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## Current Trends of Investment Climate in the Republic of Kazakhstan

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**Abstract:**

*Kazakhstan is a leader in terms of foreign investment per capita in the CIS countries today. Direct foreign investment in Kazakhstan is about \$1,300 per capita. This suggests that the investment attractiveness of the country will rise. In addition, the intention of the republic to enter the 30 most developed countries of the world by 2050 opens up numerous new opportunities for companies from different sectors. According to opinion polls, the investment attractiveness of Kazakhstan is due to the following factors: 1) it Recommendations for further improvement of the investment climate in Kazakhstan include: 1. Informing potential investors about the attractiveness of Kazakhstan (through diplomatic missions, non-governmental organizations, mass media, social networks, etc.). 2. Reduction of regional disparities and the development of economically backward regions. Today, only three cities – Astana, Almaty and Atyrau – can attract foreign investors. 3. Enhancing the transparency of business in Kazakhstan.*

**Key Words:** *Investment, Direct Foreign Investment, Investment Policy, Investment Climate, Investment Activities*

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## **1. Introduction**

Investment climate is an essential element of the business climate, which is largely formed by the state authorities in order to create an attractive environment for investors by introducing effective measures. Business environment in a particular country has great influence on the size of investments. These conditions are also called *an investment climate*. Important indicators of a favorable investment climate are guarantees of property rights, as well as the predictability and stability of business environment.

It should be noted that the investment climate is closely associated with the investment policy and is an object of the impact of the investment policy. On the one hand, it determines the starting conditions for the development of investment policy, and on the other hand, it is its result. In this regard, the effectiveness of investment policy is measured by the degree of change in the investment climate to a more favorable direction. In turn, a more favorable investment climate influences the investment policy towards its further improvement.

Investment policy, serving as a set of different activities, affects different (mostly subjective) components of the investment climate. It is actualized through the development and implementation of the strategy of investment activity regulation.

In assessing the investment climate of Kazakhstan, the following factors are taken into account: abundant natural resources, agricultural and industrial potential, strategic location, political stability and absence of interethnic conflicts (Kaderova, 2011).

Methods to assess the investment climate are very diverse. They are based on different economic, political and financial indicators, the totality of which defines the investment grade rating assigned to the country, region or city, which is an important indicator for investors, most of whom are not able to conduct independent detailed research, especially in other countries, and are guided by the assessment of rating agencies. Therefore, the rating increase is always associated with the influx of investment needed for economic growth.

## **2. Methodology**

There are many definitions of investment in the scientific literature. Some authors consider the investment as an input of financial resources in various (tangible and intangible) assets, while others define it as the cost of the funds aimed at reproduction, i.e. support and expansion of capital. Currently, the works of scientists refer investment to all types of property and intellectual values invested in objects of entrepreneurial and other activities.

Perhaps the most common is the point of view that identifies investment with capital investments. In recent years, investments and investment policy in Kazakhstan have become urgent subjects of many scientific developments and research. However,

investment saw increased attention of the scientists and practitioners from the second half of the 90s, while before that the most urgent issues in the economy were those of financial stabilization.

The outbreak of the global financial crisis in the late 90s has necessitated a rethinking of many questions of economic policy of Kazakhstan. For a certain period of time, the government had to switch to the mobilization model of development. The priorities in foreign and domestic economic policies changed. All of this also requires making substantial changes in the investment policy of Kazakhstan, based on the realities of globalization and the crisis of the world economy, which sets new challenges for the economic and political science (Nigmatulin, 1999).

On the basis of theoretical and methodological research, the article reveals the essence of investment and investment climate in the country, justifies the state's role in regulating the investment climate and the creation of favorable conditions for attracting domestic and foreign investment. A. Smith in his book (1776) "An Inquiry into the Nature and Causes of the Wealth of Nations" introduces the category of "additional capital", which in fact is an investment in fixed capital. He also first raises a question on the impact of investment on economic growth here (Smith, 1993).

A. Smith first puts forward the idea that savings are a source of investment, which subsequently received extensive development in the works of the representatives of the modern neoclassical and Keynesian economics. Adam Smith's views were crucial in understanding the basics of market economy and have been further developed in "On the Principles of Political Economy and Taxation" by David Ricardo (1772-1823) (Ricardo, 1995).

David Ricardo explained many concepts of political economy, such as cost and workforce (instead of labor), and also gave a definition of the concept of a capital as a prerequisite for the economic dynamics of society: "Capital is that part of the wealth of a country which is employed in production and consists of food, clothing, tools, raw materials, machinery, etc. necessary to give effect to labor". (Ricardo, 1995).

Karl Marx expanded the Adam Smith's labor theory of value by developing the theory of surplus value and considering the capital as the circuit, determining the law of the rate of profit trend to fall; pointed at the crisis of over saving and inefficiency of the capitalist mode of production, which may result in self-destruction. (Marx, 1949). The "initially advanced capital" is considered by Karl Marx in monetary form, which is divided into two parts: one is for the purchase of the labor force, the other – for the purchase of capital goods. These two series of purchases take place in different markets: one in the commodity market, the other in the labor market.

Thus, K. Marx refers to investment objects and investment goods markets. Next in the process of circulation of industrial capital, after a certain time lag, a new form of investment appears in the form of the capital part of the surplus value, which Marx calls "additional capital". In the Marx's interpretation, "additional capital" or investment is part of profit allocated to increasing the elements of productive capital, which becomes the basis of saving and, consequently, the expansion of production. The link determined by Marx between investment and economic growth is bilateral. Marx also determines the areas of investment. Based on the Karl Marx's research, it can be concluded that the investment is the input in the means of production, through which the economic growth is ensured.

According to K. Marx, the "binding of capital" means turning a profit into the elements of constant capital: raw materials and semi-finished products, as well as machinery and other fixed assets. He clearly defines the areas of investment – "... in additional natural elements of productive capital" (Marx, 1949). The most important conclusion of the Marxist school is to consider the investment as a function of profit growth. According to Karl Marx, investment demand will be maintained, and the accumulated capital will be invested in its entirety as long as the money invested brings at least a minimum profit.

The theory of investment has gone through several stages in its development. We can mention the works of the Austrian School of Economics (E. Böhm-Bawerk); in the 20-30s of the last century, during the birth of the theory of finance as a science, the works of I. Fisher on the theory of interest rate appeared (Fisher, 2004). The theoretical approach to the assessment of capital assets was proposed in the works of F. Williams (Williams, 1999).

In the western economic literature, investment is considered in the unity of the two aspects: resources (capital value), and investment (costs). Most obviously, this approach is represented in the works of J.M. Keynes, according to whom the investment is part of the income for the period, which has not been used for consumption, the current increase in value of the capital property as a result of the productive activities of the period. (Keynes, 1978). This definition, which is not exhaustive, is characterized by reasonably clear separation of the two sides of investment: resources (accumulated in order to accumulate income) and investment (use of resources) that ensure the gains of capital property.

Thus, in one of the first translations of monographs on the market economy by E.G. Dolan and D.E. Lindsey, investment at the macro level is defined as "an increase in the volume of capital functioning in the economic system, i.e. increase in the supply of productive resources carried out by people" (Dolan, Lindsey, 1994). Campbell R. McConnell and S.L. Brue define investment as "the cost of production and the accumulation of the means of production and an increase in inventories" (McConnell, Brue, 1993).

According to these definitions, investment is viewed as a mechanism for increasing the productive resources of society. In fact, they narrow the concept of investment to production (real). At this interpretation, investing capital in securities and bank deposits cannot be attributed to the category of "investment", as there is no increase in the productive resources of society. (Michael D, 1988).

A well-known textbook by W. Sharpe and G. Alexander "Investments" provides a broader definition – the word "to invest" means "to part with money today in order to get a great amount of it in the future" (Sharpe, Alexander, Bailey, 1997). In the most common form, investment is understood as input of capital with a view to its increase in the future.

Similar definitions are given in other most popular writings, while the general attitude to investment differs insignificantly. Many authors believe that investment is a capital input with a view to its subsequent increase. At that, capital gain shall be sufficient to compensate the investor refusal to use his or her own funds for consumption in the current period, to reward him or her for the risk and to compensate the losses from inflation in a future period (Koszhonov, Atamkulov, 2000; Gednev, Temrezova, 2007).

This concept of investment is adhered to by I.A. Blank, V.V. Bocharov, M.I. Knysh (Blank, 1996; Bocharov, 1999). Close to a specified definition of investment is the one suggested by Lawrence J. Gitman and Michael D. Joehnk who understand investment as the method of locating capital that should ensure the preservation or increase in the value of capital and (or) bring positive value of income (Lawrence, 2007; Joehnk, 1988).

The development of market relations in the transition economy of Kazakhstan necessitated the revision of the interpretation of the category of "investment" in accordance with the new conditions. Generalization of the different approaches of the scientists to the research of the stages of formation and development of the investment process allows revealing its characteristic features in the market environment:

- connection of investment to income as the motive of investment activity;
- consideration of investment in the unity of the two sides: the resources (capital value) and investment (expenses);
- inclusion of any investment providing economic (social) effect into investment objects;
- analysis of investment not in the statistics, but in the dynamics, which allows to bring together resources, investment and return on investment under the category of "investment" as the motive of this unification.

Currently, the works of Kazakh scientists have broad interpretation of both investment and the investment process. Investing as a political, economic and legal phenomenon is a free activity based on the own interests of the investor, freedom of

their will, choice of investment objective and the means to achieve it. The emergence and development of the broad interpretation of the category of "investment" helped upgrade the role of the investment process in the domestic economy and form a fundamentally different investment policy, its strategy and tactics, its criteria and principles.

**Investment** is all kinds of property and intellectual values invested in objects of entrepreneurial activity for profit, including:

- movable and immovable property and property rights, liens and other, except for goods that are imported and intended for sale without processing;
- stocks and other forms of participation in commercial organizations;
- bonds and other debt instruments;
- claims for money, goods, services and any other execution under the agreements relating to the investment;
- right to intellectual property, including copyrights, patents, trademarks, industrial designs, technological processes, know-how, design and technological documentation;
- any right to carry out activities based on a license or other form of provision to public bodies (Smagulov, Kurmanbaev, Potapov, Toykin, Nurekenov, Smagulov, Murzataeva, 2009) [21].

The definition of investment is closely connected with the concept of investment activities. Investment activities (investment) are money input implemented by economic entities to generate income and increase capital. (Kaderova, 2011).

"Investment activities mean that the investor on the basis of a serious analysis assumes both a reimbursement of invested capital and achieving an adequate return. Operations that do not meet these requirements are speculative" (Graham, 2015).

When planning investments at the level of the country and regions, the term "investment climate" is used. According to P. Gagloyev, S. Belogur, "the investment climate of the country or region refers to generalized characteristic of the set of economic, social, political and state-legal conditions that create a certain level of attractiveness of financial investments" (Gagloyev, Belogur, 1997).

According to K. Guseva, the investment climate is a "system of social and economic relations, which are formed under the influence of a wide range of inter-related processes on the macro- and micro-level of management and create preconditions for the emergence of stable investment motivations" (Guseva, 1996). Essentially, all authors treat the investment climate as a set of various factors by which you can determine the status of the external investment environment, which assumes the implementation and development of a specific investment process.

An indispensable condition for the successful development of the investment climate is the creation of sufficient progressive and stable legal framework that serves as the primary measure of the investment climate and its liberality. In the post-Soviet

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economic space, this work began immediately after the collapse of the Soviet Union and the formation of new sovereign states (Nigmatulin, 1999).

All CIS countries since 1993 have adopted laws on foreign investment to establish the legal regime and its regulation in their territories. Recently, many of these initially adopted laws were repeatedly changed and supplemented, including in Kazakhstan. The market approach to analyzing the nature, forms and principles of the investment activities is reflected in the definition of "investment", for example, in Kazakhstan's legislation. In accordance with the Law of the Republic of Kazakhstan "On investments" dated 08.01.2003 – one of the first market-focused laws, – investment is all types of property (except for goods intended for personal consumption) and intellectual values invested in business and other activities, which produce a profit or achieve social effect (Law of the Republic of Kazakhstan "On investments", 2003).

Similar language is contained in the Law "On foreign investments in the Republic of Kazakhstan", where investment is defined as monetary assets, securities rights that have monetary value, invested in objects of business and (or) other activities for profit and (or) achievements other useful effect.

### **3. Outcomes**

In Kazakhstan, the first peak of interest in direct foreign investment was in the mid-90s. This is when important steps were taken to improve the investment climate in the country, including the creation of the legal framework and system of preferences for investors. Of course, it all paid off – foreign companies have come to Kazakhstan's economy, especially to the primary sector, major joint projects have been launched.

Then the "cloudy" 2000s came, when petrodollars flowed into the budget, and our banks have obtained access to cheap financing abroad. Against this background, the problem of the investment attractiveness of our country has lost some of its relevance. However, the spiral of the crisis of 2007-2009 once again brought us to this point, though at a qualitatively new level. The country again needs foreign money and know-how, first of all – for the development of non-extractive sectors.

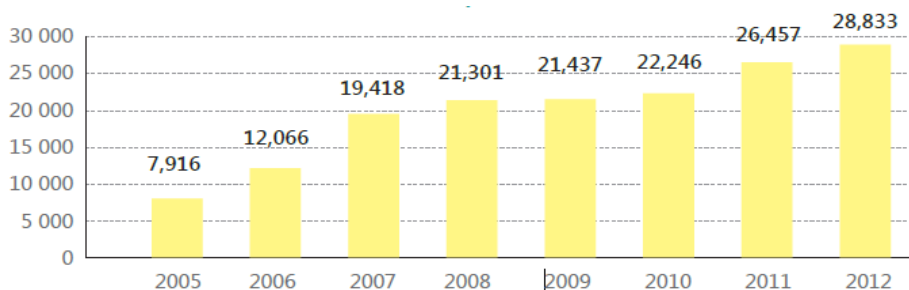
Speaking about the investment image of any country, its main component is confidence: confidence of foreign investors in the country they are going to invest in, confidence of the domestic business in their own state, which must guarantee fair rules of the game. And finally, the most important thing is confidence between the authorities and society, without which it is impossible to rely on a long-term political stability. After all, its lack puts an end to any investment benefits (Satpayev, 2014).

The Republic of Kazakhstan is of great interest to foreign investors.

Kazakhstan is rightly considered to be a leader among the CIS countries to provide the most favorable conditions for investment activities.

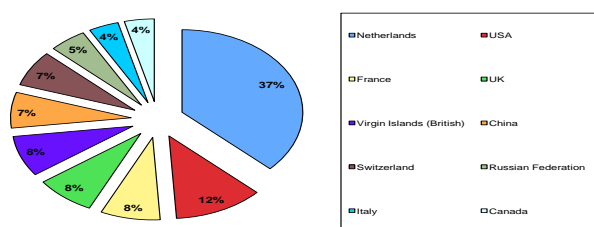
Favorable business climate and political stability contributed to a significant inflow of direct foreign investment to Kazakhstan; since 2005, Kazakhstan has attracted direct foreign investment (DFI) worth over USD 170 bln (Figure 1).

**Figure 1. Total DFI, USD bln. (National Bank of the Republic of Kazakhstan)**



Analysis of the volume of raised direct foreign investment by investing countries for the 2005-2012 period shows that the bulk came from developed countries (see Figure 2).

**Figure 2. Geographical distribution of investment in Kazakhstan in the period from 2005 to 2012. (National Bank of the Republic of Kazakhstan)**



Investment attractiveness of Kazakhstan market is ensured by combination of access to natural resources, size of the market, strategic location of Kazakhstan, as well as a stable political situation and the presence of an appropriate legislative framework. Currently, the priority areas for investment are: fuel and energy complex; agribusiness; infrastructure, including transport, telecommunications, and social infrastructure. Promising forms of attracting foreign capital are financial leasing, sale of stocks of large enterprises to foreign companies, attracting foreign investment in the venture capital industry (with equity participation of the state or government guarantees).

It is no secret that Kazakhstan is a leader in Central Asia by the volume of attracted investment. According to the Ministry of Economy and Budget Planning of the



Republic of Kazakhstan, it amounted to more than \$180 bln. for the 2005-2013 period.

There are only three nuances. **First**, the bulk of foreign investment still goes to the primary area. For example, last year oil and gas Atyrau, Mangistau and West Kazakhstan regions accounted for **84%** of all foreign inflows. **Second**, not all foreign investments are actually foreign: often, Kazakhstan money returns to the country after being laundered via offshores. **Third**, the composition of investors gradually changes, with Chinese companies strengthening positions. According to the Kazakh Embassy in China, over 1992 to 2013, China has invested about \$20 bln. in our country, including about \$6 bln. of direct investments. Since September 2013, we signed an agreement with China on the implementation of investment projects in Kazakhstan for \$43 bln. For comparison, Japan has invested in Kazakhstan about \$4.2 bln. in the last 8 years, South Korea – \$3 bln., Russia, as of 2012 – just over \$5 bln. In addition, the Eurasian Development Bank, established by the Republic of Kazakhstan and the Russian Federation, has invested more than \$2 bln. in the republic since 2006.

Kazakhstan provides a lot of benefits and preferences to investors. On June 12, 2014, a meeting of Foreign Investors Council was held on the shores of Lake Burabai, which was attended by President Nursultan Nazarbayev. The problems of Kashagan and improving the investment climate in the country were discussed. The head of state invited foreign investors to participate actively in the planned privatization of at least 700 companies in Kazakhstan and revise approaches to the procurement of the products and services investors need in Kazakhstan.

To improve the investment climate, it became known about the visa-free regime for investors from 10 countries: the United States, the Netherlands, the United Kingdom, France, Germany, Italy, Malaysia, the United Arab Emirates, the Republic of Korea and Japan.

Other major measures to improve the investment climate include the Law "On amendments and additions to some legislative acts on improving the investment climate" signed by the President, assuming provision of state support to those wishing to invest in the economy of Kazakhstan. The list of proposed measures is attractive:

- exemption from CIT for 10 years;
- exemption from land tax for 10 years;
- exemption from property tax for 8 years;
- compensation of up to 30% of capital expenditure of the investor by the state after commissioning (investment subsidy);
- stable tax rates, charges and fees (excluding VAT and excise taxes) for 10 years;

- right to employ foreign labor force for the entire period of construction of the investment project, and one year after commissioning, out of quota and without permits;
- guaranteed orders from interested legal entities;
- "one window" approach for contracts with all state bodies on the basis of the Investment Committee of the Ministry of Industry and Innovative Technology;
- limit level of tariffs for natural monopolies in the long term (5 years or more);
- institute of investment ombudsman.

To gain access to this package, it is required to propose a project with funding of at least USD \$20 mln. in the priority sectors of the economy.

At the end of the 27th meeting of the Foreign Investors Council, the Head of State proposed to hold the next meeting in Shymkent. It is the third largest city in Kazakhstan. Southern Kazakhstan is home to 15% of the population – about three million in just one region.

The topic of a new meeting of the FIC will be agribusiness. "The World Bank study says that everyone knows that demand for food will increase. By 2050, humanity will consist of 9 billion people. And the demand for food will double. Kazakhstan has suitable agriculture lands. Absolute pastures are 200 million hectares; arable lands for sowing are 45 million hectares. If we increase their productivity by just 30%, we'll have a tremendous amount of production", – said Nursultan Nazarbayev (Press Service of the President of the Republic of Kazakhstan).

Also, the Head of State set new strategic goals, to achieve which all sectors of the economy, including agriculture, should review their development paths, set new challenges and develop an appropriate action plan for the successful implementation of tasks. Due to increased competition in the Customs Union, as well as in the face of the forthcoming accession to the WTO, the Ministry developed a new Development Program for Agribusiness in the Republic of Kazakhstan for 2013-2020 (program), whose aim is to create conditions for improving the competitiveness of agribusiness entities to make it more profitable and less risky. The Ministry departed from the practice of developing directive industrial programs to the program of ensuring conditions, because business itself is able to understand how and what to plant and where to sell agricultural products.

To achieve the objectives of the program, the work in the following four areas will be undertaken:

- financial restructuring;
- increase of the availability of goods and services for agribusiness entities;
- development of systems of public support for agribusiness entities;
- increase of the efficiency of the state regulation of agriculture.

Realization of the program will allow to create favorable conditions for business development in rural areas, facilitate the flow of investments in the sector, and improve the efficiency of allocation of budget funds.

#### **4. Discussion**

In the domestic and foreign science, serious methodological apparatus was developed by definition of the "investment climate" category, which allows to adequately assessing the competitive positions in the investment area. The investment climate of the area has received considerable attention during the investment decision-making, particularly to foreign investors. The investment climate is understood as the degree of favorable investment situation from a certain territory (country or region) and the investment area (industry, enterprise).

According to the results of the research, the support of a favorable investment climate in the Republic of Kazakhstan includes the following priorities: general economic and political stability, sound system of management of the investment process, optimal tax regime, creation of special economic zones and creation of appropriate investment legislation.

The level of awareness of investors about the opportunities offered today by the republic increased – both among those who are already working in Kazakhstan and among potential investors. Despite the improvement in Kazakhstan's position in the World Bank's Doing Business rating, the main problems that international investors have long pointed at still remain unresolved. (Jey, Dosymbekov, 2014).

When we talk about investment, we mean not only financial resources, but also the transfer of new technology, knowledge, upgrade of production. Therefore, attracting foreign investment is one of the priority areas in the economic policy of the country. To further encourage investment, Kazakhstan needs to improve the stability of the business environment, as well as ensure the development of infrastructure, disclosure of human resources and independence of the judiciary.

It requires a reorientation of foreign investments in favor of agriculture and other socially important sectors, as well as high-tech industries that produce finished products. The favorable investment climate in Kazakhstan is achieved by maintaining political stability and predictability, maintaining the stability of the currency, implementation of the policy of commitment to integration into the world economy. However, the following weaknesses of the existing investment situation should be noted:

- foreign capital is mainly directed to the oil-extracting and metallurgical sectors of the primary industry of the country – the development of the productive sector should be encouraged at the expense of foreign investors;

- domestic investors have to work on equal terms with the possibility of replacing their niches in any sector of the economy. And we must make every effort to achieve the objectives of turning Kazakhstan into a regional investment hub.

## **5. Conclusion**

Creating an appropriate investment climate in any country, including in Kazakhstan, depends on a number of factors, most important of which are: political stability, radical economic reforms, favorable economic climate, legal security, transparency and stability of the legal, regulatory and institutional frameworks, production and market infrastructure, market size, availability of natural resources, quality of labor, currency convertibility and the possibility of repatriation of profits, etc. All this combination of factors can be divided into 3 blocks: political, legal and economic. Kazakhstan has achieved, in contrast to other post-Soviet states, a high level of political stability and interethnic accord.

At the level of macroeconomics and microeconomics, the state makes every effort to attract investment projects, as has been described above. The problem of low attracting of foreign investment projects in Kazakhstan can be due to the following institutional reasons: the lack of effective managers in many companies; imperfection (up to a total absence) of the business environment in the regions (up to the criminalization and administrative subordination), which defines high risks of investment.

The investment policy of Kazakhstan is one of the key factors in the successful implementation of the second five-year industrial program, which will begin in 2015. Now the Government is facing the task of attracting new investment, especially from transnational corporations (TNCs). Of course, this will require a lot of effort – especially since the world economy faces a difficult situation. There is a tough fight for investors.

Kazakhstan has created a favorable investment climate. Besides having a favorable investment climate, one of the main factors influencing the investor's decision about investing is the scale of the sales market and the availability of energy resources. Currently, the national plan to attract investment is being corrected. In particular, Kazakhstan intends to improve conditions for the arrival and stay of foreign investors. To do this, national legislation and international legal framework are improved, and the package of investment preferences is expanded. Therefore, foreign investment is one of the priorities of the entire country's economic policy. Kazakhstan's political system is rated as stable, which is reflected positively on the business environment for investors operating in the country.

Long-term national strategies contribute to the growth of investors' confidence, including "Kazakhstan 2050", which determines the priorities of the country.

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