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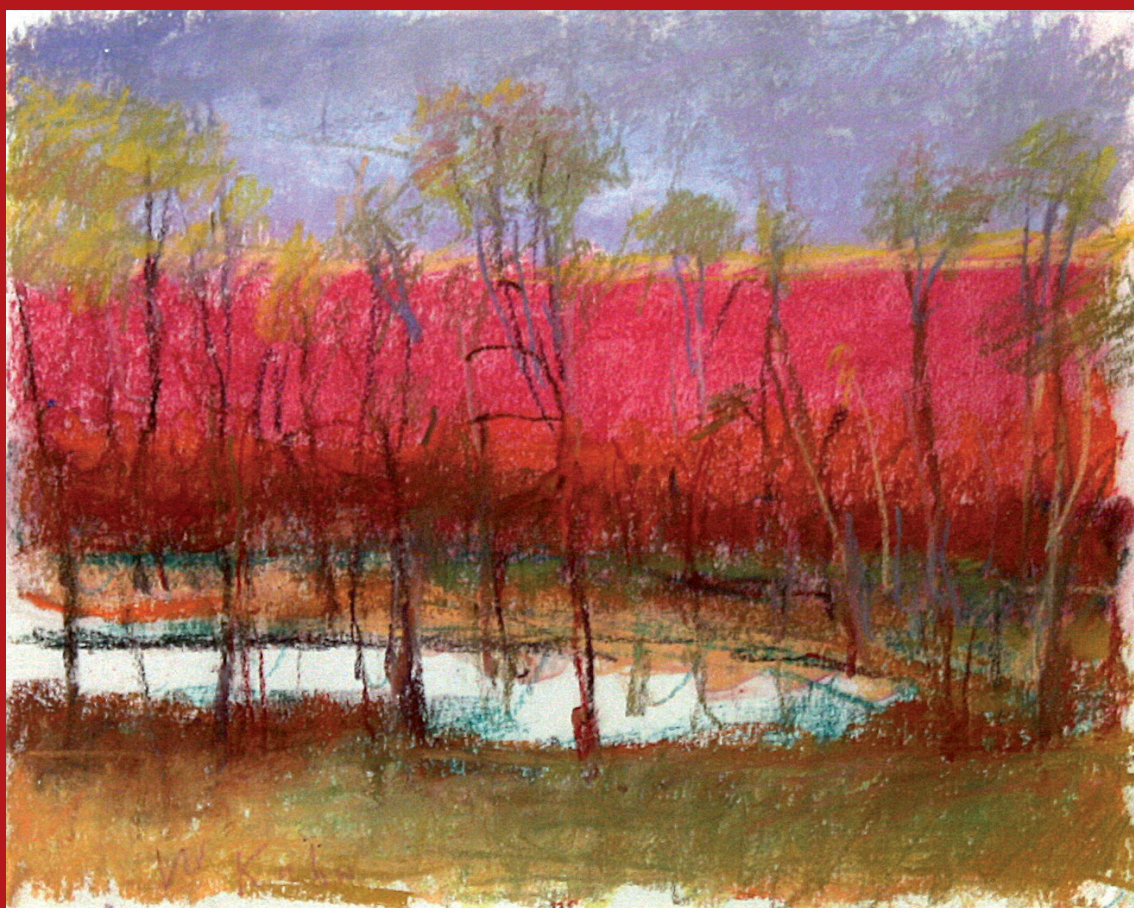


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Kazakhstan's Economic Recovery / Oil and Gas Recover Momentum



- ▶ ExxonMobil – A Lower-Carbon Energy Future
- ▶ Chevron Opens Creative Public Space in Atyrau
- ▶ Tengizchevroil – Crisis Reveals Character: TCO Commitments to Kazakhstan
- ▶ KPO Achievements – First Half-Year 2020
- ▶ IFC – Kazakhstan's Post-Pandemic Recovery
- ▶ EBRD – Kazakhstan's Economy in the Post-COVID World
- ▶ Believing in Kazakhstan's Economic Recovery?
- ▶ JP Morgan – The 2020 Economic Crisis: A Silver Lining
- ▶ ICD – Islamic Finance as an Alternative Financial Tool During the COVID Pandemic
- ▶ Deloitte - The Role of Fiscal Policy in Kazakhstan's Economic Recovery and Beyond

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Marina Kahiani is a Partner at Grata International Law Firm who focuses her practice on a wide range of M&A and finance transactions, including project finance and capital markets, infrastructure transactions, financial services regulation, and workouts and debt restructurings in many industries. She has over 12 years of experience in the Kazakhstani legal services market as well as experience in matters dealing with the former Soviet Union.

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Assel Mukhambekova has recently joined KPMG. Before joining KPMG she worked as a lawyer in several international law and consulting firms and Kazakh banks. Assel Mukhambekova has extensive experience in providing advisory services to international and Kazakh clients on a wide range of legal issues over 15 years, including banking and corporate finance, corporate and M&A, project and structured finance, foreign investment, employment, antimonopoly, regulatory and other legal issues related to business in Kazakhstan.

Assel Mukhambekova graduated from Kazakh Humanitarian Law University (Almaty) with honors in 2002 and received an LLM degree from Stirling University, UK.

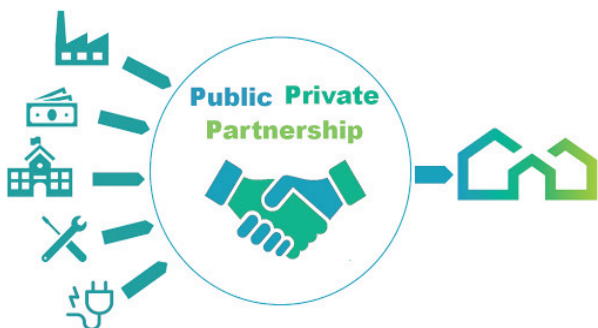
OBSTACLES TO PUBLIC-PRIVATE PARTNERSHIP DEVELOPMENT IN KAZAKHSTAN

by **Shaimerden Chikanayev**
Partner, **GRATA International**

Introduction

By 2016 Kazakhstan established what was considered a solid legal and institutional basis for public-private partnership (PPP) projects that led to a sharp increase in PPP formation with 15 PPP agreements signed in 2016, 161 in 2017, 292 in 2018 and 294 in 2019. In addition to being the leader in Central Asia in terms of establishing a PPP legal and institutional framework and the number of PPP Agreements executed, Kazakhstan has also been successful in pursuing the 66 km *Big Almaty Ring Road* benchmark concession project (a toll road around the city of Almaty), also known as *BAKAD*. This project finally reached its financial closure on 7 August 2020, making it the largest PPP project in Central Asia.

BAKAD is supported by the *European Bank for Reconstruction and Development (EBRD)*, the *Bank of China*, *PGGM*, the *Eurasian Development Bank* and the *Islamic Development Bank*. It is a groundbreaking PPP project for Kazakhstan because it is the first large-scale PPP project in Central Asia structured with international advisors in an open competitive process conforming to international best practices.



On its face, therefore, the Kazakhstan government's PPP policy has so far been very successful. The *Ministry of the National Economy* and *Kazakhstan's PPP Center*, as the bodies with the most important role in developing Kazakhstan's PPP policy, should be congratulated for what has been done. However, by 2019 it became increasingly clear to all the major stakeholders that PPP development in Kazakhstan was moving in the wrong direction, as current PPP policy and governance proved inefficient, often concealing public borrowing.

The *General Prosecutor's Office*, the *Accounts Committee* of the *Finance Ministry*, and the *National Chamber of Entrepreneurs (Atameken)* each conducted their own investigations of PPP practice in 2019 and publicly confirmed cases of fake PPPs, lack of transparency, and misuse of the PPP mechanism, including corruption by regional and local officials. The problems in the PPP mechanism became so

acute that in July 2019 Kazakhstan's President, Kassym-Jomart Tokayev, acknowledged that the whole PPP concept in Kazakhstan had been discredited.



Major Problems with PPP Development

There are various obstacles to the proper development of PPPs in Kazakhstan, but the following are the major ones:

• **Absence of a National PPP Policy Document (Strategy)**

In 2011 the Government approved the *Program for Development of Public-Private Partnership 2011–2015* (the PPP Program). Unfortunately, there were no further PPP policy documents after this Program ended in 2015, and PPP development in Kazakhstan since then has been chaotic and not very successful.

Because Kazakhstan has not had a national PPP policy with clear objectives, targets, and priority sectors for partnerships since 2015, there has been disproportionate use of the PPP mechanism at the local level (as of 1 September 2020, 813 PPP agreements worth 1.8 trillion tenge have been signed, only 9 of which are national-level projects and 803 are local-level (municipal or regional projects). The local projects are mainly small-scale and service-oriented (that is, lacking capital investment) kindergarten PPPs. About 54% of the executed PPP agreements are kindergartens.

Whereas the national-level PPP and concession projects in Kazakhstan were conducted under oversight of many controlling state entities including the PPP Center to ensure a truly competitive and transparent PPP selection process, the regional and local-level PPP projects had more relaxed oversight. The regional projects therefore acquired a common perception that the PPP model is an easy, one-off opportunity to win government-backed revenue lasting up to 30 years.

It is therefore no surprise that many regions' officials and investors with close ties to the regional and local

authorities sought to implement projects through the PPP mechanism (often by way of direct negotiations and without competition), rather than under the *Public Procurement Law* that requires an open tender. The fact that more than 50% of the PPP agreements executed by the end of 2019 were sole-sourced (without an open tender) raises serious concerns.

Many of the regional PPP projects over the past four years are therefore associated with corruption — for example, the infamous case in Mangistau region in 2019, where the deputy head of the region was sentenced to ten years in prison for “protecting” a foreign investor who proposed constructing an ice-rink stadium in Aktau under the PPP model.

Another negative result of the lack of a national PPP strategy is a public misperception of which PPP projects are really needed. This means many good projects pursued by foreign investors do not receive support because government officials do not want to take responsibility for them. The current Almaty LRT PPP project is an example of the public sector partner unexpectedly backing out in the middle of the tender process.

Although four international consortia had already invested time and money and successfully passed the first stage of the open tender, entering the second stage in 2019, the Almaty LRT PPP project has been on hold for more than a year due to the decision by Almaty’s newly-appointed mayor to abandon the PPP model. Instead he wants the public sector to build and operate the LRT system, presumably because this option is considered better value for money.

This change of plans in the middle of a well-prepared international open tender may have been triggered by the new mayor’s doubts arising from Nur-Sultan’s bad experience with the light rail system project. The Nur-Sultan project was not structured as a PPP, but its failure was an embarrassment to the government. Lack of long-term strategic planning and an inconsistent approach to PPP development by government officials jeopardizes foreign

investment in Kazakhstan’s PPP projects for a much-needed upgrade of its public infrastructure.

• *Continuous and piecemeal changes to the PPP legislation*

As a result of inconsistent, piecemeal changes in legislation there is still confusion in Kazakhstan around determining who is a public partner/ concession grantor and which assets may be identified for legal recourse by a private partner/concessionaire. To the best of our knowledge, this confusion was a major obstacle causing a more than two-year delay in financially closing with the lenders of the BAKAD project. From the bankability perspective, there is a significant difference if the grantor is the state, which has many assets, or a ministry that effectively possesses no assets to meet its contractual obligations.

The *PPP Law* provides that only the state, not municipal entities or regions (e.g. Almaty or Kostanai region), as the case may be in some other countries, can act as a public partner. Until 2017, the *Concession Law* concept of a public partner was identical to the *PPP Law* concept (that is, only the state may act as the concession grantor).

However, in 2017 the *Concession Law* was amended and now sets out that only authorized state bodies can act as a concession grantor and enter into concession agreements. The current legal definition of a concession grantor does not make sense because state bodies are not «subjects of civil law». Therefore, they do not have any assets and cannot enter into civil law agreements on their own behalf (strictly speaking, state bodies can act and sign concession agreements on behalf Kazakhstan, a region, or a city).

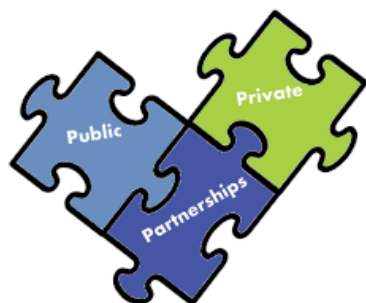
Moreover, the *PPP Law* provides that a PPP agreement is a multilateral agreement and there may be several public partners in one agreement. This is impossible if Kazakhstan is the only candidate for the role of public partner as currently stated under the *PPP Law*.

Systematic interpretation of Kazakhstani legislation suggests that not only Kazakhstan can act as a public partner/concession grantor, but also, de-facto, cities and regions (oblasts). Therefore, a private partner in a local-level PPP project has legal recourse only against the municipal budget of a city or region, not the national budget of Kazakhstan.

In accordance with Kazakhstan’s Civil Code, so-called “local subdivisions” (cities and regions) are different «subjects of civil law» (that is, for an entity to enjoy property rights and be a party to a contract, it must be a subject of civil law, a status usually reserved for natural and legal persons) that have different budgets (the national budget versus local budgets) and they are not responsible for each other’s obligations. The Budget Code also says that for local-level



PPP or concession projects, the public partner's monetary obligations are imposed on the local budget of the city or region, not the national budget.



Current PPP Policy

By 2019, therefore, it became increasingly evident that PPP development required significant adjustment and that the current PPP policy and legislation that enable exponential growth of the regional-level PPPs may wipe out Kazakhstan's state budget and seriously undermine the economy.

To address these issues, in May 2019 Kazakhstan's government announced a new PPP policy that prioritizes project quality (in contrast to previous state policy unofficially prioritizing project quantity). For the new PPP policy, the National Economy Ministry established a categorisation of all future PPP projects depending on required compensation from the state budget:

- i. **category 1 projects** require compensation of all expenses from the state budget (i.e. the "availability payment" PPP model);
- ii. **category 2 projects** require compensation of operating expenses only; and
- iii. **category 3 projects** do not require any compensation from the state budget (the "users pay" model).

Since 2019, the new PPP policy in Kazakhstan gives preference to the category 3 "users pay" model rather than projects requiring financial commitment from the public sector partner (categories 1 and 2).

To enshrine this new 2019 PPP policy in legislation and following the President's recent instructions to restore Kazakhstan's economic growth and support employment, amendments to PPP legislation will be introduced to increase project efficiency.

For this purpose, the National Economy Ministry prepared a draft law that, amongst other changes:

- i. *makes possible full reimbursement a private partner's investment costs from the state budget only if operation of the PPP facility (social infrastructure with no chargeable services possible) does not allow recouping of the private partner's investment;*
- ii. *makes possible compensation of the private partner's investment costs for a PPP project from the state budget only in equal amounts and within a five-year period;*
- iii. *introduces an auction to award a PPP contract giving priority to the entrepreneur who attracts the largest private investment, thus reducing the burden on the state budget.*



Conclusion

It remains to be seen whether current PPP policy will be successful. However, it is already clear that this new 2019 PPP policy has not been well developed. Neither the PPP Centre nor the government offered a clear understanding of what should be viewed as quality PPP projects, as it seems that so far the only criterion for quality is the absence of requests for financial support from the public sector partner.

As the coronavirus outbreak spreads across the globe, it is likely that many existing PPP projects in Kazakhstan will experience considerable revenue generation challenges.

At the same time, the need to attract private investment in Kazakhstan's healthcare system, agriculture, utilities, and other public infrastructure has become even more acute. The time has come to revisit the existing 2019 PPP policy. One option is develop a new national PPP Strategy focused on more well-designed infrastructure PPPs at the national level involving international financial institutions and foreign investors in priority sectors of economy, with fewer small-scale, service-type, local-level PPPs awarded without open tender (fake PPPs).