

## Why Islamic finance fits well in Kazakhstan's PPP projects



**KAZAKHSTAN**

By Shaimerden Chikanayev

Since 1991, Kazakhstan, Central Asia's largest economy and oil producer, has had to rely on the deteriorating infrastructure it inherited from the Soviet Union. As a result, nearly every piece of public infrastructure (eg roads, hospitals, power plants, kindergartens, sewerages) in Kazakhstan requires a different degree of upgrading or expansion.

Kazakhstan authorities have come to recognize that they cannot finance the necessary investments in public infrastructure from current budgets and that a major part of future financing must flow from the private sector. The need for the inflow of capital is becoming even more pressing because of the sharp decline in Kazakhstan's commodity revenue. As a result, the authorities in Kazakhstan are trying to offer some fiscal incentives and optimize the legal framework to encourage private investment in public assets, including by way of public-private partnerships (PPPs).

On the 7<sup>th</sup> July 2006, the Law of the Republic of Kazakhstan on Concessions No 167-III 3PK (the Concession Law) was adopted, which enabled in 2007 the execution of the now specifically recognized Kazakh law concession agreement on the passenger terminal of the international airport in Aktau City. However, the lack of popularity of concessions so far is due to excessive regulation of concession relationships by the relevant legislation, which diminishes the parties' flexibility in determining project terms and because the process for granting concessions in Kazakhstan is very bureaucratic and time-consuming.

In order to address this issue, on the 31<sup>st</sup> October 2015, the Republic enacted a new law, the Law of the Republic of Kazakhstan on Public-Private Partnerships No 379-V 3PK (the PPP Law). PPPs can now be structured not only as concessions but also used to implement projects under the PPP Law framework in any sector of the economy, though the declared priorities are education, healthcare, transport, the power industry and housing and public utilities. Even though the PPP Law took legal effect at the end of 2015, according

to publicly available information, there are already more than 500 PPP projects at different stages of implementation in Kazakhstan as of end of May 2018.

However, the biggest and most expected PPP project in 2018 in Kazakhstan is still a concession project called the Big Almaty Ring Road (BAKAD) project. To the best of our knowledge, the Ministry for Investments and Development of Kazakhstan, on behalf of the Republic of Kazakhstan, finally signed the concession agreement with the consortium of Turkish and South Korean companies at the beginning of February 2018 after protracted negotiations to build BAKAD, a toll road in Almaty, the country's business center and former capital.

Under the Concession Law framework, construction of the BAKAD officially started at the beginning of this month and experts estimate that the six-lane road with a length of 66 kilometers will relieve traffic congestion by 60%. BAKAD is the largest PPP project so far in Kazakhstan worth KZT180 billion (US\$534.06 million) and its successful financial closing, which shall hopefully happen in a near future, will pave the way for more PPPs in Kazakhstan. BAKAD, therefore, shall become a benchmark PPP project for foreign investors and lenders interested in Kazakhstan.

It is well known that the global Islamic finance market size is estimated to exceed US\$2 trillion in 2018. However, it is still a relatively untapped market for PPP financing. Given the potential of Islamic finance to support infrastructure development in Kazakhstan, it is critical to understand how Islamic finance can be applied in PPP infrastructure projects in Kazakhstan. It seems that there are already decent legal tools available under current Kazakhstan legislation that are suitable for Islamic finance-backed PPPs, including Islamic lease agreements (Ijarah) and sale and resale contracts (Murabahah). In order to build capacity for Islamic finance-funded PPPs in Kazakhstan, however, there is still a need to develop a Shariah compliant financing structure for PPPs and test it on a pilot project. (f)

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