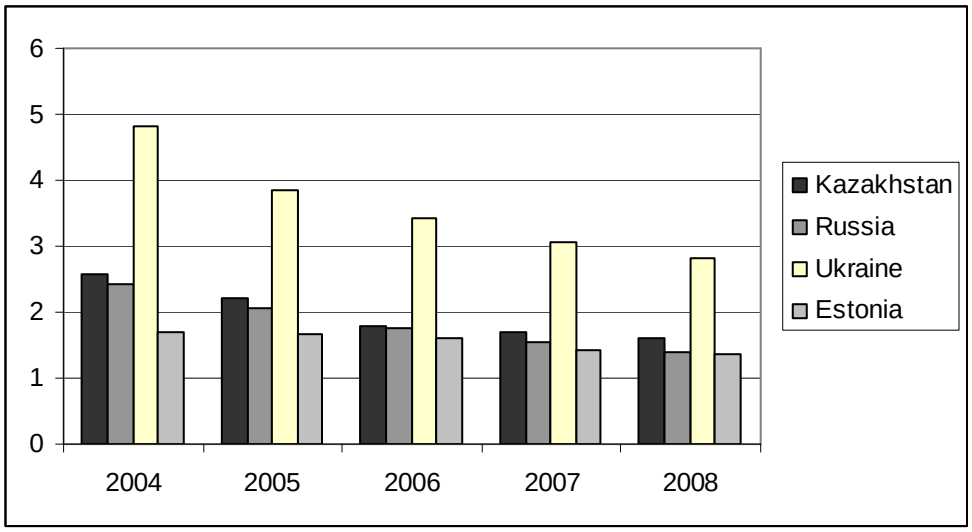
Source: USAID (2006b)

GDP per capita at current purchasing power parity in USD is used as a measurement for the living standard. Frequently used GDP per capita in USD (or euros) are misleading when emerging markets are involved. There are biases in exchange rates (the official exchange rates do not reflect the local price level correctly) (for more detailed discussion see e.g. Tiusanen et al., 2004).

Kazakhstan has an undervalued currency. This means that the official GDP per capita figures are lower than the PPP-adjusted ones. These two figures ought to be identical, i.e. official exchange rate (ER) should reflect the local price level perfectly well. The biases of the ERs can be measured with so called exchange rate deviation index (ERDI). It is calculated by dividing the PPP-adjusted GDP figure per capita (in dollars or in euros) by the original GDP per capita figure (in dollars or in euros). The result shows how much there is deviation on the official exchange rate. (Tiusanen et al., 2004, p. 12)

In 2004 the exchange rate deviation index (ERDI) in Kazakhstan had a relatively high value of 2.59. The IMF (2007a) estimate for 2007 is 1.69. With this figure, the country ought to have slightly higher price competitiveness in its foreign trade than for example Russia and Estonia but clearly lower than Ukraine. The ERDI values show a diminishing trend which means that the undervaluation advantage erodes (see figure 5).

Figure 5. Exchange rate deviation index (ERDI).



Note: estimates 2005-2008 for Kazakhstan, 2007-2008 for other countries
Source: Author's calculations based on IMF (2007a)

2.4 Income and household expenditure

According to the International Labour Organization (ILO) statistics, the average household size in Kazakhstan was 3.4 in 2004 (see table 6). For comparison, the average size was 2.4 in Estonia and 2.7 in Ukraine (in 2002).

Table 6. Average household size

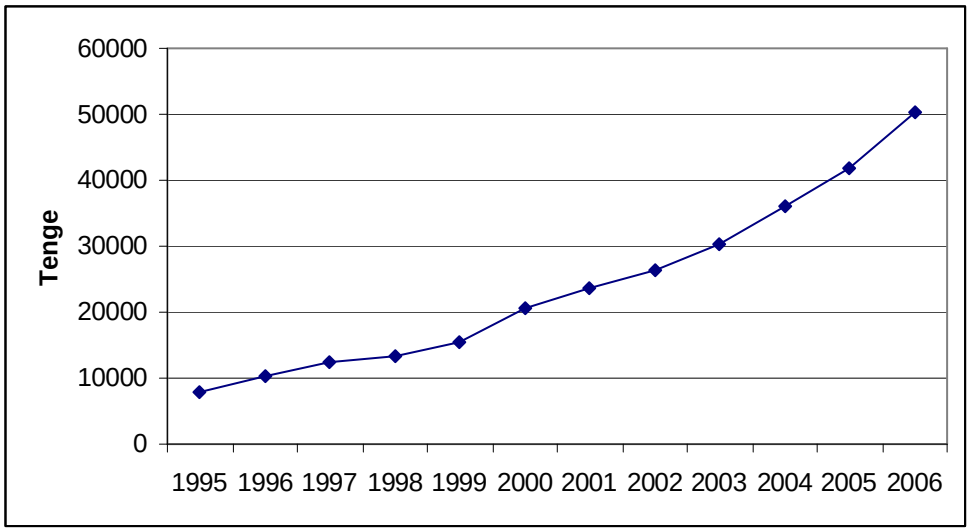
	Kazakhstan	Estonia	Ukraine
Average household size, persons	3.4	2.4	2.7
1 person, %	12.1	31.6	20.9
2 persons, %	21.0	30.1	29.2
3-5 persons, %	43.5	36.1	22.6
6+ persons, %	23.4	2.2	27.3
Total population, %	100	100	100

Source: ILO (2007) for Kazakhstan and Estonia in 2004; Tiusanen et al. (2004) for Ukraine in 2002

The **average monthly per capita income** in Kazakhstan in 2004 was 8387 tenge (KZT) which is about 50 euros. The annual growth in average wages has been about 19% from 2000 to 2004.

According to the Agency on Statistics of the Republic of Kazakhstan (2007), the **average monthly wage of industrial production personnel** has five-folded from 1995 to 2006 in nominal terms. In 2006 the average monthly wage was KZT 50000. According to the WIIW database, one euro in 2006 was KZT 158. Thus the average monthly pay in 2006 was about € 316.

Figure 6. Average monthly wage in industry in KZT.



Source: The Agency on Statistics of the Republic of Kazakhstan (2007)

The income difference between the poorest and riches households is relatively large. In income distribution statistics the population is usually divided into quintals. The difference between the lowest quintal (20%) and the highest quintal is important. The average monthly income per capita in the richest 20% of the households was about 100 euros while the poorest 20% of households earned only about 20 euros per capita per month. (See table 7)

Table 7. Household income by expenditure class in Kazakhstan in 2004.

Expenditure class	Average monthly per capita income (KZT)	In euro
Q1	3564	21
Q2	5273	31
Q3	7100	42
Q4	9684	57
Q5	16754	94
Total	8387	50

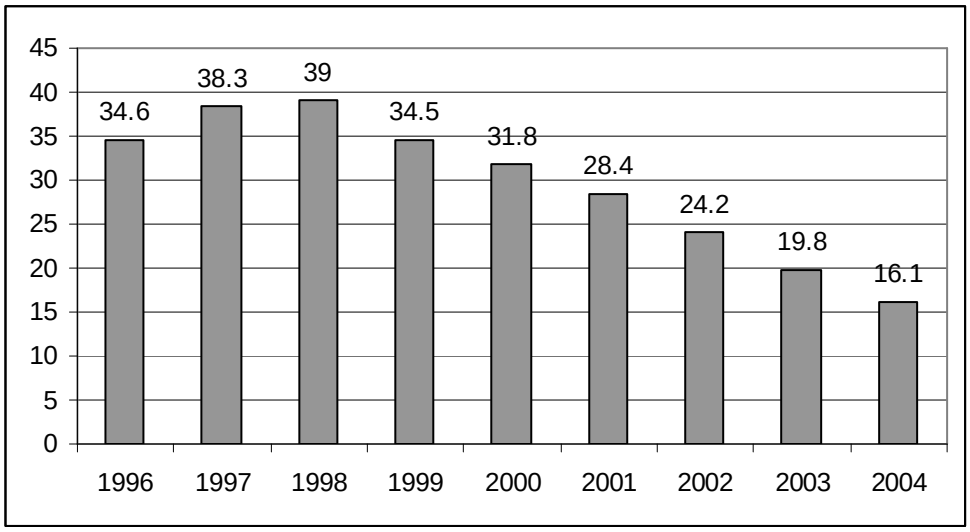
Source: ILO (2007)

Throughout Kazakhstan, poverty rates have been declining. Although growth has benefited some regions more than others, poverty has declined in nearly every region between 2000 and 2004. What is surprising is that poverty rates are highest in oil-rich regions. Atyrau is of most concern, but Kyzylorda and Kostanai districts also lag behind the national average, to a lesser degree. As poverty has declined, income inequality has also fallen in most regions. In addition, income inequality among regions declined between 1999 and 2004. The recent

decline in the poverty headcount (gauged by minimum subsistence) is impressive.[2] (USAID, 2006a)

According to the World Banks survey of living standards, about 16% of population in Kazakhstan has income below subsistence level (ILO, 2007). The poverty rate fell from 34.5 percent in 1999 to 16.1 percent in 2004. (USAID, 2006a) In 2003 the subsistence level was 5128 KZT, which is about 29 euros (UNDP, 2007). The proportion of population with income below subsistence level has been declining steadily since 1998 as can bee seen in figure 7.

Figure 7. Proportion of population with income below subsistence level 1996-2004.



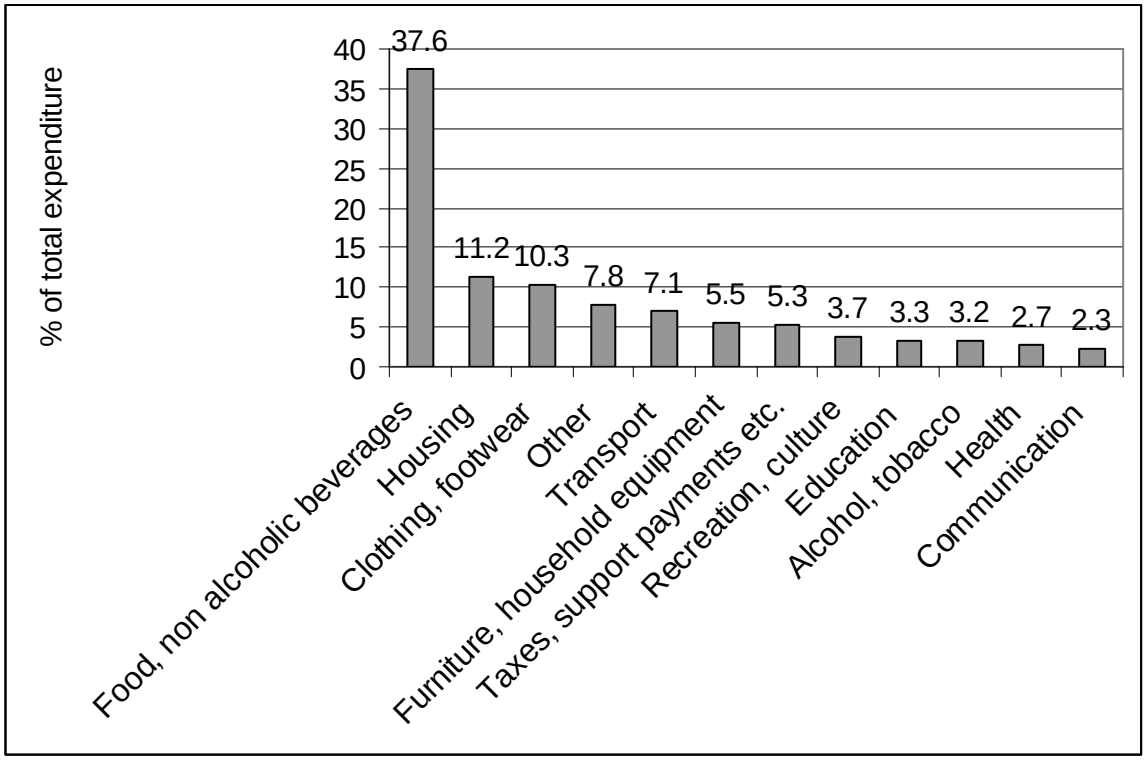
Source: ILO (2007)

Looking at poverty rates by region, the worst performers in 2004 were Atyrau (29.1 per cent), Kyzylorda (26.5 per cent), and South Kazakhstan (23.0 per cent) oblasts. Astana and Almaty cities had the least poverty (1.1 per cent and 2.8 per cent, respectively). In the worst-performing regions, Atyrau and Kyzylorda oblasts, economic activity is heavily focused on oil-extraction which is a highly capital-intensive industry that offers limited employment opportunity. (USAID, 2006a)

Over 37% of the household expenditure in Kazakhstan goes to food (including non alcoholic beverages). For comparison the respective share in Estonia is about 28%. Housing and clothing (including footwear) are the next largest expenditure groups in Kazakhstan with over 11% and 10% shares, respectively. (See figure 8)

[2] Poverty by subsistence minimum is defined as the share of households with incomes below a required monetary income per person equal to the consumption basket cost. Non-foods and services account for a fixed share of thirty percent of the consumption basket.

Figure 8. Distribution of household expenditure in 2004.



Source: ILO (2007)

3 Natural resources and industrial structure

Kazakhstan is the largest of the former Soviet republics in territory, excluding Russia. It possesses enormous fossil fuel reserves and plentiful supplies of other minerals and metals such as iron ore, manganese, chromite, lead, zinc, copper, titanium, bauxite, phosphate, sulphur, gold, and silver. It also has a large agricultural sector featuring livestock and grain. Kazakhstan's industrial sector rests on the extraction and processing of these natural resources and also on a growing machine-building sector specializing in construction equipment, tractors, agricultural machinery, and some defence items. (CIA, 2007)

However, because of years of neglect, Kazakhstan's industrial base is undergoing much-needed repair and updating. There are three major economic issues of concern in Kazakhstan: (1) a declining share of services in total output, (2) high employment in low-productivity agriculture, and (3) insufficient development of manufacturing. Because of a high degree of regional specialization, these problems are naturally reflected in the regional breakdown of output and employment. (USAID, 2006a)

Kazakhstan is a large and diverse country in terms of natural resources, climate, and population as well as industrial structure. Administratively, the country is divided into 14 provinces (oblasts) and two metropolitan areas (Almaty and Astana). Although Kazakhstan's macroeconomic success is undeniable, beneath the aggregate indicators there are some serious structural problems. The statistics available show substantial regional differences in industrial growth, investment, income, and prices. For example, oil extracting Atyrau oblast accounted for a mere 3.1 percent of the population at the beginning of 2005, but attracted 26.3 percent of total fixed investment in the country in 2004. (USAID, 2006a)

Figure 9. Kazakhstan regions.

Given the differences between the oblasts the USAID (2006a) report uses the following classifications of regions into four groups, based on the production structure:

1. ***Oil-extracting oblasts.*** These oblasts produced 99.97 percent of the crude oil in the country in 2004. Their individual shares in total oil extraction ranged from 12.2 percent to 28.9 percent.

- Aktobe
- Atyrau
- West Kazakhstan
- Kyzylorda
- Mangistau

2. ***Agricultural oblasts.*** Agriculture accounted for at least 20 percent of value added in each of these oblasts. In other oblasts, agriculture was much less important.

- Akmola
- Almaty
- Zhambyl
- Kostanai
- North Kazakhstan
- South Kazakhstan

3. ***Non-oil industrial oblasts.*** These are oblasts with relatively low agricultural production and strong industrial sectors, including coal, copper, aluminium, steel, and electricity.

- East Kazakhstan
- Karagandy
- Pavlodar

4. ***Metropolitan areas.*** The two main urban centers, the new capital Astana and the old capital Almaty, make up the final group.

The oblast groups are geographically compact. Specifically, the oil-extracting oblasts are in the west of the country. The non-oil industrial oblasts are in the northeast and the centre. The agricultural oblasts can be divided geographically into two subgroups, northern and southern, each consisting of three oblasts.

3.1 Oil, gas and coal

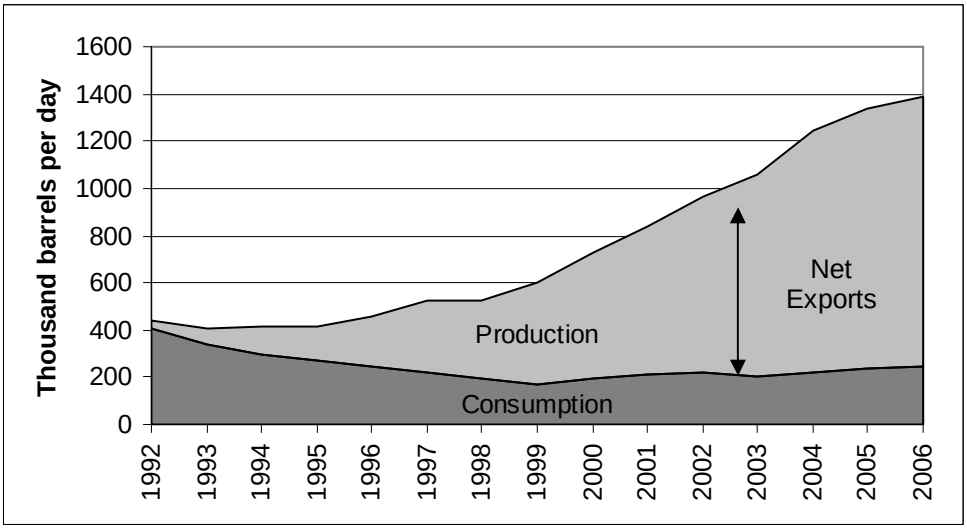
Kazakhstan has the Caspian Sea region's largest recoverable crude oil reserves, and its production accounts for almost two-thirds of the roughly 2 million barrels per day (bbl/d) currently being produced in the region (including regional oil producers Azerbaijan, and Turkmenistan). Kazakhstan oil exports are the foundation of the country's economy (EIA, 2006) and the main reason for such a high annual growth in recent years (Macleod Dixon Lawyers, 2007).

Kazakhstan's proven oil reserves are estimated between 9 billion and 17.6 billion barrels, including both onshore and offshore fields (Olcott, 2007, p. 1). According to the Energy Information Administration, Kazakhstan's combined onshore and offshore proven hydrocarbon reserves have been estimated to be even more than this, between 9 and 40 billion barrels. This is comparable to OPEC members Algeria on the low end and Libya on the high end. (EIA, 2006) It makes Kazakhstan a potential producer of considerable influence. Currently, Kazakhstan produces about 1.4 million barrels of oil a day. The opening of the Caspian Consortium pipeline, in 2001 from western Kazakhstan's Tengiz oilfield to the Black Sea, substantially raised export capacity. In 2006 Kazakhstan completed the Atasu-Alashankou portion of an oil pipeline to China that is planned to be extended from the country's Caspian coast eastward to the Chinese border in future construction.

During the period 1999-2004, Kazakhstan's oil production grew about 15 per cent every year, resulting in nearly a doubling of oil production (see figure 9). During 2005 and 2006, slower growth rates can be attributed to government restrictions on associated gas flaring, field maintenance in Karachaganak and Tenzig, and cold weather. Further restrictions due to environmental non-compliance, especially at the Tabzig field, may cause the revocation of the

operator's production-sharing agreements and would therefore slow down production growth. (EIA, 2006)

Figure 10. Oil production in Kazakhstan.



Source: EIA (2007)

The oil output is expected to be over 3 million barrels/day by 2015, as extraction from the two major wells, Tengiz and Kashagan, is stepped up. This would include approximately 1 million barrels per day from Kashagan, 700,000 bbl/d from Tenzig, 600,000 bbl/d from Kurmangazy, and 500,000 bbl/d from Karachaganak. Other smaller fields would also account for the balance. (EIA, 2006) This would make Kazakhstan a larger producer than Norway, and just behind Mexico and Iran (Olcott, 2007, p. 1). Increasing export quantity combined with high world market prices of oil will increase Kazakhs oil income substantially in the next ten years. (Tiusanen & Kinnunen, 2005, p. 23)

The Tengiz field is located in the swamplands along the northeast shores of the Caspian Sea (see figure 10). Recoverable crude oil reserves have been estimated at 6-9 billion barrels by consortium member Chevron. Tengiz has been developed by the Tengizchevroil (TCO) joint venture (ChevronTexaco 50%, ExxonMobil 25%, Kazmunaigaz 20%, LukArco 5%) since 1993. For the first half of 2005, the consortium produced 271,000 bbl/d of crude oil and condensate, or approximately 21 percent of Kazakhstan's daily crude oil and condensate production. (EIA, 2006)

The Karachaganak oil and gas/condensate field is located onshore, in northern Kazakhstan, near the border with Russia's Orenburg field (see figure 10). Karachaganak is being operated by Karachaganak Petroleum (KPO), a consortium including BG Group and Eni of Italy (each with a 32.5% interest), Chevron (20%), and LUKOIL (15%). According to KPO, the field

holds reserves of around 8-9 billion barrels of oil and gas condensate and 47 trillion cubic feet (Tcf) of natural gas, recoverable over the 40-year life of the project. Oil and condensate production from Karachaganak averaged above 200,000 bbl/d during 2005, representing almost 20 percent of total Kazakh production. (EIA, 2006)

The Kashagan field, the largest oil field outside the Middle East and the fifth largest in the world (in terms of reserves), is located off the northern shore of the Caspian Sea, near the city of Atyrau (see figure 10). Although the field is still being appraised, in June 2002 the consortium operating the field, the Agip Kazakhstan North Caspian Operating Company (Agip KCO), estimated the field's recoverable reserves at 7-9 billion barrels of oil equivalent, with further potential totalling 9 to 13 billion barrels using secondary recovery techniques (gas injection, for example). (EIA, 2006)

Located on the maritime border between Russia and Kazakhstan, the Kurmangazy field is the least developed of Kazakhstan's upcoming oil field developments. Russia and Kazakhstan signed a new $23 billion PSA agreement for the 7.33 billion barrel Kurmangazy oil field in July 2005. After some delay on the terms of the agreement, Russian and Kazakh state oil firms Rosneft and Kazmunaigaz signed the deal in the hopes that this would hasten the field's development. The first well was drilled in early 2006 but came up dry. A second well could be drilled in 2008. (EIA, 2006)

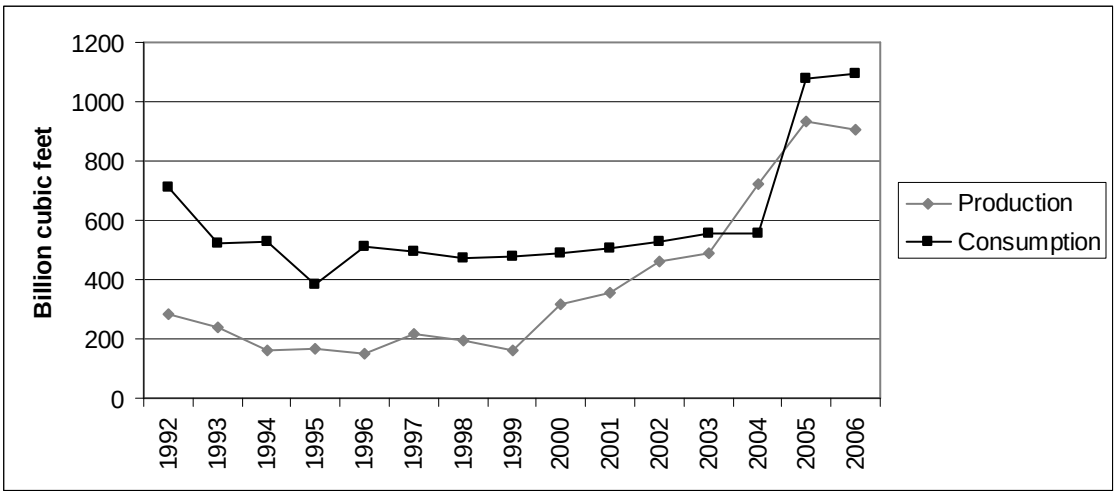
Figure 11. Kazakhstan's major oil fields.

Source: EIA (2006)

Kazakhstan's proven natural gas reserves range from 65-100 trillion cubic feet (Tcf). Despite these sizable reserves, the country spent most of the time following independence as a net natural gas importer. By 2003, however, Kazakhstan's production had reached parity with its consumption level (approximately 550 billion cf), and the country had 167 Bcf in net exports of natural gas in 2004. However, the net imports were about 140 Bcf in 2005. (EIA, 2006 & 2007)

Although natural gas production increased around 15 percent in 2005 compared to 2004, gas production during 2006 remained largely constant. Most of Kazakhstan's natural gas imports come from Uzbekistan and Turkmenistan and are redistributed via the Russian natural gas pipeline system. (EIA, 2006)

Figure 12. Natural gas production and consumption.



Source: EIA (2007)

According to the 15-year strategy of the Kazakh Ministry for Energy and Mineral Resources, Kazakhstan plans to increase its natural gas production to 1.7 Tcf by 2010 and to 1.84 Tcf by 2015. Kazakh energy officials estimate that internal consumption of around 900 Bcf in 2010 will leave 700 Bcf for export. (EIA, 2006)

Most of Kazakhstan's natural gas reserves are located in the west of the country, with roughly 25 percent of proven reserves situated in the **Karachaganak field**. This oil and gas condensate field reportedly has proven natural gas reserves of 16-20 Tcf. The consortium developing Karachaganak expects to produce 900 Bcf by 2012. (EIA, 2006)

Natural gas in Kazakhstan is almost entirely "associated" gas. For this reason, several fields including Karachaganak reinject significant quantities of gas into the ground to maintain

crude wellhead pressure for liquids extraction. In the long term, when the liquids are exhausted, this gas can be recovered. Flaring has declined steadily, but in May 2005 the government ordered all 34 oil producing firms to reduce oil production to levels that would avoid natural gas flaring. Many of the companies that produce associated gas have made pledges to develop ways to use the gas (such as for electricity generation). (EIA, 2006)

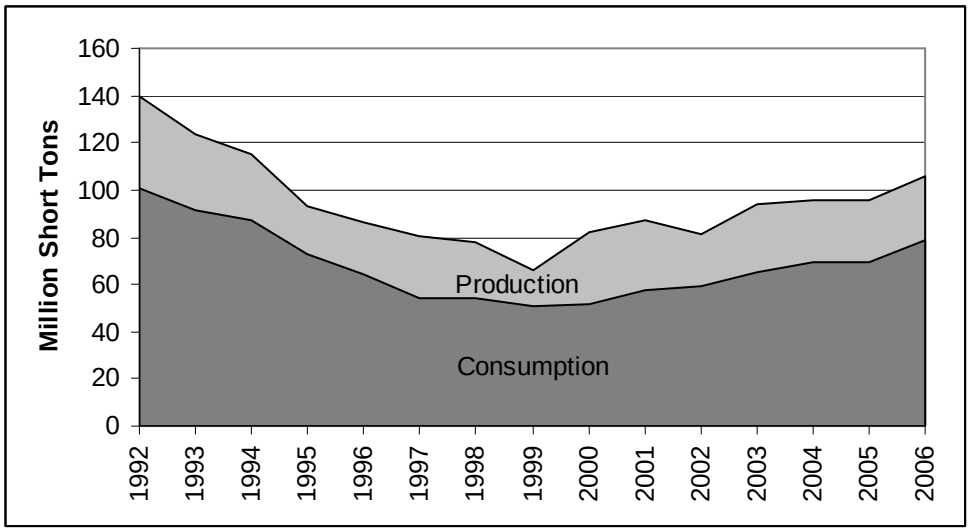
The **Tengiz field**, which produced 202 bcf in 2005, is one of the largest contributors to natural gas flaring in the country. In 2005, the company was forced to shut down some production and release sour gas into the atmosphere after the emergency halt of its five energy generators. After four years of planning and construction, the Sour Gas Reinjection (SGI) project will help increase both oil and gas production from the field and will help reduce the amount of gas flaring. The project is expected to begin operating in October 2006. (EIA, 2006)

Another important natural gas field, **Amangeldy**, is situated in the south of the country, near Zhambyl. It has estimates reserves of up to 1.8 Tcf. The field is being developed primarily by Kazmunaigas, and the company expects production of roughly 35 Bcf/year after initial developments. The Amangeldy fields that have been developed are producing approximately 10.6 Bcf/year. The new commissioning of wells at the Amangeldy field has provided a large share of the natural gas production increases over the last year. (EIA, 2006)

Plans to build a 120-mile pipeline connecting the Amangeldy field to the rest of the natural gas distribution structure will help lessen the southern region's import dependency. Because of Kazakhstan's divided distribution network, Karachaganak's natural gas is exported northward to Russia's Orenburg processing plant, as opposed to being delivered to Kazakh consumers in the south. Kazakhstan has two separate domestic natural gas distribution networks, one in the west which services the country's producing natural gas fields, and one in the south which mainly delivers imported natural gas to the southern consuming regions. The lack of internal pipelines connecting Kazakhstan's natural gas-producing areas to the country's industrial belt (between Almaty and Shymkent) has hampered the development of natural gas resources. However, as stated above, the development of the Amangeldy gas field will help Kazakhstan's southern region cease importing Uzbek gas. (EIA, 2006)

Kazakhstan has Central Asia's largest recoverable coal reserves, with 34.5 billion short tons of mostly anthracitic and bituminous coal. Kazakhstan produced 106 million short tons (Mst) in 2006, while consuming 79 Mst, resulting in net exports of 27 Mst. Russia is the largest importer of Kazakh coal, followed by Ukraine. (EIA, 2006)

Figure 13. Kazakhstan coal production.



Source: EIA (2007)

Kazakhstan was the third-largest coal producer in the Soviet Union behind Russia and Ukraine. Since independence, Kazakh coal consumption fell from 101 Mst in 1992 to a low of 51 Mst in 1999 (see figure 12) (EIA, 2007). Since then, manufacturing sector growth has provided incentives for increased coal production. Kazakhstan gets over 80 percent of its electricity production from coal. (EIA, 2006) EIA data show a modest increase in the coal production in 2000 and 2001. However, in 2002 the output fell again, in 2003-2005 it stayed quite stable and grew again in 2006 as can bee seen in figure 13.

According to the Kazakh Ministry of Energy and Natural Resources, the country aims to be producing about 105 Mst annually by 2015. Much of the decline in the last decade since independence has been due to mine problems (e.g. over 30 people died in mining accidents during 2004) and problems obtaining outside foreign investment to maintain their economic viability. This latter factor will be crucial in obtaining the government's long term production targets. (EIA, 2006)

3.2 Agriculture

Kazakhstan is bordered by Russia on the north, China on the east, Kyrgyzstan and Uzbekistan on the south, and Turkmenistan and the Caspian Sea on the west. It covers an area of about 2.72 million square kilometres, ranging about 1,600 km from north to south and 3,000 km from east to west. Most of the country has a continental climate with cold winters and hot summers. Except for the mountains of the extreme south and east, most of the republic is dry.

Kazakhstan's agriculture is diverse, ranging from small farms to large cooperatives raising crops and livestock. The agricultural base is an important resource with fertile soils and extensive irrigation. Like the industrial base, it is also in a period of transition. (Djalankuzov et al., 2004)

More than 74% of Kazakhstan's territory is suitable for agricultural production. The richness of land resources and historical roots determined the importance of agriculture for several centuries in the country. Before the Russians conquered the country, herding was the major economic branch of the country. Main agricultural commodities were wool, meat, milk and other livestock products. As Russians were keen on farming, especially on the cultivation of rice, cotton and wheat, they transformed most of the pastures into fields after they took domination in the 19th century in Kazakhstan. (ICEG, 2007, p. 10)

In the former Soviet Union there was a permanent shortage of foodstuffs. Different large-scale campaigns were organized in order to overcome this shortage. One of them in the 1950s was called "the virgin land" project. This scheme urged young people to go to the East and start cultivating corn on the steppes of Kazakhstan. Millions of people moved to the virgin land. Although the climate in Kazakhstan did not favour cornfields, many immigrants stayed on the steppes and continued farming, mainly cultivating wheat. (Tiusanen & Kinnunen, 2005, p. 22)

Under the Soviet system, agricultural activity was managed by administrative rules: how much land to plant a specific crop; how to manage the crop; how much fertilizer to apply, etc. With the onset of independence and a free market, this has all changed. Because of the Soviet domination, the sector was characterized by high and inefficient capital intensity. Therefore, it is not surprising that the exposure of Kazakh agriculture to world prices for inputs and products revealed a high-cost structure of production. (ICEG, 2007, p. 10)

The form of agricultural enterprises has changed dramatically during the past ten years. The number of state owned enterprises has decreased from 1400 to fewer than 100 while the number of private farms has increased from 30000 to 187000, i.e. over six-folded during the period of 1995-2005. New forms of agricultural enterprises such as producers' cooperatives have also emerged. The total number of enterprises has over five-folded as can bee seen in table 8.

Table 8. Number of agricultural enterprises 1995-2005.

	1995	1997	2000	2001	2002	2003	2004	2005
Total number	36285	64280	111899	131203	150696	159433	187139	196417
Agricultural enterprises	5500	6766	6729	9161	9368	9447	9256	9610
State enterprises	1405	293	82	119	126	126	125	96
Companies	0	1164	3342	4452	4822	5048	5174	5676
Joint-stock associations	0	578	293	285	269	257	222	178
Producers' cooperatives	0	3754	1710	2853	2866	2792	2609	2384
Other enterprises	0	977	1302	1452	1285	1225	1141	1276
Private farms	30785	57514	105170	122042	141328	149986	177883	186807

Source: The Agency on Statistics of the Republic of Kazakhstan (2007)

Since Kazakhstan has long nomadic traditions, stockbreeding has remained the traditional and dominant agricultural sector. Today, 84% of the total agricultural area is devoted to pasturage, mainly of cattle and sheep. Animal husbandry accounts for about 40% of the production value in agriculture. Main livestock products are dairy goods, leather, meat and wool. The output of the livestock sector is gradually growing (5% annual average) and herd sizes are recovering after a period of slaughtering animals for meat without replacement. However since much of the pastureland is degraded, herd sizes will need to be reduced to a sustainable level. (ICEG, 2007, p. 11)

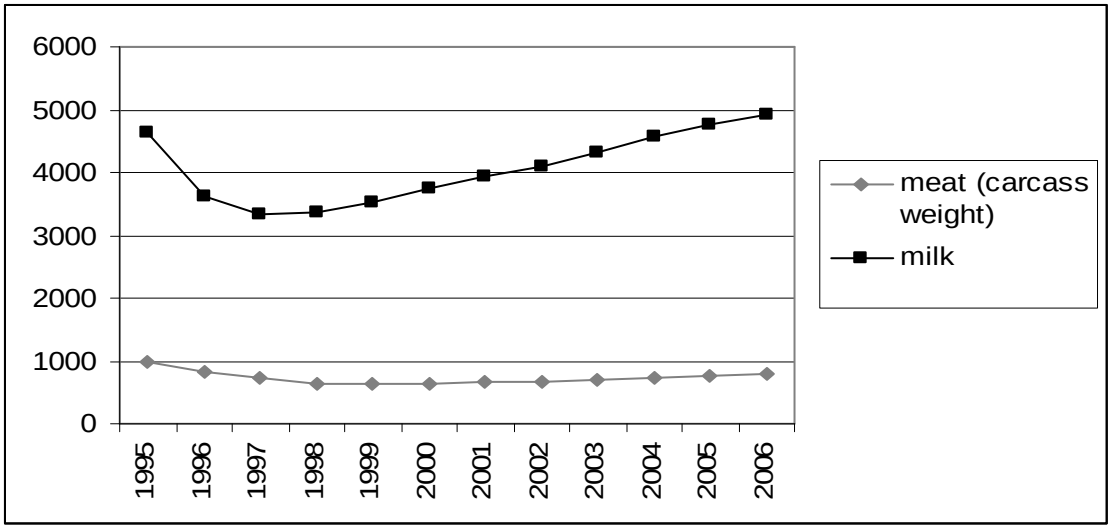
Table 9. Livestock and poultry, thsd. heads.

	1995	2000	2001	2002	2003	2004	2005	2006
Cattle	6859.9	4106.6	4293.5	4559.5	4871	5203.9	5457.4	5666.5
Cows	3045	2014.7	2077.2	2171.4	2267.3	2376.2	2442.6	2502.6
Sheep and goats	19583.9	9981.1	10478.6	11273	12247.1	13409.1	14334.5	15216.7
Pigs	1622.7	1076	1123.8	1229.8	1368.8	1292.1	1281.9	1301.9
Horses	1556.9	976	989.5	1019.3	1064.3	1120.4	1163.5	1219.9
Camels	130.5	98.2	103.8	107.5	114.9	125.7	130.5	135.8
Poultry, mln. heads	20.8	19.7	21.1	23.8	24.8	25.6	26.2	28.5

Source: The Agency on Statistics of the Republic of Kazakhstan (2007)

The number of cattle in Kazakhstan was at its lowest in 1998, with almost 50% drop from 1995. During the same period the number of cows dropped over 45% and number of sheep and goats over 50%. Since 1998 the trend has been upwards. Naturally, the decreases in the number of livestock can also be seen in the milk and meat production figures. (See figure 14.) Today, milk production has reached its 1995 level and even exceeded it whereas meat production was about 80% of the 1995 level in 2006.

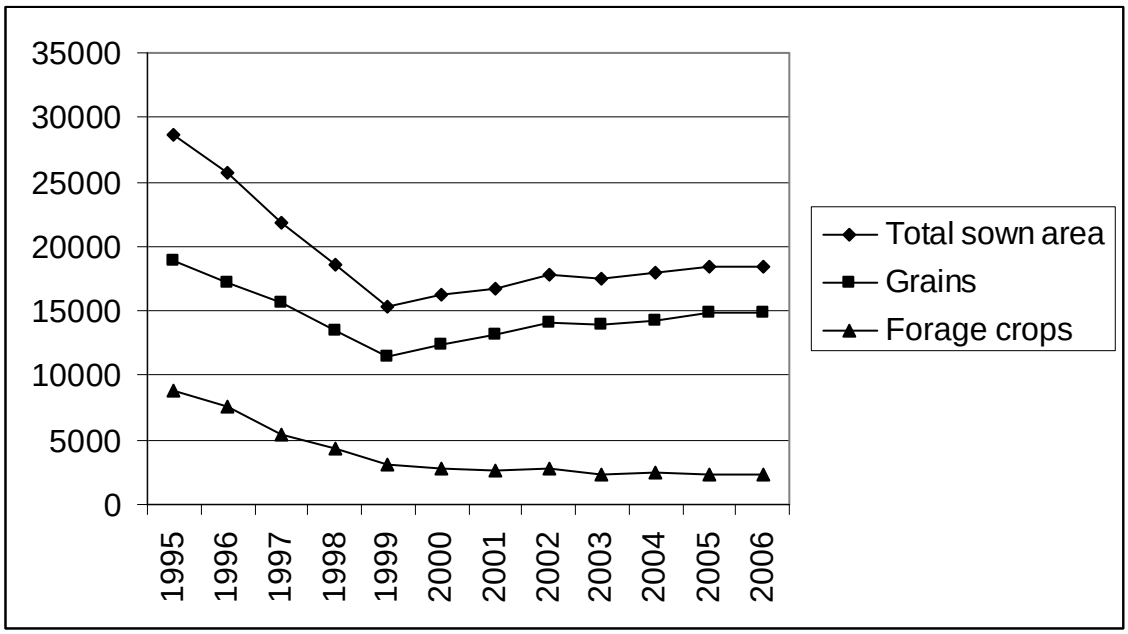
Figure 14. Meat and milk production in Kazakhstan 1995-2006, thousands tons.



Source: The Agency on Statistics of the Republic of Kazakhstan (2007)

Kazakhstan is one of the world's largest (6th) grain producer and exporter. The main grain crop is wheat, accounting for one third of total sown area. Wheat export is among the leading commodities in Kazakh export. (ICEG, 2007, p. 11)

Figure 15. Total sown area and grain and forage crops 1995-2006, thousands ha.



Source: The Agency on Statistics of the Republic of Kazakhstan (2007)

Major problems of the agricultural sector are low productivity (five times lower labour efficiency compared to Eastern European countries) and profitability, weak competitiveness of national producers, the lack of implemented international quality standards and modern technologies and insufficient infrastructure. The overall yields do not exceed 1 ton per

hectare, which is one fourth of average yields in Eastern Europe. There are also problems of transportation and quality. (ICEG, 2007, p. 11)

On the one hand, dry-land acreage in cereal production has shrunk because of decreased yield and diminished grain quality. The reduced yield and quality are probably a result of less fertilizer and herbicide, because they have become too expensive for common use. On the other hand, highly-productive irrigated acreage in the south has increased because of the demand for high quality grain, fodder, vegetables, and industrial crops. (Djalankuzov et al., 2004)

Productivity in agriculture is very low compared to productivity in other sectors. Agriculture accounted for 33.5 percent of total employment in 2004 (up from 31.4 percent in 2000) but produced just 8.8 percent of national GRP (down from 11.1 percent in 1999). (USAID, 2006a) In 2005 the share of agriculture in GDP was about 7.9% (EBRD, 2007). Its share shows a declining trend from 1993 onwards. (ICEG, 2007)

Given the low relative level of labour productivity, it is astonishing to see that the share of national employment in agriculture has been rising. The share of employment in agriculture rose substantially in the agricultural and non-oil industrial districts between 2000 and 2004: (from 42.3% to 44.4% of total employment and from 26.4% to 30.1%, respectively). This is worrying since the increasing share of jobs in agriculture and agriculture's fast growth in absolute terms suggest serious constraints on private investment in more modern activities in these regions. (USAID, 2006a)

3.3 Industrial production

Industry is a large and growing sector in Kazakhstan. As pointed out above, the share of industrial production of Kazakhstan GDP was over 40% in 2006. In the first years of the 21st century the industrial volume has grown 5-15% per year. However, the production has not reached yet the 1990 level. However, during the past ten years, the volume has doubled as can be seen in table 10.

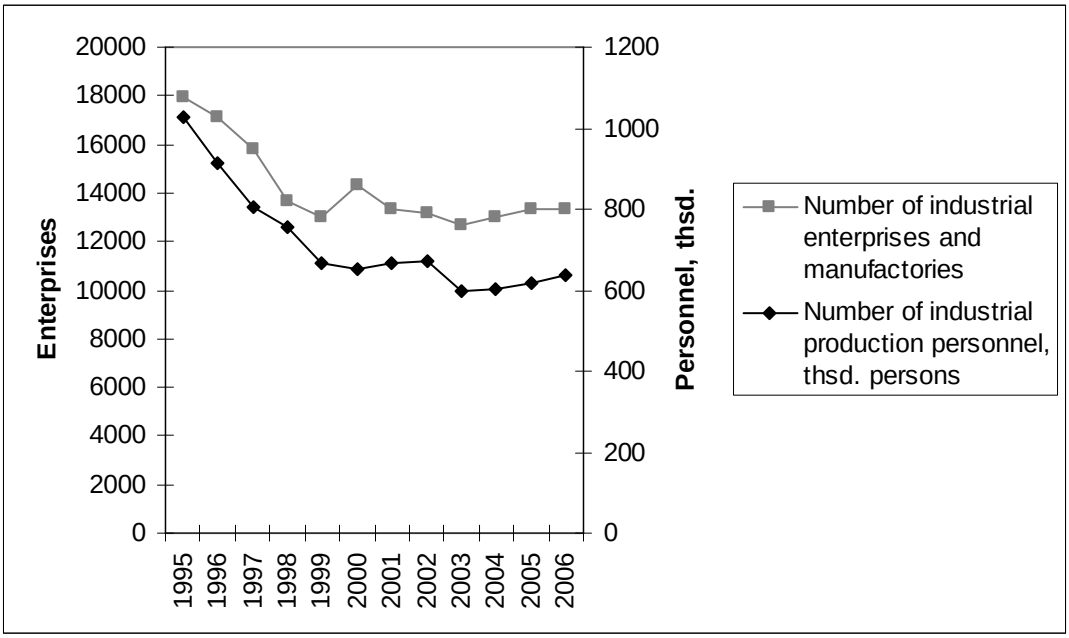
Table 10. Main industrial indicators.

	1995	2000	2001	2002	2003	2004	2005	2006
Index, % [1)]	91.8	115.5	113.8	110.5	109.1	110.4	104.8	107.2
% to 1990[2)]	48.0	54.9	62.5	69.0	75.3	83.1	87.1	93.3
% to 1995[2)]	-	118.8	135.2	149.4	163.0	179.9	188.5	202.1

1) Volume index of industrial production, as % of previous year; 2) as % to 1990 and 1995, respectively
Source: The Agency on Statistics of the Republic of Kazakhstan (2007)

During the past decade, the number of industrial enterprises in Kazakhstan has declined 25% from almost 18000 to 13300 in 2006. At the same time, the number of industrial production personnel has decreased by 40% from 10.25 million persons to 6.38 million. (See figure 16.)

Figure 16. Number of industrial enterprises and personnel.



Source: The Agency on Statistics of the Republic of Kazakhstan (2007)

Kazakhstan's industry is oriented toward the extraction and processing of raw materials. Given commodity prices and the country's abundant natural resources, the high contributions of mining and of oil in particular are justifiable. Such a strong dependence on natural resources, however, makes the country susceptible to price shocks. (USAID, 2006a)

The share of mining in industrial production (excluding construction) nationally grew from 44.3 percent in 2001 to 55.3 percent in 2004 while the share of manufacturing declined from 46.9 per cent to 37.6 per cent (USAID, 2006a).

In 2006 the share of extraction industry was 57.9 per cent of total industrial production with oil production comprising 51.5 pr cent of total. The share of manufacturing industry and

production of electricity, water and gas were 36.7 per cent and 5.8 per cent, respectively. Manufacturing industry consists of metallurgy and metal product industry (14.6%), food industry (8.2%), machine building (3.2%), chemical industry (0.8%), production of other non-metal minerals (2.1%) and pulp and paper industry (0.9%). (Spiridovitsh, 2007)

There is a clear distinction between regions that specialize in mining and those that specialize in manufacturing. Only in one non-oil region, agricultural Kostanai, was mining more important than manufacturing, accounting for 64.7 percent of industrial production. In the other non-oil regions the share of mining did not exceed 12 percent. By contrast, there was little manufacturing in the oil-extracting oblasts; they jointly accounted for only 12.7 percent of overall manufacturing production in the country. (USAID, 2006a)

Kazakhstan has launched an industrial policy programme with the aim to diversify her economy. In the Soviet era, the republic was a net "exporter" of foodstuffs within the Soviet Union. Thus, Kazakhstan has good preconditions in food processing industry. Textile and clothing branch is emphasized, because the country has plenty of cheap labour force with experience in this field. Development of a technology cluster in extractive activities and energy generating field is in the agenda. (Tiusanen & Kinnunen, 2005, p. 25)

Table 11. Production of main industrial products, as % of previous year.

	1995	2000	2001	2002	2003	2004	2005	2006
Coal	79.6	128.3	105.7	93.2	115.2	102.3	99.7	111.1
Petroleum [1)]	101.8	117.2	113.5	117.9	108.8	115.6	103.4	105.7
Natural gas	131.8	116.8	100.6	121.5	117.6	133.2	113.0	105.6
Meat [2)]	66.2	85.6	96.2	90.6	100.3	101.9	103.5	106.8
Butter	65.5	121.5	139.3	148.2	117.7	123.4	151.3	94.2
Milk, cream[3)]	50.5	121.4	99.0	112.9	120.8	104.3	116.4	125.7
Vegetable oil	97.6	125.1	142.9	105.9	169.2	112.7	105.2	126.5
Sugar	101.7	122.4	123.9	112.7	123.0	113.0	97.5	92.7
Fabrics	29.1	54.4	145.5	193.1	133.6	79.3	175.0	158.9
Cement	87.2	140.2	172.7	104.9	121.3	141.9	104.2	116.7
Iron and steel[4)]	91.3	115.3	99.9	103.3	101.5	105.3	76.9	96.6
Zinc unwrought	98.1	105.6	105.5	103.4	102.8	107.5	112.7	102.2
Refined copper[5)]	91.8	109.1	107.8	106.4	95.5	102.9	94.0	102.2
Electric power	10.0	108.7	107.3	105.3	109.5	104.8	101.5	105.5

1) Petroleum, incl. gas condensate; 2) Meat and edible offal of bovine animals, swine, goats, horses and meat of poultry; 3) Processed liquid milk and cream; 4) Flat-rolled products of iron and steel; 5) Refined copper in intermediates
Source: The Agency on Statistics of the Republic of Kazakhstan (2007)

As can be seen in table 12, the production of most of the main industrial products in Kazakhstan has just reached the 1990 level by 2006. However, there are some exceptions. On one hand, production of butter and sugar, as well as iron and steel is under the level of 1990.

On the other hand, production of fabrics is almost 60% higher than the 1990 level, and milk, cream and vegetable oil production is also clearly above the 1990 level.

Table 12. Production index of main industrial products (1990=100).

	1995	2000	2001	2002	2003	2004	2005	2006
Coal	79,6	128,3	105,7	93,2	115,2	102,3	99,7	111,1
Petroleum [1)]	101,8	117,2	113,5	117,9	108,8	115,6	103,4	105,7
Natural gas	131,8	116,8	100,6	121,5	117,6	133,2	113,0	105,6
Meat [2)]	66,2	85,6	96,2	90,6	100,3	101,9	103,5	106,8
Butter	65,5	121,5	139,3	148,2	117,7	123,4	151,3	94,2
Milk, cream[3)]	50,5	121,4	99,0	112,9	120,8	104,3	116,4	125,7
Vegetable oil	97,6	125,1	142,9	105,9	169,2	112,7	105,2	126,5
Sugar	101,7	122,4	123,9	112,7	123,0	113,0	97,5	92,7
Fabrics	29,1	54,4	145,5	193,1	133,6	79,3	175,0	158,9
Cement	87,2	140,2	172,7	104,9	121,3	141,9	104,2	116,7
Iron and steel[4)]	91,3	115,3	99,9	103,3	101,5	105,3	76,9	96,6
Zinc unwrought	98,1	105,6	105,5	103,4	102,8	107,5	112,7	102,2
Refined copper[5)]	91,8	109,1	107,8	106,4	95,5	102,9	94,0	102,2
Electric power	10,0	108,7	107,3	105,3	109,5	104,8	101,5	105,5

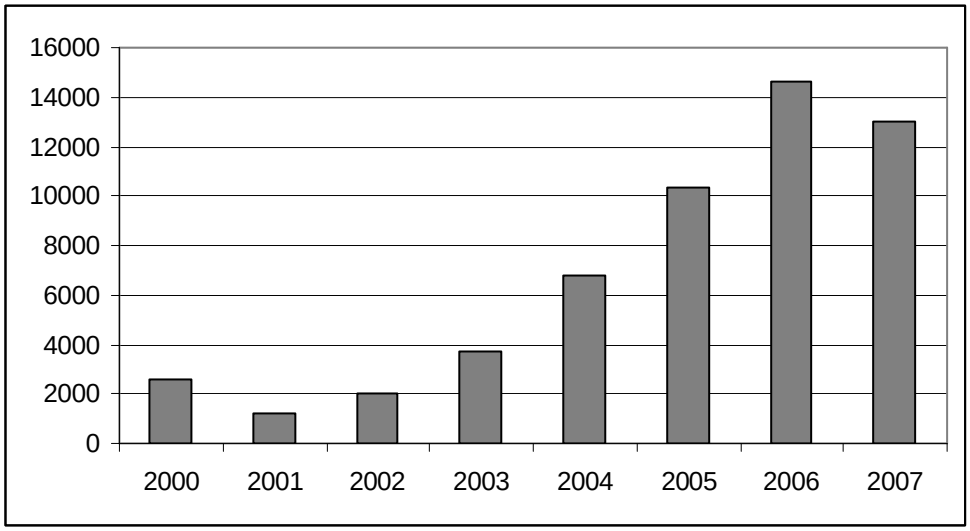
1) Petroleum, incl. gas condensate; 2) Meat and edible offal of bovine animals, swine, goats, horses and meat of poultry; 3) Processed liquid milk and cream; 4) Flat-rolled products of iron and steel; 5) Refined copper in intermediates
Source: The Agency on Statistics of the Republic of Kazakhstan (2007)

Most manufacturing branches in Kazakhstan suffer from low productivity and lack of international competitiveness. One factor underlying low productivity in manufacturing is low investment. On average, in 2001–2004, mining received 38.8 percent of total fixed investment in the country, while manufacturing received only 10.2 percent. (USAID, 2006a)

4 Foreign trade

The external sector has played a decisive, role in the development of Kazakhstan's economy, with the oil-extracting regions obtaining the greatest advantage from integration into the world economy. Exports have been soaring because of rising world prices for oil and gas. (USAID, 2006a) Kazakhstan's trade balance has shown rapidly increasing surplus since 2001 (see figure 17).

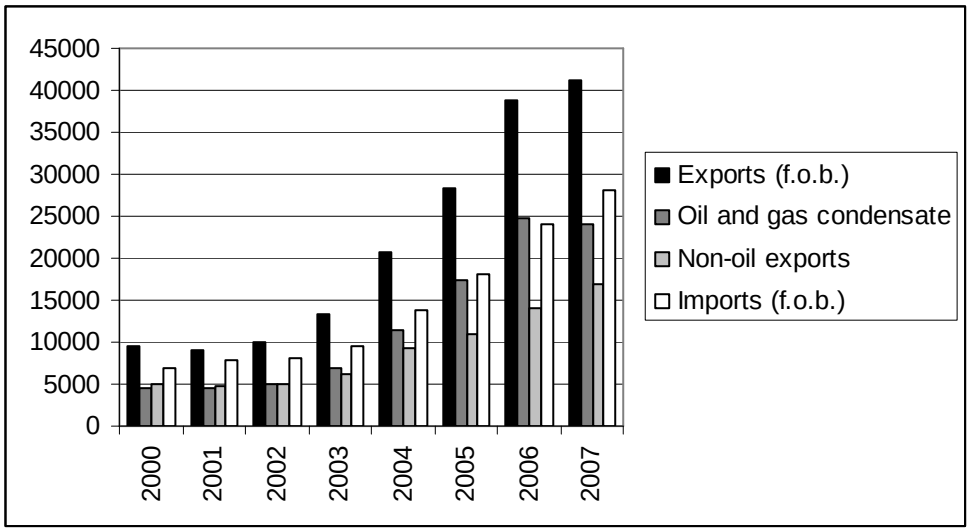
Figure 17. Kazakhstan trade balance, mln USD.



Note: 2006 and 2007 projections.
Source: IMF (2007b)

Total exports have increased from 9468 mln USD in 2000 to almost 39 bn USD in 2006 i.e. nearly four-folded during the first years of the 21st century. The share of oil and gas exports of total exports has increased from 47% to 64% during the same period. (See figure 18)

Figure 18. Kazakhstan exports and imports, mln USD.



Note: 2006 and 2007 projections.
Source: IMF (2007b)

Merchandise exports accounted for 43.9 percent of national GRP in 2001 and rose to 54.6 percent in 2004. Merchandise exports measured in USD surged 128.0 per cent from 2000 through 2004. Export growth in the oil-extracting oblasts was 212.8 per cent, far outpacing that for the country as whole. In agricultural and non-oil industrial oblasts, exports increased by 26.6 per cent and 42.8 per cent, respectively. Kazakhstan's merchandise exports have been increasingly concentrated in mineral product exports, particularly crude oil. Between 2000 and 2004, the share of mineral products in total merchandise exports climbed from 54.4 per cent to 68.3 percent. At the same time, the share of base metals, another key export category, contracted from 25.8 per cent to 19.4 per cent. Agricultural and processed food products represented only 4.1 per cent of total exports, dropping from an already low 6.9 per cent in 2000. The share of machines and equipment was negligible, at 1.5 per cent in 2004. Overall, export earnings are highly concentrated, with the top three commodities accounting for about two-thirds of total merchandise exports. (USAID, 2006a)

The oil-extracting oblasts and metropolitan areas are leaders in export growth. (USAID, 2006a) As can bee seen in table 14, exports from Kyzylorda oblast and Astana city have grown the most, over 22-folded during the period of 2000-2006. Contrary to other regions, exports from the agricultural Akmola oblast have decreased during this time. Atyrau oblast, Karagandy oblast, Mangistau oblast and Aktobe oblast account for over 60% of total Kazakhstan exports in 2006.

Table 13. Export by regions in 2000 and 2006.

Region	2000 mln USD	2000 %	2006 mln USD	2006 %	Change % 2000-2006
Akmola oblast	379.8	4.3	366.0	1.0	-3.6
Aktobe oblast	478.8	5.4	4100.9	10.7	856.5
Almaty oblast	44.3	0.5	223.2	0.6	503.8
Atyrau oblast	2029.4	23.0	10477.9	27.4	516.3
East Kazakhstan oblast	543.9	6.2	1549.5	4.1	284.9
Zhambyl oblast	55.3	0.6	195.2	0.5	353.0
West Kazakhsatn oblast	508.8	58	976.6	2.6	191.9
Karagandy oblast	1682.9	19.1	4223.8	11.0	251.0
Kostanai oblast	258.8	2.9	1021.9	2.7	174.4
Kyzylorda oblast	97.0	1.1	2206.0	5.8	2274.2
Mangistau oblast	715.2	8.1	4419.1	11.6	617.9
Pavlodar oblast	560.8	6.4	955.9	2.5	170.4
North Kazakhstan oblast	80.2	0.9	237.4	0.6	296.0
South Kazakhstan oblast	469.5	5.3	1082.3	2.8	230.5
Astana city	153.7	1.7	3416.0	8.9	2222.5
Almaty city	753.8	8.6	2798.5	7.3	371.3
Kazakhstan, total	8812.2	100	38250.3	100	434.1

Source: BISNIS (2006b)

Kazakhstan's major trading areas include Europe, the CIS countries and Asia. The country's exports to CIS countries increased 33.8 per cent and imports from CIS increased 33.5 per cent in 2006 compared to previous year. Exports to non-CIS increased 39 per cent while imports from non-CIS increased 35.6 per cent. The importance of EU-countries in the Kazakhstan foreign trade is increasing each year. (Spiridovitsh, 2007)

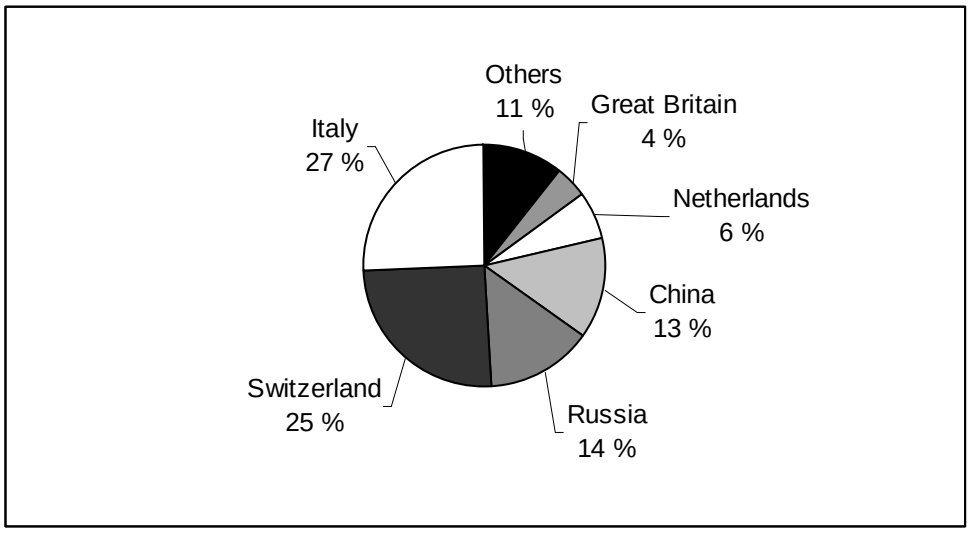
Table 14. Major trade partners in 2006, mln USD.

	Export	Import	Balance
CIS countries	**5,574.0**	**11,063.5**	**-5,489.5**
Belarus	71.0	284.3	213.4
Kyrgyzstan	267.8	138.9	128.9
Russia	3,731.1	9,072.9	-5,341.8
Turkmenistan	20.7	132.6	-111.9
Ukraine	622.8	983.9	-361.1
Europe	**24,032.4**	**6,506.5**	**17,525.9**
Great Britain	1,143.9	506.2	637.7
Germany	553.5	1,809.7	-1,256.2
Italy	6,891.6	1,430.4	5,461.3
Netherlands	1,704.5	189.5	1,515.1
Switzerland	6,721.2	97.2	6,624.0
Asia	**7,648.7**	**4,385.0**	**3,263.8**
China	3,592.5	1,925.0	1,667.6
Turkey	348.2	558.4	-210.2
South Korea	215.0	359.3	-144.3
Japan	214.1	914.1	-700.0
America	**895.9**	**1,613.0**	**-171.1**
USA	462.2	1,105.1	-642.8
Virgin Islands	109.8	14.7	95.1

Source: Kazakhstanika (2007)

In 2006, Italy was Kazakhstan's most important export country, followed by Switzerland, Russia and China (see figure 19).

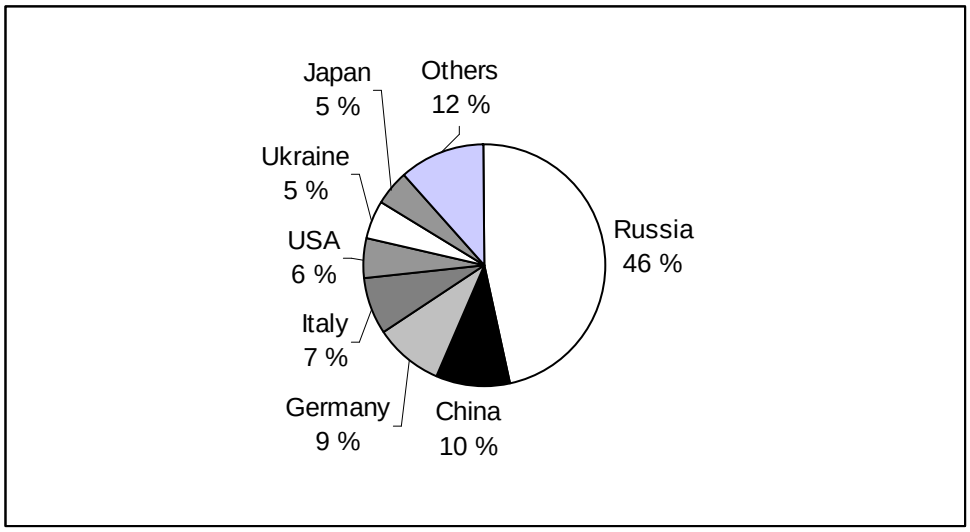
Figure 19. Exports by trading partner in 2006.



Source: Kazakhstanika (2007)

The share of Russia is almost half of the total imports to Kazakhstan. Other major sources of imports are China, Germany, Italy and USA.

Figure 20. Imports by trading partner in 2006.



Source: Kazakhstanika (2007)

Among the CIS countries, Kazakhstan is the third most important export country for Finland after Russia and Ukraine and second most important import country after Russia. In 2006 Finnish exports to Kazakhstan increased almost 28% compared to 2005 and the value of exports was 225 million euro. Traditionally, the value of Finnish imports from Kazakhstan has xceeded the value of exports. In 2006 imports from Kazakhstan increased by 64% and reached a total value of 297 million euro. (Spiridovitsh, 2007)

Table 15. Finnish trade with Kazakhstan 2001-2006.

Year	Exports			Imports			Balance
	Mln €	Share %	Change %	Mln €	Share %	Change %	Mln €
2001	98,1	0,1	+61	173,1	0,5	+75	-75,0
2002	70,4	0,1	-28,0	158,3	0,4	-9	-87,9
2003	79,8	0,2	+13	176,6	0,5	+12	-96,8
2004	151,0	0,3	+87,7	183,2	0,5	+4	-32,2
2005	176,2	0,3	+16,7	181,1	0,4	-1	-4,0
2006	225,0	0,4	+27,7	296,7	0,5	+64,2	-72

Source: Spiridovitsh, (2007)

Finnish exports to Kazakhstan consist mainly of machinery and equipment. Their share of total Finnish exports to Kazakhstan was 64.7 per cent in 2006. Other exports include paper and cardboard and related products, mineral products for construction industry and prefabricated houses. (Spiridovitsh, 2007)

Finnish imports from Kazakhstan consist almost entirely of fuels. In 2006 the share of oil was 88.7 per cent and the share of gas 5.9 per cent of total. Other imports include ore, scrap metal, iron, steel and grain. (Spiridovitsh, 2007)

5 Kazakhstan's international creditworthiness

5.1 Credit ratings

On 19th September 2002 **Moody's credit rating agency**[3] upgraded Kazakhstan by two notches to Baa3. The agency said the upgrade reflected a surge in foreign direct investment and export growth, driven mainly by oil and non-ferrous metals. In November 2004 the Moody`s further upgraded the rating to Ba1/NP (Positive) saying that Kazakhstan was well-placed for a period of solid economic growth, based on foreign direct investment in the energy sector and increased pipeline export capacity, combined with tight fiscal and monetary policy and strong banking system regulation and supervision. (Embassy of the Republic of Kazakhstan, 2007)

In 2007 Moody's rating on Kazakhstan was upgraded to Baa2 and stable. (Cbonds, 2007) Moody's annual report on Kazakhstan says the country's Baa2 government bond rating and stable outlook are supported by solid economic growth based on foreign direct investment in the energy sector, increased pipeline export capacity, and a tight fiscal and monetary policy. (KOGIG, 2007)

In 2006 the international rating agency **Standard & Poor's**[4] upgraded Kazakhstan's local and foreign currency ratings to BBB+/stable/A-2 and BBB/stable/A-3, respectively. National scale is kzAAA. (Standard & Poor's, 2007a) The ratings on Kazakhstan are based on ongoing improvements in the sovereign's general government balance sheet. Kazakhstan's economy is still benefiting from the current high oil prices, while the government continues to handle concomitant challenges to macroeconomic stability prudently. (Standard & Poor's, 2007b)

Fitch Ratings[5] upgraded Kazakhstan's long-term foreign currency rating from BBB- to BBB in 2005 and the rating stayed the same in 2006. The short-term foreign currency rating was further upgraded to F3 from B in 2004 and the long-term local currency rating upgraded to

[3] Obligations rated Aaa are judged to be of the highest quality, with minimal credit risk. The rating further goes Aa1, Aa2, Aa3, A1, A2, A3, Baa1, Baa2, Baa3 (Investment grades), Ba1, Ba2, Ba3, B1, B2, B3, Caa1, Caa2, Caa3, Ca and C (Speculative grades).

[4] An obligation rated AAA has the highest rating assigned by Standard & Poor's. The obligor's capacity to meet its financial commitment on the obligation is extremely strong. The rating further goes AA, A, BBB, BB, B, CCC, CC, C and D. An obligation rated D is in payment default. The ratings from AA to CCC may be modified by the addition of a plus (+) or minus (-) sign to show relative standing within the major rating categories. S&P rates short term credit on a scale from A-1 to D.

[5] Fitch's long-term credit ratings are set up along a scale from AAA to D. Like Standard & Poor's, Fitch also uses intermediate modifiers for each category between AA and CCC (i.e., AA+, AA, AA-, A+, A, A-, BBB+, BBB, BBB- etc.).

BBB+ from BBB in 2005. The Outlook on the Long-term ratings is positive in 2006. (Fitch Ratings, 2007)

Organization for Economic Cooperation and Development (OECD) assesses country credit risk and classifies countries into eight country risk categories (0 - 7). Kazakhstan's current rating is 4. (OECD, 2007) In January 2005 the OECD upgraded Kazakhstan's rating by moving it from the 5th to the 4th group of risks. The previous update from the 6th to the 5th group was made in January 2004. (Embassy of the Republic of Kazakhstan, 2007)

Summary of the above described ratings is presented in table 17.

Table 16. Kazakhstan in credit ratings.

Agency	Rating scale	Rating	Forecast
Moody's	Int. scale, foreign currency (AAA to C)	Baa2	Stable
Standard & Poor's	Local currency (AAA to D & A1 to D) Foreign currency (AAA to D & A1 to D) National scale	BBB+/A2 BBB/A3 kzAAA	Stable
Fitch Ratings	Long term foreign currency (AAA to D) Long term local currency (AAA to D) Short term foreign currency (F1+ to D	BBB BBB+ F3	Positive
OECD	Country credit risk (1-7)	4	n.a.

5.2 Qualitative Indexes

Many institutes compose various indexes to describe and rank the state of national economies in the world. The indexes of economic freedom, corruption and competitiveness of Kazakhstan are discussed briefly in this chapter (see summary in table 17).

Table 17. Qualitative Indexes of Kazakhstan in 2006.

Organisation	Rating Index	Place (previous year)	Number of countries
Heritage foundation	Index of economic freedom (2007)	75 (71)	157
Transparency International	Corruption Perceptions Index	111 (107)	163 (159)
World Economic Forum	Global Competitiveness Index	56 (51)	125
	Business Competitiveness Index	70	121

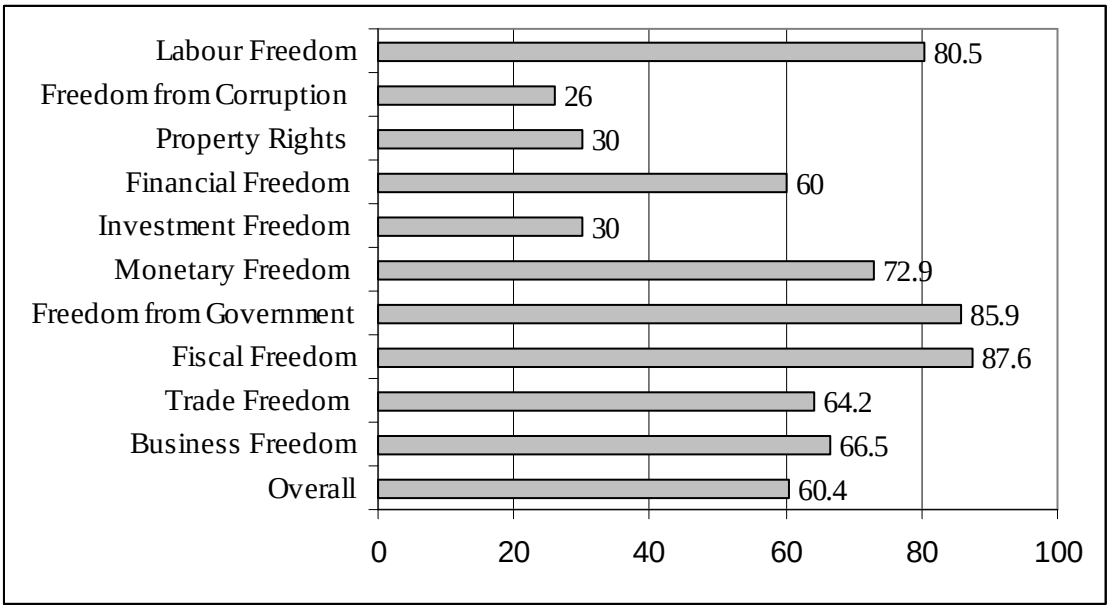
Index of Economic Freedom

The Heritage Foundation publishes a composite **Index of Economic Freedom**. The index is based on the measure of 10 specific factors, which are equally weighted in order not to bias the overall score toward any one factor or policy direction. The measures are averaged into a total score. Each one of the 10 freedoms is graded using a scale from 0 to 100, where 100 represents the maximum freedom. A score of 100 signifies an economic environment or set of policies that is most conducive to economic freedom.

The top ten countries on the economic freedom listing (Heritage Foundation, 2007) are Hong Kong (89.3), Singapore (85.7), Australia (82.7), United States (82.0), New Zealand (81.6), United Kingdom (81.6), Ireland (81.3), Luxembourg (79.3), Switzerland (79.1) and Canada (87.7). Finland is on the 16th place with a score of 76.5 and Russia on the 120th place with a score of 54.0

Kazakhstan scores 60.4% economic freedom which ranks it on the 75th place of the 157 countries listed. The ten component freedoms and their Kazakhstan scores are presented in figure 21.

Figure 21. Kazakhstan's ten economic freedoms.



Source: Heritage Foundation (2007)

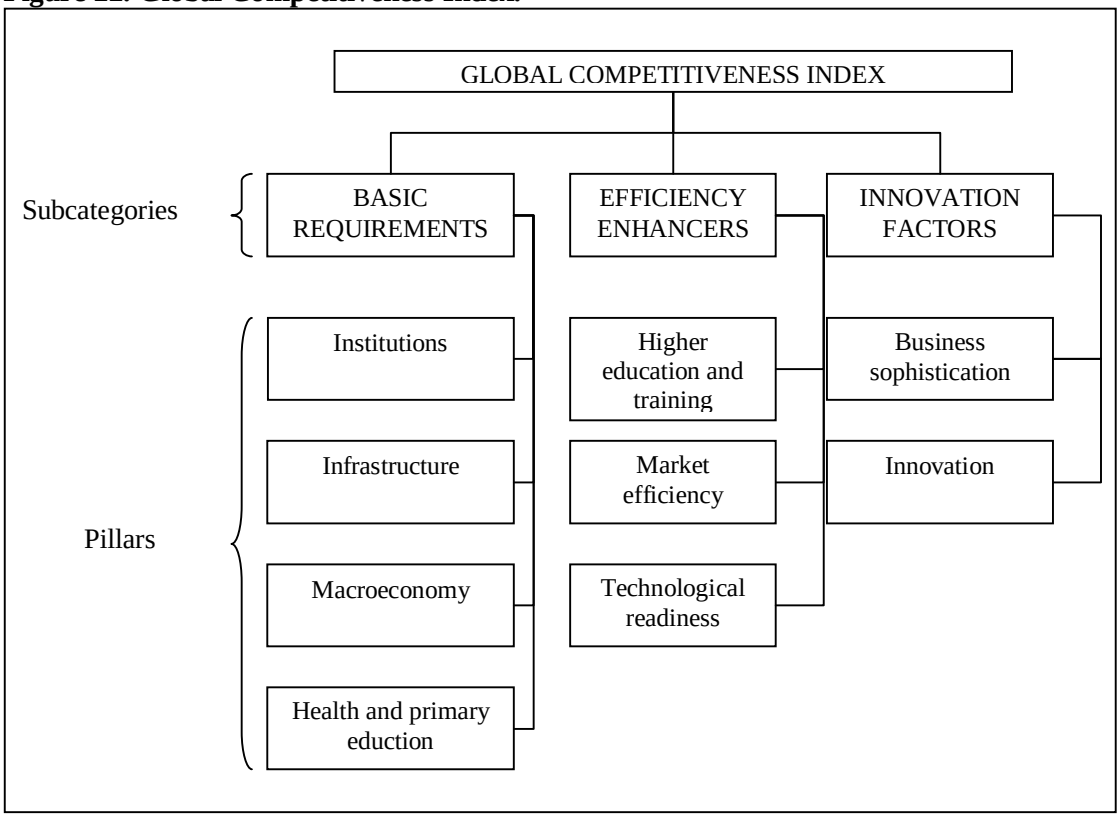
Transparency International's Corruption Perceptions Index

Transparency International's Corruption Perceptions Index is a composite index that draws on multiple expert and business opinion surveys that poll perceptions of public sector corruption in 163 countries in the world. The CPI measures countries on a scale from zero to ten, with zero indicating high levels of perceived corruption and ten indicating low levels of perceived corruption. Kazakhstan ranked number 111 in 2006. (Transparency International, 2006)

Global Competitiveness Index

The Global Competitiveness rankings are drawn from a combination of publicly available hard data and the results of the Executive Opinion Survey, a comprehensive annual survey conducted by the World Economic Forum, together with its network of Partner Institutes (leading research institutes and business organizations) in the countries covered by the Report. In 2006, over 11,000 business leaders were polled in a record of 125 economies worldwide. The survey questionnaire is designed to capture a broad range of factors affecting an economy's business climate that are critical determinants of sustained economic growth. Besides the **Global Competitiveness Index** (GCI), the report shows scores on three sub indexes as well as on nine pillars of the index. Also displayed are the ranks of each economy on the **Business Competitiveness Index** (BCI) and its two components *Sophistications of company operations and strategy* and *Quality of the national business environment*. In the GCI assessment, a scale from 0 to 7 points is used (7 is the highest possible score).

Figure 22. Global Competitiveness Index.

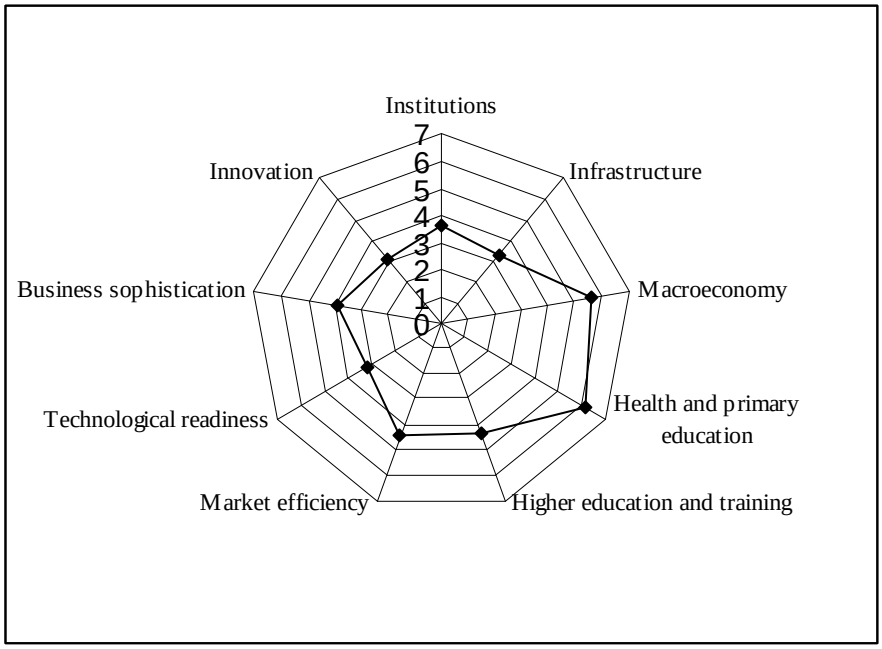


Switzerland, Finland and Sweden are the world's most competitive economies according to the report. Denmark, Singapore, the United States, Japan, Germany, the Netherlands and the United Kingdom complete the top ten list. (World Economic Forum, 2006a)

In the Global Competitiveness ranking Kazakhstan resides in the 56th place. The GCI contains three components (Basic requirements, Efficiency Enhancers and Innovation Factors, see table 19). Kazakhstan scores especially well in the first one, in which its rank is 51st. Due to her rapid economic growth, she scores 5.6 points in the pilar of macroeconomy, in which she has the global rank tenth. Kazahkstan scores even better in the Health and Primary Education (6.1), but this result gives her only the 86th global rank in this assessment.

In the second index component (Efficiency Enhancers), Kazakhstan scores rather well in Market Efficiency, in which she reaches 44th rank (better than the overall GCI rank of 65th). The nine pillars of the GCI of Kazakhstan are presented in figure 23.

Figure 23. Global competitiveness index of Kazakhstan.



Source: World Economic Forum (2007)

Among the former socialist countries Kazakhstan is left behind by all the countries now belonging to EU with the exception of Romania and Bulgaria. Among these countries the highest position belongs to Estonia (25th) followed by Czech Republic (29th), Slovenia (34th), Latvia (36th), Slovak Republic (37th), Lithuania (40th), Hungary (41st), Poland (48th) and Croatia (51st). Romania ranks 68th and Bulgaria 72nd.

In comparison with the so called CIS countries (Commonwealth of Independent States i.e. twelve former Soviet Republics; Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Ukraine, Uzbekistan and Turkmenistan[6]) Kazakhstan ranks the highest in Global Competitiveness Index.

Comparison between Kazakhstan, Russia, Ukraine and Estonia is presented in more detail in table 18.

[6] Turkmenistan discontinued permanent membership as of 2005, and is now an associate member of CIS.

Table 18. Global Competitiveness Index 2006-2007.

	Kazakhstan		Russia		Estonia		Ukraine	
	Index	**Rank**	**Index**	**Rank**	**Index**	**Rank**	**Index**	**Rank**
GCI	**4.2**	**56**	**4.1**	**62**	**5.1**	**25**	**3.9**	**78**
Basic Requirements	**4.6**	**51**	**4.4**	**66**	**5.3**	**30**	**4.2**	**86**
Institutions	3.6	75	3	114	4.7	30	3.1	104
Infrastructure	3.3	68	3.5	61	4.7	30	3.3	69
Macroeconomy	5.6	10	5	33	5.3	16	4.3	74
Health and primary education	6.1	86	6.3	77	6.6	43	5.9	94
Efficiency Enhancers	**4.0**	**56**	**3.9**	**60**	**5.2**	**19**	**3.7**	**69**
Higher education and training	4.3	51	4.4	43	5.3	23	4.4	48
Market efficiency	4.4	44	4.2	60	5	25	4.0	80
Technological readiness	3.2	66	3.1	74	5.3	16	2.7	90
Innovation Factors	**3.5**	**74**	**3.6**	**71**	**4.2**	**32**	**3.5**	**78**
Business sophistication	3.9	72	3.8	77	4.7	35	3.8	76
Innovation	3.1	72	3.3	59	3.8	30	3.1	73

6 Business environment and investment climate

The International Tax and Investment Center (ITlC) has conducted two surveys on the investment climate in Kazakhstan during the transition. In these surveys major western companies have determined what reforms the government of Kazakhstan could undertake to make the economy more hospitable to foreign investors, what progress has been made and in which areas potential foreign investors have concerns. (Hall & Witt, 1997)

The second ITIC survey (Hall & Witt, 1997) showed that foreign investors have seen Kazakhstan as an attractive market for fundamental business reasons. Access to natural resources, the large market, and Kazakhstan's strategic location for business combined provide potential rates of return.

The Kazakhstan officials emphasise the positive outcome of the efforts made to improve its investment climate:

> *"As an emerging market Kazakhstan is facing many challenges, therefore the Government of Kazakhstan is currently taking steps towards further improvement of the investment climate on the domestic market. In its investment policy Kazakhstan adheres to the principles of stability and predictability; transparent legal norms; protection of investors' legal rights; equal conditions for foreign and local investors; sanctity of contracts; encouraging direct investments to the priority sectors of the economy. In this regard the Government of Kazakhstan tries to take measures after prior consultations and exchange of views with foreign investors, particularly, within the framework of the Foreign Investors' Council (FIC) set up under the President of Kazakhstan in June 1998."* (Embassy of the Republic of Kazakhstan, 2007)

However, western view of the current situation is not that positive:

> "*Kazakhstan's economy has significant shortcomings. Investment freedom, property rights, and freedom from corruption are weak. Foreign investment in virtually all sectors is restricted by exclusive barriers and bureaucratic incompetence. Government policy actively favours domestic businesses, and the weak rule of law allows for significant corruption and insecure property rights.*

> *The government constantly challenges contractual rights and legislates to favour domestic investors over foreign ones, all of which significantly deters foreign investment. No sector of the economy is closed to investment, but the government imposes a 25 percent cap on foreign capital in the banking system and a 20 percent ceiling on foreign ownership in media companies. It also screens foreign investment proposals in a process that is often non-transparent, arbitrary, and slow. Subject to restrictions, foreign exchange accounts may be held by residents and non-residents. Most capital transactions, payments, and transfers are subject to government approval, quantitative limits, and strict documentary requirements." (Heritage Foundation, 2007)*

In sum, Kazakhstan has delivered sustained economic growth for several years, especially given its growing importance as a source of energy and metals. While the pace of its economic reforms shows some signs of decelerating, Kazakhstan's commitment to continue transforming its economy into a more market-driven business environment remains critical. In this context, potential foreign investors and exporters will need to see more frequent and more numerous examples of successes in this market in order to reassure them of its potential. (BISNIS, 2006a)

World Bank and her daughter company, International Finance Corporation compile an annual report investigating the regulations that enhance business activity and those that constrain it across the world. **Doing Business 2007: How to Reform** is the fourth in this series of reports. The report presents quantitative indicators on business regulations and the protection of property rights that can be compared across 175 economies and over time. Regulations affecting 10 areas of everyday business are measured:

- starting a business
- dealing with licenses
- employing workers
- registering property
- getting credit
- protecting investors
- paying taxes
- trading across borders
- enforcing contracts
- closing a business.

The indicators are used to analyze economic outcomes and identify what reforms have worked, where and why. (IBRD, 2006) In the following, the business environment in Kazakhstan is analysed briefly. References are also made on Russia, Estonia and Ukraine in order to compare two transition economies familiar to Finnish business operators (Russia and

Estonia) and two countries fairly unfamiliar yet but of increasing interest (Kazakhstan and Ukraine).

6.1 The ease of doing business ranking

In the World Bank assessment, Singapore is in the first place in the ranking of doing business in various national economies. New Zealand, which was ranked the first in 2006, is the second in 2007 ranking, followed by United States which retained its third position. Best performers among the transitional economies are Lithuania (16th) and Estonia (17th) which performed better than e.g. Belgium (20th) or Germany (21st).

Kazakhstan ranks 63 among the 175 economies listed in the ease of doing business ranking. Its rank is up by 19 notches from the 82nd place in 2006 mainly thanks to the reforms made in getting credit (see more detailed discussion below).

Table 19. Doing business ranking.

2007 Rank	2006 Rank	Economy
1	2	Singapore
2	1	New Zealand
3	3	United States
4	4	Canada
5	6	Hong Kong, China
6	5	United Kingdom
7	7	Denmark
8	9	Australia
9	8	Norway
10	10	Ireland
11	12	Japan
12	11	Iceland
13	14	Sweden
14	13	Finland
15	16	Switzerland
16	15	Lithuania
17	17	Estonia
18	19	Thailand
19	18	Puerto Rico
20	20	Belgium
63	**82**	**Kazakhstan**
96	97	Russia
128	132	Ukraine

Source: IBRD (2006)

Starting a business

"The starting a business data are based on a survey that investigates the required procedures that an average small or medium sized company needs to start operation legally. This includes obtaining all necessary permits and licenses and completing all the required inscriptions, verifications and notifications with all requisite authorities to enable the company to start operation. The survey calculates the costs and time necessary for fulfilling each procedure under normal circumstances, as well as the minimum capital requirements to operate. The assumption is that information is readily available to the entrepreneur and that all government and non-government entities involved in the process function efficiently and without corruption." (IBRD, 2005, p. 6)

It is the easiest to start a business in Canada or Australia. Kazakhstan ranks number 40 among the 175 countries, which is 7 places behind Russia (33rd place). The easier it is to start a business in an economy, the more businesses register. For example, new entry jumped by 78% after reforms in FYR Macedonia, 55% in Georgia and 25% in Lithuania. (IBRD, 2006, p. 8)

Table 20. Starting a business ranking.

	Kazakhstan	**Ukraine**	**Russia**	**Estonia**
Starting a business (rank)	40	101	33	51
Procedures (number)	7	10	7	6
Time (days)	20	33	28	35
Cost (% of income per capita)	7.0	9.2	2.7	5.1
Minimum capital (% of income per capita)*	23.1	198.8	3.4	34.3

* Note : Sixty-four countries have no minimum capital requirement.
Source: IBRD (2006)

Bureaucracy for starting a business takes 20 days in Kazakhstan and consists of 7 different procedures. The average time in Europe and Central Asia is 32 days and number of procedures is 9.4. For comparison the respective figures in Finland are 14 and 3 while in Australia, who regulates the business start-up the least, it only takes 2 days and 2 procedures. (IBRD, 2007)

As for the cost of business start-up, Kazakhstan's 7% of income per capita is closer to the OECD average (5.3%) than the average in Europe and Central Asia (14.1%). Minimum

capital required in Kazakhstan is lower than the OECD (36.1%) and Europe and Central Asia (53.9%) average. In Finland the minimum is 27.1%. (IBRD, 2007)

There are a number of business organizations and structures available to carry on business in Kazakhstan. The current types include:

1. Limited Liability Partnership ("LLP" or the Russian language abbreviation "TOO")
2. Joint-Stock Company ("JSC" or the Russian language abbreviation "AO")
3. Full Partnership
4. Commandite Partnership
5. Additional Liability Partnership
6. Production Co-Operative
7. State Enterprise (Macleod Dixon Lawyers, 2007, p. 15)

Foreign entities that plan to establish a presence in Kazakhstan may also set up a branch or representative office, which must, as all of the above types of business organizations, be registered with the Ministry of Justice or its local departments. The most common commercial organizations, including those in the form of a joint venture, are a limited liability partnership and a joint-stock company. More information and analysis of the advantages and disadvantages of the various business entities are presented, for example, by Macleod Dixon Lawyers (2007)

Dealing with licenses

Doing Business records all procedures required for a business in the construction industry to build a standardised warehouse as an example of dealing with licences (IBRD, 2006, p. 64) These procedures include obtaining all necessary licenses and permits and completing any required notifications, inspections, and document (plans and maps) submission with relevant authorities for legally completing a warehouse. The survey also investigates procedures associated with obtaining utility connections, such as electricity, telephone, water and sewage. The costs and time necessary for accomplishing each procedure under normal circumstances are calculated. All the official fees associated with legally completing the procedures are included. Time is recorded in calendar days. The survey assumes the entrepreneur is aware of all existing regulations and does not use an intermediary to complete the procedures, unless required by law. (IBRD, 2005, p. 9)

Table 21. Dealing with licenses ranking.

	Kazakhstan	Ukraine	Russia	Estonia
Dealing with licenses (rank)	119	107	163	13
Procedures (number)	32	18	22	13
Time (days)	248	242	531	117
Cost (% of income per capita)	35.0	186.5	275.3	34.3

Source: IBRD (2006)

Kazakhstan is among the countries that require the most procedures (32) to have all the necessary licenses to build a warehouse exceeded only by the number of procedures in Moldova (34) and Sierra Leone (48). Its takes over four time longer (248 days) than in Finland (56 days) but costs relatively about the same (35%) as in Estonia (34% of income per capita). Europe and Central Asia averages are 21.4 procedures, time 242.5 days and cost 564.9 % of income per capita and Finnish figures are 17 procedures, 56 days and 108%, respectively. (IBRD, 2007)

Employing workers

Three measures concerning employing workers are presented in the Doing Business report: a rigidity of employment index, a cost of hiring measure and a cost of firing measure. The rigidity of employment index is an average of three sub-indices: difficulty of hiring, rigidity of hours, and difficulty of firing. Each index takes values between 0 and 100, with higher values implying more rigid regulation. Difficulty of hiring measures flexibility of contracts and the ratio of minimum wage to the value-added per worker. Rigidity of hours covers restrictions on weekend and night work, working time and workweek requirements, and mandated days of annual leave with pay. Difficulty of firing covers workers' legal protections against dismissal, including the grounds for dismissal, and procedures for dismissal (individual and collective). Cost of hiring covers all social security payments and payroll taxes associated with hiring a new employee, expressed as a percentage of the worker's salary. A cost of firing indicator measures the cost of advance notice requirements, severance payments and penalties due when firing a worker, expressed in terms of weekly wages. (IBRD, 2005, p. 12)

Table 22. Employing workers ranking.

	Kazakhstan	Ukraine	Russia	Estonia
Employing workers (rank)	22	107	87	151
Difficulty of hiring index (0-100)	0	44	33	33
Rigidity of hours index(0-100)	60	40	60	80
Difficulty of employment index (0-100)	10	80	40	60
Rigidity of hours index (0-100)	23	55	44	58
Nonwage labour cost (% of salary)	22	39	31	34
Firing cost (weeks of salary)	9	13	17	35

Source: IBRD (2006)

Employment regulations are designed to protect workers from arbitrary, unfair or discriminatory actions by their employers. Beyond the regulations and principles, governments struggle to reach the right balance between labour market flexibility and job stability. (IBRD, 2006, p. 18) In Kazakhstan employment contracts may be concluded for an indefinite term or definite term of not less than one year, except for instances where the work is short-term and where the temporarily absent employee is substituted. If the employment agreement for the definite term has been renewed, it is deemed as made for an indefinite term. The probation period is limited to three months, and the employment agreement with the employee on probation may be terminated during this period without stating a reason. Certain categories of employees (pregnant women, minors or transferees) are not subject to the probation period. (Macleod Dixon Lawyers, 2007, p. 21)

The current minimum wage is 9,752 tenge a month (approximately 62€). Foreign employees may be paid in foreign currency, while local employees are always paid in Kazakhstan tenge. The length of a workweek should not exceed 40 hours. The Labour Code provides for shorter working hours for example in shift and night work. If an employee is working a longer week by choice, the maximum overtime cannot exceed 2 hours per day and 4 hours per week. Overtime is payable at 150% of the regular wage if working on a business day or 200% for weekends and statutory holidays, or should be compensated by additional days-off. After twelve months of employment, employees are entitled to a minimum annual paid vacation of 18 calendar days (excluding statutory holidays). (Macleod Dixon Lawyers, 2007, p. 21)

Compared to Russia, Ukraine and Estonia, it is easy to employ workers in Kazakhstan measured by all other indexes except rigidity of hours which is higher than in Ukraine. While in Finland the firing cost is equivalent of 26 week's salary, in Kazakhstan it is only 9 week's

salary. In nonwage labour cost the difference between Finland (24.6%) and Kazakhstan (22%) is only a couple of percentage points. (IBRD, 2007)

Registering property

"Doing Business measures the ease of registering property, assuming a standardized case of an entrepreneur who wants to purchase land and building in the largest business city. It is assumed the property is already registered and free of title dispute. The data cover the full sequence of procedures necessary to transfer the property title from the seller to the buyer. Every required procedure is included whether it is the responsibility of the seller, the buyer, or where it is required to be completed by a third party on their behalf." (IBRD, 2005, p. 15)

Table 23. Registering property ranking.

	Kazakhstan	Ukraine	Russia	Estonia
Registering property (rank)	76	133	44	23
Procedures (number)	8	10	6	3
Time (days)	52	93	52	51
Cost (% of property value)	1.8	3.4	0.3	0.7

Source: IBRD (2006)

Registering property in Kazakhstan is harder than in Russia or Estonia measured by their rank. It takes almost four times (52 days) longer than in Finland (14 days), but is however cheaper than in Finland, where the cost is 4% of property value. Europe and Central Asia averages are 6.4 procedures, time 102 days and cost 2.7 % of property value. (IBRD, 2007)

Getting credit

"Access to credit may be expanded significantly by credit registries—institutions that gather and disseminate information on credit histories. The information-sharing role of credit registries helps lenders to assess risk and allocate credit more efficiently, which means that entrepreneurs don't need to rely on only personal relations when trying to obtain credit. The indicators report whether public credit registries or private credit bureaus operate and the amount of credit information they cover. An index of the extent to which the rules of credit information registries facilitate lending is constructed on the basis of: scope of information distributed; ease of access to information and quality of information. The data were obtained from surveys of public and private credit registries. A minimum score of 0 represents weak legal rights and the maximum score of 10 represents strong legal rights. Data were obtained

from by examining collateral and bankruptcy laws and legal summaries, and verified through a survey of financial lawyers. "(IBRD, 2005, p. 18)

Table 24. Getting credit ranking.

	Kazakhstan	Ukraine	Russia	Estonia
Getting credit (rank)	48	65	159	48
Strength of legal rights index (0-10)	5	8	3	4
Depth of credit information index (0-6)	4	0	0	5
Public registry coverage (% of adults)	0.0	0.0	0.0	0.0
Private bureau coverage (% of adults)	5.5	0.0	0.0	18.2

Source: IBRD (2006)

Kazakhstan reformed its credit system by launching new private credit bureaus in 2005/06. It also established new credit registry thus increasing its depth of credit information index to 4 in 2006. (IBRD, 2006, p. 20-30) For comparison, the depth of credit information index in Finland is 5 and the private bureau coverage 14.9% of adults. (IBRD, 2007)

Protecting investors

To document the protections investors have, Doing Business measures how countries regulate a standard case of self-dealing—use of corporate assets for personal gain. Three indices of investor protection are constructed. All indices vary from 0 to 10 with higher values indicating more protections or higher disclosure. (IBRD, 2005, p. 22)

Table 25. Protecting investors ranking.

	Kazakhstan	Ukraine	Russia	Estonia
Protecting investors (rank)	46	142	60	33
Extent of disclosure index (0-10)	7	1	7	8
Extent of director liability index (0-10)	1	3	2	4
Ease of shareholder suits index (1-10)	9	7	7	6
Strength of investor protection index (1-10)	5.7	3.7	5.3	6.0

Source: IBRD (2006)

Investors are most protected in New Zealand and Singapore. Kazakhstan shares the same rank with Finland (46). The biggest difference between Finland and Kazakhstan is in their extent of director liability index, which are 4 and 1 respectively. (IBRD, 2007b)

Paying taxes

The Doing Business tax survey records the effective tax that a medium size company must pay or withhold. The total amount of taxes that must be paid by the business and the process to do so are reported. (IBRD, 2005, p. 31)

Table 26. Paying taxes ranking.

	Kazakhstan	Ukraine	Russia	Estonia
Paying taxes (rank)	66	174	98	29
Payments (number per year)	34	98	23	11
Time (hours per year)	156	2185	256	104
Total tax rate (% of profit)	45.0	60.3	54.2	50.2

Source: IBRD (2006)

According to the Doing Business report, reducing tax rates has been a trend in Eastern Europe and Central Asia. For example Estonia, Kazakhstan and Russia have each seen tax revenues rise. The larger is the share of informal business activity before reform, the higher is the revenue growth after. (IBRD, 2006, p. 38) In Kazakhstan it is easier to pay taxes than in Finland in terms of number of payments, time and total tax rate. In Finland, although the number of payments is 19 per year, it takes 264 hours to prepare, file and pay taxes, and the total tax rate is 47.9% of profit. (IBRD, 2007)

Trading across borders

"Doing Business compiles procedural requirements for trading a standardized shipment of goods. Every official procedure—including time, signatures and documents—for importing and exporting the goods is recorded—starting from the final contractual agreement between the two parties, and ending on delivery of the goods. For importing the goods, the procedures measured range from the vessel's arrival at the port of entry to the shipment's delivery at the factory warehouse. For exporting the goods, the procedures measured range from the packing of the goods at the factory to their departure from the port of exit." (IBRD, 2005, p. 24)

Table 27. Trading across borders ranking.

	Kazakhstan	Ukraine	Russia	Estonia
Trading across borders (rank)	172	106	143	6
Documents to export (number)	14	6	8	5
Time to export (days)	93	33	39	3
Cost to export (USD per container)	2780	1009	2237	640
Documents to import (number)	18	10	8	6
Time to import (days)	87	46	38	5
Cost to import (USD per container)	2880	1025	2237	640

Source: IBRD (2006)

Trading across borders is not easy in Kazakhstan. In fact Kazakhstan ranks the fourth most difficult country (Rank 172 out of 175 nations) in trading leaving only Kyrgyz Republic, Niger and Rwanda behind it. Trading across Europe is becoming seamless, thanks to the European Union and related free trade agreements. Finland is the second easiest in trading after Hong Kong, and Estonia ranks number 6. Only in Iraq the time for export is longer (105 days) than in Kazakhstan (93 days) and only in 9 states it takes longer to import than in Kazakhstan. Import and export costs are more than four times higher in Kazakhstan than in Estonia, for example. (EBRD, 2007)

Enforcing contracts

"Doing Business tracks the efficiency of contract enforcement, looking at simple transactions of relevance to the average firm in everyday business activity" (IBRD, 2005, p. 28). The data are built by following the step-by-step evolution of a payment dispute before local courts (IBRD, 2006, p. 72).

Table 28. Enforcing contracts ranking.

	Kazakhstan	Ukraine	Russia	Estonia
Enforcing contracts (rank)	27	26	25	20
Procedures (number)	37	28	31	25
Time (days)	183	183	178	275
Cost (% of claim)	11.5	16.0	13.5	11.5

Source: IBRD (2006)

Closing business

"The closing a business data track the step-by-step procedures for a standardized company to go through the bankruptcy process. Three indicators were constructed from the survey responses: the time and cost to go through the insolvency process, and a measure of the proportion of the insolvency estate recovered by stakeholders—taking into account the time, cost, depreciation of assets and the outcome of the insolvency proceeding." (IBRD, 2005, p. 28)

Table 29. Closing business ranking.

	Kazakhstan	**Ukraine**	**Russia**	**Estonia**
Closing business (rank)	100	139	81	47
Time (years	3.3	2.9	3.8	3.0
Cost (% of estate	18	42	9	9
Recovery rates (cents on the dollar)	23.6	8.7	28.7	39.9

Source: IBRD (2006)

One aspect of doing business which is closely related to closing business is profit making. An indirect gauge of the climate for doing business is the incidence of loss-making enterprises. Interpretation of this indicator is not clear-cut, because a high prevalence of loss-making can indicate either a weak business environment, or difficult economic fundamentals and a lack of opportunities for profitable operations. Given the rapid growth rates throughout the country, however, the latter condition is not a likely explanation for the observed high incidence of losses in Kazakhstan. For the country as a whole, the share of loss-making enterprises fell from 47.8 percent in 1999 to a still very high 36.9 percent in 2004. Municipal districts and oil-producing regions (with an exception of Kyzylorda) have relatively low rates of loss incidence, as does Pavlodar, where coal production is the main industry. Enterprises in agricultural regions are significantly more likely to make a loss. (USAID, 2006a)

As reminded by its authors, the methodology used in Doing Business report has limitations. The rankings on the ease of doing business do not tell the whole story. The indicator is limited in scope: it covers only business regulations. It does not account for a country's proximity to large markets, the quality of its infrastructure services (other than those related to trading across borders), the security of property from theft and looting, the transparency of government procurement, macroeconomic conditions or the underlying strength of institutions. To make the data comparable across countries, the indicators refer to a specific type of business—generally a limited liability company operating in the largest business city. (IBRD, 2006)

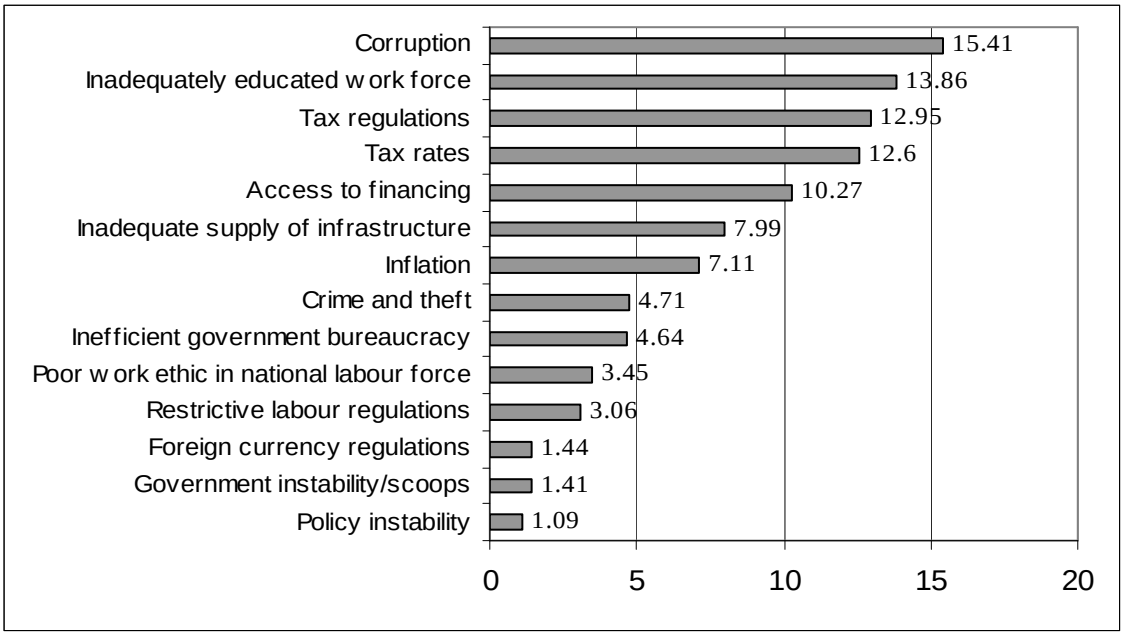
The report gives an example of its limitations as follows: “So while Namibia ranks close to Portugal on the ease of doing business, this does not mean that businesses are just as eager to operate in Windhoek as they are in Lisbon. Distance from large markets and poor infrastructure—2 issues not directly studied in Doing Business—make Namibia a less attractive destination for investors. Still, a high ranking on the ease of doing business does mean that the government has created a regulatory environment conducive to operating a business. Improvements on the Doing Business indicators is often proxy for broader reforms to laws and institutions whose effects go beyond the administrative procedures and the time and cost to comply with business regulations.“ (IBRD, 2006, p. 3)

6.2 Most problematic factors of doing business in Kazakhstan

The Global Competitiveness Report summarises the factors seen by local business executives as the most problematic factors for doing business in their economy. The information is drawn from the Executive Opinion Survey where the respondents were presented with 14 different factors and asked to rank from 1 (most problematic) to 5 those they considered the most problematic. The results are weighted according to the ranking assigned by the respondents. (World Economic Forum, 2006)

The most problematic factors of doing business in Kazakhstan are presented in figure 24. Corruption is ranked the most problematic factor, followed by inadequately educated work force and taxation factors. Transparency International (2006) remarks that it is of great concern that Kazakhstan as one of Europe’s major energy suppliers is still perceived as highly corrupt.

Figure 24. Most problematic factors of doing business in Kazakhstan, percent of responses.



Note: From a list of 14 factors, respondents were asked to select the five most problematic for doing business in their country/economy and to rank them between 1 (most problematic) to 5. The figures show the responses weighted according to their rankings.
Source: World Economic Forum (2007)

Economic crimes are defined as actions in production, distribution, and consumption (including abuse of one's position) that are punishable by law. A high rate of economic crimes could increase the costs and risks of doing business and undermine the investment climate. The total number of economic crimes per 100,000 people declined in Kazakhstan from 105.0 in 2000 to 66.5 in 2004. In general, economic crimes are an urban phenomenon in Kazakhstan. Indeed, the correlation between the urbanization rate and the rate of economic crimes was 0.77 in 2004. (USAID, 206a)

7 Foreign direct investments in Kazakhstan

7.1 Foreign direct investment potential and performance

UNCTAD benchmarks inward FDI performance and potential, ranking countries by how they do in attracting inward direct investment. The exercise is intended to provide policymakers with data on some variables that can be quantified for a large number of countries. (UNCTAD, 2007a)

Comparing the two indices a four-fold matrix of inward FDI performance and potential can be drawn up. (See table 30)

Table 30. Inward FDI performance and potential matrix.

	High FDI performance	Low FDI performance
High FDI potential	Front runners	Below potential
Low FDI potential	Above potential	Under performers

Source: UNCTAD (2007a)

Countries are classified into four categories according to their performance as follows (UNCTAD, 2007a):

- Front-runners: countries with high FDI potential and performance
- Above potential: countries with low FDI potential but strong FDI performance
- Below potential: countries with high FDI potential but low FDI performance
- Under-performers: countries with both low FDI potential and performance

Table 31. Inward FDI performance and potential, country listings.

	High FDI performance	**Low FDI performance**
High FDI potential	**Front runners** Azerbaijan, Bahamas, Bahrain, Belgium, Botswana, Brunei Darussalam, Bulgaria, Chile, China, Croatia, Cyprus, Czech Republic, Dominican Republic, Estonia, Hong Kong (China), Hungary, Iceland, Israel, Jordan, **Kazakhstan**, Latvia, Lithuania, Luxembourg, Malaysia, Malta, Netherlands, Panama, Poland, Portugal, Qatar, Singapore, Slovakia, Thailand, Trinidad and Tobago, Ukraine, United Arab Emirates and United Kingdom	**Below potential** Algeria, Argentina, Australia, Austria, Belarus, Brazil, Canada, Denmark, **Finland**, France, Germany, Greece, Ireland, Islamic Republic of Iran, Italy, Japan, Kuwait, Libyan Arab Jamahiriya, Mexico, New Zealand, Norway, Oman, Republic of Korea, Russian Federation, Saudi Arabia, Slovenia, Spain, Sweden, Switzerland, Taiwan Province of China, Tunisia, Turkey, United States and Venezuela
Low FDI potential	**Above potential** Albania, Angola, Armenia, Colombia, Congo, Costa Rica, Ecuador, Egypt, Ethiopia, Gabon, Gambia, Georgia, Guyana, Honduras, Jamaica, Kyrgyzstan, Lebanon, Mali, Mongolia, Morocco, Mozambique, Namibia, Nicaragua, Republic of Moldova , Romania, Sierra Leone, Sudan, Suriname, Tajikistan, Uganda, United Republic of Tanzania, Uruguay, Viet Nam and Zambia	**Under performers** Bangladesh, Benin, Bolivia, Burkina Faso, Cameroon, Democratic Republic of Congo, Côte d'Ivoire, El Salvador, Ghana, Guatemala, Guinea, Haiti, India, Indonesia, Kenya, TFYR of Macedonia, Madagascar, Malawi, Myanmar, Nepal, Niger, Nigeria, Pakistan, Papua New Guinea, Paraguay, Peru, Philippines, Rwanda, Senegal, South Africa, Sri Lanka, Syrian Arab Republic, Togo, Uzbekistan, Yemen and Zimbabwe

Source: (UNCTAD, 2007a)

Kazakhstan is classified as a front runner in the UNCTAD matrix. This category also includes, for example, Estonia, Latvia, Lithuania and Ukraine. Many former Soviet States are listed as countries above potential. Finland is below potential along with most of the European Union member states and Russia. The Under performers –category include mostly developing countries in Africa and Asia.

Kazakhstan has succeeded in attracting a vast amount of FDI and therefore performs very well in the FDI performance index ranking. The country ranking by the inward FDI performance places Kazakhstan as number 26 out of 141 countries in 2006. Its ranking is clearly higher than Finland's (96^{th}) or Russia's (87^{th}). However, due to the high dependency of its natural resource based industries, the FDI potential of Kazakhstan remains relatively low (49^{th} in 2005). In the outward FDI performance ranking Kazakhstan is at the last place (126^{th} in world wide comparison).

Table 32. Country rankings by FDI indexes.

	Inward FDI Performance Index			Inward FDI Potential Index			Outward FDI Performance Index		
	2004	2005	2006	2004	2005	2006	2004	2005	2006
Kazakhstan	14	28	26	55	49	-	125	127	126
Ukraine	84	35	37	56	48	-	102	77	91
Russia	92	89	87	24	22	-	26	25	30
Estonia	17	7	9	34	34	-	24	21	16
Finland	70	90	96	13	14	-	40	73	57

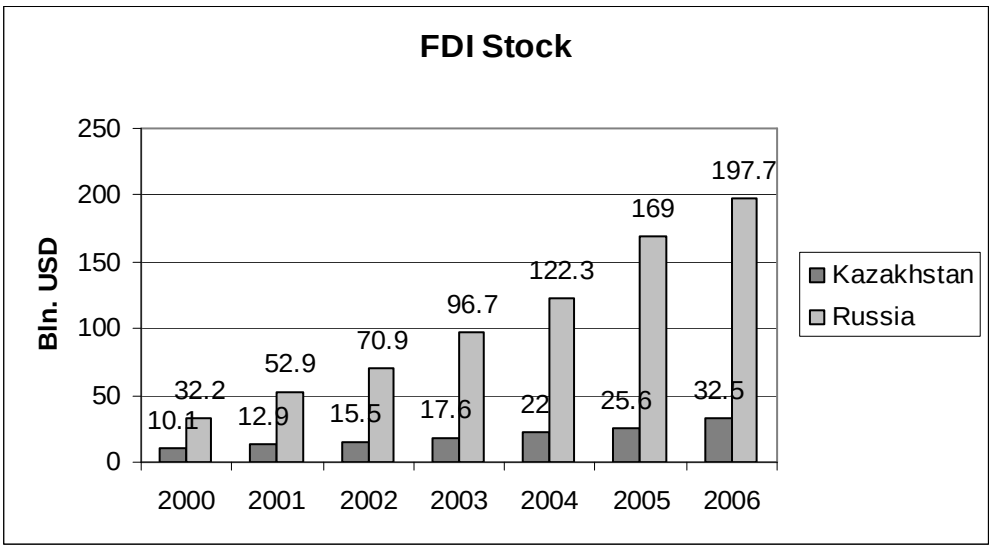
Note: Indexes are three year moving averages, three previous years, including the year in question
Source: (UNCTAD, 2007a)

7.2 Foreign direct investment stock and inflow

Foreign direct investment statistics available on Kazakhstan have some discrepancies. While EBRD and UNCTAD data are of similar magnitude, the National Bank of Kazakhstan reports sometimes double the figures compared to EBRD or UNCTAD data. This has to be taken into account when drawing conclusions on the data.

The FDI stock in Kazakhstan has grow steadily in the first years of the 21st century and over tripled during the period. However, compared to the FDI stock in Russia, the growth has been slower and the stock is still modest (see figure 25).

Figure 25. Foreign direct investment stock in Kazakhstan and Russia, 2000-2005.

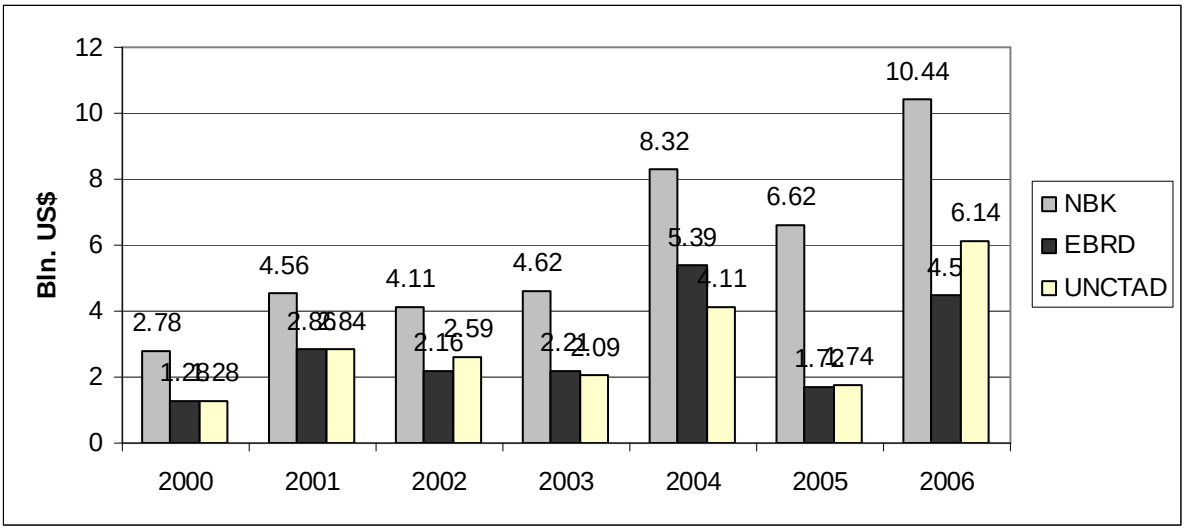


Source: UNCTAD (2007b)

In terms of FDI stock United States (76%) was the largest investing country in Kazakhstan in 1993, followed by Turkey (4%) and China (0.4%). Over the transition period the situation has

changed. In 1998 the top three investment partners were USA (29%), Republic of Korea (18%) and United Kingdom (13%) while five years later in 2002, the top three were USA (41%), United Kingdom (13%) and Netherlands (10%). (UNCTAD, 2007b)

Figure 26. Foreign direct investment inflow in Kazakhstan 2000-2006.



Source: National Bank of Kazakhstan (2007), EBRD (2007), UNCTAD (2007b)

When measured by the FDI inflow per capita, Kazakhstan is the leader in the central Asian region. Comparison of the per capita inflow between Kazakhstan, Russia, Ukraine and Estonia is presented in table 33.

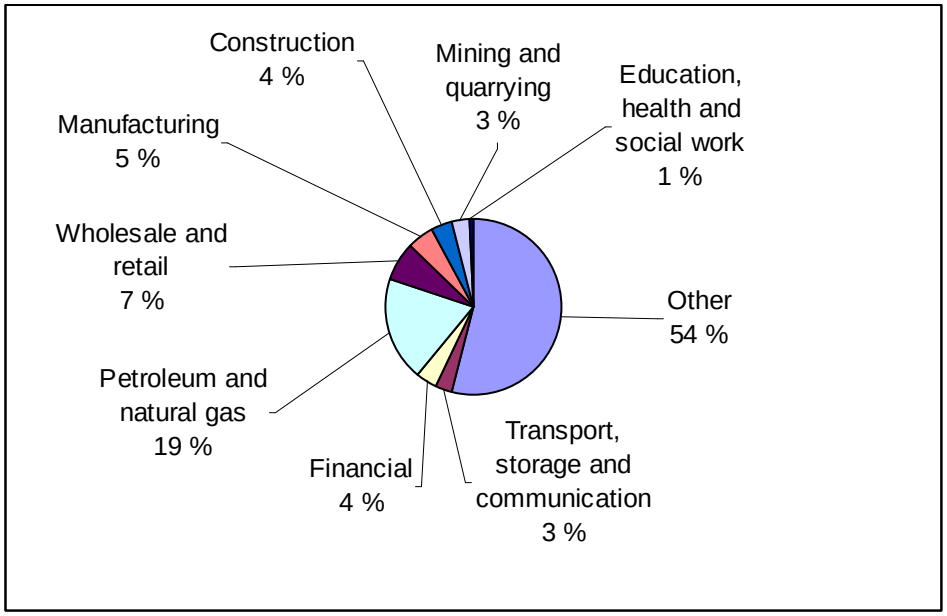
Table 33. FDI inflow per capita and in per cent of GDP.

	FDI inflow per capita USD		FDI inflow in per cent of GDP	
	2005	2006	2005	2006
Kazakhstan	114	298	3.1	5.8
Estonia	1670	417	16.1	3.4
Russia	13	75	0.2	1.1
Ukraine	160	113	8.7	5.0

Source: EBRD (2007)

In addition to sound financial management, foreign investments in Kazakhstan's natural resources have also been a key to its economic success. Oil and mineral resources have attracted the most foreign direct investment, which reached a cumulative 38.4 billion USD by September 2005 i.e. 22.7% of the total FDI stock of 169 billion USD in 2005. Energy extraction, alone, comprised 19.9 billion USD of this total, while 5.6 billion USD was invested in processing ferrous and non-ferrous metals, and an additional 1.6 billion USD was devoted to the extraction of metal ores. (BISNIS, 2006a)

Figure 27. FDI inflow by sector in 2006.



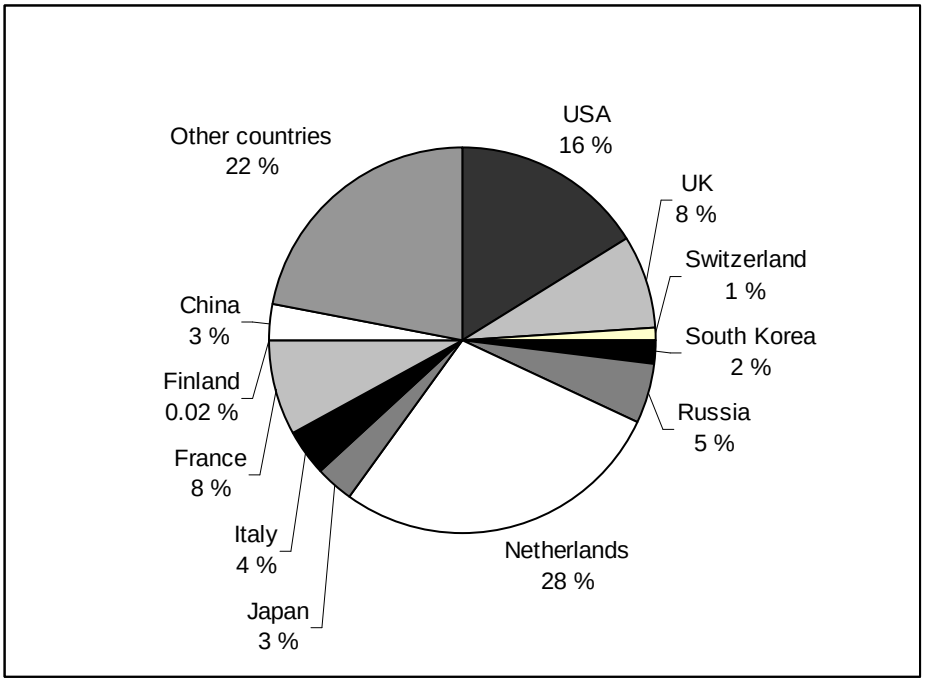
Source: National Bank of Kazakhstan (2007)

European Commission's (2007) report on Kazakhstan reminds that 80 to 90% of total FDI goes to the oil and natural gas sector, including not only large oil projects, but also a wide range of other activities supplying the oil and gas sectors (transport, services, infrastructure equipment and engineering). In fact, EU investments in sectors unrelated to oil are relatively limited in comparison – but include banking, agro-business and metals.

TengizChevrOil (TCO) is the largest single investment in Kazakhstan. This joint venture consortium between Chevron Overseas Petroleum Inc, Exxon Mobil, Kazakhstan's national oil and gas company (KazMunaiGaz), and LUKArco, is Kazakhstan's flagship foreign investment project. This huge investment is part of a 40-year, 20 billion USD agreement signed in 1993 to extract an estimated 6 to 9 billion barrels of recoverable oil. Through 2004 TCO has received more than 7 billion USD in direct investment, and its output had reached an estimated 280,000 barrels of oil per day. (BISNIS, 2006a)

Measured by the investment inflow, the largest investment partners in 2006 were Netherlands, USA, United Kingdom, France, and British Virgin Islands followed by Russia, Canada, Italy and China. (UNCTAD, 2007a) Investments from Finland remained at a modest sum of 2.2 million USD. (National Bank of Kazakhstan, 2007) Shares of the investing countries are depicted in figure 28.

Figure 28. Gross direct investment inflows in Kazakhstan by country 2006.



Source: National Bank of Kazakhstan (2007)

7.3 Motivation and opportunities for western companies

The sustained high growth rates recorded in recent years are reflected in the increased inflows of foreign direct investment (FDI) into Kazakhstan. According to the European Commission (2007), much of the increased attractiveness of Kazakhstan as a destination for foreign investment can also be attributed to the relative success with which its government has restructured its centrally-planned economy to move towards a more free-market based system. Its successes in this regard include:

- The creation, almost from scratch, of a sophisticated financial services sector (the most advanced in the former Soviet Union)
- Introduction of a private pension plan
- Privatisation of the electricity industry
- Civil service reforms
- Decentralisation to give greater autonomy to local government in its 14 administrative provinces
- Creation of a National Oil Stabilization Fund, which has hitherto accumulated more than $ 4 billion in oil revenue savings.

The Kazakhstan Law on Investments, which was enacted on January 8, 2003, provides a legal suite for foreign and national investments. It positions foreign and domestic investors on an equal legal footing. Under this Law, the investor will be compensated for any damages incurred in the event of nationalization. The market price for property held in the event of state requisition will be paid. (Macleod Dixon Lawyers, 2007. p. 9)

Investors whose business in Kazakhstan is in the list of priority activities approved by the Kazakhstan government enjoy three types of investment preferences: (I) tax preferences; (II) exemption from customs duties; and (III) state grants-in-kind. Among others, the list covers agriculture, forestry, food production and processing, textiles, chemicals, metals, machine-building, furniture, telecommunications, medical equipment, construction, hospitality and hotels. The government approves the maximum limit over the value of investments and the maximum period of tax preferences in respect of the specific category of a priority activity. (Macleod Dixon Lawyers, 2007)

Kazakhstan imposes some legal restrictions for foreign ownership in some of the sectors of economy. Foreign ownership of land is banned, and leases only up to ten years are permitted (unlike 49 years for Kazakhstan citizens). The Republic of Kazakhstan is restrictive on foreign shareholding in national security sensitive businesses. There is a limit of maximum 20% shareholding for mass media and 49% shareholding for telecommunications. (Macleod Dixon Lawyers, 2007)

Different companies in different industrial sectors have different reasons for market entry in transition economies. Motivation and reasons for market entry in CIS countries in general can be classified as presented in table 34.

Table 34. Reasons for market entry in CIS countries in general

Group 1 – the volume seekers	The need for increased volumes is forcing many companies to look outside the confines of the EU for growth.
Group 2 – the followers	This group of companies is entering the new markets as a direct result of their competitors' activity.
Group 3 – the raw material seekers	Companies that are reviewing the area closely as a possible source of raw materials for manufacturing operations in the future.

Source: Cunliffe (1995)

The volume seekers[7]

The need for increased volumes is forcing many companies to look outside the confines of the EU for growth. Spreading across Eastern Europe and the CIS is motivated by achieving production economies of scale. For this group of producers these developing markets have been a lifeline; they have nowhere else to go. As the levels of competition have increased across Europe, for this group of producers, entering the new untapped eastern European market has provided an opportunity to increase volume of sales, and therefore, to maintain or increase revenues.

The followers

This group of companies is entering the new markets as a direct result of their competitors' activity. Extra volume sales in the East are resulting in improved manufacturing efficiency in the West and the opportunity to maintain cost leadership. In effect, by entering eastern markets, western manufacturers have been able to achieve "cost leverage" back into their home marketplace.

The raw material seekers

Some western companies are entering Eastern Europe and the CIS to monitor and get close to the production of raw materials with a long-term view to procurement. Natural resources and agricultural production are of increasing interest.

For many western manufacturers, economic and political uncertainty is a very significant factor influencing the nature and degree of investment in any region. While most companies have taken their first steps into the former Soviet bloc through export, a number continue to avoid taking the perceived higher risk associated with investment. (Cunliffe, 1995)

Table 35. Comparison of operation forms.

Strategy	Positive issues	Negative issues
Exporting	- risk avoidance	- lack of control in supply chain
Joint ventures - import companies - manufacturing facilities - distribution	- greater control - least risky form of investment - stepping stone for direct manufacturing investment	- no full control - partner selection
Fully owned factory	- control - cost benefits - avoidance of border costs and tariffs	- greatest risks

[7] Descriptions are based on Cunliffe (1995)

The attractiveness of the Kazakhstan market could be assessed based on a number of key market criteria as suggested by Cunliffe (1995, p. 15) in his assessment of the CIS and Eastern European markets:

- **ease of market access:** i.e. getting the products in front of the consumer;
- **product chain development:** where demand (often at wholesale and sometimes at retail level) is beginning to drive the manufacturers;
- **economic development:** taking into account security of investment and the overall development of the infrastructure;
- **degree of transformation to market economy:** i.e. how involved the State remains in controlling structures and systems;
- **relative affluence:** i.e. disposable income levels.

There are differences in the attractiveness of the Kazakhstan regions from the FDI point of view. This is evident, for example, in the number of enterprises with foreign capital per region and the growth rates in their number. (See table 36)

Table 36. Number of operating joint ventures and foreign companies 2002-2006.

	2002	2003	2004	2005	2006
Kazakhstan, total	5,300	6,597	7,070	8,670	8,881
Akmola	22	47	54	58	87
Aktobe	114	142	186	219	272
Almaty	117	129	138	152	142
Atyrau	361	441	411	478	470
East Kazakhstan	160	252	294	322	324
Zhambyl	32	40	46	54	62
West Kazakhstan	99	130	162	173	226
Karaganda	246	260	354	392	389
Kostanai	76	103	127	174	144
Kyzylorda	19	20	33	53	75
Mangistau	85	138	186	233	206
Pavlodar	41	50	54	83	119
North Kazakhstan	96	107	152	176	135
South Kazakhstan	83	127	151	189	216
City of Astana	345	378	409	526	725
City of Almaty	3,404	4, 233	4,313	5,388	5,289

Source: Kazakhstanika (2007)

The city of Almaty and the city of Astana have attracted the most foreign companies by number (60% and 8% of total, respectively). Oil oblasts Aktobe, Atyrau, East Kazakshatn and Karanganda account for 16% of the foreign companies (1455 companies). In nine out of the 16 regions the number of foreign companies (or joint ventures) has more than doubled during

the past five years. Largest growth has occurred in Akmola and Pavlodar, where the number of foreign companies has nearly four-folded during 2002-2006.

Assistance and information for companies planning to do business in Kazakhstan is available through various organisations. For example Finpro[8] has an office in Almaty and European Business Association of Kazakhstan (EUROBAK)[9] is a non-commercial organisation representing the European business community in Kazakhstan.

[8] For more information see: http://www.finpro.fi/fi-fi/finpro/
[9] EUROBAK was formed upon the joint initiative of EU companies, working and investing in Kazakhstan, and the Delegation of the European Union Commission. See: http://www.eurobak.kz/

8 Conclusions

The opportunities in Eastern Europe and the CIS for western manufacturers of all sizes are considerable. As the new markets of the east have been opened up by the large multinational and global companies, the opportunities and potential for all manufacturers are increasing. Increasing levels of consumer sophistication and the development of structured and organized supply chains reduces the risks associated with these markets. Kazakhstan is no exception to this.

In sum, as stated by Tiusanen and Kinnunen (2005), Kazakhstan is a positive example of post-Soviet transition. It has got a higher living standard (GDP per capita at PPP) than any other CIS, except Russia. In the FDI stock per capita comparison, Kazakhstan is number one in the CIS region. Its economic growth is extremely strong, but the economy is in relative equilibrium with no rampant inflation and no considerable deficit in the current account (in 2006, the CA deficit was about 2 % of GDP.

According to Macleod Dixon Lawyers (2007) business environment analysis, Kazakhstan has set good example to other CIS states and presents an excellent opportunity for prospective investors looking for new markets with strong upside potential. Thus, despite the challenges described in this report Kazakhstan merits even more active consideration by exporters and foreign investors. It should also be realized that given its strategic importance, it is vital for western companies to be active in Kazakhstan, if they want to be competitive in the region.

Currently Kazakhstan has observer status in the World Trade Organisation (WTO), but is actively working towards full membership. WTO accession should provide an opportunity to reduce existing trade barriers, push forward internal reforms and thus have its effects on the market. This would also affect the foreign trade flows as well as FDI inflow and thus provide business opportunities for an increasing number of foreign companies.

It is mentioned occasionally that Kazakhstan is suffering from “Dutch disease”. This odd term came into being during the first oil crisis in the 1970s, when Netherlands discovered natural gas in the North Sea and earned windfall profits by exporting it. As a result, the local currency appreciated strongly hurting traditional export branches.

Amid the oil price boom, the currency in Kazakhstan has appreciated rather strongly in real terms. This is not necessarily hurting her exports (oil, gas, ores, metals), but is affecting

import substituting branches, which are facing deteriorating price competitiveness. This is possibly affecting FDI inflow in manufacturing negatively. At the same time it is likely that the increasing purchasing power will have positive effects on market-seeking FDIs, for example, in retailing, hotel business, restaurants etc. Oil price boom is not abating.

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