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Internationalization of production in Kazakhstan and its economic implications:

the role of foreign investment and transnational corporations

Nurgul Baigabylova

Licentiate Thesis
2012

Foreword and acknowledgements

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BP – British Petroleum
CIS – Commonwealth of Independent States
EITI – Extractive Industries Transparency Initiative
ENRC – Eurasian Natural Resources Corporation
EPT – Excess Profit Tax
FDI – Foreign Direct Investment
FPI – Foreign Portfolio Investment
FSU – Former Soviet Union
FIG – Financial and Industrial Group
GDP – Gross Domestic Product
IDP – Investment Development Path
IFDI – Inward Foreign Direct Investment
IPF – Investment Privatization Fund
JSC – Joint Stock Company
KZT – Kazakhstan Tenge (currency)
KMG – KazMunaigaz
LLP – Limited Liability Partnership
M&As – Mergers and Acquisitions
NOI – Net Outward Investment
OLI – Ownership-Location-Internalization
OFDI – Outward Foreign Direct Investment
PSA – Production Sharing Agreement
R&D – Research and Development
SCO – Shanghai Cooperation Organization
SOE – State Owned Enterprise
SBC – Social and Business Corporation
TCO – TengizChevroil
TNC – Transnational Corporation
TWG – Trans World Group
USSR – United Soviet Socialist Republics
USA – United States of America
USAID – United States Agency for International Development
UNCTAD – United Nations Conference on Trade and Development
WIR – World Investment Report
WTO – World Trade Organization

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1. INTRODUCTION

The collapse of the Soviet Union in 1991 was a defining political and economic episode in world history. Kazakhstan, like other former Soviet Union (FSU) republics, was left to its own devices in the challenging task of establishing an independent country with democratic institutions and building a market-oriented economy. Many international experts made optimistic assessments saying that Kazakhstan's abundance of mineral resources and well educated workforce would make transition to market economy less painful (The World Bank 1993). However, despite these relatively favourable conditions, Kazakhstan experienced a large output decline and severe economic recession in the years immediately following the disintegration of the Soviet Union. The annual growth rate of the industry was already negative by about 1% in 1990 and by 12% in 1992 (Sagers 1992). Cumulative industrial output declined by 64% during 1991-1995, while GDP dropped by 46% in the period 1990-1995 (Peck 2004, 63).

The economic literature provides various explanations of why some countries of the FSU region were successful in transition to a market economy while others were not. For instance, Kopstein and Reilly (2000) argue that geography matters, i.e. those countries located close to the developed western world made significant progress in modernization of their economies while the others did not. In the same vein, De Melo et al (1997) give empirical evidence that initial conditions, location and policy reforms are important determinants in effective transition to a market economy. Bond et al (1991) assume that it was because of investment shortage, i.e. Kazakhstani industrial enterprises had received financial aid from the central Soviet government, which stopped after the Soviet Union disintegration.

However, economic recession in Kazakhstan as well as in other FSU republics was inevitable after independence. The reason for this was the legacy of central planning, that is to say one of the features of the USSR economy was its high degree of regional division of labour (Pomfret 1995). All former Soviet republics were integrated into a production and processing chain, which made sense only in the unified Soviet Union economy. Many Kazakhstani enterprises were large though few in each sector of the industry; moreover, they were mainly producers of primary resources. During the Soviet period, Kazakhstan produced coal, iron ore, alumina, zinc, copper and other minerals, as well as oil and gas, and electricity. For example, the Karaganda Metallurgic Plant's revenues accounted for 5% of the GDP of the former Kazakh Soviet Republic (Peck 2004). After the Soviet Union disintegration, there was significant disruption of the trade connections between the FSU republics and loss of the traditional markets. As a result many large enterprises went bankrupt and the economy collapsed.

The raw-material orientation of the Kazakhstani economy and lack of processing facilities were the major obstacles for reformation of the economy. Kazakhstan exported raw materials and semi-finished products while it had to import expensive finished goods. In these conditions it was impossible to modernize the structure of the economy very quickly.

Kazakhstan, as a land-locked country, was faced with increasing problems in marketing its products because of logistics problems and that the products did not meet international quality standards. Kazakhstan's industry was dependent on Russia's markets, so the synchronous collapse of the Russian economy meant collapse in Kazakhstan too. The Russian GDP declined by 49% from1990 to1995 (Peck 2004).

The economic collapse affected all aspects of social and economic life of the people in Kazakhstan. The government, after several unsuccessful attempts to reorganize state owned enterprises (SOE) through the privatization program involving domestic investors, started to attract foreign direct investment (FDI) in order to develop and put into operation the extractive enterprises. Privatization of state owned enterprises was rapidly carried out roughly within 3

years, from 1994 to 1997. As a result FDI increased remarkably during that period from about $600 million in 1994 to $2,107 million in 1997. Consequently FDI inflows to Kazakhstan have grown significantly, especially since the commodity price boom in 2004. FDI inflows to the country reached an unprecedented level of more than $6 billion in 2006, $11 billion in 2007 and $14 billion in 2008.

The participation of foreign investors in the privatization process in Kazakhstan during the 1990s has become a starting point for the development of internationalization of production in Kazakhstan. Its natural resources attracted investment from transnational corporations such as ChevronTexaco, ExxonMobil, Shell, British Gas, AGIP, the Chinese National Petroleum Company in the oil and gas sector, and Ispat International, Samsung, Glencore International in the metallurgical sector.

The new managers of the reconstructed enterprises were able to revive the production output in Kazakhstan within a short period; as a result positive growth of the GDP per capita has been recorded since 1996, except in 1998 when negative economic growth was affected by the crisis in Russia. Owing to the export of hydrocarbons and other minerals and increases of world commodity prices, the economy of Kazakhstan showed strong growth of more than 9% per year from 2000 to 2007. Although the world financial crisis in 2008 and the sharp fall in the commodity prices slowed down economic growth, GDP growth recovered to 7% in 2010 following the recovery of oil prices.

1.1. Research question (research objectives)

Why is it important to investigate the internationalization process in Kazakhstan? It has become one of the largest host countries for FDI inflow in Central Asia. Since 1993 the country has received more than a hundred billion dollars of FDI (Statistical Yearbook 2011). The main investors are the world Transnational Corporations concentrated in the key sectors of the country. Kazakhstan has attracted FDI mainly due to its vast fossil fuel reserves, metals and minerals, such as oil and gas, coal, iron, manganese, chromite, lead, zinc, copper, gold, titanium, bauxite, uranium and many other minerals. More than 75 percent of all FDI inflows to Kazakhstan are directed to the extractive industry. The government has increased its control of strategic industries recently[1], but foreign investors are still keen to get access to the mineral resources of Kazakhstan, even under harsh conditions. Countries rich in natural resources gain an advantageous bargaining position in trade when commodity prices grow. On the other hand, prospective investors gain if the prices fall. Meanwhile, there is a positive relationship between high commodity prices and foreign investment in the extractive industries (UNCTAD 2007).
Though foreign investment gives new prospects for development of the economy by exports of primary resources, there are adverse effects such as crowding out of the domestic investment, crowding out of the investment in manufacturing and agriculture sectors, negative impacts on the environment caused by their extraction, as well as discrimination in wages and human rights. In this regard, it is important to investigate the causes and effects of foreign capital in Kazakhstan, in order to understand the relationship between foreign capital and economic development in Kazakhstan during the last two decades.

This licentiate thesis examines the development of the internationalization process in the economy of Kazakhstan from independence in 1991 to 2010. As the economic literature fairly states, there is now established economic knowledge that explains many problems of internationalization of production and capital, their intensification processes, transformation of

[1] The government of Kazakhstan issued an edict on a preferential right to block the sale of energy assets on its territory. For example, the sale of PetroKazakhstan to CNPC was allowed to go through only after CNPC agreed to sell a 33% stake in PetroKazakhstan to State owned KazMunaiGaz. (UNCTAD 2006, 58)

the world economy, including the problem of interdependence, the growing role of TNCs, cooperation, integration, etc. (Khusainov et al 2006). However, there are a number of elements and aspects that require deep economic analysis, since many issues still remain under-researched, especially the problems from the perspective of Kazakhstan as a host country for foreign capital. The aim of this study is to explore the causes and effects of internationalization of production in Kazakhstan. What is the role played by FDI in its economic development as a host country? What are the economic implications of internationalization of production in Kazakhstan? How do TNCs' activities affect the economic development? The thesis focuses on one aspect of economic internationalization, namely the role of direct production activities of transnational corporations in the economic growth of Kazakhstan. A primary rationale for a study of this kind is the contribution to a better understanding of the relationship between internationalization of production and economic growth; better understanding the contribution of inward FDI to Kazakhstan's economic growth. When we know how the internationalization process affects the national economy we might learn more about how to deal with the threats from the activity of TNCs and how to benefit from FDI-assisted economic development.
The process of market reformation carried out in Kazakhstan seeks to achieve socio-economic stabilization in the country (Kazakhstan-2030 1997). Moreover, the intensification of globalization in Kazakhstan is connected with the concentration of production and international integration which create specific forms of partnership. It is important to provide an economic explanation of how and why transnational corporations emerged in Kazakhstan during the reformation process and during open economy conditions. The main questions will thus concern the following:

- How did internationalization of production develop in Kazakhstan during the period 1991-2010?
- What were the causes of the development of internationalization of production?
- What are the economic implications of the internationalization of production in Kazakhstan?

1.2. Previous research

The relevant literature in the field of this thesis is focused on two main strands. First, what are the determinants or motives for implementing direct production in a host country by TNCs? (Hymer 1976, Dunning 1988, 1993a, Caves 1971, Vernon 1966). Second, what are the direct and indirect effects of FDI on a host country? (Dunning 2002, Dunning and Narula 1996, Narula and Dunning 2000, 2010, Narula and Guimon 2010). These two strands of research are interlinked with each other. The motives of TNCs for locating their direct production abroad depend on the host country's locational advantages; in turn, host countries with the aim of attracting inward FDI make structural changes in their economies and institutions, creating favourable conditions for FDI. Namely these structural changes would promote positive economic development in the host country (Narula and Dunning 2000).

The main paths followed by the classics in the literature on international production and capital are reviewed in chapter 2. Here, in this section of chapter 1, we provide a review of the relevant empirical research from the perspective of the relationship between FDI and the economic growth of a developing host country.

The link between economic growth and TNCs' direct production activities in a host country is widely highlighted in the economic literature. The theoretical body of the literature is straightforward in arguing that inward foreign direct investment (FDI) contributes to the host country's economic growth, especially if it is a developing one. However empirical evidence on the positive relationship between economic growth and inward FDI in the host economy is mixed. It is difficult to determine if direct foreign capital is bad or good for the host country's economic development. How to benefit from FDI and how to prevent the possible negative

implications of the activities of TNCs remain challenging tasks for developing countries (UNCTAD 1992, 2007).

There is a considerable body of empirical studies of the specific effects of FDI on the economic growth of a host country. Some empirical studies directly test the relationship between FDI and one or two variables, such as productivity, technological spillover, GDP or GNP as a proxy for growth (De Mello 1999, Dunning 1994, Zhang et al 2010, Aitken and Harrison 1999, Blomstrom and Persson 1983, Blomstrom et al 1994, Borensztein et al 1998, Akinlo 2004, Alfaro et al 2004). The results of such studies are controversial, i.e. they cannot give clear-cut answers to the question of whether FDI is good or bad for the host country. For example, Bosworth et al (1999), using regression analysis, evaluate the implications of foreign capital inflows (FDI and FPI) in 58 developing countries for the period 1978-1995. They find that FDI tends to increase domestic investment while foreign portfolio investment (FPI) has no such effect. Alfaro (2003) examines the effects of FDI on growth in the primary, manufacturing and service sectors in 47 countries between 1981 and1999. The author's empirical evidence shows that FDI in the primary sector has a negative impact on growth, while inflows into the manufacturing sector have a positive impact. FDI in the services sector shows ambiguous effects. Therefore, host countries may not always benefit from foreign capital inflows. Based on their empirical data analysis for 72 countries for the period 1960-1995, Carkovic and Levine (2005) argue that there is no link between FDI and economic growth, but do not deny that FDI is relevant for long-term economic growth.

A different vein of the empirical literature, on effects of FDI, considers whether a host country should meet certain conditions in order to benefit from the inflow of foreign direct capital. For example, Borensztein et al (1998), applying cross-country regression analysis, tested the influence of FDI on the economic growth of 69 developing countries during 1970-1989. They found a positive relationship between FDI and economic growth, and that FDI promoted higher productivity if the hosting country possessed a minimum threshold of human capital stock capable of absorbing advanced technology. The same results are reached by Xu (2000), who examined TNCs of the US as a source of technology diffusion in 20 developed and 20 less developed countries during 1982-1994, and found that TNCs may contribute to the economic growth of developed countries but not of less developed countries. Thus a country should have a minimum level of human capital in order to benefit from the foreign capital inflow. However this vein of studies is not conclusive either, because it does not provide a clear mechanism that could enable host countries to benefit from FDI-assisted development.

Although there are numerous empirical studies on the implications of FDI for a host country, little attention has been paid to any particular analysis of the role of foreign capital in the economic development of transition countries, especially Central Asian countries. Existing studies on the transition economies are mainly focused on the Central and Eastern European transition countries. Nevertheless, a review of the empirical literature on the analysis of the impact of FDI on Kazakhstan's economy also shows that there is no robust relationship between FDI and economic growth. For example, Waikar et al (2011) regressed FDI on GDP per capita for 1991-2006 and found that FDI had a moderate positive impact on GDP growth mainly due to the extractive industries, while on the sectoral level FDI had adverse effects on agriculture and manufacturing while crowding out the domestic investment in these sectors. Lee et al (2010) used a multivariate regression model for the period 1997-2006 and found no significant impact of FDI on the GDP growth of Kazakhstan They concluded that resource-seeking investment had minimal effects on the economic development of the country. However, the effects of foreign capital on Kazakhstan as a host country, when tested from the perspective of the relationship between FDI and GDP, shows that a macro variable such as GDP may not be good proxy for the economic development of a country (Dunning and Lundan 2008, Narula and Dunning 2010, UNCTAD 2007). FDI inflow data is also a macro variable, it omits extra financial borrowing

from the local financial markets by the TNCs. This does not appear in the balance of payment of the country (Ietto-Gillies 2005), implying that the aggregated FDI data may be underestimated (UNCTAD 1997).

Moreover, recent studies of endogenous growth theory pay attention to endogenous, growth inducing factors which TNCs may spill over in the host country, such as learning by doing, knowledge spillover, capability and absorptive capacity building (Ozawa and Castello 2001). Narula and Guimon (2010) argue that one should take into account the idiosyncratic characteristics of a country when analyzing the relationship between FDI and economic development. Each country follows its own particular development path, which reflects exogenous factors such as size, population, geography, natural resource endowments, political and social conditions. Others emphasize endogenous factors such as the quality of human capital, the absorptive capacity of a country, and knowledge diffusion (Ozawa and Castello 2001, Dunning and Lundan 2008).

The contribution of the present licentiate thesis is a qualitative analysis of the relationship between foreign capital and economic development in Kazakhstan. Following Dunning's eclectic paradigm, the present thesis discusses motives and impediments of FDI, as well as the economic implications of internationalization of production in Kazakhstan during the last two decades.

1.3. Methods, sources and data. Limitation of the study

This section discusses the research methods and data sources used to answer the questions posed in the Research Question section above. The macro data on FDI flows and stocks that we use stem from the balance of payments, and are collected by the national statistical agencies. FDI data include the following in the balance of payments of a country:

1) Net capital contribution by the direct investor in the form of purchases of corporate equity, new equity issues or the creation of companies;

2) Net lending, including short term loans and advances by the parent company to the subsidiary;

3) Retained (reinvested) earnings (OECD 1994, 100).

TNCs' investment in the host country is not limited by these records which highlight the balance of payments, but TNCs may also borrow money from local financial markets, although this is not reflected in the balance of payments. Consequently, macro FDI data, constructed only from the balance of payments, ignore additional investment made by TNCs with capital borrowed from the local financial markets. Therefore the total investment made by TNCs in the host country may be underestimated (Ietto-Gillies 2005, UNCTAD 1997).

Analyses of various activities of transnational corporations and trends in flows of FDI around the world have been presented in the World Investment Report (WIR) by UNCTAD annually since 1991. Particularly WIR 2007 is focused on the analysis of the role of TNCs in extractive industries and their effects on recipient countries (UNCTAD 2007).

The present study uses data from multiple sources. Primary data are obtained from the annual reports of enterprises, governmental documents, legislative acts, newspaper and magazine news. Secondary data are obtained from previous studies on the relevant problem, such as UNCTAD World Investment Report issues from 1991 onward.

In order to find answers to the questions posed in the thesis, we apply Dunning's OLI paradigm. Dunning emphasizes three conditions that should be fulfilled for the firm to be involved in the process of FDI:

1) The investing firm must possess pure Ownership specific advantages or O-advantages, which provide this firm a competitive position over local firms.
2) The host country must possess Location specific advantages or L-advantages in a comparison with other countries, including the country of the investor, which makes it attractive for foreign investors and allocation of international production.
3) There must also be Internalization advantages or I-advantages, that is, advantages from realization of certain bargains within a firm (between different subdivisions, affiliations of one and the same international production) in comparison with realization of these bargains on the market.

Using the framework of OLI theory, this thesis explores whether Kazakhstan provides location-specific advantages and whether it fits into OLI paradigm.

Statistical descriptive tools are employed to evaluate the degree of penetration of foreign capital into the Kazakhstani economy, and its concentration by sectors. The empirical data are from the Statistic Agency of Kazakhstan, Ministry for Industry and Trade of Kazakhstan, Ministry for Oil and Gas of Kazakhstan, UNCTAD statistics, annual reports of the companies, and the World Bank statistics.

A major problem that needs to be recognized is the relative difficulty of obtaining consistent and reliable information on the activities of TNCs in Kazakhstan. There is limited access to information about the activities of foreign TNCs. A general feature of the available information indicates that TNCs are unwilling to show the true state of their activity. This mainly concerns the economic indicators, including production costs, profits of corporations, tax payments, and the quality of the activities for environmental protection in Kazakhstan.

1.4. The outline of the thesis

The thesis consists of 7 chapters. Following the introductory chapter, the next chapter is the relevant literature review designed to introduce the reader to the main theories of foreign investment, TNCs, and international production. Chapter three discusses the emergence and development of internationalization of production in Kazakhstan after independence in 1991. The chapter describes the process of restructuring of the large enterprises in the key sectors of the economy during the privatization process started after independence of the country. It also explores the entry mode of foreign capital in the economy of Kazakhstan during the period 1991-2010, foreign direct investment inflow in Kazakhstan and the main investors. Chapter four deals with the process of internationalization and consolidation of the principal enterprises in Kazakhstan over the period 1991-2010. The enterprises reported in this chapter account for a significant share of the country's total production output and a large proportion of the total FDI inflows to Kazakhstan. Since the majority of FDI inflows are concentrated in the extractive industry, the chapter focuses mainly on the analysis of the foreign enterprises involved in this industry. Chapter five examines the motives for internationalization of production in Kazakhstan. The chapter discusses why foreign enterprises invest in Kazakhstan and the favourable factors and advantages that encourage foreign enterprises to invest in the economy of Kazakhstan and to be involved in internationalization of production. This chapter also investigates whether Kazakhstan has Ownership-Location-Internalization (OLI) advantages based on Dunning's eclectic paradigm. Chapter six considers the economic implications of the internationalization of production in Kazakhstan during 1991-2010. Applying Dunning's investment development paradigm, it analyzes the interaction between FDI and economic development in Kazakhstan over the same period. Finally, the last chapter is devoted to the concluding discussion and future research on the role of primary resources in long-term economic development.

2. KEY CONCEPTS AND THEORETICAL FRAMEWORK

This chapter is designed to review the basic concepts of foreign direct investment and international production.

In the current conditions of world economic development the internationalization of production has acquired a variety of organizational forms, such as corporation, transnational corporation, financial and industrial group, and joint venture. Traditionally they are related to the concepts of international production, TNC, and FDI which are as the key concepts of the methodological and theoretical basis for this thesis.

2.1. Neoclassical approaches to foreign capital movements

There are two strands of approaches on international investment which were developed during the pre-WWII period: Marxist imperialism and neoclassical approach.

The concepts of internationalization of production, FDI and TNC are not fully explained in the economic literature; however antecedent research in this area goes back to the Marxist imperialism approach (see Hobson 1902, Lenin 1917, Luxemburg 1913). It should be noted that Marxist theory does not deal specifically with TNC, FDI or international production as such, but issues such as financial flows between capitalist countries and their colonies, concentration of capital and others issues raised by Marxist followers have analogies with the contemporary theories of international production developed since after WWII.

Neoclassical theories of the international capital movements were formed in line with the neoclassical approach to international trade which historically and logically was the first form of the international economic transactions. As a starting point here we should name theories of Eli Heckscher (1919) and Bertil Ohlin (1933) who proposed a neoclassical model of international trade. Subsequently this approach was developed by Paul Samuelson (1948, 1949), Wolfgang Frederich Stolper (1941), Tadeusz Rybczynski (1955), and others. Like the neoclassical trade theory the neoclassical theory of foreign investment argued that the countries were endowed with different amounts of capital and labor, assumed to be immobile between countries, while technology and, of course, commodities were mobile.

Ohlin (1933) considers the capital movements only in the context of international trade theory, not as an essential part but a concomitant one of international trade. Ohlin relies on the same premises and analysis as used in the neoclassical theory of international trade. Ohlin's analysis applies primarily to portfolio investment, and he does not distinguish between foreign direct and portfolio investment. Moreover, he considers the capital movements as an independent phenomenon in relation to other variables of the national domestic economy. According to Ohlin's approach, capital movements may take place primarily through the "reparations and gifts" for the capital importing country. Generally Ohlin, adheres to the assumption of capital immobility between countries as it is required by the neoclassical tradition. The analysis also includes the impact of this process on the exchange rate, terms of trade, volume of exports and imports, as well as some other variables of the domestic economy. Ohlin also considers the location of production and factors affecting this process, and the elements that influence the distribution of production at the interregional and international levels were considered as identical.

Ragnar Nurkse (1933) extends Ohlin's approach in his first work "Causes and effects of capital movements" considering the endogenous capital movements as a consequence of the incentive to gain profit. His analysis is also conducted within the framework of the neoclassical paradigm. Nurkse considers foreign investment as a portfolio investment, although capital movements in

his view is not caused by exogenous factors, i.e. by reparations or gifts, as it was in the case of Ohlin, but by the differences in interest rates. Nurkse's contribution to the analysis of foreign investment in the neoclassical framework is that he considers the portfolio investment movements across countries as a result of the difference in interest rates in different countries. This difference is caused, in his view, by the changes in supply and demand for capital, which changes its price. This Nurkse's seminal idea has subsequently been thoroughly developed by the followers and has not lost its relevance today.

Carl Iversen (1935) gives a detailed analysis of international investment in his work "International capital movements", based on assumptions of the neoclassical approach. Like previous authors, Iversen does not make a clear distinction between direct and portfolio investment. He writes that capital movements are conditioned by cross-country differences in interest rates, which, in turn, are directly dependent on the level of country and sector risks. Iversen explains the bilateral cross-country capital flows in various industries namely by the difference in sector risk. In general, foreign investment is more risky than domestic investment, so that investors expect higher interest rates abroad compared to the domestic market. The difference in interest rates necessary for starting the international movement of capital can be used as an indicator of the costs and the additional risk inherent in the movement of capital between countries. Iversen gives a detailed analysis of the causes of differences in interest rates between countries and industries.

Like the previous authors, Iversen's analysis is a comparative equilibrium static type analysis, which means that a comparison of equilibrium states before and after the movement of capital, but there is no analysis of what happens between these two points, i.e. no analysis about the process of investing (Ietto-Gillies 2005). In addition, the analysis assumes that the situation certainly moves from one equilibrium point to a subsequent final point, although in practice it certainly cannot be achieved. Iversen's contribution to the theory of portfolio investment can be considered as an introduction to the analysis of the risk which adheres to foreign investment, as well as a sufficiently detailed and systematic consideration of all other factors affecting the differences in interest rates between countries. However, it is difficult to find supporting evidence for the hypothesis of Iversen that such differences in different sectors can be explained by different degrees of risk, i.e. the difference in interest rates depends on the differences in the risks of investing (and evaluation), and at the same time, capital movements and the difference in interest rates are indicators of the level of existing risks.

The neoclassical literature of the postwar period on foreign investment mainly concerns the problems of impact of foreign investment on the distribution of wealth in investing and host countries. However, again, there is no distinction between portfolio and direct investment.

One of the most interesting works in this area is the article by Robert Mundell, "International trade and factor mobility" (1957) where, still in the mainstream of the neoclassical approach, he examines the relationship between international trade and factor mobility in terms of trade tariffs. In his analysis, commodity movements and capital flows between countries are substitutes: "… *an increase in trade impediments stimulates factor movements and ... an increase in restrictions to factor movements stimulates trade*." (p.331). Consequently, an equalization of prices for commodities as well as of factors of production develops, or at least, there is such a tendency, even if the commodities or factors of production do not have full mobility.

Mundell (1957, 331) concludes that "In order to achieve efficiency in world production it is unnecessary that both commodities and factors move freely. As long as the production conditions are satisfied it is sufficient that either commodities or factors move freely."

Mundell's hypothesis that the mobility of commodities and factors substitute each other has been difficult to assess due to the tendencies of simultaneous increase in trade flows and direct investment flows. The question is whether international production substitutes international trade, or if one simply complements another one still not fully clarified.

The starting point for the development of theories of international production was that most economists disagreed with the basic assumptions and conclusions of the neoclassical model of foreign investment when, in the early 1960s, these were obviously contradicted by reality.

Let us recall the major components of the neoclassical approach. First, it should be noted that a clear, consistent and comprehensive theory of foreign investment has not been established, and in the first place it refers to the theory of foreign direct investment and international production (Ietto-Gillies 2005). The neoclassical approach does not distinguish between direct and portfolio investment but concentrates by default on the analysis of the portfolio investment. Problems of foreign direct investment and international production are mentioned but they are analyzed in terms of space (spatial) distribution of factors of production abroad. This is understandable, since the neoclassical school believes that the location of production is based on the relative possession by those countries of one or another factor of production, which gives them the opportunity to specialize in a particular type of production.

Second, within the framework of the neoclassical approach it is assumed that the markets (both domestic and foreign) have a perfect structure, all firms have an equal access to information and market failures are rare exceptions. The market was seen as the perfect and the only mechanism that can determine the structure of cross-border movements of production factors, as well as the relative cost of such movements. However, in 1950s it became quite obvious that many markets have an oligopolistic industry structure, and large firms operating in these markets are, of course, in a privileged position compared with the smaller competitors in terms of access to resources, information and technology, employment of cost factors, and etc. (Ietto-Gillies 2005, Dunning 2000).

Third, in neoclassical theories of international trade a firm was viewed as a "black box" as something that is granted (Ietto-Gillies 2005). The company operates in a perfect market, and this "perfect" means that the transaction costs of using the market as an exchange and coordinating mechanism is zero. Each firm produces a single product (or is occupied by single activity) in a single "place" (i.e. it has only one production unit). Actions of the firm conform to the circumstances in which it has no effect. The fact that firms are able to penetrate the foreign markets can be explained only by their ability to ensure the best use of resources compared to firms in countries that receive their exports. There are no other specific advantages taken into account, which these firms are possessed in comparison with the local firms.

From this point of view, there is no need or advantage to place the firm’s affiliates abroad, as this foreign affiliate will not have any advantages compared with local firms already operating here and know the market. Moreover, under these assumptions establishing the foreign affiliate would certainly be unprofitable.

One can argue that the main problem of the neoclassical approach is related to its unrealistic assumption of perfect competition, with all its consequences. Perfect competitive environment, might not look so unrealistic assumption, when it was used for the analysis of international trade in the 1930s. But it contradicts the reality when we use it to analyze the current activities of transnational corporations as applied to foreign investment and to trade, where they control large amounts of capital flows. However here we need to make some exceptions. Milton Friedman (1953, 9) in his famous "Essays in Positive Economics", suggests an instrumentalist perspective (subordination of theory the objective of forecasting), defends the methodological approaches

that are based on unrealistic assumptions "… *the relevant question to ask about the 'assumptions' of a theory is not whether they are descriptively 'realistic', for they never are, but whether they are sufficiently good approximations for the purpose in hand*." According to Friedman, we should evaluate the theory in terms of what it can predict, not what it can explain.

2.2. Alternative approaches to the international production

As it usually happens in science, incomplete or even poorly developed aspects of a theory in the framework of a theoretical paradigm encourages the development of alternative approaches, where they try to give their interpretation of the problem. That is why the phenomenon of international production has been actively analyzed from alternative points of view.

Location of production abroad is seen as a process that depends on complex factors such as:

• Peculiarities of the market (what is the structure of the market: perfect or imperfect; what are the opportunities of local and foreign markets in providing sales and supplying of cheap resources, and etc.);

• Peculiarities of the firm (what is its organizational structure and size, multinationality of a firm, the presence of specific assets, and etc.);

• Peculiarities of the interaction of the firm and the market (how high are the transaction costs for the implementation of the interaction of firms in the market: whether it is difficult or easy to find partners, whether it is difficult to conclude contracts and implementing it, how affordable and reliable information is available on the market, etc.).

Alternative approaches to the international production can be divided into the following directions of international production analysis:

1. Focus on a firm (primarily on TNC):

- Specific advantages of firms in imperfect markets: Hymer (1960) and Kindleberger (1969);

- Classification of different types of specific advantages of a firm: Caves (1982).

2. Emphasis on the features of the external market, the so-called location-based approach or an approach from the standpoint of territorial location of production:

- Product life cycle theory and location of production: Vernon (1966);

- Development of the neoclassical paradigm: Kojima (1978) and Ozawa (1979).

3. Emphasis on the interaction of firms and markets:

- Approach from the standpoint of transaction costs: Coase (1937), Williamson (1981), Caves (1971), Hennart (1982);

- Internalization theory: Buckley and Casson (1976, 1998a, 1998b, 1999), Rugman (1981).

Before turning to the characterization of these directions we should note two points. First, like any other, this division of theories is largely arbitrary. However, the basis for the classification of the theories is the priorities authors have given to various factors which determine the international production and factors associated either with the peculiarities of the market, or the peculiarities of the firm, or their interaction.

Second, the basis for the development of alternative approaches to the analysis of international production were the various branches within the framework of general economic theory: the theory of international trade and international capital movements, theories of organization of firms, the theory of spatial distribution (location theory), theory of a firm, etc. Using these models, of course, has enriched the theory of international production, filled its content, which largely reflects adequately the rapidly changing reality.

The first explanation of international production and foreign direct investment in terms of a firm's activity as the subject of this investment (in conditions of imperfect markets) was given by Stephen Hymer (1960). Trying to explain the phenomenon of FDI, Hymer writes that firms' investment abroad is associated with high costs and risks which include: costs and risks associated with currency exchange; costs of communication and information on cultural, linguistic, legal, economic and political spheres of countries receiving the foreign capital; costs associated with less favorable conditions in a host country for the foreign investors in comparison with the local investors.

Hence Hymer (1960) did the logical conclusion that firms investing in foreign markets do not operate under perfect competition. Moreover, he argued that in general FDI could not exist in a perfect market. Instead of FDI in order to penetrate foreign markets it would be used forms such as export and licensing. According to Hymer, FDI is a strategic response of a firm to market failures as well as a tool to overcome this imperfection.

The firm acting in imperfect markets should have certain specific advantages (firm-specific advantages), which local firms do not possess and which give the foreign firm an opportunity to compete successfully in the host markets. The presence of these advantages is a prerequisite for FDI. Each firm has its own specific advantages. Hymer singled out certain types of firm specific advantages, in particular, he related to them a firm's size and the possibility of economies of scale in production, intangible assets such as brands, technological innovation, access to cheaper funding sources.

The firm which has specific advantages in producing and marketing goods may find it profitable to use these benefits and produce directly in another country. The reasons for employment of these particular benefits may be different. Thus, the investing firm may be aimed to retain and expand its benefits, and that FDI provides the firm such an opportunity, because the firm's inherent control over the production makes it possible not to "share" its benefits with local firms, and use these benefits effectively in order to compete.

The existence of natural barriers for exporting to foreign markets (such as high transport costs) or artificial (such as tariffs or nontariff barriers) means that the firms cannot profitably use their benefits just simply by exporting goods to the host country. In this case, FDI may be the only way to penetrate the foreign markets, as namely because of FDI it is possible profitable employment of the firm-specific advantages.

Hymer assumes that in imperfect markets a firm has a real opportunity to expand their market power (the ability to influence prices of goods) outside the national boundaries primarily in its industry. As the only large TNCs have a real advantages allowing them to organize and control overseas production, eventually it may come a time when the concentration of production in the industry will be so large that only a few firms remain in the market. So these firms collude with each other in order to achieve maximum power over the market.

Along with Hymer's approach there are other interpretations of the factors determining the structure of international production. First of all we should mention the so-called location approach, which focused on the issues of territorial (spatial) distribution or mobility of

production. This theory is also developed as a specific contrast with the neoclassical approach or possibly extends it. What happens if the neoclassical assumption of immobility of production factors will be eliminated or the technology will no longer be regarded as a free factor of production moving quickly across national borders?

The product life-cycle is one of the most influential theories, at least until the early 1970s., which was proposed by Raymond Vernon in his paper "International Investment and International Trade in the Product Cycle" in 1966. The theory assumes that the purchasing demand leads to new goods. When the market is saturated with this product the demand for it stabilizes and then declines and ceases altogether. That is why first the firms establish business on their own territory, they gradually saturate the domestic market and at the same time export new products abroad. Since the marketing is the simultaneous act, firms in order to avoid transport costs, customs fees and other expenses, in order to maintain the firm's profits have to seek new markets for extending the product's life cycle. Thus, production changes its location and begins adapting in new countries.

The main questions that Vernon wanted to answer were: where is it most likely new ideas and technology arise for the creation new products? Where is it most likely production of new goods begins? What circumstances lead to locating the production overseas? What are the implications for foreign capital flows and international trade? According to Vernon's concept, production of new technologically advanced products begins in countries that are sufficiently capacious and «solvent» markets, the United States were such a country in 1960. The new goods become standard and usual while demand for these goods is growing, and they simultaneously expand exports to similar (in terms of consumer demand) markets in Europe. Then, as a result of some reasons, it may cause the direct transfer of production of this commodity to host markets.

In Vernon's view, among the most important factors influencing the movement of production are the following: the threat of imitation by competitors in Europe, lower production costs in European countries, the threat that European governments control the import. As the product becomes more standardized, its imitation is becoming increasingly easy, competition is exacerbating, which leads to the need to reduce costs. Then the situation is repeated, with the only difference being that as the new location of production (the "new location") becomes less developed countries with low cost of low resources, primarily low wages. At the same time the production of this commodity in the United States falls or stops producing at all, increasing its imports and the U.S. are losing their competitive advantage as a location for the production of this commodity.

Thus, according to Vernon, substitution of exports to foreign production will occur to the extent that, as new technological product will standardize, and reduction of the production costs will become a decisive factor in winning over competitors who subsequently can imitate the goods with reasonable ease. Under these conditions, foreign production is simply changing the "place" of production, but no change of ownership of this production or the economic strategies of the firm that initiated the production of new goods.

The theory of the product life-cycle is relevant for several reasons. First of all, it contributes to the question of why firms tend to go international, or why firms are involved in foreign production. Second, this theory is dynamic in terms of full mobility of production capital, which is true in conditions of globalization. Thirdly, knowledge and technology is considered as endogenous factors which can also be mobile, i.e. have the possibility to spillover from developed countries into developing ones.

There are other authors extending the neoclassical analysis. In particular, Japanese researchers Kojima (1978) and Ozawa (1979) put in the center of their analysis the comparative advantages

of firms in conditions of international mobility of production capital. Based on empirical data on Japanese investment in Asia, they sought to understand the causes why firms choose to locate their production in one or another place. They divide these causes into two groups:

1) Access to the market through locating production close to the end consumers or through the location of production, which allows overcoming tariff barriers;

2) Access to resources reducing production costs, or technical know-how. Thus firms can expand their activities in different countries based on different comparative advantages.

When markets of intermediate products are imperfect, there is an incentive for them to avoid it through the creation of "internal" markets. This leads to the internalization, i.e. occurrence of internal markets within the firms.

Internalization of markets across national borders leads to the creation of organizations such as multinational corporations. Trying to reduce transaction costs firms combine ("internalize") number of transactions, thereby narrowing the boundaries of market share and becoming a large company operating in many regions of the world. Such firms are called transnational corporations, multinational companies or global corporations.

In internalizing the market the main tool that is used by TNCs is foreign direct investment, which allows carrying out worldwide operations under a single ownership, control, and often management. Such firms grow being subject to the laws of vertical integration and saving on transaction costs.

2.3. Internalization and internationalization

The theoretical concept of internalization is related to the organizational approach of the firm developed in works by Coase (1937), Penrose (1959), Williamson (1981). The concept is based on the idea of economies of scale, namely, that along with increasing size of a firm there are additional features of the productive use of previously unexploited economic resource. In this situation, the processes of diversification and combination cause the emergence of diversified companies, which have several advantages.

The competitive advantages of these firms are based on the effects derived from risks eliminations which related with highly specialized business, overcome the difficulties of marketing products and services, improving the competitiveness of a product, as well as the possibility to save on transaction costs. Thus, we can say that economies of scale stimulate firms to expand business, first within the specific market, and then beyond national borders, i.e. abroad.

The other theoretical direction of the internationalization development is associated with Howard Perlmutter (1972). Perlmutter's theory has become widespread in recent decades. This theory assumes that success of any firm is predetermined by the principles of decision-making. In other words, firm managers' behavior and beliefs show that the managers consider each branch or subsidiary of the firm as an element of the overall corporate system operating in the world, not as an independent company (Perlmutter 1972). Thus, it can be argued that the principles of management decision-making are becoming more and more impulse for the emergence of TNCs.

In recent decades, the nature of internationalization formation presupposes that productive forces are more and more likely to arise and function relying on the world market and leaving national boundaries. Minimal cost-effective capacity of some companies increasingly go beyond the scope of the domestic markets of individual countries, the optimization of production presupposes its import supplies and export sales. For example, according to UN data on TNCs

the profitability of the modern tractor building involves a series of optimal level of 90 thousand units per year, automobile building - 2 million units. More than 80% of all produced gas turbines in Western Europe are exported. Economic evidence shows that the larger modern production, the higher level of internationalization should be (UNCTAD 1992).

We assume that the international production does not require obligatory TNC patronage for its operation. It is perfectly capable of evolving out of contract, non-share partnerships basis between independent business entities on all levels of horizontal and vertical manufacturing processes. Moreover, these processes may universally merge with regionalization processes. This is evidenced by development programs within the Eurasian Economic Community[2], and SCO[3], etc.

Analysis of the world market structure depicts that country sensitivity to production internationalization depends on country's size, level of its development and level of integration into the world economy. The world economy becomes more and more like a single functioning organism (Khusainov 2005). This means that this process emerged at the micro level through the interaction of individual firms and industries, and at the macro level through the intergovernmental associations and agreements of national policies, at the mega level through the development of productive forces which starts closely depend on the situation and solving of global problems of mankind, requiring concerted international approach.

Summarizing, we move our discussion to the next aspect consisting of three categories. Before turning to them it should be noticed that it is important that the analysis of interaction of the individual agents involved in economic activity, organization of companies, corporations, and, finally, quite independently existing markets may be radically changed if we assume that they are involved in so-called global economy. That is why it is necessary to distinguish such conceptual categories as "internalization", "internationalization» and "transnationalization" within the context of international production.

The term "*internalization*" means transformation of external transactions into internal ones. Internalization is used in interpretation of the genesis of transnational corporations. From the beginning it had narrow meaning and was considered related to the aspects of production.

Now internalization covers activities of transnational banks, which operate as internalization mechanism due to the imperfections of international financial markets. We agree with Buckley and Casson (1985) that internalization in the broadest sense is a response to all the external conditions of such corporations.

A. Rugman (1981) argues that internalization is the process of creating a market within the firm. Internal market of a firm replaces the constant missing external market and solves issues of distribution of various resources by administrative declaration instead of an imperfect mechanism of competition. In other words, here is the process of transforming external market transactions of a firm into internal operations (Obminsky 1990).

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[2] Eurasian Economic Community (EEC) – international economic organization vested with functions related to the formation of common external customs borders of its member countries (Belarus, Kazakhstan, Kyrgyzstan, Russia, Tajikistan and Uzbekistan), the elaboration of unified foreign policy, tariffs, prices and other components of the common market functioning.

[3] The Shanghai Cooperation Organization or SCO is an intergovernmental mutual-security organization. Country-participants are China, Kazakhstan, Kyrgyzstan, Russia, Tajikistan and Uzbekistan.

The term "internationalization of production" means establishing stable links between business enterprises in different countries; consequently the production process in one country becomes a part of the process in the global scale. Thus, here we mean the production that goes beyond national borders.

Internationalization, including internationalization of production, gets its beginning in the term 'international' and is related to the process of markets' internalizations, i.e. the process of involvement of enterprises in international markets. That defines a new dimension, which is located outside of modern arrangement, characterized by expanded openness of national economies. As a result it leads to cost reduction of production and distribution of international goods and technology inflows, effective and rational use of resources (Buckley and Casson 1985).

Besides, the major trend in modern development is the formation of a world economy based on international production, international markets of capital, labor force and international information technology. The latter is a sign of the *transnationalization* processes of production and capital.

The difference between the terms internationalization and transnationalization is that in general transnationalization of production and capital is understood as a new phenomenon and qualitative changes taking place in the world economy such as increased number and of TNCs. We assume that this is a *new level* of world economy internationalization, which differs in the way how countries and companies are involved in world division of labor and influences the internationalization of technological progress and production process.

In this situation the world market dictates the quality and economic standards of products, which are made by Head Company, its branches and franchises. Moreover, development of international corporate production begins in this form of economic internationalization. This is also true for head company plants, its branches and joint ventures of the kind that are involved in international intra-firm cooperation (Rugman 1981).

Therefore, one can assume that transnationalization is a new form of capital and production internationalization, when it is transformed into a new kind and the process inseparably linked with expanding corporative activity and their transformation into international economic bodies.

To be specific, the process of *transnationalization* is understood as a process of expanding international activity of industrial companies, banks, service sector companies, their breakout from national boundaries, which leads to transformation of national companies into transnational ones. It is characterized by capital mergers due to company takeovers of other countries, establishment of joint ventures, mobilization of investment from foreign banks, building strong and long term foreign relationships.

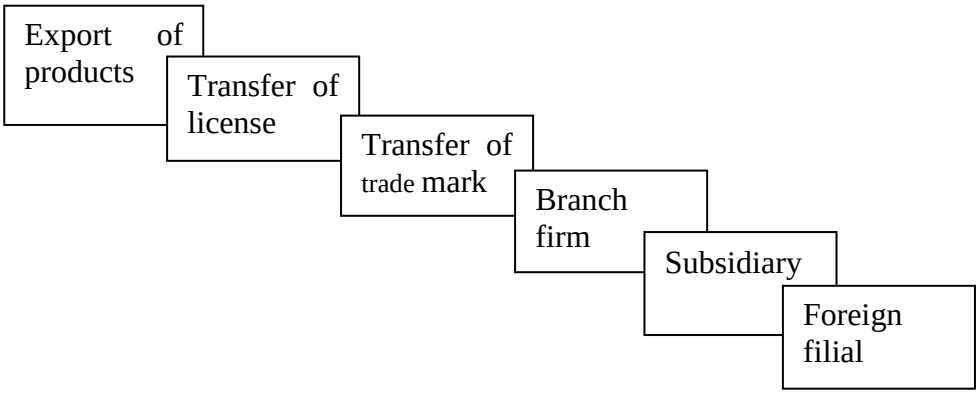
Defining processes of production and capital transnationalization, TNCs serve as drivers of the world economy and are created by a number of reasons. First, it is internationalization of production and capital based on the development of the labor force, which crosses national borders. The process of internationalization of production and capital expands economic relations by creating affiliates of big corporations abroad and transforming national companies into transnational ones. Export of capital becomes one of the most important factors in the formation and development of international corporations. Second, it is obvious that increasing the profits is the main goal. Third, tight competition and the will to succeed are also promoting concentration of production and capital on the world scale.

Therefore, one of the most important characteristics of the modern level of global economy development is the forthcoming and rapid development of the transnational sector in national structures as well as in the world economy.

Whatever differences in the defining reasons for the creation of TNCs are, most current economic concepts pay special attention to rapid growth, internationalization and high technologies as the main sources of TNCs' profit, ways of improving competitiveness and durability of companies.

During the study, in order to understand the mechanism of formation of international production we build the block diagram of development of production internationalization process based on the concept of product life cycle (Vernon 1966, Graham 1995, Aliber 1970). The diagram summarizes the theory of the formation of an internationalized company.

Figure 2:1 Development of internationalization of production



The theory defines the "life-cycle" as such. A company-innovator beginning with export of goods eventually moves manufacturing to the recipient country. When products reach maturity level, the company loses its technological superiority and companies-copyists compete also in foreign markets. Moreover, local companies in importing countries also start mimicking the product to fill their market niche. For instance this is vividly depicted by Chinese companies. Thus, technological monopoly is being replaced by oligopoly. It means that whilst the product matures, obstacles for entering the market are weakened. In order to retain the leadership, the company-innovator should be the first in moving its production to importing countries' markets.

The strategy aims at replacing absolute technological superiority with relative superiorities in cutting costs and differentiating the product in order to retain leadership abroad. In the end of the life-cycle, when the product becomes widespread and market competition is mostly price oriented, the availability of low-skill labor motivates the company to seek a labor force with the lowest price. The production could be transferred to developing countries where there is still a demand for the product.

Provided that oligopolistic competition is not strict, the production transfer could be made by selling a license to production or service. During the transfer abroad, at the same time, the company gives rise to its branches abroad, that phenomenon is called "clustering" (Kindleberger 1969). Entering foreign markets, the company-innovator tends to change the structure of the market to its own benefit. Companies-imitators experience inferiority in oligopolistic environment. As a response, they transfer their production abroad too, trying to regain the market share they used to have. There is a type of competition, during which, every company is trying to open a branch abroad because this is what competitors are doing. Therefore, the more

oligopolistic the structure of a sector, i.e. the fewer the companies controlling the sector, the more motivated is this behavior. The example of such behavior of companies is modern rapid delocalization of the number of multinational companies to Asian countries.

The similar competition is taking place on natural resources market. Impulses, peculiar to this market, lead a company to the situation when it provides itself with advantages by acquisition of cheap natural resources securing internal supply.

2.4. John Dunning and eclectic paradigm of international production

A special place among foreign direct investment (FDI) theories takes the eclectic paradigm of international production, the author of which is John Dunning a leading world specialist in the sphere of FDI and TNC. Dunning's conception claims that systematization of factors determining international production creates a unique format for theoretical investigations in this sphere, and that format could logically integrate numerous theories of international production and FDI.

The eclectic paradigm assumes that TNCs have ownership advantages in comparison with its main competitors. It uses its advantages by allocating production in those locations where there are location advantages. TNCs safe or hold control over their assets networks (production, commercial, financial etc.) owing to internalization advantages. Very often this approach is called the OLI paradigm or OLI advantages (OLI - Ownership — Location — Internalization). Let us examine more thoroughly each of these conditions which as a whole determine capacity and structure of international production.

Ownership Specific Advantages

Dunning (2002) distinguishes two types of ownership advantages (sometimes he calls them competitive advantages since they allow investing firms to win in the competitive struggle). The first type includes privileged assets possession (asset advantages), primarily by intangible assets such as, for instance, a special technology that takes place only at that firm. These advantages allow the firm creating new assets and thereby increasing its competitive ability. The second type of ownership advantages appears due to joint management in the frame of TNCs by available assets (transaction costs minimizing advantages) as well as additional assets which can be formed due to across-the-border activity. They include advantages of affiliations of already operating firms over new enterprises, and advantages connected with transnationality of an enterprise. Advantages of TNC's affiliate in comparison with new firms come from its belonging to a greater and stronger parent company with access to cheaper resources, knowledge about the market, low and sometimes flat marginal costs on R&D. Advantages of transnationality mean that a firm operating in many countries is in a better position than a local company in the point of view of obtaining advantages from different factor opportunities and market situations.

In explicit form the idea of ownership advantages was presented by Dunning in his work in 1977. However the first suppositions that an investing firm must obtain some advantages in comparison with a local firm, has been already stated by him in the book "American Investment into British Manufacturing Industry", published in 1958. In the 1950s the productivity of American manufacturing industry was 2,5 times higher than the British. The issue that immediately emerged was as follows: reasons of such difference in productivity are connected with the fact that the USA obtain more complete resources (as it was commonly explained in the frame of international trade theories and areal production location) or it is a consequence of the fact that American firms better manage resources that are available to them. Dunning's supposition assumed that if the last statement is true then affiliates of American firms located in Great Britain should operate not worse of its parent companies and much better than their local

English competitors. This was named as the ownership specific effect. Let us recollect that at the same time there was issued a work by Hymer who talked about specific advantages of a firm that allow it competing on external markets. It is obvious that both authors imply one and the same thing, however Dunning focuses on the fact that differences in productivity are based on ownership of a firm from the home base country, and Hymer pays attention to specific advantages of a firm which are revealed in conditions of imperfect markets. Subsequently a lot of scientists worked in the direction of typification of different ownership advantages: especially, one can name a well-known work of Caves (1982), where he emphasized such types of ownership advantages as technological knowledge patented and not patented; special marketing skills transmitted from one country to another by means of markets internationalization. Caves also paid attention to similarity of intangible assets, such as knowledge with "public benefit".

Location Specific Advantages

Unlike ownership advantages, internal for a firm, location advantages play a role of an external factor stimulating (or not stimulating) investment. A country where FDI are forwarded must offer location specific advantages that could be used together with other advantages that come from ownership and internalization. Location advantages include advantages in cost of production (primarily cheap labor force) on markets of a host country, closeness to customers, correspondent economic structure, tax remissions and other state incentives, legal, social and political infrastructure etc.

Let us come back to the example of Dunning about the activity of American firms in manufacturing industry of Great Britain in the 1950s. Say that American affiliates in Great Britain operate not better than their local competitors and accordingly much worse than their parent companies in America, then, as per Dunning, this can be a consequence of specific local features of the USA economy that are not transferable. However if American affiliates successfully operate on the British market, this means that this market obtains specific features making it attractive for FDI. This phenomenon took its name as a specific component of location and allocation.

It is obvious that this constituent of eclectic paradigm develops within the framework of production location or allocation theories that were briefly characterized above. This is the most traditional element subsequent directly from neoclassical model; it is quite often used for explanation of force of attraction extent of this or that region or country for foreign investment. In particular it "works" quite well in Russian conditions: force of attraction of Russia for foreign investors is accounted for by availability of cheap resources and potentially broad market outlets, and insignificance of real inflows of FDI is connected with complicated system of taxation, contradictory legal base, high corruption level, nonobservance of ownership and other factors forming investment environment.

Internalization Incentive Advantages

Explaining the activity of firms across national borders, in addition to the benefits of ownership and location advantages, Dunning introduced internalization advantages, which refer to how firms organize the use of available benefits. Internalization advantages are closely related to ownership advantages: internalization, according to Dunning, helps enterprises to increase the assets that give them ownership advantages. Introducing the internalization factor into eclectic paradigm, Dunning sought to explain why firms choose to use their ownership advantages independently to establish international activity, rather than sell their rights to foreign firms. Dunning makes a distinction between those ownership advantages, which the company owned before it became a multinational (advantages in the possession of intangible assets indicated above), and advantages that are a direct result of involvement of a firm into international

production. The first of these advantages are internalized because a firm does not want to "share" them with their competitors, which is inevitable if foreign and local firms enter into contractual relationships. Internalization of this type leads to the preservation of right of ownership of intangible assets and therefore increases profitability.

While the first internalization type implies internalization of company benefits, the second type implies the internalization of markets. The advantages of the second type cannot be sold to an independent company from another country for their "individual" use. They can only be achieved through vertical or horizontal integration, or, in other words, they can be used only through co-ownership that is used in specific production chains.

Dunning admits that, when developing the concept of internalization advantages, the ideas of Buckley and Casson (1976) had a significant influence over him. However, one should admit the similarity of the Dunning approach with the approach of Hymer: they both believed that market imperfections are strong incentives for internalization. According to Dunning, market imperfections may be structural (e.g., barriers to competition), as well as 'cognitive' (associated with imperfect knowledge of a seller or a buyer about products or processes). Government intervention (government interference) is likely to enhance market imperfections, and is likely to lead to further internalization.

Dunning's approach is attractive because it considers foreign direct investment as a consequence of the simultaneous possession of advantages of ownership, location and internalization. Thus Dunning is trying to integrate micro and macro analysis and explain the international trade and international production in one analytic form. Despite the fact that Dunning prefers a theory of the internalization before a theory of market power, it would be wrong to mix or to identify an eclectic approach with the approach in terms of internalization. The general nature of the eclectic paradigm, as it has been noted before several times, is that it gives equal weight to theories that emphasize the importance of benefits of macro-economic placing of international production, as well as the interaction between a firm and its macroeconomic environment. Thus, the theory of production owned by foreigners, stands at the intersection between macroeconomic theory of International trade and microeconomic theory of firm (Dunning and Lundan 2008).

The strength of the eclectic paradigm is the fact that it can be considered as a dynamic approach where advantages of ownership, location and internalization influence each other. Eclectic paradigm further asserts that the value of each set of factors or advantages and their specific configuration will depend on industries, regions or countries, as well as companies participating in international production. Location advantages create incentives for internalization, in its turn; internalization generates additional ownership advantages and contributes to their effective use in conjunction with the existing ownership advantages. Changes in outflows and inflows of country investment may be due to changes in ownership advantages of enterprises of the country, in comparison with companies in other countries, changes in "location" assets of the country compared with other countries, as well as changes in the internal organization of assets within a firm.

The main question regarding this approach is: will it be able to go somewhat further, beyond the boundaries of the classification analysis, i.e. a simple taxonomy? Dunning's approach is very useful as a descriptive and classification tool. However the explanatory and predictive power of the theory is weakened by excessive concentration on the taxonomy.

2.5. Summary

Neoclassical theories of international capital movement were formed within the framework of the neoclassical approach to international trade. It should be noted that there has not been

established a clear, integrated and comprehensive theory of foreign investment, or more specifically, a theory of foreign direct investment and international production. Neoclassical theories do not distinguish between direct and portfolio investment, by default concentrating on the analysis of portfolio investment. Issues of foreign direct investment and international production have only been addressed, and their analysis was carried out in terms of regional (areal) distribution of factors of production abroad. This is understandable, since neoclassical school assumes that production location is based on the relative countries possession of these or those factors of production, which gives them the opportunity to specialize in a particular branch of industry. Fundamentals of the neoclassical theory of foreign investment are found by B. Ohlin, who considers the international capital movement as a "by-product" of international trade. Nurkse expanded Ohlin's approach, considering endogenous capital movement due to profit motive. Iversen explains capital movement by cross-country differences in interest rates, which, in their turn, directly depend on the level of country and sector risk. Mundell considers the movement of goods between countries and capital flows as a kind of substitutions, generating a tendency to equalize the prices of goods and factors of production, even if goods or factors of production do not possess full mobility.

The starting point for the development of alternative theories of international production was the opposition of economists to the main conclusions of the neoclassical approach, which in the early 1960s were evidently contrary to reality. Hymer is rightfully considered as a pioneer in development of alternative approaches to analysis of foreign investment. His works are not only distinguished by their novelty, but also largely determined the subsequent directions of study of direct investment. Hymer argues that in imperfect markets large multinational firms have real benefits, enabling them to organize and supervise overseas production. In course of time it may occur that the concentration of production in industry will be so great that only a few firms will remain in the market that will collude to achieve maximum power over the market. Along with Hymer's approach there appeared other interpretations of factors determining the structure of international production.

This is first of all a "location approach", which became a kind of extension of the neoclassical approach and it focuses on the issue of territorial production location (Vernon 1974, Kojima 1978, Ozawa 1979). Further theoretical interest has shifted to the study of a multinational firm as an institution which replaces market. The basis for this approach was the idea of Coase (1937) of positive transaction costs. Buckley and Casson (1985) use Coase's approach for the development of a "long-term theory of multinational enterprise", today known as the theory of internalization. The basic premise of this approach was the recognition of market imperfection, so-called "market failures" that set the stage for the benefits of internalization.

A special place among FDI theories takes Dunning's eclectic paradigm of international production. It proposes a typology for the determinants of international production, thereby offering a single format for theoretical research in this area, which logically could integrate multiple theories of international production and FDI. Dunning identifies three requirements that must be met for a firm to be involved in the process of foreign direct investment. The investing firm must have ownership specific advantages, which may be or may not be embodied in the form of assets and that provide the firm a competitive advantage over local firms in the market, where it is supposed to make investment. The host country must have location specific advantages compared to other countries, including investor country. These advantages make it attractive to foreign investors and for the allocation of international production. Advantages of internalization should also exist, i.e., advantages from the implementation of certain transactions within the firm (between different divisions, affiliated firms of the same TNC) in comparison with the implementation of these transactions on the market. Summarizing, we can say that the eclectic paradigm suggests that TNC has ownership advantages compared to its main

competitors, which it uses by the allocation of production in areas where there are location and internalization advantages.

3. DEVELOPMENT OF INTERNATIONALIZATION OF PRODUCTION IN KAZAKHSTAN DURING 1991-2010

This chapter discusses the emergence and development of internationalization of production in Kazakhstan after independence in 1991. The chapter describes the process of restructuring of the large enterprises in the key sectors of the economy during the privatization process that started after independence of the country. Privatization process has become a precondition for internationalization of production in Kazakhstan. The chapter explores the entry mode of the foreign capital in the economy of Kazakhstan during the period 1991-2010. It also deals with the discussion of the foreign direct investment inflow in Kazakhstan and the main investors.

3.1. Privatization and reorganization of the state owned enterprises after independence in 1991

The government of Kazakhstan after gaining its independence in 1991 started the transition program, and privatization of the state owned enterprises (SOE) was the starting point in modernization of the Kazakhstani economy. Privatization of SOEs was planned to implement in 3 stages[4]: the first stage (1991-1992) was to cover 50 percent of all small and medium enterprises in the industry and agriculture sector, small retail and service facilities; the second stage (1993-1996) included medium and large enterprises; and the third stage (1997-2000) was completing phase (Kazakhstan Ministry of Finance database). However, in fact, this initial plan was far from the reality. It was challenging task for the government to reorganize the ownership of the enterprises. Quick privatization program did not yield desired results due to inefficient approach.

In 1991 there were nearly 21 thousand of SOEs; 3473 large and medium enterprises and 17500 small enterprises were allocated for privatization. The large and medium enterprises employed 83 percent of all employees in the economy while the 17 percent of employees were employed by a small number of enterprises (Kazakhstan Ministry of Finance database).

The largest industrial enterprises were based on extraction of natural resources such as oil, gas, coal, iron, copper ore, gold, lime and phosphates. In 1991 the mining, metallurgical and chemical industries were accounted for 57 percent of the total industrial fixed assets. SOEs produced over 90 percent of the industrial production in the country. The remaining enterprises were collectively owned either by public organizations or specialized funds. According to official statistics, private households produced less than 1 percent of the production (Jermakowicz et al 1996).

In June, 1991 it was passed the Law "On denationalization and privatization". The government made an attempt to carry out the privatization through three directions, namely, (1) surrendering of the state property to the employees of the enterprise; (2) sale in the auction; and (3) through tender offer. Preferences were given to the favor of employees, but if the latter did not show any interest in privatization of the enterprise then the government sent it to the auction or the tender (Kazakhstan Ministry of Finance database). But there were problems with corporate management in the large enterprises which were assigned to the employees. Therefore the government made adjustments for the rules of selling medium and large enterprises, where then employees could get no more than 25 percent of stocks, while the rest of stocks were intended to distribute among different investors like suppliers and clients of the enterprise, foreign investors, distribution among the citizens through investment coupons, and keeping some part of stocks by

[4] In fact the privatization program is running up to now. The third stage completed in 1998 (2 years earlier than planned) and since 1999 to nowadays it is held the fourth stage. However today the privatization lost its importance since all more or less major enterprises already sold before 2005.

the government. Though such a tough policy of distribution of stocks did not give the opportunity for an investor in purchasing the majority of an enterprise's stocks. It adversely affected the efficiency of management and repelled foreign and domestic businessmen to invest in SOEs. As a result, in 1992 by the end of August, 205 SOEs were incorporated as joint-stock (Jermakowicz et al 1996). But mainly it was managed to allocate the employees' and the suppliers' stock, while as yet the government kept the majority of stocks, in other words, the government still was the only owner of those enterprises. The government could not maintain many industrial enterprises due to lack of finance and experience. Therefore those enterprises could just lose their efficiency.

At the end of the first stage 4771 enterprises were privatized which was less than planned. At this stage all efforts were spent on reorganization of the small enterprises. The small enterprises included mainly trade retails (shops and supermarkets), services sphere, public catering (cafes and restaurants), freight motor transports and others. 10 percent of privatized enterprises were in agriculture, and 8 percent was for the industry. During the first stage the privatization which had affected medium enterprises only partially, but the large enterprises were not even involved. Moreover, only employees and suppliers of enterprises benefited from the privatization those years. However it did not facilitate the establishment of effective system of control of the new owners which would have provided the development of those enterprises in the long term. In addition, it was widespread the opinion among the society that such privatization was unfair. As a result, the economic condition of SOEs continued deteriorating. The enterprises were restructured not by their new owners but the state officers. Property ownership continued to be uncertain.

According to the Ministry of Finance's database the second stage (1993-1995) covered different directions of privatization, namely: 1) Privatization of the small scale enterprises; 2) Mass privatization; 3) Privatization by individual projects; 4) Privatization of the agriculture.

The small scale privatization program was intended involving small enterprises with employees less than 200 workers. Mass privatization included enterprises with employees from 200 to 5000 workers. While individual projects included only the largest enterprises more than 5000 employees. Privatization of the agriculture was for state farms (sovkhoz). As a result of the second stage, another 6037 (10808 in total with previous stage) of small scale items and 385 medium enterprises were sold (see Table 3:1).

Privatization on individual projects was intended to capture the largest enterprises with more than 5000 employees. At the second stage 5 large enterprises were sold entirely under the individual projects program: Karmetkombinat, Pavlodar Aluminum Plant, Almaty tobacco factory, Kazkhrom, and Chimkent Confectionary (Kazakhstan Ministry of Finance database).

Transferring to entrusted management was popular way of organization the SOEs. Despite the fact that the overall privatization policy did not provide for pre-privatization restructuring of SOEs, in the case of the very large enterprises it was necessary. In total through the tender offer 44 contracts were made on entrusted management for of 5 years (mainly enterprises in the mining sectors) (USAID 1996). Six contracts were terminated because of failure of the entrusted administration. As a result, in 1995-1996 entrusted 38 contracts operated, including 12 with the foreign companies. For example, among such entrusted enterprises were the largest enterprises like the Pavlodar aluminum plant, Turgay and Krasnooktyabrskoe bauxite mine, Sokolovo-Sargaysky and Donskoy mining-and-processing works, Karaganda Metallurgic Works (Karmetkombinat) (USAID 1998).

Based on Czech coupon model it was initiated the non-monetary privatization investment coupon (PIC) that was distributed among the citizens. These PICs were private; they could not

be passed to another person. The citizens could allocate their coupons in specially established investment privatization funds (IPF), which by- turn bought stocks of enterprises in the auctions (Kazakhstan Ministry of Finance database).

It was hoped that IPFs would play significant role as an investor. Coupon method was supposed to turn all citizens into the owners of SOEs, in fact never took place. However they were inefficient because of lack of investment resources or experience of the business conducting. Therefore the coupon privatization was limited only to the formal procedure of exchanging the coupons to the stocks, without any clearly delineated prospects. The government allocated stocks of poorly performing enterprises with large debts, IPFs collapsed over time, and coupons became worthless paper.

Table 3:1 Privatization of the state's property from 1991 to the 1st April, 2010, in number

Year	Small scale	Medium scale	Individual projects	Profits (thousands KZT)
1991-1992	4771	-	-	165
1993	153	-	1	783 989
1994	2645	-	1	1 459 266
1995	3239	385	6	7 233 421
1996	3526	889	27	31 214 565
1997	5641	1315	48	54 511 449
1998	2716	513	11	66 701 804
1999	2462	162	-	34 815 880
2000	1766	93	-	22 048 029
2001	2059	146	-	16 583 078
2002	1756	67	-	19 340 183
2003	2041	65	-	60 127 949
2004	2036	58	-	8 600 547
2005	1223	16	-	10 795 695
2006	653	1	-	13 179 986
2007	945	0	-	314 036
2008	846	0	-	70 751
2009	1238	3	-	591 474
1st quarter 2010	32	1	-	13 757
Total	39 748	3714	94	348 386 024

Source: The Ministry of Finance of Kazakhstan database accessed at www.minfin.kz

It can be argued that free distribution of shares of SOEs could not produce successful owners. In addition, privatization was supposed to be not declarative-social, but purely economic process. That is, it should be done solely for the purpose of improving the efficiency, competitiveness and profitability of enterprises, which was possible only with large investment in production. The third stage (1996-1998) began the privatization program in the electricity and oil and gas industries. At the third stage in total 14,686 SOEs were privatized (Kazakhstan Ministry of Finance database).

Individual project program included 142 enterprises, 5 of them were sold entirely, 32 of them were sold partially, while 44 enterprises were transferred into entrusted administration. Ten percent of 7 enterprises were placed on coupon auctions. Around ten percent of all enterprises were transferred to their employees. So at the end of the second stage 85 percent of stocks were still owned by the government; 10 percent were given to the employees and only 5 percent were sold to other investors. Five entirely sold enterprises comprised 138,5 million of US dollars.

An analysis of the privatization process in Kazakhstan suggests that the transformation of ownership in the country was held slow, on a limited scale and mainly formal. SOEs were not restructured before or during the privatization program. Many SOEs privatized at the first stage were not restructured even after the privatization. Since if only employees of an enterprise take part in the privatization then such a privatization may not provide additional investment in production or to restructure the enterprise or to any kind of changes in the management (Jermakowicz et al 1996).

Initially the government's strategy was to keep number of principal sectors under the state's control. The government intended to transform extractive enterprises into joint-stock companies where the state would own the largest share, while the rest stakes would be distributed among employees, suppliers and other investors. However this strategy of the government did not yield desired results. The state apparatus, as it was in 1993 in Kazakhstan, did not have adequate expertise and capacity to act effectively as an owner of several hundred large enterprises in different industries.

Moreover the attempt to involve only the labor collective form of ownership did not change the productivity efficiency in order to eventually resolve the industrial collapse. Virtually only top managers of those enterprises benefited from the privatization. As a result managers of those enterprises who had got the right to decide the issues of ownership bargained away assets of the enterprises, while the employees having no tangible payoff from their shares in unprofitable firms, acted as good as outside observers. Having understood that the privatization process became chaotic, the government introduced a new scheme; namely this time the employees were given only 25 percent of stocks, subcontractors, suppliers and clients could buy another 10 percent, while foreign investors could get only 10 percent. However, after a fairly short period of time it became clear that the proposed scheme could not change the situation in the privatization, to attract investors and activate the labor collectives (Jermakowicz et al 1996).

At the same time, the sale of all enormous amount of the state's property through the tenders and auctions was practically impossible due to lack of solvency of the citizens, moreover it could lead to concentration of the most ownership in mafia-related structures (Jermakowicz et al 1996).

In 1994 GDP in Kazakhstan decreased by 25 percent compared with the previous year while industrial output dropped to about 28 percent (Levine 1995). Thus in 1994 the Government of Kazakhstan State property Committee decided to sell the strategic state enterprises to the foreign investors through issuing tenders. So, the 38 largest enterprises of the country mainly in the metallurgic, mining and chemical industries were allocated for the privatization under the individual projects program (Levine 1995).

Denationalization and privatization of the largest and medium enterprises was carried out through the transformation the enterprises into joint-stock companies (JSC), i.e. JSCs with the total ownership of the state. The State Property Committee is presented as an incorporator of those JSCs. After the transformation of SOEs into JSCs, they were transferred to the state holding companies. The state holding companies were the companies where the state's share was no less than 51 percent (Kazakhstan Ministry of Finance database).

During 1993-1995 it was transformed 2 thousand enterprises into JSCs. The privatization under the individual projects program was implemented through the auctions and tenders, or transferring the enterprises to the entrusted management of foreign companies. In 1995 the first five large enterprises were sold to foreign investors: Karmetkombinat, Pavlodar Alumina Plant, Almaty tobacco factory, Kazchrome, and Chimkent Confectionary (Kazakhstan Ministry of Finance database).

Table 3:2 Privatization of the principal SOEs under the individual projects program during 1996-1998, by economic sectors

Sector/industry	Privatization	
	Total	Including sold to foreign investors
Oil and gas	23	5
Electric power	19	17
Metallurgy, mining and machine-building	41	29
Transport and communications, other sectors	10	5

Source: Ministry of Finance of Kazakhstan database accessed at www.minfin.kz

26 SOEs out of 66 enterprises transferred to the entrusted management contract, were subsequently sold to the managing companies. Among such enterprises was the Pavlodar alumina plant, Kazchrome, natural gas pipelines, oil refinery factories. Privatization in agriculture sector was carried out the same as with other JSCs and sold in the auctions and tenders. However the agriculture sector was not attractive for the foreign investors. 75 percent of all agriculture enterprises were privatized through coupons, i.e. through the distribution among the local people and employees by non-monetary way. In the agriculture sector 13 state holding companies were established during 1993-1995.

Thus, in 1997 it was sold shares of two oil companies; 60 percent of "Mangistaumunaigaz", JSC was purchased by Indonesian company "Central AsiaPetroleum" and 60 percent of "Aktobemunaigaz" JSC was sold to Chinese National Petroleum Company.

During 1996-1998 the government sold 93 large principal enterprises under the individual projects program, which comprised about 80 percent of the whole production asset of the country (see the Table 3:2). In total 56 SOEs were sold to the foreign investors from the Great Britain, South Korea, Switzerland, Belgium, Gibraltar, Indonesia, Canada, Germany, China and Russia.

3.2. Forms of participation of foreign capital in Kazakhstan

Foreign direct investment in Kazakhstan is carried out mainly through mergers and acquisitions (M&As) by establishing joint ventures, subsidiaries, affiliates, and privatization of state enterprises with foreign investment, transfer of control to foreign firms of large industrial enterprises and through the investment of banking sector.

The main form of direct investment inflow in the country becomes joint ventures, to a lesser extent with 100% of foreign capital and foreign affiliates. According to the National Statistical Agency of Kazakhstan in 1997 there were 995 joint ventures with foreign firms registered in Kazakhstan. Their number increased to 19 109 in 2009, from about 137 countries (Statistical Yearbook 2010).

Most of the equity is contributed to the fixed assets of the joint ventures in the form of equipment. The greatest number of them organized with Turkey, Russia, China, Germany, the USA, Italy, South Korea, Great Britain and other countries. Inflows of FDI in 2007 amounted to 17.5 billion U.S. dollars, which is higher than previous year by 65%. In general, in terms of attraction of foreign investment, Kazakhstan is one of the leaders of the former Soviet Union. Between 1993 and 2007, Kazakhstan has attracted 68.8 billion U.S. dollars of foreign direct investment, which is more than 4.4 thousand dollars per capita (Statistical Yearbook 2010).

In addition, primary resources extractive industry is the most profitable and attractive to investors and currently it provides more than 60% of total industrial output. The sectors of oil, gas and metals comprise 80% of the national export and about 90% of export to markets outside the CIS (KAZNEX Invest 2010).

Joint ventures can be differentiated into two main types: joint-stock company with joint ownership of the capital and joint ventures on contract basis. The former one is a new firm that is created by two or more partners where each partner owns a share of the capital or engages in the distribution of shares in an existing enterprise. This form is the most common. On the other hand, in contractual joint venture partners, parties do not create a jointly owned company. The relationship between them is carried out by a contract. For example, a foreign firm invests in a host enterprise, but it does not have a right to own shares or assets. Rights and obligations of foreign partners in joint ventures, in which they invested the capital, will be determined by mutually written contracts that are backed by the national law of a host country.

In case of an equity joint venture, the members of managerial bodies are responsible for the decisions made within a company. While in case of the contractual joint venture, there is no common legal entity whose interests the managers of the firm would give a high priority and would be directly subordinated.

Creating a large number of joint ventures with small authorized capital stock mostly in the sphere of commercial and intermediary activity was common at the initial stages of foreign investment activities in Kazakhstan. Programs of ‘small’ and ‘mass’ privatization, economic reforms led to the emergence of such large enterprises with foreign participation like JSC "Tobacco C." involving "Philip Morris" was established in 1993. Liberalization of the economy enabled the access of foreign investors to the key sectors of the Kazakhstani economy. For instance in 1993 “TengizShevrOil” JV was established by joining ”Chevron Overseas K.” (USA) and "Tengizmunaygas" JSC. The level of foreign direct investment only in these two companies in 1993 amounted to more than $ 1.2 billion (Kazakhstan Ministry of Finance database).

According to the National Statistics in 1996 in the country, joint ventures were established with 72 countries foreign countries including CIS (Commonwealth Independent States) countries. Foreign trade turnover of the joint ventures in the same year reached 180,11 thousand dollars and increased by 123% in comparison with the previous year. Accordingly, export increased by 118%, and import by 133%, in particular, significantly increased exports to Germany, South Korea, Britain, Russia, and imports increased from Turkey, South Korea, Italy, Britain, Russia and Switzerland (Statistical Yearbook 2000).

In the domestic market the joint ventures are activated mainly in the extractive sectors of the economy, especially in the mining and energy sectors. For example, in the mining industry the example of well known and largest foreign direct investment is the investment of joint ventures «Minpror-Chilevich» and national JSC "Altyn Almas", which produce and process gold and arsenious ores of Bakyrchiksky field in the Semipalatinsk region, where the volume of investment is 198 million dollars. In the energy sector direct investment is mainly directed at the exploration and extraction of oil and gas. Currently there are 13 joint ventures working in exploration and extraction sectors (Statistical Yearbook 2011)

In 2008 the number of internationalized joint ventures reached 10110 enterprises that produce goods supplying external and domestic markets. In addition to FDI by establishing of joint ventures, there are other forms of foreign capital inflows into Kazakhstani economy that include an establishment of foreign banks. Currently, the list of banks on the register of the National Bank of Kazakhstan includes ABN AMRO Bank, TEXAKA Bank, Alfa-Bank and others (The National Bank of Kazakhstan statistics).

There are alternative forms of investment or non-equity forms of investment (UNCTAD 2011) such as licensing (exclusive, when a firm sells know-how to the only foreign licensee, and non-exclusive, where the know-how is sold to a number of foreign partners), leasing, franchising, joint production, subcontracting, and so on.

Lease or concession is attractive form of foreign capital investment. Concessions provide foreign entrepreneurs the right for different kind of economic activities in the long-term leases. Granting rights to develop renewable and nonrenewable natural resources which are state property, or for other activities that are under the state's monopoly, implemented on the basis of specific terms in accordance with the laws of the country. However, concessions are not well developed in Kazakhstan, because there is no valid Law "On concession" in the country. Even though, this form is quite beneficial to the host country for the foreign capital.

3.3. FDI inflow: volume, distribution, and main investors

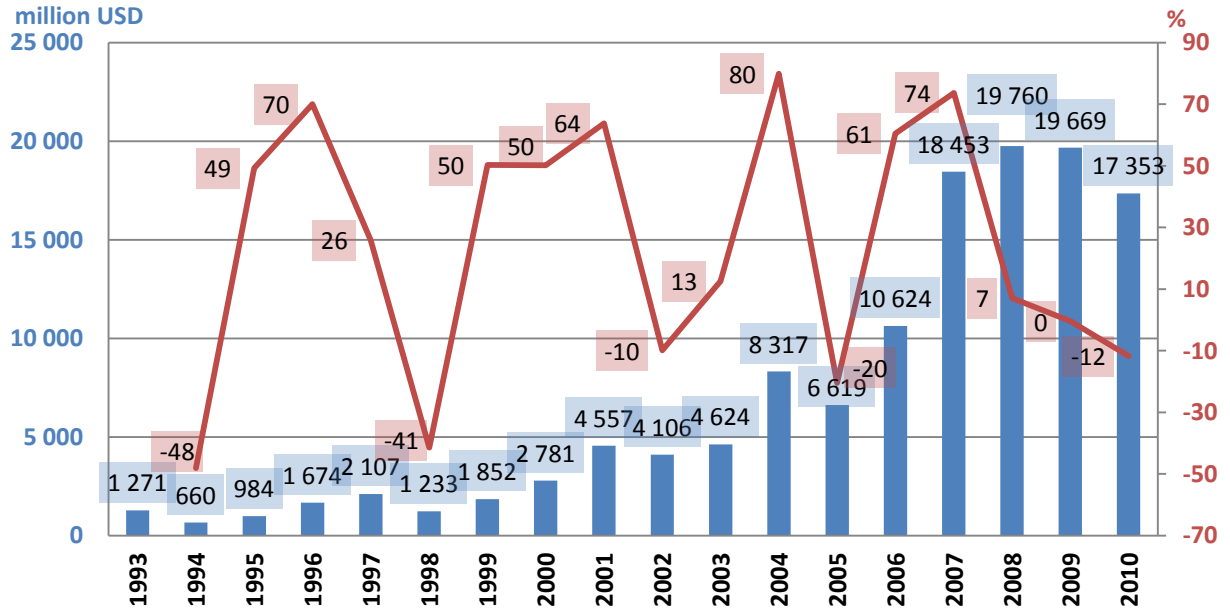
Kazakhstan has attracted significant attention of foreign investors, which makes it possible to engage the national economy in the international division of labor, increasing each year the extent of its internationalization.

According to the National Bank of Kazakhstan for the period from 1993 to 2008 Kazakhstan received about 89.7 billion U.S. dollars of FDI. Kazakhstan is the second largest FDI recipient country after Russia in the CIS region (UNCTAD 2007). The annual FDI inflow in Kazakhstan is shown in the Figure 3:1 below. Unprecedented level of FDI inflow was recorded in 2007 with 18.5 billion dollars which is 73 percent increase from its level in 2006. In spite the global 39 percent decline in FDI inflow in 2009 provoked by the financial crisis (UNCTAD 2011), trend of FDI inflow in Kazakhstan is not affected so dramatically by the financial crisis. The stable inward FDI is due to primary resources of Kazakhstan; mainly foreign investors are attracted to oil and gas extraction. The share of the primary sector in the total FDI inflow in the economy was on average 70 percent during 1995-2010, while the share of oil and gas extraction in the total FDI inflow in the primary sector was about 85 percent during the same period.

The large inflow of foreign capital has also been provided by external borrowing of domestic banks, and by attracting medium-and long-term loans for non-financial enterprises. Disbursement of new loans by commercial banks increased to 11% over the baseline period and totaled $ 2.6 billion. In 2006, banks and major enterprises in Kazakhstan have substantially increased borrowing on international capital markets. During the year banks and enterprises issued Eurobonds worth about $ 7.8 billion through the mediation of specially created

subsidiaries abroad in compare with $ 3 billion in 2005. As a result, the external debt of banks in 2006 increased, which reflected in the balance of payments that was 18.2 billion dollars (The National Bank of Kazakhstan statistics).

Figure 3:1 FDI inflow in Kazakhstan, 1993-2010 (million of USD)



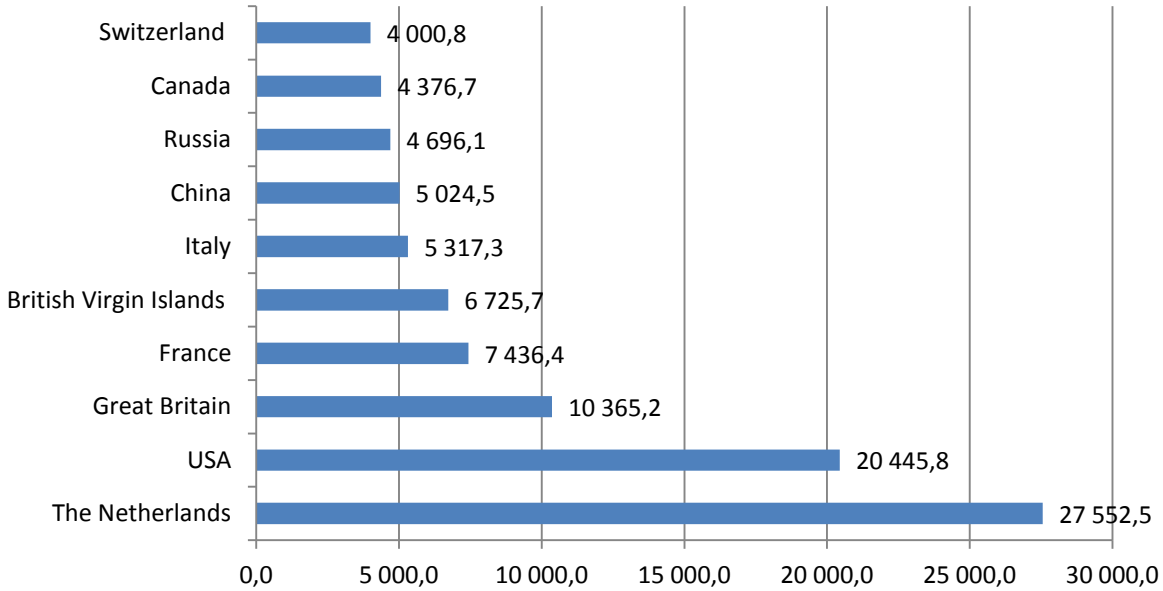
Source: The National Bank of Kazakhstan statistics accessed at www.nationalbank.kz.

The net inflow of debt capital of the private non-banking sector, with the exception of the operations of direct investment amounted to $ 3.3 billion during a year. Another cause for the inflow of foreign capital into the country is the increasing participation of non-residents in the domestic market of stocks. In 2006 the sum of acquisition of such securities by the foreign investors amounted to about $ 0.8 billion. The country received over $ 4.7 billion through the portfolio investment of non-residents in shares of domestic banks and enterprises, including through the issuance of depositary receipts in international markets capital. As a result, the total FDI in the economy of Kazakhstan in 2008 amounted to about $ 20 billion (The National Bank of Kazakhstan statistics).

FDI inflows in Kazakhstan during 1993-2010 from foreign countries are represented in the Figure 3:2. Analysis of the FDI inflows in Kazakhstan during 1993-2010 shows that the large portion of FDI was received from developed countries (about 64%), such as the Netherlands (20%), USA (18.5%), Great Britain (8.4%), France (5.4%), Italy (4.4%), Canada (3.6%), and Switzerland (3.3%) (Statistical Yearbook 2006a, 2011). Besides significant FDI inflows were received from Russia (3.7%), China (3.5%) and South Korea (3.1%), and also substantial investment is from offshore zone (5.6%). The total number of foreign countries invested in Kazakhstan is more than 166 countries.

According to the Figure 3:2 the Netherlands is the country with the largest cumulative FDI inward in the economy of Kazakhstan, which invested over 27 billion dollars since 1993 to 2010. The largest share of the total FDI inflow is directed to the extractive industries, mainly in oil and gas sector. The Netherlands' Royal Dutch Shell oil company is an active member of Kashagan project where the company has 18.52 percent of shares. There are other three large American oil TNCs operate in the oil and gas sectors, they are: Chevron, ExxonMobil and ConocoPhillips.

Figure 3:2 FDI inflow in Kazakhstan during 1993-2010, 10 top large country-investors, in million USD



Source: The National Bank of Kazakhstan statistics accessed at www.nationalbank.kz

In assessing the relative FDI inflows in Kazakhstan it is interesting to note another factor, the geography of investors. Significant amount of the investment comes from the offshore zone such as British Virgin Islands, Bermuda, Switzerland and Luxembourg, and other unknown sources. They may be originally the Kazakhstani capital, which were taken to offshore zones, and then returned to Kazakhstan. According to the Figure 3:2 British Virgin Islands is among the top ten largest county-investors with the cumulative 7 billion dollars investment in Kazakhstan.

3.4. Foreign investment policy, investment environment

In spite of the abundance of the natural resources, the poor transport and communication infrastructure of Kazakhstan became an obstacle to the economic modernization followed after the collapse of the Soviet Union. Rapid privatization of mining industries did not produce significant results. As the government of Kazakhstan was constantly changing the rules (the imperfections of the investment policy), therefore investment risks for foreign companies remained high.

The formation of a favorable investment climate requires consideration of not only internal but also external factors that can influence it. Foreign investors expanding the scope of their activities prefer to deal with countries with a stable political situation and favorable socio-economic conditions. In this regard, the government began to establish legislative norms for investment. After gaining independence a special legislation “On foreign investment” was enacted in 1994, which was appended and reissued in 2003.

The legal regime provides significant guarantees for foreign investors. In short, these are as the provisions:

• National duty, i.e. the foreign investors are entitled to use the same favorable conditions as the domestic investors;

• The government is the only guarantor for the foreign investment in the country;

• Guarantee against legislative and political changes;

• Guarantees against expropriation;

• Guarantees against illegal actions of the state bodies and officials;

• Guarantees free to use of profits and own foreign currency funds;

• Transparency in the activities of foreign investors;

It should be noted that this is a steady sequential and consistently implemented policy of continuous improvement of the legal regime of foreign investment in Kazakhstan (Law "On investment" 2003). Investment climate is a criterion of maturity of market reforms indicating the trust of the international community to the stability of property rights, to the situation in the country as a whole.

However, incompleteness and instability of the existing legislation of economic activity, poor operating systems of accounting and reporting, high taxes (imperfect tax system in Kazakhstan), high cost of loans, corruption, arbitrariness of officials and local authorities, insecurity and inconsistency of accounting to international standards did not satisfy foreign investors (CountryWatch 2005).

Although Kazakhstan is characterized by large market potential, abundance of natural resources and strategic business location, according to many foreign investors the investment climate of Kazakhstan is promising, but unstable (Umurzakov 2003). Instability is accompanied by a predominance of negative factors that hinder the flow of foreign investment into the country.

The existence of these factors is due to the negative attitude of foreign investors to the internal domestic policy of the country. According to Sagandykova (1994) there are five major obstacles to foreign investment inflow in Kazakhstan, namely, bureaucracy, financial risk, tax and finance regime in Kazakhstan, legal infrastructure / pace of change in the legislative sphere, and poor currency control. Two out of the five factors are not purely economic, but they still may have a significant impact on investment inflows into the country. The bureaucracy in the country is largely due to ineffective methods of privatization and structural reforms. The most recent survey on investment climate in Kazakhstan was conducted by Ernst & Young in 2010. It surveyed 204 respondents from 20 countries, 41 respondents do business in Kazakhstan, while the rest 163 are outside Kazakhstan. According to the Ernst & Young's investor opinion survey (2010), Kazakhstan is marked as a highly bureaucratic country, where decisions related to business are associated with unnecessary delays.

Financial risk is associated with inflation and currency fluctuations. High inflation rates often cause a lot of difficulties, which affect the activities of TNCs. The most significant challenges include the following: 1) accelerated depreciation or devaluation of the local currency, 2) the establishment of more tight capital control and the imposition of import restrictions, 3) reduction of the loans availability and increase of the interest rates, 4) the increase of accounts of debtors and lengthening the period of encashment, 5) the introduction of price controls with the intent to keep inflation under control, 6) economic and political chaos and disturbances among the population, 7) capital flight, and 8) complication of evaluating the performance of subsidiaries abroad (Sagandykova 1994). With currency fluctuations involve the identification of three types of risks: risks associated with foreign exchange recounting; risks associated with foreign exchange transactions, and the risk of economic implications.

Overall level of taxation acts as impediments to the participation of foreign investors due to the fact that they reduce the profitability of investment, i.e. levels of regulation and taxation leading

to a decrease in return on investment after taxes are below the point required to pay the investor for the inherent risk, for which he has to go, build artificial barriers to foreign investment inflow in Kazakhstan (Sagandykova 1994).

Although currently such factors as tax and fiscal regime and currency control in Kazakhstan are recognized as one of the most liberal one among the CIS countries, they still do not operate in favor of foreign investment. Only 31 percent of Ernst & Young (2010) respondents assessed the corporate taxation system in Kazakhstan as attractive.

According the new Tax Code of the Republic of Kazakhstan, which came into force on January 1, 2009, the investment tax preferences have been simplified. Namely, the procedures for obtaining investment preferences which were previously granted only after signing the contract with the authorized body were abolished (KAZNEX Invest 2010).

Investment tax preferences imply reduction in costs of investment objects and subsequent expenses on reconstruction and modernization of that object.

At the same time the transfer of losses increased from 3 to 10 years, which allows getting benefits from the advantages of investment tax preferences. It also provided reduced rates of corporate income tax up to 20% in 2009, up to 17.5% in 2010, and up to 15% in 2011(to compare with 2008 - 30%). Value-added tax rate is decreased to 12%.

Thus, under the realization of projects in the non-extractive industries of the Kazakhstani economy, investors are given the following types of investment preferences.

1) Exemption from customs taxations for imported equipment and its components intended to use in the investment project framework;
2) Governmental in-kind grants (it can be provided land, buildings, facility, machinery and equipment as a government in-kind grant).
3) Investment tax preferences.

Thus, currently in Kazakhstan it is created quite favorable investment climate both politically and legally. Today Kazakhstan has created the entire necessary legal framework for investment activities. The new law (2003) fully regulates the legal and economic framework for stimulating the investment, and according the assessment of international experts, it is accepted as one of the best laws in the area of investment among the countries with transition economy. Kazakhstan is the first among the CIS countries received investment ratings from international rating agencies Moody's (2002), Standard & Poor's and Fitch (2004). The Law guarantees the full protection of investors' right and the stability of signed contracts, as well as it is very strictly regulated the role of the state bodies with regard to investors (the free movement of capital, repatriation of capital, freedom of using the profits, the right of private ownership to land, including for foreign companies).

However 53 percent of Ernst & Young's (2010) respondents felt that legislative and regulatory system in Kazakhstan were unattractive in terms of transparency and stability, while 14 percent of respondents felt they were attractive. According to CountryWatch's country review (2011) Kazakhstan adopted excellent legal system with assistance of USAID, however it was not implemented effectively in the spheres of enforcing property and contractual rights.

Besides the Law defines measures of state support of investment directed to priority sectors of Kazakhstan's economy. It is important to note that the measures of state support of investment subject to the same extent as for the domestic so as for the foreign investors.

The arrangements of investment legislation aimed at promoting and protecting investment in the territory of Kazakhstan, the government signed bilateral agreements on mutual protection of investment with 41 countries, including USA, United Kingdom, Germany, France, Russia, Netherlands, Turkey, Jordan, Qatar etc., as well as a multilateral agreement between member states of Eurasian Economic Community (EurAsEC)[5].

In addition, it should be noted that as one of the measures of state support of investment there are co-financing projects through public development financial institutions (such as the National Innovation Fund, the Corporation for Insurance of Export Loans and Investment, the Development Bank of Kazakhstan, the Investment Fund of Kazakhstan, the Corporation for Export Development and Promotion "KAZNEX") (KAZNEX Invest, 2010).

The main purpose of these development institutions is to promote the diversification of the national economy through the creation of development systems and support of entrepreneurship at all levels and effective management of investment resources.

Besides, there are social and business corporations (SBCs) playing a significant role in accelerating economic diversification and sustainable development of the regions. They operate in seven regions of Kazakhstan[6].

Each corporation is like a regional development institution managing the entrusted national assets in the region of the country, including areas of undeveloped lands and fields. SBCs are established with the status of national companies and fulfill the role of the project generator attracting investment for their realization.

Participation in the projects of SBCs will be attractive for businessmen due to access to finance, land, technological resources and external markets.

Foreign companies also have the opportunity to get assistance of these SBCs in establishing joint ventures with domestic partners in Kazakhstan, where the use of foreign technology and domestic raw materials may increase the competitiveness of their products (KAZNEX Invest, 2010).

According to the government document “The Industrialization Map of Kazakhstan for 2010-2014” (2010), there are new development tools of economic incentives such as industrial and special economic zones, industrial parks. Now Kazakhstan has six special economic zones, such as "Seaport Aktau" carries out transportation and logistics services, “Astana - New City” deals with construction and produces construction materials, Information Technology Park near the city of Almaty, “Ontustik" is in South Kazakhstan region deals with development of textile industry, the National industrial Petrochemical Technology Park in the Atyrau region and special economic zone "Burabai" is to develop the tourism cluster, 200 km from Astana.

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[5] Eurasian Economic Community (EurAsEC) is an international economic organization, vested with functions relating to the formation of common external customs borders of the member states (Belarus, Kazakhstan, Kyrgyzstan, Russia, Tajikistan and Uzbekistan), the elaboration of unified foreign policy, tariffs, prices and other components for functioning of the common market.

[6] According to the Government’s Decree #483 from the 31st May, 2006 it was enacted “The Concept on establishment of the regional social and business corporations” (SBCs). The main mission of SBCs is to support the economic development in regions through consolidation of the state and private businesses.

In the above special economic zones investors are given plots of land provided with necessary infrastructure for effective organization of new productions. On those territories it is activated the regime of free customs zone, as well as it is provided significant tax benefits (for corporate income tax, tax for land and property), which allows not only to encourage investment in the manufacturing sector, but also to determine the location of points of industrial growth according with national economic and regional policies.

Summarizing, it can be noted that the Kazakhstani government tries to provide favorable investment climate in order to attract FDI to the national economy. According to the policy makers there are three main determinants which attract foreign investment in Kazakhstan. The first is the business climate of the country, supported by favorable investment laws, attractive measures to support investment and economic and political stability.

The second is the natural and mineral resources endowment. According to the international estimates, Kazakhstan is ranked as the sixth in the world reserves of natural resources. Kazakhstan is endowed with large mineral resources such as copper, lead and zinc, gold, chromite, coal, iron, oil and gas, and many others (Levine et al 2011).

The third is favorable geographical position of Kazakhstan, providing investors with the consumer market of almost half a billion people that is to say the markets of Central Asia, Russia and China.

3.5. Summary

This chapter addressed the emergence and development of internationalization of production in Kazakhstan since 1991 onward. The privatization of SOEs started after the independence in 1991 has become a starting point for the development of internationalization of production in Kazakhstan.

The realization of the privatization program prior 1995 was complicated and controversy. Reorganizing the ownership of the large enterprises was challenging task for the new government due to lack of experience in doing business and controlling more than a hundred large enterprises simultaneously. Starting from 1995 the government utilized contract based method or concession, i.e. the large enterprises were given to the foreign investors under the trust management contract for the limited period of time with the consequent sale to the managing companies. Thus privatization of the large state owned enterprises, despite the fact of bankruptcy of some of them, contributed to the irreversibility of the liberalization process of the national economy.

The participation of the foreign investors in the privatization contributed to the recovery of the industrial production in the country. Sale of the large enterprises was the starting point for the establishment of the new industrial corporations with private and state ownership. These companies operate in the international markets providing jobs for thousands of the citizens.

The study shows that the established integrated enterprises are the basis of the internationalization of production. The differentiation of the specific forms of internationalization of production in the country is carried out in four ways:

- The first group represents joint-stock companies established by the government and consequently sold to investors of privatized enterprises;

- The second group represents national and state-owned companies;

- The third group represents private corporations formed by the means of market self - organization;

- The fourth group represents affiliates and subsidiaries of multinational companies, international firms, etc., mostly joint ventures.

Since independence in 1991 Kazakhstan has been doing significant reforms in modernization of its regulation and legislation in order to attract foreign investment to the national economy. According to the international experts, the legislation of the country is recognized as one of the best among the countries with transition economy. For example, in 2002 the international rating agency Moody's ranked Kazakhstan by Baa3 due to FDI inflows and export growth in the country driven mainly by extraction of minerals. In 2004 Moody's upgraded the rank of Kazakhstan to Ba1/NP (Positive) due to the country's positive economic performance, FDI inflows, liberal fiscal and monetary policy and strong banking system regulation (Moody's Investor's Service 2004, 2010).

Kazakhstan received significant FDI inflows from 1993 to 2008. It reached almost 90 billion US dollars during the same period, which makes Kazakhstan the second largest host country for FDI in the FSU region after Russia. However foreign investors are mainly interested in extractive industries in Kazakhstan. During 1995-2010 about 70 percent of the total FDI inflows in the country is attracted to the primary sectors, mainly to oil and gas extraction.

According to the data on FDI inflows in Kazakhstan during 1993-2010, large portion of FDI was received from developed countries (about 64%), such as the Netherlands (20%), USA (18.5%), Great Britain (8.4%), France (5.4%), Italy (4.4%), Canada (3.6%), and Switzerland (3.3%) (Statistical Yearbook 2006, 2011). Besides significant FDI inflows were received from Russia (3.7%), China (3.5%) and South Korea (3.1%), and also substantial investment is from offshore zone (5.6%). The total number of foreign countries invested in Kazakhstan is more than 166 countries.

4. INTERNATIONALIZATION AND CONSOLIDATION OF THE STRATEGIC ENTERPRISES IN KAZAKHSTAN

This chapter discusses the process of internationalization and consolidation of production in Kazakhstan over the period 1991-2010. The enterprises reported in this chapter account for a significant share of the country's total production output and account for a large portion of the total FDI inflows in Kazakhstan. As in Kazakhstan the majority of FDI inflows are concentrated in the extractive industry, the chapter focuses mainly on the analysis of the foreign enterprises involved in the extractive industry.

4.1. Who owns the metals?

Mining and metallurgical industry is one of the strategic sectors of the economy of Kazakhstan. In 2009 it produced almost 17 percent of the country's total industrial production. The share in export comprised about 20 percent. According to the National Statistics Agency the sector employs nearly 164 thousand specialists. The share of the metallurgical industry accounts for more than 35 percent of the total manufacturing production of the country.

Now the metallurgical sector extracts 29 types of non-ferrous metals, 3 types of ferrous metals and 2 types of precious metals. The current reserves of copper are estimated at 36 million tons, while reserves of manganese account for 600 million tons (BMI 2011a).

During the early privatization period, in 90s, the enterprises of the mining sector were the first among privatized under the individual projects and transferred to foreigners under the management contract. Consequently they all were sold to the managing investors. Some of enterprises were sold more than once. As a result today the mining and metallurgical sector is highly consolidated and monopolized sector, controlled by a few giant financial and industrial corporations like ENRC, Kazakhmys, Kazzinc, Arcelor Mittal Kazakhstan and others.

ALUMINA and ALUMINUM production

The Pavlodar alumina plant (now part of "Aluminum of Kazakhstan" JSC), was the largest alumina producer in the FSU, with the capacity to produce 1.2 million metric tons per year of alumina. The plant was put into operation in 1964. The Pavlodar plant also produced 40 percent of the gallium output of the FSU (Levine 1995). During the Soviet period the plant was the part of the production chain, i.e. it had not smelter so it shipped most of its alumina to Russia's aluminum smelters for the further processing, namely Sayanogorsk, Novokuznetsk and Bratsk smelters in Siberia.

After the collapse of the Soviet Union in 1991 the mining sector declined rapidly. Though production of alumina was not affected significantly, dropping from 1.1 million tons in 1992 to just a bit less than 0.9 million tons in 1994 (Peck 2004, 73). However, the Pavlodar alumina plant was the first enterprise that was transferred to entrusted management of the foreign investor with its subsequent sale. In 1994 under the privatization program the plant was transferred for five years under the management of unknown company called Whiteswan Ltd registered in the British Virgin Islands. The ownership of Whiteswan remained unknown for the long time. But it came to light afterwards that Whiteswan was a joint venture of the Trans World Group (TWG) of the UK and Kazakhstan Mineral Resources Corporation (KMRC) of the British Virgin Islands (see Levine 1998).

According to the management contract Whiteswan was obliged to resolve tax and other debts of the enterprise right away of KZT 674.9 million (about 10 million dollars) (Peck 2004, 78). Though 5 year management contract had not been ended, and just after around a year Whiteswan

without tender acquired 52.75 percent of the Pavlodar aluminum plant paying 22.1 million dollars with the obligation to invest another 123 million dollars in the future (Kalyuzhnova 1998). Afterwards the company acquired two more bauxite plants paying for them 11.3 million dollars with the obligation to invest 30 million dollars in the future and clear off debts (Kalyuzhnova 1998). In 1996 it was established Aluminum of Kazakhstan, JSC where the partners of Whiteswan got 56.48 percent share, the government had 31.86 percent, while the rest was distributed among the employees. Besides in 1996 they bought the thermoelectric plant for 110 million dollars. So within comparatively short period of time they consolidated alumina production sector and established monopoly. However, they fulfilled taken responsibilities and paid all the fees. Since privatization the group has invested 290 million dollars in the financial recovery and rehabilitation of the affiliated enterprises. Moreover it invested about 900 million dollars in constructing aluminum smelter in Kazakhstan (Kazakhstan Ministry of Finance database).

Currently Aluminum of Kazakhstan, JSC employing about 12,000 workers is an integrated part of Eurasian Natural Resources Corporation, plc (ENRC). ENRC registered in the UK is an industrial giant solely controlling the entire alumina, gallium, chromite and ferroalloy, manganese and part of iron ore production in Kazakhstan. It is the large electricity and energy supplier in Kazakhstan with power and heating complexes, and has its own logistic and marketing companies. Besides, the corporation owns natural resources producing assets in Russia, Brazil, China and South Africa (ENRC prospectus).

The history of the foundation of ENRC goes back to early 90s when after collapse of the FSU the new government of Kazakhstan carried out privatization of the SOEs. The following business partners and old friends Alexander Machkevich, Patokh Chodiev, and Alijan Ibragimov founded Kazakhstan Mineral Resources Corporation (KMRC) in 1992. They took active part in privatization of SOEs and built a business empire in Kazakhstan together. Now they are oligarchs ranked in the list of the richest people in the world by Forbes. Almost all the assets of ENRC were bought during privatization and comprised of the largest strategic industrial enterprises of the FSU.

LEAD AND ZINC production

Kazakhstan ranked as the world's 4th country in proved reserves of lead and 6th in proved zinc reserves, which estimated of being 25.7 million tons and 11.7 million tons respectively (Mukhanov and Bolgert 2010).

Kazakhstan was the leader republic in lead and zinc production in FSU. It accounted for more than 60% of mined, more than 90% of smelted lead and almost 50% of zinc production. Production was mainly located in Eastern Kazakhstan operated by large enterprises such as Ust-Kamenogorsk, Leninogorsk and Zyryanovsk mining and metallurgical complexes, and in Karaganda region with the large enterprises such as Akchatau, Karagaily, Zhezkazgantsvetmet mining complexes, Saryarka polimetal and other industrial enterprises. In total there are about 50 ore supplying deposits and about 15 mining complexes involved in extraction and processing of lead and zinc in the country. These mining complexes extracted not only lead and zinc at those deposits, but also there are substantial concentration of copper, manganese, silver, gold, selenium, cadmium and gallium (Mukhanov and Bolgert 2010).

During the Soviet period Kazakhstan processed lead in 3 refineries, namely in Ust-Kamenogorsk, Leninogorsk and Shymkent lead plant (present Yuzhpolimetal). Zinc was refined in Ust-Kamenogorsk and Leninogorsk complexes.

During 1992 – 1995, lead and zinc production was shrinking due to lack of mine output which fell by more than 66% for lead and 25% for zinc, hitting the Ust-Kamenogorsk and the Leninogorsk smelters the hardest (Levine 1995).

As Kazakhstan government was implementing a restructuring program involving privatization and foreign investment in 1995, the Ust-Kamenogorsk lead-zinc enterprise and the Zyryanovsk lead plant were placed under new management by a domestic company Metalou Ltd. Another lead-zinc mining complex, Karagaily, was put under 5 year managing contract with Kazakhstan Postovalov Co. (Levine 1996). According to the contracts the new managers were obliged to clear off debts and improve the production output. However these contracts did not last long due to the failure of the new managers and after all Karagaily mines were shut down until it ones again changed hands in favour of Kazakhmys in 2001. While Ust-Kamenogorsk and Leninigorsk complexes together were passed to another domestic company called Ridder-Invest (Peck 2004, 94). Besides Ridder-Invest owned Irtyshpolimetal in addition to those mentioned above. However Ridder-Invest also turned out to be failed and its contacts on those enterprises were annulled in 1996.

Later, in an effort to improve lead and zinc production integration, the government established Kazzinc as a joint-stock company that absorbed the biggest lead-zinc producers: Ust-Kamenogorsk, Leninogorsk, Zyryanovsk and Tekeli. By 1997 Kazzinc owned five mines, two zinc plants and a lead plant employing in total 26000 people. In the same year 62.4 percent of Kazzinc's was sold to Kazastur Zinc AG which was founded by Glencore International AG of Switzerland and Asturiana de Zinc of Spain. Kazastur Zinc AG was obliged to pay all the debts of 133 million dollars and additional 400 million dollars investment in the production. In 1999 Kazastur Zinc AG raised its shares in Kazzinc up to 72.32 percent (Peck 2004, 94). Currently Kazzinc is a blue-chip corporation producing lead and zinc, and by-products such as copper and precious metals.

RR Kazakhstan Trade owed the Shymkent lead smelter, Novo-Trading of Switzerland owned Akchatau complex and River International owned Achisay complex. Nonetheless, these managing companies were in significant distress making their contracts future validity questionable. (Levine 1998)

The productions of lead and zinc in 1997 declined compared to the peak in 1980 by 85% and 55% respectively. The industry facilities were working far below their capabilities, partly due to exhausting deposits with lowering grade of ore and partly because of lack of investment for developing new deposits, thought they still fully met domestic needs and were working mostly for export. (Levine 1998)

Like ENRC and Kazakhmys, Kazastur Zinc AG of Glencore International took over mining assets one by one. Furthermore, it acquired Kaz-Tyumen JSC, a processing plant in Ridder for refining lead from battery scrap, merging Kazzinc's existing assets of the Ridder Metallurgical Complex. In 2007 Kazzinc has increased lead production to 90,689 t and zinc to 294,384 t. (Levine et al 2010)

Kazzinc is not absolute monopoly in the lead and zinc production industry, but it controls quite a significant portion of the industry. In 2007 the share of Kazzinc in zinc production industry was about 87 percent in Kazakhstan (Samruk Kazyna Resources).

There were other producers of lead-zinc such as a copper company Kazakhmys registered in the United Kingdom. One of three zinc refineries Balkhash belongs to Kazakhmys, while two others Ust-Kamenogorsk and Ridder belong to Kazzinc.

ShalkiyaZinc N.V. founded in Netherlands (Kazzink Electronic Resources) with the Shalkiya and the Talap greenfield deposits feeding a processing plant near Kentau (Levine et al 2010). ShalkiyaZinc's N.V. deposits were estimated to be 30% of country's zinc reserves. The company also announced the planned increase in extraction by 2010. (Levine et al 2010)

The major portion, 85-88 percent of produced lead and zinc is exported to Netherlands, Turkey, Italy, Ukraine and China.

COPPER production

Kazakhstan owns 37 million tons of proved reserves of copper which ranks the country as 4th in the world after Chile, Indonesia and the USA (Statistic Yearbook 2011). More than 90 deposits of copper have been explored in Kazakhstan. The largest deposits of copper include Zhezkazganskoe, Aktogaiskoe and Aidarly (KAZNEX Invest 2010).

Copper is mined and processed in major four complexes the Zhezkazgantsvetmet; Balkhashmys, Karagaily mining complex (Karaganda), and Zhezkent mining complex (East Kazakhstan), and in other four complexes along with substantial concentrations of lead or/and zinc: the East Kazakhstan Copper-chemicals, Zyryanovsk, Leninogorsk and Irtysh mining complexes (East Kazakhstan).

Zhezkazgantsvetmet and Balkhashmys have been fully integrated ore-mining, processing and refining enterprises since the soviet times (Peck 2004, 84).

In 1995 Zhezkazgantsvetmet was in dreadful situation with 170 million dollars debts including 10 million dollars wages for employees. So in June 1995 the enterprise was transferred under the entrusted management to the South Korean company Samsung. Samsung was obliged to pay 170 million dollars debts. However it was turned out that debts were much higher than it was reported, up to 240 million dollars. Only a few months later Samsung reported about the acquisition of 40 percent of Zhezkazgantsvetmet for 351.1 million dollars in total (Peck 2004, 85).

Balkhashmys had to go through even harder path in restructuring of its ownership. In 1995 like other SOEs Balkhashmys also was put under the foreign management, this time with CAM Finance SA (Switzerland). However the contract was canceled after a year because of the failure of the contract terms. The government allocated 83 percent share of Balkhashmys to an open tender. The contract was given to the Consortium of three companies Glencore International of Switzerland, Phelps Dodge of the US, and Kazkommertsbank of Kazakhstan. However this contract had to be canceled as well, because the enterprise's debts were much higher than it was in the contract. The Consortium tried to negotiate with the government about revision the contract terms, but instead the government annulled the contract and in the early 1997 transferred the contract to Samsung. Samsung was obliged to clear off the debts and invest 700 million dollars before 2000 and improve the situation at the enterprise (Thoenes July 4, 1996).

Samsung, in fact, helped to revive the copper industry of Kazakhstan, making significant investment in the mining industry of the country. In a short time the company reversed production decline and was able to restore production output. And already in one year the enterprise repaid 200 million dollars of credit money given by Samsung. Samsung was successful in operations and in the end of 1997 established the firm Kazakhmys which integrated all the assets purchased or/and given in entrusted management including Balkhashmys, Zhezkazgantsvetmet, electricity plants located in Zhezkazgan and Balkhash, Karaganda heat and power plant (30%), Zhezkent ore mining plant, the East-Kazakhstan Copper-chemical complex and the Irtysh smelter plant in 1999 after changing many hands. Later Samsung bought many

licenses for mining such as Shatyrkol mine, the Zhman-Aibat mine, Abyz, Kosmurn, Akbastau deposits and many others.

Currently mainly Kazakhmys and Kazzinc are the most involved in the extraction of copper, but the share of Kazakhmys in copper production is about 85 percent in Kazakhstan. The major portion of produced copper is exported. The volume of exported copper is varying from 100 thousand to 200 thousand tons per year.

Kazakhmys, plc registered in the UK is another blue-chip company consolidated the whole copper production industry in Kazakhstan. The company also produces by-product metals such as zinc, silver and gold. It is a large electricity supplier in Kazakhstan. Like ENRC, Kazakhmys acquired the majority of its assets during the privatization in 90s. In 1992 Zhezkazgantsvetmet, JSC was established by the resolution of the government. Later, in 1997 it was renamed as Corporation Kazakhmys, JSC. In 1995 the government put the copper industry under the trust management of South Korean company Samsung for five years. In 1996 Samsung Deutschland GMBH (Samsung's subsidiary in Germany) acquired 40 percent of Kazakhmys while the other 40 percent share of the government remained to be under the trust management contract with Samsung. In 2000 the trust contact with Samsung was expired and the government passed its share to Vladimir Kim who worked first for Zhezkazgantsvetmet in 1995-1997 and then for Corporation Kazakhmys, JSC since 1997. Today Vladimir Kim owns the majority of Kazakhmys. The ownership structure of Kazakhmys is not transparent and it is not public how Vladimir Kim turned out to be an owner of Kazakhmys. Nevertheless rumors say that Kim appears in the "Kazakhmys", most likely as a very trusted person of rather more significant people in Kazakhstan who control the company through their offshore company. By the way, they say that the ENRC is controlled in the same way.

In 2008 Kazakhmys was ranked as the world's 9th largest company in copper production extracting up to 430 thousand tons per year and 5th company in silver production extracting up to 650 thousand tons per year (Mukhanov and Bolgert 2010). Besides the company produces high quality gold up to 5500 kilogram per year, 100 thousand tons of zinc per year and others. Since 2005 Kazakhmys has been included to the listing of London Stock Exchange (Kazakhmys web resources). In 2007 Kazakhmys acquired 14.6 percent of ENRC plc, and consequently the following year it increased its share in ENRC up to 26 percent.

FERROALLOYS production

Kazakhstan's ferroalloy industry included the Donskoy mining complex, producing all the chromite output in the FSU, and two ferroalloy plants: the Aksu and Aktyubinsky ferroalloy plants. The Donskoy complex was a main supplier of chromite producing almost all of the chromite (more than 95 %) in the entire FSU (Levine 1994).

Donskoy mining and processing plant was established in 1938. Nowadays there are 6000 thousand employees working there. It includes two mines and two dressing plants that are the largest complexes in the world on extraction and processing of chromium raw materials. It produces 2.5 million tons of tradable chromium ore per year (it is 20% of international production standard). A new mine is being under construction, which will be the largest in the world on extraction of chromium ore. There has been realized the first stage of creation of capacities on coking of chromium ore breakages for the needs of ferroalloy industry; a preforming workshop has been entered with capacity of 200 thousand of tons of preforms per year. 70 percent of produced chromite was sent to Aktyubinsky and Aksu ferroalloy plants for the further processing into ferroalloys based on chrome and silica, while more than 90 percent of ferroalloy output was exported to FSU republics, especially to Russia (Levine 1994).

Aksu ferroalloy plant was first launched at the beginning of 1968 and today is one of the largest enterprises of ferroalloy production in the world. Its production capacity reaches 1 million tons of ferroalloy per year. It includes 4 ferroalloy workshops; 26 electric furnaces; two workshops for charge preparation; railway, motor transport and repair workshops. Originally the plant was designed for ferroalloy production; nowadays it has been diversified into scale production of chromic, silicon and manganese alloys (Mukhanov and Bolgert 2010). Aktubinsky ferroalloy plant was the first plant in the ferrous metallurgy in Kazakhstan that was put into operation in 1943. It produces high quality ferrochromium, which is the most important component in producing stainless and alloyed steel.

In 1996 it was established the Kazchrome Transnational Company which integrated the whole ferroalloy industry, namely the Donskoy mining complex and two ferroalloy plants Aksu and Aktyubinsky. During the privatization the ferroalloy enterprises were transferred to the foreign management under the 5 year entrusted contract. Japan Chrome Corporation (JCC) got the contract which turned out to be another offshore company of Trans World Group and Kazakhstan Natural Resources Corporation partnership, registered in British Virgin Islands. Like with Whiteswan, the partners of JCC acquired the majority of share of Kazchrome just after several month of their first management year. They bought 57.5 percent of Kazchrome and paid 582.6 million dollars plus 66.8 million dollars to the government budget and were obligated to invest 398 million dollars more (Kalyuzhnova 1998).

After breakdown of the Soviet Union, Russia was heavily depended on ferroalloys import, which is not surprising since Soviet Kazakh Republic produced all the chromite in the entire former Soviet Union. The new management of Kazchrome cut down supplying the Russian market with low-carbon ferroalloys and started oriented to the world high-carbon ferrochromium market (Levine 1997). Ferroalloy import scarcity from Kazakhstan affected on ferrochromium output in Russia falling at the major ferroalloys plants (Levine 2007).

In 1996 Kazchrome acquired energy assets for supplying its ferroalloy plants with power and fuel, those were the Aksu heat and power plant and the Vostochny and part of the Stepnoi coal mines in Ekibastuz. They paid 10 million dollars for coal mines and were obliged to pay 150 million dollars to the budget and invest 1.2 million dollars in the mines (Peck 2004, 119). The following year Kazchrome increased its assets buying the manganese mining plant Kazakhmarganets located in Zhezkazgan. In 2001 the company acquired a titanium-zirconium mine and another power plant in Aktyubinsk named Akturbo power complex with the capacity of 98 megawatt. After the complex had been reconstructed its capacity increased up to 135 megawatt. They paid 28 million dollars for Akturbo power complex (Peck 2004, 119).

Today Kazchrome TNC produces more than a million of ferroalloys and approximately 2.5 million tons of chromium ore per year, and has 18 300 employees. The company exports around 700 thousand tons of ferroalloys per year and supplies the main world ferroalloy markets including the USA, EU, Japan, South Korea, and China (ENRC Prospectus). Kazchrome is controlled by ENRC and integrates four mining enterprises such as Donskoy mining and enrichment plant, Aktyubinsk ferroalloy plant, Aksu ferroalloy plant and Kazmagranets mining enterprise.

IRON ORE production

Kazakhstan major iron ore reserves are located in Qostanay region. They were developed by Lisakovskiy and Sokolovsko-Sarbay mining and metallurgical complexes. According to the state priorities of 1994 it was announced to increase iron ore and pellet production by up to 60%. That included expanding Western Karazhal iron ore mine and building beneficiary complex in Kachar (Levine 1995).

In 1995, according to the governmental plan, the iron ore and pellet production increased by 50%. The Icelandic company Ivedon International Ltd. got a 5-year managing contract with the Skolovsko-Sarbay complex. The contract stipulated that 75% of the complex' output must be exported. As well as Ivedon International promised to extend its credits and restructure the enterprises' debt (Levine, 1996). Although Ivedon International was registered in Iceland it appeared to be a joint venture of two companies: Kazakhstan Mineral Resources (KMRC) and the Trans World Group. In 1996, a domestic financial Yesil enterprise, bought 51% stakes of the Lisakovskiy, the second largest mine of the field. The following year, Kazakhstan firm ELROVO purchased 80% of the Atasuruda mine, which was the main raw material supplier for the Ispat-Karmet steel mill (Levine 1998).

One of the big events of 1997 was banning Trans World Group from Kazakhstan mineral industry leaving KMRC as the only manager of the Skolovsko-Sarbay complex (SSGPO). After that incident it is not clear how ENRC became the major owner of SSGPO in 2007, although some unreliable sources refer to ENRC as the owner of KMRC from the very beginning.

Kazakhstan's biggest steel complex in Karaganda - Karmet steel mill worked using 50% of its capacity. First company managing the mill until 1995 was the Israeli Eisenberg Group, a subsidiary of the U.S. Steel. In 1995 Kazakhstan government dismissed the Eisenberg Group as the manager company and opened a tender that was won by Ispat International Ltd registered in the United Kingdom. Ispat expressed the intention to increase Karmet's output by 50% until 1997 by paying existing liabilities, buying new assets, upgrading the equipment and expanding exports. Also, the plan included 10000 lay-offs to reduce the number of employees to 28000 (Levine 1996). The successful management and the option in the contract to purchase the mill lead to renaming Karmet steel mill into Ispat-Karmet Steelworks in 1998.

Under a new name, the enterprise attracted $473 million investment from the European Bank for Reconstruction and Development and the International Finance Corp. for production facilities upgrade. In addition, Ispat International purchased the Karaganda powerplant and 15 coal mines in the Karaganda region (Levine 1999). As Ispat International was established by Lakshmi N Mittal, the Mittal Steel and then its successor, ArcelorMittal Corp., owns the Karmet steel mill (Arcelor Mittal Corp. resources).

MANGANESE production

Kazakhstan ranked as the world's 8th largest manganese producer (Levine 2000). Kazakhstan possesses 600 metric tons of proved reserves of manganese positioned in eleven deposits (Levine 1997). Manganese was produced in three mines: Atasuruda, Kazakhmarganets and Saryarkapolimetal (now Zhayrem) mines. In 1995 Zhayrem was under the management of the company Nakosta AG (Switzerland) for five years. In 1996 Nakosta bought some share in the enterprise. Atasuruda was sold to Ispat-Karmet, while Kazakhmarganets went to Japan Chrome of ENRC in 1997.

In 1998 between the partnership Trans World Group and Kazakhstan Natural Resources Company arose disagreement. In fact the owners of the Trans World Group were oligarchs Russian emigrants in the UK, the Chernyi brothers. KNRC was owned by "trio" oligarchs Mashkevich, Chodiev and Ibragimov. Maskevich and Ibragimov were from Kyrgyz Republic, while Chodiev was from Uzbekistan. The partnership of Trans World Group and KNRC established three offshore companies through which they acquired many of large SOEs during the privatization in Kazakhstan. In the similar way they purchased others assets in Russia too. However in 1998 KNRC made an attempt to get rid of its Trans World Group partners. Dispute between partners reached court where the Trans World Group was found guilty in making damages for the enterprises.

Table 4:1 Internationalization and consolidation of the mining industry

Metals and enterprises	Current owner(s) (country)	Share (percent)	Prior owners/partners
ALUMINA "Aluminum of Kazakhstan" JSC Pavlodar alumina plant Kazakhstan aluminum smelter Turgai mines Krasnooktyabrsk mines Keregetus limestone quarry Pavlodar power plant *CHROMIUM* "Kazchrome" TNC Donskoy mines Aksu ferroalloy plant Aktyubinsk ferroalloy plant Ekibastuz coal mines Aksu power plant Kazakhmarganets Tur manganese mines Aktyubinsk power plant Titanium deposites Zhayremsky GOK *IRON* Sokolov-Sarbai iron ore mines	ENRC plc (UK)	in 2010 Kazakhmys plc (26.00) Mr. Machkevitch (14.59) Mr. Chodiev (14.59) Mr. Ibragimov (11.71) KZ Government (11.65)	Trans World Group (UK) lost its assets in 1998
COPPER Kazakhmys Zhezkazgantsvetmet Balkhashmys East-Kazakhstan Copper Zhezkent Enrichment Complex Irtysh Copper and Chemical plant Zhezkazgan power plant Karaganda power plant Balkhash power plant Borly coal mines Karagaily mines Samarskoe mines Other mineral deposits	KAZAKHMYS plc (UK)	In 2009 Cuprum Holding B.V. (29.88) Tobermory Holding Europe B.V. (9.48) Perry Partners S.A. (4.02) Harper Finance Limited (5.55) KZ government (15)	Samsung ABN AMRO Bank Aton (Russia) Unknown
LEAD and ZINC Kazzinc Leninigorsk polymetal Ust-Kamenogorsk lead and zinc Zyryanovsk lead and zinc Bukhtarma power plant Tekeli lead and zinc Other mineral deposits	KAZZINC plc	In 2012 Glencore International AG (50.7)	Ridder-Invest (KZ) Metalou (KZ) RR Kazakhstan Trade and Finance (KZ)
IRON and STEEL Arcelor Mittal Temirtau, JSC Karaganda Metallurgical Plant Karaganda power plant 15 coal mines in Karaganda Lisakovsk iron ore mines Atasuruda iron ore mines Rudnyy power plant	Arcelor Mittal Temirtau, JSC	Arcelor Mittal (India)	-

Source: adopted from A.Peck (2004); updated from the official websites of the companies

Damage cost was 200 million dollars that was the exact amount TWG invested in the enterprises. Their names were implicated in scandals, money laundering and bribery of high officials in the government to gain access to strategic production capacity of the country. They were being investigated for money laundering in Belgium as well as suspected insider-dealing with Kazakhstan president Nazarbayev (Serafin 2006).

The majority of ENRC enterprises are the largest Kazakhstani exporters. ENRC provides 5% of GDP in Kazakhstan being the third world producer of ferroalloys, the world leader in the sphere of iron ore extraction and processing, a supplier of two fifth of gallium produced in the world as well as a leading producer of alumina oxide and manganese concentrates. The group controls a quarter of the world chromium reserves and is the largest electric power supplier in Kazakhstan.

Many major ENRC affiliated enterprises are vertically integrated starting from extraction of raw materials to producing intermediate goods. However major ENRC enterprises (and this is typically for all major Kazakhstani companies) have partial vertical integration up to 3-4 levels of processing. Vertical integration in them does not reach more mature processing levels which allow getting higher value added; i.e. they do not produce finished goods.

In substance, the enterprises produce intermediate products for other domestic enterprises or for export. Therefore these enterprises like the majority of large Kazakhstani enterprises are aimed to export raw materials or semi-finished products. Thus, for instance, Aluminium of Kazakhstan, JSC exports alumina rather than aluminum to Russia and China. Aluminium of Kazakhstan, JSC provides Russian aluminum plants with alumina under the tolling conditions. Aluminum is produced from alumina, the owner of which remains the proprietor of processing feedstock. When supplying and producing a product as per tolling conditions, both parties are tax exempted for the finished product. The owner of Aluminium of Kazakhstan, JSC forwards metal via offshore zone (Virgin Islands) at a low price and then realizes it on London broker's board by world market prices. The whole income and taxable added value from more mature products remains abroad while Kazakhstan as a provider of the raw material gets the least profit. Therefore Kazakhstan has to import consumer goods from foreign countries at much higher prices. According to Forbes ENRC doubled its profit in 2007 which was 800 million dollars. According to international estimations ENRC costs approximately from 8 to 13 billion dollars.

4.2. Who owns the fuels?

COAL

According to the British Petroleum statistics (BP 2011) Kazakhstan's coal reserves comprise 31.3 billion tons which is 3.78 percent of the world's reserves. There are more than 400 coal deposits in Kazakhstan. In the FSU Kazakhstan was the third major supplier of coal after Russia and Ukraine. There are two main coal basins Ekibastuz and Karaganda. Ekibastuz supplies power generation plants while Karaganda coal is used in the heavy industry.

Ekibastuz includes four open pits with significant reserves of coal nearly 7 billion metric tons. The biggest pit in Ekibastuz is Bogatyr with production capacity of 50 million tons per year (Levine 1995). Karaganda basin is involved in underground mining of coal and comprised of 26 underground and 3 open pits (Levine 1995). Three open pits were the Chekinsky, the Molodezhny and the Shubarkol.

Like other minerals, coal production also declined immediately after the FSU breakdown, in 1994 decreased by 7 percent comparatively with the previous year, while in 1995 the production fell by 20 percent. In total during 1992-1999 coal production fell by 54 percent in the country.

Before the privatization of coal mines, both Ekibastuz and Karaganda were under the control of SOE Kazakhstanugol.

In 1996 the government started selling coal mines. Two mines of Ekibastuz basin, the Vostochny and 30 percent of the Stepnoi mines were acquired by Japan Chrome Corporation which was already actively participating in privatization of chromium enterprises, the offshore registered subsidiary of Trans World Group and Kazakhstan Natural Resources Corporation partnership (present ENRC).

In 1996 Ispat-Karmet (present Mittal Steel Temirtau) bought 15 coal mines of Karaganda basin. Access Industries of the US acquired the remaining 70 percent of the Stepnoi mine and the Bogatyr in Ekibastuz basin. In 1997 Zhezkazgantsvetmet (present Kazakhmys, plc) acquired Borly coal mine (Levine 1998).

First time improvement in coal production was in 2000 when it increased by 28 percent comparatively with 1999. The energy assets namely Aksu heat and power plant, two coal mines Vostochny and Stepnoi in Ekibastuz were put under Eurasian Energy Corporation which is also a division of ENRC (it was named the Eurasian Industry Association back then). In 2000 the Eurasian Energy Corporation bought 79 percent of the Shubarkol coal mine.

Eurasian Energy Corporation, JSC (EAC) is the largest energy enterprise in Kazakhstan. It is a fully integrated complex involved in the full production chain from fuel to the energy. It includes three structural subdivisions: Aksu Fuel Power Station with 7 power-generating units with the capacity of 2100 megawatt, Vostochny Open-Pit Mine and Production and Overhaul Plant. Aksu Fuel Power Station is a major node connecting energy systems of Western Siberia, Altay, and Northern-Eastern Kazakhstan. Among major consumers of electric power are Aksu Ferroalloys Plant, SSGPO, Mital Steel Temirtau, Aluminium of Kazakhstan and others. The share of Eurasian Energy Corporation is 15% of electric power production in Kazakhstan.

PETROLEUM and NATURAL GAS

Kazakhstan is the second largest oil producer after Russia in the FSU. Despite the abundance of oil and gas, after the Soviet Union collapse, the production of oil and gas declined by 25-30 percent during 1992-1995.

There are two major oil fields in Kazakhstan: Tengiz and Mangishlak. Development of the Tengiz was already started in the early 90s because the Soviet government already conducted negotiation with the Chevron (present ChevronTexaco) about developing Tengiz as it was not easily accessible and needed substantial investment inflows. However production works were delayed due to logistic problems. Chevron sought to set path to export oil to the developed countries and developing Asia. Available pipelines were not economically suitable and Russia through which territory the pipelines pass, limited the amount of oil that was allowed to be shipped (Levine 1995). In order to solve the problems with pipelines, the Caspian Pipeline Consortium was established in 1992 including Kazakhstan, Russia and Oman (Levine 1996). However lack of investment was an obstacle in the way of building the pipeline. So, in 1996 Chevron and Mobil joined the Caspian Pipeline Consortium and the construction works were continued. The constructed pipeline linked Tengiz with the European markets.

In 1993 Chevron and the government of Kazakhstan established the joint venture Tengizchevroil in order to develop Tengiz oil field in the North Caspian Basin, 80 percent share of Tengizchevroil is owned by the Kazakhstan government and 20 percent by the Chevron Corp. of the US (ChevronTexaco 2001). In 1996 another American TNC Mobil Corp. acquired 25 percent of the Kazakhstan government's share in the Tengiz consortium. So, in 1996 Tengizshevroil's

ownership structure was: Chevron – 45 percent, the Kazakhstan government – 25 percent, Mobil – 25 percent, Lukoil – 5 percent (ChevronTexaco 2001).

Table 4:2 The main operating oil and gas fields and operator companies, in 2010

Operator company	Projects	Year of exploration	Reserves, million tons	Investors
NCOC (North Caspian Operating Company B.V.)	Kashagan: East and West Aktoty Kalamkas-offshore Kairan	2000 2003 2002 2003	6400 269 156 150	Agip KCO (Italy) – 16.81% ExxonMobil (US) – 16.81% Shell (UK) – 18.52% Total (France) – 16.81% KMG (Kazakhstan) – 16.81% ConocoPhillips (US) – 8.4% Inpex (Japan) –7.56%
Tengizchevroil	Tengiz	1979	3100	Chevron (US) – 50% ExxonMobil (US) – 25% KMG (Kazakhstan) – 20% LukArko (Russia) – 5%
Karachaganak Petroleum Operating B.V.	Karachaganak	1979	1000	Agip KCO (Italy) – 25% Chevron (US) – 20% BG (UK) – 20% KMG (Kazakhstan) – 10% Lukoil (Russia) – 15%
CNPC-AktobeMunaiGaz	Kenkiak Zhanazhol	1959 1978	150 500	CNPC (China) – 85.42%
Turgai Petroleum, PetroKazkhstan Kumkol Resources	Kumkol	1984	90	CNPC (China) – 67% KMG (KZ) – 33%
Buzachi Operating Ltd, Zhalgiztobemunai	Severnoe Buzachi including Zhalgiztobe	1975	70	CNPC (China) – 100%
Tyub Karagan Operating Company B.V	Tyub-Karagan	2008	388	Lukoil (Russia) – 50% KMG (KZ) – 50%
Mangistaumunaigaz	Kalamkas Zhetybai Asar	1976 1961 1969	510 330 30	CNPC (China) – 50% KMG (KZ) – 50%
Karazhanbasmunai	Karazhanbas	1974	50	CITIC (China) – 50% KMG (KZ) – 50%

Source: Samruk Kazyna accessed at www.sk.kz, KazMunayGas accessed at www.kmg.kz

There were logistic problems were also in transferring of gas condensates due to lack of pipelines that connect gas producers with their consumers in the country. As a result all produced

gas had to be exported to Russia, while for supplying the south and east part of Kazakhstan it had to import 40 percent of gas from Turkmenistan, Uzbekistan and Russia (Sagers 1993).

In 1993 the British Gas and the Italian Agip KCO (affiliate of Eni) partnership won the tender to develop Karachganak oil and gas field. In 1997 it was formed another consortium for the development of the Karachaganak oil and gas field including Total, Royal Dutch Shell Group, BP, Norway's Statoil, BG, Agip KCO, Mobil and KazakhstanCaspishelf was formed.

In 1996 Canadian company Hurricane Hydrocarbons Ltd bought Yuzhneftegaz through tender offer. 70 percent of another large state oil enterprise Mangistaumunaigaz was sold to the company of Indonesia Central Asia Petroleum in 1997, while in the same year Chinese National Petroleum Company (CNPC) acquired two oil companies Aktobemunaigaz and Uzenmunaigaz pledging to construct a pipeline linking Kazakhstan to China (Levine 1997). Economic situation started improving since 1996 due to increased oil exports. FDI inflow in the oil industry since independence to 1999 reached almost 13 billion dollars (Statistic Yearbook 2010). Foreign investment helped to increase oil production from 25.8 million tons in 1992 to 39.7 million tons in 2001 (Statistic Yearbook 2003).

In 2001 Eni (Italy) won the tender to operate another large oil field Kashagan discovered in 2000 (Levine 2009).

In 2007 the Kashagan project included the following shareholders: Eni (Italy), ExxonMobil (US), RoyalDutch Shell (Netherlands/UK), Total (France) with 18.52 percent share each; ConocoPhillips (US) with 9.26 percent, Inpex Corp. (Japan) with 8.33 percent, and Kazmunaigaz (Kazakhstan national oil company) with 8.33 percent (Levine 2009). The government of Kazakhstan increased its share in Kashagan project up to 16.81 percent in 2008 as the result of dispute arose concerning violation of fire safety issues and violation of environmental protection law by the operating company Agip KCO.

Currently there are about 80 extractive companies, 3 oil refineries, 6 gas refineries and about 250 petroleum storage facilities in the oil and gas sector in Kazakhstan. The majority of produced oil is exported to European countries mainly to Italy, France, Netherlands and Austria. In 2010 it was exported 1.9 million tons of crude oil was exported (Kazakhstan Ministry of Finance database). According to the British Petroleum data, Kazakhstan's proved reserves of oil is 5.5 billion tons and gas is 1.8 trillion cubic meters while expected reserves of oil accounted 17 billion tons. In 2010 extraction of natural gas was recorded to be 33.6 billion cubic meters (Statistical Yearbook 2011).

4.3. Consolidation of the national enterprises

During the privatization period in the 1990s, several national holding companies were established in order to improve the management of the national companies and effectively coordinate the assets of the government. They consolidated state owned enterprises in the transport and communication, finance, oil and gas, and agriculture sectors. Holding companies are usually established to promote cooperation between enterprises or subcontractors, and they implement investment policy in order to consolidate businesses in various industries. A holding company distributes funds to revenue managing subsidiaries, covering the losses of some with the profits of others. The advantage of holding companies is that they become stronger to compete with their competitors due to their consolidation. However, consolidation of companies is also a significant disadvantage for consumers because excessive consolidation of production and sales leads to a monopoly.

1. The holding company “Samruk”, JSC, is responsible for management of state owned assets. Initially the government transferred to Samruk its shares in joint-stock companies such as “Kazakhtelecom”, “Kazakhstan company on management of power grid”, “NC Kazakhstan Temir Zholy”, “Kazpost”, “NK Kazmunaygaz” and 14 other companies (Kazakhstan Ministry of Finance database);

2. Fund for the sustainable development “Kazyna”, JSC. The Fund received the shares of the government in financial organizations such as “Development Bank of Kazakhstan”, “The National Fund of Innovation”, “The Investment Fund of Kazakhstan”, “The Fund for development of small business”, “The State Insurance Corporation on insurance of export loans and investment”, “Center for marketing and analytical research” and others (Kazakhstan Ministry of Finance database);

3. National holding company “KazAgro” consolidated the state owned JSCs such as “Food Contract Corporation”, “Agriculture lending corporation”, “KazAgroFinance”, “Fund for financial support of agriculture”, “Mal onimderi” (Animal products), and others (Kazakhstan Ministry of Finance database).

4. “Samgau”, JSC is responsible for the assets in the information and technology development sphere.

Besides the above-mentioned national holding companies, seven social-industrial corporations (SICs), established by the resolution of the government, are responsible for supporting the businesses and social projects in the districts/regions of the country.

Consequently, the national holding company “Sovereign Wealth Fund “Samruk-Kazyna”, JSC was formed in 2008, by merging “Samruk” and “Kazyna”. The Fund is defined as a national managing holding (parent) company. The assets of the Fund comprised all the state owned enterprises or companies with a state share. As a result the Fund controls about 95 percent of all the state’s assets in the country. The capitalization of the Fund is 40 billion dollars (Samruk Kazyna Resources).

Kazmunaigaz, JSC (KMG) is a national oil company that was established by government resolution in 2002, through merging Kazakhoil and Oil and Gas Transport Company. The KMG is involved in exploration, extraction, processing and transporting of hydrocarbons, and is wholly owned by the national fund “Samruk-Kazyna”. Currently KMG controls 44 oil and gas fields in the Mangistau and Atyrau regions (West Kazakhstan). Affiliated transport companies Kaztransgaz, JSC and Kaztransoil, JSC are responsible for the transportation of hydrocarbons (Kalyuzhnova 2008).

KMG also solely controls the Rompetrol Group NV (TRG), the oil company in Romania. The main vehicle of KMG is KMG Exploration and Development (KMG E&D), the affiliated company formed by merging Uzenmunaigaz, JSC and Embamunaigaz, JSC in 2004. The capital of the company is estimated to be 9.5 billion dollars (Borisov and Vahrameev 2011).

KMG E&D is involved in the development of 42 fields in West Kazakhstan, and the largest field Uzen was started in 1965 (Kalyuzhnova 2008). In 2010 proved and expected reserves of oil were 232 million tons (BP 2011).

In 2007 the KMG E&D acquired 50 percent of Kazgermunai, Ltd JV as well as 50 percent of Karazhanbasmunai, JSC. In 2009 the company acquired 33 percent of PetroKazakhstan Inc., JSC (KMG info). The company aggressively participates in M&A because the reserves and production of oil in its main fields are decreasing. The Emba and Uzen fields have been

exploited for a very long time and more investment are required to support the current production of oil. Acquired assets during 2007-2010 increased the total oil reserves of KMG E&D, so in 2010 reserves of oil were as follows: JV Kazgermunai LLP (50%) – reserves 13.7 million tons; CITIC Canada Energy ltd (50%) – reserves 30.3 million tons; PKI Finance BV (33%) – reserves 16.2 million tons. The Emba and Uzen fields' reserves in 2010 were 81.6 million tons (Borisov and Vahrameev 2011).

4.4. Consolidation of the industrial enterprises with the financial entities

Financial and industrial groups are the economic associations of enterprises, institutions, organizations, financial and investment institutions that can be created for the purpose of joint economic activities. Participants of the financial and industrial groups are legal entities that come to an agreement to create a business partnership. A mandatory condition for the creation of a financial and industrial group is the presence of organizations in the sphere of production industry, as well as banks or other lending financial institutions.

Financial and industrial groups may arise on the basis of the largest industrial and trading companies. They have great influence and power which give them access to the resources of financial institutions. They may form a mixed partnership, because the state-owned enterprises as well as private companies can also be involved. The process of formation of financial and industrial groups in Kazakhstan goes in two directions: 1) they are voluntary, based on the contractual form of consolidation of business entities; 2) the possibility of formation of financial and industrial groups as a result of the government's resolution.

For example, one of the largest Kazakhstani companies, Astana Holding, JSC has the following financial and industrial partners: banks such as Turan-Alembank, Temirbank, and Centrcreditbank, and trade and manufacturing companies such as Astana Motors, KEGOK, Koronamacaroni factory, Araltuz, the Shymkent match factory, and Astyk (the large grain company where the whole production cycle is covered from raw material to finished products).

The next major Kazakhstani financial and industrial group is the partnership of banks with industry, as follows: Kazkommertsbank, Narodny Bank, Almaty Trade and Financial Bank as well as enterprises such as KEGOK (top management), Kaztransoil, Kazaktelekom, Kazakhstan TemirZholy, Air Kazakhstan, Shymkentnefteorgsintez, Alautransgaz, Zhambyl State Regional Electric Power Station, Hurricane (51% of shares of Canadian parent company Hurricane-Kumkol), Akcept, Zangar, Pavlodar Oil Refinery, Atyraubalyk, and Kazagrofinans.

The next large financial and industrial group can be named the partnership between the bank Nur-Bank and industrial enterprises such as Kazatomprom, Sakharny Center (Sugar Center), Neftyanoy Center (Oil Center), Mangistaumunaygaz, Kazairuest. The Nur-Bank partnership also controls television channels NTK, "Khabar", KTK, and the newspapers "New Generation", "Panorama", and "Caravan".

Tsesna Corporation has grown from a small commercial firm to one of the largest investment companies in Kazakhstan. In the Soviet period Tsesna Corporation was named "TselinogradGlavSnab" producing resin-bonded chipboard, metal and asbestos wallboard, and roof tiles. After the Soviet Union collapse, the company was involved in trading and purchasing activity oriented both to internal and external economic relations particularly with China, Hungary, Turkey, and Austria. It established new production facilities in 1990-1991, commissioned representation offices in many regions of Kazakhstan, Moscow, Chelyabinsk, Budapest, Italy, and the USA.

In December 1991 the company was renamed Tsesna Corporation, CJSC (Joint-Stock Company of the Closed Type). Tsesnabank, JSC was founded in January 1992, and Tsesna Cereal-

Processing Complex was founded in 1992-1993. The European Bank for Reconstruction and Development allocated credit for refunding of Ameks, CJSC Tsesna-Bazis, CJSC of which Tsesna Corporation, CJSC owns 50% and was one of the founders on 31 May 1995.

Currently Tsesna-AstykCocern, LLP is a domestic manufacturer specializing in deep grain processing. Since 2002 Tsesna Corporation has been participating in the realization of projects connected with housing construction in Astana, Karaganda. In this project Tsesna Corporation is an investor providing investment of own cleared funds; Naiza-KurylysConcern, LLP is a construction company which performs customer functions and is responsible for the technical aspect of a project: designing, construction, and real estate sale; and Tsesnabank, JSC provides partial financing of a project via own mortgage loan activity programs.

Currently the Corporation is involved in the following business activities and consolidation of financial and industrial enterprises:

- Financial sector including Bank (Tsesnabank, JSC), broker-dealer company (Tsesna Capital, JSC);
- Agro-industrial sector – production of grain and food (Concern Tsesna-Astyk, LLP);
- Construction sector – housing construction, infrastructure development, industrial construction (Naiza-KurylysConcern, LLP, Medet-Holding, LLP);
- Retail trade - chain of supermarkets and trade centers (Alma-Tses, LLP);

As a whole the Corporation represents financial and industrial groups owning stocks and shares of more than 20 enterprises of different branches of the economy.

Besides financial and construction enterprises, Tsesna consolidates a large number of diversified companies and enterprises. They perform services and the full cycle of production in construction, agro-industrial and financial sectors.

4.5. Concentration of production and foreign capital in Kazakhstan

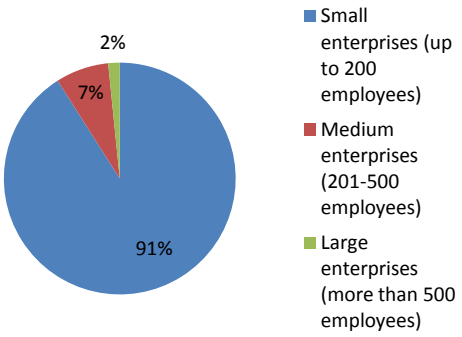
According to the World Bank report (1993), there were 37,000 state owned enterprises (SOEs) in Kazakhstan in 1991, of which 200 were very large enterprises, natural monopolies with more than 5000 employees in each. The key sectors of the economy were represented by 1300 large and medium enterprises. About half of the SOEs comprised the main industries of the economy, mainly in the extractive, power and heating, and telecommunication sectors. In 1991 their proportion of the volume of industrial production was 69.2%. These enterprises employed 46.7% of the total number of employees in the industry (Statistical Yearbook 1998).

In 1990 the largest proportions of the total industrial production were in food (16%), machinery building (16%), and textiles (15.6%), while in 1997 the proportions shifted to the fuel industry (29.5%), electricity (15%), ferrous metallurgy (13%), and non-ferrous (15%). In 2010 the concentration of production in Kazakhstan was higher than in 1991-1997; extraction of crude oil (51%), ferrous metallurgy (6%), non-ferrous (3%), precious metals (7.5%), food (7%), water and electricity (6%), and machinery building (3%) (Statistical Yearbook 1998, 2009, 2011). Currently nearly sixteen thousand enterprises are operating, and only 2% of those produce about 77% of Kazakhstan's industrial products; for example, the largest corporation, Mittal Steel Temirtau, contributes 5-7% to the GDP of the country.

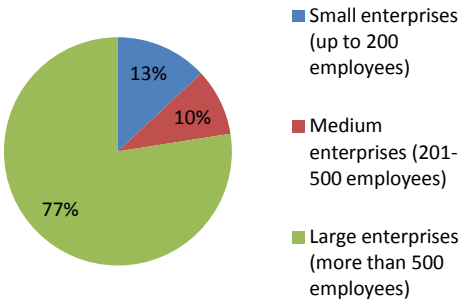
The Kazakhstan market is characterized by a significant and growing share of foreign capital. According to the National Statistics, 1862 foreign companies were registered in Kazakhstan in 1999, while in 2010 their number reached 8565 companies. The foreign companies produced about 4 percent of the total industrial output in the country in 1995; while in 2010 this increased to more than 65 percent.

Figure 4:1 Industrial enterprises, by size and volume of output, in 2009

a) Number of enterprises



b) Volume of production



Source: Statistical Yearbook 2011

The concentration of production and capital of TNCs is distributed unevenly among the sectors. The foreign investors are mostly interested in the mineral resources and especially extraction of oil and gas in Kazakhstan.

Table 4:3 The share of the large companies in the oil market of Kazakhstan in 2009

Company	Share in stocks, %		Share in oil extraction, ml. tones		Share in reserves, ml. tones	
	KZ	Foreign invest	KZ	Foreign invest	KZ	Foreign invest
LLP «Tengizshevroil»	20	80	4.5	18	225	898.9
«Karachaganak Petroleum Operating»	-	100	-	18.6	-	1200
JSC «Prospecting Extraction «Kazmunaigaz»	58.39	41.61	6.71	4.79	136,63	97.36
JSC CNPC-Aktubemunaigaz	-	100	-	6.05	-	121
JSC «Mangistaumunaigaz»	-	100	-	5.69	-	969
JSC «PetroKazakhstan Kumkol Resources»	33	67	2.1	4.26	15,5	67.7
JSC «Karazhanbasmunai»	50	50	0.91	0.91	36,5	36.5
LLP «Kazakhoil-Aktobe»	50	50	0.38	0.38	8,7	8.7
JSC «Turgai-Petroleum»	-	100	-	3.36	-	45.4
JSC «JV Kazgermunai»	50	50	1.6	1.6	15	15
Agip KCO N.V. in the project Kashagan	16.81	83.19	-	-	340	1683

Source: Annual reports of the companies

In 2010 the share of the primary industry was 75 percent of the total FDI in the country, all directed to oil and gas extraction and processing (Statistical Yearbook 2011). Many large TNCs in Kazakhstan, such as ChevronTexaco, ExxonMobil, BG Group, Total Fina Elf, Eni Group, CNPC, ConocoPhillips, Shell, Inpex, and Lukoil are involved in the oil and gas industry.

The share of the foreign and the domestic companies in the oil market is shown in Table 4:3, according to which the share of the foreign capital in the oil and gas sectors dominates the domestic capital. The share of the foreign capital in stocks and oil production is on average 74.7%, i.e. ¾ of the oil market is controlled by the foreign investors.

The large enterprises in Kazakhstan can be distinguished by size, structure of company, ownership structure, form of organization and management status. Despite the lack of development and the small number of corporate sectors in Kazakhstan, 4 stable types of corporate structures now exist: 1) about 15 large SOEs involved in the extractive, transport and communication and agriculture sectors; 2) about 40 companies privatized through case-by-case programs by foreign/local investors, mainly in extractive industries; 3) about 10 private enterprises established by market self-organizations, namely in oil and gas sectors, and banks; 4) about 45 subsidiaries of TNCs operated operating in the extractive, manufacturing and finance sectors (Khusainov 2005).

4.6. Summary

This chapter has dealt with the process of consolidation and concentration of production and capital in Kazakhstan since its independence in 1991 and onward.

Foreign investors took an active part in the privatization of the strategic enterprises in Kazakhstan during the 1990s. During the privatization, the concession or contract non-equity form of foreign investment was a popular method in reorganization of the SOEs. Many metal mining enterprises were put under the management of foreign companies for a particular period of time. Managing companies had special privileges in acquiring the majority of stocks in the enterprises when they fulfilled the terms of the contract. The foreign investors were to reverse the decline of output, invest in upgrading the enterprises, clear off the debts and improve the production. For example, the Pavlodar Alumina Plant, Zhezkazgantsvetmet, the Karaganda metallurgical complex and many other industrial giants were first put under foreign management and a trust contract and were later entirely or partly sold to the managers.

Foreign managed enterprises were successful in reversing the downward trends in Kazakstan's mineral industries, though many enterprises were transferred from hand to hand more than once. For example, one of the best production outputs was achieved by the Sokolovsk-Sarbay iron ore mining and enrichment combine (GOK), managed by the Ivedon, which was an affiliated offshore company of the Trans World Group and KNRC partnership. During 1995-1996 the production at Sokolovsk- Sarbay GOK rose almost fivefold and reached the 1991 level. In 1996, at the Zhezkazgantsvetmet copper mining and metallurgical complex managed by Samsung of South Korea, the volume of refined copper output reached 185,000 metric tons, which was 37 percent more than in the previous year (Levine 1997).

However the privatization also resulted in the concentration of strategic assets in the hands of a few companies which consolidated major mining enterprises and established monopolies, e.g. ENRC, Kazzinc, Arcelor Mittal Temirtau, and Kazakhmys. ENRC plc has the sole monopoly in the production of alumina, chromite and gallium in Kazakhstan, and Kazakhmys has a monopoly in the production of copper and other by-products. These corporations tried to internalize markets in order to reduce transaction costs. As a result, they acquired all the coal deposits and bought electricity plants in order to fuel their enterprises. In the process, they became large electricity providers.

ENRC alone employs 65,000 people in its numerous enterprises and integrates large mining enterprises like the Pavlodar Alumina Plant, which supplied 20 percent of the total FSU output, or Kazchrome, which supplied 95 percent of all FSU chromite output. However, currently the share of ENRC in GDP of the country is no more than 5 percent, which might be an indicator of inefficiency of the company’s integration into the international production chain, i.e. the company is more involved in producing raw materials.

Many contracts were signed behind closed doors and prices paid for enterprises were very low in comparison with the profits they earned. For instance, Sokolovsk-Sarbay GOK was acquired for 49 million dollars, and the same year the profits were reported to be 88.3 million dollars;

Kazchrome was sold for 66.8 million dollars while its profits were 50 million dollars the same year (Peck 2004, 124).

Analysis of the structures of internationalized companies in Kazakhstan such as KMG, Mittal, Kazzinc and others shows that most companies are involved in the natural resource industry; they have a steady demand for their products, but with a low level of value added. By exporting the raw materials, they deprive the country that owns the subsoil of its high share of value added; therefore the countries where more mature stages of processing take place get much higher profits from the finished or semi-finished products.

An analysis of the development of internationalization of the Kazakhstani economy has shown that the feature of the process of transnationalization in the case of Kazakhstan was an active development of the joint cooperation of TNCs from different countries. Most multinationals operating in Kazakhstan is concentrated in the oil and gas sectors mainly in order to maximize exports. Examples are: Chevron, Shell, ConocoPhillips, Inpex, Mobil, Eni, Total, BG, CNPC, and Lukoil. At the moment, most of the oil and gas is produced in the Tengiz field controlled by the consortium including Chevron (50%), ExxonMobil (25%), KMG (20%), and LukArko (5%). The majority of the crude oil produced is exported.

The penetration of TNC into Kazakhstan's economy, as is shown in this thesis, is considerable. According to statistics, 90% of the total FDI in the extractive industries is directed to the production of oil.

Kazakhstan is not in a good situation in terms of investing in reserves and extraction of oil in comparison with foreign companies. About 75% of the oil production in the country is controlled by the foreign TNCs.

We can state that, as a result of reforms favorable to foreign capital, the Kazakhstan economy has become unregulated and disorganized into a "two-level of processing", which is based on profits from intermediate production.

5. DETERMINANTS FOR INTERNATIONALIZATION OF PRODUCTION IN KAZAKHSTAN DURING 1991-2010

This chapter explores the motives for internationalization of production in Kazakhstan. Why do foreign enterprises invest in Kazakhstan? What are the favorable factors and advantages that encourage foreign enterprises to invest in the economy of Kazakhstan and to be involved in internationalization of production? This chapter investigates whether Kazakhstan has Ownership-Location-Internalization (OLI) advantages based on Dunning's eclectic paradigm. Does the Kazakhstani economy fit into the OLI paradigm?

5.1. Eclectic paradigm: OLI advantages for foreign enterprises to invest in Kazakhstan

International production is formed as a result of TNC's investment activity, and according to Dunning's approach (2000), it is a process when ownership-location-internalization advantages (OLI advantages) work together. Dunning emphasizes three conditions that should be followed for the firm to be involved in the process of foreign direct investment, they are:

1. The investing firm must possess Ownership specific advantages or O-advantages that can or cannot be embodied in the form of assets, which provide this firm with competitive position over local firms in the market where the investment takes place. Ownership advantages are specific for a firm in the sense that the firm can control them. They include patents, know-how, different types of technology, labor skills, the benefits of scale, management innovation, etc. These factors determine the competitiveness of a firm in relation to other firms; they allow an investing firm to obtain a competitive advantage. Dunning (2002) identifies two types of Ownership advantages. The first type includes a firm's privileged possession by assets (Oa or asset advantages), primarily intangible assets, for example, a special technology that is available only in this company. These advantages allow the firm to create new assets, thereby increase its competitiveness. The second type of Ownership advantages arises from the joint management by available assets within TNC (Ot advantages or transaction costs minimizing advantages), as well as additional assets that can be formed as a result of cross-border activities. They include advantages of affiliated branches of TNC that are already working on new enterprises and advantages associated with the multinationality of an enterprise.

2. The host country must possess Location specific advantages or L-advantages in comparison with other countries, including the investor's home country, which makes it attractive for foreign investors to engage in international production. In contrast to ownership advantages, specific to a firm, location advantages play a role in external factor stimulating (or not stimulating) investment. A host country, where FDI are to take place, must offer special location advantages, which can be used together with other advantages arising from the ownership and internalization advantages.

Location advantages are the most traditional element of the eclectic paradigm; it is often used to explain the attractiveness of a region or a country for foreign investment. Location advantages include immobile, natural or created endowments (Dunning 2000), such as advantages in production costs (cheap labor) in the market of a host country, proximity to customers, stable economic, legal, social and political infrastructure, tax breaks and other government incentives, etc.

3. There must also be Internalization advantages or I-advantages that are the advantages from realization of certain bargains inside a firm (between different subdivisions, affiliations of one and the same TNC) in comparison with realization of these bargains on the market. Advantages of internalization arise from the existence of market imperfections, and are closely related to ownership advantages. Internalization factor helps explain why firms prefer to use their

ownership advantages by themselves for establishing international activity, rather than selling the rights to them to foreign firms. Dunning (2002) makes a distinction between those ownership advantages, which the company owned before it became a multinational (indicated above advantages in the possession of intangible assets), and advantages that are the direct result of involvement of a firm in international production. The former advantages are internalized because the firm does not want to "share" its advantages with the competitors, which is inevitable if foreign and local firms enter into a contractual relationship. In other words, while the first type of internalization implies internalization of advantages of a firm, the second type implies internalization of markets. Advantages of the second type cannot be sold to an independent firm from another country for their "individual" use. They can only be realized through vertical or horizontal integration, or, in other words, they can be used only through the joint ownership that is involved in specific production chains of creation of value (Dunning 2002).

5.2. Motivation for FDI: interaction of ownership and location advantages

The eclectic paradigm claims that a TNC carries out FDI if it possesses ownership advantages in comparison with its main competitors, which it uses by placing production in areas where there are location advantages. Ownership and internalization advantages are specific to the firm-investor while location advantage is directly linked to a host country. If only ownership advantage is met, firm-investor will rely on exports, licensing, or patent sale in order to serve a foreign market (Dunning 2000). Thus location advantage is crucial for FDI inflow to a host country.

Meanwhile, a firm having one or another asset must have some motivations for the creation of production abroad. Dunning (2000) proposes the following classification of motives for direct foreign investment: Resource-seeking (and/or strategic asset-seeking); Market-seeking; Efficiency-seeking.

It is obvious that with the course of time and the changing position of a firm in the market, motivations for FDI may change, especially if investors are moving from the initial investment to strengthening in the host market and expanding its activities.

Initial investment is usually associated with the orientation for obtaining of natural resources and access to markets. Subsequently, firms set the goal of improving the efficiency of the whole cross-border production activities. At the same time firms can pursue pluralistic goals by investing abroad.

The main inducement for *resource-seeking FDI* is an acquisition of certain resources for a lower price than they could be purchased on the domestic market (if they ever are available there). There are three groups of investment depending on the type of acquired resources: natural, human and technological. First, natural resources seeking FDI include minerals, metals, fuels, agricultural stock. Besides, some resource-seeking FDI can be observed in the services sectors, such as tourism, car-rentals, oil drilling, construction, medical and educational services. Resource-seeking FDI are often characterized by significant capital expenditure and are location bound (Dunning and Lundan 2008).

The second group comprises investment aimed at the acquisition of cheap, well-motivated work, usually carried out by TNCs from countries with high labor costs. These TNCs establish (or purchase) foreign affiliates for labor-intensive production of intermediate or final products. The third, FDI aimed at acquisition of technological resources are associated with obtaining access to new technologies, management and marketing experience. Before the II World War, about three fifths of accumulated capacity of FDI was just of such kind. By the mid 1980s a share of

resource-seeking FDI has decreased to about one third of accumulated capacities of FDI in the world. The long-term trend is in the growth of FDI oriented to the acquisition of technology and managerial skills. However, in recent years due to rising of commodity prices, primarily oil, it is observed the rise of the primary resource-seeking FDI, such as metals and fuels (UNCTAD 2007).

Market-seeking FDI is carried out by enterprises that invest in a particular country or region in order to serve the local market or the markets of adjacent countries. In most cases, first, an investing company exports its products to foreign markets, either partially or totally, and then due to increase of tariffs and other barriers imposed by an importing country, or because of growth in the market this investing company decides to set up a local production. Causes for market-seeking FDI can be very diverse. They can be carried out, in order to retain or protect existing market outlets or go out and strengthen in new markets. There are also additional causes. First, it is the necessity for presence in those foreign markets where the major suppliers, customers and competitors of an investing firm have already set up production facilities. Second, it is a necessity to be closer to the consumer than export can allow. Third, market-seeking FDI give an opportunity to reduce transaction costs, compared to export supply of a foreign market. In the late 1980s market-seeking enterprises made up approximately 45% of global FDI. Typically, firms focused on implementation of such investment organize foreign affiliates poorly associated with the entire global system of international production. At best, they are focused on regionally integrated markets. Market-seeking TNCs usually treat their foreign affiliates as self-contained units rather than as a part of integrated network (Dunning and Lundan 2008). As a result, such affiliates become more responsive to the local needs, consumer tastes and cultural preferences. Foreign affiliates of TNCs usually produce products to serve the local market and/or supply adjacent markets.

Motivation for FDI aimed at improving the efficiency or efficiency-seeking FDI is to improve the structure of already created resources-seeking and market-seeking FDI. TNCs engage in further investment in the foreign market in order to increase their efficiency by exploiting the benefits of economies of scale and also those of common ownership. In this case, TNCs want to benefit from differences in resource endowments, cultural differences, differences in institutional and market structures, economic systems and economic policies in host countries, concentrating production in a limited number of geographic locations for future supply of multiple adjacent markets. Typically, such FDI carry out large and diversified TNCs producing standardized products that are deeply involved in the process of international production and that require rationalization of FDI that have already implemented in different regions. This type of FDI take place after either resource or market seeking FDI has been realized, with the prospect that it further increases the profitability of TNC.

Strategic asset-seeking FDI are FDI that are aimed at acquisition of assets of other companies. Strategic-asset-seeking investment is associated with cross-border M&As. TNCs seek for strategic assets in the form of know-how or technology of other firms, or to get access to resources (Dunning and Lundan 2008). FDI of this type firstly pursue long-term strategic goals, maintain and expand international competitiveness of a firm-investor and/or weakening of the competitive advantages of competitors. Many FDI of this kind are associated with implementation of cross-border M&As. Gradually strategic FDI and FDI-seeking efficiency are performed in parallel, as companies restructure their assets to achieve long-term goals. Both types of FDI strive to benefit from joint ownership for diversified global operations. Taking into consideration the nature of strategic investment, it is rather difficult to find adequate statistical data on significance of strategic asset-seeking FDI or efficiency-seeking FDI in TNCs' activities (Dunning and Lundan 2008). However, it is clear that this kind of investment is becoming increasingly important for global operations, particularly in major world markets where TNCs

are increasingly concentrated in the area of technology, capital-intensive manufacturing, and sectors with intensive use of information technology.

Besides there are other incentives for investment that do not fit into any of the four categories of motives described above. Dunning categorize them as escape, support and passive investment (Dunning and Lundan 2008). Some enterprises may be involved in foreign investment in order to escape some restrictive legislation, high taxes or other reasons that make doing business economically unacceptable in the home countries of investing firms. Support investment is associated with trade and finance related investment provided by a parent company to support its foreign affiliates. Usually these affiliates are not self-contained; they are treated as a part of the parent company. Passive investment may be made by small firms or individuals in real estate with the expectation of future land and property values. This investment also can be simply the desire of an investor to have holiday home in a foreign country (Dunning and Lundan 2008).

5.3. Ownership and location specific advantages, and FDI inflows to Kazakhstan

Dunning's approach suggests considering FDI as a result of simultaneous interrelationship of ownership, location and internalization specific advantages. We utilize an OLI framework to determine the factors that motivate foreign investors to be involved in the process of internationalization of production in Kazakhstan.

Ownership advantages, as shown above, are directly related to the competing ability of investing enterprises, i.e. these advantages are specific to the firm. These advantages help the firm to compete with local firms in host markets. In this sense, the ownership advantages interact with the location advantages of a country where FDI is directed to. Based on the available ownership advantages, the investing firms are intended to obtain new advantages through the access to resources, gaining a market share, new technology, restructuring of the existing assets or improving their effectiveness. Thus location advantages are specific to a host country. The link between ownership advantages of an investing enterprise and location advantages of a host country can be seen in the example of Kazakhstan. Moreover, we assume that the changes in dynamics and volume of FDI inflows to Kazakhstan can be explained if we classify foreign investment in terms of the motivations of enterprises engaged in this investment. Here, however, we may encounter some difficulties. It is often very difficult to unambiguously determine to which type one or the other investment inflows belong. For example, the investment in the tobacco industry can be classified as market-seeking or resource-seeking investment, while investment in the automotive industry can be classified as market-seeking or efficiency-seeking investment. In addition, firms may pursue different objectives (pluralism of motivation) when choosing their overseas investment strategy.

Nevertheless, we classify FDI inflows into 3 categories: Resource-seekers, Market-seekers, and Efficiency-seekers.

1) Resource-seeking FDI include: Agriculture, Fishery, Hunting, Forestry, Extractive industries (metals, fuels, gas, coal);

2) Market-seeking FDI include: Food, beverages, textile, clothing, leather products, shoes, chemical industry, machinery, equipment, transport equipment, electronics, and digital products;

3) Efficiency-seeking FDI include: Construction, Transport and communication, Production and distribution of electricity, water and gas, Education and Health services;

Table 5:1 FDI inflows in Kazakhstan by economic sectors, various years (in million USD)

Sector/industry	1995	2000	2002	2004	2006	2007	2008	2009	2010
Total	984	2781	4106	8317	10624	18453	19760	19669	17353
Extractive & geological exploration	590.8	2273.7	2908.6	7007.2	7809.6	8353	10904.9	13840.8	13057.3
Ferrous & non-ferrous metallurgy	160.4	101.4	575.1	323.7	426.3	821.2	1330.4	1311.7	1770.3
Agriculture, hunting, forestry, fishing	-	3.8	2.4	-	37.3	-	38.5	57.7	13
Share of oil and gas extraction in extractive sector, %	40	98	97	98	83	93	85	87	75
Total resource-seeking FDI (%)	751.2 (76)	2378.9 (85.5)	3486.1 (85)	7330.9 (88)	8273.2 (78)	9174.2 (50)	12273.8 (62)	15210.2 (77)	14840.6 (85.5)
Food, tobacco, textile, clothing, leather, shoes	39.5	43.5	66.1	38.2	57.8	65.4	127.7	166.6	139.8
Chemical industry	20	7	21.9	25.2	13.7	11.9	34.4	44.3	34.5
Machinery, transport equipment,	0.3	6.8	3.7	8.7	76.6	149.9	47.6	28.8	22.4
Electronics, digital products	16.3	47	43.1	71.4	39.7	53.9	96.1	97.1	93.6
Total market-seeking FDI (%)	76.1 (8)	104.3 (4)	134.8 (3)	143.5 (2)	187.8 (2)	281.1 (1.5)	305.8 (1.5)	336.8 (1.7)	290.3 (1.6)
Production and distribution of electricity, gas and water	19	82.4	11.4	119.5	26.7	36.6	124.1	-	101.5
Transport & communication	95.1	75.2	101.1	98.1	300.6	182.4	178.4	242.1	444.8
Construction	47	50.6	160.3	94	367.8	478.8	448.3	580.8	621.1
Education, public health and social services	2.7	11.5	23.4	11.5	6.3	-	66.3	4	63
Total efficiency-seeking FDI (%)	163.8 (16.6)	219.7 (8)	296.2 (7)	323.1 (4)	701.4 (6.6)	697.8 (4)	750.8 (4)	826.9 (4)	1128.9 (6.5)

Source: The National Bank of Kazakhstan statistics accessed at www.nationalbank.kz

The remaining economic sectors that cannot be classified into the three above-mentioned categories are excluded from the list. They are: trade, hotels, real estate, and restaurants, among others. Regarding the fourth category, the strategic-asset-seeking FDI, we do not include it in the list because strategic-asset-seeking investment is mainly implemented in order to acquire created assets in the form of know-how or innovation driven assets. It is likely that this kind of investment does not exist yet in Kazakhstan because there is no data available for FDI inflow in R&D.

Dunning's approach suggests considering FDI as a result of simultaneous interrelationship of ownership, location and internalization specific advantages. We utilize an OLI framework to determine the factors that motivate foreign investors to be involved in the process of internationalization of production in Kazakhstan.

Ownership advantages, as shown above, are directly related to the competing ability of investing enterprises, i.e. these advantages are specific to the firm. These advantages help the firm to compete with local firms in host markets. In this sense, the ownership advantages interact with the location advantages of a country where FDI is directed to. Based on the available ownership advantages, the investing firms are intended to obtain new advantages through the access to resources, gaining a market share, new technology, restructuring of the existing assets or improving their effectiveness. Thus location advantages are specific to a host country. The link between ownership advantages of an investing enterprise and location advantages of a host country can be seen in the example of Kazakhstan. Moreover, we assume that the changes in dynamics and volume of FDI inflows to Kazakhstan can be explained if we classify foreign investment in terms of the motivations of enterprises engaged in this investment. Here, however, we may encounter some difficulties. It is often very difficult to unambiguously determine to which type one or the other investment inflows belong. For example, the investment in the tobacco industry can be classified as market-seeking or resource-seeking investment, while investment in the automotive industry can be classified as market-seeking or efficiency-seeking investment. In addition, firms may pursue different objectives (pluralism of motivation) when choosing their overseas investment strategy.

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3) Efficiency-seeking FDI include: Construction, Transport and communication, Production and distribution of electricity, water and gas, Education and Health services;

According to Table 5:1, the bulk of FDI inflow is concentrated in the extractive industries, the share of resource-seeking FDI during 1995-2010 on average is 76 percent of the total FDI in Kazakhstan. Mainly resource-seekers are interested in the extraction of oil and gas, the share of which is 84 percent of the total FDI in the extractive industries. Stocks of inward FDI in the extractive industries of Kazakhstan increased from over 7 billion dollars in 2000 to about 13 billion in 2005 (UNCTAD 2007), while total FDI stock reached more than 81 billion dollars in 2010 (Statistical Yearbook 2011).

The main reason for these changes is related to the increasing demand for primary energy resources from fast growing emerging markets like China and India, and the upward trend in

commodity prices in the world markets (UNCTAD 2007). The concentration of foreign capital in extractive industry is due to the location advantage of Kazakhstan attributable to its natural resources abundance.

"The existence and extractability of natural resources are the most important economic determinants of where TNCs invest in mineral exploration and extraction" (UNCTAD 2007, 125).

In this respect, according to the British Petroleum database, there were 5.5 billion tons of proved reserves of oil, 1.8 trillion cubic metres of natural gas, 33,600 million tons of coal, and minerals in Kazakhstan at the end of 2010, while expected reserves of oil were about 20-25 billion tons (BP 2011). TNCs driven by resource-seeking motivations are highly concentrated in the extractive industry of Kazakhstan, especially in the oil and gas industry. According to UNCTAD, the 11 largest extractive TNCs out of the 25 top world TNCs located their production in the oil and gas sector of the country in 2005. In 2009 about 75% of the oil and gas market of Kazakhstan was controlled by foreign investors.

TNCs tend to invest in a foreign country if three main location determinants are present. They are a policy framework for FDI, economic characteristics, and business facilitation (UNCTAD 1998). In order to attract FDI, Kazakhstan provides more or less favorable conditions for doing business in the country. Some progress of the country can be seen in international rankings, for example, according to the World Bank's Doing Business Ranking, in 2011 Kazakhstan was positioned in 59th place, up from 74th the previous year (see Table 5:2). Also in 2010, the International Ranking Agency, Moody's, upgraded the ranking of Kazakhstan as "stable" (Moody's Investor's Service 2010).

However, the dynamics of commodity prices is unpredictable in cases of falling demand for minerals and downward price trends, and FDI in these sectors may also be reduced. We may assume that, in terms of long-term and stable integration of Kazakhstan into the global production system, this type of FDI will be recognized as less favorable. This kind of production relation is not long-term and stable, and can easily be weakened, laid up, or even disrupted.

Table 5:2 The World Bank's Ease of Doing Business ranking of Kazakhstan, 2010-2011

Ranking	2010	2011	Change in rank
Doing business rank	74	59	+15
Starting a business	85	47	+38
Dealing with construction permits	156	147	+9
Registering property	29	28	+1
Getting credit	69	72	-3
Protecting investors	57	44	+13
Paying taxes	53	39	+14
Trading across borders	182	181	+1
Enforcing contracts	36	36	no change
Closing a business	54	48	+6

Source: The World Bank, Ease of Doing Business ranking 2010-2011 accessed at www.doingbusiness.org

Market-seeking motivations are related of the size of a host country's markets, access to regional and global markets, consumer preferences and so on. Despite the fact that the Kazakhstani government created favorable investment conditions in the non-extractive industries in terms of taxes and other preferences discussed in an earlier section above about the foreign investment policy, the share of FDI inflow motivated by market-seeking is very low, about 3 percent of the total FDI in Kazakhstan (Table 5:1).

Market-seeking investors tend to invest in a particular country in order to serve the local market or/and markets of adjacent countries (Dunning and Lundan 2008). We assume in this respect that most of the market-seeking investment is directed to Russia, which is to be expected if we take into account the size of the Russian market with its population of 144 million people. Many large enterprises producing food, clothes, electronics, household items and so on, tend to locate their production in Russia or China and export their products to Central Asia from those countries. For example, Nestle has about 8 factories and 11 affiliates in Russia; currently Nestle has invested a total of 950 million dollars in the Russian economy (Nestle Russia electronic resources). Meanwhile, Nestle established a regional representative office in 1997 in Kazakhstan, and since 2004 it has become "Nestle Food Kazakhstan" Ltd. However, the company has no production facility in Kazakhstan.

Like Nestle, there are other large TNCs which have branches and representative offices in Kazakhstan. They are widely represented in industries such as pharmaceuticals, automotive, food and electronics. For example, there are products of large American, European and Japanese TNCs (IBM, Sony Corporation, Hewlett-Packard, Philips Electronics, Nokia, Nike, Adidas, Puma, Danone Groupe SA, Interbrew SA and British American Tobacco Group) in the Kazakhstan market. However, their products are not produced in the home countries of TNCs, but in countries such as China, Malaysia, Singapore, Vietnam, Thailand and Russia.

Market-seeking FDI is a more favorable investment for gradual integration of Kazakhstan into international production. Market oriented FDI may lead to the formation of sustainable value added production chains in the host country, and, from this point of view, they are certainly more desirable than resource-oriented FDI. Moreover, they can provide an opportunity for the local manufacturing firms to become fully fledged participants of the production chain controlling the process of production, which means the local firms may get a higher value added share.

However, there are impedimental moments here. Typically, a firm focused on the implementation of such investment organizes overseas production weakly associated with the entire global system of international production (Dunning and Lundan 2008). That is to say, such FDI is mainly targeted to supplying the local markets of the host country, or, in more favorable circumstances, also the adjacent regions. For example, in Kazakhstan there are production affiliates of TNCs such as Coca-Cola Company, Philip Morris and LG Electronics, but these companies do not implement the export-oriented policy, since they produce only for the domestic market. Nevertheless we assume that market-seeking investment is more desirable for the sustainable economic growth of Kazakhstan and they may promote long-term integration into the world economy.

Efficiency-seeking investment is motivated by the decision to improve and develop already established resources and market-seeking investment. However, the amounts of efficiency-seeking investment is very small; moreover, according to Table 5:1, this kind of investment shows a decreasing tendency from about 17 percent in 1995 to 4-6 percent in 2010. The share in total FDI inflows amounts to about 1.5 percent if we consider only the transport and communications sector. Of course, certain types of machinery, the chemical industry, and perhaps some types of services (unfortunately unspecified in Kazakhstan FDI statistics) can also be attributed to FDI focused on improving efficiency. According to our estimates, the total share of this investment in FDI is no more than 7 percent. Moreover, it should be noted that during

privatization in 1993-1999 many investors who bought large mining enterprises also acquired heat and power enterprises in order to get unlimited access to electricity. So, one can assume that efficiency-seeking investment is also mainly related to improving already invested resource-seeking FDI.

Nevertheless it is precisely this kind of investment that contribute to the consistent and irreversible integration of the country into international production, participation in this production as innovation centers, and serving national, regional and global markets. Efficiency-seeking FDI may improve infrastructure, and promote capability building in Kazakhstan (UNCTAD 2007).

5.4. Location and internalization advantages

We try to explain FDI in Kazakhstan through the internalization advantages in the framework of Dunning's eclectic paradigm. This time we combine location and internalization advantages. TNCs operating in foreign markets seek to minimize transaction costs, and one possible way is to internalize the host market and turn that market into the firm's internal or in-house space. FDI acts as a tool to implement the internalization process, which is possible in conditions of imperfect markets. The more opportunities for internalization, the greater will be the inflow of FDI (Dunning and Lundan 2008).

TNCs involved in FDI in Kazakhstan (and locating international production), internalize the Kazakhstani marketplace, thus minimizing transaction costs. A TNC which has competitive ownership advantages while entering the Kazakhstani market finds itself in a particular institutional structure, which can be called transitive, by analogy with the transitional nature of the Kazakhstani economy.

Transitive institutional structure is changeable by nature, and it generates a constant volatility and uncertainty in transaction costs. This leads to the fact that foreign companies are faced with transaction costs in the Kazakhstani market that cannot be precisely estimated or predicted in advance. As a result, the constant volatility of the institutional structure leads to the fact that internalization of transactions in the transitive institutional space may run hard. In addition, Kazakhstan's institutional structure can be seen as strange by foreign investors, or different from that to which they are accustomed to facing in their domestic markets. Effective internalization can be carried out in markets in the same way as investing in the firm's home market, and, importantly, in the markets with a stable institutional framework. Otherwise, the process of internalization will not be easy and successful, despite the fact that the cost-based and complexity of market transactions will be more effective and profitable than internalization of intra-firm transactions.

Thus, the relatively low inflow of market-seeking (3%) and efficiency-seeking (7%) FDI may be connected with the complexities of the internalization of the Kazakhstani marketplace, characterized by an unstable institutional structure: the intricate system of taxation, conflicting legal framework, a high level of corruption, disregard of property rights and other factors shaping the investment environment. The most important element of the institutional environment, especially for explaining the peculiarities of foreign trade transactions of Kazakhstan with its foreign partners, is a legal regime of the transitive economy, since it is an adequate legal component of the institutional environment that is the basis on which to save on transaction costs.

We assume that volatility and dissimilarity of the institutional environment are the main causes for the low FDI in the non-extractive industry of Kazakhstan. Having made the first step in the Kazakhstani market in the form of export sales, a very limited number of firms decided to move

to the next stages of market penetration, i.e. licensing and FDI. In such circumstances, to build a long-term strategy in the Kazakhstani market can only be afforded by large TNCs, like Chevron, BG Group, Exxon Mobil, Total, Eni, etc. Manufacturing giants like Coca-Cola, Philip Morris may have motives to capture a new market rather than to seek high profits.

The eclectic paradigm of international production should be recognized, without a doubt, as a successful theory. In the case of Kazakhstan, we make an attempt to show that the value of each set of advantages and their specific configuration in the eclectic paradigm will depend on industries, regions or countries, as well as participating in international production companies. Location advantages create incentives for internalization, while internalization generates additional advantages of ownership and contributes to their effective use in conjunction with the existing ownership advantages. The strength of the eclectic paradigm is the fact that it can be considered as a dynamic approach in which the ownership, location and internalization advantages affect each other.

5.5. Summary

This section examines the motives and impediments behind the foreign investment inflows to Kazakhstan during the period 1991-2010. We approach this task by utilizing Dunning's eclectic paradigm and we analyze what determinants drive foreign companies to invest in the economy of Kazakhstan.

Kazakhstan has been improving its location advantages through reforms and modernization of its regulation and legislation in order to attract foreign investment. According to the international experts, the legislation of the country is recognized as one of the best among the transition-economy countries. For example, in 2002 the international rating agency Moody's ranked Kazakhstan as Baa3 due to FDI inflows and export growth in the country driven mainly by extraction of minerals. In 2004 Moody's upgraded the rank to Ba1/NP (Positive) due to the country's positive economic performance, FDI inflows, liberal fiscal and monetary policy and strong banking system regulation (Moody's Investor's Service 2004, 2010). However, foreign investors are mainly interested in extraction of the primary resources in Kazakhstan. More than 76 percent of the total FDI is in the extractive industry, particularly the oil and gas sector.

The study explores the fact that FDI inflow to Kazakhstan is driven by resource-seeking investment rather than market-seeking ones. The low level of market-seeking investment can be explained by the narrow market size of Kazakhstan, red tape, corruption, imperfect institutions, currency fluctuation and other obstacles. Market-seeking investors tend to invest in a particular country in order to serve the local market or/and markets of adjacent countries (Dunning and Lundan 2008). Accordingly, foreign investors prefer to establish their production facilities in neighboring countries like China and Russia. TNCs produce their products in those countries and then export to the Central Asian countries as well as to Kazakhstan.

Despite the fact that the Kazakhstani government provides favorable investment conditions in he non-extractive sectors of the economy, the share of market-seeking investment is less than 3% of total FDI in Kazakhstan. While resource-seeking investment comprises 76% of foreign investment in the country, 85% of all FDI in the primary sector is invested in oil and gas extraction. This is evidence of the high dependence of the country on world prices for oil and gas, because about 90% of all extracted crude oil and gas is exported.

The dynamics of commodity prices is unpredictable and FDI in these sectors may also be reduced in the event of falling demand for minerals and downward price trends. We assume, in terms of long-term and stable integration of Kazakhstan into the global production system, that

this type of FDI will be recognized as less favorable. This kind of production relation is not long-term and stable, and can easily be weakened, laid up, or even disrupted.

Market-seeking investment decreased to 1.6% in 2010 from its level of 8% in 1993 (Table 5:1). There are large American, European and Japanese TNCs in the of Kazakhstan market, which may be referred to as market-seekers: IBM, Sony Corporation, Hewlett-Packard, Philips Electronics, Nokia, Nike, Adidas, Puma, Danone Groupe SA, Interbrew SA and British American Tobacco Group. However, their products are not produced in the home countries of the TNCs, but in countries such as China, Malaysia, Singapore, Vietnam, Thailand and Russia.

In Kazakhstan there are production affiliates of TNCs such as the Coca-Cola Company, Philip Morris and LG Electronics, but these companies do not implement an export-oriented policy, but produce products only for the domestic market. TNCs tend to serve local markets and are weakly connected with the world production process, but linked with their parent company.

Nevertheless, we assume that market-seeking investment is more desirable for the sustainable economic growth of Kazakhstan and for promoting long-term integration into the world economy. Market-seeking FDI is a more favorable investment for gradual integration of Kazakhstan into the international production. Market-oriented FDI may lead to the formation of sustainable value added production chains in the host country, and, from this point of view, they are certainly more desirable than resource-oriented FDI. Moreover, they can give the local manufacturing firms the opportunity to become fully fledged participants of the production chain controlling the process of production, which means the local firms may get a higher value added share.

6. ECONOMIC IMPLICATIONS OF INTERNATIONALIZATION OF PRODUCTION IN KAZAKHSTAN

This chapter is devoted to the economic implications of internationalization of production in Kazakhstan over the period 1991-2010. In particular, the aim of the chapter is to analyze and assess the possible impacts of the internationalization process on the economic development of Kazakhstan during the given period. In this chapter we utilize the investment development path (IDP) paradigm developed by Dunning and Narula (1996), Narula and Dunning (2000, 2010), and revised by Narula and Guimon (2010), in order to analyze the interaction between internationalization of production and economic development in Kazakhstan over the same period. Though the economic literature highlights wide-ranging effects of the TNCs' activities on a host country through their direct production, I focus mainly on the economic effects in the following chapter. Indeed, social, environmental, political and other effects are very relevant, but, they are not the subject of this thesis, as they may require separate research of their own. Nonetheless, they may be mentioned here and there throughout the chapter.

6.1. The Investment Development Path paradigm

The focus in this section is on the effects of TNC's activity, i.e. how TNCs, using their Ownership (O) advantages, influence the economy of Kazakhstan as a host country, taking into account that TNCs may have some motivations (Resource or Market seeking). In the previous chapter we observed that TNCs tends to be involved in internationalization process if OLI advantages are jointly present. If there are only O advantages, then TNCs would rather engage in exporting products than in foreign production. We examined how OLI variables interact with each other in order to explain the motivation and impediments behind FDI inflows in Kazakhstan since 1991 and onward. We now turn to the IDP framework that analyzes how FDI behaves in response to changes in the O advantages of the domestic firms, O advantages of the foreign firms and the L advantages of Kazakhstan in order to examine the effect of TNC activity in Kazakhstan over the period 1991-2010.

The IDP model is developed in the seminal works of Dunning (1981, 1986, 1988, 1993), Narula (1993, 1996), Dunning and Narula (1996), Narula and Dunning (2000, 2010), and revised by Narula and Guimon (2010), where the authors argue that development tends to stimulate significant structural change in the economy, while the inward (IFDI) and outward (OFDI) direct investment pattern of a country is systematically related to its economic development.

The IDP framework implies that any country tends to go through five stages of development, although the rate of change and points of inflection are unique to every country. There is an interactive effect between three groups of advantages: the O advantages of domestic firms; the O advantages of TNCs; and the L advantages of countries. This three-way dynamic interaction is the essence of TNC-assisted development.

The stages are classified according to the country's propensity to engage in inward or outward investment depending on the threefold OLI competitive advantages: the extent of O-advantages of the domestic firms relative to the foreign firms, the extent of L-advantages of the country relative to the foreign countries, and the extent of I-advantages when domestic and foreign firms deploy their O and L advantages and internalize the cross-border market in order to reduce transaction costs. These five stages are summarized in Table 6:1.

1) The first stage reflects the situation of the least developed countries. A country's competitive advantages may be due to its natural resources. Insignificant FDI inward is mainly directed to the primary sectors or to labour-intensive manufacturing sectors. There is very little or absent outward FDI. The country lacks O and L advantages, i.e. lack of infrastructure, limited domestic market, undeveloped institutions and legislation base for FDI; 2) the second stage is

characterized by a significantly increasing inward FDI due to the development of some L-specific advantages that raise the country's attractiveness to TNCs. However, outward FDI remains very limited because the O-advantages of domestic firms are still weak; 3) the third stage is innovation driven development. Outward FDI increases as domestic firms become more competitive in comparison to foreign firms. In this stage OFDI may exceed IFDI, but the NOI position remains negative; 4) in the fourth stage, OFDI grows faster than IFDI, hence the NOI position turns positive; 5) finally, the fifth stage reflects the most developed countries such as US, Japan and Sweden, where the NOI position is around zero. They increasingly engage in efficiency and asset-seeking investment abroad.

Table 6:1 Stages of economic development

Stage	IFDI	OFDI
Stage I: natural resource based	Little IFDI initially. As L advantages improve, resource based motives, and market seeking later.	Negligible OFDI. Mainly minor strategic investment and capital flight.
Stage II: investment driven	Increasing IFDI. Still resource based, but in more capital-intensive sectors; low-cost labour exploiting	Limited OFDI. Resource and market seeking investment in other developing countries; some 'escape' investment to developed countries; mostly regional Greenfield investment; natural resource investment.
Stage III: innovation driven	Raising inward FDI, market-seeking and increasing efficiency-seeking FDI in manufacturing, even in activities supplying more sophisticated products for domestic markets, or requiring more skilled labour.	OFDI increasing faster than IFDI. All kinds of investment including efficiency-seeking and some asset augmenting investment; mass-produced differentiated consumer goods, e.g. electrical products, clothing; more service investment, e.g. construction, banking.
Stages IV-V: increasing knowledge and service intensity; knowledge economy	Increasingly market-seeking, efficiency -seeking and asset-augmenting investment	Increasingly efficiency-seeking and asset-augmenting investment; regional and global; more M&As and alliances; investment in knowledge-intensive sectors, e.g. ICT, biotechnology, and high value-added services, e.g. consultancy

Source: Adopted from Dunning and Lundan (2008, p.332-333) Table 10.1; Narula and Guimon (2010, p. 9), Table 1.

As economic development is in progress, IFDI increases significantly and thereafter declines. In the earliest stage, the country's infrastructure will be too poor to support even resource seeking investment. The resource seeking investment will grow as the economy develops though. In this stage, the role of the government may be important in improving policies in order to attract more FDI. Over time the domestic firms accumulate the firm-specific assets (O-advantages) that would allow them to engage in OFDI (Dunning and Narula 1996, Caves 1996). As the country develops, OFDI will grow faster than IFDI. The incentive for market-seeking and efficiency-seeking investment may expand.

6.2. The Investment Development Path: implications for Kazakhstan

Analyzing the IDP of Kazakhstan requires carefully considering its specific historical and political background. The shape and peculiarities of the IDP in Kazakhstan as well as other FSU countries were heavily influenced by the transition from central planning to market-oriented economy in the 1990s.

In the narrow sense, these path dependencies have created an unusual IDP for most FSU countries, which differs from the IDP of other countries (Narula and Guimon 2010). Prior to independence, inward and outward FDI was virtually non-existent in Kazakhstan. However, as a whole, foreign investment is not new in Kazakhstan. When Kazakhstan was a part of tsarist Russia, three British companies were engaged in developing mineral deposits through concessionaire contracts. They were Spassky Copper Mine, the Irtysh Company, and Ural-Caspian Company. These enterprises still operate nowadays, and have become core industrial enterprises in Kazakhstan. Foreign investment existed in Kazakhstan until WWII, when all contracts with foreigners were canceled and Kazakhstan and other republics in the former Soviet Union were closed to foreign investment entirely[7].

Privatization opened up opportunities for FDI inflow to Kazakhstan in the 1990s. During the 1990s the transition from central planning to a market system brought radical changes to the socioeconomic structure of Kazakhstan. This was exacerbated by lack of finance and dreadful conditions of industry, and in some instances the inability of domestic investors to compete effectively with foreign firms. In just a few years, many state owned enterprises were transferred to foreign investors through privatization programs. Fragmentary experiences of foreign investment in Kazakhstan prior to WWII, and also 70 years of isolation from the world economy, make the assessment of the country's IDP difficult. Nevertheless, since we have data on inward and outward FDI starting from 1993 up to the present, we can try to estimate the country's IDP following Dunning and Narula (1996). Table 6:2 illustrates the changes of inward and outward FDI in Kazakhstan since independence.

Table 6:2 Inward, Outward, Net Outward Investment Position, and GDP per capita, various years

	1995	2000	2007	2010
IFDI stock per capita	181	676	2896	5020
OFDI stock per capita	0.02	1	140	998
NOIP per capita	-181	-675	-2756	-4022
GDP per capita	1052	1229	6771	9070

Source: author's calculations based on UNCTAD data (FDI interactive database available on-line www.unctad.org, last accessed April 2, 2012); National Stat. of Kazakhstan (Statistics available on-line www.stat.kz, last accessed April 2, 2012).

Note: FDI stocks and GDP per ca are in US dollars, current prices.

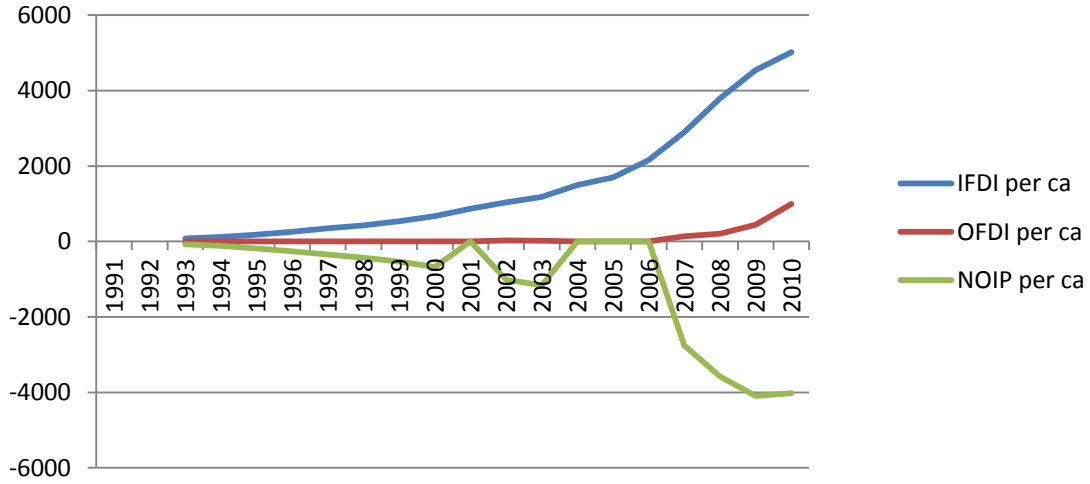
According to the IDP paradigm, the economic development of a country should change inward and outward FDI positions. Privatization and liberalization policies after 1991 have facilitated the growth of inward FDI in Kazakhstan. Figure 6:1 shows the dynamics of IFDI, OFDI and

[7] For detailed discussion see Peck (2004)

NOIP per capita over the period 1993-2010. It is important to note that, on a macro level, the NOIP is negative throughout the given period, since IFDI is constantly higher than OFDI, thus suggesting either a Stage II or Stage III positioning for Kazakhstan.

For a better understanding of the changes of NOIP, IFDI, and OFDI, we try to analyze them individually. OFDI stocks from Kazakhstan were almost negligible from 1993 to 2007, but increased thereafter, showing a continuous rising trend, and reached 16.2 billion dollars in 2010 from its level 2.2 billion dollars in 2007. This late upward trend in OFDI suggests that Kazakhstan is entering the Stage III (Dunning and Narula 1996). This is evidenced also by the steady growth of GDP per capita during the period under study (Table 6:2). GDP per capita in Kazakhstan is nine thousand dollars, which is characteristic for the countries in stage III. However, according IDP paradigm, the Stage III is driven by innovation and the increasing level of market-seeking and efficiency-seeking investment (Dunning and Lundan 2008).

Figure 6:1 Inward and Outward FDI stocks, Net Investment Position in Kazakhstan, per capita, 1993-2010



Source: UNCTAD data (FDI interactive database available on-line www.unctad.org, last accessed April 2, 2012); National Stat. of Kazakhstan (Statistics available on-line www.stat.kz, last accessed April 2, 2012).

However, according to our analysis in the previous chapter, the majority of FDI in Kazakhstan is the resource-seeking investment, which does not support our earlier suggestion that Kazakhstan entered the third stage of development. Despite the increased GDP growth rate, Kazakhstan may still be in its second stage of development. According to our estimations (Table 6:2), inward FDI per capita grew dramatically from 1993 to 2010, while growth of outward FDI is much lower, leading to an increasingly negative NOI position, a trend which characterizes countries at stage II of the IDP.

Kazakhstan possesses comparative L-advantages or absolute advantages due to its mineral resources. So, the country tends to generate domestic firms that possess O-advantages operating in mining industries. Such countries tend to receive significant FDI inflow, because TNCs from developed and recently developing Asian countries wish to have access to mineral resources wherever they are located (UNCTAD 2007, Narula and Dunning 2000). This kind of inward FDI will continue rising as the L-advantages of a host country undergoes changes. The development of L-advantages of a host country is highly dependent on the formal and informal institutional incentives (Dunning and Lundan 2008). Moreover, L-advantages include the absorptive capacity of a host country, the quality of human resources, the quality of infrastructure facilities and a

stable political and economic situation. Eventually, improved L-advantages may lead to vertical investment in extractive industries by foreign firms as well as domestic firms. By then the domestic firms will have improved their O-advantages as a result of positive spillover effects from foreign TNCs. Consequently the extractive industry may continue attracting inward FDI even when the host country is developed, as for example Australia, the NOIP of which is negative due to increasing IFDI (Narula and Dunning 1996). It means that the NOIP of a host country with abundant natural resources will remain negative even if it is developed. Outward FDI of a country providing mineral resource will be in the related industries of other developing countries, but the extent of inward FDI in the country will be dominant (Dunning and Lundan 2008).

So, summing up, in this section we have tried to determine Kazakhstan's IDP following the seminal works of Dunning and Narula (1996), Narula and Dunning (2000), and come to conclusion that the assessment of Kazakhstan's IDP is controversial. On the one hand, it can be assumed that Kazakhstan is in Stage III, because its income level corresponds to third stage countries. On the other hand, the dynamics of IFDI, OFDI and NOIP show that Kazakhstan is still in the second stage of the investment development path. In this regard, the assessment of Kazakhstan's IDP is controversial and requires more detailed investigation of the problem. What is required is a study of whether Kazakhstan benefits from the FDI-assisted growth inducing endogenous effects, such as knowledge spillovers, learning by doing, improving the quality of human capital, development of R&D, public goods and infrastructure, improving the social capacity and so forth.

6.3. Implications for overall economic performance

This section discusses the direct effects of the internationalization process in the extractive industry on the macroeconomic performance of Kazakhstan during 1991-2010. What is the relevance of internationalization of production in the macroeconomic performance of Kazakhstan, particularly in GDP growth, productivity enhancement, capital formation, employment, and international trade?

FDI inflows played a significant role in the early transition period when the economy of Kazakhstan collapsed immediately after independence in 1991. The production output during 1991-1995 declined by 64 percent, while GDP dropped by 46 percent in the same period (Peck 2004). The participation of foreign investors in the privatization of the principally state owned enterprises in the period 1994-1998 helped to revive the production output and reverse the economic recession. Foreign investors initially moved into Kazakhstan due to the natural resources and cost advantages (low labour cost and taxes), but the share of the market-seeking investment is insignificant in comparison with the resource-seeking investment.

Abundance of mineral resources can provide opportunities for the acceleration of economic growth, reducing poverty and improving welfare of the people where the minerals are located (UNCTAD 2007). Involvement of foreign capital in the extractive industries may affect a host economy.positively as well as negatively. Despite the fact that Kazakhstan has abundant mineral resources, the lack of local investment and access to world markets may be obstacles to exploiting the mineral resources fully. Besides, TNCs are not only sources of finance, but also bring managerial and technical capabilities (UNCTAD 2007). However, TNC activity may cause additional economic, social, political and environmental costs.

Capital formation: financial and physical

Does FDI generate extra capacity? The notion that countries should increase the quantity and improve the quality of their stock of physical capital is well known and widely accepted in the

literature. Classical growth theory highlights the importance of the stock of physical capital, along with the technology and human capital stock, in economic growth (see Solow 1957, Denison 1985). Mergers and Acquisitions (M&As) and greenfield investment are the main ways in which inward FDI can generate extra capital stock in the host country. M&As take place when a TNC acquires an already existing enterprise, while greenfield investment is related to the establishment of a new business entity. Greenfield investment is an obvious kind of investment that adds to the capital stock of a host country, but M&As may be also beneficial if the acquiring enterprise was not profitable or closed down (UNCTAD 1992, 1995). Besides, this entry mode may have positive spillover effects in generating more capability among the employees. During the privatization period the majority of FDI inflows to Kazakhstan were M&As. However, there is no data on FDI inflows distinguished by either M&As or greenfield investment in Kazakhstan, which is why it is difficult to assess the extent of capital formation generated by foreign investors.

Nevertheless, the analysis of entry mode in Chapter 4 of the present thesis shows that M&As are prevailing in the metallurgical sector, while greenfield investment is prevailing in the oil and gas sector. The one reason for this is that the metallurgical sector has been exploited since the pre-Soviet period, so it has a very long history. The oil and gas sector was not as well developed as the metallurgical sector; the production of crude oil was less than 1 percent of the total industrial production in 1991 in Kazakhstan, while today its share is more than 56 percent.

The extraction of minerals is associated with enormous investment. Development of the mining industry can be faced with technological challenges and the uncertainty of the socio-political situation in the host country. FDI in the extractive industries may take a long time before gaining real profits (UNCTAD 2007).

Financial scarcity may be an obstacle to exploiting the natural resources. The extractive industries of Kazakhstan were in a dreadful state and required significant investment during the early 1990s. Especially the development of oil and gas fields needed large finances and state-of-art technology. Therefore, Kazakhstan sought external sources, i.e. TNCs and loans from international financial markets to solve the problems. The Kazakhstan government's difficulties in overcoming the economic recession and lack of domestic funding pushed the country to sell the strategic metals and hydrocarbon deposits to foreign investors in the 1990s. For the period 1993-2010 the stock of inward FDI in Kazakhstan amounted to more than 81 billion dollars (Statistical Yearbook 2011), which is about 80 percent of all inward FDI in Central Asia. The extractive industries attracted about 68 percent of the total FDI inflow to Kazakhstan for the period 1995-2010, while about 90 percent of the total FDI attracted to the extractive industries is attributable to the oil and gas sector (Chapter 4).

ChevronTexaco (US), which is engaged in development of Tengiz oilfield, is one of the largest greenfield investors in the oil and gas sector of Kazakhstan. In 1993 Chevron Corp. and the government of Kazakhstan established a joint venture "Tengizchevroil" worth 20 billion dollars (Levine 1996). Kazakhstan had problems with exporting its oil and gas due to lack of pipelines, and the only available pipeline, which could carry a limited amount of oil, passed through Russia. Transport of oil was the major problem in the 90s, needing substantial investment in new pipelines to link Kazakhstan with the world markets. ChevronTexaco has become one of the major members of the Caspian Pipeline Consortium along with Mobil (US), the Kazakh government and Russia. A 990-mile pipeline, at a cost of 2.8 billion dollars, was commissioned in 2000. ChevronTexaco paid 750 million dollars for the new pipeline (Peck 2004, 154).
From 1993 to 2010, Tengizchevroil (TCO) made cumulative payments of 45.4 billion dollars to Kazakhstan, including purchases of local goods and services, tariffs and fees paid to state-owned companies, the Kazakhstani employees' salaries, profit distributions to KazMunaiGas, taxes and royalties paid to the government (TCO 2009-2010).

ENRC made a greenfield investment in building an aluminum smelter, which is the first aluminum smelter in Kazakhstan. The Kazakhstan Aluminum Smelter (KAS), with a capacity of 125 thousand tons per year, was commissioned in 2007. In 2008 KAS fulfilled its production capacity, while in 2010 the second production line doubled its capacity to 250 thousand tons per year. The cost of KAS was 900 million dollars (ENRC Prospectus).

Kazakhmys plc is involved in developing the Aktogay and the Bozshakol copper mines to expand their production capacity. The projects are scheduled to be launched in the Bozshakol in 2014, and the Aktogay in 2015 (Kazakhmys 2010). Aktogay has unexploited copper deposits with reserves of 100 thousand tons per year for 40 years (Levine 2011). The cost of the Aktogay project is estimated to be 3.5 billion dollars, which will be shared between Kazakhmys plc (UK) and the Jinchuan Group ltd (China) (Levine 2011). Increasing the capacity of copper production may result not only in increasing copper production, but also byproduct metals like gold, among others.

M&As do not generate significant extra capacity in a recipient country, but may add capacity for the acquiring enterprise. For example, according to a report by Phelps Dodge Corp. of US, which won a tender to acquire the majority of Balkhashmys, the copper mine, in 1996, the technical equipment was heavily depreciated and it required 75-100 million dollars just to improve the environment of the plant, while general upgrading of the plant needed 600-900 million dollars (Levine 1996). As a result Phelps Dodge changed its mind about investing in Balkhshmys, and consequently Samsung undertook the investment in the plant (Levine 1996).

Recently the developing countries also became a source of finance for the extractive industries in Kazakhstan, especially in the oil and gas sector. For example, the Chinese National Petroleum Corporation (CNPC) has made significant investment in the extractive industry of Kazakhstan; the cumulative investment of China in 2010 comprised 8.4 billion dollars (Kazinform 2010). The cumulative investment of the Russian Lukoil in the Kazakhstan oil and gas sector was 350 million dollars in 2011 (Kazakhstan Newsline 2012).

FDI does not generate foreign debt for the host country, but such financing may be much more costly in comparison with borrowing from financial markets, because rent profits tend to exceed the rate of interest on borrowings (UNCTAD 2007). Besides, the extractive activities are associated with pollution of the environment. The cost of environmental consequences may exceed the profits that the country could get from exploiting the natural resources. Especially the metal mining industry is identified as the highest polluting industry (UNCTAD 2007).

International trade, export enhance

Many mining industries in Kazakhstan are exporters; moreover, they are exporters mainly of raw minerals with low value added. Virtually the majority of mineral output is exported. 75 percent of metals and 90 percent of oil and gas are exported (Statistical Yearbook 2010). In this sense, TNCs help to market the Kazakhstan commodities through their established channels. However Kazakhstan gets limited value added for its primary resources while importing countries producing the final goods get much higher value added. Export of final goods can help the country in achieving economies of scale, expanding scope of production and gaining experience in export markets, but the export of raw resources may not yield such benefits (UNCTAD 2007). For example, metal industries entail five main stages: exploration, development, mining, processing (smelting/refining) and mine closure (UNCTAD 2007). For example, oil needs to be refined, while gas does not need refining, but gas can be transformed into liquefied form in order to be transported via pipelines. The share of value added at the mining stage is shown in Table 6:3.

Table 6:3 Share of value added at the mining stage of selected metals, 2005/2006 (%)

Metal	Share of value added at the mining stage
Gold	100
Platinum group metals	100
Tin	83
Copper	77
Lead	77
Nickel	70
Zinc	63
Cobalt	33
Bauxite/aluminum	9

Source: adopted from UNCTAD 2007, Table III.2, p. 85

For example, the Aluminum of Kazakhstan, JSC is a subsidiary of ENRC ranked as the second largest alumina producer in the FSU. Until the second quarter of 2008, AoK was involved in production of alumina where the production chain stopped at the mining stage. It meant that Kazakhstan was exporting alumina with value added of less than 10 percent. In 2007 the new Kazakhstan aluminum smelter was commissioned and in 2008 the first 125 thousand tons of aluminum were produced (ENRC com). A second line of production was introduced in 2010 with 250 thousand tons of aluminum. However, the company produces 1.5 million tons of alumina per year but refined only 125 thousand tons in 2008 and 250 thousand tons in 2010, i.e. the rest of the crude production was exported. The main importers of Kazakhstani alumina are China and Russia (Mukhanov and Bolgert 2010).

TNCs boost the export capacity of Kazakhstan; however, foreign companies in a host country tend to buy repatriated goods and services, thereby limiting the revenues for the host country (UNCTAD 2007). The government of the host country can increase revenues from its mineral resources through two main ways: the first is fiscal instruments such as taxation and government royalties, and the second is non-fiscal such as local content and local participation (Kalyuzhnova 2008). Local content is understood to be the value added of goods and services provided by the local subcontractors and service businesses to the foreign companies in the host country. At a meeting of the foreign investors council in December, 2008, the President of Kazakhstan pointed out that the share of local content in GDP was 30-32 percent in 2008, while in the developed countries the local content accounted for 50 to 80 percent of GDP. Besides, in 2008 the local content from the total bought goods and services in the activities of the foreign companies was no more than 10-15 percent (Kazakhstan Today 2008).

Starting from 2004, the government of Kazakhstan paid more attention to subsoil exploiters in terms of participation of the state owned oil company KMG in all new development projects; no less than 50 percent participation of the state is required (Petroleum and Subsurface Law). In addition, the government is concerned to increase the local content up to 50 percent (Kazakhstan Today 2008). In order to stimulate the foreign companies to buy local goods and services, the government made amendments in the Law providing a 20 percent discount. Still, increasing the local content can meet obstacles, because the subcontractors may not be able to provide high quality services due to aging technology or lack of sufficient experience.

Nevertheless, TNCs may also benefit if they use the local services and buy the local goods, since it would substantially reduce their costs. For example, BG Group is involved in investing in a

human resources development program in Kazakhstan. In 2004 BG and its partner Shell invested in the graduate school in the Kazakh-British Technical University in Almaty, which prepares technical specialists for the oil and gas sector. BG invested 340 thousand dollars in this project (Kalyuzhnova 2008).

Since 2001 the Karachaganak Petroleum Operating B.V. (KPO) has registered more than 3,000 Kazakhstani subcontractors. In 2010 the company bought goods and services from 283 local companies for 527 million dollars (KPO webpage). KPO is a partnership of four companies: BG Group (32.5%), Eni (32.5%), Chevron (32.5%) and Lukoil (15%).

Tengizchevroil (TCO) has spent up to 9.6 billion dollars for purchasing goods and services from the local subcontractors since 1995 (TCO 2009-2010).

In 2009, out of 401 mineral developers, 175 companies showed that a share of the local goods, works and services provided by the local subcontractors made up 59.2%. In 2009 local goods were purchased for 21 billion KZT, and expatriate goods for 175 billion KZT.

Table 6:4 The total purchase of goods and services by the subsurface users in 2009, in USD

	Total	Expatriate	Local	Local content, %
Total purchase	4 645 748.4	1 896 396.4	2 749 352.0	59.2
Goods	1 321 420.0	1 179 587.1	141 832.9	10.7
Works	1 183 174.6	238 719.2	944 455.4	80
Services	2 141 153.8	478 090.1	1 663 063.7	78

Source: Contract Agency database accessed at camng.kz

The Kazakhstan economy is highly dependent on export of its mineral resources. Therefore the country seeks ways to get more benefits from the extraction of its mineral resources, since mineral extraction may contribute in generating government revenues. The country is concerned about the value added and how it is distributed between the host country and TNCs (UNCTAD 2007). Anyway, the payments in the form of salaries to employees in the extractive industries, and buying goods and services from the local suppliers can contribute to increasing the income to some extent. At the same time the government is trying to capture a more significant portion of profits through the taxes, royalties and other payments. Increasing the production capacity and exports may not yield large government revenues, because the significant proportion of the mineral rents goes to investing TNCs. Therefore taxes, royalties, levies, other contractual payments and direct ownership of the company (or some part of the company) are particularly important in generating government revenues.

Table 6:5 Contribution of the extractive and other industries to GDP growth in Kazakhstan, 1991-2010 (%)

Year	1991-1995	1996-2000	2001-2005	2006-2010
Extractive	28	26	30	31
Other	72	74	70	69

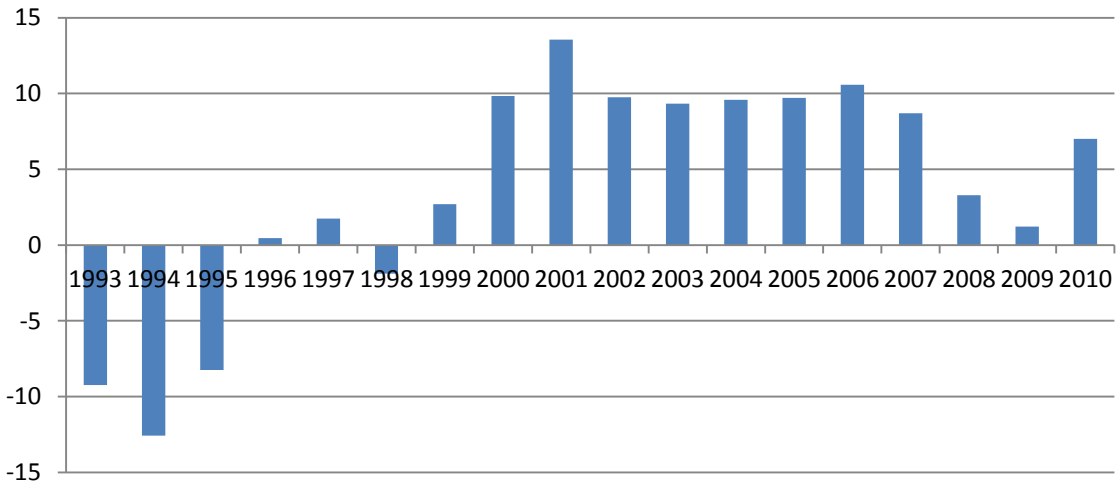
Source: National Stat. of Kazakhstan (Statistics available on-line www.stat.kz, last accessed April 2, 2012).

The impact of internationalization of production on the economy of Kazakhstan has been integrally linked with that of the mining industry as a whole, as almost all the extractive enterprises are either wholly owned by TNCs or are established as joint ventures with the

government. Over the period 1991-2010, the extractive industry directly contributed to about 29 percent of total GDP growth of Kazakhstan. Mineral resources accounted for about 80 percent of Kazakhstan's total exports in 2010, which make the country one of the world's most significant hydrocarbon suppliers.

Over the decade from 1999 to 2010, the economy of Kazakhstan showed steady growth and the structure of its economy was transformed. At the time of the country's independence in 1991 the proportion of industrial production was: food 16%, textile 16%, machinery building 16%, crude oil 1.8%. In 2010 the share of the mineral extraction sector increased to more than 56%, while food production decreased to 7%, textile to 0.2%, and machinery building to 3% (Statistical Yearbook 2006, 2011).

Figure 6:2 Real GDP growth rate in Kazakhstan, per capita, annual, 1993-2010



Source: UNCTADstat, database is available on-line www.unctad.org, last accessed April 2, 2012

Employment

At macro level TNCs' contribution to job creation is limited, because many industrial enterprises were overtaken through M&As during the privatization in the 1990s. In this regard, greenfield investment may be beneficial in additional job creation, but this kind of FDI is less significant in Kazakhstan. For example, according to the data in Table 6:6, only 2.5 percent of the total labour force is employed in the extractive industries, while in 2010 these industries accounted for 33 percent of GDP and 90 percent of exports.

Table 6:6 Employment in extractive industries during 2006-2010, in thousands people

Item	2006	2007	2008	2009	2010
Total employment in the country	7403,5	7631,1	7857,2	7903,4	8114,2
Total employment in extractive industries	186,8	193,5	200,3	197,9	193,7
Employment in extractive industries as % of the total employment in the country	2,5	2,5	2,5	2,5	2,4

Source: Statistical Yearbook 2010

The use of high technology in the mining sector by TNCs may limit employment as a result of productivity improvement. Besides, TNCs tend to attract expatriate staff, mainly from the home countries of TNCs. The proportion of expatriate workforce can be high. For example, of the workforce in TCOs only 50 percent was made up of local people in 1993, but subsequently the share of Kazakhstani workers increased to 85 percent in 2010 (TCO 2009-2010). Usually, expatriate workers are recruited to the senior positions. TNCs do not publish the wages they pay to their employees and especially to the expatriate workers. However, they say that expatriate workers get significantly higher salaries than the local workers, which shows discrimination. The average nominal wages per month in large and medium enterprises are shown in the Table 6:7.

Table 6:7 The average monthly nominal wages in large and medium extractive enterprises, during 2006-2010, by the categories of personnel, in KZT

Year	Blue-collar worker	White-collar worker
2006	58121	136283
2007	67367	160699
2008	83598	193052
2009	92934	213645
2010	75710	144178

Source: Statistical Yearbook 2010

Employees of TNCs can benefit from training and human resource development programs carried out by TNCs. For example, the oil companies ConocoPhilips, ExxonMobil, Shell, Chevron and others have trained qualified local engineers for onshore and offshore oil explorations. Such training can be mutually beneficial as TNCs themselves do not need to hire overseas engineers because they might be expensive.

TNCs tend to utilize capital-intensive technologies in the extractive industries, which may reduce the labour force because the new technology increases labour productivity (UNCTAD 2007). To some extent the large scale projects can create additional jobs. Besides, TNCs have knowledge spillover effects and on-the-job training and improving skills can be very useful for the country's overall capability building.

The government's revenue enhance

The oil and gas industry of Kazakhstan plays an important role in the economic growth of the country. The share of the oil and gas sector of GDP increased from 11 percent in 2001 to 28 percent in 2010 (Statistical Yearbook 2011). Volatility in mineral resource markets has an impact on the government policy as well as on the investment decisions of TNCs. As the experts of UNCTAD (2007) note, a favorable pricing environment has prompted many governments to try to increase their share of the profits by changing the mining codes, fiscal regimes and contracts. Recent regulatory changes, in developed and developing countries, as well as in countries with a transition economy, point to the fact that previous regulatory policies might have been too "generous" towards foreign investors (Peck 2004).

The fiscal regime for the subsurface users is regulated by two main Laws in Kazakhstan: Law "On subsoil and subsurface use" and Tax Code of Kazakhstan. Subsurface users in Kazakhstan are mainly oil and gas, and metal mining companies which sign contracts on subsurface use in order to get access to extraction and develop mines. There are two types of such contracts; one is the Production Sharing Agreement (PSA) and the other includes the tax on excess profit (EPT-

excess profit tax). PSA contracts were signed before 2009, but have now been replaced by EPT contracts.

In Kazakhstan, in accordance with the law on subsurface use, the government has the right to unilaterally make changes to existing contracts in the oil and gas and metals mining industries if they conflict with the economic interests of the country.

In fact, PSA contracts remain stable in the amount of taxes and royalties and other payments to the country's budget as agreed in the contract, while EPT contracts may be volatile except in cases where special terms are considered and authorized by the president of Kazakhstan. As many strategic enterprises and mineral resources deposits were sold or shared during privatization in 1993-1999, it can be assumed that almost all large TNCs pay taxes according to PSA in Kazakhstan. Though subsurface users do not publish their obligatory payments to the budget, it is known from unofficial sources that taxes for ENRC do not exceed 8-15 percent, TCO 3 percent, Kazakhmys 15 percent, and Kazzinc 10 percent, while the average tax rate should be 20-21 percent. Data on profitability and tax payments are generally hard to obtain because they are not published.

TCO published payments amounted to 45.4 billion dollars from 1993 to 2010. These payments included purchases of goods and services from the local suppliers, wages and salaries for the local employees, dividends to NC "KMG", taxes and royalties. In 2010 the payments were 9.6 billion dollars due to high commodity prices (TCO 2009-2010). In the same year TCO reached its highest production level with crude oil extraction of 25.9 million tons. It was 15 percent higher than for the previous year (TCO 2009-2010). We can get approximate calculations by applying simple maths; the world market price of crude oil in 2010 was between 75-85 dollars per barrel (Reuters 2010), so the result is roughly about 14 trillion dollars in one year. No wonder they avoid publishing their earnings!

The government undertakes different activities to control the implementation of contract terms by the subsurface users. For example, according to the Ministry of Energy and Mineral Resources (2008), there were 822 contracts with the subsurface users. In 2007 the government monitored fulfillment of contractual obligations by subsurface users. As a result, 454 contracts were found to meet contract terms fully, but 97 contracts were terminated due to violation of the terms of the contract. Also, warning notes of violations of contractual obligations and license provisions were forwarded to 182 companies.

Technology transferring

TNCs are not only sources of finance but also sources of managerial experience; they have access to high technology and know-how. The exploitation of mineral deposits is technically challenging and requires high skills. During the Soviet period the metals mining industry was heavily exploited and resulted in the exhaustion of deposits. The remaining deposits became hard-to-reach and ores are at great depth (Levine 1997). For example, combined copper, lead, and zinc deposits in Rundyy Altay, Irtysh, Leninogorsk and Zyryanovsk regions were not easily accessible and left in deep levels (Levine 1997). The other project requiring advanced technology is the development of offshore oil deposits in Kashagan where the oil contains a large amount of sulfur and the gas is under very high pressure. Besides, weather conditions can be severe in the North Caspian Sea (Levine 2011).

TNCs contribute to improving extractive efficiency in both short and long terms (UNCTAD 2007). For example, TCO has been engaged in increasing gas supplies and eliminating routine flaring for several years. As a result, the total gas flaring volumes were reduced by 94 percent (TCO 2009-2010). The "Gas Utilization Project" of TCO, costing 258 million dollars, and completed in 2009, has helped to remove routine flaring.

6.4. Summary

The chapter has examined the economic implications of the internationalization of production in Kazakhstan during the period 1991-2010. We have employed Dunning's IDP framework to analyze how FDI behaves in response to changes in the O- advantages of the domestic firms, O-advantages of the foreign firms and the L- advantages of Kazakhstan in order to examine the effect of TNCs activity in Kazakhstan over the same period.

The assessment of the IDP of Kazakhstan during the given period suggests that the level of development of the country may correspond to either stage II or III of IDP. The relatively high income level of Kazakhstan supports the conclusion that the country is entering stage III; however, the changes of inward and outward FDI in Kazakhstan, leading to increasingly negative NOI positions, characterize countries at stage II of IDP. The early stages of the IDP of a country reflect the situation of less developed countries. Kazakhstan's competitive advantages may be due to its natural resources. The second stage of the IDP is characterized by a significant increasing inward FDI due to the development of some L-specific advantages that raise the country's attractiveness to TNCs. However, outward FDI remains very limited because the O-advantages of domestic firms are still weak.

Involvement of large TNCs in the principal sectors of the economy may have both positive and negative effects on the national economy. Rich mineral resources gave the country the opportunity to recover from the economic recession after independence in the 1990s. Despite the fact that Kazakhstan has abundant mineral resources, the lack of finance and access to markets may be obstacles to exploiting the mineral resources fully. FDI inflows play a significant role in exploiting the mineral resources in Kazakhstan. TNCs involved in the extractive industries provide not only financial sources, but also bring managerial and technical capabilities (UNCTAD 2007). However TNC activity may cause additional economic, social, political and environmental costs. In 2009 the share of industrial production accounted for 53.6 percent of GDP (Statistical Yearbook 2010).

Extractive projects are highly capital-intensive, which is why participation of the global TNCs can be crucial for exploiting offshore and onshore mineral deposits. Many TNCs such as Chevron, BG Group, Eni, Total, ConocoPhillips, CNPC, and Lukoil are involved in the development of oil and gas fields. These TNCs have constructed pipelines which link Kazakhstan oil and gas with the world markets, and improved infrastructure in the industries.

Besides, TNCs enhance the export capacity of the country; almost 75 percent of all extracted metals and 90 percent of the crude oil are exported to the developed countries.

Extractive companies make a limited contribution to job creation, because TNCs tend utilize capital-intensive technology which increases labour productivity. However, TNCs play an important role as employers at local level, creating additional jobs or temporary/seasonal jobs, especially in large-scale projects. TNCs often attract expatriate labour. For example, 50 percent of Chevron's workforce in 1993 was made up of expatriates; this figure has since decreased to 15 percent.

The government is concerned about getting more revenues from the extraction of mineral resources. The most important economic challenge is how to get value added from its resources, since Kazakhstan gets limited value added for its primary resources, while importing countries producing the final goods get much higher value added.

The world mineral markets are volatile, so the recent increase in commodity prices led to increasing FDI in Kazakhstan, especially in the oil and gas sector. The commodity prices boom also had an impact on the government policy concerning the contracts with subsurface users. Foreign owned enterprises successfully operate in Kazakhstan. For example, in 2009 they employed more than 400 thousand people, their export products comprised 27 billion dollars,

import products comprised 12 billion dollars, and the domestic market supply accounted for more than 3 billion dollars (Statistical Yearbook 2010).

The benefits of attracting foreign direct investment are obvious, and if they are used effectively and reasonably, they do not put long-term pressure on the national budget and allow significant resources to be invested in production that is crucial to the economy of Kazakhstan. The outcome of such investment has had a positive influence on the key index (GDP) characterizing development of the country. GDP grew steadily at an average of 7-9 percent annually during the period from 2000 to 2008.

Kazakhstan lacks its own capacities for processing natural resources into marketable products, so TNCs provide the country with the necessary capital, knowledge and access to the world markets.

The question of whether internationalization of production generates location advantages is very important for the economy of a host country. It is known from the economic literature that the economic growth of a nation may be stimulated by investment in physical capital to improve productivity. Besides, economic growth may be driven by innovation and technology and by investment in improving the quality of human resources (UNCTAD 1992).

TNCs may provide endogenous growth inducing effects on a host country such as knowledge spillovers, development of R&D, improving the quality of human capital, social capital, infrastructure and so forth. Notwithstanding, the extent to which Kazakhstan benefits from FDI-development is an issue that ought to be investigated thoroughly.

7. CONCLUDING DISCUSSION

This licentiate thesis highlights the development of internationalization of production in Kazakhstan and its economic implications over the period 1991-2010. The main objectives of the thesis have been to investigate the role of foreign investment and TNCs in the economic growth of Kazakhstan since its independence in 1991 and onward; to explore the motives for foreign enterprises to invest in Kazakhstan; and to understand how the internationalization of production affected the Kazakhstani economy during 1991-2010. Three research questions are addressed in the thesis:

- How did internationalization of production develop in Kazakhstan over the period 1991-2010?

- What were the causes of the development of internationalization of production?

- What are the economic implications of internationalization of production in Kazakhstan?

In order to address these objectives, the thesis applies Dunning's eclectic paradigm and Investment Development Path (IDP) theory.

We utilize an eclectic paradigm to analyze the determinants that make foreign businessmen invest in Kazakhstan. The study explores whether FDI in Kazakhstan is driven by resource-seeking rather than market-seeking investment. The foreign investors are mainly interested in the extractive industries in Kazakhstan. About 76 percent of the total FDI inflows to the country is attracted to the primary sectors, mainly to oil and gas extraction, while the share of market-seeking investment is less than 3% of the total FDI in Kazakhstan.

The assessment of IDP of Kazakhstan over the last two decades suggests that the level of development of the country may correspond to either a II or III stage of IDP. The relatively high income level of Kazakhstan supports the conclusion that the country is entering stage III; however, the changes of inward and outward FDI in Kazakhstan, leading to increasingly negative NOI positions, characterize countries at stage II of the IDP. The early stages of the IDP of a country reflect the situation of less developed countries. Kazakhstan's competitive advantages may be due to its natural resources. The second stage of the IDP is characterized by significantly increasing inward FDI due to the development of some L-specific advantages that raise the country's attractiveness to TNCs. However, outward FDI remains very limited because the O-advantages of domestic firms are still weak.

7.1. Development of internationalization of production in Kazakhstan during 1991-2010

Development of the internationalization of production in Kazakhstan has revealed certain trends which are defined in the thesis as follows:

1) *The first trend* is related to the reorganization of SOEs into joint-stock companies during privatization in the 1990s. In 1991 there were about 21 thousand SOEs; about 4 thousand of them were medium and large scale enterprises. Medium and large SOEs accounted for 83 percent of the total employment in the country. The number of large SOEs was 142; each of them employed more than 5 thousand employees. Between 1993 and 1998 all medium and large SOEs were transformed into joint-stock companies, in order to allocate the shares of these companies in auctions and tenders. The main advantage of a joint-stock company is its ability to seek investment funds through the emission of stocks and bonds for the investors. It gives opportunities for enterprises to grow and expand their activity due to attraction of additional funds. 94 large SOEs were privatized under the case-by-case program.

The mineral industry of Kazakhstan was critically in need of investment and restructuring during the immediate post-Soviet period. As a result, in the period 1993-96 many of the principal enterprises were put under foreign management through concession contracts, and subsequently sold to the managing companies. Participation of the foreign investors in the privatization of the principal enterprises in the 90s was the starting point of the development of internationalization of production in Kazakhstan. The foreign investors were successful in reviving the industries and returned them to profitability soon after taking control. Currently there are many large world TNCs operating in the Kazakhstani market: Chevron, ExxonMobil, ConocoPhillips, Glencore International, Samsung, Arcelor Mittal Steel, BG Group, Philip Morris, and Coca-Cola among many others. Almost all of them came to Kazakhstan in the early 90s.

2) *The second trend* is associated with the increasing tendency of consolidation and concentration of production and capital in Kazakhstan since 1995 onward. Consolidation of assets within the sectors by foreign investors followed after privatization and taking control of the principle enterprises. The new owners of the former SOEs also acquired power plants and coal mines. As a result, a few large corporations such as ENRC plc, Kazakhmys plc, Kazzinc plc and Arcelor Mittal Steel Temirtau control the entire ferrous and non-ferrous metals industry. Meanwhile, the oil and gas sector is dominated by the largest world oil TNCs such as Royal Dutch Shell, Chevron, CNRC and others.

Today, the concentration of production and capital in Kazakhstan is high, for example, extraction of crude oil 51%, ferrous metallurgy 6%, non-ferrous 3%, precious metals 7.5%, food 7%, water and electricity 6%, and machinery building 3% (Statistical Yearbook 2011). Nearly sixteen thousand enterprises operate currently, and only 1.6% of those enterprises produces more than 77% of Kazakhstan's industrial products, for example, the largest corporation, Mittal Steel Temirtau, contributes 7-10% to the GDP of the country.

3) *The third trend* is connected with the uneven concentration of production and capital in Kazakhstan. Formed over many years, the high concentration of the domestic economy was transformed into a monopolized and dominant sector. In such uneven conditions of weighted structure of the economy, the large enterprises of the country become monopolistic production giants dominant in particular sectors, especially in the oil and gas and metals sectors. Those companies were capitalized during the privatization period in 1990s. According the scale of production there has been formed a highly concentrated capital.

The study shows that the concentration of production and capital of TNCs is distributed between the sectors unevenly. The foreign investors are greatly interested in the extraction of mineral resources in Kazakhstan, and especially involved in the extraction of oil and gas.

In 2010 the primary industry attracted 75 percent of the total FDI in the country, all directed to oil and gas extraction and processing (Statistical Yearbook 2011). Hence, many large TNCs, such as ChevronTexaco, ExxonMobil, BG Group, Total Fina Elf, ENI Group, CNPC, and Lukoil are involved in the oil and gas industry in Kazakhstan. At the moment, most of the oil and gas is produced in the Tengiz field controlled by a consortium consisting of Chevron (50%), ExxonMobil (25%), KMG (20), and LukArko (5%). Their share of stocks and oil production is 74.7%, i.e. ¾ of the oil market is controlled by foreign investors.

7.2. The determinants of internationalization of production in Kazakhstan during 1991-2010

We utilize Dunning’s eclectic paradigm in analyzing what determinants drive foreign companies to invest in the economy of Kazakhstan.

Since independence in 1991 Kazakhstan has been carrying out significant reforms to modernize its regulation and legislation base in order to attract foreign investment to the country. According to the international experts, the legislation of the country is recognized as one of the best among the countries with a transition economy. For example, in 2002 the international rating agency Moody's ranked Kazakhstan as Baa3 due to FDI inflows and export growth in the country driven mainly by the extraction of minerals. In 2004 Moody's upgraded Kazakhstan to Ba1/NP (Positive) due to the country's positive economic performance, FDI inflows, liberal fiscal and monetary policy and strong banking system regulation.

This study explores whether FDI inflow to Kazakhstan is driven by resource-seeking investment rather than market-seeking ones. The share of market-seeking investment is less than 3% of the total FDI inflow in Kazakhstan, while the resource-seeking investment comprises 76% of foreign investment in the country, and particularly 85% of all FDI inflow to the primary sector is invested in oil and gas extraction. This is evidence of the high dependence of the country on world prices for oil and gas, because about 90% of all extracted crude oil and gas is exported. The dynamics of commodity prices is unpredictable, and, in cases of falling demand for minerals and downward price trends, FDI in these sectors may also be reduced. It can be argued that, in terms of long-term and stable integration of Kazakhstan into the global production system, this type of FDI can be less favorable. This kind of production relation is not long-term and stable, and can easily be weakened, laid up, or even disrupted.

The share of the market-seeking investment is very limited in comparison with the resource-seeking investment. The share of the market-seeking investment was 8% in 1995 and 1.6% in 2010, while resource-seeking investment was 76% and 85%, respectively. The low level of market-seeking investment can be explained by the narrow market size, red tape, corruption, imperfect institutions, currency fluctuation and other obstacles in Kazakhstan. Market-seeking investors tend to invest in a particular country in order to serve the local market or/and markets of adjacent countries (Dunning and Lundan 2008). Accordingly, the foreign investors prefer to establish their production facilities in neighboring countries like China and Russia. TNCs produce their products in those countries and then export to the Central Asian countries as well as to Kazakhstan.

There are products of large American, European and Japanese TNCs such as IBM, Sony Corporation, Hewlett-Packard, Philips Electronics, Nokia, Nike, Adidas, Puma, Danone Groupe SA, Interbrew SA and the British American Tobacco Group,; which may be referred to as market-seekers, in the Kazakhstan market. However, their products are not produced in the home countries of TNCs, but in countries such as China, Malaysia, Singapore, Vietnam, Thailand and Russia.
In Kazakhstan there are production affiliates of TNCs such as Coca-Cola Company, Philip Morris and LG Electronics, but these companies do not implement an export-oriented policy, since they produce products only for the domestic market. These TNCs tend to serve the local market, and, though linked with their parent companies, are weakly connected with the world production process.

Nevertheless, we assume that market-seeking investment is more desirable for the sustainable economic growth of Kazakhstan, and it promotes long-term integration into the world economy. Market-seeking FDI is a more favorable investment for gradual integration of Kazakhstan in international production. Market-oriented FDI may lead to the formation of sustainable value added production chains in the host country, and, from this point of view, it is certainly more desirable than resource-oriented FDI. Moreover, it can give local manufacturing firms the opportunity to become fully fledged participants of the production chain controlling the process of production, which means the local firms may get a higher value added share.

7.3. Economic implications of internationalization of production in Kazakhstan during 1991-2010

We utilize Dunning's IDP framework to analyze how FDI behaves in response to changes in the O (ownership) advantages of the domestic firms, O advantages of the foreign firms and the L (location) advantages of Kazakhstan in order to examine the effect of TNC activity in Kazakhstan over the period 1991-2010.

The assessment of IDP (Investment Development Path) of Kazakhstan during the given period suggests that the level of development of the country may correspond to either stage II or III of IDP, in Dunning's typology. The relatively high income level of Kazakhstan supports the conclusion that the country is entering stage III; however, the changes of inward and outward FDI in Kazakhstan, leading to increasingly negative NOI (Net Outward Investment) positions, characterize countries at stage II of the IDP. The early stages of the IDP of a country reflect the situation of less developed countries. Kazakhstan's competitive advantages may be due to its natural resources. The second stage of the IDP is characterized by a significantly increasing inward FDI due to the development of some L-specific advantages that raise the country's attractiveness to TNCs. However, outward FDI remains very limited because the O-advantages of domestic firms are still weak.

It is difficult to assess which stage of the IDP Kazakhstan is at, since the relationship between its natural resource endowment and its level of development on the one hand, and its inward and outward FDI on the other, is vague. Moreover, as Duran and Ubeda (2001) assume, the natural resources endowment can be considered as an exogenous factor, and such countries will be significant inward FDI recipients due to absolute advantages. Thus, the IDP paradigm has limitations in progressing further with the analysis of the relationship between foreign capital and economic development in Kazakhstan during the given period. This in turn is closely related to the fact that the internationalization of production in Kazakhstan is very specific given its historical context. The shape and peculiarities of the IDP in Kazakhstan as well as other FSU countries are heavily influenced by the transition from central planning to market-oriented economy in the 1990s. Before independence, inward and outward FDI was virtually non-existent in Kazakhstan. During the 1990s the transition from central planning to a market system brought radical changes to the socioeconomic structure of Kazakhstan. Privatization opened up opportunities for FDI inflow to Kazakhstan in the 1990s, and in just a few years, many SOEs were transferred to foreign investors through privatization.

Inward FDI had a very important role in the transition process. Foreign investors initially moved into Kazakhstan due to the natural resources and cost advantages (low labour cost and taxes), but the share of market-seeking investment is very limited in comparison with resource-seeking investment.

In all their modalities TNCs may have both positive and negative effects on a host country's economy. In this thesis we have discussed several direct effects of inward FDI on the overall economic performance of the country over the period 1991-2010. Inward FDI adds to the physical and financial capital stock, i.e. inward FDI can generate extra capital in the host country through M&As (Mergers and Acquisitions) and greenfield investment. Greenfield investment is an obvious way of extra capital formation in a host country because it can establish totally new business entities. However, the majority of inward FDI was made through M&As during the privatization period. It is difficult to assess to what extent inward FDI added extra physical capital in Kazakhstan because there is no distinction between M&As and greenfield investment in the National statistics. M&As may be beneficial, though, if the acquiring enterprise was not profitable or closed down (UNCTAD 1992, 1995). Besides, this entry mode may have a positive spillover effect in generating higher capability of the employees. Greenfield investment can generate not only extra capital formation but also more jobs. So, both types of entry mode have benefits of their own. The present thesis shows that M&As are prevailing in the metallurgical sector in Kazakhstan, while greenfield investment is prevailing in the oil and gas sector, one of

the reasons being that the metallurgical sector has been exploited since the pre-Soviet period, and it has a very long history. The oil and gas sector was not as developed as the metallurgical sector; the production of crude oil was less than 1 percent of the total industrial production in 1991 in Kazakhstan, while today its share has increased to more than 56 percent. So, since independence in 1991, the oil sector has attracted significant greenfield FDI inflows.

Rich mineral resources gave the opportunity to overcome the economic recession after independence in the 1990s. Despite the fact that Kazakhstan has abundant mineral resources, the lack of finance and access to markets may be obstacles to exploiting the mineral resources fully. FDI inflows play a significant role in exploiting the mineral resources in Kazakhstan. TNCs involved in the extractive industries provide not only financial sources, but also bring managerial and technical capabilities (UNCTAD 2007). However TNC activity may cause additional economic, social, political and environmental costs.

Extractive projects are highly capital-intensive, which is why participation of global TNCs can be crucial in the exploiting of offshore and onshore mineral deposits. Besides, TNCs enhance the export capacity of the country, almost 90 percent of the extracted oil is exported to the developed countries.

Besides helping Kazakhstan in exploiting its mineral resources, TNCs enhance exports by helping to market the Kazakhstan commodities through their established channels. Many mining industries in Kazakhstan are exporters; moreover, they are exporters mainly of raw minerals with low value added. Virtually the majority of mineral output is exported. However, Kazakhstan gets limited value added for its primary resources, while importing countries producing the final goods get much higher value added. The export of final goods can help the country to achieve economies of scale, expand the scope of production and gain experience in export markets, but the export of raw resources may not yield such benefits (UNCTAD 2007).

The extractive companies make a limited contribution to the job-creation issue, because TNCs tend to utilize capital-intensive technology, which increases labour productivity. Still, TNCs play an important role as an employer at local level, and may create additional jobs or temporary/seasonal jobs especially in large-scale projects. TNCs often attract expatriate labour. For example, 50 percent of Chevron’s workforce was made up of expatriates in 1993; this figure has now decreased to 15 percent.

The government is concerned about getting more revenues from the extraction of mineral resources. The most important economic challenge is how to get value added from minerals, since Kazakhstan gets limited value added for its primary resources, while importing countries producing the final goods get much higher value added. We can state that, as a result of reforms favorable to foreign capital, Kazakhstan has an unregulated and disorganized economy of "two-level of processing", which is based on gaining the profit from intermediate production. The world mineral markets are volatile, so increasing commodity prices during the recent decade led to increasing FDI inflows to Kazakhstan, especially in the oil and gas sector.

The economic literature gives mixed evidence on the optimum effects of FDI on the host country economy. The FDI-assisted development of a country depends so much on country-, industry-, and firm-specific characteristics and the kind of FDI being undertaken (Dunning and Lundan 2008). The analysis of FDI patterns, as well as their impact on the Kazakhstan economy, shed light on the fact that resource-seeking investment yielded few positive effects on the economy of the country. Kazakhstan has failed to attract market-seeking investment which would provide more spillover effects. Why? Dunning and Lundan (2008) argue that the quality and content of formal and informal institutions and enforcement mechanisms of a country are crucial determinants in attracting and benefiting from FDI inflow to the country. Moreover, an institutional determinant is critical in generating the country’s home-grown TNCs.

Since its independence in 1991, Kazakhstan has been reforming its regulation and legislation base to meet international standards and attract FDI. The Kazakhstan government achieved good results in improving foreign investment legislation with the assistance of USAID, but key

concerns still remain in poor implementation of the legislation. The problem is in the vagueness of the laws and the contradictory legal provisions which may create varying interpretations (CountryWatch 2011). The liberal investment regime of Kazakhstan implies that the economy of the country is fully open to investors. Nonetheless, the decision process regarding investment proposals can take a long time and it is often non-transparent. The lack of transparency and corruption, which remain major problems in Kazakhstan, may dissuade TNCs from investing in the non-extractive sectors of the country. Therefore, the role of institutions might be important in order to attract more inbound FDI and benefit from TNC spillover effects. According to Dunning and Lundan (2008), inclusion of the institutional determinants in the context of IDP may be important in understanding the economic development of a country. Institutional incentives enable an economy to move through the stages of IDP; therefore, incorporating institutional incentive structures into the IDP paradigm is a new research area which deserves further research.

7.4. Further research

So, this licentiate thesis has explored the causes why a significant portion of inward foreign direct investment has been attracted to the extractive industry in Kazakhstan. The share of market-seeking and efficiency-seeking FDI is insignificant in comparison with the share of resource-seeking FDI in the country. We have made an attempt to analyze the economic implications of FDI in Kazakhstan. Our conclusion is that inward FDI has affected the overall economic performance in terms of enhancing export capacity, addition to physical capital stock, increase of productivity, marketing primary commodities, generation of government revenue and other direct effects. However, we have not been able to identify the development stage, according to the Investment Development Path (Dunning and Narula 1996), that Kazakhstan has reached. It is difficult to fit Kazakhstan's economic development into the IDP paradigm, which implies that the IDP paradigm has limitations in analyzing the relationship between foreign capital and economic development in Kazakhstan. In this regard, the IDP assessment of Kazakhstan is controversial and requires more detailed investigation. What is required is a study of whether Kazakhstan benefits from the FDI-assisted growth-inducing endogenous effects such as knowledge spillovers, learning by doing, improving the quality of human capital, development of R&D, public goods and infrastructure, improving the social capacity and so forth.

It is difficult to make a conclusion about whether inward FDI in the extractive industry is good or bad for the economy of Kazakhstan in the long-term. Due to abundant mineral resources, Kazakhstan has attracted significant inward FDI to its economy. However, the economy of Kazakhstan is heavily dependent on its crude oil export. During the Soviet period, the economy of Kazakhstan was the most diversified in comparison with other former Soviet republics in Central Asia (Pomfret 1995). For example, the proportion of industrial production in 1990 was: food 16%, textile 16%, machinery building 16%, crude oil 18%, but in 2010 the share of the mineral extraction sector increased to more than 56%, while the share of food production decreased to 7%, textile to 0.2%, and machinery building to 3% (Statistical Yearbook, 2006, 2011). It means that natural resources-seeking investment may be crowding out investment in other non-extractive industries. It is a widely accepted view that countries with abundant natural resources and, moreover, heavily reliant on oil production and export, may suffer from so-called Dutch Disease (Corden 1984, Kronenberg 2004, Kutan and Wyzan 2005, Rowthorn and Ramaswamy 1997, Sachs and Warner 1995). Gylfason (2000, 2008) argues that natural resources have a propensity to crowd out human, social, financial and real capital, i.e. many countries that are rich in natural resources are not capable of diverting their economies and achieving steady economic and social development. When the price of oil rises, the oil sector attracts more investment and more labour, which results in productivity increase for that sector. The adverse effect of FDI attraction in the extractive industry is that it may lead to driving out labour and investment from the non-extractive sector into the tradable and profitable oil sector.

Corden (1984) argues that this *resource movement effect* can lead to direct deindustrialization, i.e. when the price of some tradable resource e.g. oil rises, it draws labor and investment from the non-oil manufacturing sector to the oil sector.

Therefore, the role of FDI inflow in the mineral extraction industry of Kazakhstan has to be investigated thoroughly if the problems are to be solved. Answers to the following questions are most certainly required: Does mineral endowment provide long-term economic growth in the country? Is mineral endowment a blessing or curse for the country? It is important to find out whether mineral endowment has a vital role in sustaining Kazakhstan's welfare? If so, would Kazakhstan be capable of experiencing further sustained growth after natural resource reduction? What is the role of natural resources in the economic development of the country?

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