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# The U.S.-Kazakhstan Transitioning Relationship

## Supporting a Rising Middle-Income Power

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### Overview

As the Soviet Union collapsed in 1991, Kazakhstan was one of 15 former Soviet republics that declared independence. In the 25 years since then, Kazakhstan has seen steady economic growth and raised its gross domestic product (GDP) from \$18.3 billion in 2000 to \$212.3 billion in 2014. As Kazakhstan's second largest trading partner behind Russia, the United States should view Kazakhstan as an important economic and strategic partner in Central Asia and work to ensure that Kazakhstan follows the path of other middle-income countries such as South Korea. Secretary of State John Kerry's trip to Central Asia this week is a reminder of the continued ties that the United States has in the region.

In order to encourage a closer economic relationship, the United States should actively support Kazakhstan's ongoing engagement with the Organization for Economic Cooperation and Development (OECD), with the ultimate goal of Kazakhstan joining the OECD. Furthermore, Kazakhstan should commit to: (a) improving transparency; (b) increasing accountability; and (c) cutting corruption. We have [discussed the strong ties between good governance and economic growth](#) previously, especially when coupled with citizen participation. These three areas will help secure OECD membership for Kazakhstan in the future, moving the country toward better governance and a stronger relationship with the United States.

Though Kazakhstan has made significant progress in a number of areas, consistent effort is required to address governance and human rights issues. This is not the first time that the U.S. government has worked with a rising middle-income power with a troubling human rights and governance record. This was true in the case of South Korea when U.S. foreign assistance programs ended in 1980. At that time, South Korea was a growing economic power, regional security partner of the United States, and deeply authoritarian government. Yet for strategic and economic reasons, the United States remained engaged with South Korea: in the place of foreign aid programs, the two countries constructed a series of binational institutions (e.g., the U.S.–Korea Foundation) that sought to deepen ties. These ties laid the groundwork for the close

relationship that remained as South Korea transitioned to a multiparty democracy in the late 1980s.

In the case of Kazakhstan, the United States faces a similar situation, and though there are challenges, the opportunity is immense. Kazakhstan wants to diversify away from a simple choice between its traditional partner—Russia—or its encroaching neighbor—China. There are a number of areas where the United States can play a role in supporting Kazakhstan’s transition. **First, the United States should identify a small amount of foreign assistance resources to assist Kazakhstan’s implementation of the Bali Trade Facilitation Agreement** (see below for a greater discussion of trade and Kazakhstan). Kazakhstan will ratify membership in the World Trade Organization (WTO) in December, immediately before the WTO ministerial meeting in Kenya where countries are to submit their programs of action for the Trade Facilitation Agreement. This is important not only for U.S.-Kazakhstan relations; it will also help Kazakhstan realize its ambitions to be a regional trade hub and to further regional trade integration—Central Asia is one of the least integrated regions in the world.

**Second, the two nations should work to create a binational foundation that would promote U.S.-Kazakhstan cooperation in trade, investment, and good governance.** The United States should use remaining foreign assistance dollars in Kazakhstan to seed such an organization, seeking matching funds from the government of Kazakhstan, as well as engaging the private sector. The fund could be established with an endowment or it might be set up as a sinking fund to be spent down. Such a binational foundation could also work to improve governance by supporting independent civil society and independent media, promoting other transparency initiatives, and deepening trade and people-to-people ties.

The most recent [Doing Business Indicators for Kazakhstan](#) reflect room for improvement in transparency for the business environment, receiving six out of a scale of zero to nine on the corporate transparency index. Developing approaches to citizen-based service delivery by encouraging citizen participation in policymaking, monitoring, and evaluation should frame Kazakhstan’s approach to increasing transparency. With 43 percent of Kazakhstanis living in rural areas and 4 out of 16 oblasts providing 47 percent of Kazakhstan’s GDP, simplifying the strategic planning process and increasing citizens’ access to decisionmaking would foster greater transparency.

Kazakhstan has taken some important steps toward improving accountability, most notably a [comprehensive tax system reform in 2010](#), and is currently ranked 17th globally for its tax system. However, the government of Kazakhstan still has significant work to do in terms of decentralization; clarifying levels of government and roles and responsibilities of cabinet members, ministries, and subnational organizations is critical.

**Finally, Kazakhstan needs to confront grand corruption.** Corruption is a tax on business, as we have written [previously](#), and corruption endangers the legitimacy of any government. As Kazakhstan begins to consider what a post-Nursultan Nazarbayev government looks like, a transition’s odds of success will be higher if corruption is confronted now. For all its progress on

the Doing Business Indicators, [Transparency International still ranks Kazakhstan 126 out of 177 globally in terms of corruption](#), citing the highest levels in judiciary, police, customs, property rights, land registration, and construction projects. Many developing countries have taken steps to reduce corruption and Kazakhstan should follow that well-worn path.

To guarantee U.S. support, the government of Kazakhstan can undertake a number of key practices to reinforce its dedication to good governance. These include:

- Kazakhstan must remain committed to the governance reforms outlined in President Nazarbayev's reform program—the 100 Steps. Though the country is widely seen as a stable and safe destination for investment, over time there is the possibility that, as incomes continue to increase, citizens will demand greater accountability and transparency. This would be a laudable outcome; if Kazakhstan does not manage this properly, it could lead to instability, and therefore the government must remain committed to governance reforms that will address citizens' future demands.
- [Kazakhstan ranks poorly on strength of government protection for minority investors in the Doing Business Indicators](#). Kazakhstan can facilitate a better investment climate by targeting the roots of these low scores through well-defined practices. Clearly delineating these processes and responsibilities for civil servants will increase accountability and reduce opportunities for corruption.
- Kazakhstan should undertake an OECD integrity review for its ministerial departments. Once roles and processes are better defined, undertaking this review would reaffirm Kazakhstan's commitment to OECD standards for its member states. [It should seek participation in OECD's "Enhanced Engagement" program, which acts as a transitional step for an eventual accession process.](#)

Kazakhstan has demonstrated impressive progress and has defied many who believed that the country would collapse quickly following independence from the Soviet Union. Its next steps will require even greater political will. Increasing accountability and fighting corruption will be difficult tasks. Unlike other partners, the United States offers a genuine partnership built on shared interests and mutual benefits. The United States and other partners to Kazakhstan should remain engaged because we have a willing and capable partner in Kazakhstan. If the United States does not engage fully, then others will.

## Integrating Kazakhstan into the Global Trading System

In the 2012 CSIS report [on middle-income countries](#) (MICs), the authors concluded that in countries that have made sufficient economic progress, the United States needs to transition away from assistance-based relationships and toward robust engagement on trade, investment, and other mutually beneficial forms of cooperation. Kazakhstan offers yet another example of a country that is transitioning away from a foreign assistance-based relationship and ready for deeper cooperation on technical and strategic issues. In particular, simplifying and harmonizing

international trade procedures, a process known as [trade facilitation](#), is an important step for Kazakhstan as it looks for deeper international and regional economic integration. Kazakhstan could, for example, become a logistics and shipping hub connecting East and West and serve as a bridge among trading partners across the Eurasian land mass. Opportunities exist to develop stronger agricultural value chains, as well as to provide offshore and onshore services and supplies to the oil and gas sector. Kazakhstan could also position itself to be the site of regional distribution hubs and high-technology global value chain centers.

Since independence, Kazakhstan has experienced steady, strong economic growth. Kazakhstan's [poverty rate](#) dropped dramatically from 47 percent in 2000 to 3 percent in 2013, and [GDP per capita](#) is roughly \$13,000, ranking ahead of both China and Brazil. The recent downturn in oil prices, stumbling global demand for other raw material inputs, and ongoing U.S.-led sanctions against Russia have dampened economic expectations in Kazakhstan for the short term, but they also provide an opportunity for pursuing structural reforms that might not otherwise be plausible. The new national budget is based on [oil prices of around \\$50 per barrel](#), and there is clear recognition within the government that Kazakhstan must continue to diversify its economy. Kazakhstan maintains deep economic ties with Russia, and international sanctions on Russia have impacted trade, investment, and remittances from Russia to Kazakhstan. While increased economic engagement with China can help fill some of this gap—[trade between China and Central Asia](#) has grown from \$1.8 billion in 2000 to \$50 billion in 2013—Kazakhstan should diversify its trade relationships beyond China.

Kazakh leaders seem prepared to make the financial and political investments necessary to drive economic progress. With growth expectations for 2015 down significantly to around 2 percent, the government has announced a multiyear fiscal stimulus package known as Nurly Zhol (Bright Path), totaling [approximately \\$20 billion](#). The package is being financed jointly through the national oil fund ([estimated to total roughly \\$77 billion](#)) and multilateral development banks. This aims to modernize infrastructure while promoting private-sector development with a focus on small and medium-sized enterprises.

Kazakhstan was approved for WTO accession this July, a process that has taken nearly 20 years to complete, and this should increase Kazakhstan's ability to trade with partners beyond the Eurasian Economic Union. All of these steps point toward commitment to economic change from the highest levels of Kazakh government. Kazakhstan will ratify the [WTO Trade Facilitation Agreement](#) this December as an additional step toward increasing international trade flows and creating the environment to establish itself as an international trade and logistics hub for the region.

For Kazakhstan to establish itself as a strategic trade, logistics, and technology hub in the region, and to participate in vital global value chains, it needs to address urgently its ranking in the [Doing Business Indicators](#) for ease of trading across borders, which ranks Kazakhstan 185 out of 189 countries. It is well accepted in international development circles that a strong or improving performance in Trading Across Borders is crucial for fostering sustained economic growth and is the engine for trade market sector development. Removing barriers to a wide range of border

services can improve private enterprise productivity and help improve economic growth and job creation.

Further economic analysis suggests that small and medium-sized enterprises (SMEs) in countries that have a strong trade enabling framework and well-developed registries have greater access to markets and improved performance with regard to economic growth and lower costs of trade. A constrained volume of exports and imports remains one of the top limitations on economic growth in Kazakhstan. Until Kazakhstan is able to address the impediments to free flowing goods and services, both in terms of hard infrastructure and burdensome regulation, its ability to integrate into the modern global economy will be limited. The indicator for Trading Across Borders illustrates a critical opportunity for the country, which needs to be given top priority.

Kazakhstan relies heavily on aviation for trade and economic development. In order to raise its prominence as a hub for tourism, natural freight, and transportation, Kazakhstan needs to implement an aviation strategy aimed at improving its aviation infrastructure, which will enhance the quality, safety, and efficiency of air services provided. By taking advantage of its location, Kazakhstan could develop transportation hubs for technology and high-end value chains, encouraging efficient transshipment. Tourism could also be a cornerstone of aviation development, as well as a lead contributor to the local economies. Aviation development in Kazakhstan could be achieved through the modernization of its regulations, a controlled opening of traffic rights, aviation infrastructure planning, and an organized air service development.

Kazakhstan and its partners should work together to:

- Establish a direct flight to the United States (New York) and open new aviation traffic rights to foreign air carriers that will allow greater flexibility to carry traffic beyond Kazakhstan. The freedoms of the air are a set of commercial aviation rights granting a country's airline the privilege to enter and land in another country's airspace. Modern civil aviation and open skies agreements allow for passenger and cargo carriers to go beyond third and fourth freedom rights that allow foreign carriers to drop off and pick up traffic between their two countries. To have true connection of East and West, it is crucial to allow air carriers to pick up and go beyond to a third country, known as fifth freedoms. Further, to create efficient transshipment and attract viable transportation hubs for technology and high-end global value chains, it would be imperative to allow air carriers to have originating flights from Kazakhstan, or seventh freedom rights. Finally, in a truly liberalized civil aviation market, Kazakhstan might consider opening domestic civil aviation rights through eighth or ninth freedom cabotage rights or opening investment opportunities in national carriers.
- Ratify the WTO Trade Facilitation Agreement and then quickly notify the WTO of Category A, B, and C commitments under the agreement. This process will help Kazakhstan identify areas where it can enact rapid change, as well as provisions that may require assistance to be enacted. Priority attention could be made to initiatives that will make the most immediate impact on attracting air carriers to use Kazakhstan as a hub and inducing corporations to nestle near those hubs. Electronic pre-clearance, risk assessment, *de minimus* single manifest

for low-value shipments, and separation of release from payment, with a goal to meet or exceed global best practices of clearance times and procedures, would all serve as key initiatives.

- Upgrade aviation and aerodrome infrastructure and increase the number of international airports in strategic regions of the country, thereby increasing efficiency of air services through the adoption of more advanced technologies and improving air service quality and safety.
- Streamline border processes for faster and more reliable trade. Kazakhstan is attempting to move toward a single window system, and donors should be ready to support these efforts, as well as initiatives in the WTO Trade Facilitation Agreement. Kazakhstan can significantly improve its processes for clearing goods and handling of documents to reduce transaction time and costs at the border. Experience shows that this is likely caused by several potential issues, which can include complex export and import processes and procedures; high costs to manage and control cargo; a legal framework showing no appropriate new trends of more open borders; lack of adherence to the World Customs Organization's (WCO) Revised Kyoto Convention (RKC); and deficiency in obtaining other border agency permits on time and in a simple manner.
- Address “behind the border” reforms to facilitate trade. Kazakhstan has done an admirable job fomenting economic development across its vast reaches, but the social and economic impacts of development can be enhanced and disseminated further to small and medium-sized businesses. Kazakhstan must continue to pursue reforms that make it easier for businesses to access finance, complete registration procedures, and clear customs. This is particularly true for SMEs that need to reduce transaction costs in order to be competitive in international markets. Institutions at the federal level, such as KAZNEX Invest and the Ministry of Investment and Development, should work with the private sector, provincial government, and other institutions to develop and enhance connections between large foreign businesses and SMEs, creating backward and forward linkages to promote employment and enterprise development.

Falling oil prices, shifting geopolitical realities, and readily available investment provide the impetus for Kazakhstan to pursue an ambitious economic development agenda. To date, Kazakhstan has demonstrated the political will to make these changes; the United States should support Kazakhstan and hold Kazakhstan accountable as it pursues these and other reforms.

## Kazakhstan as an Emerging Donor

Since independence from the Soviet Union 24 years ago, Kazakhstan has increasingly financed its own development. Today, Kazakhstan also extends financial support and shares its experience with neighboring countries in Central Asia. Its evolving leadership role in the region is reflected in strong GDP growth—from [\\$18.3 billion](#) in 2000 to [\\$212.3 billion](#) in 2014—and in its resulting upper-middle-income country status. This regional leadership role demonstrates Kazakhstan's

desire to see its neighbors progress, contributing to a stable and prosperous region where robust trade and mutually beneficial cooperation help to create new opportunities.

Kazakhstan is now the third-largest aid donor in the region after the United States and the European Union and has provided more than \$100 million in foreign aid since independence. This includes substantial humanitarian aid to Ukraine, Tajikistan, and Afghanistan. The country is also the top investor in Georgia and Kyrgyzstan. In 2010, Kazakhstan initiated a [\\$50 million, five-year program](#) to educate 1,000 Afghan students in Kazakh universities. As of February 2015, 827 students had enrolled in the program, and many had returned to Afghanistan with a bachelor's or graduate degree. The program was extended this year.

Kazakhstan follows the trend of several other “emerging donors” that are driven by geopolitical and economic interests, regional concerns, and the desire to share expertise from their own experiences as developing countries. These emerging donors are defined as those that provide development assistance to other countries; are not part of OECD's Development Assistance Committee (DAC) or joined it in the last decade; and were formerly recipients of foreign aid or are currently still receiving some assistance. There are currently [38 recognized non-DAC donor countries](#). In 2012, emerging donors contributed 7–10 percent of all foreign aid dollars; this contribution is expected to grow to [20 percent by 2020](#).

In addition to important funding and other resources, emerging donors offer the local expertise and linguistic and cultural understanding that traditional donors often cannot. This is certainly the case with Kazakhstan. The UN Development Program has said it prefers to send Kazakh technical experts to neighboring countries. Kazakhstan's government views the country as a success story with translatable lessons for its neighbors' development.

In 2014, the Kazakh parliament passed legislation to create a foreign assistance agency, [KazAID](#), with the primary mandate of sharing expertise with and spurring development in the Central Asia region. Afghanistan will be a specific focus of the new agency. While some [citizens are wary](#) of directing funds away from Kazakhstan's own [ongoing development needs](#) including infrastructure and healthcare, the government views regional integration and reducing barriers to trade as a priority given that Central Asia is one of the least integrated regions in the world.

Kazakhstan's aid program reflects a greater desire for partnerships and connectivity. The country is one of four that have an individual partnership program with OECD. While the country is progressively graduating from UN aid programs, it hopes to keep working with UN institutions that remain in the country to apply their technical expertise to regional development challenges.

This year the country established “Central Asia Plus One,” a forum for Central Asian countries and the United States to share information about what is happening in Central Asia, facilitate cross-border trade, and discuss strategies for human rights and democracy development. Kazakhstan is looking to develop the policies and systems that will enable it to be one of the top 30 developed countries by 2050. The government faces challenges with regard to public-sector

integrity, responsive and inclusive governance, and the rule of law that could impede its continued progress. It has also acknowledged the necessity for continued infrastructure development and trade capacity building and is working to diversify the economy further away from oil and mineral resources.

As part of this search for greater connectivity, Kazakhstan is seeking broader ties with the United States. It is currently looking for greater commercial engagement from U.S. companies and is working to diversify the economy further away from oil and mineral resources. Kazakhstan intends to stop receiving bilateral assistance from the United States while at the same time deepening its relationship with the United States.

Importantly, Kazakhstan would benefit from a formal institution, such as a bilateral foundation, endowed with funds from the Kazakh government, U.S. government, and relevant corporate partners. Kazakhstan could follow the path of Costa Rica, Portugal, and others that have established binational foundations when a U.S. assistance program has ended. Such foundations pay for expertise, exchanges, and scholarships and can serve as focused think tanks on the bilateral relationship.

As it seeks to solidify its role as a donor and leader of development within the Central Asia region, Kazakhstan and the United States should look to the following approaches.

Kazakhstan should:

- *Prioritize participation in the OECD.* The United States should support Kazakhstan in its efforts to meet the country requirements for OECD membership.
- *Continue to build and support the “Central Asia Plus One” forum as a platform for dialogue and action on the development challenges facing the region.* The United States should expand its involvement in this forum to support a more connected, democratic, and prosperous Central Asia.
- *Create a U.S.-Kazakhstan binational foundation jointly funded by the U.S. government, government of Kazakhstan, and the private sector.*
  - The United States and Kazakhstan should host a joint conference to plan the scope of work for the binational foundation.
  - Recognizing that Kazakhstan faces ongoing challenges to its government’s transparency, rule of law, and human rights record that will impede its economic progress and effectiveness as a donor, the binational foundation should prioritize examining these issues and developing approaches for reform.
  - The binational foundation should additionally focus on the following topics: supporting trade missions, deepening travel links, facilitating student and people-to-people exchanges, funding specific U.S. and Western experts in Kazakhstan,

financing “triangular cooperation,” and deepening civil society with a goal of advancing the creation of a multiparty democracy.

The United States should:

- Encourage UN agencies to remain in Kazakhstan to pursue regional projects and provide technical expertise and guidance to local reform efforts.
- Continue bilaterally, or perhaps through the World Bank, the Asian Development Bank or the European Bank for Reconstruction and Development, to assist Kazakhstan to operationalize its foreign aid program through KazAID.
- Identify next steps in its bilateral trade relationship with Kazakhstan in order to deepen those ties.

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