

## A Note on India-Kazakhstan Trade and Investment Relations

*The Ministry of External Affairs, Government of India and the Department of Commerce, Government of India have jointly commissioned CUTS to do a study to explore the possibility of a comprehensive economic cooperation agreement between India and the Belarus-Kazakhstan-Russia customs union. This note is a part of this ongoing work.<sup>1</sup>*

### Executive Summary

- The Kazakh economy is recovering from the financial crisis and so its trade openness (trade-GDP ratio is almost 50). There is a steady and increasing trend in trade between India and Kazakhstan. However, the gap between actual and potential bilateral trade was estimated at 86.19 percent of potential trade volume.
- The single most important challenge before Kazakhstan is to overcome its predominant reliance on natural resources so as to diversify into sectors such as telecommunications, financial services, transport, construction, pharmaceuticals, food processing. With the possibility of developing (including value addition) of many key industrial sectors and modernisation in services sectors, Kazakhstan offers an enormous amount of opportunities for trade and investment.
- However, over the last five years (2005-09), the composition of bilateral trade (exports as well as imports) has remained more or less unchanged. There is hardly any sign of product diversification with overall growth in trade volume. Trade deepening through exploring prospects in other commodities and reaping full potential of bilateral trade is yet to be materialised.
- Given the current state of affairs and the high rating of Kazakhstan's FDI potential, looking beyond energy and mineral sectors in Kazakhstan is important for several reasons. In the context of future investment relations between India and Kazakhstan, it is interesting to note that India's intra-industry trade index is highest in mineral products (average compound growth rate of 19.01% in 2005) and it is also high in petro-based products (9.96%). Other than reaping the benefits of scale economies (increasing returns to scale production function under imperfect markets), intra-industry trade will depend on technological advancement for product differentiation.
- Economic diplomacy with Kazakhstan must take into account the larger goal of increasing better trade and investment ties with the CIS region. Increased bilateral ties would help to leverage the larger market potential of Belarus-Russia-Kazakhstan customs union as well as the combined market potential of CIS countries.

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## 1. A Brief Outline of the Kazakh Economy

1.1 Kazakhstan is the largest economy in Central Asia and the second largest (after the Russian Federation) amongst the Commonwealth of Independent States. During 2000-2007, it registered an impressive annual average growth rate of about 11.6 percent. In the aftermath of the global financial crisis, this growth rate fell to 3.3 percent in 2008 and further to 1.2 percent in 2009.<sup>2</sup> However, the Kazakh economy has shown strong recovery in the first two quarters of 2010-11. Growth for the year was estimated at 7 percent.<sup>3</sup> In respect to trade openness and business environment, since the year 2000, Kazakhstan has made considerable progress. In recent years, trade in goods and services reached almost 50 percent of its gross domestic product.<sup>4</sup> In 2009, the country was ranked 70th amongst 181 countries in terms of ease of doing business, registering a significantly better rank amongst CIS countries with Russia placed at 120th.<sup>5</sup>

1.2 Over the years, the Kazakh economy has structurally shifted from agro-based to manufacturing and services based, respectively accounting for 42.8 percent and 51.8 percent of its GDP.<sup>6</sup> The country is endowed with enormous fossil fuel reserves and abundant supplies of other minerals and metals such as uranium, copper, Iron, zinc. More than 1,200 types of minerals are reportedly available in the region. Certain estimates puts Kazakhstan as the second largest source of uranium, chromium, lead, and zinc reserves and among the top ten sources of coal, manganese, copper, iron, and gold reserves. Kazakhstan also has the 11th largest proven reserves of both oil and natural gas.<sup>7</sup> Mining accounts for 61.6 percent of industrial output.<sup>8</sup>

1.3 While the resurgence of economic growth in 2010 is expected to continue, the single most important challenge before Kazakhstan is to overcome its predominant reliance on natural resources so as to diversify into sectors such as telecommunications, financial services, transport, construction, pharmaceuticals, food processing. With the possibility of developing (including value addition) of many key industrial sectors and modernisation in services sectors, Kazakhstan offers an enormous amount of opportunities for trade and investment.

## 2. India-Kazakhstan Bilateral Trade

2.1 From US\$113.14 million in 2005, India-Kazakhstan bilateral trade has grown to US\$280.59 million in 2009. During this period India's imports from Kazakhstan has grown much faster than exports (Figure 1). In 2009 India registered a negative trade balance of US\$12.73 million. It is interesting to note that prior to the financial crisis in 2008 India had a positive trade balance with Kazakhstan. However and though as on today India's trade balance with Kazakhstan is negative, over the last two years there is not much change in that volume (Figure 1).

<sup>2</sup> *World Development Indicators*, World Bank, 2011

<sup>3</sup> *CIA World Facts Book*, March 2011 (provisional figures)

<sup>4</sup> *Ibid*; trade as a percentage of GDP is a theoretically acceptable and ready measure of trade openness of a country.

<sup>5</sup> *Ease of Doing Business Report*, World Bank, 2009

<sup>6</sup> For a comprehensive understanding of the Kazakh economy, see various works of Kazakhstan Institute of Management, Economics and Strategic Research (KIMEP) – [www.kimep.kz](http://www.kimep.kz).

<sup>7</sup> *Central Asia's Energy Risks*, International Crisis Group, Asia Report No. 133, 2007

<sup>8</sup> *Statistical Handbook*, Agency of Statistics of the Republic of Kazakhstan, 2008

2.2 Validating the fact that Kazakhstan is fast becoming a major source for metals and minerals, iron and steel accounted for about 50 percent of India's imports (Table 1). Zinc and its compounds constituted another 27.7 percent of imports and about 16 percent was accounted by salt, sulphur, lime and other minerals. Thus, more than 90 percent of India's imports are on account of these commodities (Table 1). Significantly, oil and natural gas do not feature in this list of major import items.

2.3 On the other hand, pharmaceuticals, coffee, tea, spices, textiles and apparel are the main categories of exports from India (Table 2). However, except for pharmaceutical products, among the top 15 merchandise imports to Kazakhstan Indian exports is less than one percent (Table 3). Even in case of Indian pharmaceutical export to Kazakhstan, percentage share of that export (as a percentage of total Indian export of pharmaceutical products) is less than one percent (Table 3).

2.4 India's export of services to Kazakhstan is negligible. Other than personal travel, financial services accounted for 3.94 percent of India's total export of that category and architectural, engineering and other technical consultancy accounted for 1.95 percent (Table 4).

2.5 It is important to note that India's share in major Kazakh imports from other Asian countries is less than 10 percent in all categories of products except articles of iron or steel (Table 5). It would be interesting to look at India's revealed comparative advantage in those product categories and compare them with that of its Asian competitors to understand future potential of Indian exports to Kazakhstan.<sup>9</sup> However, over the last five years (2005-09), the composition of bilateral trade (exports as well as imports) has remained more or less unchanged. There is hardly any sign of product diversification with overall growth in trade volume. Trade deepening through exploring prospects in other commodities and reaping full potential of bilateral trade is yet to be materialised.

2.6 An important study on India's future trade prospects in the light of financial crisis has identified Kazakhstan as one of India's trading partners with a high unexplored trade potential. The gap between actual and potential bilateral trade was estimated at 86.19 percent of potential trade volume.<sup>10</sup> In fact, the corresponding figures are very high for other prominent CIS countries – Uzbekistan (81.95%), Tajikistan (94.39%), Armenia (82.47%) and Kyrgyzstan (93.34%). This result coupled with the fact that Kazakhstan fares far better in the Central Asian region in terms of economic stability as well as governance indicators shows the huge potential that they have in improving (net of trade creation by taking into account trade diversion factors as well) their trade relations in future.<sup>11</sup>

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<sup>9</sup> This exercise (calculation of India's revealed comparative advantage in different categories of goods and services and those of its competitors in other Asian countries) will be done as part of this ongoing work.

<sup>10</sup> De, Prabir, *Global economic and financial crisis: India's trade potential and future prospects*, ARTNeT Working Paper Series, No. 64, May 2009

<sup>11</sup> Jafari, Ahmad *et al*, *Political Stability and FDI in OIC Countries*, Journal of Social and Development Sciences, Vol. 1, No. 1, pp. 18-23, 2011

### 3. India-Kazakhstan Bilateral Investment

3.1 Since the year 2000, foreign direct investment in Kazakhstan has increased by more than six times to reach US\$72.3 billion (cumulative figure) and it stands as the second most attractive investment destination amongst the CIS countries after Russia.<sup>12</sup> Reduction of capital controls in general and in foreign currency transactions in particular has contributed to this increase. During 2007-09, annual FDI inflow has continuously remained above US\$11 billion. On the other hand, outward FDI from Kazakhstan has reached US\$6.8 billion.<sup>13</sup>

3.2 Kazakhstan's FDI flow to India has been minimal till date. Kazakhstan's outward FDI initiatives are driven by the need for economic diversification beyond mining and improvement in competitiveness through overseas experiences, adoption of internationally accepted standards of corporate governance, etc.<sup>14</sup> Therefore, its FDI destinations have been developed countries with very high concentration in The Netherlands, Italy and UK. Likewise, India's contribution in FDI stock of Kazakhstan is also low.<sup>15</sup> Despite having an investment treaty (bilateral investment promotion agreement) between India and Kazakhstan, which came into force in July 2001, cross-border investment relations are weak.

3.3 In 2005-06, India's OFDI stock in transition economies including Kazakhstan stood at US\$3.02 billion, out of total stock of about US\$12 billion.<sup>16</sup> A predominant share of this was concentrated in Russia. Since then a number of investment avenues opened up in Kazakhstan, mostly in sectors such as oil and natural gas, pharmaceuticals, banking and information technology. It is clear that energy security is the primary motivation for India's investment interests in Kazakhstan. The long-standing bid of Oil & Natural Gas Commission of India for joint oil exploration with KazMunayGaz (both are state-owned oil and gas companies) in the Satpayev Block has been a highlight of this motivation and with the signing of the deal, the ONGC is expected to invest about US\$400 million.

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<sup>12</sup> *World Investment Report*, United Nations Conference on Trade and Development, 2010

<sup>13</sup> *Ibid*

<sup>14</sup> Amagoh, Francis and Ustina Markus, *Kazakhstan's Outward Foreign Investments: Issues and Perspectives*, Central Asia Business Journal, Vol. 3, November 2010

<sup>15</sup> In a bilateral meeting of CUTS Secretary General Pradeep S. Mehta in August 2006 with the then Ambassador of Kazakhstan to India Kairat E. Umarov, he asked CUTS to do a study of investment opportunities in Kazakhstan and disseminate the information to Indian business. Alas the project could not take off as there was no funding.

<sup>16</sup> *Potential and Prospects for Trade and Investment between Developing countries and Transition Economies*, UNCTAD, 2008; Also see *Developing Countries: Globalisation through Overseas Investment*, EXIM Bank, 2008

3.4 While petrochemicals and uranium are of key strategic interests to India, building momentum in other sectors is hindered mainly by lack of adequate and authentic information available in both countries about the business potential and prospects. In 2010, the Ambassador of India to Kazakhstan, Ashok Sajjanhar, reported that there is a huge ‘information divide’ between the two countries and Indian businessmen and entrepreneurs are not fully aware of Kazakhstan’s attractive investment climate.<sup>17</sup> Language barrier is an additional cause of hesitation on the part of Indian business enterprises.<sup>18</sup>

3.5 In short, given the current state of affairs and the high rating of Kazakhstan’s FDI potential, looking beyond energy and mineral sectors in Kazakhstan is important for two reasons.<sup>19</sup> First, in order to ensure a better stake in Kazakhstan’s energy resources, a wider presence in other sectors is necessary. Expansion of business ties in sectors like banking and infrastructure will help to enhance the ease of doing business not only in Kazakhstan but also in other fast growing and resource rich countries in Central Asia. Secondly and diversification being a pressing priority of the Kazakh economy, lucrative opportunities are fast emerging in a number of non-energy sectors such as agri-business, fertilizer, logistical and other business service and information technology.<sup>20</sup>

3.6 In the context of future investment relations between India and Kazakhstan, it is interesting to note that India’s intra-industry trade index is highest in mineral products (average compound growth rate of 19.01% in 2005) and it is also high in petro-based products (9.96%).<sup>21</sup> Other than reaping the benefits of scale economies (increasing returns to scale production function under imperfect markets), intra-industry trade crucially depends on technological advancement for product differentiation.<sup>22</sup> Given the profile of mineral products sector, there is a significant possibility of exploring intra-industry trade between India and Kazakhstan through bilateral investment and transfer of technology.

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<sup>17</sup> Sajjanhar, Ashok, *India-Kazakhstan Relations: Opportunities for Future*, 2010; See Rana, Kishan S. and Bipul Chatterjee (ed.), *Economic Diplomacy: India’s Experience*, CUTS, 2011 for a comprehensive account of the role of economic diplomacy in enhancing trade and investment relations

<sup>18</sup> Bhatia, Vijay Kumar, *India-Kazakhstan Relations: Challenges and Prospects*, Mainstream, Vol. XLVII, No 38, 2009

<sup>19</sup> *Kazakhstan: Sector Competitiveness Strategy*, Organisation for Economic Cooperation and Development, 2011

<sup>20</sup> *Ibid*

<sup>21</sup> Burange, L. G. and Sheetal J. Chaddha, *Growth in India’s Intra-Industry Trade*, Department of Economics, University of Mumbai, Working Paper UDE24/2/2008, March 2008; During the trade liberalisation era, the Grubel-Lloyd index of India’s intra-industry trade has steadily increased from 23.99 in 1990-91 to 32.09 in 2005-06 – the value of this index ranges from 0 to 100 (0 being no intra-industry trade in a product/sector); See Grubel, H. and P. Lloyd, *Intra-Industry Trade: The Theory and Measurement of International Trade in Differentiated Products*, Macmillan Press, London, 1975

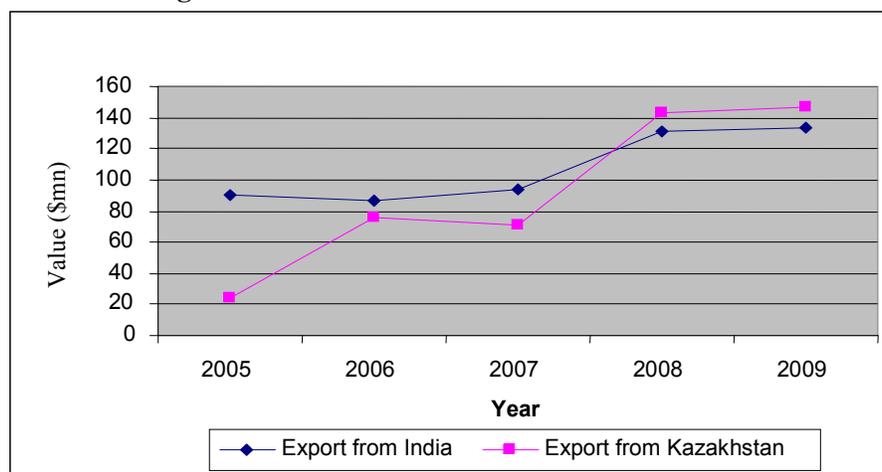
<sup>22</sup> Davis, Donald R., *Intra-industry trade: A Heckscher-Ohlin-Ricardo approach*, *Journal of International Economics*, 39, pp. 201-226, 1995

#### 4. Future Prospects of India-Kazakhstan Economic Relations

4.1 For India, Kazakhstan offers the best possible opportunity as a gateway to the Central Asian region. Following are certain suggestions that may serve these goals:

- Keeping in mind the overall pattern and indices of Kazakh imports, key products and services sectors that are of importance for diversification of India's export basket to Kazakhstan are: machine tools, construction and building materials, processed food and spices, edible oils, engineering and construction services, business management and consultancy, agro-business services, public relations and advertising, travel services.
- There should be target-oriented promotional policies for increasing investment in Kazakhstan's mineral sector. Investment risk assessment in Kazakhstan should be conducted on a regular basis with a view to dynamically review the effectiveness of the provisions of India-Kazakhstan BIPA.
- Earmark specific funds in the annual supplements of India's Foreign Trade Policy for regular business delegation meeting in different cities in both the countries. There should be Business Consular Service Centres in Astana, Almaty, New Delhi and Mumbai and such institutions should be set up as public-private partnerships with business associations and other civil society groups.
- Economic diplomacy with Kazakhstan must take into account the larger goal of increasing better trade and investment ties with the CIS region. Increased bilateral ties would help to leverage the larger market potential of Belarus-Russia-Kazakhstan customs union as well as the combined market potential of CIS countries.

**Figure 1: Trade between India and Kazakhstan**



Source: UN Comtrade, 2011

**Table 1: Kazakhstan's Top 10 Export Items to India (2009)**

Product Category	Value (US\$, 000)	Share in Total Exports (%)
Iron and steel	72,968	49.75
Zinc and articles thereof	40,746	27.78
Salt, sulphur, earth, stone, plaster, lime and cement	23,630	16.11
Pearls, precious stones, metals, coins, etc	2,696	1.84
Inorganic chemicals, precious metal compound, etc	2,277	1.55
Raw hides and skins (other than furskins) and leather	1,762	1.20
Lead and articles thereof	1,373	0.94
Lac, gums, resins, vegetable saps and extracts nes	425	0.29
Mineral fuels, oils, distillation products, etc	362	0.25
Cotton	262	0.18

Source: UN Comtrade, 2011

**Table 2: India's Top 10 Export Items to Kazakhstan (2009)**

Product Category	Value (US\$, 000)	Share in Total Exports (%)
Pharmaceutical products	47,127	35.19
Coffee, tea, mate and spices	24,873	18.57
Articles of apparel, accessories, knit or crochet	19,671	14.69
Machinery, nuclear reactors, boilers, etc	10,356	7.73
Articles of apparel, accessories, not knit or crochet	5,641	4.21
Optical, photo, technical, medical, etc apparatus	4,307	3.22
Articles of leather, animal gut, harness, travel goods	3,622	2.70
Electrical, electronic equipment	3,092	2.31
Essential oils, perfumes, cosmetics, toiletries	1,701	1.27
Rubber and articles thereof	1,695	1.27

Source: UN Comtrade, 2011

**Table 3: Top 15 Merchandise Imports of Kazakhstan (2009)**

Product Category	Total Imports of Kazakhstan			Imports from India		
	Value (US\$, 000)	% Share in Total Imports	Rank in the World	Value (US\$, 000)	% Share in Total Kazakh Imports	% Share in Total Indian Exports
Machinery, nuclear reactors, boilers, etc	5,444,006	19.16	50	10,356	0.19	0.1
Articles of iron or steel	4,569,698	16.09	15	519	0.01	0
Mineral fuels, oils, distillation products, etc	2,834,785	9.98	61	364	0.01	0
Electrical, electronic equipment	2,284,213	8.04	60	3,092	0.14	0
Vehicles other than railway, tramway	1,553,324	5.47	65	53	0.00	0
Plastics and articles thereof	781,109	2.75	64	288	0.04	0
Pharmaceutical products	759,606	2.67	53	47,127	6.20	0.9
Iron and steel	622,988	2.19	63	729	0.12	0
Optical, photo, technical, medical, etc apparatus	622,571	2.19	52	4,307	0.69	0.3
Railway, tramway locomotives, rolling stock, equipment	560,877	1.97	15	0	0.00	0
Furniture, lighting, signs, prefabricated buildings	489,315	1.72	38	97	0.02	0
Ships, boats and other floating structures	441,874	1.56	33	0	0.00	0
Paper & paperboard, articles of pulp, paper and board	407,306	1.43	62	92	0.02	0
Miscellaneous chemical products	381,341	1.34	54	379	0.10	0
Rubber and articles thereof	358,084	1.26	55	1,695	0.47	0.1

Source: UN Comtrade, 2011

**Table 4: Top 15 Services Imports of Kazakhstan (2009)**

<b>Product Category</b>	<b>Value (US\$, 000)</b>	<b>% Share in Total Imports</b>	<b>Exports from India (US\$, 000)</b>	<b>% Share in Total Exports from India</b>
Architectural, engineering and other technical consultancy	2,269,840	22.54	2,017,160	1.95
Construction in the compiling economy	2,057,140	20.43	721,940	0.70
Other transport – Freight services	1,151,120	11.43		
Other personal travel	920,840	9.14	1,183,190	11.49
Rail transport - Freight	619,540	6.15	--	--
Operational leasing services	538,260	5.34	559,310	0.54
Road transport - Freight	529,410	5.25	--	--
Business and management consultancy, public relations services	457,080	4.54	--	--
Other agricultural mining, and on-site processing	386,480	3.83	272,580	0.26
Reinsurance	323,980	3.21	107,290	0.10
Financial services	287,340	2.85	405,8950	3.94
Air transport - Freight	284,510	2.82	--	--
Embassies and consulates	183,290	1.82	239,600	0.23
Other business travel	177,180	1.76	--	--

Source: UN Comtrade, 2011

**Table 5: Main Kazakh Imports from Asian Countries and India's Share (2009)**

<b>Product Category</b>	<b>Value (US\$, 000)</b>	<b>India's Share in Kazakhstan's Imports (%)</b>
Articles of iron or steel	1,414,157	21.53
Vehicles other than railway, tramway	607,989	9.25
Plastics and articles thereof	288,909	4.39
Mineral fuels, oils, distillation products, etc	333,695	5.08
Furniture, lighting, signs, prefabricated buildings	137,977	2.10
Edible fruit, nuts, peel of citrus fruit, melons	78,692	1.19
Iron and steel	79,690	1.21
Ceramic products	82,073	1.24

Source: UN Comtrade, 2011