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The consequences of granting PNTR to Kazakhstan



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Summary

This policy brief looks at why Kazakhstan has not - as yet - been accorded Permanent Normal Trade Relations (PNTR) by the US despite acceding to the WTO in 2015. At this stage, both sides appear keen to resolve the matter. Even if the scope for augmenting trade and investment is in the short run quite limited, the grant of PNTR could unlock further US investment in the future. However, this would require some complementary policies to be taken, such as further privatisation along with divestiture by politically connected businesses. In addition, there is considerable scope for improving the business environment, even if political movement towards greater democracy is unlikely. The major pivot eastwards by Russia since 2022 and China's use of Kazakhstan as a trade route to Europe, has hugely boosted trade and investment flows from both countries. In this context, PNTR would also support mutual engagement between the US and Kazakhstan while helping the latter maintain some balance in its trade relations at a time of growing polarisation.

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Introduction

One instrument of US trade policy is the granting of most favoured nation – in effect bilateral free trade status - to other economies. Over time, this has become the norm, although there have been some enduring exceptions, such as Cuba and North Korea. Yet, the process of granting free trade status has also had some idiosyncratic features, notably for the former socialist economies of Eastern Europe and the Soviet Union. In particular., Section 402 of the Trade Act of 1974 - the Jackson—Vanik amendment - placed restrictions on the granting of normal trade relations (NTR) conditional on each of these jurisdictions' approach to emigration, principally Jewish emigration. The US President was however allowed under this amendment to extend conditional NTR status to a country subject to annual review. Outright lifting of Jackson-Vanik would require the US Congress to authorise the President to extend Permanent Normal Trade Relations (PNTR) status.

There is today little argument about the anachronistic nature of this amendment. Indeed, bit by bit over the past couple of decades, the great majority of the erstwhile socialist economies have had PNTR approved. This approval has commonly come at, or close to, the time of their accession to the World Trade Organisation (WTO). Even so, there are some enduring exceptions that include Kazakhstan, Uzbekistan and Tajikistan in Central Asia, as well as neighbouring Azerbaijan. The fact that PNTR has not been conferred on Kazakhstan may seem particularly odd given the country's accession to the WTO at the end of 2015.

The reasons for withholding PNTR from these countries have not been explicitly spelled out. However, it can be surmised that it relates to their political regimes, accompanying civil and political rights, as well as features of their trading and investment regimes. The importance of political considerations in affecting decisions about trade relations is evident from the withdrawal of PNTR in 2022 from Russia and Belarus as a consequence of the war against Ukraine.

Despite lacking PNTR, Kazakhstan and the other countries have been consistently deemed compliant with the Jackson-Vanik Amendment and have thereby received conditional NTR status subject, however, to annual review. Such compliance has allowed them to benefit from free trade ties to the US. Indeed, since the mid-1990s trade between Kazakhstan and the US has grown at 11-12 percent per annum. However, the value of total trade between the two economies remains, in comparative perspective small; US-Chile trade, for example, is over thirteen times larger. Although energy exports have supported a robust trade balance, Kazakhstan has consistently run current-account deficits that are largely attributable to foreign investors in the energy sector remitting profits.

Even if the need for annual renewal has doubtless added some element of uncertainty, the low probability attached to a failure to renew, as well as the nature and composition of the US's trade and investment with Kazakhstan, would suggest that the grant of PNTR would be unlikely to deliver major economic benefits. Most of the benefits have already been captured under the annual temporary grant. Indeed, analysis of the impact of large numbers of FTAs has found that the effects tend to be weaker when a prior trade agreement has been in place, as well as when economies are further apart geographically (S. Baier et al.) - both factors being of obvious relevance in the case of Kazakhstan.

What a grant of PNTR would do, however, is send a positive signal about US perception of the broader governance and political strategy of the country. If so, it might be expected that a tilt towards approval would have been triggered by some demonstrable improvement in key indicators. The signals that approval would send doubtless explains why the Kazakh government has been lobbying for the grant of PNTR even if the benefits from escaping the club of the exclusions may be limited and certainly hard to quantify.

In the US Congress, there is also some appetite for change. A bipartisan Kazakhstan Permanent Normal Trade Relations Act was introduced in May 2023 and granting PNTR is also supported by the Biden Administration. However, all of this is now unfolding against the background of Russia's invasion of Ukraine and the assortment of policy measures, including sanctions, that have been put in place in response. These have had implications for Kazakhstan and have raised some potentially difficult issues regarding sanctions.

This brief looks at whether granting PNTR could be convincingly related to improvements in Kazakhstan's political, business – particularly investor – environment, as well as the broader political and civil rights situation over recent years. Or whether other factors, such as those of a geopolitical nature, are more likely to account for the shift. In short, could a grant of PNTR be a credible signal that Kazakhstan is now a safer place to invest? Or is this more about geopolitical factors, including Kazakhstan's ability to balance relations with its immediate neighbours, as well as with Western trade and investment partners?

Political system and rule of law

Since emerging as an independent nation, Kazakhstan has been an unambiguously authoritarian regime. The widely used Polity 5 dataset classifies the country as an autocracy. The 2023 V-Dem rankings place Kazakhstan as 128 out of 179 countries in terms of electoral democracy. This assesses whether elections are free and fair and whether a free and independent media exists. It also assesses countries in terms of liberal democracy, measured by the rule of law, checks and balances and civil liberties. For electoral democracy Kazakhstan's score in 2023 was 0.28 and for liberal democracy 0.14. To put this in perspective, the top ranked country – Denmark – had scores of 0.91 and 0.88 respectively.

The founding President and autocrat – Nazarbayev – stepped down in 2019 having secured a set of immunities and positions of influence for himself and family. Following a period of disorder in early 2022, the parliament subsequently took away his status as the 'Leader of the Nation' and repealed a law that gave his immediate family legal immunity. In January 2024 he was also relieved of the influential role of Chairman of the Security Council. By such means, his successor – Kassym-Jomart Tokayev – has sought to limit his predecessor's powers and influence. But that has not so far come with any credible commitment to deepening democratic reforms, despite some rhetoric to the contrary.

There has, nevertheless, been some legislative action. A set of constitutional amendments was approved by a very large majority in a referendum in June 2022. Those reforms notionally limited presidential power and reduced the barriers to the registration of political parties. Even so, power continues to be highly centred on the President. Moreover, the ruling Amanat party has a very comfortable majority ensuring no major challenge from the parliament.

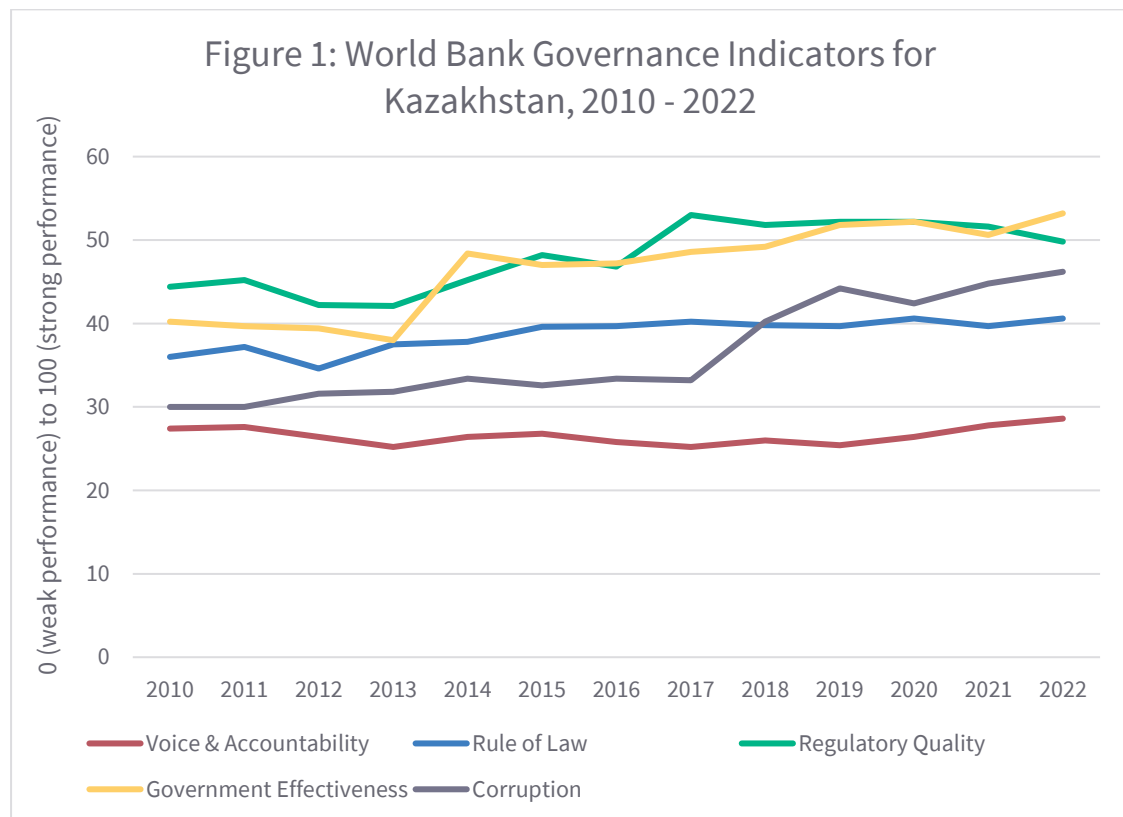
To complement judgements about the shape of the political system, *Figure 1* gives World Bank measures for dimensions of both political and economic governance². These draw on a wide variety of sources and judgements. For Voice and Accountability there has been some small improvement since 2019. A Freedom House measure that runs until 2024 reports no change since 2021. This is also true for a supplementary rating for political rights and civil liberties that they compile. For the Rule of Law, the World Bank reports essentially no change since 2015. However, the Heritage Foundation's Judicial Effectiveness indicator shows clear deterioration between 2021-2024. Outside these measures, a recent US State Department Report (US State Dep. 2022) has argued that the executive branch continues to control the legislature and the judiciary, as well as regional and local governments. A new law that established a process for electing the chairmen of district courts and strengthening guarantees for the immunity of judges was introduced in March 2023. However, it is too early to tell how effective this will prove.

In short, there are few, if any, signs that the country is evolving away from an authoritarian form of government in the direction of greater democracy. Power remains centralised in the presidency and although elections are held, they are neither free nor fair. Open and meaningful political competition remains absent.

² <https://www.worldbank.org/en/publication/worldwide-governance-indicators>

Measures of the business environment

Kazakhstan has always struggled with its business environment where regulatory interference, arbitrary policies, preferential treatment and other features have affected the incentives to invest and imposed costs on companies operating in the country. The most recent Economist Intelligence Unit (EIU) index for the business environment continues to assign a relatively low ranking to Kazakhstan between 2019-23 with little improvement expected in the coming years. In a regional context, the country ranks 13 out of 16.



Source: World Bank Development Indicators

Turning to the components of the business environment, *Figure 1* shows that for regulatory quality, government effectiveness and corruption there has been some improvement after 2016/17, particularly with regards to corruption. Transparency's Corruptions Perceptions Index also shows some improvement, albeit slight, between 2019-2023. Set in comparative context, Kazakhstan's country ranking for corruption and government effectiveness improved between 2017-2022/23, while for regulatory quality it has fallen back. The installation in January 2024 of a new Prime Minister and cabinet with few or no ties to the previous President has been interpreted as the prelude to a further push to improve the business climate and act against corruption.

Finally, firm survey data suggest that many longstanding complaints have yet to be resolved. Complaints range from deficiencies in the legal system and rule of law to the high level of regulatory interference by government, as well as the quality of infrastructure, human capital and the workings of the tax administration.

Politically connected business and competition

Although the measures used above suggest some clear improvements in the business environment over time, it is important to understand that in Kazakhstan, company ownership and market structure have an enormous impact, not least on the ability of new companies to enter and grow. In these regards, the Kazakh economy has some well-embedded features that impede competition and, more widely, impair the quality of the business climate.

There remains a large public sector. Despite a rash of earlier privatisations, by early 2023 there were still around 26,000 state-owned enterprises (SOEs) and companies where the state has some stake. Samruk-Kazyna (the National Welfare Fund) continues to act as the main (but not the only) holding company with over \$70 billion in assets - equivalent to 37% of GDP - through its control of the major SOEs in oil and gas, energy, mining, transportation and communication.

As striking, however, is the accumulation of market power by a limited number of private companies and business groups, most of which have had close ties to the former President (Commander and Prieskienyente 2022). In his time in power, large parts of the economy came to be dominated by these connected companies and individuals, some of whom were direct family members. Moreover, these companies tend to feed off the public sector through contracts and other privileges.

The consequence of these arrangements has been the accretion of considerable concentration. By 2020, the largest 25 companies – listed and unlisted, state-owned and private – had revenues that amounted to 25-28% of GDP. This is a high share when compared with the advanced economies, let alone many emerging ones. Further, it is unlikely that this level of concentration has materially changed in the last few years.

Initially after Nazarbayev's resignation in 2019, there was little apparent effort made by the new government to dilute the influence and weight of these privileged groups and companies. However, after the riots and killings of January 2022, this changed, not least because the disorder was attributed to loyalists of the former president. Once the disorder was suppressed, cases were opened against people accused of fomenting trouble but also against some vested interests. Indeed, Tokayev explicitly condemned the accumulation of out-sized wealth by an oligarchy, let alone the ways in which that wealth had been accumulated.

To date, the main foci of attention have been the relations, by birth or marriage, of Nazarbayev. Some have been arrested for embezzlement and corruption and this has been accompanied by seizures of assets. The most prominent instance has involved Nazarbayev's nephew – Kairat Satybaldy – who has been jailed, stripped of his rank on the National Security Committee and barred from running for public office for ten years. Gains, deemed illicit, amounting to around \$1.5bn have also been seized from him by the state. These include a 30 per cent stake in the Kazakhtelecom company as well as in the financial sector. By early 2024, the total amount seized from multiple sources has exceeded \$2bn which implies that over 75 per cent of this is from Satybaldy alone.

Confiscations have also been accompanied by measures inducing Nazarbayev's family members to resign from official positions as well as cede some of their interests in companies. The most prominent example concerns Timur Kulibayev, Nazarbayev's son-in-law and one of the richest people in Kazakhstan. Aside from resigning as the chairman of the nation's main business lobby, he has handed over his 49 per cent stake in Petrosun, a large oil and oil products trader whose majority shareholder is China's National Petroleum Corporation (CNPC). He also relinquished his 50 per cent stake in the Liquefied Petroleum Gas Storage Park in Atyrau in favour of the state. Other sons-in-law of Nazarbayev have been forced out as chairmen of the major state-owned oil and gas companies (KazTransOil and QazaqGaz) while his younger brother has had to relinquish his 32 per cent share in the Almaty Heavy Machine Building Plant.

Although the combination of criminal cases, asset seizures and transfers has gathered pace, it should be noted that it has left untouched the interests of most of the main business owners that dominate large parts of the Kazakh economy. Indeed, even the business empires of Kulibayev and his wife – Dinara Nazarbayeva - have not been substantially affected. Moreover, the businesses of three other major oligarchs, all of whom were very strongly connected to the previous President – Vyacheslav Kim, Vladimir Kim and Bulat Utemuratov - remain untouched. The wealth of the top 5 individuals which was equivalent to 10 per cent of GDP in 2020 has only slightly declined to 9 per cent by 2023. The lock-hold of a few immensely wealthy business owners on significant parts of the economy continues.

In sum, the great majority of those who benefited materially from their close connections to the previous President have retained control of their business vehicles and interests. The result is that the economy remains strongly marked by high concentration in assets and market shares. Needless to say, these arrangements continue to impede competition while also affecting incentives for new investment.

Foreign Direct Investment in Kazakhstan

Kazakhstan has managed to attract significant Foreign Direct Investment (FDI) over the past three decades. By 2000 the stock of FDI was just above \$10bn rising to nearly \$83bn in 2010 and \$169bn by 2023. FDI inflows went from an annual average of \$1217m between 1992-2001 to \$8130m between 2002-2011 before falling back to \$6362m between 2012-2021 (and as low as \$3500m between 2018-2021). The peak years for incoming investment were 2007-2013. In this process, the country has managed to attract the lion's share of FDI – over 70 per cent - flowing to Central Asia.

In March 2024, President Tokayev declared that the country is targeting at least \$150bn additional investment by 2029 (A. Satulbaldina 2024). This is certainly ambitious as \$30bn annual inflows would be 250 percent larger than in the peak years and 750 percent larger than in the five-year period ending in 2022. Part of this ambition can be traced to the large uptick in investment from China and Russia in the last few years.

Despite the recent surge in investment from China and Russia, the main source of FDI - approaching 50 per cent - has been Europe, with a further 25-33 per cent originating from the US, making it the second largest investor in the country. A significant part of this investment is long-standing with most directed to hydrocarbons and mining where US companies – notably Chevron and Exxon-Mobil - are major players. The spurt in US companies' investment in hydrocarbons dates to the 1990s/2000s with major stakes then assembled in the Kashagan, Karachaganak and Tengiz fields. Chevron holds a 50 per cent interest in Tengiz, 18 per cent stake in Karachaganak, as well as being the largest private shareholder in the Caspian Pipeline Consortium. Additional investment of \$45bn in Tengiz is slated for late 2024 which, if implemented, would raise daily output by around 36 per cent. In addition, the US-Kazakhstan Business Council estimates that over 700 US companies are presently operating in Kazakhstan in around twenty sectors including agriculture, insurance and infrastructure. Nevertheless, energy projects account for nearly 95 per cent of total US investment to date and most of the remaining investments remain fairly small-scale.

Investment disputes

Despite being a clear pole of attraction for investors drawn to its natural resources, Kazakhstan has had a troubled history with the resolution of commercial disputes, including those involving foreign investors. Disputes can be submitted for settlement in Kazakhstan's courts or international arbitration. Between 1996 and 2021, 21 investor state disputes covered by treaties were filed with the total value of claims being in excess of \$12.5bn. Up to 2020 the investment under dispute amounted to over 8 per cent of the total stock of FDI. The number of cases against the Kazakh state launched between 2010-2018 remained relatively high, certainly when compared with neighbouring states. More recently, the evidence suggests that the number of cases under dispute has been declining sharply. Further, cases of expropriation by well-connected persons/companies and arbitrary action by the state which became more common in the later years of the Nazarbayev Presidency have largely disappeared. Even so, in February 2022, the Ministry of Justice reported about 25 pending arbitration proceedings, including 14 in international arbitration courts.

Historically, most disputes have taken at least 3-4 years to settle with some stretching on for over a decade, mostly due to the sovereign refusing to conform with the various legal judgements. What remains problematic to this day is that judgements are not always enforced with the government not always abiding by even final international arbitral decisions. There is the well-publicised case of Tristan Oil in which a set of rulings against the Kazakh Government have been ignored so that the matter remains in legal process without resolution.

The impact of the Ukraine war: eastern pivots and trade diversion

Even as the prospect of PNTR enters into view, the Kazakhs find themselves in a potentially difficult situation following the invasion of Ukraine by Russia in February 2022. Not only has Russia had PNTR revoked and extensive sanctions imposed by the US, as well as by the EU and others, but it, in turn, has placed pressure on its neighbours – including Kazakhstan – to provide support, either of a political or trade nature. Indeed, there have been recent voices raised in Russia attacking what they see as tepid support from Kazakhstan ('Terror Attack...').

This pressure meets with limited ability to push back, at least overtly. Not only does Kazakhstan have a long border with Russia and a large Russian-speaking minority but the current government was reliant on a Russian-led military intervention in January 2022 to prop it up in the face of large-scale disorder. Moreover, the Kazakh political and business elite has profound ties to Moscow. All of this puts the Tokayev government in a highly exposed position. At the same time, its other large neighbour – China – has forged an explicit alliance with Russia which also places additional pressure on the Kazakhs. In this context, the latter have sought to bolster relations with the US and Europe without antagonising Russia, or indeed, China.

Set against these pressures is the fact that – at least initially – higher commodity prices boosted substantially the value of Kazakhstan's exports. In addition, trade diversion through Kazakhstan has grown. But, more importantly, there are also several, potentially structural, changes that have been triggered and are being worked through. Of the most lasting significance is the way in which Russian trade and investment has been redirected eastwards while, at the same time, the Chinese have sought to develop trade routes through Kazakhstan to European markets. This has led to a notable increase in activity in Kazakhstan (as well as other Central Asian economies) by Russian entities, from both public and private sectors, as well as from China. In addition, Kazakhstan has benefited from – mostly young and entrepreneurial - Russians choosing to relocate outside of Russia as a response to the political situation at home.

The Ukraine war and the Russian pivot eastwards has had several characteristics. For a start, gas and oil transportation infrastructure is being increasingly directed towards China. For example, Gazprom has invested in reconfiguring and upgrading a pipeline – the so-called Central Asia Centre – that allows gas to flow to Central Asia and, in due course, China. With this reorientation has come investment into transport and logistics corridors and infrastructure. At the same time, commercial avenues for digital retail financial services have opened up, as well as rapid growth in e-commerce leading to a boom in the construction of warehouses and logistical centres³.

³ See the recent report by the Eurasian Development Bank, <https://eabr.org/en/analytics/special-reports/infrastructure-in-eurasia-short-term-and-medium-term-trends/>

Hardly surprisingly, given this context, Kazakhstan's economic ties to Russia and China have grown rapidly (K. Mallinson). China has become Kazakhstan's leading trading partner, with trade turnover amounting to \$31.5bn in 2023 and this is likely to expand further given the Chinese view of Kazakhstan as a transit hub for the passage of its goods towards European markets. The development of the Trans-Caspian International Trade Route (TITR) which bypasses Russia is expected to boost trade further. Trade between Russia and Kazakhstan has also jumped and now amounts to \$26-27bn per annum. This includes the export of dual-use goods that could support Russia's war effort. This trade has the potential to be a source of political trouble with the US and EU.

The Kazakhs have also actively turned to Russia for additional investment in the energy sector. This includes new coal and gas fired power plants, as well as exploration of new onshore and offshore blocks in partnership with Russian companies, Lukoil and Tatneft. They have also been negotiating with Gazprom to supply discounted gas to the northern regions of the country. And amid worsening relations between the Government and Arcelor Mittal, the sale of the latter's huge Timertau metallurgical plant to Russian investors has been broached.

Russian investment in aggregate has grown quite significantly. In late 2023, it was announced that Russian investment in the country had exceeded \$20bn with Russian companies being among the five leading investors. In March 2024, the Kazakh Government also announced that it had recently attracted 41 foreign companies, of which 37 were Russian companies (V. Abbasova). With these changes, it appears that almost half of all foreign companies operating in Kazakhstan are now Russian and the share is growing.

Russia also controls a number of strategic assets. Foremost among them is the Caspian Pipeline Consortium which exports 79 per cent of Kazakh crude. That volume of exports contributes a formidable 60 per cent of GDP. Moreover, Russia has not shied away from periodically holding up flows through the pipeline to make a political point. Russia also controls around 26 per cent of Kazakhstan's uranium production and holds rights to a further 22 per cent of annual output. This increasing presence has been facilitated by the Kazakh government recently allowing the sale of strategic licenses. Into this mix, Chinese companies – notably CNUC - hold rights to nearly 60 per cent of future Kazakh production and most exports of ore now proceed by rail to China.

The extent to which Kazakhstan has emerged as a centre for trade diversion and sanctions evasion is not easy to measure. However, it is evident that the flow of goods transiting through Central Asia and Kazakhstan to Russia has grown rapidly. A recent EBRD study (M. Chupilkin et al.) identified a very large drop in exports from Europe and the USA to Russia following the imposition of sanctions. At the same time there was a substantial increase in exports to Central Asian economies, including Kazakhstan. This has been particularly true for Europe (US exports have been only 16 per cent of combined European exports). Many of those exports are product groups partially or fully sanctioned or close substitutes. This pattern suggests that a significant share of additional exports to Central Asia and the Caucasus may have been re-routed to Russia.

Although the growth in exports of sanctioned goods to Central Asia represents a small fraction of the reduction in direct exports of sanctioned goods to Russia (around 5 per cent), it has been very large for specific product groups. Further these are likely to be under-estimates as they do not pick up any illicit trade nor do the data cover actual goods, costs, traders or trademark owners.

The Kazakh Government has committed to complying with sanctions and the export control regimes that have been put in place. As such, a Law on Control of Specific Goods was introduced in March 2023 aimed at clarifying the legal basis of trade in dual-use goods and defence items. In addition, an online system for tracking goods has been introduced that requires electronic invoices for all goods traded with Russia and other Eurasian Economic Union (EAEU) member-states.

In short, the Ukraine war and the sanctions imposed on Russia have had a variety of consequences for Kazakhstan. Not only has trade with, and investment from, Russia and China expanded but there has also been a longer-term reorientation that is affecting Kazakhstan and Central Asia more generally. Russia has pivoted east, while also benefitting from some trade diversion through Central Asia to circumvent sanctions. China increasingly sees Kazakhstan and other neighbours as trade conduits for its products towards Western Europe. There is a risk, however, that growing exposure to Russia, in particular, may make Kazakhstan's PNTR status hostage – or at least explicitly linked - to compliance with sanctions. Doubtless, this is another reason for why the Kazakh Government is keen to resolve the matter sooner rather than later.

PNTR as a trigger for investment?

Even if the grant of PNTR by the US would provide only a very limited short-term fillip to US-Kazakh trade and investment, it could send signals to investors that could ultimately unlock incremental investment over and beyond that indicated by existing investors, such as Chevron.

But for that to happen will require some complementary steps to be taken. The first is to continue the improvement in the business environment that has occurred in the last few years. There is ample scope for raising the quality of government effectiveness and services as well as improving regulatory authority. The incidence of corruption appears to be declining but, again, there is much room for further improvement. Actions to suppress asset seizures and settle investment disputes have been taken but, in the latter case, still lack consistency and full conformity with legal judgements. Across multiple dimensions, Kazakhstan still ranks low for indicators of the business environment whether in relation to other economies in the region or globally.

The second trigger could be to open additional opportunities for investors through the selective privatisation of parts of the portfolio of Samruk-Kazyna and the other holding companies. The third trigger would be to dilute the role in the economy of businesses whose owners gained inordinate privilege (and assets) from their connections to political power and the former President, in particular. Inducing divestiture from members of this group would yield benefits, including creating scope for increased competition but also space for foreign and domestic investors. In the case of US and European investors this would require full divestiture (rather than partial dilution) by Politically Exposed Persons (PEPs) from specific companies if those assets were to become investor quality.

In sum, granting PNTR would send a signal that Kazakhstan's political and business environment is not a barrier to ratification. Perhaps most significantly, it would allow both sides to affirm their intentions to maintain trade and investment and for Kazakhstan to balance its growing exposure to China and Russia with continuing and visible engagement with the US, let alone other Western partners. The immediate impact on trade and investment will not be consequential but PNTR could in due course raise the volume of incoming US investment if complementary actions and policy decisions on the part of the Kazakh Government are implemented.

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