

Kazakhstan

Reforms to attract foreign investment to this oil-rich nation are top of the government's agenda, say Aset Shyngyssov, Klara Nurgazyeva and Marat Mukhamediyev

Kazakhstan became an independent sovereign state in 1991 as a result of the dissolution of the former Soviet Union. Since then, it has undergone significant change as it has journeyed from having a single-party political system, and a centrally controlled command economy, towards a market-oriented, more democratic approach. Between 2001 and 2007, its GDP grew cumulatively by almost 200% in real terms, according to the National Statistics Agency of Kazakhstan.

Kazakhstan is known for its vast reserves, and active export, of natural resources. These include oil, gas, steel, copper, ferroalloy, iron ore, aluminium, coal, lead, zinc and wheat. As a landlocked country, Kazakhstan relies on having good relations with its neighbours to ensure its ability to export. So it has taken various steps to promote regional economic integration among nearby countries. In 2009, Kazakhstan, Russia and Belarus set up a customs union. The aim of the union is to create a free customs area within which member countries enjoy free movement of goods, services, capital and labour. The member countries also intend to harmonise their fiscal,

credit and currency policies to support further economic integration with other post-Soviet Union nations and to assure continued access to export routes. In the meantime, Kazakhstan is looking to join the World Trade Organization (WTO) and negotiations on its accession to the WTO are still pending.

Foreign investment regime

Like many other emerging economies, Kazakhstan's economy is still substantially dependent on foreign investment.

According to official sources, Kazakhstan has attracted over \$160bn of foreign direct investment since 1993. Although there was an insignificant decline in foreign direct investment in 2008-2010, this investment has picked up since 2011 and reached approximately \$22.5bn in 2012. Inbound foreign direct investment is mainly in the oil, gas and mining sectors.

From 1993 to 2012, the Netherlands (a key hub for holding companies due to a favourable Kazakhstan-Netherlands tax treaty) was responsible for a third of all investment into the Kazakhstan economy (\$43bn) followed by the US (\$25bn). The top 10 foreign investors also include the UK (\$11.6bn), France (\$10bn), the British

Virgin Islands (\$7.8bn), China (\$7.8bn), Russia (\$6.4bn), Switzerland (\$6.4bn), Italy (\$5.8bn) and Canada (\$5.5bn).

Kazakhstan law grants foreign investors the same rights as Kazakhstani nationals. Foreigners may invest in almost all sectors of the economy. But restrictions apply to foreign ownership in certain areas, for example, national post, air and seaports, oil and gas, and mass media and telecommunication. The law also imposes restrictions to encourage companies to hire local personnel and procure goods and services locally.

Kazakhstan is a party to bilateral investment treaties with 45 countries, the Energy Charter Treaty, the New York Convention of 1958 and other international treaties that secure protection of foreign investors' interests in Kazakhstan.

New foreign investment reforms are top of the Kazakhstan government's agenda. Some of the key policies that should stimulate investment opportunities in Kazakhstan include:

- ◆ Economic incentives through the creation of special economic zones and/or granting of investment preferences. These apply to investments in certain areas, such as agriculture, manufacturing or the government's strategic projects (reconstruction and modernisation of refineries, creation of digital television transmission, etc). The incentives relate to corporation tax, VAT, land and/or property tax, customs duty, etc.
- ◆ Institutional support through the Special Permanent Commission on Foreign Investment, which is headed by the prime minister of Kazakhstan. The main purpose of the commission is to promote direct dialogue between the government of Kazakhstan and foreign investors in order to efficiently address key issues related to their investment activities in the country.
- ◆ Service support through the National Export and Investments Agency, Kaznex Invest, which is responsible for organising business forums and meetings, and providing information and analytical support to investors.

Meanwhile, slow, step-by-step liberalisation reforms are being introduced to reduce the number of licences and permits, and other administrative hurdles. Also, the parliament and government are drafting a new, more liberalised administrative code, a mining code, and various other laws and



Country file

Population size: 17 million
Geographical area: 2,724,900 sq km
GDP growth (2013): 6%
Type of govt: Republic
Official languages: Kazakh and Russian
Capital city: Astana
GDP (PPP) in 2012: \$235.6bn
Central government debt as a proportion of GDP (2012): 13.2%
Currency: Kazakhstani tenge
Currency rate against the euro: 0.0039

SOURCE: INDEX MUNDI

TOP TIPS FOR DOING BUSINESS IN KAZAKHSTAN

1 Carry out due diligence on your potential local partner in advance. A professional adviser can help you to identify and understand key issues associated with the deal, for example, the approvals process, tax structuring, documentation and likely timeline.

2 Negotiations may take longer than expected, but the signing of transaction documents can happen very quickly, especially if the government is involved.

3 Informal meetings with the local partner are useful for establishing relationships.

4 Learn a few phrases in Kazakh and something of the history of Kazakhstan.

5 Be prepared to accept when offered horse milk or horse meat, and to make eloquent toasts.

Like many other emerging economies, Kazakhstan's economy is still substantially dependent on foreign investment



The launch pad at Baikonur cosmodrome in Kazakhstan

PHOTO: © EPA EUROPEAN PRESSPHOTO AGENCY CREATIVE ACCOUNT / ALAMY

initiatives, in order to improve the climate for attracting foreign direct investment.

Banking system

Kazakhstan has a two-tier banking system with the National Bank of Kazakhstan (NBK) comprising the first tier and the commercial banks comprising the second tier (with the exception of the Development Bank of Kazakhstan, which, as a state development bank, has a special status and belongs to neither tier). According to NBK, there were 38 commercial banks licensed to operate in Kazakhstan in February 2014.

Currently, foreign banks are prohibited from opening branches in Kazakhstan. They must establish a Kazakhstani subsidiary or joint venture in order to provide banking services in the country. In February 2014, there were 16 banks with foreign participation operating in Kazakhstan, including RBS Kazakhstan, Citibank Kazakhstan and Sberbank of Russia. Legislation defines a bank with foreign participation as a bank that has more than one-third foreign ownership.

Kazakhstan's banking sector has been particularly adversely affected by the global financial crisis. Between 2000 and 2007, while the Kazakhstan economy was experiencing rapid growth, banks in Kazakhstan incurred high levels of foreign debt in order to fund a rapid expansion of credit. Some Kazakhstani banks

came under pressure due to the growing number of non-performing loans on their books. So, in 2008-9, Kazakhstan's parliament adopted the Restructuring Law with the twin aims of enabling consensual financial restructurings that are approved by a qualified majority of creditors and of revising the existing framework for banks to be reorganised into 'good banks' and 'bad banks'. The Kazakhstani banking system continues to remain under stress, with banks starting to deleverage through partial repayments and debt restructurings.

Capital markets

The Kazakhstan Stock Exchange (KASE) is the only functioning stock exchange in Kazakhstan. It is located in the largest city of Almaty and was founded in 1993. KASE is a universal financial market that is active in foreign currency, government securities (including the bonds of international finance institutions), shares and corporate bonds, and derivatives.

KASE is undertaking several projects aimed at attracting investors and increasing market liquidity. These include establishing a clearing and settlement system that will enhance operational efficiency, reduce the volume of settlement transactions, delivery instructions and costs, and minimise the risks of default to broker dealers.

Kazakhstani companies tend to raise equity and debt investment in Western markets, mostly on the London Stock Exchange (LSE). Among the companies that are listed on the LSE are miner Kazakhmys, mobile network operator Kcell and energy company KazMunaiGas. In 2013, mid-sized bank Kaspi Bank offered \$200m in three-year eurobonds with a coupon of 9.875% on the Irish Stock Exchange. Kazakhstani companies are also attracted by the Hong Kong Stock Exchange.

While the global financial crisis has negatively affected Kazakhstan's economy, particularly its banking sector, the country still offers lots of opportunities to foreign investors, with the support of ongoing legal and economic reforms. To make the most of these opportunities, foreign investors need insight into the Kazakhstani market, which can be provided by experienced professional advisers. ♥



Aset Shyngyssov and Klara Nurgazyeva are partners, and Marat Mukhamediyev is an associate, in the business and finance practice of global law firm Morgan, Lewis & Bockius (Almaty office)