

KAZAKHSTAN

TRADE SUMMARY

The U.S. goods trade deficit with Kazakhstan was \$563 million in 2005, an increase of \$345 million from \$218 million in 2004. U.S. goods exports in 2005 were \$538 million, up 68.0 percent from the previous year. Corresponding U.S. imports from Kazakhstan were \$1.1 billion, up 104.5 percent. Kazakhstan is currently the 77th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Kazakhstan in 2004 was \$4.8 billion, down from \$5.0 billion in 2003.

Kazakhstan has been negotiating membership in the WTO since January 29, 1996. Kazakhstan is still negotiating market access agreements with a number of WTO members, including the United States, and made progress in 2005 with several other WTO Members, including China, Pakistan, Turkey, and the Republic of Korea. In the area of WTO rules, additional legislative changes to eliminate WTO-inconsistent practices and fully implement WTO provisions will be necessary in several sectors, including subsidies based on use of local materials, customs practices, SPS, TBR, and taxation.

The U.S.-Kazakhstan Bilateral Trade Agreement, which came into force in 1993, grants reciprocal, normal trade relations treatment. A bilateral investment treaty (BIT) came into force in January 1994.

IMPORT POLICIES

Kazakhstan is a member of the Eurasian Economic Community (EAEC) along with Russia, Kyrgyzstan, Belarus, and Tajikistan. Moldova and Ukraine currently have observer status. Trade among the five EAEC countries is generally duty-free, but protective measures, including tariffs, may be applied in selected areas. The countries have not yet established a common external tariff. The EAEC is developing coordinated customs procedures, which it hopes to complete in 2006, that would reduce the cost of transshipment through the EAEC member states of U.S. goods destined for Kazakhstan. Kazakhstan is also (with Russia, Ukraine, and Belarus) part of the Single Economic Space (SES), a nascent common market. Kazakhstan is committed to deeper integration with its neighbors through SES, but the progress of this organization has been hampered by uneven levels of enthusiasm from its members, as well as by the sheer number of founding documents that must be negotiated.

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The average weighted applied import tariff in Kazakhstan is approximately 7.9 percent. Goods imported for short-term use in Kazakhstan under a temporary import regime can be fully or partially exempt from duties, taxes and non-tariff regulations. The government has the right to issue a list of goods that cannot be temporarily imported into Kazakhstan. Typical examples of goods not eligible for duty exemptions are food products, industrial wastes, and consumables.

As with the 1994 Foreign Investment Law, the Law on Investments, enacted in January 2003, provides customs duty exemptions for imported equipment and spare parts, but only if Kazakhstan-produced stocks are unavailable or not up to international standards.

Kazakhstan's new Customs Code became effective on May 1, 2003, superseding the previous law which had been in effect since 1995. There are positive changes in the Code, such as provision for WTO-compliant customs valuation methodologies. In practice, however, customs administration remains a problematic aspect of trade. In addition, key provisions for such practices as voluntary disclosure are not included in the Code.

The customs authorities continue to discuss the automation of customs procedures, but little progress has been made. Since October 2002, Kazakhstan has maintained a "customs audit" procedure administered by a private contractor. The contractor determines customs value based on a database of world prices, in contravention of international standards. Under this system, approximately 20 percent of all goods crossing Kazakhstan's borders are subject to valuation uplifts. While the government pays for inspections, the declaring party pays penalties in the event of discrepancies. There are concerns that this process is used to generate extra-legal revenues. Courts have overruled the Customs authorities on over 85 percent of all appeals under this system. In addition, Ministry of State Revenues Order 402 sets conditional prices for certain imports, a practice inconsistent with international norms.

U.S. companies have consistently identified Kazakhstan's requirement that they obtain a "transaction passport" to clear imported goods through customs as a significant barrier to trade. This regulation is designed to stem capital outflows and money laundering by requiring importers to show copies of contracts and other documentation to legitimize and verify the pricing of import/export transactions. The practice retards the growth of trade, as the regulations place relatively tight restrictions on transaction parameters. For example, the regulations allow a maximum financing term for imports of 120 days, after which time the transaction passport lapses. This limits the range of business activity and creates a potential bias towards short-term financing in the economy.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Kazakhstan's system of Metrology, Accreditation, Standards and Quality (MAS-Q) has long been considered by businesses to be weak and fragmented. Many businesses complained of mandatory certification requirements that have no technical basis or aim. The Committee on Standards, Metrology and Certification – Gosstandart (the national governing body operating under the Ministry of Industry and Trade) was plagued by frequent management changes that make stable, long-term progress difficult. Government observance of existing standards, testing, labeling, and certification requirements was reported to be uneven.

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In response to these well-known deficiencies, Kazakhstan adopted new legislation in 2005. The legislative base governing technical regulation and metrology in Kazakhstan now consists of the laws “On Technical Regulation,” “On Ensuring Uniformity of Measurement,” and on supporting government regulations, which were adopted in furtherance of the government’s 2004-2006 programs for the development of national systems of standardization and certification. Of the government’s regulations, the most fundamental is entitled “On the Mandatory Confirmation of Compliance of Products in the Republic of Kazakhstan.”

The law “On Technical Regulation” was signed on November 9, 2004, and came into effect on May 13, 2005. This new law supersedes two previous laws, “On Standardization” and “On Certification.” The main purpose of the new law is to define the division of responsibilities between the state and private sector. The government is responsible for product safety, while the private sector is responsible for quality control.

Though this new law cancels the laws “On Standardization” and “On Certification,” some approaches from the old laws have been maintained. Under the new law, a wide range of goods is subject to mandatory certification requirements. The certification requirements apply to both domestically produced and imported goods. A related regulation lists the categories of products subject to certification, which include but are not limited to machines, cars, agricultural equipment, clothes, toys, food, and drugs.

Standards for imported goods are addressed further in the law “On Technical Regulation.” That law specifies that contracts for the delivery of imported goods subject to mandatory certification should be required to confirm compliance with the mandatory certification. Such contracts should be accompanied by documents describing the products and listing the country of origin, the producer, the expiration date, storage requirements and code of use in both the Kazakh and Russian languages. In addition, the law states that foreign certificates, testing protocols and compliance indicators will be in accordance with international treaties.

The government has accepted placement of Kazakh language stickers on products as compliance with the law, instead of requiring entirely new labels. The government has also issued a wide-ranging regulation exempting pharmaceutical products and several other categories of goods from the Kazakh labeling requirement.

GOVERNMENT PROCUREMENT

Kazakhstan is reforming and harmonizing its system of state procurement. Some potential U.S. investors have raised concerns about the transparency and efficiency of Kazakhstan’s government tender process.

The State Procurement Agency was established by Presidential decree in December 1998, and the “Regulation on the State Procurement Agency” was approved in March 1999.

In October 2004, the State Procurement Agency was merged with the Committee on Financial Control and was accordingly subordinated to the Ministry of Finance. The procurement process in Kazakhstan is regulated by the law “On State Procurement” and by the Budget Code, the current version of which applies to budgets for 2005 onward.

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The government has taken steps to improve the transparency of the procurement process. In particular, the Committee on Financial Control published on its website the state register of agencies and state enterprises subject to state procurement regulations, the “Rules of Inclusion and Exclusion” that determine whether an agency or a state enterprise is subject to government procurement regulations, and a blacklist of unfair and unreliable suppliers of goods and services.

However, the government procurement situation remains inadequate. Since January 2005, about 240 court claims against ministries and state enterprises have been filed. An inspection by the Finance Ministry identified procurement violations in the amount of 81 billion tenge (about \$602.2 million) during the first nine months of 2005. Further legislative improvement in this area is needed.

The “Rules on Oil and Gas Procurement,” which went into effect in 2003, also give significant preferences to local suppliers, and establish what many firms, foreign and domestic, consider unwarranted state interference in even small tenders. Despite governmental promises to amend the rules, they remain as originally drafted although it does not appear that the government enforces them.

U.S.-funded assistance projects are helping Kazakhstan to establish a database to assist in procurement. The database was launched by the State Procurement Agency in 2003, but is still incomplete.

INTELLECTUAL PROPERTY RIGHTS PROTECTION

The 1992 U.S.-Kazakhstan Agreement on Trade Relations incorporates provisions on the protection of intellectual property rights (IPR). As part of its effort to join the WTO, Kazakhstan began in 2003 to bring its IPR legislation into compliance with the WTO’s Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement) and other international conventions and agreements. In 2004, Kazakhstan was identified on USTR’s Special 301 “Watch List” and an industry-initiated case is pending to review Kazakhstan’s status as a beneficiary country under the U.S. Generalized System of Preferences (GSP) program.

In 2004, Kazakhstan ratified the World Intellectual Property Organization (WIPO) Treaties on Copyrights and the Uses of Performances and Phonograms, and amended the Law on Copyrights to guarantee retroactive protection to copyrighted works. In addition to legislative initiatives, Kazakhstan has worked cooperatively with law enforcement agencies, public organizations and international organizations to fight piracy.

In 2005, the Government of Kazakhstan worked toward improving its IPR regime. A new law lowered the minimum threshold for criminal liability for IPR violations, increased penalties for both criminal and administrative infringements, and expanded the government’s power to protect intellectual property. A new government working group, comprised of key enforcement agencies along with private industry groups, was formed to combat piracy. Since these changes are so recent, it remains to be seen what effect the new penalties and IPR working group will have on enforcement and piracy/counterfeiting rates nationwide. In addition, although the

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Customs Code provides for the seizure at the border of items that violate IPR, there is little border protection against the import of illegal material, as illegal sound recording continue to be imported, particularly from Russia and China.

SERVICES BARRIERS

The Oil and Gas Procurement Regulations, enacted in June 2002 (see Investment Barriers, below), stipulate that oil companies must purchase services only from Kazakhstan-based companies unless the required service is unavailable in Kazakhstan.

INVESTMENT BARRIERS

According to major foreign investors and law firms, Kazakhstan's Investment Law represented no significant improvement over prior legislation. Investors have concerns about the Law's narrow definition of investment disputes and its lack of clear provisions for access to international arbitration.

There has been a trend over the past few years to favor domestic over foreign investors in most state contracts. The 1999 amendments to the Oil and Gas Law required mining and oil companies to favor local goods and services. The rules implementing these legal provisions were enacted in June 2002 (Decree 612), but were not being enforced as of December 2005. The decree creates onerous requirements for government involvement in, and approval at, each stage of private procurement.

Amendments to the Law on Subsurface Use adopted in December 2004, require investors to state in their tender proposals what affirmative actions they will take to satisfy local content requirements. Operations can be suspended for up to six months if a company is found to have failed consistently to meet the requirements.

The July 2005 Law on Production-Sharing Agreements (PSAs) contains explicit requirements regarding local purchase of goods and services and the hiring of Kazakh nationals, and applies to all investment in offshore oil and gas exploration and production. The new law also requires that KazMunayGas, the national oil company, have a minimum 50 percent share in offshore projects, and it creates a new means by which the national oil company may obtain field rights outside of a tender process. Taken together, these clauses establish KazMunayGas as a necessary partner for international oil companies investing offshore, at least in the initial stages of an agreement.

In 2005, Kazakhstan added a controversial "pre-emption" amendment to its Law on Subsurface Use. The amendment guarantees the state a right of first refusal when a party seeks to sell any part of its stake in a mineral resource extraction project. The state claims this preeminent right even in cases where the controlling agreement assigns preemptive rights elsewhere (e.g. to other investors in a consortium.) The amendment applies the preeminent right retroactively, as well. This new amendment raises serious questions about the government's respect for contract sanctity.

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In October 2005, the government asserted even broader pre-emption rights under national law. The government now claims for itself pre-emptive rights when an investor seeks to purchase a company that possesses drilling rights. Theoretically, this latest assertion of pre-emptive rights (which has not yet been tested) could be read as a statement that the Government of Kazakhstan has a preferential right to purchase or prevent the sale of stock in any company that is involved in the oil, gas, or mining sectors in Kazakhstan.

The Law on Subsurface Use prohibits gas flaring except in emergency cases. Amendments adopted in October 2005 mitigate this requirement, providing for a transition period up to July 1, 2006, for subsurface users to draft and present to the government a program for gas utilization.

Kazakh law allows citizens of Kazakhstan and foreigners to own land under commercial and non-commercial buildings, including dwellings and associated land. Such land may be leased for up to 49 years. The new land code, which came into effect in June 2003, for the first time allows the private ownership by Kazakhs of agricultural land, in addition to industrial, commercial, and residential land. Foreign individuals and companies may still only lease agricultural land for up to 10 years, however, and the wording of the law is unclear with regard to the purchase of such land by local legal entities, either wholly-owned or joint ventures.

Kazakh authorities often require, as part of a foreign firm's contract with the government, that the firm contribute to social programs for local communities.

Foreign insurance companies are limited to operating in Kazakhstan through joint ventures with Kazakh companies. Overall capital of all foreign insurance companies may not exceed 25 percent of the non-life insurance market and 50 percent of the life insurance market. The total registered capital of banks with foreign participation must remain below 25 percent of the total registered capital of all banks in Kazakhstan. Foreign ownership of individual mass media companies is limited to 20 percent. Legislation is under consideration that would lift the restrictions on foreign participation in the registered capital of Kazakh banks, but would leave other restrictions in place.

Foreign investors continue to have difficulty obtaining work permits for employees who are not Kazakh nationals. A quota system established in 2001 limited the number of work permits for that year to 10,500, with exceptions for investors' lead representatives. The quota is set each year, based on a percentage of foreign labor as a share of the total national work force. Many companies report that permits for key managers and technicians are routinely rejected or granted for unreasonably short periods, or are conditioned upon demands for additional local hires. Companies also note that hiring regulations are confusing and interpreted inconsistently by local officials and by the Ministry of Labor and Social Protection.

The government, however, has been steadily increasing the number of work permits available. In 2003, the number of permits was limited to 0.14 percent of the economically active population (reckoned to be about 8 million people). The figure increased to 0.21 percent in 2004 and to 0.32 percent in 2005. In the first half of 2005, 15,086 foreigners held valid work permits.

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Kazakhstan adopted a new international commercial arbitration law in late 2004. The law sets the role for international arbitration institutions in Kazakhstan at all stages: from the adoption of an arbitration clause in a contract through the execution of an arbitral decision. The law defines the organizational and legal elements of arbitral proceedings in Kazakhstan, and the conditions for recognition and execution of arbitral decisions made in foreign states. In practice, the Government of Kazakhstan has not consistently observed international practices relating to arbitral awards.

OTHER BARRIERS

There are other structural barriers to investment in Kazakhstan, including a weak system of business law, a lack of effective judicial system for breach-of-contract resolution, and an unwieldy government bureaucracy. Many companies report significant logistical difficulties serving the Kazakh market. In addition, there is a burdensome tax monitoring system for all companies operating in Kazakhstan. Many companies report the need to maintain excessively large staffs in Kazakhstan to deal with the cumbersome tax system and frequent inspections.

In 2001, Kazakhstan adopted transfer pricing legislation that gave tax and customs officials the authority to monitor export and import transactions in order to prevent manipulation of export prices. However, foreign investors are concerned because the government rejected the use of OECD standards to determine proper market prices, creating instead a methodology that fails to account for all cost and quality differences. The government also holds that transfer pricing can take place even in transactions between unaffiliated parties.