State ownership in terms of transition: Curse or blessing

Abstract

This paper argues that the institutional framework within transition economies, including the lack of a liquid capital market and a competitive product market, in addition to the focus on public benefits and socio-economic development, favors state-owned companies in terms of a non-market based system notwithstanding the popular concept of transaction costs and corporate efficiency. Despite the apparent costs of state ownership, including political considerations, soft budget constraints and weak profit motivations, there is a rational choice for state ownership in cases when private firms are not able to deliver the same quality of goods at a lower cost. Therefore, the paper offers another insight into questions of corporate efficiency and alternative governance models of state ownership in transitional economies based on the example of Kazakhstan. It attempts to determine whether the models of state ownership existing in transition economies diminish institutional shortcomings and have important implications for capital costs.
Introduction

Government-owned organizations exist throughout the world including the United States. Typically, these are larger companies that tend to produce a “strategically important product” or provide public services such as telecommunication, transportation, and water or electricity supply. Regardless of the corporate forms and goals of state entities, the issues of their accountability, legitimacy, corporate governance, and incentive structures have all been subject to academic discussion. These debates typically focus on the justification of state intervention in the economy, the correlation between state ownership and sound financial institutions, and the role of state-owned entities in a country’s economic development. The majority of studies touch upon concerns regarding the productive efficiency of state-owned enterprises, their political and agency

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costs, and the entire effect of state ownership on firm performance. The literature often distinguishes state-owned companies from privately-owned firms, and vice versa, largely based on a percentage of shares held either by private or state actors. Accordingly, all the deficiencies of state-owned companies are explained from an ownership perspective or the distinction between state (public) and private. The latter has been considered a key element of the market economy and, consequently, transitional reforms have focused on the increase of the private sector’s share and its autonomy from the state. This notion has significantly shaped the analysis of transition economies, where state ownership has been traditionally associated with poor economic performance. Precisely, questioning the efficiency of state-owned enterprises, the literature often emphasizes their lower profit compared to their private counterparts.

However, although scholars agree that the central process in terms of transition is the building of complete markets and liberal institutions, which have a strong positive impact on firm performance, there is often a legitimate reason why particular companies are state-owned rather than owned and operated in the private sector. Within the standard framing, successful application of the best practices of corporate governance requires an efficient financial market, where stocks are liquid and corporate conduct is transparent. In this situation, the market for corporate control is a check on the firm’s behavior. However, in transition economies, where just a small portion of the entire market’s shares is publicly traded, the stock price bears little

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3 For example, La Porta et. al. (2002), Barth et. al. (1999), Beck and Levine (2002), and Caprio and Peria (2000) point out that government ownership is associated with lower economic growth and a lower level of financial development, as well as a higher likelihood of financial crises.


relationship to a company’s underlying value, performance, or governance. Weak contract enforcement, poor protection of property rights, and underdeveloped capital markets have brought about the situation, when a controlling position of the state in many large and often strategic firms remains a significant factor in determining accountability structures, investment policies, as well as the strengths and weaknesses of state-owned companies. Therefore, any discussion of corporate governance in transition economies must consider the implications of different state ownership structures and policy agendas including the creation of competitive production capabilities, industrialization, economic diversification and social security.

This paper argues that the institutional framework within transition economies favors state-owned companies in terms of a non-market based system notwithstanding the popular concept of transaction costs and corporate efficiency. Despite the apparent costs of state ownership, including political considerations, soft budget constraints and weak profit motivation, there still might be a rational choice for state ownership in cases when private firms are not able to deliver the same, or even superior, quality of goods at a lower cost.

In this regard, this paper attempts to provide an alternative approach to understanding corporate governance and efficiency of state-owned companies by studying the example of Kazakhstan. The Kazakhstani experience demonstrates that corporate governance is largely affected by institutional environment and economic development existing in the country. In the context of the lack of sufficient capital markets and formal governance mechanisms, state-owned companies in Kazakhstan perform an active role in capitalizing the national economy and

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sustaining economic growth. These policy agendas, in turn, shape and expand a set of benchmarks for assessing corporate efficiency of state-owned companies by including tax revenues, employment and other socio-economic goods granted to the private sector and the population. Thus, the meaning of “efficiency” in terms of state companies depends on a particular institutional context and a socio-economic agenda existing in the country. Therefore, one may assess the performance of state-owned enterprises not only from the perspective of their revenue but also from the amount of social benefits produced by these companies.

The reminder of the paper proceeds as follows. The next part provides the reader with the conceptual framework of corporate governance and corporate efficiency and describes the summary of my theoretical claims. Part II provides some ideas about institutional environment existing in Kazakhstan. Part III proceeds with the review of strengths, weaknesses and tradeoff of state ownership in terms of economic transition. Finally, the paper concludes with policy measures that would improve state-owned companies’ performance.

I. What is missing in the traditional theory?

In state-based systems, governments possess strategic economic resources and distribute them in accordance with their socio-economic and political agendas. To fulfill their goals, governments engage state-owned vehicles including sovereign wealth funds, state shareholding

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8 Lin and Milhaupt (2011) raise the following question: [H]ow is a system without a plethora of formal institutions deemed important to Western firms producing a rapidly expanding list of Fortune 500 companies and supporting high and sustained levels of economic development in China?” And then, as one of the hypotheses they suggest: “[I]t is quite possible that China’s formal legal institutions may “improve” in ways that reinforce the current system of industrial organization rather than prompt a transition to different forms of corporate organization. State capitalism may prove to be a durable institutional arrangement as a result of interest group politics, public policy, and path dependence.” See Lin, L-W., & Milhaupt, C. J. (2011). Where are the (national) champions: Understanding the mechanisms of state capitalism in China. Stanford Law Review, 65(4), 697-759. Available at: http://ssrn.com/abstract=1952623.
companies, state banks, and development institutions. Although there are substantial discussions on transition economies that include many worthy insights for explaining corporate governance in state-owned companies, the analysis is usually based on a static and unilateral approach. The literature generally omits the modern dynamics of state ownership structures and governance in terms of acting and changing institutional conditions existing in transitional countries.\(^9\) Therefore, the question is what is missing in the traditional theory?

While all of the forms of state corporate vehicles are ultimately owned by the state, they differ in many aspects. Prior studies largely fail to properly identify and distinguish different forms of state ownership.\(^10\) Nonetheless, state-owned companies have a variety of corporate structures and governance models. In particular, some of them have the corporate form of a state entity per se. These entities are usually created for a particular socio-economic agenda. In this regard, in order to operate, the government grants these entities a portion of state assets. As a consequence, state entities are subject to direct state management and control. They are strictly limited in their investment and commercial activities. Also, they are exclusively funded from the state budget and have to transfer their profit back to the state.\(^11\)

Another type of state-owned companies is share-based, profit-oriented corporations (typically with the form of a limited liability company or a joint stock company), where the

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\(^9\) See Palazuelos, E., & Fernández R. (2012). Kazakhstan: Oil endowment and oil empowerment. Communist and Post-Communist Studies, 45, 27–37. This paper focuses on the role of large foreign companies as key players in influencing the initial conditions. However, even though foreign transnational companies led the reforms in 1990, today the situation have changed and governments and SOEs have become exceptionally influential not only domestically, but also internationally.

\(^10\) For example Haggarty and Shirley (1997), following Jones (1975), provide common definition of SOEs as “government-owned or -controlled economic entities that generate the bulk of their revenue for selling goods or services.” This definition has limited commercial activities for SOEs.

\(^11\) In Kazakhstan, state entities usually operate in such industries as energy or water supply, health care, national parks, professional education or academic research. As the result of their social-economic nature, the government controls pricing policies of its state entities making state funding the only source of their financing. In turn, state entities have to transfer the main portion of their net profit to the state budget. If a state entity accomplishes its socio-economic goals, it can be reorganized or liquidated. It is worth to mention that state entities become a quite obsolete corporate form remaining from the Soviet times. In Kazakhstan today, many state entities have been reorganized in the form of JSCs.
government has formally withdrawn from management and keeps the position of a shareholder (hereinafter “SOEs”). These SOEs have been corporatized and listed on domestic and international stock exchanges. As a result, the formal governance structure of many SOEs looks similar to their private counterparts including such corporate bodies as a general meeting of shareholders, a board of directors, and an audit committee. Many SOEs have minority shareholders and independent directors in their corporate structures.\(^ {12}\) SOEs and private companies have become subject to the same governance and accounting standards and regulations. These changes in the SOEs’ formal governance structures have modified the substance of corporate governance in state companies by producing a new composition of incentives and objectives as opposed to traditional state entities.\(^ {13}\) Therefore, gathering all the types of state enterprises into one group, as has typically been done in prior studies, creates a misleading notion about the real effect of state shareholding.

On a particular stage of development, the choice might not necessarily be between fully privatized or fully state-owned enterprises.\(^ {14}\) Instead, the question would be what are the ways to make the existent structure of resource allocation less costly and more efficient rather than whether SOEs perform well enough or whether state ownership itself has to be replaced by


\(^ {13}\) For instance, Chen, Firth, and Xu (2009) classify state owners in China’s listed companies into three major types based on their political and economic interests: SAMBs (state asset management bureaus), SOEs affiliated with the central government, and SOEs affiliated with the local government. They argue that these three types of state owners have very different objectives when it comes to the listed firms they control. See Chen, G., Firth, M., & Xu, L. (2009). Does the type of ownership control matter? Evidence from China’s listed companies. Journal of Banking & Finance, 33, 171–181.

private interests. Institutional arrangements, existing in transition economies, have determined the concept of efficiency applied to SOEs.\textsuperscript{15} Although the issue of what defines corporate efficiency varies among economists, all of the theories are grounded in fundamental idea of value maximization. In general, the majority of studies have treated corporate efficiency as tied to the allocation of resources by rational actors, who make their decisions based on market signals.\textsuperscript{16} From this perspective, private companies are considered to perform better than SOEs and therefore to be more efficient.\textsuperscript{17} Nevertheless, the notion that SOEs are less efficient than private

\textsuperscript{15}“In order to be efficient any corporate structure should provide its constituencies with right incentives to run the firm from the perspectives of long-term interests of all groups with a stake in the firm. For example, to improve its corporate governance a company may hire high quality auditors or have independent directors. Such steps help corporate insiders to demonstrate their intention to commit and hence make it possible to raise more capital externally. However, despite the effort to improve governance in a company, it still heavily depends on the country of its residence. Such factors as weak contract enforcement and insufficient protection of property rights can sharply increase transaction and agency costs. Thus, a country image, the overall level of its financial development as well as the existing system of political and legal institutions might considerably impact corporate governance practice and the costs of capital.” From Stulz, R. M. (2006). Financial globalization, corporate governance and Eastern Europe. Financial Development, Integration and Stability: Evidence from Central, Eastern and South-Eastern Europe, 16-40.


companies remains largely unsolved in the literature.\(^\text{18}\) For instance, along with SOEs, private firms also suffer from agency problems and the high costs of monitoring.\(^\text{19}\) In fact, in the case of liberal, liquid and competitive markets, both private and state managers act in the same market conditions and have similar incentives; as a result, the gap in performance should be less obvious.

From the viewpoint of the traditional shareholder-oriented model,\(^\text{20}\) SOEs may actually conform to the idea of profit maximization. The government can be, and actually is, interested in avoiding the SOEs’ financial losses. These losses will force the state authorities to shrink the financing of state social programs and policies of development.\(^\text{21}\) In addition, the government has a strong motivation to pursue positive return from SOE operations because poor performance of large SOEs as monopolies in their industries can hurt the economy as a whole and decrease state revenues since these SOEs are usually major taxpayers. This, in turn, will reduce the rate of economic growth, and the government’s credibility among the population and international investors will decline. Recent empirical studies point out that poor economic institutions shorten

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20 Considering the firm as the set of explicit contracts, this model focuses primarily on the equity interest as the only residual claim, which bears most of the costs and risks of corporate decisions. Based on that, equityholders are entitled to the right of decision-making. Therefore, the firm should be governed from the perspective of shareholders’ supremacy (Zingales 2000).

the expected tenures of autocrats and weaken their hold on power. In other words, well-run and financially sustainable SOEs comply with the state interest of economic development. In fact, SOEs have become the key instruments for policymakers to achieve economic diversification, provide socio-economic stability, boost technological potential, and retain political control. Transitional economies can benefit from SOEs’ operations through expanded tax revenues, dividends, sponsorship and socio-economic projects carried out by SOEs.

This means the hypothesis that politicians tend to maintain poor institutions to gain personal benefit seems quite unconvincing today. International integration and foreign investments unavoidably compel governments to proceed with further institutional reforms. Since many SOEs are listed on international stock exchanges in order to attract investors from abroad, it is a matter of state interest to ensure that these firms are profitable, transparent and operate in compliance with the listing standards. Due to the lack of domestic capital and information capacities, access to international capital and technological resources becomes important for economies in transition. To obtain the access, they have to commit themselves to international listing and accounting standards.

At the same time, there is the question of the legitimacy of using the private sector’s benchmarks and specifically the amount of net profit generated by SOEs to assess their performance. One of the peculiarities of the state sector is the presence of different priorities (for instance, social and public policy issues) rather than just the SOEs’ financial performance and market value. Furthermore, it is often difficult to calculate SOE market value, especially in the case of non-listed SOEs, which have no market-valued share prices that (at least approximately) indicate their performance. Even if the SOEs’ shares are traded on a domestic stock exchange, an illiquid stock market and weak infrastructure, as well as little or no competition in the industry, may eliminate the chance to measure SOE performance in

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accordance with market value criteria. In this context, the private sector’s standards provide little assistance in assessing SOE performance.27

However, if we expand the conventional meaning of corporate value beyond just net income, and include tax revenues and socio-economic benefits gained by the government and the population from the SOEs’ activities, the meaning of what is efficient in terms of a state corporate vehicle can change as well.28 In this context, tax revenues, employment, social programs and other goods generated by SOEs can be included in SOE value. Based on this rationale, governments can treat SOE efficiency relative to whether the SOEs’ objectives outlined by their shareholders have been achieved. While one of these objectives is an increase in profit, governments take a rather broader track and evaluate SOE performance from the perspective of


26 Accordingly, multiple objectives result in incentive structures quite different from those in the private sector. “In order to be efficient any corporate structure should provide its constituencies with right incentives to run the firm from the perspectives of long-term interests of all groups with a stake in the firm. For example, to improve its corporate governance a company may hire high quality auditors or have independent directors. Such steps help corporate insiders to demonstrate their intention to commit and hence make it possible to raise more capital externally...” From Stulz, R. M. (2006). Financial globalization, corporate governance and Eastern Europe. Financial Development, Integration and Stability: Evidence from Central, Eastern and South-Eastern Europe, 16-40.


28 Another issue noticed by Heath and Norman (2004) is that the single directive of profit-maximization hampers comparisons across firms “because all managers are trying to do roughly the same thing, in a similar economic environment. But if managers have the freedom to balance objectives as they see fit, then the basis for comparison disappears...” This leads to the case, when “[a] firm that puts more emphasis upon regional equality, or employment security, would simply not be comparable to a firm that put more emphasis on profitability.” See Heath, J., & Norman, W. (2004). From stakeholder theory, corporate governance and public management: What can the history of state-run enterprises teach us in the Post-Enron era? Journal of Business Ethics, 53, 247–265.
social welfare and long-term socio-economic benefits provided to the population and business community. Accordingly, the purposes of SOEs is not only making money but also accomplishing national industrial development and fair redistribution of resources in the absence of an adequate “marketplace.”

Thus, corporate governance in SOEs is likely to be more complex than in private firms.\(^{29}\) Multiple objectives of SOEs have produced a system in which corporate efficiency is measured relative to the SOEs’ actual agenda, including but not limited to the maximization of shareholder wealth. This, in turn, creates several obstacles. While private firms typically have a common goal of profit maximization that is a relatively straightforward index to measure the performance of managers, SOEs often have several goals that might conflict with each other. Many SOEs’ goals are not easily assessed since there is no clear understanding of what the benchmarks are.\(^{30}\) Moreover, non-listed SOEs do not have a market-valued share price. The ambiguity of measurement standards brings about monitoring difficulties, when the monitoring agency hardly knows how to evaluate the costs and benefits of SOEs’ operations and how the achieved results trade off and fit into the country’s socio-economic goals. Therefore, we may assume that the costs of SOE management and control are still quite high because of the multiple objectives of SOEs and the presence of political considerations. On balance, the state is ready to assume short-term losses in profit of their SOEs and offset them by generating socio-economic benefits because governments are motivated to commit to financially sustainable SOEs and further corporate governance reforms. Thus, the response on what constitutes SOE efficiency can be found in the


II. Institutional context of Kazakhstan

The financial crisis of 2008 revealed many institutional shortcomings in Kazakhstan, as well as the high volatility of foreign investments’ inflow. In particular, as one of the outcomes, the credit obligations to non-residents rapidly declined in the balance sheets of domestic commercial banks from almost 55.0 percent to 13.8 percent as of January 1, 2013. Commercial banks had to repay their foreign borrowings and significantly reduced the amount of credit to the national economy. The growth rate of the banks’ loan portfolios declined from 55.0 percent in 2007 to 0.3 percent in 2008. That, in turn, affected the growth of GDP and created a deficit of funds for new and existing projects.

Today, the banking system in Kazakhstan remains unstable. In this situation, most banks prefer to lend to large private companies and SOEs. Accordingly, one of the surveys has

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31 Dewenter, K. L., & Malatesta, P. H. (2001). State-owned and privately owned firms: An empirical analysis of profitability, leverage and labor intensity. The American Economic Review, 91(1), 320-334: “…whether government firms are more or less efficient than private firms is primarily an empirical issue. To date the body of empirical evidence is mixed. Douglas W. Caves and Laurits R. Christensen (1980), Stephen Martin and David Parker (1995), Stacey R. Kole and J. Harold Mulherin (1997), and others, however, present a body of evidence supporting the view that government firms are intrinsically no less efficient than private firms.”


33 In particular, according to consolidated financial statements of large commercial banks for the first quarter of 2013, many of them decreased their net profits or suffered from losses. Each bank has specific reasons for the negative financial results, but it might be assumed that further depreciation of the loan portfolio and increased spending on the creation of provisions on non-performing loans (NPLs) may persist. See Gribanova, S. (2013). God nachalsya s ubutkov. Expert Kazakhstan, 21(413). In Russian. Available at http://expertonline.kz/a11015/.

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demonstrated that the main challenge for Kazakhstani business is raising capital.\(^{35}\)
Notwithstanding the fact that a large portion of state funds are granted through commercial banks
for lending to entrepreneurs, especially small and medium sized enterprises (hereinafter “SMEs”),
SMEs are still a quite small share of the banks’ loan portfolios, although the government has set a
target to increase this share to 40.0 percent. As a matter of fact, in order to obtain a loan
entrepreneurs must comply with particular criteria: high productivity, export orientation,
substantial investments in fixed assets, innovative activities, and mandatory participation with
their own funds. The share of own funds must be at least 20.0 percent of the total investments in a
project. Moreover, commercial banks typically require liquid collateral to secure a loan.
However, in the situation when property rights are not sufficiently protected and contract
enforcement is weak, it is quite challenging for many entrepreneurs to fulfill the collateral
requirement since they prefer not to disclose their property.\(^{36}\) For start-ups the issue of liquid
collateral becomes even more problematic.

Thus, private actors have possessed quite limited funds to invest in alternative and
resource consuming industries in order to achieve economic diversification.\(^{37}\) Rather, they often
favor speculative and short-term interests. For instance, the Kazakhstani State Agency of
Statistics has found that private investors prefer to invest in the extraction and export of natural

\(^{35}\) This research distinguishes male and female entrepreneurs. Despite all differences, 64.2 percent of
women and 56.2 percent of men emphasize the problem of limited capital resources. The second challenge
is implementation of labor law provisions (35.7 percent of female and 37.5 percent of male entrepreneurs).
gender differences in Kazakhstan. Central Asia: Regionalization vs. globalization, IX KIMEP International
Research Conference (KIRC -2012), April, p. 91.

\(^{36}\) See De Soto, H. (2001.) The mystery of capital: Why capitalism triumphs in the west and fails

\(^{37}\) Russia can also illustrate this argument. In fact, one of the studies revealed that “… Russian businesses
were reluctant to invest in new technologies. According to a survey by the Higher School of Economics, in
2010, the natural resource extraction remained the most active area of investment. Most disturbingly, the
survey revealed the tendency to put new investments not into buying new technologies but in repairing
and maintenance of the old obsolete equipment.” See Busygina, I., & Filippov, M. (2011). Benefits and risks of
resources rather than support the development of alternative industries absorbing much higher capital costs with a more distant possibility of return.\textsuperscript{38} Also, the official statistics uncover the low innovative activity of domestic entrepreneurs in Kazakhstan. The share of innovative products within the total volume of domestic production fluctuates just between 2.0 and 5.0 percent across the region.\textsuperscript{39}

Alternative capital arrangements, such as the securities market, also fail to provide sufficient capital. Tremendous appreciation of the banking sector as one of the leading industries has resulted in very limited liquidity in this market.\textsuperscript{40} There has been no ground to expect the issuance of new liquid financial instruments in the domestic securities market or to anticipate the general improvement of capital markets liquidity in the near future.\textsuperscript{41} In this situation, state

\textsuperscript{38} In accordance with the IMF survey, oil sector value added accounted for 111/2 percent of GDP in 2010, while oil exports represented nearly 57 percent of total exports of goods and services. The bulk of foreign direct investment (FDI) in recent years has flowed to the extractive industries sector (751/4 percent in 2010), with oil taking the largest share. See IMF Republic of Kazakhstan. Selected Issues Prepared by Ana Lucía Coronel, Dmitriy Rozhkov, Ali Al-Eyd (MCD), and Neil Saker (MCM) Approved by Middle East and Central Asia Department June 28, 2010.

The Kazakhstani authorities tend to actively involve foreign investors, interested in Kazakhstani natural resources, in the process of industrialization. Speaking at the 25\textsuperscript{th} meeting of the Foreign Investors Council, President Nazarbayev noticed that from now on granting the right on new fields and extension of existing contracts will be possible if investors agree to finance the development of alternative industries. The President added that the subsequent issuance of licenses for the extraction of natural resources would be linked to the construction of new facilities. See Valentinova, L. (2012). Zhit’ po sredstvam. Promyshlennost, 3(72). In Russian.


\textsuperscript{40} Briefly, although Kazakhstan’s financial system embraces the securities market and nonbanking financial institutions, such as credit partnerships, mortgage companies and microcredit organizations, the Kazakhstani financial market is predominantly bank-based. The Law on Banks and Banking Activities of 1995 has introduced a two-tier banking system with the National Bank of the Republic of Kazakhstan on top. The National Bank is accountable to the President of the country. This institution is the principal regulator of the financial market and financial organizations. The degree of concentration in the banking sector has always been substantial, with the only difference that the largest commercial banks became state-owned after the 2008 financial crisis. These banks make up almost half of commercial bank assets, and the assets of each of the four largest banks exceed 20.0 percent of GDP.

\textsuperscript{41} The current picture of the Kazakhstani securities market is quite simple. 53 percent of the market is the currency trade (US$6 832.1 million), 42.0 percent - repo deals (US$5,364 million), 3.9 percent – government securities (US$503 million) and only 0.4 percent (US$56 million) - shares and 0.3 percent
securities have obtained a dominant share in corporate investments. In fact, as of January 1, 2013, government securities amounted to 50.5 percent of the investment portfolio of pension funds – the largest institutional investors in the country.42

In general, the analysis of the stock markets in transition economies has demonstrated that conservative portfolio investors have generally been reluctant to invest in such countries as Kazakhstan. Weak contract enforcement, an opaque judicial system and limited opportunities for risk diversification have created the situation, where the main players of these markets are speculative foreign and local portfolio investors seeking to invest in seriously undervalued assets with a high potential for short-term growth.43 In turn, that narrow and short-term interest prevents further liquidity in the capital markets and corporate governance reforms. Therefore, although there has been the positive impact of foreign investments on corporate governance of firms in Kazakhstan, their real effect is quite limited, especially with respect to the development of alternative industries and the implementation of socio-economic agendas.

The reality of Kazakhstan’s market is that so far private business has primarily concentrated on industries guaranteeing a quick return on investment (such as the export of raw materials, real estate, trade, and construction). Kazakhstani companies have largely lost an opportunity to attract foreign capital. Capital continues to be available solely for large companies (US$39.2 million) - corporate bonds. See Batisheva, T. (2013). Investor zhazhdet svobody. Expert Kazakhstan, 9(401). In Russian. Available at http://expertonline.kz/a10365/.

The majority of operations on the Kazakhstani stock exchange (KASE) include debt securities - 43.3 percent and government securities - 37.1 percent (from the Annual report 2012 of the Committee on supervision of the financial market and financial organizations of the National Bank of the Republic of Kazakhstan). As of January 1, 2013 the total market capitalization of non-government securities included in the official list of the KASE, was 10,114.5 billion tenge or only one third of the country’s GDP. Therefore, the domestic securities market suffers from limited liquidity. The dominance of commercial banking in the capital market has largely determined such a generic feature of the Kazakhstani stock market as a small number of reliable issuers and investors.

42 From the official website www.enpf.kz/9902

the majority of which are SOEs. Investors have treated state shareholdings, the very large size of state companies, and their dominant position in the domestic market as fundamental guarantees of their returns. In other words, in most cases it has been “the size of the company and its market share that are the main or, perhaps, even the exclusive factors that investors rely on when deciding whether to buy the stock.”

As a result, the time when profitability remained high just because of growing export revenues and foreign loans has passed. Commercial banks have scrutinized commercial financing, making it less risky, more secured and thus more expensive for borrowers. Hence, entrepreneurs have become largely deprived of bank financing as a source of capital. Therefore, after more than twenty years of independence, the majority of domestic entrepreneurs are financially unable to perform a leading role in the process of industrialization and to compete in the global market.

The experience of the last ten years has demonstrated that the political leadership of Kazakhstan has revised its economic approach grounded on a liberal market toward the growing role of the state. To efficiently channel and allocate the inflows of foreign exchange to the economy, the government has created a system of state development institutions including two domestic sovereign wealth funds: the National Fund of Kazakhstan and the Sovereign Wealth Fund Samruk-Kazyna. These institutions have become the primary vehicles for Kazakhstani policymakers to achieve economic diversification, provide socio-economic stability, and retain

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46 From the Strategy of Industrialization and Innovation Development of Kazakhstan approved by the President Decree from May 17, 2003.

47 These funds are among the largest SWFs in the world by assets under management with 17th and 13th positions respectively. See www.sovereignwealthfundsnews.com/ranking.php and www.swfinstitute.org/fund-rankings/.
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political control. They serve to accumulate and preserve wealth, diminish resource dependence and accomplish the industrialization of Kazakhstan’s economy.\textsuperscript{48} Put differently, the government has made an attempt to bring forward benefits from the country’s rich resources in order to overcome commodity dependence.\textsuperscript{49} As a result, the share of state ownership has increased. One of the studies estimates the consolidated revenue the Sovereign Wealth Fund Samruk-Kazyna as 20-30 percent of the country’s GDP; the assets - from 50.0 to 80.0 percent of GDP.\textsuperscript{50} Using accumulated financial reserves, the state authorities seek to accelerate the development of non-commodity industries and particularly to increase the share of manufacturing in the GDP, to improve productivity in agriculture, and to boost the country’s technological potential.\textsuperscript{51} In this regard, the government employs state procurements in order to support and finance the national economy. Today, the government and SOEs are one of the most solvent and reliable customers.

Significant state funds continue to be distributed to the private sector in the form of government

\textsuperscript{48} It is claimed that the Kazakhstani structure of state asset management was created in the image of Singaporean and Malaysian funds. In 2003, President Nazarbayev visited Singapore and Malaysia and was inspired by their SWF systems, which were tightly linked to the ruling families and the government. After that trip, management consultant McKinsey was hired to advise on the possible structure of Kazakhstani SOEs based on comparative studies of state companies around the world, from oil funds of the Gulf States, Temasek and Khazanah to the Scandinavian funds. However, as long as Kazakhstani financial and political systems have been evolving, Kazakhstani funds have obtained certain features of other SWFs, for instance the Chinese CIC.

\textsuperscript{49} Two factors may explain why mineral wealth limits industrialization. First, a mineral-rich country experiences an appreciation of the real exchange rate that prevents it from reducing its net imports and moving up the industrial ladder (a Dutch disease argument). Second, because mineral extraction is a capital-intensive process, a country without a deep industrial base will find its (initially) scarce physical capital diverted to mining, and hence will lack the necessary resources to deepen capital levels in the industrial sector. IMF Republic of Kazakhstan. Selected Issues Prepared by Ana Lucía Coronel, Dmitriy Rozhkov, Ali Al-Eyd (MCD), and Neil Saker (MCM) Approved by Middle East and Central Asia Department June 28, 2010.

\textsuperscript{50} See Kemme, D. (2012). Sovereign wealth fund issues and the National fund(s) of Kazakhstan. The William Davidson Institute at the University of Michigan. Working Paper No 1036, August. It worth mentioning that there is no official statistics on the share of state ownership in Kazakhstan. In one of his interviews, Minister of Finance of the Republic of Kazakhstan Bakhyt Sultanov mentioned that this share could be approximately 40.0 percent of GDP. Retrieved from web-portal Tengri.news (October 29, 2014).

\textsuperscript{51} From the Strategy of Industrialization and Innovation Development of Kazakhstan approved by the President Decree from May 17, 2003. In Russian.
contracts. In fact, the share of state procurements accounted for approximately 24.0 percent in 2014.\textsuperscript{52}

Thus, the government has become a substitute for private investments in terms of financing, monitoring and implementing national industrial projects. Accordingly, public expenditures have been increasing rapidly. A growing share of public expenditures (up from US$4.0 billion to US$25.0 billion between 1999 and 2007) was assigned for social programs, housing, infrastructure, and public employment.\textsuperscript{53} Those policy decisions were very much favored by the population and strengthened the power and the status of the political and socio-economic course of the government.

III. The tradeoff of state ownership in Kazakhstan

A. Benefits of SOE.

There is a value generated by SOEs in Kazakhstan. In fact, the state budget benefits from the operations of SOEs not only through a decrease in state expenditures on different social projects but also, and most importantly, through tax revenues and dividends. To be specific, SOEs facilitate the expansion of the state taxable base in several ways. First, investments in local production potentially increase the production capacities and the employment rate of domestic enterprises and, consequently, enlarge state tax revenues. Second, SOEs themselves are largest taxpayers in the country since they cover key economic segments, such as oil and gas, mining, transportation, energy, telecommunications, and finance.\textsuperscript{54} These SOEs are integrated in a single


\textsuperscript{54} Large commercial banks bailed out by the government as a part of the anti-crisis program with a great
corporate group structure (hereinafter “the Group”) with the state-owned Sovereign Wealth Fund Samruk-Kazyna (hereinafter “the Fund”) on the top. The Group’s share in state tax revenues was 727 billion tenge or 10.0 percent of all taxes collected in 2011, which is 20.0 percent more than in 2010.  

Another source of income for the government is dividends. In fact, in 2010 the Fund managed to pay dividends to its sole shareholder in the amount of more than US$60.6 million. In 2011, consolidated equity capital of the Group amounted to US$40.0 billion. During the same period, its consolidated book value was almost US$90.0 billion (or 13,413.1 billion tenge). The consolidated revenue of the Group reached 6.34 trillion tenge or 23.0 percent of GDP in 2011.  

In addition to official dividends paid by the Group, social expenditures not related to commercial activities of the Group exceeded US$1.7 billion (or 258.7 billion tenge) in 2011. In 2011, the amount of losses related to non-profit activities amounted nearly US$1.3 billion (200 billion tenge). For instance, the Fund’s subsidiary Kazakhtelecom JSC assumed losses from providing local telecommunication services.

One of the non-profit, but beneficial activities of the Fund is sponsorship. For example, the Fund grants financing to sport federations and teams, such as cycling, hockey, soccer, basketball, wrestling, tennis, and volleyball. According to CEO of the Fund Mr. Shukeyev, in 2011 the Group financed fourteen sport federations in an amount of more than US$55.3 million. The Fund was an official partner of the Kazakhstani team during the Summer Olympic and

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55 Form the Annual report 2011 issued by Samruk-Kazyna. Available at the corporate website.
56 See the government regulation No. 1202 from September 14, 2012.
57 From the Annual report 2011 issued by Samruk-Kazyna. Available at the corporate website.
58 Those investments included sponsorship, subsidized services of public transportation and communication, lower oil and gas prices for domestic consumers. From the speech of Managing Director Mr. Rakhmetov at the meeting on the final results of 2011. Available at [http://sk.kz/news/view/3208/7](http://sk.kz/news/view/3208/7). In Russian.
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Paralympic Games in London; so in total in 2011 more than US$250 million was spent on sponsorship.

The Fund actively participates in many social programs. For instance, the program “Affordable Housing” aims to provide the socially vulnerable segment of the population with inexpensive housing. Within this program, the government plans to construct one million square meters of rental housing annually. The Fund is accountable for the half of this project. The project’s expenditures are US$6.5 billion (983.8 billion tenge) with the Fund's share being more than 70.0 percent.

Therefore, during the period 2005-2012 the obligations of the Group significantly increased. As of October 1, 2011, the external debt of the Fund including its subsidiaries (but excluding commercial banks) amounted US$21.4 billion or 17.4 percent of the gross external debt of Kazakhstan. In this regard, Fund management intends to accomplish separate accounting of both commercial and non-commercial activities of the Group. This measure is considered to provide the Fund with clear market indicators and real evaluation of the commercial component.

Another policy task of the Fund is to increase local production. In 2010, the portion of local procurements equated to 50.0 percent of the total volume generated by the Group. It is expected that by 2020 the portion of domestic producers will exceed 66.0 percent for goods and 93.0 percent for services. The rules on procurements, adopted by the Fund, establish certain


60 From the presentation of the Fund’s Deputy CEO Mr. Bishimbayev at the Board’s meeting. Available at http://sk.kz/news/view/3212/4. In Russian.

61 From the speech of Managing Director Mr. Rakhmetov at the meeting on the Fund’s financial results in 2011. Available at http://sk.kz/news/view/3208/7. In Russian.

62 From the speech of CEO Umirzak Shukeyev at the Fund's corporate meeting 04.02.2012. In Russian.

preferences for local suppliers, such as the opportunity for long-term contracting and lending.\textsuperscript{64} Private actors have been granted a portion of state investments, particularly in such industries as residential construction, SMEs, and agriculture.\textsuperscript{65} In particular, state investments lessened the impact of the recession of 2008 and provided growth of 1.2 percent of GDP in 2009, 7.0 percent in 2010, and 7.5 percent in 2011.\textsuperscript{66} The SMEs’ share in GDP almost reached its pre-crisis level and accounted for 20.2 percent of GDP in 2010. As a consequence of low interest rates subsidized by government programs (for example, the State Road Map for Business and programs of the State Entrepreneurship Development Fund “DAMU”), new lending to firms and individuals expanded. According to official statistics, bank lending to the real sector increased by more than 15.0 percent by the beginning of 2012 compared with 2009 and constituted US$58.2 million (or 8.8 billion tenge).\textsuperscript{67}

To support the private sector, the Fund has implemented twenty-four investment projects with a value of US$17.0 billion (2.55 trillion tenge) within the State Program of Accelerated Industrial and Innovative Development.\textsuperscript{68} These projects are eventually intended to create more than 28,000,000 jobs.\textsuperscript{69} It is assumed that the new portfolio will additionally include 120 projects

\textsuperscript{64} From the Fund’s Annual report 2010, book 1.

\textsuperscript{65} In February 2009, the government channeled approximately 120 billion tenge to banks for lending small- and medium-sized enterprises. See Amalbayev, A. (2012). Adam Smith v Astane. Expert Kazakhstan, 50(391). In Russian.


\textsuperscript{67} However, it is hard to say whether the new loans from commercial banks represented actual new lending or just refinancing of previously provided loans. See Banki – eto gosudarstvo (2013). Editorial article. Expert Kazakhstan, 20(412). In Russian. Available at http://expertonline.kz/a10939/.

\textsuperscript{68} In 2010, the Fund implemented 21 projects within the state program of industrial and innovation development with the amount of US$20 billion, which was almost half of the program investments. In particular, the Fund provided 93.0 percent of investments in energetics, 86 percent in oil refining and infrastructure, and 84.0 percent in chemistry and pharmacy. Form the address of ex-CEO of the Fund Mr. Kulibayev, the supplement of the annual report 2010.

\textsuperscript{69} From the presentation of the Fund’s Deputy CEO Mr. Bishimbayev at the Board’s meeting. 04.02.2012. Available at http://sk.kz/news/view/3212/4.
With a total value of roughly US$30.0 billion\textsuperscript{,70} The volume of the Fund’s investments in the development of new technologies was equal to US$53.0 million (8.0 billion tenge) in 2011. In 2012, it was raised by more than ten times, to 92.9 billion tenge. This trend continued in 2013, with total investment of 99.2 billion tenge. Along with that, the Fund actively promotes the "Park of Innovations" (the Kazakhstani analogue to Silicon Valley).

Therefore, in the absence of sufficient and sustained institutions, SOEs have undertaken the mission of social welfare. In this regard, the government emphasizes the importance of a stable and predictable environment for further economic growth\textsuperscript{,71} Given the fact that the existing social security and pension systems in Kazakhstan are still developing, the risks inherent in a market economy are especially critical for the population\textsuperscript{,72} To mitigate those risks, the government has assumed social responsibility through state ownership and state social and pension programs\textsuperscript{.73} Social spending implemented through state ownership structures seems to be

\textsuperscript{70} From the presentation of the Fund’s Deputy CEO Mr. Bishimbayev at the Board’s meeting. 04.02.2012. Available at http://sk.kz/news/view/3212/4.

\textsuperscript{71} Analyzing autocratic regimes in Singapore and China, Victor Shin (2009) concluded that if a national leader was quite certain of gaining power over crucial state assets and was less concerned about his political survival, he might largely focus more on maximization of long-term profit and economic growth. This means that the stability of a political regime matters in the context of the efficiency of state ownership. With respect to the Singaporean experience, Shih (2009) argues that “[t]he long time horizon and unchallenged political dominance afford Singaporean rulers the luxury of focusing on long-term returns on their investment because they can expect to reap the bulk of the benefits.” See Shih, V. (2009). Sovereign wealth funds in Singapore and China. Geopolitics, 14, 328–344. In this regard, Kazakhstan reminds Singapore to a large extent because of highly influential role of the country’s leader, his family and close allies.

\textsuperscript{72} In particular, the course of the state sector’s total replacement initially applied by the Kazakhstani political leadership led to extreme social insecurity among a large part of the population that could not adjust to newly established market conditions. Moreover, the Kazakhstani state gave up responsibility for social insurance and pension payments for the majority of citizens. As a consequence, for a quite long period of time, the state sector’s guarantees were eliminated and the private sector did not demonstrate prudence and accountability in complying with its social obligations. Recently, this situation resulted in the nationalization of the pension system in Kazakhstan.

\textsuperscript{73} For example, the telecommunication industries in both countries bear the costs of the telephony lines’ contraction in rural areas. In its Tenth Five-Year Plan (2001-2005) for Information Industry, the Chinese government committed unambiguously to a universal services obligation, with the goals of providing all
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less costly for the political leadership than the establishment of new institutional and political arrangements.

B. The costs of state ownership.

The system of state ownership in Kazakhstan is deemed to be a response to the existing institutional environment. They serve to guarantee lower prices for basic goods and services and, therefore, to maintain an essential level of social stability and market predictability. However, the systems of state ownership and management in Kazakhstan have the costs of political considerations, poor profit motivation and multitasking.

A political component is one of the major sources of costs in SOEs. In particular, current or former government officials constitute the majority of corporate directors in Samruk-Kazyna and SOEs in Kazakhstan. Kazakhstani policymakers consider this board composition as taking advantage of the solid work experience of government officials. Indeed, many of them have important managerial skills and a deep knowledge of particular industries that may be beneficial for the SOEs they manage. However, this also raises a huge concern that some of the commercial interests of SOEs are sacrificed to the political or career considerations of bureaucrats, when major corporate decisions are subject to bargaining between “the bureaucracies citizens and regions equal access to telephony. See Pearson, M. M. (2005). The business of governing business in China: Institutions and norms of the emerging regulatory state, World Politics, 57(2), 296-322. Similarly, the electricity sector has been responsible for providing lower electricity prices to the population.


of the central ministries in charge of big state firms.”

The institutional context of Kazakhstan casts significant doubt on whether the government has fully separated its capacities as a regulator and as a shareholder. SOE managers and government officials routinely circulate within the systems of state governance and ownership. That reinforces a cozy relationship between the incumbent SOE managers, the government and the political leadership. Political considerations trigger the incentive problem and the lack of managerial autonomy. Opaqueness of management appointments and remuneration, as well as affiliation with the political leadership, undermines the SOEs’ independence from political influence in decision-making. The lack of transparency in SOE management and operations brings about the case when SOE managers are appointed based on their adherence to the political course not their professional knowledge and experience. Bringing political populists into SOE management, who do not have solid experience in a particular industry but make advances to the political leadership in order to get short-term political gains for themselves, cause the threat of poor management and the creation of misleading policies.

Notwithstanding that some of the SOEs are among the largest corporate entities in their industries, their position is often attributed to extensive state support, not their efficiency. As Chan (2009) puts it, there is a “concerted bureaucratic efforts” to make SOEs strong but “they are not as competitive i.e. market performing, as we would like them to be.” SOEs in Kazakhstan are subject to soft budget constraints. This means that SOEs can secure additional finances to be rescued from bankruptcy, if they make losses. Thus, the possibility of the bailout for SOEs can


Furthermore, it might be that the market will become too dependent on the state policies of financing and subsidizing. In other words, private companies will not be able to solve their financial problems without state support and the market will shrink with the termination of government programs. In addition, SOEs and quasi-state entities enjoying a privileged position in terms of state funding and may crowd out less sustainable private companies, which in turn will reduce economic diversification and competition and lead to an even more monopolistic market. For example, one of the negative consequences of the recently increased role of the state in Kazakhstan is the possible decline of entrepreneurial initiative. The essence of relationships in the state and quasi-state sectors do not create equal conditions for all actors and for private business, in particular. That may cause a situation when entrepreneurs are not able to compete with their state counterparts and prefer to leave the market or choose free riding when the state bears large expenses.

Finally, multitasking creates a challenge for SOEs because they have to comply with different priorities stated in state strategic programs and find a compromise between state and corporate interests. This compromise is typically at the costs of SOE profitability. SOEs have to follow many policy documents and comply with multiple indicators. This obligation generates a wide range of tasks, duplication of function and poor economic planning. Many SOEs in Kazakhstan deal with numerous, often conflicting, agendas. On the one hand, they are positioned as private companies seeking profit maximization. One the other hand, they have to fulfill socio-economic--typically non-profit--objectives. For instance, implementing its investment policy, the Fund shall consider such often-contradictory indicators as profitability, on the one hand, and investments for the country’s future development, on the other hand. As a consequence, state

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industrialization and economic diversification programs have barely achieved their objectives. Still, the Fund heavily invests in commodity industries. In 2010, these investments amounted to 43.0 percent of total investments by the Fund. Transportation and infrastructure, as well as energy, were the second and third industries the Fund invested in at 30.0 percent and 8.0 percent, respectively. The commodity companies continue to be the most profitable in the Group. In 2011, the national oil company KazMunaiGas generated the highest net profit in the Group: more than US$3.2 billion (486 billion tenge), which is approximately four times higher than the second most profitable company, the national railroad monopoly Kazakhstan Temir Zholy.

Nonetheless, the system of SOEs functioning in Kazakhstan has been apparently less expensive and has provided the national economy with benefits that seem to outweigh its costs. This system broadens the conceptual and empirical boundaries between the state and the market and exhibits many quasi-public, quasi-private features. As a result, such countries as Kazakhstan do not fall neatly into either the free-market category or the planned-market category. These economies have relied on markets and competition while retaining the power of the state in settling the economic course of development.

Thus, the issue of SOE efficiency in Kazakhstan is based largely on the tradeoff between costs and benefits of state ownership. These costs and benefits have been determined by the

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82 Even in case of state investments in innovative development, there has been a problem to figure out what works best for Kazakhstan. In particular, Berentayev (2010) claims that most of innovative development programs focus on technologies (e.g.: nanotechnology, biofuels and etc.) that the Kazakhstani economy cannot currently take advantage of. See Instituty razvitia Kazakhstana: A effectivnost v chem? (2010) Gazeta.KZ, March. In Russian.

83 From the Fund’s Annual report 2010, book 1.

84 “[T]he existence of transaction costs means that it is often much less costly to set up an SOE and deal with unexpected contingencies through internal government directives than to set up some contract-based regime – regulation and/or taxes/subsidies – to address such concerns.” Chang, H-J. (2007). State-owned enterprise reform. Policy Notes, Department for Economic and Social Affairs (UNDESA).


institutional conditions existing in Kazakhstan and precisely by the lack of well-developed institutions. Still, the government as a controlling shareholder assumes current failures and losses in profit of SOEs. Policymakers prefer to focus on long-run agendas of diversification and social stability. In this context, the government considers the benefits of SOEs and measures their value not from the position of their short-term profitability but rather from the perspective of public goods, including socio-economic benefits, subsidies, dividends and tax revenues generated by SOEs as well as their long-term investment activities. Furthermore, since the pension and social security systems in Kazakhstan are still evolving, SOEs bear the task of maintaining stable social and employment conditions for the populations.

Conclusion

The view that poor-quality institutions impede a country’s economic development is widespread among economists. Accordingly, the IMF and the World Bank have started to impose many governance-related covenants, which require borrowing countries to adopt “better” institutions. Typically, they are institutions that are found in Anglo-American systems. These systems are based on a liberal market approach grounded in the strong protection of property rights, a liquid stock market, a shareholder-oriented corporate governance structure, and a flexible labor market. These institutions are considered helpful in promoting investments and sustained

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87 In this regard, the State Accounting Committee responsible for state financial control assesses the SOE efficiency as full and effective budget spending in accordance with state strategic goals. This means from a policy perspective, the SOEs’ efficiency implies the achievement of outcomes outlined in the strategic documents of each SOE and state policy programs as well as the full and effective use of state funds. See Methodological guide for the state financial control of effectiveness approved by the order of the Chairman of the State Accounting Committee from February 15, 2012.

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economic growth.  

In this regard, transitional countries have been strongly encouraged to adopt institutions that call for deregulation, significant privatization, and capital market liquidity. The IMF, the World Bank and other international organizations have evaluated corporate governance in transition economies from the perspective of their formal compliance with best standards with little attention to whether these arrangements would effectively operate and carry out their anticipated functions in terms of transition. The main obstacle with the application of such best standards in transition economies is the lack of a liquid capital market, an efficient market for corporate control or a transparent labor market. The example of Kazakhstan shows that state equityholding can, and in fact does, create market systems but largely based on state, not private, ownership. These market structures do not necessarily lead to weak protection and discrimination of private property rights. For instance, SOEs can benefit and enhance private initiatives through state investments, subsidies and informational support. In Kazakhstan, the government and SOEs have been the key actors substantially responsible for industrial upgrading. They have been able to provide long-term investments that are crucial for economic

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90 The findings from an examination of the tobacco-market dynamics during China’s economic reform era suggest that market-building in transitional economies does not necessarily require or entail the decline of the state’s role in market activities as in the “shock therapy” approach. See Wang, J. (2006). State-building as market-building in China. European Journal of Sociology, 47(2), 209-240.

91 For example, the Singaporean state is well known as a strong state that protects private property rights very well. “However, the very strength of the Singaporean state that enables it to offer such protection is founded upon a very high degree of state ownership. First, the Singaporean state’s strength owes a great deal to its strong fiscal position thanks to highly efficient SOEs, which collectively produce over 20 percent of the country’s GDP. Second, an important basis for the Singaporean state’s high political legitimacy is its ability to supply high-quality affordable housing, which in turn is possible because it owns all the land in the country and operates a giant public housing corporation that supplies 85 percent of the country’s housing. In other words, a high degree of state ownership may in some cases be exactly what enables the country to offer strong protection of private property rights.” See Chang, H-J. (2011). Institutions and economic development: Theory, policy and history. Journal of Institutional Economics, 7(4), 473-498.

92 In Kazakhstan, as the result of state strategies of industrialization GDP rose to 27.3 trillion tenge (over
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diversification and the creation of capital and infrastructural conditions for the further growth of private activities (the so-called “crowding in” effect).93

However, despite the corporatization of state entities in Kazakhstan, there is much work to be done to make the economy resilient to external shocks, to ensure the sustainability of their growth, and to translate this growth into corresponding improvements in the economic welfare of their citizens. To establish clear objectives, develop workable check-up mechanisms and ensure proper coordination among multiple agendas of SOEs, government in transition economies, including Kazakhstan, should consider the following policy priorities:

First, state policies need to be coordinated, simplified and closely monitored. The number of strategic documents and reports must be downsized to focus on the actuality and feasibility of the strategic goals for the country.94 Every strategic document for a state project should be result-oriented. This means that the document should establish long-run comprehensible outcomes of the project. In order to reach these outcomes, the document should determine a roadmap with the

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93 “Over the last two decades, there has been a tendency to presume that all public investment “crowds out” private investment. However, “crowding out” becomes a significant possibility only when the economy is near full employment. In most countries with underutilized resources or increased resources obtained through aid, we can expect public investment to “crowd in” private investment. Public investment can further enhance economic development especially if they are made in areas that complement private sector investment (e.g., road facilities for major export crop region, investment in the training of engineers for a newly-expanding industry, investment in the basic inputs industries that are too risky for the private sector).” From Chang, H-J. (2007). State-owned enterprise reform. Policy Notes, Department for Economic and Social Affairs (UNDESA).

94 Another illustration of an overwhelming quantity of formal documents is the legislation of the Republic of Kazakhstan. According to an analysis conducted by the National Economic Chamber of Kazakhstan "Atameken Union", 49 laws were approved, 45 of which - the laws amending the existing legislation, just for 10 months in 2012. 147 statues were adopted in 2011. This dynamic variability of the law raises questions about its effectiveness, presenting a serious challenge to conducting business activities in the country.
coherent criteria of success for every stage that corresponds with the long-run outcomes of the project. Also, it should define concrete quantitative and quality indicators to assess the achievement of short-term and long-run outcomes. Clear and concrete criteria and indicators would improve the quality of monitoring and assessment of the project’s results and would allow tracing the project’s progress.

Second—an issue emphasized by international experts—is the increase of disclosure. The lack of complete information on the actual total amount of state financing across different industries prevents an effective analysis of state industrial policies in Kazakhstan. The available data is usually limited by a particular sector or a group of investment projects. For instance, in Kazakhstan there is no information on the exact amount of budget funds allocated to all the sectors through different instruments, nor is there a comprehensive study of the efficiency of such budget spending. Despite a great number of state programs, strategies and action plans issued by the Kazakhstani government, by state agencies, and by national companies on an annual basis, the data is typically limited to reporting on the implementation of these documents and putting the numbers on records, without an adequate examination of the outcomes of the entire system of state planning and spending. Therefore, with the exception of a few strategic state assets, the majority of SOEs can and should be fully transparent in terms of their investment strategy, portfolio allocation, risk management procedure, governance structure, and management reward system. For transparency and accountability, an external monitoring mechanism involving parliament, academics, and private sector representatives should also be set up.95

Third, decision-making in SOEs should be actually independent from politics.96

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96 “To illustrate this notion of why the government has not intervened in the Temasek—Shin Corporation (of Thailand) business deal in January 2006, the Minister told Members of Parliament said that the government had not meddled with the Shin Corp-Temasek deal because it was not the government’s job to do so. Temasek’s board, which the government helps to appoint, has the discretion to decide how the investment arm’s resources are allocated, which as Temasek’s CEO Ho Ching explained, is strictly based
Independent directors in corporate boards and supervisory committees may fulfill this function. To guarantee their objectivity, the government shall establish a sufficient system of solid regulation. Competent corporate directors and professional managers should be appointed in accordance with their skills and work experience rather than their political affiliation and personal connections. From this viewpoint, the number of independent directors in corporate boards should be increased since management largely represented by government officials cannot be fully objective. This means a qualitative expansion of the list of persons who will take over SOEs. In addition, state authorities should create the right incentives for SOE managers with respect to higher productivity of state assets through highly attractive personal benefits.

Fourth, the government must clearly define the non-profit objectives of SOEs with their subsequent approval by corporate boards. These objectives should be defined for a concrete period and/or a project in order to improve the efficiency of SOE economic planning. Good planning leads to better governance and higher profitability of SOEs, which, in turn, increase the revenue part of the state budget.

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97 The experience of SOEs around the globe demonstrates that such issues as a free-riding problem and soft budget constraints inherent in SOEs can be mitigated through independent and professional management. Indeed, there are many examples of SOEs in countries such as Singapore, France, Finland, Norway and Taiwan that are not just efficient in a narrow sense but also lead their country’s economic growth through technological dynamism and export successes. see Su, D., & He, X. (2012). Ownership structure, corporate governance and productive efficiency in China. Journal of Productivity Analysis, 38, 303–318.

98 For example, in his testimony before the House of Financial Services Committee in the United States on 5 March 2008, Simon Claude Israel (2008), who was then Executive Director and Member of the Board of Temasek, told the US audience that the professional management team at Temasek comprised 40 percent of non-Singaporeans at its senior level. This can be seen as an attempt to profile Temasek as a commercial entity on the basis that it is less likely for non-Singaporeans to serve Singapore’s political interest in the hope of moving up the state hierarchy, particularly after the government has publicly pronounced the commercial orientation of Temasek. In a similar vein, Temasek appointed 11 individuals with diverse management background and industrial experience from the US, UK, Japan, China and India to sit on the International Panel. That there exist non-Singaporeans to provide advice on how Singapore’s resources are to be allocated supports the government’s claim that Temasek is commercially and independently run. See Sam, C-Y. (2013). Partial privatization and the role of state owned holding companies in China. Journal of Management & Governance, 17, 767–789.
Finally, industrial and financial policy programs need financial participation of private actors, domestic and foreign, in order to share risks between the state and private sectors. Even though existing policy documents in Kazakhstan establish the opportunity for private firms to invest in industrial and innovation projects, the role of the private sector needs to be expanded. Moreover, foreign private investors should get the same level of access to the projects and information as domestic investors have. In this regard, the governments have to expand the list of approachable capital sources available for the private sector along with state financing and bank loans. Hence, further development of capital markets becomes essential. The conditions offered by these markets should be at least as favorable as bank financing. This means that the government in Kazakhstan should create a fair and competitive market environment for all actors.

In conclusion, institutional shifts are never simple, and the final result of any transition remains unknown. On the initial stage of institutional formation, the government in Kazakhstan took the lead of economic development, blurring the line between public and private. However, that period must eventually come to the end. As long as the market develops and integrates with the international market, capital will be allocated among companies depending on their market advantages and performance. This means that SOEs will have to equally compete with their private counterparts in the market, which, in turn, will call for the further modernization of the state sector, as well as for the reduction the number of SOEs in order to decrease transaction costs.