

Kazakhstan: *the new frontier*



Kazakhstan's banking sector has suffered from the fallout from the liquidity crisis, having borrowed heavily from foreign markets. Yet, as the country continues to diversify its economy away from its reliance on oil reserves, Kazakhstan still offers many attractive investment opportunities, argues Philip de Leon.

Ignorance is bliss, and maybe even at times a blessing... but what you do not know may hurt you, and this is particularly true if you have not put Kazakhstan on your business watch list, a young country of over 15mn inhabitants with a booming economy, a growing middle class and never less than 8.3% GDP growth since 2001.

Kazakhstan is the largest landlocked country in the world, ninth largest in size with the 11th largest world oil reserves. It is also a country with very ambitious goals set out by its very involved President Nursultan Nazarbayev. These include:

- Making Kazakhstan into one of the 50 most competitive nations;
- Implementing a cultural project to become a trilingual nation, with Kazakh as the state language, Russian as the official language used in government and domestic/CIS

business and for inter-ethnic communication, and English for linking into the global economy and high-tech leapfrogging;

- Diversifying the economy by transitioning

it from an extraction-based one to a service and technology-based economy, which would enhance its competitiveness and steer it away from the potential Dutch disease pitfall.

The growing importance of Kazakhstan as a regional player has not

escaped newly-elected Russian President Medvedev whose first official international trip was to Kazakhstan in May 2008. Similarly,

the US is launching in June a Public-Private Economic Partnership Initiative (PPEPI) to foster stability, prosperity and reforms in Kazakhstan and the region.

In 2010 Kazakhstan will rotate into chairmanship of the Organisation for Security and Collaboration in Europe, which could be seen as a leap of faith in the ability of the country to improve its track record on its professed political agenda concerning elections, political opposition, media freedom, and human rights.

Building a marketable identity at home and abroad

Kazakhstan has a rich tribal and nomadic history, but standing buildings, witnesses of a grander past, are not numerous. The existing ones, such as the mausoleum of Khoja Ahmed Yasawi, listed on the Unesco World Heritage list, have been overshadowed by the famed Silk Road cities of Bukhara and Samarkand in neighbouring Uzbekistan.

Any attempts to develop a cohesive national identity were repressed in tsarist and soviet times. Efforts since the country gained its independence in 1991 have had to take into account Kazakhstan's present day multi-ethnic, multi-confessional diversity. The transfer of the capital from Almaty to what

became Astana can be interpreted as a step in that direction.

Then in 2006 came the infamous Borat movie featuring a fake Kazakh journalist touring America, using a primitive image of the country together with outrageous comments.

An Irish author once said that: "There is no such thing as bad

publicity except your own obituary." The Borat movie could have turned into Kazakhstan's obituary in a marketing sense. However, this

The growing importance of Kazakhstan as a regional player has not escaped the newly-elected Russian president

unsolicited negative attention turned out to be a sort of blessing in disguise – a wake up call for a country whose literacy rate is higher than that of all the G8 countries (99.5% versus 99.0%). Constructively, the Borat movie drove home to the leadership the point that if Kazakhstan wanted the world to have an opinion about it, Kazakhstan would have to take an active role in shaping its own public image.

After a period of perplexity, uneasiness and

confusion on how to tackle this situation, the government and its embassies, such as that in Washington, DC, jumped on the public relations bandwagon to market the country. Proactive measures taken included: speaking on public radio, buying advertisement pages in major US newspapers and magazines, supporting the launch in New York and Washington DC of a guidebook entitled “Kazakhstan,” and supporting high profile conferences such as the annual Kazakhstan Growth Forum in London.

Parallel roadmaps to the future?

So what really is Kazakhstan? First, it is a Central Asian country with immense oil and gas reserves; it also has large deposits of barite, lead, tungsten, uranium, chromites, silver, zinc, copper, gold and iron ore.

Second, it is a country that understands the

need to diversify its economy and insulate itself from the fluctuations of commodity prices.

With the welfare of Kazakhs in mind, Kazakhstan has been paying close attention to the similar experience of Norway, which created the Norway Oil Fund in 1996 and is worth US\$391.3bn as of May 2008. The Kazakhstani National Oil Fund was established in 2000 and had over US\$25.4bn as of June 1, 2008. Third, it is a country that was recognised as a market economy by the European Union in 2001 and the US in 2002. And fourth, it is led by a hard driving president who has a vision of where the country should be going and a personal approach to democratic concepts.

There are some striking similarities between Kazakhstan and Russia because of their shared Soviet past, though Kazakhstan remains very different from Russia. Both countries over the past eight years have had at their helm ambitious and astute leaders who have a long-term road map for their country.

While President Putin of Russia came up in 2008 with a “Development Strategy Through 2020,” Kazakhstan’s President Nazarbayev, who has been at the head of independent Kazakhstan since 1991, had already launched in 1997 his forward-looking projection, “Kazakhstan 2030 – Prosperity, Security and Improvement of Welfare of the Citizens of Kazakhstan”.

Next, in 2001 a “Strategic Plan of Development for Kazakhstan till 2010” was adopted by presidential decree, followed in 2003 by the “Innovative Industrial Development Strategy for 2003-2015”. Both Putin – and now Medvedev, along with Nazarbayev see themselves as the guarantors of the economic stability and growth that is benefiting their populations. Another directly-related similarity is the shared strong belief that unbridled democracy can be a threat, jeopardising the strategic goals being pursued and bringing down all that has been achieved. Therefore, political parties and the bickering that comes with political debates should not be allowed to get out of control.

It is no surprise then that United Russia, the main political party in Russia, is headed by Vladimir Putin, and that Nursultan Nazarbayev affords Nur-Otan, the largest

“The younger generation does not want to become a sacrificed generation in the name of democracy building”



Russia & Eurasia Trade & Export Finance Forum

2ND
ANNUAL
EVENT

September 9-10, 2008
The Hotel Baltshug
Kempinski
Moscow

- Natural resources financing •
- Telecoms financing •
- Legal, regulatory and customs issues •
- Insurance specialists panel •
- Local and regional banking overviews •
- Country and economic overviews •
- Commodity financing •
- Local currency financing •
- and more

For more details on this event or to register visit www.gtreview.com,
Telephone Exporta on +44 (0) 20 8673 9666 or email info@exportagroup.com

Sponsors:



Lunch Sponsor:



political party in Kazakhstan, the leading role in advancing his national agenda.

The idea of Kazakh and Russian authorities interfering with such a fundamental feature of the political process is puzzling and worrisome to western minds. However, the vast majority of the populations of both countries would rather continue to enjoy the endless opportunities resulting from their unprecedented prosperity boom than be confronted again with the political and economic turmoil that resulted from the break-up of the Soviet Union. The younger generation does not want to become a sacrificed generation in the name of democracy building. The political instability shaking some of the former Soviet republics, such as Ukraine, is closely monitored.

On the financial front, just as Russia sees Moscow becoming a top world financial centre, Kazakhstan sees Almaty becoming a regional financial centre, exploiting the arbitrage time difference between Dubai and Singapore.

Since the Kazakh banking system has sophisticated technology and highly qualified personnel, this is an achievable goal for Kazakhstan.

Kazakhstan, however, has relied heavily on foreign borrowing, and it is not being spared either by the liquidity squeeze or the world economy's current slowdown. This indirectly impacts neighbouring Central Asian countries as Kazakh banks have used their excess liquidity to expand abroad. Construction, one of the leading industries outside the extraction industry, has experienced an abrupt slowdown, especially as mortgage lending for residential and speculative developments have become tighter. This has led to a shifting towards more short-term lending, but it remains that the Kazakh banking system, which is under the control and supervision of the National Bank of Kazakhstan and is composed of about 30 banks, is still a promising service-based sector of the economy with growth potential.

Still other similarities include the fact that both countries face the same challenges and have pledged to combat them: widespread corruption, an inflation rate over 10% in 2007, and dependency on the price of natural resources. Policy directions and implementing roadmaps can be found in the yearly 'State of the Nation' addresses on the

websites of each president. Interestingly, that of the Kazakhstani president elaborates more fully who should do what.

A critical difference with Russia is that Kazakhstan enjoys and actively nurtures good international relations, not only with its immediate neighbours, but also with more distant countries, such as the US and the European Union.

Some may see this as the making of a new 'Great Game', the name given to the 19th century struggle for influence in Central Asia between tsarist Russia and the British Empire. This time around, the US is seen as replacing Britain, and new players, such as Turkey, India, Iran and Pakistan, come into the picture.

Land-locked Kazakhstan has the need to develop both internal and external transport corridors, and its dependency on Russia and China for access to key transportation routes and export markets explains in part Kazakhstan's pragmatic and conciliatory diplomatic approach. However, Kazakhstan has not shied away from sending troops to Iraq, partnering with Nato, and openly stressing the importance of its dialogue and interaction with the US and the EU.

Export and investment bonanza but...

After having been resoundingly reelected to a second seven-year term in December 2005, Nazarbayev declared on June 6, 2008 that he is going to be president for a long time and doesn't have any successors. Kazakhstan is thus a promising export and investment destination with a mostly predictable political climate. However, the minister of economy did announce in May that he expected 2008 GDP growth to be 5.3%, a more than three-point loss compared with 2007. It is still a very enviable percentage when compared with the forecasted GDP growth of many industrialised countries.

Major investments are under way even in sectors other than natural resources, such as tourism. In May 2008, a US\$1.5bn Jordanian infrastructure project to build a resort on the Caspian Sea was announced to serve an anticipated 300,000 tourists per year. Opportunities in Kazakhstan abound, and many companies find it easier to do business in Kazakhstan than Russia. However, some large foreign companies, such as

Opportunities in Kazakhstan abound, and many companies find it easier to do business in Kazakhstan than Russia

ArcelorMittal, AES, Chevron, and ExxonMobil, have been subject to heavy fines in the hundreds of millions of dollars for alleged tax



GTR

offenses, environmental wrongdoing, and project delays. Work visas have also been denied for foreign workers, which poses scheduling problems for companies in need of complex technical skills not yet available in-country, aside from the fact that this practice is incompatible with WTO accession and self-defeating of Kazakhstan's own development goals. Such punitive treatment of existing investors sends conflicting signals as Kazakhstan at the same time professes openly to welcome foreign investors. The challenge for Kazakhstan is to establish and enforce the sanctity of contracts, and have the rule of law

apply uniformly to everyone, irrespective of connections. Over the years since independence, Kazakhstan has made visible efforts to put in place a legal and regulatory system that is permanent, clear and transparent, understandable to the companies subject to it as well as to the enforcing authorities and judges. Unfortunately, different codes in practice contradict each other. The absence of jurisprudence on some issues makes it unclear how a court will interpret the law. Clarifications sometimes given by bureaucrats on regulations are non-binding, and judges' lack of experience with commercial matters make them vulnerable to uneducated rulings. Corruption on top of this can lead to a good headache cocktail. So, while Kazakh authorities may be partly correct in saying that foreign companies breached the law or their contractual obligations, the still fluctuating legal environment makes it hard for even the most willing to be fully compliant. This is why it is strongly recommended to include an arbitration clause in contracts.

Go Kazakhstan?

The incredible wealth brought in by the natural resources revenues does mask some of the flaws operative in the political, legal and judiciary system. However, Kazakhstan's efforts towards WTO accession could lead to the legal and regulatory framework cleanup needed to establish a more predictable working environment and a new tax code is already under way. WTO accession would also help facilitate Kazakhstan's goals of becoming one of the 50 most competitive countries, which should bring the investments needed to diversify the economy. Bilateral negotiations are under way with the US, the EU, Australia, and India, and once concluded, the multilateral negotiation process will follow. No target accession date has been officially set but in light of what remains to be

done domestically and at the bilateral and multilateral negotiating levels, it is reasonable to think that Kazakhstan's accession will not become a reality before 2010. Meeting challenges of regional integration and cooperation, already hampered by long-standing rivalry and mistrust, and then further fueled by ethnic, religious and territorial tensions, will be a necessary condition, along with continued domestic reform, if Kazakhstan is to fulfil its vast potential.

As noted by William Veale, executive director of the US-Kazakhstan Business Association,

“The incredible wealth brought in by the natural resources revenues does mask some of the flaws operative in the political, legal and judiciary system”

a Washington-based organisation of major American companies investing in Kazakhstan: “the real, long-term attractiveness of Kazakhstan for the non-energy foreign investor will be to use its increasingly hospitable business environment as a base for serving the much larger markets

of the entire region.”

Kazakhstan is not picture perfect but it does not live in denial of what needs to be done in spite of some contradictions between its declared objectives and reality. The political and business elite is generally savvy and exposed to outside influences. There is reason to be hopeful for the future, too: since 2006, some 3,000 Kazakh students are being sent every year to study abroad through the Kazakh government's Bolashak scholarship programme.

At a time when many natural resources countries are of questionable reputation and raise the specter of supply disruption, the moderation of Kazakhstan on the international stage and its reliability offer a good reason to reconsider who our true friends are. Furthermore, if Kazakhstan continues to make steady progress on its planned reforms, it could become an anchor of stability and prosperity, helping support poorer and less stable countries in the region.

Philip de Leon is a business development consultant based in Washington, DC and he can be reached at: Philip@pdeleon.com



Wake-up call for Kazakhstan



Kazakhstan has been hit hard by the international credit crisis, spreading concern among banks and other potential investors. Phillip De Leon speaks to Erlan Idrissov, Kazakhstan's ambassador to the US, who believes the crisis will serve as a wake-up call for the state's banking market.

GTR: The global credit crunch that is affecting Kazakhstan may result in slower economic growth in 2008. Standard & Poor's recently downgraded Kazakhstan's credit rating from stable to negative. What measures, if any, does the government intend to take to stimulate the economy and keep inflation under control?

EI: First, let me say that one kind of positive aspect of this global credit crisis is that according to the IMF, Kazakhstan was the only Central Asian economy to be hit by it. This means that Kazakhstan is firmly a part of the global economy: what happens globally affects us.

The other effect is that it served as a wake-up call for banks that over-relied on foreign borrowing and had become too complacent. They were capitalising on high commodity prices, the good rating of Kazakhstan and got used to an easy life. Banks will have to

restructure their strategies and practices and seek out other sources of financing.

The government is pleased this wake-up call came as it had been telling the banks, that wouldn't listen, that they over-relied on foreign borrowings; that was the opinion of the World Bank and the IMF as well. This

served as a good lesson as it forces the banks to be more responsible as economic players and it will help them become healthier and stronger.

Regarding Standard & Poor's lowering of Kazakhstan's prognosis rating on its long-term sovereign credit ratings from 'stable' to 'negative'. It is in my point of view a temporary correction.

As for measures taken, the government

and the National Bank of Kazakhstan came up in January with a very strong statement that they would focus on containing inflation below 10% and that they will use a whole set of instruments to make sure this goal is met. The government recognised the economic growth rate would slow down to about 5-7% from a high of 8-10%. We believe it is a good effect that will prevent the economy from overheating.

Some of the other measures taken are the following:

- A rigorous plan to coordinate the efforts of all government agencies, regulators, and the banking system to alleviate pressures arising from tightened funding conditions in global capital markets.
- Support to the banking system by engaging in open market operations, providing loans to individual institutions and in certain cases, currency swaps.
- The government will also encourage banks to explore alternative sources of finance, such as equity listings and sale of convertible bonds, and to explore the possibility of securitisation of their credit portfolios.

GTR: Kazakhstan's banking system has long been considered as the most solid of the CIS. How are Kazakh banks weathering the present liquidity crisis?

Kazakhstan is firmly a part of the global economy: what happens globally affects us

EI: The present situation and the liquidity shortage will lead to needed corrections of the banking system. It has forced the banks to change their development strategy, to cut lending, to use

existing liquidity reserves, to refinance of debts, and consider possible merger opportunities.

The government is very wary of the interests

GTR

of other economic players like construction companies, even more so as some of their projects were funded with the start-up capital of individual stakeholders who are our middle class people. Therefore, the government has set up a US\$4bn package to help commercial banks to continue its lending to small and medium companies. The government is weary of the social cost of this crunch and has taken measures to alleviate it. Of course, there will be a cost and it will serve as a reminder that we all live in a global economy and that we should work and act accordingly.

GTR: The need for and the price of agro-commodities are going up. Does Kazakhstan intend to increase its production, and if yes, how will it address the severe water shortage affecting Central Asia?

EI: Two aspects to this issue: Kazakhstan was a net food exporter in Soviet days and a major producer of grains, meat and poultry. We are a strong agricultural country but it was the hardest sector to reform and initially the cost born by the players was the highest. It was the sector where the most inappropriate practices of Soviet days were entrenched so it was hard to transform. We had to change mentalities and habits and we have done that. The turning point was the law on private ownership of land, which created a lot of debate.

Now agriculture is on the rise. We are the top fifth or sixth exporter of grain. President Nazarbayev said at a recent conference in Sharm-El-Sheik that he will use every opportunity to raise agricultural production and that foreign investors in that sector would be welcomed.

Increasing production would contribute to solve the food shortage at a global scale. One aspect to increase production is to attract foreign investment and there is a legal framework to facilitate partnerships with foreign partners to develop production. In fact we have the potential to develop organic production for oil seeds and meat but to do so we need processing and packaging standards and managerial skills of the west, such as Europe. That would be a fantastic marriage and that could result in a sizeable growth in food products that could supply international markets.

We already have opened new markets for our wheat such as to China, Iran, Egypt, Italy, and Scandinavian markets. Everything is produced in Kazakhstan, except tropical and subtropical products like banana and oranges. Also remember that apples are from Kazakhstan.

About 47% of our water originates in Kazakhstan but the rest is downstream water so it is a big issue that we address it in three ways:

- With projects to enhance the use of water bodies. For instance we work with the World Bank for the rehabilitation of the Aral Sea and

Oil and gas sector is not the sector where we try to attract investors, as there is already a long queue,

we work on clean-up projects.

- By introducing rational use of water, as we understand water is not an ever-lasting product. For instance, we are implementing the installation of water meters.
- By negotiating mutually beneficial deals with China, Russia and Central Asian countries from which the water comes from. Central Asian countries are particularly important, as they all need water. For instance most water originates in Kyrgyzstan and Tajikistan and a lot comes through Uzbekistan. We are ready to invest in joint water projects with them. We already signed a trans-boundary water agreement with China several years ago, which is the first of its kind and we have a permanent dialogue on the topic.

GTR: Russia recently adopted a strategic sectors law that may impact foreign investment. Does Kazakhstan intend to do the same and what incentives exist to attract foreign investment?

EI: Any country is free to do whatever it deems appropriate for itself but for us foreign investment is a very important element of our growth. *Per capita*, we attract more FDI than in the entire former eastern block.

Since 1994 we have attracted over US\$70bn with US\$10.6bn in 2006, and US\$17.5bn in 2007 alone. This is a huge increase. Private sector investments are an important tool for our own vision for growth, so we continue to improve the investment climate.

Oil and gas sector is not the sector where we try to attract investors, as there is already a long queue there so we try to attract investments in non-extractive industries. We do have strategic sectors like oil and gas, but I will remind you that 80% of assets in the oil and gas sector belong to foreign companies. This tells you how open our economy is. But the government is there to make sure the economic interests of the nation are seriously observed. For example, for the new projects in the Caspian Sea, we make sure that the deals are done on a 50-50 basis regarding national/foreign involvement. We want to develop a local capacity.

Other sectors we consider as strategic are telecommunications, transport, financial services but we are quite liberal and we will keep liberalising those sectors within the framework of our WTO accession. This will strengthen the competitiveness of these sectors.

Some of the incentives we have are through our investment law that creates a level playing field for both domestic and foreign investors. We eliminated the double taxation of dividends and are working on a new tax code meeting WTO standards. We created a unique institutional mechanism which is the Foreign Investor Council chaired by the President of Kazakhstan. It comprises the largest investors in the Kazakh economy and allows investors to have a direct dialogue with senior government officials. We also have free economic zones and are working towards reducing the numbers of licenses needed to operate.

GTR: Kazakh companies are on the watch list of investors, exporters, mutual funds managers and exchange traded funds. Beyond oil & gas, which companies or sectors would you recommend considering and why?

EI: In a few words I would say the non-extractive sectors. In 2003 Kazakhstan adopted the Innovative

Industrial Development Strategy for 2003-2015. Within this framework the government is set to actively work to attract investments into non-extractive sectors of the economy. The government has identified seven economic clusters: tourism, transport logistics, oil and gas machine building, construction materials, food processing, textiles and metallurgy. Within these clusters investment activities in the following sectors are subject to a privileged treatment: food processing, machinery building, metallurgy, textiles, production of IT goods and related services, chemical industry, leather industry, supply of construction, wood processing – furniture, hotel services, agriculture, automotive industry, tourism and transportation services. Investments into these privileged sectors are subject to corporate income, property, and customs and duties exemptions.

Other areas where we welcome investments are the high-tech sector, biotechnologies and the space sector as we have our own space launching capacity. For instance, we launched in 2006 a telecommunications satellite, which is a strong signal of our capabilities. So any value-added activities such as in the service sector are sectors where foreign investment would be most welcome.

GTR: Kazakhstan sees itself as a regional leader and is aiming at joining the community of the world's 50 most competitive nations. In that process, how can Kazakhstan help poorer Central Asian countries such as Kyrgyzstan and Tajikistan and the not so remote Afghanistan?

EI: We help them in two ways: we provide government assistance such as loans but our major engagement is through our private sector. We are a major investor in Kyrgyzstan and we are now the number one investor in Georgia. Our private sector invested in a hotel chain, gas distribution network and power distribution.

The Kazakh banking sector has a significant presence in Kyrgyzstan and the mining sector in Tajikistan is of great interest to Kazakh companies, so the private sector is the driving force behind improving the situation in those countries. For example in the banking

sector, the good banking practices of Kazakh banks are now implemented in Kyrgyzstan. For Afghanistan, which is a special case, we are the only country of the former Soviet Union to have a special programme for Afghanistan. Last October, we adopted a US\$3mn action plan to assist Afghanistan for 2007-08: US\$0.5mn was allocated to humanitarian aid to restore the food, corn and agricultural seed supply; the rest was used to build a school, a hospital and a road. This is a very practical and specific contribution. We have provided scholarships for 100 Afghan students to study topic such as engineering and geology in our universities. We also provided training for the police and internal security services.

But there is also a second part to this plan, which is a private sector part as the private sector is very eager to work in Afghanistan by participating in tenders, building power

Our drive towards WTO accession is a reflection of how serious we are about the diversification of our economy and bringing it up to world standards

stations and hospitals, among other infrastructure projects. The caveat remains that security issues be addressed but our private sector is more adventurous and familiar with the environment. So I think the public and private sector efforts in Afghanistan are quite visible and I have the highest respect for these efforts.

GTR: Kazakhstan is working on its WTO accession. How do you think WTO accession will affect Kazakhstan?

EI: WTO accession is a very well thought-through thing for Kazakhstan. We do not have any market access problems with exported goods such as oil and gas so some of our neighbours may ask: why is Kazakhstan rushing into WTO?

The answer is that WTO accession is part of our long-term vision. We are working for our future, as we want to raise our competitiveness and getting market access for all our goods.

Joining the WTO will force us to raise business and technical standards up to WTO standards. This will impact all sectors and it is a long-term gain for Kazakhstan. Thirdly, education and human resources is very important to us, so by joining WTO we are investing in our human potential.

Today, Kazakhstan's trade stands at 50% with WTO countries so it will enhance our access to WTO markets. Let's not forget that we are a landlocked country and that tariffs have a huge impact on Kazakhstan, so we need to work on better tariffs.

We could sit calmly on our commodities goods now without rushing into WTO but our drive towards WTO accession is a reflection of how serious we are about the diversification of our economy and bringing it up to world standards.

GTR: How would you finish the sentence "Kazakhstan is..."?

EI: First, Kazakhstan is the heart of Eurasia. This carries a lot of messages. We are an ancient culture that was always at the crossroads of different outlooks, habits, cultures, ethics, standards and we are flexible and tolerant. We are a place where all of this meets and melts into new quality and we are a bridge to Asia, the Pacific, China, Europe and other parts of the world. We are at the centre of a huge mass of land that has a great peace, security, trade and economic potential so the heart of Eurasia is not just a geographic term, it has a very serious message.

Second, Kazakhstan is a modern, fast growing, forward looking, democracy building nation and a very responsible and active member of the family of nations. Kazakhstan is a fascinating place in terms of nature and many discoveries are to be made by explorers in Kazakhstan.

Erlan Idrissov has been ambassador of the Republic of Kazakhstan to the US since July 2007. He served as ambassador to the UK from 2002 until 2007 and as Minister of Foreign Affairs from 1999 to 2002.