Kazakhstan – The Rise of the Asian Panther

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Abstract

The Republic of Kazakhstan witnessed incredible economic growth with its real GDP growing at least 9% per year between 2000 and 2007. One must ask, is this economic growth sustainable? This paper examines Kazakhstan's current development and the factors that would impact its economic growth and prosperity. Kazakhstan shares many characteristics with the Asian Tigers, such as strong international investment, a low tax burden, a small government debt, a well-developed banking system, a paternalistic managing style, and citizens possessing entrepreneurial drive. Unfortunately, Kazakhstan's economic development differs from the Asian Tigers. Although Kazakhstan has immense mineral and petroleum wealth, its bureaucratic, corrupt, overbearing legal system could prevent Kazakhstan from reaping this wealth. Then the Dutch Disease and Resource Curse further complicate matters. Finally, Kazakhstan joined the new Customs Union with the Russian Federation and Belarus, aligning its economic growth to Russia's economy.

Keywords: Asian Tigers; Belarus, corruption; customs union; Dutch Disease; export-growth oriented; Kazakhstan, petroleum, Russia

Abbreviations: GDP – Gross Domestic Product; IMF – International Monetary Fund; VAT – Value-Added Tax

JEL: H11, O13, P31

Introduction

The Republic of Kazakhstan is the world's ninth largest country and is located in the heart of Eurasia. Kazakhstan's geography is diverse with wide deserts, vast sweeping steppes, and mountainous terrains. This large country has a small population of approximately 16 million in 2009 [1] and possesses vast reserves of petroleum, natural gas, copper, aluminum, gold, chromium, and uranium [2, 3]. Consequently, international investors, Kazakhstanis[1], and world leaders believe Kazakhstan will become a rich, developed country one day. Roadside billboards declare 2030 will become Kazakhstan's time.

[1] Kazakhstani refers to a citizen of Kazakhstan, while a Kazakh refers to an ethnic group who are indigenous to Kazakhstan.

The title of this paper may be unusual. Kazakhstanis refer to themselves as the Asian panther because they are proud of their culture and economic prosperity. They know their country possesses vast minerals and petroleum, but their economic development differs from the Asian Tigers. Thus, they use panther to distinguish themselves from the tigers. Furthermore, Kazakhstan saw an incredible 13.5% GDP growth rate in 2001 and grew at least 9% for seven years [4]. This paper begins outlining the characteristics of the Asian Tigers, and then it shifts and examines the factors that would aid or hinder Kazakhstan's economic growth.

The Asian Tigers

The Asian Tigers reached and sustained real GDP growth rates often exceeding 10% per year for decades, and they are Hong Kong, Singapore, South Korea, and Taiwan. They use export-growth policies, a form of mercantilism, to enhance their comparative advantage, causing rapid industrialization, creating manufacturing jobs, and enlarging government's tax base. Japan similarly used export growth policies to fuel its development, rising from the ashes of World War II and becoming the world's second-largest economy within one generation. The main export-growth policies are:

Policy 1: The Asian Tigers devalue their currency relative to the U.S. dollar, causing a trade surplus. Thus, foreign currencies flow into the country while products flow out. Then the businesses accumulate these currencies, and they can buy and import machines and equipment from the Western countries. Finally, the government can use these currencies to provide financing and grant incentives to its key export industries.

Policy 2: The Asian Tigers protect their "infant" industries from foreign competition. They levy trade barriers on manufactured goods and imposed few restrictions on raw material imports. The Asian Tigers do not possess abundant natural resources [5], and they need low-cost raw materials to supply their factories. Finally, the export industry creates spillover effects because international trade expands the export industries that, in turn, expand secondary industries that supply the export industries [6]. Then their export industries can compete with companies and industries from the developed countries [5, 7].

Policy 3: The Asian Tigers' export industries form linkages and relationships with the international business community, and they learn from the industrialized countries' mistakes and avoid them. Moreover, free trade standardizes business practices and encourages governments to be transparent [7]. International investors avoid nontransparent countries because they risk losing their investments. Nontransparent governments are often beset by corruption. The Asian Tigers have low corruption levels. Hong Kong, Singapore, South Korea, and Taiwan were ranked 13, 2, 37.5, and 33.5 respectively in 2012[2], where a low score indicates low corruption levels.

The governments of Asian Tigers have budget surpluses, and their governments comprise a small sector of their economies. For instance, Taiwan had a budget deficit of -2.6% in 2011 while the other Tigers had budget surpluses, which is shown in Table 1. Their debt levels are impressive and are less than 34.9% of GDP, except for Singapore. Singapore has a debt level approximately 118.2% of GDP in 2011. Furthermore, small government deficits and debt do not crowd out private investment, and the countries can maintain low tax rates. Taxes comprise between 14.8% and 22.9% of an Asian Tiger's economy. Consequently, the central banks in the Asian Tigers do not purchase the government's debt to cover budget shortfalls. Instead, they

[2] Any ties in the rankings were averaged, which is why South Korea and Taiwan has a fraction in the ranking.

focus and maintain low inflation rates [5]. Nevertheless, Asian Tigers do not have limited government because their governments use corporatism to manage their industries and rapid economic growth. For example, the governments in China, South Korea, and Taiwan created associations that serve as intermediaries between the state and industries, aligning the industries' economic interests to the state [8].

Table 1. Economic Characteristics of the Asian Tigers and Kazakhstan in 2011 [9]

Country	Investment (% of GDP)	Budget Surplus (% of GDP)	Public Debt (% of GDP)	Taxes (% of GDP)
Hong Kong	22.9%	+3.5%	10.1%	22.9%
Singapore	23.4%	+0.3%	118.2%	14.8%
South Korea	25.5%	+2.2%	33.3%	23.0%
Taiwan	22.4%	-2.6%	34.9%	15.5%
Kazakhstan	18.3%	-2.2%	12.4%	20.5%

The Asian Tigers have well-developed banking systems, and their citizens are high savers [5]. A well-developed banking system contributes to economic development. Financial intermediaries channel savings into investment activities. Thus, businesses have a source of funds to invest in infrastructure, buildings, machines, and equipment. Businesses can adopt new production technologies and modernize their industries. Consumers and families can invest in homes, cars, and appliances via bank loans. Furthermore, a country with a solid financial system and strong property rights can attract international investors, boosting the investment rates within the country. Then investments can accelerate capital accumulation, fueling high economic growth [5, 10]. The Asian Tigers have investment to GDP ratios ranging from 22.4 to 25.5% in 2011.

The Asian Tiger governments encourage their citizens to attain high levels of vocational and technical training [5]. High levels of human capital boost both the labor's quality and productivity, and companies can adopt new technology quickly [11]. For instance, productivity growth is responsible for two-thirds of the real U.S. GDP growth rate. Finally, Asian Tiger governments encourage their citizens to become entrepreneurs. Their citizens establish their own businesses, creating wealth, and they reduce their dependence upon the government for their livelihood.

The Republic of Kazakhstan shares several characteristics with the Asian Tigers. It has strong international investment, a small tax burden, and little government debt, which is shown in Table 1. The Kazakh government is fiscally solid and repaid its IMF loans in full in 2000 [12]. Furthermore, Kazakhstan has a well-developed banking system, and Kazakhstanis possess a strong entrepreneurial spirit.

Kazakhstan's economy differs from the Asian Tigers. It has a bureaucratic, corrupt legal system and possesses petroleum and mineral wealth that may hinder its growth and development via the Dutch Disease and Resource Curse. Furthermore, Kazakhstan may isolate itself from the international community after joining the Customs Union with the Russian Federation and Belarus. Finally, Kazakhstan possesses a cultural trait that could further hinder economic growth.

Kazakhstan's Transition to a Market Economy

The Supreme Soviet appointed Nursultan Nazarbayev the President of Kazakhstan on April 24, 1990, and he has continued as President after he declared Kazakhstan's independence from the Soviet Union on December 16, 1991. Furthermore, the president exerts considerable control over Parliament, the judicial system, and local governments [13, 14]. A country in transition needs a strong leader who holds society together as it transforms from communism to a market economy. People require time to change their thinking and perceptions to the outside world as they incorporate foreign ideas into their society.

President Nazarbayev guided Kazakhstan towards a market economy in the early 1990s. He immediately removed price controls and allowed market exchange rates for its currency, the tenge [14]. Moreover, the Kazakh government privatized apartments, stores, and small businesses via voucher privatization. The government sold vouchers for low prices to its citizens who used the vouchers to buy the state's assets. Furthermore, Kazakhstan encourages direct foreign investment from the Western countries because they bring financial capital, technology, and managerial experience. However, the Kazakh government restricts foreign investment to its joint ventures with large state-owned companies. The government still controls the large companies in agriculture, energy, transportation, and communication industries [14, 15, 16]. Vladmir Lenin referred to these industries as the commanding heights.

The Republic of Kazakhstan inherited the Soviet legal system, and a government cannot jettison a legal system. Leaders can only modify or change the legal system slowly over time. Thus, many Kazakhstan's laws, rules, and regulations originate from the Soviet era, and many bureaucrats were trained and educated under the Soviet Union. Their institutional memory remains strong. Furthermore, many top government officials of the modern Kazakh government were high-ranking party members in the Communist Party [17]. Thus, their thinking and decisions remain the same, but they changed the rhetoric and names of the government agencies. As the state transitioned from Communism to a market economy, the bureaucracies still administer the state but extend control to the new private sector [18].

The president's top supporters own and control large segments of the economy [13]. As the state intertwines with businesses' interests, the government leaders use the state to enhance and protect their businesses. Consequently, the leaders limit competition and encourage rent-seeking behavior. Unfortunately, the state-owned companies may suffer from x-inefficiency because they may not minimize costs, could be mismanaged, and/or their employees suffer from low morale [17, 18, 19]. The political leaders may also inflate their salaries and use nepotism to fill high-level positions in their businesses. Unfortunately, the government protects the large industries from competition, and government leaders face little competition in the elections [19].

The president and his party have created a weak judicial system and weakened property rights. Although the entrepreneurs and property owners have legal rights set forth by the Kazakh Constitution, the judges may not enforce the law [13] because they are loyal to the president, and they may be corrupt, biased, and bribed [13, 15]. After the Kazakh government had passed a new law in 2007, it can revise or rescind contracts with Western firms if the firm's activities jeopardize national security [20]. If one party can change the contract terms at any moment, then a contract is not binding. Consequently, the international investors have little legal protection of their assets and investments as contracts become illegal or non-enforceable [18]. The international investors and Kazakhstanis could reduce their investments into Kazakhstan because they fear the government will expropriate their investments, and they would have little legal recourse.

The Kazakh bureaucrats can hinder the entrepreneurial spirit and burden businesses. The bureaucrats have wide discretion whether to approve or not approve licenses, permits, and registrations because Kazakhstan has many ambiguous, complex, contradictory laws, regulations, and licensing requirements [18]. Hence, business people must develop contacts with government officials, whom they could use to penalize their competitors by paying bribes [18]. Furthermore, public officials earn lower wages than the private sector. Thus, they may demand bribes, or the best workers leave the public sector and work for private businesses. Then the bureaucracies' staff becomes incompetent over time [14, 19].

Corruption is a severe problem in Kazakhstan. In 2012, the Heritage Foundation [21] ranked the Republic of Kazakhstan the 94th most corrupt out of 152 countries. Corruption plagues all post-Soviet states and is a legacy of the Soviet legal system. The complicated, bureaucratic legal system forced people and entrepreneurs to use bribes and government connections to circumvent complex laws and regulations. Thus, corruption became a way of life and embedded into their psyche. Some view corruption as efficient because they lead to verbal agreements, but judges may not enforce these illegal agreements [22]. Unfortunately, corruption introduces price distortions in the economy when the market prices do not reflect scarcity. Instead, corruption raises businesses' costs, creates uncertainty, and hampers new business growth.

Kazakhstan suffers from tax evasion that limits its funding and leads to corruption. The government pays its bureaucrats low salaries, including the tax inspectors. The scofflaws and violators could pay bribes to avoid taxes, fees, or imprisonment [23]. The bribes become an income to the poorly paid bureaucrats [7], and the business people and government officials are not likely to report it. Unfortunately, a poorly funded government is likely to be corrupt [19].

The Kazakh government reformed its tax laws and reduced the tax burden on its citizens. For instance, the Kazakh government levies a flat 10% income tax, a 12% VAT, a flat 15% corporate tax rate [2], and property tax rates ranging from 0.5 to 1% of a property's value. Moreover, the Kazakh government sells the rights to mine minerals and to extract petroleum; levies export taxes on petroleum and minerals, and imposes fines and fees on the mining/petroleum companies. Since the 2008 Financial Crisis, the Kazakh government has been increasing its rent-seeking behavior and has done the following:

- The Kazakh government accused the Karachaganak Petroleum Operating [KPO] Company of producing beyond its production quota, evading taxes and earning illegal profits. Furthermore, the Kazakh government expelled several expatriates for labor violations, and it seeks $2.5 billion in damages [24]. Then the state petroleum company, KazMunaiGas, wants a 10% stake in the joint venture [25]. KPO is a joint venture between BG Group, Eni, Chevron, and Lukoil with market shares of 32.5%, 32.5%, 20%, and 15% respectively.

- The Kazakh government accused the Kashagan project of cost overruns and delays. Consequently, the Kazakh government, via KazMunaiGas, doubled its share in the joint venture [24].

- The Kazakh government expropriated Ascom's assets in Kazakhstan in 2010. Ascom is a Moldovan petroleum and natural gas company that owned the rights to extract oil and gas in the Borankol and Tolkyn fields. The company invested approximately $1 billion and paid $500 million in fees and taxes to the Kazakh government over 11 years. Ascom's legal troubles stated in 2008, when it discovered a large petroleum reserve and refused to sell its interests to KazMunaiGas [26].

The European Bank for Reconstruction and Development [27] estimated the Kazakhstan's private sector comprised nearly 65% of its GDP in 2009, greater than the Eastern European countries. It praised Kazakhstan for liberalizing prices and exchange rate and privatizing small businesses, but the Kazakh government received low marks for governance, enterprise restructuring, and competitive policies [27].

The Kazakh government could hinder its economic growth. First, the Kazakh government is expanding state enterprises [7], and government ownership leads to more corruption, greater business costs, and rent-seeking behavior on behalf of the state. Second, foreign investors and businesses stop investing in Kazakhstan. Then Kazakhstan loses access to financial capital, modern production technologies and efficient management practices. Finally, the Kazakh government uses fines and penalties to enhance its positions into joint ventures, and its partners have little legal recourse because the judicial system is weak and judges would never rule against the state.

The Kazakh Banking System

The Republic of Kazakhstan has a well-developed banking system. Many Kazakhstanis are depositing their savings into Kazakh banks and using the ATMs at the banks and shopping malls. The Kazakh government imposed several measures to help developed its banking system. First, Kazakhstanis can choose a bank account's denomination, the tenge or U.S. dollar. The public remembers the tenge devaluations in 1998 and 2008, and they can save in U.S. dollars. Second, the Kazakhstan Deposit Insurance Fund insures bank deposits, so citizens believe their bank accounts are protected from bank failure. Third, the government pays retired citizens their monthly pension via electronic deposits into bank accounts. Many employers electronically deposit workers' payroll too. After the president passed a law in 2006, citizens legally can deposit funds into bank accounts, even from unreported activities and sources. Subsequently, the banks have deposit funds to grant loans to businesses and households, fostering and driving economic growth.

The Kazakh government created mortgages in 2000, and Kazakhstan experienced strong growth in the real estate market. Unfortunately, a banking system might create asset bubbles as the bank loans inflate asset market values. However, the soaring property values created wealth for its citizens. For example, condominium prices in Almaty, the largest city, were about $5,000 in 1995 and surged to roughly $100,000 by 2008. The original city residents benefited because they bought multiple low-priced condominiums and sold them for large capital gains as prices soared. Furthermore, the president moved the country's capital from Almaty to Astana in 1997, boosting Astana's construction industry [3].

The 2008 Financial Crisis shut down the construction industry as large construction companies, such as Kuat Construction, bankrupted. Real estate prices have not fallen yet because homeowners' demand for apartments remains strong as they purchased existing apartments. Many Kazakhstanis leave the villages and migrate to the cities for economic opportunities. Even if Kazakhstan experienced imploding real estate prices, the impact may be minimal. First, many families outright own their flats while mortgages comprise a small portion of the ownership market. Second, the Kazakh government took control over the bankrupted, partially completed apartment buildings. The Kazakh government is finishing the construction and donating them to the citizens who do not own property.

The Kazakh government interferes with its banking system. First, the National Bank of Kazakhstan strengthened regulations over time, forcing many banks to exit the market and concentrate market power into a few large banks. Kazakhstan had 200 banks in 1995 [28] that dropped to 34 banks by 2010 [29]. Second, banks lend to politically connected companies and corporations, while the entrepreneurs and small businesses have trouble obtaining loans [18]. Finally, the Kazakh government nationalized its largest banks, when its banks teetered on bankruptcy during the 2008 Financial Crisis. The public joint-stock holding company, Samruk-Kazyna[3], become the majority shareholder in the country's largest banks: BTA Bank, Halyk Bank, Kazkommertsbank, and Temirbank [30, 31]. The banks recovered quickly from the financial crisis. The Kazkommerts and Halyk Banks earned profits in 2009, while BTA and Temir banks are expected to earn profits in 2010 [24, 30].

The Kazakh government controls the National Bank of Kazakhstan, its central bank. Both the Minister of Finance and a president's assistant serve as board members on the central bank. Then the National Bank of Kazakhstan [32] is the sole shareholder of the Kazakhstan Deposit Insurance Fund, ensuring the president's control over the country's banking system. The central bank tries to slow the depreciation of the tenge because the tenge dropped in value in February 2009. Currently, the central bank pegs the exchange rate between 127.5 and 165 per U.S. dollar [30]. Regrettably, a central bank devaluing its currency could precipitate capital flight, triggering a crisis. For example, the Thai government devalued the baht in 1997, triggering capital flight as international investors withdrew their funds quickly from Thailand. The Thai devaluation spread rapidly to the neighboring Asian countries, sparking the 1997 Asian Crisis.

The Kazakh Export Industries

Kazakhstan exports petroleum, minerals, and wheat, and it became the second largest petroleum producer of the post-Soviet states after the Russian Federation. Consequently, the regions that experienced strong growth in Kazakhstan are areas where the mining and petroleum industries expanded [3]. Furthermore, as Kazakhstan exports commodities, hard currencies flow into the country. As citizens accumulate foreign currency, they can in turn buy imports [6].

Petroleum propels the Kazakh economy. The percentage change in the world's annual petroleum price is plotted in Figure 1 with Kazakhstan's inflation rate. The left vertical scale is the inflation rate in percent while the right scale is the percent change in the nominal petroleum price. First, the petroleum price and inflation move in opposite directions, where in developed countries, rises in petroleum prices boosts inflation as products and services become more expensive. Consequently, Kazakhstanis may view the petroleum price as a barometer of the economy. If the petroleum price falls, subsequently, the people panic. They stock up on goods and services, triggering inflation because people are preparing for a recession. Furthermore, the central bank could print money because the government receives less revenue from the lower petroleum price. However, the inflation from printing money must occur rapidly, which is possible for a country with a small population.

[3] Samruk-Kazyna controls a variety of energy enterprises in Kazakhstan [31]

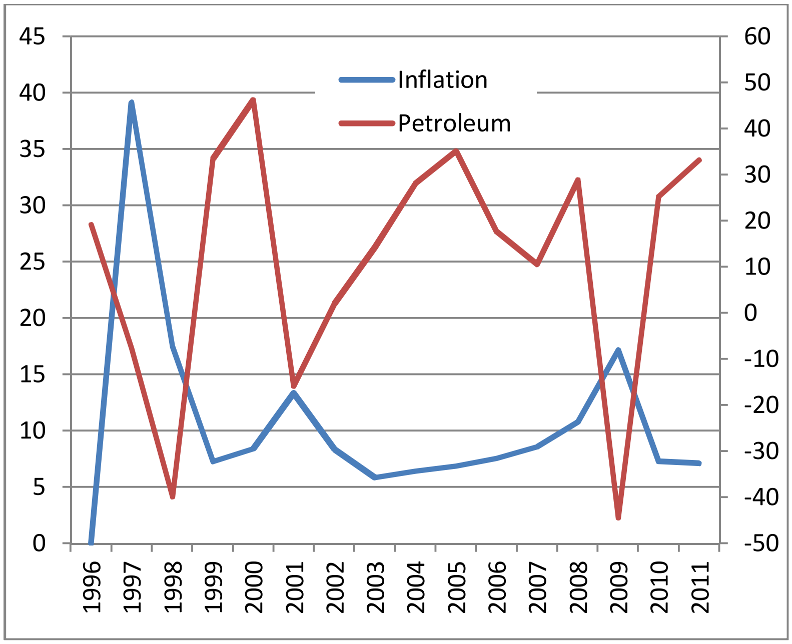

Figure 1. Kazakhstan's Average Inflation Rate and Percent Change in the nominal petroleum price [4, 33]

Kazakhstan has another problem in its long-term development. It depends on revenues from petroleum and minerals. Unfortunately, the petroleum and mineral world prices are highly volatile and unpredictable [34], and they cause a country's currency flows to fluctuate [6]. Consequently, Kazakhstan would experience wide swings in its petroleum revenue. Kazakhstan's real GDP growth rate, current account as a percentage of GDP, and percent change in the petroleum price are shown in Figure 2. The left vertical scale measures both GDP and the current account while the right scale is the petroleum price. Kazakhstan's economic growth and current account surplus depend on the petroleum's price because the variable swings coincide. Furthermore, Kazakhstan experienced five current account surpluses in 2000, 2004, 2008, 2010, and 2011.

The president created the National Fund in August 2000. The Kazakh government deposits revenues from petroleum, minerals, and corporate taxes into the National Fund [34]. The fund helps smooth government revenue from volatile commodity prices and helps maintain sustainability because petroleum and minerals are depletable resources. Every barrel of petroleum or every ton of mineral extracted today deprives future Kazakh citizens of these resources. Thus, sustainability requires the government to create consumption and investment streams. Once Kazakhstan depletes the petroleum and minerals, it still has investments in the National Fund. For instance, the Kazakh government allocates a fixed amount each year from the fund for government while it invests the rest in low risk securities in the Western countries. Moreover, the Kazakh government uses the fund to cover national and local government deficits.

The fund's management requires transparency and accountability [34]. Unfortunately, the public has little knowledge of this fund, and the Kazakh government has low transparency [14, 34]. The Ministry of Finance [35] publishes aggregate totals for the fund and provides no details of its investment activities. The National Fund held approximately 5 billion tenge or $34 million as of September 1, 2010. Furthermore, the president chairs the National Fund [14] while the National Bank of Kazakhstan manages the National Fund.

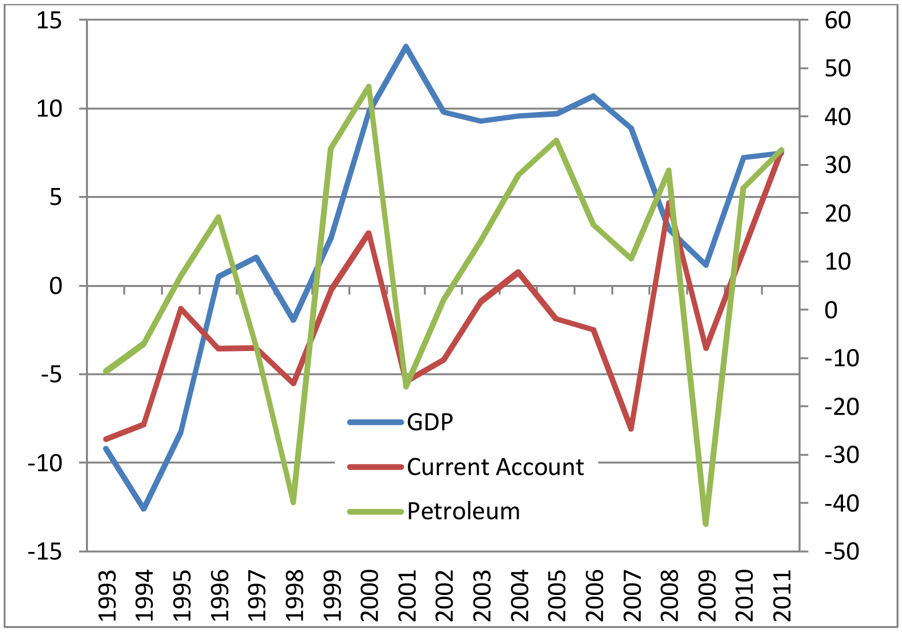

Figure 2. Kazakhstan's real GDP growth rate and current account are plotted with percent changes in the petroleum price [4, 33].

Resource rich countries could suffer from the Dutch Disease. The Dutch Disease is the foreign investors invest in the resource-rich industry, such as petroleum and minerals, causing a country's real currency exchange rate to appreciate. The export prices rise while import prices fall. Thus, the export industries cannot compete against foreign companies because their prices are greater, and the country never develops a competitive export industry. Consequently, resource-rich countries usually have poor long-run GDP growth rates [5, 36].

Resource rich countries could suffer from the Resource Curse. A country with large mineral and petroleum wealth suffers from more corruption, greater income inequality, higher poverty rates, and an authoritarian government [37]. The political leaders know their country has petroleum and mineral wealth. Thus, they believe they can interfere with all business affairs, pass bad laws and regulations, and might expropriate and steal the nation's wealth.

A bad legal system obstructs international investment and harms long-run economic growth. For instance, Kazakhstan exports petroleum, minerals, and wheat, but it manufactures few intermediate and finished products. Manufactured products have greater value and generate larger revenues and profits than raw materials. Kazakhstan does not export any intermediate or final products on a large scale. With the creation of the customs union, the Republic of Kazakhstan would remain a raw material supplier for the Russian and Belarusian manufacturing industries.

The Customs Union

Belarus, Russia, and Kazakhstan formed a customs union in 2010. All three countries agreed to remove all trade barriers and duties among themselves, but erect common customs with uniform tariffs. The import duties for non-members range as high as 30% and importers must pay the 12% VAT tax for Kazakhstan [2]. Russia and Belarus have different VAT tax rates.

The net benefits of a customs union are ambiguous. A customs union benefits countries as their economies integrate. Firms have access to larger markets, more consumers, and more potential investors. More trade fosters more competition; thus, monopolies in one country can compete with monopolies in other countries. Moreover, regions within the union can specialize in products and services as free trade links all regions within the union. If international investors believe their investments are safe within a customs union, then they would invest and manufacture products and services within the union, circumventing the trade barriers.

A customs union, however, could hinder economic growth. First, the customs union can encourage the growth of monopolies. For instance, a company could grow into a natural monopoly by supplying a large market by using economies of scale. As it increases production, its average cost fall, and rivals cannot enter the market and compete because its unit costs are greater. Second, the new trading rules and regulations may increase the size, scope, and influence of the bureaucracies, fueling corruption. Executives and investors may pay bribes and kickbacks to circumvent trade barriers and restrictions. Third, a government collects tariffs and duties from trade. Countries with widespread income tax evasion rely on tariffs and export taxes for revenue because a government has control over its ports. Trade protection may increase x-inefficiency, and government heightens its rent-seeking behavior [7].

A customs union between Belarus, Russia, and Kazakhstan has an ambiguous impact on market prices, leading to three scenarios. First, a customs union could lower market prices. If the custom union members were already major trading partners, then the customs union eliminates all trade barriers and tariffs among themselves, reducing market prices. The leaders of the customs union espouse this view, of course. Second, some products like electronics, computers, and cars are produced outside the customs union. Then tariffs and duties would boost market prices, and importers would pay the VAT tax, causing the scenario with the highest market prices. Finally, the customs union may divert trade. Trade shifts from the outside countries to members within the customs union. Thus, market prices would lie between the low price scenario and the high price scenario. Depending on the prices, a customs union may erect barriers to international trade.

The customs union could hinder economic freedom. A government grants freedom, letting its people engage in business, own, alter, or sell properties, and move resources freely. Economic freedom is difficult to measure and quantify, and is a designer's judgment call. The Heritage Foundation [21] is used because the index has 15 years of observations, showing a country's trend between 1999 and 2012. The Heritage Foundation's Economic Freedom Index comprises of 10 measures: business freedom, financial freedom, fiscal freedom, freedom from corruption, government spending, investment freedom, labor freedom, monetary freedom, property rights, and trade freedom. The data has 152 countries after deleting countries with missing observations. Linear interpolation was used to compute missing values for a country with one missing observation while all countries were deleted if they had two or more missing observations, or the first or last observation was missing. Finally, changes in methodology from year to year would alter a country's raw scores, but the assumption is the raw scores lead to the correct countries' rankings.

The customs union could worsen Kazakhstan's economic freedom. The Heritage Foundation [21] classified Belarus as repressive; Russia is borderline repressive while Kazakhstan is neither repressive nor economically free. The Freedom Index is shown in Figure 3 for Belarus, Kazakhstan, and Russia. Kazakhstan became economically freer after 2003 than its trade partners. Furthermore, the corruption rankings are shown in Figure 4. After 2008, these countries are ranked quite corrupt, and they are post-Soviet states that inherited the Soviet legal system. Therefore, corruption will remain a standard business practice.

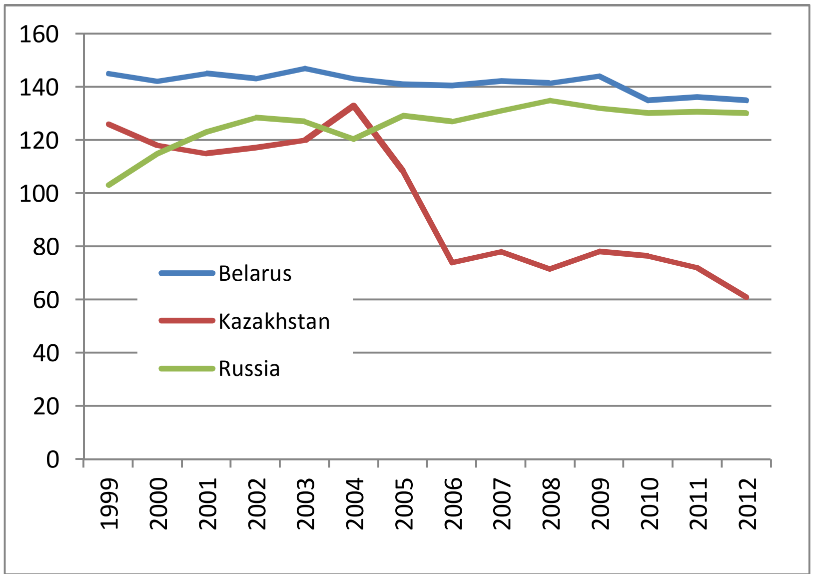

Figure 3. The Economic Freedom ranking for Belarus, Kazakhstan, and Russia

Why join the customs union? The president of Kazakhstan wants his country to survive because Kazakhstan is landlocked, and its pipelines flow into China and Russia [38, 39]. Moreover, Gazprom [40] owns many of the pipelines passing through Russia, and the Russian government is a majority shareholder in Gazprom. Consequently, Kazakhstan needs a stable relationship with Russia, so it can export its petroleum to the world, via Russia. China may go along with the customs union because Kazakhstan's small population would buy few Chinese goods, and China needs the petroleum and minerals to fuel its manufacturing industries.

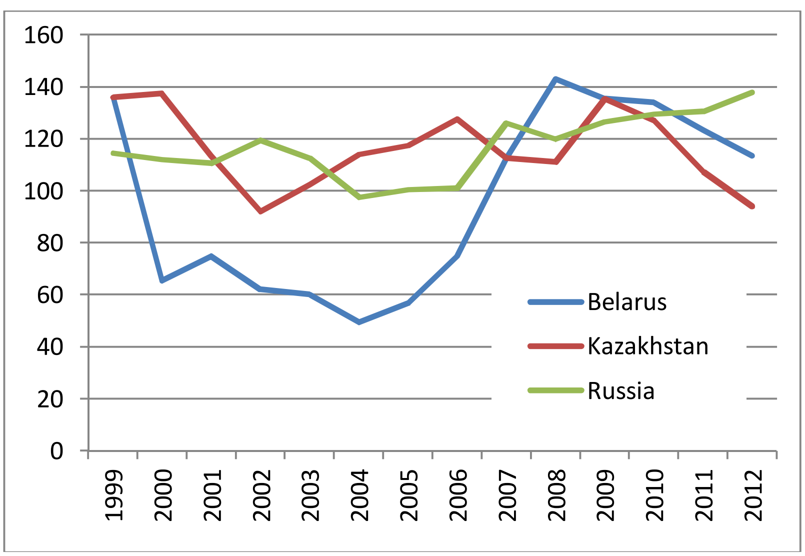

Figure 4. The Corruption Ranking for Belarus, Kazakhstan, and Russia

The customs union might create more problems in Central Asia because this area is landlocked and is filled with conflict and instability. Kyrgyzstan experienced two revolutions in 2005 and 2010; Uzbekistan is a police state, while Tajikistan suffered a civil war. Consequently, either they join the customs union, or they isolate themselves from the international community. Unfortunately, the customs union grants the Central Asian countries access to the outside world.

A Cultural Trait

Some Asian cultures develop strong paternalistic relationships between leaders and followers. The superior, the president, manager, or supervisor provides care, guidance, protection, and nurturance to the subordinates and workers. In return, the workers and subordinates must be loyal and subservient to the superiors [41]. The Asian Tigers have strong market-oriented economies that overcome this hindrance, while this cultural trait could hinder Kazakhstan's growth and development.

Kazakhstanis cannot question, criticize, or debate their authority figures, including managers, supervisors, or presidents of companies and corporations. Furthermore, the Kazakh government can charge or imprison citizens with crimes if they question, criticize, or ridicule the President of Kazakhstan [13]. If a person cannot criticize the President of Kazakhstan, subsequently, he or she cannot criticize a government agency or bureaucracy because the president heads all government agencies in Kazakhstan. If one called a bureaucrat corrupt, then the president must be corrupt too because the bureaucrat works for a government agency that is an extension of the president. Unfortunately, Kazakh citizens have little recourse to report corrupt politicians and bureaucrats while bureaucrats can hide behind a veil of secrecy and maintain their illegal, corrupt activities.

The students, teachers, and professors in the schools, colleges, and universities might not criticize or analyze the government. For example, a few of them research and analyze the customs union between Belarus, Russia, and Kazakhstan. All their reports and research would share the same conclusion. Kazakhstan will benefit from the customs union because the president believes Kazakhstan will benefit. Consequently, all researchers must slant and bias their research reports towards the government's view. Otherwise, researchers may encounter danger or shortened careers. Consequently, if leaders choose a wrong direction to traverse, no opposition can voice their concerns and point in another direction. Then the leaders' bad decisions are never corrected.

Conclusion

The Republic of Kazakhstan still possesses the structures of a planned economy. Government leaders possessing the Soviet mentality must control or interfere in any business affairs under its jurisdiction, despite a person's rights defined under the constitution. Furthermore, the government officials started nationalizing and interfering with its petroleum and mining companies. Even if Kazakhstan did nationalize all its industries, it still can export its minerals and petroleum. Nevertheless, international investors would stop investing in Kazakhstan, and the government will lack funding to develop new fields, start new companies, or use new technologies from the West. Thus, low international investment will depress Kazakhstan's economic growth.

The Republic of Kazakhstan joined the customs union with the Russian Federation, and Belarus. Furthermore, these countries are in talks about establishing a common market, where the members allow capital, investment, and labor to move freely between them. Russia will dominate the customs union, becoming its hegemony and reviving fears of the new Soviet Union. Furthermore, the customs union aligns Kazakhstan's economic growth to the Russian economy, and it could undermine President Nazarbayev's power. Kazakhstanis were proud of their independence from Russia after two centuries of occupation. Dissent, fear, and protests may erupt as Kazakhstanis fear the reoccupation and control over their country by Russia again. On the other hand, the president's death would create a power vacuum, possibly triggering instability. Although the president has three daughters, he has no son to carry his legacy. Some Kazakhstanis believe the next president will further curb and repress Kazakhstan's market economy.

International investors and citizens are afraid to retain their assets and investments in a country, where they believe the government could seize their assets, such as a new president who does not believe in capitalism. Then they quickly transfer their wealth and capital overseas, triggering a crisis. The Tax Justice Network [2012] estimated Kazakhstan has lost approximately $138 billion in capital by 2010 as people and businesses have transferred their money outside of Kazakhstan. Although the Kazakh government enforces tight capital controls, capital flight can quickly destabilize a country and deprive it of investment.

How did Kazakhstan experience incredible real GDP growth rates between 2000 and 2007? First, the booming real estate market created construction jobs and increased citizens' wealth. Second, Kazakhstan has a sizeable underground economy [18]. Thus, the Republic of Kazakhstan has a de facto deregulated economy with a low-tax burden because the government has limited funding to enforce compliance with the rules and regulations. Finally, Kazakhstan exports petroleum, minerals, and wheat, causing capital inflows into the country.

Kazakhstan could continue its phenomenal economic growth rate if Kazakhstan's positive sources of growth can dominate and exceed its negative sources. The favorable growth sources are a small population, a strong banking system, a de facto deregulated economy, high investment levels, low taxes, and large reserves of minerals and petroleum. However, the negative growth factors are weak property rights and judicial system, a bureaucratic, corrupt legal system, nationalization of its industries, trade protection through the new customs union, and the volatility in the world's prices for petroleum and minerals. Unfortunately, the negative factors create uncertainty, increase business costs, and hamper the creation of new businesses.

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