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Regulation of Natural Monopolies in Kazakhstan

Abstract. The paper aims to describe and to evaluate a mechanism of regulation of natural monopolies and tariff regulation in the Republic of Kazakhstan.

Acknowledgement of the role of natural monopolies in the modern world has generated a large number of theoretical and applied researches. The nature of the regulation of natural monopolies and its role in competitive advantages formation are the subject under consideration in Totev (1995), Kudinov (2003), Butyrkin (2003), Gorodeckiy, Pavlenko (2000), Dzhaksybekova (1999), Sagiyeva R.K. studied natural monopolies and their regulation processes at national and regional levels. The existence of a natural monopoly is justified by the fact that they give a huge economic benefit from large economies of scale. A monopoly is a business or organization that maintains exclusivity of the supply of a particular product or service, and can evolve naturally or be designed specifically based on the nature of a particular market or industry (The Linux Information Project).

Key words: regulator, service, industry, tariff, law.

Introduction

Price Capping by Regulators RPI-X

For many newly privatized industries, such as water, electricity and gas, the government created regulatory bodies such as:

- OFGEM – gas and electricity markets
- OFWAT – tapwater.
- ORR – Office of rail regulator.

Regulation of quality of service

Regulators can examine the quality of the service provided by the monopoly. For example, the rail regulator examines the safety record of rail firms to ensure that they do not cut corners.

In gas and electricity markets, regulators will make sure that old people are treated with concern, e.g. not allow a monopoly to cut off gas supplies in winter.

Merger Policy

The government has a policy to investigate mergers which could create monopoly power. If a new merger creates a firm with more than 25% of market share, it is automatically referred to the Competition Commission. The Competition commission can decide to allow or block the merger.

Methods

Amongst their functions, they are able to limit price increases. They can do this with a formula RPI-X

- X is the amount by which they have to cut prices by in real terms.
- If inflation is 3% and X= 1%
- Then firms can increase actual prices by 3-1 = 2%

If the regulator thinks a firm can make efficiency savings and is charging too much to consumers, it can set a high level of X. In the early years of telecom regulation, the level of X was quite high because efficiency savings enabled big price cuts.

Main body

The newly created Committee on Regulation of Natural Monopolies and Protection of Competition of the Ministry of National Economy of Kazakhstan («NMRA»), which is the legal successor of the reorganized Agency for Regulation of Natural Monopolies, regulates natural monopolies and maintain a register of persons engaged in this activity. NMRA functions as the authorized body means the inspection and regulation of natural monopolies (with the exception of telecommunications and postal services), it also has the right to develop and

approve regulations, which are mandatory for public authorities and natural monopolies.

State regulation of natural monopolies in accordance with the law is carried out by:

- 1) approval of the tariff (price, fee rate) or its limit level, including using the method of comparative analysis, differential and investment rates (prices, charge rates);
- 2) approval of the tariff estimate;
- 3) approval of the temporary reduction factor;
- 4) approval of a special order of formation costs;
- 5) approval of the order of separate accounting of revenues, costs and involved assets by each type of regulated services (goods, works) and as a whole on other activities;
- 6) harmonization of accounting policies;
- 7) approval of temporary compensatory tariffs.

The activity of natural monopolies in the Republic of Kazakhstan is limited by strict rules, for example, the subjects of natural monopolies must obtain the consent of the regulatory authorities to perform certain types of transactions. To reconcile these transactions, the subject of natural monopoly must submit an application to the NMRA and provide the last necessary information (the list of which is determined by AREM) of the proposed transaction. The regulatory body may reject the application if it determines that the transaction would adversely affect the interests of consumers or the development

of a competitive market, in which case the applicant may apply to the court.

Tariff regulation

Under the Act, the basic tariff formation principle provides that the tariffs or their limits for regulated services (goods, works) of natural monopolies, approved by the competent authorities shall not be less than the value of the expenditure required for the provision of regulated services (production of goods, works) and consider the possibility of making a profit, ensuring the effective functioning of a natural monopoly.

Tariffs in Kazakhstan are usually developed on the basis of cost plus method, according to which the standard mark-up is added to the cost of the product.

Under Kazakh law, the tariffs charged by natural monopoly, subject to regulation. Thus, the prices of services (goods, works) provided by natural monopoly.

There are three refineryplants in Kazakhstan (refinery) - Atyraurefining plant (ARP), Pavlodar Petrochemical Plant (PPCP) and PetroKazakhstanOilProducts (PKOP).

Raising tariffs is expedient in view of factors such as the growth of tariffs for oil transportation in Kazakhstan, modernization of production, the repayment of borrowings that a possible increase in the taxation of the industry, changes in the exchange rate in the country.

Table 1 – The proposed tariff for LLP «PKOP» from the strengthening of the US dollar to Kazakhstan tenge (1 USD = 400 KZT)

| | 2016 | 2017 | 2018 | 2019 | 2020 |
|--------------------------|-------|-------|-------|-------|-------|
| Refining | 4253 | 5000 | 6000 | 6000 | 6000 |
| Rate (approved) | 15000 | 15000 | 15000 | 15000 | 15000 |
| Total profit | 6000 | 10000 | 7200 | 7000 | 8000 |
| Rates (proposed) | 18000 | 20000 | 20000 | 20000 | 20000 |
| VAT at the end of period | 2000 | 7200 | 9100 | 1300 | 0 |

Where the volume of processing is expressed in thousands of tons;

Tariffs (approved and proposed) - in respect of KZT / ton;

Total profit and VAT at the end - in millions of tenge.

According to Table 1, it can be argued that the cash flows (VAT) at the end of the forecast period

will not have a negative value that is to be prevented by a temporary lack of funds needed to finance the next occurring costs of the budget that is the cash gap.

Conclusion

As is known, Kazakhstan's oil refining factories work on tolling, profiting by the tariff for oil refining. In turn, the rate of production depends on the main, i.e. in oil refining, as well as the investment component.

Investment component - this is the means provided in the tariff on the production, transportation and supply of oil as part of the profit remaining at

the disposal of the enterprise for the purpose financing costs associated with the restoration, reconstruction, modernization of fixed assets (including measures to improve the safety and environmental compliance) and the construction of new facilities.

Changing the investment component by raising the cost of upgrading equipment, improving the quality of the fuel directly affects the level of the tariff change. The current margin of refiners in Europe and the United States is about \$ 7-10 per barrel, which is about \$ 50-70 per ton, thus, together with the quality of petroleum products to the international standards and Kazakhstan will approach tariffs.

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