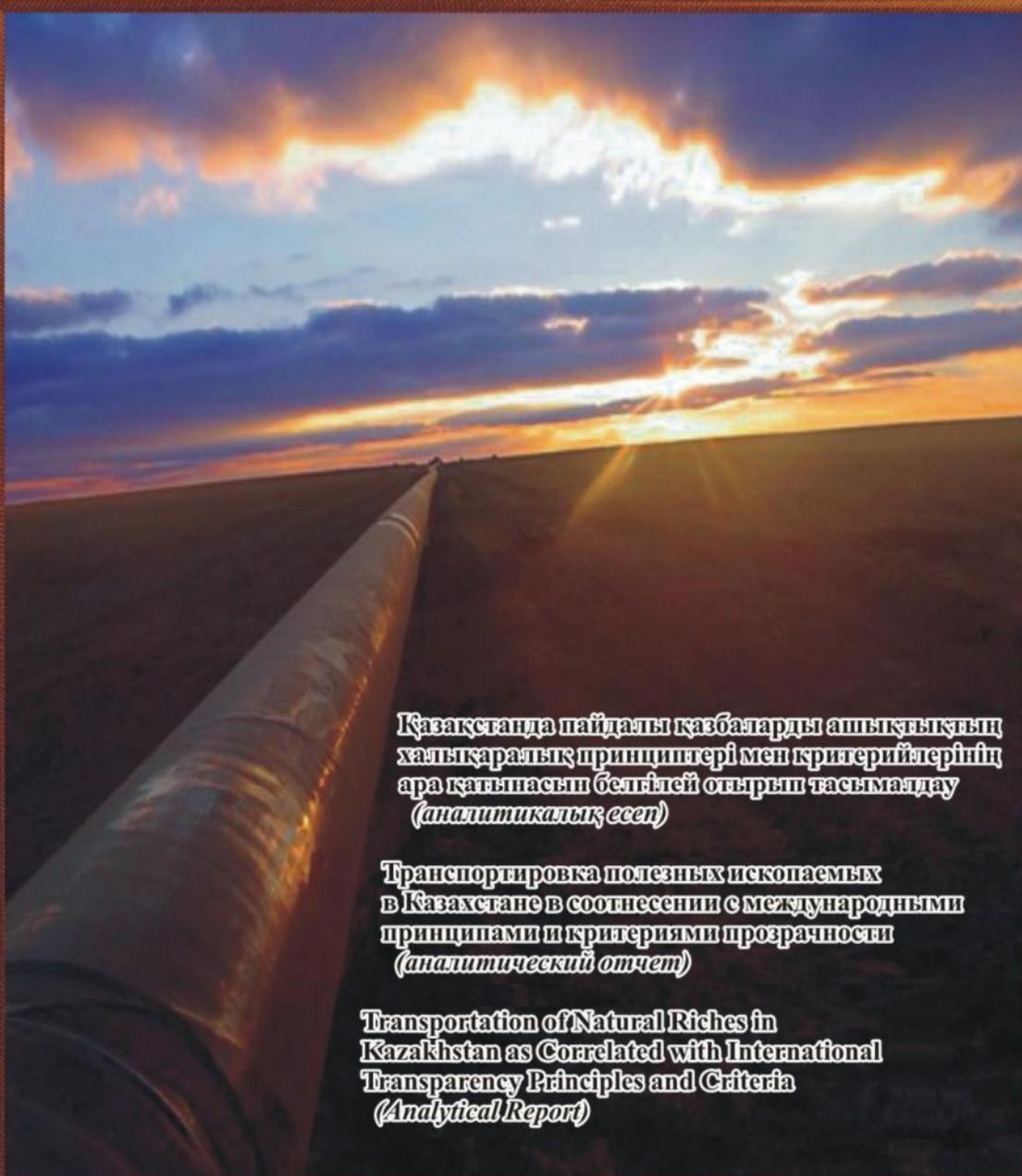




Сорос-Қазақстан Қоры
Фонд Сорос-Казakhstan
Soros Foundation Kazakhstan



«Благо» Қоғамдық Бірлестігі
Общественное Объединение «Благо»
«Blago» Public Association



Қазақстанда пайдалы қазбаларды ашықтықтың
халықаралық принциптері мен критерийлерінің
ара қатынасын белгілей отырып тасымалдау
(аналитикалық есеп)

Транспортировка полезных ископаемых
в Казахстане в соотношении с международными
принципами и критериями прозрачности
(аналитический отчет)

Transportation of Natural Riches in
Kazakhstan as Correlated with International
Transparency Principles and Criteria
(Analytical Report)

Қазақстан Республикасы
2008 ж.

EXPRESSION OF GRATITUDE

This report has summarized results of the study of compliance of Kazakhstan's laws and regulations, actual relations and situation in Kazakhstan's transportation sector, as well as reporting information of the Government of Kazakhstan and transportation companies that operate in Kazakhstan, with international transparency standards and criteria.

The study was conducted within the framework of the project of monitoring of activities of pipeline companies, which is implemented by Blago Public Association under financial support of Soros Foundation Kazakhstan.

Information presented in this report was incorporated in the report to the EITI International Secretariat, which was prepared by the author in cooperation with the following experts: Inghilab Akhmadov (Azerbaijan), Tamra Paraya (Georgia), and Mikhail Gonchar (Ukraine), with a view to prove the necessity of extending the EITI agenda to include the transportation sector of the said countries.

In its turn, it is necessary to emphasize the contribution of the said experts and Anton Artemiev, Director of Kazakhstan Revenue Watch Program, in understanding of the issues of the study and in compilation of this report.

The author would like to specially thank the reviewers of this report, Oleg Ivanovich Yegorov, Chief Research Officer of the Institute of Economics of the Ministry of Education and Science of the Republic of Kazakhstan, Doctor of Science, Economics, Professor, and Yerlan Akishev, Consultant of Permanent Mission of the World Bank in the Republic of Kazakhstan, for unbiased assessments of the report and for valuable comments expressed in this regard.

The author would like to express his special thanks to Kosuiym Mukashev and Oxana Satpayeva for professional translation of this report.

A photograph used on the cover page of the report was found on <http://www.munaitas.com>, an electronic site of Munaitas Pipeline Company, for which the author would like to thank the company and the unknown photographer who created the photograph.



Yu.P. Krivodanov

Analytical Report

Transportation of Natural Riches in Kazakhstan as Correlated with International Transparency Principles and Criteria

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REVIEW

Initiative for development of transparency in economic sectors, especially in extractive industries, is aimed at increasing transparency of transactions between the government and companies that operate in one sector or another. The work under review emphasizes that solution of this problem in Kazakhstan's extractive industries is gradually progressing to its natural result.

However, the analysis of activities of transportation companies demonstrates that there is no transparency in this sector as far as budget reports and input data for calculation of economic and financial performance are concerned. The author of the paper analyzed extensive information that included international laws, legislative documents that regulate fiscal and quasi-fiscal relations that arise between the government and companies operating in extractive industries.

The Republic of Kazakhstan possesses significant reserves of various mineral resources that are transported to consumers, both domestic and foreign, by means of rail way, pipeline and marine transportation. Here, one should note that motor vehicle transportation used for mass transit of natural riches to long distances is not a viable and cost effective option. It can be used to transport ore from pits to processing plants and to transport fuel and lubricants to service stations.

The author, paying special attention to transportation component of the system of extraction-transportation-marketing and sale, uses factual information provided by companies and arrives at conclusion that transportation companies are not transparent enough as far as their financial and economic performance is concerned. The author points out that projects with various subject matters do not contain data on payments made by the companies to the budget and on distributed dividends.

The goal of the study under review is to identify the areas of activities of transportation companies that are practically not covered in publicly available documents, including company sites, newspapers, and statistic reports. Information summarized in Tables 4 and 5 is good and unbiased evidence to that.

Summarizing my opinion of the content of the said analytical report, I believe that the report raises a problem, which is important for the country's economy and solution of which is critical and vital. Conclusion and recommendations developed by the author offer ways for improvement of activities of transportation companies and for implementation of the Extractive Industries Transparency Initiative (EITI).

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REVIEW

The survey presented in this report reflects, to a certain extent, the reality of the transportation system of the Republic of Kazakhstan. Based on the document, it is clear that the country's extractive sector is dependent on the pipeline, marine and railway transportation to a greater extent due to the transportation system being monopolized and due to the lack of multiple transportation options in the country for transportation of hydrocarbons and other natural riches.

The extractive and transportation industries are interdependent and complementary sectors of the economy; because of that, involvement of transportation companies in the EITI could contribute to improvement of transparency of the budget system as a whole.

Being non-extractive companies, transportation companies, by default, cannot be included in the EITI, because the initiative is designed for companies involved in extraction of natural riches. On the other hand, any country that is implementing the EITI has the right to expand the boundaries of the Initiative provided there is full consent of all stakeholders involved in the process. This could be achieved through the mechanism of the National Stakeholders Council, which can consider inclusion of transportation companies in the Extractive Industries Transparency Initiative in the Republic of Kazakhstan.

This reference does not constitute any official assessment of the study on the part of the World Bank; it only reflects the opinion of representatives of the World Bank, who are involved in implementation of the World Bank programs for advancement of the EITI in Kazakhstan.

**Yerlan Akishev,
Consultant in EITI,
Representative office
of World Bank**

Introduction

This report is based on results of the study of performance of pipeline, marine and rail way transportation companies that operate in Kazakhstan, from the point of view of international extractive industries transparency criteria.

The goal of this report is to prove that it is important for Kazakhstan to apply the transparency principles, which are regulated by the International Monetary Fund (IMF), to the transportation sector and to apply the Extractive Industries Transparency Initiative (EITI¹) to the said sector.

The IMF standards for transparency of revenues from natural resources² are a modification of the principles contained in the Code of Good Practices on Fiscal Transparency adapted to specific problems of the countries where a significant part of revenues is contributed by natural resources.

EITI is a process for ensuring transparency of government revenues from extractive companies so that the public could obtain full and clear reports from the governments on how the said revenues are used.

EITI is characterized by the following qualities that distinguish this initiative from other initiatives:

- informal nature, voluntary basis and simple processes;
- principles of equality of the parties, i.e., the government, companies, public institutions, in decision making;
- responsibility of all parties for implementation of the decisions.

Although commonly known terms and notions are used in this report, the author believes that it is necessary to define same:

The notion of “**transparency**” in the context of this study means *understandability, accessibility, openness and reliability, clearness, reliability, responsibility and openness*:

- *Clearness* means presentation of information important for interested parties, in the clear form for them;
- *Reliability* means objectivity, validity, comparability of the reporting and/or confirmation verifications of such reports by the independent competent auditor.
- *Responsibility* means a public presentation and observance of strategic reference points, principles and criteria of activity, the activity accountability;
- *Openness* means presence of procedures and mechanisms of revealing and the account of interests of the parties and a context, and also presence of conditions for free and timely access of the parties to the significant information for them in full.

¹ <http://www.eitransparency.org/>

² <http://www.imf.org/external/np/fad/trans/index.htm>

I. Global Significance of Kazakhstan's Transportation Sector

1 Kazakhstan's transportation sector in the global economic context

Today natural riches transportation activities are an important economic factor for extracting countries, for transit countries, and for consuming countries. Moreover, when we talk about transportation of energy sources, this issue is equally important for the global community as the issue of international security and sustainability of the global economic balance. It is because locations of extraction of the said minerals are very remote from the locations of their consumption. This intensifies the significance of transparency regulation and control in the transportation sector because this sector has its specific features and requires a special methodological, legislative and institutional base, which would be integrated in the international context and which is currently underdeveloped in Kazakhstan and in other countries of Central Asia and the Caucasus.

Routes of gas transportation from Turkmenistan and Uzbekistan via Kazakhstan and transportation corridors for transportation of Kazakhstan's natural riches via Russian and the Caucasus countries are of global importance; however, multiple unpredictable economic factors in all the above countries make it impossible to predict those routes, thus placing the global economy at risk.

National extractive companies in Kazakhstan, which are a vertically integrated holding system, include the entire change from exploration and production through transportation and refining of raw materials to sale of finished products. However, with positive qualities in place, integration, which is strictly regulated in developed countries, significantly aggravates non-transparency of the extractive industry in Kazakhstan and their entire economy of our country. As a result, being the agency, which is authorized by the government in joint extractive and transportation projects, state-owned companies serve as a governmental leverage to influence investors; this creates an important concern for the countries that relate with Kazakhstan through supplies of natural resources.

2 Kazakhstan's Transportation Sector in Geopolitical Context

Kazakhstan's transportation sector, to a greater extent as opposed to the extractive sector, is affected by political factors, because mineral resource deposits located in Central Asia attract close attention of the transit countries and consuming countries both in Europe and in Asia as an alternative to the Russian sources. Due to this fact, selection of transportation routes often depends on the political component as well.

Due to unmatched interests of the countries in the region, first of all, the Caucasus countries, Ukraine and the Baltics, on the one hand, and Russia, on the other hand, because of attempts of external forces to oppose them to each other, consumers are concerned about stability of supplies of natural riches via existing transportation communications. This concern becomes even grater because of Russia monopolizing transportation routes and using them for the purposes of intensifying political influence.

In order to avoid significant disruptions for all players in mineral resource transportation activities, under the existing balance of forces or under any change of such balance, it is necessary to apply the principles of openness, transparency and accountability, which have been recognized and applied in developed countries for many years.

Thus, the global role of Kazakhstan's transportation potential and the Republic of Kazakhstan as a whole will grow qualitatively.

3 Kazakhstan's Transportation Sector in the Context of International Law

Terms of transportation of natural riches in Kazakhstan and performance data of relations that occur in this regard are not fully covered by the international law:

1. **The Inland Transport Committee of the Economic Commission for Europe under the UN Economic and Social Council**¹, at its Seventieth session, acknowledged the importance of freight transport between Europe and Asia and development of Europe-Asia transportation links for social and economic development of the countries in the region and for their integration into the global economy. However, Kazakhstan's trunk pipeline, marine and rail way transport is not covered in this UN institution and its acts.
2. Directive 2003/55/EC dated June 26, 2003² is the only regulation of the **European Union** in the oil and gas industry that covers transportation. This Directive establishes the principles of transparency in regulation of energy resource transportation activities; however, this Directive does not apply to Kazakhstan.
3. **Secretariat of the European Energy Charter**³, due to unsatisfactory situation with transparency of transit tariffs, ascribes great importance to increase of transparency of terms of transit, first of all, in Eurasia countries that utilize complex and non-transparent government-to-government arrangements; however, this international mechanism has not been ratified in Kazakhstan either.
4. **IMF Standards for transparency of extractive industries' revenues**⁴ strictly regulate fiscal and quasi-fiscal relations of the government with companies that operate in the extractive industry as a whole. However, they lack direct reference to these Standards covering transportation companies and their relations with the government.
5. **The UN Global Compact**⁵ encourages business community to follow the principles of corporate citizenship in order to improve their economic performance and assist in solving acute social problems in the regions where they operate. The Global Compact was recognized and supported in Kazakhstan by Edict of the President of the Republic of Kazakhstan No. 80 dated March 30, 2006, Decree of the Government of the Republic of Kazakhstan No. 22 dated March 31, 2006 and the General Agreement between the Government of the Republic of Kazakhstan and the national associations of employees and employers for 2007-2008 dated December 25, 2006.

Despite the above, to date, the only companies that operate in Kazakhstan and that have submitted their reports are London Almaty Insurance Company, whose report is disappointing⁶, and ArselorMittal Temirtau, whose report⁷ has absolutely nothing to do with the reality found in the course of the study - Follow-up on Arselor Mittal⁸ - which was conducted by non-governmental organizations in the countries where this company operates – from RSA to USA.

Reports of the other eight Kazakh companies that joined the Global Compact are not available on the UN site.

Thus, there is no actual advancement of the UN Global Compact in Kazakhstan, despite the fact that certain companies, especially large companies, produce bulky reports every year where they speak of significant achievements, large scale projects and charity activities. How-

¹ <http://www.unece.org/trans>

² <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:176:0057:0078:EN:PDF>

³ <http://www.encharter.org/index.php?id=1&L=1>

⁴ <http://www.imf.org/external/np/fad/trans/index.htm>

⁵ www.unglobalcompact.org

⁶ www.unglobalcompact.org/data/ungc_cops_resources/D7DBE6EC-7BC5-40E9-B9CD-A0E634214CA2/COP.doc

⁷ http://www.unglobalcompact.org/data/ungc_cops_resources/7069A9DA-0290-494A-A3E5-5BA15DCC9E5D/COP.pdf

⁸ <http://russian.bankwatch.org/project.shtml?apc=-2001063---1&x=2115366&d=n>

ever, those reports do not satisfy the Global Compact main reporting principles and are not registered with the UN Global Compact authorities.

On the other hand, the surveys found facts of investments, which were useless for the regions, and cases when information on allegedly implemented social projects was fabricated.

6. **The Extractive Industries Transparency Initiative (EITI)**, as it has been said above, is a process for ensuring transparency of government revenues from extractive companies so that the public could obtain full and clear reports from governments on how the said revenues are used.

The EITI (the Initiative) has been developing in the world for over five years, the number of countries and regions where it is implemented is growing, new techniques are tested; thus, the countries that participate in the Initiative improve the process of ensuring transparency in the extractive sector. At the highest political level, the sixty second UN General Assembly session on September 11, 2008 adopted a resolution to support the EITI. This resolution made the Initiative equal in status to an international standard.

In Kazakhstan the Transparency Initiative was recognized at the highest level in July 2005, and since December 2005 it has been actively advanced within the National Stakeholders Council and is equally supported by the government, first of all, by the Ministry of Energy and Natural riches of the Republic of Kazakhstan and the Ministry of Finance of the Republic of Kazakhstan, representatives of extracting companies — mainly by ExxonMobil and British Gas — and by Coalition of NGOs “Oil Revenues under Public Control!” (the Coalition).

On the whole, over the three years of its implementation in Kazakhstan¹, 106 oil and gas producing and mining companies have joined the Initiative. Over these years, multiple research, information and educational projects have been implemented at the national and regional levels, and under the auspices of the World Bank, EITI Promotion Communication Strategy has been developed and conferences have been held in the five extractive regions of Kazakhstan.

As a result of joint efforts of the government, the companies and NGOs, EITI report forms have been significantly improved, thus improving the transparency of accounting and reporting of extractive industry revenues; the Coalition’s² image has grown in the estimation of the public, the companies and the government.

Thus, in the process of promotion of the EITI, a mechanism of open and equitable interaction of the government, the companies and NGOs has been established and is actively working and evolving to ensure that problems related to activities of transportation companies, which are described in this report, are solved.

This overview of international political, financial and social initiatives aimed at ensuring transparency of relations in transportation of natural riches indicates that the only possible way to apply transparency principles to Kazakhstan’s transportation sector would be by virtue of including this sector in the EITI agenda, which is being successfully implemented in Kazakhstan’s extractive industry.

¹ <http://www.eiti.kz>

² <http://www.publicoversight.kz/>

II. Description of Transportation Sector in Kazakhstan

1 Current Situation and Prospects for Development of Transportation Sector in Kazakhstan

Contribution of transportation companies in Kazakhstan's GDP amounts to about 10%; however, reports of the government and pipeline, marine and railway companies contain general information only, which does not allow making sound and reliable opinion on the degree of sustainability of their activities, on cash flows between them and extracting companies, on significance of those companies for the regions where they operate; although such information is of great interest to investors and civil institutions.

It is necessary to note that performance of the said transportation companies has been assessed in a way; however, there is no monitoring data as far as performance data of transportation of natural riches by road in Kazakhstan is concerned. Given the intention to develop this sector in Kazakhstan in order to create alternative options for transportation of natural riches (high level agreement between Kazakhstan and Russia to construct Petersburg-Almaty automobile road and the Memorandum of the Government of Kazakhstan and the World Bank to allocate a \$2 billion loan to construct West-East automobile road), it is necessary to develop and apply in Kazakhstan a special methodology of accounting and reporting of the said activity together with the activities of pipeline, marine and railway companies.

This is also necessitated by the fact that Kazakhstan possesses significant, and sometimes leading, reserves of natural riches, the demand for which in the global market is growing, and, hence, the significance of Kazakhstan's transportation sector that transports such natural riches via Russia, Azerbaijan, Georgia and Ukraine both to the South and West and to China will increase.

The above factors and poor diversification of Kazakhstan's economy necessitate compliance with transparency principles for the entire system of relations in this regard.

On the whole, transportation of natural riches in Kazakhstan, including transit of gas from Turkmenistan and Uzbekistan, transportation of Kazakh crude oil, gas, coal, ferrous and non-ferrous products to China, Russia, Iran, Europe, etc. is represented by the following performance data (Table 1-3, Picture 1,2):

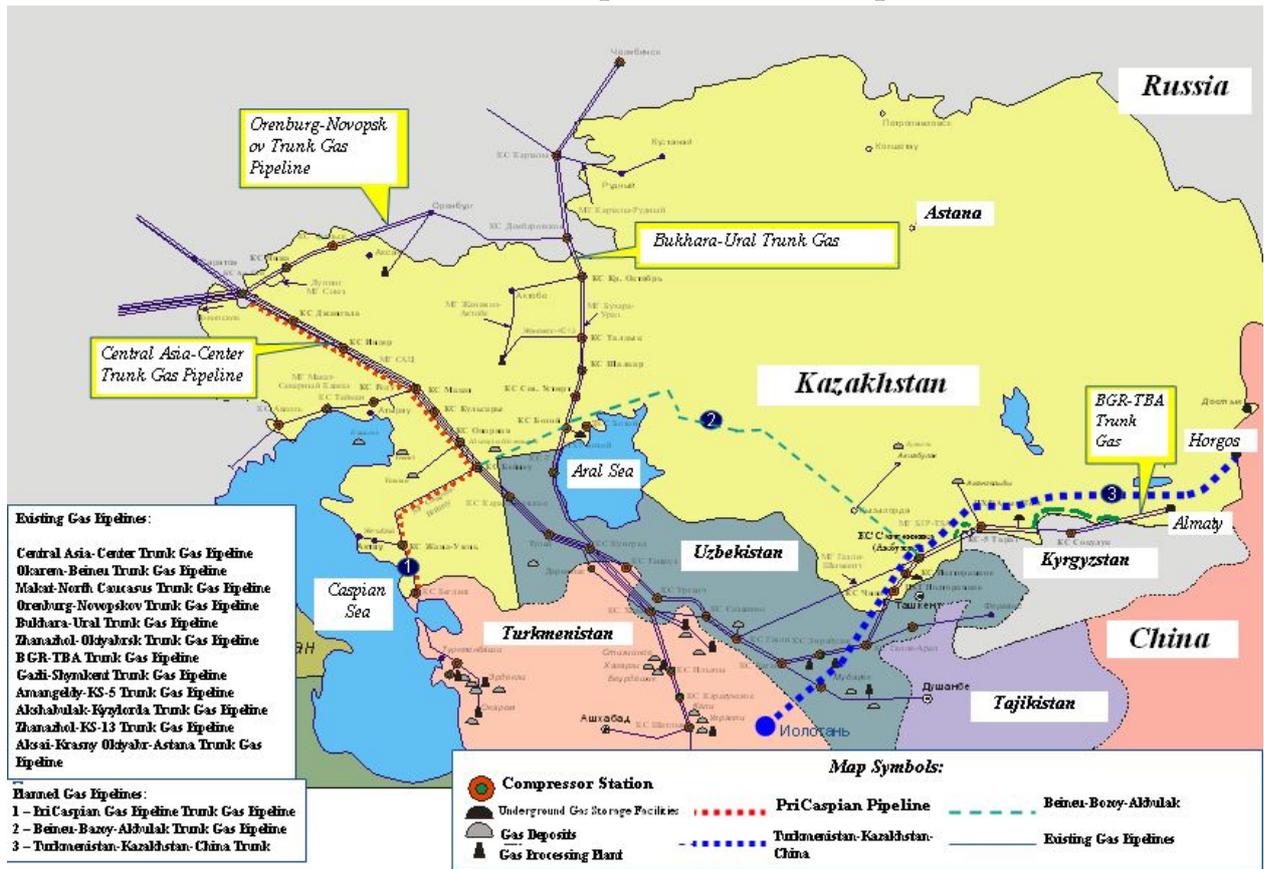
A) Via the system of trunk pipelines¹

Table 1

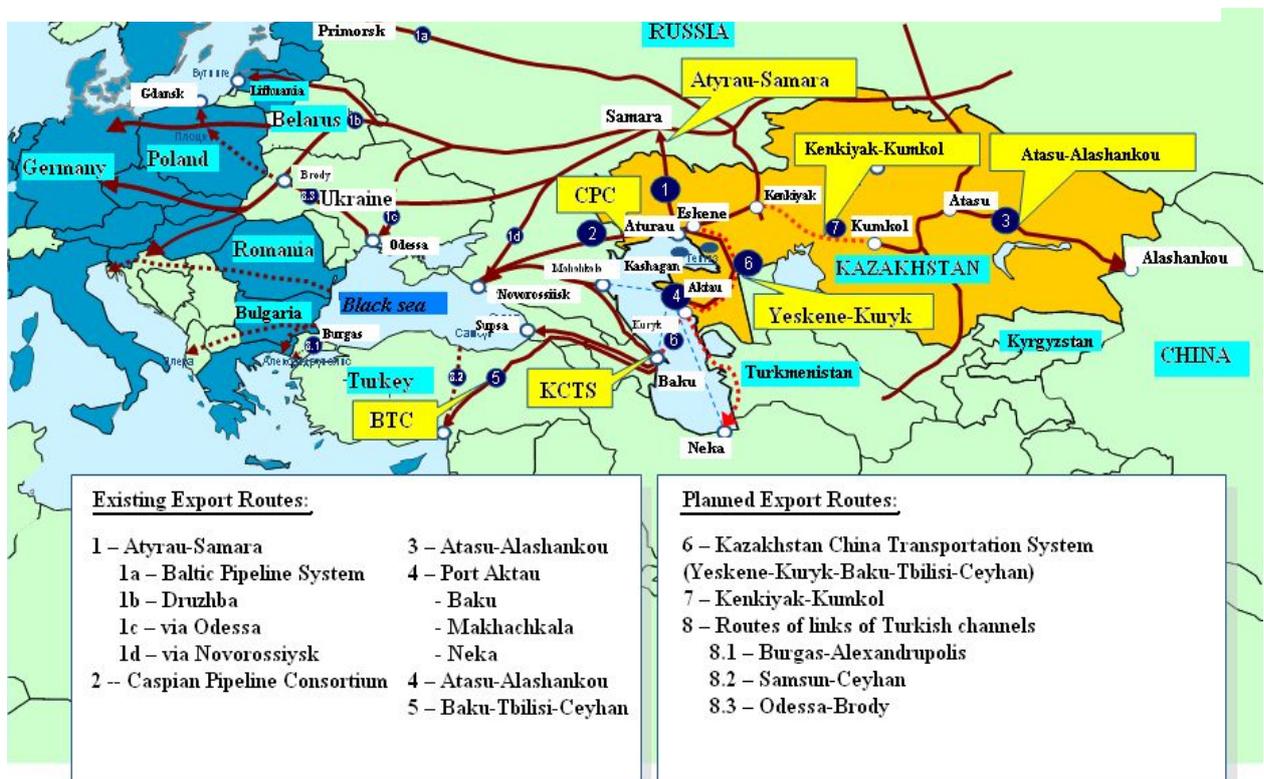
Length of trunk pipelines (kilometers)							
	2000	2001	2002	2003	2004	2005	2006
Total trunk pipelines, including:	17652	17082	17136	16896	16828	16783	16264
Gas pipelines	10137	10138	10138	10138	10138	10138	10138
Oil pipelines	6696	6944	6998	6758	6690	6645	6126
Freight Transportation via Trunk Pipelines (million tons)							
	2001	2002	2000	2003	2004	2005	2006
Total freight, including:	143.3	132.6	138.8	166.1	179.4	192.0	192.2
Gas	107.3	87.3	109.6	114.6	118.3	126.3	122.0
Of which – transit	103.9	83.9	96.1	110.8	114.2	121.6	116.7
Oil	36.0	45.3	29.2	51.5	61.1	65.7	70.2
Freight Turnover of Trunk Pipelines (billion tonkm)							
	2000	2001	2002	2003	2004	2005	2006
Total freight, including:	50.9	56.6	61.5	70.4	75.6	77.1	83.3
Gas	30.6	33.1	31.4	38.4	39.8	40.7	43.4
Oil	20.3	23.5	30.1	32.0	35.8	36.4	39.9

¹ <http://www.stat.kz>, <http://www.kaztransgas.kz>, <http://www.kaztransoil.kz>

Picture 1 Kazakhstan's Export Trunk Gas Pipelines



Picture 2 Kazakhstan's Export Trunk Oil Pipelines



B) Marine Transportation¹

Kazmortransflot National Marine Shipping Company JSC is the monopolist in the oil marine transportation market.

Table 2 Performance of Kazmortransflot in January-July 2007

Crude oil transportation via: (<i>thousand tons</i>)	2,142
Aktau – Makhachkala	1,432
Aktau – Neka	710
Aktau – Baku	0

As shown in Table 1, crude oil transportation volumes are not relevant for Kazakhstan's petroleum industry. In addition, during the audit of Kazmortransflot in 2007 it was found that:

“- the company's and its subsidiary's short-term liabilities were higher than their short-term assets by 2,670,476 thousand tenge;

- losses in 2007 amounted to 524,221 thousand tenge;

- it is doubtful that the company will be able to operate as an uninterrupted business in near future”.

The fact of suspension of both shipment of Kazakh crude in Baku and implementation of investment programs in the Batumi terminal, which was purchased by Kazakhstan, during the first days of the armed conflict between Georgia and Russia raises concerns, but not doubts, as far as prospects of transportation of hydrocarbons in Kazakhstan by sea are concerned. Moreover, immediately after those tragic events, arrangements between Kazakhstan and Russia in connection with joint development of transportation routes via Russia have progressed significantly. The project of transportation by sea with access to Europe via Azerbaijan and Georgia was an alternative option to the said transportation routes.

C) Railway Transportation²

Railway transport plays a key role in Kazakhstan's transportation and communications sector. According to information of the Agency of the Republic of Kazakhstan for Statistics, railway transportation has 70% in freight turnover of all types of transport, and there are great opportunities for development of its transit potential by virtue of increasing transportation via its infrastructure of five international transportation corridors.

Kazakhstan Temir Zholy National Company JSC is a monopolist in railway transportation in Kazakhstan and does not have any competitors. Major commodities for transportation are bulk liquids and bulk solids such as coal, grain, crude oil, ore, mineral fertilizers, etc., transportation of which by road is not efficient. Additionally, government and company reports provide only general information on performance of railway transport, and the only information that has some degree of detail describes transportation by type and by major suppliers of natural riches:

Coal: Bogatyr Access Komir — 17.3% of all shipments, Eurasia Energy Corporation — 9.3%, Borly coal department of Kazakhmys Corporation — 4.3%, coal department of ArselorMittal Temirtau — 5.6%, Maikuben West — 1.3%, Balapantrans — 1.1 %, Shubarkolsky Mine — 0.9%.

Oil: Shymkentnefteorgsintez — 3.7%, oil marketing department of Aktobemunaigas — 1.6%, Atyrau Oil Refinery Trans — 1.3%, Tengizchevroil — 1.1%, Pavlodar Petrochemical Plant —1.0%.

¹ <http://www.kmtf.kz>

² <http://www.railways.kz>

Iron ore: Sokolovsko-Sarbaiskoye Mining and Processing Enterprise —8.14%, Orken — 1.8%, Donskoy Mining and Processing Combine— 1.5%.

Ferrous metals: ArselorMittal Temirtau — 2.4%, Aksusky Pland of Ferrous Alloys — 0.5%, Ferrochrom — 0.1%.

Non-ferrous ore: Kazakhmys Corporation — 0.15%, Kazzinc — 0.22%.

Table 3 Physical Shipment Volumes of Kazakhstan Temir Zholy in 2002

Type of Freight	Shipment Volume, thousand tons	Share, %*
Coal	71981	44.2
Iron ore	20537	12.6
Crude oil	10635	6.5
Petroleum Products	8020	5.0
Non-ferrous Ore	10911	6.7
Ferrous Metals	5325	3.3
Non-ferrous Metals	1019	0.6
Total	128428	78.9

* *Note:* Share in total shipment volume of Kazakhstan Temir Zholy

2 Overview and Comparative Analysis of Legislation and Activities of Transportation Companies As Correlated with IMF Standards

In addition to general legislation that regulates entrepreneurial activities in Kazakhstan on a general level and antimonopoly legislation, oil transportation is regulated by the Law on Oil and other regulations, particularly, by Rules for Provision of Equal Terms of Access to Regulated Services (Goods, Works) in the Area of Transportation of Oil and/or Petroleum Products via Trunk Pipelines; Rules for Provision of Equal Terms of Access to Regulated Services (Goods, Works) in the Area of Storage and Transportation of Gas and/or Gas Condensate via Trunk and/or Distribution Pipelines, Operation of Gas Distribution Units and Gas Distribution Gas Pipelines Related to Them; List of Activities Which are Related from the Production Process Point of View with Regulated Services (Goods, Works) in the Area of Transportation of Oil and/or Petroleum Products via Trunk Pipelines; and acts of the Agency of the Republic of Kazakhstan for Regulation of Natural Monopolies of the Republic of Kazakhstan.

Table 4 Tariffs for Services of Kazakhstan Temir Zholy *

Type of Service	Measuring Unit	Tariff, tenge
Provision of access road for passage of railway trains	car/km	159.16
Provision of access way for shunting operations, loading-offloading operations, other transportation process operations, and for parking of railway trains which is not provided for by transportation process operations	car/hour	44.69

**Note:* approved by order of the Chairman of the Agency of the Republic of Kazakhstan for Regulation of Natural Monopolies No. 141-OD dated May 25, 2007.

However, in addition to these tariffs (Table 4), which are, at first glance, simple and clear, there is also a Provisional Price List; and Letter No. 07-10-20/2271 dated March 31, 2008 of the Agency introduces multiple indices to the tariffs of the said price list. Additionally, there are separate tariffs for trunk railway network, calculation tables and indices to those tables, various multiple rates and — on top of all that — decreasing or increasing indices for transit transportation.

This list in itself is sufficient to make a conclusion that the railway transportation tariff making system is cumbersome. A better understanding of performance of the transportation sector in Kazakhstan could be obtained from comparative analysis of laws and regulations of the Republic of Kazakhstan and the actual situation in the transportation sector as opposed to

IMF standards. This analysis is described below in accordance with the structure of the IMF Manual for Transparency of Revenues from Natural Resources.

2.1. Understandability of Structures and Relations

A) Participation of the Government in Equity Capital. National Companies

There are seven companies that transport hydrocarbons via trunk pipelines in Kazakhstan. They include KazTransGas JSC and KazTransOil, which are owned by KazMunayGas National Oil and Gas Company (KazMunayGas or KMG), which is part of Samruk Kazyna Holding Company. Additionally, Kazakhstan has shares in equity capital of the following companies:

1. Caspian Pipeline Consortium (CPC) — 19%;
2. MunaiTas North-West Pipeline Company JSC — 51%;
3. Kazakhstan-China Pipeline LLP — 50%.
4. Asia Pipeline LLP, an engineering company for construction of Kazakhstan-China Gas Pipeline — 50%.
5. Batumi Terminal JV — 50%.

Thus, what we have is some very generic information on participation of the government in equity capital of the companies. However, there is no specific information on payments made by the companies to the budget, on payment of dividends, on presence or lack of any mutual benefits or trade-offs, on possible borrowings, etc.

Significant factor in activities of transportation companies where the government holds a stake is their inclusion in vertically integrated companies. Based on how KazMunayGas¹ distributes dividends from its participation in extracting and transportation projects (Table 5), it is clear that such distribution process does not contribute to information being more open to public:

Table 5 Information on Amounts of Dividends within KazMunayGas

KazMunayGas (KMG)	2005	2006	2007
<u>Dividends earned (USD million), including:</u>	24,07	178,7	592, 52
from Exploration and Production (69 % KMG)	?	139,83	291,35
from KazTransGas (100% KMG)	1,5	1,65	?
from KazTransOil (100% KMG)	6,45	8,29	?
from KazMorTransFlot (100% KMG)	-	-	-
from KazMunayTeniz (100% KMG)	-	-	-
from Tengizchevroil (TCO) (20% KMG)	?	?	400 (estimation)
from PetroKazakhstan (33% KMG)	?	?	?
from KazMunayTeniz (100% KMG)	?	?	?
from Zhambay (50% KMG)	?	?	?
from Kazakhoil Aktobe (50% KMG)	?	?	?
from Kazakhturkmunai (51% KMG)	?	?	?
<u>Dividends Paid (100% of Samruk JSC in those years)</u>	30,50	51,55	203,38
<u>Difference:</u>	+ 6,43	- 127,15	- 440,62

Based on the above information, one can see that during two years KazMunayGas received dividends by \$561,34 million more on behalf of the Republic of Kazakhstan than it gave to the then Samruk Holding. There is absolutely no information available on dividends that

¹ <http://www.kmg.kz>

Samruk paid to the governments, even though the then Samruk Holding and the present Samruk Kazyna Holding holds over 300 Kazakhstan's largest national companies, including all transportation companies. It is quite possible that information, which is not publicly available, on amounts of dividends, which are received by Samruk from all those companies and which are not transferred to the national budget may exceed this difference by multiple times.

One should bear in mind that these estimations were made without taking into account the dividends from other lower integration levels. For instance, KazMunayGas has share in equity capital of nine oil and gas producing companies, in six trading and servicing companies, and in four transportation companies; and one of the latter, namely KazTransGas, holds stake in equity capital of nine companies. There is a list published on the site of the Agency of the Republic of Kazakhstan for Financial Control¹ that includes 337 physical persons affiliated with KazMunayGas; it is not clear from the list what relations those persons have with the company; and a list of legal entity affiliates of KazMunayGas and information on cash flows among the companies are not publicly available.

With regard to Kazakhstan Temir Zholy, according to information of the Agency of the Republic of Kazakhstan for Financial Control, the company includes the following affiliated persons: 320 physical persons, including high rank officials, and 101 legal entities. However, there is no information on issued shares, on how many of them were purchased, etc.

We did not plan to study the situation in Kazakhstan's stock exchange market within this study; however, in the course of this study it was found that this key mechanism of market relations has poor institutionalization and cannot be accessible by a large number of investors. Public companies that operate in Kazakhstan do not meet minimum mandatory international criteria which they are supposed to meet; particularly, there are no easy procedures for participation of citizens of Kazakhstan.

As a result, it is impossible to evaluate, even in generic terms, how effectively this multi-level holding company operates, and thus, there is obvious lack of information on participation of the government in equity capital of transportation companies.

B) Quasi-fiscal Activities (QFA)

Other significant factors of non-transparency of activities of transportation companies are excessive non-commercial burden on those companies, both national and private, and their expenditures for environmental protection.

Mechanisms by virtue of which international or national transportation companies make their social or environmental expenditures or provide subsidies to manufacturers or consumers without explicitly agreed support from the budget are not defined and are not reflected in the budget documents; however, such expenditures are the obligation of the companies and part of such expenditures is deducted from the taxable base, i.e., essentially, part of such costs is incurred by the government. However, the level of such expenditures is not reflected in fiscal documents together with other expenditures incurred by the government, thus distorting the understanding of the real situation in the budget.

Monitoring surveys uncapped multiple clamant facts of irrational and criminal application of innumerable funds, which, essentially, belong to the public of Kazakhstan. These examples make the issue of QFA transparency especially significant because lack of transparency is not an abstract notion for millions of citizens of Kazakhstan; it poses direct threat to their well-being and, sometimes, to their health and life. However, all QFAs of transportation companies in Kazakhstan at the legislative level has not been defined, are not fully controlled by agencies of representative authority and the public, and are outside budget process through its entire length – from selection of objects for investment, through compilation of cost estimates and selection of contractors to control and acceptance of works performed.

¹ <http://www.afn.kz>

2.2. Accessibility of Information for the Public

Reports on payments to the budget, on dividends and on QFAs of the companies to the public are of key importance for ensuring transparency in the fiscal sector; with the public in mind, this reports should be as specific as possible and adapted for understanding by the public. In reality, according to the findings of the study, the majority of transportation companies do not take efforts to ensure easy access for the public, NGOs and mass media to their information (Table 6). Budget documents provide absolutely no explanation of relations of the companies and the Government. Because of this, the public are not able to assess dependence of the budget on tax revenues and transportation revenues, on environmental payments and revenues in-kind which received through QFAs.

Table 6 Results of the study of official reports, web-sites of pipeline companies, and publications in mass media and Internet in 2006

	KazTransGas	KazTransOil	Caspian Pipeline Consortium	Karachaganak Petroleum Operating BV	MunayTas North West Pipeline Company	Kazakhstan-China Pipeline	Turgai-Petroleum
Crude oil transportation volumes (<i>million tons</i>)	-	43.266	31.121	Not available	5.296	10	Not available
Gas transportation volumes (<i>billion cubic meters</i>)	121.38	-	122.0	14	-	-	-
Payments to the budget, information from companies (<i>million USD</i>)	135.18	67.28	Not available	Not available	14.94	Not available	Not available
Revenues received in the budget, information from the Ministry of Finance of the R.K. (<i>million USD</i>)	30.12	73.36	7.75	Not available	Not available	Not available	Not available
QFAs volumes (<i>million USD</i>)	Not available	Not available	Not available	10.42	Not available	Not available	5.36

Incomplete, controversial information induces public distrust towards the companies and the Government, inactivity of companies' personnel, inefficiency of the budget process, and abuse of funds instead of their use for specific purposes.

2.3. Openness of Budget Report

A) Budget Risks

It is likely that significant change of price for resources will affect not only revenues from their sale, not only the change of such key variables as foreign currency exchange rates and interest rates, but also revenues from their transportation. In similar manner, any other change of intentions of other governments to this extent may create significant threats for transit countries.

It is necessary to take into account the above and any other risks when predicting short-term and mid-term government revenues. Nonetheless, budget documents do not show any assumptions with regard to any ups and downs in revenues from transportation of natural riches, tariff rates and expected margins of such ups and downs. Budget legislation does not contain any processes for automatic regulation in case of unpredicted growth or loss of such revenues.

B) Accounting, Internal Monitoring and Audit of Revenues

The current accounting methodology is not adapted to complex shareholding structures, to market instability, to significant growth of list of consumers of reporting information.

Internal monitoring and audit of activities, which are financed from revenues generated from natural riches, should be regulated by rules and processes, which are established for state administration agencies. All tax and budget regulations should be applied in the industry as a whole; and, first of all, this IMF requirement relates to transportation of natural riches.

Lack of consideration of risks resulting from ups and downs of revenues from transportation of natural riches in Kazakhstan's budget documents, poor accounting and poor procedures of internal audit make it difficult to reliably predict revenues and prospects of development of the companies and the economy in general.

2.4. Reliability of Reports

Control over transportation companies, over cash flows between transportation companies and extractive companies, over revenues received from all those companies in the budget is not possible without proper quality of reports and audit. Because of this, companies in the industry and audit companies must strictly comply with international accounting and financial reporting standards, international auditing standards and international standards of publication of invoices.

Additionally, many companies in Kazakhstan have not adopted international accounting and reporting standards, and quality of Kazakhstan's audit raises serious concerns with such international financial institutions as the International Monetary Fund and the World Bank.

Another method to increase reliability of reports is a tripartite mechanism of independent verification of company and government reports, which is used by the EITI; this mechanism, however, currently does not cover the transportation sector.

Lack of formal and informal systems for verification of reliability of reports of transportation companies and the government in Kazakhstan decreases the degree of trust with investors and politicians of other countries and, to a great extent, the degree of public trust towards the companies and the government.

3 Particular Significant of the Transportation Sector for Kazakhstan in General

According to general requirements of the tax legislation, transportation companies must pay generally established taxes, excise taxes, royalties, fees, and charges. However, those company payments as well as their expenditures for maintenance of objects of culture, for education and health care, for various charity and public events are not regulated by the legislation — they are regulated by contracts and local agreements (Memoranda), which are absolutely inaccessible for the public and the Parliament. Unlike some other countries, Kazakhstan established fixed rates for payments made by transportation companies directly to the budget, i.e., to

accounts of the treasury office, while the recipient of all other payments and the process of accounting of such payments are set forth by the contract terms.

Additionally, transportation companies are very important for the whole country because they occupy large territories and cover a great number of villages and towns. In Kazakhstan the lands, which are recalled from the transportation infrastructure, including easements along rights-of-way, are larger as far as their area is concerned as opposed to such lands in middle-size European countries. Departments for construction, repair and maintenance of the transportation infrastructure are located in all cities and towns, and the number of employees, including their family members, amount to 5 % of the total number of population in Kazakhstan. Cost of transportation services also greatly affects utility rates. However, in Kazakhstan there is no public monitoring over relations of the government and the companies and no mechanisms of interaction required for that. There is no complete and reliable information on transportation of natural riches. Information on strategic guidelines and principles of activities of the companies is declarative and does not consider needs of such stakeholders as investors, institutions of civil society and general public.

In general, all this induces volatile stratification of society in terms of level and quality of life and corruption at all levels of the government.

The above said problems are common for all types of companies that operate in Kazakhstan regardless of the industry. However, the transportation sector has certain specific qualities, which make these companies play a special role for the entire economy.

Transportation is a key element in the following systems of relations where all elements are integral and interrelated (Pictures 3-5).

However, if, in addition to the transportation element, all other elements of the three groups of relations are more or less under the influence of the free market, activities of transportation companies are more exposed to the influence of the government because transportation companies are included in the category of monopolists and because of ownership of key shares in their shareholding structures.

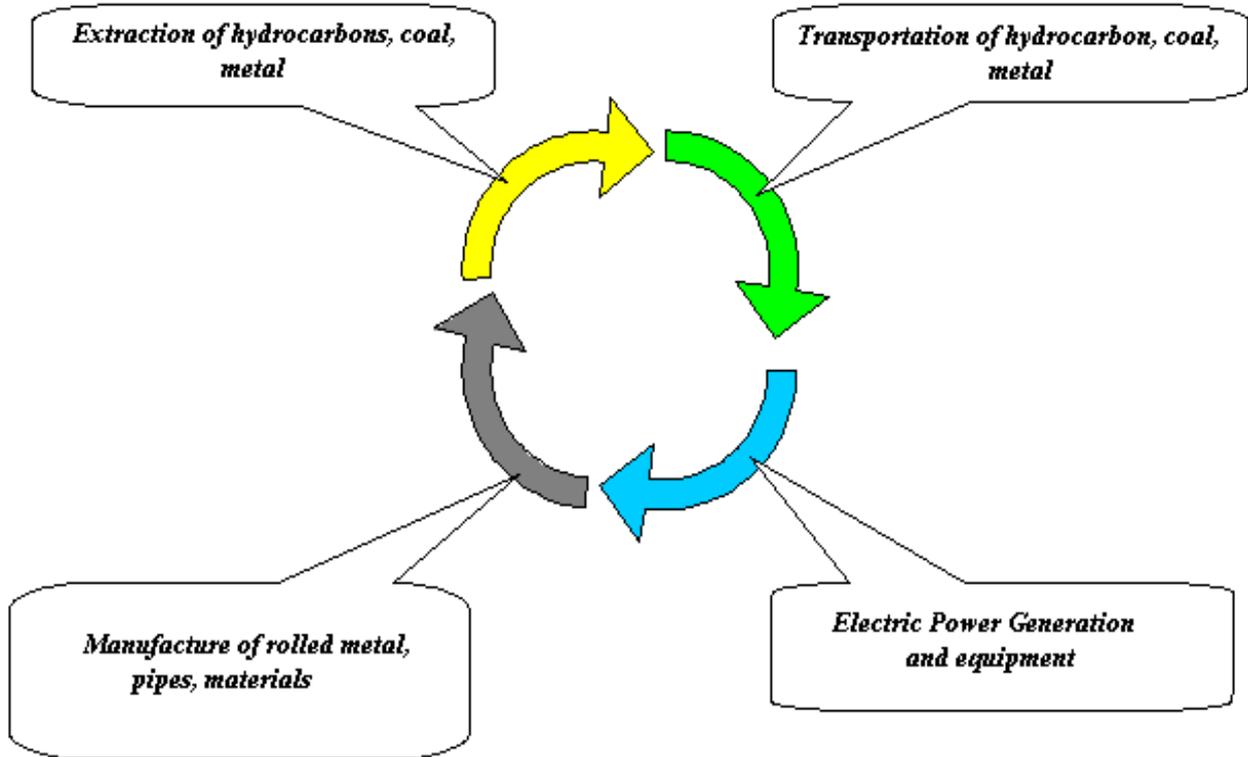
Therefore, the transportation sector is the only government leverage on all other elements of these systems of relations (Picture 6).

Battle for transportation advantages was not the last reason — and many analysts and experts believe it was the first reason — for the armed conflict between Georgia and Russia. This tragedy clearly demonstrated to the world the real threat of lack of control over the transportation sector. And for Kazakhstan, it also made it clear that one should take assurances of the government about stability of our well-being with reserve because the conflict between the two near and dear nations calls many declarations made by politicians into questions.

It is only possible to fully remove biased attitude in making decisions that can lead to unpredictable serious consequences and to increase the degree of trust, both on the part of the public and on the part of investors (and on the global level), towards the Government of Kazakhstan and the companies that operate in Kazakhstan if transparency and accountability principles would immediately apply to all elements of performance of both the extractive companies and the mineral resource transportation companies that are financed from the revenues of the extractive companies.

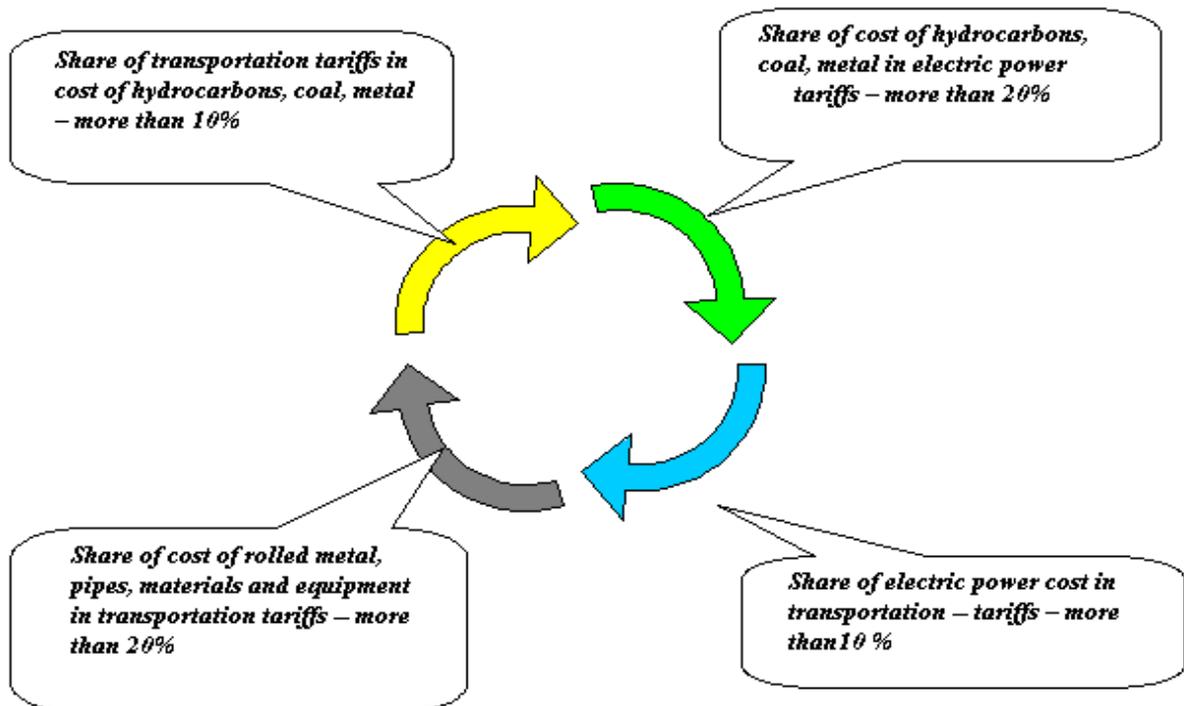
Picture 3

Process Description

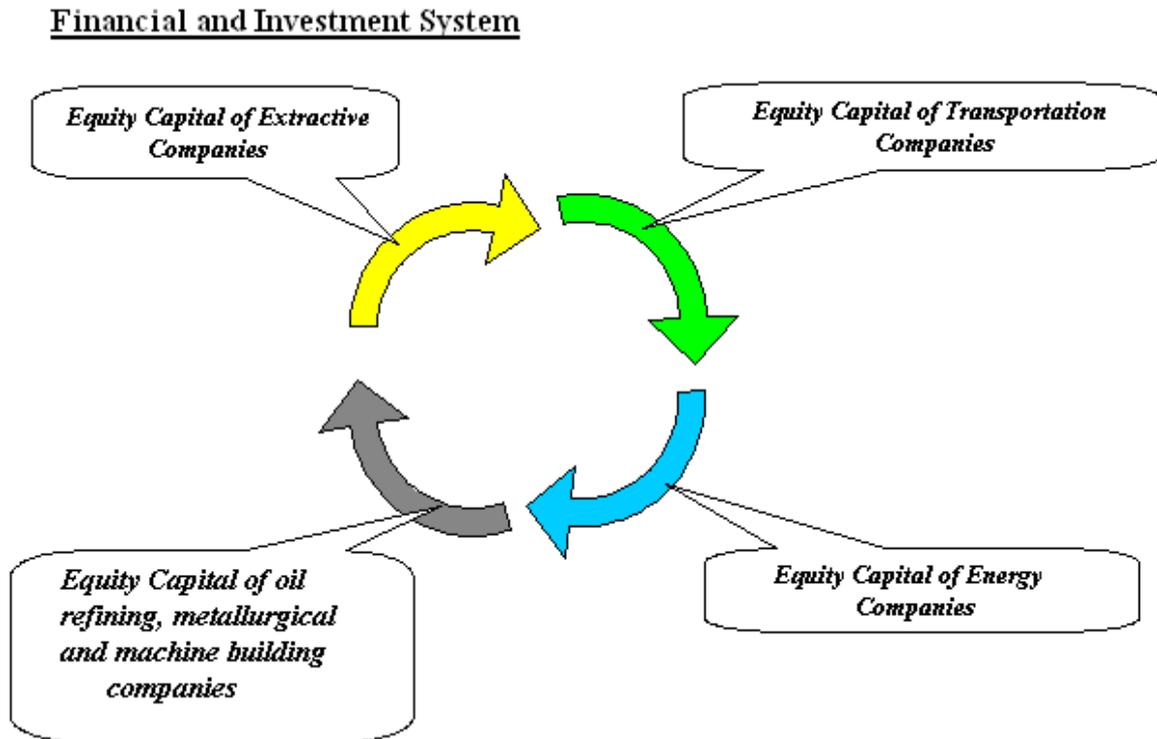


Picture 4

Tariff and Cost System

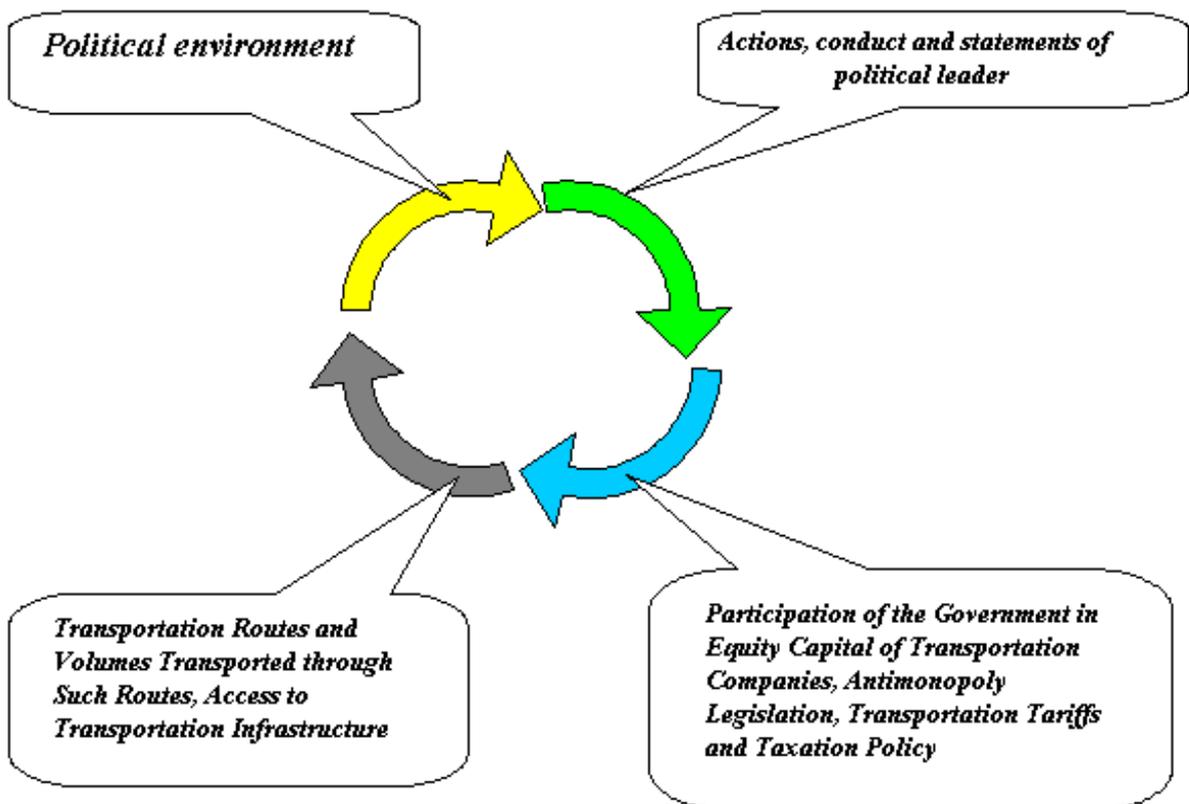


Picture 5



Piture 6.

Political System



III. Conclusion

This study of activities of the companies that transport natural riches on the territory of Kazakhstan, which was conducted in correlation to international transparency principles and criteria, allows making the following conclusion:

1. At the current stage, Kazakhstan has been irreversibly integrated in the global economic and political processes.
2. There are clear tendencies for this integration to grow, but mainly as a supplier of natural riches and/or products of their primary processing, because of the rapidly growing global demand for natural riches and because of Kazakhstan having large mineral deposits, inexpensive workforce and imbalance in raw materials in the economy.
3. Control over revenues of the government from the extractive industry is not possible without taking into account all elements of performance of transportation companies because:
 - ✓ all revenues of transportation companies are generated out of the funds of extractive companies, thus reducing their payments to the budget;
 - ✓ shareholding structures and activities of transportation and extractive companies are interrelated;
 - ✓ being the monopolists in Kazakhstan, transportation companies can impose their own terms to extractive companies and the government, in its turn (by means of anti-monopoly law, which is applicable to transportation companies), can use them as a leverage to influence the entire extractive industry.
4. In this regard, the sector of transportation of large volumes of natural riches and/or products of their primary processing is the key sector for Kazakhstan.
5. Likewise the extractive industry and Kazakhstan's economy as a whole, the transportation sector is characterized by poor access to information. This is detrimental not only for the economic development, but also, in the great scheme of things, to the development of independent Kazakhstan as a whole.
6. Kazakhstan's legislation, which regulates the transportation sector relations within this sector, and actual activities do not meet international transparency standards.
 - ✓ Information on participation of the government in equity capital of transportation companies and on activities of national companies is insufficient and unreliable.
 - ✓ Quasi-fiscal activities of transportation companies is outside budget processes and is not controlled by agencies of representative authority and the public, such information is not open public.
 - ✓ Budget documents do not consider risks resulting from potential ups and downs of revenues from transportation of natural riches, and poor internal audit impedes reliable prediction of such revenues.
 - ✓ Fewer than all companies have adopted international reporting standards, and quality of audit in Kazakhstan raises serious concerns with international financial institutions.
7. Kazakhstan's stock exchange market is underdeveloped, is characterized by poor institutionalization and cannot be accessible by a large number of investors. Public companies that operate in Kazakhstan do not meet minimum mandatory international criteria which they are supposed to meet.
8. Kazakhstan's transportation sector is not covered by the laws of Europe and the global community; that is why, Kazakhstan's compliance with international rules in this area and, thus, integration of Kazakhstan in the European and global community (as far as legislation is concerned) would be possible, to a greater extent, by means of inclusion of transportation companies in the EITI.

IV. Recommendations

The author of this report believes that it is possible and crucial for Kazakhstan to immediately resolve the issue of expanding the EITI agenda so that to include mineral resource transportation companies, including pipeline, marine and railway companies.

In addition, it is necessary to:

1. Intensify the adoption by transportation companies of international accounting and reporting standards and principles of corporate citizenship and sustainable development.
2. Arrange for a detailed study of the entire system of relations in the transportation sector, including legal, economic, and fiscal relations.
3. Based on results of the study, develop a comprehensive plan to bring this system in compliance with international transparency standards, which would include:
 - ✓ drafting of amendments to the laws of the Republic of Kazakhstan;
 - ✓ implementation of large scale R&D, educational and information programs, arrangement of system-based monitoring of all types of influence produced by transportation companies;
 - ✓ creation of mechanisms for regional leverage of the stakeholders with involvement of the civil society in order to create the environment for putting public control in place to control revenues received from transportation companies in the budget and for regional needs and to control use of such revenues at all levels of the government.

V. Reference Information

1 *Position of Kazakhstan in the Global Mineral Resource Sector*

Kazakhstan's mineral resource sector occupies a significant place in the global mineral resource balance, plays an important (in some industries, strategic) role in Eurasia region, and possesses high potential for further development and influence on the global mineral resource market. At present, there are 493 known deposits that contain 1225 types of natural riches.

As of 01.01.2003¹;, Kazakhstan's share in the global proven reserves of minerals is as follows:

Fuel and Energy Resources:

- Uranium – 18.9 % (2nd place in the world)
- Coal – 3.1 % of the world reserves (6th place in the world)
- Oil – 3.2 % (7th place in the world)
- Gas – 1.5 %

Solid Minerals:

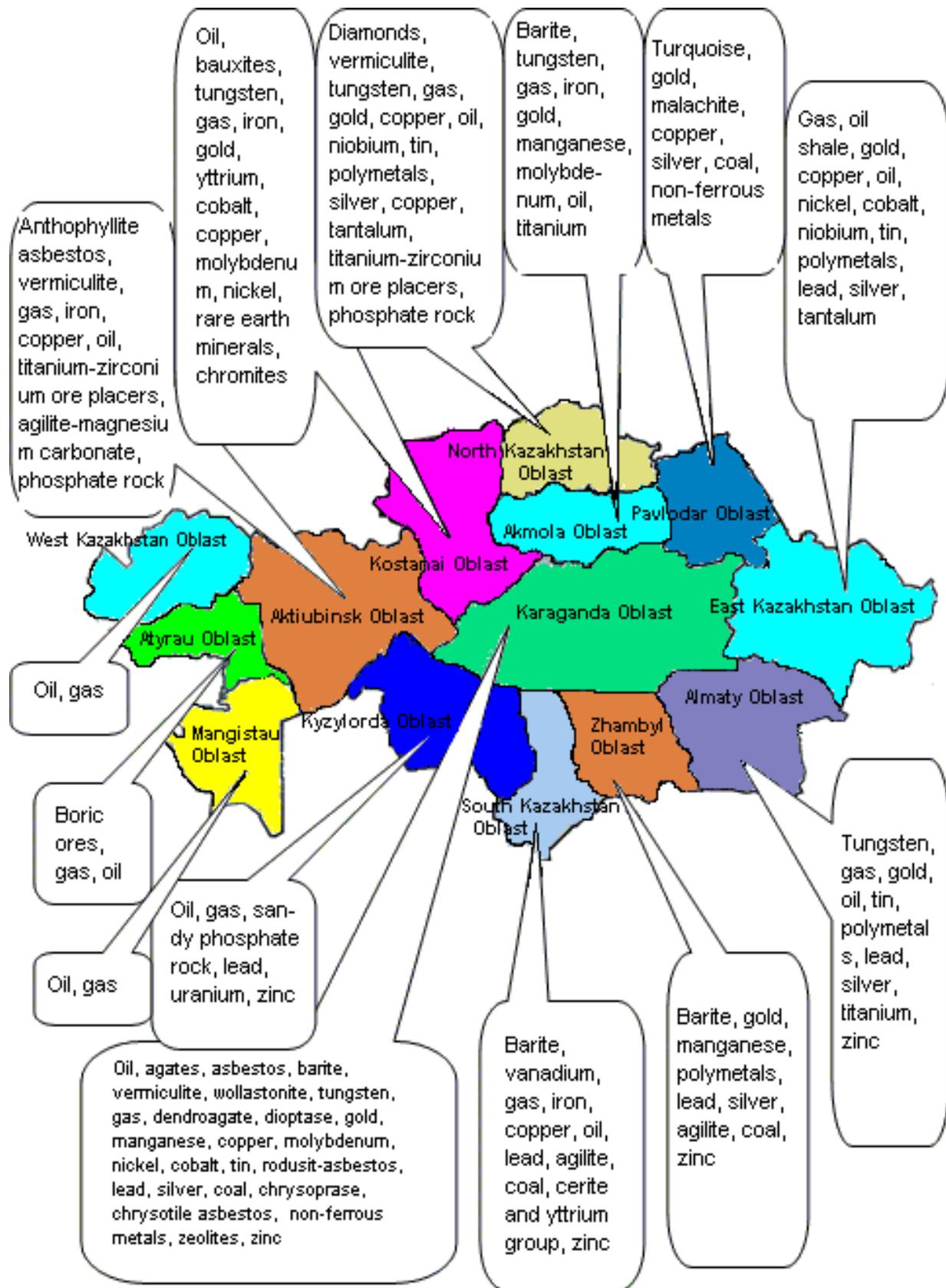
- Zinc – 15.2 % (1st place in the world)
- Barite – 47.2 % (1st place in the world)
- Tungsten – (1-2nd place in the world)
- Lead – 22 % (1-2nd place in the world)
- Chromium ore – 37.6 % (1-2nd place in the world)
- Manganese – 30 % (2nd place in the world)
- Silver – 16 % (2nd place in the world)
- Copper – 7.1 % (3rd place in the world)
- Cobalt – 3.9 % (5th place in the world)
- Iron – 6 % (5th place in the world)
- Phosphate rock – 4.5 % (6th place in the world)
- Gold – 2.7 % (6-8th place in the world)
- Bauxites – 1.4 % (10th place in the world)
- Nickel – 1.4 % (12th place in the world)

Extraction and/or Manufacture of Mineral Resource Products:

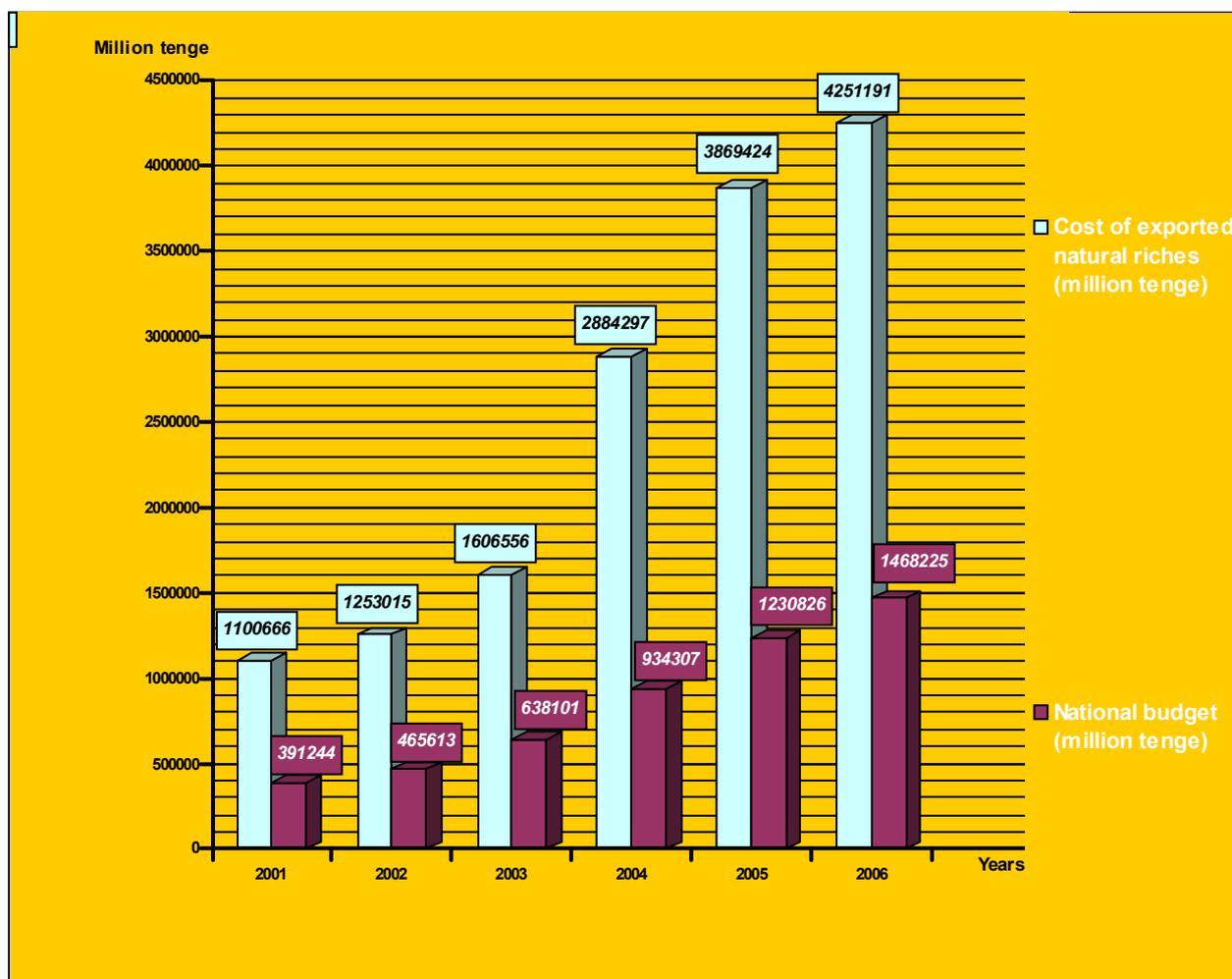
- Chromites – 2nd place
- Titanium – 2-3rd place
- Zinc – 6th place
- Manganese -8th place
- Lead – 6th place
- Silver – 9th place
- Uranium –5th place
- Copper – 10th place
- Oil, gas, coal, and iron – among 20 leading countries in the world

¹ <http://www.mining.kz/future.shtml?f=show&type=12&id=122237681089>

2 Location of Mineral Deposits in Kazakhstan by Regions



3 *Cost of Exported Natural riches in 2001-2006 according to the data of the Customs Committee of the Ministry of Finance of the Republic of Kazakhstan*



Comments to the Chart: In the data of the Customs Committee of the Ministry of Finance of the Republic of Kazakhstan, there is a clear incommensurability of methods of grouping of commodities by types. For instance, there is a group that unites eatable fruits and nuts, skin and peels of citrus fruit crops; at the same time, there is a group which includes data for mineral fuel, oil and products of their refining; bituminous matters; wax. Methodology of such grouping is not publicly available; however, it is likely that this group also includes natural gas and coal.

Thus, as far as this element of the integrated system of relations in the area of subsoil use is concerned, information is not transparent.