Introduction

In December 2016, the Republic of Kazakhstan (RK) celebrated its 25th anniversary as an independent nation. By historical standards, this period of time has not been enough for the young state to have built a sustainable economy and become competitive at the international level. In 2008, the global economic crisis and the decline in oil prices—the main financial source for Kazakhstan’s economy—raised the question of how the economy of Kazakhstan could be diversified to reduce vulnerability to particularly volatile sectors and products such as commodities. In 2012, the former President of Kazakhstan, Nursultan Nazarbayev, put forward an ambitious goal for the government to enter the group of the top 30 developed countries by 2050. Recent political and economic changes in the world, such as sanctions against Russia, Brexit, the election in the United States, the rise of China as a global player, and coronavirus COVID-19 pandemic will certainly have a significant impact on the achievement of this goal. In such an economic environment, one of the
main instruments for economic development of a young state remains foreign investments and the development of formal and informal institutions aimed at the facilitation of foreign investments (Narula & Dunning, 2000). Although the country has attracted significant FDIs since its independence in 1991, most of them were concentrated in the natural resource sector. The challenge for the country is therefore to diversify the economy and create an institutional environment to facilitate investments in the new, predominantly service sectors of the economy. This chapter will discuss the main changes in the institutional environment of Kazakhstan between the years 1991 and 2019, as well as the effectiveness of efforts that have been undertaken to improve the investment environment.

Economic institutions can be defined as informal business rules and laws regulating economic and business behavior, such as constitutional laws, government decrees, regulations, and others factors, as well as economic actors, such as industry association, development, trade unions, and so on, which can affect the economic and business behavior of the other economic actors. Numerous economic studies in recent years have highlighted the institutions' importance for economic development; in this context, institutions are important to any country, regardless of whether it is a developed country or a country in a transitional period (Acemoglu, Johnson, & Robinson, 2005). The most striking example of the importance of institutions for countries' economic development can be seen in the former Soviet Bloc countries. Obviously, the failure of socialism has led to significant institutional changes in these countries, but with different outcomes. The relative success of the countries of Central and Eastern Europe, in comparison to the former Soviet Union countries, is a result of their histories, cultures, and internal systems (Aoki, 2001), but also a result of their specific geographical positions. The newer members of the EU, such as Estonia, Poland, and Hungary, have managed to adopt the institutional framework of the EU, while Russia and Ukraine have faced significant challenges in the development of their new institutional environments (Berglof & Bolton, 2002).

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1 Diversification is defined in this research as a long-term change in economic structure.
Kazakhstan, being resource-rich, has built its economy around the oil and gas (O&G) industry that had been increasingly dominating its economy and became an O&G export-oriented country. Therefore, a major part of FDI is concentrated in this sector of the economy. As O&G projects can be very investment-intensive and Kazakhstan had none of its own financial resources to fund these projects, the Government of Kazakhstan has adopted a series of reforms to liberalize its economy and facilitate foreign investment, first and foremost in the O&G sector, since obtaining independence in 1991. As a next step in its development, the country needs to move out of this middle-income trap, defined as the inability to sustain growth, and transition from resource-driven growth, which is based on low-cost labor and capital, to productivity-driven growth (Khakas & Kohli, 2011). To diversify its economic structure, Kazakhstan has embarked on an ambitious program of economic change, innovation, investment in human capital, international trade, and attraction of FDI for job creation (UNCTAD, 2003).

**Neo-institutional Theory and Emerging Economies**

Emerging economies are characterized by, among other features, inefficient markets, active government involvement, extensive business networking, and high uncertainty (Xu & Meyer, 2013). Institutional theory is the prevalent approach in international business and management studies for explaining the strategic challenges businesses face in the context of emerging countries. For instance, institutional theory holds that norms and values of a given country are used to formulate formal and legal aspects of government directives (Kraft & Furlong, 2007). This can be helpful in an explanation of environments where market failure\(^2\) is widespread and governments attempt to substitute for

\(^2\)Market failure is an economic term covering all circumstances in which the market equilibrium is not efficient (Begg & Ward, 2013).
market-coordinated mechanisms more frequently and directly than the governments of developed countries (Kalyuzhnova, Nygaard, Omarov, & Saparbayev, 2016).

The applications of institutional theory include (1) conceptualizing national environments in terms of regulatory, cognitive, and normative “pillars,” introducing constructs such as country institutional profile; (2) conceptualizing processes of large-scale transformation of national systems through the notions of institutional transition, upheaval, and imperfection; (3) explaining comparative national business systems based on institutional embeddedness; (4) explaining similarities in practices across organizations resulting from isomorphic pressures; (5) studying constraints on the diffusion and institutionalization of organizations’ practices across borders and organizational units; and (6) explaining the relationship between foreign companies and their host environments (Kostova, Roth, & Dacin, 2008).

Institutional theory with an organizational focus has emerged from the works of Meyer and Rowan (1977), Zucker (1977), Meyer and Rowan (1983), DiMaggio and Powell (1983), Tolbert and Zucker (1983), and Meyer and Scott (1983). These works introduced the view of an organization as an actor responding to the environmental context. It explains that firm behavior is determined by the external institutional environment which includes formal institutions such as law, regulations and rules, and informal institutions such as norms, cultures, and ethics.

Before the emergence of organizational institutional theory, prevailing neo-classical theories assumed that the coordination and control of activity were the critical dimensions on which formal organizations have succeeded in the modern world. Meyer and Rowan (1977) challenged this view and defined formal organizations as systems of coordinated and controlled activities that arise when work is embedded in complex networks of relations and boundary-spanning exchanges. They supposed that organizational structures arise in a highly institutionalized context, and as a response, organizations conform to this context by reflecting the myth of their institutional environments—that is becoming isomorphic with their institutional context—by incorporating the practices and
procedures defined by prevailing rationalized concepts of organizational work and institutionalized in society to increase their legitimacy and survival prospects. However, conformity to institutionalized rules may often conflict with efficiency criteria (Meyer & Rowan, 1977; Zucker, 1987); therefore, organizations’ coordination and control activity to promote efficiency undermines an organization’s ceremonial conformity and sacrifices its support and legitimacy. In their later paper, Meyer and Rowan (1983: 84) defined institutional context as “the rules, norms and ideology of the wider society.” Table 1.1 outlines the main concepts of the institutional theory with an organizational focus.

Williamson (2000) proposed consideration of the four levels of social analysis: social theory (informal institutions), political theory (institutional environment), transaction cost economics (governance), and neoclassical economics (resource allocation). The second level according to Williamson (2000) is referred to as the institutional environment. Here “formal rules” such as constitutions, laws, property rights, and policies are introduced. Legislative, judicial, and bureaucratic functions of government as well as distribution of power across different levels of government are included. At level two research is concerned with normative design of better policies, the economics of property rights, changes in established economic and political procedures, breakdowns and development of the old and new political and economic systems, and so on. The institutions of governance are located in the third level. The concept of embeddedness helps to understand network relationships in society and business.

In this chapter, the development of the economy of Kazakhstan will be considered through the lens of its institutional context (Meyer & Rowan, 1983) or environment (Williamson, 2000), that is the economic rules and norms of Kazakhstan in comparison to other countries, and institutional change (North, 1994), focusing on the institutional evolution of an economy in the post-Soviet period.

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3 Extent to which economic action is linked to structures of social relations in modern industrial society (Granovetter, 1985).
Table 1.1  Key concepts of institutional theory with organizational focus

| Notion                    | Definition                                                                                                                                                                                                 | Indicative literature                      |
|---------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------|
| Legitimacy                | Congruence of an organization with social laws, norms, and values which provide survival benefits                                                                                                     | Parsons (1956), Parsons and Jones (1960)  |
| Institutional context     | The rules, norms, and ideologies of the wider society                                                                                                                                                    | Meyer and Rowan (1983)                    |
| Rationalized myth (rule)  | Social understandings of appropriate organizational behavior                                                                                                                                           | Meyer and Rowan (1977)                    |
| Institutionalization      | The process by which social processes, obligations, or actualities come to take on a rule-like status in social thought and action                                                                       | Meyer and Rowan (1977)                    |
| Isomorphism               | Conformity of organizations with institutions                                                                                                                                                    | DiMaggio and Powell (1983)                |
| Organizational field      | Community of organizations that shares a common meaning system and whose participants interact more frequently and closely with one another than with actors outside the field | Scott (1991)                              |
| Institutions              | The cultural-cognitive, cultural-normative, and cultural-regulative structures that provide stability and collective meaning to social behavior                                                                                                                                 |
|                           | The humanly devised constraints that structure human interaction are made up of formal constraints (e.g., rules, laws, constitutions), informal constraints (e.g., norms of behavior, conventions, self-imposed codes of conduct), and their enforcement characteristics. Together they define the incentive structure of societies and specifically economies | Scott (1995), North (1994)                |

(continued)
Since gaining its independence, Kazakhstan has made significant progress in terms of its economic development. With the separation of its economy from that of the Soviet Union, the first few years proved to be an extremely difficult period for the country (Hoff & Stiglitz, 2004). Within the 11 years since the beginning of the new millennium, economic growth has averaged slightly more than 8%, the main reason for this being the rapid increase in crude oil production. From 1995 to 2016, GDP per capita increased annually by an average of 5.2% (OECD, 2017).

The correlation between oil prices, production, and the GDP growth rate can be clearly recognized in the period between 1991 and the 2008 global economic crisis, after which moving up the income ladder lost its momentum (Fig. 1.1) and GDP growth declined substantially as compared to the early 2000s. The growth in GDP for 2015 was only 1%, while the same figure was 6% in 2013 and 4.1% in 2014 (OECD, 2017).
These data show that since 1991, FDI inflows in the country have significantly increased (Fig. 1.2), with most investments in the natural resource sector. According to OECD (2017) data, one-third of state revenue, 16% of all value-added activities, 30% of GDP, and, ultimately, two-thirds of the country’s total exports are derived from the oil and gas sector.

FDI inflows to Kazakhstan have fluctuated considerably over the past ten years. FDI reached several peaks since 2001 and declined after the financial crisis in 2008, only to rise again in 2016. The recent rise in FDI can be explained by new investment opportunities in major exploratory projects in the O&G industry. In this respect, Kazakhstan remains significantly ahead of most post-Soviet countries, even Russia, a country considerably larger in terms of territory and population. Because the domestic consumer market size of Kazakhstan is very small and the country is abundant in natural endowments, the main motive for foreign investments remains to be resource seeking.
Analysis of the investment environment shows that Kazakhstan is closely connected with various countries of the EU, as they are the country’s main investors. Additionally, powerful countries, such as the United States, Russia, China, and Japan, are currently actively investing in Kazakhstan. Table 1.2 shows a list of the ten largest investing countries in Kazakhstan.

![FDI, net inflows (% of GDP)](image)

**Fig. 1.2** FDI, new inflows as % of GDP in Kazakhstan, Russia, and Ukraine, 1992–2016. (Source: Own processed data based on WB)

**Table 1.2** Top ten FDI inflows in Kazakhstan, by country, 2018

| Country          | FDI inflow, Mln USD | Share of total, % |
|------------------|---------------------|-------------------|
| Netherlands      | 7350.0              | 34                |
| United States    | 5342.8              | 24                |
| Switzerland      | 2540.8              | 12                |
| Russia           | 1499.2              | 7                 |
| China            | 1476.2              | 7                 |
| Belgium          | 1049.0              | 5                 |
| France           | 916.1               | 4                 |
| United Kingdom   | 593.1               | 3                 |
| South Korea      | 478.9               | 2                 |
| Luxemburg        | 470.1               | 2                 |

Source: Own processed data based on NBK

Analysis of the investment environment shows that Kazakhstan is closely connected with various countries of the EU, as they are the country’s main investors. Additionally, powerful countries, such as the United States, Russia, China, and Japan, are currently actively investing in Kazakhstan. Table 1.2 shows a list of the ten largest investing countries in
Kazakhstan. As can be seen, the Netherlands dominates this list, followed by the United States, Switzerland, Russia, and China, respectively.

According to data from the Committee on Statistics of Kazakhstan, as of January 2020, there are about 26.7 thousand firms with foreign ownership in Kazakhstan (compared to 14.6 thousand firms in 2010): most of them can be classified as small businesses, some are medium-sized and large MNEs. The data on large MNEs notes that of these firms operating in Kazakhstan are predominantly extractive companies from the Netherlands, Russia, the United Kingdom, and the United States. Chevron, Lukoil, Texaco, Canadian Hurricane Hydrocarbon Ltd., British Petroleum, Exxon, Royal Dutch Shell, and Total are among the major MNEs operating in the country. Thus, according to the latest data, more than 60% of Kazakhstan’s industrial output and total exports, as well as more than 5% of total employment, can be accounted for by MNEs (OECD, 2017).

Kazakhstan’s investment policy itself represents a flexible form of regulatory policy. Kazakhstan guarantees the legal protection of investments to create more favorable conditions for existing and potential investors. The Washington Convention of 1966, which was concerned with legal dispute resolution and conciliation between international investors, is applicable to the territory of Kazakhstan. As such, all foreign arbitration decisions regarding disputed investment issues between foreign citizens and states must be recognized by Kazakhstan. Moreover, more than 40 bilateral investment treaties are currently valid in Kazakhstan. This gives foreign investors confidence in the security of their rights. Such steps show the desire of the Government of Kazakhstan to provide an institutional environment that is equal in terms of international norms and rules. These documents are important to investors, especially if their home institutional environment is more developed than that of the host country. The greater the difference between the institutional development in the MNE’s home country and in the host country, the more liability of foreignness investors face (Peng & Meyer, 2011). Investors’ competitiveness will be lower in comparison to local firms, which are

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4 Additional costs arising from the unfamiliarity of the environment, from cultural, political, and economic differences, and from the need for coordination across geographic distance (Zaheer, 1995).
used to working in a local institutional environment. Accordingly, the ratification of the above international documents has helped Kazakhstan to reduce the institutional gap between the state and the home countries of potential and existing investors.

According to the World Bank (2019), Kazakhstan has recently made a significant leap in the Doing Business rankings, improving its position from 51st in 2015 to 28th by the end of 2018. The significance of this jump cannot be underestimated, given that this rating evaluates more than 190 countries. Kazakhstan was able to achieve these results due to the fact that it had ratified a number of international agreements to improve its investment environment. These agreements, in turn, demanded the country carry out various institutional reforms. Obviously, such changes can have a positive impact on the strategic decision-making process of investors regarding a potential country as a location for their activities. The higher the rating of the state, the more investors will be interested in investing in the country. Ultimately, investors are interested in those countries in which they face fewer barriers for doing business. If it was not consistently receiving feedback from both existing and potential foreign investors, Kazakhstan is unlikely to be capable of finishing these reforms. To attract more investment, the Foreign Investors’ Council (FIC) was created in 1998, with the main objective of creating conditions for bilateral dialogue between investors and the government. The most acute problems investors face are raised during meetings with the FIC, and possible solutions are discussed.

Low levels of protection on private and intellectual property rights reduce the country’s attractiveness for investment (Acemoglu, Johnson & Robinson, 2005). This is mainly because companies, when planning to enter a new market, must be sure that their competitive advantages will be protected in the host country (Peng & Meyer, 2011). This problem is directly linked to the low level of development of legal norms and their effectiveness, as well as law enforcement. Many studies in this field have confirmed that the stronger and more developed legal institutions are, the more investors will be interested in doing business in the region, and some economic sectors will be developed more effectively and speedily (La Porta, Lopez-de-Silanes, & Shleifer, 1998). Therefore, protecting investors’ interests in the host country is of paramount importance. The
Government of Kazakhstan has signed and ratified various agreements on the protection of intellectual property rights as part of its move toward improving the investment environment. The main laws regulating intellectual property in Kazakhstan include the Agreement on Trade-Related Aspects of Intellectual Property Rights, the Civil Code of Kazakhstan, the Law on Patent, and the Law on Copying and Neighboring Rights.

The presence of competitive local suppliers and buyers is of crucial importance to the country, as these conditions create jobs and improve the competitiveness of the whole economy. Importing intermediate goods and services, especially if the country is relatively distant, can significantly increase transportation costs for companies producing final goods in Kazakhstan. Therefore, Kazakhstan has made a number of changes to the formation of its competitive local business environment. The government established the Agency for Protection of Competition and allocated significant amount of money to the agency’s budget. Therefore, for example, if the budget totaled US $4.5 billion in 2012, it then increased by more than double, equal to US $11.7 billion, in 2014 (Kazakh Invest, n/d). To achieve this, the agency had employed more than 190 full-time specialists. Recently, the World Bank published its report on Global Competitiveness Index (GCI) 2017–2018 where Kazakhstan is ranked 57th among 137 countries, and is positioned at 114th according to the intensity of local competition criteria and also ranked 84th in terms of the effectiveness of anti-monopoly policies. This shows that further improvements are still necessary.

The report notes that Kazakhstan is, at present, in transition from stage 1 to stage 2 of development, according to the well-known economic theory, distinguishing three specific stages of development—factors-driven, efficiency-driven, and innovation-driven (Porter, 1990; Porter, Sachs, & McArthur, 2002). This means that the competitiveness of the economy hinges primarily on well-developed institutions, a robust infrastructure, a stable macroeconomic environment, and a healthy workforce that has received at least a basic education. Kazakhstan has begun to invest in higher education and training, developing markets for goods (both domestic and foreign), labor, and finances that are harnessing benefits of different technologies. However, although these positive changes have not yet promoted Kazakhstan into a leading position according to the
criteria of the competitiveness of the local business environment, innovation, and the competitiveness of the country as a whole, the indicators show a continuing trend toward further improvements. Furthermore, developmental efforts need to be put into the GCI’s business sophistication pillar of competitiveness, including quality of business networks at the country level, as well as quality of individual firms’ strategies. Development efforts also need to be placed into the innovation pillar of economy, specific for stage 3 of a country’s development, namely innovation-driven growth, in order to catch up with advanced economies.

With this aim, Kazakhstan has begun to support and develop local companies in the O&G industry. With the introduction of the Law of the Republic of Kazakhstan “On Subsoil and Subsoil Use” in 2010, a local content policy (LCP), which is an industrial development policy specific for resource-rich counties, was launched in Kazakhstan. This policy includes procurement, labor, and technology transfer policies, as well as social projects. Special economic zones (SEZ) were created in 2011 in accordance with the Law of the Republic of Kazakhstan. Among the ten SEZ, three were created for the petro-chemical industry and one for the information and communication technology (ICT) industry. All these arrangements are considered to be part of LCP. Financial support is provided by a number of organizations, including the JSC National Management Holding Baiterek (founded in 2013). The company offers financial and investment support for the non-O&G sector, cooperates with the private sector, and develops business clusters, defined as “geographic concentration of interconnected companies, specialised suppliers, service providers, firms in related industries, and associated institutions (for example universities, standard agencies, and trade associations) in particular field, that compete but also co-operate” (Porter, 1998: 197).

With the launch in 2010 of the State Program Business Road Map 2020, the Entrepreneurship Development Fund Damu (established in 1997) has developed a range of tools to support small and medium enterprises (SMEs). This includes subsidization of interest rates on loans, credit guarantees, training, and consulting services. The mission of the Development Bank of Kazakhstan (DBK), which was founded in 2001, is “to promote sustainable development of the national economy by investments into non-resource sector of the country” (DBK, n/d).
The building blocks of LCP in Kazakhstan are presented in Fig. 1.3. First, the *State Program of Local Content Development in the Republic of Kazakhstan in 2010–2014* was launched for the period of 2010–2014, and currently the *State Program of Accelerated Industrial and Innovative Development* of the Republic of Kazakhstan for 2015–2019 is in operation. The measures to promote local content\(^5\) (LC) were also envisaged by the RK’s sectoral development programs for 2010–2014. These are programs to promote LC in the chemical, nuclear, and electric engineering industries, as well as in information and communication technologies, the O&G industry, mining and metallurgy, mechanical engineering, agricultural industry, tourism, light industry, construction industry, and production of building materials. A list of the main legal regulations on LC in the O&G and ICT industries in RK can be found in Table 1.3.

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\(^5\)Value-added activities in which local businesses compete with foreign companies for contracts in the industry, as well as broader social participation by the foreign investors (Kalyuzhnova, 2008).
Table 1.3  Selected regulations on LC in O&G and ICT industries of the RK

| Regulation                                                                 | Number/ Date     | Title                                                                 |
|---------------------------------------------------------------------------|------------------|----------------------------------------------------------------------|
| Decree of the President of the RK                                         | № 922 01.02.2010 | Strategic Plan for Development of the RK until the year 2020          |
| Decree of the President of the RK                                         | № 957 19.03.2010 | List of State Programs                                               |
| Decree of the President of the RK                                         | № 958 19.03.2010 | The State Program of Accelerated Industrial and Innovative Development of the RK for 2010–2014 |
| Law of the RK                                                             | № 291-IV 24.06.2010 | On Subsoil and Subsoil Use                                           |
| Decree of the Government of the RK                                        | № 964 20.09.2010 | Uniform accounting treatment to Kazakh LC by organizations when purchasing goods, works, and services |
| Decree of the Government of the RK                                        | № 1038 09.08.2012 | Rules of conducting examination according to LC                     |
| Decree of the President of the RK                                         | № 874 01.08.2014 | State Program of Accelerated Industrial and Innovative Development of the RK for 2015–2019 |
| Decree of the President of the RK                                         | № 986 26.12.2014 | Anti-corruption Strategy of the Republic of Kazakhstan for 2015–2025 |
| Decree of the Government of the RK                                        | № 1418 31.12.2014 | Map of industrialization                                             |
| Decree of the Minister of Investments and Development of the RK           | № 87 30.01.2015  | Single calculation procedure by the organizations of LC when purchasing goods, works, and services |
| Joint Decree of the Minister of Investments and Development of the RK and the Minister of Energy of the RK | № 538, № 330 30.04.2015 | Forms and rules of creation and submission of annual, medium-term, and long-term programs of purchase of goods, works, and services, reports of subsoil users on goods purchased, works, and services, and on obligation fulfillment on LC in personnel |
Despite all these efforts, however, an analysis of technological capabilities in Kazakhstan shows that main technological capability indicators of Kazakhstan, in comparison with other emerging countries, remain low (see Table 1.4). This is why emerging countries like Kazakhstan need to be willing to encourage activities that enable firms to choose and use technology from abroad (if it does not exist within the country), to create a competitive advantage, as well as to develop local technological capabilities (Yu & Li-Hua, 2010).

In January 2014, the Government of Kazakhstan announced The Strategic Plan for development of the Republic of Kazakhstan until the year 2020. The Kazakh government has also introduced the State Program of Accelerated Industrial and Innovative Development 2015–2020 (SPFIID) in order to implement the main provisions of these strategic documents.

Another important national document is the Plan of the Nation 100 Concrete Steps to implement the five institutional reforms proposed by the former President of Kazakhstan in 2015. It is designed to support the effort to join the top 30 developed countries by 2050. This document is closely linked to improvements in the investment environment, as its main goals are the development of a professional civil service, ensuring the rule of law, industrialization, economic growth, identity and unity, and establishing an accountable state. One example of such improvements is that Kazakhstan, over the past three years, has eased the process of acquiring a license; for example, the license to conduct business

### Table 1.3 (continued)

| Regulation | Number/Date | Title                                      |
|------------|-------------|--------------------------------------------|
| Law of the RK | № 438-V 07.12.2015 | On Astana’s International Financial Center |
| Decree of the Government of the RK | № 827 12.12.2017 | State Program “Digital Kazakhstan” |

Source: Own processed data based on Legal information system of Regulatory Legal Acts of the Republic of Kazakhstan available at [http://adilet.zan.kz](http://adilet.zan.kz)

*The capital city of Kazakhstan has been renamed to Nur-Sultan in March 2019 to honor outgoing ex-President Nursultan Nazarbayev*
**Table 1.4** Technological capability in selected emerging countries in 2018

| Indicator                        | Czech Republic | Hungary | Kazakhstan | Russian Federation | Ukraine | China |
|----------------------------------|----------------|---------|------------|--------------------|---------|-------|
| FDI stock, % of GDP              | 64.10          | 57.01   | 89.43      | 25.00              | 35.12   | 11.96 |
| R&D expenditure, % of GDP        | 1.8            | 1.4     | 0.1        | 1.1                | 0.4     | 2.1   |
| Researchers in R&D, per Mln people | 3690          | 2924    | 662        | 2852               | 994     | 1235  |
| Patent applications, non-residents | 54            | 36      | 193        | 13,031             | 1861    | 148,187 |
| Patent applications, residents   | 678            | 407     | 789        | 24,926             | 2207    | 1,393,815 |

Source: Own processed data based on WB and UNCTAD statistical databases
activities can now be obtained within two weeks, when three years ago obtaining it could take more than a month. This improvement is directly related to the introduction of the Concept of the Further Reforming of the Licensing System of the Republic of Kazakhstan for 2012–2015. Over this period of time, a system of e-licensing was introduced, which has significantly reduced the time, and simplified the process, of obtaining a license for such activities as business registration or obtaining a special permit for construction work (OECD, 2017). The section Ensuring the Rule of Law in the Plan of the Nation 100 Concrete Steps forms the main part of the document describing specific actions required on the part of the state in terms of institutional reforms. In recent years, Kazakhstan has significantly improved its processes of enforcing contracts and resolving disputes between the state and investors through its local and national courts. According to the World Bank’s Doing Business Report for 2019, Kazakhstan currently ranks at 28th place among 190 countries. This progress is also reflected in the World Bank’s survey of large MNEs. In 2013, less than 10% of all large MNEs operating in Kazakhstan considered the main problem and limitation to doing business in the country was the judicial system. These improvements are directly associated with the implementation of special procedures to resolve issues with investors and a result of the introduction of mandatory qualification requirements and training, as well as the procedure of revision activities for judges at all levels (OECD, 2017).

Kazakhstan’s state strategy until 2050 identifies and underlines the paramount importance of combating increased levels of corruption in the country. Corruption can be defined as the deliberate abuse of power or illegal use and distribution of resources for personal gain (Shleifer & Vishny, 1993). High levels of corruption in a country increase the uncertainty of doing business, which in turn leads to increased costs (Cuervo-Cazurra, 2006) and decreased exports (Lee & Weng, 2013). At the end of 2014, the former President signed the Anti-corruption Strategy of the Republic of Kazakhstan for 2015–2025 years, designed to be the most effective solution to this problem.

The Government of Kazakhstan has recently made several attempts to establish quasi-public authorities that attract and support foreign investors in particular, as the main problem of the country remains to be access
to financing, so investment opportunities are still limited. As such, organizations like the Development Bank of Kazakhstan, the National Holding Baiterek, the Entrepreneurship Development Fund Damu, and KazAgro have been created, in addition to special programs for subsidies and financing projects in the country. These companies provide advisory and financial support for investment projects; the Entrepreneurship Development Fund Damu, for example, offers low credit rates and flexible loan terms for companies that are engaged in local content (LC) development (Kazakh Invest, n/d).

So-called “one-stop shops” were established across the entire country of Kazakhstan; they were created in consultation with PricewaterhouseCoopers and with funding by both central state bodies and local executive authorities (Kazakh Invest, n/d). They are special institutions accountable to the Ministry for Investment and Development of the Republic of Kazakhstan (MID), the main purpose of which is to provide advisory support to investors. These initiatives are particularly important for foreign investors unfamiliar with business administration rules in foreign markets. The provision of financial and advisory support for foreign firms from the state helps to minimize the costs associated with liability of foreignness.

*The Entrepreneurial Code of the Republic of Kazakhstan* (EC) came into force in 2016 and is the main document regulating issues on the interaction of the state with investors and issues on competition, among others. This code is an update of the *Law on Competition*, adopted in 2008, and it replaced the previous *Law on Investment*, as well as other normative acts on regulating and protecting the rights of investors. The main aim of the EC is to protect the rights of investors who are facing direct confiscation of their firm’s property by the government. Moreover, the EC ensures complete compensation in the case of damage that arises from illegal actions by the state; in such instances, the amount of indemnification is calculated according to current market value. In addition, the EC is different to previous laws in that it provides increased rights and safeguards for the protection rights and property. The application of such new regulatory codes and laws helps resolve any problems associated with ambiguities in legal documents that may lead to the wrong interpretation of the implemented laws (Peng & Meyer, 2011).
Kazakhstan’s accession to the World Trade Organization (WTO) in 2016 has led to a new stage of institutional reforms. As such, Kazakhstan needs to adapt its institutional environment to the requirements of WTO standards by 2020. This will require removal of some restrictions, for example, most performance requirements, such as local content rules, restrictions on ownership of fixed telecommunications for foreign legal entities, the ban on the activities of subsidiaries of foreign banks, and restrictions on hiring foreign employees. Thus, in the subsequent and coming years, the state needed to and needs to re-design institutional policies according to WTO requirements.

In 2014, Kazakhstan joined the EAEU. This fact may also have contributed significantly to the revision of the local institutional system. Many of the economic barriers faced by Kazakhstani businesses may be reduced or eliminated in the future through the activities in international economic organizations. In the era of globalization, the role of such international organizations cannot be underestimated. They create a favorable framework for the free movement of capital, knowledge, labor, and other critical factors that stimulate market mechanisms.

The Astana International Financial Center (AIFC) was established as a part of the 100 Concrete Steps Plan of the Nation, the government’s attempt to modernize the financial sector. The main purpose of the center is to create unique and favorable conditions for the development of financial and banking services. A special judicial system, formed on the basis of the English legal system (common law), will operate in all territories of the AIFC. The AIFC will adopt all the best practices that other international financial centers\(^6\) employ, such as minimal regulation and taxation of residents, as well as a favorable social environment.

To summarize, the main governance\(^7\) indicators developed by the WB demonstrate the most important institutional changes carried out in Kazakhstan between 1996 and 2016, especially in comparison with its neighbors, Russia and China. As can be seen from Fig. 1.4 (a and b), the Government of Kazakhstan significantly increased its effectiveness and regulatory quality in the period between 1996 and 2016. Compared

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\(^6\)Such as London, Singapore, Dubai, Paris, Toronto, and New York.

\(^7\)That is, the traditions and institutions by which authority in a country is exercised.
Fig. 1.4  (a and b) Governance indicators in Kazakhstan, Russia, and China, 1996–2016. (Source: Authors’ own processed data based on WGI, World Bank)
to the 1990s, the criteria regarding the government effectiveness, rule of law, and overall regulatory quality have been steadily improving since 2006; however, Kazakhstan is still behind its neighboring countries, such as China, in terms of institutional changes, although it has also recently outperformed Russia.

Conclusion

Similar to the specific economic situations of many countries transiting from the planning system, the main non-oil economic sectors in Kazakhstan, which could be attractive to investors, are still dominated by state-owned enterprises (SOEs). SOEs often lack competition; for example, there were about 1200 SOEs conducting activities in 15 sectors in Kazakhstan in 2016. Companies, such as Temir Zholy (railways), Samruk-Kazyna (national welfare fund), KazAgro (agriculture), and others, are some of the largest SOEs operating in Kazakhstan. This obviously has a constraining effect on the whole economy, as competition stimulates supply. With the aim of giving an economy a new impetus for growth, as well as to reduce state ownership, the government launched an active program for privatization of SOEs in 2015. In total, 65 state-owned companies and 175 of their subsidiaries are in the process of being transferred partially or entirely to the private sector via a combination of negotiations, auctions, and IPOs by 2020 (O’Casey & Batchilo, 2016).

Regardless, an additional effort might be necessary to develop competition in some industrial and economic sectors of Kazakhstan where the share of the quasi-public sector is still high, and foreign companies may have increased costs due to their liability of foreignness, causing difficulties for foreign newcomers to compete with SOEs that have legal and financial support from the state. On the other hand, the SOEs may have additional transaction costs due to their size, as well as their inability to react to changing market demands. This will also allow broader groups of investors to benefit from the Kazakh economy, especially local private investors.
In addition to the large share of state participation in the economy, there are challenges associated with the implementation of government initiatives in Kazakhstan. The main reason for the failure of these projects is often unqualified and untrained human resources, as well as a lack of effective management. This results in low wages for local workers, in comparison to foreign labor. In order to further develop a sufficient qualified local labor force, the country needs to make more investment in the educational system. The RK government introduced a limit on the share of foreign specialists in the category of corporate employees; however, this can make hiring foreign specialists with specific knowledge currently absent from the local labor market difficult. For example, a foreign specialist must obtain a special work permit in order to be transferred to work in another region of the country. Each region of the country has its own specific quota for the number of foreign workers. Under such restrictions, foreign companies often consider alternative locations for their activities; for example, China National Petroleum Corporation decided to open a new ICT service center in Dubai, in addition to Kazakhstan, as Dubai has no such restrictions on hiring foreign specialists.

The local economy in Kazakhstan needs to be further developed. Compared to countries such as Turkey, for example, where small and medium businesses account for 60% of GDP, local companies in Kazakhstan make up almost three times less. Therefore, the economy currently perceives a low ability of its SME sector to benefit from new information, technology, and innovation and cannot apply new knowledge within their own business practices. Consequently, local firms do not increase their production and do not create new jobs. All this leads to the fact that local citizens remain heavily dependent on the state and foreign firms in terms of employment, wages, and savings. Finally, because the level of domestic investment cannot be increased and the country remains dependent on foreign investments, Kazakhstan has limited ability to grow its financial sector.

Kazakhstan’s government has attempted to make various institutional reforms and allocates funds for the development of the country’s infrastructure, as well as to improve the legal and judicial system. Overall,
there is a positive trend in government efforts regarding the importance of business institutions in the country, in such a way as to further improvements in the investment environment. Still, the main problem remains the effectiveness of these governmental initiatives, which need to be improved in order to reduce state budget expenditures in a new economic situation of low oil prices. The problems that investors face in practice need to be recognized; for example, not only large MNEs but also small foreign firms need to be represented in the most important discussion platform that exists between the government and such investors. This means that the opinions of foreign SME representatives are not taken into account. This assertion is confirmed by the cooperation between legislators and investors. Consequently, this broader participation will give the government proof, with more detailed feedback from foreign firms regarding the effectiveness of its institutional reforms.

Even though a wide inventory of natural resources blesses Kazakhstan’s economy, especially in the initial stages of development, these resources currently constrain the country’s level of investment attractiveness. Kazakhstan has only made feeble attempts to diversify its economy, and efforts to further development in other sectors of the economy need to be made. Thus, Kazakhstan is not fully utilizing its locational advantages to make it attractive to investments that could accelerate its entry into the top 30 advanced countries of the world. The next steps in economic advancement require improvement of the country’s educational system, with the aim of training specialized personnel, strengthening the accountability of public initiatives, and developing projects by integrating private investment to them. A change in cultural perception, especially toward corruption and bureaucracy, is also necessary. Kazakhstan must also facilitate broad participation of investors in its rule-making process, as well as strengthening local industry and continuing the further diversification of its economy. The main location advantage of Kazakhstan is its strategic position between China, Russia, and the EU, on this so-called New Silk Road. These potential future developments arising from the geopolitical and internal factors and initiatives will be considered in detail in the next chapters.
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