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INTERVIEW

Kazakhstan Plans for 21st Century: Interview with Deputy Prime Minister and Minister of Industry and Trade Sauat Mynbayev

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The government of Kazakhstan is implementing an economic development policy focused on using the proceeds of its oil and gas riches to diversify its economy. *Russia/Eurasia Executive Guide* was able to question Deputy Prime Minister and Minister of Industry and Trade Sauat Mynbayev about the government's plans and what opportunities these plans might offer to foreign business people and investors.

REEG: The government of Kazakhstan is sponsoring a conference in San Diego, California, September 8-9 entitled "Industrial and Innovation Strategy: New Business Opportunities." I understand that the purpose of this conference is to assist with diversification of the economy of Kazakhstan. Please elaborate on your goals and objectives for this conference.

MYNBAYEV: Kazakhstan sees the upcoming San Diego conference as a unique occasion to present the Strategy for Industrial and Innovation Development (SIID) for years 2003-2015 (available at www.kazakhembus.com/Industrial_policy.doc) and the opportunities it offers for bilateral cooperation and mutually beneficial business partnerships.

This will be the second time Kazakhstan will present its Strategy in the United States. The first time was in

Minister Sauat Mynbayev, born in 1962, is a graduate of the Moscow State University. He is a Ph.D. economist. He has served in both the private sector and the government, including assignments as Deputy Chairman of Kazkommertsbank, Deputy Minister and Minister of Finance, Minister of Agriculture, and Deputy Chief of Staff to the President. He has also served as Chairman of the Board of Kazakhstan's Development Bank.

Washington, DC, in April of last year. The reason for this second appearance is not just that the United States is one of Kazakhstan's major strategic partners. The U.S. has also been and remains a world leader in high technology, innovation programs and the transfer of new technologies. The Strategy seeks to develop these very spheres in Kazakhstan.

REEG: Why is diversification of the economy important for Kazakhstan? Why isn't it enough for the country to just develop its extensive deposits of oil and gas? Why is it important to establish the basis for a service and technology-based economy in Kazakhstan?

MYNBAYEV: As a country with a relatively narrow economy which shows a great potential in fuel and mineral resources, Kazakhstan today is of minor attraction for investment into processing industries. This makes the economy vulnerable and sensitive to changes in world market for raw materials. We need to attract investment to broaden the base of our economy.

Globalization of the world economy means Kazakhstan's economy faces a number of challenges. These include: raw materials orientation, insufficient integration with the world economy, poor inter-industry and intra-regional economic integration, low consumer demand, underdeveloped industrial and social infrastructure, lack of ties between science and production, low research and development expenditures, and management which is not quite up to the task of adapting the economy to globalization and moving it toward a structure based on services and technology.

As a country with an open economy, Kazakhstan can not influence world prices for its products. As a result, the country has few ways of effectively influencing its economy. Use of high technology is an obvious way to lessen our dependence on external factors.

REEG: What specific service and technology-based sectors have good prospects in Kazakhstan and why? Do you see the development of these new sectors as primarily oriented towards the domestic Kazakh market or do you see them as export oriented?

MYNBAYEV: The first stage of the Strategy is to define the competitive strengths of our economy in regional and international terms and make maximum use of our competitive advantages through major national projects.

We are currently analyzing our economy to identify where it is most competitive. Our national institutes of development and international consulting and research firms are involved in this process. The Center of Marketing and Analytical Research of Kazakhstan, i.e., has developed an original method of industrial analysis based on methods of Jeffrey (a chain of added values), Porter (competitiveness) and Kotler (classic marketing). In 2004, research was done for many industries including silicon, construction materials, biotechnology, IT, petrochemistry, light manufacturing, timber, furniture and food industries.

The Center of Marketing and Analytical Research and J.E. Austin Associates, Inc., from the Washington, DC, area, are jointly implementing a project called "Evaluation of competitiveness of current and potentially prospective sectors of the Kazakh economy and working out recommendations on their development."

The project has analyzed most non-extracting industries and sub-industries (about 150 industries and segments), rather than just arbitrarily predetermined "competitive" ones.

The project's first phase has been completed selecting 23 industries with internal assets and potential to be competitive. The market potential for them in Kazakhstan, regionally and internationally, has also been appraised. Seven pilot industries and sub-industries, called "clusters," were defined, and they are being developed.

They include clusters in food production, oil and gas machinery building, tourism, textiles, metallurgy, transportation and logistical services, and the production of construction materials.

These clusters are oriented to both domestic and foreign markets. Currently, plans are being completed on the creation and development of these pilot clusters. They include measures such as solving systemic problems of these industries such as personnel training, issues of standardization and infrastructure development and improvement of legislation governing these clusters. They will also include measures designed to solve challenges of each specific cluster, such as business strategies, implementing investment, strengthening intra-cluster cooperation. These plans have been developed through dialog between the Government and the private sector. As a result, the Government is working to solve systemic problems, while private sectors undertakes specific challenges.

REEG: In terms of the global economy, in what areas does Kazakhstan have a competitive advantage? How can Kazakhstan compete with India, the service indus-

try giant, and with China, the industrial production giant?

MYNBAYEV: Kazakhstan is famously rich with considerable reserves of mineral ores and metals. Kazakhstan's non-ferrous metals are used in the production of science-intensive and high technology goods, including space ships, armaments, and electronics.

We would like to offer international research institutions and companies participation in pilot schemes for producing a new generation of new metals and alloys and the processing of precious and rare-earth metals using Kazakhstan's existing research facilities. I should note Kazakhstan is currently among the world's very few producers of osmium and rhenium, super strong materials of the new generation which have not been fully researched.

More traditionally, Kazakhstan has also become one of the world's largest exporters of high quality grain.

To support dynamic economic development we need to raise the level of technology in target industries and to develop non-raw material industries using science and high technology. For example, in metallurgy, we need to move from exporting ores and ore concentrates to export-

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ing products of ferrous and non-ferrous metals.

Several major competitive advantages of Kazakhstan, which should be an attraction to foreign investors, are:

- relatively cheap while skilled workforce
- access to huge markets of China and Russia
- beneficial geopolitical location supported by the developed infrastructure which requires only slight modernization
- availability of sufficient natural resources
- political stability
- willingness and capability of the Government to support business initiatives regardless of their origin, domestic or foreign

REEG: Does Kazakhstan currently have the educational institutions and trained work force necessary for diversifying its economy? Does Kazakhstan currently have sufficient numbers of trained managers who are capable of establishing or working in companies in service and technology-based industries? If not, what plans are there to develop the educational, training and management support for diversification of your economy?

MYNBAYEV: Kazakhstan's innovation development can only be possible through technological advance. Our educational institutions have an exceptional role to play in

the nation's future.

Based on the situational analysis, the Ministry of Education and Science is modernizing existing mechanisms and introducing new ones to train people for the innovation drive.

Last October, the State Program of Educational Development for years 2005-2010 was approved. Its major goal is to establish an efficient system of training personnel for a new breed who can successfully solve the tasks of industrial and innovation development of Kazakhstan.

The Program has set these tasks for educational institutions:

- make personnel training for the innovation drive a priority;
- develop an innovation infrastructure of education, and create technological parks and centers;
- develop and introduce educational standards in line with international requirements, across the board;

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- improve material, technical and methodical bases of education institutions;
- international cooperation to train and attract highly qualified specialists;
- create new educational institutions while reforming existing ones as specialized universities to train personnel in high tech fields with the participation of both government and private sectors.

Some specific steps toward these goals have already been taken. National standards in higher education have been modernized. Curricula have been updated to reflect international needs.

Plans are afoot to create a unified informational space including science and education and bringing applied sciences and actual production closer, reorient institutional science to practical research aimed at economic and social progress and the introduction of science intensive technology.

One of the new forms of integrating education, science and production will be technological parks. The Kazakh National Technical University and the National Innovation Fund have signed a memorandum creating a techno park based at the University in Almaty. A science and technology park "Altai" has been established on the campus of East Kazakhstan State Technical University.

Many Kazakhs study English, and the Government is promoting the effort in schools nationwide. Beginning

this year, Kazakhstan will send 3,000 of its best and brightest young people overseas annually to get their Masters and Ph.D.s in the best universities of the world.

REEG: What specific policies has the government developed to encourage diversification of the economy? Are there tax incentives, tariff privileges, special economic zones, government-sponsored staff training programs, etc.? Please elaborate.

MYNBAYEV: To promote diversification of the economy several developmental institutions have been established or strengthened, including Kazakhstan's Development Bank, Kazakhstan's Investment Fund, National Innovation Fund, State Export Credit and Investment Insurance Corporation, Center of Marketing and Analytical Research and Center of Engineering and Technology Transfer.

All these have gone through initial stages of formation. Laws regulating their activities and plans for development are already on the books.

Each institution has its specialization. Together they represent a system of comprehensive support for investment and innovation projects.

There are already three special economic zones (SEZs) in Kazakhstan offering preferential tax and customs regulation. One is the Aktau Seaport SEZ on the Caspian. It offers attractive projects to create bases for maritime shipments as well as construct production facilities to service maritime infrastructure. The second, The New City of Astana SEZ, offers attractive prospects to build housing and industrial facilities, and infrastructure on the left bank of the Ishim River passing through the capital city. An Information Technology Park SEZ, on the outskirts of Almaty, offers expedited depreciation of capital expenditures, and tax holidays for corporate, land, property and value added taxes. Also tax exempt are bringing in equipment and spare parts for the needs of the Park. Memorandums have been signed and negotiations are ongoing with some of the world's largest companies, including Hewlett Packard, Cisco Systems, Siemens, Thales, Microsoft, IBM, and SAP AG.

In addition to building techno parks across the country, we are also creating technology business incubators where scientists and businesspeople alike will receive everything they need to create and introduce science-based products.

REEG: What role do you see for private Kazakh companies in the diversification process? What role does small business play in this process? What do you see as the proper balance between private entrepreneurship and government policy support for diversifying the economy?

MYNBAYEV: Kazakhstan puts enormous faith in smaller private enterprises.

Today we are in a situation when small and medium sized businesses must use their flexibility, mobility, market objectivity and skills to search for a place in the innovation economy. The government in its turn must create

favorable conditions for private initiatives. Assistance must be given to these smaller enterprises with a view of promoting their competitiveness and raising their innovation and technological potential.

Major international companies do business in Kazakhstan and that points to a favorable investment climate in many areas.

We have negotiated joint projects in textiles, petrochemical industries and IT with transnational corporations such as LG from South Korea, Microsoft, FMS Energy Systems, Hewlett Packard, and Guardian from the United States.

Another government program designed to promote the development of small and medium sized businesses in Kazakhstan is already in place for the years 2005-2007.

This program's main goal is to raise Kazakhstan's competitiveness through improving institutional conditions and expansion of spheres of business operations from SMEs.

The program envisions creating a fully transparent legal base for the development of SMEs, reducing the gray economy, and creating a sustainable infrastructure based on the cluster approach.

The program's implementation will allow the gradual transfer of redundant functions of the state to SMEs, increasing loans for private businesses and creating a new ideology for interaction between the government and the private sector.

Governmental support for the program will include low interest loans, export insurance, government investment in smaller companies and the dissemination of commercial information.

I should note that development institutions will not replace the market, but will become a driving force of the competitive economy and involve private businesses in the innovation processes through partnerships.

REEG: Kazakhstan has been very successful in attracting international investment for the oil and gas industry. Looking forward at the diversification process, what role do you see for foreign investors? Do you think that you have similar prospects for successfully attracting investment in new sectors of the economy? How will you compete for foreign investors in these new sectors with your rapidly growing neighbors, China, India or Russia, who are also aggressively seeking investment?

MYNBAYEV: Kazakhstan's high rate of economic growth in recent years is undoubtedly due to expansion of extraction industries, mostly oil and gas. Extraction industries continue to attract the bulk of foreign direct investment. At the same time, we note a stable growth of foreign direct investment in other industries. Investment in industries other than oil and gas grew 74.5 percent year on year in 2004.

Overall, foreign direct investment in our economy has totaled U.S. \$34 billion from 1993 to 2004. Of the total, extractive industries took 37 percent, financial activity, 21

percent, operations with real estate, rent and services to businesses, 14 percent, while the processing industry received 6.5 percent.

One of Kazakhstan's unique advantages as a new market is our geographical location. Kazakhstan borders Russia to the north, Central Asia to the south, and China to the east. Kazakhstan, because of its location at the heart of Eurasia and its free market economy, has all the prerequisites to become a perfect entry point for investors seeking access to the immense regional market place.

All of these leads to a growing interest of foreign investors in Kazakhstan. In 1999 we had 1,865 businesses with foreign participation. By 2003, the figure was 6,579

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and last year it stood at 7,070.

Kazakhstan is the first country in the Commonwealth of Independent States (CIS) to receive an investment grade rating from three leading international rating agencies: Moody's in 2002, and then Standard & Poor's and Fitch in 2004. The World Bank included Kazakhstan in the top 20 most attractive economies for investment in 2003.

Fitch analysis noted Kazakhstan's economy and government financing are in a sustainable position to deal with pressure from the oil sector and fluctuations of world oil prices.

The experience we gained in attracting foreign businesses in the 14 years since independence gives us a good background to compete with other countries.

We believe these facts are enough of a foundation to attract even greater volumes of direct investment, know how, and international brands to Kazakhstan.

REEG: If you are able to achieve all of your goals and successfully implement your projects, how would you describe the future economy of Kazakhstan as you would like to see it twenty-five years from now?

MYNBAYEV: We hope implementing the Industrial and Innovation Strategy ensures growth rates of no less than 8.8 to 9.2 percent annually. This will encourage the economy to grow 3.5 to 3.8 times by 2015 compared to a base year of 2000. It will also allow increasing annual growth rates in key processing industries to 8 percent, increasing productivity almost threefold by 2015 and halve the economy's energy consumption.

Implementing the Strategy of Industrial and Innovation Development by 2015 against a backdrop of intensive oil and gas development will not change the economic structure and the industrial production. Yet, it will allow:

- raising the ratio of goods production in the GDP from

46.5 percent to 50 to 52 percent;

- raising the ratio of services for scientific and innovation activity in the GDP from 0.9 percent in 2000 to 1.5 to 1.7 percent in 2015;
- slow down the reduction of ratio of processing industries in the GDP from 13.3 percent in 2000 to 12 to 12.6 percent in 2015 (without implementing the industrial Strategy, by 2015 that percentage would drop to 10.9 percent).

Also, without implementing the Strategy, the share of extractive industries in industrial production could have reached 55 to 56 percent by 2015, with oil production reaching 50 to 51 percent of that volume. To compare, these numbers stood at 31 and 25.6 percent, respectively, in 2000. When the Strategy is implemented, the share of extractive industries should only reach 46 to 47 percent.

Processing industries will also see changes. The share of metallurgy and metal processing should drop from 40.1 percent of the total added value of processing industries to 27 to 28 percent. However, the share of agricultural processing should grow from 38.1 percent to 45 to 46 percent. The share of science-intensive and high technology products should reach 9 to 11 percent.

Salaries and pensions will rise accordingly. Real income of the people should more than double.

As we look back at the results of our economic devel-

opment through 2004, we see the economic foundation needed to reach the goals of the first stage of the Strategy.

During the past two years, growth rates in processing industries have averaged 8.9 percent annually. In addition to growth in traditional industries such as mining and extraction (12.7 percent), chemicals (11.5 percent), metallurgy (4.1 percent), and the food industry (8.5 percent), we have registered a significant expansion in high technology and science -unk by two percent in 2002. Yet, in 2003, it grew 20.7 percent, and in 2004 growth was 35.3 percent. These products are not only sold domestically, but exported.

The year 2004 was mostly about carrying out the preparatory measures and creating a platform for large scale changes in the economy's structure under the Strategy.

The Government has introduced legislation, financially strengthened developmental institutions, developed innovation programs, introduced international systems of quality management and prepared for accession to the World Trade Organization (WTO).

The bottom line is that we see a very bright future for Kazakhstan. A vibrant and diversified economy will provide a better quality of life for our people and good business prospects for our partners. We see huge potential for mutually profitable cooperation with foreign investors and we say to them: Welcome to Kazakhstan! □