

# **Transformation in Kazakhstan: Issues and Challenges**

**The Sasakawa Peace Foundation**



---

---

Copyright © 1998 The Sasakawa Peace Foundation  
September 1998  
All rights reserved  
Printed in Japan

This book may not be reproduced, in whole, in part, or in any form without written permission from the Sasakawa Peace Foundation. For information, write to the Sasakawa Peace Foundation, Sasakawa Hall, 3-12-12 Mita, Minato-ku, Tokyo 108, Japan

---

---

# Table of Contents

## List of Tables

Preface \_\_\_\_\_ v

### 1. Problems in The Development of Small Business and The System for Its Financial Support in Kazakhstan \_\_\_\_\_ 1

A.E. Esentugelov, I.N. Dauranov, K.B. Berentaev

Table 1	Main economic indicators for 1995-1996	5
Table 2	Changes in the number of enterprises and employees, 1991-1994	7
Table 3	Changes in the number of enterprises, 1991-1994	7
Table 4	Changes in the number of employees in enterprises, 1991-1994	7
Table 5	Share of small business in the main branches of the economy	10
Table 6	Production and sale of animal husbandry and crop cultivation products in 1994	12
Table A.1	Measures to support the development of SMB in Kazakhstan	50
Table B.1	Changes in average number of employees in small business enterprises, 1991-1994	52
Table B.2	Changes in the number of small enterprises and number of employees, 1991-1995	52
Table B.3	Changes in number of employees at small enterprises, 1991-1994 (in percent)	52
Table B.4	Regional distribution of cooperatives, 1991-1994	54
Table B.5	Cooperatives: types of business activities, 1991-1994	54
Table B.6	Small enterprises: types of business activities, 1991-1992	55
Table B.7	Small enterprises: types of business activities, 1993-1994	56
Table B.8	Number of private enterprises per region, 1991-1995	57
Table B.9	Private enterprises: types of business activities, 1993-1995	58
Table B.10	Private enterprises: types of activity, 1992	59
Table B.11	Employees in private enterprises according to type of business activity, 1993-1995	60
Table B.12	Private enterprises: changes in the number of employees per region, 1994-1995	61
Table B.13	Peasant farming: main indicators of development, 1994-1995	62
Table B.14	Financial indicators per type of activity: cooperatives, 1992	63
Table B.15	Financial indicators per type of activity: cooperatives, 1993	64
Table B.16	Financial transactions per type of activity: small enterprises, 1993	65
Table B.17	Financial indicators per type of activity: private enterprises, 1993	66

Table B.18	Financial indicators per type of activity: cooperatives, 1994	67
Table B.19	Financial indicators per type of activity: small enterprises, 1994	68
Table B.20	Financial indicators per type of activity: private enterprises, 1994	69
Table B.21	Number of enterprises and employees per type of activity, 1995	70
Table B.22	Number of enterprises and population per region, 1995	71
Table B.23	Number of enterprises and labor force per type of enterprise*	72

## 2. Industrial Development and Export Promotion in Kazakhstan: Constraints and Prospects 75

Kh.A. Ospanov, A.E. Esentugelov, V.D. Markov, M.A. Khasanova

Table 1	Price indicators for different sectors	75
Table 2	Dynamics of capital investment, 1991-1995	80
Table 3	Exports of Kazakhstan to the CIS, Russia, and Belarus, 1993-1995	113
Table 4	Imports to Kazakhstan from the CIS, Russia, and Belarus, 1993-1995	113
Table A.1	Major macroeconomic indicators	128
Table A.2	GDP of the Republic of Kazakhstan, 1994—1996	128
Table A.3	Basic results of economic performance in the first half of 1995	129
Table A.4	Monthly average exchange rate of tenge (per US Dollar)	129
Table A.5	Interest rates for centralized credit resources	130
Table A.6	Volume of industrial production	131
Table A.7	Proportional share of individual branches in total industrial output	131
Table A.8	Actual volume of industrial production, January-June 1996	132
Table A.9	Production of most important producer goods, January-June 1996	133
Table A.10	Aggregate data on foreign trade	134
Table A.11	Foreign trade of Kazakhstan, 1993-95	134
Table A.12	Share of exports in the volume of production of most important products, 1996	135
Table A.13	Share of exports in the volume of production of most important products, 1996	135
Table A.14	Regional profile of basic indicators of foreign trade	136
Table A.15	Foreign trade turnover by country, January-June 1996	136
Table A.16	Exports of most important goods and major partners January-June 1996	137
Table A.17	Share of exports in total output of most important products, 1995	140
Table A.18	Export deliveries in January-June 1996	141
Table A.19	Structure of exports to non-CIS states, 1991—1995	142
Table A.20	Foreign capital in Kazakhstan	142
Table A.21	Official development aid to Kazakhstan	142
Table A.22	Exports and imports of most important goods	143

Table A.23	Payables and receivables per sector	143
Table A.24	Delinquent indebtedness per sector, 1996	144
Table A.25	Producer price index, July 1996	144
Table A.26	Basic indicators of exports per country, January-June 1996	145

### **3. Agricultural Reform and The Development of Agro-Industry in The Republic of Kazakhstan \_\_\_\_\_ 151**

Table 1	Indicators of the Development of Agriculture in the Republic of Kazakhstan	149
Table 2	Structure of Sale of Agricultural Commodities in 1995 (in percent)	156



# Preface

The countries in Central Asia have embarked on transforming their economy from a centrally-planned to a market-oriented system. While some achievements have been made recently, the economic transitions in these countries are still likely to be traumatic. Enormous investments are needed to rehabilitate, modernise, restructure, and increase physical capital stocks in these countries. In addition, the low adsorption capacity of human capital and premature market-oriented institutions also severely impede the possibility of any substantial self-sustaining economic takeoff in the immediate future, even with high level of financial assistants and investments. However, the transformation is imperative and inevitable. Evidently, the transition process in Central Asia has been accompanied by, among other things, excessive inflation, decline in production, rising unemployment collapse of the social safety nets, increase poverty and distorted income distribution. It is in this respect, therefore, failure to achieve improvements in economic performance in a transition process may threaten the security and livelihoods of millions of people.

Since its establishment in 1986, the Sasakawa Peace Foundation (SPF) has been keenly aware of Japan's obligation to make contributions befitting its economic stature in global community. Over the last decade, the SPF has been carrying out a wide range of activities related to socio-economic development issues in developing countries. Keenly aware of the unfolding events in Central Asia, the SPF believes that it can contribute to constructive development in Central Asia by focusing on projects that target at the promotion and introduction of market-oriented economy.

Against this background, in 1994, the SPF has embarked on a project entitled "Implementing a Market Economy in Central Asia: Implications from East Asian Experiences." The principal objective of this project is to promote the implementation of market economy in the Central Asian countries with particular emphasis on the East Asian development experiences. In collaboration with East Asian economies, the project sets to facilitate a smooth transition of economic system in Central Asian through a broad range of policy oriented research cum training program for the policy makers or economic managers/planners from the Central Asia countries. In this connection, since 1995, the project has conducted three study tour missions in China, Japan, Korea and Taiwan for the project's target group from Central Asia.

This Report contains the findings compiled by the Kazakhstan's working group. The SPF hopes this Report will help to disseminate the observations made by that working group with regards to the economic reforms in Kazakhstan. We hope that these observations will also further enrich the discussions in deriving lessons for economic reform and development objectives in Central Asia in general and Kazakhstan in particular.

**Akira Iriyama**  
President  
SPF



# 1

## **PROBLEMS IN THE DEVELOPMENT OF SMALL BUSINESS AND THE SYSTEM FOR ITS FINANCIAL SUPPORT IN KAZAKHSTAN**

**A. E. Esentugelov**

**I.N. Dauranov**

**K.B. Berentaev**

## Introduction

Since 1 January 1995 the following changes have occurred with regard to the development of small and medium-sized business: (i) the President issued an edict "on supplementary measures for the realization of state guarantees for the freedom of entrepreneurial activity", (ii) the government completed the re-registration of individuals and juridical entities engaged in entrepreneurial activity (through judicial organs), (iii) changes were introduced in the state statistical reports so as to reflect the economic activity of small enterprises. The first one was issued on 14 June 1996. As a result, it is not yet possible to determine its impact on the production and economic activity of SMEs. The basic goal of this edict is to realize state guarantees for the freedom of entrepreneurial activity, to provide support and protection, and to preclude any unjustified intervention by officials or state organs in the activity of individual entrepreneurs and juridical entities. The basic provisions of this decree will be examined in the appropriate section of this chapter. In addition, it is also necessary to take into account the preparation of measures to improve state support for the development of small and medium-sized businesses.

This chapter has used a methodology recommended by specialists from the Sasakawa Peace Foundation. Namely, it has conducted interviews with the people who determine financial policy with respect to SMEs, including the heads of the largest and most influential banks in Kazakhstan. Another opinion survey has been conducted among more than 380 entrepreneurs from various branches of the economy. The goal was to elucidate the problems that obstruct their activities. This study also examines materials from the research on small-business enterprises that has been conducted by state organizations.

It should be pointed out that certain changes have taken place in state statistical reporting. Until 1995, the main indicators used to characterize the activity of SMEs were distributed according to legal organizational categories (including private cooperatives, small state enterprises, and small private enterprises), regardless of the form of property ownership. Beginning in 1995, the division into groups is based solely on the form of property ownership. As a result, to a certain degree this has undermined the comparability of statistical data, and that in turn makes it more difficult to carry out a full-scale analysis of the development of SMEs in Kazakhstan. An additional policy change was instituted on 27 July 1996; the Congress of Entrepreneurs of Kazakhstan brought their organization's juridical status into line with the existing legislation.

### 1.1 A Macroeconomic Analysis of the Development of SMEs

In the first half of 1996, the social-economic situation in the country developed under the influence of a set of measures that were incorporated into the "Program of Action of the Government of Kazakhstan to Extend Reform in 1996–1998." In the first instance, it is necessary to note the intensive work to develop and improve the normative legal basis of reform, and to regulate social-economic relations, in accordance with the "Program of Action for 1996." In the course of the first half year, the government adopted a number of laws that deal with individual aspects of civil and economic law. It also worked out and adopted a complex program for individual aspects of the economic

reforms as well as a whole series of decrees. Those decrees were directed toward the implementation of existing law, the regulation of economic activity, and addressing needs in the social sphere. In the second quarter of 1996 (for purposes of operational supervision and feedback), the government organized a system to monitor the economic activity and financial condition of approximately 200 enterprises. These are situated in different branches of the economy and produce more than 70 percent of total output. It also included the monitoring of several enterprises in transportation, communications, and construction branches. The country also commenced the implementation of regional programs and plans to expand reform. These include a set of measures for the practical realization of the medium-term state program and for the resolution of regional problems.

As a result, the macroeconomic situation continued to be relatively stable, while certain indicators showed some signs of improvement. The monthly rate of inflation dropped from 3.6 percent in December 1995 to 1.7 percent in March 1996, rose to 2.9 percent in April 1996, but then dropped again for the remaining of the first half of 1996. As a result, whereas inflation ran at a rate of 32.4 percent in the first half of 1995, this indicator dropped by half for the same period in 1996 (with an average monthly inflation rate decreasing from 5.4 percent in 1995 to 2.8 percent in 1996). However, it must be noted that this inflation rate still exceeds the level predicted by the government. That is due, primarily, to the increase in public utility prices to a level that completely covers their costs (price increases on 1 April and the 1 June 1996).

Another strong tendency has been the steady strengthening of the domestic currency. As a whole, in the first half of 1996 the exchange rate of the tenge to the dollar dropped by just 4.7 percent (compared to 15.4 percent during the equivalent period in 1995). More importantly, a fall in the level of inflation permitted the National Bank to make a gradual reduction in the interest rate for refinancing. If at the beginning of 1996 this rate stood at 59 percent, by the end of March it had dropped to 44 percent. And that in turn creates the preconditions for launching a revival of investment activity.

The accumulation of gold and foreign exchange reserves of the National Bank is continuing. In May alone, it rose by US\$130 million, reaching a total of US\$1.943 billion (including gold reserves worth US\$1.36 billion). At the time when the national currency was introduced, these reserves amounted to just US\$0.723 billion; by March 1995, they had increased to US\$0.814 billion. The proportion of gold in total reserves, increased 2.2 times since November 1993, amounting to 40 tons.

The consistent implementation of measures to liberalize foreign trade activity has contributed to a growth in the volume of foreign trade. Compared with the first half of 1995, in the equivalent period of 1996 foreign trade increased by 30.5 percent, exports by 56.1 percent, and imports by 11.7 percent. The country continues to enjoy a favorable balance of trade.

At the same time, however, macroeconomic stabilization has not achieved a secure and irreversible character. Thus, after five years of a decrease in industrial production, the first quarter of 1996 brought an increase of 0.6 percent over the same period in 1995 (primarily because of a salient upswing in virtually all sectors in March). But April 1996, if compared with the previous month, again showed a decrease in all

branches except oil refining and the chemical industry. Instability in the performance of various branches of industry remained an abiding characteristic during the following months as well. Industry continues to have a high rate of forced shutdowns in production, while the financial condition of enterprises remains difficult. The production of goods and services in agriculture, construction, and transportation has also continued to fall.

Despite the repeated increases in nominal and real wages, in the first half of 1996 real wages did not reach the level of that of December 1995. Moreover, there has been a continuous increase in the volume of arrears in the payment of wages. Unpaid wages now total more than 38 billion tenge; that is nearly one-quarter more than it was at the beginning of the year. Of the total volume of arrears in the payment of wages, more than 6 billion tenge are owed by state-financed organizations (i.e., those obtaining their funding from the state budget). The collection of revenues for the state budget has proceeded under enormous strains. According to data provided by the Ministry of Finance, arrears on payments to the state budget amount to nearly one-third of the anticipated tax revenues.

Nor has there been a positive improvement in the financial condition of enterprises and businesses. The general number of unprofitable enterprises and businesses (not including agriculture) has risen to about one-half of the total number (compared to just 39 percent at the beginning of 1996). The total amount of losses, however, has decreased to approximately one-half of its former value. It is only in manufacturing, construction, and communications that the proportion of unprofitable enterprises and organizations stood at a somewhat lower level (40 percent). And in the remaining branches it was significantly higher than 50 percent.

The payment crisis is also continuing to intensify. The volume of total indebtedness, as well as overdue indebtedness of enterprises and organizations rose by approximately 20 percent in the first half of 1996. The main bulk of the debt (approximately 90 percent) is domestic; they consist of accounts among enterprises within the country, arrears to the state budget, and bank loans. The second largest amount in the volume of non-payments comes from mutual accounts with Russia. It is only in accounts with Kyrgyzstan that the receivables are greater than the payables. Of the total volume of delinquent non-payments, the share that is more than three months overdue amounts to 65 percent of payables and approximately 35 percent of receivables. The corresponding figures for the beginning of the year were 67 percent for receivables and 77 percent for payables. The constant increase of enterprise indebtedness has created a perilous situation in the economy. The increase in payables in the first quarter of 1996 alone was equal to 13.5 percent of the GDP. Table 1 portrays the major macroeconomic indicators of 1995-1996.

**Table 1 Main economic indicators for 1995-1996 (in percentage)**

Indicator	First half of 1996 (as percent first half of 1995)	First half of 1995 (as percent of first half of 1994)
Gross domestic product	100.9*	81.5
Industrial output	100.4	84.1
Gross agricultural output	90.0	81.0
Gross capital formation	56.1	59.0
Retail trade turnover	119.5	46.0
Average wage rate (June, as percent of previous December)		
Nominal	59.1	105.4
Real	74.1	n.a.
Registered unemployed (as percentage of economically active population, at end of period)	3.6	1.2
Revenues of state budget (as percent of GDP)	16.7*	20.4
Deficit of state budget (as percent of GDP)	1.8	2.0
Consumer price index (as percent of preceding December)	116.8	132.4
Industrial Price Index (as percent of preceding December)	111.3	138.4

\*Estimate by Institute of Economic Research

### 1.1.1 Analysis of Tendencies and Current Conditions in the Development of Small Business

To elucidate the sources of the problems that now beset small entrepreneurship, it would be helpful to analyze the stages in its development. The first encompasses the period between 1987 and 1990, and the second runs from 1991 to 1995 (when Kazakhstan became a sovereign state and embarked on a policy of market transition). The beginning of the cooperative movement fell to 1988, when the Soviet Union adopted a law "on cooperatives." This was the product of two years' discussion about the necessity and expediency of reviving cooperatives. By developing the cooperative sector, the government intended to achieve the following: (i) improve the state of affairs with respect to satisfying demand based on purchasing power, (ii) liquidate or significantly diminish the shortage of consumer goods, (iii) draw additional labor resources into the workforce (from the ranks of the retired, housewives, students and disabled people) and attract additional financial resources.

The cooperatives could be created both as independent economic entities and as state enterprises. However, the inadequately prepared legal basis for regulating the activity of cooperatives gave them more advantage over state enterprises. That is because the latter were obliged to fulfill orders at fixed state prices. In addition, the latter were liable to strict limits on wages and to stringent restrictions in the use of cash and non-cash accounts. By contrast, the cooperatives could acquire raw materials and semi-finished goods at fixed state prices, and then sell them at market prices. Moreover, they

had no restrictions on wages, could dispose freely of cash and non-cash accounts, and also enjoyed some special tax advantages.

By the beginning of 1991, Kazakhstan had registered more than 12,400 cooperatives. These firms employed approximately 302,600 people, or about 4.5 percent of the total number of employed. The volume of goods and services sold was equal to 2.679 billion rubles; that was the equivalent of about 6.6 percent of GDP. These figures show that, during the period under review, the country achieved a certain success in the development of small-scale entrepreneurship. The cooperatives were most widespread in industrially developed regions such as the oblasts of Iuzhno-Kazakhstan, Karaganda, Tselinograd, and the city of Almaty. During the period under review, the following negative factors in the cooperative movement became apparent: (i) a significant exodus of qualified cadres from the state sector to the cooperatives, (ii) a broad dissemination of the practice of creating cooperatives at state enterprises for the criminal purpose of diverting state resources into private hands. The fact that the same state enterprise had been operating on different and mutually exclusive principles led to the creation of conditions favorable to the "criminalization" of the economy and the state apparatus.

Measures taken by the government to establish order and to regulate the activity of cooperatives included the introduction of higher coefficients on resources purchased from the state sector. It also entailed the establishment of administrative limitations on price increases. However, such measures did not have the desired result, but rather merely created conditions favorable to a strengthening of bureaucratic arbitrariness on the part of state officials. Among the factors impeding the development of cooperatives, two deserve to be emphasized: (i) difficulties in gaining access to raw materials and production facilities, (ii) bureaucratic barriers to the registration of cooperatives on the part of local organs (in contravention of existing laws). The interim results of the development of small-scale entrepreneurship attest to the fact that the negative consequences of its development, without the requisite legislative framework, clearly exceeded whatever positive economic gains might have been achieved.

The second stage of development commenced when Kazakhstan acquired state sovereignty and launched the transition to a market economy. In accordance with the then existing normative legal acts, the founders of a small enterprise could be either an individual or a juridical entity. In addition, such an enterprise could be created as a result of separating one (or more) structural sub-units of an existing enterprise; this could be done at the initiative of the employees in this sub-unit or enterprise management. A small enterprise then had complete autonomy in carrying out its economic activities, in disposing of its output and profit, and in determining the form, system, and amount of wages and salaries.

Thereafter, once Kazakhstan had conclusively decided to embark on the transition to a market economy, it adopted a series of laws to provide the conditions deemed necessary for the creation and development of small business. These measures pertained to the following: (i) the freedom of economic activity and the development of entrepreneurship, (ii) encouragement of competition and restrictions on monopolistic activities, (iii) protection of and support for private entrepreneurship.

On the organizational level, the government created the following state

organizations to oversee the development of small business: (i) the "State Committee for the Support of New Economic Formations and Limitation of Monopolistic Activities", (ii) the "Fund for the Support of Entrepreneurship and Encouragement of Competition", (iii) the "Presidential Council of Entrepreneurs". Additionally, the government also prepared a "State Plan for the Support of Entrepreneurship in 1992-1994" and, later, a parallel plan for 1994-1996. Notwithstanding these measures, the process of creating small entrepreneurship during this period remained very difficult and contradictory, as illustrated in Tables 2 to Table 4. In addition, there was a decrease in the production of consumer goods (6.3 times), producer goods (3.4 times), construction materials (4 times), and agricultural goods (7 times).

**Table 2 Changes in the number of enterprises and employees between 1991-1994 (in percentage)**

Type of small enterprise	1991		1992		1993		1994	
	Enterprises	Employees	Enterprises	Employees	Enterprises	Employees	Enterprises	Employees
Total	100	100	100	100	100	100	100	100
Cooperatives	60.9	65.6	20.4	24.5	9.4	12.0	6.4	8.3
State enterprises	39.1	34.4	50.4	55.0	45.8	53.7	35.6	44.4
Private enterprises	-	-	29.2	20.5	44.8	34.3	58.0	47.3

**Table 3 Changes in the number of enterprises between 1991-1994**

Form of Enterprise	1991	1992	1993	1994
Cooperatives	10,060	5,148	3,296	2,049
Small				
Enterprises	6,445	12,690	16,119	11,464
Private enterprises	-	7,339	15,769	18,673
Total	16,505	25,177	35,173	32,186

**Table 4 Changes in the number of employees in enterprises between 1991-1994**

Enterprise Type	1991	1992	1993	1994
Cooperatives	248,997	97,990	43,227	26,744
Small enterprises	130,345	220,194	192,681	142,196
Private enterprises	-	81,934	122,906	151,492
Total	379,342	400,118	358,814	320,432

During these years, the cooperatives were in fact stripped of a number of tax privileges as well as their special access to plant facilities and equipment. These privileges had earlier been embedded in normative legislative acts. As a result, a significant proportion of the cooperatives either closed down operations altogether or re-registered as small businesses. A significant factor in this process was a decree of the Council of Ministers of the USSR of 8 August 1990 (no. 790 "on measures for the creation

and development of small enterprises”). This decree conferred the same privileges to small enterprises that were now denied to cooperatives. Thus, point 14 of the decree provided that newly established small enterprises, except cooperatives, were exempt from paying taxes on profits. In addition, the decree gave small enterprises special privileges and terms on credits.

The intensive growth of small enterprises was further promoted by the “Law on taxes from enterprises, associations, and organizations” (which was promulgated by the Supreme Council of the Kazakh Republic in 1991). It established an exemption from the income tax, but for the first two years only, those engaged in the production and processing of agricultural goods, in the manufacture of consumer goods and construction materials, in construction and renovation, and in the application of new technology. Small enterprises engaged in other activities were subject to a tax set at 25 percent of the general rate on profits in their first year, whereas this rose to 50 percent of the established rate in the second year. As a result, until 1993 the country witnessed a sharp growth in the number of small enterprises of all types of ownership, with their total number rising to approximately 31,800 firms. That represented 29.7 percent of the total number of economic entities and included some 15,700 private firms. The total number of their employees amounted to more than 315,500 people (5.6 percent of the total workforce).

In addition, it should be noted that in 1993 the number of small private enterprises increased 2.1 times over the previous year. This was encouraged by the fact that, in 1992, the government adopted a special “law on the protection and support of private entrepreneurship.” This statute provided for giving small business special privileges in taxation, credits, and foreign economic activity. Nevertheless, these measures proved to be inadequate. In 1994, the country experienced a significant decline in the number of small enterprises (and the number of their employees). The development of small enterprises, which began to gain momentum in 1992-1993, actually came to an end in 1994. In comparison with 1993, the number of small enterprises decreased by approximately 4,700 (with a corresponding contraction of 50,500 employees). During this period, there was also a tendency for small enterprises to decrease in all regions of the country. The only exceptions were the Severo-Kazakhstan Oblast (where the number of small enterprises increased by 116) and the Zhezkazgan Oblast (167 firms) and Leninsk Oblast (5 firms).

With respect to conditions at the outset of 1994, Kazakhstan continued to show a widespread distribution and development of small enterprises in specific branches. These included trade (3,200 entities, or 19.7 percent of the total), construction (2,700 firms, or 16.8 percent of the total), and procurement and sales (1,200 firms, or 7.5 percent of the total). Agricultural firms lagged significantly behind and accounted for only 770 enterprises (4.8 percent of all small enterprises). The number of organizations specializing in the production of producer goods and machinery amounted to just 600 firms (3.5 percent of all small enterprises). More detailed data are provided in the tables in the Appendix.

As already pointed out, during 1994-1995 small private enterprises have been developing at an accelerated rate. Compared to the previous year, in 1994 their numbers increased by 2,800 firms (with a corresponding increment of 28,600 more employees).

Their share in small business (excluding the agricultural sector) amounted to 58.3 percent of all firms and 47.3 percent of the workforce. With respect to branch activities, there was a decrease in the number of firms engaged in the production of consumer goods (1.3 times), the processing of raw materials (2.6 times), and agriculture (2.2 times). The decrease in the number of private enterprises in this branch is due to the attempt of banks to finance exclusively projects oriented toward exports, a policy that in turn is dictated by the desire to reduce credit risks under inflationary conditions.

According to data compiled by the State Statistics Bureau for 1994, the largest number of private enterprises were situated in the city of Almaty (3,200 firms). That total, which reflected a 5.2-times increase since 1992, represented over one-sixth (17.3 percent) of all private enterprises in the entire country. Ranking second was Akmola Oblast, with 2,200 private enterprises (11.6 percent of the total), followed by Iuzhno-Kazakhstan Oblast (with 10 percent). Next came Kostanai Oblast (1,500 enterprises), Karaganda Oblast (1,200 enterprises). The tendency for small private entrepreneurship to develop in Iuzhno-Kazakhstan Oblast merits particular attention. In 1993 this oblast showed an increase of 1,700 private enterprises over the previous year. But in 1994 this region experienced a sharp decrease (1.3 times). The same could be said of Almaty Oblast: whereas 1,140 enterprises were established here in 1993, the following year their number dropped by 1,200. The largest number of private enterprises (5,400 firms, or 29 percent of the total number) are active in the commercial sphere. Next in importance are in the branches of trade and procurement (2,700 firms; 14.6 percent of the total) and construction (2,600 firms; 13.9 percent of the total).

It should be said that the uneven development of private enterprises in different oblasts in Kazakhstan is attributed to the following three characteristics: (i) an uneven, clustered distribution of productive forces in different oblasts and districts, together with the predominance of branches with a mono-functional raw-material specialization; (ii) the presence of a significant number of socially backward and ecologically poor districts, which in reality are not adapted to market forms of economic activity; and, (iii) a low level of professional training of the workforce for the industry, especially in rural areas and small towns, compounded by a limited degree of social mobility.

In 1994 there were about 54,000 small economic units in operation. These included 32,500 peasant (farmer) enterprises, 18,600 small private enterprises, and 2,040 cooperatives. The remaining 11,500 enterprises were concentrated in the state sector. The number of employees in small business amounted to 406,500 people (7.6 percent of the total number employed in the workforce). Of this total, 86,040 were employed on peasant farms, another 151,500 in small private enterprises, 26,700 in cooperatives, and 141,200 in small state enterprises. The volume of profit obtained by small state enterprises amounted to 1.32 billion tenge; private firms earned 0.82 billion tenge. Consequently, during this period, the private sector of small business worked less efficiently than the small state enterprises. The private sector counted 7,100 more enterprises than were found in the state sector. The number of people employed in small private enterprises also exceeded the workforce in small state enterprises (by 10,100). However, the private enterprises earned considerably smaller profits. As survey research of the small enterprises has demonstrated, many of them existed only on paper and in fact did not engage in any kind of economic activity.

One can also observe certain differences in the payment of wages. In cooperatives and small state enterprises, the average wage per employee is approximately 176,000 tenge; in small private firms, the average wage amounted to only 147,000 tenge. The largest number of cooperatives are concentrated in construction (32 percent). Among the remaining cooperatives, some engage in the production of consumer goods (10 percent), trade (7.5 percent), and consumer services (7.1 percent). A quite different picture emerges in the case of small private and small state enterprises. About 50 percent in the private sector engage in trade (procurement, delivery, and sales). In the state sector, 37.8 percent of the enterprises engage in such activities.

The tendency toward macroeconomic stabilization in 1995-1996 did not prove sufficient to stimulate the growth of enterprises with different forms of property ownership. This was particularly true in the case of small business. According to rough calculations, the share of small enterprises in the GDP in 1994 amounted to approximately 5 percent. In 1995, this indicator fell to 3.9 percent. Therefore, the activity of small business in social production has manifestly declined. In terms of the main branches of the economy, the decrease in the share of small entrepreneurship in economic activity is evident from the data in Table 5. Table 5 also shows that the fall in the share of small business's output was apparent in virtually every branch of the economy and of course is reflected in the drop in its share in total output. The only exception was the production of producer goods, where the share of output from small enterprises rose by 0.15 percent in 1995.

**Table 5 Share of small business in main branches of the economy (in percentage)**

Type of activity	1994	1995
Production of consumer goods	0.47	0.34
Production of industrial intermediate goods	0.43	0.58
Transportation	0.02	0.88
Construction	1.43	0.88
R&D	0.04	0.01
Trade	1.18	0.95
Public Food Services	0.05	0.009
Agriculture	0.10	0.05

There was also a sharp contraction in the total number of small enterprises. According to data compiled by the State Statistics Bureau, on 1 January 1996 there were 21,300 small firms; that represents a decrease of 10,800 from the number on 1 January 1995. In 1995, the number of employees in small business amounted to 147,300; that was a significant decrease from the 320,400 employees in 1994. Moreover, the employees in small enterprises constituted only a small proportion (2.9 percent) of the total workforce. Although these data indicate that the number of employees in this sector decreased by 2.4 times in 1995, the significance of this indicator is not entirely accurate. The reason is that, as a survey poll of the directors of state statistics institutions indicates, a substantial proportion of small entrepreneurs simply failed to submit reports to the statistics bureaus. Because of the under-reporting, it is estimated that only 30 to 40 percent of the

firms are included in the statistical reports. Therefore, the data provided by the State Statistics Bureau must be interpreted with great caution and care. At the same time, in the judgment of experts working in the production and commercial sectors, in general there has nevertheless been a decrease in entrepreneurial activity in small business.

For industry, the index of the actual volume in 1995 was 97.1 percent of the level in 1994. There was a particularly striking decrease of production in the state sector (54.3 percent), whereas the private sector showed an increase in output (16 percent). The highest rate of growth was in electric power generation (934.6 percent), nonferrous metals (163.4 percent), food processing (165.4 percent), and light industry (119.3 percent). This was due to the fact that these branches are concentrated primarily in the industrially developed oblasts and most densely populated areas, where there is an adequate market infrastructure for the development of small entrepreneurship. In addition, at the present time one can see a tendency for small enterprises to be established for the purposes of serving large enterprises in the energy and nonferrous metals sectors. In terms of administrative areas, the development of small business has been most successful in the city of Almaty (which reported a growth of 149.3 percent in 1995), Zhambyl Oblast (223.1 percent), Kzyl-Orda Oblast (247.2 percent), Kokshetau Oblast (125.2 percent), Iuzhno-Kazakhstan Oblast (123.6 percent), Taldy-Korgan Oblast (117.1 percent), Semipalatinsk (115.1 percent), Kostanau Oblast (109.1 percent), and some others. Details are provided in the tables in the Appendix.

The results from 1995 show that the private sector is gaining momentum in small business. Thus, whereas the share held by small private enterprises amounted to 58 percent in 1994 (with 47.3 percent of the employees in small business), in 1995 these indicators rose to 93.3 percent and 88.9 percent, respectively. The volume of profit earnings amounted to 2.52 billion tenge; the payments to the budget were 5.37 billion tenge. As earlier, the bulk of the small entrepreneurs are engaged in trade (6,001 enterprises, or 28.2 percent of the total number). At the same time, there has been a slow but steady growth in the number of enterprises engaged in the production of industrial goods (6.2 percent) and in construction (13.9 percent).

According to data from the State Statistics Bureau, in 1995 the largest number of small enterprises were located in Almaty (4,629 firms, or 21.8 percent of the total). Whereas in 1994 the second largest number were in Akmola Oblast, in 1995 this status belonged to Vostochno-Kazakhstan Oblast (1,924 firms, or 9.04 percent). The third largest number were found in Karaganda Oblast (1,904 firms, or 8.95 percent). The smallest numbers were located in two oblasts with an agricultural orientation—Torgai Oblast (63 firms, or 0.3 percent) and Kzyl-Orda Oblast (121 firms, or 0.6 percent). This is explained by the fact that the majority of small enterprises specialize providing services for large state enterprises, not the general population. Therefore, the greatest numbers of small firms are concentrated in the industrially developed oblasts, not in regions that are oriented mainly toward the production of agricultural goods and lack a well-developed industrial base. Consequently, one can conclude that the tendencies for the regional distribution of small enterprises remained in force in 1995. Table 6 shows the main patterns in the production and sale of products from animal husbandry and crop cultivation by private peasant farmers.

**Table 6 Production and sale of animal husbandry and crop cultivation products in 1994**

Type of product	Unit of measurement	Volume produced	Volume sold
Crops			
Grain	1,000 tons	438.2	158.7
Potatoes	1,000 tons	14.5	8.5
Vegetables	1,000 tons	15.4	11.6
Cucurbits	1,000 tons	7.2	4.2
Animal Husbandry			
Meat	1,000 tons	19.8	8.8
Milk	1,000 tons	33.6	18.1
Eggs	1,000	2,941.0	1,604.0
Wool	tons	1,568.0	735.0

Small peasant farms have become most widespread and developed in Iuzhno-Kazakhstan Oblast (where 20 percent are located), Almaty Oblast (9.5 percent), Severo-Kazakhstan Oblast (9 percent), Taldy-Korgan Oblast (6.5 percent), Akmola Oblast (6 percent), and Pavlodar Oblast (5.6 percent). In 1994, small peasant farms occupied 7.1 million hectares of the total land of Kazakhstan. This consisted of 7.0 million hectares of agricultural land (98 percent), 1.0 million hectares of arable land (15 percent) and another 5.8 million hectares of pasture land (82 percent). The average land allotment per farmer was 356 hectares. Among the different regions, however, the average amount of land allotment was subject to sharp variations; it ranged from a low of 21 hectares in Iuzhno-Kazakhstan Oblast to a maximum of 3,512 hectares in Zhezkazgan Oblast. Other regions with large land allotments included Turgai Oblast (1,173 hectares), Karaganda Oblast (641 hectares), Aktiubinsk Oblast (613 hectares), Mangistau Oblast (558 hectares), and Zapadno-Kazakhstan Oblast (511 hectares). The other areas with the smallest allotments included Almaty Oblast (56 hectares), Kzyl-Orda Oblast (57 hectares), Severo-Kazakhstan Oblast (73 hectares), and Zhambyl Oblast (81 hectares).

In 1995, the number of peasant farms continued to increase, rising to include more than 30,000 units. Along with the growth in the number of farms, there was also a corresponding increase in the land area being utilized. At the present time, these farms hold 12.7 million hectares of land, including 12.4 million hectares suitable for agricultural use. Of these peasant farms, 48 percent are engaged solely in crop cultivation, and 17 percent are occupied exclusively with animal husbandry; the balance practice some form of mixed farming. The average land allotment per farm in 1995 rose to 393 hectares (compared to 348 hectares in 1994). This shows that private peasant farming is gaining momentum in the village and that the private sector is expanding. Compared with the previous year, in 1995 the land area sown to crops increased by one-third and reached a level of 1.1 million hectares. Substantial changes took place in the structure of the sowing: the share sown to fodder crops increased, while the proportion sown to grain decreased. There was also a significant increase in the land area sown to potatoes, vegetables, and industrial crops. As a result, the production of grain decreased by 35,400 tons (a fall of 8.1 percent), while production increased for potatoes (1.5 percent) as well as vegetables and cucurbits (more than three-fold). The situation is similar in animal

husbandry. There was an increase in the production of milk (1.8 times) and eggs (2.3 times). Meat production, however, fell by 7.8 percent from the previous year's level. This analysis of the activities of peasant farms attests to structural changes that are occurring in response to the emergence of new conditions. There was an increase in the number of peasant farms raising cattle (25 percent), sheep and goats (20 percent), hogs (1.5 times), and horses (3 times). The sharp increase in the number of horses is due to the fact that they are used as draft power, especially in working garden plots. There was a large increase in the number of livestock raised by farmer households—more than 1.5 times for cattle and 2 times for horses.

Nevertheless, despite these positive aspects in the development of peasant farming, there are also considerable difficulties. Above all, the farmers find it difficult to sell their products at market prices because of the shortage in the number of commercial organizations. Moreover, providing farmers with materials and machinery is also becoming an increasingly acute problem. These difficulties are especially pronounced for the farms established more recently (in 1995). Thus, whereas one year earlier (1994) 46 percent of the farmers had tractors, in 1995 this proportion had fallen to 39 percent. The same negative tendency is true with respect to trucks (the proportion of truck-owning farms dropped from 32 to 24 percent) and sowing and cultivator equipment (decreasing from 19 to 16 percent). Only one in six farms has its own grain harvesters. This analysis of peasant farms attests to the significant difficulties that stand in the way of their development. All this shows the need for the heads of enterprises and administrative offices to provide peasant farmers with direct practical assistance. At the present time, according to expert assessments, only 26 percent of the peasant farms actually receive real assistance; the remaining 74 percent (14,764 farms) are forced to survive by dint of their own efforts.

It bears emphasizing too that their proliferation results from two basic factors: (i) the disintegration of state farms and collective farms; and, (ii) the peasants' desire to run their own independent farms. Moreover, farmers—in comparison with urban entrepreneurs—must operate under unfavorable conditions because of the lack of a well-developed network of communications and the rudiments of a market infrastructure.

An analysis of these data demonstrates that, at present, these peasant farms play an exceedingly insignificant role in agriculture. Thus, they account for only a small proportion of total agricultural production—2.6 percent of the grain, 0.6 percent of the potatoes, 1.9 percent of the vegetables, 0.6 percent of the milk, 0.1 percent of the eggs, and 0.9 percent of the wool. In addition, a substantial proportion of the goods produced by private farmers are for self consumption. At this stage, it is essential to shift from a quantitative growth in production to a qualitative growth based on the development of land legislation and a system of state support. As already noted, private peasant farming encounters many difficulties. They are not able to enter the marketplace on equal terms so long as the state maintains its monopoly over the storage, sale, transportation, and processing of agricultural products. Under present conditions, it is necessary to adopt a well-targeted system of state support for the creation and development of peasant farms, which are capable of expanding the production of marketable goods and becoming a real farmer type of agricultural enterprise. In this respect, it is necessary to clarify the legal status of such farms. It is also important to strengthen the basis for its operation by

attracting outside capital (including foreign investment) and by utilizing hired labor.

Peasant farms can develop in a dynamic fashion by relying on the most modern technology, which will enable a reduction in the labor inputs per unit of production. All this is impossible without the specialization of production. Peasant farms should become a specialized link in the entire cycle of agro-industrial production—from the field to the store shelf. To accelerate this process, it is possible to use targeted foreign investments to promote the development of peasant farms and the enterprises that service them. To support peasant farming, it is necessary to take a number of concrete measures: (i) establish a mechanism to give farmers access to sources of financing, and create a system of collaterals and activity insurance (also for purposes of attracting foreign investment), (ii) assist in the creation of information centers and in the expansion of the network of leasing companies to provide farmers with modern technology and equipment, (iii) stimulate the production of machinery and equipment (including the equipment needed for small-scale mechanization) at state defense plants, with direct delivery to the farms, (iv) create a system of supplementary services to assist in the formation of peasant farms (private legal, insurance, auditing and consulting firms).

One essential factor needed for the successful development of private farming in Kazakhstan is the creation of all the conditions favorable to the appearance of genuinely private owners of the means of production, including the land itself. It is necessary to prepare and adopt a law on the priority of developing the village and the entire agro-industrial complex. Such legislation should determine the legal and economic foundations for providing support to rural commodity producers and take into account the current situation. The emerging class of private property owners in agriculture has great potential. It is precisely for this group that it would be most expedient to invest resources and provide assistance.

To elucidate the problems that impede the development of small business in Kazakhstan, a research survey was conducted among 400 small enterprises in May-July 1996. The main questions on the questionnaire were the following:

- When was the enterprise created (or purchased), and what is its legal form?
- What was the number of employees last year?
- What are the main forms of activity?
- What problems impede the successful operation of the enterprise?

Findings show, that 40.2 percent of the enterprises that are now operating were originally created in 1992–1993. In other words, they were founded at a time when small entrepreneurship still enjoyed significant tax advantages and had access to credit. The proportion created in the last two years was 38.1 percent. In the surveyed enterprises, the number of employees had decreased by 9.4 percent, and that confirms the general tendency. In 44.2 percent of the enterprises, the number of workers was between one and five; 23.7 percent had six to ten employees; 17.0 percent had eleven to twenty workers. Thus, 75 percent of the surveyed enterprises had fewer than twenty employees; 91.8 percent had fewer than thirty employees.

The surveys of small entrepreneurs conducted by other organizations essentially confirm the above findings. Loyola Marymount University and the Almaty School of

Managers have conducted a study of small business in Kazakhstan, focusing on the following data: (i) biographic data about entrepreneurs and information about their activity, (ii) the motivation for establishing their own business, (iii) problems that independent entrepreneurs encounter in their business, (iv) the needs for training and consulting, (v) branch to which the business belongs.

The survey, based on replies from 77 respondents, yielded the following results. As to gender, 85.5 percent were male. The largest number of entrepreneurs (38.4 percent) are between 31 and 40 years of age; 31.2 percent are between 21 and 30; 20.5 percent are between 41 and 50. As to schooling, 72.4 percent had a higher education. As to the source of the founding capital, 37.4 percent used their own savings, 25.3 percent obtained resources from a bank, 16 percent drew upon the funds of family and friends, and 1.3 percent used state loans. As for their employees, the largest proportion (25.3 percent) had between eleven and twenty-five employees; 24 percent had two to five; 10.7 percent had six to ten; and 16 percent had no hired workers at all. In the vast majority of surveyed enterprises (87.4 percent), the annual volume of sales was less than 1 million dollars. As for the branch classification of entrepreneurs, 28.0 percent are concentrated in the sphere of material production. Among the motives for founding their own business, they named the following (ranked in decreasing importance): (i) desire to become master of one's own fate, (ii) desire for a better use of one's life, (iii) desire to earn money.

Among the basic problems and difficulties that impede the creation and development of entrepreneurial activity, the respondents identified the following: (i) the high level of interest rates (92.1 percent of the respondents ranked this factor at 6.42 on a scale of 7.0), (ii) the high level of taxes (89.5 percent set this factor at 6.32, and also noted that the existing system of taxation is characterized by its lack of stability), (iii) difficulties in finding start-up capital to create an enterprise (83.8 percent rated this factor at 5.89). The needs of entrepreneurs for training pertain to the main problems that they face: taxation, obtaining credits and other sources of loans, economic law, foreign economic activity, etc.

An analysis of the data from the State Statistics Bureau, together with the results from the surveys, attests to the fact that the problems impeding the development of small business in Kazakhstan are quite obvious and, in principle, can be regarded as well known. Hence, the main task of scholars and administrators is to prepare a complex of measures to remove these obstacles. A major role in this belongs to the organs of the state executive branch. Their significance is due, above all, to the fact that the main parameters of reform are set under the principle of "from the top down." As a result, the quality of the documents prepared by executive organs, together with their subsequent implementation, to a large degree will determine the process for the creation and development of small entrepreneurship.

## 1.2 Financial Problems

The accelerated development of private entrepreneurship is regarded as one of the top priority dimensions of economic policy in the foreseeable future. A solution to this task is essential to the formation of an efficient and competitive economy, as well as the self-employment of the population and the creation of new jobs. As a result, all the

government documents on expanding reform in Kazakhstan give attention to questions involving the development of small and medium-sized business. In practice, however, the government is not providing concrete, effective assistance to private entrepreneurship. For this reason, a number of factors are exerting a negative influence on the general conditions for the operation of small and medium-sized business in the country. The most important of these factors include the continuing economic decline, the persistence of a relatively high level of inflation, the growth of unemployment, the contraction in the purchasing power, the increase in arrears by enterprises and businesses of all types.

The key question in the development of private entrepreneurship in the republic concerns the strengthening of its financial condition and the realization of a carefully targeted state policy to support SMB. Unfortunately, resolution of this issue at the present time is problematic due to the monetary and fiscal policies now being pursued by the government. In 1995 the state budget did not provide any special funds for the support of private entrepreneurship. An analysis of the use of resources from this fund in 1994 shows that the bulk of its resources was used to finance the state's budget deficit and that less than 50 percent was used for its ostensible purpose. Moreover, a large part of the latter funds was not used to realize investment projects (for which they had been allocated), but for commercial transactions and for financing current expenditures. It is also problematic for private entrepreneurs to obtain investment credits from two other possible sources: (i) the government banking system, and, (ii) the credit lines established by international financial agencies and individual countries to assist in the development of small and middle-sized business. This is due to the fact that local banks of a secondary rank do not have sufficient credit resources to provide full financing for private entrepreneurship, especially in the case of long-term investment projects.

At the same time, the persistence of a relatively high level of inflation (under the government's financial policy, which is directed toward an artificial reduction of inflation) makes it irrational to invest in production by obtaining credits from commercial banks. The high interest rates on credit have had the effect of making commercial activity in terms of turnover (trade, sale, and delivery) the only effective area for bank credits. Moreover, this sphere has been pervaded by corruption and bribery. This has had the effect of producing a high concentration of credit resources in the hands of family clans and corrupt organizations. During this period, banks in the second tier obtained credit resources from the National Bank, but used them as they saw fit and without regard to the existing law (which accorded certain advantages to small business). The lack of a well-designed organization and legal framework for the activity of commercial banks resulted in a significant number of abuses and led to crimes in the use of state credit resources. Consequently, that led to the bankruptcy and closing of a significant number of financial institutions.

At the present time, in view of the previous negative experience, the following practice has emerged in providing loans to second-tier banks for the purpose of supporting entrepreneurial activities. With respect to the time period for which loans are granted, they can be grouped into three categories: (i) short-term (less than one year, with most loans in fact being given for periods ranging from one to three months), (ii) medium-term (from one to six years), (iii) long-term (up to ten years). On the whole, the

medium- and long-term loans account for just 5 to 6 percent of the total value. As a result, bank loans are used to finance current expenditures of SMBs, as well as certain commercial transactions. Only to an insignificant degree are they used to finance investment projects. An obligatory condition for obtaining short-term loans is the requirement that the individual or juridical entity hold a current account in the given bank. Thus, regular clients, who have established themselves as reliable, obtain a certain relaxation of the rules when they apply for credits to conduct for one-time transactions or to finance current operations. All the banks extend investment credits in the same way. The only difference is the interest rate and list of documents required. One can identify several main features here.

First, all the banks have their own criteria for choosing clients. Here they take into account the type of activity, the potential profitability of production, the presence of a current account, and an assessment of the client's reliability or his credit history, his competence as an entrepreneur, his personal experience, and the availability of guarantees or the appropriate property collateral.

Second, each project undergoes an expert review by the bank in terms of its prospects for recovering the investment, and the possibilities for a timely repayment of the loan. At the present time, the banks have substantially raised their demands with respect to the requirement of a formal "business plan," which earlier had been obligatory, but was treated only as a mere formality. A number of banks demand that the business plan, in addition to the production section, include a well worked-out marketing strategy for the goods that are produced. The plans undergo a bank assessment only after a preliminary technical-economic evaluation to determine whether the proposal satisfies the requirements for economic efficiency, environmental protection, capacity to create new jobs, competitiveness, prospects for improving the quality of the goods produced, and other widely accepted criteria.

Another obligatory condition for obtaining credits is the submission of collaterals, or guarantees on the part of third-party sponsors. In the latter case, the sponsors must invest at least 25 percent of the total cost of the project. In addition, the banks require a collateral backing for the credit that is equivalent to 100–150 percent of the amount of credits provided by the bank. Collateral can take the form of real estate, consumer goods, securities, and machinery and equipment. Other obligatory conditions are that the collateral have a high liquidity and be free of any liabilities to individuals or juridical entities. This requirement that borrowers provide collateral creates an extremely difficult barrier for beginning entrepreneurs. The reason is that, as a rule, they do not have liquid assets or real estate in sufficient volume to provide the minimal collateral for loans. And, at the present time, it is difficult to find sponsors, not only because of the general economic recession, but also because of the unstable financial condition of most large enterprises (i.e., the group with which the small enterprises could be integrated in terms of their production activities).

More importantly, it should be kept in mind that the majority of banks do not have free resources to provide credits for the investment projects of SMBs, which are also rather risky. It should be noted here that, in the portfolio of second-tier banks, the dominant position belongs to state securities, which are the most reliable and most liquid

assets. Thus, the People's Bank holds more than half of its credit portfolio in state securities. Significant resources of the bank are also tied up in cash transactions and in the market for foreign exchange transactions. Many banks attempt to bolster their position by servicing enterprises that engage effectively in export and that produce goods with a demand on the world market. As a rule, these consist of large enterprises in the primary branches of production, which are linked with the extraction and processing of minerals and raw materials.

The credit capacity of second-tier banks, to a certain degree, has been further reduced because of the growing reserve requirements by the National Bank (in accordance with a three-year program to shift the banking system to international standards). That program provides for the introduction of a coefficient of sufficient capital and the formation of a special reserve against dubious and non-performing loans. This was made necessary because of the fact that, for the majority of banks, the situation with respect to loans issued had become unfavorable and, in terms of international standards, a number of banks would have a negative balance of assets which is not permissible. The importance of creating reserves is also explained by the fact that, because of the deepening arrears crisis, overdue bank loans had already reached billions of tenge, including various fines and penalties.

These measures were provoked by the fact that the balance of indebtedness—because of the insolvency of borrowers—had virtually not decreased at all. Thus, at the beginning of 1996 it decreased by only 4 percent from the previous year. As a result, short-term credit investments in industry decreased from 52.8 percent on 1 January 1995 to 27.2 percent on 1 January 1996. Of these short-term credits, only a minuscule proportion was allocated to transportation and communications (2 percent), trade (3.8 percent), and supply and delivery (2.3 percent). The diminishing share of credits channeled toward the development of industry and agriculture results from the fact that the borrowing enterprises of these branches are those mainly guilty of nonpayment and hence a big credit risk. Unless the payment crisis as a whole is resolved, one can expect that all of the commercial banks will go bankrupt. Consequently, the program for the development of the banking system includes provisions to increase the reserve requirements for those seeking loans to finance risky projects. The risk coefficient for a single borrower should not exceed 25 percent. That is especially important under the present conditions in Kazakhstan, since the majority of banks (but especially the small ones) basically service a few great enterprises, who are thus the main clients of these banks. An increase in reserve requirements for determining risk will place private entrepreneurs in a still more difficult position with respect to obtaining long-term investment credits, since they usually do not have sufficient collateral to back loans. In this respect, certain positive improvements in the structure of credits (to favor long-term loans, the share of which has increased from 5 percent in 1994 to 9 percent at the beginning of 1996) will in fact not change the basic picture.

Within the framework of the program to develop private entrepreneurship, credit lines have been opened by the European Bank for Reconstruction and Development (EBRD), the Central Asian-American Fund for the Support of Entrepreneurship (CAFSE), and so forth. The credits from these financial organizations are allocated for Kazakhstan through participating banks—Kazkommertsbank, Tsentrbank, KRAMDSbank,

Tsesnabank, Tsvetmetbank, and several other banks. In principle, the order for issuing credits is the same as that of issuing credits to second-tier banks. Applications for loans from the open credit lines include a short description of the project itself, a narrative about the production, a summary account of the results of marketing analysis of potential sales, a characterization of the main consumers of the product as well as the sources for raw materials and supplies, the proposed volume of production and sale, investment needs in the next three to five years, the flow of financial resources (to assess whether the project can pay for itself), its profitability, and the total costs associated with realizing the project. The application also requires the inclusion of obligatory information about the qualification and experience of the enterprise's leaders as well as any possible partners in realizing the project. In this respect, it requires the preparation of a detailed business plan (in accordance with international standards).

To a significant degree, this disciplines borrowers and raises the level required to justify a project; that is certainly a positive factor. However, a negative, restraining factor in using these foreign credits is the fact that it is difficult to receive investment credits for production projects. Moreover, in the allocation of credits (and signing of a financial agreement), such loans take the form of a direct payment transfer to suppliers and creditors. Finally, there is the covert condition that applicants attract suppliers from the donor countries, although these are not always the most efficient and cost-effective. The allocation of credits through these credit lines is encumbered by still other conditions and strict restrictions on their use. Thus, the credit line from the EBRD in 1992–1993 provided for assistance to the development of private motor transport. But this entailed obligatory conditions, including the participation of second-tier banks that satisfy the EBRD's requirements, and also certain guarantees on the part of the borrowers.

As a result, the allotted credits of 100 million ECUs were in fact not used. The EBRD also signed an agreement to open a credit line to support small and medium-sized business (for ECU 100 million). However, it set rather harsh conditions for granting these credits to Kazakh entrepreneurs. Namely, they were required to invest at least 25 percent from their own funds, and the projects must demonstrate total recoupment in hard currency. The EBRD program for the development of small business in Kazakhstan also provides for allowing large banks to become the recipients of credits. And, for small entrepreneurs, this inevitably creates bureaucratic barriers that are virtually insurmountable. Moreover, the EBRD requires that credits be given only to enterprises that have been totally privatized, or that exist as joint-venture partners with state organizations. As for the amount of the minimal credit provided by the EBRD, as a rule, it must be at least US\$ 500,000. In addition, it requires that the amount to be repaid be 1.5 times the sum that was borrowed. Finally, among the obligatory conditions, the EBRD requires that the project be export-oriented.

The activities of the CAFSE is, at present, more attractive for small entrepreneurs. That is because it offers more flexible terms and arrangements for the financing of proposals. The investment activity of CAFSE, which has a branch office in Kazakhstan, sponsors two main lines of activities: (i) a program for shared participation and loans, (ii) a program for loans to small enterprises.

The former provides for the issue of credits and financing to enterprises in

exchange for shares of stock. In this case, the loans are given for a term of up to three years, but with an interest rate that is rather high by international standards (12 to 15 percent per annum). The loans are issued through participating banks; the amount of the loan ranges from US\$100,000 to US\$5,000,00. Under the terms of the shared participation of the CAFSE in realizing the project, the means to acquire stock go directly to the borrowing enterprise (without the participation of the intermediary bank). Another obligatory condition is quarterly control over the financial condition and the right to exercise free control over the shares of stock (including sale to a third party).

Within the framework of this program, the CAFSE finances projects with a relatively quick recoupment (up to three years), which are realized by mixed and purely private enterprises. The CAFSE does not finance projects proposed by state-owned enterprises. Within the framework of the second program (loans to SMB), the CAFSE grants credits ranging from US\$1,000 to US\$50,000. The credits are issued (depending on the project) for terms of three to twelve years at an interest rate of 12 to 15 percent. The loans are granted through participating Kazakh banks, which must bear an equivalent share of the risk. In return, the intermediary Kazakh banks receive commissions for their services in transferring the loans and supervising their disposition. One of the main difficulties in obtaining credits from CAFSE is the requirement to provide an elaborate organizational-economic application with detailed description of the proposal. In effect, this requirement forces the private entrepreneur to hire highly-qualified consultants to prepare the proposals. The main problem, however, is that many small entrepreneurs simply lack the requisite means to pay for the services of such professionals.

In most countries, private entrepreneurship can obtain financial support from state and private sources, and from different funds and organizations for the support of SMBs. Unfortunately, Kazakhstan does not have the equivalent financial institutions. Those that do exist lack their own resources to provide credits to private individuals. Thus, it has established a pension fund, and it has also made plans to establish a number of other non-state pension funds. The resources for such funds are to be raised from supplementary, voluntary deductions from the wages of employees and employers. It is thought that these funds (like similar pension funds in other countries) will accumulate vast sums, which can then be directed toward financing investment projects (including those of small and medium-sized business). Non-state pension funds will be organized as private joint-stock companies, which are subjected to supervision by the National Bank, which functions as the general supervisor for these funds.

At the present time, however, the country does not yet have any non-state pension plans. As a result, at least for the immediate future, it is impossible to regard these as possible sources for financing private entrepreneurship. As for the State Pension Fund, at this point it does not even have the means to pay current pensions. Indeed, on April 29, 1996, the arrears on pension payments amounted to 4.5 billion tenge. Therefore, the State Pension Fund obviously cannot be regarded as a source of financial means for investment credits.

Nor can the newly-created fund for obligatory medical insurance be regarded as an alternative source of supplementary financing. To be sure, its charter does envision the possibility of using unencumbered resources for investment purposes. But for the

moment this is hardly feasible. On the one hand, the fund has been established under conditions marked by continuous economic decline, by an increase in nonpayments, and by a rise in the prices on all services (including medical care). As a result, in the foreseeable future, this fund will not have any unencumbered means available for investment. On the other hand, the essential criteria in the use of this fund's free resources are profitability, the reliability of investments, a high degree of liquidity, and a minimization of risk. But these are precisely the things that are not guaranteed by investment in private entrepreneurship.

For these reasons, today the country faces the critical tasks of making the maximum possible appeal to foreign investment and developing joint ventures with partners from the former Soviet republics and other countries. This is all rooted in objective necessity. At the present time, capital from abroad can be obtained through two main channels: investment credits and foreign direct investments. With respect to investment credits (which now predominate), these are credits issued via the state; they require prepayments, state guarantees, and repayment with interest. Given the tight budget, this method of attracting foreign capital puts the government under great pressure, and it also engenders violations of government guarantees.

Today and in the future, preference should be given to foreign direct investment. The main form for obtaining such funds is the joint-venture enterprise, which can include large, medium-sized, and small business. These began to emerge in early 1990; at that time, there were fifteen such enterprises. Half of them were located in the city of Almaty. During the next period, however, the number of joint-venture enterprises underwent a phase of intensive growth. As a result, by the beginning of 1995, Kazakhstan had more than 2,000 joint-venture enterprises that had been established with the participation of investors from the former Soviet republics and other countries. Of the joint-venture firms established with partners in non-CIS states, the largest number consisted of firms in Asia (183), followed by firms in Europe (166) and the United States (51).

These joint-venture enterprises also demonstrate a high level of diversification. Specifically, each has formally expressed an intention to operate, on average, in four different branches. As practice has shown, the joint-venture enterprise offers special advantages with respect to the application of advanced technology, progressive methods for organizing production, and "know-how," as well as raising the competitiveness of output, and so forth. Consequently, such enterprises should be established in all branches, but especially in the manufacturing industry. Many joint-venture enterprises engage in trade and intermediary activities. The imports of a small number of joint-venture enterprises continues to be consumer oriented (primarily toward food products, clothing, furniture, audio-visual equipment, and automobiles). As for the composition of exports, these consist predominantly of goods that have a stable export potential, for example, oil, chrome ore, ferrous alloys, rolled metal, and copper. In general, raw resources and materials comprise 98 percent of their exports.

As a result, the country faces the problem of designing new approaches to the creation of joint-venture enterprises if it is to engineer a radical change in the profile of their activities. First, it should provide state protection for those joint-venture enterprises that produce competitive finished goods (whether for domestic and foreign markets).

Second, it is necessary to increase the network of joint-venture firms in the core branches of industry; this includes the processing of minerals as well as the extraction and refining of oil and precious metals. In this regard, the country should draw upon from the experiences of countries in Southeast Asia, Europe, and southern Africa.

One should bear in mind that, even in the most developed countries of the West, support for joint-venture entrepreneurship holds a prominent place in foreign economic policy. Thus, joint-venture enterprises are given idle land and buildings without any charge whatsoever or for payment of a purely symbolic rent. In addition, they are given special preferential rates on local utilities (with lower fees for energy, water, and heat). Finally, they have up to 20 percent of their loans repaid at the expense of local government funds. These protective measures should be adopted to empower the administrative authorities at all levels in Kazakhstan. Clearly, the proliferation of small businesses has an important "feedback effect". That is, if the joint-venture enterprises operate efficiently, they create new jobs, generate more budget revenues, and in general contribute to the growth of the GDP. Hence joint-venture enterprises have, increasingly, become the predominant mechanism for attracting foreign investments. Thus, during 1994, from the total annual volume of foreign capital invested in Kazakhstan (US\$380.3 million), foreign direct investment amounted to US\$291.2 million.

At the same time, one cannot overlook a number of factors that can retard their potential and sphere of activity. The most important factors derive from the very essence of the joint-venture enterprises, namely, the need to attract credit resources (both in freely-convertible currency and in tenge) to enable them to operate. Hence, it appears to be expeditious to attract foreign investors to participate in privatized enterprises that have a joint-stock form of capital. However, for this it is necessary, in the immediate future, to do the following: (i) prepare the principles for hard currency conversion of foreign investment; and, (ii) choose specific privatized enterprises for international bidding in order to sell shares of stock in these firms to foreign investors. The essence of the latter is to accelerate the process of privatization with the participation of foreign partners, and that in turn will stimulate the growth of a network of joint-venture enterprises, especially in production.

### **1.3 The Governmental and Institutional Basis for the Development of Small Business**

#### **1.3.1 Organizational Structure: Ministerial and Government Agencies**

At the present time, the composition of the agencies to manage the creating and expanding of small entrepreneurship has been essentially determined. At practically all levels of the state and economic administration, there are corresponding structural subdivisions for this purpose. In June 1994, the Cabinet of Ministers created the "State Commission for the Support and Development of Entrepreneurship," an organ for coordination and consultation, with the charge of reviewing the most important economic and political questions pertinent to strategies for the development of small business. The Commission is headed by the first deputy prime minister; its members include the heads of the main economic ministries and committees. Until 1993, the state organ responsible for the preparation and realization of policy on SMB was the "State

Committee for Anti-Monopoly Policy and Support of New Formations.” However, in June 1993 (as a result of another reorganization of the government), these functions were transferred to the Ministry of Economy.

Under the current system, the Ministry of Economy performs the following functions: (i) prepares the basic thrust of state policy for providing support to SMB; (ii) determines the priorities in the development of SMB; (iii) determines the basic forms and methods of state support for the development of SMB; (iv) drafts, either independently or jointly with involved ministries and state agencies, laws and other normative acts to regulate various aspects of the production and economic activity of small enterprises; (v) coordinates the activity of central and local organs of state executive authority with respect to questions involving the support and development of small enterprises; (vi) conducts analyses and prepares forecasts for the development of small business; (vii) cooperates with foreign governments, but also with financial and non-financial institutions, on problems pertaining to the creation and development of small entrepreneurship in Kazakhstan; (viii) either independently or together with public organizations of entrepreneurs, organizes and conducts conferences and seminars. These functions, within the framework of the Ministry of Economy, are assigned to the Department for the Development of Small and Medium-Sized Business and Market Infrastructure.

In 1993, this department organized the preparation of a program for state support of entrepreneurship. For this task, the Ministry of Economy created a special working group, which included state officials, entrepreneurs, and scholars. The working group submitted a proposal to the Cabinet of Ministers, which in turn revised that proposal to the President for approval. The main shortcoming of this procedure lies in the fact that the staff of the government made changes in the proposal without consultation and the consent of those who had originally prepared the draft. As a result, the goals formulated in the final proposal did not have the corresponding economic basis, as will become clear in the following section. At present, the problem of promoting the development of small business in Kazakhstan has become more acute. The Ministry of Economy, under the current situation, clearly does not have sufficient organizational and legal capability to resolve the tasks it faces.

### **1.3.2 Laws Pertaining to the Support of SMB**

The foundations of small entrepreneurship were laid down in 1992, when the USSR promulgated a “Law on Cooperatives.”<sup>1</sup> At this stage, the cooperative movement encountered a large number of complex problems with respect both to organization and production as well as commercial activities. The development of cooperatives was often hindered by the bureaucratic system: opposition and a hostile reaction of different agencies. Under circumstances where cooperatives were really competitive with state enterprises, the heads of the state enterprises often came out in opposition to the new economic entities. Another serious problem that was triggered by the development of cooperatives was the palpable exodus of the most qualified and highly-motivated employees from the state sector. Thus, the staff in state administration (in the local councils) are not motivated to increase the number of cooperatives or in assisting them to improve the requisite documentation. This gave rise to massive difficulties for

cooperatives seeking to get registered and, especially, to prepare and improve their founding charters. Moreover, the state officials dragged out the time required to register cooperatives. The local authorities also imposed prohibitions on other forms of activity, even though not formally banned, but merely because they were disliked by the representatives of local executive organs. In short, the barriers impeding the development of cooperatives included the following: (i) difficulties in gaining access to raw materials and facilities for production purposes; (ii) bureaucratic barriers to the registration of cooperatives on the part of local organs (in violation of existing law). Intermediate results in the development of small entrepreneurship attest to the fact that the negative consequences of its development, in the absence of the requisite legal basis, clearly exceeded whatever economic results may have been achieved.

The beginning of the second stage of development in small entrepreneurship came within the framework of the former Soviet Union. It followed the adoption of a resolution by the Council of Ministers of the USSR on 8 August 1990 (No. 790, "On measures to create and develop small enterprises").<sup>2</sup> Even earlier, in May 1990, the Kazakh Republic adopted a "law on peasant agriculture in the Kazakh SSR." This statute sought to address the specific features in the organization and operating conditions for small business in agriculture. Specifically, it fixed the basic principles for the development of peasant farming and established the legal basis for their activity. This law promulgated the following: (i) the conception of peasant agriculture, its organizational and legal form, and the meaning of property ownership in peasant farming; (ii) the order for providing land on the basis of its life-long, inheritable use or lease; (iii) the basis of the labor and economic activity of peasant farming; (iv) the order for creating and terminating the operation of peasant farms.

Another statute, labeled as the "Law on taxes from enterprises, associations, and organizations," was adopted by the Supreme Council of the Kazakh Republic in 1991. This law further contributed to the intensive growth of small enterprises. As noted previously, it exempted small enterprises from income tax during their first two years of operation if they engaged in specific activities: (i) the production and processing of agricultural products; (ii) the production of consumer goods and construction materials; (iii) construction and renovation; and, (iv) the application of new technologies. It also extended tax reductions to small enterprises that engaged in other activities: 25 percent of the standard income tax in the first year and 50 percent in the second.

In the subsequent years, as Kazakhstan embarked decisively on the transition to a market economy, the government adopted a series of laws. Its goal was to provide the requisite conditions for the creation and development of small business. This legislation included the following acts: (i) the "Law on the freedom of economic activity and development of entrepreneurship in the Kazakh SSR" (January 1991); (ii) the "Competition and anti-monopoly law" (June 1991); (iii) the "Law on the protection and support of private entrepreneurship" (July 1992). The first legislation established the legal, economic, and social conditions and guarantees to ensure the freedom of entrepreneurial activity of citizens and legal entities. It did so by recognizing and defining their rights to own property and engage in entrepreneurial activities. Specifically, this law determined and defined: (i) the subjects of entrepreneurial activity, which includes both individuals and legal bodies, whether from Kazakhstan or foreign

countries; (ii) spheres of entrepreneurial activity; (iii) organizational forms of entrepreneurship and the order for their registration; (iv) the character of the entrepreneurs' relationship to the state and the citizens whom they employ; (v) the accountability of entrepreneurs in the process of conducting their economic activity.

The second legislation dealt with the vital issue of anti-monopoly policy. Undoubtedly, the formation of a competitive environment, without question, was critically important for the creation and development of small business in Kazakhstan. In addition to the establishment of a market infrastructure, the formation of a competitive environment required that the government pursue an effective anti-monopoly policy. The significance of this question for Kazakhstan was due to the fact that a considerable proportion of the enterprises that had been created within the framework of the former planned economy were monopolies. To wage an effective struggle against such monopolies, which still claimed a dominant position on the domestic market in 1991, the government not only adopted the "Competition and anti-monopoly law" but also created a special organ called "the State Committee for Anti-Monopoly Policy and the Support of New Economic Formations."

It should be noted that, for a number of reasons, the anti-monopoly policy that the country has hitherto conducted did not contribute to the creation and expansion of competition. There were two main reasons. First, the government has relied primarily on organizational and administrative methods, not economic tools, to regulate the activities of monopolies. Second, the government has made rather frequent reorganizations of the anti-monopoly committee.

The existing legislation did not fully address the monopolistic tendencies in the existing businesses. The main criterion for categorizing an enterprise as monopoly is its share of a particular product being delivered to the market; specifically, a firm is deemed to be "monopoly" if its market share exceeds 35 percent. However, this legislation failed to take into account the fact that, under conditions of economic instability, a "monopoly" can also include a relatively small enterprise that holds a lesser market share of a particular product, but that exploits shortages. Furthermore, the existing legislation is very general and abstract. Hence it fails to take into account the specific features of individual branches, as in fact is done in developed market economies. In the course of this period, the anti-monopoly organs directed their main attention toward the task of breaking up producer organizations that currently existed. It was assumed that this policy represented the most radical and effective strategy for combating monopolies. However, as practice has shown, the implementation of this large-scale reorganization, undertaken without adequate preparation and in the shortest time possible, led to a sharp deterioration in the efficiency of their production and economic activities.

The existing legislation is further distinguished by the fact that economic accountability for violating anti-monopoly laws is purely symbolic. The ill-considered regulation of monopolistic activities, which in effect established a maximum level of profitability, had three negative consequences: (i) it led to the enrichment of intermediary commercial firms, which bought up production at an artificially low price, but sold at free market prices; (ii) it caused a decrease in profits; and, (iii) it encouraged secret agreements between the monopolies and middle-men. The shortcomings were

aggravated by the relatively frequent reorganization of the anti-monopoly committee, as already mentioned above. Since its founding in 1991, it has undergone three major reorganizations, and that could not fail to have a negative impact on its effectiveness.

The third legislation, adopted in July 1992, sought to promote the growth of the private sector and thereby to contribute to the formation of a market economy. This law determined the basic forms and methods for protecting private entrepreneurship. Specifically, it provided for the following: (i) protection of commercial secrets; (ii) non-interference of the state in private entrepreneurial activity; (iii) accountability of state organs and individual government officials for violating the rights of private entrepreneurs. This law defined the organizational and legal status of private entrepreneurs as well as the procedure for initiating or terminating their activities.

In addition, it established the basic dimensions of state support for private entrepreneurs who are operating in the sphere of material production. Such support includes the following: (i) preferential taxation; (ii) the grant of credits to private entrepreneurs on preferential terms; (iii) creation of advantageous conditions for private entrepreneurship in foreign economic activities; (iv) the creation and development of the state system for providing information to private entrepreneurs. This law also proposed to create a "Fund for the Support and Development of Private Entrepreneurship." Such assistance was to come from the following agencies: (i) the Fund for the Support and Development of Private Entrepreneurship; (ii) the Republican Fund for the Support of Young Entrepreneurship; (iii) the State Fund for Employment Assistance; (iv) the resources obtained from denationalization and privatization of state property. However, it should be noted that this Fund in fact never came into existence.

In October 1995, the President of Kazakhstan issued a "Law on production cooperatives" so as to encourage the formation of cooperatives as a form of small entrepreneurship, which were to be based on the principle that the members of the cooperative participate with their own labor. The point is that, at the present time, the share of cooperatives in the total number of small business types amounts to approximately 5 percent, and that these employ about 7 to 8 percent of the workforce in the small business sector. The sponsors of this law believe that, in many parameters, the collective forms of property correspond to the existing mentality of the population in Kazakhstan and can play a significant role in stimulating the development of small business. The legislation contains seven main sections.

*Chapter 1: General principles.* This section introduces the concept that the producer cooperative represents a form of economic activity; it also defines the framework for this economic activity.

*Chapter 2: The Formation of Producer Cooperatives.* This section of the law establishes the procedure for establishing a cooperative, explains the composition and content of founding documents (charter or founding contract of the cooperative), and also prescribes the property to be contributed to the cooperative.

*Chapter 3: Membership in the Producer Cooperative.* This section regulates the quantitative and qualitative composition of the cooperative's membership. Specifically, it must have at least two members; they must be sixteen years of age or older, and they must also be personally capable of contributing their own labor to the activities of the

cooperative. Chapter 3 also defines the rights, obligations, and accountability of the members of the cooperative, and then prescribes the order for using and distributing the shares from their contribution to the firm's operation.

*Chapter 4: Governance of the Producer Cooperative.* Here the law defines the organizational structure of administration and the status of its sub-units and their functions. The supreme organ for governing the producer cooperative is the General Assembly of its members. Its executive organ is the Cooperative Board and its Auditing Commission.

*Chapter 5: Economic Basis of Activity in the Producer Cooperative.* This chapter establishes the sources of property of the producer cooperative, its funds, the order for distributing profits, and the character of labor agreements.

*Chapter 6: Reorganization and Liquidation of a Producer Cooperative.* This section provides that the reorganization and liquidation of a cooperative must be voluntary (through the collective decision of its members), and carried out in compliance with the Civil Law Code of the Republic of Kazakhstan or other state laws.

*Chapter 7: Concluding Principles.* As a final principle, the law provides that previous documents—legislation, normative acts, organizational instructions, and directives—are to be made consistent with this law.

As to the content of this law, one must take into account the fact that it contains certain contradictions. First, according to the decree, the founding capital is formed by the cooperative, not by its members (from their own funds). As a result, this artificially reduces the property accountability of the cooperatives' members. Second, the size of the share contributed by a member of the cooperative is of fundamental significance only in the event the cooperative is liquidated (at which time the cooperative's property is distributed in accordance with the share contributed at the time of founding). The size of the share is not taken into account in determining income or in taking decisions on the most important questions pertinent to its economic activities. In addition, the property relations created by this principle create another important contradiction: members of the cooperative who have small shares have an objective material interest in seeing that the main part of the profit goes to the consumption fund, while those who have large shares will want more of the profit reinvested in the fund for the development of production. The foregoing makes it possible to conclude that, under market conditions, producer cooperatives will not be able to achieve broad dissemination for the reasons suggested above.

In July 1996, the President of Kazakhstan promulgated a decree on "Supplementary measures to realize state guarantees for the freedom of entrepreneurial activity." The objective of this decree is evident from its very name. According to this decree, in the event that state officials deliberately commit an illegal intervention in entrepreneurial activities, or in the event they issue illegal orders, they are subject to dismissal from state service and judicial prosecution. Moreover, the appropriate organs for conducting audits and investigations should not do this more than once a year (to avoid the threat of harassment). They are also to publish the results of such audits and investigations. In this decree, the President also obliged his government to prepare and submit to the Majilis (parliament) a draft law "on the adoption of changes and

supplements to certain legislative acts of the Republic of Kazakhstan” on questions involving the intensification of administrative responsibility of state officials for deliberately illegal meddling in the entrepreneurial activities of individuals and juridical entities.

The adoption of this law was a response to numerous complaints that had been filed against organs of state administration and their heads for unjustified and constant interference in their business activities. Because such incidents began to take on a massive character, they were becoming a substantial impediment to progress toward a market transformation. A successful implementation of the basic principles in this decree will encourage entrepreneurs, including those engaged in small business, to become more active.

### **1.3.3 Programs of State Support for the Development of Small and Medium-Sized Business in Kazakhstan**

The “State Program to Support and Develop Entrepreneurship for 1992-1994” attempted to address, in a comprehensive fashion, a significant set of problems impeding the creation and development of entrepreneurship. The program specifically emphasized on creating the organizational and legal basis discussed in a previous section. On this basis, the government identified a broad list of laws that needed amendment or complete revision. It devoted much attention to various kinds of institutional reforms. Despite all the diversity of market regulators of production, which had acquired widespread application in market economies, the authors of the program limited themselves to general terms pertaining to taxes and guarantees on credits. The same is true for the third and fourth section of the program.

Above all, the program does not concretize policy measures, but merely defines the responsible party for implementation and deadlines for realization. As a result, it is virtually impossible to exercise control and to evaluate the quality of implementation for any given task and measure. The validity of this conclusion is objectively shown by the fact that the plan even lacks qualitative criteria for assessing the effectiveness of performance and implementation. For example, how is it possible to evaluate the quality of measures to realize the basic terms of this program if it also contains a list of laws requiring amendment and revision (hence changing what is to be implemented and how)? That is all the more evident given the fact that the program fails to specify the composition and content of the proposed corrections and revisions.

Among the top-priority measures, the program proposes—in the first year—to regularize the functions of all the organs of state executive authority that are involved in questions pertaining to the program. It also seeks to make changes and additions to more than fifty normative laws and statutes. In addition, it plans to limit the number of ministries and state agencies that are involved in this process. Because of the enormous workload of the state apparatus in performing current tasks, it proved impossible to carry out the recommended measures. As for the question of de-monopolization, this program proposed to prepare a model for the de-monopolization of large productive organizations and to carry out a set of measures to implement the existing anti-monopoly legislation. On the practical level, this work was primarily aimed at the dissolution of existing state conglomerations and large producer firms. In the event, however, this

merely led to the disorganization of their operations.

Within the framework of a program to provide support for small-scale entrepreneurship, the government planned to carry out the following measures: (i) prepare the procedure for a prioritized allocation of buildings, machinery, and equipment to small enterprises (on a fee-paying basis); (ii) issue state orders to produce the equipment needed for smaller economic formations (within the system of state orders for the production of machinery and equipment); (iii) devise the order for small enterprises to participate in the incorporation of the "Exhibition of Economic Achievements" and in the activity of the "Kazakh Center for Business Cooperation"; (iv) grant special tax concessions to small business that are engaged in the production of goods; (v) create a network of regional commercial centers for the transfer and exchange of technologies, and for the dissemination of new equipment, patent information, and "know-how." It must be mentioned that most of these measures were never realized. Moreover, some sections of the program (for example, the proposal to supply staff and provide information) were intended as support for entrepreneurs in general, not small business in particular.

As a whole, the main shortcomings of the program consist of the following: (i) globality or universality; (ii) lack of concreteness; (iii) absence of a means to provide resources; and, (iv) the failure to have an unambiguous, precise definition of measures and their results, thereby making it impossible to establish effective supervision and monitoring of the program's implementation. As a result, in the second half of 1993, the Ministry of Economy embarked on the preparation of a new "Program for State Support and the Development of Entrepreneurship in the Republic of Kazakhstan in 1994-1996." Among other things, this program promoted the transfer of the appropriate functions from the anti-monopoly committee to the Ministry of Economy. That change was in fact implemented during the next round of administrative reorganization in the executive branch. The new program concentrated on private entrepreneurship and laid its main emphasis on small business. The principal goal of the new program was to create the favorable conditions (legal, social-economic, financial, organizational) that are needed for the formation of a strong private sector and for the development of the infrastructure of private entrepreneurship. In addition, it proposed to create 150,000 private firms that could promote the emergence of a real competitive environment. Particularly, these firms are to supply at least 70 percent of the agricultural output, 40 percent of the industrial production, and 90 percent of services and the commodity turnover in trade. But, these figures were obviously unrealistic: according to approximate data for early 1995, small-scale entrepreneurship accounted for a mere 1.8 percent of the total volume of industrial production and 2.0 percent of the output in the agricultural sector.

The new program contained six sections, which encompassed the following spheres of state support for small business: (i) preparation of the legal, normative basis to support the development of entrepreneurship; (ii) provide financial and technological support for entrepreneurship; (iii) promote the development of institutions in the market and social infrastructure; (iv) extend state support for foreign economic activity; (v) provide training and re-training of the staff for entrepreneurial organizations; (vi) satisfy the informational and scientific-methodological needs of entrepreneurship.

The first section proposes: (i) to make changes in the civil code and tax code; and, (ii) to prepare a draft on "leasing activities." The main shortcoming of the measures contained in this section was its failure to indicate the specific character and content of the proposed measures. For example, it neglected to specify the needed revisions of the tax code (e.g., exemption from the payment of taxes for a specific period of time, reductions in the tax rate, etc.)

The second section of the program planned to carry out the following measures: (i) provide for an annual allocation of credit resources (from the central state budget and foreign sources) to promote the development of private entrepreneurship in 1994—1996; (ii) organize a system of contractual cooperation between large and small enterprises; (iii) create a system of guarantees and insurance to encourage private foreign investment; (iv) give country-level and oblast-level "Small Business Centers" control over at least 10 percent of the free industrial facilities, land plots, unutilized machinery and equipment, and also the buildings of unprofitable or low-profit enterprises (which would be allocated to businesses for leasing on a competitive basis); (v) within the framework of state orders, prepare proposals to convert defense plants to produce equipment needed by SMB, including the machinery for the small-scale mechanization of peasant farms; (vi) organize a system to sell licenses and "know-how." As in the first section, these measures did not have criteria that would enable an objective assessment of the degree of realization. Therefore, one can surmise that the effectiveness from their realization will be minimal and that they will not have much real significance in terms of supporting small business.

The third section called for the preparation of the following proposals: (i) on the reform of the banking system; (ii) on the broadening of activity on the stock market and securities exchange; (iii) on the creation of specialized private centers for the selection and industrial application of efficient technologies; (iv) on completing the formation of the "Small Business Centers." This section, in organizational terms, also committed crude mistakes and miscalculations. For example, in the task of preparing proposals to reform the banking system, the plan did not prescribe the inclusion of banking specialists as partners in implementation.

The fourth section provides for the allocation of special quotas in foreign credit lines to finance projects deemed to be of highest priority. It also proposed to create a center for business connections with foreign partners. It should be noted, that the proposals in this section are, in part, being implemented. However, banking organizations—which will actually have to implement these measures—were not included as collaborators in the project.

The fifth section contains a set of measures to educate and re-train personnel for entrepreneurial organizations. This section includes the following objectives: (i) prepare proposals to develop educational and consulting centers to train cadres for entrepreneurial organizations; (ii) revise the curriculum of secondary schools, specialized schools, and colleges to include courses on the basics of a market economy (the goal being to help instill an economic way of thinking); (iii) organize an open competition to select people for study abroad. The shortcomings of these measures include the failure to devise concrete plans for training cadres, and also the lack of specific plans to determine

how the trained entrepreneurs are to be utilized.

The sixth section is devoted to providing the informational and scientific-methodological needs of entrepreneurship in Kazakhstan. It provides for the following measures: (i) create a network of information centers to service entrepreneurs; (ii) establish a scientific center to study the problem of developing entrepreneurship; (iii) review and revise the form of statistical reporting so that they reflect more fully the process of developing small-scale entrepreneurship in Kazakhstan.

An analysis of the laws, as well as the activity of the appropriate organizations, shows that the above measures were not implemented within the prescribed period of time. The principal shortcomings of "the Program for State Support and the Development of Entrepreneurship in the Republic of Kazakhstan in 1994—1996" consist of the following: (i) the majority of prescribed measures were to be implemented in the course of 1994, but—because of the huge volume of work required—most of them were in fact not realized; (ii) a significant number of the conceptual propositions did not have a clearly defined and completed form; (iii) the lack of an organized system for administering the program, i.e., one that could provide for the on-schedule realization of the proposed measures, and one that could analyze the consequences of decisions and make the necessary corrections (during the process of implementation itself); (iv) failure to define the measure of responsibility of participants in the preparation and realization of the program (in accordance with the functions assigned to them). As a result, it would be valid to conclude that the measures taken by the government to stimulate the development of small entrepreneurship will not bring the desired results.

#### **1.3.4 The Policy of Conferring Special Privileges to Support Small Business**

The existing tax legislation in Kazakhstan provides for a relatively high rate of assessments for the state budget. According to the estimates of experts, direct and indirect taxes take more than 70 percent of the revenues earned by entrepreneurs. The high rates, mainly in indirect taxes, have two consequences: (i) they encourage enterprises to evade paying the taxes; and, (ii) these cause delays in paying other firms (for raw materials, supplies, and component parts) and repaying debts to credit institutions, thereby aggravating the problem of arrears and loan defaulting.

It is important to give special attention to the value-added tax (VAT), since it is also assessed on human labor inputs (wages and profits). As practice has shown, small enterprises not only lack their own buildings, but often do not even possess their own machinery and equipment. That is because such capital assets are quite costly; it is simply beyond the entrepreneurs' capacity to purchase and maintain them. To carry out their production and economic activities, the small businessman rents or leases these fixed capital assets. Consequently, if compared with the larger firms, the small enterprises find the VAT (where wages are so heavily weighted) a disproportionately onerous tax burden.

During this period, the structure of taxation has been characterized by complexity and fluctuations. The tax rates have been subjected to frequent changes. At present, the tax code for small business accords them no special tax advantages, which in turn has an extremely negative impact on the process of its development. The necessity and

expedience of introducing special tax privileges for small business are all the more important given the fact that the state lacks real financial means that it could allocate to support small entrepreneurship, and also given the fact that its policy for providing credits and loans has been so inefficient.

On 1 July 1995 a new Tax Code that encompasses all the questions of taxation at every level (country, oblast, and local) was introduced. One of its positive changes was to reduce the number of taxes from forty-six to eleven. Of the remaining eleven taxes, five (individual and corporate income tax, VAT, securities transaction tax, taxes and assessments for using mineral resources) are collected by central authorities; the remaining six taxes are assessed at the oblast and local level. The Tax Code does not regulate customs duties and assessments on insurance. It abolishes all other taxes that contradict the new code. It was believed that the adoption of such an important document, which regulates all forms of economic activity, would help to ensure stability in the tax laws, raise the level of tax collections, and reduce the tax burden on economic entities. Particularly, the latter had been overburdened by tax assessments (amounting to as much as 70 percent of their revenues) by central and local organs.

Additionally, the income tax rate of legal entities is set at 30 percent, while individuals are subject to a progressive income tax (ranging from 5 to 40 percent). The tax on the income from dividends and interest is 15 percent. Apart from that, the Tax Code provides for a 15 percent assessment on the profits of a firm's branches. It is important to note that the assessment of taxes should be based on declarations of earnings and income that individuals and juridical entities are required to file each month. As a result, this Tax Code is still rather complex for private entrepreneurs in small business. The situation is aggravated by the inexperience of the staff in the tax service, by the highly bureaucratic procedures for exempting individual categories of the population from paying certain forms of taxes and assessments, by the conferral of special tax privileges, etc.

In accordance with this Tax Code, small business does not have any tax advantages, and this has had an extremely negative impact on its development and growth. As noted above, the necessity and expediency of such concessions are all the more important because of the government's inability to allocate real resources to promote the growth of small business, and because of its policies on credit resources. Furthermore, this small-business sector occupies an insignificant place in the economy of Kazakhstan. The volume of profits obtained in 1994 amounted to approximately 2.3 billion tenge. Given the persisting organizational and economic chaos in Kazakhstan, it is difficult to imagine that the resources allocated to SMBs will actually be used for the purposes for which they were intended. It would be more efficient to cut the tax load and leave the resources with the entrepreneurs themselves and, in the appropriate way, ensure that these resources are directed toward the development of production.

### **1.3.5 The Distribution of Government Financial Resources to SMB**

The government established the "Fund for the Support of Entrepreneurship" essentially as a real source of financing for private entrepreneurship, but this fund ceased to exist in the second half of 1995. Structurally, the fund had consisted of a "Republic

Fund” and its regional branches throughout the country. Such a diversified branch structure made it possible to take local conditions into account. According to the fund’s charter, its resources were to come from special assessments on all economic entities in the country, and these resources were then to be directed at providing support for private entrepreneurship.

The main spheres of activity of the fund consisted of the following: (i) provide guarantees on credits to enterprises and entrepreneurs entering the marketplace and developing parallel lines of production; (ii) provide financial assistance to enterprises in specific high-priority spheres (peasant farms; processing and manufacturing, producers of consumer goods, building materials, etc.); (iii) participate in providing credits and insurance for entrepreneurial activity (including special terms and privileges); (iv) participate in the creation and operation of businesses that promote the development of the market infrastructure and information systems to support the development of entrepreneurship and competition; (v) finance the education and retraining of cadres to deal with question of anti-monopoly policies and to develop new economic structures; (vi) finance scientific research (including international projects) associated with the realization of the fund’s objectives; (vii) organize and finance consulting and publishing activities; (viii) assist in concluding international contracts and in placing state orders with the small business enterprises.

The peak period of the fund’s activities came in 1993, when approximately 90 percent of its resources were directed toward SMBs. It offered credits at specially reduced interest rates; depending on the priority assigned to an investment project, the interest rate varied between 20 and 60 percent. Simultaneously, the fund carried out quite important work in other spheres, including: (i) the preparation of draft proposals for laws that pertain to state policies to support the development of entrepreneurship; (ii) practical assistance to help and train beginning entrepreneurs; (iii) provide methodological and normative materials to regulate the activities of regional small-business centers.

At the same time, there were also certain shortcomings in the Fund’s activities. One was a formalistic approach to evaluating the importance of financial projects; the competitive selection of proposals was not free of protectionism and bias. In addition, it lacked real control over the actual utilization of credits; the low interest rates and rather long period before repayment encouraged borrowers to use the credits for commercial purposes. Furthermore, the oblast centers could not extend credits of more than 50,000 tenge. As a result, in 1993 the average sum of credit was very low for projects involving industrial production (26,000 tenge), agriculture (23,200 tenge), consumer goods (28,300 tenge), construction materials (24,900 tenge), and other spheres (30,100 tenge).

As a result, the fund was unable to assist in the realization of investment projects requiring significant initial capital, and hence could only give assistance either to entrepreneurs with insubstantial projects or to those who merely sought to obtain supplementary funds. The effectiveness of the fund’s activities also suffered from the general economic instability in the country, the high rates of inflation, and the attempt by certain state agencies to keep the fund’s resources under their own control. This in turn triggered frequent reorganizations of the fund itself as well as the failure to utilize its

resources for the stipulated targets. It bears emphasizing that the resources at the disposal of the fund were not always used for the stated purpose. In practice, there were cases where the fund's money was transferred to other financial institutions and commercial banking institutions (for example, interest-bearing deposits). The possibility for such operations resulted from the weaknesses in the existing law and from the lack of control over the fund's management from the part of administrative organs in the state.

In general, for a whole series of reasons, the fund could not cope with the functions assigned to it. These factors fall into basically two main categories: internal and external. The internal factors include the following: (i) the weak organizational and executive capacity of the fund's staff; (ii) the failure to qualify sufficiently the resolution of the assigned tasks. The main external causes include: (i) the absence of normative legislative acts, which would define precisely the organizational and juridical status and regulate the activities of non-banking financial institutions (including the fund itself); (ii) given the absence of the foregoing, higher organs of state administration could, at their own discretion, intervene in the activity of the fund and dispose of its financial resources as they saw fit.

Hence, small business in Kazakhstan encounters extraordinary difficulty in gaining access to sources of credit. The lion's share of what they receive (80 to 90 percent) comes in the form of short-term loans and therefore are of limited use (for example, being limited to the goal of providing supplementary working capital). The financial resources of the fund have been created by making an assessment (1 percent) on its behalf from the profits of all economic entities—regardless of their form of property ownership (hence, private entrepreneurs as well). In 1994, more than half of the fund's resources were used not to support and expand SMBs, but to generate revenues and thereby function as a hidden mechanism to finance the state budget. In the first half of 1995, the fund was allocated more than 200 million tenge, but these resources were, apparently, used to cover state expenditures.

To provide assistance specifically for agricultural producers, a decree of the government of the Kazakh Republic on 22 December 1994 (no. 1447) established a "State Fund for the Financial Support of Agriculture." Its main function was to accumulate all budgetary and non-budgetary resources to provide financial support for agricultural producers, to support the creation and development of private farms, and so forth. The sources of financing for this Fund were to come from the privatization of agricultural enterprises, allocations from the state budget, foreign credits, etc. Resources from this fund are issued either as repayable loans or outright grants, in accordance with the contract between the Fund and the specific recipient. The basis for making such loans and grants is a detailed business plan and the decision of the Republican Inter-Ministerial Commission for the Reorganization and Liquidation of Unprofitable Agricultural Enterprises. During the period under review, this fund was the main creditor for agriculture, but unfortunately it was unable to cope with its assigned tasks. In 1995 the fund had 3.4 billion tenge at its disposal, and in 1996 this increased slightly to 3.6 billion tenge. However, in 1995, in accordance with a government decree (on calculating indebtedness of agricultural enterprises for petroleum products as well as natural gas enterprises with arrears owed to the state), approximately 1.7 billion tenge were used to pay for these costs. In other words, the 1.7 billion tenge remained in the budget and were

never allocated to the agricultural sector. The remaining resources were used to purchase seed, mineral fertilizer, veterinary services, etc. As a result, virtually nothing was done to provide financial assistance to private peasant farming, which finds itself on the verge of collapse.

Thus, in 1992-1994, the majority of agricultural producers found themselves nearly bankrupt—because of deals in the paying for goods obtained through state procurement, because of the high inflation, and because of the problems of credit (available only on a short-term basis and at high interest rates). In 1995, approximately 80 percent of the enterprises in the agro-industrial complex were operating at a loss. Given the fact that agricultural producers lacked their own working capital, they turned increasingly to barter transactions. That became an additional cause for the deterioration in the financial condition of agriculture and the sharp contraction in the number of livestock and poultry. It also contributed to a further disruption of the financial system of the agro-industrial complex in the country. The unprofitability of agriculture does not permit agricultural producers to observe the requisite agro-technical regimes or to perform agricultural tasks in a timely manner. The virtual refusal of the government to assist in purchasing agricultural equipment, fuel, and mineral fertilizers has driven agriculture to the brink of catastrophe.

In the judgment of specialists, agriculture needs more than 50 billion tenge in credits each year. However, the volume of budget financing is considerably less. Thus, in 1995, the budget provided for the allocation of 321 million tenge to promote the development of private farming, but in fact only 19 percent of this sum was provided. As a result, one must note an ambiguity in the status of the Fund and its activities. On the one hand, the fund is to provide financial assistance to specific agricultural producers, above all, those in the non-state sector. On the other hand, the activity of the fund (and a significant part of its funds) are used to cover the debts of agricultural enterprises that were created essentially because of the state itself. The situation is further aggravated by the fact that the budget allocations to realize targeted programs for the support and development of agricultural producers are not allocated in sufficient volume. Moreover, part of these are not fully financed, but are used to cover the debts of agricultural enterprises. Thus, given the minimal demand in state financing of 50 billion tenge, the state budget for 1996 allocated just 3.6 billion tenge for financing agriculture. And of the planned funds, in the first quarter only 5 percent were actually allocated. Furthermore, budget funding for agriculture has become more austere with each passing year. In 1994, the total expenditures for the development of agriculture—in the form of credits, subsidies, tax and other privileges—amounted to 30 billion tenge (23 percent of all state expenditures). In 1995, the state allocated 11 billion tenge (7.3 percent of all expenditures), of which 4.1 billion tenge was for debts in purchasing grains from state reserves.

The lack of effective state assistance to support and develop private entrepreneurship in the agrarian sector has substantially diminished the effectiveness from using foreign credits. It has also aggravated the problem of defaults on loans (since the majority of borrowers are insolvent). Thus, in 1994, approximately US\$200 million were allocated to agriculture (for the most part, under state guarantees). The cost of servicing these credits alone is approximately US\$15 million. Because of the weak control

over the choice of projects, and because of the excessive obsession with the application of intensive technologies for crop cultivation, virtually all the projects proved incapable of earning sufficient hard currency to recoup the investment. The uncontrolled grant of state guarantees (not only by the central government, but also by local authorities) aggravated the problem of serving these debts. The problem of non-payments is manifest in agriculture, with its protracted productive cycle.

Moreover, if in the non-productive sphere, in industry, and in transportation, the problem of non-payments applies only partly to SMBs, in agriculture this problem is extremely acute—both for private farmers and for all agricultural producers, regardless of their form of property ownership. Accordingly, while the government professes its awareness of the significance of private entrepreneurship for the development of an efficient national economy, in reality it does not provide substantial assistance to SMBs. Thus, the lack of a well-targeted credit policy toward small business, together with the harsh demands of international financial and credit organizations, has the effect of denying small entrepreneurs access to credit resources.

So long as an effective system for financing small business is not created, it is doubtful whether the republic can reach the designated goals in the development of private entrepreneurship: by the end of 1996, the creation of a critical mass of private entrepreneurs producing 40 percent of the industrial output, at least 70 percent of the agricultural commodities, and 90 percent of the volume of services and commodity turnover. In 1996, state expenditures for SMBs in agriculture are budgeted at 9.5 billion tenge.

### **1.3.6 Privatization Policies with Respect to SMBs**

Of decisive importance for the development of SMBs is the privatization of state property, which is regarded as the real basis for the creation of a non-state sector of the economy. The second stage in privatization and denationalization of state property was conducted in accordance with the decree of the President of the Republic of Kazakhstan (No.1135, 5 March 1993). The program for denationalization and privatization for 1993-1995 (stage two) included the following as its main objectives: (i) formation of a rather broad stratum of private owners-entrepreneurs as efficient economic entities; (ii) development of SMBs; (iii) creation of the preconditions for large-scale foreign investments. Of the four dimensions of denationalization and privatization in the Program, the following pertain directly to the formation and development of SMB. Firstly, the Small Privatization: which is realized through the sale (by means of auctions and open bidding) of small enterprises in trade, consumer services, etc. Secondly, privatization of the agro-industrial complex: which has its own specific characteristics. Completion of the second stage of privatization has substantially changed the structure of property ownership in the country. Thus, virtually the entire network of trade and public food services are now in private hands. Privatization of the pharmacy business is also nearly complete. About 85 percent of the gasoline stations are also privately owned. Privatization has also begun in the case of urban taxi services as well as in some elements of the social infrastructure (holiday resorts, dental clinics, pre-school child care facilities, etc.) As a result, the state has virtually withdrawn from the management of trade and services.

Altogether, within the framework of small-scale privatization, approximately 11,000 enterprises have been sold, that is practically two-thirds of all the units scheduled for privatization. At the 502 auctions and competitive tenders held at the beginning of this new stage, some 12,600 enterprises were put up for sale, and of this total 10,500 were sold during this period. In 1994, the state sold 2,095 enterprises for a total sum of 564 million tenge. Furthermore about 80 percent of the privatized entities retain their earlier profile, while about two-thirds of the remaining 20 percent were temporarily closed for renovation, and about 7 percent (for various other reasons) are not operating. Within the framework of privatization in the agro-industrial complex, the state sold about 1,970 enterprises (more than 90 percent of all the enterprises in the complex). In the course of 1996, the government plans to complete the process of privatization in the village and, in place of the remaining state agricultural enterprises, to organize peasant farms and cooperatives. Only specialized agricultural units (chiefly those engaged in raising seeds and selective breeding) will remain in state hands.

The main shortcoming of denationalization and privatization is the fact that the main emphasis was placed on the form of property ownership. That, however, did not automatically lead to the appearance of a stratum of efficient property-owners or entrepreneurs. The difficult economic situation that emerged in the country left its imprint on the activity of enterprises, regardless of their form of property ownership (including the private sector).

To demonstrate the foregoing, let us examine the course of privatization in the leading branch of the economy—industry. The number of privatized industrial enterprises increased from 2 in 1990 to 1,181 by the beginning of 1995. Among these privatized industrial enterprises, one quarter was in the food-processing industry, followed by firms producing construction materials (17 percent) and by plants in the light industry branch (12 percent). This process of privatization proceeded most intensively in the industrially developed regions. Thus, in 1994, Karaganda Oblast privatized thirty-five enterprises (17 percent of the total number of privatized industrial enterprises in the republic). The proportions were lower for Kustanai Oblast (16 percent [34 firms]), Zhezkazgan Oblast (12 percent [26 firms]), and Vostochno-Kazakh Oblast (10 percent [21 firms]). At the same time, the formal change of property did not lead to an improvement in the economic performance of the majority of privatized enterprises. These found themselves unable to pay their sources for raw materials, supplies, and electric power. As a result, they were forced to work on a reduced schedule. That in turn meant a decrease in the volume of production and a deterioration in the financial performance of enterprises following their privatization. Thus, in 1994, the profitability of the firm “Sary-Arka” was only 0.4 percent of its level in 1993; the profits of the joint-stock company “Tokyma” (Semipalatinsk Oblast) in 1994 were only 10.2 percent of the previous year. Many newly created enterprises, once they had formally registered, simply never commenced to function for lack of financial resources.

Positive gains in the economy are further impeded by the fact that more than half the people in the non-state sector of the economy are engaged in entrepreneurship that fails to yield high earnings. This low profitability in the non-state sector of the economy derives essentially from the low level of labor productivity. With few exceptions, labor in the non-state sector remains the least mechanized. For all practical purposes, this sector

relies mainly on manual labor. Therefore, it is important to increase labor productivity and the quality of production through the gradual modernization of production technology and through more efficient methods of management and the large-scale application of licensing. Such changes are essential to improving the future prospects for enterprises in the non-state sector of the economy.

An analysis of the practical results of privatization shows that this process was directed not so much at creating a stratum of real property-owners, as pursuing purely political objectives. The latter were linked intimately with demolishing the old model of social development and giving a visage of irreversibility to the economic reforms. As a result, the government assigned top priority not to economic efficiency and the expediency of denationalization and privatization, but to the pace and tempo. The result was a forced, coercive pattern of privatization. Thus, at one point, within the framework of the privatization of smaller enterprises, the government issued "control figures" (i.e., plan targets) that individual oblasts were to reach within a specified period of time. The fulfillment, or failure to do so, was rewarded or punished accordingly. The forced tempo of privatization and the orientation toward quantitative indicators marginalized concern about the efficiency of production. It also pushed to the background measures to provide the conditions that would enable a mobilization of human resources for investment purposes.

One objective of privatization was to attract foreign investment. It was assumed that foreign investors would, with great enthusiasm, inject huge sums into the non-state sector. However, the country lacks the requisite conditions to stimulate such investment. Particularly, it has failed to resolve the question of providing incentives for foreign investments. At the same time, on several occasions during this period, the government changed the economic legislation regulating the activities of foreign individuals and firms. Many problems in attracting foreign capital (including support for private entrepreneurship) could be eliminated by adopting and implementing the "Program for the Attraction of Foreign Capital," which was prepared in July 1995 and revised in May 1996.

The emerging private sector has many weaknesses, based on the fact that it lacks sufficient means for full-scale participation in the creation of joint-venture enterprises, collateral possibilities, government guarantees, and the like. As a result, foreign investors apparently will give preference to large enterprises with an export orientation. In the case of these large enterprises, it is easier to achieve governmental and banking guarantees (backed by real estate and property). Hence they entail lesser risk than dealing with a businessman who has not yet established himself. Consequently, the country must still resolve the problem of attracting foreign investments if small and medium-sized entrepreneurship is to develop.

A new stage in privatization and denationalization commenced this year when the government adopted the "Program for the Privatization and Restructuring of State Property in the Republic of Kazakhstan in 1996—1998." This program aims to complete the formation of a complex, mixed economy. Furthermore, this program should extend to those firms in trade and the non-productive sphere (including the social sphere) that were not sold within the framework of the program for the "small privatization." In

general, the new program retains the basic method of privatization (direct sale of firms at auctions and bidding). It is important to note that the government will apply not only the English method of conducting auctions and sales, but also the Dutch system (whereby the selling is conducted at lower starting prices, within the limits of established framework). This should make it possible to privatize firms that were earlier put up for auction, but could not be sold because they were not sufficiently attractive for potential buyers.

#### 1.4. Reaction of the Private Sector to State Policies

The organized movement of entrepreneurs in Kazakhstan is represented by such organizations as the "Congress of Entrepreneurs of Kazakhstan" and "the Kazakh Center for the Development of Small Business," which have representatives in every oblast of the country. At the present time, the former is the most stable and influential organization for representing the interests of the broad mass of entrepreneurs. Its specialists participate in: (i) preparing the programs for the state support of entrepreneurship; (ii) conducting expert analyses of the existing legislation on economic matters; (iii) preparing draft laws to regulate the activities of the entrepreneurial sector of the economy; (iv) determining the form and methods for giving assistance to SMBs; (v) promoting the establishment of ties between domestic entrepreneurs and foreign investors. According to the report of the executive committee of the Congress of Entrepreneurs for 1994-1996, they made comments, criticisms, and addenda to such legislative acts as the laws on "bankruptcy" and "licensing," as well as presidential edicts ("on taxes and other obligatory payments to the budget", "on the support and development of private entrepreneurship", "on partnerships and joint-stock companies," etc.) In addition, it submitted draft proposals on the tax code, privatization, insurance, "state support for small entrepreneurship in the Republic of Kazakhstan," and so forth. The Congress of Entrepreneurs gives considerable attention to the providing education and retraining for cadres and to providing information and scientific methodologies to entrepreneurs.

With the direct participation of the Congress and foreign specialists, the following organizations were created: (i) the Kazakh Center for the Support and Development of Entrepreneurship; (ii) the Center of Business Relations (the business-communications center); (iii) the Kazakhstan Center for Small and Medium-Sized Business; (iv) the Consulting Center; (v) the Informational Center for Small and Medium-sized Business; (vi) the Small-Business Centers (in the city of Almaty and oblast centers).

In June 1996, in order to define its juridical status, the Congress of Entrepreneurs carried out its reorganization (in accordance with existing law). On 27 July 1996, the third assembly of the entrepreneurs of Kazakhstan approved the charter of the Congress, which is established as an organization of juridical entities with the status of an "association." The assembly authorized the executive committee of the Congress to carry out its registration in the organs of the state administration in accordance with current law. In conformity with the adopted charter, the Congress of Entrepreneurs of Kazakhstan represents an independent, non-commercial organization. On a voluntary basis, it unites "juridical entities" (i.e., companies) that are engaged in entrepreneurial activity on the territory of the Republic of Kazakhstan.

The main objectives of the Congress of Entrepreneurs include the following: (i) comprehensive support (legal, economic, and information); (ii) creation of conditions for mutually beneficial cooperation of enterprises; (iii) systematic resolution of the problems that impede collaboration between domestic entrepreneurs and foreign partners.

The supreme organ of administration of the Congress is the general assembly of the members of the Congress, which convenes one time each year. The general assembly confirms the charter of the Congress, elects the members of its Presidium, its President, and the members of the auditing commission. It also takes decisions with respect to the reorganization or termination of the activities of the Congress, its membership, and so forth. The executive organ of the Congress of Entrepreneurs is the Presidium, which directs its activities between the general assemblies. It has the following functions: (i) prepare documents for consideration by the general assembly; (ii) elect the members of the presidium of vice-presidents of the congress; (iii) coordinate the activity of the members of the Congress, and represent and defend their interests; (iv) determine the amount of membership dues and the rules for their payment; (v) establish ties to various other organizations interested in collaboration with the Congress of Entrepreneurs; (vi) determine the structure of the executive committee of the Congress, the auditing commission, and their operating procedures. In conclusion, it should be noted that, at the preceding assembly, its members affirmed their support for the policy of reform being undertaken in Kazakhstan. Specifically, it endorsed the general objective of creating and developing a market economy.

In 1993, in accordance with the project TACIS LK 003, the "Kazakhstan Center for the Training and Consultation of Entrepreneurs" was established. Its main objective is to provide training for people who are already entrepreneurs, but also those who wish to work in the sphere of small or medium-sized business. The scientific and educational base of the Center consists of twenty instructors, who had previously received training in Great Britain. The training of entrepreneurs for Kazakhstan is conducted both at home and in Great Britain (after a preliminary selection of participants). The training of entrepreneurial cadres gives attention to a variety of subjects, such as: (i) the legislation; (ii) the market and marketing; (iii) enterprises and finances; (iv) international business; (v) the organization and management of an enterprise; (vi) the preparation of business plans. In terms of its curriculum and content, the program to educate and retrain entrepreneurs is problem-oriented, and the length of study is variable. Furthermore, the Center provides consulting services for parties interested in a broad range of questions involving the realization of economic activities.

Another important dimension is the Small Business Center. Because the activity of the Fund for the Support of Entrepreneurship and Development of Competition (as well as other organizations) failed to produce the desired results, in September 1993 the Cabinet of Ministers adopted a resolution "on the order for establishing Small Business Centers." In so doing, the government expected that, in accordance with this resolution, the activities of the Small Business Centers would make it possible to coordinate the work of both the organs of state administration (at the central as well as the local level) with that of other organizations seeking to promote the development of entrepreneurship. The latter organizations include the Congress of Entrepreneurs, the Union of Small Peasant Farmers, and several others. The Small Business Centers were created by the

State Property Committee, the Fund for the Support of Entrepreneurship, and juridical entities (in the form of joint-stock companies that include the participation of local administration, and several interested ministries and state agencies). The main objectives of the Small Business Centers consist of the following: (i) render assistance in providing entrepreneurs, at an early stage in their work, with production facilities, material resources, and services of an organizational and methodological character; (ii) provide legal support for the activity of SMEs; (iii) make grants of production facilities and offices, machinery and equipment; (iv) offer financial assistance; (v) provide engineering support for proposals and assistance in organizing production; (vi) supply training and consulting with respect to the realization of independent economic activity; (vii) offer legal, economic, and technical assessments of entrepreneurial projects; (viii) provide information, marketing, and consulting services; (ix) assist in the filing of reports, compiling of contracts and agreements, and preparation of normative documents for economic organizations; (x) help entrepreneurs to establish foreign economic ties.

It should be noted that the forming of Small Business Centers was a very complex process and failed to yield the desired results. First, it was unrealistic to assign them the function of coordinating the activities of state organs in the executive branch, since this responsibility, in terms of status and authority, properly belongs to the Ministry of Economy. Second, objectively speaking, the organization of Small Business Centers as a joint-stock company presupposes that their main efforts will be directed toward earning a profit, not providing the support of entrepreneurs (who have limited resources to pay for services at the going market prices). In this case, the proclaimed goals of the Small Business Centers do not correspond to the economic content of an enterprise that has been established with the organizational and legal form of a joint-stock company. In other words, the goals of the centers primarily corresponded to those of a public organization or an government body, but its organizational and legal form was that of a business. Such a resolution of the problem for providing support for small business was, from the very outset, doomed to failure. The advanced experience of developed foreign countries attests to the need to divide these functions among the corresponding organizations.

## **2. The Main Patterns and Prospects for the Development of Entrepreneurship in the Transition to a Market Economy;**

The transition of entrepreneurship to a qualitatively new level is not possible without an effective system of state and public support for entrepreneurship at both central and local levels. State support must be comprehensive and diversified. Above all, this means that the state must provide financial support, assistance in creating or acquiring firms, and insurance for newly-formed private enterprises. It is also necessary to devise a system of cooperation between state organs and entrepreneurial organizations in all aspects of this problem.

Resolution of all these problems will require the greatest possible effort on the part of both the state and entrepreneurial organizations. It also means that the state must prepare the main outlines of its general strategy for the development of entrepreneurship as well as the specific tactical measures to resolve the pertinent questions. For this it is

necessary to do the following.

First, as soon as possible, it is essential to prepare legislation to regulate all aspects of the formation, operation and cease of activity of a small business firm. The packet of economic laws in the sphere of developing entrepreneurship needs expert assessment with respect to their effectiveness, degree of completeness in designing levers to influence entrepreneurial activity, and guarantees of economic freedom for entrepreneurs. It is necessary to amend the existing legislation in order to provide a real stimulus for the development of new forms of business, and to create conditions favorable to the production of competitive goods. It is also essential to organize a reliable system to protect the rights of entrepreneurs. For purposes of increasing the security of business and protecting the rights of entrepreneurs, it is necessary to take the proper legislative, administrative, and organizational measures to make a cardinal change in the existing situation and to provide for a real legal, actual defense of their rights. Today, private business urgently needs legal protection, because it is suffering from the growing influence of racketeering and from the lack of legal restraints on officials.

Another requirement is a legal decision and social protection of entrepreneurship so as to guarantee the independence of entrepreneurial structures, the inviolability of private property, the observance of collective agreements and contracts, the creation of a system of hiring, contracts, etc. The country has not adequately worked out a mechanism to give its citizens the rights of property ownership. Nor has it given them the opportunity, in an independent and free manner, to determine their place in the system of market relations. It is also important to accelerate the preparation and adoption of laws on the legal system, courts of arbitration, commercial secrets, responsibility for pseudo-entrepreneurship, and divulging of information about entrepreneurs and their activity (by state officials). The country also needs to prepare a civil code. Given the urgency of these questions, they should be the focus of a special program.

It is also necessary to work out a state program to support and develop entrepreneurship for the period of 1996-2000 and to combine the efforts of all branches of the state to ensure that it is actually implemented. This program should envision measures to stimulate small business and to create a simplified system of accounting and taxation for small business. To increase the volumes of financing for individual branches of this program, the government should mobilize additional resources from regions and commercial organizations (belonging to both domestic and foreign entrepreneurs). There are also a number of questions pertaining to the mechanism needed for realizing state policies to support entrepreneurship. This issue must, certainly, be incorporated in the new program. It is essential to create a mechanism that can stimulate the investment of resources by non-state enterprises (especially commercial institutions) in production.

The economic basis of entrepreneurship in a market economy is the earning of profits. Such profits come from reducing per unit production costs, adopting innovations, developing new types of goods and services, and expanding new markets to sell these products. However, the economic situation in Kazakhstan—the continuing decline in production and the high rates of inflation—make it senseless to undertake any forms of productive activities in the small business sphere. The creation of such a mechanism presupposes access to the sources of financing for entrepreneurial activity.

This is possible only if the following conditions are met. Firstly, presence of legally defined privileges, with a differentiation according to the type of activity (based on the program for supporting entrepreneurship with a national or state significance). Secondly, establishment of an advantageous regime of corporate income taxation, which should be targeted at realizing the state program. Thirdly, partial exemption from taxation or grant of state subsidies for banks that issue credits to entrepreneurs to invest in production. Fourthly, existence of a system of guarantees for the above credits from commercial banks (to be provided by state organs and the Kazakhstan Center for the Support and Development of Entrepreneurship). Finally, development of a network of companies to provide insurance for commercial markets, with state participation and use of property collateral.

An important mechanism for attracting private capital to invest in production is the creation of conditions that would enable the participation of non-state enterprises (including commercial organizations) in the privatization of state plants and enterprises. State enterprises, whose resources (together with centralized capital investment) were long the main source of investment in production, are now virtually incapable of realizing a program for the development of production. Many enterprises have only enough financial resources to cover current expenditures. At the same time, commercial structures have some unencumbered financial resources, both for them and for the population in general. Thus, a more attractive alternative is to use these resources for the privatization of state property. Participation in privatization will enable commercial structures either to acquire the right to control privatized enterprises (at a minimum cost), or to obtain the right to conduct and expand their own activities. In the case of the privatization of industrial enterprises by commercial institutions, this would signify a real diversification of these enterprises. However, this is something that they themselves cannot achieve for lack of funds. Ensuring the participation of private capital in mass privatization and in the privatization of individual enterprises is a high priority. It should precede not only the conversion of state enterprises into joint-stock companies (as foreseen in the National Program of De-nationalization and Privatization for 1993—1995 [stage 2]), but also the transformation of large enterprises into more flexible production units. This transformation is achieved by giving greater autonomy to their structural subsidiaries (even to the point of giving them the full status of an independent juridical entity). In the first instance, this independence should be given to those who can produce finished goods on their own.

The break-up of enterprises is necessary not only for purposes of ensuring the possible participation of private firms in this privatization, but also for putting the enterprises themselves back on a sound financial base. The Kazakhstan Center for the Support and Development of Entrepreneurship can also serve as an instrument to attract state and private capital to invest in production projects. For purposes of coordinating state assistance for entrepreneurship, it is necessary to provide systematic support to the Kazakhstan Center and to the Small Business Centers. These can be assigned the function of registering SMBs, financing work to create an infrastructure for the development of entrepreneurial organizations, and also realizing programs and projects that bear a general country-level and regional significance. It would be expeditious to expand the geography of cooperation among regions to develop the backward areas, and

also to conduct an open competition for the selection of the most effective projects and programs in small business (on the basis of tenders). It is essential to seek the involvement of the maximum number of regions. It is important to allocate the requisite budgetary funds to create a network of informational-analytical centers and a data base.

It would be appropriate to pose the question of the need to stop the practice of dissipating state financial resources among numerous budgetary and non-budgetary funds. At the same time, under conditions where the bank interest rates for credit is extremely high and investment activity is sharply contracting, it is important to preserve and develop the system of supporting entrepreneurship through the Small Business Centers. The Small Business Centers in the regions, which act in accordance with market laws and make assessments of proposals that have applied for funds, should become the basis for the creation of investment funds and companies. In the future, the latter will assume the center of gravity for investment activity and for participating in the realization of the program for mass-scale privatization. Second, the tax system is the most effective and universal method for regulating SMBs. By establishing differential rates and conferring special privileges (given the acute shortage of financial and credit resources at the present time), the tax system can be used as a powerful stimulus for the development of production. At the present level of development, and in the period under planning, it would be expeditious to use the following types of tax measures: (i) "tax holidays," i.e., an exemption from the payment of taxes for up to five years (depending upon the branch and regional characteristics); (ii) reduced differential tax rates; (iii) grant of tax credits (with repayment in the future).

In the sphere of financial and credit policies, it is necessary to establish a quota on targeted credit resources that are available for the development of SMBs. These quotas should have 10 to 20 percent for domestic investors (15 to 25 percent for foreign investors) of the total volume of possible investments. These credits should be distributed among the different sectors: (i) agriculture (20 percent); (ii) production of industrial goods, consumer goods, pharmaceutical products, and medical equipment (20 percent); (iii) innovation activities (20 percent); (iv) development of transportation, communications, construction, and production of construction materials (15 percent); (v) public utilities and consumer services (15 percent).

As noted above, the state budget has virtually no funds to finance the development of small and medium-sized business. For their part, banks find it profitable only to finance capital-intensive projects, which, as a rule, are being undertaken by large firms. This is because credits for small entrepreneurs are associated with higher risk, and because of the higher per unit costs of bank services in issuing small credits. These factors make it necessary for the state to establish a network of non-banking financial institutions to stimulate the investment process for small and medium-sized business. At present, it would be expeditious to create a special investment company to grant credits (on preferential terms) to small entrepreneurs. The sources for financing this could include: (i) personal funds (deposited in a people's bank); (ii) pension funds; (iii) the resources of non-budgetary funds.

Third, it is essential to prepare measures to create the broad network of a market infrastructure. This will ensure the strengthening and development of horizontal

linkages through a system of securities exchanges, trading markets, banks, innovation and holding companies, and stock markets. It is also essential to devise a mechanism to support private firms and commercial-information centers, and to establish the legal and organizational foundations for the creation of holding companies, acquisitions, factoring, etc. For these purposes, it is necessary to attract foreign organizations, to prepare for the creation of transnational corporations, and to draw upon the experience of foreign countries in developing a market infrastructure. The principal task here is the total separation of enterprises from the state. Their relations with the state should be regulated only by market mechanisms through prices, credit, finance, interest rates, and the like.

Fourth, it is necessary to devise a mechanism and procedure for providing credits to small business not only through commercial banks (backed by guarantees from state budgetary resources), but also through specialized state and public funds and organizations. Above all, it is important to make it more appealing banks and other financial institutions to provide credit resources for small business. For that purpose, it is necessary to prepare measures to protect investments and, in particular, to provide guarantees for credits issued by commercial organizations, and to compensate for losses from preferential credits extended to entrepreneurial undertakings.

It is necessary to create preferential conditions for banks that perform factoring services and act as an instrument to resolve the payment arrears problem. The country must introduce this form of operation (which is new for the banking market in Kazakhstan), which is associated with a higher risk. It is also necessary to stimulate the creation of independent, specialized factoring companies; these would be formed by enterprises themselves by combining their resources. Another step is to establish a system of credit corporations that would specialize in providing credits to small businesses. In return, these corporations would then receive specific tax advantages, credit resources, and guarantees from the state. Such credit corporations can be private and operate on a commercial basis.

All these questions involve a great deal of difficulties. In essence, we have only taken the first steps toward creating a financial market. Above all, it is necessary to create guarantee mechanisms for entrepreneurship by buttressing the security of collateral-backed loans and by regulating credit instruments. It is necessary to create a civilized securities market, to learn to work with foreign currency, and to put the tax system into order. In general, a program for the movement of long-term and short-term capital is needed.

At present, enterprises cannot count on assistance from the existing financial institutions. The period given for bank loans is very short. Therefore, it is necessary to introduce those forms of financial institutions that correspond to the real, existing corporate model of the economy. In other words, it is essential to assist in the organization of collective, cooperative banks of industrial enterprises, or mutual credit associations, and also to support enterprises by offering credit at lower interest rates. Such measures are needed because commercial banks are not interested in providing such credits (given the state's failure to provide specific incentives and advantages).

To attract the resources of large enterprises to SMBs, it is possible to use a system

of franchising. This method, which has been widely used in the West, produces a significant economic effect in terms of cooperation between large and small entrepreneurship. In essence, for a stipulated period of time, the large "parent" company (franchiser) confers the right for a small enterprise (the franchisee) to engage in entrepreneurial activity and to use its trade name, know-how, and production technology. Usually, the parent firm assumes the responsibility for training the personnel, delivering the equipment and raw materials, providing assistance in organizing the new business, and establishing a system of management. Sometimes, the franchiser firm provides financial support for its franchisee by providing credit or guarantees. Large firms, with a minimum of risk to themselves, can thereby expand into new markets. The small firm, with the aid of the franchise, can quickly open its business, and the constant support of the mother firm enables to resolve quickly any problems that emerge in the early start-up phase. In foreign countries, franchising has become widespread in retail and wholesale trade, in the service sphere, and in the production of beverages.

Fifth, it would be expeditious to finance entrepreneurship by making budgetary allocations at all levels. It is also possible to direct part of the resources from privatization as well as the resources that accumulate in unemployment, pension, conversion, and other non-budgetary funds. All these budgetary and non-budgetary resources should be consolidated in the Kazakhstan Center for the Support and Development of Entrepreneurship. The financial resources assigned to Kazakhstan by international organizations and foreign states, which are now dispersed among various agencies and organizations, should also be concentrated in the Kazakhstan Center.

Sixth, to provide small enterprises with conditions for productive activity, the process of privatization and reorganization should create small enterprises on the basis of unutilized, or inefficiently utilized, buildings, land plots, and equipment. Thus, privatized enterprises and social-cultural organizations should be put in trusteeship, treated as a leased concession, or sold on time. At present, the technical level of the basic productive funds of many small enterprises is extremely low. To intensify the investment activity of such enterprises, it is necessary to change the policy on amortization. All amortization payments should remain at the enterprises and be directed exclusively toward capital investment.

The structure of industrial production retains its orientation toward satisfying the needs of large state enterprises. In addition, the condition of the material-technical base of industrial production is growing worse with each passing year. Thus, at present, from 30 to 40 percent of the fixed capital of enterprises in light industry and food processing is physically depleted and worn out. And the percentage of obsolescent machinery is much higher.

The acute shortages of virtually all means of production have affected not only the development of industry as a whole, but above all the formation of a non-state sector of entrepreneurship. The lack of a material and technical base has put a virtual halt to the creation and formation of SMEs. On the other hand, the reorientation of industry (above all, the machine-building complex) is only possible through the efforts of SMEs. That is because they have greater flexibility and maneuverability. The potential for this does in

fact exist. More than 2,000 enterprises in heavy industry (including 60 enterprises in the defense complex) provide the necessary material and technical base for a reorientation of the structure of industrial production.

Seventh, for purposes of helping to raise the social status of entrepreneurship and to stimulate a social orientation, attention should be given to the exceptional influence of small business on issues affecting the general public. This includes realization of the state's social policy, the creation of new jobs, and achieving a reduction in the number of unemployed. In other words, support for entrepreneurship should be regarded as one of the basic components in the state's program to increase employment. The only way to prevent a large-scale increase in unemployment is to pursue a coherent state employment program that provides not only for assistance and material aid to the jobless, but rather helps in placing the unemployed, organizing public works projects, creating jobs, and retraining and advanced training.

Eighth, it is necessary to support entrepreneurs' efforts to unite along professional lines to defend their interests and positions in the organs of the legislative and executive branches. It is necessary for entrepreneurial associations and organizations to participate in the preparation of documents and laws that affect their interests. For this purpose, public funds, trade unions, and entrepreneurial organizations should combine their efforts to support entrepreneurship and to create favorable legal, financial, and organizational conditions. It is appropriate to create a clear, effective system for certifying educational institutions that train future or current entrepreneurs. It is also effective to conduct international and country-level conferences and to hold scientific seminars on the problems of creating and expanding entrepreneurship. Participants should include international, research and government organizations.

Ninth, small entrepreneurship is primarily found among young people. Therefore, one should give particular attention to the formation of a qualified, literate, and educated stratum of future entrepreneurs, and to forecast employment and create favorable conditions to create new jobs for youths. Accordingly, in the shortest possible time, the country should organize the massive preparation of specialists who will be capable of creating, providing professional management, and running their own businesses. The training of entrepreneurial cadres should be conducted through several channels. The main problem today is the lack of an alternative (non-state) system of education. The current system has the following deficiencies: (i) lack of an organ to coordinate the task of training entrepreneurs; (ii) backwardness of the material and technical base; (iii) lack of a mechanism to encourage enterprises to invest in an improvement in the qualifications and skills of their employees. Tenth, it is necessary to promote the development and higher productivity of foreign economic activities by small businesses and to help them expand their cooperation with foreign partners. For this purpose, particular attention should be given to a network of information centers, which are associated with an international data bank and consulting services that operate both abroad and at home. A partial subsidy should be made in order to facilitate access for entrepreneurs. To the list of top-priority spheres of technical assistance one should also add the task of promoting cooperation between domestic and foreign companies.

Eleventh, entrepreneurs are doomed to fail if there is no research on market

conditions (demand and supply), or on the organization, planning and management of the system of production and sale of output. A powerful scientific research structure of the entrepreneurs themselves is essential. Information is the most valuable capital of entrepreneurs. To be supplied with this, it is necessary to solve a mass of technical, organizational, and financial problems. The resolution of this question could serve to form a system of organs to supply informational, methodological, and consulting assistance to entrepreneurs. Such aid can take the form of centers for the development of small business, the widespread formation of business incubators, establishment of technology parks (based on the models found in foreign countries), and so forth.

Realization of these strategic dimensions for the development of entrepreneurship, to a large extent, will depend on the entrepreneurial organizations themselves. The priorities in the development of SMBs, in general, should correspond to the structural, industrial, and foreign economic policies being pursued. These should be coordinated and adjusted toward the main parameters of regional policies.

The State Program for the Support and Development of Entrepreneurship should set the following as the top priorities:

- Agriculture: (i) the production, processing, and preservation of agricultural products, including the development of a network of manufacturing plants located primarily in the village together with the creation of an industrial infrastructure; (ii) creation and development of peasant farming on the basis of new technologies while taking into account traditional forms of production.
- Production of food products, industrial goods, consumer goods, medicines, and medical equipment.
- Production of import-replacing and competitive goods oriented toward export.

Innovative Activities: (i) organization and development of R&D-intensive lines of production; (ii) creation of small innovative enterprises, regional centers of innovation and technological assistance, and innovation business centers; (iii) creation of business centers, educational centers, research and technology parks; (iv) introduction of resource-saving technologies, and technologies for the use of secondary raw materials and by-products.

- Development of transportation, communications, and the production of construction materials
- Provide public utility services for industrial and consumer needs.

In backward regions and small declining towns, it is necessary to develop small business even in unprofitable branches. Such a policy reflects the fact that small entrepreneurship in these areas can perform a primarily social function.

Given the insufficient stability of processes transpiring now, the priorities in developing SMBs can be corrected. In the more remote perspective, it is necessary to consider the most efficient branches for the functioning of SMBs such as: (i) branches that did not succeed in undergoing a radical technical transformation; (ii) branches with a pronounced local production and market; (iii) branches oriented toward the production

of a broad range of products and changed demand (housing construction, garment industry, and food-processing); (iv) new branches, that are at infant stage; (v) branches where large-scale mass production is not profitable.

## Appendix A

**Table A1 Measures to support the development of SMB in Kazakhstan**

Problem	Proposed Measures
<b>1.Legislative and legal support for the development of SMB</b>	
1.1 Shortcomings in the existing legislation, contradictions in existing laws and normative acts to regulate private entrepreneurship	Make the requisite adjustments to all laws and normative acts that regulate entrepreneurial activity in the country; make them compatible with the Civil Code; remove all contradictions.
1.2 Non-implementation of the existing laws and normative-legal acts that pertain to support for small business	Increase the discipline on implementation; establish personal accountability for the observance of laws; increase the penalties for violation of the law.
1.3 Inadequate legislative support	Prepare draft laws and normative acts on SMB, on the physical and legal protection of entrepreneurs, on guarantees of their autonomy and independence from interference by state organizations.
<b>2.Creation of a favorable economic environment for the development of SMB</b>	
2.1 Tax policy	<p>Adopt changes in tax legislation to create preferential conditions for SMB such as:</p> <ul style="list-style-type: none"> <li>• exemption from taxes for up to 5 years (depending on branch and regional characteristics)</li> <li>• reduce the differentiated tax rates;</li> <li>• grant tax credits (with later repayment)</li> </ul>
2.2 Credit policy	<ul style="list-style-type: none"> <li>• Devise a mechanism and procedure for providing credit to small and medium-sized business by commercial banks (backed by the state and non-state organizations).</li> <li>• Introduce obligatory quotas on the grant of credits to private entrepreneurs by banks in the republic.</li> <li>• Provide for obligatory, targeted financing of SMB (above all, by assisting in the development of institutional investors and the infrastructure for SMB).</li> </ul>
2.3 Economic support for the development of SMB.	<p>Prepare a complex of measures to facilitate the creation of small and medium-sized private enterprises by:</p> <ul style="list-style-type: none"> <li>• providing entrepreneurs with production facilities and offices;</li> <li>• selling incomplete construction projects to parties interested in organizing production</li> <li>• engineering improvements in land plots for housing and production facilities;</li> <li>• creating a park for small enterprises, specialized buildings for production, offices, warehouses, storage facilities, facilities for leasing, with an option for later purchase).</li> </ul> <p>Assist in organizing specialized, small enterprises to provide technical and transportation services for small and medium-sized businesses, agricultural cooperatives, and peasant farms.</p>

**Table A1 Cont.**

Problem	Proposed Measures
<b>3.Organizational and institutional support</b>	
3.1 Creation of an infrastructure for SMB	Create new, and develop old, institutions to support private entrepreneurship: <ul style="list-style-type: none"> <li>• a specialized bank to finance small business;</li> <li>• non-banking credit organizations;</li> <li>• systems for insurance and reinsurance;</li> <li>• systems to provide information;</li> <li>• systems to provide consulting services;</li> <li>• auditing and legal assistance;</li> <li>• centers to train entrepreneurs;</li> <li>• centers to conduct marketing, scientific research, and engineering work</li> </ul>
3.2 Provide state support for the development of SMB	<ul style="list-style-type: none"> <li>• Create a state organ to regulate all questions pertaining to the formation, operation, and closing of small business enterprises.</li> <li>• Assist in the creation of a consulting service for private entrepreneurship (drawing upon people who have retired and have high qualifications and experience in management, research, and organizational work).</li> <li>• Prepare special programs to develop entrepreneurship in the republic and/or appropriate sections in other national programs, with constant monitoring of the process of developing SMB, and with operational intervention insofar as it is necessary.</li> </ul>

## Appendix B

**Table B.1 Changes in average number of employees per SMB between 1991-1994 (person)**

Type of Enterprise	1991	1992	1993	1994
Cooperative	24.8	19.0	13.1	13.0
State enterprise	20.2	17.4	12.0	12.4
Private enterprise	-	11.2	7.8	8.1

**Table B.2 Changes in the number of small enterprises and number of employees between 1991-1995**

Category	1991	1992	1993	1994	1995
Number of small enterprises	16,505	25,177	35,179	32,186	21,260
Average number of employees	379,342	400,118	358,814	320,432	147,248
Share of GDP (percent)	-	-	-	5.2	3.9

**Table B.3 Changes in number of employees at small enterprises between 1991-1994 (in percentage)**

Type of Enterprise	1991	1994	1993	1994
Total	100	100	100	100
Cooperative	65.6	24.5	12.0	8.3
State Enterprise	34.4	55.0	53.7	44.4
Private Enterprise	0.0	20.5	34.3	47.3

**Table B.4 Regional distribution of cooperatives between 1991-1994**

Region	1991	1992	1993	1994
Akomola Oblast	627	299	234	179
Aktiubinsk Oblast	355	182	73	46
Almaty Oblast	680	238	538	157
Atyrausk Oblast	71	64	79	62
Vostochno-Kazakhstan Oblast	444	391	273	165
Zhambyl Oblast	242	176	123	39
Zhezkazgan Oblast	195	83	36	42
Zapadno-Kazakhstan Oblast	204	128	57	32
Karaganda Oblast	846	339	191	130
Kzyl-Orda Oblast	137	121	31	20
Kokchetau Oblast	371	171	126	134
Kustanai Oblast	586	345	161	98
Mangistau Oblast	292	128	86	54
Pavlodar Oblast	659	392	200	180
Severo-Kazakhstan Oblast	458	236	143	101
Semipalatinsk Oblast	264	89	72	46
Taldy-Kurgan Oblast	379	132	80	36
Turgai Oblast	76	77	58	16
Iuzhno-Kazakhstan Oblast	1,759	544	267	205
City of Almaty	1,415	981	461	301
City of Leninsk	23	32	7	6

**Table B.5 Cooperatives: types of business activities between 1991-1994**

Type of Business Activity	1991	1992	1993	1994
Production of consumer goods	1,302	600	355	207
Production of industrial goods	402	250	193	119
Public food services, catering	104	38	24	26
Trade	52	148	164	154
Trade procurement	191	181	96	73
Delivery and sale	17	32	58	51
Procurement/processing of scrap	127	28	19	7
Consumer services	1,005	322	238	147
Construction	2,597	1,692	1,109	664
Construction planning and surveys	123	69	38	25
Planning and design, innovation	79	72	33	27
Scientific research	84	46	24	5
Information and program services	80	29	19	12
Agriculture	920	409	280	124
Passenger transportation services	132	165	101	29
Medical care	91	48	26	19
Nursing care for aged and ill	1	3	1	0
Pre-school child care	1	0	0	0
Sport and sanitararia	38	20	12	15
Educational programs	26	16	14	11
Tutoring	0	2	1	4
Artistic design	321	101	69	27
Recreation	66	17	8	9
Video theaters	4	1	0	0
Hotel services	14	1	0	2
Other	2,287	859	414	292
Total	13,847	5,148	3,296	2,049

**Table B.6 Small enterprises: types of business activities between 1991-1992**

Type of Activity	1991	1992
Industrial enterprise	954	1,703
Agricultural enterprise	349	647
Transportation enterprise (including taxi)	64	160
Forestry enterprise	2	10
Communications	18	38
Construction	1,350	1,978
Capital renovation, industrial installations	324	335
Planning and surveying	88	204
Trade and public food services	648	3,092
Materials and equipment procurement	182	378
Procurement organizations	44	56
Information, program services	89	140
Public utilities and consumer services	303	715
Health, sports, and social care	130	251
Public education	44	90
Culture and art	105	169
Science and research	277	497
Credit and insurance	15	139
Other	1,446	2,011
<b>Total</b>	<b>6,445</b>	<b>12,690</b>

**Table B.7 Small enterprises: types of business activities between 1993-1994**

Type of Activity	1993	1994
Production of consumer goods	1,487	747
Production of industrial goods	557	551
Public food services and catering	157	148
Trade	3,168	2,382
Trade procurement	1,107	986
Delivery and sale	1,204	975
Procurement/processing of scrap	22	15
Consumer services	796	703
Construction	2,702	1,879
Construction planning and surveys	168	103
Planning and design, innovation	266	202
Scientific research	262	128
Information, program services	143	110
Agriculture	772	385
Passenger transportation services	149	95
Medical care	147	105
Nursing care for the elderly and ill	4	4
Pre-school child-care services	10	9
Sports and sanitariums	88	54
Educational programs	119	81
Tutoring	78	50
Recreation	126	92
Hotel services	16	13
Other	2,571	1,627
Total	16,119	11,464

**Table B.8 Number of private enterprises per region between 1991-1995**

Region	1992	1993	1994	1995
Akmola Oblast	1,371	1,807	2,169	1,499
Aktiubinsk Oblast	349	326	321	344
Almaty Oblast	831	1,977	734	881
Atyrau Oblast	71	282	651	538
Vostochno-Kazakhstan Oblast	377	877	967	1,875
Zhambyl Oblast	291	846	926	492
Zhezkazgan Oblast	174	34	94	328
Zapadno-Kazakhstan Oblast	340	554	990	624
Karaganda Oblast	524	1,096	1,217	1,839
Kzyl-Orda Oblast	31	13	39	102
Kokchetau Oblast	252	664	969	767
Kustanai Oblast	197	1,443	1,547	1,441
Mangistau Oblast	37	98	122	261
Pavlodar Oblast	601	338	1,170	1,030
Severo-Kazakhstan Oblast	315	508	554	717
Semipalatinsk Oblast	278	625	741	839
Taldy-Kurgan Oblast	65	258	241	473
Turgai Oblast	58	76	109	63
Iuzhno-Kazakhstan Oblast	520	2,253	1,862	1,400
City of Almaty	628	1,679	3,236	4,423
City of Leninsk	29	20	24	0
<b>Total</b>	<b>7,339</b>	<b>15,764</b>	<b>18,673</b>	<b>19,936</b>

**Table B.9 Private enterprises: types of business activities between 1993-1995**

Type of Activity	1993	1994	1995
Production of consumer goods	1,321	1,007	1,448
Production of industrial goods	260	553	1,202
Public food services and catering	118	221	184
Trade	4,829	5,419	5,899
Procurement	1,370	2,723	1,782
Delivery and sale	580	963	751
Procurement/processing of scrap	24	9	24
Consumer services	615	814	899
Construction	2,371	2,587	2,805
Planning and surveys for construction	84	66	131
Planning and design, innovation	166	214	232
Scientific research	131	120	320
Information, program services	126	120	168
Agriculture	798	360	515
Passenger transportation services	113	84	145
Medical care	130	112	164
Nursing care for the elderly and ill	2	3	2
Pre-school child care	0	0	4
Sports and sanitariums	48	42	60
Educational programs	47	80	140
Tutoring	0	0	2
Artistic design	65	70	84
Recreation	82	132	200
Hotel services	3	13	13
Other	2481	2,973	2,762
Total	1,5764	18,674	19,936

**Table B.10 Private enterprises: types of activity between 1992**

Type of Activity	
Industrial production	865
Agriculture	335
Forestry	1
Transportation (including taxi services)	96
Communications	12
Construction	1,202
Capital renovation and installation of industrial facilities	225
Planning and surveying for construction	82
Trade and public food services	2,124
Material and equipment supply	222
Procurements	38
Information, program services	52
Housing, utilities, and consumer services	304
Medical care, physical exercise, and social care	86
Public education	35
Culture and art	73
Science and research	146
Credit and insurance	15
Other	1,397
<b>Total</b>	<b>7,339</b>

**Table B.11 Employees in private enterprises according to type of business activity  
between 1993-1995**

Type of Activity	1994	1995
Production of consumer goods	15,412	14,825
Production of industrial goods	6,573	12,535
Public food services	3,343	1254
Trade	37,066	28,981
Procurements	12,676	8284
Delivery and sale	6,114	3232
Procurement/processing of scrap	70	232
Consumer services	7,551	7440
Construction	34,444	26,259
Planning and surveying for construction	293	597
Planning and design, innovation	958	976
Scientific research	626	1260
Information, program services	615	804
Agriculture	3,041	3,378
Passenger transportation services	1,249	1,038
Medical care	551	940
Nursing care for the elderly and ill	39	4
Pre-school child care	4	11
Sports and sanatoria	269	335
Educational programs	722	1,446
Tutoring	86	3
Artistic design	465	525
Recreation, including:	721	1,009
tourist services	389	585
circus, theater	112	247
video showings	134	123
Hotel services	230	93
Other	18,384	15,314
<b>Total</b>	<b>151,492</b>	<b>130,775</b>

**Table B.12 Private enterprises: changes in the number of employees per region  
between 1994-1995**

Area	1994	1995
Republic of Kazakhstan	151,492	130,775
Akmola Oblast	14,021	6,497
Aktiubinsk Oblast	2,216	3,103
Almaty Oblast	6,437	9,708
Atyrau Oblast	4,894	3,315
Vostochno-Kazakhstan Oblast	6,019	14,803
Zhambyl Oblast	9,898	3,483
Zhezkazgan Oblast	530	2,778
Zapadno-Kazakhstan Oblast	6,654	3,030
Karaganda Oblast	13,217	10,371
Kzyl-Orda Oblast	602	495
Kokchetau Oblast	6,555	4,449
Kustanai Oblast	7,681	13,103
Mangistau Oblast	1,181	2,236
Pavlodar Oblast	10,796	7,376
Severo-Kazakhstan Oblast	4,120	3,704
Semipalatinsk Oblast	9,520	5,351
Taldy-Korgan Oblast	3,146	3,505
Turgai Oblast	1,438	907
Iuzhno-Kazakhstan Oblast	15,979	8,609
City of Almaty	26,427	23,952
City of Leninsk	151	0

**Table B.13 Peasant farming: main indicators of development between 1994-1995**

Indicator	1994	1995
Number of peasant farming units	22,521	30,785
Area of agricultural land (thousands of hectares)	7,697.7	12,431.5
Livestock and Poultry (units)		
Cattle	98,561	154,773
Sheep and goats	703,777	1,118,664
Hogs	12,568	15,340
Poultry	93,823	126,191
Products of crop production and animal husbandry (tons)		
Grain	438,226	402,788
Vegetables and cucurbits	22,587	83,262
Potatoes	14,564	21,562
Meat (deadweight)	19,768	16,382
Milk	33,616	61,382
Eggs (in thousands)	2,941	6,785
Wool (in physical weight)	1,568	1,674

**Table B.14 Financial indicators per type of activity: cooperatives in 1992**

Type of Activity	Average number of employees	Receipts from sales	Net profit	Production and sales
	Thousands of Rubles			
Production of consumer goods	14,934	5,067.7	588.3	4,401.4
Production of industrial goods	11,667	3,133.4	537.6	2,406.9
Public food services	299	46.8	5.8	37.3
Trade	1,799	585.8	31.6	531.9
Procurements	1,717	714.9	28.8	407.4
Supply and sale	360	78.9	-12.2	78.6
Procurement/processing of scrap	400	30.2	2.1	19.0
Consumer services	4,652	474.1	93.2	459.6
Construction	42,083	8,816.1	1,093.4	6,951.3
Planning and surveying for construction	602	47.0	4.6	39.1
Planning and design, innovation	497	59.3	2.2	47.4
Scientific research	551	79.2	20.5	71.3
Information, program services	180	27.7	4.6	17.3
Agriculture	4,893	846.6	189.4	766.8
Passenger transportation services	2,043	431.5	23.5	401.7
Medical care	372	21.3	-0.3	21.6
Nursing care for the elderly and ill	39	1.1	0.1	1.0
Pre-school child care	0	0.0	0.0	0.0
Sports and sanatoria	114	3.5	-0.8	3.9
Educational programs	93	10.2	0.9	7.5
Tutoring	6	0.8	0.0	0.8
Artistic design	782	56.2	9.6	34.5
Recreation	92	15.7	1.9	12.0
Video showings	3	0.1	0.0	0.0
Hotel services	16	0.3	0.0	0.0
Other	9,791	2,053.7	155.2	1,577.6
<b>Total</b>	<b>97,990</b>	<b>22,602</b>	<b>2,780</b>	<b>18,295.9</b>

**Table B.15 Financial indicators per type of activity: cooperatives in 1993**

Type of Activity	Average number of employees	Receipts from sales	Net profit	Production and sales
	Thousands of Tenge			
Production of consumer goods	5,934	23,856.0	2,786.1	20,850.1
Production of industrial goods	4,791	25,091.0	2,586.8	21,466.3
Public food services	335	941.3	-4.4	945.8
Trade	1,571	13,642.0	1,032.3	12,381.2
Purchasing	896	4,372.5	60.3	4,566.6
Supply and sales	404	1,806.5	55.6	1,911.1
Procurement/processing of scrap	148	307.7	-232.2	539.9
Consumer services	2,810	7,637.7	267.2	7,335.8
Construction	17,929	78298.0	8,231.8	6,9424.8
Planning and surveying for construction	262	388.3	57.3	334.4
Planning and design, innovation	189	1,054.8	-220.4	1,275.3
Scientific research	275	1,427.7	805.4	621.4
Information, program services	85	432.5	26.9	404.4
Agriculture	2,222	7402.0	-1647.0	8,091.7
Passenger transportation services	933	2,230.8	547.7	2,011.5
Medical Care	98	158.6	1.5	157.0
Nursing care for the elderly and ill	10	0.0	-1.9	1.9
Pre-school child care	0	0.0	0.0	0.0
Sports and sanatoria	44	25.2	-7.4	32.6
Educational programs	71	204.3	58.1	147.1
Tutoring	15	1.8	0.0	1.8
Artistic design	417	1,293.2	110.9	1,182.3
Recreation	47	87.4	3.9	89.5
Video showings	0	0.0	0.0	0.0
Hotel services	0	0.0	0.0	0.0
Other	3,741	20,912.0	1,892.6	17,882.2
<b>Total</b>	<b>43,227</b>	<b>191,570</b>	<b>16,401</b>	<b>171,654.7</b>

**Table B.16 Financial transactions per type of activity: small enterprises in 1993**

Type of Activity	Average number of employees	Receipts from sales	Net profit	Production and sales
	Thousands of Tenge			
Production of consumer goods	24,576	124,302.4	16,597.3	109,774.6
Production of industrial goods	11,464	77,488.8	-52,970.0	126,434.1
Public food services	2,305	7,105.8	-261.6	7270.0
Trade	23,208	204,962.6	28,829.0	171,417.1
Purchasing	7,732	73,854.2	7,981.8	67,353.2
Supply and sales	7,065	64,721.4	13,681.4	52,863.9
Procurement/processing of scrap	345	941.6	118.4	837.0
Consumer services	13,818	33,189.1	2,872.5	29,722.8
Construction	55,633	311,082.3	44,924.5	265,847.7
Planning and surveying for construction	2,208	3,719.9	-448.3	12,850.8
Planning and design, innovation	2,131	10,162.8	1,309.9	8,706.8
Scientific research	1,971	8,711.7	-139.7	9,086.2
Information, program services	876	5,921.0	902.1	5,063.5
Agriculture	6,620	18,760.4	-1,913.6	20,500.8
Passenger transportation services	1,922	6,860.9	666.1	6,367.5
Medical Care	1,176	4,110.8	476.8	3,664.4
Nursing care for the elderly and ill	28	39.0	-21.8	67.9
Pre-school child care	659	121.6	241.6	490.5
Sports and sanatoria	611	1,218.2	-36.5	1,219.6
Educational programs	867	2,506.6	285.1	2,117.7
Tutoring	0	0.0	0.0	0.0
Artistic design	676	1,328.6	83.0	1,242.9
Recreation	1,113	4,866.1	213.3	4,682.7
Video showings	0	0.0	0.0	0.0
Hotel services	394	782.4	-301.8	1072.0
Other	25,294	157,514.0	11,844.7	139,010.7
<b>Total</b>	<b>192,681</b>	<b>1,124,272</b>	<b>74,934.7</b>	<b>1,047,664</b>

**Table B.17 Financial indicators per type of activity: private enterprises in 1993**

Type of Activity	Average number of employees	Receipts from sales	Net profit	Production and sales
Thousands of Tenge				
Production of consumer goods	14,687	68,421.3	17,606.1	80,409.6
Production of industrial goods	4,308	53,338.7	3,750.4	19,970.9
Public food services	1,618	6,672.9	1,441.2	4,803.3
Trade	28,315	256,198.0	28,811.4	216,460.7
Purchasing	6,573	54,427.2	7,830.5	52,707.7
Supply and sales	2,297	1,5915.0	3,613.4	12,246.9
Procurement/processing of scrap	284	621.9	12.7	391.8
Consumer services	5,691	19,368.8	1,420.8	16,332.0
Construction	36,344	173,785.0	38,784.2	127,489.0
Planning and surveying for construction	527	2,244.1	416.2	1815.0
Planning and design, innovation	810	4,037.4	735.5	3,341.4
Scientific research	505	3,310.1	169.1	3,142.6
Information, program services	544	5,392.9	241.0	5,097.8
Agriculture	2,862	11,146.6	1,842.6	8,896.4
Passenger transportation services	601	1,534.4	134.8	1,521.7
Medical Care	544	2,079.7	-169.5	3,835.8
Nursing care for the elderly and ill	15	0.0	-11.7	11.7
Pre-school child care	0	0.0	0.0	0.0
Sports and sanatoria	188	405.4	-61.8	465.7
Educational programs	321	722.2	2.5	728.8
Tutoring	0	0.0	0.0	0.0
Artistic design	384	1,455.4	304.2	11,571.0
Recreation	435	2,500.1	47.2	3,107.6
Video showings	0	0.0	0.0	0.0
Hotel services	13	18.9	-2.1	21.0
Other	15,040	89,356.1	11,954.7	71,207.0
<b>Total</b>	<b>122,905</b>	<b>774,540</b>	<b>118,873</b>	<b>635,161.5</b>

**Table B.18 Financial indicators per type of activity: cooperatives in 1994**

Type of Activity	Average number of employees	Receipts from sales	Net profit	Production and sales
	Thousands of Tenge			
Production of consumer goods	3,617	212,349.0	30,769.5	183,643.2
Production of industrial goods	2,661	250,911.0	27,930.8	225,768.5
Public food services	194	6,709.1	245.1	6,672.9
Trade	1,315	86,548.0	1,755.3	84,768.6
Purchasing	590	31,337.8	163.8	19,960.9
Supply and sales	370	35,1112.0	3,420.5	34,415.6
Procurement/processing of scrap	52	13,046.0	5,051.7	7,994.3
Consumer services	1,461	40,417.0	4,004.4	36,302.8
Construction	10,535	572,264.0	71,690.4	509,947.6
Planning and surveying for construction	242	14,307.4	1,734.8	12,578.0
Planning and design, innovation	122	6,654.7	1,116.6	7,227.3
Scientific research	32	377.6	-30.4	398.0
Information, program services	56	5,479.3	442.1	5,037.3
Agriculture	1,484	39,459.9	-1,370.9	42,674.7
Passenger transportation services	159	5,624.2	103.2	5,252.2
Medical Care	90	1,167.1	175.7	1,169.8
Nursing care for the elderly and ill	0	0.0	0.0	0.0
Pre-school child care	0	0.0	0.0	0.0
Sports and sanatoria	57	520.3	-16.7	548.7
Educational programs	40	1,102.1	-46.7	1,148.8
Tutoring	13	981.9	214.3	767.6
Artistic design	178	5,736.7	457.2	5,277.4
Recreation	39	403.6	-12.2	423.6
Video showings	0	0.0	0.0	0.0
Hotel services	14	249.6	9.7	239.8
Other	3,423	249.6	9.7	239.8
<b>Total</b>	<b>26,744</b>	<b>1,538,939</b>	<b>164,798</b>	<b>1,383,650</b>

**Table B.19 Financial indicators per type of activity: small enterprises in 1994**

Type of Activity	Average number of employees	Receipts from sales	Net profit	Production and sales
Thousands of Tenge				
Production of consumer goods	13,800	916,625.7	194,266.1	733,095.7
Production of industrial goods	12,337	1,167,095.9	107,847.7	108,8064.0
Public food services	2933	89,012.0	1807.4	94,156.2
Trade	21,538	1,789,290.8	82,649.9	169,5275.0
Purchasing	7,070	569,686.0	69,928.0	50,5209.0
Supply and sales	5,087	370,998.1	86,594.4	29,4281.1
Procurement/processing of scrap	182	7,046.9	537.3	6,624.1
Consumer services	11,500	384,124.0	17,973.8	364,707.3
Construction	35,849	3,203,640.6	583,348.2	244,7457.0
Planning and surveying for construction	878	58,113.4	4,241.1	5,4214.2
Planning and design, innovation	1,451	98,094.0	3,759.5	10,2205.0
Scientific research	819	46,357.4	6,756.6	41,344.7
Information, program services	691	44,275.3	8,638.1	36,424.6
Agriculture	5,501	2740,92.7	11,437.9	266,333.3
Passenger transportation services	1,650	68,148.6	1,901.9	59,595.0
Medical Care	932	33,936.2	2,353.3	30,976.7
Nursing care for the elderly and ill	15	6,794.7	90.5	6,704.5
Pre-school child care	580	29,762.3	-61.8	29,836.0
Sports and sanatoria	560	32,990.0	-6,101.3	41,837.4
Educational programs	642	18,570.3	-400.3	19,590.8
Tutoring	4	28.5	0.3	28.2
Artistic design	348	12,751.5	354.1	13,354.2
Recreation	866	88,959.1	12.6	8,8891.1
Video showings	0	0.0	0.0	0.0
Hotel services	157	2,685.0	-1,562.8	42,47.8
Other	16,806	1,082,336.6	146,705.4	1,023,111.0
Total	142,196	10,395,416	1,323,078	9,0475,65

**Table B.20 Financial indicators per type of activity: private enterprises in 1994**

Type of Activity	Average number of employees	Receipts from sales	Net profit	Production and sales
Thousands of Tenge				
Production of consumer goods	15,412	975,168.4	138,888.0	812,696.9
Production of industrial goods	6,573	538,433.5	79643.0	478,702.0
Public food services	3,343	125,272.2	11,148.8	114,913.1
Trade	37,066	3,419,736.0	91,534.1	3,290,247.0
Purchasing	12,676	967,364.4	-88,790.5	110,6941.0
Supply and sales	6,114	59,7619.0	116,227.0	48,6650.0
Procurement/processing of scrap	70	925.2	149.7	775.5
Consumer services	7,551	200,014.4	17,981.6	183,979.8
Construction	34,444	2,670,903.0	276,307.0	253,8951.0
Planning and surveying for construction	293	13,036.3	1,277.8	11,920.5
Planning and design, innovation	958	78,440.7	4,661.4	75,135.6
Scientific research	626	51,077.7	8,462.9	42,794.2
Information, program services	615	82,853.9	835.1	66,882.6
Agriculture	3,041	141,752.8	-1,925.1	146,813.5
Passenger transportation services	1,249	39,946.2	-2,168.1	41,904.8
Medical Care	551	16,138.8	1,584.1	14,582.9
Nursing care for the elderly and ill	29	155.8	8.4	147.4
Pre-school child care	4	188.9	0.1	189.0
Sports and sanatoria	269	3967.0	-1,105.4	5,827.9
Educational programs	722	37,975.8	6,523.0	32,292.3
Tutoring	86	6,939.6	511.5	7,037.3
Artistic design	465	13,368.7	2,371.8	10,948.2
Recreation	721	62,955.7	8,541.2	53,014.6
Video showings	0	0.0	0.0	0.0
Hotel services	230	4,206.4	250.0	3,968.6
Other	18,384	1,316,781.0	153,380.0	1,199,036.0
<b>Total</b>	<b>151,492</b>	<b>11,365,221</b>	<b>826,298</b>	<b>n.a.</b>

**Table B.21 Number of enterprises and employees per type of activity in 1995**

Type of Activity	Number of enterprises	Number of full-time employees	Other employees	
			Concurrent with another job	Working on contract
Production of consumer goods	1,604	18,110	1,134	1,398
Production of industrial goods	1,325	15,519	1,848	2,264
Public food services	191	1,316	43	118
Trade	6,001	29,958	2,994	3,315
Purchasing	1,849	8,619	993	709
Supply and sale	777	3,349	442	368
Procurement/processing of scrap	26	255	21	66
Consumer services	945	8,471	695	682
Construction	2,959	28,582	3,016	7,144
Planning and surveying for construction	158	738	273	618
Planning and design, innovation	259	1,204	377	660
Scientific research	367	1,470	688	1,162
Information, program services	187	891	295	146
Agriculture	558	3,653	248	429
Passenger transportation	154	1,219	64	136
Medical care	189	1,534	556	258
Nursing care for the elderly and ill	2	4	0	0
Pre-school child care	1	11	6	4
Sports and sanatoria	83	414	52	46
Educational programs	173	1,862	1,037	470
Tutoring	4	10	0	1
Artistic design	93	591	64	261
Recreation, including:	229	1,207	110	162
Tourism	146	621	39	68
Concerts, circus, theater	34	287	26	61
Video showings	26	182	18	32
Hotel services	16	93	5	11
Other	3,110	18,168	3,014	3,185
<b>Total</b>	<b>21,260</b>	<b>147,248</b>	<b>17,957</b>	<b>23,614</b>

**Table B.22 Number of enterprises and population per region in 1995**

Area	Number of enterprises	Number of full-time employees	Other employees	
			Concurrent with nother job	Working on contract
Republic of Kazakhstan	21,260	147,248	17,957	23,614
Akmola Oblast	1,734	8,007	1071	853
Aktiubinsk Oblast	372	3,644	233	548
Almaty Oblast	971	11,753	658	1,296
Atyrau Oblast	612	4,107	459	1,163
Vostochno-Kazakhstan Oblast	1,924	15,995	2395	3,058
Zhambyl Oblast	536	4,259	174	444
Zhezkazgan Oblast	379	3,438	193	382
Zapadno-Kazakhstan Oblast	665	3,351	276	600
Karaganda Oblast	1,904	10,809	2,264	2,937
Kzyl-Orda Oblast	121	670	17	76
Kokchetau Oblast	833	5,140	642	776
Kustanai Oblast	1,496	14,207	1,393	1,339
Mangistau Oblast	283	3,003	676	749
Pavlodar Oblast	1,074	7,715	1,414	1,284
Severo-Kazakhstan Oblast	775	4,743	483	452
Semipalatinsk Oblast	893	6,015	522	898
Taldy-Kurgan Oblast	489	3,635	220	297
Turgai Oblast	63	907	10	29
Iuzhno-Kazakhstan Oblast	1,507	10,223	689	1,126
City of Almaty	4,629	25,627	4,168	5,107

**Table B.23 Number of enterprises and labor force per type of enterprise\***

Type of Activity	State enterprise		Private enterprise		Mixed enterprise without (foreign capital)		Including those with more than 50% state participation		Other types of property forms	
	No.	Labor	No.	Labor	No.	Labor	No.	Labor	No.	Labor
Production of consumer goods	124	2481	1,448	14,825	23	690	7	199	9	114
Production of industrial goods	89	2043	1,202	12,535	30	937	13	503	4	104
Public food services	7	62	184	1,254	0	0	0	0	0	0
Trade	74	565	5,899	28,981	19	362	8	21	9	50
Purchasing	62	291	1,782	8,284	4	41	1	4	1	3
Supply and sale	17	78	751	3,232	8	34	3	12	1	5
Procurement/processing of scrap	2	23	24	232	0	0	0	0	0	0
Consumer services	44	1002	899	7,440	2	29	0	0	0	0
Construction	134	1963	2,805	26,259	14	323	3	208	6	37
Planning and surveying for construction	24	127	131	597	2	9	1	5	1	5
Planning and design, innovation	23	189	232	976	4	39	2	25	0	0
Scientific research	36	154	320	1,260	10	52	0	0	1	4
Information, program services	12	52	168	804	6	32	1	3	1	3
Agriculture	38	253	515	3,378	4	21	0	0	1	1
Passenger transportation	7	156	145	1,038	2	25	0	0	0	0
Medical care	15	210	164	940	6	376	4	353	4	8
Nursing care for the elderly and ill	0	0	2	4	0	0	0	0	0	0
Pre-school child care	0	0	4	11	0	0	0	0	0	0
Sports and sanatoria	12	26	60	335	1	2	0	0	10	51
Educational programs	25	327	140	1,446	3	74	1	47	5	15
Tutoring	2	7	2	3	0	0	0	0	0	0
Artistic design	7	52	84	525	0	0	0	0	2	14
Recreation, including:	21	168	200	1,009	2	10	2	10	6	20
Tourism	5	16	137	585	2	10	2	10	2	10
Concerts, circus, theater	3	34	30	247	0	0	0	0	1	6
Video theater	4	59	22	123	0	0	0	0	0	0
Hotel services	0	0	13	93	0	0	0	0	0	0
Other	224	2260	2,762	15,314	29	242	9	62	95	352
<b>Total</b>	<b>999</b>	<b>12,469</b>	<b>19,936</b>	<b>130,775</b>	<b>169</b>	<b>3,198</b>	<b>53</b>	<b>1,452</b>	<b>156</b>	<b>786</b>

\*No date is given for these entries [Translator]

# 2

## **Industrial Development and Export Promotion in Kazakhstan: Constraints and Prospects**

Kh. A. Ospanov

A. E. Esentugelov

V. D. Markov and M. A. Khasanova

# 1. The Current State of Industrial Production

## 1.1 The Macroeconomic Situation and Industry

The crisis in the industry sector of Kazakhstan, as in the entire territory of the former USSR, gradually became apparent in the middle of the 1970s. The crisis manifested itself in a decrease in the efficiency of production and in a technical and technological backwardness vis-à-vis the developed countries that was steadily increasing with each passing year.

In 1990, the central and republic-level governments adopted programs to embark on the transition to a market economy. However, for a number of reasons, they did not take into account the experience of economic reform in other countries, most notably China and the states of Eastern Europe. The reform approach taken to realize the program was essentially the same as the earlier one; characteristic of a command-administrative system, it aimed only at an improvement. The most radical change at that time was the law on enterprises, which laid the basis for weakening the directive planned-distribution system. The result was an intensification of the crisis, already long since apparent, in the system of production relations. Characteristic features of this time included several main tendencies: the inclination of commodity producers to resist delivering their goods to the distribution organs, the predominant use of mutually agreed-upon prices, and an unwarranted increase in wages. That in turn triggered an enormous increase in the money supply, without the backing of the appropriate commodity resources. All this laid the foundation for inflationary processes and a corresponding intensification in the economic and political crisis. During these years, there also arose the idea of a regional "cost-accounting" of entities within the USSR, and that strengthened the centrifugal forces in republics for their withdrawal from the Soviet Union. This resulted in a situation where the ruble virtually lost its function as a mean of payment. Consequently, enterprises and organizations began to trade on the basis of barter.

A new stage of reform started in 1992-1993, with the declaration of independence by Kazakhstan and the introduction of its own national currency. In this period, the economy of Kazakhstan depended upon economic and political oscillations in the Russian Federation. The economy was characterized by a half-heartedness in reforms, by polarized decisions in the conduct of reform, and by a virtual lack of systematic monetary and fiscal policy. Thus, the process of price liberalization (which commenced in January 1992) dragged on until the end of 1994. This led to many distortions in the realization of reform in all spheres of the economy, but particularly with respect to industry and foreign economic activities. The liberalization of foreign trade where prices were still regulated led to the export of the most important raw materials. That is because the world prices were two to three times of the fixed domestic prices. As a result, at this stage of reform the government began to erect barriers in the form of quotas, licenses, and customs duties to control the movement of "strategic" types of goods. But that included virtually all the goods that had traditionally been exported from Kazakhstan: oil and petroleum products, metallurgical raw materials and goods, phosphorus, mineral fertilizer, plastics, grain, agricultural raw materials, and so forth. However, despite the barriers, the outflow of such products (both to the Commonwealth of Independent States

[CIS] and to other countries) continued to increase, and the hard-currency earnings from such trade were being accumulated in accounts in foreign banks.

The indecisiveness with respect to deregulating the price of energy (in contrast to the liberalization of prices on other goods and services) came amidst the constant depreciation of the ruble. As a result, it was necessary to make periodic (three or four times per year) increases in the cost of electricity, oil, and petroleum products in order to make production profitable for the producing enterprises. In turn, that impelled consumers to make corresponding increases in the price of their own goods and services, which in the final analysis led to a new spiral of higher prices on energy. As a consequence, this process brought about unprecedented rates of inflation in Kazakhstan (see Table 1).

**Table 1 Price indicators for different sectors (as percentage of previous year)**

Sector	1991	1992	1993	1994	1995	1996*
Consumer prices	184	3060.8	2265.0	1258.3	160.3	116.8
Consumer prices: food products	200	2108.3	2297.1	1155.7	158.7	117.2
Consumer prices: non-food products	300	3897.8	1795.6	1159.9	133.5	104.4
Consumer prices: services	200	3019.7	4143.4	2522.6	258.0	146.6
Producer prices on industrial products	272	3916.9	1423.8	2023.8	140.2	111.8
Producer prices on agricultural products	200	1031.7	775.7	1888.3	323.0	130.0
Price index on capital investments	...	1180.0	1904.6	1171.2	179.2	110.4
Price index on freight shipments	...	2163.0	1363.0	2177.0	132.0	113.2

\* June 1996 to December 1995

Source: Data of the State Statistics Bureau

The next stage in the economic transformation of Kazakhstan began in November 1993, when it introduced its own national currency (the tenge). It also began to attract large-scale assistance from international financial organizations within the framework of transformation and stabilization-loan projects. This period is characterized by the beginning of the formation of an independent macroeconomic policy. In the initial phase, there was a certain lack of confidence and a tendency to pursue contradictory policies. Above all, this pertains to the problem of price liberalization, which dragged on throughout 1994. And this was one of the basic factors in the acceleration of inflation (12.6 times) over the previous year. Despite repeated increases in the price of oil and oil products, at the point where these products were deregulated (March 1994), they stood at only 20 percent of the prices on world markets.

The inconsistencies in realizing the chosen policies were expressed in attempts by the government to resolve the problem of payments by providing enterprises with state credits to pay their debts. Thus, in 1994 enterprises and organizations were transferred preferential credits of 18 billion tenge, which would seemingly sustain strong expectations of a repayment on time. However, in 1994, only 4 billion tenge were repaid. This measure, however, only aggravated the inflationary processes and diverted a significant proportion of the state's budget resources, which were badly needed to

support social programs. Moreover, this measure was the source of abuses in the banking and production sectors.

In July 1994, the government adopted its next anti-crisis program, which was to be fully implemented in 1995. The principal goal of this program was to realize, by the end of 1995, macroeconomic stabilization and a qualitative institutional transformation. In accordance with this program of state measures to extend the reforms and put an end to the economic crisis, the government was to create and improve the normative legal basis for the transition phase. This legal framework was aimed to regulate many dimensions such as: relations in taxation, budget and banking, foreign economic activity (including the introduction of foreign capital and customs policy), the development of markets and a market infrastructure, the processes of sanation (financial restructuring) and bankruptcy of insolvent enterprises, the improvement in the management of state enterprises, and so forth. Realization of this program was more consistent and focused, especially with respect to adherence to an austere monetary and fiscal policy.

The fiscal policy underwent radical changes. It was increasingly adapted to the unfavorable economic conditions associated with the sharp contraction in state revenues. The smaller income was due to the decrease in production in all branches, to the attempts of economic entities to evade taxes, to the high level of inflation, to the upsurge in mutual non-payments among enterprises, etc. Given the conditions of falling revenues from taxes and the limitations on budget resources, fiscal policy was forced to resort to a survival strategy, whereby it financed only the most urgent social-economic measures and supported only the activity of the most important functional systems in the economy (energy, heating, and public utilities). As a result, in recent years the budget has substantially forfeited important functions pertaining to investment, innovation, structural formation, and social policy. Financing on the basis of the Fund for Economic Transformation was extremely weak. Hence the government was unable to realize its investment program, which had already been reduced.

Characteristic of this entire period of reform is the extremely low level of budget revenue. Thus, in 1994, the state budget collected only 80.7 percent of its taxes and assessments, and in turn it spent 84 percent of planned expenditures. The budget revenues were short by 19.3 billion tenge, including 3 billion tenge from the value-added tax (VAT), 3.8 billion from individual tax-payers, 5.8 billion from assessments and various non-tax revenues, and 6.8 billion from privatization. Nor did the situation with respect to revenues and assessments improve in 1995. In that year the total revenues to the state budget represented 22.7 percent of the gross domestic product (GDP); tax and other revenues alone represented 10 percent of the GDP. In 1996, the situation has not substantially changed. The shortfall in budget revenues, according to a forecast on 1 July 1996 (by the Main Tax Inspectorate of the Ministry of Finances) was more than 18.2 billion tenge, which corresponds to the actual revenues and funds received in June.

In accordance with the policy to restore order in state finances in 1994, the government made a maximum possible cutback in budgetary subsidies to support the agro-industrial complex, energy, public utilities, and the like. In the course of 1994, financial support for enterprises took the form of centralized credits at the interest rate for re-financing. From the beginning of 1995, the government terminated the grant of

budgetary credits. As practice showed, the inflationary support of production did not yield any tangible effect. In addition, state credits (as earlier) were taken by the heads of enterprises as a kind of subsidy, which in turn explains the low level of repayment for such credits.

The deficit in the state budget in 1994 (excluding extraordinary external resources) was 2.2 percent of the GDP (compared to 4.6 percent foreseen in the "stand-by" agreement). In 1995, the level of the budget deficit was 4 percent of the GDP. This situation did not change in the first half of 1996. Thus, according to data from the Ministry of Finance, the revenues of the state budget amounted to 100.8 billion tenge in the first half of 1996; expenditures amounted to 113.6 billion tenge. Hence the budget deficit for this six-month period amounted to 12.8 billion tenge, or 2.3 percent of the GDP. Since 1994, the government has covered part of this budget deficit by drawing upon non-inflationary sources: foreign loans and the emission of state securities. Accordingly, it has gradually reduced the use of credit resources from the National Bank for such purposes. In 1995, for example, the latter's share amounted to approximately 34 percent. In addition to reducing credits from the National Bank to finance the budget deficit, the government has restrained the growth of the money supply and also regulated the prices on credit resources. If in 1993 the refinancing rate lagged behind the inflation rate, in 1994 it had risen to a positive level. Thus, it rose from 270 percent in January 1994 to 300 percent in March and August 1994, but then dropped to 230 percent in December the same year. Beginning in 1995, the government introduced a differentiated refinancing rate for one-, three-, and six-month credits. The rate on six-month credits dropped from 210 percent in January 1995 to 156 percent in March, and then to 55 percent in December. The drop in the level of inflation in 1996 enabled the National Bank to reduce gradually the refinancing rate. If it stood at 59 percent at the beginning of 1996, it fell to 44 percent in March, then dropped to 36 percent in June and 32 percent in July (at an annual rate). This has created the necessary conditions for a revival of investment activity.

The consistent, stringent monetary and fiscal policy made it possible, already by December 1994, to reduce the level of inflation to 10 percent over the previous month (compared to 46 percent in June). In 1995, this tendency persisted, with a monthly inflation rate of 5.1 percent in March, 2.3 percent in June, and 3.6 percent in December. Altogether, in the course of the year the consumer prices rose by 60.3 percent, far less than in 1994, when they had increased 12.6 times. The level of inflation decreased from 3.6 percent in December 1995 to 1.7 percent in March 1996, rose to 2.9 percent in April, but then fell again for the first half of the year. Altogether, whereas in the first half of 1995 inflation was 32.4 percent, in the same period of 1996 it was about one half that level, with the average monthly inflation rate dropping from 5.4 percent (first half of 1995) to 2.8 percent (first half of 1996). However, it should be noted that the inflation level, whether for the monthly rate or for the first half of the year, nonetheless exceeded the indicators expected by the government. That is due, mainly, to its decision to raise the rates on public utilities for the population to a level that fully covers the actual costs. This was done through increases from April 1st to June 1st.

From the beginning of 1995, the speed of depreciation of the national currency slowed and indeed began to show signs of relative stability. Thus, in 1995, the average monthly exchange rate (to the US dollar) was 60.51 in March, 57.25 in August, and 63.38

in December (compared to 53.61 in December 1994). In 1996, this tendency for the tenge to stabilize continued. The average monthly exchange rate for the tenge (to the US dollar) dropped in March 1996 (by 2 percent from the previous December), and further in June (by 2.8 percent from March). However, whereas the drop in the exchange rate of the dollar was 15.4 percent in the first half of 1995, during the same period in 1996 it fell by only 4.7 percent.

In 1996, the hard-currency market shows a tendency for a decline in the volume of trading on the Kazakhstan Inter-Bank Foreign Exchange Market. In May, compared with the previous month, the volume fell for the US dollar (46 percent) and for the Russian ruble (27 percent), although it did show an increase in the case of the German mark (42 percent). However, in June the volume of trading for the dollar did increase (1.87 times from the previous month); the average monthly exchange rate for the tenge was 67.01 tenge to the dollar. The exchange rate had been 65.83 in April and 66.81 in May. In the case of the German mark and Russian ruble, the situation was different. The average monthly exchange rate for the mark was 43.92 in April, 43.67 in May, and 43.95 in June. The monthly exchange rate for ruble (tenge per 1,000 rubles) was 13.43 in April and May, and decreased to 13.26 in June. The stable inter-bank hard currency exchange that was formed continues to expand the volume of transactions. The volume of trading outside the exchange exceeds its transactions for the dollar and ruble by a factor of five and, in the case of the German mark, by a factor of eighteen. The gap between the cash and non-cash exchange rates continued to narrow. Similarly, the difference between the buying and selling rates for hard-currency cash also decreased.

The gold and hard-currency reserves of the country are rapidly accumulating. Its magnitude was first officially announced when the National Bank introduced the national currency. At that time, it amounted to US\$722.9 million; this included US\$222.4 million in gold reserves (approximately 18.4 tons). A presidential edict obliged the National Bank to publish monthly data on the size of the gold and hard-currency reserves, although in fact such publications are not done in a systematic manner. The growth in the volume of these reserves began in mid-1994. By March 1995, the reserves had risen to US\$814 million; by July 5, 1995 they amounted to US\$1.277 billion. According to the available information, the reserves reached their highest point in October 1995 (US\$1.4 billion), but then decreased somewhat and stabilized at a slightly lower level. According to the most recent announcement by the chairman of the National Bank, the net reserve fund amounted to US\$1.2 billion in May 1996 and then US\$1.36 billion in June. Compared with November 1993, the reserves in gold rose more 2.2 times and comprise 40 tons.

The consistent implementation of measures to deregulate foreign economic activity has contributed to a growth in the volume of foreign trade. In the first half of 1996 (compared with the same period in 1995), the foreign trade volume rose 30.5 percent, where exports increased by 56.1 percent and imports by 11.7 percent. The country continues to enjoy a favorable balance of trade. At the same time, the macroeconomic stabilization in the initial stage affected primarily the fiscal and monetary spheres: it did not lead to an increase in production. It is essential, above all, to reestablish the disrupted production process, to create all the institutions of the marketplace, and to provide a truly functioning private sector and a competitive

environment.

The crisis in the economy has not been fully overcome. Enterprises owe large debts to the banks and to each other; many of them are either idle or not functioning on a full-time basis. The low quality and lack of marketing activities make their products non-competitive on world markets. The technological backwardness leads to high costs of production. For example, the proportion of expenditures on electricity to produce the most important export goods, in some cases, are five to eight times greater than in their Western analogs. All this has its impact on the efficiency of production and the financial condition. In the final analysis, in 1994-1995 it led to the insolvency of even the largest and well-known enterprises. These included enterprises such as "Zhezkazgantsvetmet" (Zhezkazgan Nonferrous Metals), the "Karaganda Metallurgical Combine," the ferroalloy plants in Ermakov and Aktiubinsk, and others.

In 1995, the tendency for the volume of production to contract continued to prevail in many branches of the economy. However, the rate of decline did noticeably slow, and in certain branches the output of goods actually increased over the levels in 1994. On the whole, in 1995 the economy witnessed a decrease in the GDP (8.9 percent) and the volume of industrial production (7.9 percent). The gross output in agriculture fell by 21 percent (including a decrease of 42 percent in the production of grain). Gross capital formation dropped by 17 percent (more detailed data are in the Appendix). With the liberalization of the economy, the problem of the non competitiveness of Kazakh products became particularly apparent. This was particularly true in the manufacturing branches, where the volume of output dropped sharply. And that led in turn to a still greater deformation of the structure of industrial production. Particularly a significant growth in the share of the extractive branches and a decrease in the share of light industry, the food-processing industry, and machinery industry (see Appendix). A significant growth in the share of the extractive branches is linked not only to a lower growth rate in the overall volume of production, but also to a faster rise in the prices on the goods from these branches. It is necessary to note that the prices of many types of products, at the present time, are approaching those on world markets and, in a number of cases, are even higher. At the same time, these prices differ substantially from the corresponding world analogs in terms of their formation. This applies especially to the proportional share of expenditures for material resources, electric power, fuel, and transportation. These factors sometimes account for more than 80 percent of the total production costs. There is a correspondingly lower level of costs in terms of wages and profits, which are therefore insufficient to ensure savings and the accumulation of capital. It was mainly a consequence of the significant backwardness of technology and the low level of organization with respect to production and trade.

As the crisis comes to an end, it will not be possible to achieve development without a higher rate of capital formation. At the present time, Kazakhstan continues to suffer from a decrease in investment activity. Investment activity in 1991-1995 was hindered by the influence of two main factors: (i) an austere fiscal policy, which predetermined a low investment demand from the part of the state; and, (ii) an unfavorable inflationary climate. The volume of investments for these years fell by 72.3 percent; that in turn led to a contraction in the domestic market for equipment, construction materials, and contract work. It also weakened the factors essential for a

structural transformation of the economy.

**Table 2 Changes in capital formation, 1991-1995 (as percentage of previous year)**

	1991	1992	1993	1994	1995
Total capital formation	100.5	53.0	61.1	54.2	63.1
For purposes of production	98.2	52.5	58.8	59.6	64.0

A contraction in investment activity is a consequence not only of the high rates of inflation, the complex financial situation, and the low investment demand, but also difficulties in providing steady work in the construction and machinery industries. As the share of consumption in the GDP continues to rise, the share of resources used for investment continues to contract. The proportion of capital investments in the GDP amounted to 15.0 percent in 1995 (compared to 11.3 percent in 1994, 19 percent in 1993, and 29 percent in 1991). In terms of sectors, the share belonging to construction was 7.0 percent in 1995 (compared to 9.1 percent in 1994). For purposes of comparison, it should be noted that, during the last forty years in developed countries, the share of capital investments in fixed assets has not fallen below 20 percent, while in Japan it has been at a level of 30 percent and higher. In developing countries, in the years since 1975, it has also been in excess of 20 percent. During the period of profound transformation in East and Southeast Asian countries (Taiwan, South Korea, and Malaysia), the share of gross capital investment in fixed assets has amounted to 31 to 34 percent of the GDP. Indeed, in Singapore, it has even gone as high as 45 to 48 percent.

The gravity of the investment crisis, to a decisive degree, is determined by the low level of investment activity on the part of state enterprises. These enterprises, in fact, constitute up to 55 percent of the demand for investments. The highest rate of contraction in investment has affected industrial construction, principally because of the lack of enterprises' retained earnings. The maximum level of decline in investment was reached in agriculture, machinery, food-processing, and light industry. The efficiency of investments has also decreased: the additional value created from each tenge of new investment dropped from 0.49 tenge in 1992 to 0.21 tenge in 1994 and 0.18 tenge in 1995. The depreciation of assets held by enterprises, the mounting problem of mutual non-payments, and the crisis in sales have had a profound impact on investment. Consequently, because of the limited availability of credits and the under-developed stock market, investments from retained earnings amounted to 25 to 40 percent of capital formation.

Nor have expectations about a sharp surge in foreign capital been justified. This is due to the continuing deficiencies in the legislative and normative framework for attracting foreign investment. It is also due to the limits on the sphere of activity with state guarantees. This is an important factor, given the low confidence level of investors in guarantees from secondary banks and the end borrowers the majority of which still belongs to the state. The transfer of a number of enterprises to trusteeship has also failed to trigger a significant increase of investments in fixed capital. The bulk of the resources attracted from the managing firms is intended to supplement the working capital and to retire some of the outstanding debts.

An increase in the investment sources could be promoted by an accelerated development of the securities market. However, its development is being impeded by the lack of financial means among enterprises themselves, the lack of primary and secondary securities markets, and the lack of normative laws to regulate the issue and circulation of such securities. The commercial joint-stock banks have yet to assume their place in the securities market, for they do not perform all their normal functions. In particular, they do not conduct transaction of clearinghouse settlements with securities; nor do they function to register the stocks of this or that company, as is the case, for example, in the United States. Still in the stage of formation is the secondary market for securities. It is one of the basic goals of the stock market to support the activities of a secondary market. Today, there has been two stock markets registered: the Central Asian Stock Market in Almaty and the Kostanai Stock Market. However, at present, only the Central Asian Stock Market (which first commenced transactions in April 1995) is actually operating. On the Kazakh stock market, the following categories of securities are in circulation: (i) state treasury bills; (ii) shares of second-tier banks; (iii) shares of enterprises that entered the stock market through privatization and incorporation; and, (iv) the stocks of newly established enterprises. For the present, the main demand is for state treasury bills. At the same time, the market for securities has still not become one of the main sources of investments, and this is retarding the pace of all the reforms in Kazakhstan. In this respect, Kazakhstan lags considerably behind the reforms in Russia. In the future, this factor could have a negative influence on the competitiveness of Kazakh banks.

The insurance market, which is of considerable significance (especially for the development of foreign trade transactions), is only in the stage of gestation. The incompleteness of the existing legislation on insurance, the lack of an effective system to regulate the activities of insurers, and that of a systemic approach to the insurance question—all these constitute factors that retard the development of the insurance market. On July 1st, 1995, Kazakhstan had 45 companies with a permanent license to engage in insurance activities. The sharp contraction in the number of insurance companies (six months earlier, there were 118 insurance companies) is explained by the fact that they had branch offices with the status of independent insurance companies. At the present time, with the application of new requirements on the volume of charter capital and reserves (3 million tenge for existing firms; 2 million tenge for newly established ones), many insurance companies are forced to terminate their activities. The reason is that they were unable, within the allotted period of time, to assemble charter and reserve funds in the stipulated amounts.

Commodity exchanges play an extremely insignificant role in economic turnover and other economic operations. Such is the case, notwithstanding the fact that they are in virtually all the oblasts (the only exception being Atyrau, Zhezkazgan, and Mangistau oblasts). At the present time, there are seventeen commodity exchanges; which include eight independent exchanges and nine others that are daughter exchanges of the International Agro-Industrial Exchange. The measures that the government has taken in the previous year to organize exchange trade (include the open sale of export quotas, the auctions or tenders for the delivery of grain under inter-state agreements and to ship unencumbered reserves, the registration of the export of agricultural products through a

minimally set prices). As a result, they have had tangible positive results and become an important factor in the formation of a commodities market. Still in various stages of formation are several other markets and corresponding components of the infrastructure. Underway too is the process of establishing a market for the professional support of entrepreneurship.

The results of the second stage of the state program for denationalization and privatization give grounds to think that, with respect to the reform of property ownership, substantial changes have occurred. Today, the level of denationalization is rather high. In industry, the share of production by purely state-owned enterprises is 40 percent of total output; in agriculture, it is only five percent. However, the main idea of privatization—the formation of an efficiently operating private sector and a competitive environment—has not in fact been realized. Above all, this is due to the fact that privatization was realized on a non-compensatory basis as well as in pursuance of a political goal, namely that of maintaining the appearance of social justice. Moreover, the main criterion for the efficiency of the process of denationalization and privatization was, above all, the pace of forming private property, not its economic expediency.

In general, the creation of a real, efficiently operating class of private owners did not result from the very process of privatization for the following reasons. Firstly, the approach to realizing privatization was wrong in economic terms, being based on political, not economic, considerations. Secondly, the choice of methods suffered from inconsistencies, as the government first made the transfer of property principally to collectives (without compensation), then mainly sought to form public or private joint-stock companies and to transfer the controlling share of stocks to individual enterprises. Thirdly, shortcomings in the legal framework. All this resulted in the need to provide post-privatization assistance to virtually all the enterprises instead of creating a sector of viable private firms. This made it necessary to reexamine the existing approaches to the process of privatizing state property. It is essential to establish economic expediency and obligatory payment as the two basic principles.

The reform of the economy should include active state stimulation for the development of entrepreneurship. At the same time, the existing "Program of State Support and Development of Entrepreneurship for 1994-1996" is not being fully realized. As a result, a real competitive environment in the economy is not being created. This is mainly due to the fact that the government is not sufficiently active in preparing legal and normative documents on questions of entrepreneurship. The decline in entrepreneurial activities by small, private business has ensued from a host of factors. These include: (i) the deterioration in the general economic situation; (ii) the presence of an unfavorable and crime-ridden environment; (iii) the excessive tax burden; and, (iv) lack of access to credit resources, raw materials, new technologies, and idle productive capacities and plants, and so forth.

The social policy, under conditions where production is decreasing and hence budget revenues are limited, has been directed toward the creation of a network of social protection, above all, for the indigent and needy strata of the population. The government is carrying out, in a series of stages, the transition to targeted social assistance. It has prepared documents that regulate the order for providing the various

privileges to individual categories of the population. Part of the social payments, which had earlier come from the central budget, has been transferred to local budgets.

With respect to the reform of compensation and wages, the government has introduced new conditions on the basis of a unified wage system. Seeking to coordinate and link wages with the results of labor (and at enterprises of all property types), the government is establishing state regulation on the means being allocated for consumption. At the same time, this policy comes amidst a fundamental restructuring of the economic mechanism (with the transformation in the form of property ownership as its core), high rates of inflation, a decline in production, a budget deficit, and a deterioration of the standard of living. As a result, the measures taken with respect to wage policy have not fully had their intended effect of stimulating labor efficiency and productivity. The share of the fund for wages (as part of the GDP) was 22.8 percent in 1994 and rose to 26.6 percent in 1995.

The balance of payments and foreign debt of Kazakhstan are significant issues. The consolidated deficit in the balance of payments in 1994 amounted to US\$ 523.8 million (4.5 percent of the GDP). This unfavorable balance resulted from the deficit in its main components: the current and capital accounts. The creation of a negative balance in the capital account, in turn, was influenced by its main component, capital transfers (including the transfers of migrants, i.e., the export of their capital). According to the estimates of the State Statistics Bureau, in 1994 the transfers of migrants exceeded US\$1 billion.

A substantial role in the foreign trade in recent years belongs to the so-called "shuttle traders." In 1995, they accounted for US\$62 million in exports and US\$488 million in imports. If these sums are added to the foreign-trade volume, the total export in 1995 amounted to US\$4.974 billion, while imports reached the value of US\$3.742 billion. The country also spends considerable resources on purchase of energy from neighboring countries. In 1994, it imported electricity for US\$336 million and natural gas for US\$370 million.

In 1994, Kazakhstan registered a growth in the influx of foreign capital. Foreign direct investments amounted to US\$875.6 million, while foreign loans stood at US\$838 million (excluding loans from Russia). Apparently, there is also a high volume of uncontrolled transfer of capital from the country, which is deposited in foreign banks. An important item in the balance of payments, which has a positive influence on the bottom line, is the trans-shipment of freights and natural gas.

According to the data of the National Bank of the Republic of Kazakhstan, at the beginning of 1996 the foreign debt was US\$3.1 billion. This was equivalent to US\$182 per capita of the population, 19 percent of the GDP, and 53.3 percent of the total volume of exports. In 1995 the country spent 8.1 percent of exports on servicing its debt. The debt-service ratio was equivalent to 18.1 percent of the hard-currency earnings from exports. The official foreign debts consisted of the following: (i) commercial (export) credits, given under state guarantees; (ii) loans from international financial organizations and donor states to provide official development assistance; (iii) technology credits, etc.

In the opinion of specialists from the National Bank of Kazakhstan, this country is highly vulnerable to the risk of price changes. There are two reasons for this: (i) the

structure of foreign debt (expressed in various hard currencies, most of which are based on agreements with a floating interest rate); and, (ii) the market is oriented mainly toward the export of raw materials. The growing volume of foreign indebtedness demands that more attention be devoted to the question of controlling these risks. To create financial devices that will minimize the unfavorable changes in future money flows (due to changes in foreign prices), it is essential to have specialists who are thoroughly acquainted with world commodity, hard-currency, and financial markets. It is also necessary to create the corresponding organizational structures to deal with these issues.

The current debt situation is really far from critical. However, it would be expedient in the middle-term perspective to establish maximum norms for servicing the foreign debt, not in terms of the export of goods, but in terms of the so-called hard-currency export. And this indicator for the first five months of 1996 was 59 percent of the exports passing through customs.

For the period to the year 2000, the maximum level of foreign credits and loans obtained under new governmental guarantees should be limited to US\$6.5 to 7.0 billion. That amounts to US\$1.0 to 1.5 billion per annum. Taking into account the current practice of restructuring foreign loans and the scheduled term for repayment, the maximum admissible level of the foreign debt should be limited to about 35 to 40 percent of the GDP. The main problem with respect to foreign debt is the default on the repayment of foreign credits and loans because of the shortage of budgetary funds (due to the unjustified granting of state guarantees) and the lack of money on the part of the end borrowers. One cause of this unsatisfactory situation is the lack of a complex system to manage the foreign debt. As a result, there is no clearly defined accountability of state organs in this sphere. To normalize the situation with respect to obtaining and using foreign loans, the government is taking several measures. Firstly, regularize the accounting of guarantees. Secondly, organize the process of obtaining, using, and accounting for foreign investment and goods credits given to the state or received with state backing. Thirdly, provide for the repayment of overdue debts where the credit had been backed by a state guarantee.

Thus, the economic reform in 1991-1995 has brought about qualitative changes in the macroeconomic situation and is creating the preconditions for a new stage in the reforms. The latter will include financial stabilization, gradual increase in savings, and an active role of the securities, commodities, real estate, information, and labor markets. All this should, in the coming years, contribute to a resolution of the crisis and help to create a market economy that functions normally and remains socially oriented.

The new stage of economic reforms, in contrast to those that came earlier, will be based on definite qualitative achievements from the realization of the previous programs. The government proposes to make a comprehensive resolution of the plethora of problems that exist in the economy today and, apparently, will persist for the next few years. A successful resolution of these will, to a large degree, depend on the comprehensiveness and clarity of focus in the work undertaken to achieve the following two objectives. First, creation of a normative legal basis. Second, preparation and adoption of the appropriate programs at the national, sectoral, and regional levels.

These programs must seek to do the following: (i) resolve the most complex questions in macroeconomic, sectoral, and regional policies; (ii) form a system of markets; (iii) devise effective policies to obtain and utilize foreign capital; (iv) create new jobs; (v) adopt new approaches to deliver education and public health services as well as to provide social protection for the most vulnerable strata of the population; (vi) stimulate efficient, productive labor; (vii) create a modern production and social infrastructure. In the first half of 1996, the social-economic situation developed under the influence of a complex set of measures. These had been prescribed by the "Program of Actions by the Government of the Republic of Kazakhstan for the Extension of Reform in 1996-1998." In the first instance, one should note the intensive work to develop and improve the normative juridical basis of reform and to regulate the social and economic relations. These were conducted in accordance with the expanded "Plan of Measures of the Government of the Republic of Kazakhstan to Extend Reforms in 1996."

During the first six months of 1996, the government adopted a number of laws to deal with individual aspects of civil and commercial law. It also prepared and adopted a complex program pertaining to individual aspects of the economic reforms. That was a whole series of government decrees, which were directed toward implementing current laws, regulating economic activities, and supporting the social sphere. In the second quarter of 1996, in order to ensure operational supervision and feedback, the government organized a monitoring system for the economic activity and financial condition of approximately 200 enterprises in various branches of industry. These enterprises account for over 70 percent of the total volume of output in Kazakhstan. The monitoring also included some businesses that engaged in transportation, communications, and construction. The government also initiated the realization of regional programs and plans to intensify the reforms. This included a complex of measures to carry out the practical implementation of the middle-term government program and to achieve a resolution of specific regional problems.

At the same time, however, macroeconomic stabilization has still not become irreversible and permanent. Thus, after five years of decline in industrial production, in the first quarter of 1996 the country achieved a growth rate of 0.6 percent (compared with the same period in 1995). But in April, compared with the previous month, production once again began to fall in virtually every branch, except petroleum refining and the chemical industry. Instability in the performance of industrial branches also remained characteristic of the ensuing months as well. Industry continues to be plagued by involuntary shutdowns and temporary suspension of operations, and the financial position of enterprises also remains exceedingly difficult. The decline in the production of goods and services has also persisted in agriculture, construction, and transportation.

Despite the noticeable growth in nominal and real wages in the first half of 1996, the country has still not succeeded in bringing real wages back to the level of December 1995. Moreover, the volume of unpaid wages (which now exceeds 40 billion tenge) has been continuously increasing; the arrears are now more than one-quarter greater than they were at the beginning of the year. Of the total volume of unpaid wages, more than 6 billion tenge is owed by state-owned organizations. Nor has there been an improvement in the financial condition of enterprises and businesses. About half of the total number of enterprises and businesses (excluding agriculture) are unprofitable; that compares with

39 percent at the beginning of the year. To be sure, the total volume of losses has decreased (by half). Still, only in manufacturing, construction, and communications is the proportion of unprofitable enterprises less than half (specifically, at a level of 40 percent); in all others it significantly exceeds the 50-percent level.

The non-payments crisis also continues to mount. The volume of total and overdue debts (both bills payable and bills receivable) by enterprises and businesses increased by 20 percent during the first six months of 1996. The bulk of the total bills receivable and payable (approximately 90 percent) consists of domestic indebtedness such as arrears in payments to the state budget, and credits and loans from banks. The second place in the volume of indebtedness involves accounts with Russia. Bills payable exceed bills receivable only in the case of Kyrgyzstan. Nearly one-half of the overdue bills payable fall on industry, while the bills receivable exceed 50 percent. The steady growth in indebtedness is creating a perilous situation in the economy. In the first quarter of 1996, the increase in total volume of bills payable amounted to 15.2 percent of the GDP for that period. It is estimated that, in the second quarter, this indicator reached 20 percent. The overdue bills receivable amounted to 19.3 percent of the GDP in the first quarter of 1996, falling only slightly (to approximately 18 percent) in the second quarter. Thus, the macroeconomic situation continues to remain rather complex and contradictory: it is exerting an uneven influence on production and the development of foreign trade.

## **1.2 Current Condition of Industrial Development**

The results of the development of industry in the first half of 1996 attest to the fact that the slower pace of decline and the relative stabilization have been achieved primarily because of the export-oriented branches and lines of production. These consist of nonferrous metallurgy, petroleum refining, and the chemical industry. The processing branches of industry are also attempting to reorient themselves toward foreign markets because of shrinking domestic demand. However, they do not have sufficient potential in terms of competitive products that are highly processed, and they orient their foreign trade primarily toward markets in Russia and other countries in the CIS. Furthermore, a substantial share of the goods needed by domestic enterprises is being shipped to foreign markets. For example, the foreign deliveries of cotton fiber, fine wool, and raw leather have increased two to three times, while the domestic consumption has contracted by 10 to 15 times, with a corresponding fall in the production of textiles and footwear. An analogous situation has emerged in the production of the chemical industry and in several other branches. Under these conditions, the fall of output in the processing branches, the low level of competitiveness of goods on the domestic market (because of price factors, quality, design, packing), and the increase in imports of analogous goods only further aggravate their position. A significant structural change in the potentials of commodity markets is due to the increase in the share from extractive industries (compared to the processing industries). Increasingly, the economy is falling into a vicious cycle: export raw materials, earn hard currency, import consumer goods, export more raw materials, and so forth. Moreover, in a number of cases, the prices are dropping for raw materials and semi-finished goods that are already being exported on a massive scale. As a result, it becomes necessary to export them in even larger quantities

in order to sustain the same volume of hard-currency earnings.

There has also been an intensification of another negative tendency—a distortion of the structure of the economy. That is due to the fact that the primary branches of industry are accounting for an ever greater share of the total volume of production. This tendency raises the specter that Kazakhstan will descend to the rank of peripheral countries that are solely engaged in supplying raw materials. For the moment, it does not appear to be possible to overcome these negative tendencies and to carry out a serious structural transformation. That is because of the lack of domestic investment resources and because foreign capital is being directed mainly toward the primary industries.

In the first half of 1996, the volume of industrial production (compared with the same period in 1995) rose by 0.4 percent. Moreover, it should be noted that such a situation was, to a significant degree, predetermined by the rapid growth of production in the sector of private households. In general, it proved impossible for the sector of non-financial corporations to overcome the decline. According to data collected in surveys by the Institute for Economic Research, the productive capacities for industry as a whole operated at only about 35 percent of maximum capacity. These rates varied among the different industrial branches: 30-34 percent in machinery and food-processing industries, 25 percent in the chemical industry, and 16 percent in light industry. In 1996, the share of output from the private household sector in the total volume of industrial production has been steadily increasing: 3.0 percent in January, 3.3 percent in March, and 5.3 percent in June. As a result, there has been a "naturalization" of industry, a process that is particularly pronounced in the case of the food-processing industry.

There has also been a growth in the number of enterprises that reduced their volume of production. Thus, whereas such enterprises numbered 1,500 in January 1996, they had increased to 2,000 by the middle of the year. There has also been a deterioration in their financial condition. Compared with the same period in 1995, in the first half of 1996 the share of unprofitable enterprises increased 1.4 times and came to exceed 40 percent of all enterprises. Moreover, there has also been a further growth in the volume of overdue bills payable and bills receivable (13.8 and 12.4 percent respectively) since the beginning of the year.

### **1.3 The Privatization of Industry**

Kazakhstan has carried out two programs for de-nationalization and privatization of state property. The program of June 22, 1991, which covered the years 1991–1992, concentrated primarily on the sale of entities in the trade and service sectors, but it also included the transfer of some state enterprises to labor collectives employed in these enterprises. The "National Program of De-nationalization and Privatization in the Republic of Kazakhstan for 1993–1995" (stage two), which was adopted on March 5, 1993, embarked on "massive privatization" of whole categories as well as the privatization of large entities on the basis of individual projects. Within the framework of small privatization, it sold 11,000 entities. The massive privatization put up 1,600 enterprises for sale. Within the framework of the privatization of large enterprises on an individual basis (which involved enterprises employing more than 5,000 employees), the state sold

five enterprises and placed another forty-four enterprises to control by trustees (including foreign entities). At the beginning of 1996, approximately 60 percent of the charter capital of the privatized enterprises (excluding the entities in small privatization) was in private hands. In 43 percent of the enterprises subject to privatization, private owners acquired more than 50 percent of the voting shares. And in 29 percent of the enterprises, private parties acquired 80 percent or more of the stocks.

On February 27, 1996, in decree no.246, the government promulgated a new "Program of Privatization and Restructuring of State Property in the Republic of Kazakhstan for 1996-1998." Its main goal is to achieve and secure the dominance of the private sector in the economy by completing the basic process of privatization. The realization of this goal will be accompanied by a reorganization of entities owned by the state. It is expected that the realization of this program will promote the demopolization and change in the proportions in the economy in favor of developing the predominance of small and medium-sized business. Beginning from 1996, any privatization of state property is to be realized only in exchange for money funds.

On March 1, 1996, the government issued a list of major enterprises to be privatized on an individual basis. It divided these enterprises into two categories: (i) stable, profitable enterprises, which do not require a special pre-privatization restructuring; and, (ii) those enterprises that do require restructuring prior to privatization. Stable, profitable enterprises first are to undergo prior conversion into joint-stock companies. The state stock in enterprises should be sold in accordance with the following distribution: at least 15 percent is to be sold at auctions, while at least 50 percent of the total shares are to be sold as a single bloc to a particular investor (which will thereby be ensured of having a controlling share of stock).

In the coal mining complex, the existing laws establish exclusive state ownership of the deposits and reserves of useful minerals. They also establish the principle that the exploration and extraction are to be carried out by investors who have submitted successful tenders to hold management trusts. The oil, gas, and the petrochemical complex of the branch program for privatization provides for ways to restructure enterprises and organizations that perform exploratory work, extract and process oil and natural gas, and transport the end products. The privatization of entities in the oil and gas complex will be realized on the basis of individual enterprises and through the announcement of tenders (including international tenders). The state packet of shares will be privatized on the basis of tenders, with the state retaining at least one-third of the voting shares. It is possible to transfer the state bloc of shares to trustee management. The conditions of tender for the right to hold trustee management include the following: (i) restore the financial solvency of the enterprises; (ii) provide long-term financing; (iii) prepare a full program for restructuring; and, (iv) satisfy various social and ecological requirements. The remaining shares of stock are to be sold at open tenders for cash.

In the case of especially important sectors of the economy (e.g., oil, natural gas, energy, transportation, communications, and ferrous and nonferrous metallurgy), diagnostic and analytical work will be first conducted to determine the optimal type of ownership and the strategy for achieving this. The program for the electric energy complex provides for restructuring, establishment of the economic independence of

entities, and then their subsequent privatization. In 1996, the government is to complete the transformation of the organizational structure of the electric power complex. This new structure includes: (i) state regulatory organs in the form of the "State Energy Supervisor" and the "State Commission for Price-Setting on Electric Power"; (ii) state enterprises not subject to privatization (including system transmission lines and entities, which will serve to ensure the integrity and operation of a single energy system); (iii) enterprises subject to privatization. In 1996, the affiliates of the joint-stock company "Munai onideri" (which supplies petroleum products) will be privatized. The same year the joint-stock company "Alaugaz" (a producer of natural gas) will be reorganized; this will involve the separation of those enterprises that engage in the transportation and wholesale trading in natural gas. According to the plans for the privatization of the state holding companies "Munai gaz" and "Kazakhgaz," the state will retain the controlling share of stock.

As for the metallurgical and ore complex, the sectoral program for restructuring and privatization will complete the process of dismantling large enterprises into smaller units. This will be done by separating from their charter capital the state's share of stock, which will be transferred to trustee management on the basis of tenders. The conditions for such trusteeship in the metallurgical and ore complex are the same as in other branches. They also include the obligation to expand production and the raw-material base of mineral ores. In the branch of mineral and ore extraction, the fundamental principle continues to be that the state retains exclusive ownership over all oil and mineral reserves. The participation of the non-state sector is strictly limited to licensing, which is realized either through the grant of concessions to exploit these mineral deposits or through the transfer of state enterprises to trustee management.

The state's role in the economy consists in the fact that the state is a major participant in the market in the form of state enterprises and corporations. An important function of the state is to determine the social-economic strategy of development, the prices on socially significant goods and services, and the choice of strategies for microeconomic development. The development of market relations at the micro-level continues to be spontaneous and chaotic. The financial markets has expanded at the expense of the commodity markets; the export and import sectors contribute to a situation where raw resources are drying up for the domestic producers, thereby driving them out of the domestic market. Privatization has proven to be disconnected from the task of resolving a systemic crisis. It has contributed nothing to stopping the decline of production, to resolving structural problems, or to creating the preconditions for the formation of a competitive environment.

The formalistic de-nationalization has triggered destructive processes in the state sector of the economy and resulted in a loss of its manageability. A new stage in the cash privatization (upon which great hopes were placed) no longer can eliminate these problems, although the program for privatization and restructuring in 1996-1998 is making an attempt to overcome them. The new stage in cash privatization will not bring a significant upsurge in industrial activity. The reason is that it does not solve the old problems: non-payments, subsidies from the state budget, unemployment, and the mechanism for bankruptcy. One can, furthermore, predict that the monopolization and associated processes will continue to intensify. Namely, this will ensue from the further

contraction of the state sector, the transfer of large blocks of shares of enterprises (which previously belonged to the state) to the control of banks, and the sale—at dumping prices—of large blocs of shares in enterprises declared to be insolvent. The parameters and limits of the state sector have been neither defined nor fixed in law. This deficiency is becoming ever more important, for the threat of a future crisis in industry has increased as a result of the changes enacted in the fundamental rules on cash privatization.

In the contemporary mixed economy, the state sector should perform a number of important functions: (i) support strategically important spheres of scientific-technical progress that entail high risk and require extended periods for the recoupment of investment; (ii) exercise control over those branches that bear a threat to the safety of the public (atomic energy; certain branches of the chemical industry). The model adopted for privatization has upset the balance not only in the social-economic interests of the population, but also the branches of industry. Among the negative consequences of privatization, the following are the most serious: (i) intensification of the exodus of financial resources from the sphere of material production; (ii) aggravation of the investment crisis because of the non-fulfillment of the obligations on investment; (iii) creation of numerous distortions in property relations. Thus, privatization has neither stimulated the growth of production in industry nor generated additional resources for the state budget.

In the cash stage of privatization, the impact of negative factors can unleash a new spiral. There are grounds to fear serious shortcomings in the realization of the bankruptcy mechanism. Specifically, enterprises that have a high export potential and modern technology may be vulnerable to privatization by dishonest people. To prevent this, the following measures would help: (i) freeze the proportion of government blocks of stock due to be sold; (ii) provide for strict legal accountability on compliance with investment obligations. Within the framework of individual privatization (in accordance with the "National Program of De-stratification and Privatization in the Republic of Kazakhstan for 1993-1995"), forty-four enterprises were transferred to trustee management. Twelve of these were assigned to the control of foreign firms, and by the middle of 1996 the number of contracts had increased to more than fifty.

Further, in accordance with the "Program for Privatization and Restructuring of Property in 1996-1998," the special conditions for the operation of each branch were to be taken into account whenever these were transferred to trustee management. Thus, the formation of joint-stock companies and privatization of enterprises in the electric power complex will be realized on the obligatory condition that these enterprise retain their present production profile and that the state retain one-third of the voting shares. In the cases of enterprises reorganized as joint-stock companies, the state's share of stock will be transferred to trust management. In the mining and the oil and gas complexes, the government has proclaimed the state's exclusive ownership of mineral resources and reserves. The country has called the process of issuing concessions as the "streamlined transfer to trustee management." Uzbekistan has adopted a law "on concessions," with an exhaustive list of the rights and obligations of those holding concessions. The civil code of Kazakhstan and the statute "on bankruptcy" lack a definition of the term "trustee management," which is nonetheless employed in many juridical documents.

In January 1996, the government promulgated the "Temporary Statute on the Procedure for the Conduct of Closed Tenders in Implementing the Law 'On Privatization' of December 23, 1995." However, this statute does not eliminate all the problems. The mistakes made in the transfer to trustee management are rather substantial (as, for example, in the case of "Karmetkombinat" and others). These mistakes are still occurring in the middle of 1996. This concerns the protracted transfer to trustee management on the basis of declared tenders, the results of which are still not known in the case of the "Vasil'kovskii GOK" (Mining and Enrichment Combine), "Iuzhneftegaz" (Southern Oil and Gas), and "Shymkentnefteorgsintez" (Shymkent Oil and Organic Synthesis).

Here it is necessary to note that all the enterprises transferred under contractual terms were on the brink of shutting down completely. Specifically, their volume of production had decreased drastically, their accounts payable had swollen to an enormous volume, their debts to the suppliers of raw materials and supplies had amassed to a substantial sum, and—most important—their debts on wages to enterprise employees posed a threat to both economic and social security. The state, given its budget deficit, could not independently cope with this social and economic crisis. It was therefore forced to transfer these enterprises to foreign management. And this was intended as the key factor in reinvigorating these enterprises and the economy as a whole, for these lines of production account for 49 percent of the total industrial output. The foreign partners are conscientiously fulfilling the obligations that they assumed: they have settled the debts of the enterprises on schedule (as fixed in the contract), paid off the arrears on wages and other debts (on raw materials and supplies, on electricity), significantly modernized the fixed capital, eliminated the tax arrears, and increased the working capital. All this has had a positive influence on the stabilization of production and on the development of the social infrastructure in the surrounding regions.

An important factor is the influx of foreign capital, which, as a result of the transfer of enterprises to trustee management, amounted to more than US\$1 billion. For the further acceleration of development in these enterprises, it is necessary to resolve the question of their privatization. The managing firms are interested in the most rapid possible privatization, and that in turn would signify an increase in investment. But because of problems in determining the value of enterprises already transferred to trustee control, privatization is not occurring at the present time. For the moment, of the fifty trustee firms currently operating, the right to privatization has been granted and realized in only three cases—viz., the firms that control the Pavlodar Aluminum Plant ("PAZ"), an enterprise called "SSGPO," and Kazakhstan Chromium ("KazKhrom"). Privatization of "SSGPO" involves the sale of 49 percent of shares of simple registered stock of the managing firm "Aivedon Interneshnl LTD" for the amount of 3.2 billion tenge. In addition, 40 percent of the investments obtained will be channeled into the state budget, and another 10 percent into the budget of Kostanai oblast. The remaining funds from the sale of the stock will go into the account of the enterprises as an outright grant to finance a program for the development and application of new technologies, for the modernization of machinery and equipment, and for resolving the social questions involving its employees. Furthermore, 1.5 percent of the stock of this joint-stock company's founding capital will be sold on the stock market. All the funds obtained from this privatization are exempt from taxation. An identical system of privatization is also

being applied to the other enterprises held in trust management. Thus, significant investments from privatization and the activity of the trust enterprises will go both to the central and local budgets. But the question is whether they will reach their designated goals and, if not, why?

One must also note that the level of breakdown, economic mismanagement, and debts are such that billions of dollars are needed to restore these enterprises to normal operations. Under these conditions, it is very complicated for foreign companies to finance such changes. They must contend a whole series of adverse factors: the lack of a market infrastructure, the large volume of non-payments and debts in many spheres, the frequent turnover in key government positions, and the incessant changes in the tax rates and customs duties. Moreover, foreign companies find it very difficult to adjust to the local conditions of financial and economic operations. Nevertheless, they are forced to adapt themselves to these local requirements and to give attention to social problems to avoid provoking opposition to themselves. This can be expressed both by making direct investments in the social sphere and by inviting domestic firms to do the construction and installation work and thereby create new jobs. Thus, social tensions are actually reduced or altogether eliminated; the unemployment rate decreases; wages are paid on schedule; the debts of enterprises are paid off; the bills for raw materials, supplies, electricity, and other services are regularly settled; the volume of production increases. And this also means that profits have reappeared, and that in turn signifies that the central and local budgets are now receiving additional tax revenues. t.

It is now necessary to establish a firm legal basis for the transfer of industrial enterprises to trustee control by domestic and foreign investors. However, the government should reserve the legal right to dissolve a contract for trustee management in the event the managing firm commits abuses. Therefore, the model contract for trustee management requires some further work. When the trustee firm acquires the controlling bloc of shares at privatization, there are essentially two main scenarios with respect to investments.

First, the firm will invest in a further increase in the volume of production along traditional lines, improve the product quality, raise the competitiveness of its goods, reduce production costs, raise the profitability of the enterprise, and strengthen its position on the market. As a result, state interests will be satisfied, since the GDP will grow, enterprise profits will increase, and tax revenues will grow accordingly. Under this scenario, the managing firm has minimal investment risk.

Secondly, the firm behaves the same as in the first variant, but simultaneously it also invests in the creation of new lines of production (to produce highly finished goods) and establishes itself in new markets. The predicted rate of growth in profits ranges from 10 to 50 percent. Such, for example, is the case with respect to the joint-stock company "Zhezkazgantsvetmet" (Zhezkazgan Nonferrous Metal), which produces copper cathodes in a volume of 50,000 tons in its cable and wire production, or the joint-stock company Pavlodar Aluminum Plant ("PAZ"), which processes 30,000-50,000 tons of aluminum metal into rolled metals and its products such as construction materials, metal blanks, window and door frames, foil, and packaging materials. In this second variant, the firm obtains maximum profit, while the state gains a substantially larger GDP and

correspondingly larger tax revenues. In this variant, however, the firm encounters a considerably higher level of investment and risk.

It is essential to accelerate privatization and to improve the legal and economic environment for the operations of the managing firms so as to create the basis for a stable, efficient development of these enterprises. Therefore, the government is expanding the rights of the trustee firms to participate in the privatization of enterprises. However, it is essential to have programs for long-term development (as a business plan) for the trust enterprise in order to enhance their rights to the continuation of business operations.

#### **1.4 Goals and Tasks of Industrial Policy**

The term “industrial policy” concerns the entire complex of measures taken by state organs to ensure the stable development and operations of industry in a market environment—that is, under the conditions of open economy. The main goal of industrial policy is to create an industry that is competitive on foreign and domestic markets, capable of successfully resolving the most important social and economic problems that it faces, and worthy of participating in the integration of world economic relations. Concretely, industrial policy is expressed in the following: (i) putting an end to the industrial decline and achieving stabilization in industrial production; (ii) provide the conditions needed for the development and efficient utilization of the country’s potential in resources, production, and science and technology; (iii) create conditions favorable for a fundamental structural and institutional transformation.

In accordance with the prescribed goals, it is necessary to resolve the following tasks, which are regarded as high-priority dimensions of state industrial policy in the foreseeable future. These include: (i) creation of an effective system for state regulation of industrial production (whereby both direct and indirect methods of regulation are effectively combined); (ii) determination of the priorities in structural transformation in industry, followed by the application of a well-focused, targeted structural policy; (iii) removal of the existing structural disproportions between branches and promotion of progressive changes, including changes in the form of ownership; (iv) rational combination of different types of property forms, comprehensive support of small and medium-sized enterprises that engage in production, and stimulation of the development of entrepreneurship; (v) formation of new organizational structures and forms that are effective under the conditions of a transition period; (vi) preparation of a state scientific-technological policy; (vii) an economically justified development of import-substitution production to reduce the dependence on other states and to cut the hard-currency expenditure; (viii) integration of the Kazakh industry into the world economy; (ix) preparation and adoption of a normative legal and legislative basis for the formation of a favorable environment for the development of industrial production.

#### **1.5 State Regulation of Industry**

Realization of an industrial policy presupposes that the state has the capacity to influence its various dimensions through direct and indirect policy measures such as:

- establishment of a system of priorities and assistance for the structural transformation of industry;

- selective support of industrial plans during the period of crisis and stabilization;
- de-monopolization;
- initiation of the formation of efficient organizational structures in industry;
- support of individual, unprofitable industrial enterprises;
- support for entrepreneurship as well as small and medium-sized business;
- privatization of state enterprises;
- participation in the management of joint-stock companies in which the state holds the controlling share of stock;
- purchase of goods for state needs;
- attraction of foreign investments for the development of industry;
- assistance in a radical modernization of production on the basis of modern machinery and technologies;
- assistance in the development of international ties;
- direct state subsidies for individual enterprises;
- allocation of centralized capital investment;
- allocation of subsidies to individual producers;
- establishment of preferential tax treatment, tax credits, and “tax holidays”;
- allocation of targeted, preferential credits;
- introduction of accelerated amortization of capital assets;
- establishment of advantageous prices and rates on certain types of products;
- regulation of wage rates;
- regulation of customs duties on exports and imports;
- creation of non-budgetary funds to serve industrial enterprises in various targeted areas;
- financial reorganization and sanation of industrial enterprises;
- through a juridically established procedure, declaration of unprofitable enterprises as bankrupt;
- sale of part of the shares of stock that belong to the state;
- organization of expert assessments of projects and the holding of auctions and competitive bidding;
- application of anti-monopoly measures;
- regulation of the exchange rate of the national currency;
- regulation of the structure of expenditures;
- introduction of an intensified system of hard-currency and export-import controls;
- participation in the administration and exertion of influence on the economic policy

of enterprises through the supervisory council of a public joint-stock company;

- grant of state guarantees when enterprises conclude contracts with foreign partners, obtain investment credit, etc.;
- organization of multi-lateral inter-branch agreements to regulate prices and incomes;
- preparation and control over the implementation of laws, normative acts, statutes, etc.

### **1.6 Structural Transformations and Priorities in Industrial Policy**

Structural transformations in industry can proceed at three different levels: (i) in the sector; (ii) in the reproduction and renewal of capital assets; and, (iii) in organizational form. A carefully targeted structural transformation in industry presupposes the creation of a system of priorities, the choice of top-priority branches, and the creation of instruments to ensure the realization of these policies. With respect to branch structure of industry, the state must base its policy on the need to provide targeted assistance to the group of producers determined to be of highest priority. The main criteria for “priority” in guiding state policy for the next ten to twelve years, as it provides selective support for branches and enterprises of industry, consist of the following: (i) possibilities for exports; (ii) the preservation and support of production that is vital to the economic, scientific and technological potential of the country; and, (iii) protection of the country’s economic security. Based on these criteria, the top-priorities in the immediate future consist of the following: (i) fuel and energy sector; (ii) metallurgy; (iii) the petroleum and chemical industries; (iv) the military machinery industry undergoing conversion to non-military production; and, (v) the scientific-technological base of industry. Moreover, the selective support should be extended only to enterprises that are economically efficient; it should also be given to those that, to a significant degree, are oriented toward export. During this period, the number of selectively supported enterprises can also include individual enterprises from other sectors (for example, light industry and food-processing) if they are recognized as sufficiently strong and if they can play a noticeable role in preserving the basis of the country’s economic potential. The list of such areas is to be determined by the Ministry of Economy in collaboration with branch ministries and agencies.

To improve the reproduction process of industry, the government must direct its efforts toward the following tasks: (i) eliminate the raw-material orientation; (ii) support the development of manufacturing of highly processed goods; and, (iii) accelerate the application of organizational measures, modern machinery and technology in order to ensure the production of products competitive on foreign and domestic markets and in order to reduce the energy, raw-material, and capital intensity of production. In industry the waste of natural and human resources-required for the production of each unit of output should be eliminated. The most immediate goal is to prepare and implement a set of organizational measures for the conservation of energy. On the basis of such measures, the energy consumption of industry can be reduced by 20 to 25 percent. Another major problem is transportation costs. This can be achieved by optimizing the distribution network, by eliminating irrational transportation links, and by avoiding any overlapping routes or cross hauling.

The conditions of creating a market economy, also entail the formation of adequate organizational structures. However, the state will not forcibly impose from above, through administrative measures, new forms of organization in industry. Every form of organization that can ensure profitability and the production of competitive goods will have the right to exist. The state will promote the formation and strengthening of new, efficient organizational structures such as joint-stock and holding companies, conglomerations, and financial-industrial groups. It can do this by adopting a corporate law and by promulgating the other normative legal documentation that are needed. Above all, the government will stimulate the creation of diversified structural forms, as more flexible in manipulating financial resources. These forms include, in particular, regional and inter-regional joint-stock companies and financial-industrial groups. A special place in industrial policy is devoted to stimulating the development of small and medium-sized private enterprises, which have close cooperative ties among themselves and with large enterprises, joint-stock companies, financial-industrial groups, etc.

Another goal is institutional transformation in the country. This includes a policy aimed at creating a "mixed economy," i.e., one that provides a rational combination of state and private ownership of the means of production. It is essential to adopt new legislation in order to support the privatization process and also to create equal conditions for the operation of enterprises of different forms of property. Specifically, these laws should regulate state entrepreneurship, develop a system of competition in investment projects, and create the legal basis for the participation of foreign investors. The industrial policy of Kazakhstan provides for measures to initiate the creation of new organizational forms in order to achieve a more rational utilization of the existing resources. These will also contribute to making products more competitive, to breaking up monopolies, and to ensuring the effective cooperation of enterprises that have different forms of property ownership.

To do this, it is essential to create the conditions to facilitate the merge of enterprises with different forms of ownership and different sizes. These could then be restructured to form multi-branch, diversified conglomerations or groups. Such conglomerations would consist of the following: (i) large enterprises that produce finished products and constitute the nucleus of the conglomeration; (ii) allied enterprises that provide parts and are linked to the nucleus enterprise through technology; (iii) a common financial center (bank or holding company); (iv) firms that provide service for the enterprises of the conglomeration. The formation of such conglomerations should be based on the principle of voluntary membership and should aim at raising competitiveness by taking advantage of the economies of scale to reduce production costs. For this, it is necessary to apply transfer prices on goods used within the conglomeration. The presence of a financial center will make it possible to concentrate unencumbered funds and to use them in the interests of the conglomeration as a whole. Within the framework of such structures, it is possible to obtain a rational combination of large, medium-sized, and small enterprises representing different ownership types.

One of the priorities in industrial policy is to create the preconditions for forming inter-state financial-industrial and multinational corporations. There are a number of favorable preconditions for establishing such entities with states in the CIS in particular,

the complex of existing technological, production, and economic relations. But there are also a number of negative factors that impede the formation of such new business forms. The most important include the unfavorable economic conditions, the inconsistencies in reform policy in these states, and the differences in the production structure. The last factor has created the essentially raw-material orientation of Kazakh enterprises and their subordinate position with respect to the production of finished goods.

Therefore, in creating transnational corporations, the following must be taken into account: (i) the gravity of the existing economic situation and hence the urgent need to stimulate production (by reinforcing ties with technologically compatible enterprises in the states of the CIS, and by restoring order to the system of mutual deliveries); (ii) the branch character of production and the significance of particular goods both for domestic consumption, but also for their potential role in the development of the economy; (iii) the presence of potential foreign markets to sell the goods produced in Kazakhstan; (iv) the nature of the current situation in the sector, the opportunities for development through domestic resources or through foreign investments, and the gravity of the problem with respect to selling the goods produced and obtaining foreign deliveries; (v) the proposed mechanism for determining the amount of profit (and its distribution) as well as the allocations for re-investment; (vi) the requirements of national economic security: the share of admissible participation of capital from other states of the CIS in particular domestic branches and enterprises, the permissible level of concentration of goods sold in Kazakhstan, the total number and the proportions of parent companies (in Kazakhstan and in the other states of the CIS) that are capable of exerting a controlling influence on the development of a branch, etc. The formation of transnational corporations should proceed on the basis of parity and mutual benefits for all the participating states.

An exchange of products among subsidiaries can be done through transfer prices (averaged marked prices that eliminate fluctuations due to business conditions). These prices will be determined by the parent company of the corporation; they will correspond to a level of profitability typical for a given branch. For certain types of products that have a strong and constant demand on world markets, it is more expedient to introduce taxes in kind (as a kind of royalty), with recognition of the right of first-priority to purchase these goods at prevailing world prices.

### **1.7 Accelerated Development of Small and Medium-Sized Business**

Within the framework of industrial policy, the government envisions the adoption of measures needed to develop small and medium-sized enterprises (SMEs). Such enterprises can help to supply the domestic market with consumer goods and to create a competitive environment. As a result, particular significance is attached to the questions of creating a system of state support to promote private entrepreneurship. The top priorities in state support for SMEs is the creation of conditions that can promote effective cooperation between SMEs and large enterprises. A key factor is the fact that, because of their size, SMEs can only engage in simple lines of production; they lack the resources to produce goods with a complex technological cycle. In addition, small enterprises are more flexible in adopting innovations; they also can more easily restructure themselves in response to changes in business conditions. Finally, small firms are more efficient than large enterprises if it is a matter of low-scale production.

The cooperation of SMEs with large enterprises can be achieved by initiating the formation of the following enterprises: (i) those capable of producing individual types of goods that are not needed in a large volume and that cannot profitably be produced in large-scale enterprises; (ii) those that develop and produce new types of goods which are technologically finished and subsequently transferred for use at the head enterprise; (iii) those that design new technologies at the request of the leading enterprises; (iv) those specializing as a service enterprise for the conglomeration's parent or main firm by researching and entering new sales markets. To organize this cooperation, it is necessary to adopt a law on the protection of SMEs that are active in the production sphere.

It is particularly important for the state to provide support for industrial entrepreneurship in towns and townships. Such urban areas generally have a single-industry profile and currently is in a state of depression. At the same time, the smaller cities even offer certain advantages over large ones: (i) availability of idle or unencumbered productive facilities and capacities; (ii) availability of idle labor resources; (iii) less acute housing problem; (iv) presence of a more or less developed production infrastructure. A concentration of state support for entrepreneurship in depressed towns can achieve two goals, first, it can ameliorate the social tensions in such areas, second, it can liquidate the one-sided economic line of development and also create real preconditions for the more efficient utilization of a town's economic potential.

In order to create the conditions whereby SMEs can develop in local areas, it would make sense to create Small Business Centers there. The goal for such centers is to provide assistance in several key tasks: forming and registering an enterprise; determining the line of business; obtaining credits; acquiring machinery and technology; providing consultations; establishing ties with large enterprises; and providing access to productive facilities and other services. In addition, Small Business Centers at the regional level can provide an arena to train the cadres for entrepreneurship—for example, by organizing individual and group instruction, by offering special training courses and seminars for entrepreneurs, and by establishing business schools. Besides, it is necessary to compile inventories of non-residential buildings, as well as unused productive facilities and machinery, so as to make these be available for leasing or purchase by entrepreneurs.

For purposes of allocating credits to promote the development of small and middle-sized business in the sphere of material production, it would be useful to establish specialized banks to provide the necessary credits. Within the framework of the program for attracting foreign investments, it is necessary to prepare measures to facilitate their utilization for this purpose and thereby accelerate the development of private entrepreneurship.

## **1.8 Special Regional Features of Industrial Policy**

The regional dimension of industrial policy in Kazakhstan involves the need to change the economic structure of oblasts. This policy must take into account the typology of regions, development of diversification, and support (through taxation and credit policies) of various lines of production, remote rural areas, and small towns and

townships. Based on a typology of the regions in the country, the following programs are proposed for particular regions: First, in industrial regions with significant scientific-technological potential: (i) rapid privatization; (ii) accelerated creation of market structures, joint-venture enterprises, and conditions favorable for foreign investment; (iii) the development of innovative activities; and, (iv) the establishment of technology parks. Secondly, in raw-material regions with high export potential: measures to attract foreign capital and technology in order to achieve an efficient and comprehensive exploitation of raw-material resources and to gain access to world markets. Thirdly, in regions with surplus labor: develop small-scale commodity production in urban and rural areas, with the introduction of a preferential régime and realization of projects to create labor-intensive production and thus new jobs. Fourthly, in regions with a high proportion of converted defense plants: a program of structural transformation and re-profiling aimed at civilian markets, with the support of the state and in compliance with the conception and program for conversion, while still observing defense interests and security needs of the country. Regional industrial policy provides for the formation and development of new lines of production in small and medium-sized towns, which are currently on the brink of extinction. For these purposes, it is essential to reject a one-sided mono-industrial production (which has dominated economic policy until now) and to use tax, credit, and other forms of support to promote the development of SMEs. In such areas, the government also plans to create primary units for the industrial processing of local raw materials and agricultural commodities. This will help to increase employment, raise the standard of living, and overcome the seasonality in the use of the labor force in remote rural areas. Realization of the regional industrial policy presumes a division between the functions of central and local organs of administration.

At the regional level, state administration should concentrate its efforts on the following: (i) formation of proposals for targeted programs and forms of state support of significant projects for the regions; (ii) within the framework of local budgets, introduction of tax preferences for industrial enterprises that are oriented toward the needs of the regions and based on priorities of the regions; (iii) creation of conditions to attract entrepreneurs and foreign investors to small and medium-sized towns.

Further, central administrative organs can actively cooperate with regional authorities by doing the following: (i) allocate financial and credit resources to regions in accordance with the goals of the industrial policy; (ii) provide regions with economic forecasts and information about the industrial development of the country, the most profitable forms of investment, the tendencies in the development of mutual relations with countries of the CIS and elsewhere, and the market conditions for the sale of industrial goods; (iii) assist in the conduct of scientific research in the interests of the region and introduction of most recent achievements in science and technology in order to resolve the regional problems in the industrial sector; (iv) take into account the needs of regions when formulating various targeted programs and projects; (v) promote the process of study, retraining, and raising the qualification of specialists in the oblasts.

## **1.9 Development of Interstate Cooperation and Economic Ties with Countries in the CIS**

A priority in the industrial policy of Kazakhstan is the strengthening of economic

cooperation with the republics of the former USSR. This priority derives from two important factors. First, these states have traditionally had strong economic ties with Kazakhstan, second, they also provide an enormous market for industrial goods and sources for acquiring the means of production. Thus the government will assist enterprises and firms in Kazakhstan and other countries of the CIS to establish voluntary, efficient economic ties and to develop the common market. To be sure, it will also take into account its own economic independence and security, as well as the state and national interests of Kazakhstan. Realization of this policy will be abetted by the agreement to form an economic union, which was signed by the CIS states in 1993 and formally went into effect in 1994. An "Inter-State Economic Committee" has been founded to realize the provisions of this agreement. For purposes of a following a step-by-step process to create a common economic space for the states of the CIS, these countries propose to participate in the main spheres of activity of the Inter-State Economic Committee. This includes the formation of customs and payment unions which will enable the free movement of goods and services, capital and labor as well as the creation of financial-industrial groups and transnational companies.

The agreement to create a single economic space that initiated Kazakhstan, Uzbekistan, and Kyrgyzstan specifically aims at the economic integration of enterprises in the processing branches of the agro-industrial complex, light industry, machinery, and transportation among the three countries. It also provides for the creation of a Central Asian bank to finance joint-venture projects.

Kazakhstan is taking an active role in the gradual integration of industrial development in the countries of the CIS. For example proposes to create customs and payments union in the very near future, followed by the establishment of a hard-currency union in 1998. At the present time, the main task is to establish commercial ties between industrial enterprises for the most important categories of goods and on mutually advantageous terms. Above all, these goods include oil and its distillates, natural gas, electric power, machinery, and technology. The prices should correspond to supply and demand on the CIS marketplace, while taking into account the instruments of inter-state economic ties that constitute the basis of the treaty on economic union and the statute of the Inter-State Economic Committee.

A special place in the industrial policy of the republic belongs to the creation of inter-state and inter-regional transnational companies and financial-industrial groups. The creation of such organizations should be carefully prepared. It is also essential to demonstrate their economic expediency from the perspective of long-term strategic goals—that is, branch restructuring, capital reproduction, structural transformation, and integration into the world economic system. One must also take into account several key factors, including: (i) the alternative opportunities to restore or redefine vitally important economic relations under extreme conditions; (ii) the reliability and stability of deliveries needed for industrial production; and, (iii) the protection of domestic exporters in the competitive struggle on world markets. The Ministry of Economy and the Ministry of Industry and Trade of Kazakhstan should organize expert evaluations of all proposals to create transnational companies and financial-industrial groups. Their formation should proceed on the condition that the pertinent countries adopt a law on both these forms of business organization. The key underlying principles must be that these are voluntary

formations, that the government provides assistance, but that there be mechanisms to prevent harm from being wrought to the state's interests and the economic security of Kazakhstan.

### **1.10 Integration of the Industry into the World Economic System**

Some of the key goals in the emergence and development of Kazakhstan as a sovereign state include the formation of an open society, the country's entry into the world economic system, and the growth and improvement of its export potential. In the interests of providing for the economic security and independence for certain items of production, the country pursues a policy of import-substitution. Favorable conditions exist for enabling the industry to become part of the world system as an equal partner in international economic relations. These include great natural resources, the existing production potential, a labor force that is relatively highly-skilled but inexpensive, and a broad network of economic relations. In general, the export potential is estimated to be US\$10 to 12 billion, although, at present, this remains at a much lower level.

A number of factors have retarded the development of the production and export potential, especially during the transition period. These include: (i) the high share of capital assets that are exhausted and obsolescent; (ii) the backward, resource-intensive technologies; (iii) the high per-unit cost of production and the non-competitiveness of products in virtually every branch of the manufacturing industry; (iv) the low level of technology in the extractive industries; and, (v) the inadequate development of transportation links for establishing access to world markets.

The main thrust of policy to promote the development and increase the efficiency of the export potential consists of the following: (i) liberalization of foreign trade, with a step-by-step incremental rejection of administrative methods of regulation; (ii) improvement in the structure of export-oriented production by increasing the proportion of goods that are finished, technologically or scientifically intensive, and by making them more competitive; (iii) exploration and securing of new sales markets; (iv) accord a greater role to the purchase of foreign technologies, integrated complexes of equipment, licenses, and know-how that are critical to the development of promising export-oriented and import-substituting lines of production. In the next few years, the total volume and structure of exports cannot be substantially changed. As a result, the immediate task is to preserve and to expand the sales market for traditionally exported products by reducing their unit production cost and by improving their competitiveness on the world market. Support for competitive products is to be achieved through several measures: (i) raising its quality to the level of world standards; (ii) expanding the system to take account of the demands of concrete consumers; (iii) providing supplementary services; (iv) concluding inter-governmental agreements; and, (v) creating associations, consortia, and other forms of producer alliance to ensure stability in the markets for individual categories of goods.

An improvement in the structure of exports after 1997 will be obtained through three key policies: (i) introducing new lines of production in key industries, above all, the chemical industry and nonferrous metallurgy including the production of carbon plastics as well as copper rods and wire; (ii) creating opportunities for trade in various products

from the defense sectors either independently or jointly with other countries of the CIS; and, (iii) expanding the export of scientific-technical goods and engineering services.

Development of the export potential requires the creation of a system to provide economic stimulation of exports as a whole and highly processed goods in particular. This system must include, among other things, the following components: (i) differentiated customs duties on raw materials and finished goods; (ii) preferential amortization and tax rates for exporters; (iii) subsidies and targeted preferential credits to develop export industries; (iv) formation of an insurance system on the risks of exporters. Particular attention should be given to the R&D-intensive industries that are based on expanding the inter-governmental cooperation in the scientific and technological sphere.

The long-term plan for the development of the country's export potential is linked to the realization of measures for a structural reorganization of industry. This will make it possible to shift to more cardinal changes in the nomenclature of exported goods. The import policy should solve the task of reducing hard-currency expenditures and improving the structure of imports. It makes sense to become reoriented toward cooperation that is mutually beneficial, toward specialization, and toward a rational division of labor within the framework of the world economic system. It is essential to raise the imports of know-how, patents, licensing, leasing services, integrated equipment systems, and so forth. This is true for development projects imported on the "turn-key principle" (either by foreign investors alone or with their participation), as a whole complex with the services to train the personnel to operate it. The government also plans to organize the production of a number of new types of import-substitution products, but its orientation must be carefully balanced. In particular, it should not lead to a striving for autarky, since such a path can lead, in many cases, to the proliferation of outmoded technologies and the persistence of technological backwardness. A more detailed description of current and long-term goals and policies in exports and imports is contained in the "Conception of Foreign Economic Policy of the Republic of Kazakhstan."

### **1.11 Science and Technology Policy**

Under conditions of general economic decline, a broad-scale modernization of the production system in all branches of the economy is hardly realistic, since that would require significant expenditures. Thus, the exhaustion of machinery and equipment in industry as a whole is at a level of approximately 45 percent, and in some branches such as machinery and the processing branches of the agro-industrial complex actually exceeds 50 percent. Therefore, for the efficient utilization of the existing production capacities, it is necessary to have a rational combination of the old and new in machinery and technology. That approach, within an acceptable period of time and with smaller costs, will make it possible to achieve a new technological level of production. This can help the country to gain access and to solidify a respectable position on regional and world markets. And all this pertains not only be to raw materials, but also to industrial products. And it can be done through a step-by-step conversion of the economy to the production of goods that are primarily R&D-intensive and high-tech.

In accordance with the foregoing, the basic thrust of science and technology policy is to create the preconditions for a radical modernization of the means of

production and for a large-scale application of modern technologies that conserve resources and that are environmentally safe. At this stage, the following steps are essential: (i) initiate leasing operations to accelerate the process of modernizing the apparatus for industrial production; (ii) on a large scale, apply new and progressive forms of labor organization, strictly observe technological and production discipline, and ensure full and timely compliance with any contractual obligations; (iii) expand the industrial use of licenses, patents, and modern machinery and technology from foreign countries; (iv) create large scientific-technological centers to conduct the full complex of work from exploratory research to the application of discoveries to production; (v) create centers of innovation and technological assistance as well as research-oriented technology parks; (vi) provide state support for academic, industrial branch, and university science; (vii) train highly-skilled workers and engineering personnel; (viii) develop comprehensive scientific-technological cooperation with states in the CIS and in other countries; (ix) improve state evaluations on investment projects, contracts, and treaties; (x) create a legal basis to protect intellectual property rights.

## **2. Development of the Export Sector and Foreign Trade**

### **2.1 Development of Trade**

Once Kazakhstan became a sovereign state, it acquired the opportunity to develop independently its foreign economic ties with other countries and to design and implement its own foreign economic policy. In 1991, it prepared a "Program for the Development of Foreign Economic Activity of the Republic of Kazakhstan in 1992—1993." This program determined the main goals in all spheres of cooperation with foreign countries. In an evaluation of how this program was realized, it should be noted that in 1993 the country did achieve certain positive results, but that on the whole the development of foreign economic relations encountered serious problems. In comparison with the previous year, the structure of exports underwent changes. Thus, for example, the country exported one-fifth as much oil, but eight times as much rolled ferrous metal and twice as much diesel fuel and ferroalloys. However, the main articles of export continued to be raw materials and, indeed, the orientation toward raw-material exports even intensified.

One of the main problems in exports was the massive shipment abroad of strategically important raw materials. This was done primarily on the basis of individual deals through middlemen. And the prices on these materials were significantly below the average world level. As a result, it became necessary to establish effective levers of state regulation in this sphere and to carry out organizational transformations. In particular, by creating specialized organizations (*ob"edineniia*) to conduct foreign trade. In many cases, the export of strategic raw materials was conducted on the basis of barter. Moreover, the exchange in such barter deals often involved consumer goods (both foodstuffs and non-foodstuffs) as well as luxury goods. There were also instances where hard-currency earnings were, in whole or in part, deposited in accounts in foreign banks. And, finally, there were also some outright abuses.

The main articles of import in 1993 consisted of the following goods: machinery

and equipment, sugar, vegetable oil, tea, and clothing (textiles and knitwear). However, neither the volume of these imports nor their structure corresponded to the state's import policy, which was oriented toward specific goals or the realization of concrete measures to develop import-substitution industries.

To improve state regulation of foreign economic activity in 1992 and 1993, the government took new measures to reallocate the functions of state organs. In particular, these functions concerned the formulation of a strategy for the development of foreign economic relations, operational regulation of foreign economic activity, and various other things. It also improved the procedure for issuing quotas and licenses on the export and import of goods, established a new instrument for customs controls over export-import operations, and changed the approach to regulating hard currency in the country. The government also made substantial corrections in the legal framework for controlling foreign economic activities. Thus, it annulled laws that no longer corresponded to the requirements of the country's economic situation (e.g., laws "on concessions," "on the basic principles of foreign economic activity," and others). However, the instability and contradictions in the legislation continued to complicate cooperation between domestic and foreign entrepreneurs.

In the period since 1993, one can observe a tendency for the volume of foreign trade turnover to increase steadily. The growth applies both to countries in the CIS and those outside it, and indeed the geography of foreign trade has also tended to expand. Thus, if in 1993 Kazakhstan conducted import-export transactions with 62 countries in the world, in 1995 this had increased to 129 countries. It has also strengthened its cooperation with European countries, which now account for about 62 percent of the total trade turnover (compared to 60 percent in 1993). Asian countries represented 27.2 percent in 1993, but subsequently increased their share (to 30.2 percent in 1995).

Although Kazakhstan represents only a tiny proportion of total world trade (0.043 percent in 1992)<sup>1</sup>, this foreign trade turnover represents a significant share of the country's GDP (from 54.9 to 75.3 percent). In 1995—1996 the share of exports in the GDP remains at the level of 31—33 percent, a proportion comparable to that found in such developing countries as Malaysia and Iran. The basic domestic factor behind the active establishment of broad foreign economic relations for Kazakhstan is the presence of rich natural resources. These resources enjoy a high demand on world markets, and the existing production of these materials exceeds domestic demand. Above all, such is the case for oil, nonferrous metals (copper, zinc, and lead), chrome and its alloys, rolled ferrous metal, and the products of oil refining and chemical industries (including mineral fertilizers). Grain is also an important component of export. Finally, further, the country has the opportunity to ship abroad its wool, cotton, unprocessed leather, and other products from the agro-industrial complex. To a large degree, the country's active entry into world markets in recent years has been due to the difference between domestic and foreign prices on the basic goods being exported from Kazakhstan. It bears noting that, at the present time, this factor has been almost entirely eliminated.

One should also note the need for integration among the Asian states based on the fact that they jointly use the same transportation routes for access to world markets. In the opinion of the President of Kazakhstan, this process is gaining momentum. Thus,

<sup>1</sup> World Development Report, 1994. Infrastructure for Development

chiefly on the initiative of Kazakhstan, a "Trans-Asian Railway" has commenced operations; it provides opportunities for direct access to Europe (via Turkey), to the Persian Gulf (via Iran), and to the Pacific Ocean (via China, at its port of Lianyungang). The countries of this region have gained direct access to the Pacific rim through railroad junctions on the Kazakhstan-Chinese borders. There is also an agreement today to construct a highway (running from Karachi to Islamabad, Kashgar [Kashi], Naryn, and Bishkek), which will link the states of Central Asia with ports on the Indian Ocean. By combining countries with a population of approximately 300 million people and the enormous natural resources of the corresponding states, the "Organization of Economic Cooperation" can become a significant force. Thus the "Great Silk Route" will be reestablished.

In recent years, one can see a change in the geography of export-import transactions. While preserving close ties with countries in the CIS (especially Russia and the states of Central Asia), the foreign economic cooperation with states outside the CIS has shown a noticeable increase in the share of trade held by the more developed countries. In the first half of 1996, the foreign trade turnover (including unorganized informal trade) reached US\$ 6.0 billion. That represented an increase of 30.5 percent over the same period in the preceding year. This turnover in the first half of 1996 consisted of US\$ 3.2 billion in exports and US\$ 2.8 billion in imports. Compared with the same period in 1995, exports increased by 56.1 percent and imports by 11.7 percent. In the second quarter of 1996, the foreign trade volume (including unorganized informal trade) was estimated to be US\$ 3.0 billion (11.5 percent more than the same quarter in 1995). Export transactions in April-June amounted to US\$ 1.5627 billion (20.8 percent more than the same period a year earlier). This growth in the volume of exports came both through an increase in the physical volume of the basic export goods and through a rise in the prices on some of them. However, compared with the first quarter of the current year, the growth of exports occurred mainly on the basis of changes in the physical volumes of goods.

Under the conditions that prevail during the transition to an open market economy, the role of foreign trade activity in the economy of Kazakhstan has substantially increased. A significant part of the goods produced by the primary sectors of the economy (viz., the extractive and processing industries) go to foreign markets. Here, for example, is the share of output being exported from the following industries: 58.8 percent of the oil and gas condensate, 31.3 percent of the iron ore and ferrous concentrates, 90.7 of ferroalloys, 81.4 percent of rolled ferrous metals, 105.4 percent of copper (including the output from processing imported ore), 90.4 percent of the zinc and zinc alloys, 81.6 percent of the lead, 52.1 percent of the natural gas, and 127.2 percent of the iron-ore pellets (including output from imported ores). These figures do not include any balances of production from previous years. During this second quarter, the average export prices have fallen (compared with the first quarter) for iron-ore pellets, ferroalloys, copper, cotton, wheat, and coal. However, prices rose for oil, the products of oil refining, and zinc. Prices remained stable for alumina, rolled ferrous metals, and lead. In the second quarter of 1996, countries in the CIS received 58.4 percent of the exports (with a value of US\$ 912.7 million). That represents an increase of 3 percent over the first quarter of the same year. The CIS countries received 94.0 percent of the wheat, 92.1 percent of the

ores and slags, 34 percent of the ferrous metals, almost 100 percent of the lead and lead products, and 65.6 percent of the mineral fuels, oil, and oil products.

During the second quarter of 1996, countries outside the CIS received 65.8 percent of the ferrous metals, 96 percent of the copper and copper products, 85 percent of the zinc and zinc products, 75 percent of the cotton, 74 percent of the wool, 89 percent of the unprocessed leather, and 34.4 percent of the mineral fuels, oil, and oil products. Exports to these countries show a decrease in the volume of ferroalloys, rolled ferrous metals, and copper; these decreases were due to the unfavorable conditions on foreign markets and also to transportation problems. The general volume of exports to the countries of outside the CIS amounted to US\$ 650 million. Thus, the decrease in the share of exports to countries outside the CIS during the second quarter was not due to a reorientation of exports to the CIS states. Rather, it was due to the fall in demand and prices on those goods being exported primarily to the non-CIS countries.

Exports at present are one of the means for the survival of producer enterprises and for preserving jobs. Today, the role of imports is significant in providing the domestic market with three types of goods: (i) products from the fuel and energy sector; (ii) investment goods (machinery and equipment); and, (iii) consumer goods. As for the first two categories, the shortage of domestic production is due to the fact that territorial distribution of production is irrational or even nonexistent. As for consumer goods, one factor is the fact that the country does not have enterprises capable of producing durable goods competitive with imports; another is the fact that light industry and the processing of raw materials for light industry have completely collapsed. The main characteristics of the condition and dynamics in foreign trade activity are evident in the statistical materials in the Appendix.

## **2.2 The Main Problems in Export Policy**

As already pointed out, the country has both significant natural resources and a production base, which allows it to expand its export potential by producing goods with a rather high degree of processing. However, in the next two years, it does not appear to be possible to make substantial changes in the export structure. Nevertheless, on the condition that the existing rates of production in the export sector persist and that the foreign business conditions remain favorable, the export potential during these two years is estimated to be on the level of US\$ 6.5 to 7.0 billion per annum. In the last months of 1995 and in early 1996, there was a tendency for the favorable foreign economic conditions for raw-material exports to deteriorate, even while domestic demand remained stable at a low level. One can see a decrease of production branches associated with the processing and finishing of raw materials (machinery, light industry, food-processing, and the timber and wood-processing industry), but also in construction materials (mainly because of the decreased demand for these products in allied industries). For a number of export goods, conditions have deteriorated on the world market; these include copper, iron-ore pellets, ferroalloys, cotton, wheat, and coal. At the beginning of the year, it proved only profitable to export oil, the products of oil refining, and zinc. Enterprises had not been able to use the time of high earnings from exports to reconstruct their production, to intensify the processing, and to cut costs.

Moreover, during the second quarter, the volume of output was reduced in the following areas: (i) extraction of natural gas and gas condensate at the joint-stock company "Karachaganakgazprom" because of limitations on the volume being processed at the Orenburg gas treatment plant; (ii) the extraction of coal at the state enterprise "Karshakhtugol" (because of equipment breakdowns and shortage of workers), at the joint-stock company "Ekibastuzkomu" (because of a strike that began on May 20, 1996), and the limited-liability partnership "Semeikomerleri" (because of the fall in demand due to the end of the heating season); (iii) production of rolled metal at the joint-stock company "Ispat-Karmet" (because of difficulties in selling products, which is due to the insolvency of the consumers); (iv) production of ferroalloys at the joint-stock company "Ferrokhrom" in Aktiubinsk Oblast (because of the lack of own working capital to pay for electric power from Russia); (v) production of motor vehicles dropped 2.4 times, trailers and semi-trailers by 1.4 times, and trolley buses by 5.7 times, even as produced altogether ceased in the case of small tractors, hay bailers, and trailers to distribute hay to cattle.

### ***Third Quarter of 1996: Forecasts***

#### ***Foreign Trade***

In the third quarter of 1996, in comparison with the first quarter of the year, it is expected that there will be an insignificant increase in foreign trade volume. It is estimated to be US\$ 3.0375 billion. The turnover with countries in the CIS will increase somewhat their share of the total volume (to 58.1 percent). This will result from the stable relations that underlay the delivery of oil and oil products, rolled stock of ferrous metals, and stabilization of the economic condition to Russia (Kazakhstan's main trade partner).

#### ***Exports***

The growth of exports slowed and even slightly declined in the second quarter of 1996. It amounted to US\$ 1.4812 billion, or 94.8 percent of the level in the previous quarter. The main reason for the decline was the fall in world prices on exported goods, it was also due to a certain contraction in the actual volume of exports. The market prospects for the main export goods appear to be as follows.

**Oil and Oil Products.** The situation on the world market for oil, once the embargo on Iraqi oil is lifted, will inevitably have an impact on the export prices of crude oil from Kazakhstan. Experts predict that the price on oil will drop by US\$ 1.00 to 1.50 per barrel. The greatest influence will be apparent in the area of the Mediterranean Sea; it will therefore directly impact oil exports from the Black Sea ports (through which Kazakhstan's oil is also shipped). Nevertheless, because the price on Kazakhstan's oil is still significantly lower than the world price, the decrease in average export prices will be proportionately smaller than the change in world markets. The situation with respect to markets for the products of oil refining is more stable. The harvesting of crops and an increase in business activity in industry will contribute to a stable demand for gasoline

and diesel fuel within the countries of Central Asia and Russia.

**Coal.** Seasonal fluctuations in the consumption of coal have led to a fall in price during the second quarter of 1996. But in the third quarter, as the heating season draws nearer, these prices will rise again. However, because the purchasing power is small, the increase in prices will be insignificant.

**Nonferrous Metals.** The conditions on the world market for nonferrous metals are unfavorable for Kazakhstan. Although experts had forecast a fall in the price of copper (because of the increased output in Chile, North America, and Indonesia), they did not expect such a rapid and substantial drop in prices. Experts believe that, in the immediate future, the price of copper could drop to US\$1,600 per ton (compared to the US\$2,540 per ton that prevailed on the London Metal Exchange during the first quarter of 1996). If one takes into account the fact that over 90 percent of the copper is exported to countries outside the CIS and that the prices are strongly corrected by world markets, the decrease in export earnings could be significant because of the fall in prices and the decrease in the physical volume of deliveries. The situation with respect to zinc is more stable. A small, floating increase in prices and the constant volume of exports since the beginning of the year make it possible to speak about stable, well-organized connections.

**Ferrous Metals.** An analysis of the indicators for the export of ferrous metals shows that Kazakhstan has constant partners both in the CIS and in other countries as well. During a recent two-month period, the geography of deliveries expanded. Nevertheless, the unrhythmic flow of operations in ferrous metallurgy (and, consequently, the real possibilities for a breakdown in deliveries) makes a precise forecast for the export of ferrous metals impossible. In the event that, at a minimum, production itself stabilizes at a steady level, one can expect an increase in the portfolio of orders, especially from the countries in the Asian region. While the consumption of metallurgical production has generally increased throughout the world, countries in the Asian region have had a higher rate of growth. But the depreciation of machinery and equipment, paralleled by a lack of investment in the reconstruction and technological retooling of enterprises, has gradually undermined the competitive potential of Kazakhstan's ferrous and nonferrous metallurgy. The effect has been to render this branch incapable of producing goods that satisfy world standards.

**Grain.** The price of grain on world commodity markets, which reached a peak in mid-May 1996, thereafter began to fall sharply. The reason lay in the fact that it became possible to make a more reliable forecast of the harvest prospects in the main cereal-growing regions of the world, and these forecasts proved to be rather optimistic. Because of the anticipated increase in area sown to cereal cultures in North America, Europe, and other regions, there was good reason to conclude that the world grain reserves—which had fallen because of poor harvests during the previous two years—would now increase. Moreover, the reserves held by sellers in Kazakhstan have fallen; as a result, by the end of the agricultural year, the physical volume of exports will correspondingly decrease. Given the fall in price and physical volume of exports, the republic must expect that the total earnings from grain sales will drop.

**Cotton.** The situation on the cotton market remains unclear. Experts predict various scenarios for the development of the cotton market. On the one hand, the

<sup>10</sup>On the new order for custom inspection prior to shipment, see below. section 2.3.

constantly increasing reserves of left-over cotton and the low demand for this commodity will of course not serve to raise prices. On the other hand, the low quality of cotton from South American sources (because of poor weather conditions) and the contraction of areas sown to cotton in many other regions (in particular, in Central Asia) have triggered a significant growth in the price of high-quality cotton. The final realistic prognoses will not become possible until the middle of the third quarter of 1996, when the situation with respect to the cotton harvest in the northern hemisphere becomes clear. The measures taken in Kazakhstan to improve the quality and certification of cotton give reason to hope that the prices on its cotton will rise.

### **Imports**

The imports of goods and services in the third quarter of 1996 are predicted to amount to US\$ 1.5563 billion, an increase of 8.1 percent. The share imported from the CIS states will decrease somewhat (from 57.4 percent in the second quarter to an estimated 56.8 percent in the third quarter), in absolute terms amounting to US\$ 884 million. Imports from non-CIS countries will rise to US\$ 672.3 million; that will represent an increase of 9.7 percent over the previous quarter. That increase is due primarily to the larger exports of machinery and equipment (both in terms of physical volume and the higher costs due the inspection of imports before shipment). The share of foodstuffs and finished goods remains high. The delivery of electric power and natural gas will increase slightly. The processing of imported Mongolian copper ore (with the output shared with the supplier) will remain on about the same level as it was in the second quarter.

For the whole period of January-September 1996 foreign trade will amount to US\$ 9.1 billion. That represents a 14.2 percent increase over the same period in 1995. Exports will rise by 27.5 percent and amount to US\$ 4.7 billion; imports will increase by 3.7 percent and reach the sum of US\$ 4.4 billion. One key factor inhibiting the growth of foreign trade for Kazakhstan is the fact that it has a closed continental geographic location and lacks direct access to sea routes. It also suffers from the underdeveloped state of highways. This fact is all the more important given the fact that the main export goods from Kazakhstan consist of large-tonnage freight. Nor can one overlook another factor: Kazakhstan does not have stable, long-term partners and buyers for strategic raw materials among countries outside the CIS. Thus, for example, the markets of Western countries impose certain quantitative limitations on Kazakhstan's commodities and goods (e.g., textiles and steel). It seems likely that this list will increase as the processes of integration proceed.

### **2.3 Tariff Regulations**

For purposes of achieving further liberalization of foreign economic activity and also a better coordination of customs tariff regulations (within the framework of the Customs Union), on March 12, 1996 the government published decree no. 298 "on the order for exporting and importing goods and services to the Republic of Kazakhstan." This decree made substantial changes in the existing order for foreign trade. In questions of export registration, it annulled those restrictions that excluded the registration of certain exchange transactions for export and, in the future, reduced the registration of the commodity exchange and contracts in the Ministry of Industry and Trade. Moreover, on

March 12, 1996 the government significantly reduced export duties (governmental decree no. 299). For example, it reduced the customs duties (per 1,000 kg.) on the exports of such goods as crude oil (from ECU 20 to ECU 10) and copper and copper products (from ECU 200 to ECU 100). The new laws also abolished duties on such goods as nickel tailings and scrap, wool, cotton, ferrous ores, nonferrous metals, and machinery equipment. As a result, the list of commodity categories subject to export duties dropped from 93 groups to 5.

However, in the opinion of experts from the International Kazakh Agro-Industrial Bank, the abolition of the registration of contracts for ferrous and nonferrous metals on the exchange has led to a fall in contract prices. The explanation, in their view, lies in the fact that the lack of export controls has resulted in deliveries at dumping prices. It has also caused violations in the preparation of contracts, which can lead to a decrease in the volume of exports as a whole. These experts attribute this to the fact that the customs service does not have sufficient funds and resources to ensure that qualified staff engage in the preparation of the contracts. In another decree of March 12, 1996 (no. 300), the government reduced the average import duties (from 7.5 to 5.3 percent) and the list of product groups subject to such duties (from 95 to 87 groups). The abolition of customs duties for such types of imported goods as ores and concentrates will contribute to increasing the load on the production capacities of the metallurgical complex. Moreover, the abolition of duties on imported machinery and equipment will stimulate the technical modernization of the primary branches of industry (mining, metallurgical, chemical, and construction industries).

The earlier customs tariff, excise duties, and VAT on imported motor vehicles significantly reduced the imports by juridical entities. The sales rooms of the leading firms began to cut back their work in Kazakhstan. All this led to a fall in tax revenues for the budget and a flood of old vehicles on the market. The introduction of the above degree will stimulate the import primarily of new vehicles, since the customs rate on vehicles over ten years old is 15 percent, whereas the rate for new ones is set at 2 percent. Previously, the rate had been 40 percent for old vehicles and 30 percent for new ones. The reduction in customs duties (and the total abolition for a large group of imported goods) will have a favorable impact on the development of foreign trade and promote more efficient operations of enterprises.

On May 28, 1996, the government adopted decree no. 654 "on the independent inspection of goods prior to outward shipment from the Republic of Kazakhstan." According to this decree, effective July 15, 1996, all organizations that engage in foreign economic activity and that export certain goods (metals, fertilizer, ferroalloys, flour, and other goods) must submit their shipments to a pre-shipping inspection. The government has announced a tender (with the participation of foreign companies) to determine who will carry out the state function of export control.

In our opinion, during the transition period the most effective structure for independent export inspection is the commodities exchange. As experience has demonstrated, open bids at commodity exchanges not only stimulated foreign trade transactions in 1995, but also made it possible for form objective prices on export goods and contributed to a fuller account of export transactions. The organization of work on

the commodity exchanges has also contributed to a reduction in the substantial gap between trade with CIS countries and the general level of world prices.

## **2.4 The Customs Union and Relations with the Countries of Central Asia**

On January 20, 1995 Kazakhstan, Russia, and Belarus signed the "Agreement on a Customs Union." Its purpose was to restore the disrupted productive ties and promote a general recovery of the economy in all the three countries. To achieve these goals, it is essential to fulfill a number of conditions: (i) achieve coordination in the conduct of economic reform and create the same type of economic mechanisms (based on market principles) to regulate the economy; (ii) provide equal opportunities and guarantees for all entities to engage in economic activities in the member states of the Customs Union; (iii) standardize their legislation on foreign trade, customs, hard currency and finances, taxation, and so forth; (iv) conduct a coordinated foreign economic policy toward third countries; (v) provide effective, joint protection of the member countries of the Customs Union. During the last year, from the day that Kazakhstan entered into the trilateral Customs Union, it abolished customs and non-customs restrictions on mutual trade. To be sure, it still does retain quota allocations with respect to fuel and energy as well as mineral resources; the trade in such goods is governed by special bilateral agreements. And the three countries also maintain the system of customs controls on their common borders. The first stage in the creation of the Customs Union was completed with the abolition of limits on mutual trade and the adoption of a single system to regulate foreign trade activity in the mutual relations of the three member states. The second stage proposes to standardize the tax system and hard-currency regulation and to proceed to the creation of transnational companies for production purposes (the so-called financial-industrial groups). At the same time, the agreement stipulated a strict schedule for implementation, but this has since been modified, with the due dates for implementation being set back.

There are also disagreements during the process of standardizing tax, customs, and other legislation. The first results of the unification of customs legislation and regulation of foreign economic activity showed that there have been some violations of the principle of observing a single order for conducting foreign economic activity. Russia, for example, inserted amendments to the rates of its customs duties without holding prior consultations with its partners in the Customs Union. Despite the presence of a single set of legislation, the three countries have different procedures for processing goods in customs zones and for dealing with the import of goods by individuals. These violations to the principle of a common customs legislation have resulted primarily from the adoption of decisions to make changes in the system of foreign-trade activities without the requisite consultation and coordination. The Russian side was forced to reestablish its former procedure for declaring sums in rubles, dollars, and in hard currency when goods cross its borders with Kazakhstan (effective July 1st, 1996). That is because the Kazakhstan side adopted a decree whereby all those who enter or leave the country may take up to US\$ 10,000. By contrast, the Russian norm allows a maximum of US\$ 500. In addition, under the pressure of the Kazakh side, it was decided to assess a duty on imported motor vehicles, which is unfavorable to Russian interests. The rates were subsequently reduced, because the Kazakh market had begun to be inundated with

old vehicles.

There are also contradictions in interests regarding the decision of Kazakhstan's government to transfer enterprises to foreign control, for this limits the opportunities for Russia to obtain cheap raw materials from Kazakhstan. Consequently, the agreement of the Customs Union can, to some degree, become a barrier to attracting foreign capital. That is why, for example, the government intends to sell part of the stock in "Kazakhrom" (Kazakhstan Chromium) to Russian enterprises and within the framework of these agreements. This will serve to stimulate the delivery of significant volumes of chromium ore for processing on Russian markets and, simultaneously, will ensure the uninterrupted delivery of electric power for the western oblasts in Kazakhstan.

As a result of these measures and the abolition of customs duties, the trade between Russia and Kazakhstan began to improve. That, in turn, led to a revival of industrial production. Thus, according to the available statistics, in 1995 foreign trade with the two states in the Customs Union (Russia and Belarus) increased over the previous year by 45 percent; simultaneously, foreign trade with other CIS countries that did not join the Customs Union fell by 4 percent. In 1995, when total trade (official customs data) amounted to US\$ 8.7165 billion, trade with Russia alone amounted to US\$ 3.9367 billion; that represented an increase of 45.8 percent from the previous year. Moreover, exports to Russia amounted to US\$ 2.1026 billion; hence Kazakhstan had a favorable balance of trade (US\$ 268.5 million). Trade with Belarus increased by 26.8 percent in 1995. In the first quarter of the year, trade with Russia rose by 132 percent over the same period in 1995; the turnover with Belarus also increased (17 percent). In addition to these factors, an important role in the development of commercial and economic cooperation between Russia and Kazakhstan is played by the complementary function of their economies and the mutually beneficial trade between the two partners. It should be emphasized that the trade with Russia, given the current circumstances, is advantageous for Kazakhstan. The bulk of its exports consists of heavy-tonnage freight, such as meat, grain, ores and concentrates, coal, ferrous metals, and polymers; it is therefore exceedingly important to reduce the shipping costs for these goods. The factor of high transportation costs is why some of these goods cannot be profitably shipped to countries outside the CIS.

At the same time, the noticeable expansion in trade with partners in the Customs Union is expressed in monetary terms even as the physical volume of exports falls and the physical volume of imports increases. The growth of exports, in other words, is explained by the increase in prices on these goods in comparison with the previous years. An analysis of the dynamics in mutual trade among the three countries for 1993—1995 shows a decrease in the role of exports to Russia as part of the total volume of exports to the CIS (see Table 3). That proportion has decreased from 55 percent in 1993 to 42.3 percent in 1995; the proportion of Belarus has decreased from 4.3 percent in 1993 to 2.1 percent in 1995.

**Table 3 Exports of Kazakhstan to the CIS, Russia, and Belarus, 1993-1995**

Recipient of exports	1993		1994		1995	
	Volume (US\$ million)	Percent	Volume (US\$ million)	Percent	Volume (US\$ million)	Percent
CIS (Total)	1886	100.0	1873	100.0	2801	100.0
Russia	1051	55.0	1439	44.5	2103	42.3
Belarus	82.5	4.3	44	2.3	57.5	2.1

The causes of the decrease in the share of exports received by the members of the Customs Union are well known. A significant part of the trade deliveries was eliminated as irrational and not economically justifiable. Another part of the inter-republic trade fell because these countries had a low level of purchasing power and because there was no reliable system for settling accounts and making payments. The contraction in export deliveries is also due to the differences in legislation with respect to imports, and it can also be explained by the fact that Russia introduced all kinds of restrictions on imports (in the form of registration requirements). However, the principal reason for the decreasing share of mutual trade was the significant difference in their economic mechanisms. This was essentially due to the discrepancies in the rate and character of economic reform being conducted in these three countries. The former mechanism of mutual deliveries was disrupted, but the transition to a new system proved to be fraught with great difficulties. Moreover, the rates of contraction in exports could have been even greater if Kazakhstan had not been dependent on the import of energy resources from Russia.

An analysis of the dynamics of exports for the production of capital goods for the last three years (see the tables in the Appendix) shows a further contraction in the export of oil and gas condensate to Russia (from 10,343,300 tons in 1993 to 6,834,600 tons in 1995). Similarly, the export of this same product to Belarus decreased no less dramatically (dropping from 95,000 tons in 1993 to 500 tons in 1995). There has also been a further decrease in the exports of coal, ferroalloys, zinc, lead, and copper; by 1995, these had fallen to about half of their volume in 1993. There has also been a contraction in the export of rolled ferrous metals to Russia (from 827,100 tons in 1993 to 243,300 tons in 1995) and to Belarus (from 106,000 tons in 1993 to 31,300 tons in 1995). Compared with 1993, in 1995 there was also a huge decrease in the export of zinc (10.5 times) and copper (14 times).

During the same period, there has also been an increase in the proportion of imports from Kazakhstan's partners in the Customs Union (see Table 4).

**Table 4 Imports to Kazakhstan from the CIS, Russia, and Belarus, 1993-1995**

Source of imports	1993		1994		1995	
	Volume (US\$ million)	Percent	Volume (US\$ million)	Percent	Volume (US\$ million)	Percent
CIS (Total)	2626.2	100.0	2108	100.0	2606.1	100.0
Russia	846.4	32.2	1262	59.8	1843.1	70.4
Belarus	36.3	1.3	64	3.0	79.4	3.0

Thus, if imports from Russia in 1993 amounted to 32.2 percent of the total imports

from CIS countries, by 1995 this had increased to 70.4 percent. Similarly, the share of imports from Belarus rose from 1.3 percent in 1993 to 3.0 percent in 1995.

An analysis of the import of capital goods from the countries in the Customs Union shows an increase in the shipments of gas and gas condensate from Russia (2.3 times), but a 15 percent decrease in the import of oil products in 1995 (with an absolute volume of 1,473,800 tons). There was also a significant decrease in the import of coal from Russia (from 4,543,800 tons to 730,000 tons). And while the import of rolled ferrous metals from Russia increased (by 20 percent), imports of the same good from Belarus dropped by 6.2 times. There was also a significant increase in the import of motor vehicles from both countries.

During the first quarter of 1996, the foreign trade turnover between Kazakhstan and its partners in the Customs Union was characterized by a certain stability. The Russian Federation accounted for 45.8 percent of the total volume of export-import transactions with all countries. Because exports continue to exceed imports, each month of trade with the Russian Federation left Kazakhstan with a favorable balance (US\$ 244.6 million, or 17.6 percent of the trade turnover with Russia). As in the previous year, the trade with Belarus left an unfavorable balance (US\$ 7.5 million, or 23.1 percent of the total trade turnover with Belarus). Therefore, the agreement for the Customs Union did lead to an increase in mutual trade among its three members. At the same time, it should be noted that the principal means to regulate relations between Kazakhstan and the CIS states is still at the bilateral level of agreements and cooperation. Their main advantage is the opportunity to coordinate in one packet of agreements the most diverse aspects of cooperation—from trade and customs and payments to joint protection of common borders.

The treaty signed on March 29, 1996 (between the Republic of Kazakhstan, the Russian Federation, the Republic of Belarus, and the Kyrgyz Republic) and the creation of joint organs to direct integration the same month were directed toward the preparation of a strategy for cooperation among the signatory states. The Inter-State Council is to determine the basic stages in its realization; the Integration Committee is to prepare the formation of a single economic space, which will provide for the efficient operation of a common market of goods and services. A program of top-priority goals has also been worked out to realize the Treaty of 1996. It provides for a strategy on the development of integration, i.e., an agreement on the main lines of policy and a schedule for economic reforms as well as the preparation of coordinated tax, customs, financial, and tax policies.

Based on the example of Belarus, Russia, and Kazakhstan, this process amounts to the preparation of a model for drawing the CIS states closer together during the first stage of development. Inter-state agreements have been signed between Kazakhstan and the Kyrgyz Republic, and also between Kazakhstan and the Republic of Moldova; these agreements provide for a régime of free trade (with some exceptions). For purposes of creating favorable conditions in mutual trade, the parties abolished the collection of import duties, but have retained export duties.

The emergence of a Central Asian union is due to the fact that there are common borders and a long history of economic ties. The government of Kazakhstan is also devoting significant attention to the question of integration with two Central Asian

countries—the Kyrgyz Republic and the Republic of Uzbekistan. A common economic space in these three states provides for a free movement of goods, services, capital, and labor; it should also entail a coordinated policy on credits, settling of accounts, budget, taxation, prices, customs, and hard currency. However, it should be noted that the Treaty on a Single Economic Space, for all practical purposes, is inoperative because of the lack of investment resources to finance projects foreseen in the Program. Hence many questions are not being positively resolved. The development of the three Central Asian states shows the following result: Kazakhstan, Kyrgyzstan, and Uzbekistan in 1995 advanced toward macroeconomic stabilization, which was marked by a slower rate of contraction in industrial production, by lower levels of inflation, and by a strengthening of their national currencies. A common pattern in all three states during 1995 was the substantial increase in their foreign trade. Furthermore, Kazakhstan and Uzbekistan had a favorable balance of trade.

At a meeting held on May 6, 1996 in Bishkek, the presidents of these three Central Asian countries noted that, during the last two years (when the Central Asian Union was created), they had confirmed the “Program of Economic Integration by the Year 2000” and the “List of Primary Investment Projects” (taking into account the top priorities for development in the economies of the participating states). The National Bank has begun the financing of individual projects foreseen in the Program of Economic Integration. At the meeting, a positive assessment was also given to the work of ministries, agencies, and businesses in advancing the integration of economies, creating joint-venture enterprises, and expanding cooperation.

At the same time, however, one must note that the formation of a normative juridical base for the creation of a single economic space is progressing slowly. Moreover, these three countries have not abolished the tariff regulations on trade between each other. Nor have they introduced a single order for non-tariff regulation or standardized their commercial ties with other countries. Another serious problem that remains is the need to provide mutual convertibility of national currencies. And there are a number of other unresolved problems, which are linked to the differences in customs and tax regulations. As a result, it has become essential to seek greater compatibility in customs duties, to cooperate in setting the rates on taxes and assessments, to harmonize customs legislation, and generally to create the legal, economic, and organizational foundations for the free movement of capital and labor as well for honest competition.

Together with the Central Asian Bank, the National Bank must yet prepare proposals to regulate hard currency and payment transactions between Kazakhstan, Kyrgyzstan, and Uzbekistan. The Executive Committee of the Inter-State Council must prepare measures to create a special economic zone on the border areas of these three countries. As for cooperation in the domain of production, the goal is to review the possibility of abolishing customs duties, taxes, excise duties, and quantitative limitations. At the same time, Kazakhstan faces the goal of eliminating its excessive dependence on the delivery of energy resources from neighboring countries. The main form of transportation for domestic and international shipping is the railroad system. Kazakhstan has three railroad junctions with Kyrgyzstan and Uzbekistan, but this network in Central Asia is a dead end, for it fails to interface with other lines abroad.

## 2.5 The Exchange Rate and Exports

In the summer of 1995, the pattern of possible fluctuations in the exchange rate of the tenge underwent a substantial change. Earlier, shortly after the introduction of the new national currency, there had been a marked tendency for the exchange rate to move (if at varying rates) in a single direction: downward. From the end of May 1995, however, the tenders showed periods when the tenge moved upward against the US dollar. As a result, from the middle of June 1995, there has been a major change in the dynamics of the exchange rate. In the beginning, until July 25, 1995 the tenge steadily rose in value; that resulted from a massive intervention by the National Bank, which bought hard currency and sometimes sold in small quantities. From July 27 to the end of August, there was a significant amplitude of fluctuation in the exchange rate. The rise in the exchange rate of the hard currency alternated with its fall. What were the factors behind this dynamic? The main cause was the increase in hard-currency earnings from exports at the same that imports were falling.

On the whole, for the first half of 1995, the net exports rose and this was precisely the main reason why the supply of foreign currency exceeded demand on the Kazakh Inter-Bank Hard-Currency Exchange. Income from the investments of foreign firms, which were given control of a number of large enterprises in Kazakhstan, also had an impact on the exchange rate. Moreover, this also showed immediately the inadequate capacity of the domestic foreign exchange market. The influx of loans to the government from international financial agencies and foreign banks cannot serve as the source for increasing the supply of hard currency, since the National Bank handles directly the conversion of these resources into the tenge. Therefore, foreign loans actually have the reverse effect, stimulating an increase in the domestic supply of tenge, not hard currency.

Nevertheless, in our view, the existing exchange rate is rather overvalued. According to our calculations, the exchange rate should be in the range of 120 to 134 tenge per dollar (given the necessary monetary instruments in circulation); a level of 130 to 150 tenge per dollar establishes parity with the purchasing power of the tenge. If one does not include the factor of the necessary emission and if one takes into account only the difference in the rates of inflation and the rate of increase in the value of the dollar, this yields an exchange rate of 95.45 to 99.75 tenge to the dollar.

However, the stabilization of the exchange rate last year, in general, had a positive influence on foreign trade and did not create a barrier to its growth. The costs of exporters were much lower than the value of exports; moreover, they did not have a great need for the national currency (with the exception of the obligatory payments to the budget and funds needed to cover their energy costs) since they do not depend on the domestic market. For their own needs, they purchase neither intermediate nor finished goods on the domestic market. The majority of exporter/commodity-producers of Kazakhstan deal either with the output of the mining industry, or the products from primary processing of ores. In turn, this is all explained either by the simple lack of domestic producers for the needed goods (e.g., machinery and equipment), or by the fact that domestic goods are not competitive. It became a standard practice for the controlling foreign firms and joint-venture enterprises to use food products from developing countries, i.e., to increase the imports of consumer goods and food products. In addition,

in the total volume of imports, the purchase of consumer goods for freely convertible currency was twice as large as the basic hard-currency expenditures to purchase fuel and energy and raw mineral resources.

It is interesting to note the fact that, alongside the national currency, foreign money continues to circulate on the domestic market in Kazakhstan. The majority of joint-venture enterprises and foreign firms, in their official reports, report only the turnover and wages in tenge. At the same time, however, the wages of their personnel are paid in freely convertible currency, which is not reported in official documents and hence not subject to any kinds of taxes. Thus, the supply of freely-convertible currency on the domestic market is increasing further through these unreported channels. The demand for freely convertible currency is supported, primarily, by the steady inflow of critical imports. For Kazakhstan, these critical imports include electricity and natural gas. In general, they make up the dollar component in imports from CIS countries. Thus, freely convertible currency is used to acquire 71 percent of the fuel and energy resources and mineral ores coming into the country; hard currency also pays for 68 percent of the food products and 46 percent of the machinery, equipment, instruments, and means of transportation. In trade with CIS countries, freely convertible currency is used to cover 41 percent of the total import operations; however, this indicator varies considerably—for example, being 99 percent for Turkmenistan, 58 percent for Uzbekistan, 68 percent for Kyrgyzstan, and 58 percent for Belarus.

At the present time, the existing exchange rate is not the principal factor regulating the volume of imports and exports. Thus, an analysis of 1995 and the first four months of 1996 showed that the largest deviation in the exchange rate came in March 1995 (+3.7 percent) and in August 1995 (-3.7 percent). At the same time, the exports in these months were as follows: exports decreased in March (-2.2 percent), despite the fall in the tenge, and the export increased in August (+17 percent), despite the rise in the tenge. The largest deviation in exports occurred in February 1995 (334.6 percent) and in October 1995 (-35.6 percent); these changes were the result of seasonal fluctuations in business activity, but also reflected the measures taken by the government to regulate foreign trade. For a number of years, one has regularly seen a decline in business activities in January. Hence export-import transactions at the beginning of each year have remained at a minimal level. The decrease of imports in April-June (compared with February-March), to a certain degree, could be caused by the costs of the VAT on imports, which was announced in April and took effect on July 1st, 1995.

As of July 20, 1995, the government also prohibited barter transactions in exports and imports. This rule applied to all businesses, all types of products and services, and all countries (whether in the CIS or not). The sole exception was to be barter transactions conducted directly between commodity producers within the CIS (decree of the Cabinet of Ministers, No. 984, on July 17, 1995). This decree should lead to a decrease in exports and an increase in imports, whereas, for a number of years, the country had had a favorable balance in barter deals.

The decrease of exports in October 1995 can be explained by the imposition of new export and import tariffs on October 1st, 1995 (decrees No. 1124 and 1125 of August 15, 1995 from the Cabinet of Ministers “on the rates of customs duties on exported

goods” and “on the customs duties on imported goods”). These decrees reduced the customs duties on exports, but increased the duties on imports (by 5 percent for about four-fifths of the entire list of goods). An increase of the customs duties on imported goods contributed to the fall in exports in October, since the export-import transactions (under the conditions of non-payment) often had the character of barter deals. Notwithstanding the fact that the presidential edict abolished barter operations after July 20, 1995, companies signed agreements on productive cooperation, or agreements for shared production (with one enterprise processing raw materials for a share of the final product), which were in effect barter deals.

Nor is there a correlation between the exchange rate and exports of copper. The explanation can only reside in the difference between world prices and the prices charged by domestic producers. A significant increase in the domestic price of copper in March was due to the simplification of the process for exporting goods abroad; it was also due to the fact that domestic consumers lacked the funds to purchase this commodity. As a result, it became more profitable to sell copper for export since prices abroad were higher than those at home. And because the transactions involving copper were conducted on the commodity exchanges in Kazakhstan, the increase in the domestic price of copper reflected the stable demand for this commodity on foreign markets.

At present, the price structure on the domestic market is far from the price proportions found on the world market. Simultaneously, one must take into account the fact that the extraction of oil and natural gas, as well as the production of other export goods, do not require such high expenditures as they do, for example, in Russia. This is because of a number of natural conditions. Nevertheless, at present the domestic price of oil and natural gas still has a tendency to rise to world levels. That is because a large proportion of the trade turnover is with Russia and, above all, for goods from the fuel and energy complex.

A calculation of the real exchange rates for 1995, based on the example of Russia (the country’s largest trade partner), made a comparison of the volume of prices by commodity producers of export goods (crude oil and refined copper). The study showed that, for both goods, the real exchange rate was below the nominal rate (13.42 per 1000 rubles): it amounted to 0.25 tenge per 1,000 rubles for crude oil and 0.32 tenge for copper, whereas the real exchange rate was higher in 1994 (0.36 tenge per 1,000 rubles). This shows that the prices of Russian commodity producers are growing at a faster rate than the prices of goods from Kazakhstan’s commodity producers. The reason for this lies in the fact that Kazakhstan has a relative advantage in the production of these goods. And so long as Kazakhstan does not have difficulty selling its traditional exports to Russia, it is possible that these goods will be re exported from Russia to other countries.

Therefore, the question of the advantages of stimulating exports through a devaluation of the national currency or through steps to ensure its relative stability—for the present—should be decided in favor of the latter. At the same time, a factor in stability in the national currency is its monopoly in the comprehensive development of trade turnover—not at all in a so-called free exchange for foreign currency. The resolution of the task of stabilizing the tenge and increasing its purchasing power demand that it be confirmed as the instrument for the payment within the country. It is necessary, as well,

to introduce an official exchange rate, which should be based on the real correlation between its purchasing power and that of the dollar. There can be no doubt that, if goods and services, the funds of privatized enterprises, natural resources, etc., begin to be acquired exclusively through the tenge (and not only by domestic, but also by foreign buyers), the tenge will be strengthened.

## **2.6 Foreign Economic and Foreign Trade Policies of the Republic of Kazakhstan**

Kazakhstan has the conditions that create favorable circumstances for the successful development of its foreign economic ties. These include political stability, abundant natural resources, a relatively well-developed industry and agriculture, a rather highly-skilled labor force, a network of economic ties with most members of the CIS, and rich recreational resources for the development of foreign tourism.

Among the basic factors that retard development of the foreign economic activity, especially during the transition period, are the following: (i) the crisis state of the economy, its structural distortions, and the disproportions in the development of the extractive and processing sectors; (ii) the insignificant share of goods (in virtually every branch of manufacturing) that have a high degree of processing, that are R&D-intensive, and that are competitive; (iii) the high proportion of machinery and equipment that is worn out and obsolescent, and the reliance upon backward, resource-intensive technologies; (iv) the landlocked continental geographic location and insufficient development of transportation links to the world market; (v) backwardness of the entire infrastructure for foreign economic activity; (vi) inadequate development of the legal basis and, in some cases, the deviations from the generally accepted norms of international law; (vii) the high proportion of remote and extremely backward regions, which suffer from serious ecological problems and other extreme conditions; (viii) the presence of regional and economic self-sufficiency in the use of export potential. In spite of the above negative factors, the president, the government, state organs, and individual companies have done a considerable amount of work to coordinate, develop, and improve foreign economic activities. There has been a steady increase in the number of states with which Kazakhstan has signed agreements for economic cooperation, for the development of trade, for mutual guarantees in the investment sphere, taxation, and so forth.

The foreign trade turnover has steadily increased. There has also been a growth in the volume of foreign direct investment. The country has been accepted for membership in a number of world and regional financial organizations. It is preparing to join analogous commercial organizations and associations. It is also conducting work to improve the legal framework for foreign economic activity and to bring this into line with the norms of international law. The primary goal of foreign-economic policy is to promote the achievement of strategic objectives. In the short term, that means stabilization of economic development, but in the future it includes several aims: stable economic growth, savings in aggregate costs of national production, efficient specialization of the economy, rationalization of its internal structure (through integration into the world economic order), and utilization of the advantages of an international division of labor.

The main criteria for the effectiveness of foreign-economic activity are two-fold: the achievement of stable growth in the GDP and an optimization of the balance of payments. To reach the main goal, the government proposes to resolve the following extended tasks: (i) increase the effectiveness of foreign trade activities; (ii) conduct a well-considered policy to attract foreign capital and to ensure its efficient utilization; (iii) establish effective controls over hard currency; (iv) provide for the country's economic security; (v) even out the conditions of economic activity in the different regions of the country; (vi) improve the system of institutions for the organization and conduct of foreign economic activities; (vii) create a system to provide trained personnel for foreign economic activities. The main principles in the formation of foreign economic policy are independence, openness, mutual benefit, effectiveness, durability of international economic ties, and identification of regional and national priorities in economic cooperation.

In expanding the geography of foreign ties, it is essential to determine regional and country priorities in foreign economic activities. These can be dictated by traditional partnerships with individual countries, by the opportunities for finding new sales markets, by regional interests, by the economic potential and stability of economic development in the partner countries, by the opportunities and willingness to invest in the economy of Kazakhstan, and by their foreign economic policy.

Taking the above factors into account, the following seems to be the most expedient course to follow: (i) preserve and expand the broad traditional cooperation with the CIS states, and establish a common economic and customs space with them on a bilateral and multilateral basis, with the first priority being given to ties with Russia, Belarus, and Ukraine; (ii) increase the integration with Kyrgyzstan and Uzbekistan, taking into account the prospects for the realization of the idea of their association in a Eurasian Union, as the most effective form for achieving multilateral cooperation and for using the potential of all these countries to resolve their common problems; (iii) develop relations with the United States, the European Union, expand bilateral cooperation with Germany, France, and Great Britain, and also enhance the economic ties with Austria, Italy, the Scandinavian countries, and the other European states; (iv) develop economic ties with the China, Japan, Korea, and other countries in the Asian-Pacific region; (v) expand cooperation with the countries of the Economic Cooperation Organization, South Asia, the Near and Middle East, and the Persian Gulf (taking into account the opportunities for Kazakhstan to gain access—through Turkey, Pakistan, and Iran—to the sea and world transportation lines). At the same time, this does not exclude or limit cooperation with other regions and countries on a mutually beneficial basis.

The export-import policy of Kazakhstan is based on the principles of improving the balance of trade, pursuing a consistent liberalization of foreign trade, and seeking to increase its effectiveness and develop export potential. That latter entails a steady improvement in the structure of exports and the rationalization of the volume and list of imported goods (so as to take into account the present economic situation and its main trade partners on the world market). At the present time, because of the existing structure of the economy, the export potential is determined mainly by the fuel, metallurgical, chemical, and agro-industrial complexes. Moreover, the export structure is dominated by raw materials and products from the primary stage of processing. In the

medium-term perspective, it will evidently not be possible to make substantial changes in the structure of exports. During this phase, the primary goal is to preserve and, insofar as possible, to expand the markets for the sale of traditional export goods under conditions of growing competition with other countries of the CIS and with non-CIS states as well.

An expansion in the volume and an improvement in the structure of exports during this period, when the exports of ferrous and nonferrous metals remain stable, can be based on the powerful potential of the oil and natural gas branch. This branch has immense reserves of hydrocarbon raw materials of world-level significance. The expansion can also come through some additional production in nonferrous metallurgy and the chemical industry, through the creation of trade opportunities for certain spheres of the defense industries (either independently or jointly with other CIS countries), through the increased export of scientific-technical goods, through an expansion of transportation services (transit), through engineering services, and through the development of foreign tourism. An important goal of this period is to identify additional opportunities to expand the list of exported goods by adding some new items to the traditional list. In the long-term perspective, the development of export potential is linked to realizing measures for a structural transformation of the economy. This will make it possible to shift to more fundamental changes in the list of exported goods and services.

For the development of the export potential and for an improvement in the structure of exported goods, a system is now being created to support and provide incentives for exporters and, especially, the producers of goods with a high degree of processing. These incentives include: (i) differentiated customs tariffs on raw materials and finished goods; (ii) preferential regimes for exports; (iii) subsidies and targeted credits to develop export industries; (iv) the formation of a system to insure exporters against risk; (v) top-priority allocation of state investments and foreign capital for the creation of an infrastructure of foreign economic activity; and, (vi) stimuli to channel foreign capital into the development of export-oriented industries.

An important role in the development of the export potential belongs to an improvement in the competitiveness of goods. This requires that the country do the following: (i) raise the quality standards to world levels, along with the introduction of a system of obligatory certification; (ii) expand the system to take into account the requests of specific consumers; (iii) conclude inter-state agreements; and, (iv) create associations, consortia, and other organizations of producers to provide for stability in the markets of individual goods.

Given the current market conditions for individual types and groups of products, top priority must be given to the preservation and expansion of the sales markets—above all, in the Asian-Pacific region, South Asia, and the Near and Middle East. The most important goal is to prepare, well in advance, markets for the new types of products (taking into account the changes in the goods structure of exports). It is essential to continue the policy of shifting trade to a long-term basis and, correspondingly, to reduce the role of individual, one-time transactions. It is also necessary to expand the sale of direct agreements and to reduce the volume of trade through intermediaries. Furthermore, it is important to create opportunities for direct access to world and

regional commodity exchanges. Finally, the member states of the CIS should also coordinate their export policies on individual groups of commodities.

In the import and export of goods involving flora and fauna, it is essential to observe rules established by the Conference on International Trade with respect to wild forms of endangered species of flora and fauna. The import policy must resolve the following goals: (i) reduce the hard-currency expenditures and improve the structure of imported goods; (ii) carry out a consistent liberalization of import transactions and increase the openness of the economy; (iii) free the economy from ties with a high degree of risk, i.e., ties that can be used as levers for political and economic pressure. In resolving these tasks, it is not expedient to orient the economy toward achieving complete import-substitution. That can have ruinous consequences, dooming the economy to technological backwardness and saddling it with high production costs and a rise in prices. In view of world experience, a more effective policy is one that is based on mutually beneficial cooperation, specialization, and a rational division of labor within the framework of the world economic system.

The scale and structure of imports should be based on the need to create a competitive environment and, thereby, to realize indirect pressure on producers for purposes of forcing them to lower the costs of production, to raise the quality of output, and to make these goods more competitive on domestic and foreign markets. The defense of our own commodity producers, through protectionist measures, is only permissible in exceptional instances. The above should be done through a flexible regulation of import by using primarily economic instruments, with a gradual liberalization of import transactions until one reaches the level generally accepted in world practice. Provision should also be made for stimuli and opportunities for outside producers to gain direct access to the domestic market. The top-priority goal is to realize a complex of measures to rationalize the structure of imports by using regimes of tariff and non-tariff regulation, by rejecting credits for projects that are not economically justified, and by denying state guarantees for foreign credits used to import goods (with the exception of critical imports). There should also be a reduction in the import of certain types of agricultural goods and simple consumer goods. But one should continue to purchase raw materials for light industry and food-processing, medicines, complex forms of household appliances, certain other consumer goods that have been traditionally imported (chiefly from CIS countries), and machinery and equipment. The country should increase the share of imports of "know-how," patents and licensing (as part of the complex of services to train personnel), technologies, and advanced equipment. The latter should include imports under the "turn-key" principle (either by foreign investors or with their participation).

In the short-term perspective, import policy should be oriented toward the following: (i) protect the domestic market from the import of goods that do not correspond to the country's needs for quality and do not serve its national interests; (ii) create privileges for the import of high-quality goods (including science and technology), which can ensure the technical and technological modernization of production; (iii) ensure the import of critical goods and in the needed volumes. An improvement in the structure of imports and exports can also be achieved through state regulation of the export of capital and the creation of joint-venture (or firms controlled by stock held

outside the country). Accordingly, this will stimulate the import of foreign capital, including from the CIS states, for similar goals. The creation of transnational financial-industrial groups and corporations can also play an important role.

One of the factors impeding the development of foreign economic activity (including the liberalization of exports and imports) is the sharp difference in the structure and level of world and domestic prices. This factor causes numerous problems: a decrease in the effectiveness of export-import transactions; violations in the customs regimes, price norms, and hard-currency regulation; and the use of dumping prices. All this leads to anti-dumping measures and undermines the authority of the country as an honest trading partner. Consequently, an important strategic goal is to achieve a gradual convergence in the structures of world and domestic prices. This is to be based on the real correlation of demand and supply on the domestic market. In this sphere, along with realizing measures for economic support of producers of export-oriented goods, it is possible to establish different types of associations of producers where the raw materials and finished goods are technologically linked with one another. The purpose is to reduce the cost of the basic raw materials and to offset the production costs by redistributing the income from exports. The export of goods should be realized on the basis of average world prices. Ever greater significance will accrue to the acquisition of indirect measures for the price regulation of exports. These include the use of payments for using mineral resources, rental payments, and so forth. At the same time, it is necessary to increase the control of state representatives in supervisory councils of joint-stock companies to monitor the results of foreign trade activities.

The liberalization of foreign trade demands the creation of an effective system of anti-dumping controls, which should take into account relevant world experience. In the matter of imports, price policy must aim at stimulating an influx of high-quality goods through non-state foreign-trade organizations. To do this, it is necessary to keep import duties as low as possible.

The state regulates foreign trade activities on the basis of legislation, which takes into account the economic interests of the country, the generally recognized principles and norms of international law, and the obligations it has already assumed in international agreements. The state also uses customs regulation (including tariffs and similar instruments) as well as other measures to protect the country's financial position and to support the optimal parameters in the current accounts of the balance of payments. A flexible tariff regulation is one of the basic economic regulators. It entails the establishment of a differentiated rate of duties on the various goods.

In the current situation, the import duties of Kazakhstan have primarily fiscal objectives. However, their level should not be so high as to prevent supplying the domestic market with high-quality goods and to impede the formation of a competitive environment. The policy on import tariffs should be coordinated with international practice and existing agreements (above all, the trilateral agreement of the "Customs Union" with Russia and Belarus). This is a precondition for Kazakhstan's entry into various international and trade organizations. In coordinating tariff policy with its international treaty obligations, the country must—as far as possible—follow a policy of abolishing or reducing to an absolute minimum the import duties on centralized, critical

products. This also includes the delivery of machinery and equipment, tools for automation, and all capital goods intended for the modernization of production in high-priority branches of industry. Tariff regulation of exports is a temporary, involuntary measure. It pursues not only fiscal goals, but also to contribute to the structural transformation of the economy, to improve the structure of exports, to guarantee economic security, and to prevent dumping. At the present time, tariff regulation of exports has been almost entirely abolished.

Measures of non-tariff regulation include the imposition of quantitative limits on exports and imports, and also the establishment of a state monopoly on exports and imports. The prohibitions and restrictions on the export and import of goods and services (including the rights to the products of intellectual work) can be established in compliance with the laws and international agreements, but as special exceptions. Such extraordinary circumstances, based on national interests, can include the following needs: (i) to protect public morality and safeguarding law and order; (ii) to protect the life and health of people, flora, fauna, and the environment as a whole; (iii) to preserve the cultural inheritance and cultural values from illegal exports, or transfer of property claims to these; (iv) to ensure national and economic security. As a rule, the redistribution of quotas and issue of licenses (for purposes of establishing quantitative limits on exports and imports) is done through competitive bidding or auctions. Preference in the right to quotas and licenses on the export of goods should be given to producers.

For purposes of protecting national interests, it is possible to establish a state monopoly on the export or import of certain types of goods (through the issue of licenses to ship such goods into or out of the country). The lists of such goods are to be determined exclusively through formal state law.

In cases where any goods are imported in such quantities or under conditions that inflict substantial harm to domestic producers of similar or competitive goods, it is possible—but within the parameters of generally recognized norms of international law—to adopt protective measures. These can the form of a special, higher customs duty or quantitative limits. The basis and procedure for adopting such measures are determined by law.

Goods imported to Kazakhstan should correspond to the technical, sanitary, and other standards and requirements that prevail in the country. They must also have the corresponding certification. The procedure for certification and quality control is regulated by law and other juridical acts.

The preservation and expansion of markets to sell Kazakh products demand an accelerated formation of the infrastructure for foreign economic activity. Above all, this concerns the transportation system. Given the existing branch structure of Kazakh production and exports (which are dominated by large-tonnage goods), the transportation factor is a serious barrier to finding new sales markets and to increasing the volumes of goods from the traditional list of Kazakhstan's exports. This barrier could be relatively quickly overcome by developing the production of competitive, small-tonnage goods (based on a more intensive processing of the initial raw materials). However, this task of structural transformation requires substantial expenditures and

time. As a result, while orienting toward a gradual and consistent realization of structural transformation, it is simultaneously necessary to take steps to solve the strategic task of creating opportunities for access to the sea and forming a rational network of international transportation links (above all, through pipelines). This presupposes, in particular, the creation and participation in work on a Trans-Asian and Asian-European international railway lines. For the same purpose it is also essential to arrange access to an international Asian highway as well as to create a road access to the seaport of Karachi (through Kashgar and Islamabad). It is also important to develop the port at Aktau, to design mixed shipping routes (including hauling freight through an integrated river-sea network), to construct international terminals at the juncture points of different types of transportation, and to build a system of oil pipelines to satisfy domestic needs as well as provide access to bulk-oil sea terminals.

As a result of the expansion in the volume of international trade and transportation cooperation, it would make sense to organize an international center for multiple modalities of shipping. It is also necessary to develop and improve the material and technical basis for all types of transportation that service foreign trade activities. This applies as well to the system and communications network that provides access to the world system of information. To increase the effectiveness of foreign trade activity, it is essential to create and develop such components of the infrastructure as exchanges, brokerages, and offices on the leading exchanges in the CIS and elsewhere. Needed too are trading houses and representatives in those countries that comprise the most important trade partners for Kazakhstan. Both foreign and domestic economic activities, as a whole, depend on the level of development in the banking, insurance, informational, consulting, and auditing services. These should be based on a system of state and private organizations, including those created with the participation of foreign partners.

Kazakhstan is a member of authoritative international organizations. These include the International Monetary Fund (IMF), the International Bank for Reconstruction and Development (and its subsidiaries), the European Bank for Reconstruction and Development, the Organization for Economic Cooperation and Development, and the Asian Development Bank. It is also expanding its cooperation with organizations in the system of the United Nations (United National Industrial Development Organization; the United Nations Conference on Trade and Development; the United Nations Environmental Protection; the United Nations Development Program, etc.) and other international organizations that deal with problems of ecology, public health, education, employment, labor migration, and so forth. The activity of Kazakhstan in regional economic organizations, such as the United Nations Economic and Social Commission for Asia and the Pacific Ocean and the Economic Cooperation Organization, will give some opportunities to reorient the economic ties of the republic and to expand the geography of its economic cooperation.

It is also very important to enter into international trading unions and associations, or at least to collaborate with them. One high priority is entry into the World Trade Organization; for this, above all, it is necessary to bring domestic legislation on foreign trade into compliance with the generally accepted norms of international law. The prospects are good for cooperation or membership (on mutually acceptable terms) in the Organization of Petroleum-Exporting Countries, in the council of copper exporting

countries, the association exporting countries of iron ore, and so forth.

The exchange rate of the national currency is an important instrument for conducting the economic policy of the state, for it is a powerful factor in activating and increasing the effectiveness of foreign economic activity. Its stability contributes to increasing the volumes of foreign trade and the influx of foreign capital; it can enable the country to achieve and sustain high, stable rates of economic growth and also to ensure the stability of prices. For purposes of ensuring the stability of the national currency under the conditions of a free hard-currency market, and strengthening the national currency, Kazakhstan proposes to improve the state regulation of foreign economic activity, but within the framework of consistent liberalization, development of a hard-currency market, and tightening currency controls. In selecting a policy and specific measures to regulate currency, the country must take into consideration the recommendations and terms set by the IMF and other international financial organizations of which it is a member. It uses their financial assistance to support the stability of the national currency.

Export-import controls are an important instruments for protecting vital state interests. Under conditions of liberalization in foreign trade, it is necessary to protect the security of the country and to safeguard its political, economic, and military interests as it conducts its foreign trade activities. It is also necessary to observe international agreements and conventions. For these purposes, there is a system of controls over military arms, military equipment and technology, and goods and technologies with multiple applications. There are also controls to restrict or prohibit the import and/or export of certain other goods. The list of goods and services subject to such controls is fixed by inventories and registers that have been promulgated through formal law.

The purpose of currency controls is to provide for the export of capital within limits and on terms that have been established by the law. The aim is to shield the monetary system from the influence of de stabilizing influences from outside.

All regions and enterprises are given equal conditions to conduct foreign economic activities within the limits established by law. Moreover, natural resources, which are the exclusive property of the state, as well as certain exported resources of all regions, are used above all to satisfy general national interests. An exception could be special economic zones, created for purposes of resolving economic, scientific-technical, and production problems of a region. Such zones must receive a special juridical status in the sphere of policies on finances, credit, hard currency, taxation, commodity exchange, and customs.

## **2.7 Trade Strategy and Membership in the World Trade Organization**

According to estimates prepared by the Ministry of Economics, the export potential is about US\$15 to 18 billion per year. In our opinion, however, this estimate is substantially inflated if one takes into account the real condition of world markets for particular categories of export products. In any event, at present the existing potential is being inadequately realized. However, large investments are required before the country will be able to achieve a substantial increase in the volume of its exports. A certain increase in the volume of foreign trade and an increase in its effectiveness could be

achieved if Kazakhstan were to join the World Trade Organization. And it is actively striving to do this. In early 1996, the country filed the requisite declaration, and in mid-year it submitted a "Memorandum on the Foreign Trade Régime of Kazakhstan." As a result, the strategy for trade policy in the immediate future is aimed at a further liberalization of foreign trade, but in combination with a moderate protectionism for domestic commodity producers (on the basis of principles espoused by the World Trade Organization). Non-tariff methods of regulation can be introduced in compliance with international treaties. But this should be done exclusively for purposes of ensuring legality and the military security of the state, international security, environmental protection, and preservation of the cultural, historical, and archaeological heritage. The country proposes to review its tariff policy and bring it into compliance with generally accepted norms in the world. It will conduct this work in cooperation with other members and participants of the Customs Union–Belarus and Russia, who have also set for themselves the goal of joining the World Trade Organization.

## Appendix;

**Table A.1 Most important economic indicators (as percentage of previous year)**

Indicator	1991	1992	1993	1994	1995	1996*
Gross domestic product (as percent of previous year)	88.2	87.0	87.1	74.6	91.1	100.1
Industrial production (as percent of previous year)	99.1	86.2	85.2	71.5	92.1	100.2
Gross output of agriculture (as percent of previous year)	89.6	100.8	94.8	80.0	79.0	85.5
Gross capital formation (as percent of previous year)	98.0	53.0	61.0	39.0	83.0	58.8
Retail trade turnover in comparable prices (as percent of previous year)	80.3	66.6	83.0	47.0	91.0	122.3
Budget deficit as percent of GDP	11.5	9.1	1.4	2.2	4.0	2.3
Proportion of population with income above the subsistence minimum	60.0	68.0	49.0	55.0	n.a.	n.a.
Officially registered unemployed (thousands)	4.0	33.7	40.5	70.1	139.6	244.4**

\*January-June 1996 to corresponding period of 1995

\*\*at end of June 1996

**Table A.2 Gross domestic product of the republic of kazakhstan, 1994-1996**

Indicator	1992	1993	1994	1995	1996*
Nominal GDP in current prices (billions of tenge)	1,119.6**	14.9	449.9	992.5	561.1
GDP in comparable prices:					
1993	17.2	14.9	11.2	10.2	n.a.
1995	1,678.6	1,460.4	1,089.5	992.5	421.4***
Average size of population (million)	16.9	16.9	16.8	16.6	16.5

\*January-June

\*\*GNP in billion rubles

\*\*\*In prices for first half of 1995

**Table A.3 Basic results of economic performance in the first half of 1996 and 1995**

Indicator	1996/1995	1995/1994
Gross domestic product	100.1	81.5
Industrial production	100.1	84.1
Gross output of agriculture	85.5	81.0
Capital investment from all sources	58.8	59.0
Retail trade turnover	122.3	46.0
Nominal average wage (June/previous December)	89.0	105.4
Real average wage (June/previous December)	80.1	n.a.
Unemployment rate (officially registered as percent of economically active at end of year)	3.6	1.2
Revenues to state budget (as percent of GDP)	18.0	20.4
Budget deficit (as percent of GDP)	2.3	2.0
Consumer price index (as percent of preceding December)	116.8	132.4
Producer price index (as percent of preceding December)	111.8	138.4

\*First half of year as percentage of same period in previous year

**Table A.4 Average exchange rate of tenge (per US Dollar)**

Month	1993	1994	1995	1996
January		9.28	55.69	64.61
February		11.50	58.98	65.38
March		16.95	60.51	65.15
April		25.43	62.29	65.83
May		37.68	63.12	66.81
June		42.06	63.51	66.95
July		44.92	62.20	67.02
August		45.77	57.25	
September		47.11	60.23	
October		48.68	61.91	
November		51.11	63.40	
December	5.9	53.61	63.88	
Yearly average		38.37	61.04	

Source: Kazakh Interbank Exchange

**Table A.5 Interest rates for centralized credit resources**

1994		1995		1996	
Date	Terms	Date	Terms	Date	Terms
1.3	300%	1.1	210% (6 months)	3.1	59%
1.9	280%		176% (3 months)	23.2	50%
20.9	270%		152% (1 month)	11.3	48%
5.11	250%	15.2	190% (6 months)	1.6	36%
5.12	230%		158% (3 months)	8.7	32%
			141% (1 month)	6.9	30%
		9.3	170% (6 months)		
			144% (3 months)		
			130% (1 month)		
		24.3	150% (6 months)		
			129% (3 months)		
			117% (1 month)		
		5.4	120% (6 months)		
			106% (3 months)		
			98% (1 month)		
		3.5	95% (6 months)		
			86% (3 months)		
			80% (1 month)		
		1.6	75% (6 months)		
			69% (3 months)		
			65% (1 month)		
		1.7	55%		
		1.9	45%		
		20.1	52.50%		

Source: Informational Biulleten Ministerstva Finansov

**Table A.6. Volume of industrial production (in percentage of previous year)**

Branch	1991	1992	1993	1994	1995	1996*
Electric power	99.1	93.9	97.2	85.6	98.1	95.9
Fuels	102.5	93.6	86.7	86.2	87.7	105.6
Ferrous metallurgy	106.2	91.2	76.9	70.0	117.4	83.3
Nonferrous metallurgy	94.3	92.7	93.4	74.3	101.9	110.5
Chemical industry	94.9	69.7	55.1	59.1	103.4	76.1
Machinery and metallurgy	102.4	83.5	82.4	56.8	67.1	86.3
Timber, Wood-processing, cellulose-paper	102.7	86.2	79.5	61.5	55.0	100.1
Construction materials	101.3	80.8	68.2	44.9	68.7	68.4
Light industry	102.5	80.0	87.5	44.1	40.2	99.1
Food-processing	93.3	70.8	82.2	74.1	79.3	121.9
All branches	99.1	85.2	83.9	71.5	92.1	100.2

\*January-June 1996 compared to the same period in 1995

Source: State Statistics Bureau (including household production sector)

**Table A.7 Proportional share of individual branches in total industrial output (as percentage of sector of non-finance corporations)**

Branch	1991	1992	1993	1994	1995	1996*
Total industrial output	100	100	100	100	100	100
Extractive branch	10.6	19.7	16.8	23.5	28	n.a.
Manufacturing	89.4	80.3	83.2	76.5	72	n.a.
Individual Branches						
Fuel and energy complex	12.3	28.8	33.1	40.8	44.6	42.6
Electric power	5.0	9.3	17.7	18.9	19.7	16.8
Oil and natural gas	4.4	12.6	9.9	13.0	16.8	n.a.
Coal	2.9	6.9	5.5	8.9	8.2	n.a.
Metallurgical complex	14.1	27.7	22.7	23.9	28.3	25.3
Ferrous metallurgy	5.5	10.7	10.0	11.9	15.1	12.1
Nonferrous metallurgy	8.6	17.0	12.7	12.0	13.2	13.2
Chemical and petrochemical	6.0	7.6	3.7	3.7	3.3	3.7
Machinery	11.0	8.5	10.2	7.3	5.2	7.5
Light industry	17.0	6.4	5.9	3.8	2.8	2.5
Food-processing	21.2	9.7	10.9	9.9	6.8	8.4

\*Data for January-June 1996

**Table A.8 Physical volume of industrial production, January-June 1996**

Branch	Index of physical volume of production (in percent)					
	Sector of non-financial corporations, including household production			Sector of non-financial corporations only		
	July 1996/ June 1996	July 1996/ July 1995	Jan-June 1996/ Jan-June 1995	July 1996/ June 1996	July 1996/... July 1995	Jan.- June 1996/... Jan.- June 1995
All branches	101.6	100	100.1	101.2	89.4	93.4
Electric and thermal power	97.4	82.2	94.6	97.4	82.2	94.6
incl.: electricity	96.9	80.5	92.7	96.9	80.5	92.7
thermal power	100.4	93.9	100.3	100.4	93.9	100.3
Fuel industry	105.9	105.2	105.6	100.9	105.2	105.6
incl.:oil drilling	103.4	109.7	114.4	103.4	109.7	114.4
oil refining	100.9	116.3	109.4	100.9	116.3	109.4
natural gas	104.9	78.4	94.6	104.9	78.4	94.6
coal	119.1	90.7	94.4	119.1	90.7	94.4
Ferrous metallurgy	104.9	74.6	82.1	104.9	74.6	82.1
Nonferrous metallurgy	95.3	103.6	109.8	95.3	103.6	109.8
Chemical and petrochemicals	79.8	74.6	75.9	79.8	74.6	75.9
Machinery and metallurgy	145.7	141.1	93.0	145.7	141.1	93.0
Timber, Wood-processing, Cellulose-paper	81.2	106.8	100.8	77.1	77.0	85.7
Construction materials	106.3	79.9	85.2	106.3	77.7	68.4
Light industry	71.7	156.9	104.2	62.4	122.0	87.8
Food-processing	104.1	137.9	123.2	103.4	78.8	78.8
Milling and animal feed	118.1	91.6	88.3	118.9	78.6	81.9

**Table A.9 Production of most important producer goods, January-July 1996**

Branch	Absolute production		As percent of same period, 1995	
	July	Jan.-July	July	Jan.-July
<b>Fuel and energy complex</b>				
Electric power (million kW/h)	3,387.0	36,050.0	80.5	92.7
Oil and condensate (thousands of tons)	1,877.7	12,690.7	105.7	111.0
Natural gas (million of cubic meters)	459.8	3,573.9	102.8	105.5
Coal (thousands of tons)	5,586.0	47,309.0	99.6	102.6
Gasoline (thousands of tons)	192.0	1,390.8	130.4	119.0
Diesel fuel (thousands of tons)	298.5	1,932.3	115.2	106.0
<b>Metallurgy</b>				
Refined gold (kg.)	879.0	6214.0	99.3	98.9
Silver (kg.)	24,728.0	239,357.0	105.5	108.7
Refined copper (tons)	24,728.0	175,623.0	116.9	126.7
Lead (tons)	6,507.0	38,587.0	99.1	63.8
Titanium (sponge; in tons)	1,010.0	6,750.0	126.3	132.9
Zinc (tons)	13,613.0	95,632.0	114.3	94.1
Iron ore (commercial; thousands of tons)	1,165.0	8,158.6	100.3	94.4
Pig iron (gross output; thousands of tons)	223.5	1,557.4	103.4	99.6
Steel (tons)	303,393.0	1,967,369.0	116.5	103.6
Finished rolled steel (tons)	12,359.0	84,912.0	89.3	89.6
Tin plate (tons)	12,359.0	84,912.0	89.3	66.5
Ferroalloys (tons)	33,545.0	324,061.0	54.5	89.7
<b>Chemical industry</b>				
Sulfuric acid in monohydrate (thousands of tons)	52.5	401.3	89.0	98.2
Chromic oxide (tons)	391.0	3,856.0	81.3	79.4
Yellow phosphorous (tons)	1,955.0	12,202.0	32.3	49.3
Mineral fertilizers (pure nutrients; thousands of tons)	13.2	119.8	76.7	113.4
Synthetic resin and plastics (tons)	5,152.0	27,958.0	533.9	80.5
Tires for agricultural machinery (thousands)	18.9	48.5		59.2

**Table A.10 Aggregate data on foreign trade (in US\$ million)**

Indicator	1992	1993	1994	1995	1996*
Total Foreign Trade Turnover	7,924.4	9,524.9	6,724.6	8,716.5	2,636.5
Exports	4,196.7	4,823.9	3,230.7	4,974.4	1,652.2
including:to CIS	2,707.7	3,323.9	1,905.3	2,631.5	937.6
to non-CIS countries	1,489.0	1,500.0	1,325.4	2,342.9	714.6
Imports	3,727.7	4,701.0	3,493.9	3,742.1	984.3
including:from CIS	3,138.7	3,753.0	2,139.8	2,569.8	743.9
from non-CIS countries	589.0	948.0	1,354.1	1,72.3	240.4
Balance	469.0	122.9	-263.2	1,232.3	667.9

\*For January-March 1996

**Table A.11 Foreign trade in the economy of Kazakhstan, 1993-95 (in US\$ million)\***

	1993			1994			1995			Jan-June 1996	
	Vol.	% of GDP	% of prior year	Vol.	% of GDP	% of prior year	Vol.	% of GDP	% of prior year	Vol.	% of GDP
Foreign trade turnover	7,852.0	75.3	95.3	7,475.0	54.9	95.2	10886.0	67.2	145.6	5,213.0	52.3
Exports	3,323.0	31.9	93.3	3,285.0	24.1	98.9	5,109.0	31.5	155.5		
Exports (customs)	3,277.0			3,224.0			4,954.9			1,652.0	32.8
To non-CIS states	1,437.0	13.8	96.5	1,327.0	9.7	92.3	2,175.4	13.4	163.9		
To CIS states	1,886.0	18.1	91.0	1,958.0	14.4	103.8	2,933.6	18.1	149.8		
Imports	4,528.0	43.4	96.8	4,189.0	30.8	92.5	5,776.9	35.6	137.9		
Imports (customs)	3,686.0			2,788.0			3,742.2			984.3	19.5
To non-CIS states	1,902.1	18.2	125.1	1,756.0	12.9	92.3	2,623.7	16.2	149.4		
To CIS states	2,626.0	25.2	83.1	2,433.0	17.9	92.3	3,153.2	19.5	129.6		
Net trade	-1,205.0	11.5	107.9	-903.0	6.7	75.0	-667.9	4.1	74.0		

Source: Data on Balance of Payments, State Statics Bureau, Republic of Kazakhstan

**Table A.12 Share of exports in the volume of production of most important products, 1996 (in percentage)**

Good	Jan.	Jan.-Feb.	Jan.-Mar.	Jan.-Apr.	Jan.-May
Iron ore and concentrates	0.0	32.1	31.4	30.3	31.3
Ferroalloys	68.3	51.0	85.1	84.0	90.7
Rolled ferrous metal	51.1	61.9	69.7	67.4	81.4
Copper	109.8	123.6	102.3	103.3	105.4
Oil and gas condensate	58.4	69.1	56.4	64.1	58.8
Zinc and zinc alloys	100.0	101.6	95.1	82.9	90.4
Lead	0.0	0.0	0.0	83.3	81.6
Natural gas	83.0	72.3	63.4	57.9	52.1
Iron-ore pellets	116.9	202.5	169.4	134.1	127.2

**Table A.13 Share of exports in the volume of production of most important products, 1996 (by month, percentage)**

Product	Jan.	Feb.	Mar.	Apr.	May
Iron ore and concentrates	n.a.	66.3	30.5	26.8	35.1
Ferroalloys	68.3	30.1	181.2	77.3	146.4
Rolled ferrous metals	51.1	78.1	85.7	60.4	149.2
Copper	109.8	137.8	64.2	106.4	112.9
Coal	n.a.	49.9	52.2	96.3	29.1
Oil and gas condensate	58.4	80.4	32.7	86.6	39.0
Zinc and zinc alloys	100.0	103.2	83.3	46.6	115.3
Lead	n.a.	n.a.	n.a.	366.7	75.4
Natural gas	83.0	60.4	45.9	41.5	25.1
Iron-ore pellets	116.9	303.1	111.9	49.1	105.3

**Table A.14 Regional profile of basic indicators of foreign trade**

Region	Jun-96		January-June 1996	
	Millions of US dollars	% of May 1996	Millions of US dollars	% of Jan.-June 1995
Countries in the CIS				
Trade turnover	501.6	109	3,223.2	154
Exports	252.8	105	1,754.6	164
Imports	248.8	114	1,468.6	143
Balance	4.0		286.0	
Countries outside the CIS				
Trade turnover	317.5	82	1,989.9	124
Exports	208.3	68	1,476.6	148
Imports	109.2	130	513.3	84
Balance	99.1		963.3	

**Table A.15 Foreign trade turnover by country, January-June 1996 (in US\$ million)**

Country	Exports	Imports	% of Total	
			Exports	Imports
Total	3,231.2	1,981.9	100.0	100.0
Non-CIS Countries: Total	1,476.7	513.3	45.7	25.9
Great Britain	124.6	29.9	3.9	1.5
Germany	113.5	64.1	3.5	3.2
Italy	96.2	21.0	3.0	1.1
China	276.8	14.7	8.6	0.7
Netherlands	219.2	18.5	6.8	0.9
United States	15.6	23.2	0.5	1.2
Turkey	27.0	49.4	0.8	2.5
Switzerland	119.9	16.1	3.7	0.8
South Korea	98.4	27.4	3.0	1.4
CIS Countries: Total	1,754.5	1,468.6	54.3	74.1
Belarus	24.7	54.3	0.8	2.7
Kyrgyzstan	51.9	34.6	1.6	1.7
Russia	1,479.8	1,132.4	45.8	57.1
Turkmenistan	18.6	140.2	0.6	7.1
Uzbekistan	95.3	35.2	2.9	1.8
Ukraine	43.0	44.3	1.3	2.2

**Table A.16 Exports of most important goods and major partners January-June 1996, (US\$ million)**

Goods and partner	Total	Including		
		For non-convertible currency	For freely convertible currency	Barter
Total	3231.2	931.8	1947.7	224.3
Grain	238.8	103.2	120.4	12.2
CIS states total	219.3	101.0	103.1	12.2
Belarus	15.1	3.2	11.5	0.3
Kyrgyzstan	4.7	1.3	3.4	
Russia	166.6	89.5	62.7	14.4
Tajikistan	11.7	3.1	8.6	
Turkmenistan	2.6	0.5	2.1	
Uzbekistan	15.7	2.2	13.5	
Non-CIS states total	19.5	2.2	17.3	
China	0.3	0.3		
Estonia	2.9	0.3	2.6	
Latvia	1.8	1.0	0.8	
Lithuania	1.3	0.8	0.5	
Saudi Arabia	11.4		11.4	
Ores, slags, and ash	85.2	43.4	17.4	24.4
CIS states total	77.5	42.6	11.2	24.4
Russia	75.5	41.5	10.5	23.8
Uzbekistan	1.7	1.0	0.6	
Non-CIS states total	7.6	0.8	6.8	
Switzerland	5.0		5.0	
United States	1.3		1.3	
Fossil fuels, petroleum, and products from their processing	994.5	285.7	593.6	105.4
CIS states total	616.8	285.7	219.0	105.4
Georgia	8.6		8.6	
Kyrgyzstan	25.7	4.2	21.3	0.4
Russia	537.2	276.5	156.0	104.4
Tajikistan	6.2	2.4	3.8	
Ukraine	34.4	0.4	33.3	0.7
Uzbekistan	3.8	1.5	2.3	
Non-CIS states total	377.7	0.3	377.4	
Virgin Is. (UK)	3.3		3.3	
Bulgaria	4.8		4.8	
Finland	15.8		15.8	
Germany	31.4		31.4	
Ireland	12.6		12.6	
Liechtenstein	1.7		1.7	
Lithuania	75.6		75.6	

**Table A.16 Cont.**

Poland	1.5		1.5	
Sweden	2.5		2.5	
Switzerland	113.4		113.4	
Great Britain	113.0		113.0	
Products of inorganic chemistry; compounds of organic and inorganic precious and rare-earth metals; radioactive elements	221.8	52.9	142.4	26.5
CIS states total	185.6	52.6	114.1	18.9
Belarus	2.3	1.7	0.6	
Russia	172.1	43.6	103.7	9.6
Ukraine	3.0	1.1	0.5	1.3
Uzbekistan	6.9	5.1	0.8	0.5
Non-CIS states total	36.2	0.3	28.3	7.6
Belgium	2.1		2.1	
Czech Republic	9.4		4.8	4.6
Germany	2.1		1.8	0.3
Hungary	4.0		2.6	1.4
Japan	1.4		1.4	
Republic of Korea	1.8		1.8	
Malta	1.1		1.1	
Poland	2.8		2.1	0.7
Great Britain	2.0		2.0	
United States	3.4		3.4	
Mineral fertilizer	26.6	0.5	20.3	5.8
CIS states total	1.3	0.4	0.9	
Kyrgyzstan	0.7		0.7	
Russia	0.5	0.4	0.1	
Non-CIS states total	25.3	0.1	19.4	5.8
China	25.0		19.2	5.8
Cotton	68.3	1.3	66.8	0.2
CIS states total	20.3	0.8	19.3	0.1
Russia	19.6	0.8	18.7	0.1
Non-CIS states total	48.0	0.5	47.5	
Austria	7.5		7.5	
Bahamas	4.7		4.7	
China	9.4	0.2	9.1	0.1
Taiwan	1.2		1.2	
Czech Republic	3.8		3.8	
France	1.3		1.3	
Latvia	2.3		2.3	
Poland	3.1		3.1	
United Arab Emirates	3.7		3.7	

**Table A.16 Cont.**

Turkey	3.0	0.1	2.9	
Great Britain	2.9		2.9	
Ferrous metals	564.4	138.3	417.7	8.4
CIS states total	165.8	129.8	27.9	8.1
Belarus	2.2	1.0	0.9	0.3
Kyrgyzstan	1.4	0.8	0.6	
Russia	156.2	125.9	22.6	7.7
Turkmenistan	1.0	0.2	0.8	
Uzbekistan	4.2	1.0	3.1	0.1
Non-CIS states total	398.6	8.5	389.8	0.3
China	207.2	7.3	199.6	0.3
Taiwan	13.7		13.7	
Estonia	1.8		1.8	
Hong Kong	3.0		3.0	
Iran	15.1	0.5	14.6	
Japan	15.3		15.3	
Republic of Korea	2.8		2.8	
Latvia	1.8		1.8	
Lithuania	7.4	0.1	7.3	
Malaysia	2.8		2.8	
Monaco	23.0		23.0	
Netherlands	69.3		69.3	
Pakistan	1.3	0.3	1.0	
Philippines	4.5		4.5	
Thailand	12.0		12.0	
Turkey	8.9		8.9	
Egypt	1.4		1.4	
United States	2.4		2.4	
Copper and copper products	378.9	4.4	288.3	7.8
CIS states total	13.2	4.2	1.2	7.6
Kyrgyzstan	1.6	0.1	0.1	1.4
Russia	11.0	4.1	1.1	5.8
Non-CIS states total	365.6	0.2	365.2	0.2
Germany	69.9		69.9	
Ireland	4.6		4.6	
Italy	94.0		94.0	
Republic of Korea	82.7	0.1	82.6	
Netherlands	111.8		111.7	0.1
Lead and lead products	21.6	9.4	11.9	0.3
CIS states total	15.3	9.4	5.6	0.3
Russia	15.3	9.4	5.6	0.3
Non-CIS states total	6.3		6.3	

**Table A.16 Cont.**

Netherlands	1.6		1.6	
Sweden	4.4		4.4	
Zinc and zinc products	67.3	5.4	60.6	1.2
CIS states total	9.2	5.2	3.0	1.0
Russia	8.2	5.2	3.0	1.0
Non-CIS states total	58.1	0.2	57.7	0.2
Finland	11.8		11.6	0.2
Iran	2.1	0.2	1.9	
Japan	3.8		3.8	
Republic of Korea	10.3		10.3	
Netherlands	21.2		21.2	
Slovakia	1.9		1.9	
Turkey	5.9		5.9	
Reactors, boilers, machinery and mechanical adapters, spare parts	64.3	49.8	11.3	3.3
CIS states total	62.2	49.6	9.6	3.0
Russia	55.8	44.5	7.7	2.8
Ukraine	1.0	0.8	0.2	
Uzbekistan	4.1	3.0	0.9	0.2

**Table A.17 Share of exports in total output of most important products, 1995  
(cumulative totals , in thousands of tons)**

Product	January-June			January-December		
	Volume of Output	Exports	Export as Percent of Output	Volume of Output	Exports	Export as Percent of Output
Rolled ferrous metal	1,241.1	963.4	77.6	2100.0	1,694.0	80.7
Copper	117.5	95.8	81.5	255.6	216.6	84.7
Coal	40,400.0	5,015.7	12.4	83,200.0	12,950.8	15.6
Oil and gas condensate	9,641.5	3,826.2	39.7	20,500.0	11,249.5	54.9
Wheat	n.a.	1,223.2	n.a.	9,514.0	2,485.6	26.1
Zinc and zinc alloys	89.7	73.5	81.9	169.2	149.7	87.3
Lead	53.9	29.5	54.7	88.5	n.a.	n.a.

**Table A.18 Export deliveries in January-June 1996**

Good	Unit	CIS states			Non-CIS states		
		Volume	Value (mill. US\$)	As percent of total exports to CIS	Volume	Value (mill. US\$)	As percent of total exports to non-CIS states
Iron ore and concentrate	thous. tons	2,063.4	58.2	3.3	32.6	0.8	0.1
Bituminous coal	thous. tons	19,350.0	310.5	17.7	35.4	0.6	0.04
Oil and gas condensate	thous. tons	2,996.6	217.5	12.4	3,201.0	318.7	21.6
Products of oil refining	thous. tons	401.0	46.7	2.7	680.0	57.1	3.9
Natural gas	mill. meter <sup>3</sup>	1,487.5	23.6	1.4			
Alumina	thous. tons	584.4	106.4	6.1			
Cotton fiber	thous. tons	12.1	18.2	0.0	31.8	46.5	3.2
Ferroalloys	thous. tons	29.7	13.6	0.8	244.0	112.3	7.6
Iron-ore pellets	thous. tons	3,064.2	108.3	6.2	224.0	7.3	0.5
Rolled ferrous metals, incl. tin plate	thous. tons	68.7	34.3	2.0	926.0	269.8	18.3
Refined copper and alloys	thous. tons	3.1	5.0	0.3	147.0	352.8	23.9
Zinc (unprocessed)	thous. tons	6.8	7.4	0.4	62.3	58.1	3.9
Lead (unprocessed)	thous. tons	19.7	15.2	0.9	8.1	6.3	0.4

**Table A.19 Structure of exports to non-CIS states, 1991-1995 (in percentage)**

Good	1991	1992	1993	1994	1995
Fuels, unprocessed mineral resources, metals	54.3	78.5	72.7	73.8	84.4
Chemical products	16.1	16.7	6.9	10.9	6.1
Machinery and equipment	1.3	1.9	2.8	4.2	1.8
Construction materials and parts	0.2	0.0	0.0	0.6	0.1
Non-foodstuffs (raw materials and processed goods)	25.0	1.7	1.8	0.6	1.6
Raw materials for the production of foodstuffs	0.9	0.5	0.6	4.8	1.6
Foodstuffs	1.8	0.6	11.9	1.4	0.3
Industrial consumer goods	0.4	0.0	3.0	3.2	4.0
Other	-	0.1	0.3	0.5	0.1
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

**Table A.20 Foreign capital in the Republic of Kazakhstan (US\$ million)**

Type	Total (from 1993 to 1995)	Amount Per Year		
		1993	1994	1995
Direct investment	2,633.4	1,271.4	638.7	723.3
Trade credits-total	1,250.1	384.0	490.0	376.1
Long- and medium-term credits (used)	1,205.3	384.0	490.0	331.3
Short-term credits (used)	44.8	n.a.	n.a.	44.8
Loans of international financial organizations-total	1,890.1	499.0	522.3	848.8
<b>Total</b>	<b>4934.3</b>	<b>1743.55</b>	<b>1663.65</b>	<b>1527.1</b>

Source: National Bank of the Republic of Kazakhstan

**Table A.21 ODA to the Republic of Kazakhstan (1 January 1996)**

Type	Source	Amount of credit		Amount used (million US\$)	
		In granted currency		Million US dollars	
Multilateral financial assistance	Total			1,477.7	817.92
	IMF	433.1 million SDR		640.9	430.43
	IBRD			556.8	300.83
	EBRD	100 million ECU		120.0	22.98
	Asian Development Bank			160.0	63.68
Bilateral financial assistance	Total			408.0	232.87
	Eximbank of Japan	41.3 billion yen		400.0	224.87
	Austria			5.0	5.00
	Sweden			3.0	3.00
<b>TOTAL</b>				<b>1,885.79</b>	<b>1,050.79</b>

Source: National Bank of the Republic of Kazakhstan

**Table A.22 Exports and imports of most important goods, 1994**

Good	Non-CIS states	CIS states	Share of total exports (percent)
<b>Exports</b>			
Oil (thousands of tons)	2,827.8	6,765.9	17.0
Coal (thousands of tons)	396.6	19,350.7	10.0
Rolled ferrous metals (thousands of tons)	542.0	928.8	10.0
Copper (thousands of tons)	211.4	86.0	13.0
Zinc (thousands of tons)	106.1	26.9	3.0
Ferroalloys (thousands of tons)	285.0	157.0	5.0
Aluminum oxide (thousands of tons)	7.3	587.3	4.0
Wheat (thousands of tons)	40.1	2,394.8	2.0
<b>Imports</b>			
Sugar, including raw sugar (thousands of tons)	101.2	72.9	2.0
Clothing and footwear (millions of dollars)	36.5	125.4	5.0
Medicines (tons)	2,716.2	1,148.5	2.0
Fuel oil (thousands of tons)	-	1,564.5	1.0
Electric motors and generators (thousands of units)	11.4	95.4	3.0
Automobiles (units)	3,636.0	15,152.0	4.0

**Table A.23 Accounts payable and receivable per sector (1 July, 1996)**

Sector	Receivables	Payables	Excess of payables over receivables	
			Total	As percent of receivables
Industry	242	555	313	129.3
Agriculture	18	120	102	566.7
Transportation	42	42	-	-
Communications	8	3	-5	-62.5
Construction	51	54	3	5.9
Trade	12	29	17	141.7
Other	127	135	8	6.3
<b>TOTAL</b>	<b>500</b>	<b>938</b>	<b>438</b>	<b>87.6</b>

**Table A.24 Delinquent indebtedness per sector, 1996 (billions of tenge)**

Sector	Delinquent bills payable	Tax arrears	Debts for goods and services	Debt to the financial sector
On 1 January 1996				
Industry	194.0	37.0	107.0	12.0
Agriculture	70.9	4.5	38.9	9.9
Transportation	32.8	9.1	15.0	1.7
Communications	12.2	3.1	5.6	0.0
Construction	0.8	0.1	0.2	0.2
Trade	5.6	0.2	2.9	1.2
Other	51.9	1.9	34.2	2.0
<b>Total</b>	<b>368.2</b>	<b>55.9</b>	<b>203.8</b>	<b>27.0</b>
On 1 July 1996				
Industry	225.0	49.0	123.0	
Agriculture	101.0	49.0	128.0	
Transportation	28.0	6.0	12.0	
Communications	1.0	n.a.	n.a.	
Construction	42.0	14.0	18.0	
Trade	8.0		6.0	
Other	69.0	4.0	49.0	
<b>Total</b>	<b>474.0</b>	<b>80.0</b>	<b>270.0</b>	

Source: State Statistics Bureau

**Table A.25 Producer price index, July 1996 (in percentage)**

Branch	July 1996 as percent of June 1996	July 1996 as percent of December 1995
Electric power	102.6	120.4
Fuels	100.8	112.4
Ferrous metallurgy	97.9	96.0
Nonferrous metallurgy	93.0	101.1
Chemical industry	99.8	115.2
Machine-building	100.4	123.5
Timber, wood-processing, cellulose-paper	99.8	105.0
Construction materials	99.0	115.9
Light industry	102.6	105.9
Food-processing	100.7	117.9
All industrial branches	99.7	111.4

**Table A.26 Basic indicators of exports per country, January-June 1996 (thousands of US dollars)**

Country	Trade turnover	Exports	Percent of total exports
Country/CIS countries -total	3,223,162.0	1754561.9	54.3
Azerbaijan	227,891.7	4,350.7	0.1
Armenia	197.2	53.7	0.0
Belarus	78,940.3	24,656.3	0.8
Georgia	10,788.5	9,543.3	0.3
Kyrgyzstan	86,421.4	51,855.8	1.6
Moldova	5,982.8	412.6	0.0
Russian Federation	2,612,252.3	1,479,824.1	45.8
Tajikistan	29,270.2	27,028.1	0.8
Turkmenistan	158,839.9	18,596.3	0.6
Uzbekistan	130,421.8	95,251.7	2.9
Ukraine	87,255.9	42,989.3	1.3
Non-CIS countries-total	1,989,956.5	1,476,659.2	45.7
Europe	1,221,830.4	920,588.0	28.5
Austria	18,278.8	10,580.1	0.3
Belgium	9,571.3	2,350.3	0.1
Bulgaria	10,813.8	6,579.5	0.2
Great Britain	154,499.9	124,641.8	3.9
Hungary	19,458.1	7,795.2	0.2
Germany	177,521.9	113,459.4	3.5
Greece	5,270.9	493.1	0.0
Ireland	21,836.1	17,749.0	0.5
Spain	2,123.5	616.5	0.0
Italy	117,161.7	96,169.8	3.0
Latvia	10,691.9	7,369.1	0.2
Lithuania	98,649.6	85,236.2	2.6
Liechtenstein	2,585.8	1,887.4	0.1
Malta	1,060.5	1,055.7	0.0
Monaco	23,019.9	23,019.9	0.7
Netherlands	237,658.0	219,207.3	6.8
Poland	25,754.5	10,417.6	0.3
Portugal	241.4	61.6	0.0
Rumania	2,585.7	440.1	0.0
San Marino	25.4	25.4	0.0
Slovakia	9,543.3	3,713.8	0.1
Finland	72,454.3	40,573.5	1.3
France	15,106.1	1,832.0	0.1
Czech Republic	22,620.8	13,369.9	0.4
Switzerland	136,026.6	119,894.5	3.7
Estonia	10,130.8	4,987.9	0.2
Sweden	12,798.8	7,161.4	0.2

**Table A.26 Cont.**

ASIA	691,599.4	526,300.5	16.3
Macao (Aomen)	346.3	346.3	0.0
Afghanistan	2,093.2	2,087.3	0.1
Bahrain	10.2	10.2	0.0
Israel	10,000.2	192.7	0.0
India	8,251.3	126.7	0.0
Indonesia	855.7	162.9	0.0
Jordan	51.3	34.9	0.0
Iran	29,557.8	25,736.7	0.8
Yemen	49.1	49.1	0.0
Qatar	276.3	146.1	0.0
Cyprus	2,319.6	1,195.1	0.0
China	291,503.5	276,772.4	8.6
Korean People's Democratic Republic	482.0	289.0	0.0
Kuwait	16.0	16.0	0.0
Lebanon	370.9	278.7	0.0
Malaysia	4,624.7	2,800.9	0.1
Maldives	24.1	24.1	0.0
TOTAL	5,213,118.5	3,231,221.1	100.0

# 3

## **AGRICULTURAL REFORM AND THE DEVELOPMENT OF AGRO-INDUSTRY IN THE REPUBLIC OF KAZAKHSTAN**

**A. F. Deberdev**

## Introduction

The transition to a market economy and the renunciation of state control over the agro-industrial complex took place in the absence of a free entrepreneurial environment and a well-developed infrastructure. And all this unfolded in the midst of profound economic crisis: (i) a decrease in the production of foodstuffs; (ii) a growth in the deficit; (iii) a contraction of supply and demand; and, (iv) a lowering of the nutritional standards for the general population. The formal, inconsistent conduct of agrarian reform and the disregard for the interests and peculiar features of agricultural producers have led not to the expected revival of the agrarian sector, but to its degradation. The mutual relations between agricultural producers and the processing industry, and also the ties with other partners in the foodstuffs market (both domestic and abroad), have become strained and difficult. This in turn caused a contraction in the delivery of commodities, raw materials, supplies, and equipment. It has also led to the disruption of ties and to the problem of chronic non-payment and arrears.

The share of agriculture in the GDP fell from 21 percent in 1991 to 11 percent in 1995. The rate of growth in per capita income lagged 2.5 to 3.0 times behind the rate of price increase on foodstuffs. Approximately 65 percent of the inhabitants have an income below the average income and have shifted to a diet of bread, potatoes, and whole milk.

Despite the edicts of the president, the decrees and directives of the government, and the various programs launched to revive the agrarian sector of the economy, the efforts have not yielded the desired results. The main underlying factor is the failure to prepare the mechanisms to reform the agrarian sector. This chapter offers an analysis of the course of the market reforms in agriculture and in those branches of industry that process agricultural commodities. It also examines the problems that have arisen and the ways to resolve them. More importantly, it highlights the instruments needed to form a system of agro-business in Kazakhstan.

## 1. The Contemporary Development of the Agrarian Sector

### 1.1 The Agricultural Sector since the Onset of Reform

In recent years, agriculture in Kazakhstan has undergone radical changes, which were provoked by the transition to a market economy. The agrarian transformations have brought about various new forms of economic organization such as property rights and shares. The goal was to enable them to engage in independent agricultural production. They have also acquired the right to dispose of their products and income as they see fit, as well as to establish their own prices on these goods. However, conducted against the background of a decline in the economy, the agrarian reform has not yielded positive results. As noted above, its proportional share in the GDP has fallen from 21 percent (1991) to 11 percent (1995).

An agrarian transformation in the country has been blocked by a host of negative factors. These include the instability of production and economic ties, galloping inflation, the higher cost of credit, the budget deficit, and the reduction in state financing. These changes all occurred at a time when the sector itself had far fewer resources, which was due to the reduced purchasing power of the consumers of agricultural products and further aggravated by the increase in non-payments between enterprises. Other negative factors include the low competitiveness of these products on world markets and the impact of inadequate,

contradictory legislation. A substantial deficiency in the conduct of agrarian reform is the lack of preliminary scientific analysis and practical on-going oversight to monitor the key factors in the agrarian policy. If such preparation had been conducted, it is entirely possible that, instead of the radical transformation, the government would have adopted a more modest “program for the adaptation of agriculture to market conditions,” as was done in Germany, when it had to deal with the former German Democratic Republic.

The sharp deterioration of conditions in the agrarian sector has been aggravated by a host of administrative errors. These include a penchant for hastiness, a lack of careful consideration in conducting privatization and denationalization, and frequently the use of coercion. And all this took place amidst the collapse of the older system for purchasing agricultural products and for supplying that sector with materials and equipment. In effect, agriculture was left to fend for its own survival, as the government ignored the essential problems, interests, and special features of this branch of the economy.

Although the reforms have proclaimed the right of market freedom, as well as the equality of all actors in the marketplace, but they failed to create the conditions and instruments to realize these rights and freedoms. Negative consequences ensued for agriculture when the prices on industrial goods were liberalized, but the state grain procurements and price controls remained in place with respect to the prices on the products of animal husbandry. As a result, the country has squandered the opportunity to make a painless transition from the command-administrative system to one based on the market. The situation has been further aggravated by the lack of legal and normative measures aimed at the reform of agriculture. In the final analysis, the attempt to resolve the problem of agrarian reform essentially amounted to nothing more than a change in the form of property ownership. Moreover, the reformers apparently thought that the process would spontaneously proceed on its own. The results of the agrarian reform are graphically apparent from the data on the development of the agrarian sector (see Table 1).

**Table 1 Indicators of the development of agriculture in the Republic of Kazakhstan**

Indicator	1991	1992	1993	1994	1995
Agriculture's share in GDP (percent)	21.0	18.0	24.0	18.0	11.4
Gross production of agriculture (as percent of previous year)	89.6	100.8	94.8	82.9	79.0
Proportion of enterprises operating at a loss (percent)	12.0	-	50.0	62.0	80.0
Profitability of agricultural production (percent)	34.2	-	-2.4	-9.0	20.7
Production of grain (thousands of tons)	11992.0	29772.0	21631.0	16454.0	9514.0

Source: Data of the State Statistics Bureau of the Republic of Kazakhstan

The sluggish performance as shown in Table 1, to a significant degree, has been caused by the violations of agro-technical rules for the cultivation of crops as well as the veterinary requirements for the raising of livestock.

## 1.2 Factors Causing the Current Conditions in Agriculture

The ill-conceived privatization and allocation of land and property shares resulted in a disruption of the planting cycles, and this in turn has triggered a decrease in productivity. Specifically, as measured in yields (centners per hectare) have fallen for grain (by 2 to 3

centners), sugar beets (by 100 to 120 centners), cotton (by 5 to 7 centners), and potatoes (by 50 to 80 centners). The difficult financial position of agricultural producers has meant that, for the last four to five years, they have acquired virtually no new machinery and equipment. The result has been a decrease in the absolute size of the machinery park. Thus, on January 1, 1995 (compared to previous year), this sector reported a decrease in tractors (8 percent), grain harvesters (18.5 percent), reapers (12.3 percent), grain planters (55.0 percent), and maize planters (26 percent). In 1994, the coefficient for the retirement of tractors of all types (excluding motorized equipment) was 15.7 percent, compared to a renewal rate of 1.6 percent. The corresponding figures for harvesters were 17.5 percent and 0.7 percent for withdrawn from service and renewal, respectively. Besides, the energy capacities fell by 15 percent in 1994. Thus, there has been virtually no renewal in the tractor and harvester park, and, that in turn means an increase the number of worn-out machinery. Nevertheless, for lack of resources, the number of machines receiving a capital overhaul has decreased. In 1994, compared with the previous year, there was a decrease in the number of capital repairs on tractors (34 percent) and harvesters (20 percent). Meanwhile, the number of short-term repairs increased sharply for both tractors (67 percent) and harvesters (45 percent). The State Statistics Bureau does not provide data on the supply of spare parts for agricultural machinery in 1994, but the previous year it reported that the supply of various parts ranged from 2 to 10 percent of real demand. As a result, most of the spare parts used for repairs must come from equipment that has been written off and cannibalized. That of course means that the time span for effective, repair-free service is short, and this will significantly increase the expenditures for the production of agricultural goods.

The fertility of the soil has also been declining. Given a demand for approximately 4.0 million tons of mineral fertilizer (if the nutrient requirements are to be fully met), in 1993 only 226,300 tons were used. According to calculations, this means a replacement rate of only 9 percent for the nutrients taken away by the crops. In 1994, the volume of mineral fertilizers dropped still lower (to 71,600 tons), meaning that only 3 percent of the nutrients were replaced. The cumulative effects of fertilizers used in 1986-1990 (approximately 1 million tons per year) have been exhausted. Hence the most important law of agronomy is being violated: the yield of a crop is determined by that particular nutrient which is present in the smallest amount. Thus the soils, especially in northern Kazakhstan, have little phosphor, which determines the level of agricultural productivity. The reason is that the lack of phosphor makes it impossible for the plant to use the natural reserves of potassium and nitrogen. This in turn causes a lower protein level in the grain and hence results in inferior quality.

Furthermore, mineral fertilizers help to establish a balance in the plant's needs for different nutrients. Thus, in the case of maize, the ratio of nitrogen, phosphor, and potassium should normally be 1: 0.6 : 0.4. In 1994, however, it was 1 : 0.41 : 0.145. The same discrepancies appear in the case of sugar beets (not 1 : 0.9 : 0.6, but 1: 0.52 : 0.145), rice (not 1 : 0.5 : 0.4, but 1: 0.7 : 0.007), and cotton (not 1: 1.1 : 0.4, but 1: 0.25 : 0.005). Because of the higher price of fuel and lubricants, as well as the unsatisfactory condition of equipment, for all practical purposes there has also been no application of organic fertilizers. Thus, compared to a demand of 124 million tons of manure, the amount applied was only 11 million tons in 1993 and 5.2 million tons in 1994.

The violation of crop rotation cycles and agro-technical requirements on the growth of vegetation has led to the spread of weeds, diseases, and pests. But there are virtually no means

to protect the plants other than herbicides, of which only 3 percent of the required quantity is available. The system for the change, development, and cultivation of new varieties has also been demolished.

The area sown to cultivation has also been reduced. Thus, in 1994, this area amounted to 31.7 million hectares (compared to 34.9 million hectares in 1990). In 1995, the cultivated area was 28.6 million hectares (an 18 percent decrease from 1990). The reduction has been particularly pronounced in the case of grain and fodder crops.

The contraction in cultivated area is proceeding in a spontaneous fashion. Thus, in our opinion, the reduction of grain cultivation is due to the lack of fuels and lubricants as well as to various organizational factors. This is confirmed by the results of more detailed analysis. In a number of oblasts, cereals are cultivated on land that yields less than five centners per hectare. Such cultivation is found in Aktiubinsk (586,000 ha.), Karaganda (402,000 hectares), Pavlodar (614,000 hectares), Semipalatinsk (412,000 hectares), and Torgai oblasts (174,000 hectares). By contrast, in Kustanai and Kokshetau oblasts, the cultivation of cereals is reduced regardless of the level of productivity.

There is also a persisting tendency for the production of potatoes, vegetables, and cucurbits to decrease. Thus, in 1995 (compared to the previous year), there was a decrease in the production of potatoes (11.2 percent), vegetables (3.3 percent), and cucurbits (19.9 percent). To be sure, the production of fruits and berries increased by 17.6 percent, but if one factors in the cyclicity, the output in 1994 was actually 40.6 percent lower than in 1992. A distinctive feature in the production of these products is the increasing proportion that is produced by individual household plots. Thus, as a share of total output, the latter produced 79 percent of the potatoes in 1995 (compared to 73.6 percent in 1994) and 63.8 percent of the vegetables (compared to 60.8 percent in 1994). Despite the increase in the share produced by individual household plots, in 1995 total production fell for both potatoes (2.7 percent) and cucurbits (22.3 percent). Only the production of vegetables increased (1.4 percent) over the previous year. To a significant degree, the contraction in production was due to the peasant farms, which showed a decrease in the production of potatoes (77.2 percent), vegetables (60.8 percent), and cucurbits (78.8 percent).

A substantial role in the agricultural production of Kazakhstan has always belonged to irrigated cultivation. Irrigated lands occupy slightly more than one percent of the agricultural land area, but account for approximately 30 percent of the crop production. On January 1, 1995, irrigated lands amounted to 2.2 million hectares. Despite the fact that on January 1, 1995 (compared to January 1, 1993) the area of irrigated land had been maintained (with a 1.4 percent increase), the production of goods in 1994 had sharply decreased from the levels reached in 1992. That is true in the case of grain (42 percent), including maize (34 percent), rice (38 percent), sugar beets (60 percent), raw cotton (16 percent), vegetables (45 percent), and fodder crops (38 percent). All this was the result of the sharp deterioration in the maintenance of irrigated lands, the decrease in the quantity of watering equipment and personnel, and the worsening of agro-technical cultivation of crops. At the present level of expenditures, agricultural enterprises cannot conduct land improvement projects and support the existing system of irrigation in proper working order. The reconstituted agricultural enterprises, peasant farms, cooperatives, and other organizations cannot conduct this work for lack of funds. The credit policy of the state also fails to contribute to a resolution of this problem. The

destruction of hydraulic system means that the irrigated land turns back into unirrigated land, a phenomenon that makes absolutely no sense from the state's point of view.

First, approximately 80 percent of the irrigated land is in arid or semi-arid zones, where agriculture is simply impossible without irrigation. Furthermore, the decline of agricultural production from irrigated land will lead to a growth in unemployment among the rural population. Second, this will lead to a decrease in the production of vegetables, potatoes, cucurbits, fodder, and fruits. The production of cotton, sugar beets, and tobacco will be reduced to a minimum. Third, the complex of agricultural machinery and equipment on enterprises with irrigated cultivation will go unused; to embark on a new specialization, however, it would be necessary to acquire new machinery, buildings, etc. Thus, to maintain agricultural production on irrigated lands and to develop the irrigated cultivation of crops, it is necessary to provide state support. Otherwise, the system of irrigation will simply disintegrate, leading to a further deterioration of conditions in agriculture.

Negative tendencies also continue to accumulate in animal husbandry, as reflected in a sharp contraction in the number of livestock. Thus, in 1994 (compared to 1992), the country registered a decrease in the number of cattle (by 16 percent), hogs (33 percent), sheep and goats (27 percent), fowl (45 percent), and horses (2 percent). A distinctive feature in this decrease is the fact that the rate of decrease has been accelerating. Thus, as the rate of decline intensified from 1992 to 1994 in the case of cattle (from 0.2 to 11.7 percent), hogs (from 12.9 to 18.8 percent), sheep and goats (0.4 to 26.5 percent), and fowl (from 12 to 34 percent). In 1995 the decrease in the number of livestock continued. Thus, in January-November 1995 (compared with the same period in 1994), there was a decrease in the number of cattle (17 percent), hogs (28 percent), sheep and goats (24 percent), poultry (40 percent), and horses (8 percent). Particularly drastic effects might have the reduction in the number of cows, which commenced in 1994 and continued in 1995. Nevertheless, under these conditions, the raising of horses and camels is proceeding on an extensive basis. In 1994, however, the number of horses and camels began to decrease. In our opinion, that is due the fact that unemployment in rural areas increased and those working were not receiving their wages. The effect was to force the population to sell its livestock.

The intensifying crisis in animal husbandry contributes to a deterioration in the conditions for the reproduction of livestock. Another factor was the sharp rise in the price of feed grain, which in turn caused the collapse of the animal feed industry. Still another factor is the contraction in the market, which itself results from the decline in the purchasing power of the population. Above all, one must note the deterioration in the fodder and feed base. The production of raw and wet fodder (converted to equivalents in hay) decreased 46.6 percent between 1991 and 1994. The decrease amounted to 58.6 percent on arable lands and 41 percent on natural resources. The production of animal feed decreased from 4 million tons to 1.4 million tons, and that production continues to decline. This is leading to a contraction in the poultry and hog-raising industries.

Violations of the proper fodder rations, disregard of the requirements, drastic contractions in veterinary care—all this has led to an increase in pestilence and sharp decrease in productivity. Thus, in 1994, each 100 head of livestock yielded only 67 calves, 876 pigs, and 78 lambs and goats. In 1994, pestilence killed 336,600 cattle, 586,300 hogs, 5.3 million sheep and goats, and 100,000 horses. The average live weight of livestock at the time of slaughter has also

decreased; in 1994, it stood at 275 kilogram for cattle, 86 kilogram for hogs, and 32 kilogram for sheep and goats.

The situation with respect to selective breeding, which is intended to raise the productivity of livestock, has become particularly unfavorable. If in 1990 enterprises sold 106,000 head of pedigree cattle, in 1994 this had fallen to just 3,400 head; the corresponding figures for thoroughbred horses were 2,500 head in 1990 and 500 head in 1994. Because of the sharp increase in the price of liquid nitrogen, fuels, and lubricants, the price of artificial insemination has risen many times over. As a result, many farming operations have ceased to conclude contracts and to arrange insemination from pedigreed bulls and rams. Instead, livestock farms rely on non-pedigree insemination, which leads to a decline in the productivity of the livestock.

Ruin too has beset the scientific-research institute for poultry-raising (the only such institution in Central Asia). That also holds true for its experimental farm, which is creating new breeds of birds. The breakdown in the selective breeding program, together with the loss of the genetic bank of birds, is wreaking irreparable harm to the economy. Hence the current condition of animal husbandry will lead to serious consequences, and it will require ten to fifteen years to overcome the damage.

As to the restructuring of agriculture, it would seem—at first glance—that a multiplicity of economic formations has indeed been established. Thus, by early 1996, there were 30,700 peasant farms, 390 collective farms, 3,134 agricultural associations (as cooperatives, partnerships, and joint-stock companies), 1,405 state enterprises, and 571 other agricultural forms. 1,292,024 families are engaged in the individual or collective cultivation of household plots or gardens. Such plots occupy only 0.05 percent of all agricultural land. The remainder belongs to peasant farms (4.3 percent), collective farms (6.6 percent), agricultural cooperatives (0.5 percent), small enterprises (1.5 percent), other non-state agricultural enterprises (53.9 percent), and state agricultural enterprises (33.1 percent). The latter includes collective farms of all types (28.3 percent). The amount of agricultural land allotted to each type of land utilization sharply varies. Although the average amount is 135.6 hectares, it ranges wildly: 0.075 hectares in plots tilled by individual households, 341 hectares for peasant farms, 28,746 hectares for collective farms, 3,977 hectares for agricultural cooperatives, 4,127 hectares for small agricultural enterprises, and 21,887 ha. for state agricultural enterprises. The non-state agricultural enterprises include approximately 1,200 collectives. These were founded on the basis of collective farms that had existed previously.

In 1992-1994, 2,404 agricultural enterprises were privatized (of which 514 were privatized in 1992). However, it is impossible to draw any conclusion about the economic efficiency of these reformed enterprises. Only in 1994, for the first time, were data compiled separately for collective farms, privatized entities (including all collective farms), mixed enterprises, and agricultural enterprises. An analysis of their work shows that a number of indicators (per unit production costs; yields; productivity) are better in privatized enterprises than in collective farms. However, this does not in the least demonstrate that the former are more productive, since this category of privatized enterprises includes collective farms that, previously, had been more efficient and productive than state farms.

Many mistakes were also committed during the process of privatizing agricultural enterprises. The objective of privatization, in the final analysis, was to dismantle large

enterprises or to reduce their size. The establishment of land shares (based on a regional average) led to the disruption of the crop rotation cycles and the elimination of the basis for feeding livestock. Furthermore, privatization failed to take into account the specialization and interrelationship of different branches, the supply of labor for enterprises, and other factors. Instead, it resulted in the creation of a stratum of temporary landowners. These included many retired pensioners and employees in the service sector, who will basically lease out their land plots to others. Furthermore, privatization failed to design a system of mutual relations between the landowner and renters so as to regulate the leasing of property and the products it produces. Indeed, the country does not even have a law on leasing. The privatization of property (or, more precisely, its division) has magnified the inequalities that existed both among enterprises and among individual agricultural workers. As a rule, those enterprises closer to administrative centers, rail lines, and highways had greater opportunities for development than those located in remote and inaccessible areas. Although the country has a significant number of regions that are economically backward precisely because of their location, privatization failed to take this factor into account. Thus, although the amount of human labor invested in each unit of production could be the same, in effect some enterprises were able to privatize property that was actually of far greater value than was possible in the case of others.

As a result of the foregoing, at this stage in the agrarian reform one finds a catastrophic decline in the production of agricultural goods, the loss of domestic and foreign markets, and a tendency for life to be extinguished altogether in the countryside. This situation in agriculture is fraught with catastrophic consequences for the social-economic situation in the country as a whole and in the village in particular. At the present time, 7.4 million people reside (44 percent of the population) in the village. Furthermore, there are more than 7,000 rural towns, 4,600 pre-school child care centers, 7,300 libraries, and 7,200 recreation clubs in the countryside. The rural social-economic situation is characterized by disorganization, an abysmal level of public and social services (in everyday needs, trade, medical care, and cultural opportunities), and the weak economic basis for the majority of enterprises.

The level of wages for those working in agriculture is among the lowest in any branch of the economy. Currently, it stands at about 47 to 48 percent of the average wage. By contrast, the wages are much higher in industry (146-147 percent of the average), in transportation (134-144 percent), and in credit and insurance firms (206-209 percent). The weak economic basis of agricultural enterprises is intensifying the migration of the rural population to the city. These migrants consist chiefly of young people, highly-skilled personnel, and specialists. The village is becoming older; the fertility rate is declining; the rates for illness and death are rising. The factors impelling the population to leave their traditional residence are many, but the most important is the deterioration of the living standards that currently prevail in the village.

## **2. The Development of Industrial Plants Processing Agricultural Commodities**

### **2.1 The Current Status of Processing Plants**

The processing of agricultural raw materials is done by three types of industrial enterprises: (i) large enterprises, which are primarily located in the major cities and oblast centers; (ii) medium-sized plants, which are located in oblast and raion centers; and, (iii) small

plants, which belong to various state agencies and are mainly situated in rural areas.

Under the conditions in which a planned economy operates on the basis of centralized directives, the strategic goal in the development and distribution of industry was to maximize the concentration of production. Consequently, a planned economy did not take into account transportation costs and the losses due to shipping, and, in the case of agriculture, all this came at the expense of the rural producers. The striving to concentrate production simultaneously gave rise to their monopolization (with the formation of monopolies at the regional and local level) while retarding the development of small enterprises in the countryside. As a result, this approach basically served to suppress competition. Until 1990, under conditions of relative economic stability, the large enterprises supplied the population with 100 percent of its meat products, flour, and bread, 90 percent of its milk products, 70 percent of its vegetable oil, and 30 to 50 percent of its sugar, fish products, and canned vegetables. A significant share of raw foodstuffs was imported from other republics of the Soviet Union and from abroad.

The backwardness of the processing branch resulted in the fact that its share of the final product of the agro-industrial complex was less than 40 percent (compared to the level of 80 percent in developed countries). Because of the backwardness in the processing industry and its uneven distribution, industrial processing took only 10 to 30 percent of the raw vegetables and fruits, and 50 percent of the meat and milk. The assortment of foodstuffs is extremely limited. In recent years, only 30 to 40 percent of the needs of this branch for the most important forms of equipment have been satisfied. In the case of refrigeration equipment, no more than 18 to 30 percent of the demand has been met. Because of the shortage of good-quality domestic machinery and technology, for many years the food-processing enterprises were equipped to a large degree with import machinery.

As a result, the foreign sources generally provided more than a third, sometimes that proportion rose to as much as 85 percent in the tobacco industry and 67 percent in the confectionery industry. Not much attention was given to the development of the refrigeration and storage facilities either. The available refrigeration capacities can accommodate only 58 percent of the demand for storing meat and milk products. Up to 25 percent of the storage facilities for potatoes and fruits are not equipped with ventilation. Only 50 percent of the grain is stored in specialized elevators. In terms of technical equipment, the weakest sphere for the food-processing enterprises is the treatment of fruits and vegetables. In fact, only 20 percent of the gross output is processed. Moreover, of the amount processed, the coefficient of utilization for such crops does not exceed 79 percent, the remainder going to waste (mostly in the preparation of vegetables for canning).

Great difficulties in obtaining raw materials have been experienced by the enterprises that produce meat and milk products, can vegetables and fruits, and make butter and fats. The same problem has beset those that are engaged in the primary processing of agricultural commodities. The reason is that they cannot reach an agreement with agricultural producers on the price of raw commodities, even though these producers, as a rule, are corporate entities of the processing industry. In effect, for commodity producers to sell their goods at a price suitable for the processors, they would have to do so at a loss to themselves. Similarly, the processors cannot sell their products because of the high price of raw materials, supplies, energy, and other production costs. As a result, a significant proportion of agricultural raw materials are not sold to processors, but rather are either sold at city markets or used in barter

exchanges (see Table 2).

**Table 2 Structure of sale of agricultural commodities in 1995 (in percentage)**

Product	Total	Including Procurement Organizations	Public Food Services	Direct Sale at Market Exchange, Auctions	Other (including barter)
Cereals	100	19.4	18.2	4.0	58.4
Vegetable oils	100	0.0	8.0	26.8	65.2
Potatoes	100	3.9	17.9	12.2	66.6
Vegetables	100	18.2	18.8	19.5	43.5
Livestock and poultry	100	14.8	36.5	7.2	41.5
Milk	100	63.8	10.3	10.7	15.2
Eggs	100	36.4	2.7	23.5	37.4
Wool	100	29.0	8.4	17.4	51.2

Source: State Statistics Bureau of the Republic of Kazakhstan

In general, this situation can be explained by the mechanism of costs in both agriculture and processing under inflationary conditions. In essence, the producers obtain profits and raise prices at every stage of production, heedless of an economically efficient utilization of resources. There are also other problems of obtaining raw materials for food-processing. Thus, the decline of production in the salt branch is due to the exhaustion of natural deposits; in the sugar industry it is due to the degradation of sugar beet production; in the confectionery business it results from the limited opportunities to import nuts, cocoa, and other ingredients.

The enterprises in the food-processing industry are equipped with obsolescent and, in many cases, worn-out machinery and equipment. The low level of utilization leads to an even greater degradation. The low rate (or virtual nonexistence) of attempts to apply new technology and equipment is the cause of the low level of mechanization of labor (32 percent) and the unsatisfactory quality of production. The goods produced by enterprises cannot withstand competition either in terms of assortment or appearance if compared with goods that now flood the marketplace through commercial channels. At the same time, the price of domestic goods is now very close to those on world markets.

The shortage of raw materials and supplies forces processors to use non-traditional sources, which, in general, is a positive phenomenon. Thus, the tea industry is developing new types of tea by using the additives of medicinal herbs and fruits; the non-alcoholic beer industry is developing drinks with a lower sugar content (or without sugar, which is replaced by new ingredients); it is also brewing beer with wheat instead of barley, and with artemisia and coniferous needles instead of hops. The confectionery industry, by contrast, is forced to shift to the production of goods that consume large quantities of sugar. In order to stay solvent, many food-processing industries have begun to develop unusual lines of production. Thus, the oil-extraction plant in Ust'-Kamenogorsk has organized the production of buckwheat; the oil and fat combine in Chimkent is producing potato chips and drying oil; a fruit canning plant in Almaty is making flour, bread products, and vegetable oil.

In the course of 1990-1995, the production of goods in the food-processing industry

dropped by two-thirds, while industry as a whole decreased by one-half. Moreover, the share of the food-processing industry in the total volume of industrial output decreased from 15.9 percent in 1990 to 7 percent in 1994. The crisis in the system of state procurements, together with the disruption of ties between enterprises (both within the country and beyond its borders), has led to a constant increase in the shortage of agricultural and edible raw materials. This has also resulted in a general decline of production in the food-processing industry. In pure monetary terms, the decline in production was less intense, but that is because of the high rate of growth in the prices for food products. It bears noting that, if earlier the increase of prices on food products exceeded the increase in the cost of agricultural raw materials. In 1995, the growth in the price on agricultural goods exceeded the rise in the price of the finished products. In general, the high price of food products is a consequence of the failure to change the system of agricultural production and processing. At the present time, the prices of such products as animal fat, sausage, and sugar are approaching world prices, while the price of vegetable oil is even higher. In addition, the quality of the goods and their appearance do not correspond to world standards.

The problem of non-payments is now the most serious difficulty of all. Enterprises are forced to reduce the output of goods because of financial difficulties in acquiring raw materials, while rural producers sell their goods on the market in order to be paid in cash. Because of the decline in production, the existing enterprises have begun to operate with a significant under-utilization of capacities (from 20 to 70 percent). As a result, enterprises are forced not only to lay off and furlough specialists for extended periods of time without pay (in effect, creating a hidden form of unemployment), but also to discharge people permanently. The creation of small enterprises for the primary processing of raw agricultural commodities does not always mean that such discharged people will again find a job in their specialty: the small plants are located in rural areas, while the large enterprises with under-utilization are in cities. The situation is better for skilled workers who work in bread bakeries, because the demand for bread has remained virtually unchanged. And the increase in the number of city bakeries, including Turkish bakeries, provides job opportunities for people from industrial professions as well as specialists with a higher education who have lost their jobs in state administration.

The drastic shortage of unprocessed agricultural commodities should serve as an impulse for more intensive processing of what is available. However, the lack of the requisite equipment and economic stimuli, along with the difficult financial situation of industry, makes it impossible to install machinery with little or no waste products. Moreover, this branch has reduced its assortment of goods and reduced the volume of pre-packaged goods that it produces. Another source of concern is the fact that today the processing industry, given the already backward state of its technology, is being subjected to the negative consequences of the investment crisis: its capital assets are gradually being depleted and not renewed. Thus, in enterprises of the processing industry, more than half of the technological equipment is physically worn out and exhausted. The share of manual labor is equal to 40 to 50 percent.

## **2.2 The Formation of Rural Industry**

The conception and content of reform in the agrarian sector are in the creation and development of entrepreneurship in rural areas. That will help to locate the processing closer to the place of production. It will also contribute to overcoming the monopolies and create a competitive environment. The development of entrepreneurship presupposes the creation of

enterprises with different capacities, which are based on different forms of property. Unfortunately, the official statistics do not provide data on the activities in rural areas. Therefore, this report must rely upon the scattered information of the State Statistics Bureau as well as materials from the periodical press to address this question.

In the sphere of agriculture, in 1995 there were 124 cooperatives (6 percent of all cooperatives), 385 small enterprises (3 percent of the total), and 558 very small enterprises (2.6 percent of the total). They contribute goods and services with an aggregate value of 6.6 billion tenge (4.5 percent of the total). The difficult economic situation has left its imprint on the operation of enterprises regardless of their form of property. One can see not only a slowdown in the activity of these enterprises, but also, in a number of cases, a shift from the productive sphere to trade and procurements, where the capital turnover proceeds with less effort and returns are higher. Hence the majority of small enterprises include, in addition to their main activity, commercial operations and in fact are engaged exclusively in the latter. Until financial stability is achieved, this situation cannot be overcome.

Small enterprises are created from the funds of agricultural formations themselves, and this process is occurring in all regions of the country. In particular, the collective farm "Cherkasskii" (in Severo-Kazakhstan Oblast), the collective farm "Kamyshinskii" (Kustanai Oblast), the collective farms "Put' k kommunizmu" and "Karabulak" (Taldy-Kurgan Oblast), and some others have created subsidiary enterprises to process their raw agricultural products. These include smoking sheds, sausage shops, creameries, fur-breeding farms, shops to process leather and sheepskins, canning plants, grain warehouses and drying facilities, flour mills, shops to produce macaroni products, seed-cleaning complexes, plants to produce crackers, and dairies to produce butter and cheese products.

The experience of developing entrepreneurial activities makes it possible to identify a number of problems in the system of state support for small and medium-sized business (SMB). First, the government has neither devised a development strategy for entrepreneurship as a whole, nor defined the role and place of SMEs in the national economy, nor created mechanisms to coordinate the realization of state programs. Secondly, the process of preparing the legal foundations for the operation of SMB has been proceeding at a slow pace and a qualitatively low level. Thirdly, legislation pertaining to entrepreneurship is neither systematized nor integrated into a coherent order. Fourthly, because of the lack of financing and the high interest rates on loans, small business is concentrated mainly around larger enterprises and on speculative activities. Fifthly, economic organizations of all property types lack an orientation toward the broad-scale, accelerated application of world achievements in science and technology (based on R&D-intensive technologies). Sixthly, the mechanisms to grant and recoup funds have not been activated and therefore remain idle, the special investment and financial institutions created to support small business do not perform their functions. Seventhly, there are many crime-ridden phenomena and violations of the law.

Some small private enterprises and cooperatives have been formally established to operate in rural areas and to process agricultural commodities. Apart from these, agricultural producers—former collective farms and state farms, now reconstituted as joint-stock companies, collective partnerships, and private peasant farms—have their own shops and plants to process agricultural products. According to a study by state statistics organs, the total number of shops amounted to more than 7,000. And 97 percent of these are engaged in the processing of their

own raw materials as well as that from other producers (in exchange for a share of the final output). In 1994, the value of industrial fixed capital for production was 97 million tenge, while the average number of workers in subsidiary production was 32,400. The agricultural producers under study had many different operations. These included 430 mills, 918 hulling and millet mills, 259 creameries, 49 shops to can fruits and vegetables, 1119 units to slaughter livestock and poultry, 375 dairies to produce butter, cheese, and milk, 104 shops to catch and process fish, and 139 shops to produce animal feed and protein-vitamin additives. The current capacities of these shops in agricultural industry make it possible to produce 72,200 tons of flour, 1,200 tons of animal fat, 517,000 tons of whole milk products (calculated in terms of milk), 270,000 tons of meat (including derivative products of the first category), 4,300 tons of sausage, and 6,300 tons of vegetable oil.

In addition to enterprises that process agricultural raw materials, also enterprises producing construction materials, treating animal skins, engaging in commercial procurements, and so forth have been created in the countryside. In particular, every other enterprise in Pavlodar Raion has constructed its own brick-kiln factory. There are now eight such plants in the raion. As a rule, the plants obtain the necessary raw materials from their own territory. Each plant has the capacity to produce one million bricks per year. For the time being, however, because of the low level of demand, in most cases output is currently limited to about one-half million bricks.

Such are the first steps in the creation of rural industry in Kazakhstan. The main problem encountered by the beginning entrepreneurs is the lack of means to create small plants. Once established, such processing enterprises suffer from an inadequate processing of the raw materials; the degree of nonproductive losses is high. In order to prepare concrete proposals in this sphere, it is desirable to study the experience of the countries of Southeast Asia, which have accumulated considerable experience in this regard.

### **3. Organization of Sales Market for Foodstuffs in Kazakhstan**

The transition of the agro-industrial complex to market relations requires the creation of an efficient market infrastructure. Concretely, such an infrastructure must be able to provide stable and reliable financing, supply the materials and equipment that are needed, and offer the most profitable markets for the sale of their products. The infrastructure of the market for agricultural products also consists of many basic institutions. These include commodity exchanges, trading houses, wholesale auctions, commercial enterprises, and procurement and supply organizations. These are gradually to master the market methods of cooperation with the agricultural producers of commodities.

It is essential to attract significant amounts of middle- and long-term credits for agriculture at preferential rates. There are several reasons for this: the seasonal character of agricultural production, the shortage of working capital, and the high dependency of the financial results of economic activity on climatic and weather conditions. The needed credits should come from various sources and be given in exchange for the delivery of consumer agricultural products (at a fixed time and for a specified price and quality). Such a policy has been designed and widely applied in the developed countries to regulate the interrelationship between peasant farmers and their partners. The aim was to prevent sharp fluctuations in

prices and other crisis phenomena and to stabilize the financial condition of agriculture. The practice of world trade shows that, for this to function successfully, it must be based on the use of commodity-exchange mechanism. The prices in trade, for the majority of goods, are based on the quoted prices of the most authoritative exchanges. In July 1995, a special decree of the government of Kazakhstan approved the formation of a commission for commodity exchanges and the licensing of commodity exchanges. Both documents were adopted in fulfillment of the presidential edict "on commodity exchanges." The commission is responsible for the licensing and also exercises control over the activities of commodity exchanges. In addition, it handles the exchange registrations, analyzes their activities, and prepares methodological recommendations.

Beginning in 1996, the independent non-departmental price commissions (established at the country and oblast levels) began to carry expert assessments of contracts. Once an economic entity that has prevailed in the selection of inter-governmental agreements and in the expert assessment of the price commission, it has the right to export products from the agro-industrial commission beyond the borders of Kazakhstan. And it can do this without filing for a license and without paying any customs duties. At the customs post itself, it must present the contract (which is registered in the commodities exchange and which bears the certification that it has passed the assessment of the price commission) and the certificate. In addition, the conduct of tenders, expert evaluations, registration, and issue of certificates for the export of grain with a volume exceeding 1,000 tons is assigned to the International Kazakhstan Agro-Industrial Bank.

In 1995, agricultural producers continued to search for the most profitable channels to sell their products. The delayed payment for purchases of agricultural goods by procurement organizations (meat combines, milk conglomerates, oil extraction plants, and other industrial enterprises) caused agricultural producers to sell the bulk of their goods through barter, at the market (through their own shops), and directly to the employees of the enterprises. And that was the case even though procurement enterprises often pay a higher price for goods than do the other purchasers. In 1995, a special situation took shape with respect to the purchases of cotton. It resulted from the fact that the cotton growers of Iuzhno-Kazakhstan Oblast did not accept the purchase price that had been set by the procurement centers. An analogous situation arose in the case of sugar beets. This commodity was therefore not sold, but shipped to sugar plants only on the basis of a shared division of the final product.

In the structure of products of agriculture, grain occupies over 40 percent, but in the foodstuffs market crops account for approximately 80 percent. The largest proportion of grain belongs to wheat (which accounts for almost 70 percent of the volume of sales). Of this volume of grain sales, in 1995 procurement agencies accounted for 23 percent, barter deal 42 percent, and sale to the population (in various forms) 19 percent. Other channels (trading houses) account for 16 percent. The barter deals in grain are particularly salient in Karaganda, Kustanai, and Semipalatinsk oblasts.

What is the reason for the growing share of barter deals? In our opinion, the main objective reason is the failure to satisfy the commodity producer's desire to receive the agreed-upon sum in a definite period of time. For a number of years, the government has not settled its accounts on time. Hence, rural producers are in no hurry to turnover their grain and other products to procurement organizations. Nor do the stimuli to raise procurement price have much effect. In general, the value of grain production in barter deals in Kazakhstan is five to ten

percent below the prices offered by procurement agencies (including sales through direct channels). But the attractiveness of barter varies. In barter deals in 1994, it proved profitable for producers of oil-bearing crops (sunflower seeds), vegetables, and livestock. In 1995, however, it was profitable for producers of milk and wool. These facts show that barter deals should be examined in terms of the concrete situation, taking into account their profitability and expediency.

To make state purchases of grain in 1995, for the first time the country put into circulation simple bills of exchange of the Kazkommertsbank (Kazakhstan Commercial Bank). Together with the International Kazakhstan Agro-industrial Bank, the Ministry of Agriculture conducted tenders to determine which economic enterprises (grain companies) would have the right to purchase grain for the state on the basis of registered contracts at the exchanges. The winning tender belonged to the joint-stock company "Astyk" and the joint-stock holding center "Turan-Aziia." However, because of the financial difficulties of "Turan-Aziia," Kazkommertsbank withdrew its offerings from the bills of exchange program. The winning tender of "Astyk" presented credits in the form of simple bills of exchange worth US\$70 million, with a preferential annual interest rate of 10 percent. The credit was given in two tranches, in equal parts with the right to submit bills for payment that were limited to certain holders (e.g., material suppliers for oil products, fertilizers, pesticides, seeds, and so forth). A decree of the Cabinet of Ministers provided for the purchase of 875,000 tons of third-grade wheat at a price of US\$72 per ton.

The bills of exchange credit of the first tranche was issued in May 1995 for a period of time corresponding to the cycle of the production and sale of grain (approximately eight months). A grain company (the joint-stock company "Astyk") transferred the bills of exchange to agricultural commodity producers in accordance with the advance contract to deliver grain to state resources. The agricultural producers use the bills of exchange from the grain companies to settle accounts with the suppliers of materials and equipment. After the production of the necessary goods and the date set for payment comes due, the suppliers present the bills of exchange to the Kazkommertsbank for payment. In the case of a premature cashing of the bills, a discounted lower interest is calculated.

The bills-of-exchange credit of the second tranche in August 1995 set a term for the harvesting and delivery of grain to the elevators (about five months). After the delivery by "Astyk" of the grain to the foodstuffs contract corporation (i.e., to the state resources), the bills of exchange credits obtained from the Kazkommertsbank are regarded as retired. However, because of the unfavorable weather conditions, 131 enterprises in four oblasts (Torgai, Kustanai, Aktiubinsk, and Zapadno-Kazakhstan) were unable to fulfill their contractual agreements. During the distribution of the second tranche, part of these enterprises, fearful of a poor harvest, declined to accept the bills of exchange. As a result, the state purchased 801,000 tons of wheat, but the indebtedness of agricultural producers for undelivered grain (in bills of exchange) amounted to 49,000 tons of class-3 wheat. These debtor-enterprises signed debt agreements to deliver this grain after the 1996 harvest. The experience in 1995 of purchasing grain for state reserves and procurements by using bills of exchange revealed both the positive and the negative sides of the program. In 1996, the program for bills of exchange was extended. This year, the government plans to purchase 1.1 million tons of grain on the basis of these bills of exchange.

The abolition of state procurements for agricultural production creates the necessary preconditions for the expansion of the foreign market. At present, it is mainly wheat that is exported, which is sold for an average price of US\$150-160 per ton (mainly to Central Asian countries). A stable source of hard currency could come from the export of rye and the products derived from its processing. In Kazakhstan, the production of rye amounts to 250,000-260,000 tons, of which more than 100,000 tons is proposed for export.

The market for the sale of foodstuffs needs, above all, to supply the population with food products and industries with raw materials. While satisfying both these needs, the government proposes to use trading in commodity futures, for that can ensure advance monetary support for agricultural producers. Forward and futures contracts are deals of a purely exchange character. Attention should be given to the activities of the agricultural exchange created by the firm "Sain" (in the city of Karaganda). It provides a broad choice of agricultural products from peasant farms, associations, and other commercial structures. The firm does not have the goal of earning money on the exchange, extracting surplus profit, or offering large dividends. Rather, it has an entirely different function: namely, to create in central Kazakhstan a full-scale agricultural market to satisfy the demand of consumers. This exchange gives agrarian enterprises and consumers access to the mass of commodities that they need. It also provides the freedom to conduct trade at market prices. It regularly announces quotes on exchanges prices. In addition, starting prices on commodities are established in consultation with the oblast price committee. Thus, the specialized agricultural exchange of the firm "Sain" creates the conditions for successful entrepreneurial activity by the producers of agricultural products. It also contributes to the growth of production in agriculture. Participants in the work of the exchange "Sain" include villages from Akmola, Kustanai, Pavlodar, and Zhezkazgan oblasts.

The experience of recent years strongly suggests the conclusion that, in conducting purchases of agricultural production, it is necessary to use different forms of cooperation between producers and buyers. The choice of this or that form of contract on the selling market for agricultural goods is to be made by the seller and buyer. The mechanism for concluding all forms of contracts should be completed before the beginning of the next year; that makes it possible for commodity producers to set their own business plan. In the opinion of specialists, it would very desirable to establish associations of producers. This would enable them to make a more careful analysis of future conditions on the market.

#### **4. The Political Dimension of Reform**

At the present time, reforms in the agro-industrial complex are being conducted in accordance with the "Program of Action of the Government for the Extension of Reform, 1996—1998." The reform follows the decisions of a conference of people working in the agro-industrial complex that convened in December 1995. In conducting the reforms, the government is shifting the center of gravity to the regional and local level. The oblasts are now to prepare regional programs for the mid-term perspective for developing market relations in the village. All the oblasts have accumulated a certain positive experience in the transformation of enterprises in the countryside.

In Taldy-Kurgan Oblast, for example, the former large enterprises are divided into

several economic units on the basis of their production and technological characteristics. The founders of these new economic units are share-holders, who voluntarily combine their property shares and land allotments.

In Zhezkazgan Oblast, much attention is given to the creation of peasant farms and small enterprises. A peasant bank has been established. To support rural commodity producers by providing farmers with machinery and equipment, a special fund "Auyl" and the association "Zhezkazganmarketing" have been established. On the basis of the raion subdivisions of the territorial joint-stock company "Ulytau" (formerly "Oblagropromtekhnika" [oblast agro-industrial machinery]), a service firm now functions to provide technical assistance on the model of the old Machine-Tractor Stations, with their own machinery and equipment.

In Pavlodar Oblast, a former state farm (later reconstituted as a collective farm) called "Tselinnyi" (Aksu Raion) was transformed into an association of peasant farms called "Kurkol'." Of more than 700 share-holders, only 43 remained as property owners. The rest transferred, sold, conceded, or gave away their share of property, and then became hired employees of the association. This is one variant of the reorganization of agricultural enterprises whereby not all the share-holders want, or can, become independent farmers. The experience of the joint-stock companies "Irtysh" (Pavlodar Oblast) and "Berek" (Zapadno-Kazakhstan Oblast) suggests that it is correct to create joint-stock companies on the basis of a meat-processing and other enterprises, with the participation of rural commodity producers.

In Semipalatinsk Oblast, a new structure of the agrarian sector, consisting of family farms, has emerged. The former branches and farms are transformed into private enterprises that engage in the production of animal feeds, in the processing and transportation of agricultural products, and in the repair and maintenance of machinery. Machine-tractor stations are also being established on the basis of the shops that formerly belonged to state and collective farms.

Iuzhno-Kazakhstan Oblast has experience in creating machine-tractor stations. Here, on the basis of an oblast experimental agricultural station, and in collaboration with the Ministry of Agriculture of the German state of Saxony, the oblast is creating a center to service machinery and equipment. Much of the equipment comes from Germany.

These examples attest to the fact that the republic is creating different types of property owners. The first real independent agricultural businesses, as private enterprises, have also emerged, and they are achieving excellent results in their work. These include the firms "Petrovskoe" and "Rodina" (Akmola Oblast), "Kaskabual" (Semipalatinsk Oblast), "Nicol'skii" (Vostochno-Kazakhstan Oblast), and "Kirovskoe" (Iuzhno-Kazakhstan Oblast).

However, in conducting these reforms in a number of oblasts, shortcomings and mistakes are apparent. Thus, in several oblasts (Zapadno-Kazakhstan, Kokshetau, Kustanai, Severo-Kazakhstan, and Turgai) the former state farms were essentially transformed into collective enterprises, without any fundamental changes in the structure, form of labor organization, and management. In reforming the collective farms, one finds also that the charters ignored norms in the law, the opinions of collective farmers were not taken into account, and the principle of voluntary participation was violated. 30,785 peasant (farmer) units are functioning now, and 8,264 of them were newly founded in 1995 alone. They occupy 12.6 million hectares of land, with the average allotment being 412 hectares. It must be noted that the central organs and the oblast and local authorities have all failed to give much assistance in

creating such farms. The farmers experience great difficulties in obtaining materials and equipment and in selling their products. The majority of peasants cannot obtain bank credits, even if they can provide property collateral needed for the loan. Because of these and other factors, 1,254 peasant farms failed in 1995.

The personalization of property ownership of the transformed agricultural enterprises has been completed. However, the actual allocation of property shares and land allotments has still not been extended to all members of labor collectives. There are also delays in the issue of certificates of property shares and the right to a land allotment. To accelerate the issue of ownership certificates, a decree of the government (no. 602 on 14 May 1996) abolished the law requiring a down payment of 10 percent for the property being redeemed.

The government encourages the investment of private capital, both domestic and foreign, in the development of the agro-industrial complex, but especially in the processing industry. Large sugar factors, distillation plants, elevators, and combines are being transferred to the control of various non-state firms, including some foreign concerns. For example, the joint-stock company "Almaty kant" has been transferred to the control of the English company "Man and Shug Refining LTD." The joint-stock company "Petropavlovsk Elevator," together with a mill and macaroni plant, has been transferred to a Turkish firm ("Okan-Holding"). A government decree has approved the initiative of the Ministry of Agriculture to attract foreign investors to develop agricultural production. In particular, this includes the participation of the company "Agro-invest GPAL" as well as the creation of agro-industrial complexes in Ruzaev Raion (Kokshetau Oblast), Uritskii Raion (Kustanai Oblast), and Timiriazev Raion (Severo-Kazakhstan Oblast). It also includes the reconstruction of the sea port "Aktau."

Particular attention is given to expanding reform on the basis of including land in market relations. The land reform has been substantially accelerated by the presidential edicts (with the force of law) "on land," "on mortgages for real estate," and "on state registration of rights to real estate and transactions involving such property." These presidential edicts were promulgated for the purpose of implementing the previous decrees of the government. More than 16 million hectares of land have been placed under the control of the heads of the local government. However, in the majority of cases, these lands are not used in a rational manner, and indeed frequently are not used at all. Significant areas of land remain uncultivated. The fertility of the land is decreasing. In recent years, the humus content has fallen by 20 to 30 percent in Kustanai, Vostochno-Kazakhstan, Semipalatinsk, and Zapadno-Kazakhstan oblasts. The area of degraded pasture land now exceeds 24 million hectares (being concentrated mainly in Aktiubinsk, Atyrau, Kzyl-Orda, and Mangistau oblasts). Many enterprises show a declining productivity of fields and farms. They also violate the agro-technical requirements for cultivating cereals and other crops. Less attention is given to growing more productive seeds. The work of transferring social and cultural objects to the accounts of local government is proceeding slowly.

The economic difficulties of the transition period have had a serious impact on animal husbandry, especially the sheep-raising, commercial poultry-raising, and hog-breeding. These have undergone a significant contraction in the number of livestock and poultry. This is particularly characteristic of enterprises that have been reformed. To stabilize the work of industrial poultry-raising and hog-breeding (and in accordance with a decree of the Cabinet of Ministers of 15 November 1994 [no. 1288]), the government is carrying out several special

measures. These include the allocation of arable land (to raise fodder crops), the formation of joint-stock companies with enterprises in the animal feed industry, and the sale of state shares of stock to potential investors. A positive example of such work is the joint-stock company "Volynskii Bekon" [Volhynian Bacon], "Ust'-Kamenogorskaia Ptitsefabrika" [the Ust'-Kamenogorsk Poultry Factory], and "Semptitsa" [a poultry farm], where the production of output has been stabilized. The basis of the development of animal husbandry is stock breeding. At the local level, authorities are completing the investigation that a commission has conducted to investigate the status of stock breeding and to determine if it meets requirements. At the central level, a list of breeding farms remaining in the possession of "Asyl" (a state joint-stock company) has been confirmed.

An analysis of reforms in the agrarian sector shows that the conditions in agriculture continue to be very difficult and that financial-economic and social tensions persist. However, the environment of new property owners is creating a different psychology of people, ever more strongly impressing on their consciousness the belief that market relations are more effective and efficient. This year, despite the extremely difficult conditions, farming enterprises have completed the wintering of livestock and have shown signs of stabilizing the number of head. They were also successful in completing the spring field work.

The government is taking a number of measures to stabilize and improve the economic conditions in the agro-industrial complex. It has adopted a presidential edict "on supplementary measures for state support of the village and the agro-industrial complex in 1996—1997." Specifically, that edict provides for allocating 10.7 billion tenge of budget funds for the village. The government has also expanded efforts to realize the loan programs of the Asian Development Bank (US\$ 100 million) and to organize agro-leasing (by allocating 0.6 billion tenge from the state budget). It is also introducing the bill-of-exchange system to settle accounts for the purchase of commodity producers (with a value of US\$165 million). In addition to the state fund for the support of the village (which accepted unbacked debts to banks worth 33 billion tenge), the government is providing assistance to agricultural enterprises to help reduce the cost of mineral fertilizers, pesticides, and herbicides. It is also resolving the problem of providing the village with petroleum products.

A further reform of this sector, according to the mid-term program of the government, aims to proceed in the following directions:

- Complete the privatization of state agricultural enterprises and reform collective farms.
- Continue the policy of de monopolization.
- Sell state shares of stock in the procurement and service enterprises in the agro-industrial complex in the first half of 1996.
- Provide financial assistance for agriculture and, above all, give support to those agricultural businesses that, in the shortest period of time, are able to increase the output of competitive goods.
- Organize the processing of raw materials and the products from animal husbandry.
- Import advanced contemporary technologies of agricultural production and processing.
- Prepare a program to develop market infrastructures (marketing services; market information; trade on exchanges; etc.).

- Establish a network of wholesale commodity markets for agricultural products and foodstuffs.
- Protect commodity producers on domestic and foreign markets.
- Create in the oblasts a vertical integration of production (corporations, associations, etc.), which would include all branches of production from the commodity producer of raw materials to processing and to trade in the final product.
- By 1 September 1996, complete the issue of certificates on the right to allotments to all citizens who have a right to land.
- Create banking structures to conduct transactions involving mortgages (using land allotments and the right to land as collateral).
- In animal husbandry, complete the integration of the livestock complexes and poultry factories with the animal-feed plants and allot them land to grow their own fodder.
- Improve the system to supply the village (and especially private peasant farmers) with machinery and equipment, as well as maintenance and service; create rental centers in the form of small machine-tractor stations.
- Assign to oblast and raion centers scholars to ensure a scientific approach to the economic reforms and to provide practical assistance and consultations at the local level.
- Integrate rural commodity producers with enterprises in the processing industry.
- Transfer agro-industrial enterprises to the control of various non-state firms, including foreign concerns.
- Reassign facilities in the social sphere from organizations and enterprises in the agricultural sector to the account of local government budgets.

## **5. Some Conclusions on the Process of Reform in Agriculture and the Development of Agro-Industry**

### **5.1 The Results of Reforming State Farms and Collective Farms**

Within the framework of the agrarian reform, the state has carried out a reorganization of collective farms and state farms. On December 1, 1995, the agricultural sector included 34,774 enterprises. In terms of the form of property ownership, these included 1,733 state enterprises (5.0 percent), 32,665 private enterprises (93.9 percent), 38 mixed enterprises without foreign participation (0.1 percent), and 13 mixed enterprises with foreign participation (0.04 percent). Altogether, in 1992—1995, the government privatized 2,404 agricultural enterprises, and this allows one to conclude that privatization in this branch is reaching completion. In 1995, privatization proceeded mainly as a transfer of property without compensation and cost. The transferred property had a value of 15 billion tenge. Of this amount, the government sold property for 1.5 billion tenge (hence at one-tenth of its true value). Of 514 enterprises privatized in 1995, these included 469 collective farms and 31 state farms. From these, the government created 746 independent economic entities, including 88 cooperatives, 134 partnerships, and 72 joint-stock companies. The formation of joint-stock companies from all the state poultry factories, livestock complexes, and breeding farms has been completed. On the basis of the

procurement, processing, and service enterprises in the agro-industrial complex, 1,449 joint-stock companies have been created with the participation of rural commodity producers. By a decree of the government, the state sold—on an experimental basis—twenty collective farms at auctions, converting them into private property. A significant part of the property was given, without cost, to 33 directors of state enterprises as their personal property. To qualify for this, however, the directors had to show a seniority of twenty or more years.

On the basis of the reconstituted collective farms, state farms, and individual plots, the government created a new set of peasant farms. The latter now represent the most numerous form of agricultural organization in the country; altogether, they number more than 31,000 units. However, despite the fact that they are numerically a large proportion (88 percent) of all agricultural organizations, in 1995 they accounted for a very small share of the output in the agricultural sector. Specifically, in 1995 the peasant farms produced only 4.2 percent of the grain, 1.3 percent of the potatoes, 5.6 percent of the vegetables, 1.7 percent of the meat, 1.4 percent of the milk, 0.6 percent of the eggs, and 3.1 percent of the wool. On January 1, 1996, the average peasant farm had 412 hectares of land allotment, 5 head of cattle, 0.5 hogs, 36 sheep and goats, 2 horses, and 4 chickens. During the first years of reform, the members of collective and state farms preferred to choose collective types of economic organization. These were based on a collective-share system of property. As a result, the new unit did not make any radical changes in production relations, organizational structure, and management.

In many cases, the reform of agricultural enterprises was conducted without taking into account local conditions and the potential of the labor collective. There were also cases of an arbitrary interpretation of the laws. In addition, the privatization in many enterprises was followed by the decision to close many vitally important social institutions, such as child-care centers, hospitals, paramedic and midwife centers, clubs, and cultural centers.

The tendency of people to think in old, traditional ways is the most difficult thing to change in the process of carrying out economic reforms. Not all property-owners were able to adapt to a market environment and to realize their rights to act on their own. It proved anything but simple for the share-owners to determine and to choose the type of economic organization that they found most acceptable for themselves. Many became private farmers by accident, lacking the requisite knowledge about agronomy, zoo technology, economics, management of production, and experience with working the soil. In a number of raions, there are still cases where the heads of local administrations and enterprises block the reconstitution of agricultural enterprises and refuse to allow people to create private peasant farms and associations.

At present, on the basis of the accumulated experience in a number of regions, work is underway to prepare the normative framework for the reform. The main task is to identify an efficient property owner and to organize mutual economic relations within the joint-stock companies that were created from the procurement and processing enterprises (with the joint participation of agricultural producers). The framework must also provide a mechanism for the economic structures to operate in the post-privatization phase as well as to regulate the mutual relations between these new entities and the organs of state administration. Moreover, it is necessary to make substantial changes in the existing laws that today govern the formation and operation of agricultural enterprises.

## 5.2 Evaluation of the Situation in Privatized Enterprises in the Agro-Industrial Complex

The productive and economic indicators in privatized agricultural enterprises in many regions are slightly higher (if not much higher) than in state enterprises. In Vostochno-Kazakhstan Oblast, the results for the grain harvest in 1995 showed that the yield in privatized enterprises was 14.8 centners per hectare; that is considerably more than the 8.7 centners/hectare reported by state enterprises. Whereas 72 percent of the private enterprises earned a profit in 1995, only 37 percent of the state enterprises could say the same. Non-state agricultural enterprises and private plots had better productive and economic indicators for 1995 (compared with 1994) than did state enterprises. In Akmola Oblast, privatized enterprises showed an increase in the grain yield (8 percent), milk output per cow (18 percent), and wool production (13 percent).

At the same time, however, it must be noted that in general the country did not obtain the desired results from the reform of state enterprises. An analysis of the financial results from Aktiubinsk Oblast for 1995 shows that, of 146 agricultural enterprises in the oblast, only 10 percent earned a profit. The proportions of state enterprises, private enterprises, and collective farms that operated at a profit were about the same. The yields for potatoes, vegetables, and milk, as well as the average annual earnings, were higher for privatized enterprises than for state enterprises. However, in 1995, the gross output per employee was 74,100 tenge on state enterprises, compared with 61,300 tenge on privatized enterprises and collective farms. In Karaganda Oblast, almost 63 percent of the privatized enterprises ended 1995 with a loss. The financial condition of privatized enterprises was worsened in Torgai Oblast. Whereas 6 of the 126 state farms scheduled for privatization in 1994 had a profit, the next year all of them—now privatized—were operating at loss.

In many enterprises, a positive effect resulted from transferring part of the property to personal ownership of the directors (with twenty or more years of seniority) and from the sale of state farms to private citizens. In 1995, the private agricultural enterprise “B. Momyshev” (Zhambyl Oblast) harvested from all its territory 10.1 centners/hectare, an increase from 7.7 centners/hectare the previous year. Its average wool output was 2.7 kg.; the offspring per 100 head of livestock was 63 calves and 36 colts. For all practical purposes, it kept the same level of output in animal husbandry. During two years, it built a mini-mill; it opened a mini-bakery and sausage shop; it is now completing the construction of a shop to process raw leather and sew coats and leather goods. It also opened its own store to sell everyday consumer goods as well as its own products, and this outlet has also enabled it to expand the volume of its gross output. The private enterprise “Timiriyev” (Tel’mansk Raion) and the private enterprise “Ushkobe” (Ul’ianovsk Raion) in Karaganda Oblast have achieved excellent results in crop cultivation. Compared with the previous year, in 1995 they increased the gross output and raised the yields in cereal and potato cultivation.

At the same time, a number of enterprises that were sold to private owners have displayed many instances of poor economic management and a careless attitude toward private property. Compared with the previous year, in 1995 the private agro-firm “Tattinskii” (Zhambyl Oblast) sharply reduced the production of all forms of agricultural products and the number of livestock. Its average yield from all land was 4.1 centners/hectare; the productivity of livestock and breeding of offspring decreased; pestilence and death among its livestock rose.

As a result, the enterprise suffered a loss of 3 million tenge, and its debts to creditors continued to mount.

Some directors have changed the profile of operations on their enterprises, but they have not always done this in a rational and effective way. Thus, the private agricultural enterprise "Iaroslavskii" (Vostochno-Kazakhstan Oblast) lies close to the city of Ust'-Kamenogorsk; previously, it supplied the population of that city with vegetables and milk, producing up to 5,000 tons of vegetables and 4,000 tons of milk. At the present time, the enterprise has completely ceased to raise livestock (with the exception of horses), while its production of vegetables has fallen to one-third its former level. All this shows that unqualified cadres are still being chosen to fill the leading positions in agricultural enterprises.

The process of forming larger joint-stock companies from procurement, processing, and service enterprises is also progressing with difficulty. The task of regulating mutual relations within such joint-stock companies is a complicated, if highly promising, undertaking. Thus, good mutual relations between the producers and processors of agricultural commodities have been forged in the joint-stock company "Irtysh" (Pavlodar Oblast), which combines a meat-packing plant with 105 other agricultural enterprises. The governing organs of this joint-stock company consist of a general assembly of the stockholders, a supervisory council, the board of the joint-stock company, and an auditing commission.

For purposes of cutting the costs of production and providing primary commodity producers with consumer goods, "trade associations" have also been created. Thus the joint-stock company "Irtysh" established "Irtyshorg," which included four trade enterprises, four enterprises for public food services, and one enterprise to provide warehouse services. The joint-stock company "Irtysh" thus became directly engaged in trade, hence by-passing middlemen. "Berek" (a joint-stock company formed on the basis of a milk combine in Zapadno-Kazakhstan Oblast) also attempts to regulate the mutual relations with commodity producers. In this case, all the milk-producing units of agricultural enterprises are transferred to the accounts of the plant; the settling of accounts with milk producers is conducted on schedule. It has organized its own trade in the enterprises. The purchase price of milk is differentiated, being based on individual agreements with the producers. In 1995, the joint-stock companies of the meat and milk industry of Karaganda Oblast ended with a profit of 86 million tenge.

For purposes of creating a competitive market environment, work is also underway to de-monopolize branches. Thus the government has reorganized the state joint-stock companies "Astyk," "Tagam," "Ken dala," "Zhivprom," "Ak kaursyn," "Balyk," "Berek," and "Kunarlylyk" as well as the state holding companies "Kazagroremmash" and "Akzhol." By the end of 1996, all the other state joint-stock companies will also undergo reorganization. The joint-stock company "Volynskii Bekon" (Karaganda Oblast), formerly the state farm "Volynskii" specializing in hog-raising and relying on Italian technology, reported a small reduction in the number of hogs and in total output in 1995. However, because of the free market prices for pork products, it ended the year with a profit of 13 million tenge.

At the present time, collective farms are being actively included in the process of reorganization. On January 1, in Almaty Oblast alone, 21 collectives (the majority of such) underwent reorganization. Of 48 collective farms in Zhambyl Oblast, 24 were restructured as agro-associations, with a personalization of property and determination of land allotments. It also deserves to be noted that the reform of property in the former collective farm "Komintern"

(Kordai Raion) led to the formation of an association of peasant farms called "Iunchi." The latter included the distribution of land and property among members of the collective farm and the organization of peasant farming units. The latter were then, on a voluntary basis, united into the "Association of Peasant Farm."

### **5.3 Patterns in the Development of Small and Medium-Sized Business in the Agro-Industrial Complex and Measures to Support This Process**

The problem of small business in agriculture is a matter of particular urgency. This is explained not only by the necessity of achieving fuller utilization of the potential in agriculture, but also by the large-scale exodus of the able-bodied workforce from the auls (hamlets) and towns because of lack of jobs. Under the current situation, in order to use the surplus labor resources, it is necessary to support the formation of a stratum of farmers in the village. In recent years, the country has extensively developed private peasant farms, the number of which increased from 320 in 1991 to 34,770 in 1996. Such peasant farms are most widespread in Iuzhno-Kazakhstan, Almaty, Severo-Kazakhstan, Taldy-Kurgan, Zhezkazgan, Akmola, and Pavlodar oblasts. At the present time, these enterprises have been allotted 12.7 million hectares of land, including 12.4 million hectares of agricultural land (of which 1.47 million hectares are arable land). In terms of production activities, 48 percent of the peasant farms engage exclusively in the cultivation of crops, 17 percent concentrate solely in animal husbandry, and 35 percent engage in both. However, the proportion of output produced by peasant farmers has remained very low. In 1995, they accounted for small proportions of the gross output of cereals (4 percent), vegetables (6 percent), potatoes (13 percent), and products from animal husbandry (2 percent). It bears noting that, in 1995, the commodity output (for markets) rose among the private farms. These still have a weak material and technical base: since only 36 percent have their own machinery and equipment, the rest must rely upon renting and hiring. The farmers also encounter difficulties of an organizational nature in producing and selling their products. At this stage, it is necessary to switch from a quantitative growth to a qualitative increase in production. This must be done on the basis of developing land legislation and the system of state support.

The share of small firms in the total number of enterprises runs as follows: 80 percent of those in food-processing, 90 percent of those in meat and dairy, 76 percent of those in fish production, and 95 percent of those in milling and animal feed. Undoubtedly, such a structure creates a favorable environment for the development of competition. However, among the small enterprises, one should distinguish between the "old enterprises" (i.e., created before 1991) and the "new enterprises" (i.e., those which commenced operations since 1991). The "old enterprises" are poorly equipped and can only perform a primitive kind of processing; they offer a small assortment of goods and have a high degree of waste. Part of them continue to remain on the accounts of collective farms and state farms (as their subsidiaries). Some of them, as a result of the reorganization of the agricultural sector, have become independent. The "new enterprises," such as the 700 firms in the meat-packing business, were constructed in accordance with the recent policies of the government. Its overriding aims were to develop remote areas, to reduce the waste in agricultural raw materials, and to increase the efficiency of production. To do this, the government has proposed to tap not only central funds, but also the resources of the agricultural businesses in various raions of all oblasts.

But the formation of market relations in the agro-industrial complex is progressing with

difficulty. The ties between rural commodity producers and the processors are being sundered. There are also growing contradictions because of the continuing disorder in price-setting. As a result, an ever smaller amount of raw materials is being made available for processing. Because of the shortage of raw materials and the constant rise in the price of such commodities, both large and smaller enterprises must operate in the face of a constantly intensifying competition and make on partial use of their productive capacities. As a result, there has been a general decline of production, as well as a steady increase in the share of production from small shops. Thus, the latter's share has risen from 35 percent in 1993 to 42 percent in 1994 and then over 50 percent in 1995. One cannot, however, regard this as a satisfactory development. On the one hand, small enterprises do not make efficient use of the raw materials; the share of advanced enterprises is small. On the other hand, large enterprises—because of the low level of utilization of plant capacities—are being subjected to gradual degradation.

In recent years, Kazakhstan has prepared programs to promote the development of small industry in rural areas. The government prepared the "State Program for the Support and Development of Entrepreneurship in the Republic of Kazakhstan" for 1992—1994 and then 1994—1996.

In spite of its intention, the basic principles in these programs have not been implemented within the prescribed period, because of the disorganization in the state executive branch. Contrary to expectations and plans, small and medium-sized business did not become the moving force of an economic revival. That is because the policies hitherto pursued in this sphere have not contributed to the efficient operation of new forms of economic organization. The condition of small and medium-sized business is one of destitution. Kazakhstan does not have flexible mechanisms to regulate the relations between state organs and small entrepreneurs.

It is necessary to prepare a precise state conception for the development and support of small and medium-sized entrepreneurship. That is because the individual premises in the state program for small and medium-sized entrepreneurship give no opportunity to concentrate attention and resources to support this sector of the economy. Therefore, it would be sensible to create a country-level "Committee for the Support and Development of Small Entrepreneurship," to prepare and adopt a "statute on state support" for this sector, and to devise a state program to develop small business. The program should provide the material-technical, scientific, tax, insurance, financial-credit, personnel, informational, auditing, and consulting assistance. Of these various forms of assistance, consulting is of particular importance for the operation of small business. As the experience in other countries has shown, up to 90 percent of the bankruptcies in small business are due to the lack of experience and poor management. Another essential measure of support is reliable legal guarantees and state protection from the activities of mafias and racketeering. In addition, it is necessary to prepare the simplest possible normative system for creating (and registering) small enterprises in order to preclude any chance of extortion by state authorities.

Investment support for small business should be multi-tiered. At the primary level, support can be generated from the funds of local voluntary credit unions, associations, and societies of entrepreneurs for mutual assistance. At a second level, the resources can come from local authorities and also from the conversion of the regional Small Business Centers into joint-stock companies. In extreme cases where local resources do not suffice to realize a project,

assistance can be obtained from a central committee. This should be the "credit of last resort." To provide credits for small business, one should provide for using at least 30 percent of the credit resources of the national bank. An important dimension in the development of entrepreneurship can be the creation of foreign-owned subsidiaries or joint-venture enterprises. These can have branches in rural areas and various types of franchises. To attract foreign investors to the agro-industrial complex, it is necessary to establish legal safeguards to protect their capital from risk. It is also possible to mobilize the resources of the general population. This can be done by issuing securities, the proceeds of which could be used to provide funds to create enterprises in small and medium-sized business. To avoid the dispersion of resources and an inundation of obsolescent technologies and equipment, there should be a competitive system for selecting projects. This will entail the creation of permanent regional consultative councils, which will include the participation of leading specialists from various branches of the economy (and, if need be, foreign ones as well).

Considering the extreme shortage of financial resources in the period of crisis that now besets the country, it is necessary to prepare a normative basis for the creation and operation of a variety of institutions. In particular, this normative framework must encompass: (i) credit cooperatives or unions; (ii) credit and financial associations; (iii) a system of credit corporations (banks) specializing in small business loans (receiving special tax advantages in return); and, (iv) the use of the securities market.

Effective April 1, 1995, the government abolished the Fund for the Support and Development of Entrepreneurship. In our opinion, that was a correct decision, since the Fund had provided support for virtually every kind of entrepreneurial project. That, in turn, led to a lack of focus and the dispersion of its resources. At the same time, the government has designated the "Small Business Centers"—which essentially had had no financial resources of their own—to be the legal successor to the Fund. Among the possible measures of support, one is the grant of tax advantages as well as credits on preferential terms for concrete projects. In accordance with presidential edict "on taxes and other obligatory payments" (effective July 1, 1995), small enterprises lost the special tax status that they had previously enjoyed. In our opinion, this decision was a mistake, since the majority of developed countries do offer preferential tax treatment (in one or another form) for small business. In the United States and Great Britain, for example, the size of the tax rate is linked to the volume of annual income that an enterprise earns. For small enterprises in the food-processing branch, it is possible to provide for taxes in the range of 5 to 20 percent (depending on their annual income). It is also possible to create special tax advantages in the form of tax credits, which would correspond to world practice and which is especially urgent now that the "tax holiday" for small and medium-sized business has been abolished. Other privileges that might be extended to small business can include free use of premises and land, abolition of all local assessments, elimination of certain local (oblast) taxes, and the leasing of equipment. The support by local authorities and Small Business Centers, furthermore, should include measures to provide entrepreneurs with production facilities. The government should also create so-called "economic quarters" or zones based on the German model.

#### **5.4 Private Ownership of Land and Problems in Its Realization**

At present, land relations are regulated by a new law "on land" (the presidential edict of December 22, 1995, which has the force of law). According to this law, it is possible to

transfer to private ownership of citizens of Kazakhstan land plots that were previously used as individual household plots and also used for the construction of private dachas. In addition, the law also allows citizens and non-state legal entities (include foreign ones) to acquire ownership of land plots needed for the activities of enterprises. These lands are given for the construction of production and non-production buildings, installations, and other complexes (including the land needed to service the foregoing). Concretely, this category of owners has now acquired land to build plants, factories, stores, restaurants, offices, barber shops, saunas, residential apartment buildings, and the like. The owners of such land have the right to conclude any transaction with respect to the land (unless explicitly prohibited by law). For example, sell the plot at mutually agreed upon price, or transfer the land as their investment in the founding capital of a partnership, or use the land as collateral. In short, they can use the land in any way they see fit. The law affirms that, for the first time, land in Kazakhstan has become the object of purchase and sale, although in a limited volume. The above categories of land, which have become the subject of private ownership, in the immediate future will come to encompass approximately 6.8 million hectares (three percent of the total land resources in Kazakhstan). In addition, this process is concentrated in the most highly urbanized territories, and that will be a favorable factor in the organization of production and commercial activities.

At the same time, the presidential edict prohibits that land plots of agricultural significance be turned into private property. Rather, agricultural land can only be held in "permanent use." However, this permanent user of the land user does have the right to sell his right to that land utilization or to lease the land to another party. The main legal difference between the rights of land owners and land users is that land can be taken away from the land user. That can happen in the event that the land is not used for its specified purpose or the laws are violated in some way. In contrast to the right of private ownership of land, the right of permanent use cannot be given to foreign citizens. However, the latter can acquire the right to the temporary use of land (on the basis of a lease).

The law on collateral, as established by this presidential edict, applies both to private land and to land held in individual use. In many respects, it should facilitate access to bank credits. The mechanisms for realizing the collateral law (as well as the juridical norms and procedures for regulating the mutual relations of both parties in a collateral transaction) are specified in presidential edicts of December 1995. These two edicts ("on mortgages" and "on state registration of the rights to real estate and transactions involving such property") have the force of law. As a result, for the first time Kazakhstan is introducing a land cadastre (i.e., a system that juridically fixes land rights and the rights of property). These edicts also established the principle of land payments. The payment to the government for land (which is assessed as a land tax or leasing fee) is determined by the quality, location, and the supply of water available to a land plot. The land payments are assessed according to a procedure specified by the legislation of Kazakhstan.

However, the land tax, assessments from market transaction, and fines can be effective only if they are based on scientifically determined norms. The land must have a starting price that is approximate to its market value. The law allows three months to carry out the enormous work of determining the value of land. However, given the existing financial, technical, and personnel of the pertinent state organs, it is simply impossible to complete this work anytime in the near future. At present, the state land service has prepared a temporary methodology for determining the normative price of agricultural lands. According to this method, the normative

rates for land are based on the principle that the land price equals the capitalization of its rent. It encompasses not the entire profit, but only that part which is a differentiated income; this depends on the quality, location, and water supply of a land plot. According to the calculations based on this method, the monetary value of land is approximately equal to three times the normative gross product (measured in world prices). This was one of the indicators in the third round of land evaluations for the base period of 1980—1986. Given this simplified approach, all land will carry a high price. However, this is contradictory to reality, since agricultural land brings losses rather than profits (which is tantamount to making the land worthless). Under these conditions, it is possible that the government will have to transfer a large part of the agricultural land to private ownership or individual use on advantageous terms or even without any compensation.

Organizations designated to control the use of land are in a destitute condition and in no position to exercise control to ensure that the land is used for its designated purpose. The danger of abuses and corruption is growing. The legal registry of agricultural land can only be based on a land cadastre; however, the basis of the land cadastre, especially with respect to its assessment of land values, does not today correspond to the demands of the market. The organization of land presupposes that two conditions are fulfilled: (i) creation of a juridical basis; and, (ii) preparation of a mechanism for the purchase and sale of land. The first condition, with certain reservations, can be said to have been met. But the second is yet to be satisfied. A land market is meaningless without an established system to register land and real estate and any transactions involving them. Therefore, much organizational work is still need to form the corresponding network of intermediary organizations to handle this task.

## **5.5 Agrarian Production and Marketing**

For purposes of studying the condition of the domestic and foreign markets, the Ministry of Agriculture has created a center for marketing research and market information. The main focus of its work is to collect, process, and disseminate market information. The Ministry is taking measures to organize a system that will provide the rural commodity producer with reliable and regular information. In addition, it concludes contracts for the free exchange of information with the ministries and agencies; it is also establishing contacts with the Ministry of Agriculture of Russia. It has established a computer connection with the International Agro-Industrial Exchange; it provides a flow of information to oblast marketing structures through electronic mail (within the communications system of the State Property Bureau). It has sent out a packet of documents, which contains a “conceptions” for further measures (with the approval of the Ministry of Agriculture). These measures include the construction and operation of an informational system on marketing, the structure and technology for supplying information, and the founding contract for the creation and operation of a “Fund for the Development of Marketing Infrastructures and Market Information.” The oblast marketing services have every opportunity to use the system of information. At present, four oblasts (Kostanai, Torgai, Pavlodar, and Aktiubinsk) are actually prepared to tap into this system. Despite the measures taken to supply rural commodity producers with market information, many areas (especially those in remote raions) do not have an opportunity to study market conditions because they are not equipped with the necessary means of communication. However, this gap can be filled by using radio, television, and the press. As a result, the government is preparing a decree “on the state delivery of information on agricultural

marketing.” It provides for allocating, free of charge, each week a certain amount of radio and television time (as well as space in newspapers) for such information. The adoption of this decree will improve the study of the market and ensure a broad dissemination of the findings in marketing studies.

An exchange trade in agricultural commodities is also being established, a change that can also contribute to the development of cooperation. On the basis of exchange information, one can analyze the prices on the domestic and foreign markets, forecast the primary costs, and recommend export prices on agricultural products. The price commission and the marketing service will provide an integrated, coordinated export price policy for the whole country. The minimal starting prices recommended by the commission are obligatory for all economic entities (regardless of the property type). The work of the commission contributes to safeguarding the interests of commodity producers by preventing the sale of goods at dumping prices. As a result, in 1995 the average price (in dollars per ton) rose from the levels in the previous year: from US\$29 to US\$97 for wheat, from US\$14 to US\$57.2 for barley, from US\$55 to US\$309.5 for rice. The government is now preparing a draft decree “on the development of futures markets.” Its purpose is to establish market mechanisms to determine the prices of goods, to forecast prices, to protect the market from price risks, and to provide conditions for a broad participation of producers and consumers in the exchange trade.

An analysis of the contemporary condition of the market for foodstuffs shows that the producers of agricultural commodities cannot earn a profit by selling their goods directly to the consumer. As a result, they must sell these commodities to wholesale intermediaries, who in fact receive the larger share of the income. To change this situation, various kinds of agricultural associations and cooperatives are being created. Their goal is to provide an organized sale of agricultural products through commodity exchanges and wholesale markets for foodstuffs. These organizations also handle the delivery of essential materials, supplies, and other resources. Branch associations of agricultural commodity producers have been organized in all the raions of Semipalatinsk Oblast. In a number of raions of Aktiubinsk, Karaganda, and Pavlodar oblasts, agricultural producers have held founding assemblies to register grain, milk, and seed-growing associations.

At the present time, it is particularly urgent to address the question of producing good-quality products and providing controls to ensure that mandatory standards are observed. In the course of the reorganizations in many oblasts and raions, there has been a sharp reduction in the number of specialists and even a liquidation of the services responsible for exercising state inspection controls over the quality of products. In 1985, these services employed 820 inspectors, but today they have only 92 inspectors. In addition, 161 raions do not have a single inspector. And several oblasts (Zhambyl, Zhezkazgan, Kzyl-Orda, Zapadno-Kazakhstan, Mangystau, and Torgai oblasts) have abolished altogether the services for supervising quality in oblast and raion agricultural enterprises. That has created favorable conditions for a violation of standards and the technical conditions for production in the agrarian sector. In the light of all this, the government has worked out a conception for the structure and operation of inspection services. To coordinate the work of these services, it has established a council under the leadership of the deputy minister of agriculture; its goal, above all, is to increase control over the quality and prices of export goods.

## 5.6 The Reforms and the Condition of Irrigated Land

The extremely critical situation that has developed in the agrarian sector has had its impact on the condition of irrigated land and the irrigation network. The engineering system for land improvement and water, which was constructed at colossal expense, is deteriorating and breaking down. Irrigated lands (the main reserve for the stable production of goods under the arid climatic conditions in the country) are degenerating into the category of unusable land. In the last four years, this has resulted in a decrease in the productivity of crop cultivation from irrigated lands (on the order of 1.6 to 1.8 times). Each year, the country neither uses nor waters a significant area of previously irrigated lands. Thus, in 1995, of the 2,373,000 hectares of irrigated land, crops were not grown on 450,000 hectares of irrigated land (18 percent of the total available). The reasons for the non-utilization include: salination and degradation into bogs (180,000 hectares), breakdowns in the irrigation, drainage, and run-off system (144,000 hectares), and miscellaneous other reasons (126,000 hectares). In addition, according to the melioration cadastre, 828,000 hectares of irrigated lands now belong to the category of "adverse land" and hence have a low productivity.

The country continues to show a tendency of insufficient application of advanced methods of irrigation. Thus, of the 12,000 sprinkling machines (including 4,600 wide-span sprinklers), some 7,500 virtually did not function at all. The majority of the sprinkling aggregates and installations were not used because of the enormous expense of energy and spare parts, because of the shortage of technical personnel (in turn due to the low wages), and in general because of the unprofitability of using such equipment given the current leasing and market conditions. Apart from the foregoing, the main reason is the fact that most agricultural consumers (as well as the raion and oblast services) lack specialists in hydraulic technology who would be qualified to resolve these questions. Nor is the utilization of irrigated land on the basis of underground water being done in the best manner. The lack of the necessary services to exploit and the materials and machinery for this have essentially nullified the efforts of agricultural producers to tap this resource. The significant increase in the price of energy has also had a negative impact on this. Because of the lack of deep-well pumps (due to their higher cost) and the significant cost of electricity, the products obtained from irrigated land are becoming unprofitable. Hence many agricultural operations decline to use electrified wells.

It is now necessary to reconstruct the irrigation system on at least 1,000,000 hectares of irrigated land and to construct (or reconstruct) the drainage network on more than 180,000 hectares of land. This would significantly improve the land. However, the necessary capital investments have not been allocated, and this raises a threat to irrigated agriculture and poses serious doubts about its future. On January 1, 1996, the debts of agricultural producers for irrigation water amounted to more than 800 million tenge.

A similar situation is apparent with respect to the watering of pasture lands. According to materials on the inventORIZATION of irrigated pasture lands in the Kazakh SSR on November 1, 1988, 7,974 (31.8 percent) of the total of 25,061 shaft wells needed to be rebuilt. From the same data, 6,727 (21.8 percent) of the 31,144 drilled pipe wells were in need of reconstruction. In 1995 (according to data from the Oblast Agriculture Administrations) the country had 13,611 shaft wells and 19,350 drilled wells; these represented only 54 percent of the shaft wells and 61 percent of the drilled wells reported in 1988.

The decrease in the number of watering installations poses a serious threat to animal

husbandry. The underlying causes here are the same as in land irrigation: the insolvency of those who own these fixed assets for supplying water to pasture land. As a result, the oblast organizations of the former state agency "Kazsel'khovzodosnabzhenie" [Kazakhstan Agricultural Water Supply] have either suspended their operations or lost part of their productive capacities. For many years, these organizations had provided the foundation of the repair infrastructure for the water supply installations of the Ministry of Agriculture. To avoid a further decline in agricultural production on irrigated lands, it is essential that the following steps be taken: (i) change the structure of sown areas so as to increase the proportion of highly productive and more profitable crops with a reliable market (cotton, sugar beets, tobacco, winter cereals, and feed corn); (ii) allocate resources from the Fund for the Financial Support of Agriculture to repair and construct the drainage system on 160,000-180,000 hectares, carry out a capital plan for 20,000 hectares of irrigated lands, and provide power pumps and repair of pumping installations; (iii) devise a mechanism for the government to confiscate irrigated land that is not being rationally used; (iv) organize support for seed-growing. There is no shortage of new varieties. However, because of the collapse of the state system of seed-growing and the lack of state support, newly developed domestic varieties have not been widely adopted for production. Instead, because of these circumstances, the agricultural sector is actively putting into production expensive foreign varieties (along with the technology required to cultivate them).

### 5.7 Export Potential of the Agrarian Sector

The export potential of the agrarian sphere in Kazakhstan is estimated at US\$1.3 to 1.5 billion. The most substantial export items are grain and its processed products, meat and meat products, fish products (including sturgeon caviar), cotton, wool, and raw leather. The main thrust of development in exports is to ship out finished products, rather than the raw materials now being exported. Grain (including hardy varieties of wheat) enjoys a firm demand on markets. However, it is economically in expedient to export grain, since the price for grain is less than one-third the price of flour. The productive capacities of the mill industry would make it possible to export a million tons of first-quality flour each year and thereby earn up to US\$500 million.

It is also possible to enter world markets to sell rye and its products. Given contemporary conceptions of a healthy diet, dark bread is gaining a more prominent role. At present, this market has been largely ignored. There is an enormous potential for the production of rye. Its output now fluctuates between 400,000 and 600,000 tons, while domestic demand stands at only 100,000 tons. In addition, some regions (Aktiubinsk, Ural, Vostochno-Kazakhstan, and some northern oblasts) can significantly increase their production of this cereal.

The export of licorice root (and extracts derived from this) can also become a source of hard-currency earnings. The price on the foreign market for a standard-sized licorice root (cleaned; 10 cm in length and 1 cm in diameter; 12 percent moisture content) is US\$1,600 per ton. The yield of licorice roots, if undertaken as an industrial crop, can be at least 20,000 tons of root per hectare (with a moisture content of 5 percent). Furthermore, the cultivation of licorice can contribute, to a certain degree, to bolstering the fodder base for animal husbandry, since it produces 5 to 6 tons of fodder per hectare. Despite the fact that licorice production is only possible on irrigated land, the water requirements of licorice (compared with other crops) is

small: the water norm is 800-1200 cubic meters per hectare during two to three waterings per year. Moreover, it is able to tolerate the salination of the soil (2-2.5 percent for cuttings and 1-1.3 percent for seeds). An expansion of licorice cultivation in the Tady-Kurgan, Chiiliisk, and Syr-Darya raions of Kzyl-Orda Oblast (and also in a number of raions of Chimkent Oblast) would help to reduce the volume of water taken from the Syr-Darya River. Under present conditions, it would make sense to organize the industrial production of licorice root in Kzyl-Orda, Chimkent, Ural, Almaty, and several other oblasts. Calculations show that, in its seventh year, the licorice industry could earn approximately US\$ 2 million per annum.

No less important for earning hard currency is the expansion of the area sown to flax as the raw material for high-quality linseed oil (to be used for food and industrial purposes). The leading producer of flax in the world is now Canada, followed by Argentina, but the production of linseed is constantly increasing because of the high prices. Kazakhstan has the natural climatic conditions to cultivate flax. Flax is a crop with great potential. Under the conditions in Kazakhstan, its linseed contains 40 percent oil. The linseed cake left after the extraction of the linseed oil provides a concentrated animal feed for livestock. The straw from flax contains 10 to 15 percent fiber, which is suitable for using as canvas, burlap, twine, and oakum. Flax chambers are used to obtain furfural. The natural climatic conditions of the northern oblasts are favorable for the cultivation of flax. An expansion of the area sown to flax does not require additional costs, since the agricultural machinery required for its cultivation is similar to that used to raise cereal crops. However, it is necessary to solve two problems. One is to arrange the seed-growing for flax, with the concentration of varietal sowings in experimental seed-growing farms. The other is to apply extensively the more progressive forms of labor organization. Calculations show that it is possible to increase the production of linseed to a volume of 160,000-200,000 tons. This will make it possible to produce 55,000-75,000 tons of linseed oil per year. Taking into account the use of part of this oil for industrial purposes (to satisfy the needs of the population for industrial goods) and for foodstuffs, it is possible to sell 20,000-35,000 tons of linseed oil for hard currency. Such exports earn the producers US\$15 to 20 million per year.

Hard currency can also be earned from non-traditional forms of production. Thus, Taldy-Kurgan Oblast can engage in raising frogs for export (especially to China and France), for it has all the requisite conditions. Subterranean thermal waters have been begun to be used for mineral-bath sanatoria, heating of buildings, and several hothouses. Upon discharge the water is at room temperature; that forms the natural conditions to support the growth and proliferation of frogs. Here a complex of problems can be addressed: the enterprise will earn hard currency, and the water discharge can be used for economically beneficial purposes.

Another reliable source of export earnings is the shipping of food products from the fishing industry, including sturgeon caviar. Another is the export of the antlers of Siberian stags, products from which are recognized as a delicacies on the world market and as a raw material for the production of medicinal preparations.

## **5.8 Integration Process in the Agriculture**

To raise the efficiency of the agro-industrial complex, it is necessary to create a system of agro-business by giving attention to the integration and cooperation of agricultural, processing, trading, and other organizations. In the formation, on a new basis, of long-term economic ties and contracts, as well as the on-schedule sale and payment for products, a major

role belongs to the exchanges, small wholesale markets, associations of commodity producers, and various other kinds of organizations.

An increase in the efficiency of the agro-industrial complex (together with the above forms) can be promoted by the following forms of integration: (i) the joining of large trade and industrial capital with agriculture by forming various kinds of production associations (cooperatives, associations, corporations, combines, etc.); (ii) association through the usual short-term contracts and agreements; (iii) formation of industrial-commercial groups, which include the producers of agricultural and food products, banks, supply and sale infrastructures, insurance agencies, scientific-technical production, etc. International practice shows that, in combining the interests of rural commodity producers and processors, higher results are obtained from integrative systems with a maximum completeness in the production of goods. To weaken the effect of monopolies, it is necessary to have multiple firms operating in the same sphere of activity. Therefore, a number of economists deem it expedient to review the existence of the present associations, including joint-stock companies, and to consider the need to modify these.

It is possible to establish various kinds of vertical cooperation, associations, companies, joint-stock companies, associations, firms with limited liability, agro-consortia, and the like. The leading role in this integration can be played by large industrial or commercial capital, which becomes involved in agriculture and acts under the influence of market demand. Collective agricultural forms (cooperatives, etc.) can reach an agreement among themselves, and with industrial enterprises, to create various types of organizations. Private enterprises can participate directly (for example, by purchasing stock and concluding contracts) or indirectly (for example, by creating horizontal cooperatives, which can form an integrated system). At this stage, the formation of such market structures as production-commercial centers could be of significance. At the raion level, it is especially important to create trade-industrial financial groups. For this, it is necessary to buttress their status and security in law. Moreover, it is necessary to ensure that the distinctive feature of industrial-financial groups is a strong bank, which fixes the mechanism for combining and the inter-penetration of banking and industrial capital. One must not permit, under the guise of being an industrial-financial group, the analogs of the former ministries to enjoy the special privileges and advantages of such associations. Other variants include inter-branch, inter-regional, and multi-functional associations. The organization, its composition, and its form depend on the peculiarities of each region and the character of the economic branch.

## **5.9 The Development of Entrepreneurship and Competition**

This is an important factor in raising the efficiency of production. To achieve the desired results, it is necessary to have identical conditions for the development of different forms of economic organization: collective farms, state farms, joint-stock companies and collective enterprises, cooperatives, small enterprises, and associations of peasant farms. In the course of a healthy competition, this will contribute to increasing their vested interest in increasing the volume of production in agriculture. It will also help to create the conditions favorable for the creation and development of small private enterprises to process agricultural commodities. To do this, the following are required: First, provide all producers of agricultural products with an equal opportunity: (i) to acquire machinery and supplies; (ii) to obtain assistance in agricultural matters (crop cultivation, zoo technology, and veterinary medicine),

economic matters, and the sale of products; and, (iii) to obtain credits from specialized agrobanks. Second, adopt a law on "small business" and prepare a "Program for the Support and Development of Small Business."

Development of entrepreneurship for any organizational form and for different scales is only possible if enterprises are given the freedom to engage in economic activities and if they are backed by solid legal guarantees. In lieu of administrative control over the management of an enterprise, market forms should come into play—i.e., control on the part of banks, stockholders, and the stock market. To regulate the interrelations with the state, it is necessary to prepare and promulgate a "code of administrative law," which will make the actions of state authorities and administration more controllable and predictable. Furthermore, it is necessary to adopt a normative base with respect to collateral and bills of exchange. This should include the following: (i) a unified system to register collateral; (ii) a decrease in the state duty for notarizing collateral transactions; (iii) more order and a simplification in the judicial mechanism to seize mortgaged property; (iv) implementation of harsh measures to ensure the accountability of those who issue bills of exchange; and, (v) introduction of an accelerated procedure for arbitration courts and declaration of bankruptcy by borrowers. To make entrepreneurs more obedient to the law, it is also necessary to establish a legal upper limit for the income tax of enterprises. This would serve to diminish the opportunities for tax evasion. To support competition and to avoid the formation of monopolies, the activity of large conglomerates should strictly observe the anti-monopoly laws. Harsh measures should be applied against those who violate the laws. These measures should include the confiscation of profits exceeding the established level and the assessment of fines and sanctions on a scale several times the amount of additional profit earned. It is, furthermore, possible to establish a progressive tax on the increase in profit obtained by a growth in prices.

For purposes of creating a favorable investment climate that would contribute to the development of entrepreneurship, it is essential to do the following: (i) create a system of state-commercial insurance on investments, which, to the maximum possible degree, is consistent with the international system for providing insurance and protection of commercial capital; (ii) purchase imported equipment by using (among other sources) the means allocated by the IMF and other organizations, and abolish the customs duty on imported machinery and equipment; (iii) in addition to the national leasing company ("Asia-Leasing"), establish regional and sectoral leasing companies, and use different forms of leasing (financial, commercial leasing, etc.); (iv) prepare a law on "investment competition," which would provide for a simplified procedure to change investment programs that have already been promulgated (in the event of an increase in the efficiency of technology); (v) grant an exemption from income tax on the production of secondary raw materials as well as profits that are reinvested; (vi) give income tax privileges on goods produced beyond the level of production in the previous year; (vii) provide an income tax exemption of financial investments used to purchase stock in investment bids and to acquire more than 10 percent of an emission; (viii) impose taxation on juridical entities as a whole, not their subdivisions; (ix) make a transition to the assessment of the value-added tax (VAT) on the amount of the fund of wages and profits, and increase the differentiation, which will also make it possible to control aggregate demand for individual products, diminish the price disparities, and ensure stability in the collection of the main tax assessments; (x) grant commercial banks the right to invest in the agro-industrial complex, and to place part of their surplus in the national bank on previously-established terms; (xi) create, together with the countries of the

Commonwealth of Independent States (CIS) with greater purchasing power, and with Kazakh commercial formations, an international agency of cooperation in the sphere of the agro-industrial complex, along with a whole complex of business services.

Entrepreneurial activity under market conditions should be realized on the basis target plans, which are coordinated with national programs for individual branches. But, above all, it should be tied to business plans or marketing programs, the main documents of strategic planning for activity (from the preparation of a project and production to the sale of goods). With the assistance of marketing, make a detailed study, analyze, and then forecast the demand of consumers. In the final analysis, this will make it possible not only to create a competitive market for foodstuffs, but also to avoid disproportions. In large enterprises and conglomerates, it is expedient to create special marketing services. Small enterprises should probably join forces and use their financial resources to establish such activity through specially created branch marketing centers. The economic mechanism of a producer's vested interest in delivering agricultural commodities on a specified schedule (in the necessary quantity and quality) can consist not only in the participation of agricultural producers in profits as shareholders of enterprises, but also in establishing guaranteed surcharges to the prices through contracts on deliveries. As for new agro-industrial projects, their viability is also determined by the reliability of all the component parts: delivery, processing, and marketing. The logical basis for an analysis of projects is marketing, which will determine the reaction of the exterior environment to the production of this or that good (by examining its consumer characteristics and the competition on the market).

## **6. Main Dimensions of Agrarian Reform, 1996—2010**

### **6.1 Primary Objectives of the Agrarian Policy**

It is essential to work out a conception for the development of individual branches in the agro-industrial complex, taking into account the peculiarities of each. It should be based on the following premises: (i) rely, above all, on one's own resources; (ii) transform production while taking into account the demands of the marketplace, but do not attempt to demolish whatever remained from the old order if this does not impede production; (iii) recognize the equality of all types of property and economic organization.

The oblast conception for the development of branches in the agro-industrial complex should provide for the following: Firstly, integrate the economic interests of commodity producers and those who process these goods. Secondly, integrate large joint-stock companies in industry with the joint-stock companies of agricultural enterprises (with common property and land shares). Thirdly, provide investment for large projects through the joint efforts of industrial enterprises and local government budgets. Fourthly, apply intensive economic practices and newest developments of science. Fifthly, so far as possible, preserve the re-establishment of large livestock complexes, in which animal husbandry is steadily expanded. Create specialized enterprises and subdivisions to raise fodder crops. For the production of animal feeds, establish associations of specialized enterprises and joint-stock companies. Lastly, create, on a self-paying basis, seed-growing firms, with common tasks and funds, under the supervision of scientific institutions and enterprises to grow seeds for more productive agricultural crops.

These programs should reflect the proposed structural improvements in the agro-industrial complex. The further condition for the improved supply of foodstuffs for the population is the development of the food and processing industries and their storage facilities. This development should proceed at a faster pace than in agriculture itself, since the development of the base for storage and processing (through improvements in technology and equipment) requires far smaller capital outlays than an expansion of agricultural production itself. This is the reason for the need to reconstruct and re-equip the existing medium-sized and large enterprises, and to construct new ones as well, all on the basis of a competitive selection of proposals.

The structural policy should differentiate between country and oblast levels: (i) at the country level, it is necessary to provide for the creation of favorable conditions to increase the production of raw materials, resources, and finished products that hold inter-branch, inter-regional significance; (ii) at the oblast level, it is necessary to resolve the problems of food production and consumption in individual regions by achieving, within reasonable levels, self-sufficiency in foodstuffs. First priority should be given to the following: (i) the industry for manufacturing baby foods, the packaging industry, and the storage base; and, (ii) the development of a network of small enterprises, especially in rural areas.

To realize the regional programs, it is expedient to use—along with budget resources—the capital of joint-stock companies, private individuals, and foreign investors. In addition, it is necessary to provide for a mechanism to stimulate investments whereby the investor who places his funds in the development of an enterprise has the right to receive the corresponding number of shares. As for foreign investment, it is necessary to renounce credits backed by state guarantees (with the exception of equipment for the production of food products for children), but rather to attract investments. That can be done by using fixed assets as collateral, clearing operations, creating joint-venture enterprises, leasing, and so forth. The scientific-technical policy should consist in the improvement of traditional technologies as well as the application of new ones. These should be characterized by the complex processing of raw materials, by increasing the production of goods with a longer shelf life, and also by organizing the production of goods in individual bags and packages. To provide enterprises in the agro-industrial complex with modern machinery and equipment, it is essential to expand the collaboration with countries in the CIS and to increase the purchase of imported spare parts. For the most rapid realization of the new technical policy, it is necessary to form a system of wholesale markets for industrial goods (based on the state's function in regulating market relations). For purposes of ensuring quality control of food products and to protect the consumer, it is necessary to form a state system for hygienic control and for the certification and standardization of foodstuffs.

## **6.2 Development of the Production and Processing of Agricultural Raw Materials**

The development of the food-processing industry by the year 2010 allows for two main phases: (i) Stage 1 (1996-2000): resolution of the crisis phenomena and stabilization of production; (ii) Stage 2 (2000-2010): transition to an intensive path of development. The first period aims to stabilize the financial and economic condition of enterprises, to overcome inflationary processes, and to develop entrepreneurship, competition, and a market infrastructure on the basis of an agrarian reform. The main goal of the second phase is to create

a market and structural corrections, which will make it possible to increase the efficiency of industry and the competitiveness of products.

Despite the general growth of production (in Stage 1) in the processing industry (food-processing by 116.5 to 126.7 percent; milling and grinding by 127 to 130 percent), the decline of production in branches for processing agricultural commodities will continue to persist until 1997-1998. In Stage 2, there will be a gradual growth of production, but one should not expect a major leap forward, since agricultural production (given its high degree of inertia) cannot develop at a high pace after so profound a crisis in earlier years. Furthermore, the extremely low level of the food-processing enterprises, together with their backward technology (which prevents the production of high-quality goods with an attractive appearance that could appeal to consumers) will retard the production of foodstuffs. In addition, it will be necessary for industry to regain its place on markets in the CIS, an extremely difficult task. Finally, one must also take into account the low purchasing power and hence limited demand of the general populace. Given the growth of production in the food-processing industry by the year 2010 (on the order of 140 to 160 percent), this branch will nevertheless fail to regain the production level it had at the beginning of the 1990s. However, the milling and animal feed industries, because of a growth of 150 to 170 percent, can be higher than the 1990-1991 level.

### 6.3 Development of Agriculture

The contemporary state of affairs in this branch attests to the fact that the current crisis will continue to exert a negative influence for the next five to seven years. That is because the problems in agriculture are so complex and diverse—for example, sharp decline in the fertility of arable land, the disruption of technical requirements for the reproduction of livestock, the destruction of the material and technical base, the sometimes ill-conceived reorganization of enterprises. The agricultural problems will persist even if the general economic conditions stabilize. Each year the land under cultivation is contracting. And branches like the cultivation of sugar beets and the industrial production of hogs and poultry have virtually collapsed.

The negative consequences of all these phenomena will accumulate until the economy's health is finally restored. This means that, compared with 1994, there will be a sharp contraction in the supply of domestically-produced foodstuffs by the year 2000. Specifically, per capita production will decrease for meat and meat products (from 56 to 46 kg.), milk and milk products (from 234 to 192 kg. [measured in terms of whole milk]), eggs (from 148 to 77 units), and vegetables and cucurbits (from 58 to 47 kg.) There will be some increase in the consumption of potatoes (by 9 percent) and fruits (by 50 percent) through the development of privately-held plots as well as collective gardening and horticulture. The main food product will remain bread. By 1994 bread consumption already exceeded the norm by 1.9 times, and this indicator will increase to 2.4 times by the year 2000. The state of sugar-beet cultivation will come to the point where sugar refineries will obtain only 6 to 8 percent from domestic raw materials.

For an improvement of conditions in the agriculture by the year 2000, the following problems must be resolved: (i) establishment of economic control over the agrarian sector by forming a regulated market; (ii) improvement of tax policies; (iii) creation of a better mechanism to supply credit to the village; (iv) establishment of a system of state support (which, in the first instance, will enable agricultural enterprises of all types to restore their working capital); (v)

continuation of land reform; (vi) preparation of a scientifically based model for the rational organization of agriculture and all branches of the agro-industrial complex to allow for a diversity of economic forms (taking into account natural and climatic conditions); (vii) preparation of a conception for the development of the agricultural sector in each oblast; (viii) liquidation of the negative consequences of the privatization of agricultural enterprises; (ix) creation of conditions to support the further development of privately-held plots and gardens, various forms of agro-industrial integration and cooperation, entrepreneurship, and competition; (x) realignment of the system of administration for the agro-industrial complex to the conditions of its work and the requirements of the agrarian sector; (xi) an increase in the effectiveness of scientific support for this branch.

With an improvement in the economic situation and the resolution of problems in the agrarian sector itself, the conditions will be laid for the expansion of production in agriculture. An increase in the production of cereals will create the conditions for a restoration of the commercial raising of hogs and poultry, which will improve the supply of meat for the population.

An improvement in the financial condition of the agrarian sector will make it possible to satisfy fully the agricultural and zoo technical requirements of this branch and to utilize the natural climatic and resource potential. All this will contribute to an improvement in the supply of food products for the population and raw materials for industry. By the year 2010, domestic producers will be able to supply much of the population's need for meat (98 percent), milk (74 percent), eggs (39 percent), vegetables and cucurbits (75 percent), and fruits (59 percent). The capacity of the sugar refineries will obtain 22 to 26 percent of their raw materials from domestic sources. The domestic demand for bread products and the need for animal feeds (for livestock and poultry) will be fully satisfied by the year 2000. The country will then have the capacity to export 3.0 million tons of grain in 2005 and to increase this amount to 3.3 million tons in 2010.

The share of non-state formations in gross output will rise from 67 percent (1994) to 84-85 percent (2010). The state will retain ownership of those enterprises that determine scientific-technological progress in this sector. The share of state capital investments in the total volume of all capital investments will amount to 50—58 percent, which is somewhat lower than it is at the present time. This will be promoted by economic stabilization. State capital investments will be directed toward increasing the fertility of the soil, improving natural fodder resources, developing elite seed-growing and selective-breeding farms, and generally supporting those goals that determine scientific-technological progress in this sector.