

Natural monopolies in Kazakhstan: A right time to invest?



KAZAKHSTAN

By Shaimerden Chikanayev

The importance of the so-called natural monopolies in Kazakhstan can be seen in the fact that some of Kazakhstan's largest and most powerful corporate empires, such as the KEGOC (national transmission grid operator) and KTZ (national railway company), are officially subject to natural monopoly regulation. The obvious lack of transparency in the tariff-setting of natural monopolies is one of the most important and long-standing problems in Kazakhstan. There is no doubt that the ever-growing corruption and inefficient management in the natural monopolies inevitably lead to an increase of tariffs for practically all services provided by monopolists, a distrust of potential investors and even social unrest among the population of Kazakhstan.

The optimal path to reforming the monopolized industries is, therefore, currently a very hot topic for Kazakhstan. The development of natural monopoly regulation in Kazakhstan can be seen as an important test case for structural reforms in the country. The government of Kazakhstan has declared its intention to introduce competition into potentially competitive areas of the natural monopoly sectors and its readiness to attract private investments, including through Islamic finance, into the housing and utilities sectors, as well as other industries subject to natural monopoly regulation. If successful, these initiatives would increase bankability and investment attractiveness of many projects in Kazakhstan.

In accordance with the current Natural Monopolies Law, entities operating within certain law industries (which include, among others, transportation of electrical energy, generation, transportation, distribution and/or supply of heat energy, airport services, operation of water and sewage systems) are subject to specific regulation. Under Kazakhstan's current legislation, in particular, tariffs charged by a natural monopoly entity are regulated so that prices for services (goods, works) produced by the natural monopoly

entity will be, generally, subject to cap levels of tariffs approved for a five-year period. Tariffs in Kazakhstan are generally designed based on the cost-plus method under which a standard mark-up is added to the cost of a product.

The Kazakh government recently studied the foreign experience in the field of natural monopoly regulation and is trying to adopt it to the Kazakh conditions. Taking into account the foreign experience of tariff regulation, the relevant authorized body has developed the draft of the whole new Natural Monopolies Law in a new wording, which provides, among others, for the new tariff-setting system, whereby the approval of tariffs for the services of natural monopoly entities would depend on the increase in the efficiency of their activities and compliance with service quality standards.

A key challenge in attracting private investments into Kazakhstan's natural monopolies so far is tariff-setting. Potential investors have difficulty investing in infrastructure when they cannot rely on revenue streams that cover the costs of operation and investment. Islamic financing is starting to emerge as a significant source of funding for public-private partnerships and infrastructure projects such as airports, water utilities, etc. Once the new Natural Monopolies Law is adopted, Kazakhstan would be able to mobilize private financing for infrastructure through the use of, inter alia, Islamic finance. (2)

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