SPILLOVER EFFECT OF FDI IN KAZAKHSTAN ECONOMY

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Foreign Direct Investment has known as the most important source of external resource flows to developing countries over the 1990s and has become a significant part of capital formation in the some countries despite their share in global distribution of FDI continuing to remain small or even. The role of the foreign direct investment (FDI) has been widely recognized as a growth-enhancing factor specially in the developing countries. The effects of FDI in the host economy are normally believed to be increase in the employment, increase in productivity, and increase in exports and, of course, increased pace of transfer of technology. The potential advantages of the FDI on the host economy are it facilitates the use and exploitation of local raw materials, it introduces modern techniques of management and marketing, it eases the access to new technologies. The local enterprises are able to learn by watching if the economic framework is appropriate it stimulates the investment in R&D.

A number of studies have analyzed the relationship between spillover effect of FDI and economic growth, the issue is far from settled in view of the mixed findings reached. Most of these studies have typically adopted standard growth accounting framework for analyzing the effect of FDI inflows on growth of national income along with other factors of production. Within the framework of the neo-classical Solow models. Therefore, FDI could only exert a level effect on the production per capita, but not a rate effect. In other words, it was unable to alter the growth rate of production and structure in the long run.

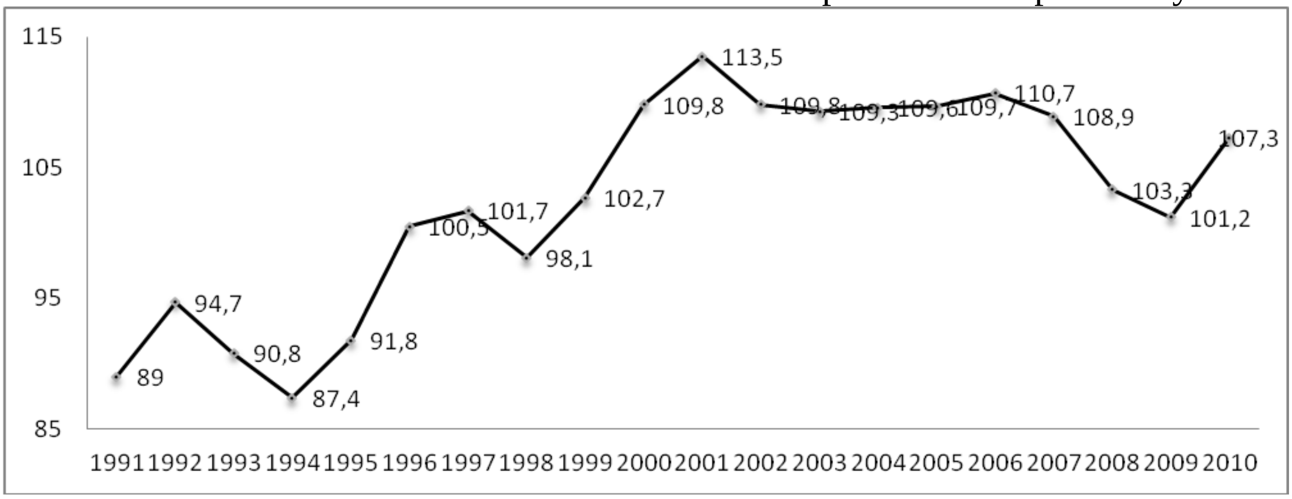
In the contrast, the New Theory of Economic Growth, however, concludes that FDI may affect not only the level of production per capita but also its rate of growth. However, the extent to which FDI contributes to growth depends on the economic and social condition or in short, the quality of environment of the recipient country. This quality of environment relates to the rate of savings in the recipient country, the level of openness and the level of technological development. Host countries with high rate of savings, open trade regime and high technological product would benefit from increase FDI to their economies. Many empirical works are available in the economic literature showing the causal relationship between FDI effect and growth. At the firm level, several studies provided evidence of technological spillover and improved plant productivity. At the macro level, FDI inflows in developing countries tend to “crowd in” other investment and are associated with an overall increase in total investment. Most studies found that FDI inflows led to higher per capita GDP, increase economic growth rate and higher productivity growth (De Mello 1997). FDI increases technical progress in the host country by means of a contagion effect which eases the adoption of advanced managerial procedures by the local firms.

A number of early studies have generally reported an insignificant effect of FDI on growth in developing host countries. FDI may have negative effect on the growth prospect of the recipient economy if they give rise to a substantial reverse flows in the form of remittances of profits, particularly if resources are remitted through transfer pricing and dividends and/or if the transnational corporations (TNCs) obtain substantial or other concessions from the host country. For instance, FDI penetration variable to have a little or no consequences for economic or industrial growth in a sample of 73 developing countries. In the same way some studies reported an insignificant effect of FDI inflows on medium term economic growth of per capita income for a sample of 41developing countries.

For Kazakhstan economy due to the destabilizing force of disintegration of Soviet Union for the first few years of Kazakhstan's independence were characterized by an economic decline (see Graph 1.). From 1991 it continued to decline and by the 1995, real GDP dropped to 61.4% of its 1990 level. GDP started to increase slowly from 1996 year 0.5% only. But from 1999-2000 years Kazakhstan economy growing rapidly average of 10 per cent increase annually. Only 2008 and 2009 years GDP growth rate decreased 103.3 and 101.2 respectively. It can be explained by global financial crises impacts. (Kazakhstan 2010).

Graph 1. GDP growth rate

/in percent to the previous year/



Source: Database of Statistics agency of Kazakhstan Republic

To make clear the graph above we postulate some main macroeconomic indicators in the table below. Comparison is done for years of economic increase. In this time period we can see economic rapid growth in all macroeconmic indicators. For instance from 1996 to 2010 GDP amount (GDP per capita) has increased for 7 times, investmens about 40, foreign investment and export 80 and 10 times respectively (see Table 1.). At the same time ratio of investments to GDP from 8.4 to 21.3% and ratio of foreign investments GDP 1.1 to 5.7% increased. Which means country is open and potential to attrack both domestic and foreign investments to national economy. Only the last indicator or ratio of oil and gas sector in export is increasing dramatticcally from 21.3 upto 61.8% that critical. Once more confirming UNCTAD list that Kazkahstan is one of the countries in "Developing and transitional economic countries with highly dependence on exporting minerals" UNCTAD (2007, p 87).

Table 1. Some macroeconomic indicators and comparison

Indicators	1995	2000	2010
GDP, mln. tenge	1415749.7	2599901.6	21815517
GDP, mln. dolar	21036.4	18292.4	148052.4
GDP per capita, tenge	90880.2	174684.7	1336465,9
GDP per capita, dollar	1350.4	1229.0	9070.0
Invesments, mlrd.tenge	119.0	595.7	4653,5
Foreign investments, mlrd.tenge	15.5	148.9	1240.8
Export, mln.dollar	5911.0	8812.2	59830.3
			in ratio
Ratio of investments in GDP	8.4	22.9	21.3
Ratio of foreign investments in investments	13.0	25.0	26.7
Ratio of foreign investments in GDP	1.1	5.7	5.7
Ratio of oil and gas sector in export	21.3	48.2	61.8

Source: Database of Statistics agency of Kazakhstan Republic

Note: depending on database indicators given in different currencies.

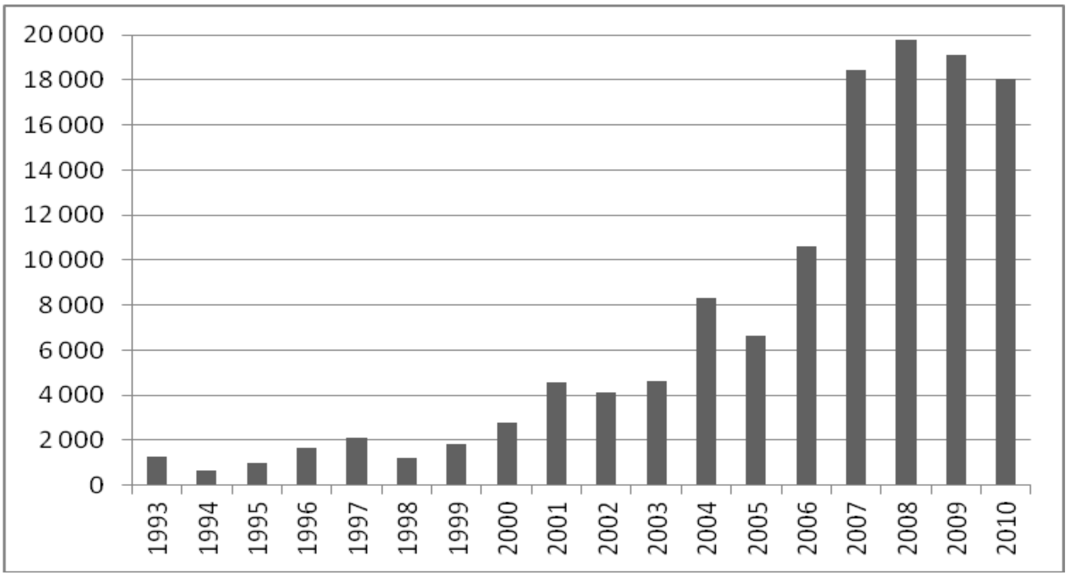
Kazakhstan has open economy it trades with many countries. For 2010 year we can see trade partners of Kazakhstan briefly. The biggest trade partners are the biggest neighbors sharing Russia 14.3% of export 47.7% of import, and China 16.9% of export and 12.9% of import. Export goes 53.6% to EU countries (mineral goods) Import comes 47.7% from CIS countries (technical and agricultural goods.)

It is rich with its natural recourses and rapidly developing transitional economic country. It is bordered with seven countries including through Caspian Sea bordering countries. Its biggest neighbors and trade partners are Russia and China. Kazakhstan on the way of long term development policy established ”Kazakhstan 2030” strategy moreover this strategy has certain policy on attracting FDI. This policy tends to economic development, advance competitiveness of country and diversify economics. In this reason Kazakhstan in needy of both domestic and foreign investment. Specially joint ventures and other foreign investments into Kazakhstan are not just permitted but actively encouraged. Among all the countries of Eastern Europe and the former Soviet Union, Kazakhstan is one of the most open toward foreign investment.

According to UNCTAD (World investment report 2007, p 14) for investors Kazakhstan is one of the most attractive countries among developing country. Kazakhstan ranked third among the CIS countries in terms of total amount of FDI inflow after Russia and Ukraine. During independence years country attracted more than 120 milliards of to its economy. Foreign direct investment (FDI) in Kazakhstan averaged 6.3 milliards of dollar per year, or more than 1200 dollar per capita in 2010. After 2000 FDI inflow is growing rapid annually. (National Bank of Kazakhstan, 2010). For example in 2003 and 2004 it annually grow more than 4 milliards of dollars. In 2009 it increased 60.5% and reached 19.7 and 18 in 2010 respectively (see Graph 2.).

Graph 2. Dynamics of FDI inflow into Kazakhstan, 1993-2010

mln. USD



Source: Database of National bank of Kazakhstan Republic

All those years due to end of 2010 year data from 1993 the main investor countries USA invested more than 30 milliards of dollar (about 20 percent share in total FDI in country), Netherlands and United Kingdom 19.3% and 8.15% respectively. Country's two biggest neighbors Russia and China invested 3.81% and 3.42% each.

So why do countries invest to Kazakhstan? Theoretically attractiveness of a country to FDI depends on economic factors affect the, such as the trade and investment regime, the "openness" of the host country, and the adequacy of basic infrastructure. For Kazakhstan its open and small economy. Its all sectors of the economy are open to foreign investment and foreign investors are allowed to participate in privatization.

Graph 3. Main investors to Kazakhstan economy, 1993-2010

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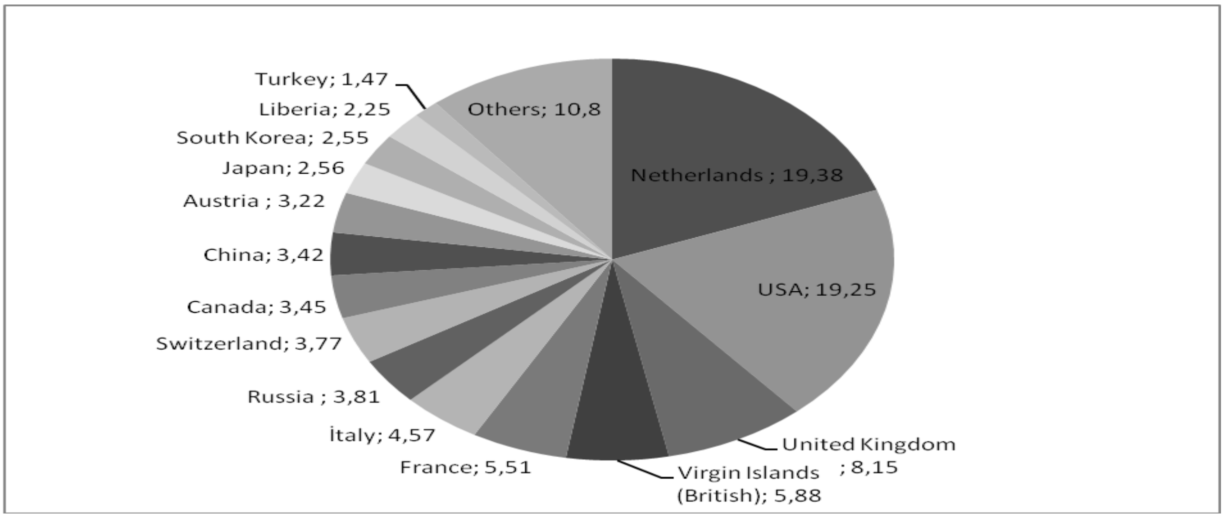

Source: Database of National bank of Kazakhstan Republic

Foreign investors are involved in the primary sector, which contains on average more than 90% of oil and gas production in primary sector. From total FDI in 1993 to 2010 share of primary sector and geological exploration not changed significantly. 76.8 percent and 74.9 percent respectively. But it is no more than 10 % manufacturing sector which requires more technology intensiveness. Most studies on spillover of FDI take manufacturing sector (Alfaro 2003). And third which is rapidly increasing share and close to world average service sector. In this case, taking base on evidence according to Alfaro (2003) impact of FDI on economic growth in the primary sector tend to have negative whereas manufacturing sector has positive effect. But evidence from the service sector is dependable. In other word FDI on economic growth vary greatly across the economic sectors, namely primary, manufacturing and service sectors. In addition to this claim according to UNCTAD (World investment report 2007, pp 87) Kazakhstan is one of the countries with highly dependence on exporting minerals, in 2007 among developing and transitional economics.

Table 3. Foreign direct investment by sector in Kazakhstan

/millions of dollar/

Sector/year	**1993**	**2000**	**2005**	**2010**
Primary + Geological exploration	976.8 (76.8)	2,277.60 (81.9)	5,319.50 (80.4)	13,538.70 (74.9)
Manufacturing	44.7 (3.5)	246.9 (8.9)	303.6 (4.6)	2,042.80 (11.3)
Service	249.9 (19.7)	256.8 (9.2)	995.5 (15.0)	2,494.20 (13.8)
Total	1,271.40	2,781.20	6,618.60	18,075.80
* Share of oil and gas production in primary sector	100	98.2	93.6	78.7

Recourse: calculated on the base National Bank of Kazakhstan republic, database

Note: numbers in parenthesis shows share of sector in total FDI

All sectors of the economy are open to foreign investment and foreign investors are allowed to participate in privatization. Foreign investors are involved in the energy sector, the steel industry, extraction industries, and many other sectors.

Laws on foreign investment, the Agency of the Republic of Kazakhstan for Investment (ARKI), and the Foreign Investors’ Council all encourage and support foreign investors. The Law “On Foreign Investment” (27 December 1994) protects foreign investors from nationalization/expropriation, changes in legislation, and illegal action by state agencies or officials and guarantees the unrestricted use of income and currency convertibility for dividends and other uses. In addition, the Law “On the State Support of Direct Investment” grants state assets and concessions, income, land and property tax holidays for five years with additional periods at reduced rates, plus duty and VAT exemption for imported machinery and inputs for varying periods. Furthermore, foreign investors may own and lease land according to the Law “On Land” (24 January 2001).

Conclusion

The paper attempted to show FDI role in Kazakhstan economic growth and its future prospects. Within the Central Asia and CIS countries Kazakhstan is one of the rapidly growing and one of the most FDI attractive countries. For instance in 2009 country attracted alone 58 percent of all FDI to land-locked developing countries. Kazakhstani economy is growing rapidly and role of FDI in economy is also growing. However since independence year 1991, more than 80 millions of dollars or 70 percent of all FDI inflows involved in primary sector and geological exploration. As Alfaro postulated above investing in primary sector even after a long time even make harm for economic development. But share of manufacturing sector for all the time not more than 10 percent. As above mentioned FDI spillovers more on manufacturing or technology intensive sector. Investing in manufacturing sector can bring the most favorable spillover for the economy.

Kazakhstan government formed the most favor condition for investors. As UNCTAD noted Kazakhstan is FDI attractive, at the same time it has highly dependence on energy sector. So as a conclusion of this paper for long time being highly dependence on energy sector can bring economy negative impact. It could be better to direct FDI to other sectors to assure long time growth for the technology intensive sectors.

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