State Ownership in Terms of Transition: Curse or Blessing

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This Article 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, this Article 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 in the United States. Typically, these are larger companies that tend to produce a "strategically important product"[1] or provide public services such

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I would like to express my deepest appreciation to my J.S.D. committee chair, Professor Charles K. Whitehead, for being a tremendous mentor, for encouraging my research, and for allowing me to grow as a research scientist. I would like to thank all the participants of the Symposium "The Rule of Law in Central Asia" at Cornell Law School for their valuable comments and questions, and especially the Advisor to Nazarbayev University's President, Dr. Dennis de Tray. I also want to express my gratitude to the leadership of Nazarbayev University and the *Cornell International Law Journal* for organizing the Symposium. The opinions expressed in this Article are the author's own and do not reflect the view of Nazarbayev University or Cornell Law School.

1. Robert Cull & Lixin Colin Xu, *Who Gets Credit? The Behavior of Bureaucrats*

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as telecommunication, transportation, 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.[2] The majority of studies touch upon concerns regarding the productive efficiency of state-owned enterprises, their political and agency costs, and the entire effect of state ownership on firm performance.[3] 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.[4] Accordingly, all the deficiencies of state-owned companies are explained from an ownership perspective or the distinction between state (public) and private.[5] The latter has been considered a key element of the market economy and, consequently, transitional reforms have focused on the increase of the

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and State Banks in Allocating Credit to Chinese State-Owned Enterprises, 71 J. DEV. ECON. 533, 545 (2003).

2. James R. Barth et al., *Banking Systems Around the Globe: Do Regulation and Ownership Affect Performance and Stability?*, *in* PRUDENTIAL SUPERVISION: WHAT WORKS AND WHAT DOESN'T 31, 55 (Frederic S. Mishkin ed., 2001); Cull & Xu, *supra* note 1, at 533–34; Kathryn L. Dewenter & Paul H. Malatesta, *State-Owned and Privately Owned Firms: An Empirical Analysis of Profitability, Leverage and Labor Intensity*, 91(1) AM. ECON. REV. 320, 320 (2001); Serdar Dinç, *Politicians and Banks: Political Influence on Government-Owned Banks in Emerging Markets*, 77 J. FINAN. ECON. 453, 454 (2005); Luke Haggarty & Mary M. Shirley, *A New Data Base on State-Owned Enterprises*, 11 WORLD BANK ECON. REV. 491, 492, 497 (1997); Marcel Kahan & Edward B. Rock, *When the Government is the Controlling Shareholder*, 89 TEX. L. REV. 1293, 1348 (2011); Ross Levine, *Financial Development and Economic Growth: Views and Agenda*, 35 J. ECON. LITERATURE 688, 705 (1997); Juliet Roper & Michele Schoenberger-Orgad, *State-Owned Enterprises: Issues of Accountability and Legitimacy*, 25 MANAGEMENT COMM. Q. 693, 699 (2011); Marcia Millon-Cornett et al., *The Impact of State Ownership on Performance Differences in Privately-Owned Versus State-Owned Banks: An International Comparison*, 19 J. FINAN. INTERMEDIATION 74, 75 (2010); Enrico Perotti, *State Ownership: A Residual Role?* 3, 5, 8 (World Bank. Pol'y Res., Working Paper No. 3407, 2004); Eduardo Levy Yeyati, Alejandro Micco & Ugo Panizza, *Should the Government be in the Banking Business? The Role of State-Owned and Development Banks* 3, 10, 16 (Inter-American Dev. Bank, Working Paper No. 571, 2004).

3. Rafael La Porta et al., *Government Ownership of Banks*, 57 J. FIN. 265, 267 (2002); James R. Barth et al., *Financial Regulation and Performance: Cross-Country Evidence* 16, 19, 20 (Central Bank of Chile, Working Paper No. 118, 2001), http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.541.9003&rep=rep1&type=pdf [https://perma.cc/2LPT-CKQ9]; Thorsten Beck & Ross Levine, *Industry Growth and Capital Allocation: Does Having a Market-or Bank-Based System Matter?* 10 (NBER, Working Paper No. 8982, 2002), http://www.nber.org/papers/w9082 [https://perma.cc/R6GF-Z29N]; Gerard Caprio & Maria Soledad Martinez Peria, *Avoiding Disaster: Policies to Reduce the Risk of Banking Crisis* 25 (Egyptian Ctr. for Econ. Studies, Working Paper No. 47, 2000) (pointing 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).

4. Przemyslaw Kowalski et al., *State-Owned Enterprises: Trade Effects and Policy Implications* 19–20 (OECD Trade Pol'y Papers, Working Paper No.147, 2013).

5. Millon-Cornett et al., *supra* note 2, at 77–78.

private sector's share and its autonomy from the state.[6] This notion has significantly shaped the analysis of transition economies, where state ownership has been traditionally associated with poor economic performance.[7] 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,[8] 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 corporate governance best practices requires an efficient financial market, where stocks are liquid and corporate conduct is transparent.[9] In this situation, the market for corporate control is a check on the firm's behavior. In transition economies, however, where just a small portion of the entire market's shares is publicly traded, the stock price bears little relationship to a company's underlying value, performance, or governance.[10] Weak contract enforcement, poor protection of property rights, and underdeveloped capital markets have resulted in state control of many large and often strategic firms, which in turn significantly affects 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.

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6. Berger et al., *Corporate Governance and Bank Performance: A Joint Analysis of Static, Selection, and Dynamic Effects of Domestic, Foreign, and State Ownership*, 29 J. BANKING & FIN. 2179, 2180 (2005).

7. Analyzing the role of governments in China, Latin America, and Eastern Europe, scholars almost always find its unfavorable effect. *See id.* at 2210.

8. Seung Ho Park et al., *Market Liberalization and Firm Performance During China's Economic Transition*, 37 J. INT'L BUS. STUD. 127, 128 (2006) ("Broadly defined, market liberalization includes all forms of government initiatives to break the state monopoly in the market, free price controls, reduce entry barriers, and privatize state-owned enterprises (SOEs). Many emerging and low-income countries commonly use market liberalization as a strategy to promote economic development . . . .").

9. An existing "marketplace" has been assumed to provide the owners of private firms with stronger incentives to manage their companies efficiently as opposed to state-owned enterprises. *See* Stephen P. King, *Corporatisation and the Behaviour of Government Owned Corporations*, *in* FROM BUREAUCRACY TO BUSINESS ENTERPRISE LEGAL AND POLICY ISSUES IN THE TRANSFORMATION OF GOVERNMENT SERVICES 43, 45 (Michael J. Whincop ed., 2003) [hereinafter *Corporatisation*].

10. If the securities market is thin and the workers and managers have strong attachments to their employing firms, market signals of corporate valuation would be garbled and full of noise. CORPORATE GOVERNANCE IN TRANSITIONAL ECONOMIES: INSIDER CONTROL AND THE ROLE OF BANKS, at xiv (Masahiko Aoki & Hyung-Ki Kim eds., 1995) [hereinafter Aoki & Kim] ("Further, exercising corporate control through the market (the takeover mechanism) would simply not be feasible unless insiders gave up their shares.").

This Article 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.[11] Despite the apparent costs of state ownership—including political considerations, soft budget constraints, and weak profit motivation—there might still 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.[12]

This Article attempts to provide an alternative approach to understanding corporate governance and the efficiency of state-owned companies by studying the example of Kazakhstan. The Kazakhstani experience demonstrates that corporate governance is largely affected by a country's current institutional environment and economic development existing in the country. Due to 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 sustaining economic growth.[13] The government's policy agendas, in turn, shape and expand a set of benchmarks for assessing the corporate efficiency of state-owned companies by including tax revenues, employment, and other socio-economic goods granted to the private sector and the population. 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 these companies produce.

The remainder of the Article proceeds as follows. Part I provides the conceptual framework of corporate governance and corporate efficiency and describes the summary of my theoretical claims. Part II offers some ideas about the existing institutional environment in Kazakhstan. Part III proceeds with a review of the strengths, weaknesses, and tradeoffs of state ownership in terms of economic transition. Finally, the Article concludes with suggested policy measures that would improve the performance of state-owned companies.

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11. Dani Rodrik, *Institutions for High-Quality Growth: What They Are and How to Acquire Them*, 35 STUD. COMP. INT'L DEV. 3, 10 (2000) ("The institutional basis for a market economy is not uniquely determined. Formally, there is no single mapping between the market and the set of non market institutions required to sustain it.").

12. *See* Andrei Shleifer, *State Versus Private Ownership*, 12 J. ECON. PERSP. 133, 138–39 (1998).

13. Li-Wen Lin and Curtis J. Milhaupt 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 their hypotheses they suggest:

> [I]t is therefore 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 Li-Wen Lin & Curtis J. Milhaupt, *We Are the (National) Champions: Understanding the Mechanisms of State Capitalism in China*, 65 STAN. L. REV. 697, 752 (2013).

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.[14] To fulfill their goals, governments use state-owned vehicles including sovereign wealth funds, state shareholding companies, state banks, and development institutions.[15] Although there are substantial discussions on transition economies that include many worthy insights into 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 of transitional countries, and creates a misleading notion about the real effect of state shareholding.[16] Therefore, the question is: what is missing in the traditional theory?

Economists widely believe that poor-quality institutions impede a country's economic development. Accordingly, the International Monetary Fund ("IMF") and the World Bank have started to impose many governance-related covenants, which require borrowing countries to adopt "better" institutions.[17] Typically, these "better" institutions are found in Anglo-American systems.[18] Anglo-American systems are generally 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.[19] These institutions are considered helpful in promoting investments and sustained economic growth.[20]

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14. *See* Shleifer, *supra* note 12, at 142.

15. Artur Grigoran, *The Ruling Bargain: Sovereign Wealth Funds in Elite-Dominated Societies*, 17 ECON. GOVERNANCE 165, 166 (2016).

16. The generally known concept called the Washington Consensus requires transition economies, such as Kazakhstan and China, for a strong orientation toward a market-based economy. It focuses on minimizing the government involvement since a country's economic growth can be ensured only by free and open markets. Those markets considered to be achieved through full privatization and opening-up the domestic economy for trade and investments. In this regard, transitional countries have been strongly encouraged to adopt institutions that call for deregulation and significant privatization. Further, the International Monetary Fund, the World Bank, and other international organizations have evaluated corporate governance in transition economies from the perspective of their formal compliance with the best standards with little attention to whether these arrangements would effectively operate and carry out their anticipated functions in terms of transition. *See* Lázló Árva & András Schlett, *The Long March: The Lessons of China's Economic Transition*, 11 ASIA-EUR. J. 39, 43–44, 50 (2013); Erik Berglöf & Ernst-Ludwig von Thadden, *The Changing Corporate Governance Paradigm: Implications for Transition and Developing Countries* 21, 26 (Annual World Bank Conf. on Dev. Econ., Conference Paper, June 1999), https://ssrn.com/abstract=183708 [https://perma.cc/3DS4-GBUQ]. *But see* Lin & Milhaupt, *supra* note 13, at 750–51.

17. Ha-Joon Chang, *Institutions and Economic Development: Theory, Policy, and History*, 7 J. INT'L ECON. 473, 473 (2011).

18. *Id.* at 474.

19. *See id.*

20. Rafael La Porta et al., *The Economic Consequences of Legal Origins*, 46 J. ECON. LIT. 285, 302, 322–23 (2008); Rafael La Porta et al., *Investor Protection and Corporate Valuation*, 57 J. FIN. 1147, 1147 (2002). The correlation between law and market

Transitional countries have thus 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 operate effectively and carry out their anticipated functions in terms of transition.[21] The main obstacle with the application of such best standards to transition economies is the lack of a liquid capital market, an efficient market for corporate control, or a transparent labor market. The Kazakhstani example shows that state equity-holding can, and in fact does, create market systems, but that they are largely based on state, not private, ownership.[22] These market structures do not necessarily lead to weak protection and discrimination of private property rights.[23] For instance, state-owned enterprises can benefit and enhance private initiatives through state investments, subsidies, and informational support. In Kazakhstan, the government and state-owned enterprises have been the key actors substantially responsible for industrial upgrading.[24]

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development has been discussed in the literature, especially after La Porta et al.'s research. In general, these debates have the "law matters" focus. *Id.* at 1166 (cash flow ownership contingent on a country's legal system). La Porta et al. claim that law is the key precondition for market development. In other words, deep markets cannot be in place unless fundamental legal reforms are implemented. Therefore, common law countries perform better because their legal systems protect contract and property rights more effectively. However, a group of scholars offers the opposite hypothesis that market development precedes legal reforms (a so-called "crash-then-law" thesis). John C. Coffee, Jr., *The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control*, 111 YALE L.J. 1, 19–20, 65–66 (2001).

21. *See, e.g.*, László Árva & András Schlett, *The Long March: The Lessons of China's Economic Transition*, 11 ASIA-EUR. J. 39, 43 (2013) (Hung.).

22. *See*, *e.g.*, Junmin Wang, *State-Building As Market-Building in China*, 47 EUR. J. SOC. 209, 209–40 (2006). 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. *Id.*

23. 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[%] 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[%] 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.

Ha-Joon Chang, *Institutions and Economic Development: Theory, Policy, and History*, 7 J. INT'L ECON. 473, 480–81 (2011).

24. In Kazakhstan, as the result of state strategies of industrialization GDP rose to 27.3 trillion tenge (over US $180 billion) in 2011, which was 107.5% more than in 2010. More importantly, the GDP growth in 2011 was achieved thanks to sustainable expansion of the manufacturing and the services sector. The growth of industrial production reached

State-owned enterprises have been able to provide long-term investments that are crucial for economic diversification and the creation of capital and infrastructural conditions that will further increase private activities—the so-called "crowding in" effect.[25]

In any given stage of development, the choice is not necessarily between fully privatized or fully state-owned enterprises.[26] Instead, the question is whether there are the ways to make the existing resource allocation structure less costly and more efficient, rather than whether state-owned enterprises perform well enough or whether private interests should replace state ownership. Institutional arrangements existing in transition economies have determined the concept of efficiency applied to state-owned enterprises.[27] Although economists hold varying opinions of what defines corporate efficiency, all of the theories are grounded in the 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.[28] From this perspective, private companies are considered to perform better than state-owned enterprises and

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3.8%. In general, 237 start-ups with the total amount of 1 trillion tenge (almost US $6.7 billion) were initiated in 2011, which allowed the creation of twenty thousand new jobs. Summing up, the overall effect of the industrialization program in 2011 was 2% of GDP, which could be a solid evidence of the efficiency of state asset management. *See* SAMRUK-KAZYNA, ANNUAL REPORT OF 2011 (2011) (Kaz.), http://sk.kz/en/about-fund/otchety-i-plany/?temp=full&iblock=51&id=210 (report accessible for download) [https://perma.cc/Y466-5CHZ].

25. *See* Ha-Joon Chang, *State-Owned Enterprise Reform*, U.N. Dep't for Econ. & Social Affairs (UNDESA), National Development Strategies Policy Notes, at 6–7 (2007) ("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.").

26. *Id.* at 17.

27. 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. *See* Rene M. Stulz, *Financial Globalization, Corporate Governance, and Eastern Europe* (Nat'l Bureau of Econ. Research, Working Paper No. 11912, 2006).

28. *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, J. FIN. ECON. 305, 328 (1976); Luigi Zingales, *In Search of New Foundations*, 15 J. FIN. 1623, 1630 (2000). *See generally* Frank H. Easterbrook, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1416–48 (1989).

therefore are more efficient.[29] Nevertheless, the question of whether state-owned enterprises are less efficient than private companies remains largely unsolved in the literature.[30] For instance, private firms, as well as state-owned enterprises, suffer from agency problems and high monitoring costs.[31] 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; consequently, the gap in performance between private firms and state-owned enterprises should be less obvious.[32]

Under the traditional shareholder-oriented model,[33] state-owned enterprises may actually conform to the idea of profit maximization. The government can be, and actually is, interested in the state-owned enterprises' avoiding financial losses. If incurred, these losses would force the state authorities to shrink the financing of state social programs and policies of development.[34] Additionally, since the large state-owned enterprises are usually major taxpayers, the government has a strong motivation to pursue positive return from state-owned enterprise operations because poor performance of these large, state-owned enterprises as monopolies in their industries can hurt the economy as a whole and decrease state revenues. The effects of poor performance from large state-owned enterprises can in turn reduce the rate of economic growth, and decrease the government's

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29. Maxim Boycko et al., *A Theory of Privatisation*, 106 ECON. J. 309, 309 (1996); Robert Cull & Lixin C. Xu, *Bureaucrats, State Banks and the Efficiency of Credit Allocation: The Experience of Chinese State-Owned Enterprises*, 28 J. COMP. ECON. 1, 23 (2000); Dewenter & Malatesta, *supra* note 2, at 332; Millon-Cornett et al., *supra* note 2, at 92; Frederic Mishkin, *Is Financial Globalization Beneficial?*, 39 J. MONEY, CREDIT & BANK. 259, 269 (2007); Juliet Roper Schoenberger-Orgad, *supra* note 2, at 704; Shleifer, *supra* note 12, at 146; Perotti, *supra* note 2, at 8, 19; Mary M. Shirley & Patrick Walsh, *Public Versus Private Ownership: The Current State of the Debate* 10 (WBG Pol'y Res., Working Paper No. 2420, 2000) (concerning whether private companies perform better than SOEs and are more efficient).

30. Although many empirical studies have found that government ownership is negatively associated with firm performance, other researchers have recently concluded that there might be solutions where government ownership increases corporate value. In particular, Lihui Tian and Saul Estrin find that the relationship between corporate value and government ownership becomes positive as long as the size of government shareholdings reaches 25%. *See* Lihui Tian & Saul Estrin, *Retained State Shareholding in Chinese PLCs: Does Government Ownership Always Reduce Corporate Value?*, 36 J. COMP. ECON. 74, 85 (2008); Zuobao Wei et al., *Ownership Structure and Firm Value in China's Privatized Firms: 1991–2001*, 40 J. FIN. & QUALITATIVE ANALYSIS 87, 89 (2005).

31. John Vickers & George Yarrow, *Economic Perspectives on Privatization*, 5 J. ECON. PERSP. 111, 115 (1991).

32. *Id.* at 113, 115.

33. Zingales, *supra* note 28, at 1631. 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, equity-holders are entitled to the right of decision-making. Therefore, the firm should be governed from the perspective of shareholders' supremacy. *Id.*

34. Yingyi Qian & Gerard Roland, *Federalism and the Soft Budget Constraint*, 88 AM. ECON. REV. 1, 3, 23 (1998) (arguing that loss-making SOEs in China create an enormous drain on government budgets and state-owned banks, and that this loss eventually forced the government to adopt the privatization program).

credibility among the population and international investors. Recent empirical studies point out that poor economic institutions shorten the expected tenures of autocrats and weaken their hold on power.[35] In other words, well-run and financially sustainable state-owned enterprises comply with the state interest of economic development. In fact, state-owned enterprises have become the key instruments for policymakers to achieve economic diversification, provide socio-economic stability, boost technological potential, and retain political control. Transition economies can benefit from state-owned enterprises' operations through expanded tax revenues, dividends, sponsorship, and socio-economic projects carried out by state-owned enterprises.

This means the hypothesis that politicians tend to maintain poor institutions to personally benefit from them seems quite unconvincing today. International integration and foreign investments unavoidably compel governments to implement further institutional reforms.[36] Many SOEs are listed on international stock exchanges in order to attract investors from abroad; therefore, it is a matter of state interest to ensure that these firms are profitable, transparent, and in compliance with the listing standards.[37] Because of the lack of domestic capital and information capacities, access to international capital and technological resources becomes important for economies in transition. To obtain this access, they must commit themselves to international listing and accounting standards.

Prior studies largely fail to properly identify and distinguish different forms of state ownership.[38] While all forms of state corporate vehicles are ultimately owned by the state, they differ in many aspects. Nonetheless, state-owned companies have a variety of corporate structures and governance models.[39] In particular, some of them have the corporate form of a state entity per se.[40] These entities usually exist for a particular socio-economic agenda.[41] In this regard, in order to operate, the government grants these entities a portion of state assets.[42] As a consequence, state entities are subject to direct

35. Randall G. Holcombe & Christopher J. Boudreaux, *Institutional Quality and the Tenure of Autocrats*, 156 PUB. CHOICE 409, 412, 420 (2013).

36. Ronald J. Gilson & Curtis J. Milhaupt, *Economically Benevolent Dictators: Lessons for Developing Democracies* 45, 58, 64 (Colum. L. Sch. L. & Econ. Stud., Working Paper No. 371, 2010).

37. *See generally* Katharina Pistor & Chenggang Xu, *Governing Stock Markets in Transition Economies: Lessons from China*, 7 AM. L. & ECON. REV. 184, 185 (2005) (giving an example of a state taking interest in its exchange listed enterprises); John C. Coffee, Jr., *Racing Towards the Top?: The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance* 8–9 (Colum. L. Sch. Ctr. L. & Econ. Stud., Working Paper No. 205, 2002), https://papers.ssrn.com/sol3/Papers.cfm?abstract_id=315840 [https://perma.cc/A48L-CPQR] (explaining the effect of transparency on a listed-enterprises regulatory structure).

38. *See* Haggarty & Shirley, *supra* note 2, at 497.

39. *See id.*

40. *See id.*

41. Vickers & Yarrow, *supra* note 31.

42. Zuobao Wei et al., *Ownership Structure and Firm Value in China's Privatized Firms: 1991–2001*, 40 J. FIN. & QUANTITATIVE ANALYSIS 87, 88 (2005) (giving an

state management and control.[43] They are strictly limited in their investment and commercial activities. Additionally, they are exclusively funded from the state budget and have to transfer their profit back to the state.[44]

Another type of state-owned company is the share-based, profit-oriented corporation (typically with the form of a limited liability company or a joint stock company) (hereinafter "SOEs"), where the government has formally withdrawn from management and keeps the position of a shareholder.[45] These SOEs have been corporatized and listed on domestic and international stock exchanges.[46] 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.[47] Many SOEs have minority shareholders and independent directors in their corporate structures.[48] 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

example of how China has managed state assets in listed companies).

43. *Id.*

44. In Kazakhstan, state entities usually operate in such industries as energy or water supply, health care, national parks, professional education, or academic research. *See* U.S. DEP'T OF STATE, BUREAU OF ECON. & BUS. AFF., 2015 KAZAKHSTAN INVESTMENT CLIMATE STATEMENT 11 (2015), https://www.state.gov/documents/organization/241825.pdf [https://perma.cc/B4QS-AXNS] (demonstrating an example of energy companies owned by the Kazakhstani government that are funded by the state budget and that are required to submit profits to the state). As the result of the social-economic nature of state entities, the government controls their pricing policies, making state funding the only source of their financing. *See id.* at 7. 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. *See* World Bank, *Kazakhstan - Low Oil Prices, an Opportunity to Reform*, WORLD BANK (2015), http://www.worldbank.org/en/country/kazakhstan/publication/kazakhstan-economic-update-spring-2015 [https://perma.cc/6MY7-2367]. It is worth mentioning that state entities have become a quite obsolete corporate form remaining from the Soviet times. In Kazakhstan today, many state entities have been reorganized in the form of joint-stock companies, or JSCs. *See* Order of the Government of the Republic of Kazakhstan, Dec. 14, 2012, No. 1539 (Kaz.), http://cis-legislation.com/document.fwx?rgn=57120 [https://perma.cc/NW9F-TF8H].

45. ORG. FOR ECON. CO-OP. & DEV. [OECD], OECD GUIDELINES ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES 14 (2015), http://www.oecd-ilibrary.org/docserver/download/2615061e.pdf?expires=1478880010&id=id&accname=guest&checksum=BAC7C274D4BE04DA1A942F11D36767D9 [https://perma.cc/CBA5-R7SQ] (listing the various corporate forms of state-owned enterprises).

46. *See* Corinna-Barbara Francis, *Quasi-Public, Quasi-Private Trends in Emerging Market Economies: The Case of China*, 33 COMP. POL. 275, 284 (2001) ("[S]tate-owned enterprises . . . have transformed themselves into quasi-autonomous, corporatist entities."); *see, e.g.*, David Ralston et al., *Today's State-Owned Enterprises of China: Are They Dying Dinosaurs or Dynamic Dynamos?*, 27 STRATEGIC MGMT. J. 825, 827 (2006) (noting China's decision in the 1990s to list many large state-owned firms on exchanges).

47. *See* Ralston et al., *supra* note 46, at 828.

48. By and large, SOE reform has targeted the application of the principles of private management to SOEs with the only difference being the nature of the owner: a state institutional investor instead of a private actor. As a result, boundaries between public and private as well as between state and market become quite vague. Many SOEs demonstrate quasi-public, quasi-private features. *See id.* at 832–33; *see also* Francis, *supra* note 46, at 280–82.

modified the substance of corporate governance in state companies by producing a new composition of incentives and objectives as opposed to traditional state entities.[49]

At the same time, the legitimacy of using the private sector's benchmarks, specifically the net profit generated by SOEs, to assess their performance is questionable.[50] One of the peculiarities of the state sector is the presence of different priorities (for instance, social and public policy issues) rather than just a SOE's financial performance and market value.[51] Furthermore, it is often difficult to calculate a SOE's market value, especially in the case of non-listed SOEs, which have no market-valued share prices that (at least approximately) indicate their performance.[52] Even if an SOE's shares are traded on a domestic stock exchange, market conditions such as an illiquid stock market, weak infrastructure, as well as little or no competition in the industry, may eliminate the chance to measure a SOE's performance in accordance with market value criteria.[53] In this context, the private sector's standards provide little assistance in assessing the SOEs' financial performance.[54]

However, if we expand the conventional meaning of corporate value beyond just net income, and include tax revenues and socio-economic benefits created by the SOE's activities, the meaning of what is efficient in terms of a state corporate vehicle can change as well.[55] In this context, tax

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49. For instance, Gongmeng Chen, Michael Firth, and Liping Xu classify state owners of China's listed companies into three major types based on their political and economic interests: state asset management bureaus (SAMBs), 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* Gongmeng Chen, Michael Firth & Liping Xu, *Does the Type of Ownership Control Matter? Evidence from China's Listed Companies*, 33 J. BANKING & FIN. 171, 172 (2009).

50. *See Corporatisation*, *supra* note 9, at 46–47.

51. Accordingly, multiple objectives result in incentive structures quite different from those in the private sector. "Firms can take steps to improve governance. For instance, they can choose to hire high quality auditors or to have independent directors. Such steps enable corporate insiders to reduce their ownership stake in the firm's cash flows and hence make it possible to raise more capital externally." Rene M. Stulz, *Financial Globalization, Corporate Governance and Eastern Europe*, *in* FINANCIAL DEVELOPMENT, INTEGRATION AND STABILITY: EVIDENCE FROM CENTRAL, EASTERN AND SOUTH-EASTERN EUROPE 16, 20 (Klaus Liebscher et al. eds., 2006).

52. *Corporatisation*, *supra* note 9, at 46–47.

53. *Id.*

54. In this regard, some scholars suggest that the traditional point of view focuses on what transition systems lack, as opposed to how they actually function. *See* Lin & Milhaupt, *supra* note 13, at 750–51.

55. *See* Joseph Heath & Wayne Norman, *Stakeholder Theory, Corporate Governance and Public Management: What Can the History of State-Run Enterprises Teach Us in the Post-Enron Era?*, 53 J. BUS. ETHICS 247, 258 (2004) (discussing the inability to compare efficiencies of state-owned companies using criteria that measures profit-maximization and stating that "[h]aving the single directive of profit-maximization permits 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]

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 can take a rather broader track and evaluate SOE performance from the perspective of social welfare and long-term, socio-economic benefits provided to the population and business community. Accordingly, the purpose 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."[56]

Thus, corporate governance in SOEs is likely to be more complex than in private firms.[57] 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.[58] 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.[59] Moreover, non-listed SOEs do not have a market-valued share price. The ambiguity of measurement standards brings about monitoring difficulties when monitoring agencies barely know 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. On balance, states are ready to assume short-term losses in profit from their SOEs and offset them by generating long-term socio-economic benefits. Thus, the response to what constitutes SOE efficiency can be found in the institutional environment of transition economies.[60]

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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.").

56. *Corporatisation*, *supra* note 9, at 45.

57. *See* Dongwei Su & Xingxing He, *Ownership Structure, Corporate Governance and Productive Efficiency in China*, 38 J. PRODUCTIVITY ANALYSIS 303, 315 (2011) (providing an example of a study of ownership structure's effect on efficiency and accounting for the additional complexities inherent in determining the efficiency of a SOE). *See generally* Aoki & Kim, *supra* note 10, at 9; Chen, Firth & Xu, *supra* note 49, at 172; Dongwei Su, *Corporate Finance and State Enterprise Reform in China*, 16 CHINA ECON. REV. 118, 118 (2007).

58. Chen, Firth & Xu, *supra* note 49, at 172–74; Su & He, *supra* note 57, at 306.

59. Su & He, *supra* note 57, at 306.

60. Dewenter & Malatesta, *supra* note 2, at 320 ("[W]hether government firms are more or less efficient than private firms is primarily an empirical issue. To date the body of empirical evidence is mixed."). Other scholars, however, present a body of evidence supporting the view that government firms are intrinsically no less efficient than private firms. *See generally* Douglas W. Caves & Laurits R. Christensen, *The Relative Efficiency of Public and Private Firms in a Competitive Environment: The Case of Canadian Railroads*, 88 J. POL. ECON. 958, 958–76 (1980); Stacey R. Kole & J. Harold Mulherin, *The Government as a Shareholder: A Case from the United States*, 40 J. L. & ECON. 1, 1–

II. Institutional Context of Kazakhstan

Kazakhstan is a large, sparsely populated, transition economy.[61] It is abundant with mineral resources, especially oil and gas.[62] Hence, due to commodity exports, Kazakhstan's per capita income has increased significantly.[63] Nonetheless, Kazakhstani policymakers acknowledge that the country faces a number of challenges arising from its dependence on resource exports.[64] Therefore, economic diversification has become a key objective of the state's policies, and many state industrial programs have been approved in the last ten years.[65] For example, the system of state development institutions, which includes two sovereign wealth funds, has been created in order to reduce the dependence on commodity exports.[66]

In today's Kazakhstan, the state plays the central role in the country's economic development.[67] This role has been affirmed in "Strategy Kazakhstan 2050," which was introduced by President Nazarbayev.[68] According to "Strategy Kazakhstan 2050," an economically steady state is particularly important to ensure the country's accelerated economic growth and effective economic planning in terms of existing macroeconomic and institutional conditions.[69] In his interview with the Russian news channel "Russia 24," President Nazarbayev mentioned that he has become disappointed in the idea of a liberal economy and believes that a planned economic system is more advantageous.[70]

At the dawn of independence, however, Kazakhstan followed an opposite path of development. The old concepts of a planned economy, a powerful state and government market intervention, were discredited.[71] The

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22 (1997); Stephen Martin & David Parker, *The Impact of UK Privatisation on Labour and Total Factor Productivity*, 42 SCOTTISH J. POL. ECON. 201, 201–20 (1995).

61. JESUS FELIPE & CHANGYONG RHEE, REPORT TO THE GOVERNMENT OF KAZAKHSTAN: POLICIES FOR INDUSTRIAL AND SERVICE DIVERSIFICATION IN ASIA IN THE 21ST CENTURY 1 (2013), https://www.adb.org/sites/default/files/publication/30432/kazakhstan-policies-industrial-service-diversification.pdf [https://perma.cc/4CJ2-C3NM]; Timur M. Aliev, *Kazakhstan: Resource Curse or Dutch Disease?*, 57 PROBS. ECON. TRANSITION 1, 4 (2016).

62. FELIPE & RHEE, *supra* note 61.

63. *Id.*; Aliev, *supra* note 61, at 9–12.

64. FELIPE & RHEE, *supra* note 61.

65. *Id.* at 7.

66. *Id.* at 9.

67. *See* Eimear O'Casey & Alexander Batchilo, *Kazakhstan: Privatization Versus Control*, FORBES (July 28, 2016, 10:52 AM), http://www.forbes.com/sites/riskmap/2016/07/28/kazakhstan-privatization-versus-control/#4a6c1752de4d [https://perma.cc/HGQ5-LWBU].

68. *See* Nursultan Nazarbayev, President, Kaz., Strategy "Kazakhstan 2050," Address at the Annual State of the Nation (Dec. 15, 2012), http://www.kazembassy.org.uk/en/pages/page/20 [https://perma.cc/3UWD-YQAG].

69. *Id.*

70. Igor Pereverzev, *Nash otvet Chemberlenu* [*Our Response to Chamberlain*], ZKSLERR KAZAKHSTAN [EXPERT KAZ.] (May 28, 2012), http://expertonline.kz/a1051 [https://perma.cc/DF29-8F7A].

71. Alan Greenspan, Chairman, Fed. Res., Economic Flexibility, Address before the National Italian American Foundation (Oct. 12, 2005), *in* FED. RES. BROAD, https://

idea of a free market economy captivated the minds of the political leadership. The "invisible hand of the market" as the supreme driving force of economic development replaced state regulation in the majority of industries.[72] Privatization was the most important element of the Kazakhstani business community's growth during the first ten years of its independence.[73] State properties privatized at that time have become the basis for many large private companies today.[74] The state delegated the governance of privatized entities to a newly formed group of managers.[75] Many of those enterprises survived and succeeded.[76] However, the lack of professional knowledge and experience of corporate and risk management, and the absence of contract enforcement and proper commitment devices, brought about many failures.[77] At the beginning of the 2000s, many private companies founded in the 1990s expanded and eventually emerged as financial industrial groups, which usually included commercial banks in order to manage financial flows within the groups.[78] As their business expanded, private groups required additional external capital, which they typically borrowed from abroad.[79] As a result, during the global recession of 2008, many domestic corporations, and especially commercial banks, were heavily burdened by foreign credit obligations.[80] Therefore, when foreign capital left the country, domestic

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www.federalreserve.gov/boarddocs/speeches/2005/20051012 [https://perma.cc/Q945-SQA3].

72. *Id.*

73. Amalbayev Asilbek, *Adam Smit v Astane* [*Adam Smith in Astana*], ZKSLERR KAZAKHSTAN [EXPERT KAZ.] (Dec. 17, 2012), http://expertonline.kz/a645/ [https://perma.cc/J4B7-ACF6].

74. For example, the state-owned Karaganda Regional Steel Mill was transformed into JSC Ispat Karmet, a private company. *See id.*

75. *See id.*

76. *Id.*

77. In this regard, President Nazarbayev, in his book "The Kazakhstan Way," recalled that after Kazakhstan's young entrepreneurs took over the management of Air Kazakhstan, they made such a mess that Kazakhstan's aircraft began being impounded in foreign airports, and "[f]oreign companies refused to let their employees fly on Air Kazakhstan flights because of their poor safety standards. Had it not been for [Nazarbayev's] decision to set up the Kazakhstan-British joint company Air Astana, we would have no airline at all now." NURSULTAN NAZARBAYEV, THE KAZAKHSTAN WAY 172 (2008).

78. *See* Asilbek, *supra* note 73.

79. *See id.*

80. According to a 2008 report commissioned by Microfinance Initiative for Asia (MIFA), a joint venture of the International Finance Corporation of the World Bank Group and KfW Bankengruppe,

> [t]he credit boom in Kazakhstan was fuelled by high levels of foreign currency borrowing by domestic banks until the second half of 2007, when foreign borrowing declined drastically as the global financial crisis reached the country. In third quarter 2007, the net inflow of foreign lending to the financial sector was just $200 million—a decline of $8.9 billion compared to the previous six months.

KAZAKHSTAN: MICROFINANCE AND FINANCIAL SECTOR DIAGNOSTIC STUDY, MICROFINANCE INITIATIVE FOR ASIA [MIFA] 5 (2008), https://www.microfinancegateway.org/sites/default/files/mfg-en-paper-kazakhstan-microfinance-and-financial-sector-diagnostic-study-apr-2008.pdf [https://perma.cc/FN53-9GLA].

companies were severely hit by the scarcity of capital.[81] This, in turn, affected the growth of GDP and created a deficit of funds for new and existing projects.[82] In those circumstances, the government of Kazakhstan undertook the leading role in financing the economy.[83]

Today, the banking system in Kazakhstan remains unstable.[84] The time when high profitability was driven by the growth of export revenues and foreign loans has passed.[85] Commercial banks have scrutinized commercial financing, making it less risky, more secure, and thus, more expensive for borrowers.[86] Most banks prefer to secure their lending for large private companies and SOEs.[87] In contrast, small and medium-sized enterprises ("SMEs") have a quite small share of the banks' loan portfolios, although the government has set a target to increase the share to 40%.[88] 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.[89] The share of own funds must be at least 20% of the total investments in a project.[90] Moreover, commercial banks typically require liquid collateral to secure a loan.[91] 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

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81. World Bank Group [WBG], *IBRD Program Document for a Proposed Development Policy Lending Loan to Kazakhstan*, at 1, WBG Doc. 53575-KZ (Apr. 27, 2010).

82. *See* World Bank Group [WBG], *Oil Rules: Kazakhstan's Policy Options in a Downturn*, at viii, WBG Doc. 82509 (2013).

83. *See id.*

84. 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. Svetlana Gribanova, *God nachalsja s ubytkov* [*The Year Began with Losses*], ZKSLERR KAZAKHSTAN [EXPERT KAZ.] (May 27, 2013), http://expertonline.kz/a11015 [https://perma.cc/BG8H-HU8C]. 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. *Id.*

85. *See* Asilbek, *supra* note 73.

86. *See* ORG. FOR ECON. CO-OP. & DEV. [OECD], IMPROVING ACCESS TO FINANCE IN KAZAKHSTAN'S AGRIBUSINESS SECTOR 25–26 (2013), https://www.oecd.org/countries/kazakhstan/Improving%20Access%20to%20Finance%20in%20Kazakhstan's%20Agribusiness%20Sector.pdf [https://perma.cc/T2Z9-2FMR].

87. Samruk-Kazyna, *Banki—jeto gosudarstvo* [*Banks—The State*], ZKSLERR KAZAKHSTAN [EXPERT KAZ.] (May 20, 2013), http://expertonline.kz/a10939 [https://perma.cc/HFZ5-TKZK].

88. *Id.*

89. O bankah i bankovskoj dejatel'nosti v Respublike Kazahstan [On Banks and Banking Activity in the Republic of Kazakhstan], Aug. 31, 1995 (Kaz.), *translated at* http://online.zakon.kz/Document/?doc_id=1003931 [https://perma.cc/3PRJ-TZQT] [hereinafter Law on Banks and Banking Activity].

90. *Id.*

91. *Predlagayet samyi vygodnyi credit pod zalog nedvizhimosti* [*What Kazakhstan Offers the Most Convenient Bank Loan Secured by Real Estate*], FORBES KAZ. (Sept. 2, 2015), http://forbes.kz/process/property/kakoy_bank_predlagaet_samyiy_vyigodnyiy_kredit_pod_zalog_nedvijimosti [https://perma.cc/HNA3-4ZNW].

they prefer not to disclose their property.[92] Hence, entrepreneurs have become largely deprived of bank financing as a major source of capital.

One of the surveys has demonstrated that the main challenge for Kazakhstani business today is raising capital.[93] This means that private actors have possessed quite limited liquid funds to invest in alternative and resource-consuming industries in an attempt to achieve economic diversification.[94] Rather, they often favor speculative and short-term interests. In this regard, the Kazakhstani State Agency of Statistics has found that private investors prefer to invest in the extraction and export of natural resources rather than support the development of alternative industries, which absorb much higher capital costs with a more distant possibility of return.[95] Official statistics also uncover the low innovative activity of domestic entrepreneurs in Kazakhstan. The share of innovative products within the total volume of domestic

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92. *See* HERNANDO DE SOTO, MYSTERY OF CAPITAL: WHY CAPITALISM TRIUMPHS IN THE WEST AND FAILS EVERYWHERE ELSE 47 (2000).

93. This research distinguishes male and female entrepreneurs. Despite all differences, 64.2% of women and 56.2% of men emphasize the problem of limited capital resources. Paul J. Davis & Fatima Abdiyeva, *Self-Employment in a Post-Soviet Economy: Entrepreneurship and Gender Differences in Kazakhstan*, *in* IX KIMEP INTERNATIONAL RESEARCH CONFERENCE 91, 96 (2012). The second challenge is implementation of labor law provisions (35.7% of female and 37.5% of male entrepreneurs). *See id.* at 91.

94. 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.

Irina Busygina & Mikhail Filippov, *Benefits and Risk of Political Modernization in Russia*, *in* WAITING FOR REFORM UNDER PUTIN AND MEDVEDEV 213, 230–33 (Lena Jonson & Stephen White eds., 2012).

95. In accordance with the IMF survey, value added by the oil sector accounted for 11.5% of the GDP in 2010, with oil exports representing nearly 57% of total exports of goods and services. IMF, *Republic of Kazakhstan: Selected Issues*, Country Report No. 11/151, at 27 (June 2011). Furthermore, according to the report, the bulk of foreign direct investment (nearly 75.25% in 2010) has flowed to the sector for extractive industries, particularly to oil, which accounts for the largest share. *See id.* The Kazakhstani authorities tend to actively involve foreign investors, especially those interested in Kazakhstani natural resources, in the process of industrialization. *See, e.g.*, Foreign Inv. Counsel, *Regulations of the Joint Innovative-Technological Development and Economy Diversification Working Group* (Joint Innovative-Tech. Dev. & Econ. Diversification Working Group, 2015), http://www.fic.kz/eng/rabochie-gruppy/ITDED%20WG/regulations-itdedwg.php [https://perma.cc/FG7K-6BTP]. Speaking at the 25th meeting of the Foreign Investors Council, President Nazarbayev emphasized the importance of foreign investors in the development of alternative industries. The President added that both the government and the council should focus on the expansion of foreign capital and technologies in the implementation of the country's industrialization and innovation strategy. *See* Nursultan Nazarbayev, President, Kaz., Address at the 25th Foreign Investors Council (Dec. 15, 2012), *in* AKORDA (May 2012), http://www.akorda.kz/ru/speeches/external_political_affairs/ext_speeches_and_addresses/zaklyuchitelnoe-slovo-prezidenta-respubliki-kazakhstan-nazarbaeva-n-a-na-25-m-zasedanii-soveta-inostrannykh-in [https://perma.cc/YJ8L-5283]; *Next FIC Session to Focus on Innovative Development*, KAZINFORM (May 22, 2012), http://www.inform.kz/en/next-fic-session-to-focus-on-innovative-development_a2465749 [https://perma.cc/E5KS-YTZB].

production fluctuates just between 0.5–1.65% across the country.[96]

Alternative capital arrangements, such as the securities market, also fail to provide sufficient capital to entrepreneurs. Tremendous appreciation of the banking sector as one of the leading industries has resulted in very limited liquidity in this market.[97] 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.[98] In this situation, state securities have obtained a dominant share in corporate investments. In fact, as of December 1, 2016, government securities amounted to 44.16% of the investment portfolio of pension funds—

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96. U.N., Econ. Comm. for Eur., Innovation Performance Review of Kazakhstan, U.N. Doc. ECE/CECI/14, at 10 (2012).

97. 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. *See* Tatyana Batischeva, *Staraya pesnya o glavnom* [*It is Time to Invite the Exchange SMEs*], EXPERT KAZ. (Dec. 5, 2011), http://expertonline.kz/mag/2011/48/ [https://perma.cc/T6VG-YVF6]; Askar Yelemessov, *Are Kazakh Bankers Capable of Financing the Growth of the Kazakh Economy?*, CHAMBRE DE COMMERCE ET D'INDUSTRIE FRANCE KAZ. (May 2011), www.france.kz/ru/documents,18.html. Kazakhstan has a two-tier banking system with the National Bank of the Republic of Kazakhstan on top. *See* Law on Banks and Banking Activity, *supra* note 89, art. 3. The National Bank is accountable to the President of the country, and is the principal regulator of the financial market and financial organizations. *Id.* 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. *See* Farhad Karagusov, *Pravovye aspekty bankovskogo crisisa v Kazakhstane* [*Legal Aspects of the Banking Crisis in Kazakhstan*], ZAKON (2010), http://online.zakon.kz/Document/?doc_id=31664356#pos=64;-227 [https://perma.cc/AR5X-26QZ]. The share of banking sector assets to GDP became 42.8%. The share of five largest banks in total assets amounted to 53.1% of the total bank assets. The share of the five largest banks in the total loan portfolio was 58.7%, and in the total deposit portfolio—51%. *See Otkrytoe zasedanie Mezhdunarodnogo Koordinacionnogo Soveta bankovskih associacij stran SNG, Central'noj i Vostochnoj Evropy (Mezhdunarodnyj Bankovskij Sovet, MBS): Sbornik Analiticheskih Materialov* [*Open Meeting of the International Coordination Council of Banking Associations in the CIS, Central and Eastern Europe (International Banking Council, MBS): Collection of Analytical Materials*], BANK ASS'N REPUBLIC KAZ., http://www.kba.kz/rus/analitics/ [https://perma.cc/4EA7-DVTG] (last visited Feb. 5, 2017).

98. The current picture of the Kazakhstani securities market is quite simple: 53% of the market is the currency trade ($6,832.1 million), 42% is repurchase agreement deals ($5,364 million), 3.9% is government securities ($503 million), 0.4% ($56 million) is shares, and 0.3% ($39.2 million) is corporate bonds. *See* Tatiana Batishcheva, *Investor Zhazhdet Svobody*, EXPERT KAZ. (Mar. 4, 2013), http://expertonline.kz/a10365/ [https://perma.cc/BAL8-EGY6].

The majority of operations on the Kazakhstani stock exchange (KASE) include debt securities (43.3%) and government securities (37.1%). COMMITTEE FOR THE CONTROL & SUPERVISION, ANNUAL REPORT OF FINANCIAL MARKET AND FINANCIAL ORGANIZATIONS OF THE NATIONAL BANK OF THE REPUBLIC OF KAZAKHSTAN FOR 2012, at 71 (2012). 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. *See id.* 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.

the largest institutional investors in the country.[99]

The reality of Kazakhstan's market is that so far, private businesses have 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 opportunities to attract foreign capital. Capital continues to be available solely for large companies, the majority of which are SOEs.[100] The majority of domestic entrepreneurs are financially unable to perform a leading role in the process of industrialization and compete in the global market.[101]

To efficiently channel and allocate the inflows of foreign exchange to the economy, the government has created a system of state asset management and development institutions including two domestic sovereign wealth funds: the National Fund of Kazakhstan and the Sovereign Wealth Fund Samruk-Kazyna.[102] These institutions have become the primary vehicles for Kazakhstani policymakers to achieve economic diversification, provide socio-economic stability, and retain political control.[103] They serve to accumulate and preserve wealth, diminish resource-dependence, and accomplish the industrialization of Kazakhstan's economy.[104] Put

99. The numbers have been updated with the most recent statistics as of December 2016. *Investment Structure of APFs Portfolio,* NAT'L BANK KAZ. (Dec. 1, 2016), http://www.nationalbank.kz/?docid=729&switch=english [https://perma.cc/LFA8-7HPY].

100. *See* U.S. DEP'T OF STATE, BUREAU OF ECON. & BUS. AFF., 2014 KAZAKHSTAN INVESTMENT CLIMATE STATEMENT 16 (June 2014).

101. *See generally* Innovative Industrial Development Strategy of the Republic of Kazakhstan for 2003–2015, President Decree May 17, 2003, 3–4 (Kaz.).

102. These funds are among the largest sovereign wealth funds in the world by assets under management with 17th and 13th positions, respectively. *See Tracking the Activity of Sovereign Wealth Funds, Pensions, and other Public Funds*, SWFI, www.swfinstitute.org/fund-rankings/ [https://perma.cc/F6PA-8JMT] (last visited Nov. 15, 2016); *The Largest Sovereign Wealth Funds by Assets Under Management*, SOVEREIGN WEALTH FUNDS (Sept. 16, 2011), www.sovereignwealthfundsnews.com/ranking.php [https://perma.cc/2BCG-9VS2].

103. It is claimed that the Kazakhstani structure of state asset management was created in the image of Singaporean and Malaysian funds. G. Sansyzbayeva & Zh. Ametova, *The Role of "Samruk-Kazyna" Sovereign Wealth Fund in Implementation of State Programs of the Republic of Kazakhstan*, 11 ASIAN SOC. SCI. 1, 1 (2015). 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. Rakhat T. Akhmet et al., *Framing the Diplomatic Ties Between Kazakhstan and Malaysia*, 2 J. SOC. SCI. & HUMAN. (SPECIAL ISSUE) 162, 163 (2015). 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. Eric Ellis, *Samruk: The Outsider's Inside Story*, EUROMONEY, Jan. 2008, at 94. However, for as long as Kazakhstani financial and political systems have been evolving, Kazakhstani funds have obtained certain features of other SWFs, for instance the Chinese China Investment Corporation ("CIC"). *China Investment Corporation Buys Stake in Kakakh Gas Company for $939* Million, SWF INST. (Sept. 30, 2009), http://www.swfinstitute.org/sovereign-wealth-funds/china-investment-corporation-buys-stake-in-kazakh-gas-company-for-939-million/ [https://perma.cc/A8W2-9G3B].

104. Essentially, oil revenue accounts for one quarter of GDP, half of fiscal revenues, and two-thirds of export proceeds. *See* IMF, *Republic of Kazakhstan: 2012 Article IV*

differently, the government has made an attempt to bring forward benefits from the country's rich resources in order to overcome commodity-dependence.[105]

The system of state institutions is grounded in the concept of the best standards of corporate governance and accountability.[106] The concept defines the relationship between the government and SOEs as a form of cooperation, where the government delegates some of its functions to the market and largely acts through stimulation and regulation.[107] SOE management is expected to switch to a customer-oriented model grounded in market categories such as profitability, competition, transparency, business initiatives, and equal access to capital.[108] The new concept of state management also implies an active involvement of private organizations in activities traditionally carried out by the state sector in Kazakhstan.[109] The eventual objective of the new concept is to increase SOE efficiency, with a primary focus on the citizens' needs, by the transfer of some economic functions to the market.[110]

Using accumulated capital reserves,[111] 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.[112] In this regard, the government employs state procurements to support and finance the national

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Consultation, IMF Country Report No. 12/164, at 16 (June 2012).

105. Some scholars argue that 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 . . . . 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.

See IMF, Country Report No. 11/151, *supra* note 95, at 31.

106. Zakon Respubliki Kazahstan o Fonde Nacional'nogo BlagosostojAnija [VP RK] [Law of the Republic of Kazakhstan on Sovereign Wealth Fund], 2012, No. 4, Art. 29 (Kaz.).

107. *Id.*

108. *See id.*

109. *See id.*

110. *See* O Fonde nacional'nogo blagosostojanija [ZK RK] [On the Fund of National Welfare], Feb. 1, 2012, No. 550-IV (Kaz.), *translated at* http://online.zakon.kz/Document/?doc_id=31122521 [https://perma.cc/FT4E-UAML].

111. One study estimates the consolidated revenue of the Sovereign Wealth Fund, Samruk-Kazyna, as 20–30% of the country's GDP, and the assets of Samruk-Kazyna from 50–80% of GDP. *See* David Kemme, *Sovereign Wealth Fund Issues and The National Fund(s) of Kazakhstan* 3 (William Davidson Inst., Working Paper No. 1036, 2012).

112. *O Gosudarstv͡ennoĭ programme po forsirovannomu industrial'no-innovat͡sionnomu razvitiiu Respubliki Kazaxstan na 2010-2014 gody i priznanii utrativshimi silu nekotoryx ukazov Prezidenta Respubliki Kazaxstan* [*On the State program for accelerated industrial-innovative development of Kazakhstan for 2010-2014 and abrogating certain decrees of the President of the Republic of Kazakhstan*], KAZAKHSTANSKAYA PRAVDA, Mar. 31, 2010, No. 74, Item 26135.

economy.[113] Today, the government and SOEs are one of the most solvent and reliable customers, and significant state funds continue to be distributed to the private sector in the form of government contracts.[114] The government has become a substitute for private investments in terms of financing, monitoring, and implementing national industrial projects. Accordingly, public expenditures have been rapidly increasing. A growing share of public expenditures (up from US $4 billion in 1999 to US $25 billion in 2007) was assigned for social programs, housing, infrastructure, and public employment.[115]

III. The Tradeoff of State Ownership in Kazakhstan

A. Benefits of SOE

There is value generated by SOEs in Kazakhstan. First, the state budget benefits from the operations of SOEs 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.[116] Second, SOEs themselves are some of the largest taxpayers in the country because they cover key economic segments, such as oil and gas, mining, transportation, energy, telecommunications, and finance.[117] These SOEs are integrated in a single corporate group structure ("the Group") with the state-owned Sovereign Wealth Fund Samruk-Kazyna ("the Fund") on the top.[118] The Group's share in state tax revenues was 727 billion *tenge* or 10% of all taxes collected in 2011, which is 20% more than in 2010.[119]

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 $60.6 million.[120] In 2011, consolidated equity capital of the Group amounted to $40 billion.[121] During the same period, its consolidated

113. *Id.* at 14.

114. In fact, the share of state procurements accounted for approximately 24% in 2014. Nurlan Sakuyov, *Podderzhka otechestvennogo biznesa v uslovijah VTO* [*Support for Domestic Business in the WTO*], ATAMEKEH (July 3, 2015), http://palata.kz/ru/articles/19018 [https://perma.cc/LKY6-XMQ2].

115. *See* Enrique Palazuelos & Rafael Fernández, *Kazakhstan: Oil Endowment and Oil Empowerment*, 45 COMMUNIST & POST-COMMUNIST STUD. 27, 27–37 (2012).

116. SOVEREIGN WEALTH FUND SAMRUK-KAZYNA JOINT STOCK CO., SAMRUK-KAZYNA, SOVEREIGN WEALTH FUND ANNUAL REPORT FOR 2011, at 449, 455, 460 (2011) [hereinafter SAMRUK-KAZYNA, SWF 2011 ANNUAL REPORT].

117. Large commercial banks bailed out by the government as a part of the anti-crisis program with a great share of non-profit loans are not officially included in the Group. *See id.* at 452. This means that these banks with their losses are excluded from the balance sheet of SOEs and do not officially impact the Group's consolidated income.

118. *See id.*

119. *Id.* at 447.

120. *See id.* at 496.

121. *See id.* at 509, 523, 556.

book value was almost $90 billion (or 13.423 trillion *tenge*).[122] The consolidated revenue of the Group reached 6.34 trillion *tenge* or 23% of GDP in 2011.[123]

The second benefit of SOEs in Kazakhstan is wealth distribution through different social projects. In 2011, social expenditures not related to commercial activities of the Group exceeded $1.7 billion (or 258.7 billion *tenge*).[124] In the same year, the amount of losses related to non-profit activities amounted nearly $1.3 billion (200 billion *tenge*).[125] For instance, the Fund's subsidiary, Kazakhtelecom JSC, assumed losses from providing local telecommunication services to rural regions.[126] Another non-profit activity 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.[127] According to the CEO of the Fund, Mr. Shukeyev, in 2011 the Group financed fourteen sport federations in an amount of more than $55.3 million.[128] The Fund was also an official partner of the Kazakhstani team during the Summer Olympic and Paralympic Games in London;[129] so in total in 2011, more than $250 million was spent on sponsorship.[130]

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.[131] Within this program, the government plans to construct one million square meters of rental housing annually.[132] The Fund is financing half of the $6.5 billion (983.8 billion *tenge*) project,[133] with the Fund's share exceeding 70%.[134]

As a result, during the years 2005–2012, the obligations of the Group

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122. *Id.* at 531.

123. *Id.* at 447.

124. *Id.*

125. Those investments included sponsorship, subsidized services of public transportation and communication, and lower oil and gas prices for domestic consumers. N.K. Rahmetova, Managing Director, Samruk-Kazyna, Presentation on the Expanded Board of Samruk-Kazyna for 2011 (Feb. 3, 2012).

126. JSC KAZAKHTELECOM, REPORT OF JSC KAZAKHTELECOM IN THE FIELD OF CORPORATE SOCIAL RESPONSIBILITY FOR 2012, at 29 (2013).

127. Press Release, Samruk-Kazyna, Samruk-Kazyna is an Official Partner of the Nat'l Team of Kaz. at the XXX Summer Olympics (June 18, 2012).

128. *Id.*

129. *Id.*

130. SAMRUK-KAZYNA, DETAILED ANALYSIS OF FINANCIAL STATEMENTS OF JSC "SAMRUK-KAZYNA" FOR 2011, at 5, 15 (June 2012), http://sk.kz/en/about-fund/otchety-i-plany/?PAGEN_1=10 [https://perma.cc/36S5-9A3L] (report accessible for download).

131. Press Release, Samruk-Kazyna, "Affordable Housing 2020" Program Implementation by Real Estate Fund "Samruk-Kazyna" JSC (Nov. 18, 2014), http://sk.kz/news/view/4034?lang=en [https://perma.cc/F4PU-7WQL].

132. Press Release, Samruk-Kazyna, Outcome of the Samruk-Kazyna's Session: New Guidelines for the Fund's Grp. of Cos. (Feb. 3, 2012).

133. *Id.*

134. K.V. Bishimbaeya, Deputy Chairman of the Board, Samruk-Kazyna, Presentation on the Expanded Board of Samruk-Kazyna (Feb. 4, 2012).

increased significantly. As of October 1, 2011, the external debt of the Fund, including its subsidiaries (but excluding commercial banks), amounted to $21.4 billion, or 17.4% of the gross external debt of Kazakhstan.[135] In this regard, Fund management intends to accomplish separate accounting for commercial and non-commercial activities of the Group.[136] This measure is considered to provide the Fund with clear market indicators and real evaluation of the commercial component.

The third component of the SOE value is the increase of local production. In 2010, local procurements equated to 50% of the total volume generated by the Group.[137] By 2020 the portion of domestic producers is expected to exceed 66% for goods and 93% for services.[138] The rules on procurements, adopted by the Fund, establish certain preferences for local suppliers, such as the opportunity for long-term contracting and lending.[139] Private actors have been granted a portion of state investments, especially in industries such as residential construction, SMEs, and agriculture.[140] In particular, state investments lessened the impact of the 2008 recession and helped GDP grow by 1.2% in 2009, 7% in 2010, and 7.5% in 2011.[141] The SMEs' share in GDP almost reached its pre-crisis level and accounted for 20.2% of GDP in 2010.[142]

To support the private sector, the Fund has implemented twenty-four investment projects worth a total of $15 billion (2.55 trillion *tenge*) through the State Program of Accelerated Industrial and Innovative Development.[143] These projects intend to create more than 28,000 jobs.[144] It is expected that the new portfolio will additionally include 120 projects with a total value of roughly $30 billion.[145] The total volume of the Fund's investments in the

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135. Rahmetova, *supra* note 125.

136. *Id.*

137. Umirzak Shukeyev, CEO, Address at the Fund's Corporate Meeting (Apr. 2, 2012).

138. Press Release, Samruk-Kazyna, The Development Strategy of Samruk-Kazyna for 2012–2022 was Approved by the Government of Kazakhstan (2011).

139. SOVEREIGN WEALTH FUND SAMRUK-KAZYNA JOINT STOCK CO., SAMRUK-KAZYNA, SOVEREIGN WEALTH FUND ANNUAL REPORT FOR 2010, at 29, 30 (2010) [hereinafter SAMRUK-KAZYNA, SWF ANNUAL REPORT 2010].

140. In February 2009, the government channeled approximately 120 billion *tenge* to banks for lending small- and medium-sized enterprises. *See* Asilbek, *supra* note 73.

141. *Id.*

142. Yerdos Khamzin & Rassul Moldabayev, *Statutory Regulation of Small and Medium-Scale Entrepreneurship in Kazakhstan*, 25 WORLD APPLIED SCI. J. 827, 828 (2013).

143. In 2010, the Fund implemented twenty-one projects within the state program of industrial and innovation development with the amount of US $20 billion, which was almost half of the Fund's investments. SAMRUK-KAZYNA, SWF ANNUAL REPORT 2010, *supra* note 139, at 14. In particular, the Fund provided 93% of investments in energetics, 86% in oil refining and infrastructure, and 84% in chemistry and pharmacy. Timur Kulibayev, Former CEO of the Fund, Address (2010), *in* SWF 2010 ANNUAL REPORT SUPPLEMENT.

144. Bishimbaeya, *supra* note 134.

145. *Id.*

development of new technologies was equal to $53 million (8 billion *tenge*) in 2011.[146] In 2012, it was ten times more, growing to 92.9 billion *tenge*.[147] This trend continued in 2013 with total investment of 99.2 billion *tenge*.[148] Additionally, the Fund actively promotes the "Park of Innovative Technologies" (the Kazakhstani analogue to Silicon Valley).[149]

In the absence of sufficient and sustained institutions, SOEs have undertaken the mission of allocating and expanding socio-economic welfare. In this regard, the government emphasizes the importance of a stable and predictable environment for further economic growth.[150] Given the fact that the existing social security and pension systems in Kazakhstan are still developing, the risks inherent in a market economy are particularly critical for the population.[151] To mitigate those inherent risks, the government has assumed social responsibility through state ownership and state social and pension programs.[152]

B. The Costs of State Ownership

The system of state ownership in Kazakhstan is deemed to be a response to the existing institutional environment. However, this system causes certain costs, including the costs of political considerations, poor profit motivation, and multitasking.[153]

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146. *Id.*

147. *Id.*

148. *Id.*

149. *Id.*

150. Analyzing autocratic regimes in Singapore and China, Victor Shih argues 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 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* Victor Shih, *Tools of Survival: Sovereign Wealth Funds in Singapore and China*, 14 GEOPOLITICS 328, 332 (2009). In this regard, Kazakhstan mirrors Singapore to a large extent because of the highly influential role of the country's leader, his family, and close allies.

151. 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 and lost their confidence in the pension system. As a result, the Kazakhstani authorities sought to transfer responsibility for social insurance and pension payments to the private sector. *Reforming Kazakhstan's Pension System: Social Protection Project Briefs*, ASIAN DEV. BANK (Oct. 2009), https://www.adb.org/publications/reforming-kazakhstans-pension-system [https://perma.cc/QPE3-7PZY]. Consequently, for a long period of time, the state sector's guarantees were limited and lots of enterprises did not demonstrate prudency in their contribution to the pension fund. *Id.* Recently, this situation resulted in the nationalization of the pension system in Kazakhstan. Sania Baikenova, *Modernization Involves Reliability*, ZAKON (Dec. 5, 2013), https://www.zakon.kz/4590020-chto-takoe-enpf-i-chem-objasnjaetsja.html [https://perma.cc/PZT2-XWP9].

152. *Id.*

153. Scholars emphasize the existing tension between two models as well as tensions "between the economic and political systems." Jiang Hua et al., *Empirical Taxonomy of*

A political component is considered as one of the major sources of costs in SOEs.[154] In particular, current or former government officials constitute the majority of corporate directors in Samruk-Kazyna and SOEs in Kazakhstan.[155] Kazakhstani policymakers consider this board composition as taking advantage of the solid work experience of government officials. Notwithstanding the fact that many of these government officials have important managerial skills and a deep knowledge of particular industries that may be beneficial for the SOEs they manage, their appointments raise a huge concern that some of the commercial interests of SOEs can be sacrificed to the political or career considerations of bureaucrats, considering some major corporate decisions are subject to bargaining between "the bureaucracies of the central ministries in charge of big state firms."[156] The institutional context of Kazakhstan casts significant doubt on whether the government has fully separated its function as both a regulator and as a shareholder.[157] SOE managers and government officials routinely circulate within a revolving door system of state governance and SOE leadership.[158] This dynamic reinforces a cozy relationship amongst the incumbent SOE management, the government, and the political leadership.[159] Political considerations trigger the incentive problem and the lack of managerial autonomy. The opaque process of management appointments and remuneration, as well as the affiliation of the SOE managers 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 system and not their professional knowledge and experience. The appointment to SOE management of political populists—who do not have solid experience in a particular industry, but instead make advances to the political leadership with the goal of achieving short-term political gains for themselves—is the potential cause 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, and not necessarily their efficiency. As one scholar puts it, there are "concerted bureaucratic efforts" to make SOEs strong but "they are not as

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SOE Governance in Transitional China, 10 J. MGMT. GOVERNANCE 401, 402 (2006).

154. Su & He, *supra* note 57, at 307. Dongwei Su provides evidence that corporate boards in China's publicly-listed firms are largely selected through political and administrative processes rather than endogenously chosen in competitive managerial labor markets, and hence are less likely to monitor management. Su, *supra* note 57, at 119.

155. *See* Michael Mesquita, *Kazakhstan's Presidential Transition and the Evolution of Elite Networks*, 24 DEMOKRATIZATSIYA 371, 378–79 (2016).

156. *See* Choon-Yin Sam, *Partial Privatisation and the Role of State Owned Holding Companies in China*, 17 J. MGMT. & GOVERNANCE 767, 776–77 (2013).

157. *See* Margaret M. Pearson, *The Business of Governing Business in China: Institutions and Norms of the Emerging Regulatory State*, 57 WORLD POLITICS 296, 298, 307 (2005).

158. *Id.* at 307.

159. *Id.*

competitive i.e. market performing, as we would like them to be."[160] SOEs in Kazakhstan are subject to soft budget constraints.[161] This means that SOEs can secure additional finances to be rescued from bankruptcy, should they incur losses. Thus, the possibility of the bailout for SOEs can cause moral hazards.[162]

Furthermore, it is possible 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 that benefit from privileged positions in terms of state funding may crowd out less sustainable private companies, which in turn will reduce economic diversification and competition—leading to an even more monopolistic market. For example, one of the negative consequences of the recently increased role of the Kazakhstani government in the economy is the possible decline of non-governmental entrepreneurial initiatives.[163] In particular, the essence of relationships in the state and quasi-state sectors do not create equal conditions for all actors and for private businesses.[164] This may cause a situation where entrepreneurs are not able to compete with their state counterparts and prefer to leave the market, or choose to free ride 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 while finding 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 government-determined indicators.[165] This obligation generates a wide range of tasks, duplication of functions, and poor economic planning. Many SOEs in Kazakhstan deal with numerous, often conflicting, agendas.[166] On the one hand, they are positioned as private companies seeking profit maximization. On the other hand, they have to fulfill socio-economic—typically non-profit—objectives. For instance, when implementing its investment policy, the Fund considers often-contradictory indicators such as profitability, on the one hand, and investments for the country's future development, on the other. As a consequence, state industrialization and economic diversification

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160. *See* Hon. S. Chan, *Politics Over Markets: Integrating State-Owned Enterprises Into Chinese Socialist Market*, 29 PUB. ADMIN. & DEV. 43, 52–53 (2009).

161. *See* Yelena Kalyuzhnova & Christian Nygaard, *State Governance Evolution in Resource-Rich Transition Economies: an Application to Russia and Kazakhstan*, 36 ENERGY POL'Y 1829, 1832–33 (2008).

162. HA-JOON CHANG, U.N., DEPT. OF SOC. & ECON. AFF., NAT'L DEV. STRATEGIES, POLICY NOTES: STATE-OWNED ENTERPRISE REFORM 13 (2007).

163. *See* Asilbek, *supra* note 73.

164. Pearson, *supra* note 157, at 301.

165. *See, e.g.*, WORLD BANK GROUP [WBG], CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES: A TOOLKIT 112 (2014).

166. *Id.* at 15.

programs have barely achieved their objectives.[167] Still, the Fund invests heavily in commodity industries.[168] In 2010, these investments amounted to 43% of total investments by the Fund.[169] Transportation and infrastructure, as well as energy, were the second and third industries the Fund invested in at 30% and 8%, respectively.[170] The commodity companies continue to be the most profitable among the SOEs.[171] In 2011, the national oil company, KazMunaiGas, generated the highest net profit in the Group—more than $3.2 billion (486 billion *tenge*)—which is approximately four times higher than the second most profitable SOE company, the national railroad monopoly, Kazakhstan Temir Zholy.[172]

Nonetheless, until recently the system of SOEs functioning in Kazakhstan has been apparently less expensive than expected and has provided the national economy with benefits that seem to outweigh its costs.[173] This system broadens the conceptual and empirical boundaries between the state and the market, while exhibiting many quasi-public, quasi-private features.[174] Therefore, Kazakhstan does not fall neatly into either the free-market category or the planned-market category. Its economy has relied on markets and competition while retaining the power of the state in setting the course of economic development.[175] SOE efficiency in Kazakhstan is based largely on the tradeoff between costs and benefits of state ownership. These costs and benefits result from the institutional conditions existing in Kazakhstan, particularly the lack of well-developed institutions. Still, the government, as a controlling shareholder, assumes current failures and losses in profit from SOEs. Policymakers prefer to focus on long-term 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,

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167. *See Instituty Razvitia Kazakhstana: A Effectivnost v Chem?* [*Kazakhstan Institutions of Development*], CARAVAN, Mar. 5, 2010, at 2, https://www.caravan.kz/articles/instituty-razvitiya-kazakhstana-a-ehffektivnost-v-chem-373623/ [https://perma.cc/P4C2-8A7J].

168. Even with state investments in innovative development, it is difficult to figure out what works best for Kazakhstan. In particular, Kanat Berentayev, the Deputy Director of the Public Policy Research Center, claims that most innovative development programs focus on technologies (e.g., nanotechnology, biofuels, etc.) that the Kazakhstani economy cannot currently take advantage of. *Id.* at 2–3.

169. *See generally* SAMRUK-KAZYNA, SWF 2010 ANNUAL REPORT, *supra* note 139.

170. *Id.*

171. *Id.*

172. SAMRUK-KAZYNA, SWF 2011 ANNUAL REPORT, *supra* note 116, at 493.

173. "[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, *supra* note 162.

174. Francis, *supra* note 46, at 280.

175. *See Ob utverzhdenii Gosudarstvennoĭ programmy industrial'no-innovat͡sionnogo razviti͡ia Respubliki Kazaxstan na 2015–2019* [*On Approval of the State Program of Industrial-Innovative Development of Kazakhstan for 2015–2019*], KAZAKHSTANSKAYA PRAVDA, Aug. 1, 2014, No. 874, at 121.

including socio-economic benefits, subsidies, dividends and tax revenues generated by SOEs, as well as their long-term investment activities.[176]

Conclusion

Despite the corporatization management reforms 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 the entities' growth, and to translate this growth into corresponding improvements in the economic welfare of the state's citizens. To establish clear objectives, develop workable check-up mechanisms, and ensure proper coordination among multiple agendas of SOEs, governments 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 feasibility of the strategic goals for the country.[177] 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 provide a roadmap with the coherent criteria of success for every stage that corresponds with the long-run outcomes of the project. Additionally, the state should define concrete quantitative and quality indicators to assess the achievement of short- and long-term outcomes. Clear and concrete criteria and indicators would improve the quality of monitoring and assessment of the project's results and would allow better tracing of the project's progress.

Second, governments should consider an issue emphasized by international experts—the increase of disclosure. The incomplete information available 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 to a particular sector or

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176. 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 (1) the achievement of outcomes outlined in the strategic documents of each SOE as well as state policy programs and (2) the full and effective use of state funds. *See* ORG. FOR ECON. CO-OP. & DEV. [OECD], STATE-OWNED ENTERPRISES IN THE DEVELOPMENT PROCESS 34 (2015) (suggesting that successful SOEs have clearly spelled out objectives); *O vnesenii izmeneniĭ i dopolneniĭ v nekotorye zakonodatel'nye akty Respubliki Kazaxstan po usileniiu otvetstvennosti uchastnikov biudzhetnogo protsessa, poluchateleĭ biudzhetnyx sredstv i povysheniiu ėffektivnosti biudzhetnyx protsedur* [*On Amendments and Additions Legislative acts of Kazakhstan on Strengthening Accountability of the Budget Process, Budget Beneficiaries, and Improve the Efficiency of Budgetary Procedures*], ADILET, Feb. 16, 2012, No. 557-IV LRK.

177. Another illustration of an overwhelming quantity of formal documents is the legislation of the Republic of Kazakhstan. According to the statistics available at Adilet, an official information system of legal acts, 8,487 legal acts were approved in 2012, 7,131 acts in 2013, and 9,887 in 2014. ADILET, www.adilet.zan.kz [https://perma.cc/TA5B-X6XM]. This dynamic variability of the law raises questions about its effectiveness, presenting a serious challenge to conducting business activities in the country.

a group of investment projects.[178] 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.[179] Despite a great number of state programs, strategies, and action plans issued by the Kazakhstani government, state agencies, and 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 adequately examining the outcomes of the entire system of state planning and spending.[180] 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.[181]

Third, decision-making in SOEs should actually be independent from politics.[182] Independent directors in corporate boards and supervisory committees may fulfill this function.[183] To guarantee objectivity, the government should 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

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178. World Bank Group [WBG], *Kazakhstan: Adjusting to Lower Oil Prices; Challenging Times Ahead Kazakhstan*, at 7, (WBG Doc. 101506, Nov. 30, 2015).

179. *See* JANAR JANDOSOVA, INT'L BUDGET PARTNERSHIP, OPEN BUDGET SURVEY 2015: KAZAKHSTAN 3 (2015) (reporting that Kazakhstan received a score of fifty-one out of a possible one hundred for budget transparency because it provides the public with limited information); *Respublikanskiĭ b͡iudzhet* [*Republican Budget*], ADILET, Apr. 1, 2016, No. 13701.

180. *See* SOVEREIGN WEALTH FUND SAMRUK-KAZYNA JOINT STOCK CO., SAMRUK-KAZYNA, SOVEREIGN WEALTH FUND ANNUAL REPORT FOR 2015, at 52 (2015).

181. FELIPE & RHEE, *supra* note 61, at 56.

182. When asked to explain why the government had not intervened in the Temasek–Shin Corporation deal in 2006, the Minister for Finance Tharman Shanmugaratnam

> told Members of Parliament 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 on returns.

Choon-Yin Sam, *Partial Privatisation and the Role of State Owned Holding Companies in China*, 17 J. MGNT & GOVERNANCE 767, 782 (2013).

183. The experience of SOEs around the globe demonstrates that issues such as the free-riding problem and the soft budget constraints inherent in SOEs can be mitigated through independent and professional management. FELIPE & RHEE, *supra* note 61, at 56. 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 & He, *supra* note 57, at 306.

fully objective.[184] This means a qualitative expansion of the list of persons who will take over SOEs. In addition, state authorities should incentivize SOE managers through highly attractive personal benefits if SOE managers attain higher productivity of state assets.

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, increases the revenue for the state budget.

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 that domestic investors do to the projects and information. In this regard, the governments must 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. Market conditions offered should at least be 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 results of any transition remains unknown. On the current stage of institutional formation, the government in Kazakhstan took the lead of economic development, blurring the line between public and private. However, 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 further modernization of the state sector, as well as for the reduction of the number of SOEs in order to decrease transaction costs. At the same time, for such transition economies as Kazakhstan, the process of transition does not mean the evolution from state ownership to purely private markets. Instead, this

184. For example, in his testimony before the House of Financial Services Committee in the United States on March 5, 2008, Simon Claude Israel, who was then Executive Director and Member of the Board of Temasek, told the U.S. audience that the professional management team at Temasek comprised 40% of non-Singaporeans at the team's senior level. Sam, *supra* note 182, at 783. 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 eleven individuals with diverse management backgrounds and industrial experience from the United States, United Kingdom, Japan, China, and India to sit on the International Panel. *Id.* The fact that there are non-Singaporeans who provide advice on the allocation of Singapore's resources supports the government's claim that Temasek is commercially and independently run. *See id.*

process can introduce alternative approaches to transition, where SOEs perform an active role in capitalizing national economies, sustaining economic growth, and allocating wealth.