Government Hopes to Anchor Foreign Exchange Rate by 2001

But Many Say Target To Phase Out Forint Devaluation Is Unreachable

by Monika Csanyi

Finance Minister Zsigmond Jarai announced on October 28 that the crawling peg devaluation of the Hungarian currency could be phased out as early as 2001. But this target was greeted with some skepticism by both foreign and domestic analysts.

"The deadline seems far too close," said Gyorgy Durucz, a fund manager at Erste Bank Investment Hungary Rt.

By the end of this year Erste Bank expects inflation to be 11 percent or higher, Durucz said, and even if it could come down by 2 percent to 3 percent next year, the inflation rate would still be 8 percent to 9 percent and not 6 percent to 7 percent, as the government projects.

Jarai has earlier said that the government was aiming to cut the rate of the crawling peg once or twice next year, as it did in 1999. As part of its three-year forecast for the Hungarian economy, the government also plans to push inflation below 4 percent to 5 percent by 2001-2002. If successful, the government then would fix the forint's exchange rate to the euro. If the inflation rate in the two currencies was closer to each other, the euro could be introduced in Hungary two or three years after the country joins the European Union, according to the government proposal.

"I think 2002 is reasonable, but 2001 could be difficult," said Charles Robertson, emerging Europe economist at ING Barings in London.

According to analysts' expectations, inflation could be above government projections in 2000, which will make it impossible to reach the desired target to abolish crawling peg the year after.

Both analysts agreed that Jarai is trying to increase faith in the stability of the local currency.

"It sends the message [to foreign investors] that the government will do its best in order to achieve this," Robertson said. "Overall, it is positive. However, it won't have any dramatic short-term impact."

Hungary last lowered the rate at which it devalues the forint by 0.1 percentage point to 0.4 percent on October 1. ❑

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PRIVATIZATION

Legal Aspects of Privatization in Kazakhstan

by Yury G. Basin and Olga I. Chentsova

(Editor's Note: Yury G. Basin is a Partner and Senior Consultant with Aequitas Law firm in Almaty, and Olga I. Chentsova is the Managing Partner of the firm. Professor Basin is also the former chairman of the Civil Law Department at Kazakhstan State University. Both authors have served on several Kazakhstan government-appointed drafting committees. Aequitas has correspondent relations with Debevoise & Plimpton.)

General Description

Privatization in Kazakhstan was carried out in two major stages: the period between 1991 and 1998; and under the Program for Privatization and Increase of the Effectiveness of State Property Management for 1999-2000 (approved by Resolution No. 683 of the Government of the Republic of Kazakhstan, dated June 1, 1999—the "Privatization Program for 1999-2000").

The first stage focused on small-scale privatization, a large-scale (mass) privatization, and privatization by individual projects and sector programs. Under this stage, most state-owned productive assets have been privatized.

The Privatization Program for 1999-2000 provides specific regulation for the privatization of: (1) state shareholdings in "blue chip" companies; (2) large works; (3) state shareholdings in the "second tier/echelon" state-owned shares in business partnerships that were earlier transferred into trust management; and (5) community facilities.

The privatization so far has been accompanied by many normative acts, which ranged from Laws of the RK, Decrees and Edicts of the President of the RK, Resolu-

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tions of the Government of the RK to departmental regulative acts. Special enabling acts have addressed the specifics of the privatization of individual state assets.

The Program of Privatization for 1999-2000 is expected to generate many new regulations.

First Stage of Privatization

The first normative acts to regulate privatization were the Resolution of the Supreme Council of the Kazakh SSR "On Major Trends of Denationalization and Privatization of State Property in the Kazakh SSR," dated February 16, 1991, and the Law On Denationalization and Privatization, dated June 22, 1991, which was effective until December 23, 1995.

The vague legal definition of "denationalization" given in the Law of June 22, 1991, was often interpreted to include purely organizational changes in the state management of the economy. This permitted the state to continue to operate monopolies in the productive sector.

Decree No. 549 of the President of the Republic of Kazakhstan, dated September 13, 1991, approved the Program for Denationalization and Privatization of Property in Kazakh SSR for 1991-1992 (the first stage), which ordered compulsory privatization of certain enterprises. (Decree No. 549 also held out the possibility of privatization of enterprises upon the initiative of labor collectives with many considerable privileges to be granted to the latter.) The decree also exempted some state-owned enterprises from this stage of privatization.

Under the new program, the government will renegotiate with past buyers where necessary.

The following forms of privatization were established: auction, tender or sale of shares (corporatization). A labor collective was entitled to choose the form of privatization and had substantial advantages over other buyers. The Privatization Program of the first stage provided specific regulation for the privatization of state property in various sectors of the national economy, including on the basis of "small-scale" and "large-scale" privatization. The Program restricted privatization of state-owned dwellings to a coupon mechanism. It envisaged allotment of privatization coupons to all citizens who have contributed their work into the development of the economy.

Participation of foreign citizens and foreign legal entities in the privatization was restricted. For example, the Law of Kaz SSR On Denationalization and Privatization, dated June 22, 1991, established that buyers of state property must be located in Kazakhstan. Under the legislation then in effect, foreign companies could participate in privatization purchases through joint ventures and partnerships with local companies.

Second Stage of Privatization

The second stage of the privatization was launched with the adoption of Decree No. 1135 of the President of the Republic of Kazakhstan On National Program for Denationalization and Privatization in the Republic of Kazakhstan for 1993-1995 (Second Stage), dated March 5, 1993.

Based on the classification of the enterprises to be privatized into three groups—small, medium and large enterprises—this Program established that:

- large and unique property complexes must be privatized on a project-by-project basis (examples of such enterprises were: Aktyubinskneft JSC, Yuzhneftegas JSC, Shymkentnefteorgsintez JSC, Sokolovsko-Sarbaiskij Ore Mining and Concentrating Production Complex);
- medium enterprises (for example, Ural Confectionery Plant, Shymkent Macaroni Plant, Zhambyl Textile and Fancy Goods Plant, Karaganda, etc.) must be privatized through a "mass privatization;" and
- small trade, utility, catering and service enterprises must be privatized through a "small privatization" process.

Much attention was paid to "corporatization" of state sector enterprises. These enterprises were reorganized into 100-percent-state-owned joint stock companies, shares of which were subsequently transferred to legal entities and persons (including members of the labor collective) on a paid or free basis.

The second stage permitted formation of holding companies that were established as closed joint stock companies.

The second stage program provided for the privatization of very large enterprises on a project-by-project basis through the following devices:

- negotiated sale to specific investors;
- sale through auctions or tenders;[1]
- open sale of shares (that is, the sale to legal entities and persons on the securities market);
- execution of a management agreement (this method of privatization was generally excluded from the Program on May 12, 1995).

The Privatization Program of the second stage contained a special section regulating participation of foreign legal entities and persons in the privatization.

A large package of normative acts regulating various aspects of the second stage was adopted. Many enabling acts were also adopted on a project-by-project basis. The first of these was Resolution No. 951 of the Cabinet of Ministers of the RK, "On Privatization of Almaty Tobacco Plant on a Project-by-Project Basis" (December 27, 1993). Later, Special Resolution No. 1565

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of the Government of the RK On Privatization of Enterprises of Oil and Gas Industry, November 17, 1995, Resolution No. 1815 of the Government of the RK On Procedure for Privatization of the Open Type Joint Stock Company Sokolovsko-Sarbaiskij Ore Mining and Concentrating Production Complex, dated December 19, 1995, and other resolutions were enacted.

1995 Decree on Privatization—an Important Stage in the Development of the Legal Framework for Privatization in the Republic of Kazakhstan

On December 23, 1995, the President of the Republic of Kazakhstan signed the Decree On Privatization that had the force of Law. The Decree was further amended by the Laws of August 2 and August 4, 1999 (the "Privatization Decree").

The Privatization Decree prohibited transfer of a privatized object into ownership of the labor collective and some other methods that had previously been permitted. Privatization was defined only as a sale of state property into ownership of physical persons, non-state legal entities and foreign legal entities.

The Program calls for preparation of laws and regulations to set out the rules for possession, use and disposal of state property, and another law to improve procedures for work-outs, bankruptcy and restructuring of insolvent entities.

Under the Decree the objects to be privatized included both state property and state-owned shares in the charter funds of business partnerships, such as shares of joint stock companies.

The Decree established the main principles of privatizations as transparency, competition and continuity. Direct sale to particular persons or entities was permitted only when attempts to sell the property through auctions had failed. Privatization on a project-by-project basis was specifically allowed, but had to be carried out on a competitive basis.

The Privatization Decree regulated the preliminary stages of the privatization, which included corporatization of state enterprises, their lease or trust management with appointment of lessees or trustee managers on a competitive basis, and sale of shares through a tender.

Hundreds of state enterprises were privatized under the Privatization Decree. However, many disputes arose over violations of the privatization procedures and breaches of the terms of agreement.

Most violations were due to non-compliance with tender requirements. For example, the Administration of the Karaganda Region, taking advantage of the imprecise language of the Privatization Decree, approved its own regulations, under which several hundred enterprises were sold to buyers selected by the Administration of the Region. Many were sold at very low prices.

Responsibility for these violations lay both with authorized governmental agencies (e.g., inaccurate evaluation of liabilities of the entities sold), and with buyers (e.g., breach of investment terms, non-payment of the entities' debts, failure to achieve promised production figures).

Foreign investors sometimes sought court orders to resolve disputes with government agencies. This was particularly true for investments in large, state-owned enterprises. For example, the Supreme Court of the Republic of Kazakhstan approved a claim of a Swiss company to ownership of railroad lines that were a part of a privatized mining integrated plant.

In order to provide a greater degree of certainty to the process, the Privatization Decree limits claims over sale-purchase agreements to six months from the date of signing of an agreement (provided that the claim is filed by a party to the agreement), when the claimant seeks to invalidate the agreement. If the claim is filed by another interested party or by a public prosecutor, the six-month limit would begin on the date on which the claimant has learned (or should have learned) of circumstances that give rise to the claim for invalidation, up to a maximum time of 3 years.

However, a three-year limitation on actions is to be applied to disputes over violations as opposed to actions seeking to invalidate the sale-purchase agreement of privatized property.

In order to prevent possible restrictions on foreign investor participation in the privatization process, the Foreign Investment Law of December 27, 1994, was amended on July 16, 1997.

Development of Privatization Legislative Framework in the Privatization Program for 1999-2000

According to the Privatization Program for 1999-2000, the legislative framework urgently needs to be improved at the new stage of the development of the reforms.

The Program stresses the need for legislative regulation of investment relations arising from privatization and concession contracts for transfer of state property into trust management.

In order to improve privatization legislation, the Plan of Action to Implement the Privatization Program for 1999 requires many new laws and regulations to

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carry out the policies. The Program calls for preparation of laws and regulations to set out the rules for possession, use and disposal of state property, and another law to improve procedures for work-outs, bankruptcy and restructuring of insolvent entities.

Other regulations called for by the Plan of Action include an act to regulate the procedure for registration of the recovered property of legal entities, or property pending for recovery in favor of the state; Rules for Appointment of Officers of Joint Stock Companies; Rules for Decision-Making On Behalf of the State as a Shareholder; Rules Governing Activities of "National Companies;" Rules for Holding of Competition for Selection of Top Managers of "National Companies;" and Rules for Auction Sale of State Shareholdings.

Under the program, a government agency (yet to be named) will closely monitor the performance of purchasers of privatized assets after the sale, to ensure that contractual obligations are carried out. (The Plan of Action notes that many purchasers of privatized assets are in arrears in payments to the state budget.) Also under the program, the government will renegotiate with past buyers where necessary.

The government will complete the inventory of creditors' demands and determine legal liability and methods of payment for obligations that arose prior to privatization.

Because, in many instances, privatization sales were not conducted in full compliance with the legislation, buyers often did not properly assume the obligations of former state-owned enterprises.

Creditors have demanded payment against the government. During the term of the Program, the government will complete the inventory of creditors' demands and determine legal liability and methods of payment for obligations that arose prior to privatization.

Draft Law of the Republic of Kazakhstan on State Property

As called for under the Privatization Program for 1999-2000, a new law "On State Property" has been drafted. While still subject to changes, the draft provides for:

- more precise definition of the types of state-owned assets that may be privatized;
- cancellation of the special regime of the preliminary privatization stage, which under the existing law may be applied to lease or transfer into trust management of the state enterprises to be privatized;
- cancellation of the special privatization regime for individual projects;
- more comprehensive legal regulation of the specifics of state shareholdings on the organized and non-organized securities market, including securities markets abroad.

The Draft Law more precisely sets out the concepts of legal succession through privatization and transfer of land rights to buyers of property to be privatized.

It is expected that the existing Privatization Decree will become null and void after the adoption of the Law On State Property. However, for the objects privatized before adoption of the Decree, the legislation that governed their privatization will still control.

Foreign Investor Seeks U.S. Court Protection to Block Kazakhstan from Terminating Agreement

On August 1, 1997, Kazakhstan unilaterally terminated an agreement for trust management of the Tselinny Mining and Chemical Integrated Plant with World Wide Minerals of Canada in violation of the procedure for termination. Under the terms and conditions of the agreement, the company must have been informed of the termination 90 days prior to the termination. World Wide Minerals was notified 4 days before the termination date. World Wide Minerals filed a claim against Kazakhstan with the Federal District Court, DC.

The issues of privatization of state shareholdings in six largest oil and mining companies with foreign participation are under discussion.

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[1] In the case of a tender sale, a buyer had to meet certain requirements (for example, preserving the type of enterprise or function of the facility, to keep the same number of jobs, to finance new facilities, and the like). Auctions were based solely on the highest price.

Commercial tenders were held through open bidding. At the tender, an object would be sold to the buyer who offered the highest price and complied with the tender terms and conditions.

Through an investment tender, state enterprises (or shares in enterprises reorganized into joint stock companies) were sold to the buyer who offered the best investment program meeting the criteria of the tender. ❑