

## Chapter 4

# Privatisation and the role of the state in the economy of Kazakhstan

*Kazakhstan is in transition from an economy dominated by state-owned enterprises (SOEs) to a full market economy. Since independence from the Soviet Union in 1991 Kazakhstan has made efforts to reduce, through privatisation programmes, the share of the state in the economy. The current goal is 15% by 2020. Most important industries are organised into large groups of companies owned and managed by independent national managing holdings, with politically powerful people on their boards and in top management. Yet the government has published no ownership policy to manage and reduce the number of SOEs currently under dispersed governance by several ministries. This chapter presents the national managing holdings system of state ownership; their legal framework and governance structure; generic OECD recommendations regarding state ownership and measurement methodology; the privatisation programme under way; and recommendations to meet the set state ownership goal and to strengthen the policies of Kazakhstan in governing its state-owned entities.*

## Introduction

There is overwhelming support for the idea that privatisation brings about a significant increase in the profitability, real output and efficiency of privatised companies (OECD, 2003). The Kazakhstan government has set a target of reducing the state's share in the economy to 15% by the year 2020. In Kazakhstan, the government dominates the economy via a complex system of holding companies. Groups of companies with full or partial state ownership are managed by holding companies, which represent, through a high level of political involvement, the interests of the government in their management.

The organisation, administration and governance of state ownership in Kazakhstan do not meet internationally agreed good practices in many respects. The *OECD Guidelines on Corporate Governance of State-Owned Enterprises* (referred hereafter as the "OECD Guidelines") (OECD, 2015b) have been used as benchmarks for the reform of state ownership by a number of nations since their introduction in 2004. One reason behind their recent revision was to ensure their relevance to non-member countries, too, and to provide guidance to countries in different economic circumstances, particularly those in transition to a market economy.

This chapter presents the extent and structure of the state's involvement in the Kazakhstan economy, and how that can be adjusted better to realise the entities' economic potential. The first half of this chapter examines the state's dominance in the economy with an analysis of the main national managing holding companies, including legal frameworks, governance structures and alignment with good practices for state ownership. The second half presents the privatisation programme under way and makes recommendations for state ownership reform towards Kazakhstan's privatisation goal.

### ***Through their legacy Kazakhstan's state-owned enterprises still dominate its economy***

The economy of Kazakhstan is dominated by state-owned enterprises (SOEs) and large, private industrial and banking conglomerates. Kazakhstan's industries were established under Soviet rule and economic planning. The new constitution recognised the right to private ownership for the first time in 1991.

A process to privatise virtually all SOEs started soon after independence. Initially, 21 000 SOEs employed 87% of the nation's workforce. Small companies were privatised through cash sales; medium-sized companies through Russian-style voucher programmes; and large companies through direct trade sales. There was widespread criticism by business people and citizens of various perceived irregularities in these processes.

Attracting foreign capital to the under-invested and deeply indebted oil and gas industry was a central motive in the first privatisation effort. The government originally intended to allocate 10% of shares to each company's workforce, sell controlling stakes to foreign strategic investors, and, over time, sell the remainder in smaller stakes on the stock exchange

at increasing prices, while at the same time stimulating the stock exchange and the local capital market.

The privatisation programme met several difficulties. These difficulties resulted partly from lack of experience and skill on the part of the government officials in charge of implementation, as well as a continuation of corrupt, Soviet-era business practices. Foreign investors were interested in the oil and gas reserves but did not want to buy shares in companies with potential liabilities, including non-transparent debts, obligations to local communities and non-remediated environmental damage.

Privatisation in the 1990s gave influential business people an avenue to create industrial groupings under holding company structures, particularly in extractive industries and banking. Development of the small and medium-sized enterprises (SMEs) sector as a consequence of privatisation was much weaker. The government disposed of thousands of SOEs, but the revenue transferred to the state budget was relatively modest. The total proceeds from privatisation over the first 15 years were approximately KZT 350 billion (OECD, 2012a). After this privatisation process, SOEs still accounted for between 30% and 40% of Kazakhstan's gross domestic product (GDP) (OECD, 2014a).

### Measuring the role of the state in the economy

The OECD has developed various metrics to provide complementary perspectives on the economic role of the state. Each metric seeks to reduce a complex, multi-faceted concept to a limited number of indicators. The Product Market Regulation (PMR) State Control Index is designed to assess this control by summarising results from a detailed questionnaire covering a range of key sectors and aspects of state influence in the provision of goods and services. It allows for the assessment of the extent of state control between sectors, across countries and over time (Box 4.1).

#### Box 4.1. PMR State Control Index

The OECD developed the Product Market Regulation (PMR) Indicators to assess the extent and design of regulation in product markets. They provide economy-wide indicators of regulations affecting the operating environment for product market firms across seven network sectors (electricity, gas, rail transport, road transport, air transport, postal services and telecommunications) and five services sectors (legal services, accounting services, engineering services, architecture services and retail distribution).

The PMR Index is constructed as a pyramid based on responses to a detailed questionnaire, which are then aggregated into various levels of indicators (Figure 4.1.). Responses to a questionnaire covering 18 low-level indicators form the base of the pyramid. Qualitative responses are converted into categorical measures (0-6), which are then aggregated into 16 topics. The summary indicators for these topics are weighted and aggregated into seven groups of constraints on competition, which in turn are further weighted and aggregated into three high-level indicators: state control, barriers to entrepreneurship and barriers to trade and investment. This chapter concerns the state control indicator.

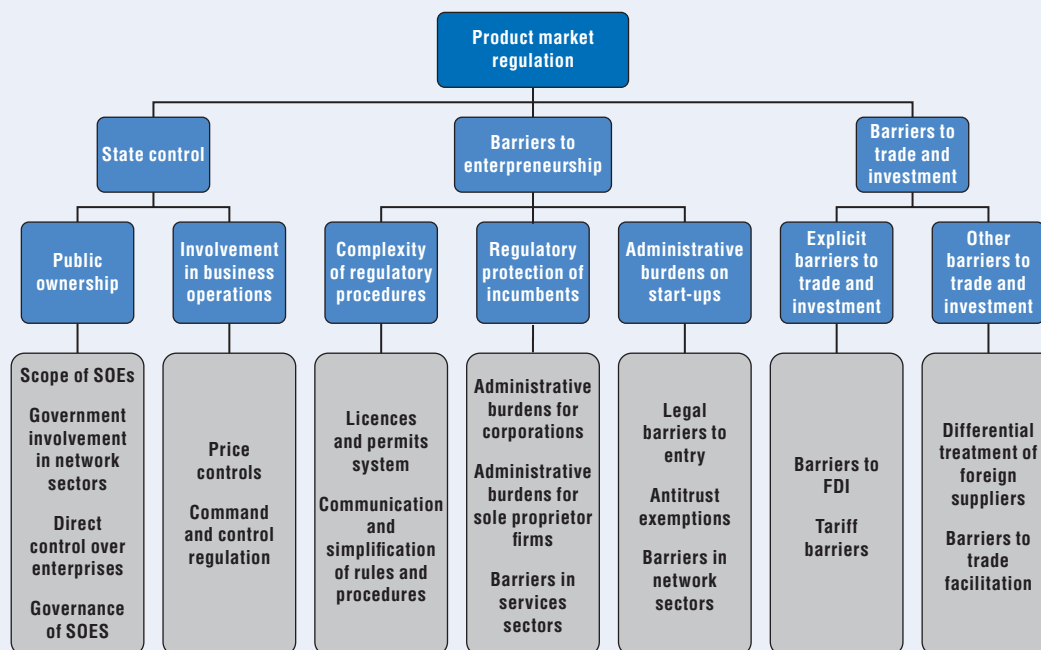
The state control indicator summarises the various dimensions of the state's presence in the observed sectors according to whether a SOE is active in the sector, as well as what proportion of the most important enterprises in each sector is owned by the state. State control measures the nature of the relationship between the state and SOEs by observing the form of regulation applied, constraints on the sale of the firms, governance of the firms, degree to which they are insulated from market discipline, and political interference in the management.

Box 4.1. **PMR State Control Index** (cont.)

The indicator is computed using six low-level indicators:

- Scope of SOEs: the pervasiveness of state ownership across business sectors, measured as the share of sectors in which the state controls at least one firm;
- Government involvement in network sectors: the government's stake in the largest firms in six network sectors (electricity, gas, rail transport, air transport, postal services and telecommunications);
- Direct control over enterprises: special voting rights of the government in privately owned firms and constraints to the sale of the government's stake in publicly controlled firms (based on studied sectors);
- Governance of SOEs: degree of insulation of SOEs from market discipline and degree of political interference in their management;
- Price controls: extent and type of price controls in eight sectors (air transport, road freight transport, retail distribution, telecommunications, electricity, gas, water and professional services); and,
- Command and control regulation: extent to which the government uses coercive (as opposed to incentive-based) regulation.

The first four indicators measure the scale of public ownership in the economy. The last two measure the state's involvement in business operations. These two measures are then computed into the high-level state control indicator.

Figure 4.1. **Structure of the PMR Index**

Source: Koske et al. (2015).

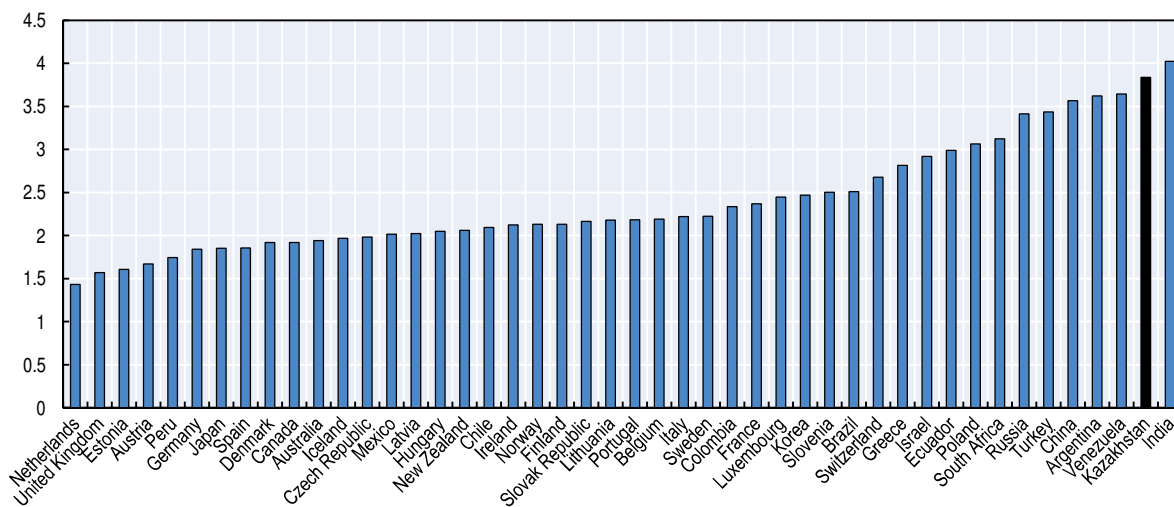
The SOEs are the dominant form of state control in Kazakhstan's economy. Their presence is in addition to the weight of the other parts of the state, including non-incorporated government entities at the central and sub-national levels. These entities generate considerable economic activity related to the provision of, for example, hospitals and health care, schools and education and security, as well as holding significant financial and real estate assets.

### State control in the economy

The scale of Kazakhstan state involvement in the economy stands out among benchmark and OECD economies, according to preliminary PMR data. All indicators of state control, apart from the governance of SOEs, are above average for OECD economies. The summary indicator for state control is above those for all OECD countries, except Turkey, and is slightly below the values for the neighbouring economies of Russia and China. This assessment reflects the heavy involvement of government in network sectors, the preference for coercive regulation rather than encouraging desired action through incentives and price controls, and the pervasiveness of state ownership across sectors.

The strong state control of the economy is led by the government's heavy involvement in network sectors. The state controls 100% of shares in the largest firms in all branches of the gas sector, transport sector (except air passenger transport), postal sector, mobile services, and electricity distribution, supply and generation. The government holds over half the equity of firms in remaining branches of the network sectors. This is a significantly larger government holding than in OECD economies.

Figure 4.2. **The Kazakhstan state has a high level of control of the economy**  
Product Market Regulation State Control Index, latest available



Source: Authors' calculations and OECD Product Market Regulation Indicators (database) available at <http://stats.oecd.org/Index.aspx?datasetcode=PMR>.

StatLink <http://dx.doi.org/10.1787/888933445639>

The state owns firms across most sectors of the economy covered by the State Control Index, although the measure is not significantly higher than in some OECD economies. The state is particularly present in energy sectors, controlling at least one firm in all branches of the electricity supply industry at either the national or regional level, with the exception of electricity imports. All branches of the gas sector (production, import transmission, distribution and supply) include state-controlled firms, as is the case for the telecommunications, postal and transport sectors. The state controls firms that refine petroleum; manufacture basic and fabricated metals; manufacture railway vehicles; transport freight by road; provide financial services, insurance, reinsurance and pension funding; and deliver health care. Overall, this presence is not significantly higher than in those OECD member countries where the state plays the largest role. It is also consistent with other

former Soviet Union countries where, while generally reduced, state ownership of firms across the economy remains significant.

The state, therefore, has an important influence over resource use within and between sectors. These allocations potentially offer lower economic returns than market-based allocations. In addition, concentrated ownership means that the dominance of state control of the most important enterprises in various sectors undermines competitive pressures and efficiency (Hess, Gunasekerage and Hovey, 2008). More diversified ownership could raise the efficiency of management in firms and lead to more complex, value-added products and a competition-friendly marketplace environment.

#### Box 4.2. What makes an enterprise state owned?

The term state-owned enterprise (SOE), as applied by the OECD, denotes “any autonomous public entity i) involved in commercial activities; and ii) controlled, directly or via other government-controlled institutional units, by the central or federal level of government” (OECD, 2015a). According to the System of National Accounts, a public corporation must be i) controlled by another public unit; and ii) a market producer. Control is defined as the “ability to determine the general policy or program of an institutional unit”. Being defined as a market producer depends on a separate assessment of whether or not the institutional unit charges “economically significant prices” (European Commission et al, 2008).

The definition of state in the context of SOEs also varies between nations. The question is whether only commercial enterprises owned and controlled by the central government and the subsidiaries of such enterprises should be calculated or whether the corporate assets of regional or local administrations should be taken into account to give a full picture. For example, in Germany, the states (*Länder*) are significant owners of enterprises. Likewise, in Switzerland, most SOEs are owned by the cantons and not by the federal government. In view of the relative autonomy of the *oblasts* and the municipalities in Kazakhstan, it appears appropriate to limit, following the OECD definition, the concept of SOEs to the entities owned by the central government, either directly or through the various holding companies with different rankings, and to all subsidiaries of such entities.

Treatment of fully state-owned entities is clear, but there are different practices regarding partial ownership by the state. Certain nations recognise only majority ownerships, leaving minority shares out of reporting. The OECD defines enterprises with state ownership of between 10% and 50% as partially state-owned enterprises (PSOEs). However, minority ownerships in large listed enterprises may be very valuable, and companies with an otherwise dispersed ownership could effectively be controlled by the state with, for example, 30% of the votes at the annual general meeting. In addition, some nations use the total value or output of a PSOE; others use the portion calculated on share of ownership.

State SOEs are often incorporated into joint stock companies (JSCs) or limited liability partnerships (LLPs), the same forms of incorporation available for privately owned companies. Many countries have additional, special statutory forms of incorporation reserved for governmental purposes. Taking statutory companies into consideration when assessing the state share in the economy is problematic, since they typically do not report their financial data under the same rules as JSCs or other privately owned companies. The true value of a statutory company is difficult to assess, since it cannot be sold to other owners, and the asset value on the balance sheet might be unreliable for many reasons, ranging from accounting and pricing challenges through to misaligned incentives. A similar problem arises in the evaluation of monopoly companies and enterprises with specific societal tasks.

Price control is much stronger in Kazakhstan than in any OECD member or enhanced engagement country. Preliminary assessment suggests that price control is predominant across the Kazakhstan economy. It is applied in most of the surveyed economic sectors, including domestic airfares and road freight services and to many retail products, such as petrol, tobacco, alcohol, cellular communications, Internet services, certain staples, water and energy.

The government plans to deregulate prices in Kazakhstan substantially and instead use antitrust measures to manage monopolistic industries. The Committee on Regulation of Natural Monopolies and Protection of Competition has announced plans to abolish price regulation from 1 January 2017. Antitrust tools will replace price regulation, bringing Kazakhstan into line with the conventional OECD approach and potentially allowing for the far more effective role of price signals in driving economic behaviour. This may, for example, reduce barriers to entry in the regulated market, thereby attracting additional resources and supply in industries that offer significant returns.

Regulation in Kazakhstan stands out for taking a coercive rather than incentivising approach. Regulators are also not required to assess alternative regulatory approaches before adopting new regulations. This can hamper innovation and economic efficiency. On the other hand, opening hours of shops are not regulated, and there are no restrictions on the advertising and marketing of professional services, including accountancy; legal, sole proprietorship; engineering and architecture. Command and control regulation offers no incentive to improve quality beyond the standard set by a particular law. Once the regulation is satisfied, actors have no incentive to do better, reflecting the rigidity of regulations that are unable to adapt to the cost and operating structures of individual actors.

### ***Assessing the SOE share in the economy***

The impact of the SOE sector on GDP is a meaningful metric to assess the state share in the economy. It is also practical, since all nations calculate their GDP using the same basic methodology, and international organisations ensure that these calculations are consistent across countries. Thus, the GDP provides a reliable and uniform basis for comparison. A 2011 OECD working paper (Christiansen, 2011) documented the share of SOEs in OECD member countries in terms of number, employment and the economic value of the enterprises. It compared the relative “weight” of SOEs across economies by measuring the valuation of the SOE sectors relative to GDP, although noting that measuring asset valuation relative to a flow variable such as the GDP makes only limited economic sense.

The paper found that “the average for all reporting countries is around 15% of the GDP”. However, only 27 out of the 34 member countries provided their data, and several countries with substantial SOE sectors did not supply theirs. In addition, values of companies with minority state shareholdings were not included, even though they are significant in some countries. Reporting countries also had different ways of assessing the value of non-listed companies, particularly statutory companies, which were ignored altogether by some respondents.

The most economically meaningful indicator would be the assessment of the share of the SOE sector in the GDP. Since the GDP measures value added, the relevant data should be collected from SOEs entity by entity, which would be a laborious exercise. Simply reflecting aggregate output, such as turnover or gross sales relative to GDP, would introduce systematic bias since value added in the aggregate output varies greatly across sectors.

A more recent OECD report notes that “the absolute size of national SOE sectors is notoriously difficult to compare”. It proposes that the share of employment by SOEs of the total non-agricultural dependent employment would be a useful measure of the weight of the SOE sector in the domestic economy (OECD, 2014b). This measure is based on relatively easily available data, it would preclude differences in valuation or accounting issues, and comparable data could be collected from most countries, allowing comprehensive benchmarking. According to data collected by the end of 2012, Norway has the largest SOE sector, employing close to 10% of the dependent workforce. When listed partially owned SOEs were included, Norway jumped to over 12%, and France, Slovenia and Finland exceeded 10%. However, the share of SOE employment of the total workforce illustrates the economic weight of the SOE sector only if the productivity of labour is at the same level in the SOE sector as in the private sector. There is ample evidence that this is often not the case. Especially in transition economies, there is a clear gap between the productivity of the workforce in the respective sectors.

### Present condition of state ownership

There were 27 283 registered state-owned legal entities in Kazakhstan as of 25 August 2016. This figure includes all types of legal entities available to the state for different purposes: state institutions and state enterprises, which are financed within the budget economy, as well as JSCs and LLPs, which are established and operate under the same laws as privately held enterprises. *State institutions* are primarily intended to provide for administrative, social, cultural or other functions of a non-commercial nature. For *state enterprises*, the Law on State Property lists a large number of specific tasks, typical for state or municipal administration, such as supply of power, water, gas or heat, health care, primary schooling, etc. According to the Department on the Policy of Managing State Assets the total number of SOEs in Kazakhstan is 6 948, including 679 JSC’s and LLP’s, the remainder being state enterprises under the right of economic management (1 258 entities) or operational management (5 011 entities).

The majority of the registered legal entities are small. Only 1 002 entities are classified as large, i.e. with more than 250 employees. SOEs are active in all sectors of business and industry, particularly in oil and gas, energy, mining, transportation, and information and communication but with a notably thin presence in manufacturing, banking and insurance activities (Committee on Statistics, 2015). According to data supplied by the Ministry of National Economy, the gross value added by the SOE sector was 7.85% of GDP in 2014.

### Legal framework

SOEs doing business or otherwise involved with economic activity are incorporated as either JSCs or LLPs.<sup>1</sup> Both the law on JSCs and that on LLPs are intended, in the first place, to regulate privately owned businesses, including those with foreign, non-Kazakhstani participation. Consequently, with certain exceptions, they apply international business standards and practices to state ownership equally.

Small or medium SOEs with participation by non-state parties are often incorporated as LLPs. The law on LLPs provides a simpler corporate structure, a lighter capital requirement and a less burdensome administration. A more widespread use of this corporate form for the state’s small-scale businesses should be considered as an economic alternative.



Stipulations concerning state institutions and state enterprises are included in the Law on State Property 413/2011. This is a large piece of legislation covering all aspects of state ownership: corporate, real estate, machinery, public space, museums, collections, etc. The law defines state institutions and state enterprises, the two corporate forms reserved for state ownership, and regulates their governance and management at both state and municipal levels. The Law on State Property completes the laws on LLPs and JSCs by regulating in detail the governance and management of companies 100% owned, majority owned and minority owned by the state. There are stipulations on the powers of the authorised state body to act as the shareholder, on the composition and powers of the boards of directors, as well as activity planning, including ten-year development strategies and five-year development plans.

The Law on State Property also regulates the privatisation of state-owned assets. It describes in detail the procedures applied in the privatisation of various kinds of property, particularly shares in JSCs and stakes in LLPs, preparations for privatisation, use of funds received and subsequent control over execution.

Other pieces of legislation also regulate SOEs. These include the Law on Natural Monopolies and Regulated Markets and the Law on Sovereign Wealth Fund. It is of concern that the Law on Public Procurement does not apply to SOEs. The Law on Competition has been replaced by the Entrepreneurial Code of October 2015. The general laws on taxation, accounting and audit apply to SOEs and privately owned entities alike.

### The state as an owner: OECD Guidelines and measurement methodology

The *OECD Guidelines on Corporate Governance of State-Owned Enterprises* provide recommendations on ownership and governance practices. The Guidelines (Box 4.3) are an OECD legal instrument, implementation of which is overseen by the OECD Working Party on State Ownership and Privatisation Practices (in which Kazakhstan takes part as a Participant). Assessing whether the Guidelines have been fully implemented thus goes beyond the scope of the present chapter. The chapter describes the Kazakhstani reality vis-a-vis an “OECD consensus” which encompasses the Guidelines as well as a number of publications issued by the OECD offering additional guidance on good practices for SOE ownership and governance.

#### Box 4.3. OECD Guidelines

The OECD Guidelines on Corporate Governance of State-Owned Enterprises were first adopted by the OECD Council in 2005 and revised in 2015. They are consistent with the likewise recently revised OECD Principles of Corporate Governance and set the complementary guidance for state-owned enterprises. The Guidelines provide a set of good practices on the legal and regulatory framework of the state ownership function and the corporate governance arrangements of the enterprises. Their purpose is to help policy makers evaluate and improve the legal, regulatory and institutional framework for the governance of the enterprises that they control. This is achieved by providing the shareholders, board members and executives with the right incentives to perform their roles within a framework of checks and balances.

Source: OECD (2015a, 2015b).

### ***Kazakhstan lacks a general ownership policy***

The OECD consensus implies that the government develop an ownership policy, which should be disclosed to the public. The policy should define the overall rationales of state ownership, the role of the state in the governance of companies and the roles and responsibilities of government offices involved in the implementation of the policy (Guideline I:B-D). The annotations to the Guidelines note that the absence of an ownership policy may lead either to a passive conduct of ownership functions or the state's excessive intervention in matters of the enterprises.

The government of Kazakhstan has yet to develop or publish any comprehensive statement to this effect. In legislation, particularly in the chapters of the Law on State Property concerning state ownership and management of SOEs, there are stipulations on the roles, powers and responsibilities of the relevant state authorities. The Law on Sovereign Wealth Fund simply states that “the purpose of the Fund shall be to increase the national wealth of the republic of Kazakhstan”. Kazakhstani authorities argue that the Law on State Property and the recent Entrepreneurial Code constitute an ownership policy but in the spirit of the Guidelines an ownership policy should be a political statement, from time to time reviewed by the government, and not a legal norm. The Guidelines further specify a number of elements which are not to be read in the Law on State Property. The declarations by the president in 2015 and 2016 on fundamental economic reform programmes – particularly the Kazakhstan 2050 Strategy (Nazarbayev, 2012), the Five Institutional Reforms and the 100 Concrete Steps for implementing the reforms (Nazarbayev, 2015) – make only a few references to state ownership and privatisation.

### ***The marketplace playing field is not level***

The legal and regulatory framework for SOEs should ensure a level playing field and fair competition in the marketplace with privately owned companies (OECD, 2012b). A very large number of SOEs are active and operating in most network sectors in Kazakhstan. Enterprises with foreign ownership report that state-owned companies often enjoy better access to resources, markets, credit and licences than private enterprises. There have also been concerns about the tendency of officials to challenge the contractual rights and interfere in the operations of private companies, particularly regarding procurement decisions (U.S. DoS, 2015). As discussed in this chapter, the power of industrial conglomerates led by national managing holdings on the one hand, and the apparent under-development of privately held SMEs on the other, generates an economy that is strongly dominated by the state sector and weakens the competitive position of the private sector (OECD, 2014a).

Equal opportunity for privately held and publicly owned enterprises requires separation of ownership and regulation in the organisation of the government. The Guidelines (III: A) recommend that “there should be a clear separation between the state's ownership function and other state functions that may influence the conditions...” This is not how the government of Kazakhstan is organised. Ministries charged with ownership functions are also regulators of their respective sectors, and ministers maintain influential positions on the boards of directors of national managing holding companies which they are charged with regulating.

SOEs in Kazakhstan are subject to general laws, but these may not be applied consistently. In addition, there is a tendency of courts to favour the government, which has created obstacles in business for privately held enterprises (U.S. DoS, 2015). However, SOEs do carry

the same tax burden as privately held enterprises except those which operate in the social sphere providing medical services, education, innovation etc. as specified in the Tax Code.

The Entrepreneurial Code (375/2015) limits state involvement in the market economy. Article 192 requires prior permission from the competition authority, the Committee on Regulation of Natural Monopolies and Protection of Competition under the Ministry of National Economy, before public bodies are allowed to establish new undertakings. The competition authority inspects the relevant market and bases its decision on the development of competition.

The Entrepreneurial Code provides for when the state may participate in economic activity. It describes several cases and circumstances which justify the participation of the state in entrepreneurial activity such as the absence of any other possibility of national security protection, national defence capability or protection of interests of society; the use of state-owned strategic objectives; the existence of a state monopoly; and the absence of private businesses in production of the goods or services intended.

The code also prohibits a number of anti-competitive actions by SOEs that could lead to restriction or elimination of competition or infringe upon consumer rights. The list is not exhaustive but does include failures to act, such as failures to respond to licensing requests by private entrepreneurs.

A state monopoly can only be granted to entities organised as state enterprises established by a governmental decree. The creation of monopolies is possible in cases where competition would have negative effects on the constitutional order, national security, public order, human rights and freedoms, and public health. There are currently about 20 state monopolies in Kazakhstan. Some of them operate in traditionally public services areas, such as assessment of patent applications or veterinary control. Some monopolies have been granted in sectors with environmental or social sensitivities, such as wildlife protection and security-related services (OECD, 2016b).

State-owned companies enjoy readier access to finance than their private sector counterparts, despite efforts by the government to provide additional finance for SMEs. Inadequate supply of finance is one part of the issue. Insufficient access to financing, both for investment and for working capital, is a serious problem for privately held enterprises in Kazakhstan. This is particularly relevant to SMEs, which are not in a position to approach foreign sources of financing, and are constrained by the shallowness of the Kazakhstan banking sector (Chapter 3). Local banks have difficulties mobilising wholesale financing, while also being challenged by the uncertainties in the regulatory and legal landscape, and limited expertise to assess and evaluate the risks in financing SMEs (OECD, 2012a).

The government has attempted to use its structure of SOEs to provide additional finance for private firms. It has drawn on the National Oil Fund to inject financing for private SMEs via the banks, but this has at best balanced the situation. JSC Baiterek National Managing Holding is a holding of state-owned financial institutions that provides financing through public and private firms. The practice is that funding approved by commercial banks is partly provided by Baiterek. Privately owned SMEs receive financing and development support from the Damu Entrepreneurship Development Fund JSC, a subsidiary of Baiterek. Damu channels financing through local banks and operates several programmes subsidising interest rates, guaranteeing loans and providing training to improve the competencies of private entrepreneurs (Baiterek National Managing Holding JSC, 2014).

SOEs are able to draw on the government's financial reserves. Large state-owned conglomerates have wide access to internal financing arrangements not available to private industries. For example, the Law on Sovereign Wealth Fund includes specific provisions on credits to be provided between companies belonging to the Samruk-Kazyna group on the basis of internal credit policies and a common policy on management of funds implemented by Samruk-Kazyna itself. The recent purchase by the National Bank of Kazakhstan (NBK) of 10% of the shares of the national energy company KazMunaiGas from Samruk-Kazyna was noteworthy with regard to NBK's basic regulatory role, given that it also manages both the National Fund and the National Pension Fund (Lillis, 2015). Even companies that are partly privatised enjoy privileged access to finance, as private lenders infer a state guarantee in assessing the risk of the loan.

### **Responsible authorities for state ownership**

In Kazakhstan the organisation of the state's ownership is very dispersed. The primary ministries responsible for state ownership are the Ministry of National Economy and the Ministry of Finance. In the hierarchy of the Kazakhstan government, departments have strategic and regulatory functions, whereas committees have functions regarding implementation and control (OECD, 2014a). The Department of State Assets Management Policy in the Ministry of National Economy is the central policy-making authority for state ownership. It is responsible for the development of all regulation but is not operative in governance or the privatisation of state assets.

The OECD consensus implies that the exercise of the government's ownership rights should be centralised in a single ownership entity or at least be carried out by a co-ordinating body. The Committee of State Property in the Ministry of Finance is the authorised owner of state assets on behalf of the government. Since the Committee of State Property is the legal owner also of entities where the ownership rights have been delegated by the government to other sector ministries, it could be regarded as the centralised co-ordinating body. Legislation often references "the authorised body that has been transferred the rights of ownership". In cases of "republican" assets directly owned by the state and not by a holding company, this reference means the Committee of State Property. It represents the state's shareholding at annual general shareholders' meetings, nominates appointees to boards of directors, monitors the financial performance of companies and has an active and central role in privatisation operations. However, there are a number of responsible sector ministries which have been vested with shareholders' rights and also a number of legally independent holding companies on top of large groups of subsidiaries, resulting in a very dispersed ownership organisation.

No emphasis has been placed on the separation of ownership and regulation. Both the Ministry of National Economy and the Ministry of Finance are responsible for the regulation of several sectors that affect the operations of SOEs, including taxation, general industrial policy, competition policy, public procurements, etc. The same applies to sector ministries endowed with ownership rights, such as the Ministry of Agriculture. The organisation of large and important groups of companies under national managing holdings provides a certain distance that might be formally regarded as wide enough to break, *de jure*, the contact between regulation and ownership. However, the presence of the relevant ministers, such as the minister of finance and the minister of national economy, as members on boards of the most important national managing holdings connects, *de facto*, the decision making in practice.

Accountability is enhanced where the ownership entity develops consistent reporting on the SOEs and publishes an annual aggregate report. According to the OECD consensus such a report should be the key vehicle of disclosure to the general public, the legislature and the media. There is no aggregate public reporting on the financial and operational performance of SOEs by, for example, the Committee of State Property. The Register of State Enterprises and Agencies and the Depository of Financial Reporting publish data on the performance of SOEs on their websites. The national managing holdings and the largest companies, some of them listed on the stock exchange or having issued bonds, publish comprehensive and detailed annual reports fulfilling international standards.

The supreme audit institution of Kazakhstan is the Accounts Committee, the purpose of which is to control the execution of the republican budget. The Accounts Committee is subordinated to the president but also reports annually to the parliament on the execution of the budget. The primary role of the Accounts Committee and regional audit commissions is to ensure compliance with legislation related to the implementation of the budget. In this respect, they are also authorised to execute external audits of all types of SOEs and their subsidiaries. The OECD 2014 survey of the Kazakhstan central administration (OECD, 2014a) is very critical of state financial control and calls for building capacity and professionalism in the Accounts Committee and subordinated state audit bodies. In November 2015 Kazakhstan adopted the Law on State Audit and Financial Control restructuring and completing the system of state financial control and internal audit.

### ***National managing holding companies and state ownership***

The state's full or partial ownership of a very large number of enterprises has been organised through holding companies. A *national company* is a JSC operating in fundamental industries or facilitating regional economic development, and controlled, through majority ownership or otherwise, directly or through a national managing holding company, by the state. A *national holding company* is likewise a government-created entity which holds shares in national companies. A *national managing holding company* manages the interests of the government in national holding companies, national companies, development institutes and other entities.

### ***Samruk-Kazyna***

The most important national managing holding company is the sovereign wealth fund Samruk-Kazyna JSC, officially the National Welfare Fund. It is organised as a JSC under the relevant laws but is also covered by the special, dedicated Law on Sovereign Wealth Fund 550/2012. Samruk-Kazyna's purpose is "to increase the national wealth of the republic of Kazakhstan by increasing the long-term value of the organisations included into the group of Samruk-Kazyna and by effective management of assets belonging to the group of the Fund" (Law on Sovereign Wealth Fund, Article 4.1). Samruk-Kazyna owns and manages close to 600 companies in fundamental commodity, infrastructure and service areas. Samruk-Kazyna is the owner of important subsidiaries such as KazMunaiGas, representing state interests in oil and gas; the national atomic company, Kazatomprom; the railway company, Kazakhstan Temir Zholy; the national airline, Air Astana; and the owner and systems operator of the national power grid, the Kazakhstan Electricity Grid Operating Company (KEGOC). These companies are, in turn, mother companies of vast groups of subsidiaries. The group employs more than 320 000 people and its consolidated revenue was equivalent to 13.3% of national GDP in 2014 (Samruk-Kazyna JSC, 2015).

The Law on Sovereign Wealth Fund includes specific provisions regarding the activity of Samruk-Kazyna. In addition to the purpose, the law defines the tasks and principles of activity of Samruk-Kazyna. It extends and complements the laws on JSCs and on LLPs by explaining in detail the powers and tasks of the sole shareholder, the board of directors and the management board.

As with other national managing holdings, there is a substantial degree of active, high-level political participation in the governance of Samruk-Kazyna. The chairman and the members of the board of directors are elected by the shareholder, although the law also confirms the prime minister as chairman. Currently, the other state representative members of the board are the minister of national economy, the minister of finance and the assistant to the president of the Republic. The CEO of Samruk-Kazyna, a former first deputy prime minister, is also a member of the board. Three independent directors are very experienced, high-profile foreign businessmen. The Law on Sovereign Wealth Fund requires that no fewer than two-fifths or 40% of the board be independent. Three out of eight falls short of this requirement.

One might assume a corporate board with such high-level membership would have a formal role and hold few meetings. However, in 2014, the board of Samruk-Kazyna held 13 meetings considering 120 issues, taking 180 decisions and giving 45 instructions. The attendance of the majority of members was 100%. The board has nominated three committees: the Audit Committee, consisting of the three independent directors, the Nomination and Remuneration Committee and the “Specialised Committee”.

The executive body of Samruk-Kazyna is the management board, headed by the CEO, with members appointed by the board of directors. All members are Samruk-Kazyna employees in top managerial positions. The law lists in detail the issues belonging to the exclusive competence of the management board. The management board acts as the shareholder of the portfolio companies.

The state representatives on the boards of Samruk-Kazyna subsidiaries generally hold high positions in their respective ministries. Samruk-Kazyna is also represented on the boards of subsidiaries.

Samruk-Kazyna is presently audited by Ernst & Young. Its financial reporting follows the International Financial Reporting Standards (IFRS), and annual reporting is transparent and comprehensive, with the exception of remuneration to directors.

Specific provisions in the Law on Sovereign Wealth Fund inform the special role of the Samruk-Kazyna fund in the economy:

- The basic rule is that neither the government nor other state bodies should interfere with the operations of Samruk-Kazyna or the group companies, unless otherwise stated.
- A representative of the Accounts Committee is a permanent member of the “Specialised Committee” of Samruk-Kazyna, with powers to start an external audit of any company of the group. There is a centralised internal audit service within the group.
- Samruk-Kazyna and all group companies are required to have ten-year development strategies complemented by five-year development plans.
- In the interests of national welfare, Samruk-Kazyna has priority rights to acquire strategic objects, shares of banks and rights to subsoil use.
- The main principles of interaction between the government and Samruk-Kazyna are included in an agreement on co-operation.

According to the Law on Sovereign Wealth Fund, Samruk-Kazyna and the group companies may be required to participate in the realisation of “socially significant and innovative industrial projects”. According to the 2014 annual report, Samruk-Kazyna participated in financing the construction of, for example, a multifunctional ice palace, the Choreography Theatre, schools in the Kyrgyz Republic and an exhibition centre in Moscow.

The existence and organisation of Samruk-Kazyna and the other national managing holdings imply that a major part of the wealth of the nation, both assets and cash flow, has been separated from budgetary control through incorporation into independent JSCs. These companies are financed by the state, which provides equity and loans, and they pay dividends and taxes to the state. However, this immense wealth remains under the control and management of, albeit political, boards of directors and not parliament, which otherwise has powers over the budget of the nation.

#### ***Other important holding companies: National management holdings Baiterek and KazAgro***

JSC Baiterek National Management Holding is a government organisation aimed at promoting the sustainable development and diversification of the economy. Through its subsidiaries, it offers financial and investment support to the non-oil and gas sector, particularly to SMEs. (Baiterek National Managing Holding JSC, 2014.) Baiterek has 11 subsidiaries: development institutions, such as the Development Bank of Kazakhstan, that provide financing, investment and export support to large projects and enterprises; institutions, such as Damu Entrepreneurship Development Fund, that provide support to innovative activity and SMEs; and financial organisations, such as the Housing Constructions Savings Bank, that participate in the implementation of real estate and housing projects. The Baiterek group employs a relatively modest 2 400 staff but in 2014, it made a profit of KZT 41.6 billion, and its assets grew to over KZT 2.3 trillion, equivalent to 6% of GDP.

As with Samruk-Kazyna, Baiterek's board of directors includes very high-level politicians. The prime minister is the chairman, and the other state representatives are the first deputy prime minister, the minister of industry and new technologies, the minister of finance, the minister of national economy, and an assistant to the president of the republic. The three independent directors are experienced foreign professionals. The CEO is likewise a member of the board. The members of the executive board are professionals employed by the company in top managerial positions. Baiterek is audited by KPMG, and it reports annually following the IFRS. Baiterek applies its own corporate governance code.

JSC National Management Holding KazAgro owns and leads the group of agribusiness companies of Kazakhstan. Its purpose is to increase the availability of financing and sales markets, corporate management efficiency and the development of human capital in agribusiness entities (KazAgroFinance JSC, 2015). The group includes 53 companies. Food Contract Corporation JSC is the agent for the management of state resources of grain. It was formerly active as the national regulator of grain prices, but since Kazakhstan entered the World Trade Organization, the company has operated solely as a trader of grain and cotton. Kazagrofinance and AAC Agrarian Credit Corporation provide financing to investment projects and the purchase of agricultural machinery on leasing terms. Kazagromarketing supports agricultural producers in various ways to find markets for their products.

Ownership rights of KazAgro shares have been delegated by the government to the Ministry of Agriculture. The chairman of the board is the first deputy prime minister and the present members are the minister of agriculture, the chairman of the Kazakhstan

Development Bank and the vice-minister of national economy. There are three independent directors: one Kazakhstani, two foreign. The CEO is not a member of the board. KazAgro has applied its own corporate governance code since 2010. The company has been audited by Ernst & Young, and the financial reporting follows the IFRS.

## Governance of companies

### **Law on JSCs**

Kazakh legislation tends to be very detailed and comprehensive on paper, giving rise to differing interpretations. It also frequently includes positive lists – of everything that is allowed, for example, or a complete list of the duties of an administrative body – leading to the interpretation that anything not included is forbidden.

The Law on JSCs provides a rigid base for the corporate structure of JSCs. The administration of a Kazakh JSC is one-tier, with no supervisory board. The law allows only two series of shares: ordinary and preferred. Specific provisions apply for golden shares – shares that give power over and above the share of capital they represent (e.g. veto power on some decisions) – which are, however, forbidden in public (listed) companies. The general meeting is the supreme body of the company. The board is appointed by the annual general meeting, and the chairman is elected by the board. The board appoints the executive management, including the chief executive officer (CEO), as well as the auditors, following the instructions of the general meeting.

There are only a few specific stipulations concerning state ownership in the Law on JSCs. An overdue tax liability of a JSC with state ownership may be covered by the issuance of additional shares to the state.

The state representative at shareholder meetings is the agency to whom the powers of the state as shareholder have been assigned. This is the Committee of State Property or, following a specific government decision, the relevant sector ministry, such as the Ministry of Agriculture. The Committee of State Property is authorised to take decisions independently on issues to be dealt with at shareholder meetings. The sector ministry is required to consult and to agree with the committee on certain central issues, such as approval of annual finances and issues of composition of the board of directors.

The board of directors has a central role and wide powers, performing the overall management of the company, with the exception of issues that are reserved to the competence of the shareholder meeting by law or the company's charter. The members of the board are appointed and dismissed by the general shareholder meeting. They are elected for a specific term set by the shareholder meeting, but there is no limit to the length of the term or the number of re-elections. The minimum number of board members is three. No fewer than 30% of the members must be independent.

The Law on State Property requires that the Ministry of National Economy, the Committee of State Property and the relevant sector ministry be represented on the boards of national managing holdings and national holdings. There are no requirements regarding the representation of both genders on the boards of directors. Almost all board members in state-owned companies are male, even though there are a number of women in high positions in the ministries, as well as in top managerial positions in the companies. Employee representation at the level of boards is not a practice in Kazakhstan. Board membership is strictly personal. The laws do not recognise deputy members and there is no practice of



ministers or high officials sending assistants to meetings as personal representatives, as might be found in other countries.

The boards facilitate their work by establishing committees to consider important issues and to make recommendations to the board. Examples of such issues include strategic planning, nominations and remuneration, internal audit and social issues. Other experts than board members may also be appointed as committee members. The committees are to be chaired by independent directors. The fiduciary duty of care and loyalty of all officials of JSCs, including board members, towards the company and its shareholders is clearly stipulated in the Law on JSCs. The boards are required to have their performance evaluated annually.

The remuneration of members of a board is determined by the shareholder meeting. Companies are very discreet in reporting the benefits of board members, the CEO and the top management. In some companies, the independent directors are reported to receive an annual remuneration and a separate fee for each meeting attended. The Law on State Property orders that board members who are public servants do not receive remuneration for board membership.

### **Corporate governance codes**

Kazakhstan has a general policy of striving for better corporate governance in both the public and private sectors. However, this has led to a certain overregulation, with very comprehensive corporate governance codes regulating the daily administration and operations of firms in detail.

Samruk-Kazyna recently issued a corporate governance code to be applied, in addition to Samruk-Kazyna itself, in all companies of the group where state ownership exceeds 50%. The code has been drafted with assistance from the OECD Working Party on State Ownership and Privatisation Practices. It applies the same composition as the OECD Principles and Guidelines, separating brief “Principles of Corporate Governance” and explanatory “Annotations”, although the code is very detailed, comprehensive and explains Samruk-Kazyna’s corporate policies even in internal administrative and operational issues. Whereas the recent version of the OECD Guidelines has 40 typewritten pages, the Samruk-Kazyna code has over 100.

There are several corporate governance codes in the state sector, and companies listed on the stock exchange have to abide by specific transparency rules linked to disclosure requirements. Each of the national managing holdings has a corporate governance code, as well as KEGOC, which has been listed on the stock exchange since 2014. Samruk-Kazyna has put much effort into drafting its new code and has proposed that it be the basis of a unified code for SOEs. A working group, co-ordinated by the Ministry of National Economy and with participation from, e.g., the NBK, is working towards a unified code for all JSCs with state participation, following the OECD Guidelines as well as the *G20/OECD Principles of Corporate Governance* (OECD 2015b).

### **Corporate reporting and audit**

Financial reporting following the IFRS is widespread, since all corporate groups owned and managed by the three national managing holdings follow that practice. Annual reports are very comprehensive, including chapters, for example, on corporate governance, corporate social responsibility and related party transactions. The annual reporting of the large companies conforms to high international standards. Quarterly reports are published by the national managing holdings, as well as those companies with state participation that

are listed on the stock exchange or have issued bonds. The Committee of State Property receives performance reports from all companies on a quarterly basis.

The external auditors are usually appointed by the sole shareholder or by the shareholder meeting. However, in national managing holdings and national holdings, including Samruk-Kazyna, this authority is by the Law on State Property delegated to the board of directors. This is exceptional, since external auditors are normally seen as agents of the shareholders auditing the performance and actions of the board as well. However, the corporate governance codes of Samruk-Kazyna, Bayterek and KazAgro give this right also to the sole shareholder, in addition to the board. Large SOEs are usually audited by the international “Big Four” companies, while smaller SOEs employ local audit firms. Procurement legislation for these contracts requires companies to run annual tendering processes, a costly system, since auditors are commonly appointed on three-year contracts. There is obligatory rotation after five years. In the audit of state-owned entities other than JSCs, the external auditors are obliged by law to report on discovered violations of legislation concerning use of public funds, state assets, guarantees, etc.

## Privatisation

### ***Legal framework, relevant authorities and decision making***

The essential norms regarding privatisation of assets owned by the state are included in the Law on State Property. Enacted in 2011, it replaced the 1995 privatisation law, as well as the earlier Law on State Enterprises. The relevant authorities are the government of Kazakhstan, the Committee of State Property and the boards of directors of the holding companies owning the shares not owned directly by the state. The Law on State Property was amended in a number of details by the end of 2015 to provide regulation to the ongoing privatisation programme.

The central decision-making authority is the Committee of State Property, which holds the powers of the shareholder pursuant to state-owned shares, unless otherwise regulated. Sales of companies classified as strategic objects require a decision by the government. The boards of holding companies are authorised to decide upon sales of shares up to 25% of the total assets of the holding. According to the Law on Sovereign Wealth Fund (article 7.7), the disposal of shares owned by Samruk-Kazyna in strategic companies included on a list defined by the sole shareholder also requires a decision by the government as the sole shareholder of Samruk-Kazyna.

The two most important actors for privatisation in Kazakhstan are the Committee of State Property and Samruk-Kazyna. They are both expected, under normal circumstances, to have sufficient resources to do the job: the preparation and execution of various sorts of transactions, including professional evaluation of the assets to be offered for sale. Assistance by external advisors, as well as international investment banks, is sought particularly in connection with the privatisation of assets belonging to the group “Top 65” (a list of large state-owned assets due for privatisation starting in 2017) or to the ownership of Samruk-Kazyna. The selection and appointment of external advisors is usually done through competitive bidding.

The OECD Guidelines do not include any recommendations in terms of privatisation. The OECD has not issued any recommendations or other legal instrument bearing on privatisation processes. However, the Working Party has published a stocktaking of recent privatisation

and tentative conclusions on good practices (OECD, 2010). These will be referred to in the following as the “OECD consensus”.

### **Restrictions on privatisation**

The Law on Natural Monopolies includes a list of activities that are regarded as natural monopolies, and thus are generally not to be privatised. These activities include oil and gas transport through trunk pipelines, electric and thermal power transmission and distribution, trunk railway and highway networks, ports and airports, etc. The Civil Code includes a corresponding list of assets that have strategic significance to the welfare or defence of the nation and its people. Such assets and the entities owning such assets should, as a rule, stay in the possession of the state and not be subject to privatisation. The sale and, thus, the privatisation of such assets are, however, not totally excluded, but require a specific decision by the government.

### **Methods of disposal**

The Law on State Property regulates all processes of privatisation in detail. A number of stipulations were amended with a Law “On amendments and additions to some legislative acts of the Republic of Kazakhstan on public procurement” of 4 December 2015, effective 1 January 2016. The changes were introduced in view of the vast, ongoing privatisation programme.

The vendor of an asset is obliged to be prepared for the sale in advance by executing a vendor’s due diligence process. The vendor must ascertain by evaluation the market value of the asset to be sold; finding all information on possible indebtedness, burdens or encumbrances affecting the value of the asset; defining the method and conditions of the sale; and securing the safety of the asset.

The price of an asset to be sold shall be its market price. The Law on State Property specifically notes that the market price may be lower than the book value. Assets with a book value exceeding 2 500 000 times the monthly calculation index (KZT 2 121 as of 1 January 2016) i.e. KZT 5.3 billion, are to be evaluated by independent consultants following international evaluation standards. Assets with a lesser book value are to be valued according to Kazakhstan regulations. The law also regulates in detail the conditions of payment. The proceeds of the sales are to be directed to the state or municipal budget.

Amendments to the law have made the price decisive in determining the purchaser of an asset, with or without conditions. The law previously differentiated between an open auction, where the highest bid wins, and a tender in written procedure, where the winner offers the best overall terms. After the recent amendments an auction may be held in three steps – first, by rising bids. If the asset is not sold, a second auction is held at decreasing bids with a minimum price. If needed, a third auction is held with no minimum. Entities not sold after a third auction are liquidated. In a tendering process in writing, additional conditions may be imposed on the purchaser, including preservation of the business profile of the entity for a certain period.

The law regulates in detail the well-known method of a structured auction process. The vendor appoints, through competitive bidding, a financial advisor who assesses the market value of the asset to be sold. First the vendor and the advisor agree on a “long list” of potential purchasers to whom the advisor delivers the asset information, together with a request to place a preliminary bid. Simultaneously, the vendor makes a public announcement of the auction in newspapers. Based on the preliminary bids and negotiations between the

bidders and the vendor, assisted by the advisor, a “short list” of at least two bidders is drawn up. The bidder who offers the best conditions in the second and final bid wins the sale. The process must be documented in protocols signed by the vendor, the advisor and all bidders after each phase. This method is also widely used outside Kazakhstan, since it is relatively transparent and it offers a fair possibility of attaining the best conditions for sale at a true market price. The presence and activity of the external advisor guarantees the fairness and transparency of the process.

Direct targeted sales of state assets to “strategic investors” are allowed, following the amendments to the law. A strategic investor must have experience in the relevant field of industry or business, must acquire a substantial portion of the ownership in the asset, must participate in the management of the company and must be able to transfer new technologies, as well as attract highly qualified professionals.

The purchaser in a direct targeted sale must make a number of commitments and undertakings. These may concern capital inputs; the level of output and the range of products and services; environmental protection; and job preservation and creation, maintaining a workforce with at least two-thirds Kazakhstani nationals. At the same time, the business profile of the entity should be maintained and the industrial and social infrastructure preserved. Accounts payable should be settled in a timely manner, along with salaries in arrears, if any. The resale of the purchased asset will be restricted.

All direct targeted sales must be carried out by independent external advisors. This imposes on the advisor the responsibility of ascertaining and safeguarding the integrity of the sales process, and maintaining the maximal openness and transparency and the exclusion of any corrupt practices.

The law also recognises the sale of state-owned securities, including derivatives, through the stock exchange – the Kazakhstan Stock Exchange (KASE) as well as foreign exchanges. This includes initial public offerings (IPOs) for previously non-listed shares. In secondary offerings of already listed shares, the method of accelerated book building would offer a fast and precise way to set the market price. Incentives, such as price reductions or bonus shares, are sometimes offered to domestic retail investors to boost demand in this particular group. The trade-off is that such incentives are ultimately transfers from all taxpayers to investors. Such practices may also set precedents for future privatisations (OECD, 2003).

State enterprises may be sold through asset sales as a property complex and then liquidated as an empty shell. Another possibility is to convert the state enterprise into a JSC or an LLP before the privatisation.

### **The securities market**

The KASE is illiquid, has limited turnover and limited capitalisation. It was established in 1993 as a currency exchange and started trading in securities in 1995. It is organised as a JSC and located in Almaty. The KASE is controlled by the NBK through its 50.1% shareholding majority, reinforced by a golden share. Trading volumes are small and tending to decline. The number of listed companies dropped to 138 at the end of 2015, compared with 354 at the start of 2012. The aggregate capitalisation of the equity market is less than USD 40 billion. The average daily volume traded is less than USD 1 million. The most liquid shares are those of KazTransOil JSC, a subsidiary of KazMunayGas belonging to the Samruk-Kazyna group,

and KEGOC JSC, a directly owned subsidiary of Samruk-Kazyna. Both companies were listed on the KASE through the People's IPOs in 2012 and 2014 respectively. (KASE, 2016)

Kazakhstan's strongest financial institution appears to be the NBK. As the central banking institution of the state, it manages the foreign exchange reserves of the nation and oversees the financial system as regulator. In addition, the NBK owns a majority stake in the KASE, and manages the assets of the National Oil Fund and of the National Pension Fund, where all private pension funds were consolidated in 2013, although the government plans to move pension fund management to private entities.<sup>2</sup> Thus, the NBK has both regulator and investor roles. It reports that internal Chinese Walls have been erected to protect against conflicts of interest.

### **Recent and ongoing privatisation programmes**

#### **Privatisation Programme 2014-16**

Following a review of state assets in 2014, a programme was prepared for the privatisation of almost 782 entities and the reorganisation or liquidation of close to 800 entities. The programme was to be completed by January 2016 but it was cancelled by the end of 2015 with the introduction of the new "Comprehensive Privatisation Plan 2016-2020". It included all classes of entities, from state institutions and municipal enterprises to JSCs. Of these assets, 106 belonged to Samruk-Kazyna (Samruk-Kazyna, 2016). The programme was launched "for the purpose of consolidating the foundations of the market economy. The main idea of this programme was to give a momentum to further development of the private sector in Kazakhstan" (Samruk-Kazyna, 2016). It emphasised that the availability of modern technology provides more openness and transparency to the sales process and facilitates the participation of a wide range of potential purchasers in the acquisition of state-owned stakes and shares. All assets to be sold were to be evaluated in advance by external, independent appraisers.

Assets included in this privatisation programme were selected on the basis of discrepancy with the owner's core operations; market presence of private companies engaged in similar operations; lack of strategic importance; and lack of public importance (Samruk-Kazyna, 2016).

The largest number of assets were sold electronically through the web portal of the Kazakhstan State Property Registry under the Ministry of Finance. Electronic auction was used if the price was the sole decisive aspect. Electronic tender, likely the most-used method, allowed the inclusion of conditions that the successful bidder must fulfil after the change of ownership. There was also the option of a two-stage tendering process reserved for the sale of strategic assets to prequalified participants.

In addition, Samruk-Kazyna planned to introduce five companies to the stock exchange through People's IPOs in 2011. This group included KEGOC, which was listed in 2014. Partial privatisation was possible for companies that were strategic or did not compete with private industries, in which case Samruk-Kazyna would retain the majority ownership. In strategic entities, it was possible for foreign buyers to purchase a minority share only with the permission of the Government Commission of Strategic Objects. Samruk-Kazyna offered purchasers a virtual data room to facilitate their due diligence process.

#### Box 4.4. Listing of KEGOC

By mid-2016, minority stakes had been sold in only two companies under the People's IPOs programme launched in 2011: KazTransOil in 2012 and KEGOC in 2014. At the offering, KEGOC issued 26 million new shares minus one share at an initial subscription price of KZT 505. The issue was oversubscribed, and KEGOC was given more than 40 000 new shareholders. Now Samruk-Kazyna controls 90% plus one share, and the minority shareholders control 10% minus one share of the total number of KEGOC's shares.

The share price of KEGOC went down after the IPO, reaching a low of KZT 320, but the price has recovered since; the share was trading at prices above KZT 900 during most of the first half of 2016. KEGOC's dividend policy is to pay out not less than 40% of the net income. The dividend proposal on 2014 profits was KZT 8.6 billion, i.e. KZT 33 per share. For the initial subscribers, participating in the IPO of KEGOC has been a fairly sound investment.

From the point of view of the company, the listing does not provide access to an additional source of equity financing as long as Samruk-Kazyna holds on to its majority exceeding 90%. Merely as a consequence of the increased transparency required from a listed company, KEGOC will increase its efficiency through improved governance and added board independence. There are no politicians on the present board of KEGOC. It consists of two representatives of Samruk-Kazyna, three independent directors and the CEO of the company. None of the board members owns shares in the company. On the other hand, the company has to bear all the effort and additional cost of a listed company communicating with tens of thousands of small shareholders.

The People's IPOs programme was launched with the purpose of giving citizens the opportunity to profit from the development of successful companies, contribute to the development of the stock exchange and provide funds for the companies to invest. With the KEGOC IPO, the government and Samruk-Kazyna have provided the general public with a small slice of the dividends plus the possibility of capital gain but absolutely no power in decision making. The small shareholders may raise their voice at annual general meetings and express their possible discontent by voting with their feet: disposing of their shares.

The two IPOs gave the stock exchange a real and much needed boost: KazTransOil and KEGOC are by far the two most traded shares on the KASE.

Source: KEGOC, 2014.

By the end of 2015, a total of 239 assets had been sold. Fifteen assets were sold from the state portfolio, 50 from national holdings and companies, and the rest from municipalities and other organisations. The total sales proceeds were KZT 79 billion, of which KZT 5.5 billion were directed to the state budget and KZT 67.3 billion to the national holdings and companies. The latter figure has been reported as including the KZT 13.1 billion revenue of the Samruk-Kazyna group from the listing of KEGOC shares.<sup>3</sup> The Privatisation Programme 2014-2016 was annulled by the Resolution by the government 1141 "On Certain Issues of Privatization in 2016-2020" on 30 December 2015 setting forth the new programme "Comprehensive Privatization Plan 2016-2020".

#### **Comprehensive Privatisation Plan 2016-2020 – Top 65**

The Kazakhstan government has set a target of reducing the SOE share of economic activity to 15% by 2020, from approximately 30% to 40% at the end of 2015. This programme is in parallel with the current economic and societal development programmes, the Kazakhstan 2050 and the Five Institutional Reforms, although these do not make direct reference to state ownership or to privatisation. The "100 Concrete Steps To Implement The Five Institutional

Reforms” (Nazarbayev, 2015) invites international strategy partners as anchor investors to establish joint ventures with the state in priority sectors of the economy. These joint venture companies would later be introduced to the stock exchange by floating the state shares. Additionally, this declaration invites strategic investors to develop industries, such as energy saving, dairy production and meat processing, where the presence of the state is, for the time being, not substantial.

The privatisation target is very ambitious. A large number of factors affecting the success of the privatisation programme are beyond the vendor’s control. It will require primarily foreign investors, given the thinness of the financial market and the low gross savings rate of the country’s citizens. The timeline is very demanding, given the scale and complexity of the assets that the plan proposes to privatise within less than five years, and given the need for management of entities to be sold in whole or in part to reorganise the companies to attract investors. Current global circumstances add to the challenge of implementing the programme, given the effects on Kazakhstan of the sustained fall in oil prices, and the effects of United States and EU sanctions on Russia through Kazakhstan’s membership of the Eurasian Economic Union. Kazakhstan was downgraded by all major credit rating companies in the first part of 2016, while the tenge depreciated significantly against major currencies.

The SOEs to be sold have been selected for their potential for privatisation to develop competition and private capital and to reduce the share of economic activity under state ownership. On 22 September 2015, First Deputy Prime Minister Bakytzhan Sagintayev declared that a list of the Top 60 would include 38 companies owned by Samruk-Kazyna, four owned by Baiterek, four owned by KazAgro and 14 companies directly owned by the state. The Top 60 grew into the Top 65, and the programme was given more detail when the government issued the Comprehensive Privatisation Plan 2016-2020 as the Resolution of the Government No. 1141 on 30 December 2015. The programme was first presented by the then Minister of National Economy, Yerbolat Dossayev. He remarked that large-scale privatisation is the government’s top priority for 2016. The minister specifically noted that the fair market values of the assets may be far lower than their book values.<sup>4</sup> First Deputy Prime Minister Sagintayev was entrusted with implementing the privatisation resolution (Government of Kazakhstan, 2015).

The privatisation programme comprises 783 entities, which are divided into groups, firstly on the basis of size and secondly on the basis of ownership. The Top 65 comprise the large enterprises, which are the priority for privatisation. These are enterprises with a book value exceeding KZT 5.3 billion. The enterprises are presently owned directly by the state (e.g. Astana International Airport JSC) and by the national managing holdings and national companies Samruk-Kazyna, KazMunayGas, Kazakhstan Temir Zholy, Kazatomprom, Samruk-Energo, Baiterek and KazAgro. Seven companies presently owned by Samruk-Kazyna are marked to be listed on the stock exchange through IPOs: Kazakhstan Temir Zholy, KazMunayGas, Kazatomprom, Samruk-Energo, Tau-Ken Samruk National Mining Company, Kazpost and Air Astana. The remaining 718 entities, each with an asset value of less than KZT 5.3 billion, are a very mixed group, with companies owned by the state, the national holdings and national companies, as well as the municipalities. The Resolution No. 1141 has been written with due respect to corporate governance: in respect of assets directly owned by the state the government resolves to approve the list of enterprises to be privatised, whereas in respect of assets owned by Samruk-Kazyna or other holding companies, the government resolves to recommend, that the companies approve the respective lists of enterprises to be privatised.

The assets to be listed will be sold to strategic investors by placing shares on the stock exchange. Dual listings in both KASE and more liquid foreign exchanges would be considered. There is no single co-ordinating body but several special project offices called Delivery Units will be established for the co-ordination of the programme, with representation from the Ministry of Finance, the Ministry of National Economy, Samruk-Kazyna, Baiterek and KazAgro. They will seek assistance from international consultants to support the execution and to ensure the transparency of the process.<sup>5</sup> The recommendations of the delivery units on types and terms of sale, requirements of buyers and use of external consultants will be considered by the State Commission on Economy Modernisation.<sup>6</sup>

The OECD consensus strongly suggests that large privatisation programmes be organised under a single co-ordinating actor. This should be the unit responsible for state ownership or, in the absence of such a state shareholder, a specialised privatisation agency (OECD, 2010). Since there will be several (at least four) delivery units instead of one project office as originally planned, the authority is likely to remain with the actual owners of the assets, particularly the Committee of State Property and the national managing holdings.

The execution of the ongoing privatisation programme relies to a large extent on the employment and assistance of external independent advisors and consultants. Advisors with experience in privatisation often have access to networks of high-quality investors (OECD, 2003). Such advisors are responsible, for example, for the pre-sale evaluation of all but the smallest assets, assisting the vendor in structured auction processes and ascertaining the integrity of direct trade sales to strategic investors. Advisors with such responsibilities must be appointed in competitive processes with maximal integrity and transparency. The earlier findings of the OECD suggest that advisors with a mandate to evaluate assets and give strategic advice, such as regarding when, what and how to privatise, should not be given a mandate to advise on the actual sale of those assets to avoid conflict of interest (OECD, 2010).

The authorities have not given much information or detail on precisely how the privatisation will proceed. Except for the seven companies that are to be listed, the actual methods of sale, such as auction, tendering or structured two-stage tendering, will be decided on a company-by-company basis by the present owners and the delivery units. Also undisclosed is how much of each entity is going to be privatised and whether present owners are expected to abandon ownership completely, or are intending to retain some participation. The People's IPO policy consisted of selling 10% minus one share of the entities.

The requirement of maximal transparency and accountability in all aspects of the privatisation process is essential. Political interventions will undermine credibility for investors and ultimately reduce privatisation revenues. The organisation of the Comprehensive Privatisation Plan appears to be dispersed and not cohesive, with numerous agents on different levels. The execution of the programme is controlled at the top level by the State Commission on Economy Modernisation, led by the prime minister. The OECD consensus implies that the privatisation process be disclosed regularly to both the parliament and the general public (OECD, 2010). The Committee of State Property, the state assets registry and Samruk-Kazyna have provided appropriate and relevant information on the progress of the privatisation, supported with current data on their respective websites in several languages.

Past experience implies that any privatisation process should be controlled, *ex-post*, by an independent body reporting to the parliament (OECD, 2010). The supreme audit institution of Kazakhstan, the Accounts Committee, is subordinate to the president and reports to the



parliament basically only on the execution of the budget. According to the recently adopted Law on State Audit and Financial Control the Accounts Committee reports quarterly to the parliament on the effectiveness of the management of state-owned assets, including the progress of the privatisation. The Accounts Committee should also have the tasks and powers required in the *ex post* control of the privatisation process and the responsibility to report appropriately to the parliament. The International Organisation of Supreme Audit Institutions' *Guidelines on Best Practice for the Audit of Privatisations* is a common set of good practices in this respect.

### **Preparing entities for privatisation**

The implementation of the vast privatisation programme will be a huge challenge for the state administration, the holdings and the companies. It is a matter for debate to what extent the state owner should restructure the assets before privatisation.

Early planning and preparations are needed for the substantial adjustments of the functioning of a publicly owned entity to that of a listed company. A company planning to be listed must start preparations well in advance to fulfil the listing requirements set by the exchange. It must meet requirements concerning management, corporate governance and reporting. Its financial administration must be able to deliver financial reporting following international standards to the extent and comprehensiveness expected by the shareholders – and in three languages (Kazakh, Russian and English). Management must be able to organise annual and extraordinary general shareholder meetings for a large number of shareholders, including providing means for absentee voting. As an example of this process, KEGOC started preparations for listing in 2011, a year before the planned IPO. The preparations took a full year, and the company was ready in 2014 when the IPO became a reality after delays in the legislation process.

There are three aspects of an enterprise the owner might be willing to improve before sell-off to attract a better price: employment; management, board and governance; and capital structure (OECD, 2009). These aspects apply whether a company is to be privatised through listing or trade sale:

- Regarding **employment**, the labour and employment policies of Kazakhstan SOEs still follow those of the Soviet era. In many countries SOE employees enjoy better social benefits, such as housing or a larger pension, than their private-sector equivalents. Ironing out such differences post-privatisation is challenging and sometimes results in the government assuming responsibility for certain benefits such as pensions for a long time afterwards. Such “grandfathering” of existing entitlements of civil servants and other public employees by the government is not regarded as good practice by the OECD (OECD, 2010). According to the Kazakhstani authorities such social privileges can be accessed only by civil servants and the employees of SOEs have similar conditions to their counterparts in the private sector.
- Also regarding **employment**, large SOEs employ large, often bloated workforces, a state of affairs maintained for political reasons. This over-employment has resulted in severe inefficiency, negatively affecting results. Such companies are not likely to interest private investors, particularly foreign investors. Layoffs are always unpleasant and politically challenging, but the government might be in a better position to mitigate the negative effects of personnel adjustments before the fact than private owners afterwards.

- Regarding **management and board composition**, a change in ownership should be reflected in the composition of the board and the management. Even if the state retains control, the number of government representatives should be reduced, the number of independent directors increased, and new owners of substantial stakes should have the opportunity to appoint their own candidates. New controlling owners, particularly in the case of a trade sale, will likely formulate the board, management and governance following their own preferences.<sup>7</sup>
- Lastly, it is advisable to adjust the **capital structure** of the entity being sold, ascertaining on one hand that the viability of the entity is not put at risk with change of ownership while on the other hand removing excess cash. A good price for cash is rarely obtained in connection with the sale of an enterprise.

Public service obligations of companies and the compensation for those obligations should be disclosed when the companies are being listed or sold. Among the companies identified for IPO, Kazakhstan Temir Zholy as the principal transportation enterprise of the country has public service obligations, and others may, as well. The fairness of the compensation should be evaluated by independent appraisers. Kazakhstan Temir Zholy has also been involved in the Samruk-Kazyna group's commitments, under the Law on Sovereign Wealth Fund, to finance and construct public facilities not directly connected with the business of the companies (Kazakhstan Temir Zholy, 2016). Continuing such practices after the listing would also severely conflict with the requirement for equal treatment of all shareholders.

Investors today are increasingly concerned about environmental risks. Remedying environmental damage is expensive and can be lengthy. Some of the SOEs to be offered for sale may be responsible for un-remedied environmental damages, and many more would bear the risk of such remediation costs. It will be challenging for the vendors to negotiate necessary remedial actions and any future responsibilities with potential purchasers, and this can substantially weigh on the final sale price.

The present owners of the SOEs to be privatised will need sufficient time to prepare the companies for sale and to ensure that they will remain viable under different ownership. The Comprehensive Privatisation Plan extends until 2020 but with annual targets. For example, in the opinion of KazAgro, which is required to dispose of several companies, only Food Contract Corporation JSC, the grain and cotton trader, has the resources, systems and operational methods required from a company with a mixed, possibly dispersed ownership.

### **Who will buy?**

The primary challenge lies in finding buyers for the state-owned entities. The domestic demand for privatised state-owned assets is very limited, at least outside the big private conglomerates. The securities market is thin, illiquid and over-regulated, and the gross savings rate per capita is very low.

In OECD member countries, private pension funds are often important investors in local industries and thus active actors in securities markets. The National Pension Fund is not private and could rather be seen as a state agency. It invests in government securities, Kazakhstan corporate bonds and other credit instruments, not equity. The government's 2013 decision to consolidate all pension savings into a single, state-owned fund led to a sharp decrease in the liquidity of the market when the private pension funds, until then

active institutional investors, disappeared (U.S. DoS, 2015). The absorptive capacity of the Kazakhstan market as a whole is, therefore, relatively small.

The success of the privatisation programmes depends to a large extent on foreign investors. Conditions in Kazakhstan's present economy will make it challenging to attract foreign money. Stability in the exchange rate is of great importance; large fluctuations can be very costly and make valuation of an asset difficult. (Desai and Wheeler, 2016)

Significant shares of the ownership of the privatised companies will need to be sold to attract strategic investors and to facilitate listing on international stock exchanges. Strategic investors are reluctant to invest where they are unable to influence the management of their investments. The government's belt-and-braces policy to dispose of only of 10% of the shares minus one share, effectively eliminates the possibility for minority shareholders to exercise their rights under the Law on JSCs and deters such strategic investors. The policy also sends a message to the market and to the companies that the government is likely to retain control of the company and will not allow a larger proportion of private ownership. This policy ultimately conflicts with the goal of reduced state ownership given the great weight in the Kazakhstan economy of Samruk-Kazyna and the companies proposed for listing. Moreover, the listing requirements of stock exchanges in OECD member countries do not usually allow such a high percentage of majority ownership. Companies' laws also normally include squeeze-out rules, whereby the owner of such a large majority has a pre-emptive right to purchase the shares of minority owners who themselves have the right to demand that the majority owner does so.

In direct trade sales, the strategic investor must agree to a number of undertakings and concessions regarding the investment and future management and operations of the company, which will reduce the attractiveness of the asset. This requirement is included in recent amendments to the Law on State Property. Such undertakings are very restrictive and will seriously hamper the investor's ability to improve the company's efficiency and productivity. In fact, the required undertakings appear contradictory: operational improvements should be made but nothing may be changed. The undertakings are to be specified in the sales contract between the vendor and the strategic investor. It is not stipulated how the fulfilment of the undertakings may be monitored and how the non-fulfilment or non-observance will be sanctioned. A clawback of the asset by the vendor is in practice most likely excluded.

Small companies to be auctioned through the electronic auction process will likely find any new owners in the domestic market. If domestic demand is limited, sales proceeds will be small. For larger and strategic entities, vendors have the option to use the structured two-stage auction. This allows vendors the possibility of negotiating with several buyers, imposing conditions and selecting the best new owner(s) for the future of the entity.

The possibility of management buy-outs (MBO), presently uncommon in Kazakhstan, should be reintroduced and encouraged where feasible. During the first privatisation programmes in the 1990s Kazakhstan experimented with management buy-outs but with discouraging results. However that was a quarter of a century ago and then many aspects of the Soviet legacy were still apparent in the entire economy. For SMEs, a MBO is favourable from the point of view of the entity itself, since competent management is aware of the existing problems and required remedies. Moreover, members of the management will be motivated as they will benefit from the gains in efficiency after privatisation. However, a successful MBO necessitates the ability of the purchasers to pay a fair price for the shares. If a company is sold at a heavily discounted price, there is no assurance that the management

will be committed to running the entity well (OECD, 2003). An MBO is not to be confused with disposals, where the ownership of the entity is distributed to the entire personnel, for free or at a nominal price. Such operations in the past led often to the ownership of the entity falling into unwanted hands or to the demise of the entity because owners did not display interest.

### **Good things to follow**

There is overwhelming support for the notion that privatisation brings about a significant increase in the profitability, real output and efficiency of privatised companies. Fully privatised companies perform better than partially privatised ones (OECD, 2003). Listed companies will enjoy the increase in efficiency through better governance and more professional leadership and management. Listed stock can be used to incentivise management. Daily stock prices provide a day-to-day performance indicator.

Shares to be listed will likely be offered, in large part, through foreign exchanges, and the KASE will also have an opportunity to increase its volumes substantially. When the listings are completed, the securities market of Kazakhstan will be much more active than today. Improving the local capital market is one of the stated priorities of the government and Samruk-Kazyna (Samruk-Kazyna, 2016).

A well-executed privatisation programme can improve government and national wealth, by providing finance for the general budget and for development programmes (OECD, 2016a). On the other hand, the government will forfeit the long-term dividend income that could be generated by the assets once they are privatised.

## **Conclusions and recommendations**

The government has made several efforts since independence in 1991 to reduce the state's high share in Kazakhstan's economy, but the results have been disappointing. Privatisation programmes have been incomplete and have been offset by the creation of new entities. The large number of fully state-owned registered legal entities is evidence of a certain over-organisation. Small functions, and similar operations in different locations have been incorporated into separate entities: for example, a large number of municipal sports clubs have been incorporated as LLPs. The number of all state-owned registered legal entities at the start of 2015 was 27 672. Consolidation into larger units would achieve substantial administrative savings. While bringing new owners into companies that will remain partly state-owned, ongoing privatisation programmes can also reduce the number of entities with state participation.

The organisation, administration and governance of state ownership in Kazakhstan do not yet meet internationally agreed good practices in many respects. A number of nations have used the OECD consensus as a benchmark for the reform of state ownership since the introduction of the OECD Guidelines in 2004. Their recent revisions were made in part to ensure their relevance to non-member countries and to provide guidance to countries in different economic circumstances, particularly those in transition to a market economy.

An important first step would be to develop an ownership policy – a step which is particularly important in view of the high state participation in the economy. The overall rationales of state ownership should be defined, written down and disclosed to the public.

The policy should be reviewed by the government at regular intervals. The government should also define the rationales of owning individual enterprises and review these regularly. Drafting, publishing and implementing such a policy would strongly enhance the government's future efforts to reduce state involvement in the economy. It would also create an opportunity to bring the government's ownership policies and practices more into line with the OECD consensus.

The ownership structure of SOEs in Kazakhstan should be clearly identified within the administration and preferably centralised in a single ownership entity. The Department of State Assets Management Policy at the Ministry of National Economy is the central policy-making authority. Although the Committee of State Property acts as authorised owner of state shares on behalf of the government, shareholders' rights of use and possession in numerous enterprises have been delegated to sector ministries, such as the Ministries of Agriculture, Health and Social Development, and Investment and Development. Meanwhile the largest weight of state ownership in Kazakhstan lies in the groups of companies owned and managed by Samruk-Kazyna and other national managing holding companies. This arrangement places a vast portion of the wealth and revenues of the nation outside the budgetary control of the parliament. A consolidated ownership entity should have the capacity and competencies to carry out its duties effectively. Currently it is not clear what degree of supervision the Ministry of Finance and the Ministry of National Economy can exercise over the boards of the national managing holding entities, where some of the government's most senior political office-holders sit. For example, the Committee of State Property may not be in a position to give directions to the board of directors of Samruk-Kazyna, which is chaired by the prime minister.

A centralised ownership entity could be established and located in the Office of the Prime Minister. This structure would reflect the importance of the state sector in the economy. During the first years of independence the ownership function of Kazakhstan was based on a single entity but this proved inefficient under those circumstances. Successful completion of the ongoing privatisation programme will give the opportunity to restructure the present ownership function into one more consistent with the OECD consensus. This would also ensure separation of the state's ownership from its regulatory functions, with the latter located in the Ministry of Finance and the Ministry of National Economy. The ownership entity would combine the policy-making tasks of the Department of State Assets Management Policy and the shareholder's powers and duties of the Committee of State Property, and take over the shareholding rights delegated to sector ministries. The ownership entity should be held accountable to the parliament. It should develop a consistent system of reporting on state ownership and publish an aggregate report at least annually.

The ownership entity should also have the shareholder's powers over the boards of the national managing holdings, and use this to appoint professional board members. These boards should be reorganised with professional corporate leaders taking over the responsibility from political office holders. The ownership entity should develop a consistent and transparent methodology to search, evaluate and choose talented and experienced candidates, both from home and from abroad, for membership on the boards of the important companies.

#### Box 4.5. How could future scenarios affect implementation of privatisation strategies and the role of the state in the economy?

Privatisation efforts have several motivations. They constitute a significant structural reform to move towards an economy where the private sector, sustained by improved competition law and practice, plays a more important role in the economy. This results in greater productivity in firms, possibly at the cost of net employment creation in the short run. Privatisation can also generate revenue for the public purse. Transforming the role of the state in the economy also relies on improvements in the ownership function of the state and the governance of state-owned enterprises (SOEs).

For details of the scenario storylines, please see section: *Anticipating trends and preparing for future challenges: scenarios for the future of Kazakhstan* in Chapter 1.

**Scenario 1: “The New Commodity Super Cycle”** would see a renewed natural resources bonanza that would reduce pressures to increase productivity in extractive sectors and test the government’s resolve to reduce significantly the weight of the state in the economy. On the other hand, given their reduced price competitiveness, non-natural resource assets would most benefit from increased productivity. Moreover, liquidity in financial markets would allow for adequate revenue to be generated from privatisation efforts.

Conversely, in **Scenario 2: “The Great Dissipation”**, limited liquidity may reduce the efficiency of privatisation markets, while revenue would provide a strong motivation for continued privatisation efforts. In a depressed economy, the employment fallout of privatisation would need to be compensated for via active labour market policies or income support, to avoid further depressing internal demand. In this context, improvements in ownership and governance of SOEs would have great potential to increase productivity in a context of limited demand for privatisation, while allowing the state to cushion the employment fallout.

**Scenario 3: “New Silk road and Central Asia Resurgence”** would see greater trade integration with and through Central Asian economies which would shift the pattern of competitiveness of Kazakhstan, making productivity increases and complementary reforms – including in SOE governance – critical, to overcome higher labour costs in Kazakhstan. The opportunities offered by market-seeking foreign direct investment (FDI) could be capitalised and increase not only the quality of buyers, but also revenues raised from privatisation of manufacturing units and key export-driven state-owned companies.

Finding suitable buyers would be easier in **Scenario 1: “The New Super Cycle”** and especially in **Scenario 4: “New Technology Solution”**, when liquidity would be sufficient in the country and opportunities clear for private sector investors.

#### Notes

1. All direct references to laws of Kazakhstan are based on English translations provided by “Adilet”, Legal information system of Regulatory Legal Acts of the Republic of Kazakhstan, Republican Center of Legal Information, [www.adilet.zan.kz](http://www.adilet.zan.kz).
2. The President’s State of the Nation address of 30 November 2015 called for pension fund management to move from the central bank to private entities. This policy had not been implemented at the end of 2016.
3. “Sales of republic ownership replenish budget”, *Kazinform*, 8 January 2016.
4. “Government approves new privatization plan for 2016-2020”, *The Astana Times*, 5 January 2016.
5. “About 60 major state-owned companies are going to be privatized in Kazakhstan”, CIS Financial Markets, 23 September 2015.

6. The State Commission on Economy Modernisation is a special committee, headed by the prime minister, monitoring the progress of the development programmes Kazakhstan 2050 and 100 Concrete Steps.
7. Further guidance on boards of directors of state-owned enterprises can be found in OECD (2013a).

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