

## The State Policy of Investment Incentive into the Construction Sector of Kazakhstan

*Kazbek Kuandykovich Bokenchin*

Karaganda Economical University of Kazpotreboysuz (KEUK), Karaganda, Kazakhstan

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**Abstract:** The article highlights the obstacles during formation and development of a mechanism to attract investments into the construction industry of Kazakhstan as well provides an overview of the current conditions of the construction industry of the country and investigates the dynamics of investments into its development. Special attention is paid to housing construction as one of the priority national strategies of development of the country. The article analyses the factors of the investment potential, evaluates the investment attractiveness for the construction complex of the country for foreign and national investors and peculiarities of the development of this industry in Kazakhstan. It has been found that the adoption of a new Strategy “Kazakhstan-2050” has changed the principles of investment policy in Kazakhstan, aimed to retention of the investment leadership. The author assumes that the problems of incentive of investments into construction industry of Kazakhstan requires the amendments of the existing investment models as well as simultaneous development of several directions such as development of new mechanisms of investment crediting and financial technologies; formation of microfinance infrastructures of investment market, aimed to providing loans for small businesses, establishment of transport, logistics and investment-management infrastructure, increasing of the transparency of the regulations and legislation, active informing of potential investors about Kazakhstan and others.

**Key words:** Kazakhstan • Regulation • Legislation • Investment • Business

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### INTRODUCTION

Construction complex is one of the leading sectors of the economy in any developing country, which interacts with the various sectors of the economy and has a direct impact on gross domestic product (GDP) growth [1]. Priorities of the construction complex of Kazakhstan include its modernization, reduction of energy consumption and the costs of construction, production of new construction materials, development of competitive construction technologies, etc. To fulfill these objectives, the different types of investments and direct foreign investments, should be involved. Globalization has resulted in a fast increase in foreign direct investment (FDI) worldwide [2].

At the same time, various foreign studies confirm that the fiscal policy of a particular country, the efficiency of the mechanism of the state incentives of the capital inflow in one or another sector of economy are the fundamental factors for the growth of direct foreign investments [3]. The government should create a distinct stimulation

system of investments, which correspond to the specific policy objectives of FDI [4].

Over the past four decades, the developing countries, including Kazakhstan, have significantly extended the forms and methods of state tax incentives, for example, state investment tax credits [5]. However, construction activities in Kazakhstan have not fully reached the steady growth after the crisis. Despite of the increased investments from the state budget, the investments into construction work has not yet reached the level of the 2006-2008s. The construction industry has been able to save their capital assets, but higher wear in this industry requires the new investments.

**General:** In present, the construction is strategically important and actively developing industry of the Republic of Kazakhstan. Construction complex has a significant impact on the socio-economic development of the country and its regions and is the basis for the maintenance of internal political stability in the country [6].

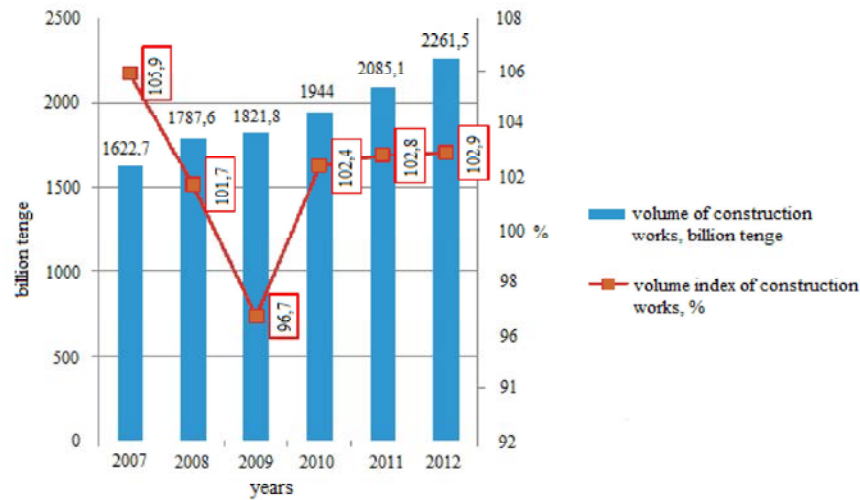


Fig. 1: The volume of construction works in 2007-2012, in billion tenge [7].

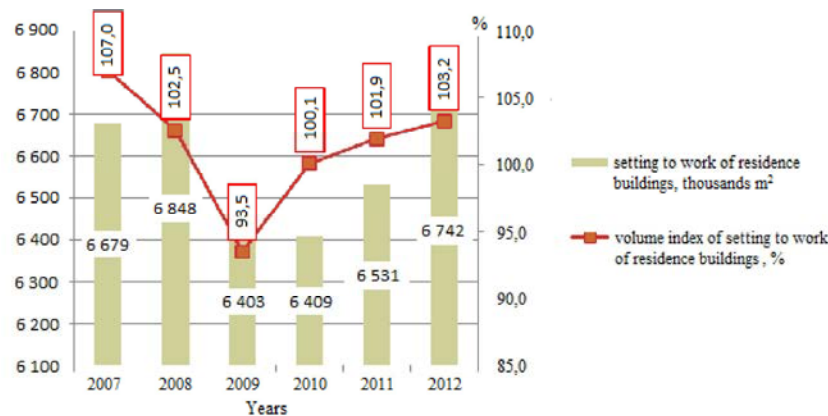


Fig. 2: Dynamics of housing construction in the Republic of Kazakhstan in 2007-2012

It has a decisive influence on the development of material-productive forces and further improvement of management of the investments. Its main task is creation and accelerated modernization of capital assets of the production and non-production purpose.

The contribution of the construction sector into the gross domestic product (GDP) is about 6.3%. Despite of the negative processes related to the consequences of the global financial crisis, the volume of construction works was increases. Dynamics of volumes of construction works in cost parameter is shown on Fig. 1.

In 2012, the volume of construction works in Kazakhstan increased by 8.5% and reached the historic maximum - 2261,5 billion tenge compared with same parameter of previous year.

Post-crisis recovery of the housing construction sector began in 2010. Realizing the importance of the

implementation of the strategic objectives, the Government of Kazakhstan continued put in to operation the social lodging and approved the new state initiative "A Housing Construction Program for 2011-2014". Implementation of anti-crisis measures of the Government enabled the stabilization and increased the volumes of housing construction.

The average annual index of physical volume of operating residential houses for the last three years was 101.7%, however, was low than pre-crisis period (during 2005-2007s this indicator was 141.6%). Dynamics of indicators of housing construction in the Republic of Kazakhstan in 2007-2012 is shown on Fig. 2.

The average actual cost of construction of 1 square meter in apartment houses in 2012 was 101,7 thousand tenge and in residential homes built by inhabitants – 53,1 thousand tenge [8].

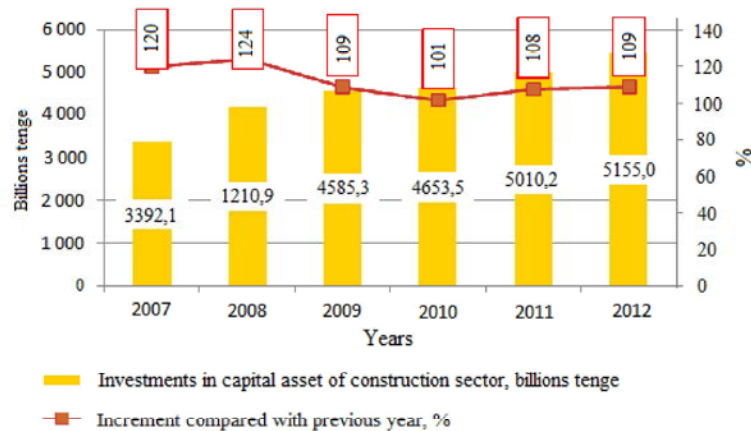


Fig. 3: Investments into fixed capital of construction industry of Kazakhstan in 2007-2012

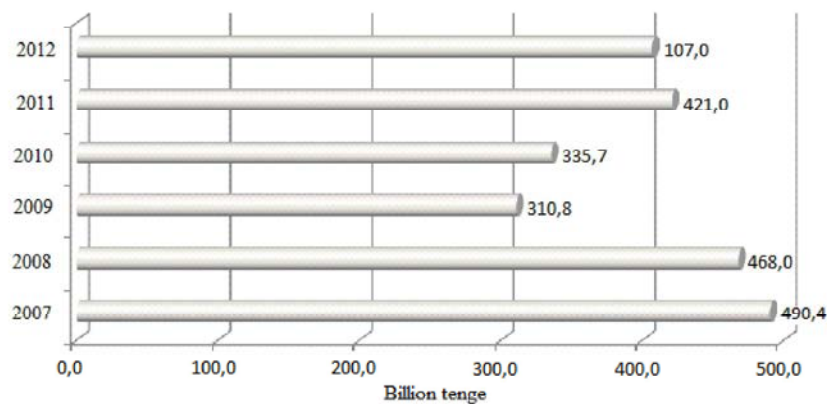


Fig. 4: Investments into housing construction, billion tenge

A large part of the housing – 5111,4 thousand square meters, or 79,8% was put in operation by private developers and 46.4% of which (2973,5 thousand square meters) by inhabitants.

Investment activity in the construction industry of Kazakhstan gradually increased from 2009. Investments into fixed capital of construction industry are growing each that indicates the subsequent renovation, investment and reinvestment into the fixed assets by construction companies.

The government support in this sector is focused on some tax exemptions for fund investing. The growth of investments and state support of the construction industry, the recovery processes in the sector make possible the higher dynamics of constructions in the future.

At the same time, the volume of investments into housing construction is still not reached pre-crisis level. Moreover, in 2012, the decrease of this indicator compared to previous year has been observed.

The volume of investments in housing construction sector was 407,0 billion tenge of total investments, which lower of 2011 by 3.3% (Fig. 4).

In present, the housing construction accounts takes 11,9% of the total investments into the economy of the country. The own funds of developers takes the great part of investments into the housing construction (Fig. 5). Their share in the total investment structure of the housing sector has increased from 39,8% in 2008 to 50,3% in 2012.

The existing solutions of the housing problem in Kazakhstan and post-crisis conditions of housing sector require more active investment policy of the government in the field of housing construction.

The need for changes in the investment process in the housing construction sector of the country is stipulated by a decrease of shared housing construction related to tighter legislation.

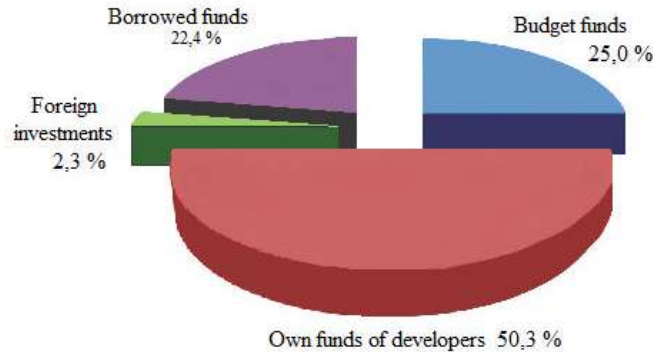


Fig. 5: Structure of financial investments into the housing construction in Kazakhstan

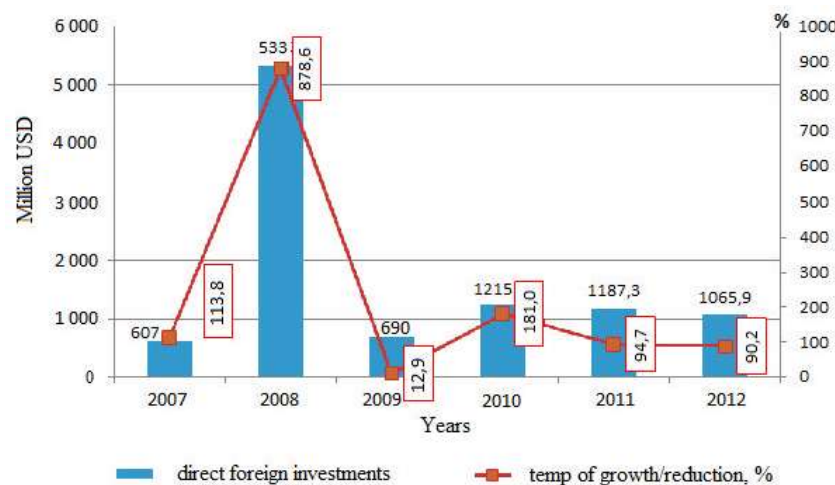


Fig. 6: Dynamics of FDI into construction industry of Kazakhstan in 2007-2012.

The government of Kazakhstan has introduced a number of significant changes to the Law on shared construction [9], which clearly focuses on the reduction of risks of potential co-investors and strengthening of the responsibility of the developers. In particular, restrictions for the period of validity of licenses for the organization of the construction using the means of co-investors, obligation for licensing of each construction object, the development of legible requirements to the size of own capital of the developer and a number of other measures to avoid the creation of one-day firms on the market have been introduced. The undertaken measures allowed the improvement of legal protection of the rights of co-investors and attract the long-term financial resources into the construction.

Foreign direct investments are the most essential form of investments to enable the implementation of large and important construction projects and ensuring the introduction of the new technologies in the country. The volume of direct foreign investments (DFI) into construction industry increased from 607 million USD in

2007 to 1065,9 million USD in 2012 [10]. However, the growth of FDI into the construction industry of Kazakhstan remains volatile during the whole analyzed period and directly depends on the economic situation in the markets and the world oil price fluctuations.

The dynamics of FDI into the construction industry of Kazakhstan is shown on Fig. 5.

The general countries-investors (for 2012) are the Netherlands (1384,4 million USD, 29,5%), China (797 million USD, 17%) and United Kingdom (755,6 million USD, 16,1%).

It should be noted that the pace of development of favorable investment climate in Kazakhstan were underlined at the world stage. Kazakhstan according to the rating of the World Bank and International Financial Corporation "Doing Business" in 2012 improved its indicators by 11 positions and took the 47<sup>th</sup> place among 183 world countries [11]. Thus, Kazakhstan takes the leading place among the CIS countries and has an evident advantage over Ukraine and its Custom Union partners. The World Economic Forum held in 2012, the assigned

the Kazakhstan to 51 line in the rating of competitiveness of the world economies, thereby enhancing the country's competitiveness by the 21<sup>st</sup> position and according to the rating of the Center for the Study of Global Competitiveness of the International Institute for management development (IMD, Switzerland, Lausanne), Kazakhstan took the 36<sup>th</sup> place in 2011.

In present, the necessary legal framework for investment activity in Kazakhstan has been largely created. Legal and economic principles for stimulation of investments are fixed in the Law "On investments" [9]. The law protects the rights of investors, rather strictly regulates the activities of the state and governmental bodies during the work with investors and establishes the measures of state support of investments in strategic sectors of the economy, including housing construction. Besides of traditional guarantees to investors (inviolability of property, stability of contracts and other guarantees), the state provides the specific support measures such as the provision of customs duties, tax exemptions, provision of land and premises.

The economy of Kazakhstan is supported by the Program of innovative industrial development for 2010-2014, which presumes the number of sub-programs in different sectors, including the construction industry of the country. The government approved the program on development of construction industry and production of construction materials for 2010-2014 and the volume of investments was determined in 358 billion tenge.

The construction sector was additionally supported by the program of development of housing construction for 2011-2014, where the volume of investments was equal 359 billion tenge. This program includes three main directions of state support of housing construction by using a system of housing savings for housing sales, investments to the second tier banks for the financing of construction and construction of engineering communications.

At the same time, the following factors have limited the direct investments into the construction industry of Kazakhstan:

- Low level of investment activity of the residents due to a discrepancy in the level of purchasing ability and market pricing;
- Insufficient development of infrastructure. The coverage of Kazakhstan by roads and railways remain at a low and the lands allocated to the enterprises are often provided without engineering-communication infrastructure. According to the audit company "Ernst and Young", the 19% of

respondents believe that the insufficiently developed infrastructure is the main obstacle for investments in Kazakhstan [12].

In many cases, the investors have to develop of infrastructure in operation areas using own financial means what results in increase of the cost of the construction projects and creates operational difficulties.

- Insufficient transparency and stability of the regulatory framework. According to a inquiry by "Ernst and Young", a half (50%) of the respondents believe that the Kazakh legal and regulatory system characterizes by low transparency and stability. The complexity of the tax administration system and ensuring of compliance to the legal requirements were also noted. According to the opinion of the respondents, the tax administration system is punitive, although it should be aimed to prevention of tax offences and the interaction with taxpayers.
- Weak awareness of investors about Kazakhstan. Among potential investors, 39% of these are insufficiently informed about the business and economic environment of Kazakhstan.
- The shortage of skilled labor in the construction. Only 25% of total number of surveyed investors are satisfied with the skill level of personnel of construction sites. According to the report made by the Statistical Bureau of Kazakhstan on January 1, 2013, the demand for construction personnel is 5278 people.

The above mentioned problems should be solved simultaneously therefore their separated solution will hardly result in increase of investment activity and improvement of general investment climate due to multidirectional action of other factors.

Thus, the successful competition in attracting FDI into the construction sector of Kazakhstan and increase of the value added, the country needs to improve the quality indicators such as:

- the level of investment activity in the housing construction sector;
- level of development of transport and logistics infrastructure;
- improve transparency and predictability of the legal and regulatory environment;
- development of human resources potential according to economic demands and innovations in construction.

Measures of state stimulation of investment activity in the construction industry are:

- development of microfinance infrastructures of investment market (credit cooperatives, societies of mutual crediting, savings and loan construction funds, structures of mortgage lending, etc) aimed to providing the loans for small businesses.

Investment attractiveness directly depends on the institutional “infrastructure” sector, including legislation. In November 2012, the President of Kazakhstan have signed the law “On microfinance organizations (MFO)” strived to improvement of micro-credit mechanisms, enhanced control over the micro-credits [13]. If legislative infrastructure of MFO will be implemented in practice, the interest in MFOs will be attractive for large financial institutions and investors to strengthen their market positions in the financial sector.

As a result, the elaboration of a strategy of development of construction sector requires the analysis of the world practice. The world countries can be divided into several groups: countries with an efficient and sustainable system of MFOs, countries with similar macroeconomic indicators and economic development history (CIS countries) and Asian countries with the fast-developing economies (like Turkey, Singapore, Malaysia, Korea, Indonesia, etc). This will allow the selection of a specific model or combination of development system of MFOs in Kazakhstan and form an appropriate legislative base. In addition, the opinions and interests of the state, represented by the regulatory bodies, MFOs themselves and consumers of microcredit must be also considered.

Improving of the creditworthiness of potential borrowers can be reached by encouraging of the integrated structures, associations and other united industrial structures as well as infrastructures of financial and credit market including the market of insurance services.

- Improvement of mechanisms of guaranteeing and insurance of investments in the construction sector, development of various schemes of financial guarantees, the enforcement mechanism of the pledge forms to ensure return of investments and credits, the establishment of a Fund for insurance of investments in the construction industry to reduce the different risks.
- The development of the economic potential of the country requires continuous improvements of the infrastructure and urban environment.

One of important requirements to ensure the stability of flows and the diversification of foreign investments is the development of transport and logistics infrastructure, the Internet communications and reduction of energy consumption. The measures to improve railway communications and creation of a regional transport and logistics centre taking into account the geographical location of Kazakhstan between the markets of China, Europe, the Middle East and Russia are also required. Implementation of the state and private partnership mechanism can contribute to the development of infrastructure, ensuring the foreign capital investments, implementation of advanced technologies, experience and knowledge, as well as increase operational efficiency.

- The transparency and predictability of legal and regulatory environment are required.

In particular, all stakeholders should be involved into development of legal and regulatory framework as the consultants. A system of regulation and control should be aimed to the prevention of offences and amount of imposed penalties should correspond to the type of the offences.

- Prospective development of personnel potential appropriate to the economy demands, formation of incentives for improvement of professional skills of the personnel in construction industry, strengthening and expanding of cooperation with the leading foreign educational institutions and leading international companies, availability of advanced knowledge and new technologies for students.

## CONCLUSIONS

All segments of the Kazakhstan construction industry are required the leading role of the state as the largest customer. Evaluating the current conditions and consequences of economic downturn, the market mechanisms are less effective. Management of industry performance was shifted to a state which provides the construction volumes of the companies-contractors.

Housing construction along with the industrial is recognized as one of the most important national objectives and the Government should increase levels of the construction activity in the future.

The catalyst of growth of the construction industry is improvement of the attractiveness of the construction industry for a continued inflow of foreign direct and private investments through higher demand and thus, reduces turnover and repayment of invested funds.

To improve the competitiveness and investment attractiveness, the Kazakhstan should find a niche in the international economy and defines the principles of integrated approach to attract the investors, continuing the work on removing obstacles for foreign direct investments. Policy on foreign direct investments should be based both on attracting new investors and support of already operating investors.

In addition, existing investors are an important stakeholder group that may expand their presence through the repeated investments.

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