KCS Country Risk & Threat Advisory

KCS Group Europe
Risk & Threat Advisory Paper

Political Risk Advisory Briefing: Kazakhstan
November 2018

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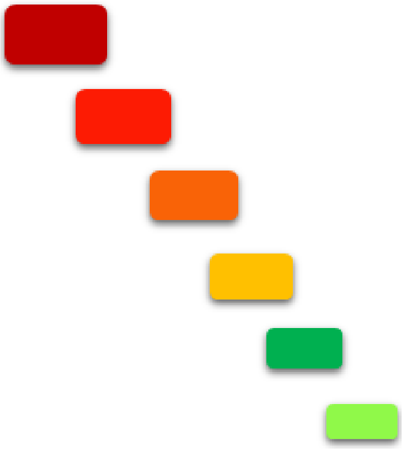
Country:	Kazakhstan
Population:	18,744,548
Source:	CIA World Factbook

Kazakhstan has a Possible risk rating of 3

6	**Very High**	The assorted threats described in the report are almost certain to have a derogatory effect.	
5	**High**	The threats are extremely likely to negatively affect the business.	
4	**Very Possible**	There is a strong likelihood of problems arising in this country.	
3	**Possible**	There is a fair chance of problems arising in this country.	
2	**Low**	There is a low likelihood of any threats impacting business.	
1	**Very Low**	There are virtually no impediments to successful business in this country.	



Kazakhstan, stuck between Russia, China and the Middle East, currently stands in the centre of a literal and figurative crossroads. Economically, the largest landlocked country at the world could be on the brink of great change. As the dominant Central Asian economy, the announcement of China's One Belt One Road (OBOR) policy has huge geopolitical ramifications for Kazakhstan and for Central Asia more broadly. Politically, however, Kazakhstan has been paralysed since its inception. It has still only seen one leader since independence. The dominance of state-run enterprises and corruption are still serious stumbling blocks; however, gradual change is palpable and even promising looking forward.

Politics

The country has been ruled with a vice-like grip by Nursultan Nazarbayev ever since the collapse of the USSR in 1990. Since then five elections have come and gone. Each one has returned Nazarbayev with an increasingly flattering result. In the most recent, in 2015, he gained 97.75% of the vote, on a turnout of over 95%. Opposition has been vehemently suppressed and each election has been criticised by the Organisation for Security and Co-operation in Europe (OSCE) for a plethora of reasons, including ballot-stuffing, restrictions on freedom of expression, voter intimidation, a lack of transparency, and wide ranging procedural violations.

The *Mazhilis* (Lower House) is dominated by Nazarbayev's Nur Otan (Radiant Fatherland), holding 84 of a possible 98 seats. The nominal opposition is made up of the Communist People's Party of Kazakhstan (7 seats) and Ak Zohl (7 seats), however both should be considered loyal to Nazarbayev and usually vote with the government. Most sources point to Nazarbayev, now 78, preparing his daughter, Dariga, to take over from him on his retirement or death. She was elected Vice Chairman of the *Mazilis* in 2014 and was Deputy Prime Minister between 2015 and 2016. The same daughter was also head of the main state-run news agency for some time, before becoming the head of the main opposition party between 2003 and 2006, a clear pointer to the token, nepotistic nature of Kazakh politics.

Recent changes to the constitution by Nazarbayev have weakened the position of any future President, yet solidified his infallible position as 'First President' and 'Father of the Nation', pointing to the start of a possible pre-emptive exit strategy, a changing of the guard and the altering of the political landscape in the years to come.

Corruption

Corruption is rife at all levels of government, judiciary and state-owned enterprises (SOEs). The familial relations and patronage of Nazarbayev extend deep into public sector business, according to the Organized Crime and Corruption Reporting Project (OCCRP). Ostensibly, elites are dependent on the President's 'patronage and indirectly control the parliament, government ministries, and major media outlets, while Nazarbayev himself appoints individuals to a range of top offices' (Freedom House). Eyebrows were naturally raised when, in 2008, Nazarbayev's 24 year old grandson, Nurali Aliyev, became Deputy President of the Development Bank of Kazakhstan, with a loan portfolio of over $4 Billion. Interestingly, his ostentatious displays of wealth and the possibility of embarrassment for his grandfather led to a hasty removal. One might make the assumption that at a certain level this shows the President is not completely impervious to public perception and image. However, within a year he had returned to public service as Deputy Mayor of Astana and is now the Akimat (Governor) of the capital. It's clear, then, that Nazarbayev's awareness of public image does not override his desire for control, through those closest to him, over positions of immense power and influence.

According to the Organisation for Economic Co-operation and Development (OECD) Kazakhstan has made significant steps to tackle corruption. However, 'public companies remain a source of great corruption risks' and 'unresolved issues regarding the separation of political and administrative posts, recruitment for service based on personal merit and payment of bonuses' remain widespread. Transparency International ranks Kazakhstan 122nd out of 176 countries on its 2017 Corruption Perceptions Index. Its 2017 Global Corruption Barometer also found that 29% of Kazakhs had paid bribes in the year to date to public institutions, including the police, judiciary, tax authorities and public services such as health and education. Clearly, in Kazakhstan corruption is pervasive from top to bottom. One positive that should be noted is that this in fact denotes a steep decline in corruption. Approximately 29% of Kazakh citizens said they paid a bribe this year compared to 39.9% in 2013. In addition, 37% of respondents noted the reduction of the corruption level over the past four years. Clearly, successful efforts have been made to reduce low level corruption. Clearly, though, those implementing decisions from above do not consider themselves bound by the same developments.

Foreign investors have complained about the irregular application and altering of laws and regulations by the Kazakh government as a way of extracting what essentially amount to bribes, according to a recent report from the US Bureau of Economic & Business Affairs. Tactics employed by the Kazakh tax authorities include 'unannounced audits', 'arbitrary tax inspections, problems finalizing contracts, delays and irregular practices in licensing', and 'criminal charges in civil disputes.' High environmental fines in the oil industry are used as a tool 'to generate revenue rather than for environmental protection'. Protecting oneself from unpredictable future legislation and government impositions clearly presents a very serious challenge to any foreign investor. More generally, western companies may find themselves at a disadvantage, with Russian and Chinese competitors more comfortable with acting less scrupulously when engaging with Kazakh officials.

This business environment is only compounded by the fact that there is no genuine anticorruption body in Kazakhstan and the media is strictly monitored to toe the party line. Any media outlet that speaks out against the government is quickly shut down. Seemingly, charges of corruption are predominantly levelled at those who have fallen from favour or fallen foul of political rivals. Whilst this does not clearly extend to foreign investors, businesses are often reluctant to challenge government actions in court due to the perceived sense that decisions were 'subject to political influence and interference due to a lack of independence' (US Department of State, 2017).

Economy & Business Environment

Kazakhstan is still heavily reliant on hydrocarbons and, despite a difficult climate in recent years, this has allowed it to leap ahead of other CIS neighbours, Russia aside, since the fall of the USSR. The Kashagan Oil Field is considered the largest find in the world in recent decades, with 13 billion accessible barrels. Currently producing approximately 350,000 barrels per day, this is expected to rocket in the coming decades, pushing the oil field into the top three oil-producing fields in the world by 2035. Much of this wealth has been pumped into the creation of a vast sovereign-wealth fund, Samruk-Kazyna, and the new capital, Astana, a symbol of Nazarbayev's intention to modernise the country. Since 2014 the economy has been reeling from the price of oil and, despite recent oil price increases, its currency (the Tenge) has lost more than half its value. Subsequent small, sporadic protests have been brutally crushed across the country and leading 'provocateurs' have been jailed.

Unsurprisingly, the immense size of the oil industry as part of the Kazakh economy makes it the go to cash cow of the government, who levy substantial fines on any alleged mismanagement or breach of contract from foreign investors, primarily for financial gain but also to strengthen any future negotiations. For example, in 2014 the Kashagan field operators were fined $737 million for burning off poisonous sulphur dioxide, something it argued was an emergency measure to prevent further environmental harm. Fines of this scale are not uncommon.

Furthermore, the pervasive nature of SOEs has had a restricting influence on the economy and entrepreneurship. ‘SOEs have suppressed initiatives of private business and the development of entrepreneurship," admitted the Kazakh Vice Minister of National Economy in 2015. Powerful interests and oligarchs will, naturally, prevent changes in business practices that are perceived to harm their position. According to the World Bank, the Kazakh economy is ‘hampered by various factors, such as the dominance of SOEs in the economy, the lack of skilled labor, some sector-specific challenges, macroeconomic vulnerabilities, as well as weak regional economic cooperation’. It is, supposedly, increasingly part of the government’s agenda. In 2016 it was announced that a dizzying array of companies across airline, oil, gas, mining, shipping, rail, energy and construction sectors would be privatised. In the past, according to Freedom House, ‘under President Nazarbayev’s rule, Kazakhstan has mastered the rhetoric of reform and democratization without demonstrating any genuine commitment to these processes’. However, the recent fall of the Tenge and oil prices has made assets more attractive to foreign investors and reignited a drive for privatisation. Hundreds of assets, whose valuations have plummeted in recent years, have already been sold, with hundreds more up for sale going forward. Foreign investors are being increasingly drawn in by the lure of cut price enterprises and the rapid removal of economic barriers by Nazarbayev. Privatisation decisions will be made on large assets, such as Air Astana, Kazakhtelecom and Kazatomprom in the coming year. Naturally, a thorough audit of any potential asset and the subsequent risks, past, present and future, is paramount to any prospective buyer.

The aforementioned lack of skilled labour should also be noted. Like many of the Central Asian states, Kazakhstan has suffered from a crippling case of ‘Brain Drain’ for years, predominantly to Russia. The lack of opportunities and entrepreneurial possibilities afforded to the young mean that, even if drastic measures are taken soon, the knock-on effects will be felt for decades. The large, better educated, more urban Russian contingent (21.5% in 2014, down from 37.4% in 1989) of the population with the ability to emigrate with relative ease only exacerbates the problem.

There are, however, some promising signs for foreign investors looking forward. The World Bank states that Kazakhstan jumped from 51st to 35th place on its ease of doing business rankings, with ‘big improvements in how straightforward it is to get construction permits or electricity. A new digital portal for basic interactions with the state has curbed low-level corruption. Officials used to demand bribes from applicants for business permits.’ (The Economist). The most exciting, tangible evidence of future progress is certainly the possibilities connected to China’s OBOR project and the vast Khorgos Rail Terminal on the Kazakh-Chinese border. It will become the biggest dry port in the world. Rising air and shipping freight costs have made rail transport an exciting, faster and viable new option. Volume is expected to eventually hit 30 million tonnes of freight per annum, an exciting new link bridging an increasingly interconnected and efficient Eurasian landmass.

These possibilities, however, are being hampered by difficulties from Kazakhstan's two main trading partners. The sanctions imposed on the Russian economy and a persistently weak rouble have had a strong knock-on effect on Kazakhstan, as has the slowing down of the Chinse economy. The over reliance on the Russian economy is possibly the single most daunting challenge facing both economic and, subsequently, political stability in Kazakhstan.

'Great strides', according to the OECD, have been made in recent years to attract Foreign Direct Investment to Kazakhstan. There is certainly truth to this. The country remains the most promising investment environment in the region. Enticing decade-long tax exemptions and refunds on capital investment, signed into law by Nazarbayev, have made Kazakhstan the region's stand out business prospect. Ernst & Young point to high investor confidence and satisfaction in country. In fact, it is at an all-time high, with 47.3% of respondents expecting Kazakhstan to become increasingly attractive over the next three years, in contrast to 41.4%, who thought so in 2013.

By all accounts, transport and logistical infrastructure are the main issues blighting an attractive business environment. Other issues cited by Ernst & Young include a desire for more open trade policies and a lack of ease in bringing in talent from abroad. Importantly, Kazakhstan only joined the WTO in 2015 after almost 20 years of negotiation, a decisive and tangible milestone.

Criminal Element & Terrorism

Terrorism is high on the agenda in Astana. It is an area where the state has had significant and prolonged success. As recently as March the National Security Committee Deputy Chair announced that the counter terrorism budget will quadruple to $837 million over the next five years. The security services have had notable success in the prevention of terrorist acts, 38 acts in the last five years. Despite this, Kazakhstan has rocketed up the Global Terrorist Index, from 94th to 67th in the year 2016-2017 alone.

Terrorist activity, after years of steady decline since 2006, has been on the rise over the last couple of years. Recently, the Prosecutor General's Office reported a rise in terrorist crimes, from 331 in 2015 to 554 in 2016. Most are small scale attacks on civilian and military targets.

Many sources point to the widening gap between rich and poor, rural and urban, and the oppressive nature of the state as areas that help foster the radicalisation of those most marginalised by Kazakh society. The economic difficulties of recent years have certainly created pockets of deep-seated resentment and this is perhaps the main driver of terrorism, above Islamic terrorist groups who have, for the most part, been largely frustrated and thwarted. Of course, with the defeat of armed groups in Syria and Iraq, the threat from returning fighters to Kazakhstan is very real. The number of Kazakh fighters active in those countries has, in the past, been put in the mid to high hundreds.

Foreign Affairs

Economically and politically, landlocked Kazakhstan remains heavily intertwined with Russia and, increasingly, with China. The simple matter of geography means that this is unavoidable to an extent. The creation of the Eurasian Economic Union (EAEU or, unofficially, EEU) is clearest and most recent development in this regard. Currently composed of Russia, Kazakhstan, Belarus, Armenia and Kyrgyzstan, other CIS countries may be willing to join in the future. Furthermore, many other countries have signed free trade agreements with the EEU, including China, Iran and Vietnam, widening economic integration as part of a strongly coordinated 'Pivot to Asia' policy. A concerted effort to counter poor trade between Central Asian states is also afoot.

EEU Membership has been offered to European former Soviet states, however most of whom have opted instead to try for EU membership. In conjunction with Kazakhstan's accession to the WTO in 2015, it has clearly signalled its intention to become a regional power in the coming decades by removing economic hurdles and promoting regional trade. China's push to develop its own interior will no doubt benefit the situation. However, the repeal of a law banning foreigners from purchasing land in Kazakhstan has, by many accounts, greatly angered Kazakh citizens and businesses concerned with the rising influence of China in the country.

Kazakhstan is keen to gain better access to Asian markets, having signed a raft of agreements with China covering a variety of sectors, predominantly energy and infrastructure based, but also in aviation, telecommunications and mining, areas where Kazakhstan is underdeveloped but has strong potential. Kazakhstan is clearly forging ahead at a much greater pace, in terms of economic reform and development, than the other Central Asian states.

Conclusion

In conclusion, the future is bright, if uncertain. There are certainly positive indications that steps are being taken that make the future of Kazakhstan a promising country in which to do business. The inevitable economic changes linked to the OBOR will have much broader ramifications long-term. Whilst the state is still a stifling, dominant player across the economy, the promised easing of business restrictions and the sale of vast numbers of SOEs points to a possible upturn in economic diversification and entrepreneurship. By all accounts, Kazakhstan has the most attractive business investment climate in the region. As always, however, the shadow of the ageing President looms large and public sector corruption persists. The arbitrary nature of governance and the implementation of laws and fines to extract capital, financial or otherwise, from investors is an area of real risk. Being able to identify threats and navigate this landscape is critical to success. The post-Nazarbayev political environment is an uncertain one and something that all foreign investors must consider and analyse thoroughly. One only needs to look across the border to Uzbekistan and Kyrgyzstan to see that post-Soviet political dynasties are not a forgone conclusion. For now, stability is tied to Nazarbayev.