CHAPTER III

Post Soviet Economic Transformation and Industrial Development
INTRODUCTION

Kazakhstan as a newly independent state embarked on a political-economic transformation of an unprecedented scope and complexity in 1991. It began the transition with a unique set of legacies from its Soviet past. It necessarily had to start with the physical and human assets in place on their territories. Kazakhstan inherited the following arrangements:

- An extraordinary degree of militarisation of the economy and severely abnormal economic structures biased toward industry and agriculture at the cost of services;
- Specialized rather than diversified economies with numerous huge firms geared to serve the needs of the Soviet state as perceived by planners;
- Technologically backward capital stocks and labour forces, trained and deployed in accordance with central priorities;
- Land similarly destroyed, along with massive environmental degradation;
- Large inter-republic trade dependencies;
- Enterprises and populations that for long had been protected from economic insecurity and competition; and
- Institutions in place that inherited with near-universal state ownership of property, near absence of a financial sector capable of carrying out economic rather than accounting functions, and a civil bureaucracy imbued with an autocratic and interventionist mentality.

More specifically, the transformation process can be analysed in a framework of seven essential tasks using words ending in -ation\(^1\). Three pillars of successful transformation are seen to be: stabilization (creating a credible currency and maintain it through appropriate fiscal and monetary arrangements); liberalization of prices, economic activity, and foreign trade; and privatisation (putting state property into private hands). Four other major tasks are: creation of suitable social safety nets,

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financial institutions, and legal, accounting, and statistical systems; *regulation* of the emerging market economy to correct market failure; *alteration* of the structure of production, trade, and investment in accordance with market signals; and behavioural *adaptation* of firms, individuals, and civil bureaucracies to the new market-created environment and incentives. The success of each major task depends on the simultaneous pursuit and success of the others. These seven *-ation*, each having numerous facets that provide a useful framework for monitoring the infinitely complex transformation process.

Economic reforms made considerable progress amid a political climate of ethnic friction and perpetual conflict between a reformist president and a conservative legislature. President Nursultan Nazarbaev dissolved the legislature on 11 March 1995 and has been pursuing reforms since then through Constitutional decrees. An IMF arrangement has been facilitating the reform process since late 1993.

Kazakhstan introduced its own currency—the tenge and left the rouble zone in November 1993. In 1994, annual inflation rates reached nearly 2,00 percent. Since mid-1994, however, the independent Central Bank’s effort and pursuance of fairly tight monetary policies made it possible to bring monthly rates down into single digits. The tax system was overhauled in 1994, and tax administration is now being modernized. Credit is allocated mainly through auctions, and the Central Bank regulation has been strengthened.

In 1992, legislation was adopted to encourage the formation of new private businesses, with registration procedures simplified by a presidential edict in June 1995. Except for grain, the system of compulsory state orders has been replaced with voluntary state purchases. Although large cuts were made in exports, subject to quotas and licensing, some export taxes remained, and a 50 percent hard-currency surrender requirement for exporters was eliminated in 1995. Kazakhstan formed a free-trade zone with Kyrgyzstan and Uzbekistan in 1994 and a custom’s union with Russia and Belarus

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2 Ibid., p.31.
3 Ibid.
the following year. Foreign investment legislation was significantly liberalized in 1994 and early 1995.

Privatisation has made considerable progress, although the process has been flawed by much controversy and bureaucratic confusion through a series of laws adopted in 1991. The government claims that 26 percent of GDP was produced by the private sector in 1994. Prior to privatisation, small farms were commercialised, larger ones corporatised, and vouchers were distributed to the population (in early 1994)\(^4\). By the end of 1994, almost all-state housing had been transferred to private owners, but privatisation elsewhere has been much less rapid than intended. According to the government's 1994 statistical report, the non-state sector (not all truly private) accounted for 38 percent of national income, 36 percent of industrial output, 82 percent of contract construction and 60 percent of retail trade turnover\(^5\).

Among CIS countries, nearly 50 percent of Kazakhstan's labour force was employed in the service sector in 1994, compared with 44 percent in 1991. As an indicator of restructuring this shift is the largest among CIS. Kazakhstan conducted about 83 percent of its trade with FSU states in 1994, compared with 89 percent in 1990. Any way, the Kazakhstan government tried to put all economic reforms into order, and made some progress in the expression of its strategy. The 1996-98 Action Programme for the Deepening Reforms better covered all the dimensions of economic reforms.

The process of privatisation, the unattractiveness of investment, and difficulties with the adoption of a taxation code exacerbated the difficulties of industrial development for Kazakhstan. The Kazakhstan economy continues to suffer great difficulties, and will continue to do so until such problems as inter-enterprise arrears are satisfactorily resolved on both macroeconomic and microeconomic levels\(^6\). The shift of

\(^4\) Ibid.
\(^5\) Ibid., p.13.
the economic structure to the material and energy consuming sources provide evidence of the difficulties. Besides, to update out dated technologies was a priority.

3.1 INDUSTRIAL STRUCTURE IN KAZAKHSTAN

A further failure in terms of structural reform has been the lack of determined oil sector privatisation—with the result that the Kazakhstan Stock Exchange (KSE) lacks liquidity largely because so few major oil stocks are traded. The restructuring of the economy currently under way has two main dimensions. The productive profile is being adapted from protected exchanges within a command economy to a competitive pattern of output. and Kazakhstan's metals have been opened towards competitive hard-currency markets and are attracting external enterprise, capital and technology.

Priority Sectors of Economy

In order to provide a selective support for the country’s most important manufactures and spheres of activity, overcoming the dominant raw materials orientation in the economy’s structure, solution of the problem of investment activity escalating, as well as for creation of most favoured regime for direct investment inflow, H.E. Mr. Nursultan Nazarbaev, the President of the Republic of Kazakhstan, has ratified the list of priority sectors for domestic and foreign direct investment attraction.

The list of the most important manufactures for the attraction of direct domestic and foreign investments for the period till 2000 are the following.

1. Manufacture Industry

• High-quality clothes, yarn, fabrics, footwear, fur and leather goods manufacture;
• Manufacture of high-quality furniture;
• Manufacture of new kinds of paper production;
• Industrial processing of agriculture production;
• Processing of fishery production;

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8 Kazakhstan; Published by the Embassy of Kazakhstan (New Delhi: 1998), p.31.
• Preparation and storage of agricultural production;
• Baby-food products;
• Confectionery, non-alcohol beverages and vine production;
• New high-technology machinery, equipment and tools manufacture;
• Manufacture of all kinds of motor vehicles (passenger cars, lorries, specialized cars), as well as other transport equipment;
• Industrial electronics and electric machinery production;
• Manufacture of consumer electrical appliances and electronic goods;
• Manufacture of mineral fertilizers and plant protection products;
• Manufacture of house chemicals and cosmetic products;
• Manufacture of medicines and pharmaceuticals;
• Manufacture of veterinarian remedy preparations;
• Manufacture of ferrous and non-ferrous products, aluminium profiled details with the newest highly effective technologies;
• Manufacture of progressive and new kinds of construction materials;
• Garbage and industrial waster processing.

Table 3.1
Main Indicators of Industry

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>Share of industry in GDP percent</td>
<td>272</td>
<td>309</td>
<td>287</td>
<td>291</td>
<td>235</td>
<td>212</td>
<td>214</td>
<td>238</td>
<td>282</td>
<td>332</td>
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<tr>
<td>Number of industrial enterprises and manufactories</td>
<td>19393</td>
<td>20160</td>
<td>19490</td>
<td>18760</td>
<td>17924</td>
<td>17156</td>
<td>15791</td>
<td>13676</td>
<td>13045</td>
<td>14326</td>
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<td>Volume of industrial production, Bin.tenge</td>
<td>854</td>
<td>13030</td>
<td>230</td>
<td>3410</td>
<td>6600</td>
<td>7191</td>
<td>8107</td>
<td>8080</td>
<td>11428</td>
<td>17983</td>
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<tr>
<td>Volume index of industrial production, as percent of previous year</td>
<td>991</td>
<td>862</td>
<td>852</td>
<td>719</td>
<td>918</td>
<td>1003</td>
<td>1040</td>
<td>976</td>
<td>1027</td>
<td>1155</td>
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<tr>
<td>As percent to 1990</td>
<td>991</td>
<td>854</td>
<td>728</td>
<td>523</td>
<td>480</td>
<td>482</td>
<td>501</td>
<td>489</td>
<td>502</td>
<td>580</td>
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<tr>
<td>As percent to 1995</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>1003</td>
<td>1043</td>
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<tr>
<td>Price index of producing enterprises as percent previous</td>
<td>2931</td>
<td>25651</td>
<td>11528</td>
<td>30204</td>
<td>2398</td>
<td>1238</td>
<td>1155</td>
<td>1008</td>
<td>1188</td>
<td>1380</td>
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</table>
Immediately following the break up of the Soviet Union, the economic conditions can be analysed in following types. Table 3.1 shows distribution of production output, workers and fixed capital in Kazakhstan. The Table 3.2 indicates that light & food industries constitute the two core industries of Kazakhstan.

### Table 3.2

**Sectoral Composition of Industries for Kazakhstan in Early 1990s**

<table>
<thead>
<tr>
<th>Sectors</th>
<th>Production (000 rbl)</th>
<th>Share (per cent)</th>
<th>Workers (no)</th>
<th>Share (per cent)</th>
<th>Fixed capital investments, min. tenge</th>
<th>Share (Per cent)</th>
</tr>
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<tbody>
<tr>
<td>Electricity</td>
<td>5,944,281</td>
<td>4.22</td>
<td>103587</td>
<td>7.91</td>
<td>7393963</td>
<td>24.21</td>
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<tr>
<td>Fuel industries</td>
<td>7066035</td>
<td>5.02</td>
<td>107433</td>
<td>8.2</td>
<td>5713602</td>
<td>18.71</td>
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<tr>
<td>Ferrous metallurgy</td>
<td>32958102</td>
<td>23.4</td>
<td>92949</td>
<td>7.1</td>
<td>2621577</td>
<td>8.58</td>
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<tr>
<td>Nonferrous Metallurgy</td>
<td>15261840</td>
<td>10.84</td>
<td>74708</td>
<td>5.71</td>
<td>2238997</td>
<td>7.33</td>
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<tr>
<td>Chemical &amp; Petrochemical</td>
<td>15146083</td>
<td>10.75</td>
<td>72156</td>
<td>5.51</td>
<td>3488776</td>
<td>11.42</td>
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<td>MBMPa</td>
<td>12589011</td>
<td>8.94</td>
<td>262807</td>
<td>20.07</td>
<td>3033168</td>
<td>9.93</td>
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<td>Lumber and paper</td>
<td>1649049</td>
<td>1.17</td>
<td>37900</td>
<td>2.89</td>
<td>389279</td>
<td>1.27</td>
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<td>Construction materials</td>
<td>3546189</td>
<td>2.52</td>
<td>83505</td>
<td>6.38</td>
<td>1440311</td>
<td>4.72</td>
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<td>Economic Activity</td>
<td>1998</td>
<td>1999</td>
<td>2000</td>
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<td></td>
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</tr>
<tr>
<td>Total Industry</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Mining</td>
<td>24.3</td>
<td>36.1</td>
<td>44.5</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Mining of energy producing materials</td>
<td>19.9</td>
<td>32.3</td>
<td>41.0</td>
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<tr>
<td>Mining of coal and lignite; extraction of peat</td>
<td>3.3</td>
<td>1.9</td>
<td>1.5</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Extraction of crude petroleum and natural gas</td>
<td>16.3</td>
<td>30.1</td>
<td>38.5</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Extraction of crude petroleum and oil- well gas</td>
<td>14.6</td>
<td>29.1</td>
<td>38.0</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Extraction of natural (fuel) gas</td>
<td>1.4</td>
<td>0.6</td>
<td>0.5</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Mining industry, excluding mining of energy producing materials</td>
<td>4.4</td>
<td>3.9</td>
<td>3.5</td>
<td></td>
<td></td>
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<tr>
<td>Mining of metal ores</td>
<td>3.6</td>
<td>3.2</td>
<td>3.0</td>
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<tr>
<td>Mining of iron ores</td>
<td>1.7</td>
<td>1.2</td>
<td>1.3</td>
<td></td>
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<td></td>
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<tr>
<td>Mining of non-ferrous metal ores</td>
<td>2.0</td>
<td>2.0</td>
<td>1.7</td>
<td></td>
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<tr>
<td>Other branches of mining</td>
<td>0.7</td>
<td>0.6</td>
<td>0.4</td>
<td></td>
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<tr>
<td>Manufacturing</td>
<td>55.1</td>
<td>50.6</td>
<td>46.5</td>
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<tr>
<td>Processing of agricultural products</td>
<td>20.6</td>
<td>15.8</td>
<td>13.3</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Manufacture of food products</td>
<td>18.8</td>
<td>14.5</td>
<td>12.1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Manufacture of tobacco products</td>
<td>1.8</td>
<td>1.3</td>
<td>1.2</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Textile and sewing products</td>
<td>1.5</td>
<td>1.6</td>
<td>2.0</td>
<td></td>
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<tr>
<td>Manufacture of leather, products of leather and manufacture of footwear</td>
<td>0.1</td>
<td>0.0</td>
<td>0.1</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Manufacture of wood and wood products</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Manufacture of paper and paperboard; publishing</td>
<td>1.0</td>
<td>0.7</td>
<td>0.7</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Manufacture of coke, refined petroleum products and processing of nuclear materials</td>
<td>4.4</td>
<td>4.8</td>
<td>3.9</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Refined petroleum products</td>
<td>3.8</td>
<td>4.0</td>
<td>3.3</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Chemical industry</td>
<td>1.4</td>
<td>1.2</td>
<td>1.0</td>
<td></td>
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<tr>
<td>Production of rubber and plastic products manufacture of other non-metallic</td>
<td>0.3</td>
<td>0.2</td>
<td>0.2</td>
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<td></td>
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<tr>
<td>Mineral products</td>
<td>1.7</td>
<td>0.8</td>
<td>0.8</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Metallurgy industry and processing of metals</td>
<td>19.6</td>
<td>22.4</td>
<td>20.9</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Metallurgy industry</td>
<td>18.7</td>
<td>21.8</td>
<td>20.3</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ferrous metallurgy</td>
<td>5.0</td>
<td>6.4</td>
<td>6.0</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Manufacture of non-ferrous metals</td>
<td>11.3</td>
<td>12.9</td>
<td>11.7</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Manufacture of fabricated metal products</td>
<td>0.9</td>
<td>0.6</td>
<td>0.6</td>
<td></td>
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<td></td>
</tr>
</tbody>
</table>

**Note:** a MBMP means machine building and metal processing industry. 000 indicates (Thousand).

### Table 1: Sectoral Composition and Distribution of Output

<table>
<thead>
<tr>
<th>Industry</th>
<th>Output A</th>
<th>Output B</th>
<th>Output C</th>
</tr>
</thead>
<tbody>
<tr>
<td>Machine-building</td>
<td>3.7</td>
<td>2.2</td>
<td>2.5</td>
</tr>
<tr>
<td>Other industries</td>
<td>0.5</td>
<td>0.5</td>
<td>0.7</td>
</tr>
<tr>
<td>Production and distribution of electricity, gas and water</td>
<td>20.7</td>
<td>13.3</td>
<td>9.0</td>
</tr>
<tr>
<td>Production and distribution of electricity</td>
<td>11.5</td>
<td>7.3</td>
<td>5.0</td>
</tr>
<tr>
<td>Production and distribution of gaseous fuel</td>
<td>1.2</td>
<td>0.9</td>
<td>0.7</td>
</tr>
<tr>
<td>Steam and hot water supply</td>
<td>6.4</td>
<td>4.1</td>
<td>2.7</td>
</tr>
<tr>
<td>Collection, purification and distribution of water</td>
<td>1.6</td>
<td>1.0</td>
<td>0.7</td>
</tr>
</tbody>
</table>


The major light industrial sector constitutes: spinning and weaving, cotton, silk and wool where as food industries constitutes primarily processed foods, including meat, breads, beverages, canned goods, vegetable oils, wine and dairy products. The spinning, weaving and food industries account for 30 percent and 11.3 per cent of industrial employment, respectively. These sectors are the largest creator of jobs among other sectors of industry.

The light industry constitute the lowest share of industrial output (9.2 percent) in Kazakhstan, where as food industry shows the highest share of total national industrial output (22.4 percent). The agricultural production in Kazakhstan emphasised grains and vegetables for food as livestock feed.  

This table also shows, there is at least another industrial sector whose industrial share ranks with those of the light industry and food sectors in Kazakhstan. These are including the ferrous metallurgy, nonferrous metallurgy and chemicals and petrochemicals industries. In Kazakhstan, abundance of natural resources accounts for the development of related industries. Even Kazakhstan’s industrial structure is ahead of that of Ukraine, itself a region of advanced industry. Thus, the ‘fully specialized or monoculture’ industries structure assumed by standard international trade theories cannot be derived from this table.

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Table 3.4
Industrial Output and Sectoral Composition in Provinces of Kazakhstan

<table>
<thead>
<tr>
<th>Names of Oblasts</th>
<th>Total production output (1000 rub)</th>
<th>Share (National Total) (%)</th>
<th>Electricity</th>
<th>Fuel</th>
<th>Industries</th>
<th>Ferrous Metallurgy</th>
<th>Nonferrous Metallurgy</th>
<th>Chemical and Petrochemicals</th>
<th>MBMP</th>
<th>Lumber and paper</th>
<th>Construction materials</th>
<th>Glass and Porcelain</th>
<th>Light Industry</th>
<th>Food Industry</th>
<th>Milling and Mixed fertilizer</th>
<th>Printing Industry</th>
<th>Others</th>
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<tbody>
<tr>
<td>Karagandinskaja oblast</td>
<td>52307227</td>
<td>37.14</td>
<td>2.17</td>
<td>4.18</td>
<td>57.38</td>
<td>0.14</td>
<td>21.86</td>
<td>7.83</td>
<td>0.13</td>
<td>0.92</td>
<td>0.4</td>
<td>1.7</td>
<td>15.08</td>
<td>70.33</td>
<td>0.17</td>
<td>1.13</td>
<td>1.29</td>
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<td>Alma-Atinskaja oblast (*) a</td>
<td>18244859</td>
<td>12.95</td>
<td>2.57</td>
<td>b</td>
<td>0.06</td>
<td>0.09</td>
<td>1.05</td>
<td>5.62</td>
<td>1.81</td>
<td>1.7</td>
<td>0.4</td>
<td>15.08</td>
<td>70.33</td>
<td>0.17</td>
<td>1.13</td>
<td>1.29</td>
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<td>Dzhezkazganskaja oblast</td>
<td>13173858</td>
<td>9.35</td>
<td>0.52</td>
<td>8.2</td>
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<td>0.33</td>
<td>0.84</td>
<td>3.78</td>
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<td>Pavlodarskaja oblast</td>
<td>7535728</td>
<td>5.35</td>
<td>20.67</td>
<td>16.95</td>
<td>6.35</td>
<td>5.25</td>
<td>2.34</td>
<td>19.93</td>
<td>1.39</td>
<td>4.44</td>
<td>4.19</td>
<td>17.71</td>
<td>0.74</td>
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<td>Chimkentskaja oblast</td>
<td>6874506</td>
<td>4.88</td>
<td>3.16</td>
<td>0.08</td>
<td>0.22</td>
<td>14.33</td>
<td>7.9</td>
<td>1.05</td>
<td>6.75</td>
<td>0.13</td>
<td>0.33</td>
<td>37.79</td>
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The industrial development priorities of the Soviet government were the main reason that industry production came to be concentrated in particular regions, basically the capital city and well-established commercial cities, as well as their surrounding areas. Besides these, there are some areas in which sufficient natural resources were discovered during the Soviet era leading to intensive development, which quickly turned them into concentrated industrial zones e.g. the provinces of Karagandiskaya, where mineral and fossil resources such as iron ore, oil and natural gas were discovered.

Even in regions with little industry, we can see quite a few cases where the steel, non-ferrous metals, petrochemicals and machine building and metal processing sectors account for relatively high proportions of local output. There are two principal factors responsible for this phenomenon:

i) Large factories or industrial complexes for gathering mineral ores, as well as related industries (such as mining equipment manufacturing) were often located near regions producing natural resources. In addition, chemical or manufacturing industries, including producers of inputs such as chemical fertilizers and agricultural chemicals of capital goods such as tractors and other farming equipment have been developed in the provinces where their products are consumed.

ii) There are a number of cases in which production sectors have been located in or near regions producing natural resources or regions consuming manufactured goods e.g. Tselinogradskaja oblast accounts for a mere 3.8 percent of the nation's industrial output, but 42.6 percent of that figure is produced in the machinery and metal processing sectors.

According to the micro data, there are total seven factories of manufacturing agricultural equipment and parts. The largest two are, Tselinogradslimash P.O (proizvodstvennoe obedinienie) and Tselinogradkormmash P.O, employ 7,000 and 2,556 workers

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10 B.A. Islamov, UNDP Program Director of the Republic of Uzbekistan, speaking at an International Seminar at Hitotsubshi University in Tokyo, 7 Aug. 1996.
workers respectively. These seven workplaces account for 35.6 percent of the province's industrial manufacturing output. Tselinogradskaja is an agricultural region, and three neighbouring provinces, Kustanajskaja, Kokchetavskaja, and Severo-Kazakhstanskaja oblast are important grain producers. It is no surprise that Tselinogradskaja oblast is the location of large-scale agricultural equipment manufacturers and is a classic example of Soviet industrial allocation principles.\textsuperscript{11}

3.2 INDUSTRIAL ORGANIZATION LEVEL

Scale and composition of production unit groups. This figure shows the production unit groups for heavy and light industry sectors, with distribution based on numbers of workers. It also shows average number of workers and the amount of fixed capital for each production unit by sector. Production unit groups with 100 to 229 workers which accounts for the largest share of enterprises up to 35 percent, but ratio of production units with more than 300 workers also reaches units with 1-99 workers account for share 29 percent. Kazakhstan and Central Asian industrial statistics include a high proportion of workplaces which could not be included in Japan according to the definition of small and 'mid-sized firms' (workplaces with 300 or fewer employees). In addition, the 'very small firms' stratum seems to be composed of extremely thin enterprise groups.\textsuperscript{12}

\textit{Homogeneous Production Technology in Kazakhstan}

The rates of fixed capital formation for each country is computed by dividing the production unit's amount of fixed capital by their number of workers in order to obtain figures for national sectors. The average values for all of Central Asia and the standard deviations are shown in Table.

All the five countries issued homogenous production technologies. Because the available data indicates that there is a considerable similarity across the countries in

\textsuperscript{11} Ibid.

\textsuperscript{12} For example, the ratio of workplaces with fewer than 10 workers in Japan is around 60 percent.
rates of fixed capital formation in many sectors. But ample variation can be seen in five sectors like; electric power, fuel, ferrous metallurgy, chemicals and petrochemicals, and other industries. This likely to indicate that the number of data items is small compared to other nine sectors. So, there is substantial difference both in product made and in production methods. There is a large difference in the cost of building electric power plants between Tajikistan, (which relies heavily on hydroelectric power) and Kazakhstan, (which uses primarily thermoelectric difference). It should be expected that there would be large differences in labour-capital ratios between countries, which invest in oil, and natural gas- based energy development, and those which nitrites labour-intensive energy sources such as coal. On the other hand, in nine sectors where there seems to be little difference in product and production methods among the five countries. So it suggests that homogeneous production technology is being used.

The Sectoral Basis of Enterprise Groups

Table-5 shows the formation of enterprise groups and a numbers of sectors in Kazakhstan. Especially, light and food industry sectors have large number of production units, which often join to form single enterprise groups. These enterprise groups choose the geographical area to establish them.

- Enterprise groups in the light and food industry sectors often organize at the public level. According to table5- such groups include Kazakhstan’s Kazmjasomalprom Association (a group producing mainly processed meat and dairy products) and Kazlegprom Konzern (textile and sewing), Kazbytspkiz (general consumer goods).
- There are so many cases in which enterprise groups in the electric power, fuel, chemical and petrol chemical, and machine- building and metal processing sectors organize at province level, or at even lower levels such as radon (district) of gorod (city), (one good example is one of Kazakhstan’s electric power companies, Juzhkazenergo P.O., which is organized at the radon level).
• The group of ferrous and non-ferrous metallurgy sectors is limited to extremely small geographic areas. Besides that, there are many cases where firms do not affiliate with any enterprise group.

During the Soviet era, enterprise groups such as Konzern, associations, and production acted as intermediaries between their member production units and the state agonies (sectoral ministries), and between the member units themselves, while regulation their various industrial activities. Enterprise groups preformed the function of 'intermediary monitoring orgs' of ownership other than cooperative unions. 13

During the Soviet era, consumer production sectors such as light and food industries were generally regulated by republic ministries. Where as producer goods sectors (fuel and non-ferrous metallurgy) were controlled in a number of different manners, depending upon their scarcity and strategic value. The controlling authorities were: a) direct jurisdiction by all union ministers; b) indirect central government jurisdiction exercised through union-republic ministries; c) jurisdiction of republic ministries. These kinds of jurisdictions were widely applied in Central Asia, by the Soviet Union. It is one of the reasons why republic-wide enterprise groups in sectors making production goods have not formed Kazakhstan.

Scale and Composition Of Production Units Groups:

There is no marked differentiation in the composition of production unit groups, especially in terms of the ratio of groups with fewer than 300 employees and more than 300, or between areas of industrial concentration and other areas. For example, in Kazakhstan’s Karagandinskaja oblast, where large scale heavy industrial manufacturers sectors such as steel and heavy machinery forms the core of industrial sector, production units with 300 or more workers accounts for over 50 percent of the total numbers of units. However, in all other provinces, with the exception of Severo-Kazakhstanskaja oblast and Turgajskaja oblast, the proportions of production units employing 300 or more workers ranges from 35 percent to 40 percent of the total.

All the light industry production bases enumerated in (Table-3) are industrial complexes or factories producing cotton thread or silk thread for the spinning industry.

This is the result of the task of reeling thread for the spinning industry. This is the result of the task of reeling thread from raw cotton or cocoons in Kazakhstan being organized in sites, which are very large scale and concentrate large numbers of workers. Besides this, Table-3 shows that these large-scale production bases are not necessarily located in the areas of industrial concentration. It can be seen that many have developed in the different regions made up of agricultural provinces.

3.3 ENTERPRISE RESTRUCTURING

Kazakhstan had about 37,000 state-owned enterprises by end of 1991. Out of these, around 74 per cent establishments were small enterprises with fewer than 200 employees, 8,000 were classified as medium-sized and large enterprises with 200-5,000 employees, and about 200 were very large enterprises with more than 5,000 employees. In addition, there were about 1,300 “special enterprises,” which included natural monopolies, mining enterprises, and a wide range of activities in the non-commercial sector. Medium-sized and large enterprises employ about half of the labour force.

A specific policy or programme aimed at the restructuring of the republic's industrial enterprises is not clear till now. The approach that has been taken is that the private sector should take the lead in the restructuring process with the government playing a supporting role. To this end, the government is preceding with the corporatisation and privatisation, and in some cases the segmentation of state-owned enterprises. The government must provide an appropriate operating environment encouraging efficiency, competitiveness and financial responsibility to ensure the proper implementation of enterprise level restructuring. For example, the imposition of meaningful penalties for the non-payment or delayed payment of debts, the enforcement of bankruptcy legislation, and the cessation of the clearing of inter-enterprise arrears by the banking sector.

3.4 POLICIES OF INDUSTRIAL DEVELOPMENT

The experience of the past forty-one years suggests that industrialization has played a critical role in overall development, especially able to tackle the problem of employment much more easily and efficiently than those countries in which industrialization has lagged. It does not mean that other sectors especially agriculture can be neglected.

Despite the considerable progress already made by the developing countries in these directions, the pace of industrialization, particularly in lower income countries is still far from satisfactory.

However, the pace and structure of industrialization in a country depends on such factors as the endowment of human and natural resources, size and geographic location, and the international environment, all of which affect access to markets, capital, and technology. The influence of industrial development policies however, has not been clearly recognized. The wide range of industrialization achievement in the past among countries with similar economic endowments strongly suggests that policies need to play a critical role in industrial development as they influence the use of existing and the development of new resources. They help determine the technical and economic structure of manufacturing, affecting capital labour ratios, capital utilization, the scale location and distribution of plants and firms competitiveness and the barriers to entry by new enterprises. These in turn, are the characteristics that determine the quality and pace of industrial growth.

When the developing countries began to consider strategies for industrialization, the USSR had demonstrated that centralised command planning could force a high rate of industrialization in an underdeveloped country with the rapid growth of industry in centrally planned economies, underlined this perception after World War II. An important role for government came to be accepted in market economies since World War II.

In developing countries, only the government could mobilize the resources to provide the social and physical infrastructure needed for industrial and other development. It was thus generally accepted that governments would have to play a central role in industrialization as part of their overall responsibility for making economic growth and development as rapid and as equitable as possible. But for most developing countries, this did not mean abandoning private enterprise as a key component of industrialization. The lessons of the USSR and of socialist planning were not all positive. Central planning has drawbacks particularly in supplying consumers with low cost and high quality of goods (economics of shortage). Government intervention was thought to be powerful enough to ensure that the social ends of industrialisation could be met even in a predominantly private enterprise economy.

The formulation of an explicit industrialisation strategy has therefore been an important component of the industrialisation process. Few countries have followed “basic industry” strategies, but most evolved strategies like import substitution, export orientation, or more recently, have given considerable scope to market forces.

The Main Weight of Planning and Strategy Implementation in Most Development Policies:

These have an impact on the decision making of enterprises, both private and public in two ways: first, by across the broad policies which affect the relative prices at which enterprises buy and sell goods and services, second, by direct measures of control modified to individual firms industries such as production, licensing, price controls or public ownership which stipulates the conditions firms must meet to enter into or remain in production. Industrial controls are designed to fulfil industrialisation strategies. But the trade, finance, tax, labour and other policies that affect the decisions of manufacturing enterprises fulfil other functions in the management of an economy. In particular, the profitability of an industrial enterprise is determined by the

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impact of policies on prices, so that in a real sense, prices link planning intervention in
direct investment and policy formulation at the macro and micro economic levels.

In the real world, however, the policy formulation process is not as simple as such a
theoretical scheme might suggest. The changes in government, changes due to impact of
development itself, a changing external environment and events such as bad monsoons
or the discovery of new mineral resources that lead to changes in objectives and hence
in the policy instruments required. The real world requires the constant consideration of
tradeoffs between consumption now and consumption later between efficiency and self-efficiency and sometimes between equality and growth. Resources are not just physical
they cannot be assessed without reference to administrative capacities to a large extent
the policy maker has always been a victim of the past.

Constraints on policy formulation are often ignored as only referred to in passing
in the existing literature on industrial development policy, not because they are
unimportant but because they are difficult to treat in mathematical boxes.

**Industrial Policies in Kazakhstan**

The key policy priority in Kazakhstan has been embodied in a wide-ranging
programme of industrial restructuring and privatisation of natural monopolies designed
to introduce free-market prices and greater competition into sectors where the
government continued to play a leading role.

During these years, Kazakhstan has successfully completed the first phase of its
strategic plan for the period 1999-2030,\(^\text{17}\) an achievement facilitated by the buoyant oil
and gas sector and an increased capacity of new pipelines. Besides, it improved
agricultural performance through the introduction of further market-based reforms.
However, high levels of inter-enterprise payment arrears and debt persisted as a result
of inadequate industrial restructuring. Attention was also to be directed to the social
sphere to ensure the creation of more jobs, to lower the incidence of poverty and
increase social benefits.

The following item is a letter of intent of the government of Kazakhstan, which describes the policies that Kazakhstan intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Kazakhstan, is being made available on the IMF website by agreement with the member as a service to users of the website.

Astana, Kazakhstan November 22, 1999

Mr. Michel Camdessus, Managing Director, International Monetary Fund Washington, DC 20431

"Dear Mr. Camdessus,

The attached describes the economic policies that the Government of Kazakhstan intends to follow during the period from January 2000 through December 2002 and provides the details of the government's objectives and policies during the first year of the program. These policies aim at fostering the conditions for sustainable long-term growth, which include macroeconomic stability, sustainability of public finances, a robust financial sector, a well-targeted social safety net, high-quality public institutions, and good governance.

In support of this program, the Government of Kazakhstan requests financial support from the International Monetary Fund in the form of a three-year extended arrangement in an amount equivalent to SDR 329.1 million (90 percent of quota).

The Government of Kazakhstan believes that the policies described in the attached memorandum are adequate to achieve the objectives of the economic program, but it stands ready to take any additional measures as necessary for this purpose. During the period of the arrangement, the authorities of Kazakhstan will remain in close consultation with the Fund (IMF), in accordance with the Fund's (IMF's) policies on such consultations.

Sincerely yours,

Erzhan A. Utembaev, Deputy Prime Minister

Grigori A. Marchenko

Chairman, National Bank of Kazakhstan"¹⁸

An IMF team visited Kazakhstan from February 20th to March 9th, 2003 and expressed its approval of the government and the National Bank of Kazakhstan (NBK, the Central Bank) for conducting what has been the most sustained economic reform programme in the Commonwealth of Independent States (CIS). As a result of Kazakhstan's policy


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advances, and of the low likelihood that the country will need to borrow from the IMF in the near future, even if there were a sudden downturn in oil prices.\textsuperscript{19} The Kazakhstan government is reported to be working on an industrial policy designed to ensure that Kazakhstan has alternative sources of growth in place by 2015, when oil reserves are projected to run out.\textsuperscript{20} However, there is little evidence of a consistent strategy. The government has not taken significant legislative measures to improve the business environment—for example, by increasing bureaucratic transparency and rationalising administrative procedures. In March, the finance policy proposed several new business registration requirements—designed to help them to identify and eliminate fraudulent companies—that are at odds with the government’s stated aim of simplifying the registration process.

**Industrial Policy and Location**

Industry has a major role not only in Kazakhstan but also to other newly independent republics of former Soviet Union and it was also central to the Soviet economy. Today’s industrial location in Kazakhstan is the result of the Soviet spatial distribution of industries. Soviet industrial output in 1953 was only one-tenth of what it was at the end of the Soviet period.\textsuperscript{21} To understand modern industrial location in Kazakhstan, the attention should be given to the situation in 1953 of the Soviet Union. The importance of inertia is one of the major factors. In any country, the locations first chosen for industry acquire advantages, which help to preserve their dominance. They include; Firstly, a reserve of invested capital, in industrial plants, utilities housing and community facilities, which can often be added to or adopted more cheaply than opening up new locations.

A transport system, which tends to preserve existing patterns of accessibility and centrality, especially if railways are the principal mode, and a pool of technical and managerial skills. The former Soviet Union, despite reiterated government intentions to spread industry more evenly through the country, inertia was at least as important as in any western country.

During most of the Soviet era, ministries, responsible for both regulation and production in such broad sectors as iron and steel, heavy engineering and pulp and


\textsuperscript{20} Ibid.

paper, managed industry. Until late in the period, their main task was to maximise output with minimal investment.

The situation was exacerbated by the almost unvarying primacy of national over regional development policies. In Soviet period, five regions accounted for 80 percent of the industrial output. Moscow was the oldest and largest centre. Local entrepreneurs had built a textile industry, first using flax, the local raw material and later wool and cotton. The cotton came originally from the United States, but by 1914, from Central Asia. The Moscow region was well favoured for industrial growth and industry in Ukraine, by contrast, was almost entirely a creation of the last 50 years of the Tsarist era. The first component was mining and metallurgical complex. The government encouraged foreign investment to speeding industrial growth and provide modern technology. The second component of Ukraine industry was an agricultural processing complex in the western Ukraine. Kiev was the centre of sugar refining based on local beet, and tropical imports were processed at Odessa.

The third industrial region comprised the Baltic ports from Riga to St Petersburg. Industries were based on imported raw materials- including coal and iron; so poor were transport links to domestic resources- and St Petersburg had on the presence of the government, the court and a substantial local market. The two remaining industrial regions were Transcaucasia (basically Baku and Chiatura) and the Urals. The former depended on petroleum and manganese, mostly exported to west European capital. The latter depended on iron ore and domestic capital.

Outside the five regions, industry was scattered through the empire, but there was very little east of Urals or in Central Asia. European Russia contained over 80 percent of the population, and the government saw the eastern regions as additional markets to be preserved for European Russian producers rather than as potential locations for new industry.

Among newer regions, industrial investment before the Second World War focussed on west Siberia and Kazakhstan because of their resources of coal and non-ferrous metals. Whether the minerals should provide a basis for manufacturing, in a

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Ibid., p.50.
region of limited markets or simply be extracted and if so on what scale, had been a
topic of debate in the 1920s. Any how, industrial growth rates in Siberia and
Kazakhstan were impressive, but there was in fact much more investment further west,
Karaganda coal through of relatively poor quality, partly replaced Kuzbass coal in the
Urals as soon as a railway could be built, because it was nearer.

Labour was hard to attract because opportunities for people with skills and
pleasant living, were easy to find west of Urals. Much of the country was short of
labour because of the then current prodigal levels of mining. In Central Asia, however,
there was still a large surplus of rural population. This proved relatively immobile,
reflecting perhaps poor education, including a poor command of Russian, and
unwillingness to move to a very different cultural set up.

Post-Independent Scene

The Soviet industrial policy was a legacy that Kazakhstan was obliged to cope
with. This heritage left by a very particular type of development history. With
Kazakhstan most of the republics have inherited a heavy industrial sector developed for
the specific purpose of serving the Soviet goals, meaning an access upon producer
goods and manufacture for military purposes. The industrial profiles of the CAR are
illustrated in this table.

Here the argument is that, although the output of these sectors found a ready market
in the old Soviet system, it is far less suited to a competitive world economy,
because of the in built conservation of the centrally planned economy, much of the
heavy industrial plants are old and the products often lag behind the latest world
standards. Lack of attention to costs in the past bodes ill for a market-oriented future. The
plants are often extremely resource and labour intensive, which not only means higher
costs but also unfortunate environmental side effects.

Other hassles like the Soviet system's national production goals took priority
over regional ones. The entire USSR was developed as a unified entity; a single “USSR
Ltd”.  

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The imposition of a new set of international boundaries created trade barriers for Kazakhstan to protect its economy from the difficulties being experienced by its neighbours.

Because of the accent placed upon national priorities and the problems, which the lack of ministerial co-ordination produced for regional planning, the Soviet system gave rise to many regions with unbalanced or narrowly focussed economies. This is an obvious difficulty for the new republics. For example, Central Asia became a ‘plantation economy’ producing raw cotton for Central Russian textile manufacturers, abetted much resentments.

**Industrial Policy and Employment:**

The Kazakhstan economy was the most industrially developed in the Central Asian region prior to transition. The composition of its industrial output has changed substantially during the years of transition with its strong emphasis on the extraction of oil and gas and, in real terms, the virtual disappearance of manufactured products. The industrial sector has become more oriented towards the extraction of raw materials at the expense of manufactured goods. Industry’s share of GDP declined from 31.2 percent in 1992 to 20.2 percent in 1997, but the industry’s share of employment has remained unchanged. This was due to a decline in aggregate employment. Production is mainly concentrated on oil, lead, zinc, copper, iron and steel. A few large enterprises are mostly located in northern Kazakhstan. About 60 cities depend on just two or three large enterprises for the bulk of their employment. More about this will be discussed in Chapter V (The Impact of Industrialisation on Kazakhstan). This chapter will consider industrial policy and its impact on the labour market during the period of transition and

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beyond in Kazakhstan. The problem of replacing a centrally planned economy with a full-fledged market economy is significant for Kazakhstan.

**Privatisation**

Among the CIS countries, Kazakhstan was the first to establish the Committee for State Property (Goskomimishchestvo, GKI) in 1991. The Kazakh government differentiated its three non-farm privatisation schemes (small business, mass privatisation and housing) from other CIS governments' by choosing vouchers denominated in points rather than money and by the compulsory use of investment funds rather than direct purchase of equity. The responsibility of the committee was to draft and implement the privatisation legislation. The GKI was also entrusted with representing the interests of the government with respect to state owned property, with the state sector accounting for approximately 90 percent of fixed assets and 87 percent of the labour force at the time the GKI faced an immense task. The main goal of this early programme was to privatise all state-owned enterprises by 2000. The privatisation process was supposed to be conducted in three phases:

- The first was scheduled to involve the privatisation of small establishments, including small retail shops and service establishments.
- The second phase was projected to involve the privatisation of medium-sized and large enterprises;

- While the privatisation of major enterprises was to be carried out during the last phase.

Several methods of privatisation has been adopted by the law on De-statisation and privatisation-1991, but gave preference to direct sales to workers' collectives. Under this scheme enterprises were entitled to submit their own privatisation plans to the GKI, with the evaluation of the firms' assets being based on their net book value.

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28 After several subsequent reorganisations, the GKI was split into a State Committee for Privatisation and a State Committee for the Management of State Property was created in March 1995.
In 1992, the basic law was modified to the extent that employees of large and medium size enterprises were limited to 25 percent of the assets of the enterprises. The balance of the shares was to be distributed to such external groups as suppliers and new investors.

By December 1992 some 6,000 enterprises had been privatised, accounting for about 15 percent of the total estimated value of the fixed assets. The predominant method of privatisation was through direct sale to employee collectives, which account for 57 percent of all state investments. The second most common method, accounting for 25 percent of the number of privatised enterprises, was through direct sale to individuals while the balance was privatised by conversion through sale to other enterprises. By getting assistance of the World Bank and the US Agency for International Development (USAID), the GKI formulated a new privatisation programme in 1993. This programme also distinguish between small, medium-sized and large firms, but added a further “special” category of large enterprises, such as mining companies, enterprises in defence related sectors and infrastructure enterprises. The privatisation of “special” category was carried out on a case-by-case basis. These include approximately 200 large state-owned enterprises with more than 5,000 employees, as well as some 1,000 enterprises subject to special regulatory norms due to their economic or strategic importance.

In December 1993, the first auctions under the new mass privatisation programme started in selected pilot cities. In April 1994, the privatisation of 3,500 medium-sized state-owned enterprises was begun, representing the largest privatisation programme among the Central Asian Countries. However the participation in this programme is restricted. During 1994-96, the pace of the mass privatisation programme was expected

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30 Ibid.

31 Ibid., p.37.

32 Ibid.
to be substantially accelerated, with new regulations being issued in December 1995 to this end.

The Kazakh government issued a list of 38 state-owned enterprises stated for privatisation on a case-by-case basis in January 1994. It included number of very large companies with more than 40,000 employees. The list included the Alma-Ata central market, metal manufacturing enterprises, the aluminium plant in Pavlodar, a lead and zinc smelting plant in Taldy-Korgan and a number of state-owned oil companies. The largest in manufacturing sector took place in September 1993.

Form March 1995 onwards, government initiated to speed up the privatisation process, *inter alia*, through the introduction of a new regulation permitting the direct sale of state assets to foreign buyers. But this attempt suffered some initial setbacks with the failure of an intended auction of four large sugar refineries in late July 1995. Because their large liabilities rendered them unprofitable to private operators, and the government was forced a few weeks, later to extend the deadline or putting vouchers issued under the mass privatisation programme into investment funds. Despite these setbacks, the process appears to have gathered pace in the second half of 1995, with almost all of the vouchers issued by government having been absorbed by the investment funds by January 1996.

Privatisation still minimal, and land ownership limited according to the report 2003. The most important recent privatisation was the sale of the remaining state-owned stake in the copper producer Kazakhmys. There appears to be little or no chance that the state-owned oil company, Kazmunaigaz, will be even part privatised.

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33 Ibid.
34 Ibid.,p.38.
Furthermore, the draft land code is so restrictive that it does not truly introduce the concept of freehold into Kazakh law. As a result, there will be no functioning real estate market for some years to come\(^\text{37}\). Not only can the state withdraw the sale of land, it can do so at a confiscator price. The maximum length of a lease is 49 years for Kazakhs and ten years for foreigners.

The conflicting aims of state agencies are one of the reasons for Kazakhstan's poor administrative capacity, which is a major obstacle to reform and to an improved business environment for investors\(^\text{38}\).

\textit{Private Sector Development:}

The private entrepreneurship of Kazakhstan began to receive official attention soon after independence in 1991. A number of laws being passed in 1992-93 to promote this process. The most important of these included new laws on petroleum extraction and mining, foreign direct investment, privatisation, bankruptcy, contracts and intellectual property rights\(^\text{39}\).

Kazakhstan took steps to assure to ‘outsiders’ control of privatised enterprises, which in most other members of the CIS went to ‘insiders’, and to attract foreign capital into the controlling equity\(^\text{40}\) for the first time among the CIS.

In fact, the taxation system discriminates against domestically owned enterprises relative to foreign-owned ones. Locally owned trading enterprises are taxed at 45 per cent, while enterprises in the manufacturing and other priority sectors are taxed at 25 per cent. With domestically owned firms also being required to make mandatory contributions to various social support funds, it has been estimated that they must pay approximately 83-85 per cent of their gross revenues in taxes and other levies. Joint ventures with more than 30 per cent foreign ownership, on the other hand, pay only 25

\(^{37}\) Ibid.

\(^{38}\) Ibid., p.16.


per cent, while wholly foreign-owned enterprises are subject to a 30 per cent tax\textsuperscript{41}. Foreign investments in priority areas are also eligible for a five-year tax holiday.

In acknowledgement of the unfavourable effects of these policies on domestic private-sector development, a state programme to support entrepreneurial development in 1994-96 was issued in the form of a presidential decree in June 1994. This programme aims to ensure that 70 per cent of agricultural output, 40 per cent of industrial output and 90 per cent of services will be produced by the private sector by 1996\textsuperscript{42}. To achieve this aim the programme intends to:

- Create stable legislative foundations for private enterprise;
- Formulate a mechanism to give the private sector access to state credit resources; support foreign economic activity and create favourable conditions to attract foreign investment;
- Create a training programme for the unemployed; and
- Improve the agencies of state support for entrepreneurship.

Despite these attempts at promoting private-sector development, the economy of Kazakhstan continues to be characterized by an extensive degree of state intervention. Numerous constraints continued to hamper the growth of the private sector, including the persistence of complex regulatory controls, ambiguities in the definition of property rights, the absence of explicit investment promotion measures, resistance from those with vested interests to any change of the status quo, and inadequate industrial, financial and other facilities for local private-sector entrepreneurs\textsuperscript{43}.

However, getting independence at the end of December 1991, the government formulated principles for voucher privatisation, which operated until January 1996 with the following characteristics.

\textsuperscript{41} The Economist Intelligence Unit Limited, The Central Asia Republics of Kazakhstan, Kyrgyzstan, Tajikistan Industrial Development Review Series Published for UNIDO, Vienna, 1996, p.38.

\textsuperscript{42} Chance Clifford, “Russia and the Other States of the CIS”, Newsletter, October 1994, p.4.

\textsuperscript{43} The Economist Intelligence Unit Limited, The Central Asia Republics of Kazakhstan, Kyrgyzstan, Tajikistan Industrial Development Review Series Published for UNIDO, Vienna, 1996, p.39.
o Of the two forms of privatisation cheque, that designated an ‘investment coupon’ was distributed to all citizens, those in rural areas receiving 120 points and those in urban areas 100 points. Distribution of coupons took place in late 1993.

o By closure at end January 1996 1,692 billion points had been issued; auctions had taken 1,127 billion points to buy into 1,688 enterprises (of which 732 still had a 51 per cent state holding, 339 had 25-51 per cent and 617 less than 25 per cent).44

o Investment coupons could only be deposited in ‘investment privatisation funds’ and could not be traded or used directly to buy equity. So few coupons had been deposited in funds (a mere 15 per cent had been reclaimed at the seven auctions by November 1994) that the government was compelled to waive deadlines for deposit and to offer a money value first of 4 roubles and then one tenge per point (a derisory offer, when a litre of petrol then cost 6 tenge officially, and 12 tenge on the open market).

o By January 1996, 169 investment privatisation funds had been established, and had accumulated 66 per cent of all points. The staff of many were inexperienced; they gave exaggerated estimates of early profits; sought to evade the legal provisions on a 37 per cent maximum holding in anyone enterprise (by creating a multiplicity of subsidiaries to buy into an enterprise); formed auction ‘rings’; and allegedly had ‘spies’ in the State Property Commit tee.45

o The other form of privatisation cheque is the housing coupon, the aggregate value distributed to citizens being equal to the estimated value of the public housing stock. Because many rebates were given on the estimated value of dwellings, and some tenants opted to buy their accommodation, more than half of these coupons remained unspent, and were converted into investment coupons (although the government had expected them to be used for small’).


In March 1993, a decree on the National Privatisation Programme, state enterprises was classed into three groups: 'small privatisation' applied to the 5,000 businesses with fewer than 200 workers; 'mass privatisation' to the 850 firms with between 200 and 5,000 staff; and case-by-case privatisation to the 100 enterprises with more than 5,000 employees (of which 25 were subsequently listed as open for a controlling foreign purchase, including the important oil and gas industries)\(^\text{46}\). The first step in the procedure was corporatisation of the medium-sized and large enterprises, and the establishment of state holding companies (34 were created, covering three-quarters of industrial production). The aim was not so much devolution as much as the assurance of ownership of previous contractual supply-sales relations. Difficulties arose because employees had un-expired leases on the equipment and challenged the legality of the sale, or because managers of the corporative business who had been under bid removed equipment before formal handover and had to be pursued through the courts. But by 1 January 1995 there were 11,464 small enterprises in private ownership.

In the medium-size category 10 per cent of the equity is passed to the employees, 51 per cent is available for purchase by an investment privatisation fund, and 39 per cent remains state property. The State Property Committee has not restructured enterprises before offering them at auction and many sales have not gone through because of the enterprise's heavy indebtedness: chiefly concerned with reducing the budget deficit in the interest of disinflation, the government has not made restructuring finance available. The total at 1 January 1996 in this private-sector category was 21,260.

Large enterprises are being sold individually, KPMG advising the State Privatisation Committee. Although employees were until January 1996 assured a 10 per cent stake, as in smaller enterprises, the majority share is available. Foreign purchasers are welcome and Kazakhstan is second only to Russia in the CIS in attracting them. Even if, hydrocarbons are not excluded from privatisation in Kazakhstan. The long-established Emba oil industry was set up for privatisation in 1995, with Western

\(^\text{46}\) Ibid., p.34.
advisers, and the huge new oil and gas deposits are being developed with Western partners. A senior official in the Department of Economic Policy of the Kazakhstan Council of Ministers explained this preference as allowing monitoring by a government agency as co-owner in a medium-term perspective. By January 1996, of the 180 large firms scheduled for privatisation, transfer had been completed for only five.

Table 3.5
Privatisation in Kazakhstan (percentage of enterprises)

<table>
<thead>
<tr>
<th>Branch</th>
<th>1994</th>
<th>1995</th>
<th>2000 slow variant</th>
<th>2000 fast variant</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industry &amp; mining</td>
<td>17</td>
<td>25</td>
<td>30-35</td>
<td>35-40</td>
</tr>
<tr>
<td>Agriculture</td>
<td>46</td>
<td>50</td>
<td>57-62</td>
<td>63-67</td>
</tr>
<tr>
<td>Trade &amp; catering</td>
<td>50</td>
<td>65</td>
<td>80-85</td>
<td>85-90</td>
</tr>
<tr>
<td>Business services</td>
<td>11</td>
<td>28</td>
<td>60-65</td>
<td>65-70</td>
</tr>
<tr>
<td>Consumer services</td>
<td>51</td>
<td>63</td>
<td>75-85</td>
<td>85-90</td>
</tr>
</tbody>
</table>

Source: Yelena Kalyuzhnova, *The Privatisation of Property in the Republic of Kazakhstan*, University of Reading Department of Economics, Discussion Papers in Economics, No.319, August 1995. Data for 1995 are provisional and in agriculture no farm is included in which some share is state-owned.

The privatisation process was radically restructured in January 1996. Preferential property treatment for staff was abolished, leaving only two channels of privatisation direct sale to investors and auctions. The social guarantees previously required of buyers of state enterprises will no longer be demanded, but a criterion among applicants to buy will be the terms they set out for restructuring (the ‘business plan’), just as the Treuhandanstalt required in East German privatisation. The programme to the end of the century (Table 2) has two scenarios, with fewer transfers

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47 Ibid., p.35.

envisaged if privatisation is reactive to purchaser demand and more if the authorities are more proactive\textsuperscript{49}.

In tandem with privatisation and the influx of foreign enterprise, the Kazak government is actively promoting an indigenous private sector. A ‘State Programme for Supporting and Encouraging Enterprise in Kazakhstan’, promulgated in July 1994, requires completion of the legal and financial infrastructure of a developed market economy, based on the inviolability and protection of private property: there is a room, it asserts, for 150,000 private businesses in Kazakhstan\textsuperscript{50} Soviet law had permitted private prospecting teams to mine for gold\textsuperscript{51} In Kazakhstan, as in Russia, these teams took over the small deposits which had been attributed to them and formed their own joint-stock companies. The Zarya \textit{artel'}, then with two mines, is now the Balkhash Company with six mines, 2,400 staff and two ore-processing plants producing gold ore of 90 per cent purity\textsuperscript{52}.

In Kazakhstan privatisation has been accompanied by accusations of favouritism towards individuals and towards the titular ethnic group. Cronyism and corruption merging into organized crime are certainly present in many property transfers of post-Soviet states and hinder the foreign participation, which could bring managerial and physical restructuring. In response to protests that ethnic Kazaks were being crowded out of small privatisation, the government provided special funds to enable such people to make purchases. The mass public protest in Almaty of October 1996 was partly a response to corrupt privatisation.

\textsuperscript{49} Yelena Kalyuzhnova, \textit{The Privatisation of Property in the Republic of Kazakhstan} (United Kingdom: University of Reading, August 1995), pp.15-17.


\textsuperscript{52} CBI (Confederation of British Industry), \textit{Doing Business in Kazakhstan}, p.17.
Till now instead of pursuing deep-reaching administrative reform, the government has chosen to develop domestic industries on the back of foreign investors—a strategy that is easier in the short term, but that carries long-term risks. The government is putting pressure on large foreign investors to source more of their content locally, the aim being to make local companies strong enough to replace foreign investors. However, investors are also under pressure to award contracts to favoured local firms, whether they are actually able to compete with foreign rivals or not. This degree of state interference is doubtful to promote genuine competition among local firms, thereby raising suspicions as to the domestic sector’s chances of development.

3.5 INSTITUTIONAL FRAMEWORK FOR INDUSTRIAL DEVELOPMENT:

The raw material base influenced by central planning decisions and it rarely was based on comparative advantage considerations. This primarily drove the pre-transition industrial structure in the former Soviet Union. In the Soviet Union in particular, enterprises were highly integrated into an industrial network and thus were largely dependent on supplies of raw materials from other parts of the region like Kazakhstan and other Central Asian countries. From the initial years of transition, countries have faced the challenge of industrial restructuring and growth. Various sub sector programs defining ‘strategic directions’ of development were designed and put in place in transition economies. Yet quite often policy responses were limited to protectionist measures aimed at preserving output and employment of (mostly still state owned) industrial enterprises. Keeping in mind the political importance of large industrial firms, in most cases the transition countries were reluctant to liquidate them, hence effectively allowing them to continue running losses.

Following recent studies on economic growth, and in particular those exploring the link between institutional quality and economic growth in general, attempt to test the


relationship between *industrial growth* and institutional quality indicators. There are strong relations between the institutional quality and financial development on industrial growth they proved.

**Quality of Institutions and Economic Growth**

North (1990)\(^{56}\) in his work described the vitality of building up adequate legal infrastructure and proper functioning institutions in promoting economic growth. Arguments in favour of strong institutional structures are numerous:

- Transaction costs associated with running business are likely to increase in the presence of corruption and bureaucratic obstacles;
- Barriers to entry and exit might become very high without a clear and transparent legal and regulatory mechanisms governing entry and exit; and
- Gains from trade are easier to realize when transactions are carried out through efficiently functioning market mechanisms.

Similarly, Gerald W. Scully writes that “life, liberty and property are not additively separable attributes; the diminution of one diminishes all. Security of rights affects their value.”\(^{57}\) Anyhow the strong argument brought forward in favour of a developed legal system and mechanisms of contract enforcement. i.e. markets are less likely to exist when property rights and contract enforcement are absent or inadequate. Exploring the link between quality of institutions and financial depth, La Porta *et al.* summarize: “To the extent that better legal protections enable the financiers to offer entrepreneurs money at better terms, ...countries with better legal protection should have more


external finance in the form of both higher valued and broader capital markets. So the point is that, a vital link between institutional quality factors and industrial growth. In what follows, the effect of developed institutions and contract enforcement on growth will be at least as pronounced in industry as it is in other sectors.

The evolution from the command economic system to a market-based economy certainly requires an immense restructuring of the political and institutional framework to support industrial development in Kazakhstan. In some fields new institutions have already been established, but in several others former institutions continue to determine and dominate economic activity and in some important fields, institutional responsibilities are not clearly defined. An area of key importance relates to the power of state-owned enterprises to make their own decisions regarding production, the procurement of inputs, and sales in the domestic and inter-republic markets and to third countries.

The central planning agency (Gosplan) previously in Soviet period had controlled all economic activity in Kazakhstan, including the organization of flow of inputs to state-owned enterprises, prices and investments. The identification of production-level and enterprise level input-output flows was organized through the USSR-wide state order system (Goszakaz system). Even after introduction of the 1987 Law on State Enterprises, which granted the state-owned enterprises increased decision-making autonomy; this central organizational structure persisted in Kazakhstan.

In 1992 the government of Kazakhstan established the State Economic Committee (SEC) instead of Gosplan after achieved independence in 1991. The State Supply Committee (SSC) of the SEC and the respective branch ministries established Kazakhstan's State Order Plan for 1992. This plan, which covered about one-half to two-thirds of the country's output, determined the pattern of production and trade during


1992. It was based on fixed prices and required state-owned enterprises to meet their obligations even if no payments were received from their buyers.

However, SSC was renamed as the Ministry of Material Resources in 1992, and was converted to a joint stock company under the name of Kazcontract in 1993. The company is required to plan and implement the flow of inputs and outputs among state-owned enterprises, with its operations being financed by the National Bank of Kazakhstan. Its share ownership is currently divided equally between the government and its employees, each of whom own 30 per cent. The remaining 40 per cent is to be distributed at a later stage.

The Ministry of Industry has created to watch over the management of state-owned industrial enterprises. In several manufacturing sub sectors kombinats or associations were formed during the Soviet era with the objective of increasing the autonomy of member enterprises from the Ministry of Industry. These kombinats often continue to implement the functions of the previous subsectoral ministries, which were discontinued in 1991-92. Their role is particularly important in the ferrous metals industries, where they are responsible for both the mining and the processing of the ore under the direction of the Ministry of Industry.

The energy sector has been given high priority by the government and was the first to be selected for institutional restructuring. The new arrangements, which began to be introduced in 1992-93, are intended to facilitate the mobilization of the large-scale investments required for this sector in the coming years, and to support the growth of its production and exports. They include the Law on Land, Natural Resources and Water, enacted in 1992, which provides the legal basis for the granting of concessions in the mining and oil exploration sectors, and designates the Ministry of Geology as the agency responsible for issuing such concessions. Control over the processing of minerals is assigned to the Ministry of Industry in cooperation with the High Economic Council of the President’s Office. The approval of foreign direct investments in the

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60 Ibid.

61 Ibid., p.40.
mining sector, meanwhile, is assigned to the National Foreign Investment Agency and the Committee for State Property.

Responsibility for various energy products has been entrusted to a number of newly created state-owned monopolies along product lines. These comprise Kazenergo, which is in charge of electricity generation and distribution; Kazakmunaigaz, which is responsible for the production and refining of petroleum; Kazakgasprom, which controls the production and transmission of natural gas; and Kazakugol, which oversees the mining of coal. The Ministry of Geology has been authorised to exploration of new while the ownership of industrial combines in the mining and mineral-processing sectors is vested in the Committee for State Property.

However Measures of Institutional Quality turned out to have a very strong positive effect on the rate of industrial growth and besides that developed legal and regulatory framework, good enforcement and low administrative barriers affect the industrial growth not only by increasing the amount of investments made available in the economy but also by improving the efficiency of resource allocation.

### 3.6 FINANCIAL SUPPORT FOR INDUSTRIAL DEVELOPMENT

In spite of its striking expansion during first half of the 1990s, Kazakhstan's banking sector remains significantly underdeveloped. It became extremely undercapitalised and heavily dependent on the central bank for subsidized credit.

Inter-enterprise arrears have become a major source of financing for state-owned enterprises due to the weaknesses of the banking sector. These arrears have increased enormously since 1991, partly in response to the liquidity crisis of 1991-92, and partly due to the acceptance of this practice by both the enterprises and the government. Credits given at negative interest rates to the state-owned enterprises by the state-owned banking system, has weakened the incentive of these firms to raise their operating

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62 Ibid.
63 Ibid.
efficiency. So it needs to impose tighter credit policies and to establish harder budget constraints for the state-owned enterprises.

The preferential access to subsidized credit from the state-owned banking system granted to the state-owned enterprises also undermines the competitive position of private-sector enterprises. In the absence of an appropriate institutional framework (mentioned above) for the provision of short- and long-term financing for new private enterprises, and in view of the high monthly rate of inflation, bank loans beyond three months' maturity have been virtually non-existent. This lack of access to constitutes a major constraint on the entry and growth of new private enterprises, and illustrates the need for the establishment of a private enterprise promotion body linked to a national development bank.

IMF supports for new private entrepreneurship and Promotion of Competition managed by the Anti-monopoly Commission of Kazakhstan. The Fund operates through a network of regional offices and assists new entrepreneurs, mostly in the consumer goods sector, with industrial extension services. It is intended to provide training in various fields, including management and marketing, and also offers technical information services. However, because of its own resource constraints, the Fund still operates on a very limited scale and is unable to provide a number of important support functions such as quality control export promotion and help with the acquisition of foreign technologies.

Promotion of Foreign Direct Investment

The foundation of industrialisation process in developing countries mainly depends on domestic resources. For their development, the shortage of capital, technology and international marketing expertise, and the urgency of the development question have forced most developing countries to seek external financing and other assistance. So in this platform

64Ibid.

65Ibid., p.41.
Foreign Direct Investment (FDI) is the major component of private capital in flows to Kazakhstan. Why Multinational corporations are interested to invest on Kazakhstan since they are extremely large organizations and about 56 largest MNCs have sales ranging from US$ 10 billion in World Production and trade. For instance, it is estimated that the largest 600 industrial corporations account for between 20 and 25 percent of the production of goods in the World market economies. They are even more dominant in international trade; it has been estimated that 80-90 percent of exports from the US and Britain are associated with MNCs. So it is easy to see, why MNCs are of such concern and interest to the Kazakhstan in particular and developing countries in general.

But, FDI flows to some selected developing countries, and the degree of concentration appears to have increased over time. According to the United Nations Centre on Transactional Corporations, only twenty states account for almost 90 percent of all FDI flows to developing countries. Generally, FDI attracts to resource-rich countries, such as oil-producing countries; to countries with large domestic markets, such as Brazil, China; to countries with export-oriented industrialisation, such as Hong Kong, Singapore, South Korea and Taiwan; or to generally middle-income countries with well-developed infrastructure. Although the presence of MNCs in the manufacturing industries of developing countries is highly variable but significant.66

Most of the FDI used to go in mining, particularly in the petroleum sector. This has now changed. Of the total FDI, the share going to manufacturing varies from one source country to another, but in the case of US, 55.9 percent of all new flows went into manufacturing in 1983; in the case of west Germany, the figure was 67.9 percent; while for Japan the figure was 31.2 percent.

Within manufacturing, most MNCs are active in chemicals, electrical and transport equipment, and in low labour cost items, such as garments and electronics. But there is still debate on the role of FDI in developing countries' development. To some extent it is clear that it has significant role to play in the context of effective government policies. To some extent UNCTC resolved the dangers of MNCS. The ground reality of

66 Trends and issues in Foreign Direct Investment and Related Flows, (New York: UNCTC, 1985)
Third World development requires capital, management and international marketing expertise for the foreseeable future through MNCs.

The FDI inflows and comparative indicators of Kazakhstan is given in this table.

Table 3.6
Cumulative FDI inflow 1988-1999 in Kazakhstan

<table>
<thead>
<tr>
<th>Billion$</th>
<th>7.1</th>
</tr>
</thead>
<tbody>
<tr>
<td>percent Of GDP c</td>
<td>44.9</td>
</tr>
<tr>
<td>Rank (among eastern Europe and FSU courtiers)</td>
<td>2</td>
</tr>
<tr>
<td>percent of GDP(ppp)c</td>
<td>9.7</td>
</tr>
<tr>
<td>Rank (among eastern Europe and FSU courtiers)</td>
<td>8</td>
</tr>
<tr>
<td>Per capita$</td>
<td>477</td>
</tr>
<tr>
<td>Rank</td>
<td>9</td>
</tr>
</tbody>
</table>

Notes: c GDP in 1999, at current prices and exchange rates. GDP (ppp) is purchasing power parity GDP

Sources: UN/ECE, Economic Survey of Europe 2000 No.-1, UN

In the case of Kazakhstan, State Economic Committee was established to replace the local branch of Gosplan and made responsible for formulating the public investment programme. In spite of this change in institutional structure in practice, the mechanisms for allocating investments for state-owned enterprises have remained largely unchanged. The tax was assessed on the costs of production of state owned enterprises, and was paid into an investment fund responsible for financing the firms’ investments.

A significant decline in public-sector investment increases the government’s budgetary constraints. It was estimated that such investments had decreased about 50 per cent by 1992 in relation to 1990. But sharp falls was recorded in the machine-building sector.

Data on the sectoral distribution of public-sector investment show that about two-thirds of this investment went to the productive sector, and the remainder for the improvement of the country’s social and physical infrastructure67.

An important element of planned new investments is the increasingly large foreign exchange component needed to cover the high import requirements of proposed

new projects in the energy sector, and to meet the cost of importing critical parts and essential industrial materials and inputs. The encouragement of inward foreign investment flows has consequently become a major objective of the government. Large-scale foreign investments are being required particularly keenly in the hydrocarbon sector for:

- The modernization of existing oil fields and the introduction of new technologies, especially in geologically or chemically complex formations,
- The exploration and development of new oil and gas fields and for the construction of refineries and oil pipelines to accommodate the projected increase in production and exports.

In December 1990, the first round of legislation relating foreign direct investment was passed, and opened up most sectors of Kazakhstan's economy to such investment. In 1992 the establishment of the National Agency for Foreign Investments (NAFI), which was responsible for screening and approving foreign direct investment. The third step in this process was taken on January 20, 1995, when a new law on foreign investments was passed with the aim of clarifying the ambiguities of the earlier law of 1990.

The 1995 law recognizes three forms of foreign investment: the representative office, the branch, and the enterprise with foreign participation (including 100 per cent foreign ownership). While the new law significantly reduces the number of documents needed to establish an enterprise with foreign participation, it also contains a number of restricting changes. These include a prohibition on the granting of guarantees to foreign investors by government and state agencies, as well as the elimination of tax exemptions or reductions for enterprises with more than 30 per cent foreign participation. However the guarantee against expropriation is also relatively weak, as the law allows for such expropriation in circumstances where it is carried out for social reasons in compliance with proper legal orders and without discrimination but with the payment of an undefined "prompt, adequate and effective compensation". In order to
minimise the adverse impact of the new legislation on existing enterprises, however, the law contains a “grandfather clause” providing a ten-year grace period for investments made prior to its enactment in cases where changes in the law or in the terms of international treaties cause “a worsening of the position of the foreign investor”\textsuperscript{68}

In a further effort to promote foreign investment, the government has identified five free economic zones where foreign investors can import equipment, material and other parts and components duty free, and where companies are exempt from corporate taxes for two to five years and free of all other local taxes\textsuperscript{69}. Each of these five zones is designated for specific industrial activities. Thus, the Taldyqorghhan region is intended to specialise in the processing of lead and zinc, and for trade with China, while the Zhesqazghan region is intended to focus on the mining and smelting of lead, zinc and copper and the Manghustau region is intended to be dedicated to natural gas processing, petroleum refining and light manufacturing. The East Kazakhstan region, meanwhile, has been designated for the mining and processing of copper, zinc and other non-ferrous metals, as well as the manufacture of pharmaceuticals, textiles and animal products, and the Atyrau region, located in the northern Caspian oil and gas field, is intended to become the centre for foreign petroleum exploration and the starting point for a proposed export pipeline.


\textsuperscript{69} The Economist Intelligence Unit Limited, The Central Asia Republics of Kazakhstan, Kyrgyzstan, Tajikistan Industrial Development Review Series Published for UNIDO, Vienna, 1996, p.42.