KAZAKHSTAN GOES GLOBAL

WTO MEMBERSHIP COULD REDUCE RUSSIA'S ECONOMIC INFLUENCE IN THE CENTRAL ASIA NATION

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Since Russia's recent accession to the World Trade Organization (WTO), the business community in Kazakhstan has carefully followed changes in the markets of our neighbor to the north. As Kazakhstan advances toward membership in the global trade club in 2014, the business world has begun to ask questions. How the country will manage simultaneous membership in the WTO and the Russian-led Eurasian Customs Union (CU) is of particular interest. Will we see an "overlap effect" that doubles competitive pressure on businesses in Kazakhstan forced to compete with both Western and Russian firms? Or will there be an "exclusion effect" in which the realities of the WTO nullify some of the advantages enjoyed by Russian companies under the CU?

COMPETITIVE ALARM

The alarm in Kazakhstan's business circles over entering the WTO is understandable. As members of the Common Economic Space (CES), Kazakh companies have found themselves hard-pressed by Russian competitors. Russian businesses enjoy lower taxes by locating factories in our country, and a robust expansion of such business into Kazakhstan has been underway since 2011. According to data published by business associations, Russians participate in 500 to 800 large- and medium-size enterprises. Russian producers of food, technology and chemicals have branch offices in Kazakhstan, and Russian and Belarusian imports have ballooned. This trend is particularly noticeable in food products, home appliances and certain other goods markets, where our partners in the CU and the CES have recently been exhibiting an undisguised strategy of price squeezing that has been difficult to counter.

This gives rise in Kazakhstan to fears that, after WTO accession, expansion of foreign companies will add to the competitive pressures already exerted by Russian and Belarusian goods in local markets. The country's business community is not just sounding off about difficulties it faces under the CU and CES. Some are speaking of bankruptcy and asking for help. We are seeing serious tension in Kazakhstan's business world. Many projects are on the verge of bankruptcy as a result of an influx of duty-free Russian and Belarusian goods.

For example, in early October, the press reported that a new vegetable oil plant, opened by LLP Sabyr and K. in Kyzylorda, closed shortly after producing its first lot of product. Building and equipping the plant cost 44 million tenge (about $283,542), with the bulk of the funds — 30 million tenge (about $193,324) — provided by the government through the Kyzylorda agricultural production cooperative's regional project as part of a public-private partnership. The plant was supposed to satisfy more than 60 percent of the Priaralya region's needs for vegetable oil at prices geared to the purchasing public. The retail price of a 4.5-liter canister of Nesibe purified oil was expected be no more than 1200-1300 tenge (about $7 to $8). However, the first lot was sold within days and a second lot has yet to be produced.

The problem, as reported by the media, turned out to be a lack of raw materials in the region, raising the question of why a plant was built in such an unfavorable location. "The simple reason for the commercial failure of this project is poor marketing by the company that took it on," Ardager Akzhigitov, head of the regional office for entrepreneurship and industry, explained to the newspaper *Karavan*. "The market must be studied. The state sponsored the opening of the enterprise, but it clearly will not maintain it. Anything further they'll have to do themselves. Grow or buy the raw materials, get production and sales going." Other publications reporting on the failure of the Kyzylorda project joined Akzhigitov in criticizing Sabyr and K.'s resource planning.

However, no one looked beyond the simple conclusion that poor business decisions were to blame. Even at a cursory glance, this conclusion seems tenuous. It is doubtful that a competitive business project supported by the regional administration — a project for which substantial budget allocations had been made — would be done so incompetently. Even allowing for provincial backwardness — the infamous "local" business relationships, a certain

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amount of corruption and so forth — the agricultural cooperative would hardly finance a project that was doomed to failure. It's unlikely they were willing to bury 30 million tenge of government funds and damage their reputations on such a risky venture.

TRADE PRESSURES

The root of the problem seems to lie elsewhere. Statistical data from the Republic of Kazakhstan Ministry of Agriculture show that two years ago, when the project was being planned, the region provided more than ample sources of raw materials for such a plant. In Kyzylorda Oblast alone, more than 10 farms were cultivating more than 1,000 hectares of sunflowers. A great deal of sunflowers and safflowers were being grown in the neighboring South Kazakhstan and Zhambyl districts. But much changed in two years.

Beginning in the second half of 2011, when the CU agreement took effect, a huge amount of cheap vegetable oil from Russia entered the country's markets. As of August 2012, the importation of vegetable oil had increased by nearly 45 percent, compared to August 2010. It's no surprise that, by late 2011, sales of the local products began to fall, oil-producing facilities reduced purchases of raw material and the wholesale price of sunflowers plummeted, discouraging farmers from growing the crops. As a result, the region's farmers' associations virtually abandoned

A driver unloads wheat at an Aktyk farm outside Astana in September 2013. Kazakhstan is Central Asia's largest grain producer.

REUTERS

oil-producing crops. Farms that had traditionally supplied oil plants began a massive shift to watermelons and cantaloupes. The 2013 season in south Kazakhstan has produced a record crop of melons and gourds.

"We know about the Sabyr and K. project," said Sergei Pyankov, a marketing specialist for the Spectrum-Trade trading company. "Not too long ago, we saw some offerings on the Internet from that company. They weren't bad at all. The project itself was quite solid; naturally they had contacts with growers, they had the support of the APC and Akimat [local administration], and they were planning to expand production and sell their products in various regions. They wanted to develop a type of product that was new for Kazakhstan — safflower oil. Everything was fine. But in our view, Sabyr and its colleagues became a victim of the opening of markets in the Customs Union. Growing imports from Russia have now made such projects not only unprofitable, but pointless. The Russians are winning with a strong brand and low price. Of the available oil brands, commercial networks now prefer Zolotaya semechka [Golden Seed]. Unfortunately, the Sabyr case is not the only example."

That conviction is reinforced at the business association level. Nikolai Radostovets, executive director of the Association of Mining and Metallurgy Enterprises of Kazakhstan, accused Russian companies of "serious dumping" by charging prices in Kazakhstan 20 to 40 percent below those in Russia. "We understand that a number of producers of domestic products are being squeezed out of the market," Radostovets said during a Moscow-Astana video bridge organized by Russian News Agency RIA Novosti in late August. "And here we are focused on immediately forcing a harmonization of anti-monopoly legislation within the common space in order to be able to act upon requests by Kazakhstan producers to investigate the activities of Russian companies in Kazakhstan. Statistics show that the importation of Russian products in Kazakhstan has grown by 30 percent." Radostovets suggested Russia was using "nontariff actions" to boost imports to Kazakhstan without a counterbalancing increase in exports from Kazakhstan.

These plain-spoken and blunt comments by the head of a major trade association vividly reflect the tension giant Russian companies have created in the domestic market. In that same video bridge, Georgii Petrov, vice president of the Russian Chamber of Commerce and Industry, placed the burden of proof on Kazakhstan businessmen as to whether dumping is occurring. "You see, if a seller is making a profit and it's also to the buyer's benefit to sell or buy at a given price, the government cannot regulate these matters," Petrov remarked. "When competitive terms and conditions are violated, then I agree with you, but it has to be proved."

DISADVANTAGES OF SMALL BUSINESSES

Life in the CU looks pretty tough for Kazakhstani business. Russian companies are continuing their active expansion in Kazakhstan's markets. Under these conditions, small- and medium-size businesses — the bulk of domestic business — find themselves in an unenviable position of competing against larger and more efficient Russian firms. Timur Nazkhanov, vice president of the Independent Association of Entrepreneurs of Kazakhstan

(IAE), succinctly stated their core concerns: "Our small and medium businesses are not competitive, even within the framework of the Customs Union with Russia and Belarus. And now you're talking about the WTO. Look, the bulk of the products we consume are now being imported. Russia has now nearly completely taken over the domestic market. As time passes, this will lead to a rise in prices for products, including the most essential ones."

Nazkhanov also expressed concerns about WTO membership and the prospect of competition from Western firms. "When goods from the West pour into Kazakhstan, it will be absolutely impossible for our producers to compete with European quality and assortment," Nazkhanov said.

Nurlan Erasyl, a businessman from IAE's Almaty office, made comparisons with Latvia's entry into the WTO. That country was forced to halt sugar production and reduce the amount of herring it fished. "We were in Latvia on business recently, and we were shaken by what we saw," Erasyl said. "Some areas had seemingly become extinct, people were abandoning their houses, villages stood empty, schools in ruins. The fishing industry is in decline."

WTO VERSUS THE CUSTOMS UNION

Tensions are high and the mood is pessimistic in the business community. But for the time being, integration of the business environment within the CU and CES is a political given that Kazakhstan cannot avoid. Since Moscow is clearly not keen on protecting Kazakh markets from powerful Russian companies, judging by the position of Petrov and the leadership of the Russian Federation Ministry of Economic Development, it is obvious that Kazakhstani businesses will have to develop in a tough environment. Whether Kazakhstan's entry into the WTO will create added pressure on business is another question. There is an alternative point of view: Joining the global trade club will minimize — if not completely nullify — the economic advantages Russia gained under Eurasian economic integration.

The WTO's destructive potential toward the CU might be judged based on the repercussions for Russia after it joined the world trade club. Russia's economic elites appear to view the WTO with the same misgivings as Kazakhs view the CU and CES. Many in Moscow consider its 19-year pursuit of WTO membership to be more about political image grooming than economic growth. For Russia, it is crucially important that the world see it as a country with a full-fledged market economy.

But a lot has changed since 1993, when Moscow started negotiations with the WTO. The Russian leadership at that time, consisting of "democratic romantics," was in many ways susceptible to Western ideas and values. Now Russia has entirely different geopolitical and regional economic interests. For Russia, membership in the WTO is now more a question of policy and diplomacy than of economic benefit. Indeed, Moscow's economic interests may contradict its political interests.

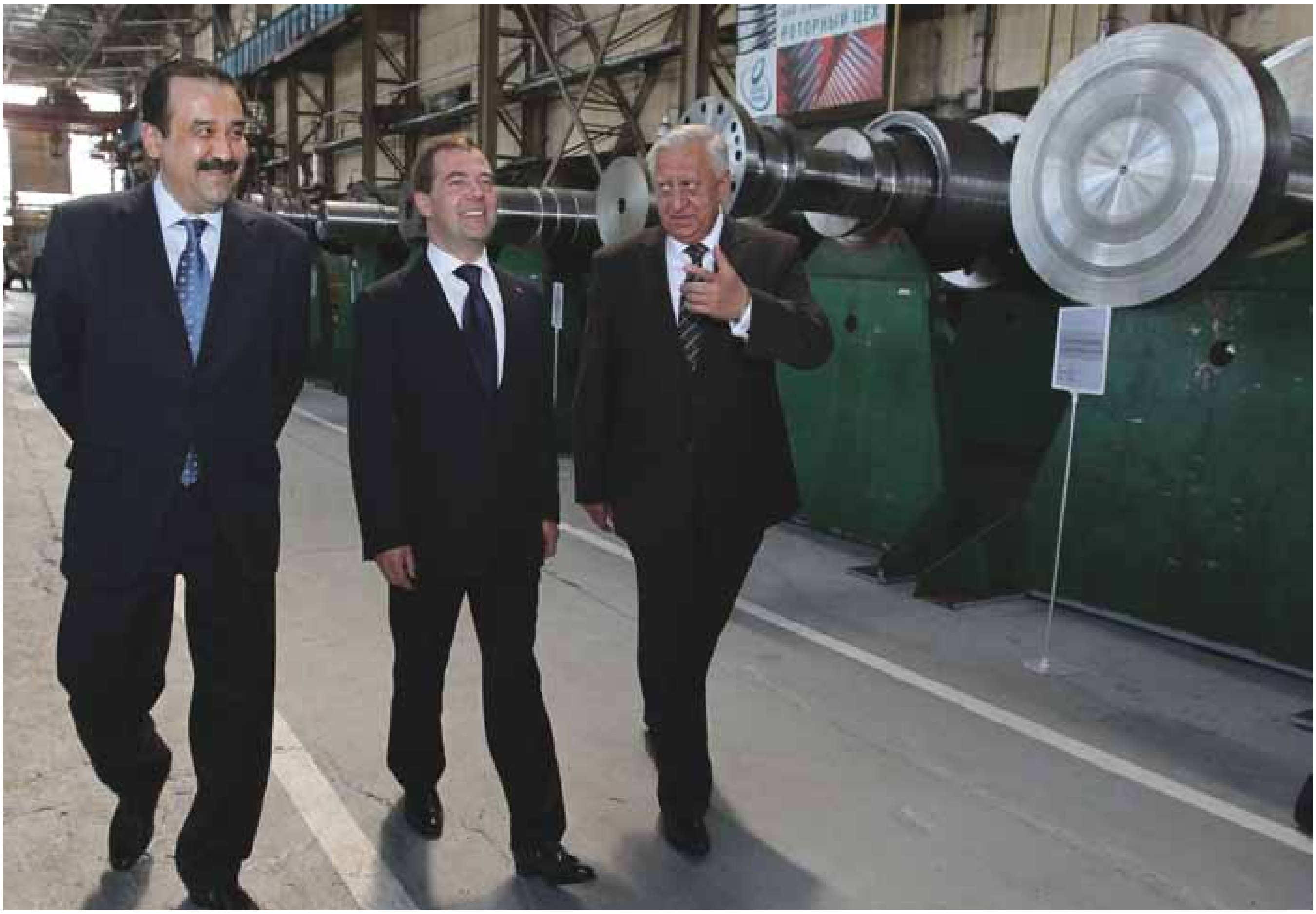
Some Russian economists believe that Russia, Kazakhstan and Belarus entering the WTO not only runs counter to the interests of the CU, but undermines the very idea behind it. In the opinion of Yevgeni Korchevoy, director of the Analytical Center of WTO-Inform, Russia's obligations under the WTO greatly limit the CU's possibilities. In a recent interview with *Regions of Russia*, Korchevoy noted that, because of customs regulations within the CU, its member states will ultimately be unable to protect the common market from external competition, though that was the very aim of creating the union.

"A huge void appears in the form of Russia, where, for example, one can ship goods with low customs tariffs," Korchevoy said. "And from there, those goods continue on unimpeded to our partners in the CU. If that's the case, what's the point in having a union? We get a paradoxical situation where the duty on many goods in Russia is lower than in Belarus or Kazakhstan, even though we have a common customs space. Thus, the WTO today is destroying the very idea of the Customs Union."

Korchevoy believes that the WTO is an organization aimed at furthering the interests of global companies. If that were the case, he is convinced that the CU would be an alternative to the WTO for Russia, protecting it from expansion by global "heavyweights."

Vyacheslav Pronin, also from the WTO-Inform Analytical Center, agrees that WTO membership will largely nullify Russia's benefit from being in the CU and CES, but he is even more categorical. Pronin believes that from the time Russia committed to significant trade liberalization, offering 155 countries preferential status to trade within its territory, the CU became "pointless."

"As an example, Ukraine, without entering the Customs Union, received the very same terms and conditions on the Russian market as Belarus and Kazakhstan. Moreover, by the end of this year, Kazakhstan plans to join the WTO on its own terms, different from Russia's terms and conditions. That means the CU customs tariff will again be revised in light of Kazakhstan's obligations. And considering the variance of interests among the CU members with respect to importation of industrial goods [including, for example, agricultural products, the conditions for Russian producers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Belarusian Prime Minister Mikhail Myasnikovich, from right, Russian Prime Minister Dmitry Medvedev and then-Kazakhstan Prime Minister Karim Massimov visit the Power Machines plant in St. Petersburg, Russia, in June 2012. Russia agreed to assist Belarus and Kazakhstan in their World Trade Organization accession.

will worsen acutely after our colleagues in the Customs Union join the WTO," Pronin said.

CONCLUSION

Of course, Moscow's economic arguments in favor of Russia joining the WTO largely coincide with what is being said these days in our country about Kazakhstan's membership in the same organization. The Russian Ministry of Economic Development is projecting the acquisition of new markets for Russian goods and an intensification of competition, which should accelerate modernization of its economy. And critics of Russia's WTO entry are essentially repeating what we are hearing at home about the problems experienced by Kazakhstan business within the CU, that inexpensive foreign goods have flooded the market. The quality of these goods is better, which hits Russian producers hard. Data on budgetary losses are also being published. By entering the WTO, Russia has reduced some import duties under the framework of the Common Customs Tariff. In particular, the duty on the automobile imports has been cut in half. The official projection is that budget revenues in 2013 will fall by 310 billion rubles, or about $10 billion.

Our northern neighbor's worries lead to one important conclusion: By entering the WTO, Kazakhstan's economy will have reduced dependence on Russian influence in the Customs Union. Only time will tell whether this will harm or benefit Kazakh businesses. Of course, as in the past, nothing will prevent expansion of those Russian companies in Kazakhstan. That said, we can expect a leveling out of the investment environment to include other competitors such as Germans and Indians.

For instance, Pyankov thinks that the Kyzylorda vegetable oil producers will have more opportunities to find suppliers of cheaper raw materials, if not in their own region, then in Ukraine, Moldova or neighboring China. He is confident that "commercial opportunities for cooperatives will increase, the selection of suppliers and partners will widen, and we will not be restricted to the Russian and Belarusian market." For our Russian neighbor, this is a definite minus, from the standpoint of its economic interests in the region and the political prospects of the integration process. But for now, it is difficult to say whether such a leveling of Customs Union influence in the midst of a general opening of markets will be a big plus for Kazakhstan. □