THE INVISIBLE PUBLIC DEBT: THE CASE OF KAZAKHSTAN

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"Lying rides upon debt's back."

Benjamin Franklin

After an oil boom, the majority of oil-rich countries end up in more debt. Latin American countries, for example, faced a debt crisis in the 1980s after the oil price collapse. Thirty years later, the same countries are still paying one-third of their export earnings to service those debts and foreign creditors owe half of their GDP.[2] In 2016 Kazakhstan celebrates the 25th anniversary of its independence. In 2000-15 the country experienced what can be considered a classic oil-boom period: every second dollar earned by the country during that time came directly from oil exports.[3]

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[2] Marcos Arruda, *External debt: Brazil and the international financial crisis* (London: Pluto, 2000), page 7.

[3] International Trade Centre (ITC). Trade statistics for international business development. Accessed on March 25, 2016. http://www.trademap.org/Bilateral_TS.aspx

Like many other oil-rich countries, Kazakhstan did not avoid the overspending driven by windfall profits. As a result the debt of state-owned companies increased significantly since 2008 and poses a risk for the country's long-term development. The financial crisis that began in 2007 was caused by the inability of banks and the private sector to pay their short-term external debt. In 2016 the overall picture has changed and now it is the quasi-public sector that is facing the issue of high external debt. In the situation of economic uncertainty caused by lower oil prices, there is risk of defaults by some state-owned companies. The largest state-owned company, Samruk-Kazyna, employs over 320,000 people, while its revenue accounts for 13 percent of the national GDP.[4] In case of an insolvency, the government will have to step in to prevent social instability.

Rating agencies have assigned high ratings for the debt of state-owned companies, primarily due to the notion that they have "an almost certain likelihood of receiving extraordinary support from the government in the event of financial difficulties."[5] This confidence in the ability of the government to provide such support is based on the considerable savings that Kazakhstan accumulated in its oil fund, the National Fund of Kazakhstan (NFK), which currently stands at around 30 percent of the country's GDP.[6] High ratings allowed state-owned companies to increase their external borrowings and implement aggressive expansion programs.

I use the term "invisible public debt" to refer to the debt of state-owned companies. The problem is that the government does not acknowledge it as part of the public debt. To illustrate, in January 2016 prime minister Karim Massimov stated that the government bears no responsibility for the debt of state-owned companies and that the latter should be treated the same as debt of any other private corporate entity. The prime minister also noted that "according to Article 3 of the Law on Joint Stock Companies, a company is not responsible for the liability of its shareholders, hence the shareholder is not responsible for the liability of the company."[7] Official economic development programs and policies do not include the risk of debt insolvency of state-owned companies. As a result, the government is not ready to face the problem: there are no funds in the state budget reserved for this situation and there is no plan in place to deal with it.

My research question is therefore: "Why should the invisible public debt accumulated by state-owned companies be recognized as part of the government debt?" To answer this question I analyze the case of the state fund Samruk-Kazyna and two state-owned companies with the largest debt, and show examples of state support to repay these debts. My research is based on my own experience as an economist who has worked in the public and private sectors and has consulted various international organizations on the issues of economic development in Kazakhstan. In order to validate my hypothesis and preliminary findings, I triangulate them with primary sources that include official statistical data and company data, as well as with secondary sources represented by relevant news flow information and informal interviews with executives of state-owned companies.

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[4] Samruk-Kazyna Sovereign Wealth Fund. 2014 Annual Report, Astana, p, 12. Accessed April 15, 2016, http://sk.kz/section/6928?lang=en

[5] Elena Kosolapova, "S&P lowers Kazakh Sovereign Wealth Fund's rating", Trend News Agency, February 25, 2016, accessed February 26, 2016, http://en.trend.az/business/economy/2499260.html

[6] National Bank of Kazakhstan. International Reserves and Assets of the National Oil Fund. Accessed on March 25, 2016. http://nationalbank.kz/?docid=180&switch=english

[7] Office of the Prime Minister of Kazakhstan. Official response to the request of parliament members #20-11/5112 on January 5, 2016.

I argue that the issue of the external debt of state-owned companies poses a significant risk to Kazakhstan's economic development and that the government should admit the existence of this invisible public debt by including it in its economic agenda. I conclude the paper with a set of recommendations for both the government and international organizations.

The current economic situation in Kazakhstan

Kazakhstan's economy is highly dependent on the export of mineral resources. This implies the vulnerability of the economy to external shocks. Major crises in Kazakhstan have been caused by external shocks—the oil price drop in 1998 and the closure of global markets for the corporate sector and banks in 2007 amid the global financial crisis. Mineral resources, though providing revenue for the country, can also become harmful, based on the experience of other developing countries that suffered from the so-called "resource curse." The main problem for Kazakhstan is its high dependence on oil exports and, as a result, the "Dutch disease," which causes appreciation of the national currency and thus reduces the competitiveness of local production, especially manufacturing.[8] Another problem is so-called "rent-seeking behavior" that leads to a decrease in entrepreneurial activities and intensifies the fight over sources of rent (extractive sector, state budget, non-tradable sectors such as construction, trade, and financial services).[9]

Since 2000 Kazakhstan has enjoyed a decade of uninterrupted economic growth averaging 7 percent. The growth was mostly driven by the favorable global prices on its main export good—crude oil. Kazakhstan is in the Top-10 of oil exporters in the world, comparable to Venezuela.[10] The share of mineral resources in total exports has increased from 54 percent in 1995 to 81 percent in 2013. At the same time, the dependence of the economy on exports has also increased: the share of exports in the GDP grew from 32 percent in 1995 to 58 percent in 2013.[11]

The windfall profits coming from the oil and gas sector allowed the government to increase the size of the public sector to almost 70 percent of the economy, if accounting for the state-owned companies. In addition, in the aftermath of the crisis of 2007–8, the state has entered some troubled banks and companies in order to keep them afloat. For example, the Kazakhstani state had to buy out BTA bank, which could not pay for its external borrowings. The bank was considered "too big to fail" as it accounted for 30 percent of total retail deposits.[12] The government had to invest over US$9bn in the bank's rehabilitation, but had to let it default on the debt in 2012 and eventually to shut it down in 2014.[13]

Since 2008, similar situations have occurred in different sectors—manufacturing, construction, retail—and the government had to use the NFK assets to buy troubled companies in order to avoid bankruptcies that could lead to an increase in unemployment and social pressure. The decline in oil prices in 2015 has led the national economy into recession. Economic growth was

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[8] International Monetary Fund (IMF), 2013. Republic of Kazakhstan: Selected Issues IMF Country Report No. 13/291, Washington, D.C. page 7.

[9] Robert T. Deacon and Ashwin Rode, "Rent Seeking and the Resource Curse," *in Companion to the Political Economy of Rent Seeking*, ed. Roger D. Congleton and Arye L. Hillman (Edward Elgar, 2015), 227.

[10] Daniel Workman, "Crude Oil Exports by Country", World's Top Exports, April 11, 2016, accessed April 21, 2016, http://www.worldstopexports.com/worlds-top-oil-exports-country

[11] Statistics Committee of Kazakhstan. Vneshnetorgovyj oborot Respubliki Kazahstan. Accessed on April 12, 2016. http://stat.gov.kz/getImg?id=ESTAT101842

[12] National Bank of Kazakhstan. Svedenija po klassifikacii aktivov i uslovnyh objazatel'stv. Accessed on April 5, 2016. http://nationalbank.kz/?docid=1063&switch=russian

[13] Euromoney, "Bank defaults: Kazakhstan's Groundhog Day", March 2016, accessed April 8, 2016, http://www.euromoney.com/Article/3535089/Bank-defaults-Kazakhstans-Groundhog-Day.html

only 1.2 percent in 2015 and the IMF predicts that the economy will grow a mere 0.1 percent in 2016 and 1 percent in 2017.[14] The sudden decrease in oil prices from $110 to $40 in 2014-16 caused a plunge in export revenues, budget revenues, and personal income. Due to the drop in "windfall profits" from oil exports, the NBK had to move to a floating exchange rate regime. As a result, the national currency (KZT: tenge) has lost half of its value and was recognized as the most volatile currency in the world, followed by the Russian ruble and the Nigerian naira.[15] Kazakhstan's government has been actively trying to integrate into the global economy: in 2010 the country became a founding member of the Eurasian Customs Union (in 2015 expanded to the Eurasian Economic Union) and entered the WTO in 2015.[16] This put additional pressure on the economy, as Kazakhstan's market instantly opened to imports (especially from Russia) but the production of goods that could be exported would require more time.

In 2015 the country has entered a period of stagnating economic growth. International development organizations have downgraded their growth forecasts for the country. The burden of servicing the debt of state-owned companies can lead to collapse in investment and output growth and thus significantly undermine economic growth.[17] If the state-owned companies cannot service their external debt, the government will have to use the NFK assets to support them. In that case the NFK funds will be spent on foreign debt repayment and will not enter the local economy.

Overview of the external debt of state-owned companies in Kazakhstan

Methodology and research limitations

In this paper I analyze the following main indicators:

- External debt
- Public sector external debt
- External debt of state-owned companies

In addition to this, I provide case studies of three state-owned enterprises with more detailed company information. Sources used for the paper include official government statistics, data from international organizations, and previously conducted research on the topic. I also interviewed and discussed preliminary results of the research with economists and researchers from following organizations: the IMF's Kazakhstan country team, GWU's Central Asia Program, World Bank Kazakhstan Country Office, international consulting firms based in Washington DC, and think tanks from Kazakhstan.

In my analysis of the external debt I show separate figures that exclude "intercompany lending," as this type of financing is done within one multinational corporation and has a different nature.

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[14] International Monetary Fund (IMF). Regional Economic Outlook Update for Middle East and Central Asia. April, 2016, Washington, D.C.

[15] Casey Michel, "Why Is Kazakhstan's Currency the World's Most Volatile?", The Diplomat, October 7, 2015, accessed March 25, 2016, http://thediplomat.com/2015/10/why-is-kazakhstans-currency-the-worlds-most-volatile/

[16] World Trade Organization (WTO), "General Council approves Kazakhstan's membership terms, only ratification left", July 27, 2015, accessed April 8, 2016, https://www.wto.org/english/news_e/news15_e/acc_kaz_27jul15_e.htm

[17] Kaminsky, Graciela L. & Pereira, Alfredo, 1996. "The debt crisis: lessons of the 1980s for the 1990s," Journal of Development Economics, Elsevier, vol. 50(1), pages 1-24.

The creditor lends to a related entity based on not only its ability to repay, but also in terms of the overall profitability and economic objectives of the multinational operation.[18]

The scope of work done for this research is limited due to the time constraint—the research was conducted from January to July 2016. The focus of research was limited to the external (foreign) debt of state-owned companies and did not cover other public debt or the local debt of state-owned companies. The research does not assess the need for foreign borrowing by state-owned enterprises or its terms and timeliness. It also does not analyze the efficiency of use of the funds borrowed. The paper focuses on the state-owned companies of the Samruk-Kazyna holding and does not cover the Baiterek and KazAgro holdings, although I acknowledge the need for such research in the future.

Information on some of the direct foreign borrowings by state-owned companies was not publicly available at the time when this research was conducted. This is especially the case for direct company loans from Chinese state-owned and private entities. The information on these transactions that can be retrieved from the news does not provide details on the nature of these loans or their terms and therefore does not allow us to analyze their possible implications for the indebtedness level of state-owned companies in Kazakhstan.

Research limitations of this paper also include the insufficient and inaccurate reporting on the external debt of the quasi-public sector. There is a problem with accurate reporting of the external (foreign) debt of state-owned companies. The National Bank of Kazakhstan (NBK) and the Ministry of Finance of Kazakhstan (MOFK) do not publish detailed data on public and publicly guaranteed external debt and external debt of the quasi-public sector. International databases do not have proper information on the matter, partially due to the fact that the official data is not being properly disseminated. For example, the WB's specialized online database—the QPSD (Quarterly Public Sector Debt) lacks data for Kazakhstan's public debt.[19] In some cases the data reported to the World Bank's International Debt Statistics differ significantly from the data reported locally.[20] The NBK produces official statistics on the external debt in accordance with international standards set by the IMF. However the NBK updated its external debt statistics methodology only on January 1, 2013.[21] Prior to that the NBK reported only public and publicly guaranteed external debt and had no separate reporting for the external debt of state-owned companies.

External debt of state-owned companies in Kazakhstan

Statistics on public debt are produced by two agencies in Kazakhstan: the MOFK reports on public debt and the NBK reports on the external debt, including the government's.

Domestic public debt is issued in the form of government notes (bonds) and is denominated in the local currency. In the period of high oil prices and budget surplus (proficit), domestic debt was used as a means to provide short-term liquidity to smooth out the budget expenditures schedule with the budget revenues. However, in 2016 the government will use domestic

[18] External debt statistics: guide for compilers and users / Inter-Agency Task Force on Finance Statistics. – Washington, D.C. : International Monetary Fund, 2014, page 41.

[19] World Bank. QPSD: Quarterly Public Sector Debt. Accessed on March 28, 2016. http://datatopics.worldbank.org/debt/qpsd

[20] World Bank. International Debt Statistics. Accessed on March 28, 2016. http://databank.worldbank.org/data/reports.aspx?source=international-debt-statistics

[21] International Monetary Fund (IMF). Balance of Payments and International Investment Position Manual, 6th edition" (BPM6), 2009, Washington, D.C.

government bonds to borrow 350bn KZT (estimated $10bn) from the state pension fund (IAPF) to finance the budget deficit.[22]

Public debt is a debt of the public sector that comprises the general government, the central bank, and those units in the deposit-taking corporations, except the central bank, and other sectors that are public corporations. Publicly guaranteed private sector external debt is the external debt liabilities of the private sector, the servicing of which is contractually guaranteed by a public unit resident in the same economy as the debtor.[23] The amount of the government and government-guaranteed external debt in Kazakhstan is not significant—in 2015 it was $13bn or 18 percent of total external debt excluding the intercompany lending (8 percent of total external debt).[24]

In 2013 NBK started to publish statistics on Public Sector External Debt including the debt of the quasi-public sector. This reporting method is based on the IMF's guidance on reporting the external debt of public corporations that in some way are controlled by the government and monetary authorities. A public corporation is defined as a non-financial or financial corporation that is subject to control by government units, with control over a corporation defined as the ability to determine general corporate policy. Because the arrangements for the control of corporations can vary considerably, it is neither desirable nor feasible to prescribe a definitive list of factors to be taken into account. The following eight indicators, however, will normally be the most important factors to consider:

(1) Ownership of the majority of the voting power
(2) Control of the board or other governing body
(3) Control of the appointment and removal of key personnel
(4) Control of key committees of the entity
(5) Golden shares and options (golden shares give the holder a decisive vote, even without a majority of shares)
(6) Regulation and control
(7) Control by a dominant customer
(8) Control attached to borrowing from the government.

In addition it may be possible to exercise control through special legislation, decree, or regulation that empowers the government to determine corporate policy or to appoint directors.[25] Most of the entities within Samruk-Kazyna meet one or several criteria of the public corporation listed above.

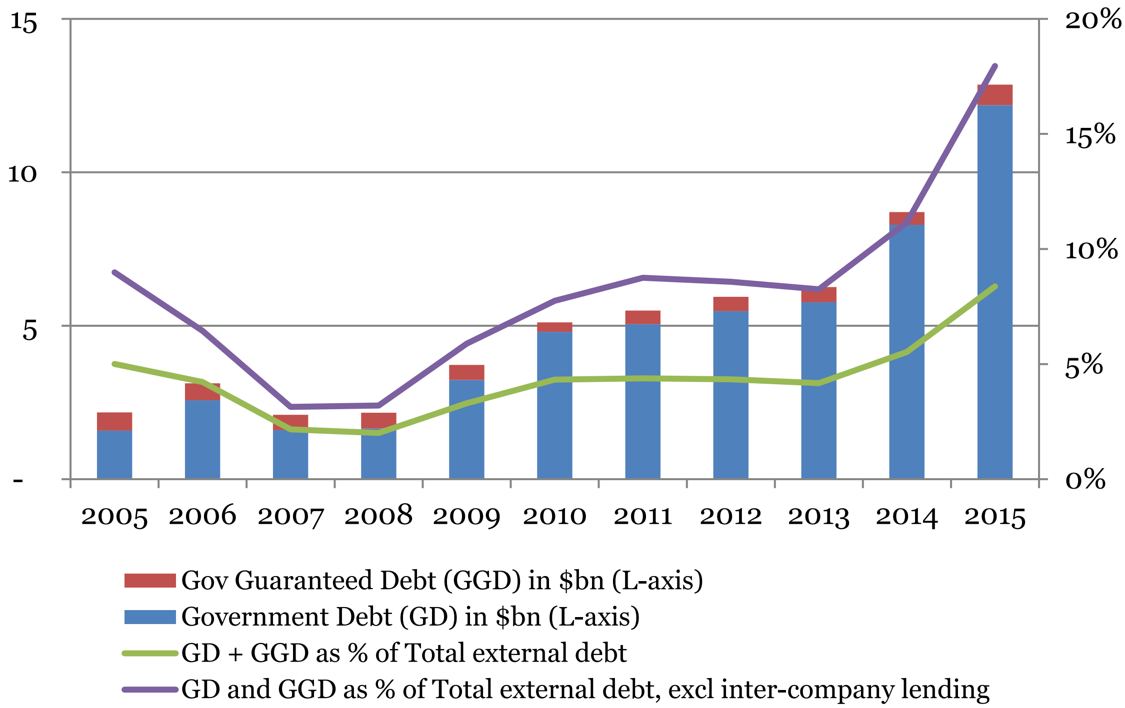
[22] Vaal Tamara, "350 mlrd. tenge iz sredstv ENPF pravitel'stvo napravit na finansirovanie deficita bjudzheta", Vlast, February 15, 2016, accessed March 9, 2016, https://vlast.kz/novosti/15754-350-mlrd-tenge-iz-sredstv-enpf-pravitelstvo-napravit-na-finansirovanie-deficita-budzeta.html

[23] External debt statistics: guide for compilers and users / Inter-Agency Task Force on Finance Statistics. – Washington, D.C. : International Monetary Fund, 2014, pages 49-50.

[24] National Bank of Kazakhstan. External Debt. Accessed on March 25, 2016. http://nationalbank.kz/?docid=202&switch=english

[25] External debt statistics: guide for compilers and users / Inter-Agency Task Force on Finance Statistics. – Washington, D.C. : International Monetary Fund, 2014, page 50.

Figure 1. Dynamics of the external government debt



Source: National Bank of Kazakhstan. External Debt.

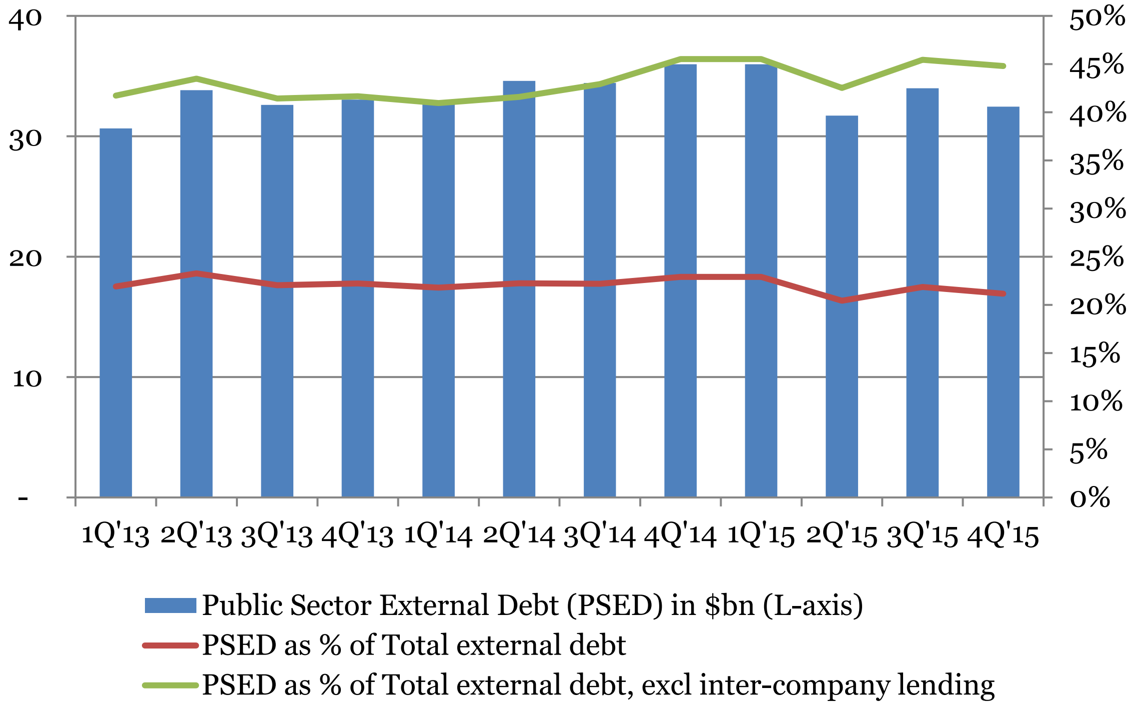
The external debt of Kazakhstan has been growing 6 percent annually on average since 2008 and reached $153bn ($4,053 per capita) in 2015. It is now equal to 83 percent of the country's GDP—which is not high relative to its peers and actually is considered to be moderate according to the World Bank.[26] Fifty-three percent of the external debt ($81bn) is intercompany lending, and state-owned companies comprise only 1 percent of intercompany lending. Currently the annual debt repayment amount (around $22bn in 2016) is much higher than the annual amount of foreign direct investments in Kazakhstan ($4bn in 2015) and is equal to 40 percent of exports ($53bn).[27] Due to a fall in oil exports in 2015, almost half of the country's income went to repaying the external debt. Within one year the debt-service ratio jumped from 35 percent to an estimated 53 percent.[28] Total debt service is the sum of principal repayments and interest actually paid in currency, goods, or services on long-term debt, interest paid on short-term debt, and repayments (repurchases and charges) to the IMF.

[26] World Bank (WB), "Kazakhstan – Low Oil Prices, an Opportunity to Reform", accessed April 3, 2016, http://www.worldbank.org/en/country/kazakhstan/publication/kazakhstan-economic-update-spring-2015

[27] National Bank of Kazakhstan. Balance of Payments. Accessed on March 21, 2016. http://nationalbank.kz/?docid=199&switch=english

[28] World Bank. World Development Indicators. Accessed on March 29, 2016. http://databank.worldbank.org/data/reports.aspx?source=2&series=DT.TDS.DECT.EX.ZS&country=KAZ

Figure 2. Dynamics of the external public debt



Source: National Bank of Kazakhstan. Public Sector External Debt.

The external debt of state-owned companies has grown rapidly since 2008. As a response to the financial crisis of 2007, the government nationalized some troubled banks and provided funding—direct (to commercial banks) and indirect (low-interest loans for state-owned companies and debt refinancing for mortgage holders). This led to increased state participation in the economy and growth in spending of public funds on subsidies for inefficient companies. This policy was also driven by the need to keep up employment and to decrease social instability. In order to sustain a high level of spending, the government had to borrow aggressively. As a result, its external debt has increased over seven times since 2008 and reached $12bn in 2015. External debt of the public sector includes government external debt, government guaranteed external debt and external debt of state-owned companies (enterprises with 50 percent or more of shares controlled by government units). In 2015 the extended public sector's external debt reached $32bn and accounted for 45 percent of the total external debt excluding intercompany lending (or 21 percent of the total external debt). State-owned banks had an external debt of almost $6bn that was more than two times larger than that of private banks ($2bn). State-owned companies owed almost $14bn and comprised a quarter of the total external debt of non-financial corporations (excluding intercompany lending).[29]

Summarizing, since 2008 the growth of the external debt was mostly driven by borrowings of the state and state-owned companies. Most of these funds were raised in order to sustain the increasingly inefficient public sector through subsidies in various forms and to implement

[29] National Bank of Kazakhstan. Public Sector External Debt. Accessed on March 21, 2016. http://nationalbank.kz/?docid=202&switch=english

aggressive investment programs set in state development programs. Although the new data on extended external public debt were available, since 2013 the government has not revised or adjusted its economic and fiscal policies. As a result a large portion of the public debt remains invisible for the government, parliament and the general population and might potentially cause a substantial risk to the economic stability in the country.

Case studies on external debt of state-owned companies

For more detailed case-analysis, I chose to look at state-owned companies with the largest debt: Samruk-Kazyna fund and its subsidiary companies, the national oil company KazMunaiGas, and the national railway company Kazakhstan Temir Zholy (hereinafter KazTemirZhol). The analysis is based on public sources of information—news, official public records, and information from companies' websites.

Box 1. Samruk-Kazyna

The Sovereign Wealth Fund "Samruk-Kazyna" (hereinafter Samruk-Kazyna) is a 100 percent state-owned fund and is the largest corporate entity in Kazakhstan. It was created in 2008 to implement anti-crisis measures, develop infrastructure, and diversify the economy away from oil.[30] In 2015 assets of Samruk-Kazyna were around $65bn or 37 percent of the country's GDP ($92bn and 42 percent in 2014). Revenue of Samruk-Kazyna in 2015 was around $10bn or 6 percent of GDP (13 percent in 2014).[31]

Samruk-Kazyna manages directly and indirectly over 500 companies, some of which are natural monopolies in areas ranging from airlines to commercial banks to telecom and pipelines. In all of these companies the state maintains the majority stake. The government transferred operational management to the holding company Samruk-Kazyna in order to increase the efficiency of the state-owned companies.

Samruk-Kazyna is managed under a separate law and the Law on Public Procurement does not regulate its procurement.[32] This means that there is no direct control by the parliament over the expenses of Samruk-Kazyna. Moreover, the company is not directly linked to the state budget and is not part of the state budget process. Samruk-Kazyna is considered to be an entity separate from the government, even though the Prime Minister heads its board of directors.

Samruk-Kazyna's debt/EBITDA ratio in 2015 was 4.9, meaning that it would take the company almost five years to fully repay its debts. In 2015 the company's external debt grew by 10 percent and was equal to $17bn, or 10 percent of the country's GDP. Eighty percent of the debt is in foreign currency, while revenue is mostly in local currency, which lost half of its value in 2015.
Samruk-Kazyna has conflicting goals—on one hand, to increase the efficiency of its companies; on the other hand, to support the development projects of state programs. In addition, it also funds the image-conscious activities of the government, including but not limited to the 2011 Asian Winter Olympic Games; the Astana bike-racing team; the middle-weight champion of the

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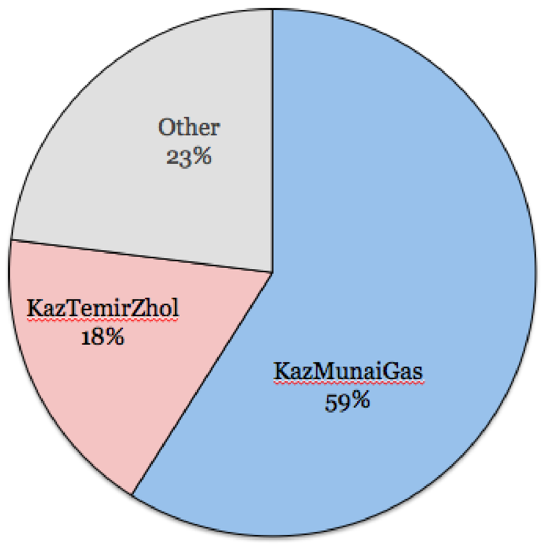
[30] Office of the President of Kazakhstan. Decree #669 "On some measures on competitiveness and sustainability of national economy", October 13, 2008.
[31] Samruk-Kazyna Sovereign Wealth Fund. 2015 Consolidated Financial Statements, Almaty, April 11, 2016, accessed May 15, 2016, http://sk.kz/page/download/8835?lang=en
[32] Samruk-Kazyna Sovereign Wealth Fund, "The Senate of Kazakhstan's Parliament adopted the new Law «On the National Welfare Fund»", accessed May 1, 2016, http://sk.kz/event/view/94?lang=en

world, boxer Gennady Golovkin; the 2017 EXPO World Fair in Astana; and the 2017 Winter Universiade in Almaty.

Samruk-Kazyna is thus Kazakhstan's largest company and its financial stability directly affects the national economy. Samruk-Kazyna has strong ties with the government—it carries the burden of investment in social projects and state development programs and in return is guaranteed full support from the government. As a result, Samruk-Kazyna has accumulated significant debt and is currently facing an issue of increased interest payments. I expect that the government will continue to provide support for the debt repayment of Samruk-Kazyna.

Figure 3: Structure of the debt of Samruk-Kazyna in 2015



Source: Samruk-Kazyna. 2015 Consolidated Financial Statements.

Box 2. KazMunaiGas

The state-owned company with the largest debt is KazMunaiGas, the national oil company that accounts for a quarter of domestic oil production and comprises 45 percent of Samruk-Kazyna assets.[33] KazMunaiGas is comprised of two entities: "National Company KazMunaiGas" and its subsidiary, "KazMunaiGas Exploration and Production," but given their joint responsibility for their debts I refer to them as to one entity.

Despite the high oil price period, the company has accumulated over $17bn of debt.[34] The drop in oil prices resulted in an earnings squeeze for the company. Currently 100 percent of its earnings go to interest payments. Over 93 percent of the company debt is denominated in foreign currencies (primarily US dollars), while only 73 percent of its revenues and 51 percent of costs were US dollar denominated in 2015.[35] Devaluation of the local currency has thus

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33 Samruk-Kazyna Sovereign Wealth Fund. 2014 Annual Report, Astana, accessed April 15, 2016, http://sk.kz/section/6928?lang=en

34 Fitch Ratings, "Fitch Affirms National Company KazMunayGas at 'BBB'; Outlook Stable", July 1, 2015 , accessed February 26, 2016, https://www.fitchratings.com/site/pressrelease?id=987258

35 Fitch Ratings, "Fitch Affirms National Company KazMunayGas at 'BBB-'; Outlook Stable", June 30, 2016 , accessed March 26, 2016, https://www.fitchratings.com/site/pressrelease?id=1008234

increased its debt, which was mostly in foreign currency. This led to the situation of potential breach of its Eurobond covenants that has a limit of 3.5 on the company's net debt/EBITDA ratio. The covenant breach would result in additional fees and changes in the conditions for its debt. In order to reduce the debt level, the company had to seek support from the government.

In July 2015 the state stepped in to help KazMunaiGas to reduce its debt levels. The NBK used $4bn from the NFK that it manages on behalf of the government, to acquire from Samruk-Kazyna a 10 percent+1 share in KazMunaiGas. The transfer was part of a scheme whereby Samruk-Kazyna bought from KazMunaiGas a 50 percent share in KMG Kashagan BV for $4.7bn.[36] The later company owns 16.88 percent in Kashagan operating company NCOC. It is important to note that the NFK was created in 2001 with the mission to reduce the oil dependency of Kazakhstan's economy and to serve as a "future generations fund." Instead, as a result of this operation, the NFK assets were used to support the highly indebted, inefficient state-owned oil company. In May 2016 assets of the NFK stood at $65bn.[37]

To cover its debt payments KazMunaiGas plans to sell all of its refineries and its network of gas stations in Kazakhstan, as well as its assets abroad. In December 2015 it reached an agreement with CEFC China Energy Company Ltd to sell 51 percent of its subsidiary company KazMunaiGas International (KMGI, formerly Rompetrol Group). Key assets of KMGI are a 100,000 barrels-per-day refinery and a 400,000 tonnes-per-year fertilizer plant in Romania, along with nearly 1,000 petrol stations in Romania, Spain and France. For this deal KMGI was preliminarily valued between $0.5bn and $1bn.[38] It is worth noting that KazMunaiGas has spent $3.6bn to buy this asset (75 percent in 2007 and 25 percent in 2009).[39]

In order to reduce its debt in April 2016 KazMunaiGas also signed a deal to sell its future oil exports from its 20 percent stake in the largest Tengiz oil field. The loan of $3bn was provided by the commodities trader Vitol in cooperation with six international banks. The price of the loan is estimated at around 185 basis points over LIBOR.[40] KazMunaiGas will thus get no dividends from Kashagan after the project starts commercial oil production.[41] Kashagan oil field was called "the world's most expensive energy project in history ($116bn)" by *CNN*[42] and dubbed "Cash-All-Gone" by *The Economist*.[43] The complexity level and harsh conditions of this offshore

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[36] Joanna Lillis, "Kazakhstan: Central Bank Steps In To Prop Up Cash-Strapped Oil Giant", Eurasianet.org, July 31, 2015, accessed March 12, 2016, http://www.eurasianet.org/node/74466

[37] National Bank of Kazakhstan. International Reserves and Assets of the National Oil Fund. Accessed on March 25, 2016. http://nationalbank.kz/?docid=180&switch=english

[38] Chen Aizhu, "China's CEFC to take control of unit of Kazakh state-run oil firm", Reuters, December 15, 2015, accessed May 12, 2016, http://www.reuters.com/article/china-kazakhstan-idUST9N0NH05G20151215

[39] Rompetrol, "KazMunayGas and Rompetrol Holding SA Announce the Acquisition by KazMunayGas of a 75 percent Interest in The Rompetrol Group NV", accessed May 1, 2016, http://www.rompetrol.com/kazmunaygas-and-rompetrol-holding-sa-announce-acquisition-kazmunaygas-75-interest-rompetrol-group-nv

[40] Helen Reid, "KazMunaiGas signs $3bn prepayment deal as it reduces debt pile", April 1, 2016, accessed May 26, 2016,http://www.txfnews.com/News/Article/5500/KazMunaiGas-signs-3bn-prepayment-deal-as-it-reduces-debt-pile#

[41] Fitch Ratings, "Fitch Affirms National Company KazMunayGas at 'BBB-'; Outlook Stable", June 30, 2016 , accessed March 26, 2016, https://www.fitchratings.com/site/pressrelease?id=1008234

[42] Steve Hargreaves, "10 most expensive energy projects in the world", August 27, 2012, accessed April 8, 2016, http://money.cnn.com/gallery/news/economy/2012/08/27/expensive-energy-projects/10.html

[43] The Economist, "Cash all gone", October 11, 2014, accessed May 18, 2016, http://www.economist.com/news/business/21623693-one-worlds-biggest-oil-projects-has-become-fiasco-cash-all-gone

project are often compared to Arctic oil projects. To cover the development costs and generate reasonable profits from oil production at this field, an oil price of over $100 per barrel is required.[44] In the low oil prices environment there is a high risk that this offshore oil production site could turn into a white elephant project.

The government's support to KazMunaiGas through getting money from further privatization is limited. Valuation of the company is under pressure from low oil prices, high debt level, and the non-investment rating of the company. The government currently owns only 58 percent of KazMunaiGas and I expect that the government would want to keep at least a majority stake in the company given its strategic importance for the country's economy. KazMunaiGas is thus not capable of generating enough revenue to cover its interest payments. Currently, the company is selling off its assets and future revenue stream in order to meet the Eurobond covenants. In 2015 the government stepped in to provide additional funds to cover its debt. Given there is no significant increase in the oil prices, I expect that this situation will continue and that the company will require more support from the government.

Box 3. KazTemirZhol

National railroads company KazTemirZhol is the largest employer in the country, with more than 150,000 employees. It provides employment in rural and remote areas and bears obligations to support social infrastructure throughout the country. The company accounts for half of all cargo traffic in Kazakhstan. Its operations have a significant impact on the economy, as railroad transportation costs are reflected in almost all goods produced and consumed in the country.

In 2014 KazTemirZhol accounted for 15 percent of total assets of Samruk-Kazyna.[45] The company has been investing aggressively to fulfill the government's agenda on infrastructure development. In 2015, KazTemirZhol saw a 12 percent drop in revenues and profitability, driven by a decline in transit of passengers and because there was no tariff indexation that year. Another negative factor was a 14 percent drop in freight volume due to a decline in commodities exports to China and trade imbalances caused by the devaluation of the Russian ruble. KazTemirZhol generates 80 percent of its revenue in local currency. In addition, the company's ability to increase prices for its services is limited by its status as a national monopoly. Any significant price increase would directly impact the competitiveness of local producers.

By 2015 KazTemirZhol has generated $6bn of debt, half of which was in foreign currency. Adjusted debt/ EBITDA of the company was around 10, meaning that it would need 10 years to repay its debt. Revenues that KazTemirZhol generated in 2015 were not enough even to cover the interest payments on its debt.[46] As a result, in April 2016 the government had to step in and provide support to KazTemirZhol to refinance its $350 million bond. The government provided funding by purchasing the company's new KZT50 billion (around $150mn) local bond using the money of the IAPF state pension fund. Money from the pension fund was provided in local currency. Therefore, the currency risk was moved from an inefficient state-owned company to

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[44] Catherine Putz, "Will Kashagan Be Pumping by the Fall?", The Diplomat, April 6, 2016, accessed May 25, 2016, http://thediplomat.com/2016/04/will-kashagan-be-pumping-by-the-fall/

[45] Samruk-Kazyna Sovereign Wealth Fund. 2014 Annual Report, Astana, accessed April 15, 2016, http://sk.kz/section/6928?lang=en

[46] Moody's, "Moody's confirms ratings of KTZ and KTT; negative outlook", April 27, 2016, accessed May 12, 2016, https://www.moodys.com/research/Moodys-confirms-ratings-of-KTZ-and-KTT-negative-outlook--PR_347964

the future pension savings of the people of Kazakhstan. There was no public or parliamentary discussion held on that decision. The remaining funding for bond repayment was provided by Samruk-Kazyna and the EBRD ($100mn) and a loan from Halyk bank ($100mn).[47]

KazTemirZhol faces a high risk of "credit cliff" due to the decline in its revenue, high indebtedness, and its non-investment rating. In addition to that, the company bears the cost of extensive social obligations that would be difficult to cut during the crisis time. I expect that KazTemirZhol will not be able to service its debts and that the government will continue to provide support for the company.

Policy issues of managing the external debt of state-owned companies

State-owned companies always have strong ties with the government. For example, the current CEO of Samruk-Kazyna is a former deputy prime minister, while its Board of Directors is headed by the Prime Minister and includes several current members of the cabinet. Another example: in May 2016 the head of another state-owned fund, Baiterek, exchanged seats with the Minister of Economy. It is no surprise that the government perceives state-owned companies as its second budget to implement social and development programs and that this leads to inefficient use of funds and to large corruption.

Since the country gained independence, political stability in Kazakhstan has been based on the economic success of the country. The social contract has rested on a semi-official consensus that can be summarized as "Economy First, Politics Later," meaning that democratic reforms should be implemented gradually and should follow the increase in average income. The current crisis poses a real risk to the preservation of this status quo. The main reason for that judgment is that the nature of the crisis stems from the current economic model, which is based on exports of raw materials (oil, metals, grain) that can no longer be sustained due to a decrease in global demand. This means that changes in the social contract will become inevitable if the government is not able to find a new growth driver to substitute for oil exports. Otherwise the government will have to move toward a new economic model that should be based on broader liberalization and a lower level of state participation in the economy.

Currently the issue of the debt of state-owned companies remains excluded from the agenda of the government. There is not enough detailed information on the current status of indebtedness of the quasi-public sector. The government's economic policy and budget plan does not include the risk of defaults of state-owned companies. Moreover, public awareness of this problem and its potential impact on the economic and social development in the country remains limited. The government does not want to acknowledge the issues of the invisible public debt and, as a result, at some point it might be forced to cut budget spending on social and development programs in order to cover the debt of state-owned companies.

Conclusions

During the period of high oil prices, rating agencies assigned high ratings to the debt of state-owned companies. Their evaluation was predominantly based on one assumption: "extremely high likelihood that the state will provide sufficient and timely tangible support when needed."[48]

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[47] Moody's, "Moody's confirms ratings of KTZ and KTT; negative outlook", April 27, 2016, accessed May 12, 2016, https://www.moodys.com/research/Moodys-confirms-ratings-of-KTZ-and-KTT-negative-outlook--PR_347964

[48] Fitch Ratings, "Fitch Affirms National Company KazMunayGas at 'BBB-'; Outlook Stable", June 30, 2016 , accessed March 26, 2016, https://www.fitchratings.com/site/pressrelease?id=1008234

In this paper I have presented two cases of state support to state-owned companies. First, the NBK has provided funds to KazMunaiGas from the NFK. The Fitch agency called this “a clear reflection of the state support.” Second, the government used public funds from the pension system to refinance the debt of KazTemirZhol. At the same time, the prime minister stated that “the government will not be responsible for the debts of Samruk-Kazyna.”[49]

A large portion of the public debt in Kazakhstan remains invisible to the general public. The government avoids taking the responsibility for this situation and does not develop a policy to prevent further build-up of the debt of state-owned companies. This debt was accumulated during the oil-boom period and it will define the economic well-being of people in Kazakhstan in the long-term future. Preserving the status quo on this issue will lead to further worsening of the situation, with the current government of Kazakhstan passing on to the next generation not savings but debts. This will seriously damage the country’s ability to achieve sustainable economic development in future. The invisible public debt accumulated by state-owned companies should thus be recognized as part of the government debt. I presented clear evidence that the state *de-facto* provides support to state-owned companies to service their debt payments. In order to respond to this issue the government has to *de-jure* recognize the existence of the invisible public debt and include it in its economic policy.

Policy recommendations

My recommendations for the *government* include four major steps.

- As a *first* step, the government needs to recognize the problem. It should include invisible public debt in the government’s economic policy. The government could start with creating a working group on the debt of state-owned companies that should be headed by the Prime Minister. The current state of state-owned companies’ debt and guidance on its size should be discussed at Parliament sessions as part of the annual budget process.

- The *second* step is to stop further debt increases. The government has to put a cap on the total debt of Samruk-Kazyna and on individual state-owned companies. As a possible cap I suggest using a threshold on the debt/EBITDA ratio. It also might be wise to allocate funds within the state budget that could be used to provide support to state-owned companies for repaying the interest on their debt.

- The *third* and most important step is to start to control the invisible public debt. The debt of state-owned companies should be included in the budget process and should be approved by the Parliament. The management of Samruk-Kazyna should present the results of its work to the Parliament on an annual basis. The Parliament should make decisions regarding remuneration of the top management of the state-owned companies based on their meeting goals and key performance indicators, including the target on the company’s debt.

- *Fourth*, the government should ensure a higher level of transparency and data availability. Given the size and importance of the state-owned companies in the national economy, the government as a major shareholder should oblige state-owned companies to disclose detailed information on their debt and make it publicly accessible. This information should be monitored and analyzed closely by the government, the

[49] Office of the Prime Minister of Kazakhstan. Official response to the request of parliament members #20-11/5112 on January 5, 2016.

Parliament and civil society to ensure budget discipline, and by the NBK as part of its financial stability assessment. The NBK should publish data on the external debt of the quasi-public sector fully in accordance with international standards. It is vital that the government and the NBK ensure timely and accurate reporting of the debt figures to the international organizations, in order to guarantee the transparency of the public debt and maintain long-term credibility.

A recommendation for *international organizations* is to give more attention to the quality of their databases on the foreign debt of countries. I also advise putting more emphasis on ensuring the adoption and use of the latest methodology for official data reporting by member countries. Unreported data on the debt can potentially lead to omitting crucial factors when analyzing the economic performance of a country, which significantly impacts the quality of the analysis and policy recommendations.

Appendix

Table 1. Dynamics of the external government debt

Year	Government Debt (GD), $bn	Gov Guaranteed Debt (GGD), $bn	GD + GGD as percent of Total external debt	GD and GGD as percent of Total external debt, excluding inter-company lending
2005	1.58	0.59	5.0	9.0
2006	2.57	0.55	4.2	6.4
2007	1.60	0.50	2.2	3.1
2008	1.65	0.51	2.0	3.2
2009	3.24	0.49	3.3	5.9
2010	4.80	0.31	4.3	7.8
2011	5.05	0.44	4.4	8.8
2012	5.47	0.47	4.3	8.6
2013	5.76	0.50	4.2	8.3
2014	8.29	0.42	5.5	11.2
2015	12.19	0.67	8.4	18.0

Source: National Bank of Kazakhstan. External Debt.

Table 2. Dynamics of the external public debt

Quarter	Public Sector External Debt (PSED) in $bn	PSED as percent of Total external debt	PSED as percent of Total external debt, excluding inter-company lending
1Q'13	30.66	21.9	41.7
2Q'13	33.83	23.3	43.5
3Q'13	32.60	22.0	41.4
4Q'13	33.05	22.2	41.7
1Q'14	32.94	21.8	40.9
2Q'14	34.60	22.2	41.6
3Q'14	34.43	22.2	42.9
4Q'14	35.98	22.9	45.5
1Q'15	35.98	22.9	45.5
2Q'15	31.71	20.4	42.5
3Q'15	33.99	21.8	45.4
4Q'15	32.46	21.1	44.8

Source: National Bank of Kazakhstan. Public Sector External Debt.

Table 3. NBK quarterly report form on public sector external debt

Public Sector External Debt

mln $

Items	12/31/15
Public Sector External Debt*	**32,456**
Short-term	*282*
Long-term	*32,173*
General Government	**11,292**
Short-term	*0*
Long-term	*11,292*
Central Bank	**900**
Short-term	*77*
Long-term	*823*
Banks and Other Sectors**	**19,422**
Short-term	*205*
Long-term	*19,216*
Banks and other financial corporations	**5,774**
Short-term	*17*
Long-term	*5,757*
Nonfinancial corporations, households, and NPISHs	**13,648**
Short-term	*188*
Long-term	*13,460*
Direct investment: Intercompany lending	**843**
Memorandum item:	
Private Sector External Debt	**121,001**
Short-term	*6,166*
Long-term	*114,834*
Banks and Other Sectors	**40,004**
Short-term	*6,166*
Long-term	*33,838*
Direct investment: Intercompany lending	**80,997**
Total External debt of Kazakhstan	**153,456**
Short-term	*6,448*
Long-term	*147,008*

* Public Sector External Debt covers:
-liabilities of the General Government, Monetary Authorities,
- covers liabilities those entities in the banking and other sectors that are public corporations, i.e. non-financial or financial corporations which are subject to control by government and monetary authorities. Control is established (directly or indirectly) through ownership of more than half of the voting shares or otherwise controlling more than half of the shareholder voting power;
- publicly guaranteed external debt.

**According to the article 8 of the Law of Republic of Kazakhstan "On governmental statistics" information which allows directly or indirectly determine the respondent is considered confidential and is allowed to be published only if there is an agreement from the respondent. As a result the sector "Banks" is united with sector "Other sectors".

Source: National Bank of Kazakhstan. Public Sector External Debt.

Abbreviations

EBRD	European Bank for Reconstruction and Development
IAPF	Integrated Accumulative Pension Fund of Kazakhstan
IMF	International Monetary Fund
KMGI	KazMunaiGas International
KPI	Key Performance Indicator
KZT	Kazakhstani Tenge
MOFK	Ministry of Finance of Kazakhstan
NBK	National Bank of Kazakhstan
NCOC	North Caspian Operating Company
NFK	National Fund of Kazakhstan
OECD	Organisation for Economic Co-operation and Development
TNC	Transnational Corporation
WB	World Bank