



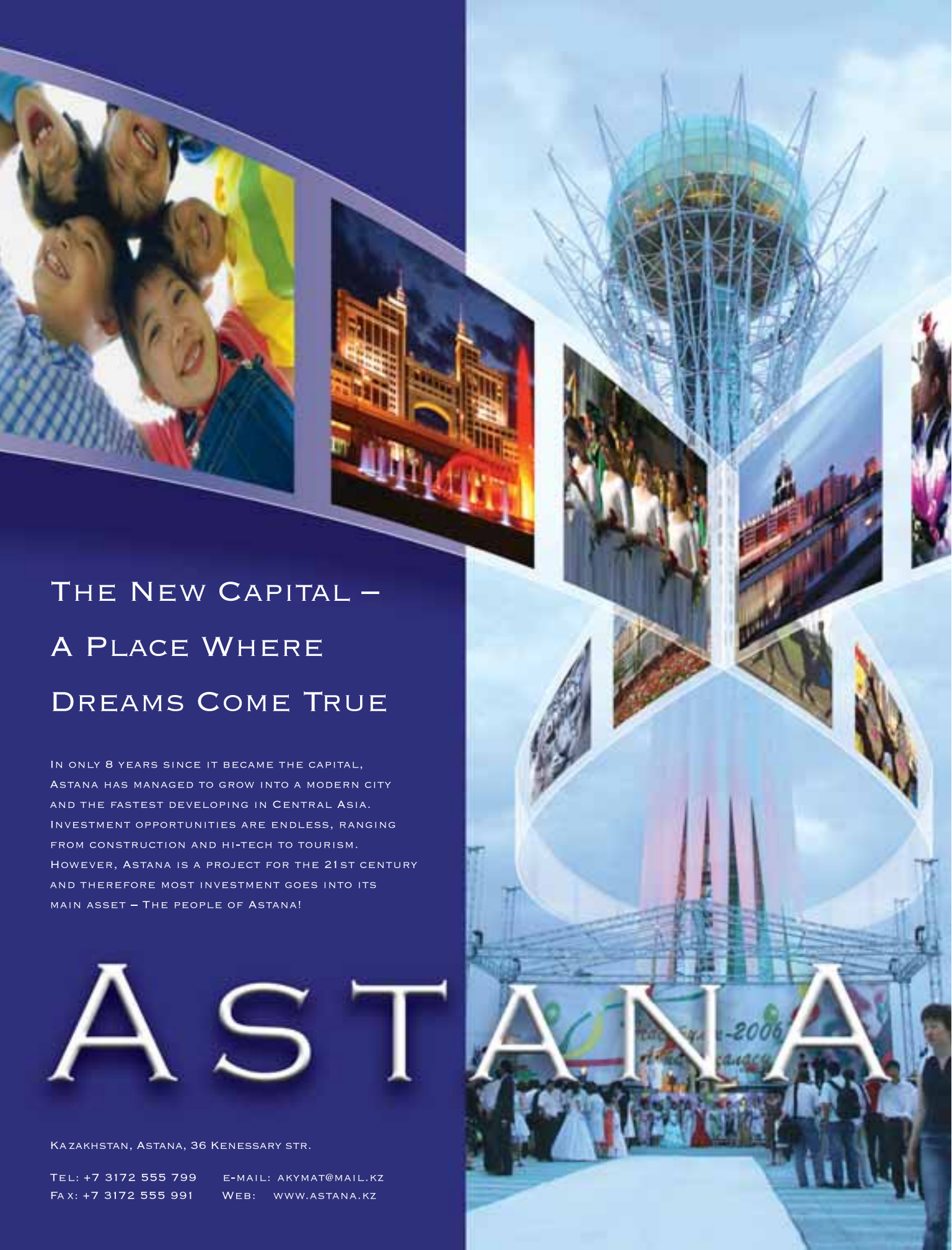
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A Giant Awakens

With its enormous bounty of natural resources, Kazakhstan is set to become one of the pivotal powers of Central Asia.



The Republic of Kazakhstan is endowed with a regal abundance of natural riches. Some of the largest oil and gas discoveries in recent years have been made there, and new pipelines both to China and the West are being laid to export rapidly rising production, which is expected to treble in the next decade.

President Nazarbayev has taken important steps to promote greater economic diversity and sustainable growth.

Its mineral resources include an estimated quarter of the world's uranium reserves and important deposits of practically every useful metal – copper, zinc, iron, aluminium, gold – known to man. With only 15 million inhabitants, landlocked Kazakhstan probably has a larger – and certainly broader – portfolio of natural assets per capita than any country on earth.

The economy has been growing at close to 10 per cent in recent years, largely on the back of higher oil and commodities prices. All the major credit-rating houses – Standard & Poor's, Moody's and Fitch – have upgraded Kazakhstan repeatedly, both for

sovereign debt and municipal/corporate borrowings.

The oil boom, combined with the shortage of local investment opportunities due to under-developed capital markets and particularly the local stock market, has caused real-estate prices to soar and is stoking up inflationary pressures.

Deputy Prime Minister Karim Massimov, who is responsible for economy and budget planning, is aware that the government and Central Bank must maintain a fine balance between further economic development and keeping inflation under control. "In the not-so-distant past", he notes, "we had 2,000-3,000 per cent inflation, after which we introduced a very strict monetary policy which brought it down to between 2 and 3 per cent year on year.

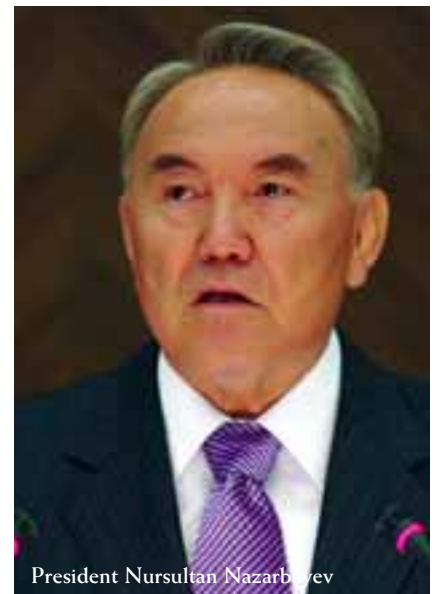
"But it is difficult to have sustainable growth in a developing economy with inflation at those levels," continues Massimov. "From one point of view, some inflation is necessary for the development of the country. Conversely, if inflation gets out of control then real economic growth and social benefits can be zero or even negative.

"Over the past six years Kazakhstan's economy has been growing at 9-10 per cent, but we have managed to control inflation at a level of 6-7 per cent, which is good. Now there are some worries

that inflation might increase beyond the government and Central Bank's control, so we need to see the real reasons why this is happening."

Massimov sees monetary tightening as being necessary and argues that the Central Bank should be less concerned with the exchange rate between local currency, the Tenge, and the US dollar, intervening less in the markets and allowing rates to float more freely. "If the Central Bank does this it will have more of a technical loss on its books", he admits. "But it should not be afraid of that, as it is normal and generally more healthy for the economy."

A second recommendation is that the Central Bank sucks in excess liquidity by



President Nursultan Nazarbayev

issuing more commercial paper. Thirdly, the Government of Kazakhstan should issue more bonds to provide additional long-term financial instruments, so that pension funds and banks can tie up some of their surplus liquidity.

"All these measures taken together can give a result", says Massimov, "but my expectations are that it still might be higher than last year, because we occupy more or less the same economic space as Russia and I see them as having double-digit inflation." Mindful of the dangers of overdependence on oil – the so-called



Karim Massimov,
Deputy Prime Minister



Natalya Korzhova,
Minister of Finance



Kasyzhomart Tokayev,
Minister of Foreign Affairs

'Dutch Disease' which distorts the overall economy and stifles the emergence of other productive sectors – President Nursultan Nazarbayev has taken important steps towards economic reform and diversification.

Special teams have been set up to encourage growth in seven different clusters of economic activity, with particular focus on small and medium-sized enterprises (SMEs). And this year has seen the creation of Kazyna, a grouping of leading development agencies and lenders, to promote greater economic diversity and a more sustainable growth path.

Previously neglected areas such as tourism are now being actively developed, with new winter sports resorts being built ahead of Kazakhstan's hosting of the Winter Asian Games.

At the same time, the former capital Almaty is being groomed to become the new regional financial center for Central Asia.

The economy has benefited from an unusual degree of political stability and the country's gradualist approach to western-style democracy. And now the Minister of Finance, Natalya Korzhova, has been charged with completely overhauling her department and introducing greater transparency and effective electronic reporting systems.

"We don't only have to minimize administrative barriers", she says, "but to make it happen in such a way that levels of corruption in the financial system are

also minimized." New laws are being passed to rein in corruption and bureaucratic obstruction at the national and district levels, encompassing customs and specific industries such as mining, and oil & gas.

"Over the past six years Kazakhstan's economy has been growing at 9-10 per cent, but we have managed to control inflation at a level of 6-7 per cent."

Fostering regional stability is also an important element. As Kasyzhomart Tokayev, Minister of Foreign Affairs, points out: "Kazakhstan is the world's largest landlocked country with Russia and China as neighbors. So we are focusing on our relationship with Moscow, Beijing and our immediate Central Asian neighbors because we believe it is an important pre-condition for having a stable domestic situation."

A recently formed forum for promoting regional stability, in which Kazakhstan plays a key role, is the Shanghai Organization for Co-operation. Tokayev believes it to be "very promising", as not

only China and Kazakhstan but also Russia are member states, while other large countries in the region such as India, Pakistan, Iran and Mongolia have taken up observer status within the organization.

Important issues on the agenda include combating international terrorism as well as developing trade and investment co-operation on a regional basis. Tokayev admits, "There are differing assessments of the so-called 'Big Central Asia', but I see it as larger-scale co-operation between the countries of the region."

"Kazakhstan", he says, "wants to establish a common market in Central Asia so that we can trade freely with each other. And, as the most developed country in the region, we want to invest in the economies of other Central Asian countries." He also believes that pulling turbulent countries such as Afghanistan into a Central Asian orbit would prove a force for stability.

However, Tokayev is also mindful that the US has been the largest single investor in Kazakhstan with over \$30 billion going mainly into the energy sector. Links with the EU and larger European economies are strengthening, with much infrastructure development and diversification programs being supported by organizations such as the EBRD (European Bank for Reconstruction and Development). Kazakhstan is seeking to further build on its good relationships with these economic superpowers and Japan while

strengthening regional links.

Kazakhstan's negotiations to join the WTO are likely to come to fruition soon – possibly early next year. This will require further economic liberalization, including tariff reforms and the partial privatization of state-owned monopolies.

All of these ambitious programs need to be implemented if Kazakhstan is to achieve the goal set by President Nazarbayev earlier this year of joining the world's top 50 competitive nations.

To see through this program a new holding company, Samruk, was recently established. Massimov says that the privatization program, due to start in

September 2006, should involve the sale of 5-7 per cent of these national companies on the local stock market.

This will provide a major boost to Kazakhstan's previously under-developed capital markets. It will also encourage the growth of new investment opportunities for pension funds, banks, individual investors and international financial institutions, building liquidity in the stock market and pulling some excess liquidity out of the broader economy and especially real estate.

Massimov says recent studies suggest WTO accession will give a boost to consumption and GDP growth, and requires 2-3 per cent of the workforce changing jobs. "I also believe that our industrial diversification program will be best supported by implementing WTO policies," he says, "as this will improve the broad investment climate, contribute towards the rule of law and discourage lobbying for rents and other market distortions."

Among the challenges to be met are under-developed infrastructure, especially transport systems (essential in so large a country) and telecommunications. There are also human resources constraints –



a shortage of skilled workers and especially management in key areas of the economy.

Kazakhstan's capital markets have grown rapidly in recent years. International credits and bond issuance have expanded and last year the leading copper producer, Kazakhmys, launched a successful IPO on the London Stock Exchange. But there is still insufficient liquidity in shares listed on the local exchange. To remedy this, it is planned to float shares of major state-owned enterprises such as Kazakhtelecom in the near future.

All of these ambitious programs need to be implemented if Kazakhstan is to achieve the goal set by President Nazarbayev earlier this year of joining the world's top 50 competitive nations. The way things are going it is a question of when – rather than whether – this vast country enters globalization's fast lane. ■



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A Tale of Two Cities

Astana – A New Capital Arises

Today, Astana is aptly described as 'the largest construction site in Central Asia'. Practically every day another new building rises up. In fact, the city is growing so rapidly, both upwards and outwards, that it is barely recognizable from one year to the next.

The cause of all this hectic activity was a decision taken by President Nazarbayev in 1994, which was endorsed by the Parliament, to move Kazakhstan's capital from Almaty in the south of the country to Astana, which lies at its very center. And so began the transformation of an undistinguished Soviet-style town located in the middle of the steppe into one of the world's newest, brightest and most architecturally startling capital cities.

"Since 1998, we have had approximately \$2 billion of investment every year."

Initially there were many who opposed moving the capital from Almaty, citing the lack of necessary infrastructure and the harsh climate of the steppes – in winter, Astana can become the world's coldest capital. But government offices, foreign embassies and corporate headquarters soon made the move north, and along with them came scores of foreign official delegations to marvel at the golden mirrored glass towers that create such an astonishing skyline in the middle of the steppe. Since becoming Kazakhstan's capital on May 10, 1998, Astana has gone on to become the twin town of almost 20 world capitals and was named 'City of the World' by UNESCO in 1999.

The man responsible for running the city today, Mayor (or as he is known locally, Akim) Umirzak Shukekeyev, says, "Making Astana the capital gave confidence to the people. With such a large-scale project they could see the country's potential being realized."



Umirzak Shukekeyev,
Mayor of Astana

Certainly there has been massive investment in the new city's infrastructure, including the use of the latest thermal insulation technologies in buildings and glass-covered walkways to mitigate the effects of the weather. Urban planning and architectural expertise was brought in from around the world, including such renowned practitioners as the British architect Lord Norman Foster. In terms of urban planning much has been learned from Canada, whose climate and low population density is similar to Kazakhstan's.

MAJOR DEVELOPMENTS

Since Astana became the capital eight years ago it has nearly doubled in size, while the population of 600,000 is close to three times what it previously was.

The main area of new development has been on the left bank of the River Yesil (previously known as the Ishim), creating a 'special economic zone' with tax breaks for investors and contractors operating there. Typically this provides 15-20 per cent cost savings.

Plans are for 176 new structures – mainly business offices and government

buildings – to be completed over three years ending in 2007. But many are far more ambitious in scope, such as Lord Foster's transparent Peace Pyramid, or the white marble and granite presidential palace topped by an 80-meter high steeple. Astana really aims to put its name on the world map.

All of which has required major capital investment. "Since 1998, we have had approximately \$2 billion of investment every year", says Shukekeyev. "Of this, only 15 per cent comes from the government. The rest is from the private sector." Japanese research indicates that returns are between 10 and 11 per cent per annum.

Shukekeyev is aware of many challenges that still lie ahead. Providing sufficient power supply and an effective electricity and heating network is a priority. "We are planning to construct a new power station at a cost of around \$60 million", he says, "and we already have multiple investors queuing up to invest."

Other priorities are to make good on shortages of hospitals and other medical services, schools, and affordable housing. "We are building several new specialist hospitals," say Shukekeyev, "to which we will invite management from world-class corporations."

Astana is neither the country's oil capital nor the preferred financial center, and is some distance from the country's main mining and industrial regions. So its strategy for sustainable development once the building boom is over focuses on services – namely hi-tech industries, healthcare, and education. "We are planning to build a 1,000-hectare industrial park", says Shukekeyev, "for high technologies. It will be in a separate zone with tax holidays."

Building a new world-class capital city virtually from scratch is an ambitious project by any standards, but both President Nazarbayev and Mayor Shukekeyev are confident that it will come off. Increasingly, Astana is being referred to as 'The Dubai of Central Asia', and the proud Mayor believes that, in ten years' time, his city will be "even better than Dubai". ■

Almaty – The Big Apple of Central Asia

When the capital was officially moved to Astana in 1998, there was widespread concern in Almaty as to its future role within an independent Kazakhstan. With all the ministries, embassies, and many state-owned enterprises relocating to Astana, how was the former capital going to cope?

The old Soviet military-industrial complex (they used to make naval warfare mines there, even though it's more than 2,000 miles from the nearest ocean) was redundant. "So we had to diversify our economic capabilities," says Mayor Imangali Tasmagambetov, "and utilize the city's natural strengths."

"The main resource we have is our people, with small and medium-sized enterprises (SMEs) contributing roughly 60 per cent of the city's budget."

"The main resource we have is our people", says Tasmagambetov, "with small and medium-sized enterprises (SMEs) contributing roughly 60 per cent of the city's budget." There is not much heavy industry left and today, Almaty accounts for just 5 per cent of total industrial capacity. The Mayor's priority then is to develop hi-tech industries, such as laser and nanotechnology, and to this end a new technological park on the city's outskirts has been commissioned.

THE PRIVATE SECTOR

Almaty is also emerging as a major financial center – not just for Kazakhstan but within the region as a whole. Most of the big banks, oil companies and commercial businesses were already headquartered in Almaty, and as surpluses from Kazakhstan's oil and gas sector have grown they too have enlarged their operations.

From the outset it was a natural

progression for Almaty to become the country's main business center, though this has now been endorsed as official government policy, with a project to move towards becoming a regional financial center expected to commence early next year. Already people are



Imangali Tasmagambetov,
Mayor of Almaty

talking about Almaty becoming the financial hub of Central Asia – in much the same way as Dubai has staked its claim in the Gulf region.

Demand for top-grade office and residential space has triggered a construction boom that scarcely lags behind that in the new capital. High-profile projects like the new Financial District, JW Marriott Towers and Esentai Park are comparable in their scale, audacity and technical accomplishment to new construction projects in the West or Middle East.

But all this private-sector development presents a challenge to the Mayor and his colleagues in terms of building all the infrastructure – water mains, electricity substations, new roads and highways, public transport systems including a subway – needed for such a fast-expanding city. Foreign investment to upgrade the city's infrastructure

"Within five years, Almaty will be comparable to any European city center. We are upgrading and modernizing everything and our living standards will reflect those of a major world-class financial and tourism center."

is already in place, and Tasmagambetov says he is open to further collaboration – particularly with respect to water supply.

Another priority is developing Almaty as a tourism destination. The nearby mountains contain wildlife parks and already boast ski resorts. Tasmagambetov has plans to create a new ski resort right on Almaty's doorstep by building a cable-car link from Medeu to Chimbulak. "I don't want to sound immodest", he says, "but our purpose is to create a resort equal to the best European standards with brand new hotels and lots of new facilities." The estimated cost: around \$400 million.

Linked to this is Almaty's ambition to host the Winter Asian Games in 2011, for which it is planned to start building an ice palace, covered stadium, and bobsled and ski runs next year. To cope with the visitors, a clutch of new hotels is to be built along with a second runway and new passenger terminal at the international airport.

Tasmagambetov smiles widely when he talks of his aspirations for the future growth of the city: "Within five years, Almaty will be comparable to any European city center. We are upgrading and modernizing everything and our living standards will reflect those of a major world-class financial and tourism center." ■

An Ever-Changing Landscape

These are boom times for real estate and construction in Kazakhstan. New buildings are going up in the capital, Astana, and Almaty at such a frantic rate that it has become known as 'the biggest construction site in Central Asia', and with prestige buildings such as Lord Foster's Peace Pyramid in Astana soon to be opened, inevitable comparisons are already being drawn with Dubai. Real-estate values have rocketed over the last decade – albeit from a low base. Prices of both commercial and residential property in the major cities have risen dramatically – by more than 900 per cent over the last five years, according to Svetlana Voronina, BISNIS representative in Astana.

Certainly, the decision of President Nursultan Nazarbayev to move the capital from Almaty to Astana triggered a frenzy of building activity there. But the boom in construction and putting in new infrastructure is just as intense in Almaty, in the 'oil capital' of Atyrau and at the country's main seaport of Aktau. Major international names such as Marriott have in association with Capital Partners developed hotel, office and residential complexes in all three of these cities.

DEMAND FOR HOUSING SOARS

While most of the major infrastructure projects are backed by the government or multilateral lenders such as the World Bank or European Bank for Reconstruction and Development (EBRD), commercial and residential projects are mainly financed by the private sector.

Demand for offices and housing remains strong, partly due to the inadequacies of the Soviet-era building stock, but mainly thanks to strong economic growth of around 9 per cent per annum over the past five years. "As in many emerging markets", comments Voronina, "people seem to believe more in real estate than in other forms of investment." And this is particularly true of Kazakhstan, whose capital markets and stock exchange have still to emerge as a viable and easily accessible alternative 'home' for investment.

Credit is also far more readily available,

Prices of both commercial and residential property in the major cities have risen dramatically – by more than 900 per cent over the last five years.

especially for real estate. The improved availability of international credit on finer terms to Kazakh has combined with the development, virtually from scratch, of a domestic mortgage market to give a further boost to real estate and construction. And, unless there is a global economic downturn and the oil price goes through the floor, most analysts expect property valuations to continue rising over the next four to five years.

GRAND DESIGNS

There is also greater emphasis on building quality, with leading developers, architects and construction companies like Capital Partners, Ahseil, BI Group, Elitstroy, Kuat and Basis A gaining market share.

Alp Gol, managing director of Capital Partners, sees more potential in Almaty as the country's financial capital than in Astana: "We have a shopping mall under construction in Astana", he says, "but even though the government is investing heavily there, the indications are that the biggest growth will be in Almaty."

"The big project that we are building right now is Esentai Park, which will be multi-purpose on seven hectares of land, with a 40-storey tower and a 15,000 sq meter sports complex next to it, 8,000 sq meters of shopping mall and three residential towers behind, which will be operated by J W Marriott Residences."

The architects chosen are SOM, who were also responsible for designing the soon-to-be world's highest tower in Dubai. "We always outsource



construction work to third parties", says Gol, specifying that Capital Partners prefers to work with renowned architects and project management companies such as HOK.

In order to diversify its portfolio, Capital Partners has invested in the Almaty logistics park project. "There will be 98 A-class warehouses", says Gol, "ranging in size from 100 up to 650 sq meters. We have already built a major logistics center in Moscow."

One of the main operational challenges is the shortage of skilled people. Work permits pose a problem even for a group associated with Marriott, which has a huge global database. "So we are spending more on training", says Gol, "with local Kazakh trainees gaining experience at existing hotels in Moscow, Budapest, and elsewhere around the world."

Gol is aware of the risks of a real-estate bubble bursting. "We sometimes feel that we are walking on thin ice," he admits. "But if you look at all the surveys and the specific micro-economics that apply in Kazakhstan, all the information points to strong growth continuing for the next ten years." So while Kazakhstan may have started later than, say, Dubai, there can be no doubt that its real estate and construction sector – particularly its high-profile, quality projects – is definitely in catch-up mode. ■

An International Perspective

The dynamism of Kazakhstan's oil and gas sector, whose production is expected to treble over the next ten years, is due to many favorable factors: geology and the discovery of super-giant reservoirs like Tengiz; the presence of major international oil companies (IOCs) alongside the national energy group KazMunayGas; political stability and a legal and regulatory environment that encourages major foreign investments.

"Kazakhstan is a much more progressive country right now than any other at a similar phase of development."

But it also depends on the presence of specialist engineering and service providers who ensure that projects are carried out to the highest technical

specification and in conformity with environmental and other regulations. One such is PM Lucas Enterprises, named after the illustrious 19th-century Austro-Hungarian engineer Captain Lucas who developed new drilling and capping technologies in Texas.

As its current president, Dr Pavle Matijevic, points out: "PM Lucas has been present here in Kazakhstan since 1999 as an integrated engineering services provider. We have drilled, managed and supervised on a turnkey basis more than 1,000 wells here in Kazakhstan, besides doing a lot of facility engineering design.

UPSTREAM SERVICES

"We provide a wide range of services from geological and geophysical (G&G), production and reservoir engineering, drilling and work-over operations, through to facilities and engineering procurement and construction commission. In other words, just about everything in the upstream business," says Matijevic.

Within Kazakhstan the company's largest client is PetroKazakhstan, which was acquired last year by China National Petroleum Corporation (CNPC). Next in size is KazGerMunai, which is also part-owned by CNPC, while more recently it has been working for the majority state-owned KazMunayGas. Other major clients include Kuant Amlon Munai – for whom it is drilling 25 deep wells – ARAWAK, Petrom, and Big Sky (including Vector Energy West).

"As an integrated engineering services provider, we provide solutions to the industry across

the complete cycle", says Matijevic, "so we do not have any direct competitors in Kazakhstan."

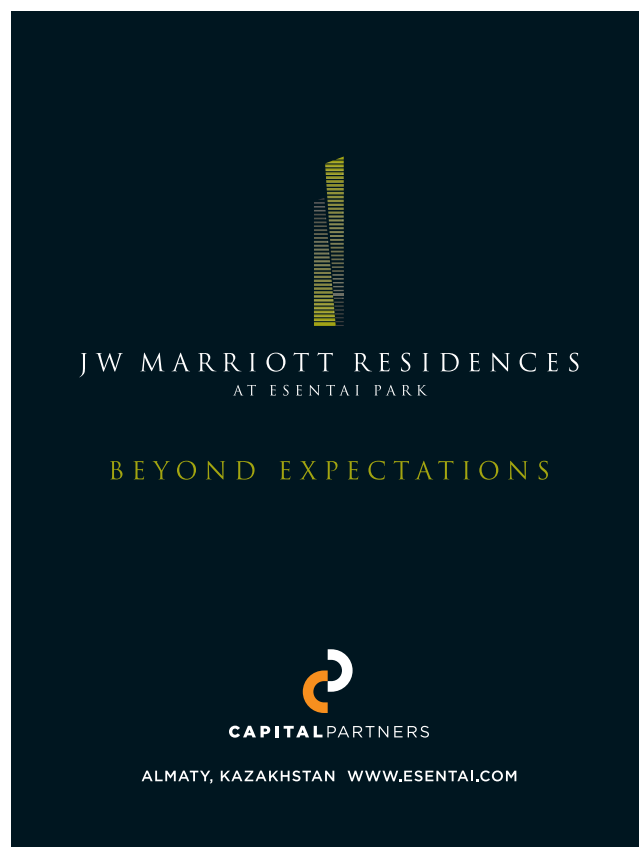
He compares the company's approach to Schlumberger IPM (Integrated Project Management), "but we target small and medium-sized projects that are too small for them." Typical of the smaller exploration and production groups now operating in Kazakhstan is the Canada-based Big Sky Energy Corporation. Al Sehsuvarogolu explains that the company has close business links with China, which is seeking to source more of its oil imports from Central Asia.

"We have five exploration blocks and are close to obtaining our first pilot production permit from the government. In production tests already conducted we had very healthy figures," says Sehsuvarogolu, "and to begin with we will be selling the oil to the local refinery." Big Sky's operations are within some of the world's most prolific fields in western Kazakhstan, specifically the pre-Caspian and Jungar basins. Whereas three out of four wells drilled do not yield," he says, "we haven't had that many dry wells."

Moreover, there are likely to be many more prospects available as the government carries out further licensing rounds.

"Kazakhstan", he says, "is a much more progressive country right now than any other at a similar phase of development." And while PM Lucas has worked in many oil-producing countries, including Algeria, Tunisia, Russia, Turkmenistan and Azerbaijan, Matijevic says: "The working conditions in Kazakhstan are far better than any of those countries. Kazakhstan has a very stable political situation. The President and the government are doing a great job.

"We cannot expect democracy here to be the same as the democracy in the USA or the EU, but it is still a democratic country and open to foreign investment. And I truly believe that Kazakhstan is years ahead of Russia, Azerbaijan, and especially Turkmenistan. Working conditions in Kazakhstan are excellent, the industry is just starting to take off, and I would recommend anyone to come and invest in this country." ■



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Samruk: Economic Engine

As part of its ongoing drive towards liberalizing the economy and improving the performance of state-owned entities, the Government of Kazakhstan established two new holding companies, Samruk and Kazyna, earlier this year. Samruk, meaning legendary phoenix-like bird of revival in Kazakh, is taking over the shares and other assets of five huge national companies. By far the largest of these in terms of assets is oil and gas giant KazMunayGas, while the others are all public utilities or service providers.

Together with the government, SAMRUK's directors will decide on the much-heralded privatization of a minority shareholding – possibly between 5 and 7 per cent.

Kazpost – as its name suggests – runs the postal and delivery services, Kazakhstan Temir Zholy (KTZ) the national railway system, while KEGOC operates the national electricity grid. Kazakhtelecom is both the incumbent player in fixed-line telephony and one of three companies competing for the fast-growing wireless market. All of them are considered 'strategic' industries if not 'national champions'.

The CEO of Samruk, Sauat Mynbayev, says that the purpose of creating a holding company as a sort of buffer between government and the day-to-day management running these companies "is to separate the regulatory function and the business itself", thereby avoiding "certain conflicts of interest."

Once it is appointed, Samruk's board of directors will act as 'an active shareholder', making key decisions on management and appointments to top positions. "Every company will invite independent experts, independent directors that have experience of

working abroad in foreign markets," says Mynbayev. They will also be more focused on directing these national companies towards the stated goal of doubling their output than the previous system, in which government deputy ministers sat on the boards of these companies but did not have the time to get to grips with the issues.

THE WAY FORWARD

"The aim of creating Samruk", says Mynbayev, "is to increase the value of these companies by introducing the best standards of corporate management."

Among the challenges ahead are tackling entrenched corruption in the state-owned sector. Mynbayev believes that introducing an effective bonus system will motivate key managers to work within the rule of law.

Together with the government, Samruk's directors will decide on the much-heralded privatization of a minority shareholding – possibly between 5 and 7 per cent of these national companies. Mynbayev notes that "All these companies are very different from each other, which means some can be present in capital markets and others cannot." While Kazakhtelecom is a distinct possibility, the postal services provider Kazpost is not.

Preparations for the privatization of parts of KazMunayGas, the country's largest oil and gas company, are well in hand. It is a huge company, with some 32 subsidiaries. According to its First Vice President, Zhaksybek Kulekeyev, KazMunayGas generates around 8 per cent of GDP and contributes 10 per cent to the national budget.

Subject to government approval, shares in its exploration and production subsidiary will be sold through an IPO. "We want to attract more investments to our company," says Kulekeyev, "as additional money never hurts and we have ambitious capital investment programs."

Negotiations to buy 33 per cent of the Chinese-owned oil company PetroKazakhstan and its key refinery at Shymkent are 'near completion'.

The other big purchase, says Kulekeyev, is a 50 per cent shareholding in KazGerMunai.



Sauat Mynbayev,
CEO, Samruk

"In terms of promoting our image internationally", says Kulekeyev, "we are making the company more transparent. For this we are going to attract new management elements and apply new technologies, so as to improve corporate management and governance. The IPO will be a decisive step but apart from this, we already work closely with some of the world's largest companies who are present in Kazakhstan and share experience with them."

Kulekeyev affirms that "We are doing everything needed to meet the requirements of modern business operations" and is confident that "the company's credit rating will be very high or at least on par with the overall rating for Kazakhstan."

The state-owned railway operator KTZ is also being restructured along more modern and competitive lines. It was turned into a joint stock company in 2002, although still 100 per cent government-owned.

Subsequently, social services such as schooling and medical care for its employees were transferred to the appropriate state provider, while its various operating divisions – the main trunk-line operator, the locomotive, logistics and container divisions – are to be run separately. The aim, according

to KTZ's President Yerlan Atamkulov, is "de-monopolization". Atamkulov further explains that this restructuring should allow KTZ to play a key role in upgrading Kazakhstan's transport infrastructure, both for domestic traffic and as part of an ambitious program to create a transcontinental economic bridge between Europe and Asia. Building up the rail link with China is a priority, though eventually four trans-Asian main lines and the EU-backed TRASECA project will all pass through Kazakhstan with a load capacity of up to 100 million tonnes a year.

INVESTING IN INFRASTRUCTURE

In the run-up to Kazakhstan's joining the WTO, KTZ is moving towards a unified tariff structure that will remove differences between domestic and international transport costs. The company has major investments ahead, including the electrification of heavily used sections and the building of 1,500 kilometers of new railroads, including high-speed lines. These may well be funded through public-private partnerships. Given high ratings from Moody's, Fitch and Standard & Poor's, KTZ successfully launched a US\$800 Eurobond issue earlier this year.

The national electricity grid operator KEGOC operates in a sector that has witnessed rapid change over the last 15 years. A large tranche of generating capacity has already been privatized, with foreign companies such as AES Corporation of America investing heavily. KEGOC is also moving rapidly

towards completion of a more effectively integrated grid – the new North-South Very High Tension line being a key element in transporting energy from the mainly coal-fired generation plant in northern Kazakhstan to major centers of consumption in the south.

Structural change is ongoing and supported by the government. A new electricity law was introduced by

KazMunayGas generates around 8 per cent of GDP and contributes 10 per cent to the national budget.

President Nazarbayev in 2004 to promote a more competitive retail market through the reorganization of electricity companies according to their specific activities. The streamlining of Kazakhstan's electricity sector has become a pressing issue since demand is growing rapidly on the back of a booming economy, and especially the upsurge in such energy-intensive activities as aluminium and other metals production. Demand for telephony – and particularly wireless – has also been growing. As the country's national telecoms operator, Kazakhtelecom still has to provide services with a 'social dimension' such as linking up schools and outlying communities. However, as its president Khairat Karibzhanov makes

clear: "From the beginnings of liberalization we decided that our company should be totally business-oriented." Profits have been rising by almost 30 per cent year on year. And Kazakhtelecom has invested strongly in mobile telephony and in competing with the six other companies now licensed to provide international calls.

FUTURE PROSPECTS

Both Kazakhtelecom and KazMunayGas are looking to expand outside the domestic market of just 15 million people. And from Samruk's position, Mynbayev agrees that "When we speak about the growth of assets we mean by active participation in foreign markets."

At the same time there are growing bonds between these national companies and the private sector, both domestic and foreign-owned. "What we are trying to do", says Mynbayev, "is to establish good partnerships with the private sector and foreign investors."

The bottom line is that these national companies need to be more commercially-driven. "By doing this", says Mynbayev, "Samruk, together with Kazyna, can initiate further diversification. But this can be done only by companies that are commercially successful in their own sectors."

The Kazakhstan government is fully aware that over-reliance on volatile commodities markets that determine the price of its main exports is not a firm base for long-term sustainable development. "From the very beginning, President Nazarbayev said we must prepare for the time when there is no oil in Kazakhstan," observes Kairat Kelmibetov, Kazyna's chairman, "so now it is a question of how best to use today's oil revenues for future generations."

Five years ago the National Fund was set up to 'bank' oil revenues surplus to immediate requirements. So far, most of this has simply been parked in 'safe' international instruments like US Treasury Bills.

But in 2003, an 'industrial innovation strategy' was adopted with the aim of building an industrial base (in Soviet times there were just a handful of huge metals and mining organizations, now privatized as Kazakhmys, Eurasia Corporation and Mittal Steel Termirtau) built around Kazakhstan's strategic competitive strengths. ■



KazMunayGas headquarters

Kazyna: Kazakh Treasure

Diversifying and broadening the base of Kazakhstan's mainly resource-driven economy is very much the focus of Kazyna's Sustainable Development Fund. As its chairman, Kairat Kelmibetov, points out: "While high oil prices mean we are earning more petro-dollars, the oil industry alone cannot generate enough employment in a nation of 15 million people."

Kazyna is an 'umbrella' holding company created earlier this year to act as principal shareholder – with a capital stock of more than \$1 billion – in seven development institutions.

The first of these is the Development Bank of Kazakhstan. The main aim, according to Mr Askar Sembini, its president, "is to provide credit strictly focused on social areas. The best way is to match a benchmark, such as EBRD, but locally." Other institutions under this umbrella include the National Innovation Fund, which focuses on grants for R&D and venture funding and the Investment Fund's equity injection into suitable projects, through to dedicated 'think-tanks' on markets and policy analysis like CMAR (Center for Marketing and Analytical Research).

Other key agencies include the SME Support Fund, which provides loans for the many small and medium-sized enterprises that remain an essential part of economic activity and employment in Kazakhstan, and the more outward-looking Kazinvest, which furnishes potential investors with information and assistance. Kazyna's capabilities are rounded off by the State Insurance Corporation's arranging terms for Kazakh exporters and investors alike.

As with Samruk, Kazyna's board of directors is to provide a mechanism for managing these different institutions, avoiding overlaps and deciding on key appointments and remuneration packages. On the other hand, each of these entities will retain independence in its day-to-day operations.

Kelmibetov says that Kazyna is pursuing a two-pronged strategy: one to build on Kazakhstan's industrial capacities; the other "to develop innovation and hi-tech activities that will create value-added products.

"We are aware that in the past we have

lacked a systematic industrial base", observes Kelmibetov. "But we are also aware that every developing country, and especially those with low labor costs, is trying to build a new industrial base. Kazakhstan's distance from seaports and its living costs mean that it cannot compete across the board.

So we are identifying niches in which we can be competitive, as in developing innovative high-tech industries."

Kelmibetov looks to Finland as a model – bordering Russia, it is another



Kairat Kelmibetov,
Chairman, Kazyna

large country with a small population and, until quite recently, not much in the way of scientific track record or high-tech infrastructure compared to their big neighbor. "But in the last 20 years it has been the Finns who have created Nokia and invested in innovation."

So now, he believes, less industrialized countries like Kazakhstan must look to the post-industrial stage of development. "In Finland they have created real science and a truly innovative environment, bringing in venture capitalists to help finance it, and we can do that, too."

By using oil revenues to build "an innovation infrastructure", Kelmibetov argues that Kazakhstan can 'leapfrog' the normal development cycle and move directly to hi-tech enterprises. "Our job", he says, "is to create the conditions for such enterprises." The National Innovation Fund (now under Kazyna's purview) is tasked with creating the necessary innovation infrastructure, such as the IT park in Alatau.

But an innovation economy also requires a broader industrial base.

The approach adopted so far has been to identify seven pilot clusters of economic activity where Kazakhstan has certain competitive advantages, and to develop these on a sustainable basis.

CLUSTERS

In a free market situation, Kelmibetov sees clusters as "a union of competitors", citing France's quality wine clusters and IT clusters in Bangalore, India, as examples. An obvious one for Kazakhstan is providing more support services and machinery for the oil and gas industry, which currently imports most of its requirements. But for this, Kazakh contractors must meet recognized international standards.

Others are developing the metallurgical sector, aiming to produce more finished value-added products for export rather than basic commodities; food processing – Kazakhstan is among the top five grain producers and nearly a third of the population live in rural areas, and Kelmibetov believes a niche in organic foods could be built by importing new technologies; and textiles, where there is already a base for expansion and an advantage in cheap energy prices. Moreover, there are plans to create a regional commodities exchange in Almaty. That would be part of a broader plan to develop Almaty as the financial hub of Central Asia. Linked to this are plans to build up another cluster around tourism, beginning with business visitors, and develop Kazakhstan's strategic position at the crossroads between Europe and Asia as a transshipment and logistics center.

Of course, all of this will require massive investment. "Kazyna will also have a major role," says Kelmibetov, "in bringing together investors abroad with opportunities within the country."

As the key holding company in charge of developing and diversifying the economy, Kazyna will play a pivotal role in achieving stated goals of maintained annual growth of 7-8 per cent in all sectors apart from extractive industries such as mining and oil. The ambition is to achieve productivity improvements of 8-9 per cent each year, which should result in a trebling of the country's overall productivity by the year 2015. And if Kelmibetov has his way, it will be on a broader, more balanced, and sustainable basis. ■

Connecting a Growing Market

Creating a state-of-the-art telecoms network across Kazakhstan, for both fixed line and wireless, is key to successfully transforming this vast, resource-rich country into a truly competitive global player. It is fundamental to the development of a more diversified and balanced economy, and a prerequisite for Almaty if the city is to realize its aspirations of being an international business and financial center.

The domestic fixed-line market is still the monopoly of state-owned Kazakhtelecom, though this situation is set to change as moves towards liberalization ahead of Kazakhstan's expected accession to the WTO next year gather pace. Moreover, ownership of the company has been vested in Samruk, whose board of directors is to decide on floating a minority shareholding – probably between 5 and 7 per cent – in the last quarter of this year.

There are likely to be further tariff reforms for local calls, according to Khairat Karibzhanov, president of Kazakhtelecom, which is also engaged in "purposeful work on tariff decreases for international communications and the Internet."

"I think that liberalization of the industry provides a firm foundation for privatization."

NEW TECHNOLOGIES

Broadband access is still around four times more expensive than in the US or Western Europe, though Karibzhanov notes that the sector's attractiveness to investment must also be borne in mind so that the necessary infrastructure can be built and developed internally, thus avoiding dependence on Russian cables and operators. He adds that "Kazakh – as opposed to Russian – content on the Internet is under-developed", and that buying in from outside is more expensive than producing it locally.

"Recently we introduced a mass-market

broadband connection branded as 'Megaline Hit', with 128 kb per second and unlimited access for around \$40 per month. Given salaries in Kazakhstan, that can still be expensive, but our current margins are minimal and we are working hard to lower prices further."

There is already meaningful competition on international services. As Karibzhanov points out, "Apart from Kazakhtelecom, there are now six other licensed companies providing telecommunications services for international calls.

"I think that liberalization of the industry provides a firm foundation for privatization", he says. "Why? Because all the necessary conditions for running a telecoms business without discrimination, and the legal status of the players and appropriate levels of transparency, are in place." Now the pressing need is to get this more open and competitive industry operating in practice through market-driven disciplines. And that means more privatization.

The fast-growing mobile market is already partially liberalized with two major operators. The market leader is a joint venture between Kazakhtelecom and Fintur, called GSM Kazakhstan OJSC Kazakhtelecom, with brands such as KCell, while the Russian entrant Kar-Tel is pricing aggressively to gain market share. Kazakhtelecom will go it alone later this year as a third operator, having recently bought a small mobile company which it plans to develop into a major player. While mobile telephony has been growing rapidly, penetration is still only 38 per 100 of the population compared to 80 plus in some Western countries.

THE MARKET LEADERS

KCell remains market leader and, as its new CEO, Serdar Canogullari, notes, "We do our best to keep it that way." He expects wireless penetration to reach 60 per cent over the next three years, so the overall market is growing rapidly even if there are new entrants.

Moreover, Canogullari believes that it is not just pricing but "quality of the network that will be the main issue with

customers, along with more and better coverage, and these are going to be our priorities. This is why we are going to invest heavily on infrastructure to improve coverage and also to keep on the edge of technology. We need to be the first in every single usable technology that benefits the customer."

"We want to be one of the first operators here to offer 3G services. This is how we can help Kazakhstan become the most technologically advanced country in the region, and one of the 50 most competitive in the world."

For the time being, KCell is concentrating on improving the existing network that covers more than 65 per cent of Kazakhstan's population. The company is also investing in marketing – particularly in customer retention programs. Part of this lies in developing value-added services that bring some value to the customer. "Voice telephony is still king", says Canogullari, "but whoever does a good job of increasing their income from additional services will remain leader in this country."

Looking ahead, Canogullari is preparing for the introduction of the best available technologies that are compatible. "We are talking 3G with STPA", he said, "and we want to be one of the first operators here to offer 3G services. This is how we can help Kazakhstan become the most technologically advanced country in the region, and one of the 50 most competitive in the world." ■

From the Slopes to the Steppe

The beauty and diversity of Kazakhstan's natural environment is only just beginning to be recognized by sophisticated travelers as a new and exciting destination – whether it be for winter sports, eco-trekking, or cultural tourism.

Previously, this vast country's potential as a destination was held back by the lack of good infrastructure – and air connections to major tourism markets. But now that is changing rapidly. The government has declared tourism a priority sector, with the announcement of a Tourism Development Plan and, more recently, setting up a separate ministry to promote the industry at home and abroad.

Kazakhstan is virtually as large as the whole of Western Europe. Its 2.7 million square kilometers of steppe and mountains contain a vast range of attractions, both natural and man-made.

The focus is on developing incoming tourism and attracting more international investment to improve existing and often dated infrastructure. This will be necessary in order to cope with ever-rising volumes of visitors – numbers have been doubling year on year since 2001, albeit from a low start point.

A growing number of international airlines, including British Airways, KLM, Lufthansa and Turkish Airlines, now provide regular scheduled services to Almaty or Astana – or, in some cases, both cities. However, the airline expanding its international routes most rapidly is Air Astana – effectively Kazakhstan's own 'flag carrier', though it is in fact a joint venture between the Government of Kazakhstan and the British aerospace group BAE – which has acquired five new Airbuses and one Boeing to provide scheduled services on 20 international routes.

"We operate only new aircraft and apply all the latest safety and security standards", says Air Astana's president Peter Foster. "Over the next five years we hope to have 20-25 aircraft flying internationally with a good overall network and a frequent-flyer program."

Currently the majority of inbound visitors to Kazakhstan come from the Russian Federation, followed by Germany, China, Turkey, the USA and the United Kingdom. The inflow of tourists exceeded the number of Kazakhs going abroad for the first time in 2004, and government revenues from tourism more than doubled.

Good transport infrastructure is essential, given that Kazakhstan

is virtually as large as the whole of Western Europe. Its 2.7 million square kilometers of steppe and mountains contain a vast range of attractions, both natural and man-made, and tour operators now offer some 700 routes all over the country through landscapes ranging from arid steppe to pine-clad hills, snow-capped mountain ranges and alpine pastures and lakes.

PRISTINE SCENERY

The beautiful Tien-Shan mountains, including Khan-Tengri – which at more than 7,000 meters is the country's highest peak – provide a natural playground not far from Almaty which is being developed as a center for skiing and other winter sports. And from spring



onwards, Kazakhstan is a paradise for alpinists and nature lovers.

For those seeking adventure there is mountain biking, white water rafting, tough mountaineering or gentle trekking, and even motorbike tours.

The number of travel agencies continues to grow, as does the diversity of their offerings.

A UNIQUE EXPERIENCE

Nature lovers can visit designated reserves such as Aksu-Zhabagly, where there are Siberian ibex, roe and Caspian deer, wild boar, and the increasingly rare snow leopard. In the Almaty reserve there are 137 species of animals, including the Turkestan lynx, as well as over 200 species of birds. And bear-watchers should be attracted to the Marakol nature reserve in the east.

There are plenty of attractions for keen anglers, too, from rushing mountain streams to deep lakes where some of Kazakhstan's 150 varieties of fish can be found. Bird-watchers should visit Naurzum in the Kostanai region, set up in the 1930s to protect the local pine forests and renowned for its waterfowl in the many lakes, while Tenghiz Lake in

Kurgaldzhino Park is the northernmost nesting point of the pink flamingo and attracts phenomenal numbers of

Nature lovers can visit designated reserves such as Aksu-Zhabagly, where there are Siberian ibex, roe and Caspian deer, wild boar, and the increasingly rare snow leopard.

waterfowl in the spring months. Kazakhstan lies on one of the main routes of the Great Silk Road, and at the ancient city of Taraz many historic monuments are preserved in excellent condition, including a necropolis dating from the 10th-12th centuries and the world-famous mausoleums of Karakhan and Davudbek. A more recent attraction is the Bayonkur Cosmodrome from which the first Sputnik was launched in 1957.

The renewal of both Astana and Almaty is making them destinations in their own right. And there are plans to develop Almaty as the first large-scale venue for business conventions in Central Asia. A champion of this idea is Dejan Djordjevic, chairman of EUROBAK (European Business Association of Kazakhstan) and general manager of Almaty's Hyatt Regency. "By building a proper convention center – and by that I mean an amphitheater for 3,000 people – you would bring domestic, regional and international conferences to Almaty, and congress participants usually spend three to four times more than the average leisure traveler.

Djordjevic points out that it would provide a major boost to airlines flying into Almaty, not to mention restaurants, cafés and other services. Delegates could go skiing at Chimbulak in between sessions.

With 12-14 conferences a year bringing in so many people, there would be immense benefits to Kazakhstan's profile abroad. But it has to be done soon, before another city in the region decides to build a convention center of its own. ■

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A Market Leader with International Ambition

On June 19, 2006, Standard & Poor's Ratings Services assigned its 'B+' long-term counterparty credit and insurer financial-strength ratings and its 'kzBBB' Kazakhstan national-scale rating to Kazakhstan-based insurer Eurasia Insurance Company. The outlook is stable. This is the first time such recognition has been assigned to an insurance company, confirming the leading position held by Eurasia Insurance in Kazakhstan's insurance market.

Here we speak with Dr. Boris Umanov, Chairman of the Board

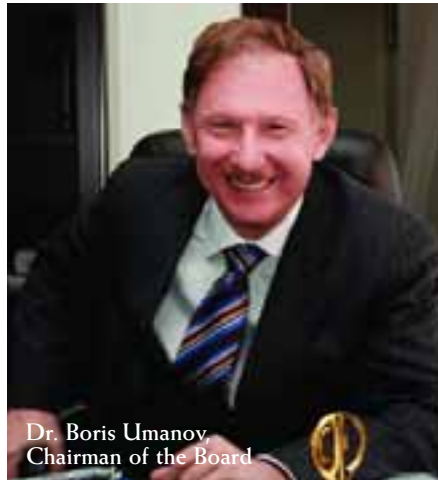
Q: WHAT WERE THE HIGHLIGHTS OF THE RECENT INVESTMENT SUMMIT?

BU: The main feature of the summit was to show that Kazakhstan is not just about the oil. Everybody used to think that Kazakhstan was just the outskirts of the Soviet Empire, a forgotten island between Russia and China. But now, 15 years after the collapse of the Soviet Union, it is obvious that Kazakhstan has managed to create its own state, its own government and its own flourishing economy. Kazakhstan is a huge country with huge opportunity and political stability. There are many negative things happening around the world like terrorist attacks, bombings and the war in Iraq, but take a look at Kazakhstan; we have political stability, a friendly mentality and you can see all religions living together without any problems. You can see a synagogue next to the mosque or an orthodox church.

Kazakhstan has developed its own economic model. It is an oil-rich economy but it is not only about oil. People live together in harmony, with strong banks and strong insurance companies, and many features that distinguish us from our neighbors.

Q: COULD YOU OUTLINE THE DEVELOPMENT OF EURASIA INSURANCE?

BU: Firstly, we now have around \$180m in assets. We position ourselves not only as an insurance company operating in Kazakhstan but also as a reinsurance company servicing the world. We service a lot of risk from abroad; however, it is not only Russia, Ukraine, Georgia, Azerbaijan etc., but also South Korea, Eastern European countries like the Czech Republic and Poland, as well as India and Jordan. We work on all the continents, and I would like you to know that we are ready for the international expansion of our business.



Dr. Boris Umanov, Chairman of the Board

"Kazakhstan is a huge country with huge opportunity and political stability."

Q: TO WHAT DO YOU ACCREDIT EURASIA INSURANCE'S RAPID GROWTH?

BU: The company has developed much faster than a lot of other companies mainly because of the innovative management system that we have here.

The Kazakhstan market is an interesting one but it is still relatively small with just 15 million people. We feel secure here but there is not enough

business for us domestically. Therefore, we decided to grow as an international player. We faced a lot of obstacles as not everybody knows Eurasia Insurance or is even familiar with Kazakhstan. It's tough because we are working together in the same field with giants such as MunichRe and SwissRe. We don't think of ourselves as the best company in the world, but we know our niche.

People in the Middle East trust us because we are a Muslim country, we are close by and there is no tension among religions here. We are ready to promote ourselves as 'Takaful' – special insurance for Islamic countries. The same situation also goes for South Korea, as there is a large Korean community here and we have Koreans working in our company.

We also work with both Georgia and Russia. Right now the relations between those countries are not very good but they have no problems with Kazakhstan. Of course, we also work with Western Europe. The companies there know how similar we are in terms of our legislation; they also know we pay our claims.

Kazakhstan as a whole and Eurasia Insurance Company in particular have a huge opportunity to work with almost everyone in the world. The US, the Middle East, the Asian countries, because we are on the Great Silk Road and our people can understand everyone! There is a huge market in China and we will soon be there, too.

Q: WHAT ARE YOUR EXPECTATIONS FOR KAZAKHSTAN AND EURASIA INSURANCE?

BU: I believe that Kazakhstan has a bright future, not only because of our oil and gas reserves. Unlike Venezuela and Libya, Kazakhstan is positioning itself as a contented and balanced country which attracts foreign investment and foreign people from all over the world. Maybe this is a bit casual for the Chairman of the insurance company, but believe me, it is our philosophy. ■



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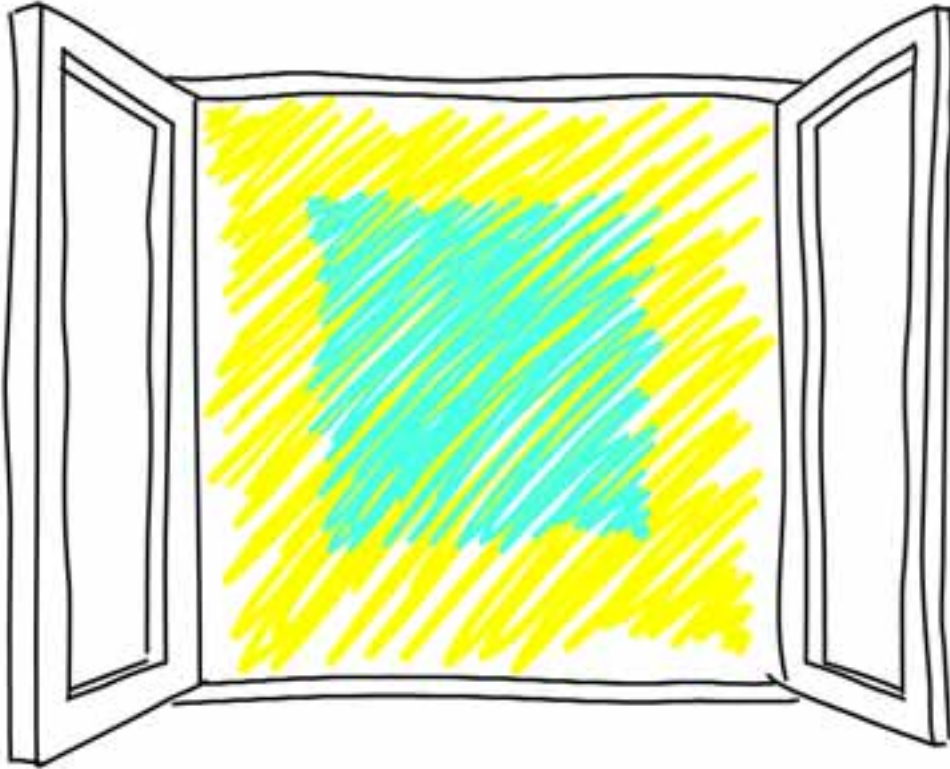
"Luxor" wellness center



"NurdyTau" business center under construction

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Growth Opportunities in Central Asia

We at Kazyna present to you a world of opportunities that await you at the heart of Eurasia. Nestled between Russia and South Asia, China and Europe, your business in Kazakhstan is uniquely positioned to serve these growing markets.

What is more, the domestic economy is also growing at a fast clip and represents significant growth opportunities.

All state development institutes in Kazakhstan come under one management company "Sustainable development fund Kazyna".

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