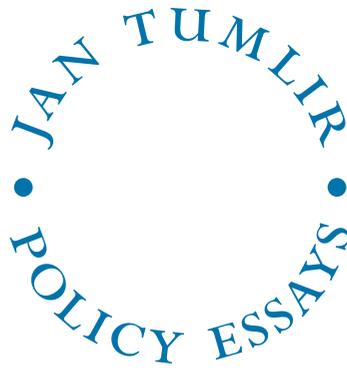


KAZAKHSTAN AND  
THE WORLD ECONOMY:  
An assessment of  
Kazakhstan's trade policy  
and pending accession to  
the WTO

By Brian Hindley

Number 01/2008

A circular logo with the text "JAN TUMLIR" at the top and "POLICY ESSAYS" at the bottom, separated by two small black dots on either side. The text is in a serif font and is arranged in a circle.

JAN TUMLIR  
POLICY ESSAYS

**About Jan Tumlir:** The late Jan Tumlir was a leading scholar of trade policy, with a distinctive constitutional, classical-liberal defence of free trade drawn from his reading of law and economics. A Czech by origin, Jan Tumlir emigrated to the West in the 1940s and in 1967 became the Director of Economic Research and Analysis at the General Agreement on Tariffs and Trade (GATT). He supervised the economic research of the GATT for almost two decades, and was known as the GATT’s “resident philosopher”. Tumlir emphasised the structural nature of protectionism as the outgrowth of overactive government at home. He strongly advocated a rule-based international economic order pillared on free trade and constitutional democracy.

- Read more about Jan Tumlir at [www.ecipe.org/tumlir](http://www.ecipe.org/tumlir)

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JAN TUMLIR POLICY ESSAYS  
No. 01  
March, 2008  
ISSN 1653-8986

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## **EXECUTIVE SUMMARY**

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KAZAKHSTAN HAS BEEN negotiating accession to the World Trade Organization (WTO) for twelve years. Long accession processes have not been unusual since the creation of the WTO, which covers more policy areas than the GATT, many of which are of greater complexity and political sensitivity.

What sets Kazakhstan-- and other countries within its region -- apart from WTO applicants in general is that it is an economy in transition. In a country where degrees of commitment to economic and trade liberalization are often uncertain, and reform speed and strength can vary between sectors of the domestic economy, negotiating the commitments required to join an organization such as the WTO is even more complicated.

WTO membership is a matter of economic strategy, and this study is chiefly concerned with such considerations. For Kazakhstan, though, the decision to join the WTO also involves geopolitical concerns. In the light of these legitimate concerns, this study sketches trade-policy alternatives and what these entail.

The past decade of economic reforms in Kazakhstan bodes well for WTO membership. However, a closer look at current international economic and trade policy shows the persistence of trade barriers that offset reform progress elsewhere, and that will be challenged in their accession negotiations. Policies likely to be challenged are discriminatory taxes, the transaction passport, TBT and SPS standards, tariff peaks, and investment barriers.

THE RESULTS OF an econometric study show that membership of the WTO would only lead to small static effects on trade. Kazakhstan has already liberalized its trade policy considerably, and the majority of its own exports are made up of oil and minerals, which are not covered by WTO agreements. Therefore, benefits will primarily come through the import side. Given the small immediate benefits of WTO accession, it can be argued

that the “price of membership” that the WTO asks Kazakhstan to pay should be low.

WTO membership, however, will provide Kazakhstan with a lock-in mechanism that can help the country to increase investor confidence. Furthermore, accession will have a more profound effect on Kazakhstan’s trade and economic welfare if it is combined with further institutional reforms and increased investment openness. If Kazakhstan attained a similar level of institutional quality as in the European Union, quantitative assessment suggests that trade can increase by 75 percent.

ACCESSION TO THE WTO is likely to have a positive influence on Kazakhstan’s regional trade agreements and lower the diversion of trade that these various agreements threaten. Kazakhstan has committed itself to deepen regional trade integration with Russia and other neighbours, but quantitative analysis shows that such political priorities may be economically costly to Kazakhstan. Kazakhstan already trades too much with some of its regional members, and, consequently, too little with other parts of the world. Regional integration will increase this bias, whereas Kazakhstan should be directing its efforts towards reversing it. Kazakhstan’s WTO accession, though, is complicated by its entanglement in a wider political and economic complex emerging from Russian pre-eminence and claims to such pre-eminence in the former Soviet Union. The complexity of the situation is compounded by Russia’s own difficult WTO accession process. Kazakhstan is economically and strategically strongly aligned to Russia, and taking the step of accelerating WTO accession without waiting for Russia demands strong political resolve by the Kazakh government. Europe and the United States seem to support the “Russia first” policy in the CIS, though by default rather than actively. However, if they wish to see Kazakhstan anchored in the multilateral trading system, a stronger resolve to finalize the process in collaboration with Kazakhstan may be required.

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## LIST OF ABBREVIATIONS:

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ADB	Asian Development Bank
AFTA	ASEAN Free Trade Area
APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
BIT	Bilateral Investment Treaty
BTA	Bilateral Trade Agreement
CA	Central Asia
CARs	Central Asian Republics
CEPT	Common Effective Preferential Tariff
CES	Common Economic Space
CETS	Common External Tariff Schedule
CIS	Commonwealth of Independent States
CU	Customs Union
EAEC	Eurasian Economic Community
EBRD	European Bank for Economic Reconstruction
ECO	Economic Cooperation Organization
ECOTA	ECO Trade Agreement
ERP	Effective Rate of Protection
EU	European Union
FDI	Foreign Direct Investment
FIE	Foreign Invested Enterprise
FTA	Free Trade Agreement
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
IISD	International Institute for Sustainable Development
IMF	International Monetary Fund
MFA	Multi-Fibre Agreement
MFN	Most-Favoured Nation
NATO	North Atlantic Treaty Organization
NTB	Non Tariff Barrier
RTA	Regional Trade Agreement
SAGIA	Saudi Arabian General Investment Authority
SCO	Shanghai Cooperation Organization
SES	Single Economic Space
SME	Small and Medium Enterprises
SPS	Sanitary and Phyto-Sanitary standards
TBT	Technical Barriers to Trade
TIFA	Trade and Investment Framework Agreement
TRIMS	Agreement on Trade-Related Investment Measures
TRIPS	Agreement on Trade-Related Aspects of Intellectual Property Rights
US	United States
WTO	World Trade Organization

## CHAPTER I. INTRODUCTION: KAZAKHSTAN AND THE WTO

KAZAKHSTAN APPLIED FOR membership of the World Trade Organization (WTO) in 1996. Twelve years later it is still not a member. Long accession negotiations are not unusual: it took 15 years for China to become a member, in 2001. Russia applied in 1993 and is still not a member. During the GATT years, accessions could usually be achieved more quickly. But the WTO covers more policy areas than the GATT, and extended accession negotiations are one consequence. Furthermore, the accession process has become more political: the issues subject to negotiation and reform are at the heart of domestic politics. Geopolitical considerations may also be involved. Yet the key fact behind longer accession negotiations is that many recent new members, and several countries in the process of acceding, are in transition: moving from command economy to market economy. That transition entails a fundamental reorganization of economic and political structures. New institutions, policies and economic perceptions do not take root overnight.

KAZAKHSTAN IS NO exception. It was a late reformer. Some of the countries that emerged from the break up of the former Soviet Union immediately embarked on radical economic reform, but Kazakhstan did not commit itself to reform until the late 1990s. Once started, however, its reform programme quickly changed the nature of economic policy in Kazakhstan. Helped by a boom in commodity prices, reform has been followed

by surging economic growth. Within eight years the size of the economy, measured in dollars, has quadrupled, improving considerably the quality of life for many Kazakhs.

GEOGRAPHY DOES NOT make it easy for Kazakhstan to become a successful trading nation. It is a landlocked country, distant from key world markets. It was once a stop along the Silk Road, but it is today surrounded by developing countries with poor transport infrastructure and dubious economic track records. Yet trade and foreign direct investments have been central to Kazakhstan's recent prosperity. Its stellar economic performance would not have been possible without increasing economic integration with the outside world, primarily its export of commodities (which accounts for around 80 percent of its total exports). This study takes stock of Kazakhstan's economic reforms and trade status and analyses issues surrounding its application for membership of the World Trade Organization. The study assesses the costs and benefits that will accrue to Kazakhstan from joining the WTO, and analyses the impact of membership on its trade policy and commercial strategy. WTO membership is a matter of economic strategy, and this study is chiefly concerned with such considerations. For Kazakhstan, though, the decision to join the WTO also involves geopolitical concerns. In the light of these legitimate concerns, this study sketches trade-policy alternatives and what these entail.

## CHAPTER 2. ECONOMY OF KAZAKHSTAN: AN OVERVIEW

THE ROLE AND economic significance of the countries of Central Asia have been transformed over the past decade. High oil and commodity prices have been a key factor in their impressive growth, but growth has also followed post-independence reforms in economic systems.

Economic reform in Kazakhstan has been more comprehensive than in some other countries in the region. Underlying reform in Kazakhstan is a desire to integrate more deeply with the global economy and to establish Kazakhstan as a significant player in global markets. A closer look at what has actually been achieved so far, however, reveals a mixed picture of economic change, success and persistent problems. Economic development over the past decade has been dependent on oil and mineral exports, coupled with capital inflows, and the impressive growth rates witnessed in Kazakhstan mask ongoing problems within the country and concerns with domestic economic management by the government. This chapter focuses on some of the key areas of economic reform to build a picture of how Kazakhstan has developed since independence.

### 2.1 Stages of Economic Reform and Growth

#### Post-Independence: 1991 – 1994

THE FIRST FEW years of independence were characterized by economic instability and decline. The break up of the Soviet Union brought with it a collapse in demand for the heavy industry products that Kazakhstan had traditionally exported in the Soviet system, and the economy contracted. The steepest decline occurred in 1994, when GDP fell by 12.6 % (Rakhmatulina, 2006).

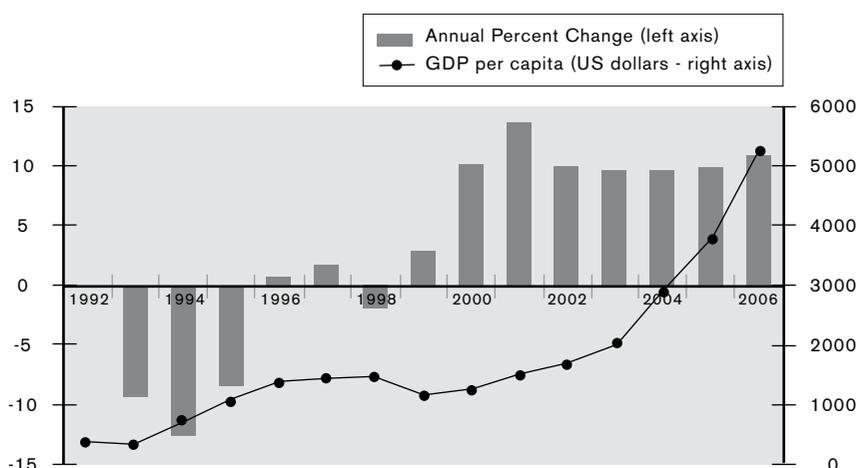
#### 1994 – 2000: Macro-Economic Development

IN THE MID-1990s, these pressures forced the government of Kazakhstan to take more seriously the idea of economic reform. Kazakhstan launched strategies such as “Kazakhstan 2030. Prosperity, security and improve-

ment of welfare of the citizens of Kazakhstan”. Seven national priorities were identified, including privatisation of state-owned corporations; foreign investment laws updated and an increase in foreign participation; lifting of restrictions on trade and foreign exchange transactions; modernization of financial systems; laws updated on labour practices, corporate governance and transparency; and upgrading of tax and customs administration.

Economic performance substantially improved during and after this period, and economic recovery and growth began in earnest in 2000. GDP growth of 8-10 % has been sustained in the last seven years (Figure 1), with real GDP slightly above the average for other transition countries in the region and GDP per capita more than doubling during that period. The budget balance currently stands at 0.2 % of GDP.

**Figure 1. Growth of GDP and GDP per capita, Kazakhstan 1992 - 2006**



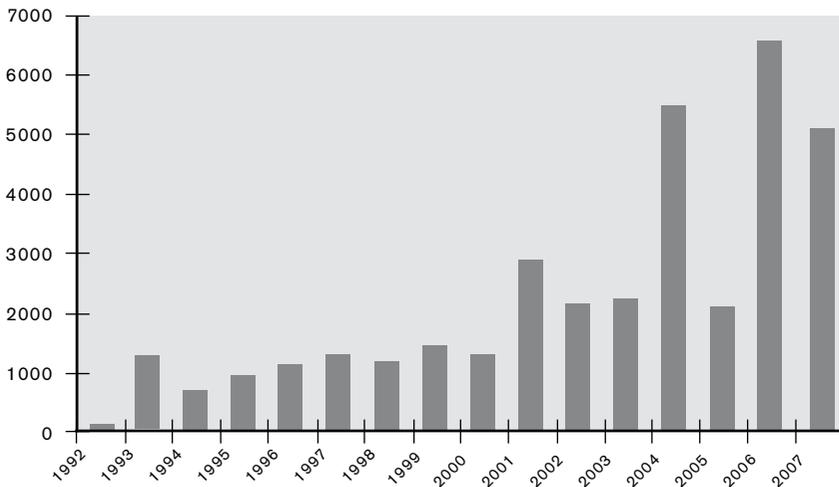
Source: EBRD (2007).

It is not clear, however, how much of this recovery can be attributed to the government’s “prudent economic policies” (IMF, 2007), and how much to surging world oil prices.

#### 2000 – Present: Banking and Financial Reform

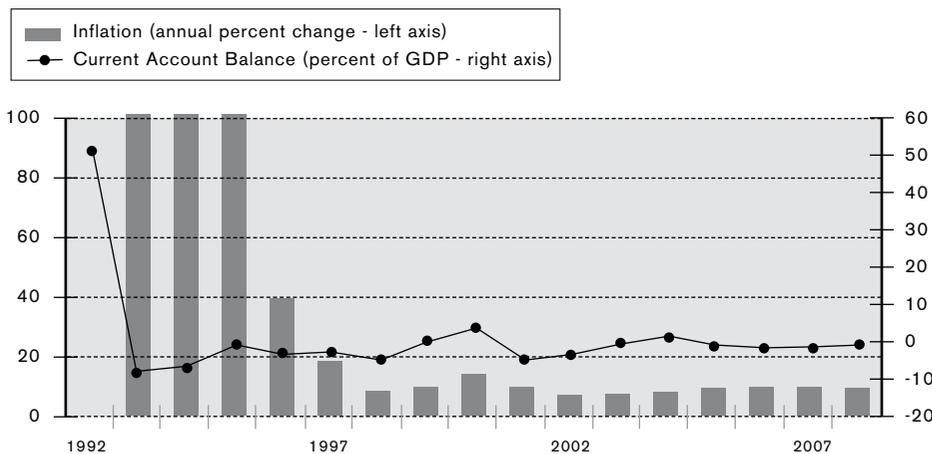
BANKING REFORMS HAVE been among the most successful of the government’s efforts in Kazakhstan. From 1996, the government began introducing Western banking laws, modern payment systems and tightening prudential regulations, as well as privatizing the manage-

**Figure 2. FDI Inflows (net, US\$ millions)**



Source: EBRD (2007).

**Figure 3. Inflation and Current Account Balance, Kazakhstan 1992 - 2007**



Source: EBRD (2007).

ment of pension contributions. More recent activity has included liberalization of the currency regime, most notably the removal of the licensing requirement for capital account transactions in early 2007. The government has also established a basic framework to attract foreign direct investment (FDI) into its resource-rich oil and mineral sector, including partial privatization of the electricity sector (World Bank, 2007). FDI inflows, though somewhat erratic (figure 2), have nonetheless increased significantly since the mid-1990s.

In the financial sector, stock market capitalization has increased in the last ten years, from 6.1 % of GDP to 54.7 %. Annual inflation has fallen from 1,662 % in 1993 to 8.6 % in 2007 (Figure 3).

All of this has substantially eased the economic pressures that the government of Kazakhstan was facing in the 1990s. The government's budget has been in surplus since 2001 and public debt is now just 6 % of GDP.

However, all is not as well as might appear from such figures. The IMF this year cautioned that rapid expansion of money and credit might spill over into inflation. The external debt of Kazakhstan's banks

– responsible for much of this external borrowing – has risen steeply in recent years, totalling \$46 billion in mid-2007, 48 % of GDP. In 2007, however, turmoil in global markets caused a sudden halt in capital inflows to Kazakhstan. The central bank has responded by injecting liquidity and supporting the tenge (IMF, 2007).

## 2.2 Transformation Through Reform?

FROM THE SECTIONS above, a picture begins to emerge of a country currently enjoying high growth rates, but also

facing some problems. Key transition indicators provide an indication of the degree of reform that has actually been carried out in the economy and how this could affect Kazakhstan's economic development. The following table shows how the European Bank for Reconstruction and Development describes the current situation using a scale of transition. Indicators are divided into those in which Kazakhstan scores above average and those in which it scores below average.

**Table 2.1: Transition indicators for Kazakhstan, 2007**

Area of reform – Above average	Level of progress
Price liberalization	Comprehensive; state procurement at non-market prices largely phased out; only a small number of administered prices remain.
Trade and foreign exchange	Removal of almost all quantitative and administrative import and export restrictions; almost full current account convertibility.
Banking reform and interest rate liberalization	Substantial progress in establishment of bank solvency and of a framework for prudential supervision and regulation; full interest rate liberalization with little preferential access to cheap refinancing; significant lending to private enterprises and significant presence of private banks.
Small scale privatization	Complete privatization of small companies with tradable ownership rights.
Area of reform – Below average	
Large scale privatization	More than 25 % of large-scale enterprise assets in private hands or in the process of being privatized, but possibly with major unresolved issues regarding corporate governance.
Government and enterprise restructuring	Moderately tight credit and subsidy policy, but weak enforcement of bankruptcy legislation and little action taken to strengthen competition and corporate governance.
Competition policy	Competition policy and legislation and institutions set up; some reduction of entry restrictions and some enforcement action on dominant firms.
Securities markets and non-bank financial institutions	Formation of securities exchanges, market-makers and brokers; some trading in government paper and/or securities; rudimentary legal and regulatory framework for the issuance and trading of securities.
Overall infrastructure reform (average of indicators covering electric power, railways, roads, telecommunications, water and waste water.)	Power company distanced from government, but there is still political interference. Some attempt to harden budget constraints, but effective tariffs are low. Weak management incentives for efficient performance. Little institutional reform and minimal, if any, private sector involvement.

Source: EBRD (2007).

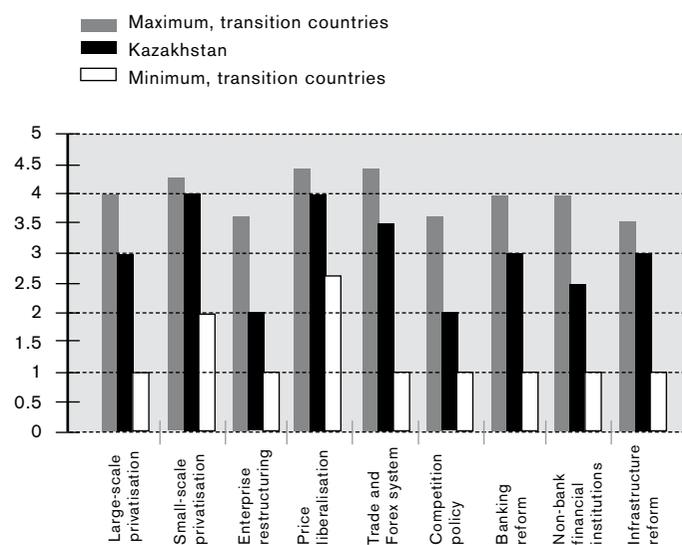
All of these indicators began at level 1, i.e. “little progress”, in the early 1990s, and they support the fact that significant progress has been made in areas such as banking reform. Price liberalization now even scores 4, close to the standards of an industrialized market economy, and private sector share in GDP was 70 % in 2007,

1. *Index of economic freedom* (2008).

up from 10 % in 1992. Kazakhstan is by no means a “minimum performer” when it comes to reform, but, despite the government’s statements, it is perhaps not as far down the road from centrally-planned economy to free market democracy as is sometimes suggested. According to the Index of economic freedom, after a decade and a half of reform, Kazakhstan’s economy is now 60.5 % free, with its overall score up from last year mainly reflecting an improvement in trade freedom<sup>1</sup>. Despite repeated statements of intent, there is clearly much progress still to be made in terms of opening up other areas of the Kazakh economy, most notably large-scale privatization, enterprise restructuring and infrastructure. Even the banking sector, despite reforms, still continues to operate with a number of restrictions, most notably with regard to foreign ownership (of the thirty three banks in Kazakhstan, fourteen are foreign owned; EBRD, 2007) and access of multinational banks to domestic markets.

Figure 4 shows how Kazakhstan compares to other countries in the region. It appears to be average, following a pattern of partial but not full reform.

**Figure 4. Transition Indicators, 2006**



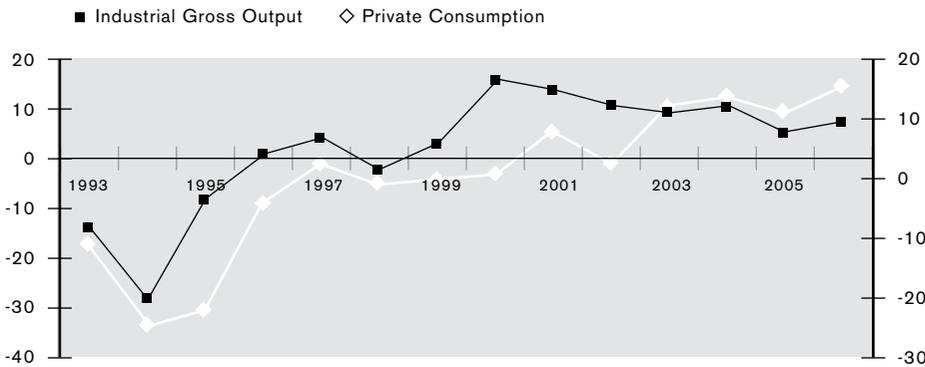
Source: EBRD (2007).

Significant shortcomings remain, however, in three areas: investment freedom, property rights and freedom from corruption. In virtually all sectors, for example, foreign investment faces barriers and bureaucratic incompetence.

## 2.3 Economic Structure

IN TERMS OF economic structure, a similar mix of change, success and persistent problems can be seen. Economic growth has clearly been led by the oil and extractive industry sectors, which continue to dominate exports in particular. However, statistics from the US Central Intelligence Agency suggest that in 2006, while agriculture accounted for 5.7 % GDP and industry for 39.4 %, services contributed 54.4 %.

**Figure 5. Output and Expenditure**



Source: EBRD (2007).

Industrial output has continued to grow over the past decade, and within Kazakhstan the impact has been broadly positive. Figure 5 shows rates of change of private consumption and output increasing consistently alongside each other. But in addition, unemployment has fallen consistently, from 12.8 % of the labour force in 2000, to 7.8 % at the end of 2006, while average monthly earnings in the economy increased by 20.4 % in 2006.

However, potential hindrances to further economic progress are causing concern for the government. A recent study by the Kazakhstan Institute of Strategic Studies (Rakhmatulina, 2006) speaks of a continuing lack of competitiveness of the manufacturing sector, as well as inadequate development of high value added industry.

Problems in the banking sector also cause concern: Kazakhstan currently performs poorly in terms of creating an enabling environment for small and medium-sized enterprises (SMEs). This has become more marked recently, as increased oil exports and significant capital inflows have led to the tenge appreciating considerably against the US dollar, making it difficult for non-oil exports to remain competitive and bringing talk of “Dutch disease.”

A related concern is social and human development within Kazakhstan. Broadly, social indicators have

improved markedly since the beginning of this decade. The poverty rate has dropped from over 30 % in 1999 to under 10 % (in 2005), while income distribution has become more even (IMF, 2007). This is compared to poverty rates in the Kyrgyz Republic, for example, of 21.4 % in 2006.

However, when such indicators are broken down, a different picture begins to emerge. Kazakhstan has some of the worst health indicators in the Europe and Central Asia region, such as access to safe drinking water, and the

World Bank warns that human capital has actually been steadily eroded over the past decade, with high incidence of tuberculosis and HIV/AIDS infection rates increasing very fast (World Bank, 2007). Meanwhile, government expenditure on health and education remains low, both at 2.3 % in 2005 (EBRD, 2007).

## 2.4 Trade

### Trade patterns

OIL AND MINERALS have been the driving force of Kazakhstan’s economic development over the past decade and a half and the country’s export and import patterns are unsurprising in this respect.

**Table 2.2 Principal exports of Kazakhstan**

Products (2006)	% of total exports
Mineral products	71.9
Metals	16.1
Chemicals	4.2
Food products	2.8
Machinery and equipment	1.8
Other	3.2

Source: The Economist Intelligence Unit (2008).

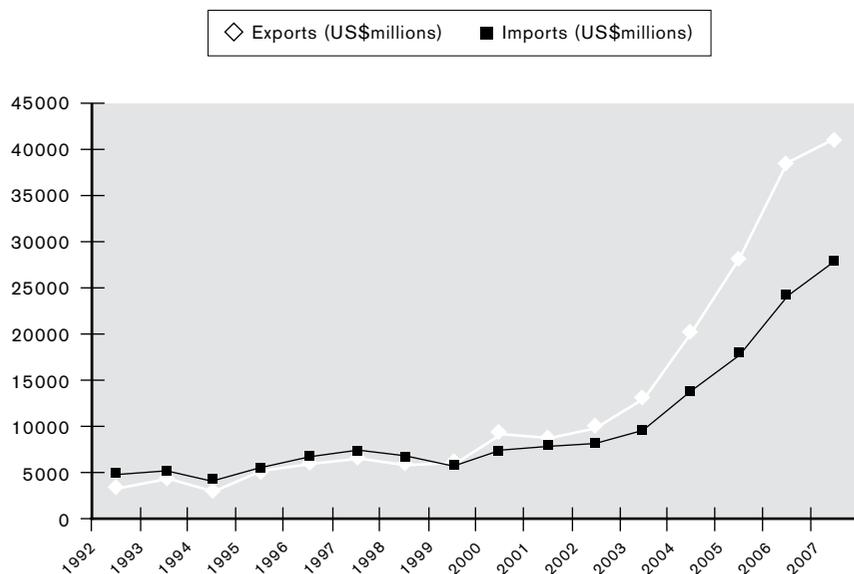
**Table 2.3. Principal imports of Kazakhstan**

Products	% of total imports
Machinery and equipment	45.2
Mineral products	14.3
Metals	13.3
Chemicals	10.8
Food products	7.0
Other	9.4

Source: The Economist Intelligence Unit (2008).

Despite the rise of the services sector, oil extraction and oil related construction, transportation and processing still account for the vast majority of exports, and the government stresses that its main economic priority is to diversify and avoid what it regards as over-dependence on the energy sector.

**Figure 6. Merchandise Exports and Imports**



Source: EBRD (2007).

In terms of destination, Kazakhstan's exports are remarkably dispersed. By far its largest source of imports, however, is Russia (Table 2.4).

**Table 2.4. Destination of exports and origin of imports, 2006**

Main destinations of exports (2006)	% of total	Main origins of imports (2006)	% of total
Italy	18.0	Russia	38.3
Switzerland	17.6	China	8.1
Russia	9.8	Germany	7.6
China	9.4	US	4.7
France	8.8	Ukraine	4.2

Source: The Economist Intelligence Unit (2008).

## Trade Policy

KAZAKHSTAN IS AMONG the better performers in the region in terms of external trade and foreign exchange policy. In 2007, the EBRD gave Kazakhstan a score of 3.7 (with 4 being the highest) in its transition indicators: a great improvement on having been at the very bottom of the scale ten years previously.

However, the transition has not been a smooth one. Tariff revenues from the past ten years show some volatility (figure 7). Having been cut substantially in the early years of reform, they have since fluctuated, showing a possible upswing beginning again in 2006.

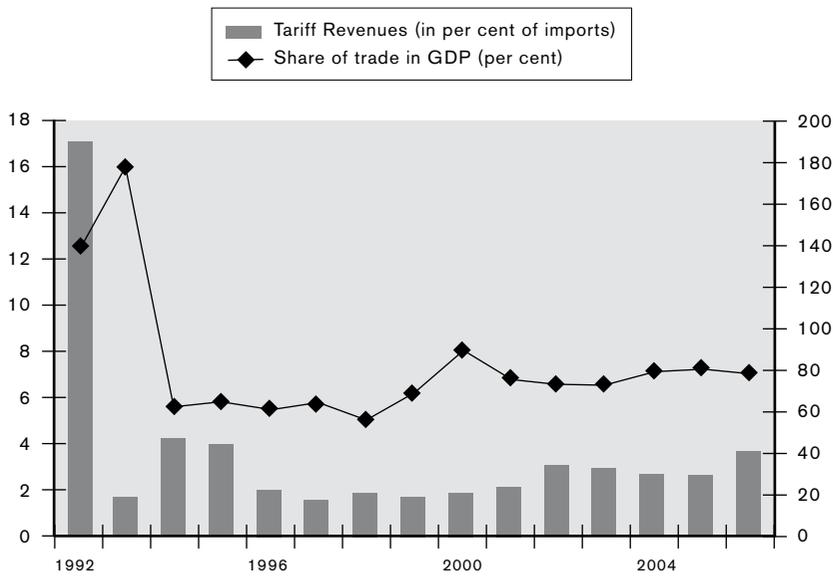
Of course, trade policy is more than just tariffs. Non-tariff barriers have persisted in Kazakhstan throughout the reform process and non-transparent regulations and standards, service market access barriers, import licensing requirements, opaque government procurement, weak enforcement of intellectual property rights, and customs inefficiency and complexity still add to the cost of trade, lowering Kazakhstan's overall performance on trade freedom.

## 2.5 Concluding Comment

THE PAST FIFTEEN years in Kazakhstan have certainly seen a transformation of the economy of Kazakhstan. Expanded oil production and inflows of foreign capital have led to high growth rates. Oil production looks set to be the main driver of the economy for the foreseeable future, implying continued economic growth, as well as abundant resources with which to further upgrade the country's infrastructure. China for example, has invested billions in oil companies and pipelines to access Kazakhstan's hydrocarbon resources, and output is projected to grow from 1.2 million barrels a day in 2006 to 3.5 million barrels a day in 2020.

The extent to which these economic achievements can be credited to the reforms of the government of Kazakhstan, however, remains unclear. Much has been done to create a more attractive business environment and financial sector in order to attract FDI, but this has been primarily in the oil sector. Concerns remain over corruption, continued barriers to foreign ownership and continued over-regulation of the country's infrastructure. Reforms have perhaps been less far reaching than is commonly believed, and the country's trading patterns and some persistent barriers to trade suggest that the Kazakh economy in 2008 is in some respects not far removed from the 1990s.

Figure 7. Trade 1992 - 2006



Source: EBRD (2007).

## CHAPTER 3 ACCESSION TO THE WTO: BACKGROUND

ARTICLE XII OF the *Marrakesh Agreement Establishing the World Trade Organization* provides for accession to the WTO. The immediately relevant paragraphs of the article say that:

“1. Any State or separate customs territory possessing full autonomy in the conduct of its external commercial relations and of the other matters provided for in this Agreement and the Multilateral Trade Agreements may accede to this Agreement, on terms to be agreed between it and the WTO. Such accession shall apply to this Agreement and the Multilateral Trade Agreements annexed thereto.

“2. Decisions on accession shall be taken by the Ministerial Conference. The Ministerial Conference shall approve the agreement on the terms of the accession by a two-thirds majority of the Members of the WTO.”

- Rules similar to those cited applied to accession to the GATT. When Japan acceded to the GATT, in 1955, 50 existing members of that organization did indeed decline to fully apply GATT rules to the new member. No such case has appeared in the WTO.
- In practical terms, therefore, the conditions for consensus in the ministerial conference are created in the working party. Any member with an interest in trade with the applicant country has a right to be a member of the working party. A member who does not join it but nevertheless objects to the accession in the ministerial conference will therefore be in a weak position – probably an untenable position – in the ministerial conference. A member would be in a similarly weak position if it joined the working party, and voted for admission as a member of it, but then decided to change its vote in the ministerial conference. Despite the reference in Article XII(2) to the ministerial conference, and the possibility of negative votes in that body, therefore, contentious issues will in fact be dealt with in the working party.

Provisions relating to accession also appear in Article XIII. Paragraph 1 says:

“1. This Agreement and the Multilateral Trade Agreements in Annexes 1 and 2 shall not apply as between any Member and any other Member if either of the Members, at the time either becomes a Member, does not consent to such application.”

These provisions seem to imply that an accession could occur with up to one-third of existing WTO members voting against it. Moreover, they seem to suggest that a country might accede with an indeterminate number of existing members refusing to fully

apply WTO rules to the new member.<sup>2</sup> These appearances, however, are deceptive: the *de facto* rule is that an accession requires consensus among existing WTO members.

Articles XII and XIII do offer a route to accession without unanimity. Thus, if one or two members tried to force conditions upon an acceding country that were regarded by all or most other members as onerous or unreasonable, a means is available to evade those conditions and still allow the accession to go forward. Still, consensus is the *de facto* rule.

### 3.1 Accession Process

#### Memorandum and Working Party

WHEN A COUNTRY applies for membership of the WTO, a working party is established to deal with the application. Any member of the WTO may join the working party. Decisions of the working party are taken by consensus.<sup>3</sup>

The applicant country is required to submit to the

working party a draft memorandum describing the applicant's trade-policy regime. The contents of the memorandum are open to question and requests for clarification by members of the working party. The applicant must satisfactorily respond to these questions.<sup>4</sup>

The issues raised by members of the working party depend on the candidate country and the composition of the working party. An invariable concern, however, is that the laws and regulations of the acceding country conform to WTO provisions. This extends beyond issues having a direct bearing on trade, such as, for example, the applicant's customs law, tariff schedule, regulations on imports and exports, and intellectual property law. Applicants must also expect to be questioned on issues that have only an indirect connection with trade – such as their laws on joint stock companies, the activities of the central bank and credit institutions, licensing of economic activity, domestic taxation, regulations on food and alcoholic beverages, veterinary medicine and quarantine regulations, and consumer protection.

### Issues for Countries in Transition

A NUMBER OF themes commonly arise when the accession process of countries in transition is at issue. Michalopoulos, 1998, identifies a number of these.

Within the context of laws and the operations of governmental institutions, two issues tend to receive special attention when questions are addressed to transition economies. One is the extent of privatization. The other is whether government agencies involved in the regulation of economic activity act on the basis of transparent rules and criteria rather than administrative discretion. Both issues stem from the dominant role of the state in economies that were formerly centrally planned and from a concern that the role of the state has been appropriately reduced.

A second set of issues relates to the capacity of national agencies to implement commitments. Governance is in question here: do government agencies have the authority and capacity to implement commitments they might offer? In some jurisdictions, local authorities have the right to nullify commitments made by the national authorities.

Third, countries may be urged to join plurilateral agreements – agreements that were not a condition of WTO membership at the time of the Uruguay Round.

Examples are the Government Procurement Code and the Agreements on Telecommunications and Information Technology.

### Issues for Countries of the FSU: Customs Unions

REGIONAL INTEGRATION TENDS to be a focus for working parties when the applicant is a country of the FSU. Following the collapse of the Soviet Union, there have been several attempts to create regional integration agreements in the FSU. The current manifestation of this impulse is the Eurasian Economic Community (EAEC) – a political and economic union between Belarus, Kazakhstan, the Kyrgyz Republic, the Russian Federation, and Tajikistan. More recently, there has been a proposal for a Common Economic Space (CES) between the Russian Federation, Belarus, Kazakhstan, and Ukraine.

EAEC and prospective CES members have said that they view the implementation of these customs unions as a first step toward deeper integration, and they have undertaken actions to this end. Although EAEC implementation is still far from complete, its members have recently increased their efforts to implement common EAEC tariff rates.

SEVERAL MEMBERS OF these arrangements are seeking accession to the WTO, and Kazakhstan is one of them. Such arrangements are not intrinsically incompatible with the WTO: customs unions and free trade areas are clearly permitted under Article XXIV.

In the case of acceding members, however, they raise problems. This is especially true when a customs union, which entails a common external tariff (CET), is proposed. A free trade area, in which each member maintains its own tariff schedule, raises fewer issues.

The issue that arises when some members of the customs union are also members of the WTO, as in the case of the EAEC, is that a member of the WTO will have committed to tariff bindings as part of its accession. The level of bindings that it has agreed will therefore be the maximum CET for the customs union: unless a higher CET can be negotiated with the WTO when the customs union is formed; or the country breaks its commitment to the WTO; or it leaves the WTO.

If members of the customs union then accede to the WTO, moreover, the WTO must either accept

4. The working party on Kazakhstan's accession was established in February 1996; Kazakhstan's memorandum was first circulated in September 1996; and the first questions of the working party were submitted to Kazakhstan in January 1997.

the existing CET as the tariff level of the prospective new member; or the members of the customs union who are already members of the WTO must agree to accept reductions in their tariff (that is, in the CET) if the negotiation with the non-member of the WTO has that outcome. These are not insuperable difficulties (as the admission to the WTO of the Kyrgyz Republic, which is involved in such arrangements suggests). They are, though, not issues that a WTO working party can ignore.

### 3.2 Bilateral Negotiations

RESPONDING TO SUCH questions from members of the working party is by no means the only interaction of the applicant with the working party. The applicant must also negotiate with each member of the working party individually, and must enter a bilateral agreement with each member to certify that the member accepts the accession package offered by the applicant.

If there are X members of the working party, therefore, the applicant must take part in X bilateral negotiations; and for accession to occur, each of these negotiations must finish with a bilateral agreement. In the case of Kazakhstan, for example, there are 32 members of the working party (counting the EC and its member states as one); and at the time of writing (December 2007), 15 of them have declared themselves satisfied with the terms that Kazakhstan is offering for its accession.<sup>5</sup>

When all members of the working party have concluded a bilateral agreement with the applicant, the working party adopts a protocol of accession for submission to the Ministerial Conference. Adoption of the protocol by the Ministerial Conference completes the accession process: the applicant becomes a member of the WTO.

The process can be lengthy. Even leaving aside the marathon of China's accession negotiations, the admission of recent entrants has on average taken roughly ten years from start to finish. It can, though, be considerably faster. The Kyrgyz Republic, whose working party was established in April 1996, became a member in December 1998.

### 3.3 Substance Of Bilateral Negotiations

FOR APPLICANTS, THE central questions are what they might be asked to do, and what pressure they will be under to concede different requests. Clearly, an applicant can be asked to bring into conformity with the WTO any aspect of its policy that is inconsistent with the WTO; and it must accept such requirements (though it may be able to negotiate delays before being required to come into full conformity). But what other requests must it consider and possibly accept?

If a member of the working party asks an applicant to reduce import duties on items that are exported by that member, for example, will the applicant be under pressure to concede that demand? If an applicant is asked to make concessions in areas in which existing members have not been required to make concessions – say specific commitments in specific service sectors – must it do so? If asked to accept a WTO agreement that was not part of the single undertaking in the Uruguay Round – the Government Procurement Agreement, for example – is the applicant obliged to accept that agreement?

Important as these questions may be for the applicant, clear answers to them are hard to come by. No WTO rule describes the “price” an applicant must pay for accession. This is, of course, also the position in multilateral trade negotiations: participants (at least developed-country participants) must exchange equal concessions – but it is the negotiating parties that define “equal”: no WTO rule tells them how to recognize an equal bargain.

Evenett and Primo Braga (2005) however, provide useful evidence on the price of accession. They study the twenty accessions to the WTO that took place before their research. Their results are conveniently summarized by type of commitment.

#### Market Access Commitments

“With respect to market access commitments, for both agricultural and non-agricultural goods the average tariff binding that acceding countries were allowed is falling over time and is now at levels well below those agreed by developing countries in the

5. The members of the working party on the accession of Kazakhstan are (\* indicates a completed bilateral): Australia; Brazil; Canada; China\*; Chinese Taipei; Colombia; Croatia; Cuba\*; the Dominican Republic\*; Egypt\*; the EC and its member states; Georgia\*; Honduras\*; India; Jamaica; Japan\*; Republic of Korea\*; the Kyrgyz Republic\*; Malaysia; Mexico\*; Moldova; Mongolia; New Zealand; Norway\*; Oman\*; Pakistan\*; Paraguay; Poland; Switzerland\*; Thailand; Turkey\*; and the U.S. Bulgaria; the Czech Republic; Estonia; Latvia; Lithuania; Poland; and the Slovak Republic; were originally members of the working party, but are now members of the EC. Bulgaria completed a bilateral with Kazakhstan before it became a member of the EC.

Uruguay Round. In short, from a “mercantilist” perspective, the relative price of WTO accession is high (in comparison to Uruguay Round commitments made by peer nations) and growing over time.”

*Evenett and Primo Braga, 2006, p. 3.*

Another way of looking at the issue is to see at what levels applicants now bind tariffs. An impressionistic view of recent accessions suggests that the average bound tariff level of applicants on accession has been 10-15 % for agricultural goods and 5-12.5 % for non-agricultural goods.

## Services

A SIMILAR PICTURE applies to services commitments under the GATS:

“Taking the number of services sub-sectors (of the 160 identified in the WTO’s classification list) committed by countries as a proxy for the “price” to be a WTO Member, one observes that LDCs that were founding members of the WTO committed on average 20 sub-sectors. The averages for founding Members in the developing and developed categories, in turn, were respectively 44 and 108. Countries that have acceded since 1995, in turn, have on average committed around 104 sub-sectors.”

*Evenett and Primo Braga, 2006, p. 3.*

This conclusion is similar to that of Grynberg, Ognivtsev, and Razzaque, 2002, page vii:

“At the most aggregate level, while WTO members have on average taken up some kind of commitment in six sectors out of a maximum of 12, the comparable figure for acceding countries is ten. At the 2-digit level, acceding countries took commitments in 36 sectors compared to only 17 taken by WTO members. Finally, at the most disaggregated level, acceding countries have commitments almost two and a half times bigger – 103 as against 42. The accession negotiations have resulted in countries undertaking commitments that apparently bear

no relationship to their level of economic development as reflected in per capita income.”<sup>6</sup>

A simple count of the number of sectors in which commitments have been made is, of course, a crude measure of the level of commitment. Simple counting does not capture the depth (e.g., the scheduling of explicit limitations) or the breadth (e.g., the modes of delivery covered) of the commitment.

Still, if countries going through the WTO accession process commit a much higher number of sub-sectors than GATT contracting parties at a similar level of development did in the context of the Uruguay Round (1986-94) negotiations, this suggests (in the absence of evidence that their commitments are shallower or narrower than founding members’) that their overall commitment is greater.

## Rules

COMMITMENTS THAT COUNTRIES have adopted when joining the WTO offer a more-mixed picture. Leaving aside China and Taiwan, acceding countries signed around 25 such commitments.

These commitments typically concern a wide range of state measures, some of which are not obviously trade-related. Bulgaria, for example, made, as well as a number relating to trade-policy measures, commitments with respect to domestic price controls, the privatization of state-owned enterprises, and excise taxes on alcohol.

## WTO+ Commitments

DO COMMITMENTS SUCH as those of Bulgaria go beyond the Uruguay Round agreements? Alternatively, do they entail agreement by an acceding country to forgo rights possessed by founder members of the WTO? If so, they are WTO+ commitments.

Identifying WTO+ agreements, though, raises problems of interpretation. WTO agreements are always open to interpretation; and interpretation of an agreement affects judgments about whether an accession commitment goes beyond it. It is not surprising, therefore, that there is sharp disagreement over the extent of WTO+ commitments.

6. In a similar vein, Nepal and Cambodia, the two LDCs that have joined the WTO since 1995, committed to 76 and 93 sub-sectors, respectively. This contrasts with the 20 sub-sectors that LDCs committed to (on average) during the Uruguay Round. Marchetti (2004) provides more information about service commitments.

The WTO+ status of some accession agreements, however, seems beyond dispute. Those of Bulgaria are one example. Another is the commitment by the Kingdom of Jordan that if any of its laws or state acts are found to contradict international treaties (not just WTO agreements) then the international treaty takes precedence. So is Ecuador's commitment to eliminate all subsidies before its accession; which is harsh, but only disputably WTO+. That commitment, however, was accompanied by an agreement never again to re-introduce the subsidies, which is more clearly WTO+. The acceptance by China of product-specific transitional safeguard provisions, more easily triggered than regular WTO safeguards is a further illustration.

The extent of WTO+ commitments is disputed, but it seems clear that they exist. It does not follow, of course, that a WTO candidate will be asked for such commitments. It does follow that any WTO candidate should be alert to the possibility that such a request will be made.

### 3.4 Concluding Comment

ACCESSION TO THE WTO can be a long and wearing process. Individual countries must decide whether the gains to them from WTO membership are worth the trials and tribulations that the accession process entails.

An interesting question is the extent to which the direct economic gains of the acceding country are taken into account when the working party considers the appropriate entry price. If so, it is worth noting that in pure economic terms – leaving aside issues such as the prestige of WTO membership – Kazakhstan's potential gains are small.

Jensen and Tarr, 2007, pp 3-4, claim that the economic gains to Kazakhstan of joining the WTO are large:

“We estimate that the gains to Kazakhstan from WTO accession are 6.7 percent of Kazakhstan consumption (or 3.7 percent of GDP) in the medium term, and could be as high as 17.5 percent of Kazakhstan consumption (9.7 percent of GDP) in the long run. To understand the sources of these gains, we execute several scenarios that allow us to decompose the impacts. Tariff reform only is

responsible for 0.4 percentage points of the gain in consumption. Improved market access accounts for 0.5 percentage points of the welfare gain. Combined VAT and local content reform in the oil sector results in a gain of welfare equal to 0.9 percent of consumption. We estimate that the gains from FDI liberalization in services are 4.9 percent of the value of Kazakhstan consumption, which amounts to over 70 percent of the total gains from Kazakhstan accession.”

This comment of Jensen and Tarr, however, does not clearly distinguish between two kinds of gain that Kazakhstan might obtain from accession to the WTO.

One type of gain can be obtained by Kazakhstan only by joining the WTO. For example, Kazakhstan can be sure of obtaining WTO-consistent treatment of its exports in safeguard and anti-dumping suits only by joining the WTO. Gains from such a source can legitimately be attributed to WTO membership.

A second type of gain is one that Kazakhstan might get through joining the WTO, but that it could in principle obtain without joining the WTO. Thus, WTO accession might bring about changes in the policies of the government of Kazakhstan that produce economic benefits for Kazakhstan. If the government of Kazakhstan could in principle change those policies of its own volition, without WTO involvement, however, their attribution to “joining the WTO” is questionable.<sup>7</sup>

Attribution of such gains to WTO accession certainly inflates the gains that will accrue to a WTO applicant from accession. But it is a tactic of dubious validity. Moreover, if a government is aware of the possibility of making the changes and of their consequences but will fail to implement them in the absence of WTO accession, the nature of the “gains” themselves – even whether they are in fact gains – comes into question.

AS A COUNTRY that primarily exports petroleum and minerals, which are typically not affected by safeguards or anti-dumping, Kazakhstan has relatively small gains in the first category. This is the 0.5 percentage points of the welfare gain calculated by Jensen and Tarr that derives from “improved market access”. All of the rest of the gains estimated by Jensen and Tarr are “gains” of the

7. The boundary between these different types of gain blurs if a case can be made that accession to the WTO is the *only* way in which the government of Kazakhstan can obtain consent to the policy changes that produce gains of the second type. To plausibly make such a case, however, a substantial knowledge of politics in Kazakhstan is required. That the government of Kazakhstan cannot find means to change the policies except by joining the WTO cannot legitimately be *assumed*.

second type, whose attribution to the WTO accession of Kazakhstan is open to question.

Kazakhstan's potential gains from acceding to the WTO are therefore not large: about 0.275 percent of GDP on the estimate of Jensen and Tarr. If the gains to Kazakhstan from WTO accession are properly taken into account, therefore, a case can be made that the price Kazakhstan should be required to pay to join the WTO should be commensurately low, calling for conformity with WTO rules and very little beyond that.

## CHAPTER 4: INTERNATIONAL ECONOMIC POLICY

THIS CHAPTER DISCUSSES the current trade policy of Kazakhstan. It focuses on tariffs, non-tariff barriers, trade rules, trade-related regulatory standards, and barriers to investment. These are issues that will attract the attention of the accession working party.

### 4.1 Tariffs

IN THE RECENT past, the trade policy of Kazakhstan had features that were problematic from the standpoint of WTO accession. The Asian Development Bank (ADB 2006, chapter 3), a source that invites credence, comments that: "Kazakhstan has a rather complex tariff schedule with a large number of tariff bands and a high maximum tariff rate, although its non-weighted average tariff is not high." ADB 2006, Table 3.1 adds numbers to these comments: it shows a maximum tariff rate of 100 percent, and says that the unweighted average tariff is 7.4 percent.

ADB 2006 notes that tariffs in Kazakhstan escalate (that is, rise with the level of processing), so that the effective protection rate for final processes is higher than the nominal rate. It gives as examples sausage (Table 3.3), imports of which bear a nominal tariff rate of 35 percent but an effective rate of 44 percent; and packed juice, on which a nominal rate of 15 percent is levied, but the effective rate of protection is 46 percent

ADB 2006 remarks that excise taxes discriminate between foreign and domestic output. "In Azerbaijan and Kazakhstan, the coverage of excise taxes on imported and domestically produced goods is identical, but the rates of the former are considerably higher than those of the latter for some commodities." Jensen and Tarr 2007, p 35 note that charges for rail transport in Kazakhstan

differ according to whether the transported good is an import, an export, or a domestic product for sale elsewhere in Kazakhstan, but do not specify how they vary. Finally, ADB 2006 notes the existence of export taxes. "Kazakhstan levies export taxes on a limited number of commodities when they are exported to non-EAEC countries." Ferrous metal scrap is cited as an example, with the comment that exports to the EU of this commodity are also exempt from the tax.

ADB, 2006, chapter 3, p 5, also comments, however, that "a serious problem with tariffs in Azerbaijan, Kazakhstan, Tajikistan and Uzbekistan is that changes in tariff schedules are rather frequent and unpredictable." Perhaps, therefore, these problematic features have already been removed.

The current tariff schedule of Kazakhstan appears to be based on six percentage rates: 0, 5, 10, 15, 20 and 30. A complication, however, is that a number of tariffs are stated as, for example, "30 per cent but not less than 2 euros per kilo." It is therefore possible that when this specific element is translated into a percentage, the actual rate charged is higher – possibly much higher – than 30 percent. If the import price of a product whose tariff is specified as above is one Euro, for example, the tariff rate actually charged would be 200 percent.

Kazakhstan apparently plans further tariff reform in 2008. Informal reports suggest that many tariffs will be reduced, and that, although some rates will be increased, the arithmetic average tariff rate will be reduced.

### 4.2 Non-Tariff Barriers

NON-TARIFF BARRIERS ARE by their nature difficult to identify. Governments publish schedules of tariffs, but few publish lists of the NTBs they maintain. Indeed, they may not recognize as an NTB the regulations that exporters believe restrict their business.

Asking exporters about the factors that limit their business in a country is probably the best way to identify NTBs in that country. Both the EU and the US publish lists of NTBs provided by their exporters. These lists have the additional benefit that they may indicate the priorities that will guide the EU and the US in their yet-to-be-completed bilateral negotiation with Kazakhstan on the terms of Kazakhstan's accession.

The EU distills its view of Kazakhstan's NTBs as follows:

"A number of typically post-Soviet problems still harm the investment climate a lot – pervasive

corruption, cumbersome bureaucracy, onerous licensing requirements, incomplete implementation of laws, partiality of the Courts in the settlement of investment disputes. Furthermore, government policy focuses on the promotion of local businesses – sometimes at the expense of foreign investors. In the last five years new regulations in various areas have reflected an attempt to increase the “local content” in the economy (local workforce, local suppliers), in ways that are not always economically favourable. The government has also tried to review the terms of contracts signed with foreign investors, so as to preserve the “balance of interests” (on the ground that the tax regime has improved).

“Examples of new laws raising concern include:

- “The Investment Law, which aims to support investment in priority sectors of the economy and to put local and foreign investors on an equal footing, but does not guarantee access to international arbitration and does not protect investors against future changes in legislation;
- The procurement rules of June 2002, which provide for strong State control over the tender procedures in the oil and gas sector, and run against the principle of national treatment for EU companies set out in the PCA.
- The 2004 Law on International Arbitration.”<sup>8</sup>

USTR 2007 is more specific but identifies only two non-tariff barriers (NTBs), and, in addition, points to problems with government procurement.

## The transaction passport

THE FIRST NTB noted by USTR 2007 is the so-called transaction passport. USTR 2007, comments that “US exporters to Kazakhstan have consistently identified the requirement to 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 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; extending it requires the approval of the National Bank.”

This description is too brief to be confident that the system described is inconsistent with the Uruguay Round Code on Customs Valuation (Agreement on the Implementation of Article VII of the General Agreement on Tariffs and Trade 1994), but it seems very likely to be. USTR 2007 comments that “Amendments to the Customs Code, aimed at bringing Kazakhstan legislation further into compliance with WTO standards, are currently in the works. Among the proposed changes is the simplification of the transaction passport requirement. The government hopes to enact the new statutes in 2007.”

## Standards, certification and regulation

SECOND, USTR 2007 notes that “a wide range of products are subject to mandatory certification requirements, which apply to both domestically-produced and imported goods. A related regulation lists the specific categories of products subject to certification, including machines, cars, agricultural and telecommunications equipment, construction materials, fuel, clothes, toys, food and drugs.”

USTR 2007 comments that “[t]he government is responsible for product safety but delegates quality control to authorized private institutions.” It does not make clear, however, whether the certification requirements noted in the last paragraph refer to safety or quality (or both).

USTR 2007 notes that the government has opened an Information Centre to provide information on technical regulations to foreign companies and governments. It also notes, however, that this information is only available in Russian or Kazakh.

The USTR report notes that “Kazakhstan intends to accede to the International Laboratory Accreditation Conference (ILAC). “This step”, it says, “would make Kazakhstan a party to a number of international treaties on metrology and standards.” It also comments that “[n]ew legislation aimed at bringing the legal environment into compliance with the WTO Agreement on Technical Barriers to Trade is in the course of being developed.”

8. European Commission (2006).

## Government procurement

THE TRANSPARENCY AND efficiency of state procurement in Kazakhstan raises problems for potential US suppliers, says USTR 2007. “The government has taken steps to improve the transparency of the procurement process. In particular, the Committee on Financial Control has published on its website the list of agencies and state enterprises that are subject to state procurement regulations; [h]owever the government procurement situation remains problematic. Further legislative improvement in this area is needed. The government is currently developing new procurement legislation, which it hopes to adopt in 2007.”

USTR 2007, notes that “[t]he ‘Rules on Oil and Gas Procurement’ give significant preferences to local suppliers, and establish what many firms, foreign and domestic, consider unwarranted state interference in even small tenders.”

Membership in the WTO, *per se*, however, would not oblige Kazakhstan to change these practices. The WTO contains an Agreement on Government Procurement, but it is a plurilateral agreement – membership of it was not a condition of WTO membership for original members of the WTO. The interest of USTR 2007 in government procurement, however, may well presage pressure on Kazakhstan by the United States to accede to the Agreement on Government Procurement when it accedes to the WTO.

### 4.3 Services

USTR 2007 SAYS that the “Oil and Gas Procurement Regulation stipulates that oil companies must purchase services only from Kazakhstan-based companies unless the required service is unavailable in Kazakhstan.” It also notes “concerns” about “possible preferential treatment for Kazakhstan’s recently launched domestic satellite, which could result in competitive disadvantage for US satellite operators.”

Most of the known barriers to trade in services, however, are barriers to investment in Kazakhstan for the purpose of providing services.

### 4.4 Investment Barriers

JENSEN AND TARR, 2007, provide the most detailed information available on barriers to trade in services. They commissioned surveys of restrictions on inward investment in a number of service sectors (telecom-

munications; financial services; insurance and securities; and air and maritime transport) from “a Kazakhstan research institute that specializes in these sectors.” Probably no better information is available for these sectors. Their table B-1, giving their estimates of protection in the service sector of Kazakhstan, is reproduced below as Table 4.1. Barriers to inward investment account for 70 percent of the total gains that would accrue to Kazakhstan from WTO accession, according to Jensen and Tarr 2007, p 4.

**Table 4.1 Ad valorem equivalent of barriers to FDI in services**

	Ad valorem equivalent (%)	Model sector
Insurance	53	Insurance
Banking	8	Financial intermediation
Securities	14	Financial intermediation
Maritime	92	Water transport
Air transport	98	Air transport
Fixed line	20	Communication
Mobile services	15	Communication
Internet	1	Communication

Source: Jensen &Tarr (2007).

Discussion of barriers to investment provides the longest section of USTR 2007. USTR 2007 notes that Kazakhstan’s 2003 Law on Investments provides the legal basis for foreign investment in Kazakhstan. “In general”, it says, “investors have concerns about the law’s narrow definition of investment disputes, its lack of clear provisions for access to international arbitration, and certain aspects of investment contract stability guarantees.”

### Local Content and Hiring Provisions

THE BULK OF foreign investment in Kazakhstan is in the oil and gas sector; and the government of Kazakhstan actively promotes local content in purchases of goods and services by firms in that sector. A 1999 amendment to the Oil and Gas Law required mining and oil companies to favour local goods and services, and rules implementing these provisions were enacted in June 2002 (Decree 612). This decree also requires government involvement and approval at each stage of private procurement.

Amendments to the Law on Subsurface Use, adopted in December 2005, require investors to list in their tender proposals the actions they will take to satisfy local content requirements. A company subsequently found

to have failed to meet these commitments may have its operations suspended for up to six months.

Furthermore, the July 2005 Law on Production Sharing Agreements contains explicit requirements regarding the local purchase of goods and services and the hiring of Kazakh nationals. It applies to all companies engaged in offshore oil and gas exploration.

### State ownership provisions in mineral extraction

THE LAW ON Production Sharing Agreements also requires that KazMunay Gas, the national oil company, should have at least a 50 percent in offshore oil and gas projects. Also in 2005, a “pre-emption” amendment was added to the Law on Subsurface Use. It guarantees the state the 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 right even when there is a contractual obligation to offer first refusal to other parties (for example, other investors in the project). In October 2005, the government claimed pre-emptive rights when an investor seeks to purchase a company that possesses drilling rights.

### Restrictions on Ownership of Land

THE LAW OF Kazakhstan allows citizens and foreigners to own land under buildings and associated with buildings. Such land may also be leased for up to 49 years.

Under the new land code, which came into effect in June 2003, Kazakh citizens are for the first time allowed to own agricultural land. Foreign individuals and persons, however, may still only lease land. The maximum permitted length of lease is 10 years. The authorities in Kazakhstan often require, as part of a foreign firm’s contract with the government, that the firm contribute to social programmes for local communities

### Restrictions on Foreign Ownership

IN INSURANCE, FOREIGN companies must operate through joint ventures with Kazakh companies. Overall capital of all foreign insurance companies may not exceed 25 percent of the non-life insurance market or 50 percent of the life insurance market.

Restrictions on foreign ownership of banks were removed in December 2005. USTR 2007 notes that “some restrictions on non-residents’ activity in the

financial sector still remain”, but does not specify what these are. Jensen and Tarr 2007 say (p 4) that “... banks with foreign participation may be subjected to additional requirements, such as the type of business in which they may engage, reporting procedures and the makeup of their Board of Directors.”

In telecommunications, according to Jensen and Tarr 2007, “... there is strong restriction on entry in some areas of services; incumbent operators have excessively long exclusivity rights in areas such as long distance and international telephone services and with respect to interconnection for mobile operators; foreign ownership of a company can’t exceed 49 percent; and cross-ownership among the incumbents limits competition.” Jensen and Tarr remark that the “costs of long distance telephone services and broadband internet access are three to six times the costs of comparator countries such as Russia, selected EU countries, and Australia.”

Foreigners are not allowed to own more than 20 percent of a mass media company in Kazakhstan.

### Work Permits

PROBLEMS WITH WORK permits for employees who do not have Kazakh nationality are common. Companies report that permits for key managers and technicians are routinely rejected; or are granted for unreasonably short periods; or are made conditional upon additional local hiring. Hiring regulations are confusing and are differently interpreted by different officials.

### 4.5 A VAT Oddity

MUCH OF THE legislation appears to be aimed at expanding employment of Kazakh nationals in, for example, the oil and gas sector. In the light of this objective, however, Kazakh taxation policy has an odd feature. As reported by Jensen and Tarr, foreign companies in the oil and gas sector are exempt from VAT (which Jensen and Tarr say is about 15 percent) on their sales (which, of course, are for the most part exports and would be exempt from VAT under most other systems) but also on their purchases of *imported* inputs. Thus, domestic inputs, sales of which the government seeks to expand, are taxed, but imported inputs are not. This taxation policy therefore encourages the use of imported inputs and discourages the use of domestic inputs. This does not, on its face, make much sense.

Jensen and Tarr note (p 3) “... that a policy option

being considered in Kazakhstan [is] the waiver of VAT on domestic inputs into oil and gas; the intent of which is to place inputs on an equal VAT footing with imported inputs in the crude oil and gas sector, as multinationals in the sector are reported to have negotiated a waiver of VAT on imported inputs.” Clearly, this would redress the balance. Equally clearly, the government would lose revenue. Whether the increase in employment justifies the loss of revenue is therefore uncertain. This strange dilemma seems to have been created by the government for itself.

## CHAPTER 5: TRADE AGREEMENTS INVOLVING KAZAKHSTAN

IN THE LAST decade, trade agreements have proliferated in every region of the world. Sometimes, though, trade agreements are a declaration of friendship or intent or ambition, without substantial economic consequences. The “rough neighbourhood” of Central Asia (CA) – as President Nazarbayev once called it – is no laggard when it comes to signing weak FTAs and RTAs and only half-heartedly implementing them. This chapter first gives an overview of the existing and proposed trade deals involving Kazakhstan. Then, the interplay of trade agreements and WTO accession is illustrated with the experience of Kyrgyzstan, which joined the WTO in 1998, and is similarly embedded into the CA trade framework as Kazakhstan. Finally, the role of Russia in the CA trading framework and its regional economic diplomacy are highlighted.

### 5.1 Overview

AFTER THE COLLAPSE of the Soviet Union in 1991, Kazakhstan and the other CARs signed a number of preferential and regional trade agreements with one another in order to revive previous linkages and as a way to secure market access for goods within the newly created Commonwealth of Independent States (CIS). In light of the malfunctioning payments arrangements and exchange rate convertibility among the CIS states, limited preferential trade agreements seemed a useful instrument to re-establish old trade relations. So far, Kazakhstan has signed seven FTAs with its regional neighbours (see Annex 1). The first came into force in 1995 with Kyrgyzstan and Moldova; then an agreement with Azerbaijan and Uzbekistan followed in 1997; with Georgia in

1999; and with Armenia in 2001. In 2007, Astana signed a bilateral trade deal with Mongolia and FTAs with Pakistan and Jordan are proposed and under consultation. The eruption of bilateral agreements among the CIS states has not, however, achieved any substantial liberalization of regional trade. The agreements state that their aim is full tariff elimination and prohibit the application of quotas, but they allow for exceptions that can be formalized in separate yearly protocols and which in fact exempt goods that account for a significant proportion of trade between the signatories. Furthermore, these FTAs include a comprehensive list of general exceptions ranging from protection of the national interest and defence of public morals and order to restrictions to foreign investment. Overall, the effectiveness of the bilateral deals has been limited by narrow coverage, complex rules of origin, and less-than-full implementation of the agreements.

### The Eurasian Economic Community

BESIDES THESE BILATERAL agreements, Kazakhstan is a central and active member in a number of regional initiatives that aim for deeper trade integration (see Annex 2). Given its relative economic strength (Kazakhstan accounts for two-thirds of the GDP for the whole central Asian region) it forms a cornerstone of RTAs like the Eurasian Economic Community (EAEC) and the Common Economic Space (CES). The EAEC evolved out of the framework of the CIS and supersedes the CIS Customs Union (CU) of the 1990s between Belarus, the Russian Federation, Kazakhstan, Kyrgyzstan and Tajikistan, which never was fully realized. The EAEC entered into force in May 2001 and envisages the implementation of a customs union and, eventually, of a common economic area that would go beyond a common external tariff (CET). In 2006, Uzbekistan joined the EAEC. Armenia, Moldova and Ukraine have observer status and since 2002, when the Central Asian Cooperation Organization (CACO) became part of the EAEC, Georgia and Turkey were brought in as further observers. According to the EAEC agreement a common external tariff should have been adopted by 2006, but so far a CET covering only a bit more than half of tariff lines has been agreed with the remaining tariffs not bound and being set independently by each member. Kyrgyzstan and Tajikistan have not yet adopted even this incomplete CETs. The agreement envisaged the CET to be finalized and implemented in stages over a period of five years

from the date of its entry into force. During the transitional period, each country has the right to maintain a list of sensitive goods, which do not exceed 15 percent of aggregate import cost for each state. However, the current EAEC tariff schedule covers only 6,156 tariff lines out of the 11,086 identified in the EAEC classification system. Moreover, EAEC member states have failed to agree on critical matters, such as the introduction of a single import tariff and convergence of tax policies. They have also failed to reach agreement on anti-dumping policies. The EAEC being a new organization, it is still too early to see whether the transformation of the CIS Customs Union into the EAEC Customs Union has allowed its members to overcome the problems of the weakly implemented CIS Customs Union.

## The Common Economic Space

AT THE CIS Summit in Yalta in 2003, Belarus, Kazakhstan, Russia and Ukraine agreed to create a CES, which would evolve in three stages: the coordination of customs duties and harmonization of trade and custom regulations; the lifting of current trade barriers and creation of a CU; and the liquidation of internal customs boundaries to be replaced by a common customs boundary and the creation of a supra-national regulating institution. Belarus and Russia even broadened the CES agenda by aiming at a monetary union based on the rouble.

This initiative marks a shift in regional policy away from the former objective of forming a CES only after Belarus, Russia and Kazakhstan had become members of the WTO. However, before the ink had dried on the agreement, Ukraine introduced a provision saying that the CES must adhere to the Ukrainian constitution and to Kiev's strategic goal of joining the European Union, and after the Orange Revolution, in 2004, the future of the CES became even more uncertain. Ukraine's reinforced Western and EU orientation clearly conflicts with the CES objective of establishing a supranational institution among some former CIS countries and the new plan of creating a monetary union. Ukraine's accession to the WTO will further complicate the process of agreeing on a WTO compatible CES external tariff. Thus, even though Kazakhstan and Russia last year ceremonially re-emphasized their commitment to realizing the ambitious CES agenda, Ukraine's objections and even threats to leave the agreement as a whole diminish the already weak prospects for progress. Furthermore, the EAEC and CES initiatives seem to overlap for Belarus, Kaz-

akhstan and Russia, a situation that can only be resolved if the two Customs Unions have the same CET.

## Other Initiatives

FINALLY, A RANGE of other initiatives on regional economic integration have been launched. In 2003, some members of the Economic Cooperation Organization (ECO) proposed an ECO Trade Agreement (ECOTA), which has been signed, but has not entered into force. In the same year, the Shanghai Cooperation Organization (SCO), including the CARs, Russia and also China, approved programmes to promote regional trade and investment by creating a free trade zone by 2020.

There is no obvious reason, however, to expect that these newly proposed RTAs will deliver more than the existing ones. The possibility that they will remain mere paper agreements, lacking proper implementation, cannot be dismissed.

## 5.2 Bilateral Investment Treaties

BESIDES THESE ATTEMPTS to facilitate regional trade, Kazakhstan has also concluded several Bilateral Investment Treaties (BITs) in order to attract foreign direct investments (FDI) into its economy but also improve its own – petro-dollar boosted – investment possibilities abroad (see annex 3). Since independence, Kazakhstan has attracted more than \$50 billion of outside investment, of which around 80 to 90 percent went to the oil and gas sector. In the last 5 years, net FDI has been consistently above 5 % of GDP, in excess of any other major emerging market economy. FDI inflows grew more than sixfold from \$964 million in 1995 to \$6.5 billion in 2006, with the European Union (40 %) and the United States (27 %) accounting for over two thirds of the flow.

European countries and the US have entered BITs and related agreements with Kazakhstan. The US-Kazakhstan treaty adopts the US BIT prototype text verbatim providing investor-dispute settlement mechanisms between investor and state as well as state-state-arbitration. Furthermore, the BIT covers both the entry and the post-entry phases of an investment as well as investor-related personnel, prohibits local content provisions and protects investors against expropriations. However, an annex to the treaty includes exceptions to national treatment concerning foreign ownership of: Kazakh land, its subsoil, water, plant and animal life, and other

natural resources; ownership of real estate (during the transition period to a market economy); ownership of control of television and radio broadcasting; air transportation; and, preparation of stocks and bond notes issued by the government of Kazakhstan. The BITs and investment related treaties signed with European countries have similar provisions. However, in contrast to the US BIT extensive list of exceptions to national treatment, the BITs with European countries include only air transport, inland waterways transport and maritime transport.

### 5.3 The Central Asian Spaghetti Bowl

THE FTAs AND RTAs in Central Asia aggravate a trade pattern typical for the region: the CARs “under-trade” in general but “over-trade” with each other and especially with Russia at a high cost due to the trade-diversionary effects of their mutual trade agreements (ADB 2006, IMF 2005). On the one hand, Kazakhstan and its neighbours do not trade “enough” due to their economic structure as mainly exporters of natural resources, their landlocked geographic location, the high costs of transit trade and their excessive regulation. On the other hand, despite their weak implementation and enforcement, limited and unclear coverage and high costs due to incompatible rules of origin, the existing FTAs and RTAs render regional trade among the CARs and Russia still more liberal than the trade with other countries. Consequently they trade more with each other than they would in a WTO MFN free-trade environment.

But this relative free trade between Kazakhstan and its neighbours comes at the cost of higher prices for consumers and of recurring protectionism. Instead of really liberalizing trade, the regional trade agreements impede sustainable regional economic development because their loopholes allow that, when one member successfully exports to another, the importing country can impose prohibitive tariffs or quotas. For example, the free trade deals Kazakhstan signed with the CARs and with Russia did not prevent Astana from imposing a ban and a 200 % tariff on some imported goods in the late 1990s. If regional trade were really liberalized, according to ADB 2006, Kazakhstan could triple its exports to Kyrgyzstan and almost quadruple those to Tajikistan while more than doubling its imports from Russia.

Thus the question arises, how the existing and proposed trade agreements – if properly and fully implemented – would impact on Kazakhstan’s economy in the

light of joining the WTO and its commitment to global free trade.

### 5.4 Customs Unions and WTO Accession

THE STUDIES OF the ADB 2006 and Tumbarello 2005 provide some interesting information on the welfare effects of a fully implemented EAEC customs union.

Tumbarello employs a simple partial equilibrium model simulating the welfare impact on each EAEC member and finds that fewer than two scenarios on the welfare effects would be negative from a consumer point of view. In her first scenario (EAEC CU implementation *prior* to WTO accession) Tumbarello assumes that EAEC members will change their MFN tariffs in the direction of the highest rate currently prevailing among them on those lines for which the tariffs have not yet been bound. She justifies this assumption with that fact that those tariff lines not yet bound correspond mostly to goods being produced in EAEC states, and the latter therefore have a strong incentive to maintain the existing rate of protection on these products.

According to her simulations (see table 5.1), Kazakhstan will incur welfare losses of \$31 million, which are then ultimately borne by consumers via paying higher prices. This loss in consumer surplus (- \$255,2 million), however, is only partially offset by an increase in tariff revenue (+ \$223,4 million). Moreover, assuming that tariff rates would not decrease, there would also be no positive change in consumer surplus deriving from imports from EAEC members and thus no trade creation effects in general. For Kazakhstan, Tumbarello’s simulation predicts a decline in imports from non-EAEC countries, which will not be offset by an increase in imports from EAEC countries – the aggregate impact of implementing EAEC CU prior to WTO accession is thus net trade diversion.

The second scenario (EAEC CU *after* WTO accession) assumes that the EAEC countries change their MFN tariffs to match the EAEC’s current CETS and lower their MFN tariffs on goods not covered by the CETS to the lowest levels prevailing in the EAEC countries. Due to their WTO commitments, EAEC members would have difficulties in raising tariffs, and the CET would thus lie below the one assumed in the first scenario. Welfare in Kazakhstan would decline by \$2,3 million due to losses in consumer surplus (- \$19,4 million), which would not be offset by an increase in tariff revenue (+ \$16,9 mil-

lion). Thus, Tumbarello's simulations of the two sequencing paths show that both paths would cause a loss of economic welfare for Kazakhstan, but that WTO accession prior to implementing the EAEC customs union is less welfare harming compared to the opposite sequencing path from a consumer point of view.

**Table 5.1 Welfare effects on Kazakhstan of Implementing the EAEC Customs Union**

(in million US dollars)

	Change in tariff revenue	Change in consumer surplus	Net welfare effect
Prior to WTO accession	223.4	(255.2)	(31.8)
Following WTO accession	16.9	(19.4)	(2.4)

Source: Tumbarello (2005).

The ADB 2006 conducts a similar analysis of Kazakhstan by simulating a rising external tariff (from 7.4 % to 10.8 %) when implementing the EAEC CU. The computable general equilibrium model also shows considerable adverse effects: cumulative real GDP from 2005-2015 is almost \$10 billion less than it would be in the absence of the customs union. By 2015, real GDP would be 20.8 % lower than real GDP in the baseline scenario. These losses are caused by substantial trade diversion.

**Table 5.2 Welfare Effects on Kazakhstan of Implementing the EAEC Customs Union in 2006 with a Reduction in External Tariffs, 2006-2015**

	Cumulative change over Baseline scenario (in million US dollars at 2002 prices)	Cumulative change relative to 2005 (in percent)
Real GDP	(2.999)	(9.4)
Tariff revenue	(5.869)	(406.5)
Exports	1.889	7.7
Imports	1.395	6.4

Source: ADB (2006).

The ADB study also explores a different scenario (see table 5.2) by simulating a slightly falling CET (from 7.4 % to 5.4 %). Even with that reduction in Kazakhstan's external tariff, there would be substantial trade diversion from the EAEC. Exports to both EAEC and non-EAEC countries would grow faster than in the baseline scenario, but these gains would be offset by a fall in tariff revenue of \$5.8 billion. Compared to the first scenario of a rising CET, the adverse effects on eco-

nomie growth would still be negative, although, but much less so.

In sum, both studies suggest that an EAEC customs union will have substantial negative welfare effects for Kazakhstan. They also suggest that, if pursued nevertheless, Kazakhstan should join the WTO before pursuing a customs union.

## 5.5 The Case of Kyrgyzstan: Hub of the New Silk Route

KYRGYZSTAN JOINED THE WTO in 1998 and is embedded in FTAs and RTAs in the same way as Kazakhstan. A closer look at its economic development since WTO accession can give some insight about the possible effects of WTO accession combined with being member of the regional trade arrangements in CA. So far, Kyrgyzstan is the only CAR to accede to the WTO. As a consequence, after accession, its tariff bindings were substantially lower than the tariffs prevailing in other countries of the region. Thus, goods from all over the world flooded the Kyrgyz market and from there – in the apparent absence of enforceable rules of origin – entered the other CARs through the relatively liberalized regional trade framework of existing FTAs and the EAEC.

Some of Kyrgyzstan's neighbours responded by imposing tight restrictions on imports from Kyrgyzstan and the latter could not resort to WTO rules and procedures to repel these restrictions. In particular since the accession of China to the WTO in 2001, the massive Dordoi market outside Bishkek has become the major trading hub for Chinese goods into the CARs and Russia – joining the WTO has made Kyrgyzstan the centre of the new Silk Route. This re-export issue has led Kyrgyzstan's FTA partners to amended extra agreements to the existing FTAs in order to limit such trade, but their actions have also hindered Kyrgyz exports to its neighbours.

FURTHERMORE, WTO MEMBERSHIP creates potential problems in implementing an EAEC. The difficulty is that the EAEC CET could be inconsistent with Kyrgyzstan's WTO commitments – Kyrgyzstan's WTO-bound rates on many tariff lines are lower than the EAEC rates. But if the Kyrgyz Republic implements a future EAEC common tariff that is higher than its own, it will violate its commitments to the WTO. At minimum, other WTO members may then demand compensation.

## 5.6 Russian Economic Diplomacy in Central Asia

THE ROLE OF Russia and its regional economic diplomacy are crucial for analysis of the regional economic framework in Central Asia. Russia's regional economic diplomacy is driven in substantial part by a desire to maintain its grip on the former Soviet republics by establishing ever closer economic and, where possible, institutionalized ties with them. The EAEC CU and the CES, besides their economic motivations, must be interpreted in this geopolitical perspective. The launching of the CES in 2003, for example, was a clear response to the eastern enlargement of the EU and an attempt to bind Belarus and Ukraine closer to Moscow. In contrast to the one-country-one-vote structure of the WTO, the proposed RTAs allow Russia to dominate its smaller partners, and also to keep its relatively high level of protectionism. In the case discussed above of an EAEC CET, Moscow's dominant position might push some more liberal members to converge towards Russia's higher tariff rates and a more protectionist trade policy.

## 5.7 Concluding Comment

KAZAKHSTAN'S EVIDENT INTEREST in trade agreements with its Central Asian neighbours – and in particular with Russia – conflicts with its expressed desire to join the WTO, and may become the main barrier to its joining the WTO. The problem is not with either objective *per se*: it is with trying to achieve them simultaneously. Suppose that Kazakhstan and Russia had a functioning customs union, but that neither was a member of the WTO. In that circumstance, it is possible to visualize a tripartite negotiation in which the WTO negotiated an accession agreement with Russia and Kazakhstan jointly, and in which those two parties negotiated changes in the CET of the customs union that both of them, and the WTO, would accept.

If Kazakhstan and Russia were both members of the WTO, a negotiation between them aimed at a forming a customs union or an economic space would raise no problem in principle – though the partial steps towards such an end, which seem to be the outcome of actual agreements between them, would probably be inconsistent with the WTO. But for one country to enter the WTO before the other, in the absence of an established

customs union, would set an upper bound to the eventual CET of the customs union. Thus, if, for example, Kazakhstan joined the WTO from the existing situation, intending afterwards to pursue a customs union with Russia, the tariff it offered for accession would have to be acceptable to the WTO, but also to Russia. The burden of such a negotiation might be too heavy to be feasible; or, if embarked upon, too heavy to complete. Various commentators (for example, Tumbarello 2005 and ADB 2006) have argued that WTO entry should precede the negotiation of a customs union. That is a perfectly fair conclusion. The problem, though, is that unless entry into the WTO of the prospective customs union partners was undertaken simultaneously, one cannot be sure that the other will follow.

In particular, if Kazakhstan joined the WTO before Russia, and Russia failed to follow, Kazakhstan would be subject to WTO disciplines directly. If Russia and Kazakhstan were partners in a customs union, however, Russia would be indirectly subject to those disciplines through the common external tariff of the customs union. That is not a position that Russia will necessarily like. It could resolve it by joining the WTO; but it could also resolve it by breaking up the customs union.

## CHAPTER 6: WHAT WTO ACCESSION REQUIRES FROM KAZAKHSTAN

AT MINIMUM, WTO accession will require Kazakhstan to bring its practices and policies into line with WTO rules. That applies to, and must be expected by, any entrant, though it may be possible to negotiate a period for adjustment.

### 6.1 Policies Incompatible with Wto Membership

VARIOUS POSSIBLE DEVIATIONS of policy in Kazakhstan from the WTO rules have been noted in earlier chapters. Examples are different taxes for domestic goods and foreign goods; discriminatory freight charges for imports and exports; and discriminatory export taxes. Another possible example is the transaction passport.

WTO accession would require Kazakhstan to do away with discriminatory excise taxes: they directly contravene Article III of the GATT, which requires WTO members to provide national treatment in taxes

and regulation. The same applies to rail-freight charges. Similarly, discriminatory export taxes would have to be abolished: they conflict with MFN treatment. The transaction passport would have to go if, on examination, it proves to be – as seems likely – inconsistent with the Agreement on Customs Valuation.

Kazakhstan's current practices with respect to standards seem likely to breach the rules of the TBT (Technical barriers to trade) and SPS (Sanitary and phytosanitary) agreements. If so, they will have to be brought into conformity with those agreements.

## 6.2 Policies Likely to be Challenged

OTHER POLICIES DO NOT, strictly speaking, breach the formal rules of the WTO, but are nevertheless regarded with disfavour by important members, and are likely to be challenged in the course of Kazakhstan's accession negotiations.

### Tariffs

HIGH TARIFFS DO NOT directly contravene GATT rules, but Kazakhstan is likely to come under pressure to reduce its tariff peaks. By and large, an average tariff in the region of 7 percent is consistent with the levels of tariffs that have recently been accepted for countries acceding to the WTO. It is widely believed, however, that the WTO insists on a reduction in tariffs on accession, regardless of their starting level. Jensen and Tarr 2007, for example, postulate (pp 10-11) that WTO accession will require Kazakhstan to cut its current level of tariffs by 50 percent.

The specific element in certain Kazakh tariffs (that is a tariff that is stated as, for example, 30 per cent but not less than 2 euros per kilo) is unlikely to be acceptable to WTO members. Kazakhstan will almost certainly be required to abandon such tariffs.

### Government Procurement

THE GOVERNMENT PROCUREMENT Agreement (GPA) is a plurilateral agreement: one that is available for all members of the WTO to join, but that a founding WTO member was not required to join as a condition of WTO membership. Nevertheless, some countries acceding to the WTO are reported to have been pressed to join the GPA. That may be the position in which Kazakhstan will find itself.

## Investment Barriers and the GATS

BARRIERS TO FOREIGN investment in the provision of services maintained by Kazakhstan and discussed in Chapter 4 will certainly not be regarded favourably by all WTO members. Moreover, removal of them is the source of 70 percent of the gains that Jensen and Tarr 2007 estimate that Kazakhstan will receive as a result of joining the WTO.

There is, nevertheless, a question as to whether they are inconsistent with WTO rules. The General Agreement on Trade in Services (GATS) contains many exceptions and let-outs. It is far from clear that the practices noted above are inconsistent with the GATS

The local content and hiring provisions of Kazakh law, for example, breach national treatment and impose quotas on the visas to be given to non-Kazakh workers. GATS Article XVI certainly lists as "measures which a Member shall not maintain or adopt" practices that are close to those in the law of Kazakhstan. GATS Article XVI, however, only applies "in sectors where market-access commitments are undertaken"; and even then, the measures are permitted if "specified in its Schedule." A founding member of the WTO, therefore, could have legally maintained provisions like those of Kazakhstan either by refusing to make market-access commitments in the relevant sector; or by appropriately entering the potentially offending provisions in its schedule.

APPLICATION OF THE national treatment provisions of GATS Article XVII is similarly lacking in absolute force. Members are required to afford national treatment "[i]n the sectors inscribed in its Schedule, and subject to any conditions set out therein ..." A founding member of the WTO could therefore have maintained practices similar to those of Kazakhstan, that formally violate national treatment, either by not inscribing affected sectors in its schedule or by stating expressly in the schedule the conditions violating national treatment.

Kazakhstan is not a founding member of the WTO and may not be able to negotiate treatment similar to a founding WTO member for its own accession. It is nevertheless worth noting that removal of these practices is not an *automatic* result of WTO membership – their removal must be negotiated, whether expressly in the form of a Kazakh commitment to remove them, or implicitly in the form of a Kazakh commitment to inscribe relevant sectors in its schedule without condi-

tions that would permit the affected practices.

Abolition of these practices by Kazakhstan is likely to produce a substantial net economic benefit for Kazakhstan, as the results of Jensen and Tarr (2007) indicate. In Kazakhstan as elsewhere, however, policies are likely to have been set up for a purpose; and that purpose cannot be ignored in assessing the benefits and costs of changing the policies. One such purpose, for example, appears to be to encourage employment of more local labour than would otherwise be hired by foreign investors.

This general policy may or may not provide an economic benefit to Kazakhstan. An optimistic interpretation is that the policy is a means of providing on-the-job training for Kazakh workers: an investment in education that is likely to show a satisfactory social rate of return. A more pessimistic view is that it is a means of finding high-wage employment for Kazakh nationals who would not otherwise be employed by inward investors, who are not properly used or trained by those investors; and whose employment therefore has no investment aspect.

Which of these views best approximates the truth cannot be determined here. Another question, however, is whether Kazakhstan can find policies to expand local employment that are less expensive to it, and more compatible with WTO rules. Perhaps, in exchange for giving up its current policies, Kazakhstan can obtain authorization, perhaps temporary, to apply other policies that increase local employment.

An obvious way to do that, by way of example, would be to apply explicit quotas on employment or on the ratio of employment – so that an inward investor would be obliged to employ and train one local workers for every X foreign workers in a particular grade. Alternatively, the government of Kazakhstan could subsidize the employment of Kazakh workers by foreign investors.

These policies may differ less than appears at first sight. A quota requirement on local employment would cause inward investors to require a higher gross return from their investment, which would reduce the amount of tax that the government of Kazakhstan could feasibly impose upon them, and possibly, therefore, reduce government revenue. A subsidy to local employment, on the other hand, would not reduce government revenue, but would require an increase in government expenditure. But from an economic point of view, a policy that results in a fall in government revenue with constant expenditure is not substantially different from one that causes a similar rise in government expenditure with revenue constant.

However, are these policies – or variants of them – compatible with WTO rules? At first glance, they do not appear to conflict with the GATS.

GATS Article XV deals with subsidies, but essentially says that disciplines will be developed (though no such disciplines have yet found their way into legislation). GATS Article XVI focuses on “market access”, and bans certain quota arrangements unless they are inscribed in a member’s schedule. None of the banned practices, however, resembles a quota on, or a subsidy to, the employment of local workers. Article XVII – “National treatment” – requires a member (subject to qualifications set out in its schedule) to provide foreign suppliers of service with treatment “no less favourable than that it accords to its own like services and service suppliers.” A quota requiring employment by foreign firms of Kazakh nationals might fall foul of this, even if the quota also applied to domestic firms; it might be argued that the requirement was less burdensome for a domestic firm than for a foreign firm. It would, however, be more difficult to make such an argument for a subsidy to local employment.

Within the constraints imposed by the GATS, therefore, it appears possible that Kazakhstan could negotiate with the WTO policies to increase local employment by foreign investors. Should Kazakhstan be required to abandon its current policies, therefore it has a possible compromise solution that would see it abandoning policies that offend WTO members in exchange for permission to use policies of the type noted above.

### 6.3 The Russian Problem

THE FINAL PROBLEM to be discussed is an issue of international relations –Kazakhstan’s relationship with Russia, in particular, but also with other republics of the FSU in its neighbourhood. When Kazakhstan applied for membership in the WTO, in 1996, it seemed certain that Russia would also join. Now that prospect seems somewhat less certain, so Kazakhstan must consider how membership of the WTO by Kazakhstan might affect its relations with its neighbours if some of them – and especially Russia – are not WTO members.

The Russian problem is not merely a matter of economic policy, and is more difficult to discuss than economic policy. It essentially turns on the valuation placed on intangibles (friendship and co-operation with countries of the region) by the government of Kazakhstan – valuations which cannot easily be questioned by outsiders.

The problem emerges in the context of WTO accession because of the expressed desire of Kazakhstan to form a customs union or an “economic space” with Russia and/or the Central Asian neighbours of Kazakhstan; but, in any event, an arrangement that entails a common external tariff. A difficulty that then arises is that if some but not all of the proposed members of the customs union or economic space are members of the WTO, they will have made commitments to the WTO regarding their tariffs. Those commitments therefore add a degree of rigidity to the process of negotiating a common external tariff. In the extreme, the requirement on the non-members of the WTO to adjust to the tariffs of the WTO members may render the custom union unattractive to them.

IF RUSSIA ENTERED the WTO before Kazakhstan – which has been the expected course of events – Kazakh accession would raise no major problem. There would be an issue with the Russian WTO tariff if Kazakhstan wanted to form a customs union with Russia – in that event, the tariff agreed between Russia and the WTO would constitute an upper bound on the common external tariff of the possible customs union. That seems unlikely to be a serious problem, however, and, in any event, Kazakhstan could make representations to the government of Russia if in the process of accession the Russian government appeared to be reaching agreement with the WTO on tariff levels that would create problems for Kazakhsta

The problem would certainly be more severe if Kazakhstan acceded to the WTO first with Russia certain to follow. It would not, though, be different in kind. If a customs union were in prospect, Russia would have a direct interest in the tariff levels negotiated by Kazakhstan, since these would then form an upper bound for the CET. This would make for a cumbersome negotiation but, probably, a manageable one.

THE REAL PROBLEM arises if Russia sets its face against WTO membership and objects to an indirect WTO discipline on itself via Kazakhstan membership of the WTO, when Kazakhstan is also a partner of Russia in a customs union. In that event, Kazakhstan could be faced with a choice between a customs union with Russia and membership of the WTO. Were it faced with that choice, it is clear which alternative it should choose, from an economic point of view – it should choose the WTO. Which alternative it should and would choose in geo-political terms, however, is very much less clear; and only the government of Kazakhstan can make that judgment.

## 6.4 Concluding Comment

A BASIC CASE, that Kazakhstan should not be required to do much more than conform with WTO rules, is that, properly considered, Kazakhstan’s gains from joining the WTO are small. As the benefits to Kazakhstan of WTO membership are small, it can be argued, so should be the “price of membership” that the WTO asks Kazakhstan to pay.

Even were Kazakhstan to be offered a low entry price, however, it is conceivable that Kazakhstan would reject membership of the WTO. That possibility arises if Kazakhstan thought that Russia would not enter the WTO, and that membership of the WTO of Kazakhstan would foreclose the possibility of a customs union or economic space including both Russia and Kazakhstan.

## CHAPTER 7: KHAZAKSTAN’S ACCESSION TO THE WTO: A QUANTITATIVE ASSESSMENT

### 7.1 Introduction

TRANSITION FROM A planned economy to a market economy entails major changes in institutions and, probably, changes in the direction of trade flows. According to recent literature (Kurkharchuk&Maurel 2004; Rose 2005) improving the quality of institutions or belonging to a trading bloc can have substantial positive effects on trade. This chapter evaluates the potential benefit of the accession of Kazakhstan to the WTO. The idea is that accession to the WTO involves a short run benefit from further reducing tariff and non-tariff barriers, and a long-term strategy that involves institutional reforms.

Economic reform in Kazakhstan began in the 1990’s, and as mentioned in previous chapters, its endeavours to shift from a transition economy to a market economy have been substantial. It is argued in this paper that although Kazakhstan’s trade policy with its major partners is well in place, it still has weak market institutions. So Kazakhstan’s accession to the WTO will work best with complementary institutional reforms.

To provide estimates of the impact of institutional reform on Kazakhstan’s potential trade, this chapter uses conventional empirical methodology and standard data sets. The empirical model chosen is the basic gravity model that is augmented to investigate the impact of institutions on trade and to provide estimates of trade

flows between Kazakhstan and its major trading partners. The aim of the study is not to provide any novelty in terms of theory or methodology, but rather to use existing models to provide results for Kazakhstan's economic integration. The rest of the chapter is structured as follows. Sections 7.2 and 7.3 present the gravity model, the econometric methodology used to determine the results and the data set. The empirical results are discussed in Section 4 and finally, the chapter concludes in Section 7.5.

## 7.2 Econometric Methodology

TO ESTIMATE THE effects of trade policy reform and institutional reform on potential trade, the quantitative analysis relies on the standard gravity model of bilateral trade. In its simplest form, the gravity equation states that bilateral trade between two countries is an increasing function of the incomes of the two trading entities and a decreasing function of the distance between them. The gravity equation has performed extremely well empirically and provides a natural benchmark to which a number of other explanatory variables can in turn be added.<sup>9</sup> This study follows the recent work of Babetskaia-Kurkharchuk&Maurel, 2004, on Russia's accession to the WTO and augments the basic gravity model with two sets of variables. These include: indexes for institutions (e.g., trade policy, a measure of tariff and non-tariff barriers) and a set of dummy variables indicating Kazakhstan's trade partners (e.g., trade flows from Kazakhstan to the European Union).

The exact specification of the gravity model to be estimated is as follows:

$$\begin{aligned} \ln X_{ij} = & \alpha_0 + \alpha_1 \ln Y_i + \alpha_2 \ln Y_j + \alpha_3 \ln D_{ij} \\ & + \alpha_4 \text{Trade Policy}_j + \alpha_5 \text{Foreign Investment}_j + \alpha_6 \text{Financial Services}_i \\ & + \alpha_7 \text{Corruption}_{ij} + \sum_k \gamma_k \text{DUM}_k + \varepsilon_{ij} \end{aligned}$$

The subscripts indicate trade flows from the exporting country ( $i$ ) to the destination country ( $j$ ). The dependent variable  $X_{ij}$  denotes the value of real exports from country  $i$  to country  $j$ . Explanatory variables  $Y_i$  and  $Y_j$  denote respectively the level of real GDP in countries  $i$  and  $j$ . They are expected to have a positive sign, because they capture the idea that higher income countries will

tend to trade more with each other. The variable  $D_{ij}$  denotes the geographical distance from the capital of country  $i$  to the capital of country  $j$  and is used as proxy for transportation costs. Distance is expected to have a negative impact on bilateral trade.

The next set of variables is used to augment the model in order to investigate the impact of institutions on Kazakhstan's bilateral trade. The institutional variables used in the model are collected from the *Index of Economic Freedom*, which are composed of indexes that influence economic growth. Each index is graded using a scale from 0 to 100, where 100 signifies an environment that is most conducive to economic freedom. Given that more freedom encourages trade, the sign of the index variables on trade are expected to be positive.

THE FIRST VARIABLE selected is *Trade Policy* <sub>$j$</sub> , which indicates trade freedom in the destination country ( $j$ ). Trade Policy is a measure of the absence of tariff and non-tariff barriers that encourage the free flow of foreign commerce. The second is *Foreign Investment* <sub>$j$</sub> , a variable for openness to foreign investment in country ( $j$ ). This variable is of particular interest, because as mentioned by Jensen & Tarr (2007), Kazakhstan has done more to lower its tariffs than it has to liberalize its barriers to foreign direct investment. The third variable among this group is *Financial Services* <sub>$i$</sub> , the exporting country  $i$ 's banking services and especially their independence from government control. The availability of competent financial institutions plays an important role in increasing the productivity of Kazakh firms and promoting international trade. Finally, a measure of *Corruption* <sub>$ij$</sub>  is included to control for corruption differences between the trading entities. As opposed to the other control variables, the latter is measured in terms of the absolute value of the difference of the two trading partners' freedom of corruption index. Its coefficient is expected to be negative; because the higher the difference in corruption between the countries, the more reluctant they are to trade. The reason for doing so is methodological and it is to reduce multicollinearity among the institutional variables

The last variables  $\text{DUM}_k$  denote dummy variables, which are configured to identify Kazakhstan's exports to and imports from its major trading partners, namely the European Union (EU-15), the Central and Eastern European Countries (CEEC), the Commonwealth of Independent States (CIS), China, and the Rest of the

9. More discussion of the gravity model can be found in Feenstra (2004) and Anderson & Wincoop (2003).

World (RoW).<sup>10</sup> These variables capture the trade bias with a trading partner. For example, the dummy variable Kazakhstan → CIS is equal to one whenever the exporting country is Kazakhstan and the importing partners the CIS. Thus, CIS → Kazakhstan denotes CIS country exports into Kazakhstan. These dummy variables are created to assess effective trade relative to potential trade.

The gravity equation is estimated using ordinary least squares (OLS) with standard errors that are robust to clustering by country-pairs. A set of year dummies is also included to control for business cycles. Furthermore, the gravity equation is also estimated using generalized least square or random effects (GLS) as a robustness check.

### 7.3 Key Data

THE TRADE DATA, which cover the period from 1995 to 2006 come from the IMF's Direction of trade statistics (DOTS) obtained from Thomson Datastream database. It contains data on the value of exports between each country and all its trading partners. The list of exporting countries and destination countries is included in the Table A.1 in the appendix. Total exports are valued free on board (FOB) and are recorded in current American dollars; so the data is deflated using the CPI of each exporting country, using the World Bank's World Development Indicators (WDI 2007). The real GDP data (in constant American dollar) is also obtained from the WDI 2007. Information on distances between trading countries is collected using the CEPII online database ([www.cepii.fr](http://www.cepii.fr)) and the institutional indexes come from the Heritage foundation (2007) Index of Economic Freedom that can be found at [www.heritage.org/Index/](http://www.heritage.org/Index/). The panel data obtained consists of 34,763 observations, which allows consistent estimation for the chosen explanatory variables.

### 7.4 Empirical Findings

ESTIMATIONS OF THE gravity model, using ordinary least squares (OLS) corrected for heteroskedasticity and generalized least square (GLS or random effects) are respectively reported in column 1 and 2 of Table 7.1. The good news is that both regressions point out that the model

works well. Countries that are farther apart trade less, while economically larger and richer countries trade more. These results are interpreted by the sign of the coefficients associated to each variable. For example, according to the OLS specification the coefficient for the GDP of the destination country ( $\ln \text{real GDP}_j$ ) is 0.77, which implies that the larger its GDP the higher its imports. These basic gravity coefficients are not only large but economically very significant and consistent with previous research.

**Table 7.1 Gravity equation estimation**

	OLS	GLS
$\ln \text{real GDP}_j$	1.00*** (0.01)	1.00*** (0.01)
$\ln \text{real GDP}_i$	0.77*** (0.01)	0.79*** (0.01)
$\ln D_{ij}$	-1.06*** (0.03)	-1.05*** (0.01)
Trade Policy <sub>ij</sub>	0.46*** (0.15)	0.58*** (0.08)
Foreign Investment <sub>ij</sub>	0.37*** (0.12)	0.25*** (0.07)
Financial Services <sub>ij</sub>	0.77*** (0.11)	1.08*** (0.06)
Difference in corruption <sub>ij</sub>	-0.65*** (0.10)	-0.42*** (0.05)
Kazakhstan → EU-15	0.23 (0.32)	0.03 (0.19)
Kazakhstan → CEEC	1.20*** (0.29)	1.32*** (0.20)
Kazakhstan → CIS	2.59*** (0.37)	2.71*** (0.17)
Kazakhstan → RoW	-0.24 (0.24)	-0.27** (0.12)
Kazakhstan → CHINA	2.46*** (0.24)	1.44*** (0.32)
EU-15 → Kazakhstan	0.48 (0.34)	-0.45** (0.22)
CEEC → Kazakhstan	1.03*** (0.18)	0.84**
CIS → Kazakhstan	2.72*** (0.07)	1.53*** (0.40)
RoW → Kazakhstan	-0.83*** (0.29)	-0.83*** (0.18)
CHINA → Kazakhstan	2.27*** (0.28)	1.13 (1.00)
Observations	34,763	34,763
R-squared	0.61	0.61

Notes :Regressand :  $\ln$  real exports. OLS with year dummies and corrected for heteroskedasticity (intercept not reported). GLS refers to random effects. Robust standard errors in parentheses. The goodness of fit is measured by adjusted R-squared for OLS and overall R-squared for the random effects.  
 \*\* Denotes significance at 5 % level.  
 \*\*\* Denotes significance at 1 % level.

10. The European Union is split into the EU-15, which refers to the 15 European countries before the enlargement and the CEEC, which refers to the 10 Central and Eastern European Countries that have joined the EU since 2004. Cyprus and Malta are not included. The reason for splitting the European Union into two blocs is that Kazakhstan tends to trade more with CEEC countries and furthermore, the data runs from 1996 to 2006, during which the EU was mainly composed of the 15 original members. Countries included are listed in Annex 5.

Beyond the basic gravity model, the model reveals that institutions have substantial effects on trade. All institutional coefficients are statistically different from zero and highly significant. A sound trade policy that lowers tariff and non-tariff barriers and improves market access improves trade. Reduction in barriers against foreign investments will also in return be beneficial to the economy because it promotes the free flow of capital. Moreover, improving financial services and their independence from government interference reduces inefficiencies in the credit market and fosters economic growth. Corruption in this model is expressed in terms of the absolute value of the difference of the two trading partners' corruption levels, and it is configured so that a higher value is associated with greater corruption. The coefficient associated to corruption is negative, implying, as hypothesized, that corruption is an obstacle to trade.

**Table 7.2 Effective trade relative to potential trade (in %)**

Econometric procedure	OLS	GLS
Kazakhstan → CIS	1333	1503
Kazakhstan → CHINA	1170	422
Kazakhstan → CEEC	332	374
Kazakhstan → EU-15	100	100
Kazakhstan → RoW	100	76
CIS → Kazakhstan	1518	462
CHINA → Kazakhstan	968	100
CEEC → Kazakhstan	280	232
EU-15 → Kazakhstan	100	64
RoW → Kazakhstan	43	44

Notes : Table 2 shows how Kazakhstan trades with its partners. The values indicate by how much Kazakhstan's imports or exports are above (or below) the normal value. For example, using the OLS estimates, Kazakhstan's exports to the CEEC countries are 3 times (332 %) above its normal level and its imports from the RoW are 43 % below its normal potential. Note that 100 signifies that the coefficient of the variable is not significant, which suggests that the potential increase in trade has still not occurred, thus not much can be deduced.

The dummy variables, which are designed to distinguish Kazakhstan's exports and imports from its main trading partners, also reveal several interesting points. The dummy coefficients can be used to compute effective trade as a percentage of potential trade to be able to determine if the trade level is above what it would

be if it was determined solely by the gravity model. The results of the computation are presented in Table 7.2. According to the OLS regression, Kazakhstan's exports to the CIS reveals a coefficient of 2.59, which implies that exports to the CIS are 13 times (1,333 percent) more than the gravity equation average.<sup>11</sup> Although the magnitude seems to be astonishing, the result is inline with previous research that has been carried on trade within the CIS countries (Babetskaia-KurkharchukMaurel, 2004).

Regarding exports to China, the magnitude is about the same as Kazakh exports to CIS countries. This again does not astonish, given China's economic growth, its dependency on energy resources, and the fact that it shares a border with Kazakhstan.

According to both the OLS and GLS estimates, Kazakhstan's trade with the EU-15 and the rest of the world (RoW) is depressed. The GLS procedure indicates that exports from Kazakhstan to the RoW are at 76 % of their normal level, while imports from the rest of the world stand only at 44 % and at 64 % with the EU-15. A final remark is to note that Kazakhstan's export profile is stronger than its imports suggesting that economic reform would probably benefit Kazakhstan's imports more than its exports.

To assess the impact of institutions on trade, the rest of the analysis will compare actual trade to a counterfactual situation in which institutions in Kazakhstan had attained the level of quality of the EU-15 institutions. Table 7.3 reports the scores of institutional variables in both Kazakhstan and the EU-15.

**Table 7.3 Institutional scores in Kazakhstan and the EU-15**

Index of Freedom: 2007 Scores	Institutions in Kazakhstan	Institutions in the European Union (average score)
Trade policy	69	85
Foreign investment	30	77
Financial services	60	71
Corruption level	26	77

Source: *Index of Economic Freedom*.

As can be seen, institutions in the European Union perform better than the institutions in Kazakhstan. So an improvement in institutions should have a positive

11. Since the regressand is the natural logarithm of real trade, the ratio of effective trade relative to potential trade is equal to  $\exp(2.56)=1333\%$ .

impact on trade as suggested by the gravity model. The potential increase in trade due to institutional improvements is reported in Table 7.4.<sup>12</sup>

**Table 7.4 Impact of institution improvement on Kazakhstan's trade (in %)**

	Potential increase in trade
Trade policy	8
Foreign investment	19
Financial services	9
Corruption level	40
<b>Total</b>	<b>75</b>

Source: *Index of Economic Freedom*.

The model suggests that if institutions in Kazakhstan attained the level of those in the EU-15, trade would increase by 75 percent. Much of this increase, at 40 percent, is due to improvements in corruption. These findings suggest that in the short run, gains to Kazakhstan from joining the WTO are 8 percent due to improvement in trade policy. In the medium to long run, the regulatory and institutional reforms that the WTO accession process entails would bring benefits. The potential trade gains due to institutional reforms could be as high as 68 percent.

## 7.5 Concluding Comment

THIS CHAPTER DEVELOPED an empirical model to examine Kazakhstan's accession to the WTO. A gravity model was used to assess Kazakhstan's trade flows with its major partners and to investigate whether and how institutional improvements facilitate trade growth. The first result from assessing Kazakhstan's imports and exports suggests that further liberalization would benefit Kazakhstan's imports more than its exports. The second result of the quantitative analysis indicates that institutions play an important role on trade flows. Higher institutional qualities make trade more attractive and profitable by providing an environment that is conducive to safe exchanges. The sources of the largest gains to Kazakhstan from WTO accession are the reduction in corruption and the liberalization of foreign investments, which are long term objectives. So it should be noted that membership to the WTO is not sufficient to increase trade without complementary institutional reforms.

## CHAPTER 8. MAKING THE MOST OF WTO MEMBERSHIP: FOUR CASE STUDIES

ACCESSION TO THE WTO comes at a cost. The bar to entry has been raised much higher since the end of the Uruguay Round. The accession procedure is complicated; it consumes time and resources. Concessions demanded of applicants go wide and deep. They require considerable domestic adjustment, and can be politically difficult.

Nevertheless, when trade – and associated inward investment – move closer to the heart of national economic activity and growth prospects, WTO membership becomes a higher priority. It guarantees access to export markets through unconditional and non-discriminatory Most-Favoured-Nation (MFN) status. Its rules provide members with rights against the arbitrary protection of more powerful countries. A strong dispute settlement mechanism gives these rights legal force, and allows members to work out conflicts in an orderly, containable manner. Membership also confers a seat at the negotiating table, with a better chance to bargain for more export market access and participate in strengthening rules. Finally, and perhaps most importantly, WTO accession locks in domestic market-based reforms and provides a framework for further reforms. For transition economies, it represents an important staging post in the journey from Plan to Market.

The impact of WTO accession potentially goes much deeper than relatively simple border barriers to trade. Now the main obstacles to doing business in transition economies have less to do with formal border barriers and more with (formal and informal) non-border barriers. These concern the unpredictability and arbitrariness that come with large regulatory discretion; the lack of a rule of law in terms of impartial judicial oversight and enforcement of property rights and contracts; and the anti-competitive drag of state-owned industrial enterprises and state-owned banks. All this gets deep into domestic economic policies and institutions. It concerns the long-term restructuring of the state, away from pervasive interference and in the direction of a smaller, more limited operation that can perform fewer functions better. This is a vast trade-related reform agenda; but it has as much to do with the liberalization of internal trade and the integration of domestic markets as with further

12. The computations required to obtain these results are provided in Appendix B.

external liberalization. A “weak” WTO-accession agreement would have little impact on these domestic regulatory barriers, while a “strong” accession would indeed have an appreciable impact. Accession agreements after the Uruguay Round, have tended to be strong. But ultimately, the real impact of WTO accession depends on the political commitment of applicant governments and the strength of ongoing domestic reforms.

To illustrate the link between accession and domestic trade-related reforms, this chapter examines the accession experience of four new members. China and Vietnam are outstanding examples of proactive governments that used WTO accession as a lever to consolidate and accelerate their unilateral reforms. In 2001, China negotiated the most comprehensive protocol of accession in the history of the WTO, with substantial commitments across the board. Vietnam followed with a similarly strong accession in 2007. Kyrgyzstan is a former Soviet satellite country that quickly completed its accession process (1996-1998). Finally, Saudi Arabia’s accession in 2005 illustrates the specific experience of an oil-exporting country. All accessions have to be judged on their own merits. But the experiences of the accessions studied in this chapter provide useful information for Kazakhstan’s pending accession.

## 8.1 China: Most Far-Reaching Commitments Ever

CHINA’S FIRST DECADE of reforms centred on internal liberalization, especially in agriculture. Then followed a brief period of uncertainty and suspense after the Tiananmen Square massacre. In the last decade-and-a-half, however, China has undertaken the biggest trade-and-investment liberalization programme that the world has ever seen. In a short time, China has swung from extreme protection to rather liberal trade policies – by developing country, standards very liberal. Indeed, China undertook enormous unilateral liberalization of trade and FDI, and with it sweeping industrial and agricultural restructuring, in the decade *before* WTO accession. That still left significant knots of up-front protection: declining state-run industries; oil and sensitive agricultural commodities subject to monopolistic state-trading arrangements; high-tech industries targeted for industrial-policy promotion; and, most important, the services sectors. This reform process was crowned by China’s accession to the WTO in 2001, with by far

the strongest commitments of any developing country. The pace of internal and external liberalization continued thereafter, though its momentum has slowed down recently.

CHINA, EXCEPTIONALLY, GAVE WTO membership top, overriding priority. Crucially, the Chinese leadership used the WTO accession process as a pillar to bolster domestic reforms: it used entry to the WTO and binding WTO commitments as a device to speed up the transition to a market economy. China’s WTO commitments are very strong. They exceed those of other developing countries by a wide margin. This holds not only for tariff ceilings on goods (including agriculture), but also for border and behind-the-border NTBs in goods *and* services. Very strong commitments are not just of the “first-generation-reform” type (border barriers), but also go deep into “second-generation” institutional reforms. Notably, there are detailed commitments on judicial and administrative review, and other transparency procedures, on all manner of domestic regulation (e.g. on services, intellectual property and product standards).

In terms of WTO tariff bindings, China’s simple-average level of protection comes down to 9.8 percent. This breaks down into 9.5 percent on manufactures and 13.2 percent on agricultural goods. All China’s tariffs are bound. The most drastic reductions are in manufactures, particularly textiles, clothing, automobiles (from 123 percent in 1995 to 25 percent), electronics and petrochemicals. China’s membership in the Information Technology Agreement takes its tariffs on computers, telecommunications equipment, semiconductors and other IT goods down to zero. In agriculture, the biggest reductions are in processed food, beverages and tobacco.

Applied tariffs are lower than WTO bound rates, especially for industrial goods. Once weighted by the volume of imports, the overall average tariff on merchandise trade came down to 6.8 percent after WTO accession (6.9 percent on manufactures and 3.6 percent on agriculture). This was a massive reduction from 40.6 percent in 1992 and 22.6 percent in 1996; and it almost halved the 12 percent average tariff at the time of accession. These figures are for statutory tariffs. The actual level of tariff protection is even lower when duty exemptions (e.g. to attract FDI for export reprocessing) are taken into account. These are astounding numbers – even more so when compared with other countries. China’s weighted-average tariffs, overall and on manufactures, are approaching *developed-country levels* (in the

region of 3 percent for the US, EU and Japan). They are below developing-country levels (an average-applied rate of 13 percent, GATT-bound at a 25 percent average after implementation of the Uruguay Round agreements). For comparison, Egypt applies simple average tariffs of 13.7 percent (bound at 36.8 percent), India 14.7 percent (bound at 49.2 percent) and Brazil 12.3 percent (bound at 31.4 percent). Apart from tariff reductions, there are disciplines on state-trading enterprises, and tight disciplines on trade-distorting domestic subsidies. Export subsidies are banned. Commitments on other NTBs to imports of goods are equally strong. Nearly all import as well as specific tendering arrangements (377 specific items in all) were eliminated by 2005, with disciplines on remaining NTBs. Most remaining price controls were also eliminated. Remaining restrictions on trading rights were phased out. By 2004, all firms, domestic and foreign-owned, with or without production facilities in China, could register to have the right to import and export goods.

In *agriculture*, high tariffs stay in place on sensitive products, especially grains (wheat, rice, maize), sugar and cotton. But these products now have tariff-rate quotas with quite low in-quota tariffs (in the 1-15 percent range), and with large quota increases phased in. State-trading enterprises will continue to operate quotas, but their monopolies will disappear and they will face competition from private enterprises. In addition, there are tight disciplines on agricultural subsidies. Trade-distorting domestic subsidies are capped at 8.5 percent of the value of production

CHINA AGREED TO fully implement the WTO agreement on TRIMS, without exemptions. All export-performance, local-content and foreign-exchange-balancing requirements on foreign-owned firms are banned. Imports can no longer be made conditional on these requirements.

China's WTO intellectual-property regime has been transformed. It has adopted the WTO's TRIPS agreement in full, and without a transition period. Legislation on patents, trademarks, copyrights, trade secrets and integrated circuits has been amended in conformity with TRIPS.

Furthermore, China adopted the WTO's agreements on TBT and on SPS upon accession, also without transition periods. This requires transparent, non-discriminatory, science-based standards of assessment on goods imports. It will help bring China up to accepted inter-

national standards of practice, such as those set by the Codex Alimentarius on food safety.

In services, the impact of WTO accession has been, roughly, to cut protection by half. With a 6-year phase-in period, this is the most radical programme of services liberalization ever seen. At least on paper, China's commitments in the GATS will transform a highly protected market into one of the most open in the developing world. This massive net liberalization contrasts with developed countries' and other developing countries' weak GATS commitments. Furthermore, its national-treatment commitments, across sectors and modes of supply, are more substantial than all other country groups.

New licenses to foreign banks are granted solely on prudential criteria, with no quantitative limits on licenses or restrictions, such as an economic needs test. Foreign currency and most domestic currency business can be conducted without geographic or other restrictions. In insurance, new licenses are also awarded solely on prudential criteria. Foreign life insurers are permitted up to 50 percent equity in a joint venture. Foreign non-life insurers can operate wholly owned subsidiaries without geographic restrictions. Foreign securities houses are allowed minority equity (up to 49 percent in some cases).

IN TELECOMMUNICATIONS, MAJORITY foreign ownership is not allowed in any area, but foreign firms are supposed to have substantial market access. On wired and mobile voice-and-data services, foreign ownership can go up to 49 percent with no geographic restrictions. In value-added services (i.e. Internet services), foreign ownership can go up to 50 percent. China has also accepted to separate regulatory from operational functions, establish an independent regulator, and provide interconnection rights and cost-based pricing so that foreign-invested joint ventures can compete with China Telecom.

Professional services were significantly liberalized. Legal and medical services in particular continue to have major restrictions on foreign participation. Foreign law firms can operate without quantitative and geographic restrictions. Foreign firms providing accountancy, engineering, urban-planning and architectural services can operate with wholly owned subsidiaries. Foreign suppliers of construction services are allowed full ownership but with restricted geographic scope. Transport services are opened up except hard traffic rights in civil aviation, which is excluded from the GATS. Also, foreign-owned

firms have the right to distribute almost all products, whether imported or locally made, through wholesale and retail systems in China. No other WTO member has made such deep commitments in this sector.

Trade remedies are another feature of China's accession to the WTO. China has adopted new anti-dumping legislation in conformity with GATT provisions – with the protectionist bias of similar legislation in other developed and developing countries. However, the innovation here is extra-generous allowance for *other* WTO members to protect their markets against Chinese exports. First, WTO members can use special anti-dumping measures against China until the end of 2015. They can continue to designate China a “non-market economy” and apply a special methodology for determining dumping margins. This involves using “shadow” reference prices in other countries, going well beyond the (fairly generous) provisions in GATT Article VI. In essence, this makes dumping even easier to find. Second, there is a new China- and product-specific safeguard instrument to restrain a surge of imports. This will be in force until the end of 2012. Its “material-injury” definition and related procedures make it easier to use than the safeguard provisions in GATT Article XIX. Third, a safeguard instrument specific to textiles and clothing will be in force until the end of 2008.

China's commitments go beyond up-front liberalization: transparency in implementing trade-related laws and regulations are strongly built in, too. New trade-related laws and regulations have to be translated into English and published regularly in designated official journals. Enquiry points have to be established so that foreign firms and governments can request information. Normally, responses should be forthcoming within 30 days. A reasonable period of time will be allowed for comment before new laws and regulations come into force.

Laws and regulations relating to WTO obligations have to be applied uniformly throughout China – vertically (at sub-national as well as central levels of government) and horizontally (in all cities and regions). Individuals and firms have recourse to a new internal review mechanism to investigate instances of non-uniform application. Finally, new – and supposedly independent and impartial – tribunals are to review administrative acts relating to implementation of WTO commitments. Individuals and firms can bring problems to the attention of tribunals, with the right of appeal to higher judicial bodies. This is nothing short of fundamental legal innovation in China – one major step in the direction of

the rule of law. Finally, the WTO set up an annual Transitional Review Mechanism to scrutinise China's implementation record. It runs annually for 8 years, with a final review in the 10th year.

THE MAIN SHORT-TERM effect of WTO accession was to accelerate the restructuring of the Chinese economy away from agriculture and towards manufacturing. The surge in garments exports, especially after the phase-out of MFA quotas, is but one symptom of a broader surge in labour-intensive manufactured exports. China's WTO membership is, of course, a powerful signal to attract more FDI in manufacturing, as well as FDI in newly opened services sectors. Finally, as a result of previous liberalization locked in by WTO commitments, China will have a relatively open agricultural market. It will not be able to follow the East-Asian Tigers' path of ever-increasing agricultural protection to accompany industrialization.

China's record since it became a member of the WTO has not been without controversy – not surprising given such a huge and complicated accession. Implementation of WTO commitments has been mixed. Commitments on tariffs, border NTBs and trading rights have been implemented comprehensively and on schedule. However, other members – particularly the USA, and followed by the EU – have complained loudly of widespread Chinese infringements in other areas, notably TRIPS, regulation of services, industrial subsidies, implementation of WTO rules by provincial and municipal authorities, and general lack of regulatory transparency. Until recently, China and its trading partners exercised restraint in taking cases to WTO dispute settlement. This has changed. The USA has led the charge in prosecuting several cases – on auto parts, TRIPS and subsidies – currently working their way through dispute settlement. Finally, the USA and EU argue that Chinese reforms have slowed down, notably on further liberalization of investment and services, and that “investment nationalism” and associated industrial-policy measures are on the rise.

Despite such post-accession complications, China is a textbook example of how WTO accession works in tandem with national market-based reforms. Unilateral pre-accession liberalization was locked in by accession. Strong WTO commitments provided a springboard for further reforms. This acted as a signalling device to accelerate the growth of trade and foreign investment. China has become a strong WTO stakeholder, active in

multilateral rule-enforcement and dispute settlement (though less so in Doha Round negotiations). Arguably, the embedding of China in the WTO has defused manifold international trade tensions that might otherwise have got out of hand; and it has smoothed China's rapid integration into the global economy. None of this would have been possible without the Beijing leadership's strategic use of WTO accession to speed ahead with domestic reforms. That was the critical factor.

## 8.2 Vietnam: Following China's Path

IN VIETNAM, THE process of market-oriented reforms started with agriculture in the 1980s. *Doimoi*, the "great renovation", adopted in December 1986 by the Sixth Party Congress launched the first phase of deep reforms. The government relaxed controls on inter-provincial and international trade, investment, land-use, banking and industrial policies. The programme culminated in 1988 with the adoption of laws replacing cooperative agriculture by household production, promoting private enterprises and establishing the first system of tariffs (in place of quantitative trade barriers). In 1993, the government granted farmers the right to use the land on a long-term basis (99-year leases). Farmers started to increase investment and production in what would become Vietnam's agricultural export engine.

IN 1995, VIETNAM joined the Association of Southeast Asian Nations (ASEAN), thereby agreeing to the ASEAN Free Trade Area (AFTA). It committed to reduce tariffs, eliminate export quotas and remove many quantitative restrictions on imports, with only seven product lines remaining subject to import quotas. Vietnam joined APEC in 1999. Before the end of the decade, it replaced the mono-bank system with a two-tier system in which the State Bank of Vietnam acts as a central bank with a macro-economic and financial supervision role. Finally, Vietnam's most significant trade agreement pre-WTO accession was the Bilateral Treaty of Accession (BTA) with the USA in 2000. This covered wide-ranging commitments in conformity with WTO norms and granted substantial preferential market access to the US. Vietnam agreed to provide full trading rights to all Vietnamese enterprises for all products, and extend trading rights for US firms gradually over six years. It committed to removing all import quotas within seven years and grant MFN treatment to US goods. Tariffs were reduced on average from 38 percent to 27 percent on 176 agricul-

tural products and from 36 percent to 25 percent on 49 industrial goods. Vietnam also agreed to provide substantial market access to US-based services providers, especially in banking and telecommunication services. Finally, it committed to implement WTO-compliant legislation on TRIPS, TRIMS, transparency, and technical standards and measures.

After starting negotiations to join the WTO in 1995, it took nearly twelve years for the Working Party to agree to specific terms of accession for Vietnam. The Vietnamese government, unlike its Chinese counterpart, was reluctant to make significant concessions in the first five years of negotiations. This coincided with a slowdown of domestic reforms. Only after the BTA was signed did the Vietnamese government show willingness to make greater concessions, which reflected a pickup in domestic reforms. The latter really speeded up from 2004/5. New trade-related laws were intended to improve regulatory transparency and predictability. The government accelerated reforms of the financial sector and public finances. There was a raft of new trade-related laws: the Competition Law; the Law on Enterprises (which harmonizes the legal environment for domestic and foreign firms, and has a five-year schedule to restructure state-owned enterprises); the Law on Investment (which creates a unified legal framework for foreign and domestic investors); the Ordinance on anti-dumping and safeguards; the Ordinance on Sanitary and Safety of Foods; the Decision on the implementation of the TBT; and the Law on intellectual property. There were procedural innovations to establish legal due process, e.g transferring the administration of local courts to the Supreme People's Court instead of keeping it under political direction.

This whirlwind of domestic trade-related reforms proceeded in tandem with dramatic progress in WTO accession negotiations. Vietnam became a member of the WTO in 2007.

In terms of tariff commitments, Vietnam agreed to reduce its bound-tariff average from 18.5 percent to 13.6 percent within three to five years. Average tariffs for industrial goods will be reduced from 17 percent in 2005 to 12.5 percent. For agricultural products, tariffs will fall from 29.4 percent to 21.7 percent within five years. The pre-accession tariff structure provided protection to domestic producers while granting them easy access to intermediate goods and inputs. For instance, tariffs on clothing were higher than on textiles. Upon accession, tariffs on clothing were reduced from 36.6

percent to 13.5 percent, thus reducing “tariff escalation” and effective levels of protection. Also, Vietnam committed to join the Information Technology Agreement (ITA), eliminating all tariffs on related products such as computers, modems and telephones. The average tariff for pharmaceuticals is now 2.5 percent.

APART FROM TARIFF reductions, Vietnam committed to remove NTBs, such as the ban on imports of large motorcycles. Most quantitative restrictions were removed, and full trading rights were extended to all sectors. The government committed to eliminate all trade-distorting industrial subsidies and agricultural export subsidies. Domestic support in agriculture is capped at 10 percent. State trading must be based on commercial considerations.

Regarding other rules: Vietnam agreed to apply fully the TRIMS agreement upon accession. It harmonized tax treatment for foreign and domestic companies by removing the tax on profit remittances for foreign entities. To comply with the TRIPS agreement, the government adopted WTO-compliant laws on TRIPS, which came into effect in 2006. Also, unlike China, Vietnam did not benefit from a post-accession transition period to implement WTO agreements on SPS and TBT.

In services, Vietnam committed to open gradually 92 sub-sectors by the end of 2008, more than China (85), Thailand (74) and the Philippines (50). One reason is the “multilateralization” of the Vietnam-US BTA, which contained wide-ranging bilateral commitments on services. In the banking sector, Vietnam now allows 100 percent foreign-invested subsidiaries and the right to issue credit cards and take unlimited local deposits. Within five years, it will allow foreign investors to own securities firms. In insurance, foreign companies will gradually obtain more freedom to operate in non-life insurance, until being able to open fully-owned branches by 2012. In telecommunications, Vietnam allows majority-owned foreign firms to offer services through satellites, private data networks and submarine cable. Foreigners can also lease local infrastructures to offer basic telephone services. The government has committed to create an independent regulator to police anti-competitive behaviour in the market. Energy services such as exploration, consulting and maintenance will gradually be opened until allowing 100 percent foreign-owned companies within five years. Other services sectors that Vietnam has committed to open to foreign competition include express delivery, transportation, wholesale and retail distribu-

tion, tourism, and professional services such as consultancy, architecture, engineering, accountancy and legal services.

On trade remedies, Vietnam, like China, can still be considered a non-market economy in anti-dumping investigations by other WTO members – in Vietnam’s case until the end of 2018. The only special safeguard mechanism to which Vietnam is subject is a textile-import monitoring programme in the US until early 2009. American authorities can impose textile-specific safeguard measures even without a complaint from the industry.

In conclusion, Vietnam’s path to WTO accession mirrors that of China in several respects. True, internal and trade-related reforms lagged behind China through the 1990s. This was reflected in a cautious, conservative approach to WTO accession negotiations, which made slow progress. However, after 2000, and especially in the 2005-2007 period, Vietnam seemed to self-consciously emulate China’s path into the WTO. The government used the WTO accession process as a lever to accelerate domestic reforms; and subsequently locked them in through strong multilateral commitments. Joining the WTO in such a manner should contribute to the market-based restructuring of the Vietnamese economy. On the trade front, this should accelerate specialization in labour-intensive exports. It sends a positive signal to foreign investors. Greater trade and FDI in labour-intensive activities should result in Vietnam’s integration into regional and global production networks. Although on a smaller scale, this would reflect the manner in which national policy reform has interacted with WTO membership to speed up and smooth Vietnam’s integration into the global economy.

### 8.3 Kyrgyzstan

COMPARED WITH OTHER recent WTO accessions, Kyrgyzstan’s process was quick. It started in early 1996, and the General Council approved the Protocol of Accession in October 1998. Kyrgyzstan formally entered the WTO in December the same year. The process of accession was never discussed publicly because other concerns, mainly the dramatic economic turmoil that followed the collapse of the Soviet Union, consumed domestic attention. Still, the Kyrgyz government regarded WTO accession as a desirable means of stimulating exports and securing equal treatment across the world. Since Kyrgyzstan

did not benefit from the massive oil reserves enjoyed by its neighbours it needed to secure market access for its exports. It also wanted to provide the country's business community with laws in conformity with international standards. Another big incentive to hasten the process was that the WTO represented an important step to secure a measure of independence from Russia, especially as Russia was not a member of the WTO and not subject to its disciplines.

Many reforms were initiated in the mid-1990s to develop a market economy. The government liberalized nearly all prices. Industries in which the government still uses price controls include electricity, gas pipelines, telecommunications, railroad, aviation and water supply. Also, between 1991 and 1997, Kyrgyzstan privatized 6,379 state enterprises (63.8 percent of the total).

Still, the big push for reforms was conducted during the implementation of WTO commitments. In many fields, Kyrgyzstan agreed to comply immediately upon accession. As any other WTO member, it committed to all rules relating to trading rights, fees and charges, custom valuation, rules of origin, anti-dumping, safeguards, export licensing, transparency, RTAs, tariff exemptions and value-added tariffs. The government agreed to apply TRIMS, TRIPS, the TBT and SPS agreements without transition periods. Kyrgyzstan also committed to eliminate all quantitative restrictions on trade and provide a system through which individuals and companies involved in trading activities can appeal to report infringements of WTO commitments. It also pledged that the central authority is solely responsible for establishing trade policy and would ensure that local authorities, including free economic zones, would comply with all commitments and WTO conditions, nullifying contravening policies. Kyrgyzstan further agreed to report annually after accession on all the data concerning the privatization programme. Finally, it committed to table proposals for accession to the GPA and the Agreement on Trade in Civil Aircraft.

With WTO accession, Kyrgyzstan bound two-thirds of its import tariffs at zero and the rest at 10 percent. The average weighted applied MFN tariff was 4.9 percent in 2005. There are no export tariffs, except on a few items exempted on national security and public health grounds.

Kyrgyzstan's strong commitments have not translated into reaping the potential benefits of WTO accession. Firstly, the economic crisis that hit Russia in 1998-1999 strongly affected Kyrgyzstan. After six consecutive years

of output decline, real GDP in 2000 was 66 percent of that of 1990. Secondly, Kyrgyzstan has been plagued by political instability. The previous government was overthrown in a combination of a popular uprising and palace coup in 2005. Thirdly, Kyrgyzstan has only marginally increased its trade with WTO members, and is still heavily reliant on trade with other CIS countries. The latter account for half of Kyrgyz trade – as it did at the time of WTO accession in 1998. Unlike China and Vietnam, Kyrgyzstan is a landlocked country and the nearest port is 3,600 km away. It is therefore much more reliant than China and Vietnam on trade with neighbouring countries, some of whom are not yet members of the WTO.

FOURTHLY, KYRGYZSTAN'S RECORD of implementing WTO commitments has been poor. Government and legal capacity remain weak. More generally, implementation of reforms has lagged behind in fiscal policy, public administration, corporate governance and the privatization programme. Fifth, Kyrgyzstan has remained on the margins of WTO negotiations, including the Doha round; and it has never been involved in a dispute-settlement case, even as third party. Finally, Kyrgyzstan is a small market, with low levels of trade and FDI. It is neither abundant in natural resources, nor does it have Vietnam's or China's comparative advantage in abundant labour. This makes Kyrgyzstan much less interesting commercially for other WTO members.

In essence, Kyrgyzstan's accession was fast-forwarded for political and security reasons, in an attempt to bolster national independence and induce stability. The use of the WTO as such a political device has not exactly been a success. A weak Kyrgyz leadership with a fragile institutional base did not make strategic use of WTO accession as a lever for domestic economic reforms. Rather it succumbed to pressure from powerful WTO members to agree to strong commitments – without adequate preparation and understanding of them and what they would entail for the domestic economy. In contrast to China and Vietnam, vaguely grasped top-down commitments were not matched by thoroughgoing bottom-up reforms. Hence it comes as no surprise that WTO commitments have proved difficult to enforce. Kyrgyzstan still relies on donors to prescribe reforms and follow up with implementation. It is the biggest recipient of foreign aid in absolute and per-capita terms among all central Asian countries. In such conditions, it is difficult to label Kyrgyzstan's WTO accession a success.

## 8.4 Saudi Arabia

SAUDI ARABIA'S WTO accession negotiations started in 1993 and lasted for twelve years. It became a member in December 2005. The economy of Saudi Arabia is very particular as it is a single commodity country: the oil industry roughly constitutes three quarters of the government's revenues and 90 percent of the country's exports. High volatility in the price of oil has caused serious fluctuations of national revenues. The GDP per capita at purchasing power parity plummeted from over USD 10,000 at the beginning of the 1980s to around USD 6,500 by the end of the 1990s, and then soared to around USD 16,500 today. The government officially supports diversification of the economy. To achieve this objective, it embarked on privatization in the late 1990s, especially in telecommunications and power generation.

Saudi Arabia agreed to comply with nearly all WTO rules upon accession. The most important changes in the country's trade regime concern the implementation of the TRIPS agreement; compliance with transparency and consultation procedures; creation of WTO enquiry points for individuals and firms; and recognition of national treatment for foreign enterprises (i.e. removal of discrimination in favour of domestic enterprises). The average bound tariff is 10.5 percent on industrial goods and 21.4 percent on agricultural products. (Applied rates are 4.8 percent on industrial goods and 7.8 percent for agriculture). Saudi Arabia also committed to eliminate all agricultural export subsidies. Also, the requirement to operate business activities through a local agent (middleman) will be lifted.

At the margin, joining the WTO can promote efficiency and diversification even for oil-related industries, especially where processing is involved. Oil companies are big consumers of related services such as insurances and transportation. The reduction of tariffs for foreign companies drives input prices down and can increase the competitiveness of the Saudi oil industry. Also, WTO membership means that Saudi producers of polystyrene and other polymers face lower MFN tariffs than was the case with non-MFN tariffs pre-accession. Saudi tariffs will also fall from 12 percent to 6.5 percent before the end of 2010 for these transformed products. The same tariff reductions apply to plastics.

Since accession, implementation of WTO commitments has been very patchy. Saudi Arabia still uses instruments such as import bans on specific products with very short notice or without notification. It also failed to apply to join the WTO GPA. Existing gov-

ernment procurement procedures considerably favour nationals. The government has not yet issued regulations on insurance branching to replace previous measures, which are supposed to be lifted by April 2008. The commitment to fully open express-delivery services seems to have been abandoned, since new regulations impose strict nationality requirements. Many businesses also complain that they still have to use agents (or middlemen) in order to obtain licenses for domestic distribution services. Finally, the commitment to allow 60 percent foreign ownership in joint ventures has yet to be fully implemented.

The details outlined above should not distort the big picture. That is one of a "weak" accession – for two main reasons. First, oil is excluded from the agreement, thereby excluding the bulk of GDP and exports. In other words, most of the Saudi economy is not subject to WTO discipline. This puts Saudi Arabia in the same basket as other oil-producing members such as Qatar, Nigeria, Venezuela, Kuwait and Angola. Second, the Saudi government applied to join the WTO when the economy was slowing down and oil prices were under USD 20 per barrel. Several domestic economic reforms were launched, with the intention of diversifying the economy. WTO membership was seen as a means of accelerating this process. However, as oil prices started to rise again, the momentum driving market-oriented reforms vanished. In this context, WTO membership is a weak discipline on national economic policy.

## 8.5 Concluding Comment

CHINA AND VIETNAM are both textbook cases of WTO accession, but there are important differences between the two countries. Compared with China, Vietnam is smaller and less complicated. Until 2001, its market reforms, including trade and FDI liberalization, lagged behind China by almost a decade. Notwithstanding these differences, both undertook wide and deep unilateral reforms, including external liberalization, before WTO accession. This provided the essential stimulus to accession negotiations. Combined with tough bargaining, particularly by the USA, this resulted in strong WTO commitments. These locked in previous reforms and provided the basis for further post-accession reforms. Both China and Vietnam have acquired strong stakes in a rule-based multilateral trading system. WTO membership has thus smoothed their integration into the world economy.

Last, but by no means least, both countries have abundant low-wage labour. Reform has exploited comparative advantage in labour-intensive exports. This has been their main channel of global market integration. It has delivered high growth and poverty reduction in a remarkably quick time. National reforms, in interaction with WTO accession, have worked with the grain of both countries' factor endowments.

The accessions of Kyrgyzstan and Saudi Arabia have had very different trajectories and outcomes.

Kyrgyzstan is small, landlocked, resource-poor, still heavily influenced by Russia and other CIS neighbours, with weak economic governance and beset by political instability. Its political and economic institutions are relatively new and fragile. WTO accession was top-down, driven more by powerful WTO members (particularly the USA) for security reasons than by national reform momentum. Results are disappointing. Kyrgyzstan has a poor record of implementing WTO commitments; its trade has not diversified much beyond the CIS; its growth performance has been poor; and economic governance has not noticeably improved.

Of the four accessions studied here, Saudi Arabia bears closest comparison to Kazakhstan. Like Kazakhstan, it is resource-abundant. Oil accounts for the bulk of GDP, government revenue and exports. These are not covered by its WTO commitments. Hence the WTO was always going to be a weak instrument for market-based reforms in Saudi Arabia. With a high oil price, WTO discipline on national economic policy is even weaker.

Both Kyrgyzstan and Saudi Arabia, in their very different ways, illustrate the limits of WTO accession. The WTO, whether through strong or weak accession commitments, is not a substitute for preceding and ongoing national reforms to marketize and globally integrate the economy. It cannot be expected to be the chief instrument of national economic reforms. It is bound to disappoint if that is what is expected of it. Where it has worked successfully, as in China and Vietnam, it has been a helpful auxiliary to national reforms already in train.

## CHAPTER 9. ACCELERATED WTO ACCESSION?

KAZAKHSTAN APPLIED FOR WTO membership in 1996, following the application of Russia in 1993. The two countries are bound together by geography, by history, by sentiment, and, more recently, by a common

declared interest in forming a customs union and an "economic space", together with other members of the FSU. It has been commonly assumed that Russia would join the WTO first and that Kazakhstan would in due course follow. More recently, however, Russia's enthusiasm for WTO entry has seemed to diminish. Whether Russia will accede to the WTO in the near future is now open to doubt. The question therefore arises: If Russian accession is postponed or abandoned, what will happen to Kazakhstan's application for membership? This is in large part a question to be answered by Kazakhstan, and Kazakhstan may decide that if Russia is not a member of the WTO, then nor should Kazakhstan be. All of the research reported in the earlier chapters suggests that Kazakhstan would thereby forego substantial economic gains. But immediate economic gain or loss will not necessarily be the decisive factor in the deliberations of the government of Kazakhstan, and the decision is clearly for it to make, although, of course, the actions of other governments, Russian and Western, may influence its deliberations. This chapter discusses the political and economic factors that surround the issue. It is divided into four sections. The first discusses the difficult legacy of trade patterns in the former Soviet Union and uncertainties surrounding the future of market reforms in Kazakhstan. The second focuses on the general issue of Russian pre-eminence in the region and how it risks interfering with Kazakhstan's WTO accession. The third part discusses the role that the major trading and strategic powers such as Europe and the United States play in Kazakhstan's WTO accession. The final section outlines possible scenarios and strategies concerning the entry of Kazakhstan into the WTO.

### 9.1 Trade and Economic Policy in Kazakhstan: Background

KAZAKHSTAN'S ACCESSION TO the WTO faces several challenges. The first is of an economic and economic policy nature: Kazakhstan's trade patterns are a legacy of distorted trade that could require painful adjustment, and its recent economic policy orientation could conflict with the goal of acceding to the WTO.

#### A Legacy of Distortions in Kazakhstan's Foreign trade

KAZAKHSTAN'S INTERNATIONAL TRADE is distorted. As Table 7.2 suggests, trade with the European Union and

the rest of the world is below its optimal level, while trade with Russia is far above, presumably a consequence of historical, political and institutional legacies from the past. WTO accession is likely to divert trade away from Russia, Kazakhstan's second largest trading partner, and shift trade more to the EU and the rest of the world. This could be disruptive. It might therefore entail political resistance in Kazakhstan and/or Russia. The European Union is Kazakhstan's main trading partner. Yet this trade is dominated by hydrocarbons. Kazakhstan represents only 0.7 percent of EU trade. Four fifths of Kazakhstan's exports to the European Union are fuels and minerals. Unlike Russia, Kazakhstan has not done much to make Europe fear for its energy supplies – at least for now. As Kazakhstan develops its economy and tries to diversify away from hydrocarbons, its exports may meet greater resistance. Acceding to the WTO will entail adaptation by Kazakhstan and its trading partners. Building up a momentum for final accession will need special political efforts.

**Table 9.1 Kazakhstan's trading partners Rank and share of overall trade - 2006**

Rank	Trading partner	Trade share - %
1	European Union	36.1
2	Russia	23.5
3	China	15
4	Turkey	2.9
5	USA	2.8
6	Romania	2.7
7	Iran	2.0
8	Ukraine	2.0
9	Korea	1.1
10	Uzbekistan	1.1

Source: European Commission, DG Trade.

### Market Reform in Kazakh: Quo Vadis?

THE SECOND CHALLENGE comes from current domestic economic conditions and economic policy trends. Domestic policy trends indicate that WTO accession might have fallen down on the economic-policy priority scale. Kazakhstan was one of the CIS' "late reformers." These, according to Anders Åslund, adopted sweeping domestic market reforms after the 1998 Russian financial crises, allowing for unprecedented levels of economic growth, backed by the recent boom in commod-

ity prices (Åslund 2007, p 75-81). Kazakhstan has since then generally maintained a steady market-oriented reform course. Yet in the last two years, the tone has somewhat changed. Kazakhstan has recently embarked upon a "clusters" policy strategy<sup>13</sup> aimed at boosting "infant industries" to help the economy diversify. It is not yet clear how this policy is to be implemented, or how far it relies on market forces and the provision of an adequate investment and competitive climate, as opposed to a pick-and-choose strategy of propping up selected industries. This policy is backed by institutions and government-sponsored funds that echo those set up recently in Russia, which raise similar concerns. These funds include the Investment Fund of Kazakhstan, the SME Development Fund, and the National Innovation Fund. The Development Bank of Kazakhstan is also involved in this policy. Priority sectors are: food, textiles, metallurgy, construction materials, tourism, transport and logistical services, and downstream oil and gas activities. The competitive conditions under which the funds operate require special attention. Some sectors that are to be promoted pose real questions of economic efficiency. Textiles is a case in point.<sup>14</sup> Kazakhstan wishes to promote cotton processing for export, but also other elements in the value chain, such as dye decorating and sewing. In the context of WTO accession, and given the fact that Kazakhstan is a sparsely populated country without comparative advantage in labour-intensive industries, the soundness of this policy deserves deeper scrutiny. Kazakhstan has so far not reneged on its commitment to promoting a market economy. But this new cluster strategy calls for closer scrutiny of its practical implementation. Some elements of the public discourse on WTO accession point to an increased reluctance to face more international competition in the industrial sector. This reluctance is further discussed below. A stronger nationalistic stance can be detected also in terms of investment in the hydrocarbons sector, as the latest state-of-the-nation discourse of President Nazarbayev in early February 2008 suggests.<sup>15</sup> Although there have been no evident signs of re-nationalization in Kazakhstan yet, contrary to what has recently been happening in Russia, the recent disputes with foreign oil majors on the Kashaghan raise questions.

This dispute was triggered by the announcement in 2007 that the consortium of foreign oil companies in

13. Kudaibergen (2007).

14. Development Bank of Kazakhstan (2007).

15. For an abstract of this speech see Nazarbayev (2008).

charge of developing one of the world's major oil fields in the Caspian Sea had run into technical and environmental problems, delaying the launch of production. The dispute was settled in early 2008, averting a major crisis and risks of loss of confidence. Penalties are to be paid by the members of the consortium, and compensatory royalties will be levied as well. In the process of solving the problem, Kazakhstan's national oil company KazMunaigaz increased its stake in the consortium so that its holding is now equal to that of the foreign companies involved. The international investment community has not questioned the legitimacy of the procedure, since the consortium was not delivering on its contract. But the strong demands by the government and the redeployment of assets in favour of the government in the process indicate that the climate has hardened in Kazakhstan. This case follows the adoption in 2005 of a controversial "pre-emption" amendment to its Law on Subsurface Use, raising uncertainty over security of investments in Kazakhstan. President Nazarbayev, in his state-of-the-nation speech in 2007,<sup>16</sup> argued that "accession to the WTO" must be "on conditions favourable to Kazakhstan." He added that "under Kazakhstan's WTO accession process, the Government should defend an acceptable level of internal state assistance to the agricultural sector and realize corresponding adjusting measures preparing industrial enterprises for the effective functioning under WTO conditions." Concretely, Kazakhstan claims the right to the same aggregate agricultural supports levels as the United States. The second argument hints at a more cautious stance towards opening the industrial sector to international competition, and not very clearly defined industrial policy ambitions.

## 9.2 "Russia first"

### WTO Accession in the CIS: It is about more than Trade

FOR MOST EMERGING economies, but above all those of the former Soviet Union, WTO accession has a wider symbolic and political meaning than simply one of economic policy. It is a seal of international respectability, an aspiration to belong to the "Western" world, and, above all, an ambition to be a full member of the international community.

This is the case of Kazakhstan as well. Kazakhstan's

WTO accession negotiations have gone on for more than ten years. But this length is not unusual in emerging market and former Soviet Union context. Russia applied in 1993 and is still not a member. Most CIS members have not entered the WTO. Exceptions are Armenia, which joined in 2003, Georgia, which joined in 2000, Kyrgyzstan, which joined three years earlier, and Moldova, member since 2001.

**Table 9.2 CIS WTO membership**

	Application date	Membership date
Armenia	1993	2003
Azerbaijan	1997	n/a
Belarus	1993	n/a
Georgia	1996	2000
Kazakhstan	1996	n/a
Kyrgyzstan	1996	1998
Moldova	1993	2001
<b>Russia</b>	<b>1993</b>	n/a
Tajikistan	2001	n/a
Turkmenistan	n/a	n/a
Uzbekistan	1994	n/a

Some countries on the CIS fringe, such as Georgia or Kyrgyzstan, joined the WTO in an attempt to reform their economies, and to protect themselves from post-Soviet Russian pre-eminence, which in fact was eroded in the 1990s. These new memberships were often an initial move to commit to economic reform, as was the case of Kyrgyzstan in particular. But they were also a political statement against post-Soviet Russian domination; and the Western allies found it expedient to accept these strategically located countries into their fold. Economic stakes for these partners were limited, and conditions of accession looser. It is to be noted that Georgia and, though less firmly, Armenia and Azerbaijan, are on the list of potential new NATO members. WTO accession is a politically sensitive matter in the CIS and is, to a greater extent than in most other regions of the world, deeply intertwined with wider security, military and political issues.

### Russian Pre-Eminence and WTO Accession in the CIS

THIS IS WHERE Russia comes into play. Russia is the largest economy still outside the WTO. Russia sees itself as

16. Ibid.

the natural leader of the CIS. Russia is in the process of joining the WTO, and tends to see WTO accession very much in the geopolitical terms described above. Russia's WTO accession has been delayed in recent years. The government has wavered on the orientation of its economic policies; it has experienced difficulties in handling the bureaucratic and legal aspects of the process of WTO accession and the associated need to abandon aspects of its sovereignty; the accession process has been de-railed by political problems such as its relationship with Georgia, and recent conflicts with Europe on trade and investment matters. Moreover, important parts of the Russian elite perceive the collapse of the Soviet Union and the waning of Russian supremacy in the CIS region in the 1990s as a national defeat. In that decade, the entry of the United States and to a lesser extent of Western Europe, via military alliances and oil-related policies into the CIS, where Russia had dominated for centuries, is perceived as humiliating. Nyrgen (Nyrgen 2007) shows that Vladimir Putin, who became President of the Russian Federation in 2000, has embarked upon a clear strategy of "rebuilding greater Russia," by reasserting Russia's supremacy in the CIS on all fronts, political, military, economic, and cultural, without, however, territorial conquest or control. Regional integration is an important tool in this new policy. Putin has tried to revive, reshape or create new regional institutions. Among these are the EAEC (Eurasian Economic Community). The SES (Single Economic Space), which includes the Big Four (Belarus, Kazakhstan, Russia, and Ukraine), became the official forum to coordinate WTO entry. Russian investment in the region was stepped up, and Russian hydrocarbon and banking interests have accompanied a general drive to raise Russia's profile in the former CIS, especially in Central Asia. Yet regional economic integration schemes have not been successful. The creation of a customs union within the SES ran into problems for two main reasons. First, political developments in Ukraine have driven it away from Russia and the SES, discrediting the idea of a functioning customs union, and also the notion of co-ordinated WTO accessions. Second, with the remaining members, the EAEC and SES have followed a familiar pattern in the CIS: "Many formal meetings and agreements and ... close-to-zero implementation" (Nyrgen 2007, p 25). Even if, *de facto*, the schemes in the CIS for regional economic

integration around Russian leadership do not work properly, these issues remain politically very sensitive, for both Russia and its potential partners. They should not be neglected when considering WTO accessions in the region. The political dynamics behind these regional economic integration schemes and the SES' official role as coordinator of WTO accession point to another set of problems: an underlying assumption that the accession of Russia to the WTO should have precedence. This matter of precedence produces two opposing dynamics: contestation or alignment. Ukraine has followed the first path: its new pro-Western government has pushed for WTO accession, and Ukraine will now enter the WTO earlier than Russia. The other response is alignment, which is Kazakhstan's model. Russia has been Kazakhstan's major ally in the CIS and in Central Asia since the collapse of the Soviet Union. Relationships between President Nazarbayev and President Putin have generally been cordial and mutually supportive. This was possible even as Kazakhstan developed good relations with the Western powers. There have been talks of joint Russian-Kazakhstan WTO accession.<sup>17</sup> Kazakhstan's security and political situation is very different than Ukraine's, or even Georgia's. Georgia, as a country from the strategic Caucasus region, and Ukraine, at the border with the European Union, are both on a hotly contested terrain in matters of security and political precedence between Europe and Russia. Both have a strong drive to join Western structures, NATO and even the European Union. For Europe, and in security matters the United States too, these countries are of increasing strategic importance. This is a consequence of both EU and NATO enlargement. In this context, WTO accession is part of a wider drama of "heading West" or, on the contrary, of continued belonging to "Greater Russia." This is not the case of Central Asia and therefore of Kazakhstan. Kyrgyzstan, despite being member of the WTO is politically aligned to Russia. Most other Central Asian nations are as well. This is increasingly true since political trends towards greater authoritarianism have raised Western criticism and led countries like Uzbekistan to strengthen their ties with Russia. But Kazakhstan's relations with the West so far have been much less problematic. President Nazarbayev has been able to maintain cordial relations in Europe and the United States. However, more recently, perceptions of corruption and

17. Radio Free Europe (2006).

of the nature of the political regime have given rise to wariness in the West and growing caution in Kazakhstan. Kazakhstan has never wavered in its security priorities: Russia is Kazakhstan's top priority and first ally. This is not incompatible with WTO accession by Kazakhstan, but it does suggest that Kazakhstan will be more comfortable with the process the more it is treated as a technical and economic policy matter and less as a political one. But this alignment also gives Russia a greater ability to interfere in Kazakhstan's WTO accession process.

The trading powers that matter most for WTO accession, Europe and the United States, do not, for their part, see Kazakhstan as a strategic priority of the first order. Their commitment and support for the accession of Kazakhstan may therefore be weak.

### 9.3 Kazakhstan's WTO Accession and the West

INDEED, THE HISTORY of WTO accessions among members of the CIS strongly suggests that support from Europe and the United States is a major factor in successful accessions. Hence, the outcome of Kazakhstan's application for WTO membership ultimately hinges on the terms on which these powers are willing to complete bilateral accession protocols with Kazakhstan. In terms of the economic interests of Europe and the United States, Kazakhstan represents an important investment opportunity, but it is not as vital and strategic as those offered by Russia, for instance. Russia and its WTO accession therefore have priority in EU and US eyes. Kazakhstan, with fifteen million inhabitants, is not a potentially lucrative mass market such as Russia. Europe is the main source of foreign investment in Kazakhstan, but investors already flock in, even though Kazakhstan lacks the benefit of WTO membership.

#### Relations with the EU

THE EUROPEAN UNION has entered a Partnership and Cooperation Agreement (PCA) with Kazakhstan: a bilateral agreement that commits Kazakhstan to what is probably the deepest economic integration it has undertaken and implemented so far. Even so, the PCA is shallow. The rules for trade in goods do not go beyond basic GATT-type MFN treatment. Europe excludes a series of sectors, and steel remains a sensitive issue requiring a

separate agreement on quotas. According to the text of the PCA, Kazakhstan "shall endeavour to ensure that its legislation will gradually be made compatible with that of the Community."<sup>18</sup> Targeted areas in particular are: customs law, company law, banking law, company accounts and taxes, intellectual property, protection of workers and the workplace, financial services, rules of competition, environment, health, consumer protection, animal protection, indirect taxation, technical rules and standards, nuclear laws and regulations, and transport. Binding commitments were made in intellectual property protection. Provisions for trade in services are very shallow and address cross-border trade only. Investment matters are dealt with by individual countries: Kazakhstan has bilateral investment treaties with seventeen EU member states. For the EU the accession of Kazakhstan to the WTO is not a matter of major importance, although the EU officially supports Kazakhstan's application. The EU receives the import it wants from Kazakhstan (hydrocarbons), and will continue to receive them whether or not Kazakhstan accedes to the WTO. As an investment destination, Kazakhstan is particularly interesting in the oil sector. But bilateral investment treaties and the oil majors' own pragmatic relations with an equally pragmatic government, as shown in the Kashaghan dispute (see above), appear to suffice. Furthermore, the WTO does not deal thoroughly with energy markets. Beyond the oil sector, the Kazakh market, although booming and growing, is less attractive than Russia's 140-million population. Kazakhstan for its part prospers on the oil boom, and can afford to be complacent in implementing reforms and other demands from Europe. What is more, political tensions deriving from Kazakhstan's record on democracy and human rights do not draw more cooperation than is necessary. However, a case can be made for stronger trade integration between Kazakhstan and the European Union. Measured in shares of trade, the EU is already Kazakhstan's main trading partner, but this position is largely determined by the commodity export to some EU countries. Non-commodity trade remains unexploited. Analysis of Kazakhstan's trade structure suggests it has comparative advantage vis-à-vis the European Union in five sectors: food and live animals; crude materials, energy, chemical products, and manufactured goods (Khatibi, 2008). In some of these sectors, trade could be considerably increased. Yet policies constrain the exploitation of this comparative advantage. Further-

18. The European Union (1999), Title V, Legislative cooperation.

more, Kazakhstan's comparative advantage has deteriorated in the last few years, which reflects the fact that its heavy reliance on trade in commodities can adversely affect other sectors.

Strategically and in terms of security policy, the EU is currently focusing on its near neighbourhood: the Balkans and Ukraine in particular are the salient issues at the moment. NATO enlargement is also an important issue, putting the three countries of the Caucasus on the European radar screen. The European Neighbourhood Policy makes inroads into the CIS and includes most Mediterranean countries. But Kazakhstan is not included in these policies, and it is unlikely that the European Union will give greater priority to Kazakhstan in the near future.

## Relations with the United States

KAZAKHSTAN'S TRADE RELATIONS with the United States are in fact tenuous. The United States is Kazakhstan's 6<sup>th</sup> largest trading partner, while Kazakhstan is the 75<sup>th</sup> US export market by size of trade. Trade and investment relations are mainly oil and mineral-related. The United States provides 26 % of FDI to Kazakhstan. A bilateral investment treaty (BIT) came into force in January 1994, and gives a broad framework for bilateral economic relations. But WTO accession could boost FDI from the United States, especially in the service sector, where the US has a comparative and competitive advantage. The military and strategic interest of the United States in Central Asia and in Kazakhstan was strong during the Clinton era. However, Russian collaboration with the United States in the post-9/11 anti-terrorism activities in Afghanistan has in practice allowed Russia to regain a foothold in the region. Russia's development of an autonomous security policy with the Central Asian nations, including Kazakhstan, has diminished the direct strategic influence in the region of the US. This policy actively involved China, in the context of the Shanghai Cooperation Organization (SCO), of which Kazakhstan is also a member. This loss of US influence is compounded by the consequences of the Iraq war. A corruption scandal involving a US banker and with ramifications in the Kazakh presidency in 2006 also presented a major embarrassment. Along with the deterioration of the democratic situation in the entire region, a certain retreat of the United States from the region is evident. Given the United States' current geopolitical priorities in the aftermath of the Iraq war, as well as its own eco-

nomical woes, incentives to accelerate Kazakhstan's WTO accession on either strategic or economic grounds are not very strong.

## 9.4 Overcoming the Last Hurdles

THE OVERALL CLIMATE for a move to accelerate Kazakhstan's WTO accession is not favourable. The problems lie principally in three areas. First, the underlying drive of Kazakhstan to join the organization is lacking: Kazakhstan's economy is currently prospering on the back of high oil prices. It can afford to delay its WTO accession. Second, Kazakhstan is entangled in a "Russia first" strategy that does not favour the acceleration of the process. Third, the incentives for the major powers to accelerate the entry into the WTO of Kazakhstan are not strong. Therefore, to fast-forward Kazakhstan's WTO accession, fulfilment of three conditions is required. First, the government's determination to get it done needs to be unequivocal and its actions must correspond to this resolve. Second, the US and the EU in particular will need to take a greater interest in Kazakhstan's WTO accession. Third, this interest must be strong enough to counter the final uncertainty, which is the strength of a potential Russian opposition to Kazakh accession.

## Kazakh Resolve and Consistency

THE FIRST REQUIREMENT for a successful accelerated WTO accession is that the government resolves to get it done. When one compares the Kazakh with the Ukrainian accession process, several issues emerge. Ukrainian accession has gone ahead despite the "Russia first" policies described above. This accession is the object of an overall national consensus on the matter. Most major laws to comply with WTO requirements were enacted by the Ukrainian Rada in 2006. This was in the midst of a political crisis that involved a national division on the overall strategic orientation of the country (Europe vs Russia), after parliamentary elections had put pro-Russian forces led by Viktor Yanukovich back into government after the Orange Revolution. Yet WTO accession is not part of these wider disputes. Both Russian-speaking and Ukrainian-speaking parts of the country and their representatives tend to support WTO accession. The Kazakh case points rather to the opposite situation. Nothing, at least in the current political configuration of the country, points to a fundamental conflict in Kazakhstan over the

country's strategic and security orientation. But there are indications that Kazakhstan is wavering on its overall economic strategy. How far is Kazakhstan satisfied with its current prosperity based on high oil prices? By which means does it wish to diversify away its economy from hydrocarbons and minerals? Two paths delineate themselves: the first possibility is industrial and agricultural policies that are likely to distort markets and therefore put at risk long-term economic performance. This path does not favour an accelerated WTO accession process. The second path is one of long-term economic performance and productivity by exposing it to greater competition and boosting exports to markets in Europe and the rest of the world. It also favours a services-based economy over an industry-based economy. This second orientation would be buttressed by swift WTO accession. A wider question for Kazakhstan is the type of position it wishes to have in the global economy. WTO membership will embed Kazakhstan in an institutional and legal framework that fosters transparency and collaboration. Kazakhstan would be better able to defend its own interests in the global economy, namely via the negotiations and especially the dispute-settlement mechanism. At the moment it is a booming oil-exporting economy. Yet its leverage and clout in its dealings with the outside world will vary with the oil price. Kazakhstan risks exposure to the "oil curse," which involves, on the macroeconomic side, "Dutch disease" symptoms (current upward pressures of the tenge, the national currency, could point to such a risk), and general governance problems that undermine growth in the longer term. With the institutional effects of WTO accession and compliance to its requirements entails, such as highlighted in chapter 7, these risks have a better chance to be contained.

### Mobilization of Greater Powers – A Role for the US and the EU

THE SECOND CONDITION for the success of a strategy to fast-forward Kazakhstan's WTO accession is a greater involvement of the European Union, its main trading partner, and the United States. As Georgian and Ukrainian WTO accession show: more than merely domestic resolve to accede to the WTO is required. Support by the greater powers is also a crucial condition to accelerate the process. In the case of Ukraine, the strategic nature of its choice naturally led to full support by the European Union for WTO accession. In the case of Kaz-

akhstan, competition between Russia and Europe over a strategic sphere of influence is less of an issue in accession to the WTO. There is little suggestion of change in Kazakhstan's fundamental security and strategic geopolitical choices, and not much suggestion of any interest on the part of the EU and US in changing this orientation. Yet support for the WTO accession of Kazakhstan has broader systemic implications. Both countries have a wider strategic interest in seeing a prosperous and stable Kazakhstan emerge in Central Asia. Kazakhstan is the region's most prosperous and stable country, in a context of deteriorating political and economic conditions. By choosing the WTO, Kazakhstan signals its wishes to belong to a world where the model of a society based on free markets prevails. This lays the foundations for further democratization of Kazakhstan, which both the EU and the US would like to see and could more legitimately demand from Kazakhstan if they provide support for such a strategic move as WTO accession.

EU and US involvement will be the more urgent and necessary the more Russia becomes an obstacle. Russia could become the hub for a region that risks sliding into poor monopolized economies, authoritarian politics and failing states. For the EU, a first step could be broader updating of its economic policies towards Kazakhstan and opening its markets further to Kazakhstan's exports. An important step would be to grant Kazakhstan market-economy status, which would to some extent shield it from protectionist anti-dumping actions against products that are the key to Kazakhstan's economic diversification.

### Dealing with Russia

THE FINAL COMPLEX issue that needs to be resolved is the "Russia first" factor outlined above. Many uncertainties surround this issue. In the current political climate in Russia, it is not clear where domestic and international policies will head after the presidential elections of March 2008. Russia could continue on its recent movement towards more nationalistic and authoritarian policies, including nationalization and monopolization. That would also mean harsher power politics in its neighbourhood. In terms of economic policy, such a trend would probably sideline WTO accession as a viable option in the near future.

Yet Russia could also head towards greater pragmatism in its dealings with the outside world. It could engage with Ukraine and especially Georgia, and decide

to join the WTO. This would continue the comparatively liberal economic policies pursued by its likely new president Dmitry Medvedev during his tenure as Deputy Prime Minister. The following scenarios for Kazakhstan's accession in the broader context of Russian dominance are possible. Policy responses would need to be adapted to make an accelerated Kazakh WTO accession possible. The first scenario is rather benign. After the presidential election in March 2008, Russia moves forward its WTO accession. In this case Kazakhstan can easily reconcile its economic strategy policies with its wider geopolitical security considerations and its wish to remain a major partner of Russia. "Joint accession" becomes possible. Positions in terms of agricultural support (Russia has similar demands as Kazakhstan) and other matters in the remaining multilateral negotiations can be streamlined and co-ordinated. The remaining bilateral accession protocols would need to be signed swiftly, especially the crucial ones with the US and the EU. The main risk is that Kazakhstan could become an involuntary victim of frictions that might arise in the final stages of Russia's WTO accession and tightened conditionality imposed by Ukraine (Kazakhstan has signed a bilateral protocol with Georgia already). This benign scenario is not unlikely. If the pragmatic policy-style associated with Dmitry Medvedev, the likely next president, prevails after the March 2008 elections it could even become a viable option. Russia has in the last weeks made steps to engage Georgia, and a potential way out of their current stalemate is not excluded. Russia has so far not shown any active resistance to Ukrainian moves to accelerate its WTO accession. Both Ukrainian resolve and full Western endorsement play a role here too. The second scenario could be summarized as "handling delays." Russia's WTO accession is delayed or postponed. Yet Russia's foreign policies remain pragmatic. This is the most likely scenario, and it requires Kazakhstan to make a clear choice in opting for "fast-forwarded" WTO accession and not waiting for Russia to take the lead.

The possibility that a political deal can be struck with Russia is relatively good in these circumstances. Kazakhstan's track record as a major ally in terms of security issues can serve as a base for this. Russia could find an interest in having an ally in the in the final stages of its negotiations, the more so if relations with Ukraine or Georgia remain tense. If Russia uses the arguments that the SES customs union should be respected, finding technical and political solutions to making it compatible with the WTO is not impossible, especially given the

unaccomplished nature of the customs union.

Here the EU and the US could play a major role as facilitator and broker. Yet, support for Kazakhstan's WTO accession in particular should be primarily emphasized by making sure the final accession protocols are signed swiftly and multilateral talks are finalized. The EU should commit to opening its market further to Kazakhstan's exports. The third scenario is the "hard-line." In this scenario, Russia either postpones indefinitely or drops altogether its WTO accession. In a move to maintain its supremacy in the CIS and promote another economic policy model less based on markets but rather on monopoly structures and authoritarian politics, it could fiercely oppose Kazakhstan's WTO accession, using structures such as the SES and the customs union to threaten and/or enforce economic sanctions against Kazakhstan, such as trade embargos, tariffs, or fines. Kazakhstan's economy would significantly suffer from these sanctions, given that almost a quarter of its trade is with Russia, and that the trade involves many non-hydrocarbon elements. This type of worst-case scenario cannot be ruled out, given the high uncertainty surrounding the direction of Russian politics. Yet it seems for the moment to be the least likely of the three scenarios outlined.

In this scenario, Kazakhstan must again make a clear-cut policy choice. The role of the West would be of particular importance. The EU and US would need to very actively support Kazakhstan's WTO accession, very swiftly open their markets, and provide economic, financial and logistical support. Joint political and economic action towards Russia would be crucial. The issue would become of strategic importance to the US, because an entire model of international economic and political relations would be at stake. Here China, with whom Kazakhstan has signed its bilateral accession protocol, can come into play. It could be asked to mediate in the context of the Shanghai Cooperation Organization, to which Russia in particular gives special importance.

## 9.5 Concluding Comment

KAZAKHSTAN'S WTO ACCESSION is complicated by its entanglement in a wider political and economic complex emerging from Russian pre-eminence and claims to such pre-eminence in the former Soviet Union. The complexity of the situation is compounded by Russia's own difficult WTO accession process. Kazakhstan is eco-

nomically and strategically strongly aligned to Russia, and taking the step of accelerating WTO accession without waiting for Russia for the sake of its own prosperity demands strong political resolve by the Kazakh government. Europe and the United States seem to support the “Russia first” policy in the CIS, though by default rather than actively. If they wish to see Kazakhstan anchored in the multilateral trading system, a stronger resolve to finalize the process in collaboration with Kazakhstan is required.

the improvements in market access for Kazakhstan’s non-mineral exports – are small. The rest of the prospective gains will stem from the government of Kazakhstan setting policy in a WTO-consistent manner, and from Kazakhstan’s acceptance of the WTO ethos – an acceptance that is more likely if it is voluntary than if it is forced.

## CHAPTER 10. CONCLUSIONS

NON-ECONOMIC CONSIDERATIONS – in particular the importance Kazakhstan places on good relations with Russia – may play a major role in determining future events surrounding the application of Kazakhstan to join the WTO. Nevertheless, we focus here on economics.

First, all of the evidence known to us suggests that WTO membership is a much better option for Kazakhstan, from an economic standpoint, than either the *status quo* (which includes, of course, the unconsummated customs unions that Kazakhstan has entered so freely) or a full-fledged customs union with Russia. The evidence suggests that Kazakhstan trades more with Russia than is optimal, and too little with the EU and the rest of the world. From an economic standpoint, Kazakhstan should be seeking means of reducing the bias towards trade with Russia, not, as would be the effect of a customs union with Russia, to increase the pressures in that direction.

Moreover, while the economy of Kazakhstan has in a short time moved a long way from its Soviet origins, it still has some way to go. It is clear that travelling this extra distance will bring economic gains. It is also clear that it is more likely to be travelled if Kazakhstan places itself in the WTO environment than if it enters a customs union with a larger trading power – especially one that is similarly afflicted by a less-than-complete transition from the habits and thought patterns of the Soviet Union, which express themselves in government control and protectionism.

Despite the gains that Kazakhstan stands to make from WTO membership and acceptance of WTO disciplines, a case can be made that the WTO should not raise the price of admission to Kazakhstan too high. The case is that the gains that will *directly* accrue to Kazakhstan from WTO membership – which are essentially

## ANNEXES

### ANNEX 1 Free Trade Agreements involving Kazakhstan

FTA	Status
Kazakhstan-Kyrgyz Republic	in force 1995
Kazakhstan-Moldova	in force 1995
Kazakhstan-Uzbekistan	in force 1997
Kazakhstan-Georgia	in force 1999
Kazakhstan-Armenia	in force 2001
Kazakhstan-Azerbaijan	signed 1997, not yet in force
Kazakhstan-Mongolia	signed 2007, not yet in force
Kazakhstan-Pakistan	proposed 2003, in consultation
Kazakhstan-Jordan	proposed in 2007, in consultation

### ANNEX 2 Regional Trade Agreements including Kazakhstan

RTA	Created	Member States	Objectives
Commonwealth of Independent States (CIS)	1991	Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Russia, Tajikistan, Ukraine, Uzbekistan Turkmenistan associate member	Customs Union (created in 1995, never fully implemented)
Eurasian Economic Community (EAEC/EEC)	2000 as successor to CIS CU	Belarus, Kazakhstan, Kyrgyz Republic, Russia, Tajikistan, Uzbekistan Armenia, Ukraine and Moldova observers	Fully implemented CIS CU
Common Economic Space (CES/SES)	2004	Belarus, Kazakhstan, Russia, Ukraine	CU and monetary union
Economic Cooperation Organization (ECO)	1985	Afghanistan, Azerbaijan, Iran, Kazakhstan, Kyrgyz Republic, Pakistan, Tajikistan, Turkey, Turkmenistan, Uzbekistan	ECO Trade Agreement (ECOTA), signed 2003
Central Asian Cooperation Organization (CACO)	1994, since 2002 part of EAEC	Kazakhstan, Kyrgyz Republic, Russia, Tajikistan, Uzbekistan Georgia, Turkey, Ukraine observers	FTA and single market
Shanghai Cooperation Organization (SCO)	1996, former Shanghai Five	China, Kazakhstan, Kyrgyz Republic, Russia, Tajikistan, Uzbekistan	FTA proposed in 2003

CU = Customs Union FTA = Free Trade Agreement  
Source: Information gathered by the authors.

### ANNEX 3 Investment-related Treaties signed by Kazakhstan

	Partner countries
Europe	BITs with: Belgium, Bulgaria, France, Germany, Greece, Hungary, Italy, The Netherlands, Spain, Sweden, Switzerland, United Kingdom European Union–Kazakhstan Partnership and Cooperation Agreement (1999)
US	US–Kazakhstan BIT (1994) Treaty on the Avoidance of Dual Taxation (1996) Trade and Investment Framework Agreement (TIFA) with Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan (2004)
Others	BITs with: Egypt, India, Iran, Kuwait, Malaysia, South Korea, Turkey

BIT = Bilateral Investment Treaty Source: Information gathered by the authors.

**ANNEX 4A Geographical distribution of merchandise exports, Kazakhstan (2000-2006)**  
(in million US dollars)

	2000	share	2002	share	2004	share	2006	share
<b>Total</b>	8.812,20	100	9.670,30	100	20.096,20	100	27.849,00	100
<b>CIS</b>	2.336,70	2,5	2.194,40	22,7	4.097,20	20,4	4573,64	16,4
<b>CARs</b>	291,2	3,3	368,1	3,8	847	4,2	751,4	2,6
<b>Azerbaijan</b>	46,8	0,5	112,7	1,2	287,1	1,4	115,60,4	0,4
<b>Kyrgyz Republic</b>	58,3	0,7	108,6	1,1	222,1	1,1	181,7	0,6
<b>Tajikistan</b>	52,6	0,6	45,8	0,5	136,1	0,7	169,2	0,6
<b>Uzbekistan</b>	133,5	1,5	101	1	201,7	1	284,9	1
<b>Rest of CIS</b>	2.045,50	23,2	1.826,30	18,9	3.250,20	16,2	3822,24	13,7
<b>Russian Federation</b>	1.751,40	19,9	1.497,80	15,5	2.838,10	14,1	3476,41	12,4
<b>Turkmenistan</b>	7,1	0,1	15,3	0,2	26,1	0,1	37	0,1
<b>Others</b>	287	3,3	313,2	3,2	386	1,9	308,83	1,1
<b>Non-CIS</b>	6.475,50	73,5	7.475,90	77,3	15.999,00	79,6	23.275,36	83,5

CIS = Commonwealth of Independent States, CARs = Central Asian Republics

Others = Armenia, Georgia, Moldova, Ukraine Source: ADB (2006) and information gathered by the authors.

**ANNEX 4B Geographical distribution of merchandise imports, Kazakhstan (2000-2006)** (in million US dollars)

	2000	share	2002	share	2004	share	2006	share
<b>Total</b>	5.040,00	100	6.584,00	100	12.781,20	100	17.352,20	100
<b>CIS</b>	2.731,70	54,2	3.043,20	46,2	6.117,90	47,9	11572,78	66,6
<b>CARs</b>	115,2	2,3	136,8	2,1	338,5	2,6	647,98	3,7
<b>Azerbaijan</b>	9,9	0,2	15,5	0,2	16,1	0,1	116,28	0,6
<b>Kyrgyz Republic</b>	30,1	0,6	31,8	0,5	91,3	0,7	179,1	1
<b>Tajikistan</b>	4,7	0,1	3	0,1	3,5	0,1	31,2	0,1
<b>Uzbekistan</b>	70,5	1,4	86,5	1,3	227,6	1,8	321,4	1,8
<b>Rest of CIS</b>	2.616,50	51,9	2.906,40	44,1	5.779,40	45,2	10924,8	62,9
<b>Russian Federation</b>	2.439,20	48,4	2.548,80	38,7	4.812,50	37,7	9867,3	56,8
<b>Turkmenistan</b>	43,4	0,9	74,6	1,1	75,7	0,6	106,6	0,6
<b>Others</b>	133,9	2,7	283	4,3	891,4	7	950,9	5,4
<b>Non-CIS</b>	2.308,30	45,8	3.540,80	53,8	6.663,3	52,1	5.779,42	33,3

CIS = Commonwealth of Independent States, CARs = Central Asian Republics

Others = Armenia, Georgia, Moldova, Ukraine Source: ADB (2006) and information gathered by the authors.

**ANNEX 5 Trading entities in the econometric sample**

Sample exporting countries		Sample destination countries	
<p><b>Eu-15 Countries</b></p> <p>Austria Belgium Denmark Finland France Germany Greece Ireland Italy Luxembourg Netherlands Portugal Spain United Kingdom Sweden</p> <p><b>Ceec Countries</b></p> <p>Bulgaria Hungary Czech Republic Poland Romania Slovak Republic Slovenia Estonia Latvia Lithuania</p> <p><b>Cis Countries</b></p> <p>BelArus Kazakhstan Russia Ukraine</p>	<p><b>Row Countries</b></p> <p>Brazil Canada China Korea R.O. Egypt United States Turkey Israel Japan Norway Switzerland Thailand India</p>	<p>Afghanistan I.S. Of Algeria Argentina Armenia Australia Austria Azerbaijan Bahamas The Bangladesh Belarus Belgium Brazil Bulgaria Canada China Colombia Croatia Cyprus Czech Republic Denmark Ecuador Egypt Estonia Finland France Georgia Germany Greece Hong Kong Hungary India Indonesia Iran I.R. Of Ireland Israel Italy Japan Jordan Kazakhstan Korea R.O. Kyrgyz Republic</p>	<p>Latvia Lithuania Luxembourg Malaysia Mexico Moldova Mongolia Morocco Netherlands New Zealand Norway Oman Pakistan Panama Peru Philippines Poland Portugal Romania Russia Saudi Arabia Singapore Slovak Republic Slovenia South Africa Spain Sweden Switzerland Syrian Arab Republic Tajikistan Thailand Tunisia Turkey Turkmenistan Ukraine United Arab Emirates United Kingdom United States Uzbekistan Vietnam</p>

**ANNEX 6 Computations required for Table 7.4.**

To ASSESS THE potential increase in trade from institutional improvements, the table compares the actual trade to a counterfactual situation in which institutions in Kazakhstan reach the level of institutional quality in the EU-15. For example, an increase in the trade policy index from 69 to 85 (Table 3) would yield an increase in trade that is measured in logarithms as  $\Delta \ln X$ . To compute this increase it should be noted from equation (1) that:

$$\Delta \ln X = \alpha_4 (Trade Policy_{EU} - Trade Policy_{KZ})$$

$$= 0.46(0.85 - 0.69)$$

from which it follows that

$$e^{\Delta \ln X} - 1 = e^{0.46(0.85 - 0.69)} - 1$$

$$= 8\%$$

The term  $e^{\Delta \ln X} - 1$  represents the potential increase in trade implied by an improvement from the initial score 69 to the EU-15 value of 85.

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*Dr. Deepak Lal* – Professor, UCLA

*Dr. Rolf J. Langhammer* – Vice President, The Kiel Institute for the World Economy

*Dr. Robert Lawrence* – Professor, Harvard University

*Dr. Jean-Pierre Lehmann* – Professor, IMD/Evian Group

*Dr. Brink Lindsey* – Vice President, Cato Institute

*Dr. Robert Litan* – Senior Fellow, The Brookings Institution; Vice President for Research and Policy, The Kauffman Foundation

*Mr. Mário Marconini* – Former Foreign Trade Secretary, Brazil; President, ManattJones Marconini Global Strategies

*Dr. Patrick Messerlin* – Professor GEM, Sciences Po (Chairman)

*Dr. Greg Mills* – Brenthurst Foundation

*Mr. Hugh Morgan* – Immediate Past President of Business Council of Australia; CEO of First Charnock

*Dr. S. Narayan* – former Union Finance Secretary and Secretary to the Prime Minister, India

*Sir Geoffrey Owen* – London School of Economics

*Ambassador Alan Oxley* – former Chairman of GATT and Australian Ambassador to the GATT

*Dr. Robert Paarlberg* – Professor, Wellesley College/ Harvard University

*Ms. Ruth Richardson* – former Minister of Finance, New Zealand

*Mr. Christopher Roberts* – Covington & Burling/ European Service Forum

*Dr. Jim Rollo* – Professor, University of Sussex

*Dr. Gary Sampson* – Professor, Melbourne Business School

*Mr. Clive Stanbrook* – Partner, McDermott, Will & Emery

*Mr. Andrew Stoler* – Executive Director, Institute for International Trade, University of Adelaide, Australia; former Deputy Director General of WTO (1999–2002)

*Mr. Bob Vastine* – President, Coalition of Service Industries

*Mr. Edwin Vermulst* – Partner, Vermulst, Verhaeghe & Graafsma Advocaten

*Ms. Catherine Windels* – Director, Pfizer

*Dr. Steven Woolcock* – Director of the International Trade Policy Unit, London School of Economics