

# **THE ANALYSIS OF STATE REGULATION TO ATTRACT INVESTMENT AND DEVELOPMENT OF SEZ IN KAZAKHSTAN**

by

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## **ABSTRACT**

This paper analyses necessity and need for creation of special economic zones during the period of formation of a model of an open economy on the example of the Republic of Kazakhstan. Period of fundamental changes in economy during transition from closed to open economic systems is studied. The role, essence and possibilities of special economic zones are considered. The study and analyses of operating special economic zones in Kazakhstan are made. The paper concludes that special economic zones will bring positive impact just in case of deep analyses and study all the possibilities and threats.

## **KEYWORDS**

Development, Special Economic Zone, Integration

## **INTRODUCTION**

In his message in 2010 "New Decade - New Economic Growth - New Opportunities for Kazakhstan" President of the Republic of Kazakhstan Nursultan Nazarbayev mentioned the need to develop effective strategies for the exit of domestic producers to new markets, build a competitive advantage, noting that the sustainable development the country will be provided by accelerated diversification and competitiveness of the national economy. Attracting investment is one of the most important factors determining the growth and competitiveness of the national economy, as well as facilitating its integration into global production processes. Foreign investment in the host economy can accelerate the development of enterprises, improve the quality of human capital, create new jobs, attract advanced technology and encourage them to spread to adjacent industries. In the last two decades there have seen increased competition for global investment, which in turn raises the problem of the state to develop and implement comprehensive policy measures aimed at increasing the country's attractiveness for investment. One of the effective tool to increase the investment attractiveness is the creation of special economic zones (hereinafter - SEZ) with preferential tax and customs regime for potential investors.

## **LITERATURE REVIEW**

The problem of functioning of special economic zones in Kazakhstan has been rather poorly studied. Practically there is no work unlike comprehensive and universal approach to the problem. However, in recent years in the economic literature of Kazakhstan it is observed significant qualitative leap forward in the study of the problem: amount of work increased the theoretical and methodological approaches have been changed.

To add that in considering the classification of export and economic zones, some authors have attempted to highlight their successive generations. Free trade area is normally related to the first generation of SEZ, export processing zones - to the second generation, technology development and service areas to the third generation. There were the first proposals for the fourth generation zone. These issues were studied by Arynova EM, [1] L. Baotay, [2] Baizakova S.B., [3] A. Esentugelova, [4] Rau A.P., [5] Semenova G., [6] N. Smorodinskaya N., [7] Kalabaeva A.N., [3] A. Kapustin [7] and others.

According to the International Development Association of Free Zones (IDAFZ), established in 1990, SEZ is special territorial and economic education as a rule open to the financial and economic activity of any country favorable to the economic, scientific, technical, environmental and social development. It is specially created by the additional delegated by central and local government rights and powers with fixed boundaries, free-zone legislation, budget, tax, and management bodies. [8]

## **Investment attraction of Special economic zone in Kazakhstan**

Nowadays in Kazakhstan all the necessary legal framework for investment activities, the program of investment promotion and development of special economic zones, export promotion in the Republic of Kazakhstan for 2010 - 2014 years have been adopted. Government Regulation of the Republic of Kazakhstan dated October 30, 2010 № 1145. By the end of 2014 it is planned:

1. Attraction of 18 target investors from the list of companies included in the Global-2000.
2. Native and foreign investment in non-primary sectors (manufacturing, processing of agricultural products and services) will increase by at least 15%.
3. Foreign direct investment (FDI) to GDP increased by five percentage points.
4. Investment sources are specified (7 main countries of investors with a share of each country more than 5%).
5. Contract execution by foreign countries on the promotion and reciprocal protection of investments.
6. Achievement of global index of competitiveness in the World Economic Forum: "The impact of rules governing foreign direct investment in the business" – 102<sup>nd</sup> place, (in 2009 - 107<sup>th</sup> place), "Foreign direct investment and technology" – 108<sup>th</sup> place (in 2009 – 113<sup>th</sup> place).
7. Improvement of Kazakhstan's position in the ranking of "Doing Business" in the category 'Protection of investors'.
8. Formation of 2 SEZ by the end of 2011: in Karaganda-based Industrial Park (for the development of metallurgy and metal) and SEZ "Cross-border trade and economic zone "Khorogos - Eastern Gate ", as the main part of the logistics framework Western Europe-Western China (for the development of various kinds of manufacturing, transport and logistics services).
9. Establishment of SEZ on the basis of "Nazarbayev University".
10. Formation of 5 SZ by the end of 2014 in Almaty, Pavlodar, Aktobe, Ust-Kamenogorsk, Semey and Uralsk different sectoral focus.
11. Increase of the number of participants, the BMS from 39 in 2009 to 159 in 2015 and to 42 SZ 2015.
12. Increase of investment in non-oil export-oriented and high-tech manufacturing in the SEZ to - 1588 bln in 2015 and in the territories of SZ - 151 billion.
13. Increase in the production of goods and services (works) in SEZ from 21.9 billion tenge in 2009 to - 718 bln in 2015, of IZ - 719 bln by 2015, including exports of at least 50% of the total output.
14. The share of non-oil exports in total exports will be at least 40% by 2015.

## **METHODOLOGY**

For state regulation and investment in special economic zone investors are given:

- plots of land, provided the necessary infrastructure for the efficient organization of new industries.
- within the area of the current regime of free customs zone and provided significant tax benefits (CIT, land tax, property tax), which will not only encourage investment in the manufacturing sector but also to determine the location of the points of the industrial growth in line with the state's economic and regional policies. The main impetus of investor participation in the SEZ is to have special preferences and privileges that make for activities in SEZ economically attractive. To date, the current legislation on SEZ contains sufficient incentives for attracting investors to the most pressing problems, is not conducive to realizing the potential of BMS Kazakhstan.

**The objects of SEZ creation are:**

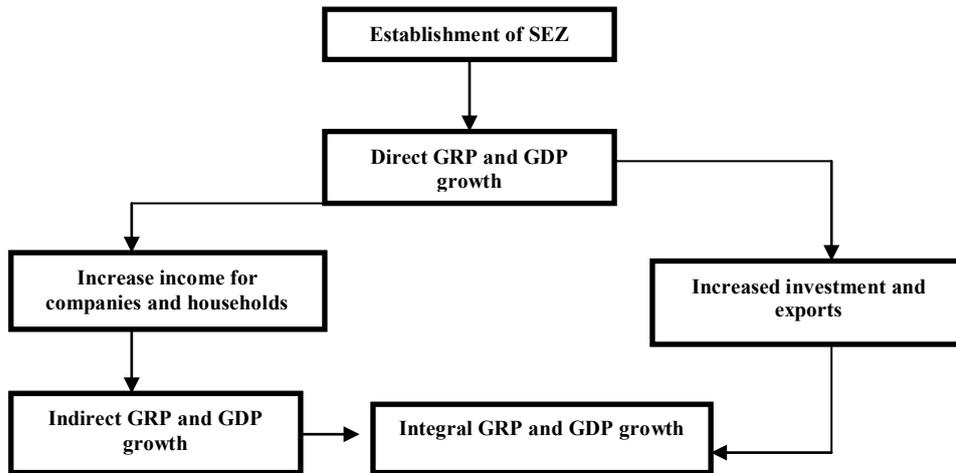
- creation of the modern (industrial, scientific and industrial, commercial, transport) infrastructure for the production and promotion of exports of goods;
- creating conditions for the development of science and technology, attracting, developing and implementing advanced domestic and foreign scientific research, know-how and technology, including in the field of ecology;
- providing a service (public, financial, banking, information analysis, consulting, transportation and other) support for exporters;
- ensure a high level of public services SEZ participants through the "single window";
- ensuring the implementation of and compliance with international conservation and environmental requirements;
- to promote a positive image of Kazakhstan as a whole and in particular the Karaganda region.

Establishment of SEZ will create a major 8000 and 2000 support jobs. During the construction of SEZ about 6,000 people will be employed.

Next, you might consider creating a special economic zone in Karaganda region. The average annual net income from infrastructure built on the budget, projected at \$2 423.3 million tenge.

According to the forecast state assets at the time of completion of infrastructure SEZ will be 25 462.5 mln. SEZ formation involves significant capital investment and the subsequent efforts of the state essential for their development. So on average in the world their own costs to attract foreign investment in SEZ have averaged \$4 per \$1 of foreign investment. In China, for example, foreign investment in four SEZ by the end of the 80s amounted \$ 4 billion, while starting their own investments exceeded \$22 billion, which is 5.5 times greater. Essentially the entire infrastructure of the SEZ PRC was established by the central government funds.

For creation an integrated SEZ macroeconomic impact of the project it is expressed in GRP growth in Karaganda region and in the growth of GDP. It can be written as the sum of direct and indirect macroeconomic effect.



The direct macroeconomic effect (TME) was calculated using the following formula:

$$TME = \sum_1^t IFA + \sum_1^t B - \sum_1^t (IpIp + Cp) \tag{1}$$

where IFA - investments in fixed assets:

- t-term period of the project;
- B - the cost of the investment marketable output of capital project by the created object of the project;
- IpIp - the cost of procurement of imported products in the region for the investment program of the project;
- Ix - the cost of purchasing goods imported into the region for use in the production program of the project;

As part of a SEZ cost of commodity products is equivalent to the total amount of the services provided by the state on behalf of the management company and the products manufactured by members of the SEZ.

The estimated direct macroeconomic effects of the project amounts 69921038.40 tenge.

Indifferent macroeconomic effects (IME) was calculated using the formula:

$$\text{IME} = \text{DME} \times k \quad (2)$$

k - Coefficient characterizing the distribution of volumes of LME-related PME of the fiscal year, in time with the rate of circulation of money in the economy.

The velocity of money is calculated on the basis of the country's GDP and the money supply. A detailed calculation is presented in Appendix calculating macroeconomic effect.

The dynamics of the velocity of money shows a decrease in this indicator during the period 2000 - 2010, to calculate the macroeconomic effects the velocity of money has been taken in 2010 which is equal to 2.53. Calculation based on the formula (2) predicts the total indirect macroeconomic effects at the amount of 158 720 757,17 tenge.

Thus, the total macroeconomic effect will be as follows:

$$\text{TME} = \text{DME} + \text{IME} = 228\,641\,795,57 \text{ thous. Tenge} \quad (3)$$

Annual index of economic efficiency of creating SEZ has being calculated for each year as a ratio TME to predictable GRP without the project. Due to the significant amount of investment in the early years of the greatest value of the index is in the first year - 0.0524 and lower values in the years of the project.

Integral indicator of economic efficiency was calculated as the product of the annual index of economic efficiency ratio indices of economic growth without the project and with the project. In the first year of the project's the figure amounted 0.0776.

The index characterizes the macroeconomic efficiency investments increasing GDP per unit of investment. For this project, it was 8.98 thous. tenge of growth for 1000 tenge of investment.

Direct benefit recipients are an investor, the public and the state, and indirect - society in the region and the country as a whole.

According to the preliminary application, SEZ is planned to build 10 commercial production at a total investment of 118 364,25 million tenge for 172 ha. The design capacity of this production per year in value terms is about 82 000 million tenge.

Only with the full development of the effective area of the SEZ (323 ha) it is planned to attract investment around 222 280.35 million tenge, with an estimated capacity of manufactured products 154 000 mln per year. Moreover, according to the criteria of SEZ at least 77 000 million tenge

Therefore, investors for the construction of commercial facilities will invest 222 280.35 mln tenge during 2012-2013.

Assuming that the establishment of SEZ will create about 10 000 jobs SEZ participants will be exempted from payment of corporate income, property and land taxes for 25 years, from the payment of land use for 10 years.

However, given that the service life of commercial buildings is at least 50 years after the abolition of SEZ, all participants will be full SEZ taxpayers under the laws of the Republic of Kazakhstan.

In addition, from appropriated funds for the construction of infrastructure in the statereturned money by way of taxes over 2 774 026.64 thous. tenge.

Domestic and international effects to create special economic zone will be export opportunities of SEZ, which when fully loaded the SEZ would be around 76,000 million tenge as the main criteria for participants is the implementation of SEZ export at least 50% of the total output beyond the Republic of Kazakhstan.

Indirect benefits of the project are:

- the creation of jobs in related industries and support activities; - improving the crime situation by creating new jobs;
- the development of engineering infrastructure;

## RESULTS

Thus, for projects in non-economic sector of Kazakhstan investors are given the following investment preferences:

By the end of 2014 it is planned:

1. Attracting 18 target investors from the list of companies included in the Global-2000.
2. Domestic and foreign investment in non-primary sectors (manufacturing, processing of agricultural products and services) will increase by at least 15%.
3. Foreign direct investment (FDI) to GDP will increase by five percentage points.
4. Sources of investment are diversified (7 major countries investors each country's share of 5% or more).
5. Agreements with other countries on the promotion and reciprocal protection of investments.
6. Achievement the indicators of the Global Competitiveness Index of the World Economic Forum:  
"The influence of the rules governing foreign direct investment in the business" - 102 place, (in 2009 - 107th);  
"Foreign direct investment and technology" - 108th place (in 2009 - 113th).
7. Improvement of Kazakhstan's position in the ranking «Doing Business» on the indicator "Defence of investors."
8. Creation of 2 SEZ by the end of 2011:  
in Karaganda on the base of Industrial Park (for the development of metallurgy and metal);  
SEZ "Border trade and economic zone" Khorgos - Eastern Gate ", as the main part of the logistics framework of Western Europe - Western China (for the development of various kinds of manufacturing, transport and logistics services).
9. Establishment of SEZ on the basis of "Nazarbayev University".
10. Creation of 5 SZ by the end of 2014 in Almaty, Pavlodar, Aktobe, Ust-Kamenogorsk, Semey and Uralsk with different sectorial trend.
11. Increasing the number of participants foe SEZ from 39 in 2009 to 159 in 2015 and to 42 SZ by 2015.
12. Increase the investment in non-export-oriented and high-tech manufacturing in the SEZ to - 1588 bln in 2015 and in the territories SZ up to - 151 billion.
13. Increase in the production of goods and services (works) in the SEZ from 21.9 billion tenge in 2009 up to 718 bln tenge in 2015, SZ - 719 bln tenge by 2015, including exports of at least 50% of the total output.
14. The share of non-oil exports in total exports will be at least 40% by 2015.

Against the background of economic globalization, Kazakhstan's economy faces a number of challenges. The main problems are:

- Raw material orientation of the economy; - Insignificant integration with the global economy;
- Low consumer demand for goods and services in the domestic market (small economy);- Underdeveloped industrial and social infrastructure;- General technical and technological backwardness;- Lack of effective communication of science to production and lower costs for research and development (R & D).

In order to ensure sustainable and balanced economic growth through diversification and increase its competitiveness on the State Program of Forced Industrial-Innovative Development of Kazakhstan for 2010 - 2014 (hereinafter - the government program), approved by the Decree of the President of the Republic of Kazakhstan dated March 19, 2010 № 958.

Targets codes of State program is:

Increase by the end of 2014:

-GDP by at least \$ 7 trillion. tenge, about 50% of GDP in 2008, in real terms, GDP growth of 15%; - the share of manufacturing in GDP to at least 12.5%; - the level of non-oil exports up to at least 40% of total exports; - volume of non-oil exports up to at least 43% of the total manufacturing output; - labor productivity in the manufacturing sector is not less than 1.5 times; - labor productivity in the agricultural sector with 3000 U.S. dollars per person employed in agriculture is not less than 2 times; - the level of local content in the procurement of government agencies and organizations; - national managing holdings, national holdings and companies - goods up to 60%, and in the procurement of works and services to 90%; - the share of innovative companies and 10% of the number of existing enterprises:

decline:

- the share of transport costs in the cost structure of non-primary sector to a level not less than 8%; - GDP energy consumption by at least 10% of the 2008 level.

Successful implementation of the State program is to promote qualitative changes in the structure of the economy that would lead to its sustainable growth based on efficient use of human, produced and natural capital, withdrawal of Kazakhstan to a new level of social development and society.

In the process of diversification of economics Kazakhstan will be able to use the existing potential of the metallurgical complex. Field or a base for the development and formation of competitive and export-oriented industries should be production, accumulating a large investment projects and producing products that are technologically possible to modify for multiple times, increasing the size of each value added.

Potential development priorities of Kazakhstan's economy is in the area of high-tech industries, such as the creation of new materials and the development of chemical and information technology. Kazakhstan has a scientific basis, which allows to develop knowledge-intensive production based on domestic developments in several areas, including:

- Metallurgy; - Mechanical engineering;- The chemical industry;- The construction industry;

- Biotechnology;- Nuclear technology;- Space; - Development of new materials, etc.

The world has accumulated rich experience in the development of models of export-oriented economy.

There are five varieties of export orientation:

- Export of raw materials;- Export-processing zones (EPZs);- Export of components; - Export a ready consumer products;

- Export of products with their own brands (brands).

The calculation is made by the budget efficiency ratio of budget revenues and expenditures. Excess of revenues over expenses incurred suggests creating SEZ budget efficiency, the reverse situation indicates a lack of any financial impact on the budget.

With the establishment of SEZ revenues of the state budget will be significantly greater than the costs incurred, which indicates a positive fiscal effect, confirms the presence of only indirect fiscal inefficiency of the project.

The main effect of fiscal efficiency and effectiveness of a special economic zone will act promoting the growth of the economy of the region - and Karaganda Karaganda region of Kazakhstan and in general - through: [9]

- The demand for construction materials, design services, consulting and construction companies;
- Development of cluster metallurgy and metalworking;

In addition, a direct manifestation of the budgetary performance of the project are collected in favor of the state and local budgets, taxes and fees:

- Accompanying investments in the design and construction of the infrastructure of the industrial park, from design, consulting and construction companies;
- from the related industries of mining, processing and production of road-building materials, structures and used in the construction of machinery, accompanying the development of the construction of the cluster in the Karaganda region;
- Cluster of metallurgy and metalworking.

The composition of income (inflows) for this project is included in the form of tax receipts of income tax on salaries and social security tax, value added tax to sales in the Republic of Kazakhstan. Also part of the proceeds will include charges for the use of land after 10 years from the date of the lease contract. [10]

From the point of view of experts, any investment project that will be beneficial in terms of budget efficiency through additional tax revenues to the regional budget. These projects demonstrate the profitability of the project, which guarantees delivery of additional tax revenue the city of Karaganda, Karaganda region and the country. At the same time it is possible under the investment agreement the investor may be granted privileges and preferences in the form of exemption from income and property taxes.

In addition, given that the management company will be with state revenues (all or part) provided the management company will be considered to be income of the state and therefore will be included in revenue. In expenses (outflows) of the budget includes the budget allocated to directly finance the construction of engineering infrastructure.

In our case, the degree of financial participation of the state will be 100%, since the construction of the infrastructure is expected to fund from the budget.

The analysis shows that at the period of the construction of engineering infrastructure from taxes received from contractors in favor of the budget, at least 12% of the costs (VAT refund in the budget), ie 2797 833.22 tenge will be paid. [11]

Budget efficiency creating SEZ will be amounted 198,829 020.66 tenge. IRR budget effectiveness will be at amount of 57.12%.

## **CONCLUSION AND IMPLICATIONS**

In view of the economic benefits of the project ENPV (economic present value) of the project is equal to 1, 216,553 458.49 tenge and EIRR (economic internal rate of return is equal to) - 103%.

Thus, the creation of free economic zone has a high economic impact.

These indicators are negative for the breakthrough time prediction 20 years, but they are more optimistic than the financial results, which once again prove it is the social orientation of the project.

The project is to receive significant financial benefits and offers to finance the state on non-refundable basis.

Possible risks associated with the project:

- Appreciation of building materials in the construction period;
  - increase in the cost of manufacturing equipment;
  - Incremental funding for the project and the extension of the period of construction
- Establishment of SEZ will lead to:

1) Direct investments and modern technologies and management; 2) Improvement of basic industries in the region (metallurgy and metal); 3) the creation of new high-tech export-oriented production of finished products with high added value in order to diversify the region's economy and the decline of raw material orientation of exports; 4) increase in the volume of processed goods in total exports of the region and the country; 5) an increase in employment and income; 6) increase in productivity; 7) increase the quality of human capital; 8) increase in revenues; 9) to improve the socio-economic situation in the region and, in general, in the country.

To achieve outcomes SEZ is planned to reach the following interim, incremental results:

by 2013:

1) creation of a management company SEZ; 2) completion of the engineering infrastructure SEZ; 3) Construction of commercial components SEZ; 4) implementation of the "one stop window" for the provision of public services in the SEZ to save time necessary procedures to improve their effectiveness and quality, which in turn will contribute to the attractiveness of the activities in the SEZ.

by 2015:

1) provision of investment in non-primary export-oriented and high-tech industries in the SEZ at least 75 billion; 2) provision of production of goods and services (works) in the SEZ at least 82 billion, including exports of at least 50% of its total output; 3) involvement of at least 2 investors from the list of companies included in the Global-2000 (currently in the steel industry of Kazakhstan from the list of invited ThyssenKrupp (Germany), NipponSteel (Japan), JFE Holdings (Japan), and POSCO (Korea)); 4) an increase in investment in fixed assets to GRP at least 5%; 5) ensuring annual growth of domestic and foreign investment in non-primary sectors of the regional economy (manufacturing) not less than 15%; 6) involvement in the activities of SEZ at least 25 potential investors; 7) creating approximately 10 thousand new jobs.

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