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CORPORATE GOVERNANCE IN KAZAKHSTAN

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Introduction

The globalization of economies, and thereby financial and investment markets in the 1990s, has led to the increasing convergence of originally separate initiatives in Corporate Governance. The fact is that good corporate governance practices are now becoming a necessity for every country and business enterprise, and are no longer restricted to the activities of publicly-listed corporations in advanced industrial economies.

As regulatory barriers between national economies are removed and global competition for capital increases, investment capital will follow the path to those countries and corporations that have adopted efficient governance standards.

There is a need to focus on policies and structures occurring on implementation of the structural adjustments. In the Commonwealth there is a necessity for micro-economic policy instruments which will support the macro-economic policies arising from the transition. Corporate Governance can be considered a powerful micro-policy instrument and an effective lever for change at the business enterprise and sectoral levels.

Several programs worldwide have initiated the appointment of national task forces in the countries concerned with drafting national codes of corporate governance and defining strategies for implementation. They have to look at their legal and regulatory systems, business enterprise structure, inherent cultural characteristics and heritage before defining any specific approaches to address issues of Corporate Governance.

Kazakhstan, being a part of global economy and being prospective for investments, needs to develop and establish common rules and procedures for Corporate Governance. The basis for a positive movement towards better practices must be based on the creation of the Kazakhstan Concept on Corporate Governance with the main principles of transparency, accountability and responsibility.

At the first stage it is necessary to gather all the information about the components of the Corporate Governance system and then make the rules of the game equal for owners, financial and investment markets, government bodies, and other interested parties. A fruitful step in the creation of this system should be the analysis of the principles laid by the OECD, taking into account experience of developed countries, and the expertise of different models on Corporate Governance worldwide.

The set of objectives for the current situation in Kazakhstan is clear. We need to:

- Increase awareness of the necessity for institutionalized Corporate Governance policies and practices amongst all interested parties
- Identify the best applicable CG practices
- Increase Corporate transparency and accountability in the region
- Develop and disseminate initiatives on Corporate Governance which could be immediately applied
- Establish equal rights and responsibilities and acceptable framework for foreign and local investors

To achieve these objectives we should start with the collection and processing of the information available about major players.

This paper is an effort to scan the corporate governance environment in Kazakhstan in order to establish further steps in the implementation and development of such an important instrument in the market. Since we have been provided with an OECD questionnaire as a set of guidelines we will closely follow this recommendation.

Paper outline

1. General economic, social, and demographic state of Kazakhstan

The first part briefly describes the current general economic situation in Kazakhstan for the given time period. The information is based on official statistics data about economic trends in GDP, debt ratio, import, export, and composition of investment in different industries.

Kazakhstan made several necessary steps in establishing and developing its the market economy. They are the introduction of free-floating exchange, the introduction of international accounting standards, pension reform, and improvement in the banking system. All these factors are influencing the general condition of the implementation of Corporate Governance.

2. Corporate Governance System Components in Kazakhstan

- a) Privatization and ownership transformation, ownership structure by sector
- b) Legal issues on Corporate Governance: consideration of the laws on joint stock companies, bankruptcy, property, accounting system, taxation, and protection of minority shareholders' rights
- c) Foreign Direct Investment
- d) Banking sector in Kazakhstan
- e) Performance of the funded pension system
- f) Finance companies and securities companies
- g) Stock market
- h) Government and ownership
- i) Capital flight from Kazakhstan

3. Corporate behavior

4. Conclusion: plan for further research on Corporate Governance in Kazakhstan

Part 1

Prior to independence, in 1991, the Kazakh economy existed as a highly integrated part of the Soviet production system specialising in agriculture, metallurgy and mineral extraction. Although growth resumed in 1996 and 1997, recovery has proved to be short-lived, owing largely to the steep drop in oil and metals prices caused by the economic crises in Asia and Russia.

In 1992, the Kazakh Government embarked on a gradual reform process towards a market economy in order to maintain social and ethnic stability in the country and to avoid the social disruption which could discredit market reforms in the eyes of society. In 1995, the first signs of macroeconomic stabilization have been observed: the inflation rate has been curbed from 1170% in 1994 to an annual level of 55% in 1995 and 2.8% in 1998.

Official language: Kazakh and Russian

Kazakh Language is spoken by over 40% of population; the Russian language is spoken by two-thirds of population and used in everyday business. An examination in the Kazakh language is obligatory for candidate to governmental positions including Presidential candidates.

President: Nursultan Nazarbaev (President since independence and former Head of the Soviet Socialist Republic of Kazakhstan before the collapse of Soviet Union), re-elected for a 7 years term in January 1999. Prime Minister: Kasymzhomart Tokaev.

Parliament

The Bicameral Parliament consists of:

- The Senate (upper house) with 47 seats. Seven Senators are appointed by the President, other members are popularly elected, to serve a four-year term.
- The Majilis (lower chamber) with 67 seats, all members are popularly elected for a four year term.

GDP

We focus on GDP, which reflects overall economic activity. Since no official quarterly data for the income side of GDP are available we focus on the production and expenditure sides of GDP. Real GDP increased by 11.9% in the second quarter of 2000 compared with the corresponding period of 1999. The increase in GDP is not only a consequence of higher prices and volumes in the export-oriented industries such as oil and gas, but also of an overall improvement in the economic situation.

Unemployment

According to the data of the Ministry of Labor and Social Security, 267.4 thousand people were unemployed in summer 2000, which represents 4.2% of work force.

Part 2

Privatization and ownership transformation

According to the latest data from the first six months of 2000, 866 entities were privatized. Of these, 324 units of state property were privatized within the small-scale privatization program, one unit within the case-by-case program and three units belonging to the agricultural sector. As of July 2000, around 130 thousand enterprises were registered in Kazakhstan, of which 1.7% were large, 8.4% were medium sized, and 89.9% small enterprises. The majority of large enterprises belong to the agricultural sector (stock companies, co-operatives, and agriculture partnerships) or industry. The share of state enterprises in total enterprises amounts to 17.6%. The largest group of state enterprises (15.2%) renders communal and personal services. Private enterprises dominate in nearly all sectors of economy, and in particular in agriculture (93.8 of all enterprises are privately owned) and in construction.

Legal issues on:

Pension reform

The transition from the pay-as-you-go system to a funded pension system began in 1998. Currently, employees are required to pay 10% of their wages to a pension fund. The contributions to the pay-as-you-go system are included in the social tax, which currently amounts to 26% of the total payroll. The newly established pension funds are privately owned with the exception of the State accumulation Pension Fund, which is of special importance as it accounts for the majority of pension savings. All pension funds may be invested in securities and Eurobonds issued by Kazakh Ministry of Finance, the NBK and local authorities, in securities of international financial organizations and in deposits to commercial banks. The private funds may be invested in some foreign debt securities as well as in securities of private Kazakh enterprises.

Banking System

Kazakhstan has a two-tier banking system, with the central bank, the National bank of Kazakhstan (NBK) representing the first tier. All other banks are in the second tier of the system. All credit institutions in Kazakhstan are required to be licensed and regulated by NBK.

NBK is an independent institution but is subordinate to the President. The President has the power to appoint and remove the NBK's Chairman and Deputy Chairman with the approval of Parliament.

NBK is charged with the overall supervision of all other banks in the country and ensuring the external and internal stability of the national currency.

Stock market

The RK securities legislation includes the Law "On the Securities Market", "Law on Transactions in the Securities Market", "Company Law", other laws governing legal relationships related to securities issuance and circulation, the statutes of the RK President and the government, as well as normative legislative acts of the RK governmental agencies issued in accordance with the legislation of the Republic of Kazakhstan.

The main executive bodies in the infrastructure of the Securities Market (SM) are the Kazakhstan Stock Exchange (KASE), National Securities Commission (NCS), and Central Depository.

The Kazakhstan stock market is presented mainly by the operations on the Kazakhstan Stock Exchange (KASE). KASE was founded in July 1996 in order to assist in the capitalization of the country's industries and in the various privatization programs. KASE is responsible for providing a trading floor, organizing trades of financial instruments, quotation of financial instruments and conducting listing of the companies.

The activity of KASE is regulated by the presidential decree On the Securities Market and the Stock Exchange (1997) and the regulations of the National Securities Commission.

National Securities Commission is in charge of developing rules, law drafts and acts, licensing the professional participants and registering state and corporate securities.

The representatives of the Central Depository responsibilities include the implementation of deals with securities, the transfer and verification of securities rights, and conduction of "depo"-accounts.

Foreign investment

Kazakhstan has a special law on foreign investment, a special agency for the promotion of investments (Agency of the Republic of Kazakhstan for Investment (ARKI)) and a Foreign Investors' Council under the President of Kazakhstan. Furthermore, Kazakhstan has signed treaties on the promotion of mutual investment with over 20 countries, is a member of the Multilateral Agency for the guarantee of Investments (MAGI), the International Association for Development (IAD), the International Center on Regulation of Investment Disputes (ICRID).

The Supreme Soviet of the Republic of Kazakhstan, 30 December 1994, adopted the Law of the Republic of Kazakhstan "On Foreign Investment". This Law defines such important statements as guarantees for foreign investments, creation and liquidation of enterprises with foreign participation, registration and activity of branches and representatives of foreign juridical persons, types and conditions of activity of enterprises with foreign participation. Also, priority spheres are defined. By law, ARKI has the right to grant different concessions to investors (both domestic and foreign), including tax-breaks and in-kind bonuses. The agency issues licenses to subsoil users, i.e. oil and mining companies developing subsoil resources.

The Foreign Investors Council (FIC) was created in 1998 by a decision of president Nazarbaev and strongly supported by the European Bank for Research and Development. It was founded in order to create a forum where representatives of the foreign investment community could discuss problems with and make suggestions directly to the president and top officials, including the prime minister, the governor of the central bank and key ministers. The membership of the Council was designed to represent different sectors and different countries of Foreign Direct Investment origin. Currently, it includes ABN AMRO, Baker and McKenzie, British Gas, Chevron, Deutsche bank, KPMG, LNM Industries, Mitsubishi, Samsung, Tractebel and EBRD. FIC is divided into four working groups (on legal matters, taxation, the enhancement of Kazakhstan's image and operations), which meet regularly and develop discussion papers for FIC meetings.

Foreign direct investment (FDI) in Kazakhstan has remained one of the most important issues throughout all the years of independence. At the current stage of its development Kazakhstan does not have enough national savings, so, to promote sustainable growth, it needs to attract external savings in the form of FDI, portfolio investments and loans.

In addition to many obvious advantages of FDI, such as bringing in new technologies, supporting local suppliers and subcontractors, creating jobs and training local personnel, developing export capabilities in new market segments, etc., there is one major need for Kazakhstan: capital investment.

The willingness of the President, the government and ARKI to promote foreign investment is widely acknowledged. Nevertheless, the relationship and the cooperation with regional and district authorities remains an important issue. Although Kazakhstan is a unitary system state where the President nominates provincial governors, the latter still exert considerable power, and this should be taken into consideration by investors in the planning stage.

The importance of the district level results from several circumstances. First, all companies file their tax forms locally and thus address the district tax inspection. Second, the local customs office is involved when an investor imports equipment into the country. Third, problems with the local administration or an employment dispute could be taken to a district court.

Unfortunately, there is a lack of understanding of the importance of foreign investors for the country on the district level and sometimes local authorities try to solve their problems at the expense of foreigners.

Kazakhstan remains a country that is attractive mostly to large investors. They are dominant in Kazakhstan for several reasons. As most FDI takes place in commodity-related industries, this requires a sizable investment. As these industries are capital-intensive, the bigger investors have an advantage. They have long-term strategies, which are the only correct kind of strategy in industries where the payback period can be as long as several years. There is also an element of strategic positioning. For large companies establishing themselves in Kazakhstan this is a part of their global game against competitors. Kazakhstan has a gap to fill between large FDI-related projects (usually over \$100 million USD) and the small projects of both foreign and local investors. Most local investors are also very small, for instance, investment into food producers. The projects are around \$2-5 million USD and payback periods are short (6-12 months). Another advantage that in this sector people sell for cash. Textiles, for instance, would require a larger investment and a longer payback period due to a slower turnover. At present, this sector is too large for local investors and not interesting enough for foreign investors.

The promotion of small and medium-sized businesses depends on further development of the banking system and capital market as well as on improvement of the investment climate in Kazakhstan.

International financial crisis has retarded rates of economic growth and forced Kazakhstan to undertake more severe measures to keep stable macro-economic indices. At the last conference of the IMF and WB, the president of the IMF proposed that investors should bear all risks connected with the unstable economic and political situation in a country. It is unclear what impact such a possible decision will have on investors in Kazakhstan. Kazakhstan has been fairly successful in attracting FDI compared with other CIS countries. According to the State Investment Agency, over \$10 billion USD was invested in Kazakhstan in the period of 1993-1999. The best year was 1997, with \$2,107 million USD. Last year, FDI amounted to \$1.2 billion USD and domestic investment of \$2.1 billion USD. In the first quarter of 2000, gross FDI in Kazakhstan amounted to \$453.9 million USD, which is 10.9% less than in the first quarter of 1999.

The structure of FDI has changed in that inflows of authorized capital further declined (3% of total FDI), while reinvested profits increased (26% of total FDI). The share of other credits remained nearly unchanged (71%). In amount of investment to Kazakhstan, USA is the leading country (29%) followed by South Korea (18%) and Great Britain (13%). To

date, Japan and the Persian Gulf Arabic countries have demonstrated noticeable business step-up in this respect.

A high shares of the USA and UK are mainly a result of their strong involvement in the Kazakh oil and gas sectors, though US investors are present in energy generation, food processing (including tobacco) and mining, too.

The breakdown of FDI by sectors shows that the majority of investments were in the oil and gas (47%) and non-ferrous metal (24%) industries. The attraction of new capital inflows accounted for 53% of FDI in these two sectors, while 47% were due to refinancing of generated profits. Three other sectors that were relatively attractive to investors in the period of 1993-1999 were ferrous metallurgy, energy generation and food processing. The continuing increase in the consumer goods industry is also worth mention.

The positive aspect of this development is that even in Kazakhstan's worst period FDI kept flowing in. Three groups of main factors, all of them external, affect the Kazakh economy: commodity prices (mostly oil and metals), the economic and political situation in Russia and the general sentiment of investors about emerging markets. In 1998 all these factors combined against Kazakhstan. That year was extremely important in proving that there is a core group of well-established investors, who remain in Kazakhstan and continue to invest. Thus, there is an almost guaranteed amount of investment of about \$1 billion USD a year coming from these large established investors, fulfilling their investment programs.

There is also a possibility of strong growth of FDI from OKIOC members (presented by nine largest international oil companies in the world: Agip, British Gas International, Mobil, Shell, Totalfina, BP Amoco, Statoil, Phillips, Inpex), as large oil reserves were found in the Kashagan (the Caspian Sea).

Historically, Kazakhstan has been more of a mining country than an oil producer. Its accumulated metals potential may be even greater than its oil and gas potential. Kazakhstan possesses practically all base and precious metals. As different metals have different cycles, being able to produce a number of products provides for much greater diversification within the sector. Several Kazakhstan metals are among the cheapest in the world. Transportation costs are also much lower for refined metals than for oil and gas, and there is no need to build a separate infrastructure such as pipelines. The attraction of one or several major investors in the mining sector could have a very beneficial effect for the country, but this sector has failed to attract big investors because of worsened perception of the overall investment climate in Kazakhstan in this sector as a result of incorrect governmental policy.

Thus, currently the most important objectives in the field of FDI are improving the investment climate and getting investment in mining, non-commodity industries and medium-sized projects, both domestic and foreign, which is necessary to diversify the economy, to protect it against low oil prices and to increase FDI to a level that would secure real growth.

Investment climate

In past years large efforts were made to improve the investment environment in Kazakhstan.

However, the existing legal and formal infrastructure is not sufficient for growth of FDI. In particular, further improvements in legislative process and court activities, observance of contractual conditions, regulation of investment disputes, methods of tax agreement application, VAT taxation, and issues related to import of foreign labor are all needed. The government carries out task-oriented work in this respect: the FDI Program has been approved for the period of 1999-2000, the Interdepartmental Foreign Investment

Committee is in place, and simplified procedures for investment applications are being developed.

Banking sector in Kazakhstan

Kazakhstan has made considerable progress in rehabilitating its banking system, through setting larger capital requirements, encouraging the creation of larger and stronger institutions through mergers and developing an effective supervisory regime, which has enforced prudential limits and improved the quality of loans. These measures succeeded in shielding the local banking system from any harsh effects from the Russian crisis. Nevertheless, some fundamental problems still persist, such as the low level of deposits in the banking system, representing a continuing reluctance on the part of consumers to trust the banking system, relatively low levels of capitalization, tight liquidity and high levels of non-performing loans. Loans carry prohibitively high interest rates, frustrating small entrepreneurs, and thus the commercial lending volume is low. Nevertheless, as of today Kazakhstan has the most advanced banking system among CIS countries.

Ratios established by the NBK	
Minimal capital adequacy	8%
Minimal liquidity	20%
Maximum lending to a single non-related party*	25%
Maximum lending to a related third party*	10%
Maximum lending to related parties (total)*	100%
Maximum net open FX position (each currency)*	30%
Maximum net open FX position (total)*	50%
<i>* - as a percentage of capitalization</i>	
Source: BTA report	

Foreign competition, under-capitalization and stiffer requirements from the NBK have led to a consolidation process in the domestic banking industry. The number of Kazakhstan banks fell from 101 at the beginning of 1997, to 76 by December 1998, and to the current level of 55. According to statistics issued by the National Bank, among the existing 55 banks one is state owned, one is interstate and 22 are banks with foreign participation.

Eleven big banks play the major role in the banking sector; their assets amount to nearly 80% of total assets, and equity is of 57% of total banking equity capital. The leaders are Kazkommertzbank, Halyk Savings Bank of Kazakhstan, Bank TuranAlem, ABN AMRO Bank Kazakhstan, Bank CenterCredit, Citibank, Almaty Merchant Bank, Eurasian bank, Kazprombank, Temirbank and Nurbank (see Exhibit 1). These leaders define the main tendencies in the dynamics of the banking sector of the country.

Main tendencies in the banking system

The year 1999 was a year of further consolidation of the banking system, continuing strengthening of the system, transition to IAS and an increasing level of capitalization, as well as an expansion of the presence of foreign capital in the banking sector of Kazakhstan.

The number of banks, that participated in the Program of Transition to IAS decreased from 55 to 36. Eleven banks out of them, which meet core international standards, including capital adequacy requirements, represent the first level of the banking system.

Throughout 1999 the total amount of banking equity rose by 46.1% to KZT 69.1 billion (roughly \$500 million USD), while total assets increased by 74.3% up to KZT 341.2 billion (\$2.5 billion). The change in the structure of assets reflects mainly an increase in the share of cash in other banks (in 4.5 times), banks' claims (by 52.4%) and the government securities portfolio (by 73.7%).

The total amount of liabilities of commercial banks increased by 85.1% totaling KZT 270.8 billion (\$2 billion USD) in 1999. This increase was mainly caused by the growth of the deposit base of major banks.

The total profit received by the commercial banks in the year 1999 totaled KZT 9.5 billion, which is 2.5 times higher compared to the results of 1998.

Impact of the devaluation process on the banks' results

The introduction of the free-floating exchange rate for the Tenge had both negative and positive effects for the banking sector. Nevertheless, despite the devaluation of the national currency in 1999, financial indicators of the banking system have positive tendencies.

The major positive effect from the introduction of a free-floating exchange rate is the increase of the total amount of a bank's liabilities, mainly due to the growth in volume of deposits. Favorable conditions for growth in the depository base have become possible thanks to two major factors. First, the National Bank fulfilled its liabilities to legal entities and individuals on conversion of the governmental debts (which aimed to weaken the consequences of the devaluation process caused by the introduction of the free-floating rate). Second, the NBK introduced the Kazakhstan Deposits Guarantee Fund, aimed to increase the trust of customers in the banking system. Today there are 16 banks participating in this system.

The total amount of commercial bank deposits over the last year increased more than 2.4 times (ignoring currency exchange difference – by 94.2%) totaling KZT 174.5 billion (\$1.2 billion USD). The amount of individual deposits grew by 94.0% to KZT 59.9 billion (\$428 million USD).

The devaluation of the national currency did not have any negative impact on the liquidity level of the banks. During the transition period to the free-floating exchange rate, NBK decreased the minimum required reserve level to 5% from the acting 10%. That allowed banks to keep an adequate level of liquidity.

One of the negative consequences of the devaluation process is the decrease of the foreign currency equivalent of the banks' equity – the total amount of foreign currency equivalent equity in 1999 fell to \$500 million USD from \$564.4 million USD in the previous year. The growth of the assets due to the devaluation of the national currency was higher than that of equity, decreasing the coefficient of the equity capital adequacy. Nevertheless, in 1999, the level of capitalization of the banking sector was still sufficient.

The rising credit and currency risks of banks caused by the falling exchange rate of the national currency made the quality of banks' loan portfolios worse. The share of standard loans in the loan structure fell to 56.8% from 60%, while share of the doubtful and "poor" loans rose to 37.8% and 5.4% from 34.7% and 5.4% respectively.

Kazkommertzbank and ABN AMRO Bank demonstrated the major stability of the financial results that were mainly connected with smart assessment of credit risks. Kazkommertzbank reached stability of financial results through establishment of the largest volume of reserves against the biggest loan portfolio, while ABN AMRO focused on the strict requirements for creditors with an average portfolio level.

The stable profitability of these banks was also the result of effective management of operational expenses. These positive tendencies allow the expectation of potential growth of assets for these banks in 2000.

Other large banks such as Eurasian bank, Almaty Merchant Bank, Citibank and Kazprombank also demonstrated high growth of assets coupled with essential growth of equity, which that also allows them to strengthen their positions further. However, taking into account stabilization of the national currency exchange rate, further stabilization and growth is possible only through expanding assets operations and increasing loan portfolio.

Reforming the pension system in Kazakhstan

Another component of Corporate Governance is a pension system of a country.

The former "Consolidated" system of pension funding was formed on payments of pensions to full-fledged pensioners thanks to mandatory fees collected from the employed. Specific features of the previous system were:

- A state monopoly on pension funding;
- An impersonality of mandatory pension fees because of the lack of personal responsibility of citizens for their own funding at the old age.
- A redistribution of pension resources inside the system.

This system was effective in planning a directive economy, with almost all able people employed, with total control by the state authority and with an already formed percentage of pensioners and working people. That is why the pension system provided a relatively high level of pensions - the amount of pensions depended on the salary received during the last several years, work experience and ages, and a lot of preferences made pension ages very attractive.

The change in the economic situation led to instabilities in the former pension system. The pension system, on one hand, became unable to provide the minimum requirements of the majority of pensioners, and on the other hand, it became a burdensome for the economy.

The drawbacks of the previous pension funding system were:

1. There was the lack of relationship between the amount of pension fees and pension payments. Pension fees were paid impersonally, but every employee had the right to receive a pension without taking into consideration whether his employer paid regularly and fully to the pension funds. The state, from its side, had to fulfill the pension liabilities before the citizen whose employer avoided the mandatory payments to the State Pension Fund.
2. A high pension rate increased manufacturing expenses. A payment of 25.5% of a salary, which was paid to the pension fund was problematic for the economy. Further increases of the pension rate for covering considerable and always growing expenses for support of pensioners' standard of living level in the condition of inflation lead to even more employers avoiding the mandatory payments to the State Pension Fund.
3. A low level of gathering of pension fees can be explained by the lack of a necessary control mechanism to track the money flow and by the fact that State Pension Fund employees were not interested in the support of state pension funding.
4. A huge amount of pension preferences created an extra load for the State Pension Fund. The legislation gave the right to many people to retire earlier and to receive preferred pensions, the amount of which is higher than of those aged pensioners.

As a result, the employees of some industries paid their fees to those who worked in the privileged industries, and this ruined the principle of social fairness.

5. The lack of personal accounting of pension fees by employees did not create any stimulus to increase the amount of fees and accumulate them on their personal accounts and to control the fees paid by the employer.
6. An ineffective system of managing the pension funds, split function of gathering and spending the pension resources over the different organizational structures encouraged their improper use as a consequence, serious financial losses.

Payment of pensions to the citizens, funding of which was conducted in accordance with the Law of Republic of Kazakhstan "About the pension services for military people, officers and soldiers of the body of internal affairs and their families", taking into consideration their peculiarities, is held at the expense of the resources of republican budget.

The perseverance of the previous pension system inevitably lead to its crisis and prolonged postponements of pension payments. That is why the pension system needed principal changes in its legislation, economic and social aspects. Reforming the pension funding system facilitated the development of the state economy, the state of which influenced the economic well being of all pensioners.

The pension paid at the expense of the accumulated accounts of citizens (including military employees, members of bodies of internal affairs and the State Detective Committee, who have work experience not less than 10 years at the time of implementing the reform and new employees who have just got the position after the reform) in the cumulated pension funds at the expense of mandatory fees. The main difference of this pension is that every employee defines for him/herself the amount of his/her future pension. Its size will solely depend on size of the pension fees of a certain person and on the additional interest (dividends) from investing pension assets. This pension is based on the principles of personalization that excludes any privileges for several categories of citizens.

International experience of developing pension systems shows that a distribution system based on the fact that the population receives pensions from the state from common taxes can work only when there are significantly more employed people in the country than pensioners. While such countries as Chile, Canada, and Japan there are 5-7 people employed for each pensioner, and in Switzerland, Germany, the USA, and the Netherlands there are 4-5 people employed for each pensioner, then in the Republic of Kazakhstan according to information from 1997 there are approximately 1.8 people employed for each pensioner. According to data from 1998, this proportion was 1:1 (based on the results of pension payments to the state center of pension payments). This is connected with the withholding of salaries, stoppage of production lines, delayed payment of taxes, etc.

Transition to the accumulative system is not a perfect remedy for all economies. In the presence of young people and a large number of employed workers, the distribution system is ideal. For example, in the USSR under Stalin, in the 30s, it was enough to pay small fees (5-6 %) in order to pay relatively high pensions to every one who survived until retirement. Many African countries are in the same situation, and it is not accidental that accumulative systems work unsatisfactorily. In China, a distribution system is being implemented. This is connected to the fact that there is a young population, and people of pension ages comprise approximately 9% of the population.

As the population of KZ is becoming older, the proportion of advantages and disadvantages of the distribution and accumulative systems change sharply. Almost

all countries of Central and East Europe are considering or have already begun the transition to the accumulative system. Latvia was the first, later joined by Poland and Hungary. Kazakhstan was first to begin this reform in the CIS. At present, it has been the most radical in the pension aspect among the countries of the former Soviet Union.

Reasons for creating a State accumulative pension fund

One of the reasons for the reform of the pension system is the provision of citizens with the right to choose where to make their pension payments: into state or non-state pension funds. The State Accumulative Pension Fund was created, first of all, as an alternative to the non-state pension funds.

In addition, SAPF represents the guarantee of security of pension on behalf of the state.

In the World Bank opinion of, SAPF has to serve as a pension fund to those who did not believe the private financial organizations from the very beginning. More severe restrictions were put on the investment portfolio of this pension fund that could secure high level of assets security and, supposedly, much lower rates of investment revenue.

The State Accumulative Pension Fund was founded by the Legislation Act of the Government of the Republic of Kazakhstan in the form of a closed joint stock company. The purpose and the main CJSC “SAPF” activities are: collection of the mandatory pension fees of the depositors and pension payments to the recipients, building the pension assets and their investment to the state securities (Treasury Bills), deposits of the state banks, and securities of the international financial organizations.

Differences between the corporate and open PAPP

Private accumulative pension funds can be of two types: opened and closed.

The opened accumulative pension funds pension accounts from the mandatory and voluntary fees of citizens independent from the place of their work. Examples of the opened pension fund are CJSC POAPF “Kurmet”, CJSC OAPF “Ular”, CJSC OAPF of the Federation of labor unions of Kazakhstan” and others.

Corporate accumulative pension funds are created by separate corporations and raise pension accounts from mandatory and voluntary fees of the employees of these corporations. An example of corporate pension funds can be APF “Kazakhmys”.

Distinctive features:

Reasons	Open	Corporate
1. Categories of depositors	Fees of depositors are accepted independent of their place of work	Depositors are the employees of those legal entities that are the founders or shareholders of the fund
2. Consequences of being firing	While being fired, an employee has the right to choose whether to stay in the same APF or to switch to another one	While being fired from an enterprise that is a founder or shareholder of the APF, the pension agreement of the fired depositor with the

		APF is terminated
3. Founders and shareholders	They can be both legal and physical entities that are residents of the RK	They can be legal entities

Stock market

Even though a satisfactory legal and regulatory framework has been put in place, the current level of activity on the KASE is relatively low, mainly as a result of the inefficient range of corporate securities. Emphasis has been placed on floating the “Blue Chips”. The low level of activity and liquidity has coincided with a decline in the level of interest in emerging markets on the part of international investors.

Program of development of the Stock Market in the RK

The Development Program for SM has been in effect since 1996. The main purpose of development of the stock market was creation of an effective mechanism for investment activities and rational allocation of capital among the industries composing Kazakhstan’s economy.

The program of development of the SM includes three stages:

- I. Development in legal framework and infrastructure for the securities market and creation of a system of institutional investors (investment funds and companies, insurance companies, pension funds). The main objective is to provide stable and professional investment activities and increase the level of trust of the population.
- II. Developments in the infrastructure of the securities market:
 - establishment of a depository-registrar system
 - development implementation and payment system for dealing with securities
 - creation of information system aimed at providing sufficient information flow to investors and SM participants.
- III. Further development of the local SM and integration into the international capital markets.

Today Kazakhstan is in the third stage of development of its securities market. It already has developed the main infrastructure and information system. Since 1996 Kazakhstan has participated in the international securities market. The credit rating agency Fitch IBCA awarded Kazakhstan with a “BB-“ credit rating.

Primary market for Treasury Bills

The government securities market is the most active sector in the Kazakhstan securities market. The Ministry of Finance and the National Bank of Kazakhstan issue treasury bonds, bills and notes nominated in the national currency and USD. Treasury securities are an important source of deficit finance for the state budget.

The National Bank of Kazakhstan and 15 commercial banks licensed as primary dealers represent the primary market for treasury bills.

In the second quarter of 2000 the volume of transactions in the primary market for T-bills amounted to KZT15.506 million, which exceeds the volume of the previous quarter by 88%. Due to the favorable performance of the state budget, the Ministry of Finance offered only KZT denominated securities in the second quarter. In June the

net issues of T-bills turned negative. Due to the low inflation rate (5.6% by October 2000), the effective interest rates of T-bills generally decreased. In the structure of trades, the share of 12-month securities fell to 34.5%. However, the demand for the latter exceeded supply by four times.

Secondary market for Treasury Bills

In the second quarter of 2000, the volume of transactions on T-bills in the secondary market increased by 28% compared with the previous quarter and amounted to KZT 99.742 million. In June, the volume of transactions reached the highest level ever. The share of securities denominated in KZT, however, decreased by 14.75 percentage points due mainly to the low volume of transactions with three-month securities (64%). The share of “others” continued to decrease in the second quarter of 2000 and to 10.6%. Transactions with state special treasury obligation, increased three times from May to June. In addition, there was also a significant increase in transactions with six- and nine-month securities in USD by 3 and 2.3 times respectively.

Corporate securities market

A-List

To be included into the Official List of KASE, emitters should meet certain requirements. The listing requirements to qualify securities for the first segment, or List A are as follows:

- Company should be three years old,
- Have at least 500 shareholders,
- Have financial statements audited for two years in accordance with international standards,
- To be profitable for the last year, and
- Have a minimum capital equivalent of \$10 million USD.

A company should also not have any debts of non-paid dividends and have to kept register records with an independent registrar.

List-B

List- B (second segment) requires the company to have audited its financial statements for only one year and have at least 100 voting shareholders (over 500 for investment funds). The company also should issue and place securities in the amount not less than \$500,000 USD in KZT and keep a register with an independent registrar.

The companies whose stocks are not included in the Official List but are allowed to trade on the stock exchange floor are called “non-listed emitter” and their stocks are traded on special floors.

As of today, there are 74 stocks of 53 companies available at the KASE floor, including 14 “A”-list companies, 8 “B”- list companies and 31 “non-listed companies”.

Capitalization of the corporate stock market by the end of September 2000 accounted for \$329.0 million USD. Capitalization of corporate bonds reached \$105.3 million USD.

In August 2000 KASE quoted 23 corporate securities deals for \$5,114.0 thousand reaching \$65.9 million in the current year. On the secondary market 17 deals were quoted on 12 instruments which totaled \$1,773.5 thousand.

Government

State-owned enterprises

Since independence, Kazakhstan has implemented a number of broadly-based reforms in an effort to move from a planned economy to a market economy, and to attract foreign investment. These reforms include: demonopolization; privatization; debt restructuring; banking reform; lifting profitability controls; price liberalization; establishing a securities and exchange commission; trade liberalization; enacting laws on investment; setting up an adequate Government procurement process; customs reform; and tax reform.

Though Kazakhstan has privatized thousands of enterprises, many large important enterprises remain under state ownership. Though few in number, these large enterprises dominate the economy. The state is still the sole owner of 333 of these enterprises, and they account for about a third of the GDP. Many of these large enterprises have been transferred by the State Property Committee to "trust management" in which existing managers or the regional administrators have control over the enterprises. Regardless, these enterprises are still under state ownership, and trust management should not be a permanent solution.¹

To examine the change in governance structures after privatization in the Kazakhstani firms own about 37 percent of the shares on average (29 percent by managers and 8 percent by employees). However, the state still has a significant ownership share in Kazakhstani firms, although the state share has significantly decreased from 35 percent in 1995 to 16 percent in 1997.

By the end of 2000, the government plans to have sold all the remaining state-owned packages of the following enterprises: "Manghistaumunaigaz", "Ust'-Kamenogorsk Titanium and Magnesium Complex", "Aktobemunaigaz", "Kazakhmys", "Kazchrome", "Kazzinc", "Kazakhstan Aluminum", "Sokolovsko-Sarbaiskii Mining and Productive Institution." Some part of state-owned packages of Kazakhtelecom and People's Bank will be sold according to individual schemes.

Many Kazakhstani firms complain that while the state has minority shareholdings, the state representative to the Board can block certain decisions.

The most common complaint by both Kazakhstani and foreign businessmen is the difficulty in dealing with officials at all levels of the Government. Based on published surveys of foreign investors and mission interviews with both foreign and domestic investors, the major problems in dealing with the government include:

Corruption

This is a serious problem at all levels ranging from governors (Akims) to local safety and health inspectors.

Coupled with a growing media interest in companies and corporate responsibility, the new laws mean that investors in countries like Kazakhstan have to think long and hard about how to do business in an environment where corruption is rife and demands for

¹ http://www.worldbank.kz/text/esw1_engt.html **Economic and Sector Work - Kazakhstan: Joint Private Sector Assessment.**

bribes almost are certain. Some respond by staying away, inevitably limiting the investment that Kazakhstan's economy desperately needs. Others find that trying to work in accordance with anti-corruption laws at best slows projects down and raises costs in other ways.

Some Western businessmen are fairly cynical about anti-corruption measures. There are many ways to circumvent the rules, such as creating offshore companies and opaque transfer pricing schemes. In the case of signing bonuses, which are standard payments made by oil companies to governments at the beginning of a contract, there is little control over where those payments go once they have left a Western bank account.

The paradox faced by Western policy-makers is that the more they emphasize corruption as a major obstacle to investment and good relations, the less influence they will have to encourage better governance. The real hope is that a new generation of Kazakh leaders - less influenced by years of deprivation in Soviet times - will have a new approach to the separation of government and business. But meanwhile, companies have to perform an uneasy balancing act: keeping their reputations clean while still making their business profitable.

Licensing and regulation

About 26 different state bodies supervise business activities. The procedures for obtaining licenses are complicated, multiple government agencies are involved, delays are long, and fees are substantial. Several attempts have been made to reduce this regulatory burden (for example, the Presidential Decree of June 14, 1996, "On Small and Medium Enterprise Regulation"), but the problem of complexity still remains.

Tax administration

Though the overall tax level is not considered high, and the number of taxes has been reduced, businessmen must still pay 11 different taxes plus payments to three social funds and several other funds. Taxes are levied at different stages of production and based on different indexes. Tax officials, often unfamiliar with the new tax codes, harass taxpayers and confiscate bank accounts apparently without due process. In spite of a bilateral agreement with Russia, Kazakhstani businessmen must still pay the value-added tax twice on exports to Russia.

Customs procedures

These are still cumbersome, and businessmen complain about long delays. Customs officials are not familiar with regulations that permit VAT payments to be deferred on imported machinery and equipment.

Land ownership

Though the Land Law allows both foreign and domestic investors to buy or lease land, a local land committee allocates land to investors and the procedure is slow and cumbersome.¹

² http://www.worldbank.kz/text/esw1_engt.html **Economic and Sector Work - The Transition to a Market Economy.**

Privatization has resulted in changes in top management in 32 percent of Kazakhstani firms, the highest among the sample countries. However, management turnover was not as high as would be expected in a change in ownership, as is the case in many developed economies. One possible explanation is that many managers of the former state-owned firms were able to purchase significant ownership rights during the privatization process. Nonetheless, it is not clear a priori whether new management per se would result in better governance. It may be that the change in ownership structure would bring about better oversight and incentives that would result in better performance by management, whether new or existing.²

Probably the root of many available problems stems from giving primary priority to the foreign companies, which are thought to be a locomotive which will pull the establishment of new market structures. Also it is natural that the foreign businessmen, having far from philanthropic intentions, are more inclined to impose their own rules of game. On the background of the foreign companies supervising manufacturing in separate strategic areas, the national companies (NC), which carry additional loads such as maintenance of social sphere, experience feelings of uncertainty.

Experts are apprehensive about the frequent rotation in the management of the national companies, the absence of priority for domestic NC in comparison with the foreign companies, and the constant intentions of sale of a part of the shares to foreign businessmen. For high-grade functioning of NC, in the experts' opinion, they [NC] should have a number of guarantees such as:

- Safeties, and stability of the companies activities
- Continuity of NC's strategic development lines
- Support for professional growth of the top-managers.

Among national companies the leading positions in efficiency of management are held by NSBK.

According to the opinion of 20% of experts, it is possible to recognize the optimum attitude of the government to the national companies. On all visibility, the support of the national companies will allow the sanction of sore public problems.³

Experts report serious political and economic risks because of long unresolved public problems in RK. The priority rate of the foreign companies in a small degree promoted forward progress of Kazakhstan in the category of the advanced countries of the world.

Capital flight from Kazakhstan

Outflow of funds from Kazakhstan is an important issue. According to the opinion of the Head of Balance of Payments and Capital Movement Division of the National Bank of Kazakhstan, this problem of capital flight is characteristic not only of transition economies countries, but also of developed, industrialized ones. While in the countries with developed capital markets exports of capital are related to the diversification of the investment portfolio in order to enhance economic efficiency, the transition countries' export of capital may cause serious problems to

² http://www.worldbank.kz/text/esw1_engt.html Economic and Sector Work -Kazakhstan: Joint Private Sector Assessment

³ Newspaper "PANORAMA" , June 26, 2000

macroeconomic stability and sustainable economic growth. Experts could suggest two approaches for the assessment of capital flight:

- The “motivational” approach
- The “normative” approach

The first tries to determine the amount of financial resources transferred abroad, the returns of which have not been repatriated. However, because of the poor quality of statistics, this method cannot be applied in the case of Kazakhstan. For the second approach, the existence of hidden outflows of capital can be assumed when the category of “errors and omissions” shows a debit balance which exceeds the usual statistical error (5% of the overall foreign trade turnover of the country in question).

Kazakhstan is a net debtor. Given the low level of domestic savings, the attraction of foreign resources for investments is important for economic growth. From this point of view, capital flight has to be considered in the context of its impact on Kazakhstan’s solvency. To gauge the extent of capital flight, the normative approach based on statistics balance of payments can be used. Imports of capital have exceeded exports since 1996, which indicates the attractiveness of Kazakhstan for foreign capital and, in particular, for foreign direct investments and loans. Assessing the increase in foreign assets held by residents, it is hardly convincing that capital outflows have been motivated by diversification aims. Moreover, the existence of a significant debit balance in the category of “errors and omissions” allows one to assume a steady capital flight. Experts offer immediate measure to prevent or reduce capital outflow from Kazakhstan. These are:

- Improvement of the legal basis
- Improvement of statistical reporting
- Insurance against foreign exchange risks

Generally, efficiency of currency transaction controls and the adoption of measures that would stop the quasi-legal and illegal outflow of foreign currency will contribute to more stability on the market. These will thus promote the efficiency of monetary policy actions and their influence on the real economy. At the same time, in the long run, the key is consistent economic policy that will create and promote favorable conditions for investments in Kazakhstan.

Part 3

Corporate behavior

We recognize the quick formation of professional top-managers. Entrepreneurs who run their own business often hire managers because their knowledge of management is inadequate. According to the survey of the Russian journal *Expert* the main traits of successful managers are spotless reputation, ability to deal with a team, responsibility, and vision of prospects. These characteristics are the same for new Kazakhstan managers.

The main current problem of professional managers’ growth lies in the lack of trust from owners. The government, be unable to support and defend ownership, destabilizes the situation. At the same time, Kazakhstani managers measure their success based on their status among state officials.

In the West, it is easy to evaluate the performance of top managers. The main indicator is company profit. In Kazakhstan, no one knows about the true revenue of

top management. There are reasons for this. On the one hand, the legalization of the capital via production is very risky in Kazakhstan. On the other hand, there are a limited number of managers on whom the company can rely.

It is difficult to estimate the real activity of top managers due to the absence of the effective instruments. The strongest mechanisms should be market stock price; some experts consider international standards as the best tools; while others insist on taking into account the tax system and other policies.

The reasons for an increase in the number of top managers are the following:

1. We should expect a new generation of managers with a substantial amount of knowledge in the field of general management.
2. Business stabilization brings less of a chance of becoming rich very fast. This has been more evident for Russia after its crisis. The vast amount of owners have gone bankrupt, after which they become somebody else's employees. Some of them do not want to take a risk again.
3. We could expect the so-called "division of labor", when an employed manager will deal with the day-to-day duties while the owner look for strategic activities.
4. Further development and enlargement of business.

It is safe to say, that we expect a boom of managers. This category of people is able to develop business. If in the West we see the relationship of managerial decisions and capital revenue, for the CIS we see the relationship between managerial activities and economic and social conditions of the whole state such as employment, tax, currency rate, and social stability. Nowadays, the state has to take into account the influence of the most powerful group of businessmen who are invited to deal with the country 's problems. This condition is considered reasonable when there is always an exchange between the government and management.

So, important worldwide tendency is the reconsideration of the government role. Its functions are changing due to the necessity of managing the state enterprises, with the same level of efficiency and effectiveness.

In 1997-1999 some research project was undertaken by the largest PR company in the world Bersson-Marseller. The topic was to reveal the roles of top managers. Fourteen hundred people, including directors, chief executives, financial analysts, mass media representatives and government representatives were questioned. The results are as follows:

Top managers reputation

A company's reputation depends on reputation of managers: 45% (in1997 - 38%, in1998 - 43%).

The most important characteristics

Ability to predict the company's future and trustworthiness are very important for top managers. Customer service was more important earlier, but now it is ranked as the sixth point.

Major executives' activities

The most important among the activities performed by executives is development of company strategy

The most important features of top managers (ranks, 1999):

Properly understand the internal problems of the company	-1-2
Trustworthiness	-1-2
Select the right managers' team	-3-4
Follow high ethical standards	-3-4
Inspire employees	-5
Customer service	-6
Increase shareholders' wealth	-7
Anticipate changes	-8-9
Effective in crisis management	-8-9

Importance of top managers' authority (% of people questioned)

	1997	1999
Provides stock liquidity	77	88
Creates a reliable business partner image for the company	80	87
Creates a trustworthy stock	n.d.	84
Makes a company trustworthy when it is attacked by mass media	78	81
Image that the company is worth working for	73	80
Attracts a positive attitude among mass media	68	75

What managers should produce (% of people questioned, 1999):

Long-term strategy	86
Short-term planning	40
Financial results	34
Corporate mission and values	33
Promotion of new products	25
Innovations in services	16
Mergers and acquisitions	16
Asset management	13

This research characterized the main features of managers. We can expect almost the same results for the Kazakstani market. We need research to bust these results. There is no research on the relationship between board of directors and managers. Composition and influence of companies' boards of directors has not been estimated

yet. All these factors are questions for the further research on Corporate Governance in Kazaknstan.

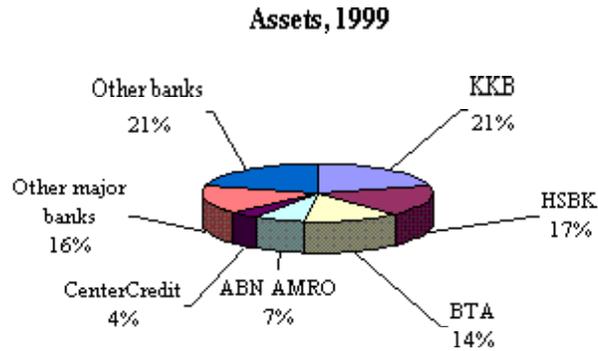
Part 4

In general, the key problem for Kazakhstan Corporate Governance is an absence of transparency, which corresponds to the international standards. We need ethical standards for joint stock companies. This process can take longer time, which is why we consider it to be a long-term project. It is necessary to analyze the real situation with the position and composition of the companies' boards of directors. The World Bank offers to organize working groups to carry out the improvement of the corporate governance and implement the best practices on it. We need to provide the necessary amendments in legislation and regulations, research on ownership, and look at the relationship among major players in Corporate Governance. This topic should a priority for further research.

Relative market share of major Kazakhstan's Banks

Assets 1999

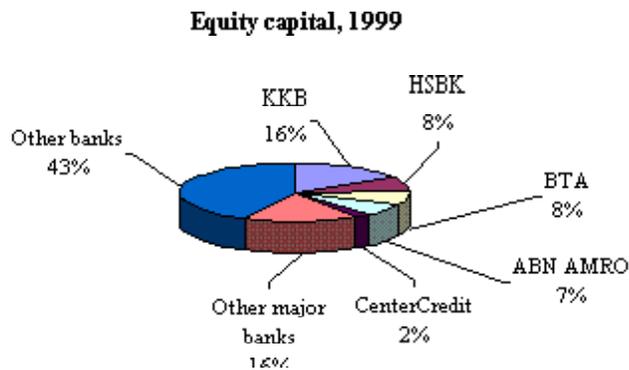
KKB
HSBK
BTA
ABN AMRO
CenterCredit
Other major banks
Other banks



21%
17%
14%
7%
4%
16%
21%

Capital 1999

KKB
HSBK
BTA
ABN AMRO
CenterCredit
Other major banks
Other banks

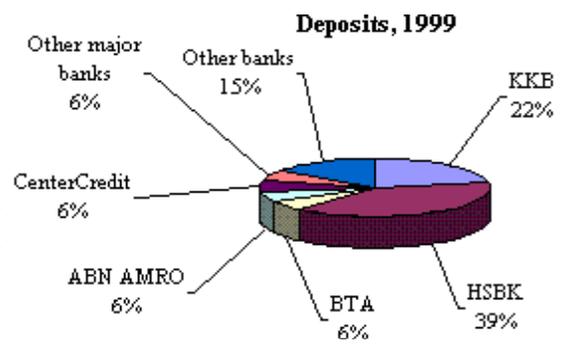


16%
8%
8%
7%
2%
16%
43%

Other banks	12%								

Deposits, 1999

KKB
HSBK
BTA
ABN AMRO
CenterCredit
Other major banks
Other banks

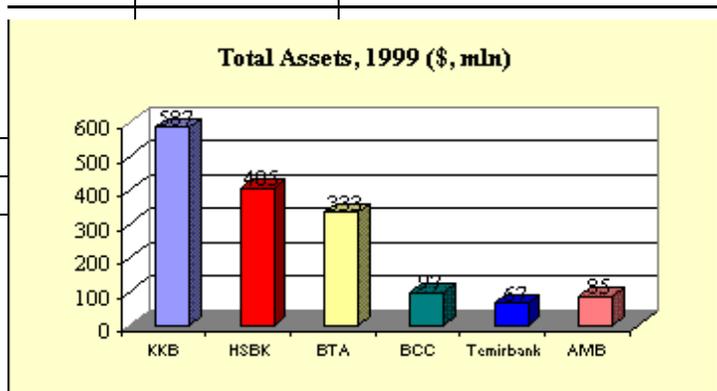


15%									
26%									
4%									
4%									
4%									
4%									
10%									

Total Assets

1999

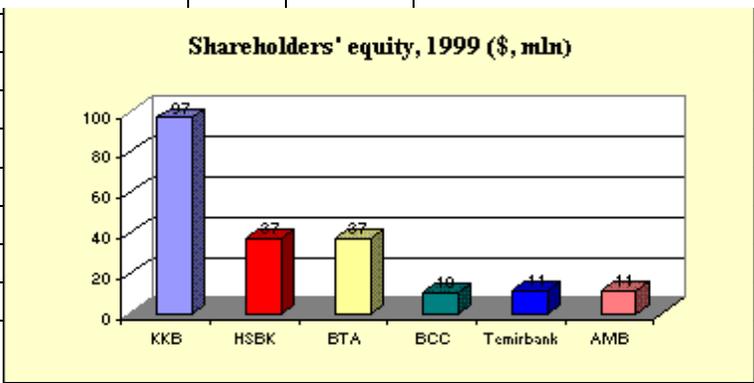
KKB
HSBK
BTA



**BTA vs competitors (mln USD)
Assets**

BCC	97								
Temirbank	67								
AMB	85								

Shareholders' equity	1998	1999					
KKB	124	97					BTA vs competitors (mln of USD)
HSBK	51	37					Equity
BTA	44	37					
BCC	15	10					
	16						
Temirbank		11					
AMB	11	11					



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