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To: SECSTATE WASHDC - ROUTINE

Action: SNIS

From: AMEMBASSY ALMATY (ALMATY 7983 - ROUTINE)

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Captions: USDOC, SENSITIVE

Subject: MARKET ECONOMY STATUS FOR KAZAKHSTAN

Ref: A) STATE 199160 B) ALMATY 7494 B) ALMATY 7876
D) ALMATY 7354

(U) This cable is sensitive but unclassified, please protect accordingly.

1. (SBU) Summary. The Embassy strongly endorses Kazakhstan's application for market economy status under tne relevant U.S. legislation (Refs A and B). We believe Kazakhstan's record under the five criteria for qualification as a market economy is outstanding. Our interlocutors at the local offices of the IMF and World Bank join us in this view. The President of the European Bank for Reconstruction and Development (EBRD) rated Kazakhstan the leading reformer among former Soviet republics and compared it favorably to Eastern European countries during his Junee visit to Almaty. We also note that the European Union granted Kazakhstan the equivalent ot market economy status in October 2000. Our EU colleagues tell us that the factors they considered is similar to those laid out in U.S. legislation.

2. (U) The points below layout the Embassy's view on Kazakhstan's performance under the five legal factors for consideration as a market economy.

Currency Convertibility
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3. (U) criteria: The extent to which the currency of Kazakhstan is convertible into the currency of other countries.

- The Tenge is fully convertible. The GOK sets minimal reporting requirements for capital flows above $100,000, but this does not constitute a barrier.

- The IMF Resident Representative (ResRep) notes that the Tenge is convertible and that Kazakhstan acceded to Article VIII of the IMF Articles of Agreement in July 1996. The Tenge haa been floating since April 1999, when the National Bank abandoned its managed exchange rate policy. It is even legal to pay wages in cash in a foreign currency.

Free Wage Bargaining
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4. (SBU) Criteria; The extent to which wage rates in Kazakhstan are determined by free bargaining between labor and management.

- Both in law and in practice, the GOK does not interfere with free bargaining between labor and management. The GOK sets a minimum monthly wage (currently Approximately $20). The IMF Resrep noted that the minimum wage does not in practice hinder wage bargaining. The GOK does regulate wage rates of government employees and employees of wholly government-owned entities. In practice, government wages are lower than private sector wages.

Openness to Foreign Investments
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5. (U) Criteria: The extent to which joint ventures or other investments by firms of other foreign countries are permitted in Kazakhstan.

- The GOK is very liberal in allocating foreign investment

and joint ventures in Kazakhstan. Tbe IMF Resrep characterized Kazakhstan as "very open" to foreign investment. In its 10 years of independence, Kazakhstan has attracted Over $12 billion in foreign investment, an impressive amount compared to 2000 GDP of just over $18 billion.

- No sectors of the economy are closed to foreign investors, although there are some sectoral limitations, as there are in the U.S. banks can be 100% foreign-owned, but foreign capital cannot exceed 25% of total banking sector capital, The 1998 National Security Law limits foreign ownership of individual media and telecommunications companies to 2O%. Kazakhstani law does not subject foreign investment to any prior authorization requirements.

- Four major pieces of legislation govern foreign investment These are: 1) The Law on Foreign Investment, 1994 (amended in July 1997) ; 2) The Law on State Support for Direct Investment, 1997; 3) The Law on Government Procurement, 1997; and 4) The Tax Code of 2001. (Note: a new Investment Law may replace the Law on Foreign Investment and the Law on State Support for Direct Investment in 2001, See above.) These four laws provide for non-expropriation, Currency convertibility, national treatment, non-discrimination, guarantee of stability in the legal regime, transparent government procurement, and incentives in certain priority sectors, including electrical infrastructure, telecommunications, light manufacturing, health and tourism. Kazakhstan has a Bilateral Investment Treaty with the United States.

- For a detailed treatment of investment legislation, please see the annual Investment Climate Statement.

Government Ownership of th~ Me~8 of Production
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6. (U) Criteria: The extent of government ownership or control of the means of production.

- Private Companies produce 71% of GDP and dominate

almost all economic sectors. As of January 2001, over 78% of small and medium enterprises have been entirely privatized. 58% of large firms are entirely or partially privatized (45% are entirely privatized). The major exception is the series of government-owned water, electricity and heat utilities, primarily in smaller cities. The government holds minority stakes in several large mining enterprises. It owns 100% of Temir Zholy (the national railroad company) TransNefteGaz (the oil and gas pipeline monopoly), National Oil Company Kazakhoil and holds a majority stake in KazakhTelecom. Kalakhoil accounts for 17% of national oil production, the remainder is in private, primarily foreign, hands. KazakhTelecom owns the existing telephone landline network, but is not a pure monopoly.

- The IMF Resrep gave Kazakhstan overall good grades for privatization. There is still room for improvement, he said, but the extent of GOK ownership of industries and small and medium enterprises is not enough to deny it market economy status. While there is government ownership of certain large enterprises such as national oil company Kazakhoil, the IMF Resrep explained, this compares to government owned energy and transport companies in other market economy countries.

Government Control over Resource Allocation
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6. (U) Criteria: The extent of government control over the allocation of resources and over the price and output decisions of enterprises.

- The GOK has been working to build private markets across all sectors. For example. a wholesale electrical power market has recently taken root, thanks to steady reforms by the GOK.

- Only in the case of wholly-owned government companies does the GOK exercise control over resource allocation, output and pricing decisions. In addition. regulated monopolies, both public and private, must submit pricing decicions for the approval of the Anti-Monopoly Committee

(AMC), which is patterned on U.S. utility regulators and has been the recipient of USG technical assistance.

- The GOK has enacted transfer-pricing lesislation to ensure that private companies are not dodging taxes by exporting to affiliated companies at artificially low prices. The legislation does not dictate prices, but rather imposes additional taxes if a company exports goods at a contract price more than lO% lower than world market prices.

- The GOK has imposed, in practice although not in law, domestic supply requirements on oil companies. The GOK has found this necessary because the dreadfully inefficient oil refining industry is unable to pay world market prices for crude. Refining margins eat up most of the differential, since final product prices are comparable to U.S. refined product prices.

- The IMF Resrep echoed our conclusions, noting that the GOK does not exercise significant official control over allocation of resources and output decisions. He added that some policy makers' personal involvement, influence and ownership of enterprises blurs the line in some cases.

NAPPER

Additional Addressees:

cc:
None

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