

KAZAKHSTAN

TRADE SUMMARY

The U.S. trade deficit with Kazakhstan was \$219 million in 2004, a decrease of \$5 million from \$224 million in 2003. U.S. goods exports in 2004 were \$319 million, up 89.6 percent from the previous year. Corresponding U.S. imports from Kazakhstan were \$538 million, up 37.1 percent. Kazakhstan is currently the 85th largest export market for U.S. goods. The stock of U.S. foreign direct investment (FDI) in Kazakhstan in 2003 was \$5.4 billion, up from \$5.3 billion in 2002. The National Bank of Kazakhstan (NBK) calculated new U.S. FDI for the first half of 2004 to be \$700 million. Most investment in Kazakhstan to date has been in the oil and gas sectors. Kazakhstan's external position is at its strongest since independence, due to growing oil export prices. The petroleum sector accounts for almost one third of gross domestic product (GDP) and well over one-half of all export earnings.

The U.S.-Kazakhstan Bilateral Trade Agreement, which came into force in 1993, provides for normal trade relations (NTR) between the United States and Kazakhstan and governs other aspects of the bilateral trade relationship. A bilateral investment treaty (BIT) between the United States and Kazakhstan came into force in January 1994.

Kazakhstan submitted its application for World Trade Organization (WTO) membership on January 29, 1996, and the fact-finding phase of the accession process was completed in 2003. Kazakhstan's Working Party met in March and November of 2004, and the next meeting is expected to take place in the first half of 2005. While Kazakhstan hopes to enter the WTO in 2005, it has been slow to enact key reforms to make its trade regime WTO-compliant. Kazakhstan also lacks key enforcement mechanisms, even in areas where appropriate laws have been passed.

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 may be applied. These countries have not yet established a common external tariff. The EAEC is currently developing coordinated customs procedures that would reduce the cost of transshipping U.S. goods destined for Kazakhstan through the EAEC member states. Kazakhstan is also part of the Single Economic Space (SES) with Russia, Ukraine and Belarus, a nascent customs union. Although the four partners, with varying degrees of intensity, have made the political commitment to move forward with SES integration, the required implementing agreements and legal harmonization will likely not be completed until at least 2007.

FOREIGN TRADE BARRIERS

Tariffs

The simple weighted import tariff in Kazakhstan in 2004 was approximately 7.9 percent. In January 2004, the Value-Added Tax (VAT) was reduced from 16 percent to 15 percent. Imported goods are subject to the VAT on the value of the goods at the time of importation (VAT destination principle), except for oil and oil products imported from Russia, where the VAT is applied before export. Kazakhstan plans to adopt the destination principle for the VAT application for all imports in the context of WTO accession. In the interim, it has negotiated agreements to this effect with individual members of the Commonwealth of Independent States (CIS), e.g., Kyrgyzstan, Moldova, and Azerbaijan. Most recently, Kazakhstan's Parliament voted to ratify an additional protocol to Kazakhstan's agreement with Russia regulating collection of indirect taxes on bilateral trade that would apply the destination principle to all goods. The protocol will go into effect with the President's signature.

Goods imported for short-term use in Kazakhstan under the 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. Goods not eligible for duty exemptions have traditionally included food products, industrial wastes and consumables.

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

Customs Procedures

Kazakhstan's new Customs Code became effective May 1, 2003, superseding the law of 1995. There are positive changes in the Code, such as a provision intended to provide WTO-compliant customs valuation methodologies. However, as of January 2004, importers continued to report that customs officials were failing to comply with these methodologies. In addition, key provisions for such practices as voluntary disclosure are not included in the Code. In September 2004, the Customs Control Agency was subordinated to the Ministry of Finance; customs authorities previously reported directly to the Presidential Administration.

The Customs Control Agency continues 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 private 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 beyond existing duties and taxes. Courts have decided over 85 percent of all appeals under this system against the Customs Agency. In addition, Ministry of State

FOREIGN TRADE BARRIERS

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 must be closed out. This limits the range of business activity and creates a potential bias towards short-term financing in the economy.

STANDARDS, TESTING, LABELING AND CERTIFICATION

The present system of Metrology, Accreditation, Standards and Quality (MAS-Q) in Kazakhstan is weak and fragmented. Many businesses complain of mandatory certification requirements that have no purpose or technical basis. The Committee on Standards, Metrology and Certification, Gosstandart (the national governing body operating under the Ministry of Industry and Trade), undergoes frequent management changes that make stable, long-term progress difficult. Government enforcement of compliance with existing standards, testing, labeling and certification requirements continues to be uneven.

In 1999, two laws – "On Standardization" and "On Certification" – were enacted to bring these areas into compliance with international standards and practices. In 2000, the law "On Ensuring Uniformity of Measurement" was passed. In 2001, the Government adopted Resolution No. 590, which outlines a national Program for Quality for 2001-2005. These laws and the quality program are intended to bring Kazakhstan's MAS-Q system into general conformity with WTO requirements under the Technical Barriers to Trade and Sanitary and Phytosanitary Agreements. However, there has been little progress in the implementation of this program.

The Law on Certification requires that all imported products subject to mandatory certification requirements be accompanied by documents identifying the producer, the date of production, the expiration date, storage requirements and the code of use in both the Kazakh (state) and Russian languages. 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 not yet a member of the WTO Agreement on Government Procurement. With the support of the World Bank, Kazakhstan is reforming and harmonizing its system of state

FOREIGN TRADE BARRIERS

procurement. Some potential U.S. investors have raised concerns about the transparency and efficiency of the government tender process. In October 2002, Kazakhstan adopted "Rules for the Organization and Holding of State Procurement." These rules established a standardized format for publicizing tenders and specified in which newspapers the offers should appear, based on the newspaper's circulation and the tender's value. However, Article 26 of this law gives broad and seemingly unrestricted preferences to domestic suppliers in all sectors.

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. This legal structure strengthened the monitoring functions of the Agency, improved control systems, and provided independence in the selection of methods for high value procurements. 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 consider unwarranted state interference in even small tenders. Despite governmental promises to amend the Rules, they stand as originally written. However, there are have been no reports yet of attempts to enforce the Rules.

U.S.-funded assistance projects are helping Kazakhstan establish a database to assist in procurement. The database was launched by the State Procurement Agency in 2003 but remains a work in progress. Not all tenders are listed, and some Government offices contacted in January 2004 stated that they do not rely on the database but instead continue to use their own contact lists to publicize tenders.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Significant deficiencies remain in Kazakhstan's regime for the protection of intellectual property. Due to these deficiencies, a case remains pending to review Kazakhstan's status as a beneficiary country under the U.S. Generalized System of Preferences (GSP) Program. Kazakhstan has been on the Special 301 Watch List since 2000.

The 1992 U.S.-Kazakhstan Agreement on Trade Relations incorporates provisions on the protection of intellectual property rights (IPR). Kazakhstan has fulfilled a number of the agreement's obligations regarding intellectual property under the agreement, but several bilateral commitments remain yet unfulfilled. As a part of its effort to accede to the WTO, Kazakhstan took steps in 2004 to bring its IPR laws into compliance with the WTO's Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS Agreement).

In 2004 Kazakhstan ratified the World Intellectual Property Organization (WIPO) Copyright and Performances and Phonograms Treaties. The Kazakh Law on Copyrights was also amended to guarantee protection for pre-existing copyrighted works. In addition to legislative initiatives, Kazakhstan has worked cooperatively with law enforcement agencies, public organizations and international organizations to fight piracy.

FOREIGN TRADE BARRIERS

In October 2003, the Kazakhstan Ministry of Justice held a national campaign for IPR in accordance with the Justice Minister's decree of September 30, 2003, aimed at studying the cause of Kazakhstan's high incidence of piracy and developing an appropriate strategy for protecting IPR in Kazakhstan. The campaign was held to raise public awareness about IPR issues, including piracy and other illegal activities, develop methods of strengthening the working relationships between various state authorities concerned with IPR, improve law enforcement practices, and solicit suggestions from the public for improving IPR legislation. The campaign continued in 2004, when the IPR Committee of the Justice Ministry, among other activities, began publishing a quarterly journal on IPR issues.

Criminal penalties for IPR violations were adopted in 2001, but the United States remains concerned about the effectiveness of these Criminal Code provisions in deterring piracy and counterfeiting due to the high burden of proof required of prosecutors. It remains unclear whether new criminal penalties for IPR violations will be effectively enforced and will deter piracy. U.S. industry reports that it is difficult to obtain judgments in infringement cases and that this serves as *de facto* encouragement for future trademark piracy. In 1999, Kazakhstan also amended its Customs Code to provide for the seizure at the border of items that violate IPR laws. However, illegal material, including illegal sound recordings, continues to be imported, particularly from Russia and China.

SERVICES BARRIERS

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

INVESTMENT BARRIERS

Kazakhstan's new Investment Law, passed in January 2003, supersedes and consolidates past legislation, but according to major investors and law firms, represents no marked improvement over previous laws. There is concern about the Law's narrow definition of investment disputes, lack of clear provisions for access to international investment arbitration, and little stability protection for contracts signed after the law went into effect. More positively, however, the Investment Law eliminates time limits for stability clauses for existing contracts, and in some cases, most notably oil and gas, gives precedence to sector-specific legislation.

For several years, there has been a growing trend 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 2003. The decree creates onerous requirements for government involvement in, and approval at, each stage of private companies' procurement processes.

FOREIGN TRADE BARRIERS

Kazakhstan recently 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 specifically applies the preeminent right retroactively as well. This new amendment calls into question Kazakhstan's commitment to contract sanctity.

The Law on Subsurface Use allows both 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. In June 2003, a new Land Code came into effect, which, for the first time, allows Kazakh citizens to privately own agricultural, industrial, commercial and residential land. However, foreign individuals and companies may still only lease agricultural land for up to 10 years, although the wording of the law is unclear with regard to 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 Kazakhstani companies. Overall capital of all foreign insurance companies should 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 is less than 25 percent of the total registered capital of all banks in Kazakhstan. Foreign ownership of individual mass media companies is limited to 20 percent.

Difficulty in obtaining work permits for foreign investors' employees in Kazakhstan continues to be a problem. In 2001, a quota system was established that limited the number of work permits to 10,500, with exceptions for investors' lead representatives. The quota is set each year, based on a percentage of the total national workforce. 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 the regulations are confusing and interpreted differently by various local officials and the Ministry of Labor and Social Protection.

Although Kazakhstan is a signatory to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, there is one arbitral award (arbitrated through the World Bank's International Centre for Settlement of Investment Disputes, as provided for under the U.S.-Kazakhstan Bilateral Investment Treaty), which the Kazakh government has neither paid nor attempted to have annulled.

FOREIGN TRADE BARRIERS

OTHER BARRIERS

There are other structural barriers to investment in Kazakhstan, including a weak system of business law, a lack of effective judicial process for breach-of-contract resolution, and an unwieldy government bureaucracy. Many companies report significant logistical difficulties serving the Kazakhstani market. In addition, there is a burdensome tax monitoring system for all companies operating in Kazakhstan. Many companies report that they need to maintain atypically large back-office operations in Kazakhstan to deal with the 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 stop distortion of earnings through manipulation of export prices. 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.