

## What are the pros and cons for Kazakhstan of joining the WTO from an export potential point of view?

Ainur Amirbekova

Diana Madiyarova

L.N. Gumilyov Eurasian National University, Department of Economics  
Kazakhstan

Inna Andronova

Peoples' Friendship University of Russia, Russian Federation  
Department of International Economics, Russia

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### Keywords

Export potential, Kazakhstan, WTO provisions, Integration effects, WTO, Driving forces.

### Abstract

*In this paper, we study the impact of integration effects on the export potential of the Republic of Kazakhstan by assessing the pros and cons of membership, in order to form a reasoned conclusion. Membership of the WTO required a large reduction of import tariffs, as well as the elimination of numerous non-tariff barriers. Empirical findings on the impact of the tariff reduction and the effect on the export potential of Kazakhstan will be discussed at the industry level.*

*The research focuses on two aspects. Firstly, we analyze the export situation within the WTO system and forecast possible changes. Using information collected on import tariffs and non-tariff barriers, we explore the relative importance of alternative mechanisms through which policy changes may have been affected. Secondly, we explore the possible measures for making managerial solutions.*

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### 1. Introduction

Today, the export strategy of Kazakhstan should be developed within the framework of international trade to ensure conformity to the World Trade Organization (WTO) and other regional and bilateral treaties. This is because the key priority is to provide internal policies where partners work in a cohesive way to achieve competitive exports. Therefore, it is necessary to set up a model system based on the phased and step-by-step liberalization in commerce with the application of a transition period and tariff rates, production of more competitive products based on comparative advantages of the Republic, and a search for new market opportunities.

The negotiations regarding Kazakhstan's accession to the WTO continued for more than 19 years and consisted of several stages.

The introductory stage ran for a period of seven years (1996–2003) during which the WTO front office and responsible authority of the Republic of Kazakhstan exchanged information.

The second stage (2003–2015) was an active stage of negotiations between the Working Group of Kazakhstan and the member states of the WTO. The working group for Kazakhstan's accession to the WTO was included 35 countries from among the main trade partners of Kazakhstan. In the framework of negotiations on systemic issues, the main subjects of the review were tariff commitments, trade regime, industrial subsidies, agricultural subsidies, local content, and sanitary and phytosanitary measures. During the bilateral talks on market access for goods, great attention was paid to the harmonization of the maximum level of customs duties. The negotiations concerning market access of services were concerned with the harmonization of conditions of access for foreign

suppliers of services to the Kazakhstan market. It should be noted that the financial and telecommunication services are the most controversial service sectors in this regard (Overview of Kazakhstan's commitments, 2015).

The third stage occurred when negotiations were completed and the corresponding treaties were signed. On July 27 2015, the Republic of Kazakhstan officially became the 162<sup>nd</sup> member of the WTO (News Inform, 2015). Since becoming a full member, Kazakhstan has been required to begin fulfilling its obligations under the treaties. The undertakings are extended to the necessary level of state support in accordance with the rules of access to the domestic market, and implementation of sanitary and veterinary measures (Voronov, 2012).

We aim to study the impact of integration effects on the export potential of the Republic of Kazakhstan by assessing the pros and cons of membership, to form a reasoned conclusion. Empirical findings on the impact of the tariff reduction and the effect on the export potential of Kazakhstan will be discussed at the industry level.

The research focuses on two aspects. Firstly, we analyze the export situation within the WTO system and forecast possible changes. Using information collected on import tariffs and non-tariff barriers, we explore the relative importance of alternative mechanisms through which policy changes may have been affected. Secondly, we explore the possible measures for making managerial solutions.

## **2. Literature review on the trade liberalization effect on exports**

Experts' opinions regarding the impact of WTO membership on export development differ considerably. Rose (2004) considers that the expanded range of exported goods, in view of joining the WTO, does not have any practical impact on the total scope of exports. However, the research conducted by Tomz et al. (2007) and Subramanian and Wei (2007) showed that such impact is apparent and the effect of commerce growth is positive. At the same time, Eicher and Henn (2011) found that the more countries try to agree on tariff reduction during negotiations with WTO members, the more positive consequences for trade become apparent.

Some authors examine the consequences of trade liberalization from the point of intensive and extensive forms of export development. For example, Helpman (2008) developed a model of international trade based on a sample of different companies. He concluded that there is a negative trend between trade growth with new partners and trade growth of new products. The work of Dutt et al. (2011) analyzes the data from the point of export structure change. As a result, it was concluded that membership of the WTO has a positive effect on the variety of exported goods (a country starts trading new products which were not present before), but for current exporting products the effect is negative. Such varying results in empiric research suggest that economic specifications of the country have a great impact on the value and effects on trade within the WTO.

## **3. Managing the WTO accession process in Kazakhstan: features, challenges and driving forces**

The strategic measures for integration into the world economy have its own characteristics, where the results have an impact on institutional development and the effectiveness of the internal policy of the country.

First, negotiations with Kazakhstan aroused great interest on the part of WTO members in connection with Russia's WTO accession and membership of Kazakhstan in the EAEU (Palata, 2015). Therefore, harmonization of obligations of Kazakhstan's membership in the WTO has been in the framework of Kazakhstan's obligations under the membership of the Eurasian Economic Union (EAEU).

Second, Kazakhstan joined the WTO as a developed country. However, although the country, in terms of GDP per capita, is not included in the category of developed countries, Kazakhstan has not requested any developing country status (Samson and Dyker, 2009). It is known that the WTO provides certain benefits for developing countries so that they are able to establish the

highest level of tariff protection in comparison with developed countries. In developed countries, the amount of customs duties tariff is much higher in this regard, and developing countries' access to markets for products with high tariff rates is limited. Clearly, this fact was taken into account and so Kazakhstan did not insist on the status of a developing country.

When examining Kazakhstan's management of accession process, it is important to address the role that institutional conditions played. A positive step in managing Kazakhstan's accession to the WTO was the creation of the Interagency Commission on WTO issues for the coordination of the Republic's entry process into the global trading space. This Commission was subsequently transformed into the interdepartmental commission on customs and tariff policy, and participation in international economic organizations (zakon.kz, 2006). Another positive step was the creation of the Center for Trade Policy Development (CTPD) under the patronage of the Ministry of Economy and Budget Planning of the Republic of Kazakhstan, which is directly related to the country's accession to the WTO. This dynamic institution includes highly qualified experts, with experience of working in international economics, politics, law, and other related fields, and is crucial to the future success of Kazakhstan. Regarding technical regulation, Kazakhstan created an information center on technical barriers to trade, sanitary and phytosanitary measures, on the basis of the Republican State Enterprise "Kazakhstan Institute of Standardization and Certification".

In addition, the management of accession process took place in a complex multilateral environment, via three sets of actors. The actors involved in the accession process were not limited to a particular state's politicians and bureaucracy, but rather included international organizations and a variety of non-state actors. As part of transnational advocacy networks, non-state actors such as NGOs, interest groups, policy think tanks, banks, and businesses, had remarkably strong voices. International organizations such as the European Commission helped to formulate, initiate, and guide the implementation of policy transfers in a project called "Development and implementation of trade policies and regulations".

The main driving force behind the successful management of accession process of Kazakhstan to WTO membership can be seen in the following issues:

- **Goal ambiguity**

Policy-makers have to take into consideration the strengths and weaknesses of the different policy instruments they use, as these factors lead to the failure or success of the implementation of government policy. In this regard, the effects of uncertainty and ambiguity in implementation and policy formation processes is very important (Moe, 1990). Therefore, Kazakhstan's trade policy within WTO conditions is driven by ambitious goals. However, there is a risk that it can lead to uncertainty on action planning and the implementation of such policy.

- **Political conditions**

The success of a particular government policy is in large part dependent on the political conditions of Kazakhstan. During the WTO accession process, Kazakhstan used a top-down model, which starts with decisions made at the highest and most central levels of government and then travels outward to lower levels, with the goal of discovering how the policy's mandated targets and procedures are followed. Kazakhstan, characterized by a political system in which only one institution (the Presidency), is a veto actor, was able to successfully implement a relatively complete transfer (Amirbekova and Amirbekova, 2013).

- **Technical factors**

In Kazakhstan, 'success' depended not only on the passing of the legislation, but also on the later development of institutions to manage the new system, the development of a capital market and investment instruments, and public awareness and support for the program, which included technical factors. Technical factors also included stakeholder-related constraints such as the requirement that stakeholders must gain from the program through technical communication about the program and its grants; and the requirement that stakeholders' behaviour not be in conflict with

policy targets through communication with the general public. Unfortunately, communication only tended to occur at the beginning of the policy and to be relatively scarce thereafter. This caused the public to lose faith that the policy transfer under the WTO conditions would ever be implemented successfully.

#### **4. Conformity of Kazakhstan's import and export regulations with WTO provisions**

The main legal condition for Kazakhstan's accession to the WTO was to bring the national law and practice of regulation of foreign economic activity into conformity with the principles and requirements of WTO legal norms. In this section, we will discuss the WTO provisions regarding regulation of exports and imports, and conformity of Kazakhstani export policy to the international trade rules. Kazakhstan became a WTO member and therefore committed to act in accordance with the agreements, and abide by the specific commitments on goods and services agreed as a result of the negotiations.

**Tariff quotas.** The practice of quotas can be used if the country produces certain products in larger quantities than is necessary for exports and domestic consumption. Kazakhstan tariff rate quotas apply to beef, pork, poultry and whey. Kazakhstan was able to defend this position in favour of preserving the right to apply tariff rate quotas for poultry meat. As of today, poultry meat production remains one of the main segments of Kazakhstan's agricultural industry (The working group report, 2015).

**Temporary reduction factors.** Temporary reduction factors may exist in the WTO. However, they should not be associated with export or import substitution. These coefficients can be justified only by the remoteness of those areas where there is demand for certain products. For such objective reasons, Kazakhstan may temporarily apply the reduction factors.

**Industrial subsidies.** Kazakhstan should eliminate certain industrial subsidies, including the provisions contained in the development program, or modify them so that any subsidy does not depend on export or import substitution. Certain sectors of Kazakhstan's economy provide financial incentives in the form of subsidies that allow producers to expand their production and improve the quality of their products. This will allow them to both sell their products on the domestic market and export them. Specific schemes regarding the subsidizing of engineering products were provided through such programs as "Productivity - 2020", "Business Road Map - 2020", the preferences within the customs regimes, and the special economic zone and "free warehouse". However, according to experts, such programs as "Business Road Map - 2020" still provide prohibited export subsidies.

**The export duty.** Kazakhstan will apply export duties in accordance with WTO agreements. Indeed, it has agreed to revise the export duty for 370 tariff lines (Overview of Kazakhstan's commitments, 2015). The adoption of the country's obligations to reduce tariff rates does not mean that it loses all its ability to restrict imports by means of customs barriers. Kazakhstan reserves the right to apply protective measures when a threat is detected, or when serious damage to national industry occurs as a result of the commitments made.

**Transportation subsidies.** One of the limitations that Kazakhstan had to apply is regarding the export transportation subsidies. These subsidies were provided to grain producers in years of a bumper crop due to insufficient storage space, as it was important to ensure that the harvest was not spoiled. Now, according to the WTO rules and commitments, Kazakhstan is not able to provide transportation subsidies to grain producers (The working group report, 2015). Therefore, it is necessary to create alternative forms of state support for agricultural enterprises that meet the requirements of the WTO.

**Benefits and preferences in free economic zones.** In accordance with the provisions of the WTO, a number of incentives in Kazakhstan's free economic zones, such as benefits on customs and export duties for the participants of free economic zones in Kazakhstan are now illegitimate. In accordance with the commitments made, customs privileges for companies in free economic zones

will be eliminated (News Items, 2015). In this regard, it is necessary to develop alternative forms of state support for free economic zones in accordance with WTO rules.

**Import substitution.** A rapid change of state foreign policy is not achievable because the accession process did not occur overnight; it was preceded by serious work and the gradual implementation of the national system of fundamental WTO rules. However, WTO membership excludes:

- the promotion policy of import substitution;
- involving the substitution of imports of domestic goods with customs tariff and non-tariff regulation;
- subsidization of industries in the country.

Until recently, Kazakhstan adopted a liberal policy with respect to imports by using tools such as low customs rates for goods for which Kazakhstan did not have production capabilities. However, this course pursued the policy of import substitution. At the same time, this policy had a negative impact on the development of industries such as textiles, clothing, and the leather industry (UNECE, 2013). In particular, it was observed that although import substitution is able to create new jobs, in the long term, there was a decline in yield and production growth.

### 5. Implications for the export potential of Kazakhstan at industry level

This section describes the empirical findings regarding the impact of tariff reduction of the export potential of Kazakhstan at industry level.

Commitments under the WTO can have a positive impact on individual sectors of the economy. A positive or negative effect on the sector resulting from WTO accession will depend on factors such as the share of exports in volume of production, import dependence, and the amount of state support. The greatest benefit may be for products with low added value (a factor which becomes irrelevant abroad). For example, countries often use a quota system in relation to the products of Kazakhstan's **metallurgy**. However, after the accession to the WTO, it is expected that this problem will be solved as WTO rules prohibit the use of any quotas. In addition, developed countries often charge very high interest rates on protective tariffs. Due to the elimination of protective duties on products of the Kazakhstan metallurgists, the industry will discover new markets, whilst providing the opportunity to compete with products on the world market.

It is expected that there will be a decline in prices for **engineering products**, components and materials due to the reduction of duties on imported goods and the reduction of bureaucratic barriers. Prior to joining the Eurasian Economic Union (EAEU), the customs rates were low at 1.9%, and after entering into the EAEU, rates increased to 6% (KIRI, 2015). Thus, lower prices for components, in particular, will have a positive impact on improving production processes with new technologies.

There will be more opportunities for the **chemical industry** as a result of WTO membership. Due to the liberalization of the trade regime after the accession to the WTO, there is a real opportunity to reduce the proportion of low quality products imported by the chemical industry from Commonwealth of Independent States (CIS) countries, especially from Russia (from which Kazakhstan buyers were forced to purchase). Thus, accession to the WTO will allow Kazakhstan consumers to use high quality yet cheaper products. In addition, it will allow manufacturers to establish a close connection with the world exporters of the chemical industry and will provide the opportunity to join the joint production and participation in Research and Development.

Competition, particularly in the market of **food products**, is increasing, with the number of participants constantly growing, and this can lead to the occurrence of trade disputes. The strongest competitors for Kazakhstan are developed countries as they have a high export potential and consumer markets. However, in the framework of WTO membership, there is the possibility for constructive resolution of trade disputes.

Despite the positive aspects of Kazakhstan's accession to the WTO, it should be noted that

there are clear risks for Kazakhstan producers.

Reduction of subsidies will bring a serious challenge for **agricultural producers**. Due to import flows of agricultural products on the domestic market, there will be serious competition to national producers.

For enterprises in the **chemical industry**, there are risks associated with the gradual reduction of import customs duties on certain types of goods, for which Kazakhstan has set a ceiling of 5.9% (KIRI, 2015). This decrease can result in even greater competition with imported goods, a reduction in profitability of production, and reduced market presence of domestic goods.

The reduction of import duties will lead to reduced revenues from taxation of imports in general. High demand for imported raw materials and components, coupled with the reduction of customs duties, will strengthen the position of producers of imported equipment and will negatively affect the **engineering industry**.

Failure to implement export duties may lead to a domestic market shortage of **metal**, as today, the deficit is constrained by export taxes and temporary bans on exports. The deficit may undermine the work of metallurgical enterprises, for which scrap is the main raw material. According to the framework agreement of Kazakhstan's accession to the WTO, after a transition period of three years, Kazakhstan should reduce the rates of customs export duties on ferrous scrap. In addition, the Kazakh market will be open to metallurgical products from other countries, particularly China, which will greatly enhance competition. Indeed, the domestic market may be under threat of increased competition from Chinese steel mills.

In respect of **light industry**, we should avoid optimistic expectations of growth in export operations and draw attention to the threat of increasing imports of the industry's products. This will mainly deal with domestic producers of garments, textiles and leather products; markets, which are characterised by low competitiveness.

## 6. Conclusion

Based on the results of the analysis, conclusions need to be drawn and approaches to encourage policy change with the overall objective of improving better export performance, need to be explored.

The significance of Kazakhstan's accession to the WTO cannot be viewed only in the short term; there is a need to analyze the immediate and long-term perspectives. Membership is necessary to strengthen the competitiveness of the Republic and improve the existing government support measures whilst also establishing new initiatives. These will be fundamental factors for the effective integration of Kazakhstan into the world trade community.

When specifically considering the economic development of Kazakhstan, it can be concluded that the main areas of change necessary to overcome barriers to export potential should be:

a) Improvements in state support measures. For example, transport infrastructure and social services for workers in rural areas need to be developed. Therefore, the policy implementation should be focused on reducing seasonal price fluctuations and overcoming geographical distances. In addition, the development of infrastructure is necessary to overcome problems with distance, price regulation, and mobilization of goods and services as the sector increases its exports.

b) Promotion of industry development. This is due to diversification of Kazakhstan's integration with the global market. For sustainable competitive advantage in the international division of labor, Kazakhstan needs to encourage the development of industries where human capital will prevail.

c) The establishment of an effective system of governance. This is needed to improve the effectiveness of public institutions under the conditions of membership in the WTO, particularly those responsible for public expenditure, as well as institutions regulating entrepreneurial activity.

Overall, high economic growth should be considered an essential objective for further economic transformations in Kazakhstan as it will create conditions which will enhance national export competitiveness and help achieve sustainable growth.

### 7. Limitations and scope for future work

It is still unclear as to how WTO membership will affect the export potential and performance of sectors of the economy, and whether it will limit the government's power.

As Kazakhstan's WTO membership began in mid-2015, it is also too early to draw conclusions about the impact of WTO membership on different sectors, since Kazakhstan's economy has not yet reorganized in accordance with the WTO requirements. For example, the five-year transition period following accession to the WTO, during which the implementation of the commitments are required to be made, has not yet been completed. In addition, Kazakhstan's exports prior to WTO membership were secured through long-term contracts with other countries, in most cases at fixed rates, and so implementing the WTO requirements will take time.

To date, it only seems possible to analyze the productivity growth of individual industries and to make tentative predictions. Without clear information, it is difficult to assess the impact WTO membership has had on Kazakhstan's export potential.

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