

**AN INDUSTRIAL DEVELOPMENT OF THE TRANSITION COUNTRY AND ITS
INTEGRATION IN TO THE WORLD ECONOMIC COMMUNITY**

: FROM THE PERSPECTIVE OF THE REPUBLIC OF KAZAKHSTAN

By

Iskaliyev Marat

THESIS

*Submitted to
KDI School of Public Policy and Management
in partial fulfillment of the requirements
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MASTER OF PUBLIC POLICY

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Contents:

Abbreviations, Acronyms and Websites	4
List of Tables	4
List of Figures	4
INTRODUCTION	5
OVERVIEW AND BACKGROUND OF THE ECONOMY OF KAZAKHSTAN	8
✓ <i>Period of initial development (1991-1998)</i>	8
✓ <i>Period of Rapid Growth (1999-2002)</i>	8
✓ <i>Steady FDI Inflows</i>	9
✓ <i>Trade overview</i>	9
✓ <i>Kazakhstan: An Oil Economy</i>	13
✓ <i>Reasons for the Energy Export-oriented Economy</i>	15
✓ <i>Advantages for High-grade Integration into the World Economy</i>	17
DEPENDENCE ECONOMY ON NATURAL RESOURCES	20
✓ <i>Qualitative analysis</i>	20
✓ <i>Quantitative analysis</i>	22
THE NON-OIL SECTOR IN KAZAKHSTAN:	
LINKS WITH THE OIL INDUSTRY AND CONTRIBUTION TO GROWTH	23
✓ <i>Sources of Growth in Kazakhstan</i>	24
✓ <i>The Impact of the Oil Sector</i>	25
✓ <i>Sectoral analysis the non-oil industry</i>	27
NEW INDUSTRIAL POLICY IN KAZAKHSTAN	29
✓ <i>Analysis of Global Economic Trends</i>	29
✓ <i>Diversification of the Kazakhstan Economy</i>	30
✓ <i>Using Investment And Production Potential of Fuel And Energy Complex and Other Fundamental Sectors of the Economy to Determine Priorities for Industrial Modernization.</i>	38
✓ <i>Potential Priorities for Establishment of Science Intensive and High-Tech Productions</i>	42
✓ <i>State development institutions</i>	43
✓ <i>Analysis of industrial policy</i>	44
KAZAKHSTAN IN THE WORLD ECONOMIC COMMUNITY	46
✓ <i>Trade liberalization and WTO accession</i>	46
✓ <i>Kazakhstan in the WTO</i>	49
✓ <i>Kazakhstan in the Regional Economic Integration Framework</i>	55
✓ <i>The economic cooperation of Kazakhstan with Northeast Asian region</i>	60
✓ <i>Perspectives of Kazakhstan's Integration into the World Economy</i>	65
CONCLUSION	68
✓ <i>Concluding remarks on industrialization of economy of the Kazakhstan</i>	68
✓ <i>Concluding remarks on integration of the Kazakhstan into world economy</i>	69
BIBLIOGRAPHY	71
APPENDIX	72

Abbreviations, Acronyms and Websites

EBRD – European Bank Reconstruction and Development

NEAC – Northeast European Asian Countries

EAEC – Eurasian Economic Community Organization

FDI – Foreign Direct Investments

GDP – Gross Domestic Product

IMF – International Monetary Fund

USSR – Union of Soviet Socialist Republic

USA – United States of America

EU – European Union

OPEC- Organization of Petroleum Export Countries

CIS – Commonwealth of Independent States

Non-CIS – Countries outside the CIS

WTO – World Trade Organization

TNC – Transnational Corporations

NAFTA – North American Free Trade Agreement

OJSC- Open Joint Stock Company

USD – Dollar of the USA

GATT- General Agreement on Tariffs and Trade

OECD- Organization for Economic Cooperation and Development

Agency of the Republic of Kazakhstan on Statistics: www.stat.kz

The National Bank of the Republic of Kazakhstan: <http://www.nationalbank.kz/eng/>

The Ministry of finance of the Republic of Kazakhstan: <http://mf.minfin.kz/>

The Ministry of economy and budget planning of the Republic of Kazakhstan:
<http://eng.minplan.kz/index.cfm>

The Ministry of agriculture of the Republic of Kazakhstan:

<http://www.minagri.kz/index.jsp?param=eng>

The Ministry of Foreign Affairs of the Republic of Kazakhstan:

<http://www.mfa.kz/english/index.htm>

National Oil and Gas Company “KazMunayGas”: www.kazmunaygas.kz

National Fund Of the Kazakhstan: www.nationalfund.kz

Kazakhstan Development Bank: www.kdb.kz

List of Tables

Table1: CIS countries in global economy, 2002

Table 2: Kazakhstan: Selected Macroeconomic Indicators, 1998-2002

Table 3: World Prices for Exports of Kazakhstan, 2001-2002

Table 4: External trade of Kazakhstan, 1995-2002

Table 5: Kazakhstan's import structure as a percentage, 2001-2002

Table 6: Kazakhstan's export structure as a percentage, 2001-2002

Table 7: Economic Growth and Productivity by Sector

Annual average 1996-2001 (percentage change)

Table 8: Oil and Non-Oil Sectors (1999-2002 average)

Table 9: Industrial Electricity Consumption.

A comparative view (kWt/h per USD1 of GDP)

Table 10: Production Costs per KZT 1 of Sales Proceeds, 2002

Table 11: Global Profile of Exports

Table 12: Trade intensity, complementary and bias between Kazakhstan and its major trading partners, 2001

Table 13: Distribution of production factors by countries

List of Figures

Figure 1: Kazakhstan: Real GDP and Oil Production, 1998-2002

Figure 2: Producer's value-added chain

(car building, computers, aircraft building, electric machinery)

Figure 3: Buyer's value-added chain

(apparel, foot-wear, toys, household appliances)

Figure 4: Distribution of main production factors

List of Diagrams

Diagram 1: GDP dynamic for 1993-2002

Diagram 2: Real growth of GDP 1993-2002

Diagram 3: Structure of incomes by activity category for 2002

INTRODUCTION

The largest Central Asian republic, Kazakhstan, has enjoyed independence from the Soviet Union since December 16, 1991. Its population is predominantly Kazakhs (55 %), but it is home to substantial Russian minority (about 35 %) and different ethnic groups (about 10%).

At independence in 1991, Kazakhstan had a promising resource base, from its sizable hydrocarbon reserves to its well-educated workforce. More importantly, though, it had the wisdom to move quickly away from the failed policies of the past. Kazakhstan's leadership embarked on a new - transformational course. In a little over ten years, Kazakhstan implemented a series of broad-based reforms that brought Kazakhstan from planned to market economy.

Kazakhstan undertook a process of de-monopolization, privatization, debt restructuring, price liberalization, customs reform, and tax restructuring. Kazakhstan established a securities and exchange commission, liberalized trade, enacted laws on investment, established a new government procurement process, and reformed the banking system.

An European Union and the United States formally recognized this achievement when, in March of year 2002, it accorded Kazakhstan the status of a market economy, and these reforms yielded impressive results at home¹.

- Today Kazakhstan has a fully convertible currency, single-digit inflation, and a sound banking system.

- Since 1993 in economy of Kazakhstan it has been involved \$23,5 billion foreign direct investments².

¹ "Alpari" Economics Journal 2002 №3, Almaty

² Information from CJSC "Kazinvest", Almaty, www.kazinvest.kz

- Both trade and investment are diversifying, and many countries are interesting to cooperate with the Kazakhstan.

- Economic growth, though uneven throughout the last decade, has been strong in recent years.

- Kazakhstan received a good investment grade rating from Moody's and others authoritative rating's agencies.

The Government of Kazakhstan has privatized much of the economy, although much work needs to be done to restructure major sectors such as telecommunications, railway infrastructure, etc. The banking sector has flourished, with \$720 million in private deposits in March 2001. The financial system has been a leader in innovation, including the emergence of successful private pension funds, the establishment of a national fund to preserve oil wealth for future generations, and a budding mortgage-lending market. Unemployment, while still high in Western terms, is lower than elsewhere in the region. These impressive reforms took place against a background of internal political stability and the gradual advance of democratic reform and a civil society.

The achievements of its first decade of independence have brought Kazakhstan to a critical crossroad. It can continue to move forward on the road toward reform and complete its integration into the global economy and the growing family of democratic nations. Or it can lose momentum, falter in reform, and miss an opportunity to be among the new "tigers" of global prosperity in the 21st century.

By other words, despite the positive economic changes in Kazakhstan a lot more needs to be done in order to become a full-fledged member of world trade and economic community.

This study is aimed at highlighting the problem of dependence from mineral

export, development of non-oil; sector of the economy of the Kazakhstan, an analysis of new industrial policy which by Government begins to implement , the perspectives for high-grade integration of the economy of Kazakhstan into the world economic community and forecast of the economic consequences of membership the Kazakhstan in WTO. The main goals are to evaluate these issues through the following prisms:

Potential dependence from natural resources export, especially form oil and gas:

Obviously, Caspian energy resources are extremely important and give Kazakhstan an enormous advantage over other transition economies that lack natural resources. Indeed, probable reserves in the huge Kashagan field are larger than oil and gas fields of others Caspian region's countries. The Government of Kazakhstan continues to take some important policy steps, such as having concluded a Caspian delimitation agreement with Russia in summer of year 2002, in may 2004 was concluded an agreement with China about construction of oil pipeline from West Kazakhstan to East China and moves now underway to link Kazakhstan to the new Baku-Tbilisi-Ceyan oil pipeline, . Next year, Kazakhstan intends to offer for tender new offshore blocks in the Caspian that could yield more world-class oil discoveries.

It would be a dangerous illusion, however, to believe that oil wealth can substitute for resolve to finish the course of democratic and market reform. Oil alone will not bring Kazakhstan into the new global economy. Nor will it create sufficient jobs for Kazakhstan's youth or spread the benefits of prosperity to large segments of the population that remain mired in rural poverty.

In 1995, U.S. economists Jeffrey Sachs and Andrew Warner conducted a study of 97 developing countries. They found that the more important natural resources were to a country's economy, the lower its growth rate was. Of all the resource-rich countries

they studied, only two were able to grow as fast as two percent a year, while a host of resource-poor nations grew much faster³.

This problem is important today, because “tomorrow” Kazakhstan will enter into the WTO and then it will be much more difficult to solve this issue.

Problem of diversification of the economy and development of non-oil sector.

The Government of Kazakhstan has an intention to build a post-industrial economy - certainly with a vigorous energy sector - but also increasingly based on high-tech, Internet-based industries, and small and medium enterprises. Introducing diversity into Kazakhstan's economy and freeing its human potential will require a huge national effort, and a renewed commitment to democratic and market reforms, and a key objective will be making this new economy open to outside investors.

Participation of Kazakhstan in a regional economic cooperation framework and future membership in the World Trade Organization (the WTO)

Kazakhstan's economy is still too small to succeed in the world community alone without cooperation with neighboring countries. For this purpose, an analysis of participation of Kazakhstan in a regional economic cooperation framework is undertaken and some recommendations in this case are given. It is necessary to think of economic consequences of membership in the WTO.

Possible Diversification and Expansion of Foreign Economic Activities Geographically

Directly reducing the economy's exposure to changes in foreign economic policy of partners is a preventive way to limit potential damage. One way to do this is through diversification and expansion of foreign economic activities geographically, which reduces the impact of sudden changes in economic partnership with particular

³ Sachs and Warner, 3

countries. It will also facilitate fast and painless integration into the global economy.

The paper is organized into six sections:

- The first section presents an overview of the economy of Kazakhstan with an estimation of its current position in the world economy and discusses opportunities for successful development of the country in the world economic system.

- The second section will include a thoughts on problem of dependence from natural resources export, in particular oil and gas, and activities of the Government of Kazakhstan to diversify the economy.

- The third section will present an analysis of development of the non-oil sector in Kazakhstan. A links with the oil industry and contribution to economic growth in Kazakhstan.

- In the fourth section an author will try to evaluate a new industrial policy developed by the Government of Kazakhstan.

- And the fifth section depicts the relationships of Kazakhstan with the WTO and highlight the process of participation of Kazakhstan in regional economic blocs. It will be an discussion about perspectives of economic cooperation of Kazakhstan with Northeast Asian region as a priority direction for expansion of Kazakhstan's foreign economic relations and highlights the prospects of Kazakhstan's development in the world economy.

- The sixth section summarizes and concludes the major findings of the study.

OVERVIEW AND BACKGROUND OF THE ECONOMY OF KAZAKHSTAN

If measured in global terms, Kazakhstan has a relatively small economy - for 2002, the nominal GDP accounted for only 0.08 per cent of world total GDP (in 2000 - 0.06 per cent); Kazakhstan occupies the 60th position out of 182 countries⁴ on the list.

Table 1. *CIS countries in global economy, 2002*

Economy	GDP, USD	Ranking	Share of total world GDP
Russian Federation	346,520	16 th	1.07
Ukraine	41,380	54 th	0.13
Kazakhstan	24,205	60 th	0.08
Belarus	14,304	76 th	0.04
Uzbekistan	9,713	86 th	0.03
Turkmenistan	7,672	98 ^{to}	0.02
Azerbaijan	6,090	102 nd	0.02
Georgia	3,324	124 th	0.01
Armenia	2,367	135 ^{to}	0.01
Kyrgyz Republic	1,632	143 rd	0.01
Moldova	1,621	144 ^{to}	0.01
Tajikistan	1,208	147 th	0.00
CIS, total	460,036	13 th	1.43

Sources: World Bank, 2003

Among the CIS countries, Kazakhstan occupies the third position after Russia and the Ukraine.

According to estimation in 2002 GDP per capita in Kazakhstan - \$7,200 (purchasing power parity)⁵. Kazakhstan is in a group of middle-income countries, occupying about same positions with such dynamically developing countries as China, Egypt, Tunisia, Bulgaria. Similarly, Among the CIS countries, Kazakhstan occupies

⁴ Out of 208 countries, the data on 26 countries is not available

the second place after Russia, and it is in the lead in the Central Asian Region with a significant gap.

The share of Kazakhstan in world industrial production is about 0.13 percent, the share of Kazakhstan in world exports is a little bit lower than 0.1 percent.⁶

Period of initial development (1991-1998)

The breakup of the USSR and the collapse of demand for Kazakhstan's traditional heavy industry and agricultural products had considerable effect on the pace and character of further economic development of Kazakhstan.

The process of macroeconomic changes in the country is irreversible. Major components and basic conditions of the market economy have already been established in Kazakhstan. Consistent monetary and fiscal policies resulted in a considerable reduction of the inflation rate from 2,200 per cent in 1993 to 11.2 percent in 1997. In 1998 the inflation rate fell to 1.9 per cent. This was the result of a major decline in the aggregate money stock from 10-11 per cent in 1995 to 8.5 percent in 1997. In 1999 the monetization of the economy increased from 8 per cent in the beginning of the year to 11.4 percent by the end of 1999. In 2001 inflation rate estimated - 8.5%⁷

Macroeconomic stabilization accompanied by growth in production resumed in 1999. In 1998, Kazakhstan GDP dropped by 2.5 percent reaching the level of \$21.2 billion. The recession was mainly due to the Asian economic crisis and falling prices for the country's main export commodities (oil, gas, and non-ferrous metals).

Period of Rapid Growth (1999-2002)

Recently, the economic performance of the country shows impressive economic

⁵ <http://www.cia.gov/cia/publications/factbook/fields/2004.html>

⁶ Muzaparova L. M. (2001), 'Kazakhstan in World Economy: A Problem of Self-determination,' *Analytical Magazine*, Kazakhstan Institute for Strategic Research under the President of the Republic of Kazakhstan.

⁷ CIA, <http://www.anynation.com/fields/2092.html>

growth over the past four years after stagnation caused by economic transition. After posting moderate growth of 2.7 percent in 1999 as a whole, Kazakhstan's real GDP rose 9.8 percent in 2000. Foreign trade turnover was increased by almost 56.7 percent, with exports increasing by 71.8 percent. A positive trade balance of 2.6 billion USD was achieved.

In 2001, Kazakhstan built on the previous year's economic performance by increasing its real GDP by an additional 13.2 percent, easily the country's best year of economic performance since its independence. In 2002, Kazakhstan's economy grew by 9.5 percent, which is for 2.5 percent higher than the government's original projections. And 2003 the of GDP grew by 9.4 percent.

Continued rapid growth was driven by buoyant world oil and other mineral prices (until the end of 2001), robust regional demand for exports, and strong investment mainly in the country's booming oil and natural gas industries, as well as by prudent fiscal policies and economic initiatives that were started in 1999.⁸

Annual inflation has been reduced to single digits, the nominal exchange rate has been stable, and the balance of payments has strengthened considerably as evidenced by the large build-up in foreign assets. Net international reserves of the central bank have risen to \$3.1 billion, which provides for more than 3.5 months of import coverage. The government's assets in the newly created national fund, have reached \$3.7 billion (8.2 percent of GDP) at the end of 2003.

The pace of growth, however, slowed in 2002 due to the softening of prices for oil and other minerals and uncertainty following the September 11th attacks in the USA. Therefore, the easing of these prices was largely responsible for a slight deceleration in industrial output growth to 9.8 percent in 2002 and 13.5 percent in 2001 from 15.5

⁸ Source: National Bank of the Republic of Kazakhstan, 2003

percent in 2000.⁹

Table 2. *Kazakhstan: Selected Macroeconomic Indicators, 1998-2002*

	1998	1999	2000	2001	2002
Real GDP	-1.9	2.7	9.8	13.2	9.5
CPI (end-of period)	1.9	17.8	9.8	6.4	6.6
External current account (in per cent of GDP)	-5.6	-0.2	5.1	-3.6	-2.4
NBK reserves (in months of imports of goods and services)	3.0	3.6	2.8	2.9	3.5
Public and publicly guaranteed external debt (in per cent of GDP)	17.9	23.8	21.8	19.9	14.3

Kazakhstan started the year 2004 at a very good pace with 10 % of GDP growth in January-March. The macroeconomic outlook for 2003: with oil prices at \$26/bbl, growth is projected to remain robust at 8.3 percent, with investment, consumption, and oil export volumes rising strongly. Based on the continued pursuit of prudent fiscal and monetary policy, annual inflation is projected to ease further to 4-6 per cent.

Steady FDI Inflows

Kazakhstan enjoys the highest level of investment in the Central Asian region, mostly tied up in fuel and mineral production. The development of the Kazakh sector of the Caspian Sea shelf will bring a considerable inflow of capital into the Kazakh economy. Kazakh gold fields are attracting international interest as well.

Economic stabilization in Kazakhstan, improved external liquidity, and discovery of the Kashagan oil field considerably strengthened country's capital position. Despite unstable prices for primary goods, Kazakhstan has been experiencing steady large inflows of FDI for the last three years, facilitated by implementation of the

⁹ <http://www.adb.org/Documents/Books/ADO/2002/kaz.asp>

large-scale investment projects in Tengiz, Kashagan, Karachaganak, and Kumkol oil fields.¹⁰

In 2002, FDI inflow totaled \$4,073 million, of which 51 percent accounts for crude oil drilling and natural gas extraction, 19 percent - for geological survey, and 14 percent -for non-ferrous metals mining. FDI structure by regions is the following: investors from the USA - 25 percent, from the UK - 15 percent, from Switzerland - 13 percent, from Italy - 12 percent, and from Russia - 5 percent.¹¹

Considerable inflow of funds from abroad, mainly in the form of FDI, has covered both the current account deficit and the capital account deficit, and facilitated the further growth of international reserves of NBK.¹²

Trade overview

Improved Terms of Trade

Since in Kazakhstan the public sector depends on income generated by primary products, the country's solvency and the medium-term performance of the real economy are greatly affected by the terms of trade¹³. Their effects can be seen not only in the exchange rate¹⁴, but also in the country's slipping indicators of solvency and the performance of tradable goods sectors.

Despite increased prices of imports, prevalence of oil in the export structure led to the improvement in terms of trade; their index increased by 1.9 percent in 2002. The index of world prices for major exports¹⁵ of Kazakhstan improved by 2.4 percent.¹⁶

Table 3. World Prices for Exports of Kazakhstan, 2001-2002

¹⁰ Annual Report of the National Bank of Kazakhstan for 2002

¹¹ Ibidem.

¹² Ibidem.

¹³ The ratio of change in exports prices relatively to change in imports prices.

¹⁴ ⁹ Where it can induce the expectation of depreciation.

¹⁵ These products represent 83 percent of total exports registered by customs statistics.

¹⁶ Annual Report of the National Bank of Kazakhstan for 2002

	2001					2002				
	I	II	III	IV	Total	I	II	III	IV	Total
Oil, \$\bar{barrel}	26.07	26.75	25.28	19.31	24.5	20.9	25.2	26.9	26.7	24.9
Copper, \$\m{.ton}	1764	1652	1472	1426	1578.5	1381	1356	1516	1554	1559
Zinc, S\m{.ton}	1020	934	826	763	885.8	795	782	766	773	779
Lead, \$\m{.ton}	493	463	470	479	476.3	491	455	430	435	453
Aluminum, \$\m{.ton}	1576	1501	1379	1318	1443.5	1557	1611	1310	1350	1353
Silver, cent\tr{.ounce}	455.8	439.9	428.5	430.3	438.6	450.7	475.4	470.1	454	462.5
Gold, \$\tr{.ounce}	263.5	267.7	274.5	278.4	271	290.4	312.8	314.2	322.5	310
Change of average indices, % previous period										
Exports prices index	-4.6	-0.9	-5.7	-13.7	-10.2	5.1	12.3	5.0	1.6	2.4
Terms of trade index	-5.7	1.4	-5.0	-11.0	-5.3	6.6	7.7	1.2	1.8	1.9

Source: National Bank of the Republic of

Kazakhstan, 2003

The world oil prices grew continuously throughout the whole period of the years 2002 and 2003. The average prices for crude oil for 2002 were 2 percent higher than for 2001; by contrast, in the last quarter of 2002 they were 38 percent higher than in the last quarter of 2001. This has somewhat compensated a decline in the prices for metals.¹⁷

Foreign Trade Turnover Growth

In 2003, the foreign trade turnover continued its growth, increasing by 10 percent compare with the same period of the year 2002, up to \$19.1 billion.¹⁸ Exports increased by 32,8 percent and that makes \$11, 6 billion , whereas the level of imports is

¹⁷ Annual Report of the National Bank of Kazakhstan for 2002

¹⁸ Ministry of economy and budget planning of the RK, www.minplan.kz

\$7,4 billion and has changed up to 24,7 percent. Stable global demand for energy products and their growing prices allowed Kazakh exports in 2002 and 2003 to hit the largest volumes ever since. This became possible due largely to the increase in physical volumes of exports rather than high prices. Total exports increased to \$9,709 million; exports to CIS countries decreased to \$2 223 million (by 16 percent), whereas exports to non-CIS countries increased to \$ 7 486 million (by ^{1/4}).¹⁹

Moderate inflation and stability of exchange rate boosted the competitiveness of both exports and domestically consumed products; they also constrained demand for imports, usually accompanying economic growth. Total imports accounted for \$6,491 million; imports from CIS declined by 9.2 percent, whereas imports from non-CIS countries increased by 10.3 percent. The decline in imports from CIS was mainly determined by the decline in prices of imports from Russia.²⁰

Table 4. *External trade of Kazakhstan, 1995-2002*

	1995	1996	1997	1998	1999	2000	2001	2002
Trade turnover -total	9056,9	10152,1	10797,8	9648,0	9526,7	13852,2	15077,1	16199,6
of which:								
- CIS countries	5536,2	6124,4	5314,1	4161,8	3114,3	5068,4	5946,7	5253,8
- Non-CIS countries	3520,7	4027,7	5483,7	5486,2	6412,4	8783,8	9130,4	10945,8
Exports - total	5250,2	5911,0	6497,0	5334,1	5871,6	8812,2	8631,5	9709,1
of which:								
- CIS countries	2883,5	3178,9	2981,9	2107,8	1510,5	2336,7	2637,2	2223,2

¹⁹ Annual Report of the National Bank of Kazakhstan for 2002 and 2003

²⁰ Annual Report of the National Bank of Kazakhstan for 2002 and 2003

- Non-CIS countries	2366,7	2732,1	3515,1	3226,3	4361,1	6475,5	5994,3	7485,9
Imports - total	3806,7	4241,1	4300,8	4313,9	3655,1	5040,0	6445,6	6490,5
of which:								
- CIS countries	2652,7	2945,5	2332,2	2054,0	1603,8	2731,7	3309,5	3030,6
- Non-CIS countries	1154,0	1295,6	1968,6	2259,9	2051,3	2308,3	3136,1	3459,9

Source: Agency of Republic of Kazakhstan

on Statistics, 2003

Thus, the share of CIS countries in total exports in 2002 was 23 percent (in 2001 - 30 percent), and non-CIS countries - 77 percent (70 percent). Thus, the share of CIS countries in total imports in 2002 was 47 percent (in 2001 - 52 percent), and non-CIS countries - 53 percent (48 percent).²¹

The main directions of Kazakhstan's exports are the Bermudan Islands (20.7 percent), Russia (15.7 percent), China (10.5 percent), Italy (9.5 percent) and Switzerland (8.1 percent). Besides, Kazakhstan production is exported to the United Arabic Emirates (4.9 percent), Poland (3.3 percent), Iran (3.2 percent), Ukraine (3 percent), Germany (2.3 percent), UK (1.4 percent), Netherlands (1.3 percent), the USA (1.2 percent), Uzbekistan (1.1 percent).²²

Kazakh Import-export composition

The statistical data of Kazakhstan's import structure indicates the dominance of high-level consumer and high-tech goods among all imported goods. The high share of imported equipment and machinery indicates the substantial dependence of the national production on the external market.

²¹ 'Statistical overview of Kazakhstan: External trade' (2003), *Quarterly Journal*, Vol. 1.

²² Agency of Republic of Kazakhstan on Statistics, 2003

Table 5. *Kazakhstan's import structure as a percentage, 2001-2002*

Title	2001	2002
Machinery, equipment, vehicles etc.	41.0	43.0
Mineral production	14.0	15.0
Chemical production, plastic, rubber etc.	14.0	15.0
Foodstuffs	8.0	8.0
Ferrous, non-ferrous metals and its products	14.0	11.0
Others	9.0	10.0

Thus, according to analysis of external trade, the share of the imported industrial and technical goods including machinery and equipment is high.²³ Most of Kazakhstan's industrial companies are still using imported raw materials and replenished goods in production process. This fact causes goods produced by domestic industries to rise and decrease of their competitiveness. The other point is that Kazakhstan imports 30 percent of all the country's foodstuffs and 90 percent of consumer goods. However, during 2001 domestic foodstuff products gained a higher share of the domestic food market and the share of imported foodstuffs decreased.

According to the forecast of the Ministry of Economy and Budget Planning of the Republic of Kazakhstan, the share of domestic foodstuff products in the domestic market may achieve 85 percent in 2003, but currently domestic food industries suffer from low demand. Hence, industrial growth has raised the problem of market narrowness.

As a matter of a fact, Kazakhstan possesses sufficient amounts of raw materials to develop the production of a wide range of consumer goods, so it is currently making efforts for the industry recreation and might give the opportunity to decrease the

²³ 'Statistical overview of Kazakhstan: External trade' (2003), *Quarterly Journal*, Vol. 1.

amount of imports in the following 3-5 years. The import of high-tech goods, machinery, equipment and transportation means that they can be replaced domestic products. At the same time, Kazakhstan still has to import modern technologies, computers, TV-sets, telecommunication equipment, cars and many other goods, the production of which is still stays behind the world standards.

The analysis of Kazakh export structure shows that the country mostly exports raw materials. Energy products export growth determined export pattern change; mineral products and base metals account for 80 percent of total exports.²⁴

Table 6. *Kazakhstan's export structure as a percentage, 2001-2002*

Title	2001	2002
Machinery, equipment, vehicles	3.0	2.0
Mineral production	58.0	61.0
Chemical production, plastic, rubber etc.	5.0	4.0
Foodstuffs	5.0	5.0
Ferrous, non-ferrous metals and its products	24.0	23.0
Others	5.0	5.0

Source: Agency of Republic of Kazakhstan on Statistics, 2003

Mineral products prevail in the export structure, which share was increased by 3 percent up to 61 percent in comparison with 2001. Mineral products make more than 60 percent of total export amount both to CIS countries and to non-CIS countries.

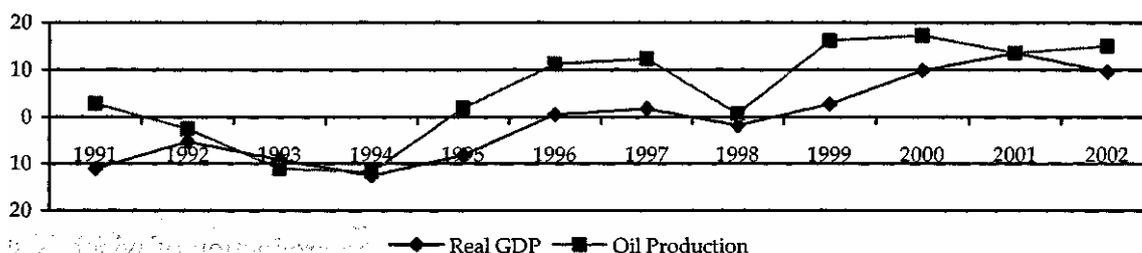
Kazakhstan: An Oil Economy

Until 1999, Kazakhstan's primary exports were minerals, metals, and grain. Since that time, the discovery of large domestic oil deposits has contributed to extensive development of the petroleum and natural gas industry. Subsequent

²⁴ 'Statistical overview of Kazakhstan: External trade' (2003), *Quarterly Journal*, Vol. 2.

development of global oil markets allowed petroleum products to become and remain Kazakhstan's primary export.

Figure 1. Kazakhstan: Real GDP and Oil Production, 1998-2002
(Annual percentage change)



Source: National Bank of the Republic of Kazakhstan, 2003

Thus, hydrocarbon reserves have a crucial significance for Kazakhstan's economy. Kazakhstan ranks 26-th in the world in volume of oil production, having extracted about 31 million tons in 2000. Today, the share of the oil sector in Kazakhstan's GDP is more than 15 percent. The country's current producing potential allows for increasing annual oil production up to 120 - 140 million tons. Oil export incomes can achieve USD 1-2 billions per year, strengthening the country's payment balance and increasing GDP.²⁵

The relative importance of the oil industry in real economic activity began in 2000 and came to represent approximately one-quarter of the economy by 2002. The medium-term outlook shows the increasing role of the petroleum sector. Oil exports are conservatively expected to grow by about 15-20 percent per annum in volume terms through 2007 as several important fields are expanded or come into commercial production.

²⁵ Muzaparova L. M. (2001), 'Kazakhstan in World Economy: A Problem of Self-determination,' *Analytical Magazine*, Kazakhstan Institute for Strategic Research under the President of the Republic of Kazakhstan

However, only limited amounts of the Kazakhstan's oil can be supplied on the world market. This is caused by rather rigid frame conditions for introduction of Kazakhstan's oil in the world turnover. First, the world oil stock has achieved a peak taking into consideration the long-term dynamics of oil-consumption in the major centers of world economy. Secondly, there is very strong competition on the part of other large oil producers, especially from Russia and countries of the Persian Gulf. Thirdly, because of problems with transportation of Kazakhstan's oil to the main oil markets and backwardness of the processing infrastructure of oil and gas industry, further exploitation of Caspian oil will be strongly tied with existing oil pipeline system, ports and terminals. Fourth, a serious obstacle for extracting of Caspian Sea oil reserves is an ambiguity of its legal status challenged by five coastal states (Russia, Kazakhstan, Iran, Azerbaijan and Turkmenistan), which does not stop investigation and extraction of Caspian oil and gas resources, but does not allow full-scale operations. Lastly, considering the difficult conditions and very depth oil bedding in the Caspian Shelf zone, as well as its poor quality (heightened corrosiveness, viscosity and sulfuring), the extraction of Caspian oil requires huge investments and expensive newest technologies lacking in Kazakhstan.²⁶

Reasons for the Energy Export-oriented Economy

Kazakhstan is basing its economic recovery and development on exports of energy resources, at least in the short to medium term, because at present they possess the largest revenue earning potential for the nation. Neither industry nor agriculture is able in their current condition to serve as an engine for economic recovery and growth. Moreover, the transportation system is inadequate to support growth in these sectors, as

²⁶ “Alpari” economics journal. “Oil and Gas in Kazakhstan’s economy”, 2003

shown below.²⁷

Industry

Industry accounted for about 40 percent of net material products in 1991 and is dominated by large, capital intensive enterprises geared to exploit the republic's natural resource base. The largest enterprises are: processing plants for ferrous and non-ferrous metals, refineries and petrochemical plants, and heavy machinery and tool producing factories. Kazakhstan also has a variety of smaller agro-processing industries, including meat and fish canneries, wineries, and footwear and textile manufacture. Practically all of Kazakhstan's industrial enterprises were closely integrated within the Soviet economic system, receiving most of their supplies from and shipping most of their output to Russia and other republics. Thus, among three oil-refining plants only one was processing crude that was extracted in the republic; the other two were working on Siberian crude.²⁸

The economic collapse and disintegration of the Soviet Union left Kazakhstan with large, capital intensive, inefficient enterprises that were unable to compete on world markets due their to low quality output and high costs of production. The severing of economic ties between the CIS states left many enterprises without suppliers of inputs and consumers of output. Poor payment records between enterprises within the CIS further contributed to industrial depression. Gross domestic product and industrial production declined sharply through the 1990s with 1994 being the worst year.

To prevent massive layoffs of employees and the disruption of production processes, the state continued to subsidize these enterprises and pay salaries to workers, thus creating significant inflationary pressure in the economy. Consumer price inflation

²⁷ Auezov M. M. (1997), 'Oil Exports as a Vehicle for Economic Transition and Development in Kazakhstan,' *Working Paper*, Institute on East Central Europe.

peaked in 1994 at 1,498.3 percent.²⁹

To maintain macro-balance in the national economy, meet IMF deficit targets, and counter a lack of domestic savings, Kazakhstan's government began a daring privatization experiment in 1995. It began selling the largest state-owned enterprises to foreign investors, a move unparalleled in other CIS states, where fear of 'selling off national assets to foreigners often hinders foreign direct investment. Thus in 1995, 30 large enterprises were sold to foreign owners. Among these were several important oil producers, one of the three oil refineries, the largest steel smelter in Kazakhstan, copper smelters, coal mines and power plants. According to reports, most sales were characterized by both haste and low bids, reflecting the government's desire to dispose of budget draining enterprises and investors' reluctance to invest in large, capital intensive enterprises, most of which carry significant debt and require thorough restructuring.

The current condition of Kazakhstan's industry prevents it from becoming an engine for economic recovery in the near future. Its large enterprises are characterized by low productivity and cannot contribute to employment creation or revenue earning. Even if the 'privatization by foreigners' strategy yields positive results in the form of greater efficiency and competitiveness, prior to that it is reasonable to expect significant layoffs of employees and low revenues, as enterprises restructure their economic ties and production methods.

Agriculture

Similar problems exist in food production, in 1991, agriculture was the second largest sector in the national economy, contributing 36 percent to GDP. Despite being a net exporter of basic food products, Kazakhstan remains an inefficient agricultural

²⁸ 'Facilitating Kazakhstan's Natural Resource Development,' (1995), *U.S.-Kazakhstan Monitor*; p. 3

producer.

Crop yields are low compared with other countries with a similar climate, such as Canada.³⁰ The severing of economic ties between the republics left state farms with large inventories of low quality agricultural equipment and a lack of spare parts and servicing. The wage differential between urban and rural sectors, as well as a deterioration of medical, social and educational facilities in the countryside lead to a significant migration of the rural labor force to urban centers. About 30 percent of the land cultivated during the Virgin Lands campaign is not suitable for cultivation and its use contributes to soil degradation. While Kazakhstan is able to export some of its agricultural production, it does not enjoy a comparative advantage in agriculture due to high costs, low efficiency, and dependence on unreliable suppliers in Russia, Ukraine, and Belarus for most spare parts for agriculture machines.

In the long run, agriculture can stimulate the creation of backward linkages that may allow agricultural supply industries to grow sufficiently to achieve their own economies of scale by drawing on existing industrial resources, particularly in chemical fertilizers, transportation equipment and farm machinery. Short run prospects for the development of such linkages, however, are bleak. Inefficiency and the need for thorough restructuring, as discussed above, should prevent these industries from developing or successfully adjusting to serve Kazakhstan's agriculture in the near future.

Transportation

Kazakhstan is a very large country (more than twenty times larger than Korea) with a widely dispersed population and resource base; therefore, transportation is of

²⁹ Auezov M. M. (1997), 'Oil Exports as a Vehicle for Economic Transition and Development in Kazakhstan/ *Working Paper*, Institute on East Central Europe

³⁰ 'Kazakhstan: The Transition to a Market Economy: A World Bank Country Study,' *Washington: World Bank*, p. 130.

crucial importance for the functioning of its economy. Railways form the backbone of the transportation system, carrying more than 90 percent of the freight in 1991. Railroads are experiencing problems similar to those in industry, and result from the severing of economic ties with the former Soviet republics. They suffer from a shortage of spare parts and materials: 95 percent of spare parts, workshop equipment, and rolling stock originates from outside Kazakhstan (mainly from Russia and Ukraine), as well as from the poor payments record of customers.³¹ Road maintenance and construction are lacking due to a shortage of road maintenance equipment. Therefore, in its present condition the transportation system is inadequate to support growth in industry and agriculture.

Advantages for High-grade Integration into the World Economy

Despite all these problems limiting the economic development of the country, there are a number of advantages in Kazakhstan's economy, based on which the country can in a rather short period of time not only strengthen the national economy, but also ensure the achievement of concrete national economic targets in the future. Such advantages include, firstly, significant scales of free and idle productive capacities, allowing a quick launching of new production. The second is a presence of cheap labor with high professional and qualification levels. The third is a quite advanced scientific and technical potential of the country. The fourth is a high educational and cultural potential of Kazakhstan. Besides specified favorable economic and social factors, Kazakhstan is also vested with lucky natural-geographical advantages - a large territory providing a wide variety of economic activities, favorable geo-strategic location, and lastly, rich land and natural resources.³²

³¹ 'Kazakhstan: The Transition to a Market Economy: A World Bank Country Study,' (1993), *Washington: World Bank*, p. 140

³² Muzaparova L. M. (2001), 'Kazakhstan in World Economy: A Problem of Self-determination,' *Analytical Magazine*, Kazakhstan Institute for Strategic Research under the President of the Republic of Kazakhstan.

Endowment of Natural Resources

Kazakhstan's major advantage is its rich endowment of natural resources. According to the latest assessments, the total reserves of oil and gas in Kazakhstan amount to 23 billion tons, 13 billion tons of which are accumulated in the Caspian Shelf. Besides prospective and rather significant oil and gas reserves, Kazakhstan has a powerful raw mineral base for development of coal and uranium industries, ferrous and non-ferrous metallurgy and gold extracting. It occupies a place in the first dozen of countries in the world on annual production of coal (more than 79 million tons), iron (7.5 millions tons), bauxites (3 million tons), copper (more than 300 thousand tons), zinc (225 thousand tons), manganese (100 thousand tons), silver (500 tons) and phosphates (1.7 million tons). Kazakhstan is also a world leader on uranium reserves.

The most important source of future revenues and development is seen in the exploration of vast reserves of oil and natural gas. As international experience indicates, exports of petroleum and its products can serve as an engine for growth. They can bring in revenues in the form of taxes and royalty payments and, by creating financial linkages in the economy, allow investment in infrastructure and industry development. More foreign investment, domestic saving, labor, and skilled manpower can complement the fixed factors of production, land and natural resources. Not only can such expansion allow Kazakhstan to move toward its production frontier, but it can also expand the frontier outward and enable the economy to produce more total goods. Growth in petroleum production may stimulate recovery and growth in chemicals manufacturing, oil wells, and refinery and processing equipment manufacturing. It can also bring improvement in infrastructure, in roads, training and medical facilities.

Furthermore, current market outlooks for oil products are good. Attempts to

move away from oil as prime energy source in the OECD countries have so far yielded only marginal results and have concentrated primarily on conservation. Many developing countries have limited energy options and remain dependent on oil as the lowest cost, most convenient energy source in their industrialization drives. The economic recoveries of former command economies are also expected to generate growth in demand for oil. Therefore, energy export-driven growth strategy will generate significant capital inflows into the country.³³

Industrial Capacities

Kazakhstan inherited a decaying but still powerful manufacturing and processing capacity from the centrally managed Soviet system. In that system, among Kazakhstan's designated products for the general all-union market were phosphate fertilizer, rolled metal, radio cables, aircraft wires, train bearings, tractors, and bulldozers. Kazakhstan also had a well-developed network of factories producing military goods that supplied about 11 percent of the total military production of the Soviet Union.

Most of the republic's manufacturing, refining, and metallurgy plants are concentrated in the north and northeast, in Semey, Karaganda, Ust-Kamenogorsk, Petropavl, and Aktobe. In south-central Kazakhstan, the most important industrial centers are Shymkent (chemicals, light industry, metallurgy, and food processing), Almaty (light industry, machine building and food processing), and Zhambyl (chemicals, machine building, and food processing).³⁴

Scientific and Technical Potential

Kazakhstan has advanced scientific and technological reserves in modern and the newest technological modes. At this stage the scientific "reserves" in the field of

³³ Auezov M. M. (1997), 'Oil Exports as a Vehicle for Economic Transition and Development in Kazakhstan,' *Working Paper*, Institute on East Central Europe.

space, radiation, laser, catalytic and biological fields could find its commercial realization. Available scientific and educational potential in Kazakhstan is another proof that definite success in this direction is feasible.³⁵

Large Territory

Kazakhstan is the ninth largest country in the world, spanning over 2.7 million square kilometers. As of January 1, 2000 from 272.5 million ha of the area of the land fund agricultural lands occupied 222.5 million ha, of which 185.2 million ha are under pastures, 21.9 million ha - arable lands, 10.3 million ha - fallow lands; 5.0 million - haymaking. There are 13 ha of agricultural lands, including 2 ha of arable lands per resident. Lands, suitable for sowing of agricultural crops without preliminary amelioration activities constitute 21.8 million ha - 9.7 percent, remaining lands need special measures: meliorate improvement of saline lands, upgrading of meliorate state of sanitized lands, prevention of water and wind erosion.³⁶

Geographic Location

Kazakhstan is a landlocked region. The only routes to the ocean are railroads to Russia and to China, and from the seaport of Aktau via the Caspian Sea, through the Volga and channels to the Sea of Azov and eventually to the Baltic Sea; however, it can be used only five to six months during the year, as the water is frozen during the winter.

Due to its remoteness from major international markets and the land-lock issue, Kazakhstan's foreign trade in these markets is still limited. Researchers have even proved that due to excessive transport costs, a strategy centered on export-led growth is not sustainable in the long term for land-locked countries.

Nevertheless, the country could make more active use of its advantageous geo-strategic position on the coast-to-coast or transcontinental trade routes. A very

³⁴ <http://www.kazakhstan-gateway.kz/economy/industry/index.htm>

³⁵ <http://www.kazakhstan-gateway.kz/economy/economicstrends/developmentprospects.htm>

promising and attractive development model for Kazakhstan - a country with significant transit potential - is specialization in the transit trade and transport services. Opportunities for the development of this sector increased with the opening of the new Silk Road, transport corridor Europe-Caucus-Asia (TRACECA), and Russia's expanding trade with Northeast and Southeast Asia, Pakistan, Iran, China and India.³⁷

Summary

The evaluation of the economic potential of Kazakhstan characterizes today's level of development of its economy as being unstable and highly vulnerable to external factors, (especially a dependence on prices on hydrocarbons), but having the certain preconditions for an effective economic development and a high-grade integration of the country into the world economy. Obviously, the strengthening of economic positions of Kazakhstan in the world economy requires not only the efficient use of all existing and potential sources for economic growth, but also an optimum balanced strategy of development all sectors of economy and a participation of Kazakhstan in international economic relations.

DEPENDENCE ECONOMY ON NATURAL RESOURCES

Kazakhstan boasts vast natural resource wealth, with mineral deposits (gold, natural gas, oil, coal and other minerals) topping the list, but it also produces cotton, cereals, and a variety of other foodstuffs. Arguably, the most important challenge that this economy faces in the coming century is devising a policy for the proper management of these tremendous endowments of natural resources and primary products. Given the perplexities of natural resource development strategizing, this portion of the thesis will explore the challenges which the republic now faces as it

³⁶ //www.grida.no/en/iri/htmls/kazahst/soe2/soee/nav/soil/soil.htm

works to parlay its broad natural resource wealth into economic well-being and higher per-capita standards of living for its 15 million inhabitants.

Industrially, Kazakhstan retains (albeit rusting) capacity, producing manufactured products such as tires, paper, cement, fertilizer, chemicals, and yarn. It is still heavily dependent upon exports of primary products. The lion's share of its output consists of coal, natural gas, gold, cotton, iron ore, electricity, meat, milk, timber, sugar, and, of course, crude petroleum.³⁸ In the petroleum industry, Kazakhstan has actively and successfully courted western companies to invest in oil extraction in the Tenghiz oil field, Karachaganak gasoline field, north of the Caspian Sea.

With this natural resource profile, how will Kazakhstan fare in the face of the natural resource export-development paradox?

Qualitative analysis

The declining terms of trade problem is a legitimate threat to Kazakhstan's natural resource exports because the country depends heavily upon oil exports. Especially today, when the prices on crude oil recordly high. This situation may take Kazakhstan down the road of the Arab exporters, enjoying successful one-product-led development. Otherwise, the terms-of-trade issue will not trump other concerns in Kazakhstan, which produces several manufactured products in addition to its array of primary products for export.

The very high price on oil commodities, as the reason for recent sanguine estimates of earnings from oil exports demonstrates the dangers of price volatility. Troublingly, there is also some evidence that price volatility may affect the agricultural sector adversely. Cereals trump cotton as the primary crop in Kazakhstan, and in 1992, a bumper crop of wheat might well have depressed regional prices were it not for the

³⁷ Muzaparova L. M. (2001), 'Kazakhstan in World Economy: A Problem of Self-determination,' *Analytical Magazine*, Kazakhstan Institute for Strategic Research under the President of the Republic of Kazakhstan

ironic fact that farmers were so undercapitalized that one-third of the grain could not get to market.³⁹

With increasing investment in distribution infrastructure, Kazakh growers, with their Soviet-era farm equipment, soon will be exposed to the productivity disciplines and cost strictures of prevailing world prices. Kazakh cereal growers generally have produced in such variable volume from year to year that output more than doubled in 1992 from 1991 levels, indicating that agricultural export earnings will continue to be an extremely volatile source of income.⁵⁷ And yet, in the first of the decade, more than a third of all Kazakhs earned a living in the agricultural sector, showing its importance in the economy overall.

While resources and capital in the mineral extraction industries may sometimes be liquidated and moved to more productive uses in the face of a sustained shock, such sectoral restructuring is much more difficult when the victim industry is agriculture, since its primary asset, land, is non-liquid.

In terms of diversification, precisely because it used to supply raw and intermediate products to other regions of the Soviet Union, linkages have developed around Kazakhstan's specific set of natural resources, such that its economy is somewhat diversified in the face of possible primary product shocks. Its timber industry, for example, has paper processing facilities; it has steel plants to process its own metal ores, as well as some capacity to process foodstuffs. Perhaps as importantly, Kazakhstan's array of primary products for export is itself diverse, though by value, the nation's earnings are precariously concentrated in one or two major exports.

Further linkages - particularly for oil, coal and gas refining and processing-must be forthcoming to maintain diversification. Such an industrial restructuring will be

³⁸ Richard Pomfret, *The Economies of Central Asia* (Princeton: Princeton University Press, 1995), 84

³⁹ Pomfret, 80-84.

driven by the signaling effect brought on by free trade; "the lowering of barriers to market-based trade is expected to realign the Kazakhstan economy towards primary production, like Chile in the late 1970s."⁴⁰ In particular, Kazakhstan should exploit an emerging comparative advantage in the industrial processing of indigenously available minerals.

Poised to become a major fossil fuel exporter, however, Kazakhstan faces a strange anecdotal history with respect to the Dutch Disease problem. Of course, it could take the competing examples of Nigeria and Indonesia as a lesson that it must craft a policy expressly acknowledging and reacting to the enigmas of the Dutch Disease. If it does follow this path, the National Bank of Kazakhstan must be prepared to devalue the tenge in response to pressures caused by the concentration of exports in one sector and by the sectoral restructuring at home. It must also commit to various forms of fiscal discipline, as explained above, in particular given the volatility of oil prices.

Alternatively, Kazakhstan may look at the experience of other oil exporters-OPEC nations in particular-and come to the conclusion that the Dutch Disease, for mineral exporters, is a taste, which may be acquired. There has already been ample speculation, in fact, that Kazakhstan will be the next Kuwait, thriving upon the accumulated wealth of its single primary commodity.⁴¹ Given the aggressiveness with which Kazakhstan has initiated the process of oil drilling and extraction in the past half decade, however, and its relatively small economic size, the nation's susceptibility to the affliction ought to be presumed.

Richard Auty's general assessment in a 1997 paper begins with the recognition that Kazakhstan's government may already have convinced itself that it will look more like Kuwait than Nigeria. His concern, in short, is that it ought to look more like

⁴⁰ Ibid., 12, citing Amin Guitierrez [sic] de Pineres and Ferrantino 1997

⁴¹ Auty, 3

Indonesia or Botswana—wary of Dutch Disease and, accordingly, careful with its policies. "A clear strategy for the deployment of oil sector revenues is required, reinforced by appropriate institutional mechanisms."⁴² He calls for the use of a sort of precautionary principle, noting that the damage from not preparing for a case of Dutch Disease which strikes is much greater than the lost benefits associated with an ultimately unnecessary policy of circumspection and prevention.

He concludes that oil rents should be accumulated in an offshore capital fund until their size and potential uses can be better gauged. In the meantime, Kazakhstan should focus on balancing public finances without oil rents, improving its domestic capital markets, and promoting the agricultural sector. In the final analysis, there is, as of yet, little indication what policies Kazakhstan will pursue in the face of the prospect of Dutch Disease.

What is clear about the prospects for the development of corruption is that, as oil goes, so will go the nation. The country continues to debate whether and how to privatize its largest company, KazMunayGas, waffling because the company alone recently generated thirty percent of government revenues.

The current plan of the Government is to maintain KazMunayGas as a quasi-state monopoly with a mandatory fifty percent equity stake in any new oil projects in the country - a plan which appears totally out of date given the negotiating strength of the world's newly-merged oil conglomerates. The plan, along with state control of oil transport through the company KazTransOil (which also including in KazMunayGas), is an open invitation for rent-seekers.

Quantitative analysis

⁴² Ibid., 14

Despite the strong trade performance in recent years, there are several constraints that have to be overcome to sustain the growth momentum. The rapid growth of exports has been largely led by the oil sector; non-oil exports have grown less rapidly and fluctuated considerably over time.

This partly results from the concentration of exports in primary commodities whose demand in the world market is volatile. With continued large inflows of foreign exchange from the oil sector, the tenge will inevitably appreciate in real terms over medium and long term which could jeopardize the competitiveness of non-oil exports.

Total exports of goods and services grew 14% per annum during 1996-2002, while imports grew 11%. The share of exports (imports) of goods and services in GDP reached 48% (47%) in 2002, up from 33% (36%) in 1996. Most of the trade expansion occurred after 1998, as GDP growth began to accelerate.⁴³

Meanwhile, it is necessary to note oil exports played a key role over this period. Total oil export value grew 29% per annum during 1996-2002. Part of the rapid growth resulted from an increase of the world oil price (over 20 percent during 1996-2002). The growth of non-oil exports accelerated after 1998, achieving an annual rate of 5%. In 2002, they grew by 9%.⁴⁴

In 2002, oil exports exceeded non-oil merchandise exports for the first time. Even as late as 1998, oil was less than 30% of total merchandise exports. In general, Kazakhstan's exports are heavily dependent on primary commodities. Mineral and primary agricultural products accounted for two-thirds of total merchandise exports. Even manufactured exports are dominated by metal products.

A situation in 2003 did not improve. For January – November of 2003 the volume of commodity circulation on given to customs statistics without taking into

⁴³ A data from the report of the Agency of Republic of Kazakhstan on Statistics, 2003

⁴⁴ A data from the report of the Agency of Republic of Kazakhstan on Statistics, 2003

account unorganized trade has made 19,1 billion US dollars: export has made 11, 6 billion dollars, import - 7,4 billion US dollars. The greatest densities in total amount of export for the period from January till November, 2003 has made mineral products - 64, 7 %, ignoble metals - 20, 3 %, vegetable products - 5,3 %, production chemical and the connected industries - 3,4 %, precious or semiprecious stones, precious metals - 1,9 %, machines, the equipment, mechanisms, the electrotechnical equipment - 1,2 %.⁴⁵

According to the Sachs and Warner parameter at face value, countries which have Kazakhstan's export profile-that is, they earn more than the mean twelve or so percent of their GDP from export-are poised to suffer this tendency to retrogression, rather than enjoy the spoils of growth as they exploit their natural resource endowments.⁴⁶

There are various reasons to suspect that the Sachs and Warner regression parameters are biased or not applicable, and that the result is ironic for a reason-it may be simply wrong. Nonetheless, this conclusion provides an occasion, looking back, to discuss analytically the finer points of the natural resource paradox as applied to the mineral-based economies specifically. If the natural resource paradox is a rule, could mineral economies (or perhaps economies endowed with high-rent natural resources) prove to be the exception?

Alan Gelb explicates the subtleties of this issue well:

“Mineral production has some peculiar features: it is large-scale, enclave, and capital-intensive, usually with close links to multinational firms, often with high wages compared with the rest of the economy and with a high degree of uncertainty.

⁴⁵ A data fro the report of the Agency of Republic of Kazakhstan on Statistics, 2004

⁴⁶ Sachs and Warner, 36

The available evidence concerning the impact on development of rent in general, and of mineral rent in particular, can only be described as mixed. On the one hand a rent has indeed played a leading role in the growth of such industrial economies as the United States, Canada and Australia.

On the other hand, a positive causal link between high-rent activities and development is certainly not inevitable. A lengthy literature raises the possibility that the high-rent sector may inhibit the accumulation and upgrading of reproducible factors of production, and that in the long run this diversion of resources and attention can stultify growth.⁴⁷

THE NON-OIL SECTOR IN KAZAKHSTAN: LINKS WITH THE OIL INDUSTRY AND CONTRIBUTION TO GROWTH

As it was mentioned already the initial recovery was mostly based on the emerging oil industry. The non-oil economy decreased or stagnated for most of the decade, but started to show significant growth from 2000 on.

Kazakhstan's transformation into an oil rich country brings a series of challenges to the economy in general and in particular to the non-oil sector. Natural resource sectors tend to rely on economies of scale, with low levels of employment and slow technical progress.

Their potential growth is also constrained by the existing reserves of non-renewable resources. Economies dominated by those sectors tend to have lower long-term growth, high income and asset inequalities, and face larger volatility associated with the changes in commodity prices, such as oil. To avoid the negative impact of increasing oil wealth, including the "Dutch disease" type of phenomenon,

⁴⁷ Gelb, 32-33

which we already spoke, it is important to develop the policies and reforms that support sustainable growth of the non-oil economy.

The oil sector can have a positive impact on the overall economy through the linkages to sectors such as the services, and investment projects associated with oil extraction. Moreover, the growth of the oil sector has contributed to rising household incomes and consumption demand. In Kazakhstan, the recent surge in overall growth of the economy, with substantial gains in non-oil employment, is partially due to positive , externalities from booming oil revenues. However, it is important that the non-oil economy be able to sustain its growth independent of volatile oil revenues, in order to achieve a balanced development, creation of jobs, and a reduction of poverty.

Sources of Growth in Kazakhstan

The economic revival was initially based on increasing productivity gains. Since 2000, factor accumulation has also played a significant role, even though productivity gains remain the major engine of growth. Transition economies typically have a first stage of recovery mostly based on large productivity gains, specially total factor productivity (TFP) gains, due to macroeconomic stabilization, structural reforms, and a more efficient use of existing capital stock and labor. While a similar trend can also be observed in Kazakhstan, there was an early move towards large investments in capital due to structural changes in the main industries.

The oil industry, which had only a small share in total output in the early 1990s, has become the dominant industry. Investment in the sector accounts for about half of all investment in the country. For the remaining sectors of the economy, the capital stock started to grow in 2001, but accounted for only a quarter of the overall growth of capital. The capital-output ratio has been decreasing since 1996 as obsolete capital has been replaced, and new investments prove to be more efficient. However, investment in

the non-oil economy remains relatively low, particularly in agriculture and non-oil industry. Kazakhstan is a landlocked and sparsely populated country, which brings even greater challenges for trade and dampens investment. It becomes, therefore, more urgent to invest in public infrastructure, particularly roads and communications, create a stable legal framework and promote free trade inside and across borders, in order to improve the profitability of private sector investment, both domestic and foreign.

Labor accumulation contributed negatively to growth during the 1990s, when employment declined substantially, and there was large emigration. After the Russian crisis, this trend started to change, and there has been a strong recovery in the last years, especially after 2000. However, the largest share of the increase was in agriculture, where productivity remains low. The increase in agricultural employment seems to be partially a response to government incentives, and also reflect a move from the unofficial to the official economy. After independence the rural economy collapsed, rural enterprises disappeared and a large segment of the population moved to subsistence agriculture. Since 1999, the state has introduced several programs to support agriculture, which resulted in a progressive move towards market activities and the official economy. The surge in official agricultural employment in 2000 and 2001 was in large part a reflection of these changes. Services and construction have seen some gains in employment, while industrial employment has been declining, reflecting better use of labor resources. The oil industry employs directly a very small share of the work force, less than one percent, and has no significant impact on overall employment.

A decomposition of growth accounting by sectors, shows that agriculture has been the worst performer of all sectors, particularly in terms of productivity. In agriculture, growth has been based on extensive use of labor and land, in particular since 1999. The sector has an increasingly obsolete capital stock, and only recently

have there been some productivity gains. The recorded large increases in agriculture production, are only in part related to better measurement of the non-official economy, Sectors where the links with the oil industry are strong, for example construction and transportation, are the fastest growing. Services have been soaring in the last three years following the increase in real incomes. The services sector has enjoyed both productivity gains and an increase in the capital stock.

Table 7: Economic Growth and Productivity by Sector

Annual average 1996-2001 (percentage change)

	Value	TFP	Labor	Capital-Output
Agriculture	2.0	-1.8	- 8.2	- 4.2
Industry	5.6	5.8	10.3	- 0.9
Construction	6.5	9.5	12.5	-6.1
Services	3.3	4.0	5.4	-2.8
of which: Transport, and Communication.	5.0	5.1	1.2	- 10.4

Source: National Statistics Agency of the Kazakhstan and staff estimates. 1997-2001

The Impact of the Oil Sector

In Kazakhstan, perhaps in contrast to more mature oil economies, the impact of oil production goes much beyond the oil industry's direct contribution to GDP. The industry is just emerging, with several new oil fields to be explored and developed, and will need large investments and services associated with the expansion of extraction and transportation of oil. In order to study the impact of oil on the economy, a broad measure of the oil sector will be used, including not only the value added of the oil industry, but also the associated services and goods, the industry's investments, and the oil refining industry.

The value added by oil extraction represents about one third of the total value of output. Among the inputs used services account for about 40%. While transportation is

the largest component, there are also significant expenditures on real estate and related services, and on a lesser scale on financial services and trade. A large part of remaining inputs is related to the oil industry itself and related industries like oil refining. The metallurgical industry also provides inputs to the oil industry.

Overall the oil sector, which in 1998 represented less than 10 percent of GDP, has been responsible for almost half of economic growth since 1998. Oil extraction alone has contributed about 1.2 percentage points a year to overall growth. The contribution to GDP growth of services related to oil extraction, transportation and investment projects in the sector, has averaged 2.3 percentage points. The non-oil economy, while posting a respectable average rate of growth of about 6 percent between 1999 and 2002, is lagging the oil sector, which grew at 24% per year over the same period.

The impact of investments in the oil industry has been impressive, particularly in the construction sector. Construction associated with oil has grown at an annual rate of 50% over the last four years. The rest of the construction sector saw an average annual decline of 7% in the same period, notwithstanding a recovery in non-oil construction since 2001. Also, services associated with oil production and investment projects have grown substantially in the last years.

Oil sector growth depends not only on oil extraction but also on the oil price. Under higher oil revenues, due to higher prices or production, there is a spill-over effect on the rest of the economy. The rise in revenues translates into higher spending on related services and, to a lesser degree, accelerated investment projects. In 2000, as the oil price increased substantially, the oil sector expanded at an impressive rate of 35 percent, more than twice the rate of oil extraction. As the oil price declined slightly in 2001, there was a slowdown in growth in the oil sector, mainly due to a sharp decline in

services provided to the oil sector. The impact of declining oil prices, however, was smoothed out by investment in the sector, less affected by temporary declines in prices, and increased oil production. There is also a role for policy in smoothing out the impact of oil prices volatility. Since 2001, the government sends a share of oil revenues to an oil fund to be invested abroad. In periods of high oil prices the fund works to sterilize part of the foreign exchange inflows. In periods of low oil prices, the state budget can receive revenues from the fund to prevent sudden shortfalls in the budget. The fund also helps to stabilize the exchange rate and eases the burden on the conduct of monetary policy.

The links between the oil industry and the rest of the economy will likely increase in the next years as production rises and the sector implements its investment plans. However the dimension and composition of the links are not completely clear. In terms of transportation, there have been large investments to move towards more efficient and less costly transportation. This will reduce the impact of increasing oil production on the transportation sector. In terms of other services to the sector, the links will depend on the development of competitive domestic suppliers. Such associated services would benefit from foreign investment and expertise at this early stage of development.

Over the next decade, the contribution of the oil sector to overall growth is likely to increase substantially. As the oil sector grows in size, the economy will become increasingly subject to oil price volatility.

Table 8. Oil and Non-Oil Sectors (1999-2002 average)⁴⁸

	Growth rates	Share of GDP
GDP	8.8	100
Oil sector	24.1	18
Other	6.3	83
Industry	10.3	30
Oil related	13.8	11
Oil extraction	16.0	9
Transportation	8.3	10
Oil related	14.4	1
Construction	17.0	5
Oil related	52.3	3
Other sectors	7.3	54
Oil related	41.4	5

Sectoral analysis the non-oil industry.

The industrial sector has been undergoing a dual restructuring process, because of the transition to a market economy, and the emergence of the oil industry. After independence the sector saw production collapse faster than employment. The recovery in industry started with the extractive sector, particularly the oil industry, which now accounts for about 45 percent of total industrial output (versus a share of 11 percent in 1990).

Manufacturing revival began in its two largest industries, metallurgy and food processing. Growth has been associated with large gains in productivity, reflecting both structural and cyclical factors. As the industry had large under-utilized capacity and excess labor, increases in demand lead to large jumps in productivity. Structural adjustment has led to the release of excess labor and some replacement of obsolete capital with new investment. However, investment in the non-oil industry remains low.

While industries such as food processing and machine building have benefited from increasing domestic demand for consumer and investment goods, there was also pressure from import competition. The development of these industries has been based

⁴⁸ International Monetary Fund Data, 2002

in part on import substitution strategies, with support from high tariffs and financing from the state through subsidies or loans. Such strategies tend to result in lower incentives for the development of competitive industries, as examples of other countries show.⁴⁹

The developments in manufacturing since 2000 were also related to the oil sector. The continuing expansion of oil extraction and a period of high oil prices have resulted in larger demand for manufacturing products and the rebounding of the oil refining and the chemical industries. The development of a diverse and efficient industrial base will depend on complementary infrastructure investments and improvements in the conditions for internal and regional trade. The EBRD transition report for 2002, shows that there is still a need to strengthen competition policy⁵⁰. Improving access to regional and world markets would allow companies to enjoy economies of scale from selling to larger markets.

Let's take as an example the agriculture sector. Agriculture was one of the hardest hit sectors during the initial transition process and has been lagging the rest of the economy during the recovery process. During the first years of independence, the sector went through the disintegration of the rural structures that existed during Soviet times and the collapse of animal and capital stock. The sector also suffered from the extensive use of low quality land during the Soviet times, hi 1996 a gradual recovery of the economy began. However, agriculture lagged and had the lowest growth rates, and the worse performance in terms of productivity. Cattle breeding, in particular, showed a very poor performance until recently.

Since about 1998, the agricultural sector has started to recover in large part due to the fast growth of private farms and, on a lesser scale, household plots. While private

⁴⁹ Sachs and Warner (1995)

⁵⁰ The EBRD Transition Report, 2002

farms and household plots have shown better performance than the declining number of agricultural enterprises, growth was mostly based on extensive use of land and labor. There have been, however, significant gains in yields for plant growing, associated with the use of better land, improved management following a land code reform in 1999, and increased use of labor. Agriculture still faces the problem of over-employment, associated with the large share of subsistence farmers, especially in cattle breeding.

Small - and medium-size farmers have a difficult financial position, a legacy of the initial years of transition. They lack access to credit not only for working capital, but also for investment. As a result, there has been little investment and the capital stock has become largely obsolete. The difficulty in accessing credits has been in part associated with a lack of clear property rights for agricultural land. The recently proposed land code appears to be a step towards introducing private ownership, but there are concerns with the transparency and length of the process. It will also be necessary to increase investment in rural infrastructures, improve water management and marketing institutions, particularly for accessing export markets.

In contrast to plant growing, where there has been a development of medium and large farms, cattle breeding is mostly related to household plots or small family farms. These farms tend to face even greater challenges in gaining access to credit or markets. They do not have strong associations to coordinate common interests. In plant growing, there is a much larger concentration of production among a smaller number of farms, specially for grain. There has been also a higher degree of support from the state, such as the creation of credit partnerships to improve credit to farmers. There is also a variety of other tools used by the state to provide inputs, such as seeds, and keep prices at above market levels.

The price support mechanism, introduced in 1999 to purchase wheat at above

market prices, is now being expanded to other goods and increasing quantities. As a result, there has been a rise in the production of grain, much beyond domestic market needs, and increasing accumulation of stocks of grain. In response, the government, through state owned companies, has started to increase its intervention further, by buying more wheat and exporting it directly to foreign markets. This discourages the emergence of private distribution channels.

NEW INDUSTRIAL POLICY IN KAZAKHSTAN

Analysis of Global Economic Trends

After the World War II the global capitalist system transformed and acquired new features of the monopoly or trans-national capitalism.

This transition was characterised by significant growth in global trade, emergence of trans-national companies, marketable increase in foreign investments and trade liberalisation. Such institutions as the International Monetary Fund and the World Bank were established.

A combination of national economies of all the countries of the world in the 50s, in 60s the global economy has started to show trends of corporation on trans-national grounds.

By the 90s goods and services production had become fragmented and scattered all over the world. Financial and industrial capital had acquired trans-national features.

This transformation is of a special importance for developing countries. Traditional relations between developed and developing countries with the periphery supplying raw materials and the centre processing them and sending back to the periphery have significantly changed.

Under the global capitalism developing countries are being involved into the production chain and produce goods with relatively low processing degree and thus with the lowest value added.

Extensive experience has been accumulated globally in implementation of industrial policy. It can be stated, however, that only a few countries succeeded in coping with the monoproduction dependence and in diversifying their industries.

Historically, use of the industrial policy for export diversification purposes in different countries can be explicitly tracked down through import substituting and export oriented policies. The main conclusion, which can be drawn from the review of the Latin American (Mexico and Brazil) and East Asian (South Korea and Singapore) countries, having mainly applied these policies, is that export orientation is the way to sustainable economic development.

Historically both Latin American and East Asian countries went through stages of import substitution and export orientation. Interesting is that at a certain stage East Asian countries shifted from import substitution to export promotion, while Latin American countries retained the import substitution focus.

Success of the export orienting policy can be explained from the economic theory perspective – having exhausted absorption capacity of the internal market countries had to expand externally not to stagnate their economic development. Notably, while promoting import substitution Latin American countries established industries based not on real competitiveness, but rather on man-made administrative and tariff barriers. Having firmed up, these sectors directed their resources to lobbying their interests through the state to further maintaining the import substitution policy instead of modernization and productivity increase. The result was inefficient

distribution of resources and loss of international competitiveness of national economies.

In general current trends dominating the global economy and creating new global economic reality can be classified as follows:

- shift from industrial to service and technology economy in developed countries;
- globalisation;
- economic liberalisation;
- increasing global competitiveness and regional integration.

During the last quarter of the 20th century economically developed countries advanced from industrial stage of development to a higher level service and technological economy. The bulk of GDP in these countries is generated in explicitly science- and innovation-based service sectors.

Economically developed countries concentrate intellectual and financial resources while phasing out industrial productions – and capital- and energy-intensive ones especially – to less economically developed countries.

Diversification of the Kazakhstan Economy

Since independence, Kazakhstan has been perceived globally as a supplier of oil, gas, ferrous, non-ferrous, rare earth and noble metals and uranium products, grain being a potentially exportable agricultural product.

So far Kazakhstan has been developing pursuant to a classical economic scenario due to comparative economic advantage of rich mineral resources endowment.

Intensive raw materials production and export helped the economy to overcome the economic crisis and ensured high rates of economic growth over the recent three years.

Economy of Kazakhstan has been progressing due to the state policy of attracting foreign investments into extraction industries and structural and institutional adjustments in financial sector resulting in increasing living standards and accumulation of financial resources in the long run potentially able to ensure transfer to a post-industrial service and technology based development.

Today Kazakhstan has been acknowledged by the global community as a country with a market economy and is the first CIS country assigned with an investment sovereign rating.

The World Bank has listed Kazakhstan among 20 most attractive countries for investments. Over USD 21 mln has been invested into the country during the independence.

Pursuant to the approved model, strategically Kazakhstan has been developing as a country with an open economy, oriented to export of goods, services, capital and labor based on competition and mutually beneficial cooperation with all the countries of the world.

Over 2001-2002 the annual GDP growth averaged to 11.5%. To double the GDP by 2010 its annual growth should average to 7.2%.

The country's economy successfully started implementation of the strategic plan. In the mid-term accelerated development should be continued with parallel economic and social quality changes.

At the same time, Kazakhstan as a small economy with large fuel and mineral resources is not really attractive for investments into manufacturing industries, which makes the country vulnerable to fluctuations in commodity prices

In view of the danger of oversaturation of the economy with excessive profits from extracting sectors and foreseeing possible negative implications from sharp downfall of oil prices the National Fund has been established in Kazakhstan to accumulate surplus revenues coming from exceeding the level of world prices for oil and non-ferrous metals over the established optimum ceiling.

This facility would also relieve the currency pressure from the Kazakhstani financial system and maintain the Tenge exchange rate at the level encouraging exports and discouraging imports.

Despite the progress in institutional and structural reforms, increased reliability of the financial sector and accelerated growth in the export potential of the country it should be noted that manufacturing industries, as well as production services providing sectors, have not been developed adequately.

Metallurgy is the only processing industry competitive externally. Some food industry products can compete with imported analogues at the domestic market, while the rest of processed products currently are supported through direct and indirect subsidies manifested in low and economically unjustified electricity, fuel and lubricants, transportation tariffs and protectionist customs duties. Up to 2003 some of industries (textile, apparel, leather and footwear industry, rubber and plastics goods production, machinery building, chemical industry) were granted prolongation in repayment of outstanding arrears to the budget. Till 2002 sales of domestic production of textile, apparel, leather and footwear industries were taxed at 0 VAT rate.

Contemporary Kazakhstan's economy is faced with the following problems:

- Lop-sided extraction orientation of the economy;
- Poor integration into the global economy;
- Poor inter-sectoral and inter-regional economic integration within the country;
- Low productivity of processing industry;
- Low consumer demand for goods and services at the domestic market (small economy);
- Undeveloped production and social infrastructure;
- Increasing depreciation of fixed assets outside of oil and gas as well as mining and metallurgy sectors;
- General technical and technological obsolescence of enterprises;
- Lack of efficient relation between science and production;
- Low allocations for research and engineering works;
- National academia's inability to adapt to the market economy, lack of efficient mechanisms of bringing scientific and technological produce to the level of a good resulting in generally low level of innovation proposals;
- Lack of modern training and re-training system for professional and general labor;
- Lack of incentives for domestic financial institutions to invest into manufacturing;
- Low economic interest of foreign investors in domestic manufacturing;
- Management inadequate to meet the challenges of globalisation and shift to service and technology based economy.

For example, electricity consumption per USD1 of the GDP is over 7-10 times higher and the labor productivity is over 7-10 times lower in Kazakhstan compared to some industrially developed countries.

Fixed assets of Kazakhstan enterprisers are significantly depreciated. At the beginning of 2001 depreciation of fixed assets averaged to 29.7% with fixed assets in some sectors depreciated over 50%.

The existing procedure for accumulation of financial resources for renewal of fixed assets from retained profits does not motivate replacement of obsolete equipment and to a certain extent even constrains its upgrade.

In 1999 the fixed assets replacement rate was 8%, in 2000 - 13.8% with the increase driven by investments in oil and natural gas extraction.

The worst depreciated fixed assets are machinery and equipment - 42.1% depreciation rate in 2000, with vehicles depreciated 41% and facilities - 36.5%.

In sectors outside the oil and metals the depreciation rate was 45-62% over the recent three years with 12% of machines, equipment and vehicles in manufacturing industries completely depreciated.

This results in depreciation and obsolescence of equipment and dergrades competitiveness of the country's economy. In Kazakhstan production of USD1 of GDP costs almost 2.8kWt/h, while in the UK, Germany, Italy and Japan - 0.22-0.3 kWt/h, in the USA, France, Turkey and Korea - 0.4-0.6 kWt/h, in Canada and China - 0.8-1.2 kWt/h.⁵¹

⁵¹ *The CIS Statistics Committee, 2000-2002 and The IMF International Financial Statistics, 2002.*

Table 9. Industrial Electricity Consumption.
A comparative view (kWh per USD1 of GDP)

	1995	1996	1997	1998	1999	2000
CIS						
Armenia	4.35	3.88	3.66	3.28	3.09	3.13
Byelorussia	2.36	1.63	1.85	1.54	2.18	2.51
<u>Kazakhstan</u>	4.01	2.80	2.35	2.20	2.82	2.81
Kyrgyzstan	8.24	7.87	7.13	7.07	10.56	
Moldova	0.83	0.83	0.78	0.71	0.94	0.70
Russia	2.55	2.02	1.95	2.98	4.37	3.38
Ukraine	5.24	4.11	3.55	4.13	5.59	
Other countries						
Great Britain	0.30	0.29	0.26	0.25	0.25	0.23
Germany	0.22	0.23	0.26	0.26	0.26	0.27
Canada	0.96	0.94	0.91	0.92	0.88	0.82
China	1.44	1.32	1.26	1.17	1.21	1.22
Republic of Korea	0.42	0.44	0.52	0.75	0.66	0.58
USA	0.45	0.44	0.45	0.44	0.42	0.30
Turkey	0.51	0.52	0.54	0.54	0.59	0.56
France	0.32	0.33	0.36	0.35	0.36	0.38
Japan	0.19	0.21	0.24	0.27	0.24	0.22

Sources: 1). The CIS Statistics Committee, 2000-2002; 2) The IMF International Financial Statistics, 2002.

Flexible and effective policy of the Government of the Republic of Kazakhstan combined with the favorable world oil prices resulted in a high GDP growth and allowed to substantially increase the state revenues.

Being a small open economy Kazakhstan has no influence over the global prices and should take them as given. As a result, the country has limited set of tools available for efficient influence on the domestic economy, which further increases the urgency of establishment of high-tech productions to reduce the country's vulnerability to externalities.

Let me present another example. The indicator of efficiency of utilization of labor and material resources is the index of the production cost per KZT1 of sales. This index is measured by the ratio of the production cost of sold products (works, services) to proceeds from their sales. The less is this index the higher is the profit of the enterprise.

In the economy of Kazakhstan in 2002 produced and human capital was utilized with high efficiency in oil and natural gas extraction (0.39), in the financial sector (0.48), tobacco products (0.58) and nonferrous metals (0.55) production. The production cost to sales proceeds ratio is low in agriculture (0.91), chemical industry (0.85), electricity, gas and water production and distribution (0.86), construction (0.85), food production including beverages (0.8).⁵²

⁵² Ministry of economy and budget planning of RK

Table 10. Production Costs per KZT 1 of Sales Proceeds, 2002

	Production costs of sold products (works, services)	Proceeds from sales of products (works, services)	Production Costs per KZT1 of Sales Proceeds
KZT' mln			
Total	1 970 993.6	3 211 898.1	0.61
Agriculture, hunting, forestry	68 687.6	75 337.2	0.91
Mining	530 423.3	1 185 646.8	0.45
crude oil and natural gas extraction	383 218.9	973 496.2	0.39
Manufacturing	526 538.1	773 500.9	0.68
food, including beverages and tobacco	124 053.5	163 793.1	0.76
food, including beverages	104 989	131 017.6	0.80
tobacco products	19 064.5	32 775.4	0.58
petroleum products	35 920.8	58 423.5	0.61
nuclear materials	10 071.5	12 170.8	0.83
chemical industry	14 138.2	16 582.6	0.85
other nonmetal mineral products	21 016.9	27 411.1	0.77
ferro-alloys	75 957	122 015.4	0.62
non-ferrous alloys	130 453	238 586	0.55
machinery and equipment	19 565.6	24 029	0.81
Electricity, gas and water production and distribution	159 056.9	185 563.2	0.86
Construction	168 742.8	198 873.7	0.85
Transport and communications	314 160.6	476 446.8	0.66
Finance	2 758.6	5 790.5	0.48

Source: Statistics Agency of the Republic of Kazakhstan

Having deducted taxes, transportation and advertisement costs enterprises in many sectors turn out loss-making.

In this situation, a today's main goal of the Government must be the sustainable development of the country through non-extraction oriented economic diversification; preparation of conditions for the transition to the service- and technology-based economy in the long-run, and production of competitive and export oriented goods, works and services in manufacturing and service sectors.

Competitiveness shall mean ability of the national economy to produce exportable products. In other words, manufactured products should meet the international standards for similar goods and be competitively priced.

As the first step in this direction Government has developed the Strategy of Industrial and Innovation Development of Kazakhstan.

Priorities for the industrial and innovation policy are all potentially competitive and export-oriented non-extracting industries. To meet long-term strategic challenges the special focus should be on creating conditions for development of research-intensive and high-tech productions.

The proposed approach does not prevent entrepreneurs from different sectors from seeking ways for technical and organisational improvement of existing production facilities and creation of new export-oriented products.

Private sector should generate specific proposals, while second-tier banks and state investment and financial institutions being established will review the proposals based on specialised methodology with the view of their potential implementation in partnership with the private sector.

Legislation of countries with market economy – including Kazakhstan – prohibits allocating budget funding for financial and investment support to private companies. Pursuant to the international law, state financial support to specific private companies should be regarded as the state corruption. This approach has already been proved by practice.

The state neither can nor may provide financial support to specific companies, but it may and must catalyse and initiate competitiveness promotion, encourage modernisation and innovative initiatives of private companies thus creating and improving their production and competitive potential.

The international practice proves that a country with a market economy can co-operate with a private sector in structural adjustments in economy. The most successful examples of such a co-operation are to be found in Japan, South Korea, Malaysia, some other countries having accomplished significant breakthrough in their economic development over the recent thirty years.

The today's China also pursues the policy of co-operation with the private sector in designing strategic industrial development directions.

Study of the World Bank proves that all approaches to the state industrial policy may be put under three broad categories: *investment co-ordination, business co-operation development and market substitution.*

Investment co-ordination. In underdeveloped markets companies are not able to assess the demand for new better quality products to be produced through expansion of the production facilities. Thus, the state undertakes to co-ordinate those investments, which can be beneficial for companies only if implemented jointly.

This investment co-ordination model suggests certain capacity at state and private institutions – which is not the case in the majority of developing countries.

Business co-operation development initiatives. Proactive state business co-operation policy can be directly targeted to strengthening business contacts under the following categories:

- Specialised groups of buyers formulate new market niches and are a signal information on product standards;
- Suppliers of equipment pass production experience together with it;
- Suppliers of inputs contribute to generating new ideas and production methods, while competitors are a rich source of new ideas.

Groups of companies, buyers, suppliers of equipment and inputs, services, sector associations, engineering and design bureaus and other specialised co-operation institutions work together within one and the same region.

Countries with underdeveloped market may need a catalyst (state or private) to activate the cumulative market extension and business co-operation processes.

I would like to present three convincing examples.

First of them - special measures on support of export. Work in the export market allows firms to get acquainted with the best samples of the international practice and promotes training and growth of productivity. Such work also can be the useful indicator of efficiency of measures of the government on assistance to development of the industry. In many countries a target crediting exporters was conducted and the organizations were created, called to promote export. However, only in the countries of East Asia these measures gave effect, and in other cases of an expense were not paid back. Other measures of support of export were applied also, and all of them resulted in inconsistent results. Norms of the World Trade Organization can quite exclude the further deadlock experiments in the given area.

The second type of measures is directed on strengthening of a local infrastructure: material, labor and institutional. The history of once backward area Cholla in South Korea is a good illustration of influence, which the local infrastructure can render. In 1983 in this southern region the large industrial zone for the first time has been formed. The success of this zone has actuated cumulative process of training of local authorities which got skills of planning, financings, constructions of similar objects and managements of them, - and soon has been created three more zones. It also promoted the accelerated transformation of the business environment: earlier it rolled in red tape and other bureaucratic obstacles, later it has turned to sphere of close

cooperation and coordination of actions of the local government and a private sector. By 1991 on a share of this area 15% of the areas of industrial development of the country (in comparison with 9 % in 1978), and rate of growth of industrial production exceeded average on the country.⁵³

Thirdly, more and more popular becomes the organization of the mixed partnership (with participation as the states, and a private sector), and the state partner can get out from local or of the regional government.

Market substitution. This approach is connected with the attempts of the Government to phase the market out completely. To push industrial growth, Government surrenders to temptation to substitute market estimates with information and estimates generated in the Government sector. These attempts very seldom yield good results.

Experience of the Philippines in 70s and 80s demonstrates what can happen when Government is manipulated by influential private groupings.

Partially moved by the desire to create new business opportunities within the country for its allies, in 1979 the Government of the Philippines promulgated new “large industrial projects” Program amounting to USD5 bln (for fund-intensive heavy industries solely). After one year having been pressed by the Programme opponents the Government agreed to economic and financial re-appraisal of all the projects. Political and financial disturbances shortly afterwards also contributed to the process. By the end 1987 5 of 11 initially proposed projects totaling to almost USD4 bln (from the total of USD5 bln) were terminated as unfeasible. Only 4 projects totaling to USD800 mln proved profitable.⁵⁴

⁵³ A magazine “Korea” 2001, Seoul

⁵⁴ World Bank Report, 2001

Based on the international experience the Strategy implementation should focus at initiatives targeting investments co-ordination and development of business co-operation. Financial support will be provided only through shared participation of development institutions with the private sector – including second-tier banks – undertaking the main risks.

Through development institutions the state will participate in projects targeting establishment of comprehensive production system producing competitive products through consistent development of technological and economic value-added chains. This will support establishment of multi-sectoral enterprises manufacturing finished products adequate to all the parameters of competitive products.

Modern economic practices have worked out and been broadly applied the development strategy review and design methodology based on perception of economic sectors as value-added chains.

The concept means that every sector can be viewed as a chain of productions, each of them consecutively adding value to the finished product.

The value-added chain review methodology distinguishes two main types depending on determinants driving or dominating the chain, thus structurally classifying value-added chains as vertical and horizontal.

As a rule, economic activity in vertical value-added chains is limited to one company only. For example, one and the same company produces and processes raw materials, manufactures component parts and assembles the product.

In horizontal value-added structures economic activity is evenly distributed across numerous economic entities: one company(s) designs the product, others manufacture component parts, third – assemble them.

As a rule, value-added chains dominated by manufacturers are vertically structured, while value-added chains dominated by buyers are structured horizontally.

In general, the maximum dominant in the chain gains the maximum added value.

The modern car building value-added chain consists of manufacturers of component and assembly parts for cars, car designers, assemblers and distributors with car assemblers dominating the chain mainly in the form of gaining the maximum value added.

Apparel manufacturing value-added chains is a conspicuous example of buyer-dominated value-added chain, constructed with designers, wholesalers, retailers, weavers, raw materials producers and processors, apparel factories with designers and wholesalers playing an exceptional role in this chain since they gain the maximum value added and determine what to produce.

In some countries growth in incomes of the population, toughening environmental and other requirements for producers affect significantly distribution of value-added. For instance, despite significant increase in wages in Hong-Kong resulting in loss of city's competitive advantage in apparel and foot-ware production it did not drop out from the value-added chain due to the experience and necessary connections of local companies to obtain quotas for supply of garments and foot-ware to the USA. Should the US Government eliminate quotas, Chinese companies most probably would deal with the direct supplies.

Figure 2. Producer's value-added chain

(car building, computers, aircraft building, electric machinery)

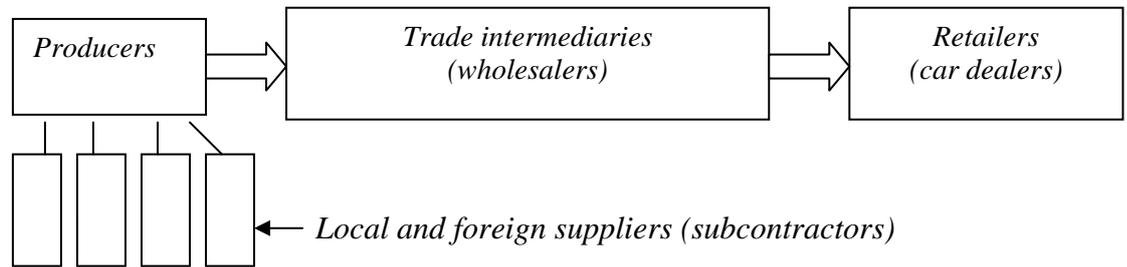
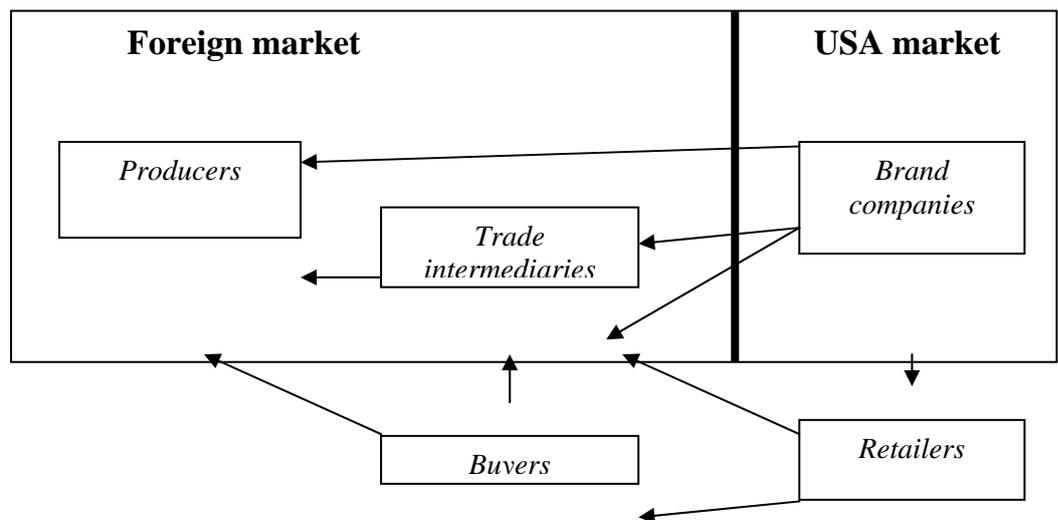


Figure 3. Buyer's value-added chain

(apparel, foot-wear, toys, household appliances)



In Kazakhstan good examples of a vertical value-added chain are the “Kazakhmys” OJSC and the “Kaztzink” OJSC with ore mining and dressing, primary and secondary metal production, by-production (gold, silver, rare earth metals) included under their structure. However, here the chain breaks. Further the products are

processed in companies of other countries with no official involvement of the above-mentioned enterprises, which reduces significantly their value added.⁵⁵

The “KazakhstanTractor” OJSC is an example of irrational production. The enterprise is organized to buy main units for assembling caterpillar tractors from outsiders – competitors. As a result, the final price for a tractor is normally higher than at their competitors.

During the implementation of the industrial and innovation strategy production arrangements in many processing industries should be reviewed for the purpose of identifying potentially competitive productions including export-oriented ones and producing economic value-added chain with consideration of world market trends and private sector initiatives.

At the same time Kazakhstan should study global and regional markets more intensively with the view to position itself in sector value-added chains, the task being significantly complicated by entering the global economy – including the extraction sector – from the scratch.

Apparently there is no necessity to encourage reproduction of the entire value-added chain, but rather to focus on elements with the highest value added or those ensuring access to global markets and further progress to economic activities with higher value added.

In this context the state should rather support comprehensively all the key value added chain elements than some separated elements as it is currently the case. In other words, to support not individual enterprises or industries, but rather all – or key – enterprises even from different industries, but connected within one value-added chain. This will be a manifestation of the co-ordinating and planning function of the state.

⁵⁵ www.kazakhmys.kz

For review of economy sectors and various productions with consideration of value-added chains the Marketing and Analytical Research Center shall be established. It is preconditioned by the fact that emergence and formation of domestic consultancy services market in the sphere of marketing and profound markets study is at its initial stage, the expenditures on analytical research are high and private sector feels a need for analytical market surveys performed at the international level. Through establishment of the Center the state pushes dynamic development of this sector. In the course of growth and development of the domestic advisory services market operation of the Center as a state one shall turn inexpedient and it shall be privatised in mid-term perspective of 3 to 5 years.

Using Investment And Production Potential of Fuel And Energy Complex and Other Fundamental Sectors of the Economy to Determine Priorities for Industrial Modernization.

The field or base for development and establishment of competitive export-oriented value-added chain-based productions should be industries having accumulated major investment projects and producing technologically multiple-convertible products with value added increasing at every conversion.

Almost all oil-exporting countries are concerned with diversification of their economy, with certain experience in this area already available internationally.

Let's look at example – diversification of economies in the countries of the Near East.

The bookmark of bases of economy of the future in the countries of this world region develops on three directions:

- diversification of the economy;

- Scale financial - investment activity on long-term and reliable accommodation of capitals abroad;
- "Nationalization" of the staff in key spheres of employment.

The diversification of local economies goes in area both industrial, and non-industrial sphere.

The first direction of diversification of the productive forces, as well as in many other similar countries - development of " the top floors " natural recourse-export cycles. The countries aspire to pass from export of crude oil and gas to export of oil products and production of oil and gas chemistry. Capacities, for example, the Kuwaiti oil refining factories make about 90 % from volumes of extracted oil, and incomes of export of oil products exceed incomes of export of crude oil.

The tendency to partial replacement of export of fuel by export of power-intensive production is observed also (the aluminium sucelted from import ores, steel in which cost the significant part is made with local oil or gas).

The largest oil refining and petrochemical complexes develop in Saudi Arabia - the Al-Djubail (at coast of Persian gulf) and Janbu (at coast of Red Sea, the raw material is delivered there on oil pipeline Petroline), in Kuwait - Ash-Shuaiba, on the coast in 40 km to the south from capital, in United Arab Emirates - Ruvays (in emirate Abu-Dhabi) and Qatar - Umm-Said.

The "Counter" direction of diversification of the productive forces is connected to stimulation of development of the fine and average enterprises of the manufacturing industry making mainly consumer goods from import raw material and details.

For accommodation of a manufacturing industry well equipped parks are created, where in every possible way (huge privileges and the state grants) involve foreign business. The rich countries - oil exporters are interested in deliveries on

channels of transnational corporations (TNC) of raw material, spare parts, the equipment, accessories and especial technologies.

Characteristic forms of penetration TNC became the mixed enterprises from more than 50 % participation of the local capital, and also not joint-stock forms of activity: license agreements, a professional training, the help in management and advertising, contracts "on a turn-key basis", engineering.

The majority of directions diversification structures of productive forces finally is based on oil. The postoil economy remains in oil captivity. A little more free from oil (though also very close image connected to regional weight of petrodollars) is rapid development of foreign tourism and especially financial sphere.

The richest oil export monarchys have rather succeeded on a field of investment in the western economy. From a simple contribution of the capital under percent they went to purposeful investments, growing (due to purchase of significant share holdings) in structures of transnational corporations.

For maintenance of development of a petroleum industry large investments into the human capital have been spent. Today in the Arabian countries management of the national oil companies is carried out by local experts. It allows the population to have high incomes and to give young generation corresponding education.

In the United Arab Emirates the basic export making - oil and natural gas. The oil component in export incomes reaches \$9,3 billion one year (78 % from the common export incomes).

Contrary to the forecast sharp falling of the prices for hydrocarbons in 1998 did not render on economy of Emirates of so serious negative influence, as on next " oil monarchy " (Saudi Arabia, Kuwait, Oman and Qatar). Moreover, test by crisis has

proved correct global strategy of the United Arab Emirates, in the middle of 90th years headed on diversification the economy.

Since then densities in gross national product of the branches which have been not connected to oil, continues to grow steadily. It first of all wholesale and retail trade (the share in gross national product has exceeded 20 %), development of own manufacturing industry (the share in gross national product has increased the last year with 5 up to 11 %), foreign tourism and, certainly, transport-communication units. Of services, for example, the international airport of Dubai have taken advantage in 1999 10,7 million passengers - on 10,5 % more, than in 1998.

The volume of foreign investments of Saudi Arabia is estimated already in hundreds billions dollars, and the most part goes in the USA. Saudi Arabia, despite of a competition on the part of Mexico, Venezuela and Canada, remains the basic exporter of oil for the USA and Japan.

Kuwait is the co-owner of tens British, Canadian, American, West-European and Japanese companies, including such as British Petroleum, General Motors, IBM, Kodak, Total, Sony, etc. Besides three oil refining factories in the territory Kuwait owns three European factories - in Denmark, Netherlands and Italy. In the property of Kuwait of thousand gas station in Denmark, Sweden, the Great Britain, Italy and Norway, ten filling stations at the large West-European airports.

Possessing fleet from own 25 tankers, Kuwait, as a matter of fact, has today own network of selling (all cycle from extraction before sale to the end user) for a significant part of extracted oil. Foreign investments of Kuwait into the advanced capitalist countries make not less than 100 billion dollars.⁵⁶

⁵⁶ "Oil and gas" magazine №3, Almaty

The profit on foreign capital investments becomes more and more essential source of currency incomes.

With a view to mitigate the impact of fluctuations in global oil and petroleum products prices over the recent ten years the largest oil exporting countries have been improving the production structure of the economy through redistribution of oil export revenues. At the same time capital has been exported to other countries to gain profits from developed economies.

Investments into oil and gas sector increasing every year in Kazakhstan nourish diversification of the economy.

In this context one of the main driving engines of industrial development is the development of Kazakhstan sector of the Caspian Sea (KSCS). The most significant growth of hydrocarbon extraction should be expected due to resources of Kazakhstan sector of the Caspian Sea with the hydrocarbon resources estimated to total of 8.0 bln tones. In the future the off-shore oil extraction may amount to 150-200 mln. tones for 25-30 years onwards.⁵⁷

Subsalt deposits in Northern part of Caspian Sea are characterized by high solute gas content in oil – about 60%. Resources of extractable gas in oil of the Kashagan field are expected to turn equal to the resources of the Karachaganak field.⁵⁸

In general, mid- and long-term development of the fuel and energy complex of Kazakhstan will be determined by the development of Kazakhstan sector of the Caspian Sea since after 2006 there won't be any significant growth of on-shore extraction.

Caspian region will experience a boom of investment and production activity significantly affecting general economic trends in Kazakhstan due to growth of hydrocarbons extraction, construction of oil-trunk pipelines, including export oil and

⁵⁷ The CIA, the World Factbook, 2002

⁵⁸ JSC "National Company "KazMunayGas" www.kazmunaygas.kz

gas pipelines, sea ports and port facilities for storage and trans-shipment of cargoes, bulk oil and gas loading railway terminals, commencement of new capacities in power industry and telecommunication infrastructure.

Development of hydrocarbon extraction at the Caspian Sea will create conditions for formation of local raw material base for petrochemical industry. Construction of petroleum chemical complex on processing of accompanying natural gas is planned near the industrial zone of the Kashagan deposit with expected involvement of major investors. The complex will produce a wide range of liquid components and primary petrochemical products – ethane, propane, butane, hexane, ethylene, propylene, acetylene, benzol, xylol, etc. and manufacture plastics and elastomers from these products.

In the nearest fifteen years investors are planning to invest more than USD80 bln into oil extraction. These funds must be utilized to create production, infrastructure and social facilities to support operations of newly commenced enterprises.

The above investments will generate demand for a broad range of partially temporary goods and services, while another part of investments will support establishment of productions demanded both internally and externally even upon exhaustion of oil reserves.

For instance, development of the Caspian coastal infrastructure will create pre-conditions for the recreation industry, sea-ports – for lowering cargo transportation costs, machinery-building factories – for production of barges, cargo, fishing and military ships, broad range of equipment and household appliances, etc.

Increasing degree of strategic raw materials processing looks promising from the value-added chain perspective.

Increasing degree of processing will allow for producing over 200 types of polymer ware for both industrial (all sectors of country's economy) and household consumption. Development of value-added chain in this area should create conditions for establishment of a multi-sectoral transnational corporation.

Metallurgy is another promising area for value-added chain development with over 100 elements from the periodic table contained in mineral ores on the territory of Kazakhstan. During the Soviet Union 74 of those elements were extracted. Ferrous products from Kazakhstan were used in science intensive and high-tech productions – space apparatuses and equipment and electronic appliances.⁵⁹

Inflow of large investments into Kazakhstan should generate demand for sanitary engineering, ironmongery, furniture accessories, dyes, paints, etc. All these items can be produced in Kazakhstan through increasing degree of processing of oil, gas and metals, with these products being able overtime to find their niche at the global market.

Kazakhstan is one of large grain producers in the world. Increasing degree of grain processing can become a starting point for a multi-sectoral value-added chain. This chain can be developed through deepening technological grain processing, production of fodder, livestock, meat and diary products. The value-added chain may include grain storage facilities, producers of agricultural machinery and mineral fertilizers, natural food dyes, pharmaceutical products, biotechnologies, etc.

The above directions of economic diversification and export orientation in Kazakhstan may potentially be priority areas. However, final decision on providing the state support to implementation of the proposed projects may be made only upon

⁵⁹ Ministry on energy and mineral resources of RK

detailed review of competitive advantages in developing deeper value-added chain-based processing technologies for the above products.

To determine the priority economy areas based on the value-added chain will require economic co-operation with regional representatives of transnational companies in establishment of productions providing for further development of value-added chains.

Potential Priorities for Establishment of Science Intensive and High-Tech Productions

One of the major characteristics of the modern economic development is its volatility due to regular replacement of technologies based on the most advanced research and developments for the certain state. At the point of technology transformation countries having lead during the previous technological period are faced with devaluation of capital and loss of qualification of workers involved into previous productions, while countries having established foundations for the new production technology system become the centres of gravity for the capital fleeing traditional productions.

The innovative industrial policy being currently developed aims to strengthen research and technological, innovation and production capacity in promising directions of post-industrial development thus contributing to future critical competitive advantages.

The main directions should be:

1. Assistance with establishment of high-tech productions including effective systems of both international and intersectoral technology transfers;
2. Establishment and support to modern scientific and innovation infrastructure institutions (technology parks, national research centres, research and

technology zones) on the basis of existing centres in the cities with a network of research and industrial institutions and enterprises with high research and technological potential;

3. Utilization of the existing research and technological capacity to develop advanced – from the post-industrial economy perspectives – sectors.

Currently there is a certain research base available in Kazakhstan for development of science intensive productions based on domestic developments in:

- Biotechnology (new varieties and gene types of agricultural crops and animals, bacteria strains, etc.);
- Nuclear technologies;
- Space technologies;
- Creation of new materials, chemical products.

4. Creation of necessary conditions for research in modern scientific and technological areas:

- New materials and chemical technologies;
- Information technologies.

5. Improvement of the legal framework aimed at encouragement of innovation activity of scientific and technological and production organizations and enterprises, attraction of investments in science and innovations and at expedition of innovations' introduction into industries and services.

State development institutions

In order to support the creation of a competitive environment among enterprises and to stimulate the high value added production by private sector, was established the special development institutes with the government support. The purpose of these development institutions is to support the private initiative financially as well as by

providing technical expertise. It is planned that the system of the government-sponsored development institutions will be comprised of the currently functioning National fund and the Development Bank of Kazakhstan as well as new Kazakhstan Investment Fund and Innovation Fund, Export Insurance Agency.

Each development institution has its own goals and role.

The purpose of the Development Bank of Kazakhstan is to provide soft loans not less than 5 million USD under low interest rates for the projects in the priority sectors of economy. These are the long-term projects directed on infrastructural and manufacturing industry development of economy. Currently the capital of the Bank is 200 million USD and it is planned to be increased up to 280 million USD. During the first year of its operations, Bank attracted an additional capital and financed more than 100 investment projects.⁶⁰

On the other hand, the Government intend to found the Kazakhstan Investment Fund (150 mln.USD), which will also finance long-term projects, and promote Kazakhstan enterprises (with the Fund's shares in it) to produce a high value added goods.

With a view of development of innovation technologies, state financing for scientific and applied researches, also was created the Innovation Fund with authorized capital of 20 million US dollars. To support the Kazakhstan's exports we plan to create a Corporation on export insurance with authorized capital of 50 million US dollars, which will be engaged in insurance of political risks that stem from international economy. It is important to note, that the state development institutes will not replace or supersede the market, they will be the driving force of competitive economy, will involve private enterprises into innovation processes on principles of partnership. In

⁶⁰ Kazakhstan Development Bank, www.kdb.kz

general, the development institutes should generate uniform system, and its steady functioning should be based on principles of decentralization, specialization, competition and transparency.

Analysis of new industrial policy of the Government

The Strategy of industrial policy presented by Government has caused quite contradicting reaction – from the applause to an open irony. Within the conditions of the fast pace of economic development there arose the question on whether there is a need in the industrial policy at all? Any measures being undertaken by the Government, especially the protectionist ones, bear risks of excessive interference in the entrepreneurial activity, may lead to the violation of the conditions of competition, and inefficient utilization or even loss of the state funds, as well as to the growth of corruption.

The matter is in that high pace of the economic development was in many parts conditioned by an abrupt improvement of the economic situation in the world and by Tenge devaluation, which has significantly facilitated competitiveness of Kazakhstan products on the domestic markets. Unfortunately, these sources do not refer to those which are generally accepted in the theory and practice of the economic growth, including labor, capital, scientific and technical progress, and aggregate demand.

However, within the Kazakhstan's economy we don't observe qualitative shifts. Within the last four years the volume of production in mining, for example, has increased by 77,5%, whereas in processing industry –by 56%. Economy is still characterized by duality, and it is still raw-material oriented.

For the reason that the world raw materials markets are quite volatile, especially oil market, conditions for sustainable development of economy in Kazakhstan are not formed yet. This why cardinal change of its structure in favor of the processing industry,

increase of the share of produced goods in the GDP is becoming a more and more actual task today. Its solution conjectures radical modernization and diversification of the Kazakhstan's economy, at first of all of the industry, including export, which require big investments and long period of time. Financial institutions and sufficient mechanisms are not developed yet enough to facilitate sustainable economic growth. This is why we avoid interference of the Government in this process. This interference was formulated by the President of Kazakhstan as the "new industrial policy".

It is obvious that this policy cannot be compared with the program of the industrial policy evolved in 1999. These two programs are aimed to solve two quite different tasks. The program of 1999 was aimed at bringing the economy out of profound economic and financial crisis, which was rather successfully implemented. Today Kazakhstan does not face the said problem any more.

The new program intends to qualitatively change development of the Kazakhstan's economy taking into account the new tendencies in the world. To be more precise – to cardinally change the structure of our economy on the account of development of the non-raw material sector, and first of all, of the export oriented production .

This why, to the displeasure of sectoral lobbyists, the new program does not envisage state loans, individual tax privileges, wide scale of the state subsidies and investments, for which they hoped for. Why?

–Such support, as is known, has always led to unfair conditions of competition, to the growth of corruption and bribery, and non-return of state loans, which discredit the very idea of the structural policy;

–Industrial-innovative policy is being carried out not at the stage when the economy comes out of the crisis. Today it is implemented when the economy is

growing, and there is a need to introduce changes in its structure in order to enhance it;

–It is necessary to create and develop competitive environment for all the economic entities, without rendering to anybody better conditions than others;

–It was and is always difficult to make a precise choice of the priority sectors, because there are no definite criteria for such selection;

–In every sector, in every field there exist some lobbyists from power who would manage to make their fields priority and facilitate for them wonderful economic conditions.

The most actual strategic problem of the Kazakhstan! economy is cardinal change of its structure, slackening of domination of the raw-material sector in it. In this connection within the conditions of a small internal market and low income of the population and of the enterprises, orientation of the economy to import substitution has no perspectives. Moreover, flow of money "from one pocket to the other" would not add neither incomes, nor jobs. This is why the state cannot support domestic goods being consumed within the country.

Other priorities of the investment-innovative policy, i.e. high and scientific technologies, are not referred to sectors and may be applied in any production. One of the fields of their introduction should be small innovative business, i.e. business, which is oriented to highly technological kinds of production with a big share of know how. In the world small highly technological business undertakings contribute much in the development of highly technological and scientific productions. It helps very much to establish and develop viable ideas and goods. At the same time it requires tutelage, especially at the stage of its formation, and it often meets serious difficulties when obtaining.

Development of respective priorities gives birth to a new reality, i.e. the

economy of a new type, in which the decisive productional resource is knowledge and information. Such situation dictates the necessity to consider science and education as the most important end efficient factor of growth. In this regard it is important to make investments in people, that is in the reproduction of the "human capital" . This, of course, will require significant increase of the state budgetary allocations on science and education, in particular, for fundamental and applied research, training of scientific specialists, training of highly qualified managers and experts.

Another central problem of the industrial-innovation policy, which provokes interests of all producers of goods, is the choice of the forms and mechanisms of state support and encouragement of development of priority productions and fields. This choice should proceed from the number of requirements. First of all, forms and methods should be chosen in such a way that they are essential and at the same time are maximally secure for the economy and correspond to the principles of its liberalization and deregulation, development of private initiatives, creation of competitive conditions in the market for business.

Concrete projects directed to production of the competitive goods are selected on the basis of special methods of control of the technological and economic value added chain (VAC). Analysis and selection on VAC are carried out by the development institutes. In the process of implementation of the Program this method, perhaps, will more efficiently solve the problem of financial support of the priority projects without big risk of the growth of corruption and bribery.

The state should behave on the market not as an owner, and not as an entity, but as a partner of the private sector. It doesn't matter whether producers want it or not, it is only a private sector that takes the main burden of investments. It is only private sector, which is responsible for the economic growth of the country. As for the government, it

does not need to invest in the production, and should not do that. It only has to facilitate favorable conditions in part of legislation and legal base, as well as create fair conditions for all the entities of the market, create excellent production infrastructure in all the cities and districts, decrease tax burden on them on the account of VAT, corporate income tax, tax on natural persons and social tax, and decrease the interest rate on loans, etc.

State guarantees on loans against export contracts and participation of export in insurance could become the said effective mechanisms. Moreover, it is necessary to promote export goods on foreign markets, including creation for Kazakhstan's trade partners consulates, trade representations, activization of the work of the chamber of commerce and industry in foreign markets, protection of the interests of Kazakhstan's exporters (companies, citizens) abroad by legal and political measures.

Small innovation business is in acute need of a simplified system of control and taxation, financing of the interest rates on loans, creation and development of innovation technical parks, technological centers and free economic zones with the developed infrastructure on the account of the state financial means. This is the only way to attract foreign investments and high technologies.

There is a necessity to support development and introduction of high technologies and scientific products, which can be widely recognized and enhance position on the foreign markets. The main instruments of support in this case are innovation and venture foundations, financing development of social sphere, as well as training qualified specialists, especially of highly professional managers.

The methods of support of the development of productional infrastructure are the investments into the objects of the infrastructure from the budget through involvement of the all state purposeful programs.

Science and education are supported by means of direct financing of the objects and the system of corresponding services from the state budget, grants, loans, etc.

These measures are most real if the government intends to really make the processing industry of Kazakhstan not less attractive for investors than, say, in Russia or China, at the same time not conflicting the principles of functioning of a free market economy.

KAZAKHSTAN IN THE WORLD ECONOMIC COMMUNITY

Trade liberalization and WTO accession

The sphere of trade should become a major ground, which will foster industrial and innovative development. Due to that trade policy of the Government of the Republic of Kazakhstan should be aimed at creation of conditions for development of competition, which is the main mechanism of market economy self-regulation.

Further protection of the market from imports leads to hopeless lagging of domestic manufacture goods behind their foreign analogues in terms of both price and consumer characteristics.

In the globalisation era a closed – and especially small – economy may remain in the early capitalism forever (as it is currently the case in many Central Asian Countries). And consequences of the closed economy will be much worse than what Kazakhstan experienced in early 90s.

The policy of competition and export promotion will have to come to replace import substitution policy.

The main objective of the Government trade policy should be to establish common economic area in Eurasian region with the closest partners from CIS. At that

the guiding line must be transformation of the country into a regional high-tech, export-import, investment, financial and trading center.

Great experience in creation of export-oriented economy models was accumulated in the world.

The following five types of export orientation can be distinguished: commodity exports, export processing zones, export of component parts, finished consumer goods and export of finished brand products.

Commodity exports is the main type of export in developing countries. In African countries (except for the SAR) these exports account to 90% of the total exports, in Latin America and South-East Asia – about 30-60% with only few countries – such as China, South Korea and Singapore – having an insignificant proportion of commodity exports.⁶¹

Export processing zones emerge in the countries with cheap labor and in the sectors requiring significant labor costs for assembly of unsophisticated items. As a rule, enterprises producing such products are owned by foreign investors. The state extends certain preferences to promote investments into such zones to provide employment for the local population and to earn foreign currency.

Export processing zones are a first step in the export industrialisation of developing countries. First of such zones appeared in 1960s in Asia and Mexico. At present export processing zones are predominantly located in countries with extremely low wages – i.e. in China and South-East Asia. Africa in general is lagging behind the other “third-world” countries due to undeveloped infrastructure (especially transport), shortage of concentrated cheap human resources and cultural barriers to foreign

⁶¹ Abdimoldayeva N. (2001), 'Accession of Kazakhstan into the World Trade Organization,' *Working Paper*, Ministry of Economy and Trade of the Republic of Kazakhstan

investments. In Latin America Export processing zones are common mainly due to cheap labor and proximity to the largest market of the USA

Export of component parts means production and export of component parts for such high-tech industries as car-building and electronics. Component parts are exported mainly by new industrial countries (South Korea, Singapore, Taiwan). Finished items are assembled in developed countries. Export of component parts is characterized by transnational control over enterprises on the territory of new industrial countries,

Finished consumer goods are exported by local companies, while design, marketing, whole- and retail sale controlled by large foreign companies from developed countries. Finished consumer goods export is dominated by new industrial countries – e.g. in 1980 the share of exports from Hong Kong, South Korea and Taiwan accounted to 72% of the total finished consumer goods exports of developing countries. It should be noted, that only East Asian countries managed to create auxiliary industries necessary for viable finished consumer goods export.

Export of finished brand products is a final goods exports more advanced than finished consumer goods export when producers come to foreign markets with their own brands. A conspicuous example of finished brand products exports is South Korea with local companies present at foreign markets with their own brands of cars and electronics.

In general, the finished brand products export is a standard to measure success of export policy of any specific country. Table 1 reviews the global profile of exports.

Table 11: Global Profile of Exports

	<i>Commodity exports</i>	<i>Export processing zones</i>	<i>Component parts exports</i>	<i>Finished goods exports</i>	<i>Finished brand products exports</i>
East Asia	X	X	X	X	X
South-East Asia	X	X	X		
Latin America	X	X	X		
South Asia	X	X			
Africa	X	X			

Despite diverse export profiles of developing countries, categories 2 to 5 are a result of one specific mechanism:

Seeking cheap labor, large transnational companies were placing commercial orders in East Asian countries with the latter, in their turn – with increasing costs of domestic labor – on-placing the orders to the countries with the labor remaining cheap. Important for this process is that developing countries of Easter Asia were enabled to enhance their industrial capacity through commercial orders from companies from developed countries, and through improving their industrial capacity developing countries strengthened their positions and advanced to new types of exports.

Due to certain reasons many countries of the world were not given this opportunity to establish new industries through commercial orders. In other words, transnational companies helped certain East-Asian countries to enter into the global economy and then – into rich markets of developed countries.

Legislative basis should be thoroughly analysed for the purpose of creating competitive environment with elimination of all the barriers to passing of goods and services interfering in establishment of healthy competition at Kazakhstani market.

A strategic area of the trade policy should be a gradual complete trade liberalisation. This policy should be implemented in the shortest possible timeframe through partial redistribution of extraction revenues to the benefit of further value added chain development and setting up new productions based on research and innovations.

Accession to the WTO is an urgent necessity for Kazakhstan.

Through accession to the WTO Kazakhstan aims to create conducive environment for sustainable economic growth through external trade and complete restructuring of domestic goods and services production structure in accordance with rules, standards and mechanisms of this institution.

Having acceded to the WTO the Kazakhstan will have to:

- prevent discrimination of exports from Kazakhstan;
- strengthen the international image of Kazakhstan as a country with an open market economy accepting rules and principles of civilised international trade;
- develop regional integration processes within the Eurasian Economic Commonwealth and the CIS;
- advance to creation of a real feasible customs union and the common market; proactively confront engagement of special protectionist, antidumping and compensation policies in mutual trade;
- develop and implement efficient measures to promote exports including export risks insurance.

Addressing these tasks through the WTO measures and mechanisms is especially relevant for the transfer to finished goods exports with the market over saturated and extremely competitive.

At present Kazakhstan is trading with 135 from the total 144 WTO member countries. Accession to the WTO will enable Kazakhstan to trade with these countries pursuant to unified rules and mechanisms.⁶²

Average weighted import rate in Kazakhstan is approximately 8.6% - that is almost equal to the average WTO rate (6-7%). Items eligible for 0-15% rate account to 95% of all commodity items. So, there is no grounds for concerns about weakening of the internal market in general.⁶³

Kazakhstan should synchronise its accession to the WTO with its main trade partner Russia.

Kazakhstan in the WTO

During the last decade, Kazakhstan has tackled the issue of accession to the WTO. In the process, a great deal of work has been done, and negotiations with member-countries on the specific terms and conditions of entry of the country on the basis of equal rights to the worldwide system of regulation of trade in goods and services were started.

Kazakhstan's accession process started on January 26th 1996, when the country submitted its official application to the Secretariat of the WTO. Kazakhstan received WTO observer status in February 1996 and is currently applying for full membership in the World Trade Organization. Kazakhstan's Working Party was established on February 6 of 1996. Bilateral market access negotiations in goods and services

⁶² Ministry of Industry and Trade

⁶³ Ministry of Industry and Trade

commenced in October 1997 and are continuing based on revised offers in goods and services. Topics under discussion in the Working Party include: agriculture, the customs system (and customs union arrangements), price controls, import licensing, industrial subsidies, SPS and TBT, transparency of the legal system and legislative reform, services and TRIPS. The Working Party last met in December 2003.⁶⁴

Benefits to Kazakhstan from WTO Membership

One of the reasons which makes the World Trade Organization appealing for Kazakhstan is the authority of this organization in arbitrating trade rows. Squeezed between two giants - China and Russia - Kazakhstan feels it is gradually losing grounds in foreign trade.⁶⁵

Kazakhstan considers accession to the WTO as a priority task of economic policy for the next two-three years. Accession of Kazakhstan to the WTO is part of the general strategy of development policy of Kazakhstan, which is directed to effective integration of the country into the world economy and global trading system and serves the following particular purposes:

- Application of best practices and non-discriminatory conditions for access of Kazakh goods and services to foreign markets.

- Ensuring a sufficient degree of protection of domestic producers within the framework of a reasonable open economy and based on norms and rules of the WTO.

Among the benefits Kazakhstan presumably can get from entering the World Trade Organization is the expected increase of foreign direct investment into the country. The creation of a stable and non-discriminatory trade environment for business would be a major step towards enhancing Kazakhstan's attractiveness as a place to invest and as a trading partner.

⁶⁴ Ibidem

⁶⁵ Information from Administration of the President of RK, 2003

WTO accession should be an opportunity to reduce existing trade barriers and push forward internal reforms to implement WTO rules. It will also promote the further integration of Kazakhstan into the global trading system based on the WTO. After joining the World Trade Organization, Kazakhstan will gain real access to international markets for the export of textiles, agricultural products and other items.

The main advantages of Kazakhstan's membership in the World Trade Organization are the following⁶⁶:

- introduction of modern technologies and production methods in industry,
- boosts competition at the internal market,
- improves competitiveness of domestic products at external markets,
- increases foreign investments,
- creation of more favorable, non-discriminatory, stable and predictable conditions for the development of foreign trade,
- access to the mechanism of the WTO for settlement of trade disputes as a very efficient mechanism for the protection of trade interests of Member Countries of the organization,
- introduction of international norms and rules of WTO into the Kazakh legislation and corresponding practices in foreign trade activity.

Accession of Kazakhstan to the WTO is not an aim in itself, and membership should not be achieved at any cost. The most important condition for membership is an improvement in its trade and political regime and proper balance of rights and obligations of the country in the WTO. In addition, it is necessary to consider that the real terms of integration of Kazakhstan into the world economy, including efficient use of advantages of membership in the WTO, will be determined, firstly, by the long-term

⁶⁶ Abdimoldayeva N. (2001), 'Accession of Kazakhstan into the World Trade Organization,' *Working Paper*, Ministry of Economy and Trade of the Republic of Kazakhstan.

development perspectives of the Kazakhstan's economy as a whole. These perspectives, in turn, will depend on how successful the country is in overcoming domestic economical crises in some industrial sectors and in completing the market reforms. Only then, Kazakhstan will be able to compete with developed countries on an equal basis. However, in meeting the interests of existing WTO members, the long-term interests of Kazakhstan should not be unduly compromised.

The benefits from WTO membership mainly arise from improved access to international markets but may only be perceived in the end. Even then, only if the country has developed a competitive export sector, improved coordination among concerned government agencies strong enough to protect the rights and interests of the country in the complicated system of the WTO, created dynamic commodity producers who are able to realize their commercial benefits from WTO membership.

Problems and Hurdles

Accession to the WTO is much more complicated and difficult than joining GATT 1947. First and foremost, multilateral trade agreements under the WTO contain more strict and detailed rules and norms for the regulation of trade in goods, and extend coverage to areas such as trade in services and protection of intellectual property.

Secondly, the demands of the so-called "main trading Member States of the WTO" to new potential members in the process of accession are ever increasing and becoming increasingly stringent. For instance, countries like Australia, European countries and the United States argue that the aspiring WTO Member Countries, such as Kazakhstan, should assume commitments at a higher level than those of the existing members of the WTO. This means that new WTO Member Countries were forced to

agree to obligatory joining of agreements under so-called "sectoral agreements," as well as to tariff levels and commitments in the services sector which are sometimes more liberal than those of most developed member countries of the WTO. Most illustrative in this regard are the terms of accession agreed to by countries like Ecuador, Kyrgyzstan, Mongolia and Panama, which, according to many specialists, are very liberal indeed to the extent that they may not serve the interests of domestic producers. In addition, these countries made concessions and assumed commitment by joining some non-obligatory agreements of the WTO with so-called "restricted number of participants" (e.g. Agreement on Government Purchases and Agreement on Civil Air-plane Engineering Trade). This has created precedents to harden accession terms for other countries aspiring to join the WTO.⁶⁷

Agreeing with such high demands for new acceding countries could result in negative consequences for trade and socio-economic development of the country.

Apparently, WTO Member Countries are only prepared to accept accession of Kazakhstan to the WTO on their terms and have little regard for the real problems and difficulties of the country. For instance, despite the fact that according to economic indicators Kazakhstan should be classified as a developing country, the demands for commitments would classify it as a developed country. The negotiations are difficult as their results will have direct implications for the operations of domestic industrial, agricultural and services enterprises, and affect the terms of competition of domestic with foreign companies in the domestic market and abroad. Industrialized developed countries with low average duty rates, set zero or minimum rates on imported raw materials, but raise those rates for import of finished industrial products, while duties on import of agricultural products (domestic production is subsidized) are raised to

⁶⁷ Abdimoldayeva N. (2001), 'Accession of Kazakhstan into the World Trade Organization,' *Working Paper*, Ministry of Economy and Trade of the Republic of Kazakhstan.

prohibitive levels effectively preventing imports from other countries. If Kazakhstan were forced to lower its average level of duties without making extensive efforts to improve its current tariff structure, producers would receive a double blow: while the domestic market is open to foreign competitors, domestic producers will face prohibitive barriers to export their own finished goods to the developed countries. ;

Accession of Kazakhstan to the WTO will also require the country to lower state support to the agricultural sector, including a gradual reduction in import tariffs, in this context, it is important for Kazakhstan to define the minimum required level of tariff protection and compare this with the level in WTO member-countries, in order to maintain certain flexibility in the near future. It is difficult for Kazakhstan to determine the acceptable conditions for access of foreign goods and services to the domestic market. The country should be able to protect priority sectors to allow the development of their competitiveness, including "infant" industries producing new products and those industries, which are not competitive in international markets. Yet are essential for the country, such as food and other light industries, while at the same time assume commitments on liberalization of foreign trade and opening its domestic market. This is a complicated problem, particularly in a period when the country is recovering from recession and needs protectionist measures to support its economy.,

Currently few services sectors are developed in Kazakhstan, as most of them are in the process of development. In some cases, foreign suppliers of services enjoy more favorable conditions than domestic ones. For that reason it is important that Kazakhstan prepares a position in the negotiation process that would ensure necessary levels of protection for its domestic services sector, not only those in the process of development but also developed ones which are not immediately able to cope with foreign

competition.

A major problem facing developing countries, including Kazakhstan is the obvious shortage of financial resources and professional personnel, which undermines those countries' abilities to undertake effective negotiations on such complex issues as those discussed as part of the accession process.

Apart from the complicated organizational and procedural issues inherent to the WTO and the accession process, Kazakhstan faces a number of difficulties resulting from structural and infrastructural backwardness and its isolated geographic location. While the countries in post-socialist Central and Eastern Europe take advantage from their proximity to Western Europe and have access to traditionally qualified labor and open trade with the European Union, Kazakhstan does not have those benefits.

While Kazakhstan is reorienting its trade relations towards developed and developing countries in the region, it is also renewing and supporting its traditional trading relations with the CIS countries by joining regional and sub-regional trading arrangements and other mechanisms for sub-regional economic cooperation. In this context, it is important to focus such sub-regional cooperation on exploiting economic complementarities in the processing of raw and semi-finished products on the basis of new technologies and technical standards. Only this way the dilemma between short- and medium-term trade cooperation with the CIS countries within the framework of the Eurasian Economic Community (initially Customs Union) and long-term trade cooperation under the WTO can be solved.

On April , the presidents of the four non-WTO members of the EAEC further endorsed an approach when coordination would enable them negotiate better terms of WTO accession. Coordination would strengthen the bargaining power if the countries involved acted with a common position. However, this is difficult for as each of the

candidates is now pursuing a separate accession process at a different pace. The best outcome for such coordination is to prevent candidates from undercutting each other. The low levels of protection agreed to as part of the Kyrgyz accession have been widely regarded by other EAEC members to have undermined their negotiation positions.

Russia's accession sets the benchmark for other countries since it is the most influential player in the coordination process and its accession process is more advanced. The average tariff in Russia is considerable higher than that in Kazakhstan. The Kazakhstan's authorities indicated that Russia's tariff levels were an informal benchmark for Kazakhstan's tariff offers to WTO members. This tends to reduce the scope of tariff reductions in Kazakhstan's offers.

Recommendations`

Kazakhstan is in the midst of its transition to a market economy. Many of the recent reforms in Kazakhstan have been undertaken in compliance with WTO requirements. Key reforms underway include creating a viable securities market, implementing pension reform, modifying its trade regime so that Kazakhstan can join the World Trade Organization, consolidating financial sector and improving Kazakhstan's investment climate.

The primary objective of further reforms is to strengthen Kazakhstan's capacity to pursue its trade and development goals in multilateral trade relations through increased professional capabilities of national institutions:

- Improve capacity for streamlining national trade strategy- and its implementation in accordance with the WTO rules and disciplines.
- Better understanding of relevant WTO provisions by the Government and private sector.
- Revision of the legal framework in accordance with WTO requirements.

- Improve negotiating capacities of Kazakhstan official negotiating team.

Kazakhstan officials should elaborate on strategy and rational tactics for conducting bilateral/multilateral market-access negotiations in the WTO accession process, including analysis of foreign trade regimes of Kazakhstan's selected trade partners.

In order to avoid the mistakes made by two post-soviet countries recently acceded to the WTO - Georgia and Kyrgyzstan - the following recommendations could be made:

- The terms of negotiations are not an aim in itself. Kazakhstan should ensure that the results of the negotiations and terms of accession would not negatively affect socio-economic development of the country.

- It is necessary to coordinate the WTO accession process with the process of obtaining credit from IMF, i.e. the terms of accession agreed with WTO should not conflict with the terms of credit agreed with IMF.

- Kazakhstan should make maximum use of its observer status at WTO in order to be prepared for the negotiations on accession.

- Kazakhstan should pay due attention to the necessity of intensifying bilateral negotiations with WTO Member States on issues such as import custom tariffs, access to domestic markets and support to the agricultural sector.

- Kazakhstan should pay special attention to the informal ways of negotiating with certain WTO members, in particular as regular informal consultations with active Working Group members will facilitate the formal negotiations.

- Kazakhstan should pay special attention to issues related to trade in services, as commitments in this area will have long-term implications.

- Kazakhstan should clearly identify its needs and requirements for technical

assistance, particularly in the area of training, from multilateral aid organizations such as ESCAP, and of course WTO; The priority area for technical assistance is training of national personnel in the areas of standardization, sanitary and phyto-sanitary measures in agriculture, and trade-related aspects of intellectual property rights;

- Kazakhstan should establish information centers on standardization and sanitary and phyto-sanitary services in each concerned ministry.

In particular, the completion of negotiations and the accession process meets the long-term interests of the country and leads to various positive outcomes.

- Removal of discriminatory measures against a number of important export goods of Kazakhstan and general improvement of their access to world markets.

- Increased competence and competitiveness of selected industrial and agricultural sub-sectors.

- Establishment of trade-economic relations of Kazakhstan with other countries on the basis of a stable and fair rules-based system, including equal rights.

- Access to the dispute settlement system within the framework of the WTO.

- Improvement of the national legislative framework and its application, which will boost further economic reforms.

In conclusion would like to note the following.

- ✓ Kazakhstan's pending status of WTO member will effectively integrate the country into the rules-based multilateral trading system.

- ✓ The largest gains from WTO accession would come from reforms to Kazakhstan's own trade regime. Furthermore, the dynamic gains in the form of higher growth are likely to be far greater than the static gains from greater allocation efficiency. As I noted earlier, a level playing field supported by a lower, more uniform tariff structure would increase domestic competition, which in turn enhances productivity

progress. Greater openness to trade has been shown to contribute to growth and poverty reduction.⁶⁸

✓ WTO accession could help reforms in areas other than trade. Accession-induced and other domestic reforms are complementary. In transition economy like Kazakhstan's, WTO commitments could serve lock in domestic reforms that often have fragile institutional support. WTO accession can be used and has been used in other transition economies as an external catalyst to further domestic reforms. China's 16-year long WTO accession has made important contribution to its domestic reform process.⁶⁹ On the other hand, any benefits from WTO accession may only be potential gains until supporting domestic reforms and institutional changes are instituted. This requires an overall strategy that exploits the synergy of trade and other reforms. Liberal trade regime needs and supports a liberal industry policy and supporting institutions to ensure fair and rigorous competition, the rule of law and transparency.

✓ WTO accession provides a unique opportunity to implement successfully an industrial policy, adopted by Kazakhstan's Government. Kazakhstan can use the accession process to accelerate trade and other domestic reforms. Much has been achieved in legislative reforms in support of WTO accession. Comprehensive reforms are needed, however, not necessarily for the sake of WTO accession, but rather for reaping the benefits of an improved investment climate and greater competition. A narrow, mercantilist approach to WTO accession needs to be avoided.

✓ It is critical that Kazakhstan maintains trade policy independence so that it can undertake trade reforms at a pace that suits its own trade strategy and in support of its WTO accession. Kazakhstan is in the process of diversifying its export away from

⁶⁸ Krueger and Berg, 2002

⁶⁹ Bacchetta and Drabek, 2003

CIS countries. Given time, domestic firms could supply an increasing variety of exports to non-CIS countries. It is important that regional trade arrangements do not create a disincentive to diversification.

✓ There will be adjustments costs associated with WTO accession. Structural unemployment may increase in the short run as the result of WTO accession. Given Kazakhstan's high unemployment, these costs deserve attention. Although broadly based structural reforms mentioned above are likely to be the most effective measure dealing with the adjustment pressure, social institutions need to be strengthened to protect the vulnerable in the society. Social protection could help build a consensus on structural reforms and WTO accession.

Kazakhstan in the Regional Economic Integration Framework

"The globalization and the integration are two interdependent processes; they still -will continue to determine the world economic development in first half of 21st century. For developing countries, the regional integration is probably the only opportunity to withstand the negative consequences of globalization and dictatorship of the world's most advanced countries. Newly independent states, whose economies used to be integrated into the economic structure of the U.S.S.R., have now the only way to get the deserved space in contemporary world economy. That is a regional integration."

Nigmatjan ISINGARIN⁷⁰

Since its independence, Kazakhstan has made all possible efforts to overcome the country's isolation and to search for effective ways to integrate into the world economy. However, it is impossible for such economically a small country, as

⁷⁰ Isingar N. (2001), 'Ten years of CIS: Problems, Searches, and Solutions,' *Pallada-Media*.

Kazakhstan, to succeed in this process without participation in regional economic blocs. Therefore, after the collapse of the Soviet Union, Kazakhstan consistently acted as the initiator of integration processes on the post-soviet territory in order to use effectively leverage the scientific, technical and economic potential of CIS countries and advantages of the international division of labor that was established during the times of the former USSR.

The Republic played an important role in signing the Agreement on creation of CIS, which could become a basis in forming common economic space. With this purpose, nine CIS states signed the Agreement on creation of the Economic Union in 1993, which, unfortunately, was not fully realized because of disagreements between the member states. In this connection, Kazakhstan has made an emphasis on the development of bilateral economic relations between separate CIS-states, and initiated the creation of the Central Asian Cooperation Organization (CACO), including the creation of interstate bodies within this regional organization - Interstate Executive Committee and special bank for cooperation and development.⁷¹

The next step towards integration was the establishment of the Eurasian Economic Community (EAEC) in October 2001 in Astana City, based on the Customs Union plus Ukraine. The new union is based on a concept of construction of a new system of interrelations between participating countries in economic, social and political spheres, generalizing the experience of existing regional economic unions, such as the EU, NAFTA, etc. It is important to note that EAEC, according to the international norms and rules, not only coordinates and solves economic and political problems, but also is the tool, which allows it to supervise the realization of decisions.⁷²

From this point, the EAEC could be considered as a transition to a higher level

⁷¹ Berentaev K. (2001), 'Eurasian Economic Community: A Step for Integration into the World Economy,' *Analytical Magazine*, Kazakhstan Institute for Strategic Research under the President of the Republic of Kazakhstan

of integration of participating countries that allows the protection of the interests of its member countries.

The main distinction of the EAEC from the other analogous organizations is that it has become the result of the political decision directed on prospect. As the experts say, the potential of the EAEC structural development is high, although the economic relations between the participating countries still have not achieved their peak.⁷³ Meanwhile large corporations, financial and industrial groups, quite often supported by the state, carry out the main projects. Much is achieved but also there is much to be achieved. The President Nazarbaev during the Eurasian Economic Forum held in Moscow has depicted five key problems of integration into the EAEC framework. He mentioned, "Together we have more significant advantages, which are capable of reducing our weaknesses and to strengthening the competitiveness of products of the countries-members on world markets."⁷⁴

First, the President Nazarbaev has noted that the EAEC possesses rich land resources that could allow to "seriously increase its share in world markets."⁷⁵ Next President Nazarbaev pointed out the necessity of joint development and consecutive realization of a common policy, favorable to all EAEC-countries, to enter the power sector of the world market. In his opinion, the key role in this area should belong to the creation of the power infrastructure that is the construction and development of pipelines, seaports and terminals. Concerning the transit potential, President Nazarbaev has noted the absence of coordinated policy between EAEC-countries. According to export estimations, today freight flows between Europe and Asia amount to 100 millions tons and expected to grow very fast. Therefore, as President Nazarbaev

⁷² Ibidem

⁷³ Berentsev K. (2001), 'Eurasian Economic Community: A Step for Integration into the World Economy,' *Analytical Magazine*, Kazakhstan Institute for Strategic Research under the President of the Republic of Kazakhstan

⁷⁴ Maltsev B. (2003), 'Towards Common Economic Space,' *Kazakhstanskaya Pravda*, 21 February

⁷⁵ Ibidem.

suggests, "the EAEC needs the coordinated policy, favorable to all, in order to keep the bigger part of these freight flows ... ". The other problem with integration that the President Nazarbaev pointed out is "the gradual decrease of positive points of mutual cooperation and the reduction of mutual trade density". However, the main reason of all existing and arising problems, as President Nazarbaev declared, is insufficient understanding of an acuteness of these problems by administrative and business elites and the absence of the necessary initiative from their side.⁴⁵

All these large problems, which should be solved by the EAEC, are followed by less significant, but also very important tasks. Participating countries should make efforts to activate small and medium economic structures, which make integration processes complete. Today, EAEC practically copies the experience of those economies, which started to grow with large corporations, whereas the sphere of small and medium businesses has not reached sufficient development. Hence, the future of EAEC depends much on the degree of development of small and medium businesses sector of participating states and on the share of this sector in the economy as a whole.

As already mentioned, EAEC was organized according to the political decision, diverging EAEC from EU or APEC. When the national small and medium businesses are undeveloped for active actions, the field of regional trade remains behind large corporations and states. In this case, the political decision is required.

The work currently carried out by the EAEC is directed to remove obstacles on the way of transformation of the community into the high-grade regional economic block, and it is necessary to note that there is much to be made. The organization faces with several difficulties, such as the overestimated transportation tariffs, low densities of mutual trade, and there are some facts of the applying of antidumping measures that does not match with the principles of free trade. This could be explained by the number

of reasons, however the main reason is insufficient volume of mutual trade inside the EAEC and disproportions in economic development of member countries. Nevertheless, there is also a positive point, such as stable economic growth of major member countries - Russia and Kazakhstan. It gives the hope that with the process of expansion of economic cooperation many current difficulties will remain in the past.

Monitoring the two years of EAEC functioning, it can be pointed out that the agreements, implemented within the framework of this organization, influenced positively on socio-economic and political development of both states and the region as whole. The President Nazarbaev, in his speech at the Moscow State University, has noted that if all signed agreements will be implemented, it will be already 90 percent of success. The President of Russian Federation Putin V. V. also has an optimistic attitude towards cooperation with Kazakhstan. He thinks that such cooperation has a strong base and sufficient economic and geopolitical reasons, which guarantee active integration processes either within the framework of the EAEC or the CIS.⁴⁶

In case the EAEC succeeds in achieving its goals, it will have a great future and heads of the member states guaranteed the fulfillment of all taken obligations. Indeed all the five participating states possess not only the industrial and resource potential, but also large scientific and intellectual potential, taking the leading positions in the world in many branches of a fundamental and applied science. The prospects of other CIS countries joining EAEC, close economic cooperation with China and, probably, with India and other states of Asia, allows us to consider the EAEC as a basis for the emergence of a large regional economic block, which can play the same role in the world economy as the USA, countries of EU and other world economic centers.

The transformation of the "Shanghai five" into the Shanghai Organization of Cooperation (SOC) connected with joining of Uzbekistan and the intention of the new

organization to expand the sphere of activities due to closer economic cooperation between the SOC members in the long term can result the creation of the large regional block with huge economic potential. It is important to note that the capacity of a Chinese domestic market potentially equals to almost 20% of the world market.⁷⁶

Regarding progress, currently the EAEC is passing the initial stage and still it is necessary to create high-grade integrated industrial complex within its framework. However, the signed agreements form the basis of the further success. Moreover, the most important step on the way of realization of EAEC goals should become the creation of a free trade zone between member countries. This can be a priority for the near future.

As the European architect Jean Monet wrote in middle of the last century, "well-being and obligatory social development are unimaginable, if European countries will not create the federation or "the European configuration", which will unite them into the economic community."⁷⁷ These prophetic words became essential in relation to EAEC.

Analysis of the regional trade.

Kazakhstan has signed a number of regional and bilateral agreements which either exclusively deal with trade or have an important component on trade and investment. As I mentioned above, probably the most important among them is EAEC, which was signed in 2001 to replace the 1995 CIS Customs Union. The aim the EAEC is to create a customs union and eventually a "Single Economic Space" among the member states.

Notwithstanding the regional trade arrangements, progress toward economic

⁷⁶ Maltsev B. (2003), 'Towards Common Economic Space,' *Kazakhstanskaya Pravda*, 21 February.

⁷⁷ Ibidem

integration among CIS countries has been limited. Under the EAEC agreement, common external tariffs are to be adopted among member countries, thus forming a customs union. However, only about 60% of tariff lines (or about 40 % of the trade value) has so far been harmonized among member countries. Even for these already harmonized tariffs, individual countries may opt for changes twice a year. Non-tariff barriers are not covered by countries have imposed contingency protection on import from other members, and major obstacles remain in the transit shipment of exports for some members countries. The Kyrgyz authorities, for example, have complained about various fees imposed on their transit trucks crossing Kazakhstan, while Kazakhstan has expressed concerns over Kyrgyzstan's seasonal duties on wheat imports from Kazakhstan.

Preferential trade arrangements among CIS countries have not prevented intra-CIS trade from declining in importance, as noted earlier. However trade intensity between Kazakhstan and its CIS partners remains high.

Table 12. *Trade intensity, complementary and bias between Kazakhstan and its major trading partners, 2001*

Trading partner	Intensity	Complementary	Bias
Russian Federation	27.70	0.91	30.54
Ukraine	13.6	1.96	6.95
EU	0.66	0.94	0.70
Chine	2.10	1.74	1.21
Japan	0.02	1.22	0.01
Nafta	0.09	0.85	0.11
Rest of the world	1.58	1.17	1.34

Source: Calculations based on the World Bank WITS Database.

Trade with Russia, for example, is 27 times more intense than the average. Although this high intensity is at least partly due to geographic proximity between the two countries and long-existed transport infrastructure (in particular, pipelines for oil transport), it may reflect the lasting effects of trade distortions during the soviet era, and the current trade pattern for individual CIS countries may still not be optimal.

Trade complementarity between Kazakhstan and Russia, Kazakhstan's most important trading partner, is below average. This is hardly surprising as both countries concentrate in the exports of oil and metal products (such as iron and steel). In contrast, there is high degree of complementarity between Kazakhstan and Ukraine – Kazakhstan's second largest CIS trading partner. Trade bias explains most of the high trade intensity in both trade with Russia and Ukraine. In addition to historical ties, the long common border with Russia and lower natural barriers in other areas (such as the use of the Russian language in all three countries) contribute to the high bias towards the bilateral trade.

Relatively low trade complementarity may explain part of the slow growth of trade between Kazakhstan and Russia in recent years. Russia's rapid economic growth since its recovery from the 1998 crisis has not generated rapid demand for imports from Kazakhstan. In contrast, Kazakhstan has high complementarity in trade with China and the "rest of the world". For instance, 90% of Kazakhstan's exports To China consist of manufactured goods, especially metal products in which China generally has a comparative disadvantage. With improvement in Transport, oil export to China could play important role in the future.

The trade diversion effect of regional trade arrangements among CIS countries is potentially large. Promotion of intra-CIS trade against underlying comparative advantage may slow down overall export expansion. It is likely that non-CIS trade will

continue to be more dynamic than CIS trade with for some time in the future. In addition, technology transfers embodied in non-CIS trade with industrial countries is likely to be more intense than in CIS trade. This leads the World Bank (2001) to conclude that in general a north-south free trade arrangement is more beneficial that is particularly important for Kazakhstan/

One approach to reducing the potential trade diversion effect of EAEC would be to have low common external tariffs (CETs) for customs union. This has been made difficult by variations in tariff levels among EAEC countries. As noted earlier, Russia has a considerably higher average tariff (11%) than the rest of the member states except Belarus. The pace of Russian trade liberalization tends to have strong influence over other member states. Although the EAEC has been largely ineffective, a free trade area among CIS countries would have given Kazakhstan more independence in trade policy.

The necessity of integration is already determined by geopolitical position of member countries - EAEC countries are situated in the middle of the continent. EAEC-countries are simply need to create the regional cooperation and to overcome all obstacles for trade and movement of the capitals. It is difficult to foresee the future shape of EAEC and those problems it might face with in future. However, today EAEC has all the necessary preconditions to become one of the important economic organizations of the region.

The economic cooperation of Kazakhstan with Northeast Asian region

In order to integrate effectively into the world economic system Kazakhstan needs expansion and diversification of its foreign economic activities. In this connection, one of the priority directions of the country's foreign economic policy is Northeast Asian Region (particularly with the newly industrialized countries). Its

importance is determined by the following factors:

- Cumulative GDP consists 14 trillion USD that is almost twice surpasses EU economy;
- Share of Northeast Asian countries (NEACs) in the world industrial production is more than 60%;
- Concentration more than 40 % of all global investments in this region;
- An useful experience of development of branches of economy with production of high added value.
- Aggregate population makes about 1/3 world population.

These factors determine a number of basic tasks, which are required to be concerned. First, development of cooperation and active participation in the integration processes in the region in order to provide external economic security of the country. Secondly, diversification of foreign economic relations in order to decrease the degree of trade- economic dependence from Russia (the trade share in Kazakhstan's import is more than 80 percent) and achievement of economic freedom is a priority direction in achieving of economic security as a whole. Thirdly, comparative advantage of Kazakhstan in natural resources allows more active promoting of Kazakhstan production into this regional market.

The Factors of Influence

According to the analysis of main foreign trade positions of Kazakhstan with the NEACs, the priority directions of development of trade-economic cooperation are the relations with the following countries: Russia, China, South Korea and Japan.

The following main tendencies can be found in the bilateral relations:

1. Domination of strong party's policy in bilateral economic cooperation. Due to the sharply asymmetric interdependence between Russia and Kazakhstan, the

character and directions of cooperation usually seem to be established by the more powerful side, which is Russia. At the same time, Russia remains one of the important economic and trade partners of Kazakhstan.

2. Stable tendency of growth of trade-economic relations of Kazakhstan and China. According to Kazakhstan's customs statistics, in 2001 the amount of trade turnover between China and Kazakhstan reached 678.1 million USD, which is 1.6 percent more than in previous year. The share of China in total amount of trade turnover equals 7 percent. Kazakhstan occupies second place among CIS countries after Russia in terms of the volume of trade turnover with China.

3. Steady growth of imports from South Korea to Kazakhstan. The volume of the trade turnover between Kazakhstan and South Korea reached 150 million USD in 2001, which is 22 percent higher than in previous year. The amount of Kazakhstan's export to the South Korea reached 45.5 million USD in 2001, import - 106.5 million USD. The share of Kazakhstan's foreign trade with South Korea equals 1.2 percent.

Despite the sharp reduction in exports in 1998 due to financial and economic changes, in 1999 the revival of export-import relations between countries has started. South Korea considers Kazakhstan's market to be very attractive due to the high demand for South-Korean products.

4. Moderate growth of trade volumes between Kazakhstan and Japan despite the significant deficit of the trade balance. Currently, Japan is concentrated on the solution of its internal economic problems. This fact formulates the nature of the Kazakhstan-Japanese cooperation.

Besides that, the volume of trade turnover between Kazakhstan and Japan reached 160 million USD in 2001, which is 27 percent higher than in previous year. The volumes of Kazakhstan's export to Japan reached 19 million USD in 2001, import - 140

million USD. The share of Japan in Kazakhstan foreign trade equals more than 1 percent. This share will grow with the development of transportation routes with East Asian Region.

Raw materials occupy the main share among Kazakhstan exports to Japan; imports from Japan mainly consist of machinery and equipment (including vehicles).

The strategic choice in the development of foreign economic relations between Kazakhstan and North-Eastern Asia

In accordance with the analysis of trade and economic interrelations, it is recommended to define the following basic priorities of such interrelations between Kazakhstan and NEACs.⁷⁸

Priority 1. Consideration and ensuring of optimum conditions for Kazakhstan integration into East-Asian system of trade and economic relations

Currently, Kazakhstan's economic interrelation with East-Asian countries is a one of the priority tasks of the external economic policy of Kazakhstan.

In these conditions, it is clear that economic relationships with Russia and China is currently the main way for Kazakhstan to enter the system of trade and economic relations of East Asia. In this connection, it is important to foster foreign economic relations with these two states.

Thus, it is necessary to indicate the most perspective directions of cooperation with Russia and China:

- The strengthening of the economic cooperation with Russia in order to be able to use Russian territory to enter the external markets by using its infrastructure network -railway lines, pipelines and etc.
- The use of opportunities of the leading oil and gas corporations, which have

established the control above a significant part of natural resource extracting in the region and which are pushing states to more closer cooperation.

- Joining efforts with Russia in development of the mining and smelting complexes.

- Creation of a favorable investment climate in the agricultural sector of Kazakhstan to attract FDI from China.

- Joining efforts in creation of special economic zones along the Kazakhstan-Chinese border, in order to increase of volumes of border trade and FDI.

- Equipping the Trans-Asian railway line and the development of transport communications network.

The necessity of strengthening the cooperation with NEACs becomes the catalyst for strengthening the economic integration, which can promote:

- Maintenance of political stability;

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- Maintenance of steady development;

- Increase of FDI inflows to Kazakhstan and simultaneous development of the investment market of the country.

The process of integration of the domestic economy into the trade and economic system does not consider the necessity for creation a certain rigid economic structure above the national economy. Quite the opposite, such integration can promote the development of the competition based on relative and absolute advantages of Kazakhstan.

Defining the priority advantages it is necessary to analyze the parameters which describe the country's ability of steady economic growth, such, as market capacity, natural resources, capital, investment goods, level of technologies and labor force.

⁷⁸ Namazbekov M. N. (2001), "Trade-economic Relations with the Northeast Asian Countries: Current Status and Priorities of Development/ *Analytical Magazine*, Kazakhstan Institute for Strategic Research under the President of the Republic of

Table 13. *Distribution of production factors by countries*

Country	Market	Natural	Capital	Investment	Level of	Labor
Japan	3	1	4	4	4	1
China	2	3	1	1	1	4
South Korea	2	1	2	2	2	2
Russia	2	4	1	1	3	3
Kazakhstan	2	4	1	1	2	2

Notes: the Rank "1" indicates the existence of minimal advantages, the Rank "4" - of maximal.

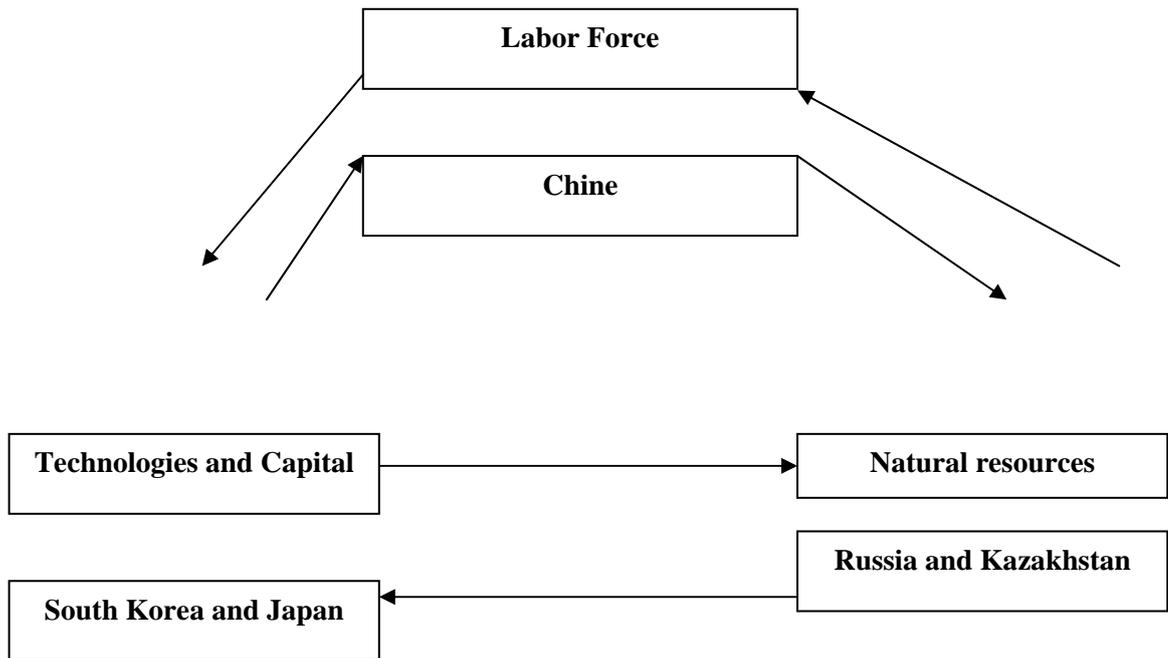
The Table 13 shows the uneven distribution of production factors, and indicates that there is no country in the region holding absolute advantage on all parameters.

The positions of Russia and Kazakhstan are supported by solid stocks of natural resources, which predetermine their active orientation on the development of "east" vector in the sphere of cooperation that as a whole will strengthen their trade and economic relations.

Thus, within the framework of development of economic interrelations of Kazakhstan and NEACs, considering uneven distribution of production factors, there are three groups of countries:

Kazakhstan.

Figure 4. *Distribution of main production factors*



The first group includes countries that hold the advantage in labor force - China.

The second group includes technologically advanced countries with significant investment potential - Japan, South Korea.

The third group includes resource-rich countries - Russia, Kazakhstan.

The region has distinctive situation of uneven distribution of production factors, which indicates the presence of necessary conditions for the development of multilateral relations in the form of commodity trade and exchange of production factors.

Certainly, the participation of Kazakhstan in the process of integration within the framework of regional allocation of the factors of economic cooperation is conditioned by the availability of natural resources and their export potential.

In this case, Russia and Kazakhstan possess a clear advantage in stocks of natural resources. The effective realization of the potential concentrated in two sectors of the

regional economy - fuel and energy complex and raw materials - in the short term perspective will render positive influence on development of national economy, and will speed up the integration of Kazakhstan into the trade and economic system of East Asian Region.

The most important points in the process of integration are formation and realization of the supportive international projects for creation of an infrastructure, which will connect countries and regions in the field of power and transport.

Priority 2. A creation of the mechanism of trade-economic activities regulation with NEACs.

Measures	Mechanism of Realization
<i>Export Regulation System</i>	
1. Prevention of unfair export practice	Creation of exports cartels. The cartels can be created, modified or abolished in case of contradiction with national interests of Kazakhstan.
2. Quality control by means of organizational and legal measures	Providing the realization of: - Inspection of quality of goods and quality of packing for preservation of characteristics of goods at transportation; - Inspection of used materials; - Technical inspection. The purpose of these measure is "a support of exporter reputation" and assistance for export development
3. Improvement of the export financial support system	Creation of favorable conditions of credit drawing up by the exporters
4. Tax stimulation of export	Tax privileges for so-called "reserve funds" of exporters in order to support the expansion of their business on external markets.
5. Improvement of the foreign trade insurance system	The insurance of trade and investment operations in order to provide more stable conditions for export - import operations, FDI, etc. by means of: - General trade insurance; - Foreign currency risk insurance; - Insurance of export bills and bonds; - Advance payments insurance for import; - FDI insurance; - Crediting insurance for domestic exporters.
<i>Import regulation system</i>	

1. Improvement of import (export) regulation legislation	Improvement and development of the laws: - "The Custom Law" and other laws regulating customs issues; - "The Law on Import-Export Operations"; - "The Law on Food Control"; - "The Law on Drugs Control."
2. Improvement of the mechanism of non-tariff methods as import quotes	The determination of import quotes should be based on real import demands on <u>Kazakhstan's market for certain goods</u>
3. Tax stimulation of import	Tax privileges for goods and technologies, which important for economic development of the country

Priority 3. A creation of more effective mechanism of attraction of "East-Asian"

FDI into Kazakhstan's economy.

Kazakhstan does not have enough of its own investment resources for development of basic economic branches. For structural transformation and achievement of a trajectory of stable economic growth, the country needs approximately 1.5 billion USD of annual capital investments. In this situation, the main task of the country's economic policy is attraction of FDI for development of priority branches of the national economy on mutually advantageous conditions.

The FDI from NEACs can meet this requirement and provide a more effective integration of the national economy with NEACs.

The country's experience shows some deficiencies and negative consequences of today's model of attraction and usage of FDI. As it present earlier, about 90 percent of the investments are directed into the power, oil and gas, metallurgical and food-processing industries. At the same time, the investment into the agriculture, textiles, tanning, machine-building, petrochemical, furniture industries etc. were substantially reduced over the time. These trends show high disproportions in FDI allocation in the economy.

Therefore, the improvement of investment activity practice and the country's

investment policy is required, focusing on:

- The creation of favorable investment climate in order to support investment attractiveness of Kazakhstan.

- The effective distribution and utilization of FDI to support proportional development of promising branches of the national economy.

To conclude, Kazakhstan should undertake all possible measures for acceleration of its economic integration with East Asian Region that will allow Kazakhstan to diversify the existing foreign economic activities geography and provide deeper integration of the country into the world economy.

Perspectives of Kazakhstan's integration into the World Economy

In light of the current level of development of the world economy, integrating a national economy to it requires an open economic market, which is constructed on similar principles, through the passage of certain stages of sequential development. It is necessary to reject the existing trade-intermediary doctrine and self-sufficiency in transition to a reproduced geo-economic model, then a postindustrial model of development in Kazakhstan's economy.

Therefore, high-grade "openness" of an economy can be achieved only as a result of its structural reorganization, development of export potential, and increase of competitiveness of the export-oriented manufacturing. A struggle for redistribution of income and other benefits from participation in international markets is a strategic task targeted at the function and interaction of Kazakhstan's economy in the world economic system.

The main purposes of the external economic policy in the transitive period are as follows⁷⁹:

⁷⁹ Sidorovich A (1997), 'Economic theory,' Moscow: Moscow State University.

- Providing access to domestic manufacturers and consumers to world markets for machinery and equipment, technologies, information, materials, raw mineral resources and transport communications;

- Achievement of favorable trade regimes in relations with foreign countries and their trade-economic groupings, organizations and unions, and removal of restrictions;

- Settlement of currency and financial problems in bilateral relations with the countries'creditors, international organizations and debtors of Kazakhstan;

- Formation of an effective system of protection of external economic interests of Kazakhstan (currency, export, customs control, etc.).

The prime tasks of current government regulation of foreign trade activities are:

- Stabilization of raw materials exports as a base of foreign currency proceeds for modernizing a national economy;

- Accumulation of capital for transitioning to an active investment policy and structural reorganization of export potential;

- Additional capital formation for expansion of the structural reorganization of economy and development of export opportunities;

- Realization of active political support of economic interests in the potential markets and export of production of process manufacturing.

Government support of export development to national manufacturers carries the realization of programs aiming to achieve all possible assistance to exporters by creating an environment for them that is favorable to trade, political and economic conditions. The first such national program of development for the export potential of Kazakhstan was developed in 1992 within the "Strategy of formation and development of Kazakhstan as a Sovereign State" by the President of the Republic of Kazakhstan. N.

Nazarbaev.

The main tasks of today's program for export development should embellish the creation of favorable economic, organizational, legal and other conditions for export development and increase its efficiency, as well as the mechanisms for granting governmental, financial, tax, informational and consulting, marketing, diplomatic and other kinds of assistance to domestic exporters.

For the strengthening of the national market, the traditional significance of imports as a means to reducing economic deficits will play a less important role and its function as a powerful competitive force and antimonopoly factor will increase. The approach to import policy should be differentiated depending on the economic and social importance of imported goods. In accordance with international practices, the state should regulate imports through indirect methods. Thus, limiting only production imports, which can damage profitability or the outlook of national industries. But protectionism should be selective and moderate, corresponding with prices on local markets and with the real situation of businesses in the relative sectors of the economy, so as not to transform to a system of encouraging monopolists and uncompetitive domestic manufacturing practices.

Development of foreign economic relations of Kazakhstan with other countries requires the use of all new tools, optimization of its participation in international specialization, protection of the national economy from negative influences of external factors (cyclical economic recessions, excessive foreign currency rate fluctuations, unfair competition, etc.), promoting escalation of positions of national producers in world markets.

For the West, Kazakhstan is an opportune market, and a potential supplier of traditional raw materials - energy resources, ferrous and non-ferrous metals. However,

substantial increases of these deliveries should only be based on conditions of granting by the West missing investments and modern technologies.

Important preconditions of success are rational concentration of the country's own resources, including cooperation with foreign companies, like joint venture business within the country and abroad, creation of free trade zones and others. At the same time, it is necessary to note that the preconditions of effective utilization of available potentialities in the external economic sphere are overcoming an economic crisis, development and perfection of new economic and external economic structures, strengthening and diversification of export potential. This, in turn, requires mobilization both of its own resources, and the use of opportunities from foreign trade activities, especially increasing of FDI, modern technologies, creation of a healthy market environment in the country and necessary infrastructure.

The deterioration of price conjuncture in the international commodity markets during 1997 - 1999 has proved to be a risk of the development model, which is based exclusively on intensive exploitation and the export of natural resources. Besides, the stimulating impact of export orientation for the sustainable economic growth can be found only under conditions of introduction of the export production with a high degree of processing (or with high added-value). If it mainly consists of raw materials, as it does in Kazakhstan, such export orientation leads to the development of raw material complexities at the expense of the processing and manufacturing industries, because these mining branches absorb labor, financial and technological resources of the country, as well as the FDI. Therefore, the funds accumulated by raw material exports should be used for the development of high-tech manufacturing.

In Kazakhstan, as well as in all resource rich countries, exploitation of natural resources is an essential contribution for economic growth, but only in a short-term

perspective. The exploitation of its own natural resources can appreciably decrease the costs of raw materials imported and release additional funds for purchasing investment and consumer goods, as well as for external debt services of the country. The extended raw materials export can be used in order to support necessary levels of foreign currency inflows into the national economy, but until it will be possible to diversify export composition through the accelerating of development of the processing industry and high-tech manufacturing.

Without doubt, the economic strategy of Kazakhstan, which is based on external factors, is appreciable at this stage of development. However, it is necessary to redirect sufficient parts of FDI from the mining industry and oil and gas complexes into base industrial sectors and labor-intensive branches, which are oriented towards domestic markets (first, into the light and food-processing industry).

To conclude, the integration of Kazakhstan became more complicated because of contradictory processes that are taking place in the world economy. The mitigation of this integration process can be achieved only if all conditions and modern tendencies of the world economy will be considered in our economic strategy, while development of concrete external economic strategy is necessary to consider the coexistence of such tendencies as globalization and regionalism take place in the world economy.

CONCLUSION

Concluding remarks on industrialization of economy of the Kazakhstan

Maintenance of a new qualitative level of development of the economy, capable to make competitive export oriented production in not raw branches of economy, is one of the priority tasks in the development of Kazakhstan's economy. With this purpose in the republic the Government has developed a Strategy of industrial-innovative development, which key approaches should underlie formation of economy of a service - technological orientation.

Achievement of the purposes of an industrial-innovative policy will allow to increase the added cost of a manufacturing industry not only by growth of volumes of production, but also due to essential economy of the human and made capital. It renders positive influence on process of reproduction of production and increase of a standard of living of the population. Besides a liberated labor recourses, energy and materials can be directed on creation of new manufactures

The main difference of the accepted Strategy of industrial-innovative development of Kazakhstan from earlier developed documents in the field of industrial development is that this strategy must be directed on active cooperation of the state with a private sector with the help of legislatively certain measures of intervention of the state to development of economy. This economic policy does not assume dictatorship of the state regarding that as whom to make and where to build objects. The basic engine of industrial-innovative development should become a private sector, and the state will act as the catalyst and the initiator in questions of increase of competitiveness of economy and to promote modernization of private enterprises, involving them in innovative processes.

The basic priority - development and creation potentially competitive, including export oriented the manufactures working in branches of economy of not raw material orientation. This approach does not close for businessmen of various branches of economy a way to technical and organizational perfection of working manufactures and creation of new kinds of

production of export orientation. Selection of the investment and innovative projects directed on modernization of the industry, at their financing with participation of the state will be provided in equal competitive conditions for the enterprises of all branches of economy.

At the same time the state have to make a work on the orientation of a private sector on search of the niche at realization of the large oil-and-gas projects, which are implementing now in Kazakhstan. The nearest fifteen years the expected volume of investments into development of an oil recovery will be more than 80 billion dollars. These means should be spent for creation of the industrial, infrastructural and social objects providing work of the enterprises. The named investment expenses will create demand for a wide spectrum of the goods and services, the part from which will have temporary character, and other part of investment expenses will be directed on creation of manufactures which even after exhaustion of stocks of oil, will be claimed in the external and internal markets.

The sphere of a deepening of processing of strategic raw material is perspective regarding development of a chain added values. So, the deepening of oil refining and gas will create opportunities for manufacture about 200 types of polymeric products, which are used practically in all branches of economy and in a life. Good prospects in this respect are available in an iron and steel industry. In Kazakhstan there are stocks of the mineral ores containing about 100 elements of the table of Mendelejev. In days of the USSR production of nonferrous metallurgy of Kazakhstan was used by manufacture of the high technology and hi-tech goods - space vehicles, weapons and technical equipment.

Questions of development in Kazakhstan of manufactures with higher added values in branches color and ferrous metallurgy get the most urgent meaning. Under forecasts, inflow of large investments to oil-and-gas sector will cause demand for the corresponding technical equipment, an accessories, the potential for which manufacture in republic is huge. Thus manufactures should be guided not only by satisfaction of internal demand, but also a having of the niche in the world market.

Kazakhstan is one of large world manufacturers of a grain. The deepening of process of processing of a grain can become starting base for construction of a diversified chain added values. A deepening of technological process of processing of a grain and other products of plant growing can be a directions of development of such chain. Also a chain added values can enter other branches of an agriculture animal industries, manufacture of meat and dairy production. Construction of factories on manufacture of agricultural machinery and mineral fertilizers, creation of the enterprises on manufacture of natural food dyes, pharmaceutical products, biotechnologies and others can be the center of innovative development of agrarian sector of republic

Thus, from the point of view of postindustrial economy, an use of the existing scientific and technical potential in development the advanced branches is the main task of an industrial policy. Now it is necessary to do monitoring of a condition of all scientific and technical base in the country with the purpose of definition of existing development in perspective directions. Besides it is important to create necessary conditions for making researches in such areas of scientific and technical development, as new materials and chemical technologies, information technologies. And one more important aspect: the legislative base demands deep perfection with the purpose of removal of obstacles for introduction of innovations in the industry and sphere of services.

Concluding remarks on integration of the Kazakhstan into world economy

From the moment of declaration of independence in 1991, Kazakhstan has proceeded with radical reforms of its economy. The reform process enabled the country to formulate and implement an independent foreign trade policy, which before independence was not possible. The transition to a market economy raised the problem of integration into the global community.

The authorities of Kazakhstan fully realize that the integration into world economy is not

a passing fad but a necessity for Kazakhstan, in joining the world economic system as an equal and vital partner. Understanding the inevitability of globalization, they feel that postponement of the integration processes might harm the country's competitiveness in the future.

The major mistake that the authorities of Kazakhstan make is that they consider different integration processes on a separate basis. That is why the present study is a basis and a step towards the further research - the harmonization of various integration processes Kazakhstan is involved; all of these processes should be considered and treated as parts of something solid.

The comprehensive development of foreign economic relations, and integration of Kazakhstan into world economy, requires the establishment of an effective trade policy mechanism based on principles, norms, rules, and practices existing in contemporary international trade. Such an active and effective mechanism for trade and political regulation is a pledge to stable development of the external economic activities of a government and economic agents. Only if the country applies the rules approved by the world community, is effective integration possible.

The current level of the country's economic development is unstable, but Kazakhstan has certain opportunities for high-grade integration into the world economy that are rich endowment of natural resources, existing industrial capacities, qualified labor forces, scientific, technical and educational potentials, large territory and favorable geo-strategic location of the country.

In the near future, Kazakh exports will continue to be resource-based. Exports of oil, metals, grain will continue to prevail. As a result, foreign trade of Kazakhstan will depend on the situation in world commodity markets, in particular the markets for metals, oil and grain. Therefore, foreign trade needs to be geared towards developing high value-added industries. Apart from establishing industries for the processing of commodities, chemical industries such as industries for the production of rubber and plastic products and new kinds of products need to be developed in order to diversify and expand Kazakhstan's industrial and export sector. In

addition, further active liberalization of foreign trade and the improvement of investment climate in the country will allow Kazakhstan deepen the integration processes into world economy.

At the same time, in order to achieve real economic independence of Kazakhstan and its deeper integration into the world economy, the country should take urgent efforts to diversify and expand foreign trade geography. One of main priority directions is East Asian region that is new growing world economic center. Growing demands for natural resources in this region, especially for oil and gas, in short-term perspective will allow Kazakhstan's raw materials export to strengthen the country's trade positions on this market. In this connection, transportation routes towards East Asian Region need to be developed that will also decrease Russia's ability to limit oil and gas exports from Kazakhstan. In long-term perspective, further effective economic cooperation with this region will provide significant benefits to the country's economic development.

With a concern for growing globalization, the processes of regional and mainly economic integration are increasing. The regional institutions all over the world are getting stronger. Many nations realize that increasing regional cooperation makes it possible to implement their national missions keeping in mind the global inter-osculation of interests. From the very beginning of its development, Kazakhstan has been gradually implementing a concept of regional economic integration. With the concern for the above, Kazakhstan is doing much within the scope of the CIS and EAEC. Thus, Kazakhstan should continue active efforts in order to create an effective connecting thread of trade and economic contacts and long-termed cooperation with the nations in the region.

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APPENDIX

Diagram 1. GDP dynamic for 1993-2002

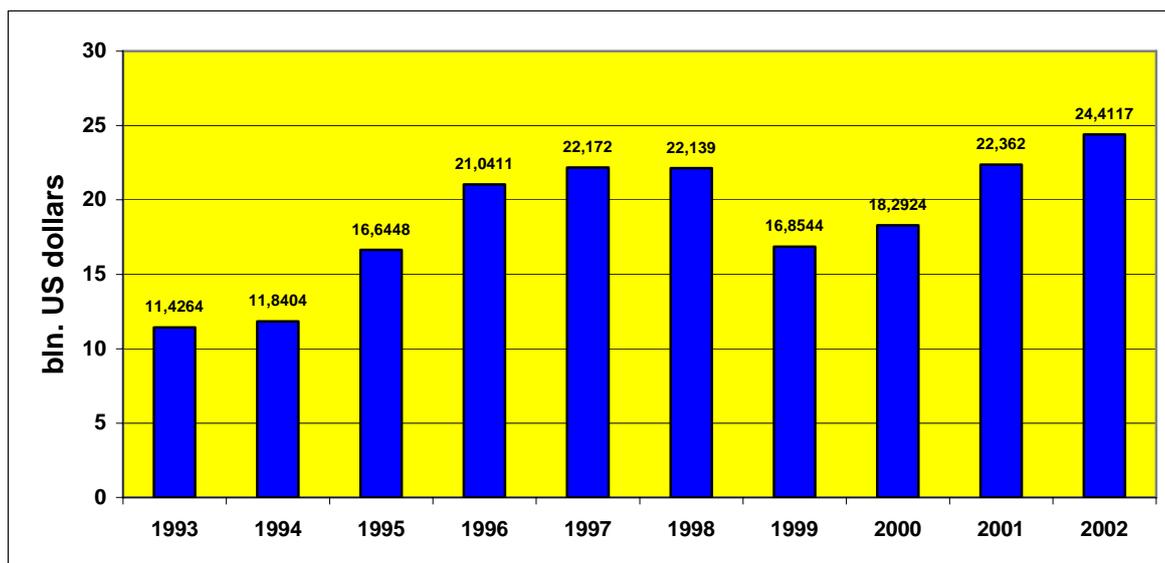


Diagram 2. Real growth of GDP 1993-2002

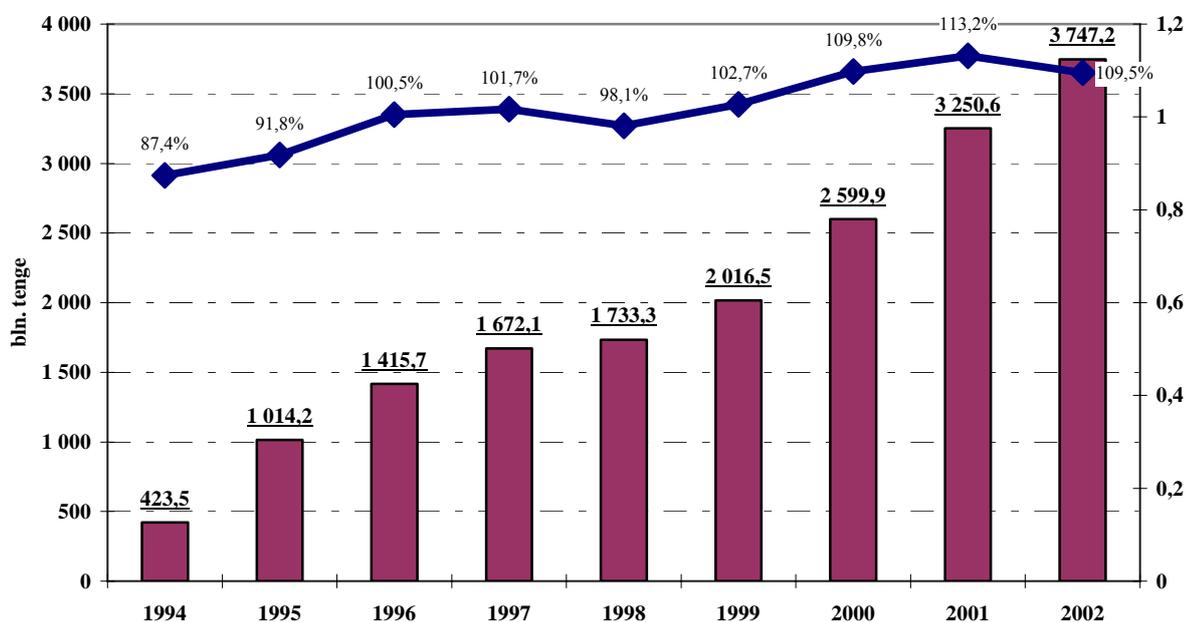


Diagram 3. Structure of incomes by activity category for 2002

