To Break The Bank: “Enlightened” Authoritarianism And The Banking Sector Reform In Kazakhstan

A Dissertation
submitted to the Faculty of the
Graduate School of Arts and Sciences
of Georgetown University
in partial fulfillment of the requirements for the
degree of
Doctor of Philosophy
in Government

By

Sergei Gretsky, M.A.

Washington, DC
December 15, 2014
TO BREAK THE BANK: ‘ENLIGHTENED’ AUTHORITARIANISM AND THE BANKING SECTOR REFORM IN KAZAKHSTAN

Sergei V. Gretsky, M.A.

Thesis Advisor: Daniel M. Brumberg, Ph.D.

ABSTRACT

Why do market-oriented economic reforms in developing countries succeed or fail? Of the three sets of factors that affect the outcome of the reforms – economic policies, formal and informal institutions, and leadership – the role of political leaders and reform teams in initiating and implementing reforms, has received the least attention. However, the prevailing conceptualization of this leadership dynamic has not moved further than the assumption that the success with reforms depends on the presence of a committed and visionary chief executive (the politician), a cohesive technocratic reform team, which he selects and empowers to implement reforms, and synergy between the two.

Through an in-depth study of the banking sector reform in Kazakhstan this dissertation seeks to enhance our understanding of the role of leadership by focusing on factors that create or undermine synergy. By comparing two periods of the reform this dissertation demonstrates why and how the market-oriented reform and the creation of a privately owned banking sector in the first were reversed and state control over the banks was reinstated in the second. Building on the “politician’s dilemma” concept, the dissertation argues that in countries with authoritarian regimes the technocratic reformers’ decision to become independent political actors, i.e., technopols, is treated by the politician as a threat to his regime and makes him choose his own survival over the pursuit of market-oriented economic reforms, which create economic and political sources of power independent of him, leading to the reform reversal and re-imposition of state control over the economy. Based on a comparative analysis of Kazakhstan and Chile, the dissertation contributes to building a theory of economic reforms in developing countries by advancing two arguments. First, it suggests that synergy between the politician and the reform team, and by extension, a successful outcome of economic reforms depend on the division of functions whereby the politician manages the politics of economic reforms while the reform team performs a technocratic function, i.e., designs and implements the reforms. Second, it argues that a successful outcome of economic reforms depends on ideological cohesion of the economic reform and political teams that work for the chief executive.
TO MY PARENTS, NADEZHDA AND VALENTIN GRETSKY
ACKNOWLEDGEMENTS

I owe a special debt of gratitude to Daniel Brumberg, Thane Gustafson, and Raj Desai for their patience, encouragement, and unfailing support throughout my research and writing of the dissertation.

I am grateful to all my Kazakhstani friends and scholars who were generous with their time, indulged my curiosity, challenged my observations, and whose hospitality I enjoyed in Almaty and Astana. I owe special thanks to Maira Salykova, Zhanar Sultanbekova, Marat Bekenov, and Mukhtar Khasanov, who recently – and tragically – passed away. The theoretical and empirical arguments, opinions, and errors are solely mine.

I am indebted to the Institute for the Study of World Politics in Washington, DC for providing me with a grant that enabled my fieldwork in Kazakhstan.

I would like to give special thanks to three close friends, Muriel Atkin, Steven Carrell, and Engel’s Doroshevich, without whom this dissertation would have not been completed.

Thane Gustafson and Alex van Oss deserve special gratitude for their invaluable editorial advice, which made my English more readable.

My sister, Irina Korsunova, and my nephew, Sergei Korsunov, receive my deepest gratitude and love for their dedication, encouragement, and support. I owe my greatest debt to my parents, Nadezhda and Valentin Gretsky, to whom this dissertation is dedicated.
# Table of Contents

Chapter I. Introduction .............................................................................................................. 1

Chapter II. Understanding and explaining agency in economic reforms developing and post-communist countries .............................................................. 17

2.1. Understanding economic reforms ................................................................. 17
2.2. Explaining economic reform ......................................................................... 22
2.3. Agents of change .............................................................................................. 24
2.4. Politics of the economic reforms: technocrat or technopol? ....................... 27
2.5. Conclusion .......................................................................................................... 35

Chapter III. Political leadership: Nazarbayev as a reformer (1991-2001) .............. 37

3.1. Independence comes to Kazakhstan ................................................................. 41
3.2. Nazarbayev: a portrait ....................................................................................... 43
3.3. Reforming the political system ......................................................................... 48
3.4. Nazarbayev as a reformer .................................................................................. 56
3.5. Conclusion .......................................................................................................... 63

Chapter IV. Reformers and reforms ........................................................................... 65

4.1. Soviet banking system ....................................................................................... 66
4.2. Banking in Soviet Kazakhstan ........................................................................... 69
4.3. Embarking on the banking sector reforms ......................................................... 71
4.4. The breakthrough of 1995 ................................................................................ 78
4.5. Reforming the banking sector ............................................................................ 82
4.6. Introduction of the new legislation and normative acts ..................................... 85
4.7. Stamping out Soviet-era banking practices ......................................................... 89
4.8. Enforcement of the new legislation and uprooting corrupt practices ............. 91
4.9. The 1997-98 financial crisis .............................................................................. 95
4.10. The rise of Kazkommertzbank .......................................................................... 97
4.11. The NBK reform team and the bank lobbying ................................................ 106
4.12. Conclusion ....................................................................................................... 111

Chapter V. Nazarbayev as a reformer (2001-2009) .................................................. 114

5.1. Political upheaval in Kazakhstan ................................................................. 114
5.2. The first cracks in Nazarbayev’s relations with the NBK reformers and the bankers .......................................................... 118
LIST OF TABLES

Table 1. Violation of prudential norms and regulations, 1993-2001................................. 94
Table 2. Banking system, 1993-2000.................................................................................. 185
Table 3. Macroeconomic stability, 2006-2013.................................................................... 187
Table 4. Bank loans by the economic sector, 2004-2012.................................................... 190
Table 5. Bank loans by the economic sector, 2004-2012.................................................... 191
Table 6. Violation of prudential norms and regulations, 2002-2010................................. 203
Table 7. Importance of social circles or groups in Central Asia........................................... 224
### List of Figures

<table>
<thead>
<tr>
<th>Figure</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Bank concentration, 1998-2006</td>
<td>139</td>
</tr>
<tr>
<td>2</td>
<td>5-bank asset concentration, 1998-2011</td>
<td>140</td>
</tr>
<tr>
<td>3</td>
<td>Consumer loans, 2001-2007</td>
<td>151</td>
</tr>
<tr>
<td>4</td>
<td>Housing prices, 2002-2007</td>
<td>152</td>
</tr>
<tr>
<td>5</td>
<td>5-Bank concentration, 1997-2011</td>
<td>179</td>
</tr>
<tr>
<td>6</td>
<td>Non-Performing Loans, 2008-2011</td>
<td>181</td>
</tr>
<tr>
<td>7</td>
<td>GDP of Kazakhstan, 1990-2011</td>
<td>186</td>
</tr>
<tr>
<td>8</td>
<td>GDP per capita in Kazakhstan, 1990-2011</td>
<td>186</td>
</tr>
<tr>
<td>9</td>
<td>Broad money (M3) in Kazakhstan, 1993-2011</td>
<td>187</td>
</tr>
<tr>
<td>10</td>
<td>Bank deposits to GDP ratio, 1994-2011</td>
<td>188</td>
</tr>
<tr>
<td>11</td>
<td>Bank credits to GDP, 1994-2011</td>
<td>189</td>
</tr>
<tr>
<td>12</td>
<td>Bank credit to GDP, U.S., Russian Federation, Kazakhstan, 1995-2010</td>
<td>192</td>
</tr>
<tr>
<td>13</td>
<td>NPLs to gross loans ratio, 2008-2011</td>
<td>193</td>
</tr>
<tr>
<td>14</td>
<td>Bank concentration, 1997-2011</td>
<td>194</td>
</tr>
<tr>
<td>15</td>
<td>Rule of law index, 1996-2012</td>
<td>196</td>
</tr>
<tr>
<td>16</td>
<td>Property rights protection, 1995-2014</td>
<td>197</td>
</tr>
<tr>
<td>17</td>
<td>Freedom from corruption, 1995-2014</td>
<td>198</td>
</tr>
<tr>
<td>18</td>
<td>Investment freedom, 1995-2014</td>
<td>199</td>
</tr>
<tr>
<td>19</td>
<td>Bank Capital to Total Assets for Kazakhstan, 2000-2010</td>
<td>201</td>
</tr>
<tr>
<td>20</td>
<td>NPLs in Kazakhstan and Russia, 1998-2011</td>
<td>204</td>
</tr>
<tr>
<td>21</td>
<td>Bank deposits to GDP ratio, 1994-2011</td>
<td>205</td>
</tr>
</tbody>
</table>
Figure 22. Bank credit to GDP ration, 1994-2011

205
Chapter I. Introduction

Why do market-oriented economic reforms in the developing countries succeed in some cases and fail in other? Social scientists and practitioners of international development have focused their search for an answer on the three sets of issues – economic policies, formal and informal institutions that structure economic activity, and agency (leadership), i.e., the role of political leaders and reform teams in initiating and implementing reforms.

Since the 1980s, the prevailing view among economists dealing with the reforms, both practically and theoretically, has been that countries wishing to improve their economic performance should adopt and implement a set of policies based on the principles of neoclassical economics and centered on the notion of “getting the prices right.” They argue that the implementation of these policies guarantees success with reforms for any country that adopts them. The World Bank and the International Monetary Fund (IMF) have mandated these policies, labeled the Washington Consensus, worldwide as a condition for their assistance with economic reforms. However, the application of these policies has yielded uneven results, not to mention exacerbated the Asian financial crisis of 1997. Moreover, in the eyes of many the Washington Consensus has been dethroned by the global financial and economic crisis of 2007-2009, in favor of the Beijing Consensus that stands for state rather than free market capitalism.

By the turn of the 21st century, the focus of social scientists and practitioners of international development has shifted from the purely technical policy aspect of reforms, to a broader issue of the institutional framework that underpins the functioning of the economy, with the goal of identifying institutions conducive to achieving sustainable economic growth.
The shift, which was not accepted by all – the IMF continued with the same set of prescriptions derived from neoclassical economics – was influenced by the work of economic historian Douglass North, and articulated in the World Bank’s *World Development Report 2002: Building Institutions for Markets.* It was driven by the acknowledgement that many economic reforms in developing countries failed because they focused on changing formal rules and structures by transplanting those from developed market economies, while disregarding informal institutions – such as prevailing domestic cultural and ideological beliefs, and existing political structures that constrained efforts to pursue reforms and affect change.

The issue of agency, however, i.e., the role political leaders and reform teams play in initiating and implementing reforms, has received less attention, despite being recognized as vital. Michel Camdessus, the IMF head in the 1990s, when asked to explain why Botswana, a diamond-rich African country, succeeded with economic reforms and achieved sustainable economic growth, while most diamond-rich countries failed, famously said that the answer was in “Three words: three honest men.” By this Camdessus meant the three presidents of Botswana who had ruled the country since its independence in 1966. Indeed, important as the correct choice of policies and their linkage to informal institutions are for the success of economic reforms – whether reforms are initiated in the first place, their agenda, and the degree to which context-specific informal and formal institutions constrain reform initiation and implementation, depends on the political leadership. Despite different circumstances leading to reform initiation (war, independence, economic crisis, systemic collapse, etc.), it is the political leader who decides whether, and when, to initiate the reforms, particularly in the context of domestic politics in developing countries, where regimes are often authoritarian
and the dominant political culture is traditional, i.e., deferential to the existing hierarchical social and political order.

The theoretical framework that postulates a correlation between agency and the outcome of economic reforms, however, has not advanced further than an assumption that the success of these reforms depends on the presence of a committed and visionary political leader, i.e., chief executive (the president or the prime minister), who exercises a high degree of centralized control over the government and domestic politics; a cohesive technocratic reform team, which he selects, empowers, and provides with autonomy from contending political and societal interests, to implement the reform program; and synergy between the two. Even then, most attention has been paid to the ‘presence’ aspect and less to ‘synergy,’ i.e., the capacity of the political leader and the reform team to work in concert to increase the likelihood of a successful outcome of the reforms.

The attainment and preservation of synergy go beyond the principal-agent problem, i.e., the likelihood that agents (the reform team members) will pursue their own (reform) agenda, circumventing preferences and directives of the principle (the politician). At issue is whether synergy is created and maintained by the vertical or horizontal relationship between the politician and the reform team. Put differently, should the relationship between the chief executive and the reform team be hierarchical (a) given the fact that it is the politician who hires the reform team, and (b) based on the division of functions whereby the former manages the politics of the reforms and the latter concentrates on the technical aspect of the reforms, i.e., their design and implementation? Or should their relationship be horizontal, i.e., should the reform team combine their technocratic function with involvement in politics and actively
participate in the political conflicts that economic reforms, particularly radical, inevitably trigger?

In other words, should the reform team members be technocrats or “technopols,” i.e., technocrats-cum-politicians? Which of the two is more likely to minimize, if not eliminate, the risk of a conflict between the politician and the reform team, ensure synergy between them, and by extension, successful implementation of the economic reform program?

Based on an in-depth study and comparison of two periods in the banking sector reform in Kazakhstan (chapters 3-7), and a comparative analysis of economic reforms in Chile and Kazakhstan (chapter 8), I make two causal arguments. My first causal argument is that synergy between the politician and the reform team is achieved by the division of functions between the politician and the technocratic reform team, with the latter focusing exclusively on economic reform policy articulation and implementation. Conversely, the reformer technocrats’ decision to enter politics and become technopols, i.e., political actors in their own right, whether they pursue their political careers as members of the politician's party, his coalition, or independently, is likely to undermine trust and synergy between them and lead to the suspension, termination or reversal of the reforms (see the discussion in chapter 2).

This argument draws on the “politician’s dilemma” concept of Barbara Geddes. Geddes, who developed the concept based on her analysis of economic and administrative reforms in Latin American countries with competitive (democratic) political systems, contends that for the politician whose primary career goal is maximization of his term in office, economic reforms is a variant of a collective action problem. Thus, whether he chooses or not to introduce the reforms (collective good) depends on his calculus of the associated costs. The most frequent outcome is that “Politicians who might otherwise consider offering
reforms as a strategy for attracting support will not be able to afford the cost in lost political resources as long as they compete with others able to use such resources in the struggle for votes. This is politician’s dilemma.”

I propose that this concept is even more applicable to the analysis of the politics of economic reforms in developing countries with authoritarian systems. In authoritarian regimes, any political activity not explicitly sanctioned by the politician is viewed as a threat to his regime. Therefore, under no circumstances the authoritarian politician will pursue or endorse economic reforms that will lead to the creation of economic and political sources of power independent of him and his regime. This, by extension, means that the politician will not support such reformers, much less appoint them to his economic team.

I further argue that should reforms result in the above outcome, the authoritarian politician is likely not only to forego any further reforms, but also overturn those already implemented and re-impose regime control over the economy. In practical terms, it means that should market-oriented economic reforms threaten the authoritarian politician and the survival of his regime, he is likely to reverse the reforms and re-impose regime – and/or state – control over the economy.

To sum, the decision of reformer technocrats to enter politics and become technopols politicizes economic reforms by introducing, whether the reformers intend it or not, an element of competition with the incumbent politician for the highest political office, precluding the emergence or preservation of trust and synergy between the politician and the technopol reform team. That, in turn, leads to suspension, termination or reversal of reforms, if it does not preclude their introduction altogether.

Selection of Kazakhstan for an in-depth inquiry into the chief executive-reform team relationship, and the factors that create synergy between them is not coincidental. At the turn of the 21st century, Kazakhstan, both a developing and a post-communist country, became an epitome of successful economic reforms and transition to market economy, particularly in comparison with the other former Soviet republics. International financial institutions, world political and economic elites, scholars and analysts, international and post-Soviet media were full of praise over the progress achieved by the Central Asian state – once an underdeveloped outpost of the Russian and Soviet empires – in transforming its command economy into a modern market-based one. The most praise was directed at the banking sector, where Kazakhstan had progressed faster and farther than any other post-Soviet state in rebuilding the sector, as its most advanced institution, and in introducing best international practices.\(^2\) The sector grew quickly, expanding internationally into Russia, other CIS countries, China, Britain, and UAE. BTA bank became the biggest privately owned bank in the former Soviet Union. Three other banks, Kazkommertsbank, Halyk and Alliance, were listed on the London Stock Exchange – compared to only one Russian bank, VTB. All but one of almost 40 second-tier banks were state-owned. What made it even more impressive was the fact that the country did all this on its own, rather than through takeover by West European banking institutions, as it happened in the former communist countries of Central and Eastern Europe.

Reform success was attributed to the fact that (a) the National Bank of Kazakhstan, which President Nursultan Nazarbayev put in charge of the banking sector reform, was led by a cohesive technocratic team that adopted a coherent set of policies, and (b) the team enjoyed

the president's trust and support, which manifested itself in the autonomy granted to them by the president in drafting and implementing the reform. Thus, it was synergy between the president and the technocratic reform team that allowed the latter to undertake sweeping market-oriented reforms, with practically zero interference by the government and the state.

However, when in October 2007 S&P downgraded Kazakhstan's sovereign rating over concerns about the ability of Kazakhstani banks to repay massive foreign debt they had taken on in international financial markets in previous years – thus making the country the first casualty of the global financial crisis – the image of success with banking sector reform showed its first cracks. It was completely shattered after concerns materialized in early 2009, when the Kazakhstani government effectively nationalized BTA and Alliance banks, claiming the danger of their imminent collapse. It thus became apparent that the presence of a committed and visionary political leader, an autonomous and cohesive reform team, and synergy between the two were not sufficient to guarantee a successful outcome of banking sector reform: the sector did not pass the “trial by crisis,” arguably the best test of the soundness of the reform and institutional stability of any banking system.

Such a turn of events could not but raise the following questions: if Kazakhstan had built the most institutionally sound and sophisticated banking sector, as ascertained by the IFIs, international ratings agencies, and the “Big Five” accounting firms that had audited Kazakhstani banks since the mid-1990s, why would it turn out to be so vulnerable when the global financial crisis began in 2007? Why did it come dangerously close to a collapse in

---

3 The "Big Five" accounting firms included Arthur Anderson, Deloitte Touche Tohmatsu, Ernst & Young, KPMG, and PricewaterhouseCoopers. In 2002, after being found guilty of criminal charges related to the firm's handling of the auditing of Enron, Arthur Anderson voluntarily surrendered its license to practice as Certified Public Accountants. The “Big Five” then became the “Big Four.”
2009, a near-death experience from which it has still not recovered? After all, the Basel prudential norms, the International Financial Reporting Standards, and best international practices were all firmly in place.

There are two sets of possible explanations of why the Kazakhstani banking sector found itself in trouble in 2007. The first one is economic: large-scale debt accumulation, be it by banks, governments, businesses, or consumers has been shown to cause debt-fueled booms that pose systemic risks to the banking sector, because they make the sector – and the entire economic system – vulnerable to crises of confidence, given that banks traditionally borrow at short term and thus require constant debt refinance.⁴

The other set of explanations relates to politics. Though many recent banking crises have been caused by financial deregulation and globalization, their frequency and magnitude have been directly linked to political interference rather than the introduction of deposit insurance (which creates moral hazard), bad regulation, or the incompetence of bank supervisors.⁵ The most common case of political interference cited by Jean-Charles Rochet is the violation of the independence of bank supervisors by pressuring them to bailout insolvent banks. That, however, is a case of political interference in economic policy-making, whereas political interference that causes or exacerbates banking crises may also pursue overtly political goals.


Thus, the question is whether economic or political factors were the main cause of the near collapse of the Kazakhstani banking system in 2009. More crucially, in what ways does the story of the Kazakhstani case change our understanding of the role of agency in affecting reforms, and help us to better conceptualize outcomes?

My analysis of the Kazakhstani banking sector reform reveals that its near collapse in 2009 and the subsequent nationalization of its biggest bank were caused by political interference, which exacerbated negative trends that had developed in the sector due to over-borrowing in international financial markets, and the channeling of foreign debt primarily to domestic consumer lending. Existing evidence points to the conclusion that political interference was driven not by concern over the possible collapse of the sector – the magnitude of non-performing loans in the banking system is only now coming to light - but by political considerations stemming from an earlier decision of the technocratic reformers and their allies among the CEOs of the biggest banks, to establish first a political movement and then a political party.

That decision made President Nazarbayev question their loyalty, created mistrust of the technocratic reformers, undermined synergy between the president and the team that had allowed Kazakhstan to move quickly with deep reforms in the banking and other sectors of the economy, eventually leading to the sacking of the reformers from the government. As a result, Nazarbayev not only abandoned further market-oriented economic reforms, but also reversed those that had already been implemented, reinstating his regime’s control over the economy, including the biggest banks.

*My second causal argument*, which derives from a comparative analysis of economic reforms in Chile and Kazakhstan, and builds on the ideas of Carlos Huneeus, is that successful
economic reform depends on the ideological cohesiveness of the economic reform and the political teams that work for the chief executive (chapter 8).\(^6\)

So far, the role of ideological cohesiveness in economic reform has not received much attention. My finding is that once President Nazarbayev withdrew his support for the technocratic reformers, elite fragmentation and lack of ideological consensus on economic policy became apparent, allowing the opponents of the technocratic reformers, who constituted the majority of the elite, to marginalize them and derail market-oriented efforts. Further research into the importance of ideological cohesiveness, through a comparative analysis of a wider range of cases, has the potential to enrich our understanding of factors that affect reform outcome, and contribute to building a theory of economic reforms in developing countries.

Existing theoretical frameworks, used to study, analyze, and conceptualize political and economic reforms in the post-communist – and developing – states and societies share an overarching problem. These approaches and theories of political processes and institutional change derive their explanatory power from the analysis of static events and stable institutional environments, which makes them less suitable to capture and explain complexities of the political and reform processes in the former communist countries. Therefore, given the absence of a single theoretical framework to explain the trajectory of economic reforms and their pro tem outcomes in post-communist countries, I adopt an eclectic approach, which attempts to integrate insights from a number of theoretical approaches and disciplines, has been increasingly adopted by social scientists dissatisfied with

---

the rigidities of the available theoretical constructs as well as by those who seek to offer a more dynamic and nuanced explanation of various political and social phenomena. In the dissertation, I draw on a number of theories and concepts of the three stands of the new institutionalist approach (historical, rational choice, and sociological institutionalisms).

The methodology used in the dissertation is also variegated. Overall, the dissertation is designed as a small-\( n \) qualitative case study, due to a number of considerations. First, this dissertation is one of the first studies of the banking sector reform in Kazakhstan, which calls for an investigation that provides detailed description and thick analysis. An in-depth study format provides the methodological advantage of being able to develop a good causal hypothesis “complementary to good description rather than competitive with it.”

Second, the qualitative method, using process tracing as its basic tool, allows a reconstruction of the sequence of events and actions that led to a particular outcome. Dietrich Rueschemeyer argues that “causal analysis is inherently sequence analysis.” In that sense, an in-depth qualitative case study based on causal-process observations is well suited to generate causal inferences that would explain the initial success of the Kazakhstani banking sector reform, and its later setback, by showing how and why a particular combination of factors have led to the outcomes in question.

---


Third, the qualitative method does not require the researcher to have “complete data across a given range of cases and variables. Thus, a few causal-process observations may provide great leverage in making inferences.” It does not mean that the hypothesis or hypotheses derived from these inferences can explain all other similar cases, but in-depth analysis of small-n cases increases the plausibility of overall conclusions.  

This dissertation deals with the twin problems of selection bias and unit homogeneity by choosing “a type of within-case analysis, which in effect becomes cross-case analysis.”

This type of analysis is based on looking at and comparing multiple measurements of the dependent variable, and the independent variables, in different temporal subunits of the original case. That allows us to control for the causal effect of a large number of the would-be independent (explanatory) variables and thus reduce significantly the problem of omitted variable bias, and achieve a high degree of unit homogeneity. All this allows one to make causal inferences that have a higher degree of plausibility and validity than if two randomly selected countries were compared.

---


11 David Collier, James Mohoney, and Jason Seawright (2004). “Claiming Too Much: Warnings about Selection Bias” in Brady *et al.* (2004), p. 94. Proponents of qualitative and quantitative research define the root cause of selection bias differently. The division of political scientists into quantitative- and qualitative-oriented scientists is, of course, relative – both kinds of research may and do include elements of each other. The arguments of the proponents of primarily quantitative-oriented research have been presented in Gary King, Robert O. Keohane, Sidney Verba’s *Designing Social Inquiry (DSI)* (1994). Its publication has generated a heated debate among political scientists and eventually led to a response by the proponents of primarily qualitative-oriented research who in 2004 published *Rethinking Social Inquiry (RSI)*, a collection of essays edited by Henry E. Brady and David Collier. The debate between the two camps has since largely been articulated along the lines of those two books.
Whether the plausibility and validity of these causal inferences extend beyond the Kazakhstani case, i.e., can be generalized to a greater number of cases, is tested through a brief treatment of economic reforms in Chile, a country from a different part of the world, with a different (political) history and institutional legacies. Extending research to cases that are in many respects different is always fraught with undermining unit homogeneity. I minimize that danger by using only two factors (independent variables) – committed and visionary leadership and coherent technocratic reform team – to explain the variation (success or failure) in the reform outcome (dependent variable). This allows my within-case analysis of the Chilean case to meet “other things being equal” criteria necessary for causal inference and achieve within-case control.12

I employ the two most commonly used methods to identify causal mechanisms and establish causal relations – process tracing and congruence procedure. The first method I use is the congruence procedure, which helps to establish consistency between the beliefs of the decision-making actor and the decisions he makes. It is a deductive procedure that allows the researcher, first, to predict what decisions the actor is likely to make, based on his core beliefs, and then to compare his predictions with the actual decisions made. If they are found to be consistent with the actor’s beliefs, the causal link is considered established.

The second method is process tracing, which seeks to establish the actor’s “assessment of incoming information about the situation, his definition of the situation, his identification and evaluation of options, as well as, his choice of a course of action.”13 I use it to reconstruct

in detail the process of decision-making, by identifying and analyzing the intervening
cognitive steps in arriving at a decision.

Research methods used in the dissertation are primarily document analysis and elite
interviews. Document analysis incorporates primary and secondary sources. Primary sources
consist of public speeches, statements, interviews, and writings of the key decision-making
actors, as well as banking laws passed by the Kazakhstan parliament, Presidential executive
orders, ordinances of the Council of Ministers, reports and publications of the National Bank
of Kazakhstan, IMF, the World Bank, international credit-rating agencies and auditing firms.
Secondary source material includes mass media materials and scholarly work.

Elite interviews were conducted in Washington, DC, during my field research in
Kazakhstan in 2001 (dissertation travel grant awarded by the Washington-based Institute for
the Study of World Politics), and subsequent trips to the country. The target group for the
interviews in Kazakhstan included officials in the executive and legislative branches of the
Kazakhstan government, National Bank of Kazakhstan, and private bankers. In total, a
hundred interviews were conducted, with the average duration of between one and two hours.
I also had follow-up interviews with a number of the key actors. Elite interviews conducted in
Washington, DC mostly targeted international bankers, experts, and consultants who were
directly involved in the banking sector reform in Kazakhstan.

Though the elite interviews were open-ended, they simultaneously were focused, in
that they included a set of the same questions asked of all the interviewees. Elite interviews
are often laden with answers and statements driven by instrumental motives. It is even more
of a problem in authoritarian countries where government employees and public figures are

Alexander George and Andrew Bennett (2005). *Case Studies and Theory Development in the
Social Sciences*. MIT Press.
cautious in what they say. In such cases, one needs to be attentive to the demeanor, gestures, and intonation of the interviewee and his or hers choice of words: often one must read between the lines. To compensate for potential reliability problems, I verified, when possible, information, particular interpretations, and accounts of events obtained during the interviews, with open-source materials, scholarly accounts of the political and economic reforms in Kazakhstan, and interviews with the international actors involved in the banking sector reform.

Thus, by using multiple data sources, i.e., triangulation, I tried to avoid reliance on any one source of data, and increase the leverage of my inferences. That said, I submit that the inferences made and conclusions reached in this dissertation are uncertain, like all qualitative and quantitative research based on empirical information about the world.14

Explaining Kazakhstan’s initial success with the banking sector reform, and its subsequent partial reversal that gradually began in 2001, is important theoretically and practically. Theoretically, the dissertation contributes to a better understanding of the politics of economic reforms in developing and post-communist states. It also contributes to the ongoing “structure-agency” debate between proponents of structural and actor-centered approaches, over which of the two is better equipped to explain social change in revolutionary times. So far, there have been no detailed accounts that expand our understanding of how political considerations factor in a chief executive’s decision to abandon an economic reform agenda, and withdraw his support from the reform team. Thus, empirically, by providing a systematic account of the banking sector reform in Kazakhstan and its partial reversal, the

The dissertation expands the pool of available data on the correlation between political and economic factors in the process of economic reform.

Based on a comparative analysis of Kazakhstan and Chile, the dissertation contributes to building a theory of economic reforms in developing countries by advancing two arguments. First, it suggests that synergy between the politician and the reform team, and by extension, a successful outcome of economic reforms, depends on a division of functions, whereby the politician manages the politics of economic reforms, while the reform team performs a technocratic function, i.e., designs and implements the reforms. Second, it argues that a successful outcome of economic reforms depends on the ideological cohesion of the economic reform and political teams that work for the chief executive.

The practical importance of this dissertation is in the lessons learned from the Kazakhstani case of the banking sector reform, which improve our understanding of obstacles to achieving a successful reform outcome. These lessons can also serve as the basis for recommendations to international financial institutions and governments on improving the bureaucratic capacity of reform implementation, as well as improving the design of economic reform programs so as to ensure their successful implementation.
Chapter II. Understanding and explaining agency in economic reforms in developing and post-communist countries

2.1. Understanding economic reforms

Scholars who seek to understand and explain economic reform face a challenge since the object of their study is “a moving target.”\textsuperscript{15} At the same time, their work is facilitated by the fact that most economic reforms in the modern world lead only to incremental change, as they do not seek the change of the entire economic system.\textsuperscript{16} The incremental nature of these changes can help what triggers them, their direction, and also the ultimate outcome of reforms.

Economic reforms in post-Soviet countries, particularly in those that embraced radical economic reforms, were different in that their goal was to bring about discontinuous, i.e., non-incremental, change by replacing one economic system (a centrally planned economy) with another (a market economy). Economic crises in other parts of the world that led to adoption of radical reforms, as, for example, in Latin America in the 1970s-1980s, were not systemic and required only structural adjustment.\textsuperscript{17}

Moreover, discontinuous change characterized other reforms and changes that were happening in post-Soviet states, in the early years of their independence. First, in most cases,


early post-communist governments sought to shift from an authoritarian to a democratic political system. Second, the collapse of communism brought about, or restored, independence of the former Soviet republics, and thus added another task: building state institutions. Third, unlike political transitions and economic reforms in East Asia and Latin America, post-communist transitions were systemic and simultaneous, i.e., political, economic, and social changes happened at the same time and led to profound discontinuities in all three spheres.

The complexity of post-communist transitions, due to their multi-track and simultaneous character, sparked a lively and fierce debate throughout the 1990s among economists and political scientists who looked for a theoretical framework that would best explain the changes taking place. The debate was not just a matter of scholarly inquiry: it had an important practical dimension as well. As sweeping changes unfolded in Central and Eastern Europe and the former Soviet Union, many of these economists and political scientists became involved in designing reform and assistance programs, and advising reformers in transition countries.

Two points of view emerged, both in terms of the theoretical approach to the study of post-communist reforms, and the practical advice given. They reflected a broader divide among social scientists over the role of agency and structural factors, and their interplay in political and economic processes, particularly during periods of change. Depending on which factors are considered dominant, scholars are divided into Marxist structuralists/Parsonian functionalists, and proponents of rational choice. The former presume “that decisions are

\[\text{In comparative politics, these two “extremes” are also known as historical and rational choice institutionalism. See the discussion in Peter Hall and Rosemary C. R. Taylor (1996). “Political Science and the Three New Institutionalisms,” Political Studies, Volume XLIV, pp.}\]
determined largely independently of the choices of the actors,” while “many rational-choice theorists view decisions as relatively unconditioned by economic or social structures or other supra-individual entities. Structuralists insist on the importance of historically created constraints in determining the choices of actors, while rational choice theorists believe that decisions are undetermined. They emphasize the notion of contingency, meaning that outcomes depend less on objective conditions than on the subjective rules surrounding strategic choice or the qualities of specific leaders.”19

Viewing elites and human agency in general as the main agents of change, the advice given by rational choice theorists to post-communist governments was: to free the invisible hand of the market forces through full-scale deregulation and liberalization. That alone, in their opinion, would stimulate entrepreneurship, lead to the creation of the capitalist class and economic recovery, and thus ensure a successful transformation of the command economy into a market economy. Structuralists, on the other hand, argued that building “capitalism by design” – i.e., through the wholesale implantation of western economic institutions and polices known as the Washington consensus – was impossible. In their view, old communist-era institutions were deeply rooted and too resilient to allow their easy destruction and replacement.

In 1995, both groups published an early assessment of the trajectory and the pro tem outcomes of the post-communist transition, in a special issue of the journal Comparative Political Studies. Both groups shared the view that “the conditions under which past legacies will or will not play a role in shaping the direction of regime change in post-Communist


societies” would be determined by the immediate context in which those changes were taking place. This shared view clearly reflected the understanding that agency played the critical role in shaping reform outcomes, just as proponents of agency-centered approaches argued.

The collapse of Russia’s economy in August 1998, triggered by the crash of its financial sector (banking and securities), exposed the “virtual” nature of its market foundations, and tipped the balance in favor of those social scientists (academic and empirical economists included) who adhered to various strands of structural theory in their explanation of the process of social change. Questioning the idea of building “capitalism by design,” they argued that the failure to transform the Russian economy through adoption of neo-liberal economic policies was the direct result of neglecting structural constraints, and old path dependence that limited the scope of feasible change. They maintained that the collapse of communism did not lead to a fundamental break with the old patterns of social, political, and economic organization and communist-era institutions. Thus, the imposition of a market economy from above by reformers was doomed to failure from the start, and those who thought otherwise ignored reality to their peril.

The question of which of the two approaches is better suited for understanding and conceptualizing economic reforms in the post-communist countries cannot be answered definitively – at least not yet – for a number of reasons. First, at the level of macro-theory,

---


understanding the process of economic reforms in general, and framing a single theory that would explain their outcomes, is complicated due to the particular circumstances and individual characteristics of each case. As Kenneth Waltz argues, no theory should even aspire to explain change, since theories explain continuities.  

Second, understanding and conceptualizing economic reforms in the former communist bloc is constrained by the temporal proximity of the reforms, and their incomplete character. On the one hand, not enough time has passed, and not enough research has been done, to generalize or reach any definitive conclusions. On the other hand, reforms still continue and their outcome is far from certain, particularly in light of the uncertainty created by the global financial and economic crisis which began in 2007 and which is not yet fully over. That leaves open the ranking of factors in the order of their effect on the outcome of reforms.

Third, the two approaches share the same theoretical and conceptual weaknesses. First, they derive their theoretical frameworks from the analysis of stasis or evolutionary change in the Western societies and thus “are not adequate for explaining revolutionary change.” It is impossible to overstate the revolutionary, systemic, and unique nature of economic reforms in the former Soviet Union: it is the only case in recent history of building market economies essentially from scratch. Second, these approaches have their origin in the study of societies with competitive democratic political and economic systems, which in the modern world are still the exception rather than a rule. For political scientists, the openness of democratic


systems means the availability of, and access to, reliable data that in other political systems is usually unavailable. Thus, the existing approaches, taken singularly, do not offer enough adequate tools to understand and conceptualize economic reforms in the post-communist countries.

2.2. Explaining economic reform

There are a number of structural and agency-related factors that affect the outcome of economic reforms. They include the size of the country, its starting conditions (political and economic, as well as institutional legacies), regime type, political leadership, presence of a cohesive reform team, state autonomy to pursue economic reforms, and foreign assistance. For a number of reasons, this dissertation focuses on human agency as the key factor that explains the outcome of banking sector reform in Kazakhstan. The first is the understanding of the role agency plays in initiating change, particularly in revolutionary periods. As Douglass North suggests, “The key to understanding the process of change is the intentionality of the players enacting institutional change and their comprehension of the issues.”

Gorbachev’s perestroika, the fall of communism, and the breakup of the Soviet Union reflected systemic breakdown, and brought about systemic shifts that included both the change of the political regime and the economic system. In such periods, “When institutional guideposts and constraints for human action weaken or collapse altogether,” Michael McFaul argues, “we should expect individual choices to be especially consequential.”

---

24 North (2005), p. 3.
Another argument in favor of human agency as the key factor, is the understanding that institutional choice and design are an elite undertaking. Karl Polanyi persuasively demonstrated that the market economy, even in the West, did not develop naturally over time, but was a result of the application of highly artificial stimulants administered by the state. In his last book, *Power and Prosperity*, Mancur Olson pointed out that the economies of transitional societies could go beyond self-enforcing or on-the-spot trades, and achieve rapid economic growth only through governmentally contrived markets. Thus, it is only logical to expect that at the time of the collapse of the old regime, and the emergence of the new, the role of the state (i.e. key decision-making actors) in shaping the institutional foundation of the new economic order would be critical.

Focus on human agency does not mean that structural factors do not affect the process of discontinuous institutional change. After all, the key decision-making actors are products of the *ancien régime*, whose formal and informal institutions, and structures, were at the foundation of the political and economic order, and permeated its social fabric. Soviet institutions and structures shaped these actors’ identities and socialized them into following a set of rules that governed politics and the economy. Among other things, these rules informed the actors’ understanding and attitudes toward institutional and structural change, and provided a template of solutions to handle these factors within the Soviet system. It is with this knowledge, these attitudes, and problem-solving skills that the key decision-making actors in post-1991 Kazakhstan had to address multiple challenges of state-building, create a


new political system and market economy, and establish themselves as international actors.

Old institutions and structures did not disappear into thin air with the collapse of the Soviet Union. Yet the fact that, amidst the uncertainty and contingency of the post-Soviet politics, Kazakhstan has been able to transition to a new economic system – the stated goal of its leader and successive governments – supports the argument that periods of revolutionary change remove structural constraints on human agency, and allow actors to pursue any number of alternative courses of action.

Moreover, at this moment in Kazakhstan’s history the formation of new structures has not been completed, nor have they been locked in. Thus, social scientists cannot claim that Kazakhstan is on a particular path-dependent developmental trajectory – or specify, ex ante, exactly how the state’s new structures limit choices available to decision-making actors, or constrain their behavior and ability to affect institutional change. The new political and economic institutions, including the regime type, are themselves products of choices made by the decision-making actors after 1991. Therefore, they could not have had a causal affect on determining the range of choices available to the actors at the outset of the reforms, nor could they have restricted them in any way. In fact, the origins and particular configuration of the new political and economic institutions can only be explained by examining actors’ preferences, the policies they adopted, and the steps they took to implement those policies so as to promote, or impede, change.

2.3. Agents of change

Based on the Asian and Latin American experience with economic reforms, two factors are usually associated with agency – the political leadership by the chief executive (president or prime minister) and the economic reform team.
**Political leadership.** In the context of economic reforms, political leadership refers to two specific characteristics that the chief executive is expected to possess: vision and commitment. Visionary is the leader whose grasp of the situation extends beyond a mere understanding of economic issues, awareness of the depth of the economic crisis, and comprehension of the need for sweeping reforms. To be a visionary requires a leader who has a clear picture of the economic future of his country, who understands which reforms are required to achieve it, who has the ability to put forward a coherent reform plan, and who can implement a successful reform strategy.

Such a leader must be committed to see the reforms through to their completion, and not to abandon them for political expediency; must put together a team to implement the reforms; give the team full backing and autonomy; and stand by it, regardless of the elite’s or the public’s discontent, or calls to sack the team or change the course of their reforms.

**The reform team.** As part of the strategy to achieve a successful outcome of reforms, the chief executive seeks out professionals who share his vision and goals, brings them together into a reform – or change – team, puts it in charge of developing a reform program, and empowers it to carry it out. Scholarship on reform teams has identified a number of factors that allow teams to cohere and achieve longevity. The first one is that it is the chief executive who creates the reform team and chooses its members. The second is that the choice of the team members is based on the meritocratic principle, i.e., technical competency and correspondence to Weberian criteria for modern administration (“straightforward duty without regard to personal considerations,” impersonal approach “without hatred or passion”28). Third, the reform team enjoys autonomy, which is provided by the chief executive, from outside.

---

interference, and this autonomy allows it to focus on implementing the reforms and maintain the integrity of the reform project. Fourth, to sustain its durability and success the reform team has to be cohesive, i.e., its members should share the same views, values, goals, and commitment to the reforms.\(^{29}\)

The scope and success of reforms is also tied to synergy between a committed and visionary chief executive, who exercises a high degree of centralized control over the government and domestic politics, and a cohesive reform team, which he selects and empowers to implement the reform program.\(^{30}\)

The concept of a successful outcome of the reforms being dependent on the presence of a committed and visionary political leader and a cohesive reform team is too wide-ranging to help frame a theory that would explain the outcome of each and every case of economic reforms. Even a cursory examination of the Kazakhstani case suggests the presence of these two factors before and after the start of the global financial crisis, when the country’s banking sector nearly collapsed. What is needed is further elaboration and specification of the factors that affect the outcome of economic reform. That will increase the explanatory and predictive power of the concept, make it applicable to a wider range of cases and bring us closer to formulating a general theory.


One factor visibly absent from the concept is politics. The supposition that politics does not affect the process, or enter into the equation of the chief executive-reform team relationship, is based on two considerations. Partly, the omission is explained by a finding that has established a plausible correlation between successful economic reform in developing countries, and the authoritarian form of government, which represses politics or at least confines it to an elite game.31 By repressing politics authoritarianism allows the chief executive to discount the elite and the public discontent caused by the high social costs that reforms usually impose – particularly in their initial stage – thus giving the leader greater freedom and capacity to pursue radical economic changes.

The other reason that explains the absence of politics from the concept is the fact that a reform team selected by the chief executive consists of technocrats, i.e., a group of experts, usually economists, who possess technical and/or managerial skills – not politicians. It is the chief executive, i.e., the politician, who manages political conflicts that economic reforms may cause, allowing the reform team to focus on the reform implementation.

2.4. Politics of the economic reforms: technocrat or technopol?

There is, however, a difference of opinion as to whether reform team members should or should not play a political role. Jorge Dominguez and Richard Feinberg, who advocate a political role for technocrats, invented the term ‘technopol’ to describe this new type of a technocrat-cum-politician.32 Their argument is based on the notion that a reform team

---

consisting of the technopols has a better chance of achieving success, owing to their change in status. They would no longer be political appointees who serve at the pleasure of the chief executive, and whose services can thus be easily terminated, as is the case with the technocrats.33

On the face of it, the argument in favor of the technocrat becoming also a politician is compelling. Indeed, the mantle of a politician would increase the technocrat’s say in choosing economic policies and drafting the program of economic reforms, as he would no longer depend on the mandate given to him be the chief executive. Instead, he would have the backing of his political party and allies, provided the political system allows for political parties. That also increases the legitimacy of the reform program and the likelihood of its adoption; it also gives the technopol greater control over its implementation. Yet, does donning a political mantle necessarily give the technocrat an advantage? Will this automatically guarantee a successful outcome of the reforms? To answer these questions we need to consider why the political leader chooses the technocrat for the top economic job in the government in the first place, and why he is willing to delegate him power.

The first and obvious reason is that the technocrat possesses highly specialized knowledge and expertise, sometimes coupled with practical business and/or administrative experience. The second is that, politically, the technocrat more often than not is neutral: he is not a political actor or a member of a political party. This has several important ramifications. First, the political leader does not perceive the technocrat as a political rival or a contender for his job. This is likely to translate into the politician’s firm public support for the technocrat.

and for the reform program, should both be criticized or opposed by the electorate or special interest groups.

Second, there are at least two reasons why economic reforms advocated by a technocrat are more likely to be adopted by the parliament and accepted by the population – which is important especially in the initial, most painful stage of reforms. Firstly, technocracy carries with itself the imprimatur of science, objectivity, credibility, and professionalism. Unlike politicians, who make value judgments, technocrats base their judgments on the technical merits of the issue at hand.

It will thus be difficult for anyone to oppose a technocrat’s program on any terms other than technocrat’s, i.e., those of economic science. Those who would oppose reforms for ideological or political reasons will find it difficult to defend themselves against inevitable accusations of sidestepping a ‘scientific’ course of action for the sake of particularistic interests. I am far from denying the fact that technocrats have ideological and political preferences of their own, which inevitably influence decisions they make. Nor are they exempt from making mistakes, since economics is not a hard science: there are different schools of thought on virtually any given issue, which often makes the decision a judgment call. The point, however, is that any opposition to the technocrat’s choice of reform policies has also to be rooted in economic science, the knowledge of which politicians usually do not have.

The experience of the first years of post-communist reforms – also known as “honeymoon” or “extraordinary politics” period – demonstrated that in the majority of former socialist states, the public, who were accustomed to the discourse of “scientific socialism,” readily and enthusiastically embraced market-oriented economic reforms that were presented
to them couched in the language of “scientific capitalism.” The experience of other countries also reveals that when the electorate is certain about politician’s motives behind the proposed economic reform agenda, it tends to support the technocratic approach to economic reforms.\(^{34}\)

Secondly, if we accept the notion that economic reforms advocated by technocrats are likely to lead to a more efficient and prosperous economy, then such reforms will equally benefit the political opposition, particularly in competitive political systems, where the opposition has credible expectations of winning the elections and forming the next government. After it comes to power, it will have more resources to distribute among its support base, an option preferable to redistribution from an existing or a shrinking pie.\(^{35}\) Thus, the political opposition will be more likely to support, rather than reject, a reform program proposed by technocrats. Moreover, should the reforms prove successful, the opposition, when it comes to power, is more likely to continue with reforms, which ensures their irreversibility. This is what happened in Chile after the restoration of democracy in 1990. The successive democratically elected governments have by and large continued the market-oriented economic reforms introduced by Chilean technocrats in the 1970s under the military dictatorship.

To sum, the technocrat is not a politician by definition: he is an expert or a bureaucrat with intensive training in engineering, economics, etc.\(^{36}\) Entering politics requires a different set of skills, which the technocrat does not possess. That does not preclude his learning those


skills, but the opportunity costs may be too high. If, nonetheless, the technocrat decides to become a politician, i.e., a technopol, this may lead to at least five major consequences.

First, the perception of his impartiality is likely to vanish. While technocrats are viewed as driven by a desire to promote the collective welfare, politicians are viewed as pursuing their personal agendas and advancing their own careers. Thus, the technopol will be seen as acting in his own interests, that of his political party, or a special interest group. His economic reform program is then likely to be opposed and obstructed by competing political parties and social groups, especially by those who will perceive themselves as potential losers of the reforms.

Second, if the reform team is composed of technopolis, their affiliation with a political party or a social group will make it next to impossible to circumvent party or group interests and carry out the reform program, because the latter may at some point view the reforms as undermining the economic wellbeing of their key constituencies, and, as a result, jeopardizing their political fortunes. Since policy choices made by politicians are usually dictated by immediate or near-term considerations, in choosing a package of reforms, technopolis, at the outset, will have to reconcile themselves to less than sound policy choices, since the alternative requires “patience and a long time horizon – two attributes not normally associated with politicians.”

Third, which is closely related to the second point, the autonomy of the reform team, which is considered so important for achieving a successful reform outcome, is also likely to vanish. When technocrats are on the reform team, they are likely to enjoy a great degree of

---

autonomy: their status of being politically nonpartisan allows them to maintain equidistance vis-à-vis various special interest groups, and thus preserve integrity of the reform project. It is the political leader who mediates conflicts and competing demands of special interest groups that the reforms are bound to create.

Embeddedness of technopols in domestic politics is therefore likely to shortchange their autonomy and lead to a rent-seeking arrangement that favors their party or group, ultimately putting at risk the success of the reform outcome. As David Stark and Laszlo Bruszt argue, the coherence and “distinctive organizational rationality” of state bureaucracies requires autonomy from a political field that mediates societal interests and has its own “distinctive selection criteria, career patterns, and forms of capital.”

Preventing the corruption of any reform project and maintaining its integrity is always important. It is even more so in the case of Kazakhstan. Unlike Asian and Latin American countries, where reforms were aimed at adjustment and deregulation, the goal of reforms in

[38] In contrast, Peter Evans considers embeddedness to be a positive factor. In his opinion, embeddedness in society connects the state to societal allies, who share its reform goals, and provides it with sources of intelligence required for successful implementation of the reform project. At the same time, he acknowledges that “autonomy is fundamental to the definition of the developmental state” and that without it “embeddedness will degenerate into a super-cartel, aimed, like other cartels, at protecting its members from changes in the status quo.” See Peter Evans (1995). *Embedded Autonomy: States and Industrial Transformation*. Princeton: Princeton University Press, pp. 248, 58. Similarly, David Stark and Laszlo Bruszt, who applied an expanded version of Evans’s concept, which included social networks in the economy, to the post-communist cases in Eastern Europe, acknowledge that these networks “have the capacity to be agencies of development – or to be rent seekers depleting the public treasury and inhibiting economic growth.” See David Stark and Laszlo Bruszt (1998). *Postsocialist Pathways: Transforming Politics and Property in East Central Europe*. Cambridge: Cambridge University Press, p. 129. The problem is that to date, as Steven Heydemann admits, no good typology of conditions under which they can become one or the other has been offered. See Steven Heydemann, ed. (2004) *Networks of Privilege in the Middle East: The Politics of Economic Reform Revisited*. New York: Palgrave Macmillan, p. 11.

Kazakhstan was to replace one economic system with another. It was the soundness of economic policies and principles laid in the foundation of the market economic system in Kazakhstan in the early 1990s that would largely determine the new trajectory of its economic development.

Fourth, the formation of a cohesive technopol reform team may either prove impossible, or its unity may be undermined, leading to its breakup. Any economic reform project requires teamwork, which is why it is generally agreed that for the reforms to be successful a team of reformers is required, and a cohesive one at that. By its nature, politics includes the element of competition, contestation, and conflict. This, at best, means that the reform team would become a coalition or an alliance formed by politicians, who would be primarily pursuing their personal agendas. Thus, at some point, political aspirations of an individual technopol are bound to run counter to political aspirations of other technopols, resulting in infighting and the team’s disintegration. Besides, the technopol may become too focused on pursuing a political career, to the point of neglecting such primary responsibilities as formulating economic reform policies, overseeing their implementation, and guiding them to a successful outcome.40

Fifth, if the technocrat decides to become the technopol, the political leader may not choose him to be on the reform team, since the chief executive is likely to view technopol’s intentions and actions with suspicion, even if the technopol belongs to the same political party or coalition. The leader may now see his appointee as a potential rival and contender for his job, more so, if the reforms prove successful. Success will raise technopol’s profile and

---

40 John Toye points to the fact that historically British economists, most notably David Ricardo, John Stuart Mill, and John Maynard Keynes, never sought political office and “shied away from partisan politics.” See John Toye’s comment in Williamson (1994), p. 37.
popularity and provide an excellent platform to run on for the highest political office. The political leader may plainly feel overshadowed by the technopol should the reforms become more closely associated with the technopol’s name rather than his. All that may lead to the withdrawal of the political leader’s support, unraveling of the political leader-reform team synergy, and the dismissal of the technopol, especially if he joins or creates an alternative political party.

In short, the decision of the reformer technocrats to enter politics may lead to the principal-agent conflict. The chief executive begins to regard reform team members as a threat to his political survival, since the assumption of a political role by the technocrats inevitably introduces an element of competition, irrespective of whether they pursue political goals as members of the chief executive’s party or coalition, or independently. As the conflict deepens, the chief executive faces “the politician’s dilemma” between his “own need for immediate political survival and longer-run collective interests in economic performance and regime stability.”

Based on her analysis of economic reforms in Latin America Geddes established that the politician invariably resolves the dilemma by abandoning his idea of introducing reforms, out of fear of losing electoral votes to his competitors. In other words, economic reforms usually become the casualty when the politician has to make a choice between reforms and his political survival.

Geddes draws her conclusions based on her analysis of economic reforms in countries which had democratic political system (Brazil, Chile, Columbia, Uruguay, Venezuela) and where the threat to the chief executive came from outside, i.e., from established opposition political parties and political opponents, rather than from inside his own political party or

---

coalition. I propose that “the politician’s dilemma” concept applies to a wider range of cases than the ones outlined by Geddes.

First, I submit that the political leader will not behave any differently in an authoritarian setting than in a competitive political system. Second, I propose that the politician’s solution to the dilemma would not be different if the perceived threat came from within the regime, e.g., from the technopols, rather than from the outside. Third, I suggest that the concept also applies to cases where the reforms have already begun, i.e., that the politician may decide to abandon or even reverse the reforms if his political future is threatened.

This leads to the conclusion that for economic reforms to succeed they need to be depoliticized. In other words, there should be a division of functions between the chief executive and the reform team. The politician should focus on managing political conflicts and risks, including those associated with the implementation of economic reforms, and the reform team should focus on drafting and implementing the reform, i.e., perform a purely technocratic function. Only then can trust and synergy be established and maintained, which in turn will enable the politician to provide the reform team with autonomy and insulation from political intrigue and pressure on the part of contending political, societal, and special interest groups. The importance of autonomy and insulation is that their presence is linked to the reformers’ ability to carry out a cohesive reform program without compromising their integrity.

2.5. Conclusion

To sum, I argue that a successful economic reform project should have the following characteristics: (1) there should be present a committed and visionary political leader, i.e., chief executive, who will appoint (2) a cohesive technocratic reform team and provide it with
his political support and autonomy from contending political forces and special interest groups, so as to enable the design and implementation of a coherent economic reform program; (3) synergy between the politician and the reform team is achieved and maintained through a division of functions whereby the politician manages political conflicts arising out of the reforms, and the reform team focuses solely on its technocratic role, i.e., reform design and implementation.
Chapter III. Political leadership: Nazarbayev as a reformer (1991-2001)

I consider the greatest role in the success of our reforms was played by the human factor. I cannot say for certain exactly how, but possibly what guaranteed success was certain features of our people’s mentality, their special talent for readily accepting innovation or adapting to foreign imports, and, in particular, the personal qualities of the people who joined the team of reformers at the time.

Nursultan Nazarbayev, The Kazakhstan Way

The presence of the political leader, i.e., the chief executive, who has vision for the economic future of his country, understands what reforms are needed to achieve that future, and has commitment to see through the implementation of the reforms is one of the necessary conditions for a successful outcome of economic reforms. Achieving a successful outcome of the reforms, particularly far-reaching, requires the chief executive to have the ability to concentrate power in his hands and exercise a high degree of control over the polity, economy, and society. Concentration of power is needed for two reasons. First, as Joan Nelson argues, it “directly facilitates implementation; it also heightens the credibility of programs, crucially shaping both political and economic responses.”

Second, it provides the chief executive with autonomy from political, special interest, and societal groups to pursue his reform agenda. Autonomy is particularly crucial at the outset of the reforms when the political and economic status quo of these groups is uncertain and because the reforms initially create more “losers” than “winners.” The “losers” tend to be

---

42 Nelson (1990), p. 25.
better organized in their opposition to the reforms and outnumber the “winners” who typically lack organization and thus are unable to provide effective support for the reforms. Autonomy also allows the chief executive to maintain the integrity of the reform project and prevent it from being corrupted by special interest groups.\textsuperscript{43}

In Kazakhstan, economic reforms that enabled its transition to market economy were, in their essence, a case of institutional change writ large. As it was argued earlier, the implosion of the Soviet system triggered the process of wholesale replacement of the old political, economic, and social institutions with the new, the blueprint for which came from the West.

In Kazakhstan, the process of three-directional institutional change did not start as a result of the concerted efforts of different political, economic, and social actors. None of these actors sought independence of their country, which was essentially forced on them by the breakup of the Soviet Union in December 1991 agreed upon by the leaders of Belarus, Russia, and Ukraine. Even then it was accepted almost reluctantly: Kazakhstan was the last Soviet republic to proclaim independence, which happened on December 16, 1991, eight days after the Soviet Union was de facto dissolved.

At independence, Kazakhstan faced a number of challenges. First, it lacked functioning state institutions. Kazakhstan, as other republics in the Soviet Union, had only nominal state institutions since the decision-making power was concentrated in Moscow.

Second, which was the consequence of the first, its bureaucratic capacity was scarce. The country did not have enough well-trained cadres to manage its post-communist transition and lead the process of national state-building. Third, in contrast to the post-communist countries in Central and Eastern Europe, the elites and the population of Kazakhstan did not have a recent experience of a market economic system nor the knowledge or understanding of its principles and mechanisms that could have facilitated economic transition.

The question then is how did President Nazarbayev – and his reform team – go about adopting and implementing the market-oriented economic reforms? What mechanisms did they employ to steer the process to a successful outcome? Finally, has the Kazakhstani president risen to the challenge and has he demonstrated the vision and commitment expected of the political leader?

A number of factors may influence politician’s approach to reforms as well as the choice of specific policies. One such factor is ideas. Peter Hall demonstrated that structural changes in the British economy in the early 1980s were driven primarily by the monetarist ideas of Margaret Thatcher, not by any specific economic factors. In that sense, “the welfare state, Keynesianism and the mixed economy, and Rechtstaat models of the public service … can be understood as the institutionalization of a set of persuasive ideas about social and political reality that have been successful in describing reality over long periods of time, as well as prescribing means of “solving” problems within that reality.”

---


Ideas as a driver of the reforms are closely connected to another factor – learning. Learning can happen in many ways: through social learning, policy learning, diffusion of ideas, or membership in epistemic communities. Learning allows humans not only to “learn extremely complex methods of solving contemporary problems, but also … to create, through imagination, events which have not actually occurred.” In politics, learning accounts for the ability of key decision-making actors to transcend “the garbage can” predicament by looking and opting for novel ideas and solutions. Learning is a continuous process, which means that


48 Michael D. Cohen, James G. March and Johan P. Olsen (1972). “A Garbage Can Model of Organizational Choice,” *Administrative Science Quarterly,* Vol. 17, No. 1, pp. 1-25. The “garbage can” model predicts that decision-makers will rather minimize decision-making costs than maximize goal attainment and that they will tap into their prior experience to find solutions to new problems. This model explains well the course of the post-independence economic development in Uzbekistan, Kazakhstan’s neighbor. Its leader, President Islam
those decision-making actors who are interested in improving economic performance of their nations have to constantly update their beliefs about the available alternative policies and their likely outcomes. That happens, as rational choice institutionalists argue, based on their prior beliefs and policy experience as well as the information about the experience of others. Based on the updated beliefs they choose new policies and then the cycle repeats itself.\footnote{Covadonga Meseguer (2006). “Learning and Economic Policy Choices.” European Journal of Political Economy, Vol. 22, pp. 156-78. Though this is a departure from the traditional rational choice models in that it treats utility (i.e., beliefs and policy preferences of the key decision-making actors) as endogenous and dynamic, it preserves the centrality of human intentionality in choosing and designing policies and institutions.} Ability to learn and embrace new ideas and new ways of doing things, what Douglass North called “adaptive efficiency,” is key to understanding and explaining President Nazarbayev’s decisions regarding economic reforms and cadres policy.

3.1. Independence comes to Kazakhstan

Gorbachev’s perestroika, which ushered in political pluralism and national revival of ethnic groups throughout the Soviet Union, did not spark off demands for independence in Kazakhstan, a Central Asian state roughly the size of Western Europe with the population of only 14 million. Neither Nursultan Nazarbayev, the First Secretary of the Kazakh Communist Party as of June 1989, nor the elites saw independence as the goal they should strive for. All they were interested was a greater autonomy from the Center, i.e., Moscow. Nazarbayev’s conviction that independence would prove economically suicidal for Kazakhstan compelled Karimov, is a perfect example of an actor with bounded rationality. He decided that there was nothing new to for him to learn and that his economic knowledge and experience as a Soviet-trained economist were sufficient to address economic issues of independent Uzbekistan. As a result, he largely opted to continue with the policies dating back to the Soviet command economy.

Karimov, is a perfect example of an actor with bounded rationality. He decided that there was nothing new to for him to learn and that his economic knowledge and experience as a Soviet-trained economist were sufficient to address economic issues of independent Uzbekistan. As a result, he largely opted to continue with the policies dating back to the Soviet command economy.
him to side with Gorbachev rather than Yeltsin on the issue of the new Union Treaty even after the failure of the August 1991 coup, which effectively started the process of USSR’s disintegration. It was Nazarbayev who presented a revised version of the treaty to the Soviet parliament immediately after the coup failed in what would be a futile attempt to preserve the country.\footnote{Martha Brill Olcott (1997). “Democratization and the growth of political participation in Kazakhstan” in Karen Dawishawa and Bruce Parrott, eds. Conflict, Cleavage, and Change in Central Asia and the Caucasus. Cambridge: Cambridge University Press, p. 209. Despite the fact that Nazarbayev sided with Gorbachev on the issue of the preservation of the Soviet Union, he was one of the few leaders of the Soviet republics who unequivocally condemned the August 1991 coup and openly supported Yeltsin in his stand-off with the coup leaders.}

The decision by the presidents of Belarus, Russia, and Ukraine to disband the Soviet Union on December 8, 1991, known as Belovezhskaya Pushcha accords, was a complete surprise to Nazarbayev, who became angry and felt wounded.\footnote{James A. Baker, III (1995). The Politics of Diplomacy: Revolution, War and Peace, 1989-1992. New York: G.P. Putnam’s Sons, p. 579-80.} Yet, even in the face of the new political reality, he and the Kazakhstani elite continued to be in the state of political denial: Kazakhstan was the last to proclaim its independence, which happened on December 16, i.e., eight days after the Soviet Union de facto ceased to exist. Independence was thus thrust on Kazakhstan and its leader against their own will.

It did not mean, however, that Nazarbayev was not up to the challenge of leading the building of an independent state. Having met him throughout 1991, James Baker, then U.S. Secretary of State, had this to say about Kazakhstan’s president: “He was a very impressive leader, one that could not be underestimated. … His near future would undoubtedly be rough
… But Nazarbayev had both a vision of what was needed, as well as an acute sense of how to get things accomplished on the ground.”

3.2. Nazarbayev: a portrait

Nursultan Nazarbayev started his career as a blast furnace worker at the Karaganda Steel Mill in Temirtau in 1960. His rise to power began in 1979 when at the age of thirty-nine he became a secretary of the Central Committee of the Communist Party of the Kazakh Soviet Socialist Republic. He was next promoted to the post of the Prime Minister of the republic (1984-1989) before becoming the First Secretary of the Communist Party in June 1989. On April 24, 1990, Nazarbayev was elected the first President of Kazakhstan by the Supreme Soviet of the Kazakh Soviet Socialist Republic. Shortly before the proclamation of Kazakhstan’s independence, on December 1, 1991, he was re-elected president in the first, albeit uncontested, popular election, winning 91.5% of the vote.

Throughout his career in the Soviet period, Nazarbayev primarily dealt with economic issues. His grasp of the economy and appetite for reform were so strong that Gorbachev – with Yeltsin’s support – intended to appoint him the next Soviet Prime Minister had the new Soviet Union Treaty been signed.

Scott Horton, an American lawyer who acted as legal counsel to Academician Andrei Sakharov and Yelena Bonner, Soviet Union’s most famous dissidents, recollects that both of

52 Ibid., p. 581.

53 As a matter of fact, the first time Nazarbayev was elected head of state was on February 22, 1990, when he became the Chairman of the Supreme Soviet of Kazakh SSR.

them admired Nazarbayev for the honest and frank critique of the Soviet system that the then 1st Secretary of the Communist Party of Kazakhstan offered at the 1st and 2nd Congresses of the people’s deputies of the Soviet Union in 1989 and 1990. In 1990, Horton watched the live broadcast of the 2nd Congress together with Bonner in her Moscow apartment. He remembers how she repeatedly punctuated Nazarbayev’s speech with “Yes” and “That’s right,” expressing her approval of his statements. For Sakharov and Bonner, Nursultan Nazarbayev embodied the new generation of Soviet leaders unencumbered by the totalitarian past and eager to pursue a new course ways in the country’s development.55

Nazarbayev’s transition from the communist leader to the president of independent Kazakhstan was easy. A charismatic politician, he was enormously popular both within the republic, as attested by the results of the December 1991 presidential election, and in the Soviet Union. The poll conducted by the Dialog magazine in 1991 placed him on top as the most popular political leader with 40% to Yeltsin’s 36% and Gorbachev’s 18%.56

Following independence, Nazarbayev had to deal not only with the economy, but also with all issues related to building a newly independent state. The first one was to secure Kazakhstan’s independence itself, which was in question due to demographics. According to the last Soviet census of 1989, the Kazakhs made only 39.7% of the population while Russians, other Slavs, and Russian-speaking ethnic groups were the majority with 50.1%. The sentiments of many Russian speakers vis-à-vis Kazakhstan’s independence were largely shaped by the statements coming from the Russian political and intellectual elites.

55 Interview with Scott Horton, January 8, 2014.

breakup, Alexander Solzhenitsyn labeled Kazakhstan an accidental creation and called for the re-unification of its northern and central parts with the post-Soviet Russia.\textsuperscript{57} In early September 1991, President Yeltsin echoed Solzhenitsyn’s ideas by stating that Russian-dominated regions of Ukraine and Kazakhstan would not be allowed to secede from the Soviet Union.

Threats to Kazakhstan’s independence continued throughout the first Yeltsin presidency (1991-1996). Nazarbayev, for example, had to endure many unpleasant conversations with the Russian president who, at the behest of Russia’s oil lobby, demanded that Kazakhstan transfer the ownership of the Tengiz oil field, the sixth largest in the world, to Russia.\textsuperscript{58}

As a result, Nazarbayev, as the leader of independent Kazakhstan, has had to walk a tightrope in domestic policy decision-making so as not to alienate both the Kazakh nationalists and the Russian-speaking majority.\textsuperscript{59} He succeeded in this task as the country has avoided potentially devastating ethnic conflicts and has maintained ethnic stability despite a degree of apprehension among many non-Kazakhs about their second-class citizen status in Kazakhstan. According to the last 2009 census, the ethnic composition of the country has


\textsuperscript{59} The threat of Russian irredentism in Kazakhstan persisted throughout the first decade of independence. The last widely reported case was that of Vladimir Kazimirchuk, who was accused of attempting to establish a Russian Republic in northern Kazakhstan (see Sergei Kozlov (1999), “Russkaya respublika v vostochnom Kazakhstane,” \textit{Nezavisimaya gazeta}, November 24, 1999).
rebalanced in favor of the Kazakhs, who constitute 63% of the population, while the Russians and the Russian-speakers are at less than 30%.

The second issue that required Nazarbayev’s attention was building functioning state institutions and putting together a government that had capacity to govern and implement his reform agenda. He also had to rally legislative and public support for the reforms, which was not easy. Unlike the post-communist leaders in most Central and East European countries, Nazarbayev did not enjoy the period which Leszek Balcerowicz called “extraordinary politics,” i.e., the timeframe when “liberation from foreign domination and domestic political liberalization produce a special state of mass psychology and corresponding political opportunities: the new political structures are fluid and the older political elite is discredited. Both leaders and ordinary citizens feel a stronger-than-normal tendency to think and act in terms of the common good.” The brevity of this period dictates that to ensure their success and acceptance by the population radical the economic reforms should be implemented quickly.

Far from being discredited, the old Soviet elite in Kazakhstan remained entrenched and opposed to the reforms proposed by Nazarbayev for a number of reasons that ranged from ideological to personal. The old elite was especially well represented in the Supreme Soviet, Kazakhstan’s parliament, which effectively became the center of opposition to Nazarbayev and his reforms.

As it happened with Yeltsin in Russia, Nazarbayev did not attempt to replace the legislature elected in the Soviet period with a new one by forcing parliamentary elections

---


following the breakup of the Soviet Union. As a result, he soon became embroiled in the confrontation with the Supreme Soviet though with less disastrous outcome than was the case in Russia. The confrontation began with the election of Serikbolsyn Abdil’din as the Chairman of the Supreme Soviet on December 11, 1991 to replace Yerik Asanbayev, who became Nazarbayev’s vice president. Abdil’din, who won the election over Nazarbayev’s preferred choice, soon started to position himself as the president’s equal, comparing their place in the power structure of Kazakhstan to “two peaks of a single mountain.”

Despite a number of concessions to Nazarbayev, such as, for example, granting him extraordinary powers, the Supreme Soviet questioned Nazarbayev’s every move, particularly in the field of economic reforms, and attempted to pass its own reform program which largely reflected the interests of the Soviet-era industrial lobby. On top of that, most of the Supreme Soviet deputies simply could not understand that their responsibilities had changed from reporting on the state of affairs in their regions to drafting and passing laws.

Third, Nazarbayev had to tackle the economy, which was in free fall. Nazarbayev’s experience as the Communist party leader and the prime minister of Kazakhstan shaped his economic thinking. By the time Gorbachev came to power and perestroika began he was fed up equally with the command economy and the methods of running it. As he put it, he was tired of lying about over fulfilling the plan, engaging in “creative” accounting through the practice of *pripiska* (upward distortion of results achieved), and other forms of concealing the real economic performance. He wanted change, though, as he admitted later, he was not yet thinking about transition to market economy. What he was thinking about was reforming the command economy to make it more transparent and responsive to objective signals. At the same time, however, he started to read Western economists and political scientists to gain
knowledge of the foundations of market economy and specifically of its financial system.⁶²
Among the books that influenced him the most, according to Yermuhamet Yertysbayev, Nazarbayev’s long-time political adviser, was Friedrich Hayek’s *Road to Serfdom*.⁶³

Of the two competing programs of transition to market economy, Grigoriy Yavlinsky’s “500 days” and Yegor Gaidar’s, Nazarbayev supported the former. The reason was simple: the former was designed to reform the economies of all Soviet republics in the context of the USSR’s transition to a confederation under the new Union Treaty. The goal of Gaidar’s program was to transform the economy of the Russian Federation only and free it from the “dependants,” as the Russian reformers called the other Soviet republics. Thus, Gaidar’s program de facto favored the breakup of the Soviet Union, which Nazarbayev did not support.

Independence gave Nazarbayev an opportunity and freedom to pursue market economic reforms of his choosing. Yet, it also brought a predicament that had to be resolved. Nazarbayev did not believe the communist-era apparatchiks and the “red directors,” i.e., SOE directors, could be entrusted with carrying out economic reforms even though there were no other cadres who had knowledge of the market economic principles or practical expertise in running a market economy he could tap into.

### 3.3. Reforming the political system

Nazarbayev announced early on his desire to take “the young sovereign state in the direction of the formation of a strong presidential republic.” He argued that the development


of statehood was dependent on the de facto presidential rule.\textsuperscript{64} Strong presidential power was also needed to carry out “swift and energetic [economic] reforms,” which “had to be implemented from above.”\textsuperscript{65}

Nazarbayev’s preference for a strong presidency was rooted in his experience of the first years of independence when his attempts to introduce reforms in Kazakhstan were met with resistance, outright opposition, or incomprehension on the part of the parliamentarians. From then on, until he finally got a pliant parliament in 2004, Nazarbayev explained his conflict with the successive parliaments in terms of their opposition and obstruction of his economic reforms. Thus, reminiscing about the initial period of the reforms in 1991-92, he said the following: “God forbid, if someone thinks I am against parliamentarism. I am simply for the constructive approach and realization that time does not allow idleness. And there was a lot of political and [economic] reform “emptiness” – not a single law, which is vitally important, is passed. Everything is drowned in an absolute torrent of abstract philosophical deliberations in the course of discussing the laws in the parliament.”\textsuperscript{66}

Apart from the human factor, there was a structural obstacle to reforms. The political system of Kazakhstan was still defined by the Soviet-era Constitution of the Kazakh SSR, which granted executive power to the parliament, i.e., the Supreme Soviet. Delineation of powers between the latter and the newly created office of the President was still underway, causing uncertainty about Kazakhstan’s constitutional model and a constant tug-of-war


\textsuperscript{65} Nazarbayev (2008), p. 185.

\textsuperscript{66} Ibid., p. 27.
between the two branches amplified by personal political ambitions of Abdil’din and a number of other parliamentarians.

There was another feature of the political system that created obstacles to the implementation of the political and economic reforms. Heads of regional administrations, who belonged to the executive branch by definition, also served as deputies in the Supreme Soviet. Many of them were the former members of the communist party nomenklatura and for ideological or personal interest reasons could block or undermine the reform process by using the vertical of the executive power in the provinces and their veto power in the Supreme Soviet. Yet another obstacle was the fact that the Supreme Soviet met only a few times a year, while independent Kazakhstan needed the immediate adoption of hundreds of new laws to establish and develop its political and economic institutions.

Nazarbayev first attempted to overcome parliamentary inertia and opposition in the first half of the 1990s by putting the Supreme Soviet under his control through the creation of a parliamentary majority party, but his attempts failed. The first among these parties, the Socialist Party, failed to gain popularity. The second, the People’s Congress Party, was not successful because Olzhas Suleimenov and Mukhtar Shahanov, its co-leaders, developed presidential ambitions of their own and started to challenge Nazarbayev’s leadership. The same happened with the first leaders of the Union of People’s Unity of Kazakhstan, later renamed People’s Unity Party, which was the third attempt to create a strong pro-presidential party. Even with the change in the leadership, the party failed to win a majority in the 1994 and 1995 parliamentary elections and secure Nazarbayev’s control over the legislature.

While attempts to create a strong presidential party failed, the opposition parties succeeded in organizing themselves into parliamentary coalitions that transcended ideological
and ethnic boundaries, e.g., Respublika (the Socialists, Social Democrats, the Communists, Lad (Russian nationalists), Azat (Kazakh nationalists), Tabigat (Kazakhstani Greens)).

Nazarbayev’s frustration with the parliament and the lack of progress with the reforms was shared by some parliamentarians and the elites. Tulegen Askarov, who would later become one of the leading economic analysts, argued that the: “The deputies showed themselves as a force that is obviously conservative, that is incapable of perceiving the economic and political reforms on behalf of the country’s market future.”

A number of the reform-minded deputies published a group letter, acknowledging that “a considerable number of the country’s ruling elites does not possess the knowledge, desire, or tools to resolve the key issues” of political and economic reforms. The group favored giving the president, the prime minister, and the government absolute power to implement economic reforms, albeit for a set period of time.

Nazarbayev’s rival, Serikbolsyn Abdil’din, the Chairman of the Supreme Soviet, himself conceded that he “thought that in difficult times power should be concentrated in the hands of one person, one structure.” Such sentiments explain why Nazarbayev was successful in extracting a number of important concessions. Thus, in January 1992, the Supreme Soviet agreed to expand presidential powers that allowed him to appoint akims (heads of local administrations), who became an important instrument in creating the vertical


of power that allowed Nazarbayev to carry out his reforms and consolidate his power in the country.\textsuperscript{70}

Alongside the attempts to domesticate the parliament, Nazarbayev sought to overcome institutional barriers to reforms through the adoption of the new Constitution, which was passed on January 28, 1993. The Constitution institutionalized the presidential form of government in Kazakhstan, but did not fully resolve the power struggle between the two branches of government. That prompted Nazarbayev to engineer a campaign of self-dissolution of the local soviets (local administrative councils), culminating with the decision of the Supreme Soviet to dissolve itself “voluntarily” on December 10, 1993. True to the adopted mantra the dissolution of the Supreme Soviet and local soviets was rationalized by the need to speed up the implementation of the economic reforms, which the parliament was accused of blocking. The dissolution of the parliament enjoyed a wide public support.\textsuperscript{71}

On the day it dissolved itself the Supreme Soviet passed the law “On the temporary delegation of the additional powers to the President of the Republic of Kazakhstan and the heads of local administrations,” granting Nazarbayev the right to issue decrees that had the power of laws. That right was to be exercised throughout the period when no parliament existed. The next parliament did not convene until late March 1994 and Nazarbayev used the intervening months to adopt a number of laws in an attempt to accelerate the economic reforms.

\textsuperscript{70} The Supreme Soviet though refused to consider another request for expansion of presidential powers in the summer of 1993.

The election of the new parliament on March 7, 1994, however, did not solve the problem of accelerating reforms despite the fact that the election process was largely controlled by the presidential administration. The new Speaker of the Supreme Soviet, Abish Kekil’bayev, though chosen for his loyalty to Nazarbayev, began to assert his own independence and that of the parliament from the president and the executive branch. In particular, he challenged the 1993 constitutional provision that rested the right for the legislative initiative with the president rather than the parliament and “expressed concern about lack of a legal framework for the economic and political transformations which the president was attempting to impose.”

In May 1994, the Supreme Soviet passed a no-confidence vote in Prime Minister Tereschenko and his government. In July, it overrode presidential vetoes on two economic bills. Demands for Tereschenko’s and Nazarbayev’s resignation were repeatedly voiced by some parliamentary factions. In September, the State Arbitrage Court of Kazakhstan supported the Supreme Soviet and ordered a halt to the further distribution of privatization vouchers. In mid-October, amid scandals related to privatization, Tereschenko’s government was finally forced to resign. At the end of 1994, against the backdrop of deep arrears in the payment of wages and pensions, the Supreme Soviet attempted to assume oversight over the financial flows in the country which the executive branch saw as a direct encroachment on its powers.

The decision by the Supreme Soviet in late January 1995 to adopt its own New Economic Policy program, which would have significantly slowed down the process of privatization, overhauled the tax structure, and discouraged direct foreign investment in

---

Kazakhstan, was the last drop for Nazarbayev. He engineered the dissolution of the second Supreme Soviet, this time involuntarily, by using a complaint filed to the Constitutional Court by Tatiana Kvyatkovskaya, who challenged the results of the parliamentary election in the district she ran in as a candidate. Though the complaint was filed in April 1994 the Constitutional Court took it up only almost a year later, issuing its ruling on March 6, 1995. The Court annulled not only the results of the elections in her district, but the results of the entire parliamentary elections. Nazarbayev feigned an appeal, but the Court upheld its decision, proclaiming the parliament illegitimate and annulling the laws it passed.

The ruling by the Constitutional Court automatically reactivated the December 10, 1993 law on the temporary delegation of additional powers to the president of the Republic of Kazakhstan and the heads of local administrations, giving Nazarbayev another chance to rule by decree and issue the laws he needed to speed up the reforms.

By the time the second parliament was dissolved, the president of Kazakhstan, in his own words, “got tired. Really tired. But not of constructive business being conducted and mountains of laws being passed, but of the complete absence of both. In such moments, when the next law, which had to be passed today because tomorrow no one would need it anymore, was met with a torrent of unnecessary commentaries and rivers of verbiage, I wanted to immerse myself in the sea of clean water and come out full of fresh thoughts and new mood.”

His solution to the political impasse was three-fold. First, he organized a referendum on April 29, 1995, to extend his power until 2000. Second, he announced his decision to adopt a new Constitution that would streamline the political system, i.e., further increase

---

73 Nazarbayev (2008), p. 27.
presidential powers and reduce those of the legislative and the judicial branches. Third, he used the direct presidential rule to pass over 140 presidential decrees with force of law that were urgently needed to accelerate the speed of reforms.

Nazarbayev won the referendum with 95.8% of the votes. The new political order ushered by the new Constitution was brought about not only by Nazarbayev’s personal conflict with the parliament. He admitted that his thinking was influenced by events in Russia where President Boris Yeltsin was embroiled in a similar confrontation with the Russian Duma: “Actively following events in Moscow, and analyzing the confrontation between the executive and political powers that had caused complete chaos and lawlessness in Russia, I became convinced once and for all that strong, centralized presidential power was an essential prerequisite for Kazakhstan to actively liberalize its economy.”

The referendum on August 30, 1995, approved the new Constitution with 89.1% of “for” votes. In accordance with the new Constitution, Kazakhstan became a unitary state with a presidential form of government. The president appoints the government (subject to parliamentary approval) and all other state officials, including judges, of all levels. The office of the vice president was abolished. It became virtually impossible to remove the president from office. From now on it could be only done because of an illness or state treason, whereas in the Russian Federation the scope of impeachable offenses was broader and included “other serious crimes.”

The Constitution created the new bicameral parliament: Mazhilis, the lower chamber, with 67 seats and the Senate with 47, seven of which were to be filled directly by the president. Crucially, legislative initiative was kept in the hands of the president.

---

Nazarbayev welcomed the adoption of the new constitution, declaring the following:

“Setting out to establish a real presidential republic in 1995, I was aware that with this template of development in place the country would be easier to manage [emphasis mine], and that the positive results of the … economic reforms were bound to be felt before too long. … From then on Parliament no longer became involved in the appointment of the heads of ministries and departments: instead, they were appointed by the country’s President.”\(^{75}\)

The December 1995 parliamentary elections, which saw representatives of 15 parties and groups as well as independents became Mazhilis deputies, were the last elections to yield the results that reflected a broad spectrum of the Kazakhstani politics. With each subsequent election the number of political parties dwindled, culminating with the election of the single-party (Nazarbayev-led Nur Otan) parliament in 2007.

3.4. Nazarbayev as a reformer

After considering various models of market economy Nazarbayev settled on the German-style social market economy based on Ludwig Erhard’s principle of “Prosperity for one and all.” Reforming the economy and switching it into the market gear posed a great challenge for Nazarbayev. Apart from inertia, opposition, and skepticism of the old nomenklatura and the red directors, who still wielded enormous power, the greatest challenge was the absence of cadres schooled in the market economic principles and possessing practical managerial experience. Nazarbayev came up with four strategies to resolve the problem:

\(^{75}\) Nazarbayev (2008), p. 81.
The first strategy was to actively seek and recruit foreign advisers to help draft and implement reforms as well as attract foreign direct investment and foreign managers to take over Kazakhstani enterprises.

The second strategy was to recruit Kazakhstaniis of the younger generation, including those with some private business experience gained during perestroika, into the government and delegate them the task of implementing the economic reforms.

The third strategy was to send the next generation of Kazakhstaniis to American, European, and Japanese universities to get training in a wide range of disciplines, including economics and business administration.

The fourth – and the most original – strategy was to move the capital of the country from Almaty to Astana as a mechanism of the elite turnover.

The first strategy of reforming Kazakhstani economy was to enlist the help of foreign advisors and managers. The president of Kazakhstan appreciated early on that without foreign help and assistance the country would not succeed with its transition to market economy. Former U.S. Secretary of State James Baker recalls in his memoirs that when they discussed U.S. assistance to Kazakhstan on December 15, 1991, i.e., one day before its independence, Nazarbayev said the following: “Send me advisers and investors – not money.”  

The first adviser Nazarbayev hired was Grigoriy Yavlinsky, whose plan of transition to market economy he liked. After the plan was rejected by Gorbachev and Yel’tsin, Nazarbayev invited its author to Almaty and appointed him his economic adviser, which happened before the Soviet Union collapsed. Yavlinsky stayed in Kazakhstan throughout 1992 and helped to map Kazakhstan’s first steps in transition to market economy.

The Russian economist was not the only source of ideas that shaped Kazakhstan’s leader reform agenda and his choice of mechanisms for its implementation. He sought the advice of Lee Kwan Yew, the architect of Singapore’s economic modernization, who first came to Kazakhstan in May 1991. At Nazarbayev’s request, Lee Kwan Yew held a seminar for the young economists who worked in the Kazakhstani government and who would later become the nucleus of the reform team.

The president of Kazakhstan turned for recommendations and assistance to the UNDP, World Bank, International Monetary Fund, and other IFIs. He was particularly eager to get the advice of the OECD countries, especially Germany and the U.S., which were regarded as models of economic development. At the same time, he was shrewd enough not to take foreign advice and assistance uncritically. To get an independent assessment of the policy recommendations and various programs offered by the IFIs as well as impartial advice on the best course of action he hired a group of economists from the German Institute for Economic Research who worked in Kazakhstan from 1993 to 2000, i.e., for the duration of the presence of the IMF mission in the country.77

Apart from advice and technical assistance, Nazarbayev was eager to open Kazakhstan to foreign direct investment and involve Western managers in running privatized companies. He dismissed criticism that the leading industrial enterprises were sold to foreigners by pointing to the fact that the attempt to carry out privatization independently not only failed, but made things even worse.78 The failure of the initial stage of privatization led to the

---


decision to sell 57 out of 94 major enterprises during its second and third stages to foreign investors.

The second strategy adopted by Nazarbayev was to turn to the younger generation of Kazakhstanis and select those among them to whom he could entrust reforming Kazakhstan’s economy. The rationale behind the decision, as Nazarbayev explained himself, was that the entrenched political and managerial elites continued to cling to the old Soviet mentality which presented an obstacle to the economic reforms and the overall modernization of the country: “All of the [Communist] party elite still had the old mentality. They said, “OK, we’ll build the market economy, but how will we direct it?” Was it possible to demand and expect that people with such mentality would bring us into the world economic system and transform the economy into a new, market-based one?”

Having asked himself whether it was possible to “brainwash people’s heads jam-packed with the never-ending string of [the decisions of the Communist party] congresses and quotations from the great and not-so-great classics of Marxism-Leninism,” he made the decision to sideline the old elite and empower the younger generation of technocrats and businessmen by appointing them into the senior positions in the government. A few months after independence, in April 1992, Nazarbayev said that he was building a reserve team and that he had the idea to establish a presidential council of businessmen and industrialists which would include young specialists who were sent to study abroad: “It is out of these people we will be forming a new team as our hopes lie with thirty-year olds.”

79 Nazarbayev (2010), p. 27.

80 Nazarbayev (2010), p. 27
In April 1996, Nazarbayev set up the Supreme Economic Council (SEC) and became its chairman. The SEC, which was tasked with drawing up strategic proposals for tackling social and economic problems, “was an important advance in forming the institutional foundations of a market economy.” Its “core personnel were young people who had none of the baggage of outmoded dogmatic opinions. They had been selected for employment primarily on the basis of their fluency in foreign languages, academic achievements and managerial experience. Each of them was put in charge of a different branch of the economy. Their employment created a pool of fresh, new ideas on the country’s future development. These energetic young people stood out in sharp contrast to the conservative apparatchiks.”

It appears that for Nazarbayev the main qualification for being selected to the reform team was the knowledge of a foreign language. He repeatedly emphasized that factor whenever he introduced his appointees and which for him ranked higher than economic credentials. For Nazarbayev, young age and the knowledge of a foreign language were clearly the markers of the new mentality and familiarity with the new way of doing things. When, for example, he appointed Oraz Jandosov as the Governor of the National Bank of Kazakhstan he presented the latter as follows: “He is 35. He is fluent in English. He is a graduate of Moscow University of Finance.” In October 1997, introducing Nurlan Balgymbayev as the new...

---

81 Konstantin Yemel’yanov. (1992). “Chto skazal president.” Kazhkhstanskaya pravda, April 14. In reality, “who were sent to study abroad” at the time meant those who got their education in the elite universities of Moscow and Leningrad (St. Petersburg) or who attended short-term courses at western universities.


Prime Minister, Nazarbayev said the following: “He has good command of the English language and knows the Kazakh economy.”

The Kazakhstani leader, however, did not attempt a complete elite turnover. He retained a few long-time trusted advisors from the Soviet period (Vladimir Ni, Nurtai Abykayev, Kanat Saudabayev et al.) and those whom he saw capable of leading and guiding the young technocrats in implementing the reforms (Erik Asanbayev, his Vice-President, and Daulet Sembayev, the Deputy Prime Minister in charge of the economic reforms).

The third strategy was to train the next generation of the Kazakhstani elite abroad to increase bureaucratic capacity of the government in reforming the economy, managerial capacity in running national companies as well as bolster an overall modernization of the country. To that end, Nazarbayev initiated the Bolashak (Future) fellowship program on November 5, 1993. The government commission on training cadres overseas was established to administer the program. In 1994-2010, nearly 3,000 students, a third of whom studied in the U.S. universities, obtained their B.A., M.A., and Ph.D. degrees. It has been the first – and still remains – the only such program in the former Soviet Union. The overwhelming majority of the alumni work in the government and national companies.

The fourth strategy pursued by Nazarbayev, which was closely linked with the second and reinforced it, was truly bold and unprecedented. On July 6, 1994, Nazarbayev persuaded

---


85 “Kazakhstan: New Kazakh PM Appointed Due to Experience In Oil.” INTERFAX, October 10, 1997 as transcribed in FBIS-SOV-97-283. Balgimbayev belongs to a different generation and can be best described as a Soviet-era technocrat.

the Supreme Soviet to approve his decision to move Kazakhstan’s capital from Almaty to Astana. Many reasons for the move were listed at the time, thirty-two in total, ranging from concerns about environmental consequences of the further expansion of Almaty to the need to preserve territorial integrity of the country in view of the threat of the Russian irredentism in the north. It was not until 2010 that Nazarbayev publicly revealed the main reason behind his decision to move the capital. In his book *V Serdtse Ebrazzi (In the Heart of Eurasia)*, Nazarbayev explains that his decision to move the capital was caused by the frustration with the Soviet-era elites and their obstructionism of his reforms: “I understood that half-measures will not do in the long run. Time is being wasted. An extraordinary decision had to be taken to shake the people and ‘ventilate’ their brains. This is how, step-by-step, I arrived at the decision to move the capital.”

For Nazarbayev, moving the capital represented the only solution to “overcome the known conservatism of the bureaucracy,” get rid of the “excess apparatchik deadweight” and “open the door for further transformation with the help of the new team of bureaucrats, who embody and reflect the progressive mentality of the society.” The Kazakhstani president reckoned that the old nomenklatura would not be willing to move away from the comforts of Almaty to a relative ‘nowhere’ in the middle of the unwelcoming steppe. To make the move further unattractive for the old guard, he announced that it would happen in the middle of winter (December 1997), when the monthly temperature in Astana averaged 17.6°F (it is around 36°F in Almaty). His calculation proved correct as most of the old elite given the

---

87 Nazarbayev (2010), p. 28. It is interesting that my numerous interviews with the younger Kazakhstani officials in the early 2000s revealed the same understanding of the reasons behind the move of the capital.

ultimatum to move to Astana or else preferred to take an early retirement and stay in Almaty.  

3.5. Conclusion

Throughout the 1990s, Nazarbayev had to deal with the parliament that persistently challenged his power and opposed his reform agenda. The opposition was not exclusively driven by ideological reasons as was the case with the old nomenklatura. Very often it was a reaction to the mistakes made by the government, particularly abuses associated with privatization.

Gradually, Nazarbayev was able to overcome the parliamentary opposition and establish a more constructive relationship with the parliament, which was achieved by reducing its powers, albeit by formally legal means, and asserting control over the selection of the deputies. Simultaneously, the opposition parties that emerged in the 1990s were prevented from developing into a viable political force while their leaders were sidelined, co-opted, or repressed.

Nazarbayev justified his actions vis-à-vis the parliament by presenting it as an obstacle to the economic reforms which Kazakhstan needed for its development. In doing that he found wide support among the population. According to a poll conducted in 1996, a 51% majority

89 In 2014, i.e., fourteen years after the move, the average age of Astana’s population is still very young at 30 years of age. See http://astana.gov.kz/en/modules/material/4104 Accessed on March 1, 2014.
believed that economic reforms were introduced too slowly, while 9% thought they were proceeding at the right speed with only 19% stating that they were occurring too rapidly.\textsuperscript{90}

Chapter IV. Reformers and reforms

The institutional reforms aimed at building a market economy are now mostly complete in Kazakhstan. In recent years our country has been steadily maintaining high rates of economic growth. And in many respects the success of this economic development has been [thanks] to the country’s developed financial system. … I have always defended and done all I could to support the banking sector. In the past we concentrated all our efforts on developing this segment with a view to giving Kazakhstan’s economy a reliable source of finance.

Nursultan Nazarbayev, The Kazakhstan Way

The transformation of the banking sector as part of Kazakhstan’s transition to market economy was not just a matter of tweaking the Soviet-era banking system. It required a complete break with its institutional organization and practices due to their incompatibility with those in a market economy. That inevitably meant that the reform team would have to overcome institutional inertia and natural resistance to reform on the part of the Soviet-era banking sector employees and their institutional clients. To steer the reforms toward a successful outcome, first, the reformers had to secure support of the chief executive. That support was needed not only to overcome opposition to reforms, but also to introduce and enforce the new rules and practices of banking. Second, the reformers had to come up with a coherent reform agenda and be able to work as a cohesive team to implement it. Third, given that their economic education and thinking were rooted in the command economy the reformers had to have the capacity to learn on the job.
4.1. Soviet banking system

Institutionally, the Soviet banking system inherited by Kazakhstan at independence was subordinate to the government and lacked any autonomy from the state. Soviet banks, all state-owned, acted as distribution mechanisms through which the Soviet government extended credits to the economy, carried out foreign trade, paid out salaries and pensions.

At the apex of the Soviet system was Gosbank (State Bank) of the USSR. Gosbank was not even remotely an equivalent of the central bank (CB) in a market economy. It was subordinate to the Council of Ministers of the USSR, had no control over monetary policy, and exercised no regulatory or supervision function over the remaining three banking institutions and their branches – Vneshtorgbank (Foreign Trade Bank) of the USSR, Stroibank (Construction Bank) of the USSR, and Gostrudsberkassa. The latter was the equivalent of a savings bank that accepted deposits from the population into checking or savings accounts and paid out salaries and pensions. It was the only Soviet bank, which performed a function – collection of savings from the population – that made it similar to the banks in market economies.

Gosbank also performed a function performed by the Treasury in a market economy – it collected and disbursed all government revenue. Gosbank was tasked with yet another responsibility uncharacteristic of a CB. It was put in charge of reporting the execution of production and labor utilization plans, the role transferred to Gosbank from the Central Statistics Administration of the USSR.\(^\text{91}\)

Decisions and responsibility for the selection of an economic sector, individual enterprise, or a particular project to be invested in or extended credit to, responsibility for associated risk, control over the use of credits and investments as well as control over the amount of money in circulation (M0) were in the purview of GOSPLAN (State Planning Committee), Ministry of Finance, and other Soviet government agencies. The role of banks was to implement the decisions made by these agencies and act as a conduit of the capital allocated by the state to enterprises.

Prudential regulations covered only the capital, liquidity, lending limits, and reserve requirements. Loan portfolio was limited to 100% of the bank capital though there was no limit on the aggregate exposure to the borrower. Requirements for the provisioning of nonperforming loans were absent.

The ancillary role of banks in the Soviet economy reflected the role of money in a planned economy. Given the absence of the institution of the market and the notion of profit, the fact that plan targets were set in units of output rather than monetary value and that prices were fixed administratively, the money under socialism did not play an active role in economic activity and was used only as an accounting unit and a means of payment.

Another feature of the Soviet economy that underscored banks’ subordinate role was a peculiar credit policy known as soft budget constraint. Formally, Gosbank was charged with the responsibility to “enforce “financial discipline” of all enterprises in the state sector, ensure that they meet their financial obligations to the bank, and keep all expenditures within limits set by the plan.” In reality, the government provided permanent subsidies or bailout credits

---

to those state-owned enterprises that chronically operated at a loss or could not fulfill the plan, the policy that became known as soft budget constraint. The reasons behind loose credit policy were socio-political. First, the Soviet government had to keep its social compact with the citizens by providing guaranteed full employment, which required keeping even failing SOEs afloat. Second, the policy of import substitution industrialization led to the emergence of uncompetitive industries and SOEs that permanently operated at a loss. Given that bankruptcy and unemployment were not an option they were kept alive through the policy of soft budget constraint.

The soft budget constraint syndrome had many negative consequences. Its most important effect was pervasive lax financial discipline that became engrained in the mindsets and practices of the banking sector employees as well as the real economy actors. Both came to rely on the government’s printing press and free flow of government credit to finance their operations and cover their losses.

Gorbachev’s perestroika sought to reform the Soviet economy by introducing market mechanisms and institutions. The banking sector was affected in two important ways. First, in 1987-90, the state-run banking sector was reorganized into a two-tier system with the CB, the role assumed by Gosbank, four specialized banks, and Sberbank (Savings Bank). Specialized banks were created to service a particular branch of the national economy and included Agroprombank (Agricultural Bank), Promstroibank (Industrial and Construction Bank), Vnesheconombank (Foreign Trade Bank), and Zhilsotsbank (Communal Services Bank).

Gosbank as the CB got some degree of independence from the Soviet government having been transferred from the government jurisdiction and subordination to the Soviet

---

parliament. It was finally endowed with the powers to pursue monetary policy, control credit allocation and ruble’s exchange rate.

The Law on Cooperatives passed in May 1988 was another important reform that led to changes in the banking sector. For the first time since the 1920s, the law permitted individual entrepreneurial activity in the Soviet Union, including the creation of privately owned banks to service the needs of individual entrepreneurs and private businesses. The emergence of the private sector in the Soviet Union, including private banks, was facilitated by the expansion of credit allocated to that end by the government and Gosbank. At the same time, a greater degree of freedom over their operations given to SOEs meant that they could now work for profit, which some of them channeled to the establishment of banks.

4.2. Banking in Soviet Kazakhstan

Banking in Kazakhstan prior to independence replicated the Soviet system. By 1991, 29 branches of Gosbank, 236 branches of Agroprombank, 70 branches of Promstroibank, and 29 branches of Zhilsotsbank operated in the republic. Sberbank had the most branches – 3044.

Even before the breakup of the Soviet Union Kazakhstan sought to take control over its banking system as well as reform it. First, it passed its own “Law on Banks and Banking Activity in Kazakh SSR” on December 7, 1990. The adoption of the law was necessitated, in the words of Boris Ryabov, Governor of the Gosbank of Kazakh SSR, by the failure of reforms initiated by Moscow to change the Soviet banking system, particularly its credit policy, in any meaningful way. The law adopted in Kazakh SSR differed from the all-Union law in that it attempted to create a credit market in the republic by abolishing the monopoly of

state specialized banks on crediting the national economy.

The law provided the foundation for the two-tier banking system. The five specialized banks were transformed into joint-stock commercial banks – Promstroibank into Turanbank, Agroprombank to Agroprombank of the Republic of Kazakhstan, Vneshtorgbank to Alembank, Sberbank into the People’s (Halyk) Savings Bank of the Republic of Kazakhstan. Commercial, i.e. privately owned, banks were now allowed to enter the credit market and choose their own clients, set their own interest rates, and determine other terms of issuing credits. For the first time, the law introduced financial leasing and factoring operations in Kazakhstan. Commercial banks were also allowed to deal with foreign currency operations, a state monopoly until then. Another distinguishing characteristic was that the Kazakh SSR law allowed municipalities to set up their own banks, which was explicitly prohibited by the all-Union law.

The law on banks and banking was followed by the resolution ‘On the Charter of the National State Bank of Kazakh SSR’ passed by the Supreme Soviet of Kazakh Soviet Socialist Republic on June 20, 1991. It established the National State Bank of Kazakh Soviet Socialist Republic (NSBK) as its CB and proclaimed its independence from Gosbank of the USSR. The resolution put the NSBK under the jurisdiction of the Supreme Soviet and gave it the monopoly over printing and circulation of money in Kazakhstan.

While attempting to introduce new elements in how banking was done in Kazakhstan, the Charter adopted by the Supreme Soviet did not depart significantly from the Soviet

---

95 “Resolution of the Supreme Soviet of Kazakh SSR ’On the Charter of the National State Bank of Kazakh SSR,’” Sovety Kazakhstana, September 17, 1991. NSBK’s Charter stipulated that the exact nature of NSBK’s relations with Gosbank would be determined by the new Union Treaty, the founding document of the USSR, which was at the time negotiated under Mikhail Gorbachev’s auspices in Moscow suburb of Novo-Ogaryovo.
banking tradition and practices. Thus, it affirmed NSBK’s responsibility for the execution of the state budget. It also upheld the policy of soft-budget constraint by allowing the bank, albeit under “extreme” circumstances, to extend credit to individual enterprises or entire sectors of the national economy. The only difference was that now it was the Supreme Soviet rather than the government had to issue the permission. The NSBK was also allowed to credit second-tier banks directly in accordance with the terms set in individual agreements rather than through a clear-cut credit policy.

The NSBK was put in charge of the development and supervision of the second-tier banking system in Kazakhstan. It was allowed to issue regulations mandatory for all banks. At the same time, the Supreme Soviet introduced a novel approach in banking reforms by tasking the NSBK to pursue its policy vis-à-vis the second-tier banks in close coordination and consultation with them. For that purpose, it mandated the establishment of the Council of Banks of Kazakhstan. The Council, which included the Governor and other top officials of the NSBK as well as heads of the state and privately owned commercial banks, was to develop the new banking regulation and pursue reforms in a consensual manner. Thus, Kazakhstan launched its own banking sector reforms before independence.

4.3. Embarking on the banking sector reforms

By independence, there were 72 commercial banks, their number increasing to 150 in 1992 and peaking at 230 in 1993. Most of these banks were little more than pocket institutions established by enterprises, factories, other state entities, and private individuals “solely for the purpose of acquiring speculative income in a climate of high inflation and instability on the
hard currency market.”

In some cases, a group of enterprises within the same industry established a bank to pool their resources together to facilitate investment after the direct credits they used to receive from Gosbank and their branch ministries in Moscow stopped. Such was the case, for example, with the mining industry in Kazakhstan when a number of enterprises established Kazmetallbank. In other cases, enterprises from different sectors established a joint bank as was the case with Kredsptsbank, whose shareholders included the light industry enterprises, Kazakhstan trade unions, a metallurgical plant, 500 enterprises total. Such banks did not offer traditional banking services, but simply extended the lines of credit to the affiliated enterprises.

The first attempt at a cardinal reform of the banking sector came with the appointment of Galym Bainazarov as the first Chairman of the National State Bank of the Republic of Kazakhstan on January 18, 1992. He was tasked by Sergei Tereschenko, the first Prime Minister of independent Kazakhstan, to replace the Soviet-era credit policy with the credit-with-return policy, make money the most expensive commodity, increase interest rates on loans and immediately begin to work on the introduction of the national currency.

However, the real transformation of the banking sector could not have begun until Kazakhstan introduced its own national currency, tenge (KZT), which happened in November 1993. That allowed the country to take control over its monetary and credit policy. The

---


98 The Bank has gone through a number of name changes. Henceforth, I am using its current name – the National Bank of Kazakhstan.

other factor that facilitated the radical reforms was the appointment of Daulet Sembayev as the Chairman (Governor) of the National Bank of Kazakhstan in December 1993. Sembayev’s appointment was logical not only because he chaired the governmental working group that was in charge of introducing the tenge. In March 1993, Nazarbayev put Sembayev, the First Deputy Prime Minister at the time, in charge of executing the radical economic reforms in Kazakhstan. In that capacity, he coordinated the activities of all ministries of the economic block and directly oversaw the Ministry of Finance, Gosekonomkomitet (State Economy Committee), the National State Bank, commercial banks, etc. The trust of the president and the mantle of the economic reform tsar that Sembayev brought with him to the NBK enabled him to pursue radical transformation of the banking sector.

Like Nazarbayev, Sembayev, a Soviet-era trained economist, understood the importance of new ideas and new people in achieving a successful outcome of the banking sector reforms. He also understood the importance of having a team to pursue these reforms. He therefore replaced deputy governors of the NBK inherited from Bainazarov with three economists in their early thirties who were educated in the best universities of Moscow and with whom he started working since 1991, including on the working group that introduced the tenge. The group included Oraz Jandosov (a member of the Supreme Economic Council under President Nazarbayev), Grigoriy Marchenko (assistant to Erik Asanbayev, Vice-President of Kazakhstan), and Kadyrzhan Damitov, whom Sembayev brought in from Alembank and who was the only trained banker in the group and one of the few people in the country.
knowledgeable in foreign currency operations. As Sembayev attested later, “(I think that) the team that was formed was great and we worked as a closely-knit group.”

The cohesiveness of the team was predicated not only on the prior experience of working together. It was also sustained by the way its inner workings were structured. Sembayev’s role was that of the organizer, champion, facilitator, the chief executor and enforcer of the reforms. As Marchenko reminisces, “Sembayev though a part of the old system … nonetheless had a tremendous penchant for new things and the desire to support his young deputies. We – Jandosov, Damitov, and myself – were just barely over thirty and not everyone took us seriously whereas older people in the Orient are traditionally treated with respect. So, without Sembayev it would have been simply impossible to carry out our plans.”

Sembayev’s three deputies were largely responsible for designing the reforms as well as oversaw their implementation in their specific areas of responsibility. The team worked by consensus. If there were strong disagreements, usually between Jandosov and Marchenko, Sembayev preferred not to intervene, take sides, or make decisions on divisive issues. Only when everyone agreed on a particular policy or step he would lend his support and the policy would be approved. The synergy thus created allowed the team to put forward a coherent reform plan and agree on the strategy of its implementation.

---


The primary task for the reformers was to reform the NBK, Kazakhstan’s central bank, by divesting the NBK of its Soviet-era functions and focusing on the typical functions of the central bank – monetary policy, foreign exchange policy, payment system, and banking supervision. The team was also charged with reforming second-tier banks to create a stable banking system in the country.

To achieve that goal the team had to develop a completely new legal framework of banking in Kazakhstan, secure NBK’s independence from the Presidium of the Supreme Soviet (parliament) and the government, to which the NBK was simultaneously subordinate, establish a system of banking supervision, introduce international accounting standards and obligatory audit of the second-tier banks by the four major international auditing companies.

The overall strategy vis-à-vis the banking sector adopted by the reformers was that the reforms, while radical in nature, should be pursued gradually and consensually and lead to the introduction of international standards, absent which best international practices should be adopted. The policy of transition to the international standards and best practices in all sectors of the economy was enunciated by Nazarbayev himself. That provided an important shield for the reform team and allowed it to overcome any opposition and resistance to the reforms, particularly coming from the parliament, the main economic actors, and the Soviet-schooled banking community. To increase transparency and inform the elites and the public about NBK policies and decisions, Sembayev introduced monthly press conferences of the NBK Governor and his deputies.

In addition, to minimize opposition and resistance to the reforms within the NBK one of the first steps taken by Sembayev was to announce to the staff that those who did not want to work differently from how they used to in the Soviet era and implement the reforms should
resign. At the same time, the new Governor sought to attract the new and talented cadres from the private sector to the NBK to boost its capacity to implement the reforms. He succeeded in persuading President Nazarbayev to agree to allow the NBK to pay 52 of its top personnel individual rate salaries that exceeded the government pay scale.\(^{103}\)

Despite Nazarbayev’s trust and support for Sembayev, it took a major setback with the economic reforms and disillusionment with the management of the state-owned enterprises (SOEs) for the president to give him and his team a carte blanche in reforming the banking sector. One of the uncharacteristic functions the NBK wanted to strip itself of was direct crediting of the economy and the second-tier banks. In the first years of independence, NBK’s share of the credit market was 80%. The team had to fight with the government and the “red directors,” i.e. SOE directors, to put an end to this practice. At its peak in 1993, the annual inflation was at 2000% while interest rates on the loans extended by the NBK to the SOEs was only 55-60%. That created an opportunity for many enterprising directors to use loans for *prokrutka*, i.e., their diversion into extending credit to each other, buying dollars or goods, selling them at a high margin of profit big enough to repay the loan and make a hefty profit for themselves.

*Prokrutka* accelerated inflation further while enterprises were left strapped for cash, leading to further decline in the industrial production. Galloping inflation and decline of industrial output, in their turn, “led to severe disintermediation as the private sector shifted its money holdings from rubles into foreign currency held outside the banking system. The deposit base fell from 96% of GDP at end-1991 to only 20% at the end of

\(^{103}\) Interview with Daulet Sembayev, June 20, 2001.
Prokrutka also caused the piling up of the pensions arrears as the banks used the monies budgeted to pay pensions for paying taxes and making other obligatory payments to the budget.\textsuperscript{105}

Yet, in early 1994, the government and SOE directors pushed for injecting even more money into the industrial sector by conducting mezhzachyot. Mezhzachyot was cross-debt settlement among enterprises, which was to be accomplished by the NBK allocating funds to enterprises to pay their debts. Despite NBK’s opposition, President Nazarbayev agreed. The consequences were disastrous. The funds allocated to pay the debts were diverted again to prokrutka, while the rapid increase in money led to the growth of inflation and depreciation of the tenge. In a matter of months, tenge’s exchange rate, which was set at its introduction in November 1993 at US$1/KZT4.75, dropped to US$1/KZT40 by March 1994. The country’s monetary base (M0) increased to KZT40 billion, which was 4.9 times higher than at the end of 1993. As a result, the annual inflation for 1994 was at 1158.3%. The SOEs paid back only 22% of the loans.

The catastrophic outcome of mezhzachyot led President Nazarbayev to the realization of the importance of a prudent monetary policy and central bank independence (CBI). The other factor that brought him over to side with the NBK reform team was the recognition that throwing more money via direct credits to the real sector of the economy would not help to


reform it the because of the incompetence of the red directors, which contributed to further

President’s conversion to CBI not only helped the reform team to get the new banking
legislation that enshrined it adopted in 1995, but also allowed to fend off further attempts of
the government to loosen credit policy in 1994 and 1995. From the late 1994 on, whenever the
NBK had serious disagreements with the government, Nazarbayev would side with the NBK
reform team and support it “absolutely and unequivocally.”\footnote{Marchenko (2008), chapter 4, loc 1303.}

4.4. The breakthrough of 1995

The year 1995 was seminal for the NBK and the banking sector. In March, the Law on
the NBK was passed followed by the adoption of the Law on Banks and Banking in the
Republic of Kazakhstan in August and the Law on Mortgages in December. Both were passed
as Presidential Decrees with Force of Law in the period when the parliament was disbanded.
Just as Nazarbayev, the reformers were frustrated with longwinded debates and resistance to
passing laws on the banking sector reforms by the parliamentarians, who were not keen on
giving up control over the NBK and endorse the CBI principle.

Thus, while refraining from political activities, the reform team supported Nazarbayev
wholeheartedly in his standoff with the legislature and his decision to disband it in March
1995 and rule by decree. As Marchenko reveals, “Among top managers of the National Bank
no one was sad about the crisis of parliamentarism. It was rather the opposite. … The absence
of the parliament simply elated us because it opened for our team a window of opportunity.
We were given a chance to introduce market-based banking legal framework in the shortest time possible.”

The Law on the NBK, drafted by the NBK finally enshrined its independence from both the parliament and the government, at the same time requiring that the NBK coordinated its activities with the latter, particularly with the Ministry of Finance. The government, despite its reformist credentials, was not enthusiastic about NBK’s independence. After Nazarbayev signed the law, Prime Minister Akezhan Kazhegeldin insisted that it should be amended with a provision that would allow the government to veto NBK decisions and insisted that the government should have a majority on the NBK Board of Governors. Again, President Nazarbayev sided with the NBK reform team and rejected any revisions in the law.

The government also objected to the principle of banking secrecy, which was introduced in the 1995 Law on Banks and Banking since it wanted to continue to have access to information about personal and business accounts. Various ministries and government agencies (e.g., customs, tax service, etc.) pushed forward laws and adopted normative documents that allowed their agents to demand information from the banks. The NBK attempted to reconcile its differences with the government through the process of legal harmonization required when a new legislation is introduced. The NBK reform team drafted a law “On changes and additions to certain laws of the Republic of Kazakhstan concerning banking secrecy” to eliminate all the discrepancies in the Kazakhstani legislation and uphold the principle of banking secrecy. The law was met with opposition on the part of the

---

108 Marchenko (2008), chapter 7, loc 2131.
government. Once again the NBK reform team appealed to Nazarbayev who sided with the reformers and signed the Law.\textsuperscript{109}

Frequent conflicts with the parliament and the government did not mean that their relations with the NBK team were always adversarial. The parliament elected in December 1995, which was in session until 1999, was attuned to the need of speeding up the reforms and supported all legislative initiatives put forward by the NBK. In 1997, for example, three laws on the structure of the securities market were adopted in 45 minutes. In part, relations with the parliament improved with Daulet Sembayev’s appointment to the Senate on January 11, 1996, and his election as the Chairman of the Committee on the economy, finance and budget.\textsuperscript{110} In that capacity, he was instrumental in shepherding financial sector legislation through the Senate, often co-authoring it with his former deputies, who succeeded him as the Governors of the NBK. Better relations with the government could be explained by the appointment of increasing numbers of the technocratic reformers as ministers and senior government officials who belonged to the same generation as the NBK reform team.

Above all, throughout the 1990s the relations with the reformers in the government, who were entrusted with reforming other economic sectors, and the handpicked parliamentarians “improved” because the latter saw that whenever disputes occurred President Nazarbayev always took the side of the NBK reform team. The awareness of Nazarbayev’s support for the NBK reformers among government officials and parliamentarians was such that despite their objections to NBK’s actions and various legislative initiatives, they felt no other option but to agree to them.

\textsuperscript{109} Marchenko (2008), chapter 12, “Sistema strakhovaniya vkladov,” loc 3932.

\textsuperscript{110} In accordance with the Constitution of Republic of Kazakhstan, the President directly appoints 15 out of 47 senators.
A telling example was the November 1996 Law on additions and changes in the banking legislation introduced by Jandosov, who succeeded Sembayev as the NBK Governor, following the crash of KRAMDS bank, the first major bank to go under in Kazakhstan. The basic novelty of the law was the right given to the NBK to mandatorily buy back shares from shareholders and immediately sell them at the same price to a new investor. At least two conditions had to be met before the NBK could exercise this right – the bank should have negative capital and there should be an investor who would be willing and able to buy those shares.

Konstantin Kolpakov, the Minister of Justice, who presented the law in the Senate referenced its legality to article 86 of the Civil Code, which stipulated that to make such a decision the NBK would have to use international formulas to calculate the negative capital, which would then have to pass legal expertise, following which it would sell shares, coordinating the sale with the government, at the same price it bought them to exclude financial interest on the part of the NBK. When the senators raised the issue of the inviolability of the private property enshrined in the Constitution Kolpakov retorted that the collapse of a bank subjects its individual depositors, businesses, and the state budget to injury and financial loss. The Minister of Justice even claimed that the state should have the right to interfere in the affairs of private entities.¹¹¹

Some senators have questioned the constitutionality of the article 86 of the Civil Code and the proposed law, arguing that the NBK took upon itself the function of a court. Nonetheless, following a heated discussion, the senators – no doubt mindful of Nazarbayev’s

¹¹¹ Konstantin Kolpakov, who was the Minister of Justice in 1995-1997, later became Deputy Governor of the NBK (2000-2002) and held senior executive positions in several Kazakhstani banks before immigrating to Russia.
unequivocal support for the NBK reform team — cast their votes in favor of the law, at the same time allowing the Chairman of the Senate to submit the law to the Constitutional Council to check its legality, which he never did.\footnote{Gulnara Rahmetova (1996). “Zdorovye banki, vas proyat ne bespokoitsya.” \textit{Kazakhstanskaya pravda}, November 15.}

4.5. Reforming the banking sector

In introducing the legal framework, laying down the institutional foundations of the banking system in Kazakhstan, and asserting the NBK independence, the reform team did not shy away from an open conflict with the parliament and the government, being assured of President Nazarbayev’s backing. Its strategy of creating the second-tier banking system in Kazakhstan was to avoid confrontation with the banking community and rely more on consensus-building in reforming the sector. The reformers faced three challenges vis-à-vis the second-tier banks and the bankers — introduction of the new legislation and normative acts, stamping out Soviet-era banking practices, and strict enforcement of the new laws to uproot predatory behavior, opportunities for which were rife in the first years of transition.

The reality was that most of the second-tier banks in the first years after independence were SOE affiliates and depended on direct credits to the economy, which explained their support for the red directors who demanded an uninterrupted flow of the direct credits. The number of SOE affiliated banks continued to grow despite the establishment of a number of privately owned start-up banks, which also largely depended on direct state credits. In 1992-1995, over 70 new state-owned banks were founded in Kazakhstan, the majority of which were 100% state-owned. In 20 banks, the state share was 24-33% and only a handful had less than 1% of state capital. The high number of the newly established state-owned bank is partly
explained by the fact that all 32 ministries that made up the Kazakhstani government at the time set up their own banks, mostly using monies allocated from the central budget to enterprises they supervised for prokrutka. According to Prime Minister Kazhegeldin, the involvement of the state-owned banks in the development of the real sector of the economy was next to zero, their credit portfolio was “shady,” and the only solution going forward was to privatize them.\footnote{Andrei Zhdanov (1995). “Kazakhstanskim investitsionno-privatizatsionnym fondam i bankam predstoyat dobrovol’nye preobrazovanya.” \textit{Kazakhstanskaya pravda}, August 23.}

It was the almost total dependence on the existing credit policy as well as the enormous scope of the reforms that forced the reform team to adopt a gradual and sequenced approach. Their objective was to turn bankers into their allies and supporters by persuading them in the need for radical reforms rather than confronting them.

The goal of the reformers, which they outlined in the March 1995 short-term reform program, was to create the following structure of the banking system in Kazakhstan by the end of the year: a total of 10-15 relatively large banks (with capital of US$10 million or more) with their head offices in Almaty and branches covering provincial centers and other key towns; branches of foreign as well as joint banks with (mostly) single offices in Almaty (only banks with high Moody’s S&P, or IBCA’s rating were allowed to set up branches); several dozen relatively small banks (with capital of US$2-3 million) located in Almaty and some in provincial centers; non-banking credit establishments, Halyk Bank (the State Savings Bank), the Agroprombank system; three specialized state banks; and the Rehabilitation Bank.\footnote{“Bank Adopts Short-Term Reform program.” \textit{Panorama}, March 4, 1995. \textit{FBIS-SOV-95-050}, March 10, 1995, pp. 84-88.}
The reformers justified their push for having a small number of big banks by the need to have a stable banking system and banks, which could provide a wide variety of services. The objective of making the banking system stable as well as transparent was behind the requirement that banks become listed and trade their shares on the Kazakhstan’s stock exchange, which, in the minds of the reformers, would simultaneously contribute to the development of the stock market in the country.

In accordance with the program, the 100% state ownership of Halyk bank had to be restored through the buyback of its shares, the retail deposits that were open as of January 1, 1992, were to be indexed, and a plan for the bank’s step-by-step privatization was to be devised. The reformers advocated the establishment of the state-owned Agroprombank as part of the new system of financing the agro-industrial complex that would end private bank participation in a highly corrupt scheme of prokrutka of state funds in agriculture. Under the new system all budget subsidies to the agricultural producers would be accumulated in the Fund for the Support of Agriculture and channeled to them through the Agroprombank.

Five other specialized banks were to be set up – Eximbank (Export-Import Bank), the Development Bank of Kazakhstan, Zhilstroibank (the Housing Construction Bank) and the Rehabilitation Bank. The Development Bank of Kazakhstan was to provide long-term credits to investment projects in priority areas of the economy. Eximbank’s task was to fund exports that were “uncharacteristic for Kazakhstan (value-added and science-intensive products), and to provide insurance and guarantees for export credits and possibly foreign investments.”

The Housing Construction Bank was to provide credit for housing construction via a network of commercial construction organizations and introduce mortgage loans. The Rehabilitation

Bank was designed as a “hospital for problem enterprises.” The bank, in consultation with the World Bank, was to select a consultancy firm that would choose 30 to 40 major enterprises that the bank would then attempt to revitalize, restructure, privatize or liquidate.

4.6. Introduction of the new legislation and normative acts

The reformers approached the legislative reform, supervision of bank operations, and enforcement of the banking laws and regulations through consulting with the banking community rather than imposing their will on it. They could have easily had the draft law on the Banks and Banking, which they authored, signed as one of the Presidential Decrees with Force of Law by Nazarbayev in March 1995, as had happened with the Law on the NBK. Yet, the reformers decided first to discuss the Law on the Banks and Banking with the banking community and seek their input and approval. As a result, the Law was signed by the president in August.

When the draft law was presented to the banking community in the early 1995 it was overwhelmingly rejected. The bankers argued that if the NBK went ahead with it, it would be better to close all private banks and restore the state-owned banking system. Toktarkhan Kozhagapanov, the Chairman of the board of Turanbank, for example, objected to supervision of the second-tier banks by the NBK. He claimed that “The key element of the democratic society – economic freedom of commercial banks, i.e., second-tier banks, is absent from the draft laws. On the contrary, the draft laws contain provisions to solidify the possibility of heavy-handed intervention in the day-to-day operation of commercial banks.” He opposed
regulatory norms set by the NBK, such as the increase in the charter capital, arguing that the Supreme Soviet should set the norms, not the NBK.\textsuperscript{116}

Such sentiments, in Marchenko’s view, were caused by the lack of understanding of how banking worked in a market economy. To change the attitude of the bankers to the draft law the NBK team held meetings two or three times a week at which they familiarized the banking community with the banking laws of Britain, France, Germany and other countries with developed banking systems. There was a lot of discussion, but the Kazakhstani bankers realized that norms and regulations stipulated in the law were not invented by the reform team, but were standard practice in countries with developed banking systems. As a result, the law that was negotiated with the banking community and signed by Nazarbayev saw practically no changes.\textsuperscript{117}

The team adopted the same gradual approach vis-à-vis all other reforms, such as for example, the introduction of international banking standards. The decision to introduce Basel I prudential norms, which contained the guidelines for setting up effective banking supervision and licensing of banks, and which specified prudential norms, including the minimum capital requirement to minimize credit risk, etc., was made in January 1995. After consultations with the banking community a memorandum – the legal position of the NBK on the order of transition of the Kazakhstani banks to international standards was adopted in December 1996.

Among the first Basel I norms introduced was the minimum capital requirement, which in Kazakhstan was set at 12\% instead of 8\% stipulated by Basel I. That was done to


\textsuperscript{117}Marchenko (2008), chapter 7, loc 2215.
consolidate the banking system by weeding out problem banks. To meet the requirement the banks were given from six months to a year. As a result of the adoption of international standards, 30 to 40 banking licenses were withdrawn annually in 1995 and 1996. Starting in 1995, the NBK practically stopped issuing new banking licenses. Simultaneously, the NBK introduced mandatory audit of all banks by the Big Five accounting firms and the requirement that the banks be listed on stock exchange. All these requirements were introduced to mutually reinforce the transition to Basel I and International Financial Reporting Standards (IFRS), increase transparency and adopt best practices.

The introduction of Basel I was impossible without simultaneous transition to IFRS. Introduction of both Basel I and IFRS was precipitated by the decision to stop financing state budget deficits though unrestricted monetary emission by the NBK, instead financing it by borrowing in international markets. To get access to international financial markets Kazakhstan had first to get a sovereign rating, which, in turn, required the introduction of IFRS. The introduction of IFRS was needed to ensure sufficiency of capital liquidity and quality of assets, and to maintain high standards of management and accounting, as well as of information collection and dissemination. Kazakhstan achieved that goal in November 1996, receiving a Ba3 rating from Moody’s, BB- from Fitch, and BB+ from S&P, and thus becoming the first CIS country to get a sovereign credit rating. Following that, Kazakhstan launched a US$100 million issue of Kazakhstani Eurobonds, becoming the first CIS country to enter the international securities market. Later, in 2002, when Moody’s gave Kazakhstan its first sovereign debt rating (BB+), it once again became the first CIS country to get an investment-grade rating.
Transition to IFRS started in 1994 and was formalized into law by the Presidential Decrees with Force of Law “On accounting” drafted by the NBK and signed by Nazarbayev on December 26, 1995. Transition was gradual: as an intermediary measure, Kazakhstani standards of financial reporting for second tier banks that incorporated some IFRS norms were introduced at the end of 1997. The transition ended in 2003 when the banking system adopted all the IFRS norms. The EU completed its transition to IFRS in 2005.

The same strategy was applied to the introduction of deposit insurance for individual depositors. Having started discussion with the banks in 1995, the NBK established the Kazakhstani Deposit Insurance Fund (KDIF) on November 15, 1999, while the deposit insurance system was introduced in 2000. As Oraz Jandosov explained, FDIC-type guarantees could not be introduced because the banking system was not “quite healthy” or stable. Under those circumstances, the government could not afford to take such obligations because of a potential severe blow to the state budget. Healthy banks were not willing to risk their capital either to support risky behavior by their colleagues. The banking system had first to be stabilized and the problem banks weeded out before deposit insurance could be introduced.\(^{118}\)

The banks were given a specific timeframe to join the system, and failure to do so entailed the withdrawal of their license to work with retail depositors. Finally, in 2006, a law was passed that made participation in the deposit insurance mandatory for all second-tier banks. Though the NBK is the sole shareholder and operator of the KDIF, its board also includes representatives of the Ministry of Finance and the Association of Financiers of Kazakhstan (FSA). Moreover, the NBK established a consultative council, which consists of second tier bank representatives, who provide the KDIF with valuable feedback.

In pursuing their legislative and normative reform agenda, the NBK reform team engaged the banking community through the FSA, which would become standard practice. The Association served not only as a discussion platform and a feedback mechanism, but also provided a platform for alleviating and mediating concerns the bankers had about the reforms and the steps taken by the NBK to implement them. The age factor played in reformers’ favor. The newly created second tier banks attracted mostly young people who were not socialized into the Soviet banking practices. They were open to learning new things and thus were supportive of the reforms.

Another factor was the “network dividend.” The reform team members (Damitov, Jandosov, and Marchenko) and the leading bankers, such as Nurzhan Sudkhanberdin, Yerzhan Tatishev, Mukhtar Ablyazov et al., were friends since their student days in Moscow. Moreover, Oraz Jandosov was among the founding shareholders of Kazakhstan Kommerts Bank, which later became as Kazkommertsbank (KKB), the leading start-up bank in Kazakhstan.119

4.7. Stamping out Soviet-era banking practices

NBK’s gradual and consensus-based approach to reforms, its desire to proceed through conversion of skeptics and opponents to the cause of the reforms can be best illustrated on its handling of credit policy. Instead of proselytizing and preaching to the nonbelievers, the reform team decided to adopt a learning-by-doing approach and make the government and the banks experience first-hand the consequences of the Soviet-era policy of direct credits to the economy.

119 When in 1993 Jandosov became Deputy Governor of the NBK he sold his shares in KKB.
First, the NBK announced that it could not evaluate creditworthiness of individual enterprises and that it would only determine credit quotas in consultation with the IMF. It argued that it was the task of the Ministry of Economy to determine which enterprises would get credit and its amount, and then to distribute them. The only condition set by the NBK for its continued involvement in crediting the economy was that the Ministry took full responsibility for the credits, and in case of default the NBK would deduct the corresponding sum from the Ministry’s account at the NBK. The government, which was in favor of continuing the policy of direct credits to the economy, agreed. At the beginning of 1995, when the SOEs were able to pay back only 22% of credits, the government of its own will decided to put the end to the policy of direct credits to the economy, i.e., supported the original position of the NBK on the issue.

For the second-tier banks, the NBK instituted the mechanism of credit auctions also based on the quotas agreed with the IMF. The banks were then free to issue credits to any economic sector or actor. At the auctions, bidding for the limited number of available credits drove annual interest rates as high as 338%, while the annual rate of inflation was only 63% in 1995. As was the case with the SOEs, albeit on a lesser scale, a number of banks could not repay back the loans and went bankrupt. That served the intended purpose sought by the NBK. On the one hand, the banks realized the perils of imprudent credit policy. On the other, they learned that they could not finance their operation with easy money, but should attract deposits of the population and enterprises and issue loans based on that. As a result, the demand for auction credits dropped significantly. Next, the NBK introduced Lombard credits
as a new instrument to help the banks stand on their feet.\textsuperscript{120} The NBK accepted only state securities as a guarantee for issuing credit.

The outcome for the banks was similar to that with credit auctions and by 1996 the NBK’s involvement in direct credits to the economy was history. The reform team achieved the desired outcome without direct confrontation with the government, SOEs, or the banks. All three arrived at the same conclusion based on their direct negative experience.

4.8. Enforcement of the new legislation and uprooting corrupt practices

Hard as the introduction of the new legislation and international standards and uprooting Soviet-era banking practices were, prevention of the new forms of predatory behavior and corrupt practices born out of the chaos of the first years of transition to market economy from taking root and enforcement of the new banking laws were even harder.

The main obstacles were the lack of the oversight capacity at the NBK, the poor quality of accounting and financial disclosure, which hampered the ability of the NBK to analyze and monitor the financial conditions of the banking system, and the partial effectiveness of the new laws and regulations. The latter was limited for two reasons. First, their effectiveness was undermined by the deficiencies in accounting and reporting. Second, “if full compliance with the capital requirement and the loan loss provisions had been required, the majority of the banks in the banking system would have had to be closed.”\textsuperscript{121} As a result, the NBK reform team had to pursue a gradual approach to reform by exercising

\textsuperscript{120} Lombard credit is credit issued to banks against pledged items, mostly in the form of securities, and thus is a secured credit.

\textsuperscript{121} Hoelscher (1998), pp. 16-17.
supervisory forbearance, while requiring the banks to develop a plan to show how the new requirements would be met within the five-year period.

In the meantime, the banks became the instruments for all sorts of fraudulent behavior by the colluding interests of their managers, owners, government officials, and the businessmen. Banking fraud reached such a scale that Sergei Tereschenko, the first Prime Minister of independent Kazakhstan, exclaimed: “It seems that the degree of corruption and the scope of economic crimes in the banking sector is unparalleled.” \(^\text{122}\)

A good example is the activities of the state-owned Alembank, which was part of the Alemsystem financial-investment corporation, created to attract long-term investment in the country and channel foreign loans secured by the government as credits into the real sector of the economy. Instead, under the leadership of Berlin Irishev Alembank became engaged in privatization of government-guaranteed loans. In April 1993, for example, Alembank issued a US$8 million loan to the Ansat trading house based in the Pavlodar province to create within one year a merchant fleet … in a landlocked country! One of the vice-presidents of Ansat was Kanat Zhabagin, brother of Asygat Zhabagin, ex-governor of Pavlodar province who in January 1993 became deputy Prime Minister. In accordance with the government scheme, the central government, the local government, or a local export company was the guarantor of the foreign loan. In the case of Ansat, the Yermakovsk metallurgical plant became the loan guarantor to Alembank because it was located in Pavlodar province. Ansat bought three ships, one registered in St. Vincent and Grenadines, the other two in the Bahamas. The ships were so old that they needed extensive repairs. After they were sent to different ports in different countries to undergo repairs, their traces were lost.

In 1994, Asygat Zhabagin left the government and became the CEO of Ansat. Claiming inability to pay back the loan, the company transferred the ownership rights of the ships to Yermakovsk metallurgical plant, which had already gone bankrupt. Alembank the attempted to debit the Yermakovsk foreign currency account, which had only US$ 320,000 by the summer of 1995 it. In the end, Alembank became responsible for the loan and interest, which by July 1995 were equal to US$10 million.

The Ansat project was not the only case of defrauding the state that was handled by Irishev who often signed credit agreements without any legal assessment of the project, approval of the bank credit committee, or a collateral agreement. As a result, when in July 1995 the government put Alembank in conservatorship for the first time, its non-performing loans reached US$100 million. When on January 15, 1997, Alembank was declared bankrupt it was the government and partly its shareholders who had to pay off its debts.123

Summing up this period in the history of Kazakhstan’s banking sector, Prime Minister Kazhegeldin stated the following: “I can’t say that absolutely all credits went down the drain and were used for nothing. [Yet] only about a dozen of enterprises are in a position to repay the credits. As for the others, we won’t be able to find anything.”124

As NBK’s supervisory and enforcement capacity grew, the reformers were able to close down shady and insolvent banks and crack down on their predatory behavior, gradually achieving greater compliance with the new laws and regulations (see Table I). To ensure access to financial services by the population in all parts of the country, the NBK set up micro-credit organizations and then credit associations to replace liquidated regional banks.


Table 1. Violation of prudential norms and regulations, 1993-2001

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of banks</th>
<th>Number banks with violations of prudential norms</th>
</tr>
</thead>
<tbody>
<tr>
<td>1993</td>
<td>210</td>
<td></td>
</tr>
<tr>
<td>1994</td>
<td>184</td>
<td></td>
</tr>
<tr>
<td>1995</td>
<td>131</td>
<td>65</td>
</tr>
<tr>
<td>1996</td>
<td>101</td>
<td>36</td>
</tr>
<tr>
<td>1997</td>
<td>82</td>
<td>52</td>
</tr>
<tr>
<td>1998</td>
<td>71 (23 with foreign ownership, 1 state)</td>
<td>30</td>
</tr>
<tr>
<td>1999</td>
<td>55 (22 with foreign ownership, 1 state)</td>
<td>17</td>
</tr>
<tr>
<td>2000</td>
<td>48 (16 with foreign ownership, 1 state, 1 interstate)</td>
<td>15</td>
</tr>
<tr>
<td>2001</td>
<td>44 (16 with foreign ownership, 2 state, 1 interstate)</td>
<td>6</td>
</tr>
</tbody>
</table>

Source: *NBK Annual Reports, 1993-2001*

Closing down state-owned banks not only was not easy, but it also posed risks to personal security of the NBK reform team. As Daulet Sembayev recounted, when the NBK board of directors decided to withdraw license of the Ministry of Interior bank in early 1994 he was personally threatened by the ministry’s senior officers. That prompted President Nazarbayev to detail his personal bodyguards to protect the Governor of the NBK while his deputies had to carry guns to protect themselves for most of 1994.¹²⁵

¹²⁵ Interviews with Daulet Sembayev (June 20, 2001) and Grigoriy Marchenko (July 14, 2001).
4.9. The 1997-98 financial crisis

When the Russian banking sector and the ruble collapsed in August 1998, it was generally expected that Kazakhstan would follow suit. Yet, instead of devaluing tenge (KZT), which would have benefited local producers whose assets were denominated in local currency but also would have made low-income groups suffer, NBK chose to tighten its monetary and credit policy, which transferred the pain to banks and local producers instead. In doing so, Kazakhstan decided to pursue a policy different from that chosen by Russia to deal with the aftermath of the crisis. The decision not to devalue tenge simultaneously with the ruble and stall it for as long as possible, was driven by a political consideration: to instill in the minds of the international business community and global financial markets the idea that the Kazakhstani financial system was independent of Russia and that Kazakhstan’s economic situation was better than Russia’s. The latter was reflected in the fact that the sovereign credit rating of the latter was at the time lowered to C, while Kazakhstan enjoyed a BB rating.

Yet, NBK’s policy pursued contradictory goals. In addition to the stringent monetary-credit policy that should have imposed capital losses on the banks, NBK wanted to “protect the financial sector of Kazakhstan.” As a result, NBK adopted policies that resulted in banks speculating with foreign currency and state securities, which led to capital flight from the real sector of the economy and exacerbated the problem of non-payments, destabilized the national currency exchange rate, and increased interest rates on bank loans.

In other words, instead of preventing predatory behavior and promoting the growth of financial intermediation, NBK’s attempts to protect the banking sector achieved the opposite

---


effect. Thus, NBK increased its refinance rate to 25%, which led the banks to increase their
interest rates on loans to 30-35%, putting them out of reach for enterprises and businesses in
the real economy. Dollarization and the high profitability of foreign currency operations (up
to 300%), on the one hand, and high risk and low profitability of investments in the real
sector (less than 10%), on the other, exacerbated the flight of capital from the real sector and
disintermediation. The share of foreign currency in the banking sector deposit base increased
from 47% in 1997 to 56% in 1998. Dollar speculation, which led to a de facto 15%
devaluation of the tenge (US$1/KZT90), prompted NBK and the government to demand that
all commercial banks stop speculation on the currency market and set a ceiling on the
exchange rate (US$1/ KZT85). That, however, was a stopgap measure and in April 1999 NBK
and the government had to devalue the tenge.

A similarly misguided policy that encouraged the banks to continue with their
predatory behavior was the policy adopted by NBK and the government of promoting GKO
(gosudarstvennye kaznacheiskiye obligatsii, i.e., state securities) in an attempt to jump-start
the securities market in Kazakhstan. Foreign currency operations were more profitable for the
banks than the GKO, so there was little interest on their part in dealing in them despite the
fact that by law the banks were the only legal entities which could buy and sell them. The
government had no other choice but to increase the dividends paid on the GKO to 25-27 %
anually, because they became the only source of financing the budget deficit given the
reduction in foreign borrowing. The increase in dividends sparked the banks’ interest and they
resumed their operations with GKO, earning 300-400 % in profits (the annual interest on
retail deposits they paid out at the time was 5.6 % and 9.5 % on business accounts). As a
result, servicing the GKO’s cost the government KZT20 billion, while bringing in only KZT10 billion (approximately US$115 million).

Having made the point that Kazakhstan’s financial system was independent from Russia’s, NBK devalued the tenge by introducing the floating exchange rate on Sunday, April 4, 1999, which before the devaluation was KZT 87.5/US$1. On Tuesday, April 6, it fell to KZT138.5/US$41, i.e., losing about 22.4 % of its value, but by Thursday it stabilized at KZT110/US$1 (buy) and KZT130/US$ 1 (sell). To prevent the flight into dollars as well as their shortage, the government introduced a mandatory sale of 50% of foreign currency earnings for enterprises and big businesses that contributed to quick stabilization. It lasted until October 1999.

To prevent panic and a run on the banks, the government and NBK offered depositors a 100% conversion rate of KZT accounts into US$ accounts at KZT88.3/US$1, i.e., at the pre-devaluation exchange rate, if the depositors would not withdraw the money for nine months. As a result, as Karim Masimov, the CEO of Halyk Bank, which held 67% of all retail deposits, stated the situation remained calm and “no flight of money had been registered.” Despite these measures, the overall rate of depreciation of tenge against the American dollar in 1999 was 65%.

4.10. *The rise of Kazkommertzbank*

NBK’s success with reforming and enforcing the new banking laws and regulations did not lead to the establishment of the level playing field for all second-tier banks. In September 1995, President Nazarbayev draw attention to the fact that “clearly the banking

---

system needs to be reformed and law and order should be established there, but not based on the principle of creating favorable conditions for certain (отдельных) banks, [facilitating] their mergers and acquisitions.”

The above statement was especially applicable to Kazkommertsbank (KKB). It was one of the first privately owned startup banks established in 1990 by Oraz Jandosov, Sauat Mynbayev, Nurzhan Subkhanberdin, and Nina Zhusupova. By 1995, KKB had emerged as the biggest private bank providing commercial banking services to large and medium-size companies. KKB’s fortunes were inextricably connected with the political ascent of its co-founding shareholders who provided the bank with profit-earning opportunities and protected it from severe penalties for repeated violations of the banking law and regulations.

The two founding shareholders in question were Jandosov and Mynbayev. Jandosov, who had been a Deputy Governor of NBK since 1994, became its Governor in 1996. In 1998, Nazarbayev appointed him the First Deputy Prime Minister and the Chairman of the State Investment Committee. In 1999, he was appointed Minister of Finance. Mynbayev was Deputy Chairman of the Board of Directors of KKB until 1995 when he was appointed Deputy Minister of Finance and Head of the Treasury. In 1998, he became Minister of Finance and in 1999 Deputy Head of the President’s Administration. Thus, both Jandosov and Mynbayev share the responsibility for adopting the GKO policy that cost the state approximately US$115 million and let the banks reap the profit in the same amount.

Despite the fact that Jandosov sold his shares in KKB, he was viewed by many in Kazakhstan as one of the chief lobbyists for the bank and accused of “constructing various

schemes benefitting KKB.” The sentiment was echoed by Nurbulat Masanov, one of the leading Kazakhstani political scientists, who asserted that: “The bank does not exist as an independent autonomous institution. It leaders are situated in the government and presidential administration. That’s how it became the number one bank in Kazakhstan... Officials ... are now lobbying the bank’s interests in the government ... Many accounts of state companies are registered with the Kazkommertsbank.”

The lobbying and schemes in favor of KKB were often pursued in a clear violation of the 1995 Law on Banks and Banking. While the law allowed the banks to establish bank holdings that could include insurance, brokerage, leasing, and asset management companies as well as pension funds, it prohibited the banks to engage in entrepreneurial activities or become shareholders in non-banking legal entities (Article 8). Exception was made for specially approved cases when a bank became the owner of a legal entity through prior transfer of its shares to the bank as a collateral and subsequent bankruptcy of the entity or its inability to repay the loan. Even then the bank could own not more than 10% share in the enterprise.

Thus, unlike in Russia, the 1995 law prohibited the formation of financial-industrial groups (FIGs) despite the fact that Kazakhstan signed and ratified the 1994 CIS agreement on creating transnational FIGs. The idea to create FIGs was abandoned prior to the adoption of the 1995 banking law as a result of the decision to either sell or transfer industrial enterprises in trust management to foreign investors. Many, including Prime Minister Kazhegeldin, were...

---

130 Interview with a Kazakhstani government official, June 14, 2001.

advocates of the FIGs and wanted to allow the banks be part of them. The banks opposed the idea and supported the prohibition on their participation in the FIGs stipulated in the 1995 banking law.

KKB, however, was an exception. Using its connections in the government, it was allowed to circumvent the law and form a de facto bank-led FIG.\(^{132}\) To illustrate how it happened we can take just one day in the life of KKB in the 1990s, May 12, 1995. That day the Cabinet of Ministers adopted two decrees that benefited KKB despite the fact that the bank lacked expertise to perform the tasks outlined in the decrees. The first decree appointed KKB as the government consultant to develop a strategic program of privatization on the “individual basis” of the Yermakovsk metallurgical plant and Pavlodar oil refinery, as well as to evaluate the investment value and to set up a tender of the latter.

The second decree appointed KKB as government representative in a two-member group of consulting firms (the other was to be appointed by the EU) that dealt with rehabilitation and privatization of 11 oil and gas companies on the same “individual basis.” Since their privatization had already begun, the State Committee on Privatization was ordered to stop it. The companies included Mangystaumunaigaz, Kazakhstankaspishel’f, Kazakhgas, Pavlodar and Atyrau oil refineries, etc.\(^{133}\) Acting as a consultant in privatization on the

\(^{132}\) The only legal exception to the prohibition on bank participation in a FIG is the case of Alexander Mashkevich-led Eurasian group. The group was allowed to establish a FIG because of its non-resident status. The core of the group holdings, which includes Eurasian bank, are metallurgical companies, including Kazchrome, Aluminum Kazakhstan, Eurasian Electric Company, etc. The group also owns ExpressK newspaper. In 1998, it was allowed to establish and sponsor Civic party, a pro-government party of the nascent capitalist class.

\(^{133}\) “Kazkommertsbank naznachen konsultantom pravitel’stva po individual’noi privatizatsii Ermakovskogo ferroplavnogo zavoda i predpriyatii neftegazovoi otrasi.” Panorama, No. 21, May 1995, p. 7. In a twist of irony, the same issue of Panorama featured an article on Leczek Balcerowicz’s visit to Kazakhstan and his meetings with Nazarbayev, Kazhegel’din,
“individual basis” schemes allowed KKB to acquire significant stakes in these companies and enterprises that were privatized, including Shymkent oil refinery, Jambul hydropower station, Atyrau thermal power station, Alatautransgaz, etc.

KKB also became one of the beneficiaries of the November 1996 Law on additions and changes in the banking legislation introduced by Jandosov, which allowed the NBK to mandatorily buy back shares from shareholders of a collapsing bank and immediately sell them at the same price to a new investor. Using the law, KKB managed to buy 20% in ABN Amro Bank Kazakhstan, the largest foreign bank in the country, which had previously belonged to KRAMDS bank, itself declared bankrupt in 1996.

Another example of using its government connections is the story of how KKB thwarted the foreign-led modernization of the telecommunications sector in Kazakhstan by subverting the agreement signed on August 14, 1996, between the Government of Kazakhstan and Deutsche Telecom (DT) on the transfer of 49% shares of Kazakhtelecom (KT) shares to DT. The government had invited DT to become a strategic investor to develop telecommunications industry in the country. Global Kazkommerts Securities, an investment arm of KKB, was appointed as government consultant in privatizing KT and signed the customary non-disclosure agreement. Yet, in October, after an apparent sharing of information with KKB, the latter succeeded in having the government transfer KT under the financial management of KKB. On November 10, 1996, the bank appointed Serik Burkitbayev as the CEO of KT. Nine days later, Burkitbayev transferred all KT bank accounts from Kazpochta Bank, where KT was a majority shareholder (47% shares), to KKB, resulting in the bankruptcy of Kazpochta Bank because 80% of its deposit base were deposits of KT and its affiliates.

et al., where he warned against privatization on ‘the individual basis’ as ineffective and prone to corruption.
On May 31, 1997, KKB succeeded in having the contract with DT cancelled. It then advised the government to sell 40% of its shares to Daewoo (Republic of Korea). In February 1998, Daewoo sought the assistance of Global Kazkommerts Securities in selling its shares in KT. In violation of the 1995 law, 30% of the shares were sold to a company affiliated with KKB, the remaining 10% to foreign investors. Following that transaction, KT and KKB announced that they would sell the KKB shares to a foreign strategic investor with experience in the development and management of a telecommunications company, which DT had been ready to become years before. After Serik Burkitbayev became the Minister of Transport, Communications and Tourism in September 1998 the idea to sell KT shares to a strategic foreign investor was abandoned “out of national security concerns,” leaving KKB 30% stake in the company.

The most incredible part of this story, however, was that in October 1996, when the government decided to transfer KT under KKB financial management, the bank was in critical condition and on the verge of bankruptcy, the conclusion reached by NBK in its supervisory review. The review gave the an overall CAMEL 4 rating based on its ‘negative’ KZT592 million capital and on the fact that classified (in danger of default) and nonperforming loans that equaled 142% of KKB’s total capital. The NBK team also recorded systematic violations


135 “Kazakhtelekom To Be Sold Only In Event Of Budget Melt-Down.” Interfax International, 26 April 1999.

136 That accidentally explains why it was necessary to transfer KT accounts to KKB, bankrupting Kazpochta bank in the process, and delay the December payment on the German loan until August 1997. KKB indeed needed to “to maintain the end-of-the-year balance of KKB” to avoid bankruptcy.
of the banking laws and regulations across the entire spectrum of bank’s activities, including submission of false data, issuing credits to affiliated persons, and the virtual control of the bank by Nurzhan Subkhanberdin and Nina Zhusupova, two founding shareholders of KKB, each owning 38.5% of shares, without the required permission of the NBK. Given a highly negative assessment of the performance of the top managers, including Subkhanberdin and Zhusupova, the NBK supervisory team recommended their removal from the management of KKB.\footnote{Interview with Nina Savitskaya, June 25, 2001. See also Nina Savitskaya (1998).}

Nevertheless, Subkhanberdin and Zhusupova had no reason to be alarmed. They knew they could rely on Jandosov, the NBK Governor at the time, to protect them. Indeed, instead of removing his onetime associates from managing KKB, Jandosov fired the head of the NBK Bank Supervision Department, allowing the KKB management continue with their high-stake high-risk management style and enjoy government protection and favoritism.

Yet another example of such favoritism was the government decision to transfer 50% of its shares in Air Kazakhstan, the national carrier, to KKB in 2000 to repay its debt to the bank, and to put the other 50% of Air Kazakhstan shares into trust management. The rationale behind the decision was that the government could not be an effective owner and manager of an airline and that a private investor would have a positive effect on the company.\footnote{Vitaliy Voloshin (2000). “Solo With No Rules-3.” \textit{Kontinent}, No 22 (35), pp. 20-21.} Leaving aside the issue of whether a commercial bank could be a more effective owner and/or manager of an airline than the government, the decision was problematic. KKB had already been the trust manager of Kazakhstan Auye Zholy, Air Kazakhstan’s predecessor, which the bank, acting both as a trust manager and a consultant, had helped to restructure into Air Kazakhstan.
in 1996. Moreover, in spite of the apparent management and financial problems (the airline accumulated a debt of US$3.5 million by 2000), KKB continued to extend loans to the airline, which accounted for a considerable part of the bank’s credit portfolio.

As Oleg Kononenko, KKB managing director, admitted, the transfer of 100% of Air Kazakhstan shares effectively meant its privatization by KKB, for mere US$3.5 million. Kononenko revealed that KKB’s interest in acquiring control over the airline was to sell it to a strategic investor following its financial rehabilitation. “What we as a bank cannot do in principle is to create a profitable airline. Because we are bankers and not aviators we simply do not know how it is done.” Indeed, after the 2000 takeover, the bank did not replace the top management of Air Kazakhstan because, as Kononenko argued, “We worked with them as borrowers for a long time and if we did not have trust in them we would not have extended loans to Air Kazakhstan.” As a result of the “financial rehabilitation” administered by KKB Air Kazakhstan was declared bankrupt in April 2004.

By the turn of the 21st century, KKB had become an owner of significant stakes in the largest companies in the oil, gas, airlines, telecommunications and chemical industries, and railways. It was able to put its own people in positions of power in the government and the national economy. Apart from Jandosov and Mynbayev, those included Yevgeni Fel’d, KKB managing director, who was appointed President of KEGOC, national electric utility company; Nurlan Bizakov, who became the CEO of Shymkent oil refinery, and others. An editorial in the Kontinent magazine summed up KKB’s economic and political clout as follows: “The brainchild of Nurzhan Subkhanberdin is one of the few legal Kazakhstani


140 Ibid.
businesses and, perhaps, the most significant. Unfortunately, there are but a few companies in our market that have history and reputation. If the economic policy in Kazakhstan had gone a different route, Kazkom [i.e., KKB] and other startups of the early 1990s could in reality have become a sort of Kazakhstani chaebols – the foundation and the engines of the growing economy. In any event, at present the Kazkommertsbank empire does not have rivals in the country, either in influence, or in international stature. Subkhanberdin is the only one among the young business elite, who not only has not made any attempts to come (probit’sta) to power, but has never tried to become a public figure, preferring to use the under-the-carpet political moves. … [His] team has been consistent in achieving its strategic goals … and not [publicly] demonstrate its power… [They really excel at] “building relations and forming a team, which, by the way, includes public figures whose number the bank continues to increase.”

The fortunes of KKB were inextricably connected to those of Jandosov, Mynbayev and other young technocrats whom Nazarbayev entrusted with reforming the banking and other sectors of the Kazakhstani economy. As Nazarbayev stated later, he was aware of the ways and methods used by KKB and other banks to amass their capital (see Chapter IV below). However, he looked at their business practices as temporary and inevitable during the transition period. Therefore, the Kazakhstani president extended his support not only to the NBK reform team, but also to the leading banks, such as KKB, to facilitate the creation of the market-oriented banking sector which would in turn support Kazakhstan’s transition to market economy and its economic development.

4.11. The NBK reform team and the bank lobbying

Yet, the underhanded business practices of KKB and the backing the bank got from Jandosov and others on the NBK Board did not sit well with Grigoriy Marchenko, NBK Deputy Governor responsible for bank supervision. By the summer of 1995, Marchenko became fed up to the point that he submitted a letter of resignation to Daulet Sembayev, who delayed passing it on to President Nazarbayev for several months. Instead of accepting Marchenko’s resignation Nazarbayev called in a meeting with the banking community, at which he said the following: “I have only one thing to tell you – everyone should obey the law. That goes for the representatives of big banks, businessmen, and, by the way, my own relatives. Here is a man who is responsible for the banking supervision [i.e., Marchenko]. Provide him with the Kremlin phone [a direct line to the president, prime minister, and other top government officials], so that now, if any problem appears, he will call me directly. And I will personally support him in his efforts to clean up the banking supervision.” As Marchenko recalls, the next day, the top managers of KKB and other banks came to see him and promised to stop lobbying for decisions favorable to them. Needless to say, the top NBK managers who lobbied for those decisions [i.e., Jandosov] did not like that turns of events.142

The Marchenko-Jandosov conflict did not end there and reignited when Jandosov was appointed the NBK Governor in January 1996. Marchenko refused to serve as his deputy and submitted another letter of resignation, which was accepted. Following his resignation, Marchenko was appointed as the Chairman of the National Securities Committee. On October 18, 1999, Marchenko was appointed the Governor of the NBK and got another chance to introduce greater transparency in the banking sector.

142 Marchenko (2008), chapter 7, loc 2348-2361.
The key element in achieving that goal was the adoption of the law on consolidated supervision. The draft law presented in 2000 met with the opposition of the bankers, key economic actors, parliamentarians, and the press, which, as a rule, the former owned. In the opinion of the NBK and the IMF, both of whom referenced their arguments to Basel I, the introduction of consolidated supervision in Kazakhstan was needed because it provided the most effective way to supervise financial operations of the banks and affiliated companies, i.e., banking holdings, as well as the FIGs that de facto existed in the country, which would ensure stability of the banking system as a whole. Hostility on the part of the leading banks and the key economic actors was understandable: to limit the risks, the draft law proposed to restrict full-scale participation of banks in the FIGs and limit the rights of the majority shareholders, if banking was not their primary business. The draft law also contained a provision requiring affiliated persons and shareholders to undergo an annual audit to check the financial health of their non-banking businesses to prevent risks to bank stability. It also instituted limits on bank exposure to a single borrower or groups of affiliated borrowers and introduced other important prudential norms such as the minimal charter capital and the coefficient of capital adequacy.

One of the most controversial provisions was the right given to the NBK to suspend under certain circumstances bank operations, put the bank as well as its shares under the direct management of the NBK, withdraw its license, close down the bank without a court order, and launch criminal proceedings against top managers of the second-tier banks. At the same time, the NBK was held responsible for illegal actions vis-à-vis the banks.

---

The draft law was opposed not only by the banks, but also by Daulet Sembayev, Marchenko’s mentor and the leader of the NBK reform team, who, for the first time, publicly opposed Marchenko. By that time, Sembayev had become the Chairman of the Association of Financiers of Kazakhstan as well as the Chairman of the Board of Directors of KKB. The objections presented by Sembayev in his capacity as the Chairman of the AFK boiled down to the fact that certain provisions of the draft law either superseded Basel I recommendations or were absent from the recommendations altogether. In particular, the AFK challenged the provision that gave NBK the right to remove board directors and senior managers who were elected by bank shareholders on the grounds that it was absent from the Basel Committee recommendations and which, in the opinion of the AFK, created a slippery slope to abuse of power. Another objection was to the provision in the draft law that gave the NBK the right to sell shares of banks with “bad reputation” without clearly defining what “bad reputation” exactly meant.\(^{144}\)

Parliamentarians, like Senator Nusupzhan Nurmanbetov, while acknowledging that “The desire of the NBK to see everything that happens in the banks and affiliated structures is justified,” raised the issue of NBK’s capacity to conduct such supervision, do it impartially, as well as be held accountable for its actions.\(^{145}\)

Valentin Nazarov, one of the authors of the 1991 Law on Banks and Banking in Kazakh SSR, drew the following parallels between the reaction of the bankers to the introduction of supervision in 1991 and consolidated supervision in 2000: “The strongest

\(^{144}\) Objections of the Association of Financiers of Kazakhstan to the Draft Law on Consolidated Supervision. Personal copy provided to the author by Daulet Sembayev.

resistance on the part of the second-tier banks was to the provisions of the law that dealt with
the NBK’s supervision of their activities. That was quite understandable since after the
absence of any control on the part of the state even the elementary forms of control caused a
clear aversion. The situation resembles the current discussion of NBK’s proposals on the
introduction of consolidated supervision. The critics are the same – the founding shareholders
of banks and the bankers who do not want to disclose their activities to the state.”

Despite the united front of bankers, FIGs, parliamentarians, and journalists,
Marchenko got the backing of the one person who counted – President Nazarbayev, who once
again came to his rescue. At the August 11, 2000 meeting of the Cabinet, the president
criticized the bankers for their opposition to the adoption of the law and their attempts to
organize a lobby to influence the votes of the parliamentarians. At the opening of the Mazhilis
session on September 1, he named the adoption of the law as the top priority out of the six
draft laws that dealt with economic and financial issues. Referring to information that the
banking lobby created a slush fund to pay parliamentarians off, the president, though saying
that it needed to be verified, nevertheless threatened to disband the parliament if it refused to
adopt the law.

The Mazhilis obliged and Nazarbayev signed the law on March 2, 2001. When it came
into effect on March 12 there was no public reaction much less opposition on the part of the
bankers. Later in 2001, the NBK was granted power to supervise the insurance sector, which
was previously under the purview of the Ministry of Finance, followed by the securities

---

pravda, January 6.

Respublika, No. 19 (54), September 28.
market (after the National Securities Commission became an NBK department) and, in 2002, the pension funds which were previously supervised by the Ministry of Labor.

While Nazarbayev unequivocally supported the NBK and its campaign to reform the banking sector, clean it up, and introduce best international practices, as mentioned earlier, he also lent his personal support to the second-tier banks. He described his personal involvement in the development of the banking sector in the 1990s as follows:

“Many of these [bank] managers I know personally and many we have helped on their way and given them “a head start in life,” so to speak. It has not simply been a case of setting up second-level banks. The old system went on working: commercial enterprises, both privately and state-owned, and local budgets kept on taking credit and, making use of loopholes in the laws, failed to repay banks. Sometimes this created serious problems for banks. For instance, occasionally I personally had to help Kazkommertsbank, the People’s Bank [i.e., Halyk bank] and Turan Alem get their money back. It was like that then. They needed my personal support.”\(^\text{148}\)

Nazarbayev’s personal involvement in the development of the banking sector went beyond removing the hurdles to their growth domestically:

“Developing the banking system to comply with international standards was partly facilitated by the fact that at the start of the 1990s they virtually all accompanied me on all my foreign visits. They then had a chance to meet the ‘sharks’ of global business, gain expertise from leading world banks and companies, and use leading Western know-how in their work, adopting the principles of financial practice. Nowadays Kazakhstan banks have the highest ratings in the territory of the CIS. What matters most is that our present banking system is one of the most highly developed in the territory of the former Union.”\(^\text{149}\)

For Nazarbayev, the leading banks such as KKB and Turan Alem and the banking sector in general were not only the symbol of the success with market economic reforms he initiated at independence. To him, the bankers, whom he helped to stand up on their feet and emerge as the new economic elite, were the embodiment of the future of the country and the


\(^{149}\) Ibid., p. 235.
one elite group he considered to be firmly in his corner. While he was fully aware of their at times legally borderline and underhanded business practices, he also recognized that the banking sector was the only economic sector that underwent a radical transformation and embraced market economic principles and best international practices.

For that reason, he saw the bankers as the people whose practical experience he could tap into in reforming other sectors of the economy. At a meeting of the Cabinet on February 9, 2000, he came back to the idea of establishing FIGs in Kazakhstan, saying “We should think seriously about the creation of FIGs and, taking into consideration the experience of the banks in achieving effectiveness in their operation, we should widely involve them in managing the real sector of the economy.”

4.12. Conclusion

For President Nazarbayev, delegating the NBK reform team, which primarily consisted of young technocrats, the power to design and implement the banking sector reforms paid off as it became the only sector of the national economy that underwent radical reform and transitioned to market economy. The appointment of the NBK reform team members to senior government positions reflected his vision of the bankers as the leading force in reforming other economic sectors. Nazarbayev’s personal interest and involvement in the banking sector reforms led to the rise of the new business elite whom he regarded as the agents of change in other economic sectors and society at large.

For their part, the young technocrats on the NBK team and their cohorts, whom Nazarbayev appointed to senior government positions in the 1990s, popularly known as the “Young Turks,” as well as the bankers owed their newly gained prominence, power, and wealth to Nazarbayev. They were about the only “winners” of Kazakhstan’s transition to market economy. Their meteoric rise was furtively opposed by the traditionalist and Soviet-era political and economic elites (see Chapter VI). They also lacked social support: the Soviet-era middle class all but disappeared as a result of social dislocation caused by economic collapse and transition to market economy, which contributed to the negative image businessmen in general and bankers in particular had among the population.  

Thus, their bureaucratic power and the ability to implement market-oriented economic reforms rested on support extended to them by President Nazarbayev and the autonomy from the political opposition and social discontent he provided them. Hence, the NBK reform team as the technocratic reformers in other government agencies focused exclusively on the fulfilling the mandate given to them by the president – drafting and implementing reforms in their respective sectors of the economy. It did not mean they did not have views on what the political system in Kazakhstan should be. However, they reached an understanding with Nazarbayev that democratization of the political system would begin soon after the completion of the major economic reforms. The technocratic reformers – and their allies among the new business elite, including the bankers – kept their end of the bargain by

---

151 For example, there was a steady decline in popular support for private ownership of banks throughout the 1990s. In 1997, only 12% thought that banks should be privately owned compared to 17% in 1994 and 19% in 1992. See, “Declining Support for a Free Market and Privatization in Kazakhstan.” USIA Opinion Analysis, December 12, 1997.

supporting Nazarbayev’s term limit-free presidency and its growing authoritarian character, expecting that he would stick to his. For that reason, they did not support Akezhan Kazhegeldin’s bid for presidency in the 1999 elections despite shared views on many issues of socio-economic development of the country and the fact that he was a mentor to a number of them. The unexpected fallout of the criminal case against Kazhegeldin (see next chapter) and the rising political and economic prominence of Rakhat Aliyev, Nazarbayev’s senior son-in-law, would dramatically change their relationship with the president and the course of the banking sector reforms – and economic reforms in general.
Chapter V. Nazarbayev as a reformer (2001-2009)

“Political stability is what matters most. In Asian society discipline and order are more important than democracy, which has to develop over time.” This was the political credo of Lee Kwan Yew. I never concealed the fact that this approach appealed to me. “Economics before politics” was what I always used to say. I was criticized for saying so. But I had seen the disintegration of the USSR with my very own eyes, when politics had taken precedence over people’s prosperity and peace of mind.

Nursultan Nazarbayev, The Kazakhstan Way

5.1. Political upheaval in Kazakhstan

Despite the existence of opposition political parties throughout the 1990s, the real political turmoil in Kazakhstan began after Akezhan Kazhegeldin announced his decision to run against Nazarbayev in the January 1999 presidential elections; to form his own political party, the Republican People’s Party of Kazakhstan; and run on its ticket in the October 1999 parliamentary elections against Nazarbayev’s Otan (Fatherland) party. Kazhegeldin was disqualified from running in both elections. Yet, for some among the traditionalist elite that was not enough and they suggested to purge Kazhegeldin from Kazakhstani politics for good by opening a criminal investigation against him for tax evasion and financial fraud.

Many observers suspected that Kazhegeldin’s resignation as Prime Minister in October 1997 was not for health reasons, as officially announced, but was caused by his growing popularity among the elites and business communities inside and outside Kazakhstan, particularly in Russia, rooted in his leadership role in market economic reforms in the country. Even before his resignation there were calls in the Russian media arguing that
Russia and the West should bet on Kazhegeldin as the next leader of Kazakhstan because of his credentials as a western-style businessman and someone who eschewed clan mentality.\(^\text{153}\)

It is difficult to say whether Nazarbayev mistook the rising political clout and aspirations of his former protégé for a sign of disloyalty on the part of the nascent capitalist class, which he was instrumental in creating and from which he expected loyalty and political support. On the one hand, there were no reasons for such suspicions. The NBK reform team members and other technocratic reformers, such as Mukhtar Ablyazov, whom Nazarbayev started to appoint to senior government positions in the late Kazhegeldin period, belonged to a different generation than the prime minister. They did not show publicly any interest in politics before Kazhegeldin joined the opposition nor did they him when he directly challenged Nazarbayev’s rule.

On the other hand, Nazarbayev decided that relying exclusively on the coalition of “winners,” i.e., the younger generation of technocratic reformers and the new business elite, as his support base was not enough. He needed a more reliable and institutionalized support base than a loose coalition of his young protégés and their followers. After years of semi-neglecting party politics that followed the failure of his domestic politics advisors to create a strong pro-presidential party, he turned to Sergei Tereschenko, the first Prime Minister of independent Kazakhstan, to create such party.\(^\text{154}\) The latter delivered, consolidating several small pro-presidential parties into the Otan party, which in the October 1999 parliamentary elections won 30.9% of the votes. The other two pro-presidential parties, the Civic Party (businessmen and private sector employees) and the Agrarian Party, won 11.6% 12.6% of the votes.


votes respectively, creating a solid government majority in the new Mazhilis for the first time. Only one opposition party – the Communist party – was able to overcome the required 4% threshold to win seats in the Mazhilis. It won 17.6% of the votes.

At the same time, however, it was clear that Nazarbayev’s trust in the elites he promoted somewhat diminished, as he decided in favor of a greater turnover of the key government officials. If in 1991-1997 Kazakhstan had only two prime ministers (Tereschenko and Kazhegeldin), in 1997-2003 there were four (Balgimbayev, Kasymzhomart Tokayev, Imangali Tasmagambetov, and Daniyal Akhmetov).

A further blow to Nazarbayev’s political self-confidence was dealt as a result of an unexpected outcome in the pursuit of the criminal case against Kazhegeldin. In 1999, the pursuit led the Kazakhstani government to request the Swiss authorities to locate and freeze Kazhegeldin’s bank accounts. While the Swiss were unable to find any accounts of the former prime minister, they did find and froze a Kazakhstani account at Credit Agricole Indosuez, the Swiss affiliate of a French bank. On October 16, it became public that the frozen account (with the US$ 80-85 million deposit) was opened in Nazarbayev’s name. After widening his investigation, Daniel Devaud, the investigating magistrate in Geneva, froze several more Kazakhstan accounts in at least two banks.155

The discovery of the accounts led the U.S. Department of Justice to open a criminal case against James Giffen, an American oil consultant, which became known as the Kazakhgate. Giffen was charged with acting as an intermediary between Nazarbayev and U.S. oil companies, creating Swiss bank accounts beneficially owned by President Nazarbayev and former Prime Minister Balgimbaev and depositing US$ 78 million on the accounts paid by the

oil companies to facilitate six oil transactions in the mid-1990s.\textsuperscript{156} In the indictment, Nazarbayev and Balgimbayev were identified as unindicted co-conspirators KO-2 (i.e., Kazakh Official-2), and KO-1 respectively.\textsuperscript{157}

The threat of a possible criminal prosecution of Nazarbayev and the possibility that the indictment could be used by the domestic opposition created such panic in Astana that an extraordinary session of Mazhilis was convened in the middle of its summer recess in July 2000 to pass the Law On the First President of the Republic of Kazakhstan. The law stipulated that Nazarbayev had the right to be president for life, which provided him legal protection in the U.S. under the foreign government immunity stipulation. The clause that any “affront or other violation of the honor and dignity of the First President of the Republic of Kazakhstan is not allowed and will be prosecuted” effectively criminalized any discussion of the origins of Nazarbayev’s Swiss bank accounts and Giffen’s case in Kazakhstan. Article 3 provided Nazarbayev with immunity “for acts committed while performing the duties of the President of the Republic of Kazakhstan, and after their termination - related to the implementation of its status as the First President of the Republic of Kazakhstan - The leader of the Nation.” Immunity was extended to all property owned by Nazarbayev and his family.\textsuperscript{158}

\begin{flushleft}
\textsuperscript{156} See Seymour Hersh (2001). “The price of oil: what was Mobil up to in Kazakhstan and Russia?” \textit{The New Yorker}, Vol. 77, No.18, July 9, pp. 48–65.
\end{flushleft}

\begin{flushleft}
\end{flushleft}

\begin{flushleft}
\textsuperscript{158} “On the First President of the Republic of Kazakhstan - Leader of the Nation Constitutional Law of the Republic of Kazakhstan dated July 20, 2000 N 83-II.” Accessed at http://adilet.zan.kz/eng/docs/Z000000083. The name of the law was changed to its current form after Nazarbayev was accorded the title of \textit{Elbasy} (Leader of the Nation) in 2010 (see Chapter VI).
\end{flushleft}
5.2. *The first cracks in Nazarbayev’s relations with the NBK reformers and the bankers*

Speaking in the Mazhilis on October 24, 2000, Nazarbayev unexpectedly announced that Kazakhstan needed to adopt a law on legalization, i.e., amnesty, of capital, that would allow the repatriation of millions of dollars back into the country which, the president argued, would be invested in the national economy. It was the first major banking – and financial – sector personal initiative announced by Nazarbayev without prior consultation or consent of the NBK.

To the public – and some parliamentarians – it was clear that Nazarbayev was concerned more with saving his family and his close associates’ other assets from being discovered and frozen than with repatriating the capital that fled the country during the uncertainty of the 1990s. As the *Financial Times* reported in November 2000, in Kazakhstan, where the average monthly salary was US$150, some people were making a lot of money as personal deposits from Kazakhstan in Swiss banks ballooned from US$1 million in 1992 to US$125 million in 1998 to US$530 million in 1999, which equaled over a quarter of the country’s GDP.159

Nazarbayev’s decision to legalize capital was, for the first time, met with open opposition by the NBK and the AFK. Grigoriy Marchenko, the NBK Governor, fully supported by Daulet Sembayev (the AFK Chairman), sent NBK’s expert opinion to the Mazhilis. The expert opinion warned of the danger legalization posed to the banking sector and the economy should it involve “a considerable amount of money,” set by the NBK at US$1 billion, and should it happen when Kazakhstan had a positive balance of payments. In

159 Mendybayev and Shelgynov (2001), p. 130.
such case, “our economy will hardly be able to quietly “digest” a big additional volume of foreign currency since investment opportunities inside the country are limited.” What would follow would be a decrease in competitiveness of Kazakhstani exports, inflow of imported goods and, as a result, crowding out domestic products from the market.

The NBK warned of another negative consequence of legalization of capital – destabilization of the banking system, which might happen as a result of increase in banks’ liabilities given their already limited possibilities for investing deposited money as well as increase in M2 (money supply) and inflation. To sum up its objections to the law, the NBK expert opinion stated that “Such an inflow of capital can be destabilizing as concrete mechanisms to control the further use of money, as well as guarantee its investment in the real economy, are absent.”

There were other reasons why the NBK and the AFK, i.e., the banking sector, opposed legalization, which did not find their way into the official expert opinion, but were widely discussed in the banking community. The NBK did not want the legalized capital of uncertain provenance to ‘contaminate’ the banking sector after so much effort was spent to clean it up and make it transparent. The bankers opposed legalization because they knew that most of the capital belonged to the top government officials and were concerned that they might be tempted to demand a say in running the banks where they deposited their money for legalization, if not become their shareholders given the lack of investment opportunities in Kazakhstan.

---


There was some opposition to the proposed law in the Mazhilis. Tatiana Kvytkovskaya, deputy from the ruling Otan party, who voted against its adoption, agreed with the scenario outlined by the NBK and expressed hope that the legalized money would quickly leave the country again.  

The Law on Amnesty of the Citizens of the Republic of Kazakhstan in Connection with the Legalization of Money was passed by the Mazhilis in April 2001 by 73 voted to 15. The law provided immunity from prosecution to those who participated in the scheme. In total, US$480 million, which equaled 2% of Kazakhstan’s GDP, were deposited tax-exempt on special accounts as cash or transfers from foreign bank accounts. Approximately 55% of the legalized capital remained in the banking sector as deposits, which helped the expansion of the bank resource base.

5.3. The cracks turn into open confrontation

Disagreement over legalization of the capital, however, was only a harbinger of the real storm that shook the foundations of the political order in Kazakhstan later in 2001 and created a rift between Nazarbayev and the technocratic reformers and the new business elite. The storm started to gather momentum when Rakhat Aliyev, Nazarbayev’s son-in-law and deputy Chairman of the National Security Committee (NSC), launched a campaign of blackmail and intimidation of businessmen, who owned biggest and most profitable companies, to either strip them of their assets or take them under his krysha (i.e., protection). Rakhat who was married to Dariga Nazarbayeva, the president’s eldest daughter, already

---

owned or controlled Nurbank, the Sugar Center, Khabar and NTK TV stations, Europa Plus Kazakhstan radio, etc.

Apart from taking control over businesses, Aliyev used websites, such as Aziopa.ru, to disseminate information that compromised Nazarbayev’s inner circle and Nazarbayev personally. Aliyev also started to speak publicly about pervasive corruption at the highest levels of the Kazakhstani elite that threatened survival of the country as an independent state. Despite a direct order from his boss, Marat Tazhin, to stop his ‘anti-corruption’ campaign, Aliyev threatened to disclose to the Mazhilis the information he collected. By the mid-2001, the situation became so explosive that rumors about a pending coup-d’état planned by Aliyev circulated in Astana and Almaty.

On July 11, 2001, Nazarbayev met with the leading Kazakhstani bankers and other representatives of the new Kazakhstani business elite and delivered a stern warning: “Your childhood – the time when I had to hover over each one of you, protect you from any difficulty, get you out of a jam, where you got because you started to do business under the Soviet laws and you were called speculators – comes to the end.” He went on to say that he expected them to be patriotic and help build Kazakhstan as the state of the middle class. He called on them to invest at home, in the real sector of the economy and in building Astana, rather than exporting capital and buying real estate abroad. He concluded his remarks with the following, “I can take anyone of you by hand to court any day.”

The last statement sent shockwaves through the attendees of the meeting. Bulat Abilov, a leading figure of the new business elite and Mazhilis deputy from Nazarbayev’s Otan party, who organized the meeting with the intended purpose of discussing the creation of

the council of domestic investors under the president, blamed Rakhat Aliyev for Nazarbayev’s antagonistic behavior and harsh words. Aliyev, who met with the president right before his meeting with the businessmen, apparently advised him against supporting the new business elite and to talk harshly to them.\textsuperscript{164}

The threat that Aliyev presented to various factions of the Kazakhstani political and economic elite brought them together in support of the suggestion by the technocratic reformers led by Jandosov, who as the First Deputy Prime Minister was the most senior member of the government among them, to collectively confront Nazarbayev and demand that he sacks Aliyev and removed him from public office. That was to be the first political demand on the part of the technocratic reformers.

At a meeting with Nazarbayev in November 2001, when they demanded Aliyev’s resignation, they not only exposed his activities that undermined the economic reforms and explained the danger he posed to Nazarbayev personally, but also argued that the time for political reforms had come. They reasoned that Aliyev’s plans to depose Nazarbayev exposed the dangers of concentrating too much power in one hands, arguing that had the coup succeeded Aliyev would use it to destroy Nazarbayev. Devolution of power, they contended, was thus in Nazarbayev’s personal interests and a guarantee that the reforms he initiated would not be reversed by his successor whoever that might be.\textsuperscript{165}


\textsuperscript{165} Interview with Oraz Jandosov, Altynbek Sarsenbayev, Bulat Abilov, Zharmakhan Tuyakbai. Almaty, April 22, 2005.
Nazarbayev agreed to remove Aliyev, which happened on November 15, but two days later he suddenly appeared on Kazakhstani TV side-by-side with his son-in-law to announce his appointment as deputy head of the presidential bodyguard service. The technocratic reformers and the new business elite took that as a sign that Nazarbayev had reneged on his promise and favored Aliyev over them.

As a result, three days later, on November 18, 2001, the technocratic reformers and the new business elite announced the establishment of the Demokraticheskiy Vybor Kazakhstana (Democratic Choice of Kazakhstan (DVK), a political party, to pursue democratization of the political system in a manner non-confrontational vis-à-vis the president. As they explained, their argument and disagreement were with Prime Minister Tokayev, an ally of Dariga Nazarbayeva and Aliyev at the time, and a number of other people close to the president, not with the president himself.

The statement, which announced the creation of the DVK, was signed by Oraz Jandosov, Alikhan Baimenov, Labor and Social Protection Minister, Galymzhan Zhakiyanov, Governor of Pavlodar province, Zhanat Yertlesova, Deputy Defense Minister and former Deputy Head of the President’s Administration, Bulat Abilov, and a number of other Mazhilis deputies and Senators. Significantly, it was also signed by Mukhtar Ablyzov, Chairman of the Board of Directors of Temir bank, Nurzhan Subhanderdin, CEO of KKB, and Erzhan Tatishev, CEO of Bank TuranAlem. Their main demand was a comprehensive political reform, including increased power of the Mazhilis and granting it full legislative powers;

---

166 Aliyev did not abandon his political ambitions and continued with his threats to expose corruption among the elites. That prompted Nazarbayev to send him as Kazakhstan’s ambassador to Austria and the OCSE in early 2002.

replacement of the presidential appointment of local heads of administration by direct
elections, most importantly for the powerful posts of provincial governors; media
independence; improved protection of rights and freedoms of citizens.\footnote{168}

Prime Minister Tokayev issued a rebuttal statement, accusing the reformers of
obstructing attempts by the law enforcement bodies to investigate the cases of corruption (a
clear nod in support of Aliyev), being in the service of foreign economic interests (an allusion
to the U.S. and the West who were supportive of the technocratic reformers), and demanding
that the president sack the reformers. Tokayev even threatened to resign if the president did
not sack his protégés.\footnote{169} The reformers submitted letters of resignation on November 21,
citing “impossibility of working in the government headed by Kasymzhomart Tokayev.”
According to Asylbek Bisenbayev, Nazarbayev’s press secretary, Nazarbayev accepted their
resignation with “great regret,” stating that they would remain in the president’s team and that
their experience and knowledge would be useful in other government posts. As for the DVK,
the “president believes that it was created within bounds of the law and fits in entirely with the
general policy of democratizing society.”\footnote{170}

Participation of the top bankers in establishing the DVK cannot be explained only by
their personal links to the technocratic reformers in the government, as one could argue is the
case of KKB and Subkhanberdin, whose name appeared third on the list of the signees of the

\footnote{168} “Statement on the creation of DVK” in S. Markelov and O. Petrovskiy, eds. (2002).

41-45.

\footnote{170} Dmitri Glumskov and Boris Volhonskiy (2001). “Prezident Kazakhstana vybral sem’yu,”
DVK statement. Nor can it be explained solely in terms of their personal conflict with Aliyev, who as far back as 1996 had used his power to detain and question Yevgeniy Fel’d, KKB managing director, and confiscate all the electronic databases of the bank. Nor they were driven exclusively by the desire for greater influence over economic decision-making in the regions, which the introduction of the elections of regional governors would have allowed.\textsuperscript{171}

Their decision to enter politics and become the founding members of an opposition political party – albeit loyal to the president – can also be explained by their wish to see “increased transparency, accountability and efficiency in the policy-making process” and for Kazakhstan to transition to a democratic form of government.\textsuperscript{172} As Timur Issatayev, one of the leading Kazakhstani bankers argued, “Many people think it is just an oligarchic interplay, but this democratic movement is quite serious. True, it is a very diverse people who sometimes have bitter fights in business issues, and business-wise we are still rivals. But we share the same culture and beliefs about where the society should go.”\textsuperscript{173}

That, by itself, according to Nazarbayev’s press secretary, did not contradict the president’s agenda. The president did not oppose in principle the elections of governors at all levels of local administration and a greater role of the parliament in Kazakhstan’s politics. What Nazarbayev objected to was the timeframe, not the goal of building a democratic state:

\textsuperscript{171} Chris Pala (2002). “Let’s Call The Whole Thing Off.” \textit{The Banker}, No. 72 (1), March. Pala argues that the elections would have allowed the bankers and other big industrial groups to exert influence over their outcome to ensure the election of more business-friendly governors than those appointed by Nazarbayev.


“We categorically reject advice aimed at artificial acceleration of the democratic processes.”

It soon became apparent that a greater danger for the regime was not the “impatience” of the technocratic reformers and the new business elite, but the appeal their message had among the technocratic Western-educated and oriented elites and the rising middle class and the success of the DVK in bringing disparate oppositions groups together and creating a united opposition movement. The technocratic reformers, the bankers, businessmen, prominent intellectuals, followers of Kazhegeldin, and the Communists under the leadership of Serikbolsyn Abdil’din, Nazarbayev’s erstwhile opponent, all came together under the aegis of the DVK to create an opposition movement that send shockwaves in the Nazarbayev camp. After Abdil’din was elected a member of the Political Council of the DVK Nazarbayev expressed his “amazement at how the reformers and the democrats could find themselves together with the Bolsheviks and the conservatives.”

In the same interview, the president declared that he drew a difference between the “responsible” opposition, which “strived toward the same things as the president, but only too hastily,” and the “irresponsible” opposition connected to Kazhegeldin and the communists. That was a not-so-veiled attempt at causing a split among the DVK leaders. The role of “irresponsible” and radical oppositionists was assigned to Zhakiyanov and Ablyazov, whom Nazarbayev accused of being “the most corrupt figures” who “used their stolen money to create a political party” in hopes that that would protect them from prosecution.

---


government opened criminal cases against them, alleging abuse of office and tax evasion, the other, “responsible” leaders of the DVK announced the establishment of the Aq Zhol (Bright Path) Democratic Party without formally renouncing their membership in the DVK.

Unlike the DVK, Aq Zhol did not encounter any problems with being registered by the Ministry of Justice. Nazarbayev met with its leaders (Jandosov, Baimenov et al.) and reappointed some of them back to the government albeit to second-tier jobs, while Ablyazov and Zhakiyanov were arrested in March 2002. Ablyazov, who was sentenced to six years in prison, expressed contrition and appealed for pardon, which was granted by Nazarbayev in April 2003. His pardon was contingent on his commitment not to engage in any political activity. Zhakiyaynov’s appeal for pardon was denied because the former Governor of Pavlodar province did not express contrition. He was released in 2006.

The resignation of the technocratic reformers from the government did not turn out to be a victory for Aliyev and his supporters. Prime Minister Tokayev was sacked in January 2002 followed by Aliyev himself, who was sent into exile as ambassador to Austria.

5.4. Nazarbayev changes course

The fallout from the bankers’ decision to enter politics did not take much time to materialize. Nazarbayev turned his shock at the leading bankers who had become the founding members of an opposition political party into a swift retaliatory action that left no room for doubt that he would not tolerate their political activities. November 20th was previously set as the date for holding the privatization auction of the Halyk bank, Kazakhstan’s biggest bank in retail deposits (51% of the household savings) and in the number of branch offices (680). The

---

state put up for sale its 33 + 1% shares in Halyk with additional 11% offered by TsentrCredit bank. The two bidders were Subkhanberdin’s KKB and Ablyazov’s Temirbank. KKB, which had only 20 branch offices and mostly corporate clientele, was a favorite to acquire Halyk. Merger with Halyk would have allowed KKB not only to enter the retail market, but would have also made it the dominant bank in the country with the 51% share of the retail and the 37% share of corporate deposits.

On November 19, i.e., one day before the auction was to be held by the State Property and Privatization Committee and one day after Subkhanberdin and Ablyazov signed the statement announcing the creation of the DVK, a third bidder, a consortium led by MangystauMunaiGas, an oil company from western Kazakhstan, suddenly appeared out of nowhere. On the day of the auction the minimum bid was unexpectedly raised to US$35 million and the consortium won by offering US$41 million compared to about US$40 million offered each by KKB and Temir bank. A month later, in December, MangystauMunaiGas sold its Halyk shares to a group of investors led by the AGIS company.

Despite secrecy about the ownership disclosure it was common knowledge that MangystauMunaiGas was controlled by Timur Kulibayev, CEO of KazTransOil and Nazarbayev’s second son-in-law. The fact that he and his wife Dinara Kulibayeva, Nazarbayev’s second daughter, became the majority shareholders of the Halyk bank was confirmed in 2006 when the bank applied for listing at the London Stock Exchange and had to open up its books and disclose the ownership structure.

Nazarbayev’s intervention in the privatization of Halyk bank signaled that he would not allow the emergence of the accept the creation of a major bank headed by an opposition leader and the possibility that its capital could be used to undermine his regime. As a
collateral damage, Nazarbayev’s intervention derailed the program of market-driven consolidation of the banking sector authored by the NBK reform team and implemented since 1995, whose goal was to reduce the number of banks in Kazakhstan to 3 to 5 big banks and a handful of regional banks.

The sale of the controlling share in Halyk bank to Timur and Dinara Kulibayev, described as “a marriage of two cultures, the corporate and that of the president’s family,” marked a major shift in Nazarbayev’s approach to the banking sector and economic reforms in general.\(^{177}\) The sale was the first step toward abandoning his earlier belief in the virtues of the market economy and private entrepreneurship and reinstating state control over the banking sector.

Despite his verbally positive attitude toward the “responsible” opposition, the events of November 2001 sowed the seeds of doubt in Nazarbayev whether his strategy of promotion and reliance on the young technocratic reformers and his efforts to facilitate the creation and growth of the new capitalist class was paying off: instead of showing gratitude and support they turned against him by demanding political reforms and devolution of his powers. A logical consequence of his diminished trust in the young technocratic reformers-turned-politicians was Nazarbayev’s decision to replace them with the politically traditioanalist and economically statist elites, who helped the seeds of doubt to grow and bear fruit in 2004 (elite relations and the politics of economic reform are discussed in Chapter VI).

In January 2002, Nazarbayev replaced Tokaev with Imangali Tasmagambetov as the Prime Minister. In June 2003, Tasmagambetov was replaced by Danial Akhmetov. Tasmagambetov, a Soviet-era apparatchik, was the last leader of Kazakhstan’s *Komsomol*, the

\(^{177}\) Pala (2002).
Young Communist League, while Akhmetov came out of the “red director” corps. Neither belonged to the group of the technocratic reformers who were in charge of reforming the economy since the mid-1990s. Their only merit was being Nazarbayev loyalists.

Tasmagambetov, for example, proudly stated: “I am Nazarbayev’s product (Ya produkt Nazarbayeva).”

With the departure of the technocratic reformers from the government economic reforms in Kazakhstan slowed down. The premiership of Tasmagambetov and Akhmetov coincided with the rise of international prices on oil, Kazakhstan’s number one industrial and export commodity. High oil prices reflected positively on macroeconomic indicators, which the government officials used as evidence to show Nazarbayev a steady progress in the development of the economy - and the country – and argue that no further reforms were needed.\(^{178}\) Moreover, Daniyal Akhmetov initiated a gradual comeback of the state into the economy, including the banking sector.

Having removed the technocratic reformers from the government, Nazarbayev turned his attention to the new business elite, issuing a harsh warning: “I want to recommend to all our bankers, businessmen [italics mine]… not to engage in politics, but to do what they know best.”\(^{179}\) The stern message reflected the concern of Nazarbayev’s inner circle that financial support of the opposition by the bankers and businessmen might lead to the destabilization of the Nazarbayev regime.\(^{180}\) It appeared that the call to stay out of politics was heard by the Kazakhstani bankers. Tatishev, CEO of BTA, announced his decision to quit the DVK in

\(^{178}\) Interview with a Kazakhstani government official. Washington, D.C., September 24, 2005.


\(^{180}\) “Pora menyat vsyu sistemu (interview Ye. Yertysbayeva),” Vremya, April 18.
April 2002. Subkhanberdin did not participate openly in politics, although he did not formally resign from Aq Zhol.

The calm in Nazarbayev’s relations with the bankers, however, did not last long and ended in 2004.

5.5. Bankers beware: the case of the Kazakhstani Khodorkovsky

The year of 2004 was a seminal event in the history of the banking sector in Kazakhstan for two reasons. The first one was the completion of the banking reforms launched by the NBK reform team in 1994. The second one was the September parliamentary elections, which not only had a profound effect on the banking sector in 2004, but also determined the trajectory of its future development.

The first act that recognized the completion of NBK’s mission to create a second-tier banking system in Kazakhstan was the establishment of the Agency for Regulation and Supervision of Financial Market and Financial Organizations (FSA) on January 1, 2004, which was to oversee banks, investment funds, insurance companies and pension funds. Thus, the task of bank supervision was transferred from the NBK to the FSA, leaving the former to focus on the typical functions of the central bank.

The second act was the appointment of Marchenko, the NBK Governor, as the First Deputy Prime Minister on January 6. The last member of the NBK reform team, who was voted world’s “Best Governor of the Central Bank in 2003,” was succeeded by Anvar Saidenov. Saidenov twice served as Deputy Governor of the NBK (under Jandosov and Marchenko) and was expected to continue with policies set out by the reform team.
Marchenko’s portfolio as the First Deputy PM included macroeconomic, financial, and tax policies as well as financial markets. However, he lasted in his job only for 98 days, resigning on April 14. He was immediately appointed as President Nazarbayev’s Economic Advisor, but did not last in that post either, resigning on October 12.

Marchenko could explain both resignations only after he left his second job. He was the last senior technocratic reformer to leave the government. His first resignation was precipitated by his opposition to the policies pursued by Prime Minister Akhmetov, which, in his opinion, were aimed at stalling further economic reforms and restoration of state control over the economy. He called the appointment of Akhmetov “a cadres mistake of the President (kadrovaya oshibka prezidenta)” and openly accused his fellow ministers of having no understanding of economic issues. \(^{181}\)

His disagreement with Nazarbayev, however, was deeper than the president’s cadres choices. Marchenko disclosed that he stayed on as economic advisor as long as he could effectively influence the policy-making process and as long as the economic policy made sense. He resigned when Nazarbayev stopped listening to him and threw his support behind Akhmetov. He explained that the president’s support for Akhmetov’s policies was driven by “political, social, and ideological motives” rather than economic rationale. \(^{182}\)

Marchenko’s statement thus confirmed that political considerations motivated Nazarbayev to abandon his market-oriented economic reforms agenda in favor of restoring


\(^{182}\) Drozd, *op.cit.*
state control over the economy. The departure of Marchenko was the departure of the last “chief reformer of Kazakhstan,” as he was often called, left in a senior position in the government. Unlike two of his NBK reform team members (Sembayev and Jandosov) he did not enter politics and openly criticized bankers for doing so.

Nazarbayev’s change of heart allowed Soviet-era elite in the government and the traditionalist political elite to move openly against the banking sector. Marchenko’s departure from the NBK and then from the government untied their hands. Because of Nazarbayev’s previously unequivocal support for Marchenko and his polices, which proved successful and had brought Kazakhstan international praise Marchenko, until 2004, had been considered “untouchable,” which shielded the banking sector from any government intervention.183

Neither Anvar Saidenov nor Bolat Zhamishev, the Chairman of the FSA, had the ear of the president or political clout to the same degree as Marchenko, which facilitated actions against the banking sector taken by the two elite groups.

The underlying reason behind the concerted actions against the banking sector was political. The traditionalist political elite in the Administration of the President and Soviet-era statists in the Akhmetov government were concerned about the outcome of the September 2004 Mazhilis elections. Given Aq Zhol’s popularity among the government bureaucrats, the new business elite, the nascent middle class, and the younger generation of Western-educated and Western-leaning Kazakhstansis the outcome of the election was far from certain. The fear that KKB, BTA, and other banks would ignore earlier warnings and bankroll Aq Zhol’s electoral campaign, which would have allowed the party to spread its message in the far

---

corners of the country and possibly garner broader support, prodded both groups to take preemptive action against the leading banks.

The government pursued the task of reasserting control over the banks through its economic policy initiatives, while the Presidential Administration, headed by Tasmagambetov, Akhmetov’s predecessor as Prime Minister, launched an all-out smear and intimidation campaign against the bankers. In early July 2004, Akhmetov chaired a meeting of the Cabinet at which he announced that the financial sector was in dire need of radical reform. Akhmetov cited a long list of transgressions that, he claimed, necessitated radical reform: (1) for a long time the banks had not been observing prudential norms (2) net interest spread (the difference in borrowing and lending rates) was not narrowing; (3) the range of services was not increasing; (4) there was no real competition in the banking sector, with the gap between the top three banks (KKB, BTA, and Halyk) and the rest constantly increasing, etc. Akhmetov called for radical reforms to be implemented in the shortest period of time given what was anticipated at the time to be the pending accession to the WTO.\footnote{Gul’mira Arbabayeva (2004). “Pravitel’stvo namereno v kratkaishyiye sroki reformirovat’ finansovyi sector.” \textit{Panorama}, No. 26, July 2. As of 2014, Kazakhstan is still negotiating its accession to the WTO.}

One of the key elements in Akhmetov’s reform plan was to make the banks accept government-set interest rates on bank loans, which effectively was an attempt to resurrect the Soviet-era policy of direct credits to the economy. Although, in part, it was tied to the affordable housing construction program adopted earlier that year over Marchenko’s objections. In May, the government strong-armed a number of banks to sign a memorandum with the Ministry of Finance and the Kazakhstan Mortgage Company, whereby the banks pledged to lower the yearly mortgage interest rate to 9-10% and the down payment to 10%,
increase mortgage maturity to 20 years, and strive to lower net interest spread on mortgages to 2-2.2\%.\textsuperscript{185}

Akhmetov’s statement about the need for radical reform in the banking sector and his push for government-set loan interest rates and net interest spreads was met with an uproar in the banking community. In early August, Anvar Saidenov and Bolat Zhamishev publicly rebuffed the reform plan proposed by Akhmetov. Saidenov said that there was no need for radical banking sector reforms and rejected the idea of imposing fixed loan interest rates on banks. Zhamishev also rejected the idea of administratively set interest rates on loans, stating unequivocally that reforms in the banking sector would be driven by economic, not administrative measures. Zhamishev argued that the lowering of interest rates on loans could happen only as a result of the implementation of a number of measures such as the establishment of credit bureaus, which would allow banks to conduct risk-weighted assessment of loan applicants, the adoption of IFRS by privately owned enterprises and SOEs, and the introduction of state guarantees on loans to SMEs. He also dismissed Akhmetov’s concern about the high concentration in the banking sector by pointing that the concentration of 62\% of total banking assets in three banks (KKB, BTA, Halyk) was not higher than in Eastern and Western Europe.\textsuperscript{186}

Apart from Akhmetov’s reform initiatives, the government employed another tactic as a warning to the banks to stay clear of financing Aq Zhol’s electoral campaign. In July, the


\textsuperscript{186} “Agenstvo finnadzora obeschayet bankam rynochnye reformu.” \textit{Panorama}, No. 31, August 13, 2004. The Law on Credit bureaus and creation of credit histories in the Republic of Kazakhstan was signed by Nazarbayev in July 2004, i.e., after Akhmetov came up with his reform plan.
Tax police finished consolidated inspection of KKB for the period of 1999-2002 and declared that the bank owed KZT (tenge) 4 billion (US$ 30 million) in back taxes. During a similar inspection of BTA the Tax police determined that the bank owed KZT 2 billion (US$ 2 million) in back taxes. In its statement, KKB noted that 73 inspections conducted by Tax police in 2003 yielded only KZT 39.3 (< US$1) in back taxes, but stopped short of accusing the Tax police of conducting a politically motivated inspection in 2004.\footnote{Ruslan Bakhtigareev (2004). “Kazkommertzbank oprovergayet informatsiyu, chto provearka banka nalagognymi organami svyazana s politicheskimi prichinami.” \textit{Panorama}, No. 26, July 2.}

The 2004 consolidated tax inspection happened on the heels of a smear campaign launched against KKB by the President’s Administration. In May, Yermuhamet Yertysbayev, Nazarbayev’s domestic policy advisor, published an article in which he identified Subkhanberdin, CEO of KKB, as the main leader in the Kazakhstani opposition movement, branding him the “Kazakhstani Khodorkovsky” and calling Aq Zhol “a formidable business project of KKB.” In the eyes of Yertysbayev, who spoke for the traditionalist political elite and the Soviet-era statist economic elite, Subkhanberdin was a “dangerous and real opponent,” the “brains” of the opposition, its chief coordinator and manager, the “exclusive sponsor and the real éminence grise of Kazakhstani politics.” Should Aq Zhol win, warned Yertysbayev, the redistribution of property would be inevitable.\footnote{Yermuhamet Yertysbayev (2004). “Chto takoye “druz’ya naroda” i kak oni voyuut protiv prezidenta.” \textit{ExpressK}, May 12.}

At the same time, Nazarbayev’s advisor acknowledged that Aq Zhol enjoyed support in the “highest echelons of power” and that it had powerful protectors in the President’s Administration. In Russia, he pointed out approvingly, Putin “threw Berezovsky and Gusinsky out [of the country] and put Khodorkovsky in prison” while in Kazakhstan, he...
lamented, the oligarchs were allowed to establish an actively functioning political party.\textsuperscript{189} It should be noted here that the word “oligarch” has been used as a synonym for the most rich among the new business elite who supported the DVK and Aq Zhol more than it has to identify the superrich who were Nazarbayev loyalists. To make a clearer distinction, the moniker “democratic oligarchs” is used in this dissertation.

By calling Subkhanberdin “Kazakhstani Khodorkovsky,” Yertysbayev was sending a clear message to the democratic oligarchs, the bankers, the rest of the new business elite, and the population: “Do not support Aq Zhol and its candidates or else.” To make sure that the message would reach every corner of the country the article was reprinted in practically all Kazakhstani national, provincial, and district newspapers.

In his reply to Yertysbayev, Subkhanberdin denied being a member of Aq Zhol and emphatically rejected accusations that KKB was involved in organizing and financing the DVK and Aq Zhol. He called for social compromise in issues related to political reforms and praised Nazarbayev for his critical role in economic reforms. At the same time, Subkhanberdin stated that political reforms were lagging behind economic ones. The CEO of KKB asserted that Kazakhstan had little in common with Singapore with its “compact Confucianism” and lack of corruption, or with Muslim countries. “Kazakhstan,” he concluded, “faces a key civilizational choice. … I watched with a certain degree of envy [TV] reports on the accession of our former Baltic republics to the European Union. I think that all

\textsuperscript{189} Yertysbayev, \textit{op. cit.}
of us should work hard for a long period of time to ensure that Kazakhstan would be able to become a part of the strong and free community of the European states.”

Subkhanberdin’s reply to Yertysbayev was nothing short of a political statement in support for political reforms advocated by Aq Zhol and DVK. In a direct challenge to Nazarbayev, he rejected the choice of the Singaporean model preferred by the president in favor of the European as the model for Kazakhstan’s economic and political development.

Subkhanberdin’s lack of repentance led Yertysbayev to publish articles and give interviews attacking and deriding Subkhanberdin, KKB, and Aq Zhol, i.e., the technocratic reformers and the new business elite, at least once every week prior to the September 19th elections. The anti-Subkhanberdin and anti-KKB campaign would continue after the elections. In one of his interviews, Yertysbayev went as far as to issue an open call to businesses and the population to withdraw their money from KKB, arguing that keeping money in a bank that supported the opposition was not safe.

Apart from political implications, the comparison of Nurzhan Subkhanberdin to Mikhail Khodorkovsky also implied that KKB could become Kazakhstan’s Yukos. By 2004, the market share of KKB was 23% of the total bank assets in the country. Its share of the banking system credit portfolio was 25%. The threat that KKB would follow in the footsteps of Yukos led some corporate and retail customers to transfer their accounts to other banks while SOEs were reportedly pressured to do so. The decline in KKB’s customer base can be inferred from a sharp decline in the level of the bank concentration and 5-bank asset

---


concentration indices for 2004 (see Fig. 1 and 2). Even at the height of the financial crises and the devaluation of the tenge in 1999 and 2008-09 the decline in the relevant indices was less pronounced.

**Figure 1. Bank concentration, 1998-2006**

---

192 In 2004, KKB was the biggest bank in Kazakhstan and was thus included in the 5-bank asset concentration index.

193 Bank concentration – 47.3% in 1999, 47% in 2004, 58% in 2008, and 62.3% in 2009. 5-bank concentration - 72% in 1999, 76.6% in 2008, 73.7% in 2009, 70.1% in 2010.
As the September 19th elections drew closer the attacks on KKB intensified. Before KKB and Tax police settled their dispute in court over US$30 million in back taxes allegedly owed by the bank, pro-government newspapers, such as *EkspressK*, claimed that KKB was on the verge of collapse because of its inability to pay the tax.\(^\text{194}\) At the time, KKB had equity capital of US$372 million and total assets of US$3.6 billion. Acting on the (dis)information in the article, the pro-government AIST (Agrarian and Industrial Union of Workers) electoral block of the Agrarian and the Civic parties staged a number of protests in front of the KKB branch offices. Apart from the leaders of the AIST, these demonstrations, which were widely covered by state TV, featured “KKB depositors who had lost their savings and demanded compensation.”\(^\text{195}\) By engineering information warfare against KKB, to which Yertysbayev


admitted, the traditionalist political elites signaled they would stop at nothing, including inciting a run on the biggest bank in the country, to ensure the electoral defeat of Aq Zhol.\textsuperscript{196}

Their tactics were denounced by the NBK, FSA, the Ministry of Finance, and the banking community, who understood that the collapse of KKB could trigger the collapse of the entire banking system of Kazakhstan. In its statement, the NBK denounced attempts to discredit the reputation of individual banks and destabilize the banking system of the country. It threatened to bring to court individuals and organizations responsible for spreading the rumors and false information to “earn political capital for themselves by inflicting harm on citizens of our country.”\textsuperscript{197}

Seven CEOs of the leading Kazakhstani banks and the Chairman of the Association of Financiers of Kazakhstan published an open letter, in which they appealed to their customers to maintain calm and ignore provocative statements. Citing the IMF, WB, and international rating agencies, which assessed the Kazakhstani banking system as stable, they reminded readers that the system was far ahead, in terms of its institutional development and stability, of that of Russia and other CIS states. They also reiterated that trust in the system, which took year to build, might be undermined by false information and rumors and would be very difficult to rebuild. Smear campaign against one bank could not but adversely affect the entire banking system and jeopardize its stability.\textsuperscript{198}

The letter, signed among others by the CEO of Halyk bank (owned by Dinara and Timur Kulibayev, Nazarbayev’s second daughter and her husband) was addressed as much to


\textsuperscript{198} “Otkrytoye pis’mo bankov Kazakhstana vkladchikam.” Panorama, September 18, 2004.
the clientele of the Kazakhstani banks as it was to Nazarbayev. The message to Nazarbayev was that unless the attacks by his political advisors and the government stopped, the banking system, the object of his pride as the symbol of Kazakhstan’s success with market-oriented economic reforms, could easily collapse, wiping out billions of dollars in assets accumulated by the banks and possibly leading to mass social unrest.

Though Nazarbayev did not directly intervene in the government vs. KKB conflict, it was clear that he heard the message loud and clear and did not allow the government to proceed any further with its anti-KKB crusade. Thus, Subkhanberdin did not become Kazakhstan’s Khodorkovsky and KKB did not share the fate of Yukos.

Nazarbayev had good reasons to prevent the forced bankruptcy of KKB. First, he could not risk social unrest, which was bound to erupt since KKB’s collapse could indeed have led to the collapse of the entire banking system, as the bankers warned him. Second, against the backdrop of the Kazakhgate case pending in a New York court, he could not risk a bankruptcy, because it would have triggered another high profile lawsuit and trial, this time in Europe. In 2003, the European Bank for Reconstruction and Development (EBRD) had acquired a 15% stake in KKB and would have sued Kazakhstan for damages had the bank been forced into a politically induced bankruptcy. Finally, social unrest and an EBRD lawsuit would have undermined the country’s reputation, just as Kazakhstan was launching its bid to become the Chairman-in-Office of the OSCE in 2010.

For Nazarbayev, 2004 was also a watershed year. In the first half of the year, he stayed away from the simmering confrontation between the traditionalist elites in his own administration and the government, on the one side, and the technocratic reformers and the new business elite, on the other. That Aq Zhol was able to function as a political party despite
the opposition by the traditionalist elites, who, in the words of Yertysbayev, would have preferred to see its leaders exiled, imprisoned, or silenced like in Russia, was Nazarbayev’s choice. When in July Nazarbayev appointed Altynbek Sarsenbaiuly, a co-chairman of Aq Zhol, as the Minister of Information, Yertysbayev openly criticized the decision.¹⁹⁹

Though the appointment of Sarsenbaiuly happened on the heels of dismissal of Oraz Jandosov, the Chairman of the Anti-Monopoly Committee, it was a sign that Nazarbayev did not resolve the politician’s dilemma one way or the other and was still maneuvering between the two camps without identifying himself fully with the traditionalist political and Soviet-era economic elites, whom he had elevated in prominence after 2001. As questions about Sarsenbaiuly’s appointment mounted, the president offered the following explanation of his decision. Nazarbayev said that as president he worked with all political groups and that “Aq Zhol are my people. I nurtured them.” He characterized Aq Zhol as a pro-reform party on the right of Kazakhstan’s political spectrum, i.e., politically and economically liberal.²⁰⁰

That was the last public endorsement by Nazarbayev of Aq Zhol and its members – the technocratic reformers and the new business elite. It had little effect on the traditionalists who continued their information war and ensured Aq Zhol’s electoral defeat on September 19th. At stake were 77 seats, 67 elected in single seat constituencies and 10 by proportional representation. The parties had to overcome the 7% barrier to qualify for one of 10 seats. Only four parties – Otan, Aq Zhol, Asar, and AIST – were able to do that. Aq Zhol finished second with 12.04% behind the Nazarbayev-led Otan (60.62%) and ahead of the two pro-Nazarbayev parties, Asar (11.38%), led by Dariga Nazarbayeva, the president’s elder daughter, and AIST


(7.07%). Despite its second place, Aq Zhol won only 1 seat. None of the Aq Zhol candidates who ran in single seat districts, including Daulet Sembayev and Oraz Jandosov, were able to win.

While speaking favorably of Aq Zhol, Nazarbayev nevertheless reiterated his earlier stance that the Kazakhstani oligarchs needed to focus on solving economic problems and stay out of politics. He expected gratitude and loyalty from them by reminding that “We all know that today’s superrich came from our ranks and they enriched themselves with our help” in ways that were far from transparent. But, he added, “We helped them ourselves.”

Since 2001, Nazarbayev, Yertysbayev, and other regime officials had been warning the bankers and the new economic elite to stay out of politics and not to finance the opposition. However, they failed to mention, much less explain, why Alexander Mashkevich, the Chairman of the Board of Directors of the Eurasian Bank, was allowed to create and bankroll a political party, the Civic party, which in the 2004 Mazhilis election was part of the AIST electoral block. In accordance with Kazakhstani law, Mashkevich, as a citizen of Canada and Israel, who was also a member of the President’s Council of Foreign Investors, should have been banned from any political activity in the country. Another important omission in the “bankers stay out of politics” rhetoric was Alexander Pavlov, who combined the job of the Deputy Chairman of the ruling Otan party with that of Chairman of the Board of Directors of Halyk Bank, owned by Dinara and Timur Kulibayev, Nazarbayev’s daughter and son-in-law.

The Mazhilis elections were criticized by the OSCE as having failed to meet the standards of democratic elections, and were dismissed by Aq Zhol and other opposition

---

201 Tsoi, *op.cit.*
parties as rigged, prompting the resignation of Sarsenbaiuly, the last Aq Zhol minister in Nazarbayev’s government. The time for Nazarbayev to resolve the politician’s dilemma had finally come. Speaking at the opening of the new Mazhilis in November, he warned the democratic oligarchs that the state would not allow them to come to power. Moreover, noting that 80% of GDP was controlled by 10 mega holdings, he announced his directive to the government to suggest measures to “conduct unwaveringly large scale work to divest mega holdings of their non-core holdings and transfer them to SMEs, employing tax and … societal levers.”

It became apparent that Nazarbayev had resolved the dilemma in favor of stability of his political future, and that he and the technocratic reformers and the new business elite had finally parted ways. It was also apparent that for the president one of the mechanisms of assuring his indefinite rule was the divestiture of the democratic oligarchs and the new business elite of their assets, either fully or partially, to prevent the use of these assets for political gain.

Nazarbayev’s solution to the politician’s dilemma was influenced by his inner circle for whom the choice of the solution meant personal political and economic life or death. The inner circle opposed the technocratic reformers, the democratic oligarchs, and the new business elite, for ideological and personal political and economic reasons. Had Nazarbayev decided to completely sever his links to the technocratic reformers and the democratic oligarchs, whom he continued to call “my people,” the interests of Nazarbayev’s inner circle and the traditionalist elites, would have been considerably advanced.

The inner circle, which included Dariga Nazarbayeva and Rakhat Aliyev, had already had a plan in place, which they used to convince Nazarbayev to, first, cut ties to his former technocratic reformer protégés and, second, to demoralize and weaken the new business elite. Back in 2002, the inner circle commissioned Global Options Management (GOM), a U.S. consulting firm, to produce a report on the legal ramifications of Kazakhgate and offer recommendations on managing the domestic political fallout.

The memorandum presented by GOM in March 2003 identified the top bankers and the democratic oligarchs as the potential political adversaries of the regime. The memorandum identified Akezhan Kazhegeldin, Galimzhan Zhakianov and Mukhtar Ablyazov by name as the “political opponents” who “seek regime change,” and “have clear motivation and understanding of how to utilize [Kazakhgate] to further those goals.” The memo also contained a detailed list of the democratic oligarchs, including Subkhanberdin, and their respective holdings. It offered guidelines for dealing with the regime’s political adversaries, calling for the use of legal mechanisms such as tax audits. That was exactly what happened in 2004 when tax audits of KKB and BTA were undertaken on the eve of the Mazhilis elections. The course of action proposed in the memo was also voiced by Nazarbayev in his Mazhilis speech on November 2.

---

203 Despite the fact that Timur Kulibayev, Nazarbayev’s second son-in-law and a big businessman, who has been on the Forb’s list of the top five Kazakhstani billionaires since the 2000s, is a member of the president’s family, he avoided any political activity, though is considered to be ideologically close to the reformer technocrats and their allies among the new business elite.


The urgency to find a permanent solution to the issue of the democratic oligarchic and technocratic opposition gained importance and urgency in light of the success of the “Orange” revolution in Ukraine, which began in November 2004 and which was backed by a group of the Ukrainian oligarchs. The inner circle once again turned to GOM, which, in October 2007, produced a document that together with the 2003 memorandum and a number of other documents produced by GOM became known as the “Super Khan papers.”

The new document, “A confidential strategy document from October 2007, titled “Project Super-Khan,”” discusses the preservation of the power of Kazakhstan’s ruling dynasty until 2035. To achieve this goal, the document states, it is necessary "to prevent intentional and unintentional, internal and external interference" in the regime of the ruler of this steppe nation." The memorandum reiterated the 2003 argument that the democratic oligarchs presented an immediate threat to the “long-term mandate” of Nazarbayev, though without naming specific names as it had in the 2003 memo. Its existence was first revealed in 2009 by Rakhat Aliyev, who by then was Nazarbayev’s ex-son-in-law, leaving in exile in Austria.

The memo counseled that the repression of the democratic oligarchs should take on the


207 The authenticity of the “Super-Khan papers,” which were submitted in multiple civil litigation proceedings in the U.S. and European courts, have been questioned by Kazakhstan’s government. In his opinion of May 7, 2013, that dismissed a lawsuit brought by Devincci and Issam Houranis, Rakhat Aliyev’s business partners, against Alexander Mirtchev et al., Thomas F. Hogan, United States District Judge for the District of Columbia, ruled that “The Court duly notes this disagreement between the parties over the “Superkhan” memorandum, yet need not delve further into the merits of the forgery issue at this stage.” See footnote 4 of the ruling available at http://dclegaltruths.wordpress.com/2013/05/31/hourani-v-mirtchev/ (accessed January 8, 2014).
appearance of the rule of law. It advised the government to use all the administrative and regulatory tools available to ascertain wrongdoing, develop criminal cases, and use them to separate the oligarchs from their property, income and even their offshore assets. “[President Nazarbayev] should once and for all demonstrate who the master in this country is to all oligarchic and bureaucratic structures.” The president’s confidants should be appointed to the boards of directors of all institutions controlled by oligarchs, with full power of oversight and monitoring.

The “Super Khan” papers singled out the major banks “as potential centers of opposition to the government and proposed a series of steps to bring them under the control of the President, to separate “oligarchs” from their investments, to control the liquid and fixed assets of these “oligarchs,” and then to limit the “oligarchs’” ability to find refuge outside of Kazakhstan.”

Thus, instead of forcing the banks out of business a different strategy of political emasculation of the new business elite and, by default, of the technocratic reformers, was proposed. The regime would now demand a share of their businesses, which would enable it to exercise control over their business transactions and money flows. Nazarbayev’s inner circle succeeded in persuading Nazarbayev to adopt the strategy and, as events proved, they did not have to wait long for an opportunity to put it into action.

---

208 Horton (2010), pp. 73-75.
Chapter VI. To break the bank: the global financial crisis of 2007-2010

After the 2004 Mazhilis elections, the Akhmetov government continued with its attempts to put pressure on the sector with his program of demonopolization, in an attempt to bring down interest rates on loans. Marchenko, who became the CEO of Halyk bank in late fall of 2004 following his resignation as the president’s advisor, rejected Akhmetov’s attempts at government intervention. He emphasized the fact that the successful development of the banking sector was achieved as a result of keeping the government out of the sector. The president determined strategic goals of its development, but the NBK ran its day-to-day operation.  

Marchenko opined that Akhmetov was pushing his plan for “reforming” the banking sector by feeding the president disinformation about the state of affairs in the sector, trying to convince him that there was a cartel agreement between the three major banks. In January 2007, Akhmetov was replaced as Prime Minister by Karim Massimov, who was close to the technocratic reformers and himself a part of the new business elite.

The development of the banking sector in the years preceding the global financial and economic crisis (2001-2007) was characterized by its 40% - 50% rapid annual growth and international expansion. The growth was achieved primarily through increase in borrowing in international markets and issuing loans to domestic customers. International expansion was pursued through borrowing in foreign capital markets, purchasing shares in foreign banks or


establishing subsidiary banks, mostly in the CIS countries, and placing IPOs at the London Stock Exchange. Prior to the onset of the crisis, the banking and the construction sectors accounted to half of the annual 9-10% growth of GDP.

By the time the crisis began, Kazakhstani banks had 13 resident banks and 17 representative offices outside of the Republic of Kazakhstan, including 6 in the Russian Federation, 4 in Great Britain, 2 in the People's Republic of China, 1 in the United Arab Emirates, 2 in Ukraine, 1 in the Kyrgyz Republic and 1 in Uzbekistan. At the height of the boom, the stability and the potential of the Kazakhstani banking sector appeared so attractive that Italy’s UniCredit bank bought at least an 85% share in ATF Bank, Kazakhstan's 5th largest financial services provider, for roughly US$2.2 billion in July 2007 – even as the situation in the international financial markets was fast deteriorating.

In November 2006, KKB became the first CIS bank to be listed on the London Stock Exchange (LSE). Its IPO drew US$846 million. A month later, Halyk Bank was listed on the LSE, raising US$680 million during its IPO. In September 2007, Alliance Bank, 4th biggest bank, placed its IPO at the LSE, raising US$704 million.

The growth of the banking sector domestically was mainly fuelled by a boom in mortgage lending and consumer credit (Figure 3), which, in turn, were driven by the windfall oil earnings. Kazakhstan’s booming economy and the positive image of the banking sector made borrowing in the international markets easy and cheap for Kazakhstani banks prior to the global financial crisis. Raising an infinite amount of money abroad and profiting from the interest rate arbitrage thus became their main growth strategy.
BTA and KKB, the two biggest banks, funded up to 45% of their capital expansion in international markets, competing with each other over who would get the biggest syndicated loan. Foreign capital funding in smaller banks varied from 10 to 15%. Most of the capital raised internationally, though, was short-term (up to 1 year). By 2007, foreign loans acquired by the banks totaled US$40 billion, which was more than half of their total non-equity funding. As a result, Kazakhstan’s external debt ballooned to 95% of GDP (US$104 billion), of which 98% was owed by the private sector.

Housing demand was one of the main drivers of credit growth. Increase in mortgage lending was fuelled by pent up demand for housing which was partly caused by a significant inflow of the population from rural areas into the cities (mostly Astana and Almaty) and partly by a speculative real estate bubble (Figure 4). By 2007, the loan portfolios of most domestic banks were overexposed to the speculative real estate and construction sectors.
The NBK and FSA, while recognizing the rapid growth of foreign borrowing by the banks and domestic lending and admitting to the emergence of the real estate bubble, took only weak measures to head off the risk of a market crash and a banking crisis. Yet it was not entirely inactive: in 2006, limits on the banks’ exposure to construction companies, loans to developers, and mortgage loans were imposed. That however, did not prevent real estate from being used as collateral to get new loans. On April 1, 2007, a link between external liabilities and the size of a bank’s capital was established. However, banks were given a one-year transition period to accommodate the new requirements.

The FSA admitted that its measures were mostly aimed at limiting the risks associated with foreign borrowings and increasing banking sector capitalization, but not at reduction of the absolute value of its foreign debt. It also admitted that despite those measures the amount of liabilities of the second-tier banks to non-residents continued to grow, which might result in increased risks in the banking sector. Nonetheless, the FSA promised to cooperate with the NBK and the AFK in considering “taking additional measures in respect to the banks which

---

will enable to minimize the risks associated with the banking sector’s foreign borrowings.”

The banks, which were not enthusiastic about FSA measures to curtail their foreign borrowing, used the following argument to block any further steps in that direction. They argued that any decline in foreign borrowing would inevitably limit the number and volume of loans, which would trigger a series of negative consequences: it would increase interest rates on loans, which, in turn, would increase competition over financial resources, leading to higher interest rates on deposits, which would increase the cost of loans even further. That, the bankers argued, would lead to the result opposite to the goal set by the government in its drive to “demonopolize” the banking sector – demands that the banks lower their interest rates on loans.

FSA’s – and NBK’s – inability to rein in the banks could be explained by two factors. The first one was that neither Anvar Saidenov, the Governor of the NBK, nor the Chairpersons of the FSA in 2004-2009 (Bolat Zhamishev, Arman Dunayev, Yelena Bakhmutova) had the same authority and political clout that Grigoriy Marchenko and his fellow NBK reform team members had had in earlier years. As discussed above, it was not always easy for Marchenko to deal with the second-tier banks, but he always had Nazarbayev’s ear and support based on his track record of success with the banking sector and other economic reforms. Neither Anvar Saidenov, nor Bolat Zhamishev, Arman Dunayev, nor Yelena Bakhmutova enjoyed the same relationship with Nazarbayev, which would have enabled them to leverage it vis-à-vis the banks, despite the fact that the FSA was directly subordinate to the president.

The second factor was that, in FSA’s judgment, the current quality of the assets in the

---

banking system of Kazakhstan did not cause serious concern.\textsuperscript{213} The international rating agencies shared a positive outlook on the banking system as well. At the end of 2006, Fitch Ratings still did not consider foreign borrowing to be the principal risk to the banking system, though it did not exclude it in the future.\textsuperscript{214} JP Morgan classified Kazakhstan as a country with medium level of exposure to systemic risks and gave it a stable forecast.\textsuperscript{215}

It was quite a shock to the government, the NBK, the FSA, and the banks when in October 2007 S&P downgraded the country’s sovereign rating to the lowest investment category over concerns about the ability of the Kazakhstani banks to repay their massive foreign debt, given that the global liquidity crunch choked off further supply of cheap foreign currency debt. Simultaneously, S&P revised its outlook from stable to negative on eight banks, which included KKB, BTA, Halyk Savings Bank, Alliance Bank, Temirbank, BTA Ipoteka Mortgage Company, Nurbank, and Eurasian Bank.

President Nazarbayev accused international rating agencies of being "non-objective" and pledged to prevent the collapse of the banking sector. He announced that the government would allocate US$4 billion to support struggling banks, construction companies, and small and medium-sized businesses. The government also increased the guarantee on retail deposits to KZT5 million (US$41,667) from KZT700,000. For its part, the NBK immediately announced that it would provide additional liquidity to help the banks meet their external debt payments, which were expected to amount to US$3.8 billion in the Q4 and US$8 billion in 2008. At the same time, however, the banks were expected to meet their obligations on their

\textsuperscript{213} Ibid., p. 9.


\textsuperscript{215} Financial Supervision Agency of Kazakhstan (2006), op.cit., p. 10.
Indeed, none of the Kazakhstani banks were unable to meet their international debt repayment obligations in 2007 and 2008. Nor did they ask for government assistance in repaying the obligations. Nevertheless, in October 2008, the Senate passed the Law on Financial Stability, which laid the groundwork for the government to partially nationalize banks by buying their equity (10% minimum) in the event of serious financial difficulties. The government was obligated to sell the shares it acquired within one year from the day of the purchase, though it had the right to extend this period. The law stipulated that the bank shareholders could not object to the purchase of their shares by the government if they were unable to raise additional capital on their own. The government was also allowed to impose restructuring of bank’s assets.

On October 13, 2008, Nazarbayev signed a decree, creating Samruk-Kazyna National Welfare Fund. Samruk-Kazyna was part sovereign wealth fund, part joint stock company, which was tasked with managing strategic sectors and SOEs, such as KMG, Kazatomprom, the state uranium company, the national rail and postal services, etc. Kairat Kelimbetov, its Chairman, announced that it would be his Fund that would purchase bank shares, and he called on the Mazhilis to quickly pass the law on Samruk-Kazyna, giving the Fund legal authority to do that.

Grigoriy Marchenko, CEO of Halyk bank, initially was generally supportive of the law. Yet, after he became familiar with the exact scheme the government, the NBK, and the FSA put together to implement it he became its vocal opponent. In a leaked letter sent to Prime Minister Karim Massimov and FSA Chairwoman Bakhmutova Marchenko lambasted fictitious data and arguments used by the FSA to justify the compulsory purchase by the
government of 25% of Halyk shares. He protested the decision to buy the shares at a discount and decried government threats to withdraw the accounts of the national companies from the bank, put restrictions on the bank’s license, and introduce external administration should the bank refuse to participate in the government scheme. He warned about the negative international repercussions of the government forcing its way into the bank, which, he argued, had ample liquidity, was not exposed to excessive international borrowing, and thus did not require government assistance. At the end of his letter Marchenko stated point blank that the bank refused to sell the government 25% of its shares voluntarily.\footnote{Nurakhmet Kenzheev (2008). “Marchenko otkazalsya ot gospodderzhki.” Respublika-
delovoye obozreniye, №39 (128), November 7.} His opposition and criticism of the scheme were not only ignored, but three days later he was forced to change his stance and agree to it (see below).

By December 2008, the World Bank estimated the problems in the banking sector to be serious enough to name Kazakhstan the second most likely candidate for the collapse of its banking system after Iceland. Thus, the uncertainty caused by the global financial crisis opened the door for Nazarbayev’s inner circle, particularly those in the politically traditionalist faction, to put into action the Super-Khan recommendations on divesting the bankers identified as political opponents of the regime from their assets, using the October 2008 Law on Financial Stability as a guise. The divestiture at this particular juncture was important because of the uncertain outcome, political and economic, of the global financial and economic crisis for the stability and longevity of Nazarbayev and his regime.

The Super-Khan papers identified Mukhtar Ablyazov as Nazarbayev’s political opponent number two after Akezhan Kazhegeldin. Yet in 2005, he was allowed to come back to Kazakhstan and assume the leadership of BTA, which emerged as the biggest privately
owned bank in the former Soviet Union.

6.1. BTA nationalization

Turan-Alem Bank, which later became known as BTA, was established as a result of the merger of two state owned banks in 1997. In 2001, Yerzhan Tatishev, CEO of the bank, announced that 5 IFIs bought around 25% of BTA shares, which gave them 2 out of 9 seats on the Board of Directors. Participation of foreign investors in running the bank was important for BTA’s development. As Tatishev said, “The board of directors will influence the choice of strategy of the bank’s development, will supervise the credit policy, which, no doubt, will positively influence the functioning of the bank.”\(^{217}\) Tatishev and Mukhtar Ablyazov, CEO of Termirbank, BTA’s subsidiary, owned the rest 75% of bank shares.

In 2002, Ablyazov was imprisoned, following his participation in establishing the DVK. When he was released from prison in 2003, having promised to abandon politics, he left for Moscow. Reportedly, while Ablyazov was incarcerated, Tatishev was forced to transfer 9% of BTA shares to Nazarbayev. In 2004, shortly before his death from a self-inflicted gun-shot during hunting, Tatishev announced an ambitious plan of establishing BTA’s presence in 20 regions of Russia and 7 CIS countries through the purchase of subsidiary banks and opening its representative offices.

Following Tatishev’s death, Ablyazov was allowed to come back to Kazakhstan, once again promising Nazarbayev not to engage in political activities, to assume control over BTA as the Chairman of its Board of Directors. He also assumed control of Tatishev’s shares, becoming the majority shareholder of the bank.

Before the global financial crisis, BTA had emerged as the biggest privately owned bank in the former Soviet Union with consolidated assets of KZT3.671 billion (US$30.6 billion) and credit portfolio of KZT2.814 billion (US$23.5 billion). Its customer base included close to 1.3 million retail and 150,000 corporate clients. BTA owned subsidiary banks in Russia, Ukraine, Belarus, Georgia, Armenia, Kyrgyzstan and Turkey. It also operated representative offices in Russia, Ukraine, China and UAE. The bank, which was ranked 173rd among top world banks by The Banker, won numerous awards, including the “Bank of the Year in the CIS” (2006 and 2007) according to the Itogi magazine (Russia), the “Best Bank in Central Asia” according to the Euromoney (2007), and one of the “Top 40 Asian Banks” according to The Banker (2008). In 2007, Oxford-based European Business Assembly (EBA) awarded BTA its “Best Enterprise of Europe” in the banking sector of Eurasia prize. Its plans included an IPO at the LSE and moving its corporate headquarters to London.

As with other Kazakhstani banks, BTA did not have any difficulty to make its foreign debt repayments in 2008, about US$1.2 billion in total. On January 26, 2009, it repaid its two-year US$250-million Eurobond syndicated loan. Publicly, Ablyazov welcomed government’s decision to acquire 25% of shares in BTA, which were supposed to increase BTA capital by US$2.3 billion: “BTA believes that additional investments into the bank capital will have a positive effect on the stabilization of the national banking system, and support increased lending to Kazakhstan businesses and the general public.”

On 22 January 2009, the FSA delivered its final report on the results of the extraordinary inspection of BTA carried out in October 2008. The report concluded that BTA should increase its provisions for the loan portfolio by an additional US$3.6 billion. The same day, the FSA sent BTA a “Remedial Letter,” which required BTA to prepare within 10 days a plan of remedial measures to address the deficiencies alleged in the report. Simultaneously, the FSA demanded that the bank transfer its domestic deposit portfolio to Temirbank, BTA’s subsidiary, in order to provide the latter with “adequate capital and liquidity.”

Towards the end of January, the NBK significantly reduced its lending to BTA, denying access to regularly available facilities BTA had previously used, thus imposing a liquidity squeeze on BTA. KKB and Halyk also suspended inter-bank lending to BTA. Finally, wealthy individuals connected to the government and state-owned companies began to withdraw their deposits from BTA, including KazakhMunaiGas (KMG), Kazakhstan’s National Oil and Gas Company, which withdrew US$300 million in a single day.

In the evening of 29 January, the FSA faxed the Astana office of BTA, rather than its Almaty headquarters, a “Written Notice.” Citing that BTA’s loan loss provision were 6.6% of its loan portfolio, which was within the established range, the notice ordered the bank to increase the number to at least 24.9%. That unprecedented directive was accompanied by

---

219 Grigoriy Marchenko admitted that he refused to provide BTA with emergency liquidity injection unless the bank put up a collateral. Interview with Grigoriy Marchenko, September 25, 2011, Washington, D.C.


an even more extraordinary demand that the bank implement the directive by Sunday, February 1, which meant that the increase in the loan loss provision had to be made in the course of one remaining business day, 30 January. The demand put BTA in an impossible position – had it increased the loan loss provision as required, its capital adequacy ratio would have dropped below the required minimum set by the FSA.

When on January 30, the government injected KZT120 billion (US$98.4 million) in KKB and Halyk each and no mention was made of capital injections in BTA and Alliance Bank, it became clear that the government planned a different course of action for the latter two. Indeed, on 1 February, due to BTA’s inability to comply with the demand to increase its loan loss provision, the FSA requested the government to consider the acquisition of BTA by Samruk-Kazyna, which effectively meant bank’s nationalization. The next day, February 2, citing concerns about bank’s stability, the government issued Decree No. 100, ordering mandatory issuance of the new BTA shares and the purchase by Samruk-Kazyna of 75.1% stake in BTA for US$1.7 billion. Simultaneously, the decree announced the dismissal of Ablyazov and a number of senior managers, at which point they fled the country with some of them moving to London.

Margulan Seisenbayev, the majority shareholder of Alliance Bank, must have seen nationalization coming after receiving the news about the FSA “Written Notice” to BTA. On February 2, he offered the bank to the government gratis.

Nationalization of BTA was carried out with multiple violations of Kazakhstani laws. First, a 30-day period is given to provide comments or objections to an inspection report before any remedial measures can be agreed on and before the report can be published. Not only did the FSA violate these provisions, but it also did not observe its own stipulation that
gave BTA 10 days to provide comments and objections. Second, a meeting of shareholders to approve the issuance of additional shares has to take place. Such a meeting did not take place though it was scheduled for February 2nd. Third, shareholders have the right of preemption to buy any additional shares, if they are issued, and are given 30 days to exercise it. BTA shareholders were denied that right.

Fourth, under the existing laws only the government had the right to become a shareholder of a private company. The law on Samruk-Kazyna that would have allowed it to alienate and buy shares of banks and transfer them in trust management was adopted by the Mazhilis and signed by President Nazarbayev on February 14, i.e., 12 days after the BTA takeover. To legitimize Samruk-Kazyna actions in nationalizing BTA, a provision was added to the law that stipulated its retroactivity to January 1, 2009.

The government implicitly acknowledged the illegality of its actions vis-à-vis BTA by decoupling the October 2008 “capital infusion for 25% of shares” deal in the case of Alliance Bank, KKB and Halyk. It waited until after the passage of the law on Samruk-Kazyna to purchase 20.9% shares in Halyk in March and 21.2% shares in KKB in May.

In Alliance Bank’s case, Samruk-Kazyna made a US$200 million capital infusion in February, but the decree on compulsory acquisition of its shares and their sale to Samruk-Kazyna was adopted by the FSA only on December 30, 2009. Since the gratis transfer of shares offered by Seisenbayev was not stipulated in Kazakhstani laws, Samruk-Kazyna paid him KZT100, i.e., 83 cents, for 82.6% of Alliance shares.

Fifth, by law any decree affecting the rights of the owners of private property has to be published in order to take effect. Government decree No. 100 was not published prior to or after the takeover of BTA by the government.
How justified was the government in arguing that the takeover of BTA was necessary because of its concerns about the bank’s stability, which implied that the bank was on the verge of defaulting on its obligations or, even worse, bankruptcy? At the beginning of January 2009, Anvar Saidenov, the NBK Governor, answering a question in the Karavan newspaper about the possibility of defaults in the banking sector, said that he did not expect them to happen in any possible scenario they were considering. His deputy, Daniyar Akishev, went on to argue that there were no negative trends in the key indicators of the banking sector and expressed confidence that the banks would be able to meet their obligations on repayment of foreign loans and would not default.

Speaking in mid-January, Yelena Bakhmutova, FSA Chairwoman, ruled out any technical defaults by the banks. FSA statistics did not show any cause for alarm or that the key BTA indicators were significantly different compared to KKB, Halyk or other top banks. According to Berik Baishev, First Vice-President of the Bank Association of Kazakhstan, the total sum of non-performing loans (NPLs) in the banking system at the beginning of 2009 was US$8.2 billion or 9.9% of total loans. KKB had US$2.8 billion in NPLs, BTA US$1.26 billion, Alliance Bank US$725 million, ATF Bank US$700 million, etc.

As discussed above, international rating agencies were also optimistic about the health of the Kazakhstani banking sector. In an interview with the Respublika newspaper at the end of 2008...

---


224 Sergei Rasov, op.cit.
of November 2008, Yekaterina Trofimova, Deputy Director of Financial Institutes of S&P Paris office, stated that the level of liquidity in the banking sector was “absolutely adequate” and that its highly liquid assets considerably outweighed its obligations on foreign loan repayment.\textsuperscript{225}

Thus, the actions of the government vis-à-vis BTA leading up to its nationalization point to the conclusion that it was targeted by the government and that the government had no intention to assist the bank as had been agreed in the October 2008 MOU. The government’s argument that the bank was on the verge of bankruptcy and had to be rescued, if accepted, would mean that the NBK, FSA, Ernst & Young, as well as international rating agencies, have for over 11 years systematically turned the blind eye on the “illegal” activities of the BTA management and/or were negligent in performing their supervisory and auditing duties and have been manufacturing false BTA data.\textsuperscript{226}

If we accept President Nazarbayev’s ex post claim that “we did not know what kind of banks they [BTA and Alliance] were, where the money went,” aside from the doubt it casts on the competence of the NBK and FSA, it undermines the government’s case for nationalization. If the government, including the NBK and FSA, was not aware of “illegal activities” of the bank’s management or negative trends in its balance sheet, then it had no reason to nationalize it.\textsuperscript{227} In fact, during Nazarbayev’s last meeting with Ablyazov on January 20, 2009, i.e., twelve days before its nationalization, they talked about BTA and


\textsuperscript{226} Ernst & Young has been auditing BTA since 2001.

Temirbank for only 2 minutes, with neither raising the issue that BTA was in any kind of trouble and the president assuring Ablyazov that BTA would receive government’s assistance in the amount agreed on.\footnote{228}

Moreover, Marchenko revealed that as the CEO of Halyk bank he was “persuaded” to drop his opposition to the “capital infusion for 25% of bank shares” scheme and agree to Samruk-Kazyna becoming a shareholder of Halyk so that the latter’s acquisition of shares in BTA and Alliance Bank would not raise any questions.\footnote{229} Most likely, the government used the same argument “persuade” KKB to agree to the scheme.

All of the above leads to the conclusion that the takeover of BTA was driven primarily not by economic, but political considerations. In his expert report submitted on December 23, 2010, to the London High Court Of Justice in connection with the lawsuit of BTA against Mukhtar Ablyazov, Scott Horton, an American lawyer with extensive experience in dealing with commercial law cases in Russia, Kazakhstan, and other CIS countries, argues the following:

“The seizure of control of BTA … appears to be a textbook example of the “Super Khan” project. … I note a strong parallel between the transfer of control of BTA in the winter of 2009 and the plan for elimination of the political threat presented by “oligarchs” in the “Super Khan” papers. First, these papers identified Ablyazov very early on as a political opponent of Nazarbayev who sought “regime change” and presented a real threat to Nazarbayev’s “extended mandate.” They argue that the “oligarchs,” a class to which Ablyazov was reckoned, urgently needed to be separated from control of their major corporate assets …, stripped of their wealth, and perhaps also criminalized to render them unable to mobilize foreign opinion against Nazarbayev. Second, the papers speak of creation of special “funds” as a means of implementing this strategy. The fund could, working side-by-side with state power, be used to

\footnote{228} “Mukhtar Ablyazov obvinyaet vlasti Kazakhstana v prestupnom reiderstve.” Interview with KazTAG, April 13, 2009. Accessed at \url{http://www.fergananews.com/articles/6094}

\footnote{229} Interview with Grigoriy Marchenko, September 25, 2011, Washington, DC.
recapitalize commercial entities controlled by oligarchs, diluting their interests into something insignificant. Samruk-Kazyna, based on its role in this case and others like it, may well be a “fund” within the contemplation of the “Super Khan” papers. Third, the “Super Khan” papers stress the need for the selection of regime-loyal “trustees” who can manage the assets on an interim basis until they can be moved into new vehicles which are safely controlled by Nazarbayev. The individuals who were placed in positions of control at BTA, some of whom are known to me by reputation and others personally, all appear to have been selected for their unquestioned loyalty to Nazarbayev and his family. The Super Khan documents considered virtually the entire financial sector of Kazakhstan including banks, brokerages, insurance firms, funds and so forth, and presented these institutions and those that ran and owned them as potential adversaries who may support political opposition to the Nazarbayev regime.

Nationalization of BTA, however, was not the first case of politically motivated expropriation of bank shares and other assets from those whom the regime considered to be its opponents. When 1.85% of Alliance Bank shares were offered for sale at the Kazakhstani Stock Exchange in December 2004 it was revealed that the shares in a privately-owned bank were held by the Kazakhstani government, which expropriated them in 2002 from a “former shareholder” to pay for “his [personal] tax arrears and arrears in other payments to the budget.” The shareholder in question was Galymzhan Zhakiyanov, the former Governor of Pavlodar province and a co-founder of DVK, who like Ablyazov was viewed as a leader of the irreconcilable opposition and sentenced to prison in 2002. Simultaneously, Zhakiyanov was divested of his stake in Irtyshavia (Pavlodar-based regional airline), which must have been substantial because the government nationalized the airline.

---


6.2. The hunt for Ablyazov

The regime did not stop at BTA nationalization. In line with the strategy outlined in the Super Khan documents the Kazakhstani government opened a criminal investigation against Mukhtar Ablyazov, simultaneously requesting his extradition from Britain. The charges brought against the banker were referenced to the “theft of property on a large scale” article in the criminal code. Ablyazov was accused of creating a large number of Kazakhstani and offshore shell companies, which were issued fraudulent loans that allowed him and his associates to syphon off BTA assets in 2005-2008. The Prosecutor General’s Office estimated the total amount of “stolen” assets to be over US$5 billion, citing eleven complaints against Ablyazov filed by BTA in The High Court Of Justice (Queen's Bench Division, Commercial Court) in London.232

It is noteworthy that all eleven complaints were civil rather than criminal lawsuits, which would have required proving the banker’s alleged crimes “beyond a reasonable doubt.” Civil lawsuits are decided based on lower standards of proof such as “the preponderance of the evidence,” i.e., showing that an event in question has more likely than not occurred in a certain way. Another important difference is that most criminal cases always involve a trial by jury, while a judge decides most civil cases. By pursuing civil lawsuits against Ablyazov and other former senior BTA officials, the Kazakhstani regime had thus chosen a strategy that increased its chances of winning.

The initial court proceedings did not yield the quick return of US$ 5 billion expected by the Kazakhstani side. It took years and hundreds of court hearings, which involved more than a dozen judges and over a hundred lawyers as well as Ablyazov’s own recklessness before BTA was able to win some of the cases against its former chairman. In October 2009, the court compelled Ablyazov to disclose his assets in the amount of the damages sought by BTA (US$5 billion), and to suspend all business activities. The court, however, prohibited Hogan Lovells, a British law firm hired by BTA to track down Ablyazov’s assets and take its case against him to the High Court, to disclose information about the banker’s assets to BTA. It also ruled that the information could not be used in any future lawsuit against the former BTA chairman and his associates.

The legal tug-of-war over the assets continued until December 2010, when BTA won an appeal court ruling that forced Ablyazov to place his assets into receivership. In 2011, Ablyazov launched a counter-appeal to have the cases against him thrown out, arguing that they were politically motivated. His counter appeal was denied on the grounds that he was being sued by BTA, the Kazakhstani government. At the same time, in July 2011, the banker was granted political asylum in Britain while Kazakhstan’s request for his extradition was denied.233

Mukhtar Ablyazov, however, failed to comply with the court order to disclose all of his assets and stop all business activities. That gave BTA an opportunity to provide the court with enough evidence about undisclosed assets to have Ablyazov charged with lying under oath. Days before sentencing, the banker fled Britain, which led the London High Court to issue an arrest warrant on February 16, 2012, for failure to appear in court for sentencing.

233 In April 2014, the British government revoked political asylum it granted Ablyazov.
Ablyazov was convicted on three counts of contempt of court and sentenced to 22 months in jail for failing to completely disclose his assets and comply with a court-ordered freeze on them. As Justice Maurice Kay of the Court of Appeal said in his judgment, “It is difficult to imagine a party to commercial litigation who has acted with more cynicism, opportunism, and deviousness towards court orders than Mr. Ablyazov.”

Following his flight, the court forbade Ablyazov to continue his defense unless he surrendered and made a full disclosure of his assets. As a result, the High Court ruled in favor of BTA by default on several of its claims, allowing the bank to retrieve US$4 billion. On July 31, 2013, Ablyazov was arrested in France. He is currently fighting extradition to Ukraine, Russia, and Kazakhstan.

Irrespective of whether the cases against Ablyazov filed by Kazakhstani government-owned BTA in London have merit or not, two things stand out. The first one is the incoherence of the Kazakhstani government case against the former BTA chairman. While the Prosecutor General’s Office accused him of embezzling US$ 5 billion, two senior government officials offered differing accounts of Ablyazov’s “wrongdoings.” The first one was voiced by Aidan Karibzhanov, Deputy Chairman of Samruk-Kazyna, who supervised the nationalized BTA in 2009-2012. Karibzhanov suggested that the bank’s current predicament was not the result of “mistakes in management, embezzling, wrong strategy, or wrong investment decisions. The history of BTA is related to money laundering, it [the bank] was a money-

---

laundering machine, which imitated banking activity. 80% of loans were given to relatives of its senior managers.”

Grigoriy Marchenko, who became the Governor of the NBK on the eve of BTA’s nationalization, characterized Ablyazov’s activities as chairman of the BTA Board of Directors as “a mistake,” not a criminal act of embezzlement. The mistake – whether innocent or deliberate Marchenko was not sure – was that Ablyazov used BTA capital to buy too much real estate in Kazakhstan and Russia and did not heed the advice given to him by many, including Marchenko, to sell it once the U.S. mortgage crisis began and real estate prices tumbled, first in Kazakhstan and then in Russia. Thus, according to Marchenko, it was the drop in real estate prices that caused the deterioration in the quality of BTA’s credit portfolio and required capital infusion, not Ablyazov’s criminal activity.

In the same interview, however, Marchenko asserted that Ablyazov transferred US$10 billion from BTA, which he saw as the root of all the problems at the bank, albeit acknowledging that the money was not stolen, but invested in real estate development in a number of countries. The fact that BTA was seeking to recover only US$5 billion and Marchenko’s statement that Ablyazov was investing BTA money in real estate raises a number of questions. First, did the exiled banker really steal the money? Second, if he did, then how much (US$5 or 10 billion)? Third, how much of the allegedly stolen money was his own, i.e., what was Ablyazov’s stake in BTA?

---


The issue of Ablyazov’s ownership share in BTA was skirted by the Kazakhstani government and FSA at the time of nationalization and by the new management of BTA in its legal proceedings against the exiled banker in London. He was not paid any compensation for his shares in the bank at the time of its nationalization or later. Marchenko’s claim that “no one knows the percentage of the bank [shares] he owned” is hardly believable (Ablyazov claimed he owned 70%). Under the provisions of the 2001 consolidated supervision law, which was drafted by Marchenko and his team and whose passage by the Mazhilis he personally lobbied hard for, the NBK and later the FSA were obligated to know the ownership structure of every bank in the country. It will take years, if ever, before we will be able to learn about the exact ownership structure of BTA prior to its nationalization.

The answer to the question whether Ablyazov was embezzling BTA money in 2005-2008, as the government alleged, has already been provided by Karibzhanov and Marchenko, themselves senior government officials. Even Ablyazov’s detractors could not but acknowledge the fact that he was investing the loans he obtained at BTA into real estate projects rather than stealing them. The asset value of these projects in Russia alone was estimated at US$23 billion in mid-2008. The issue of whether the loans were obtained illegally with violation of related-party loans provisions is a separate issue, which, in the assessment of the international rating agencies, has plagued the entire banking system of Kazakhstan, not exclusively BTA.

---

237 Ibid.

The answer to the question whether Ablyazov in fact transferred some of BTA money into his offshore accounts rather than invested it is complicated. It appears that he did though exactly how much is impossible to assess. The most interesting and important questions related to the transfer are, why and when. In 2011, the Investigative Committee of the Ministry of Internal Affairs of the Russian Federation, which investigated Ablyazov’s activities in Russia, came to the conclusion that when “at the end of January 2009, Mukhtar Ablyazov, the owner of the bank, learnt about the decision of the Kazakhstani authorities to nationalize BTA bank, which at the time was the biggest retail bank of the country, he gave an order to his subordinates to transfer the most liquid assets from the bank.”

Thus, it was the decision of the Kazakhstani government to nationalize BTA without any recompense that provoked Ablyazov to commit an illegal and criminal act of transferring money from the bank, which happened in the last days of January 2009 rather than in 2005-2008. Given the timeframe estimate provided by the Investigative Committee of the Russian Federation, it is doubtful, though, that he would have been able to transfer the sum of US$5-10 billion cited by various Kazakhstani government agencies and officials site looks.

Even if he did and BTA and the Kazakhstani government were interested only in returning the money, as Grigoriy Marchenko alleged in the interview quoted above, they would have had better chances and faced a much faster and less costly process by pursuing the case against Ablyazov in Russia where his assets valued at US$23 billion before the crisis, were well known to the Russian and Kazakhstani authorities. The fact that London was

---


240 BTA filed a criminal complaint against Mukhtar Ablyazov in Russia. Based on the BTA complaint, the Investigative Committee of the Russian Federation charged Ablyazov in
chosen instead as the main venue pointed to the recommendations outlined in the Super Khan papers that opponents of the regime, past, present, or potentially future, should be pursued and vilified in the West, including through filing criminal complaints, to deny them refuge and acceptance in the West, which they could use for activities to undermine Nazarbayev’s regime.

6.3. Conclusion

The global financial and economic crisis, which began in 2007, provided the Kazakhstani traditionalist elite with an opportunity to implement the strategy of divesting Kazakhstani bankers of their assets and imposing the regime’s control over the banking sector as outlined in the Super-Khan papers. The October 2008 Law on Financial Stability provided a legal cover to implement this strategy by requiring the compulsory sale of bank shares to Samruk-Kazyna. The October 2008 Memorandum of Understanding signed between Samruk-Kazyna and the four biggest banks outlined the agreed course of actions within the framework of the “capital infusion for 25% of bank shares” scheme.

October 2009 with stealing US$70 million from BTA Russia (renamed AMT Bank in March 2010), where BTA had a 22.26% and Ablyazov had a 19.77% stake. The outcome of the case was indicative of other cases that involved the banker’s assets and projects in Russia. In July 2011, the Central Bank of Russia withdrew AMT’s banking license and in June 2012 the Moscow Arbitration Tribunal declared the bank bankrupt. Both decisions were made irrespective of the fact that the Deposit Insurance Agency of the Russian Federation (FDIC-type organization) estimated the total bank assets to be US$2.06 billion whereas the claims of the bank creditors totaled US$1.02 billion and that its capital adequacy ratio was 26.7% while the Central Bank of Russia required only 10%. This and other cases against Ablyazov in Russia that dealt with freezing and subsequent disposal or transfer of ownership title of Ablyazov’s property and assets, particularly commercial real estate, resembled more an opportunistic seizure of his assets by various Russian and Kazakhstani business interests rather than adjudication of justice.
Subsequent government actions, however, point to the fact that the real goal was to nationalize BTA rather than to assist it with maintaining its financial health and stability. These actions were prompted by Ablyazov’s earlier involvement in opposition politics. Though Ablyazov stuck to his 2003 pledge to abandon all political activity the apprehension among Nazarbayev loyalists was that with over 50% of BTA capital invested outside Kazakhstan, the planned IPO on the LSE, and the movement of BTA’s head office to London, Ablyazov would get out of government’s reach and could channel the enormous resources at his disposal against the Nazarbayev regime should he decide to reenter politics.

The real and alleged crimes of Mukhtar Ablyazov aside, his main offence was, in the opinion of his friends and detractors alike, his idealism, recalcitrance, and stubbornness. As Yertysbayev put it, “Mukhtar Ablyazov … is an idealist. But an idealist in politics is a social catastrophe.” It was Ablyazov’s refusal to cooperate with the regime that explains the actions taken by the government against him and the bank he controlled, whose goal was to preemptively eliminate any possibility of such “catastrophe” for the regime (rather than society).

---


Chapter VII. The banking sector after the BTA nationalization

The nationalization of BTA did not resolve the problems the government alleged the bank had prior to nationalization. Quite the opposite, successive teams of managers appointed by Samruk-Kazyna to run the bank not only were unable to stabilize it, but exacerbated its situation to the degree the only solution was to declare it bankrupt or merge it with another bank.

Shortly after Samruk-Kazyna infused US$1.7 billion in the bank and took it over, the bank defaulted, which led to the first restructuring of its debts in 2010. Under the terms of restructuring, foreign creditors and shareholders agreed to write off US$7.8 billion in debt, bringing it down to US$4.4 billion, and to increase the term of its repayment to 20 years. Simultaneously, foreign creditors and shareholders were paid US$945 million in cash. Samruk-Kazyna also bought BTA bonds worth US$4.45 billion and converted that sum into the bank’s capital. As a result of the first restructuring, Samruk-Kazyna’s stake in the bank increased to 81.48% of its shares, while that of foreign shareholders decreased to 18.5%.

However, the new management proved to be ineffective as it was unable to capitalize on the debt restructuring and improve the bank’s performance, which led to another default and the second restructuring in 2012. This time foreign creditors and shareholders were paid US$1.6 billion in cash and US$750 million in new BTA bonds. Samruk-Kazyna converted its US$1.2 billion deposit in the bank into BTA shares, increasing its equity in the bank to 97.3%.
Thus, the total cost of the BTA nationalization for the Kazakhstani government is over US$10 billion. That, however, may not be the final figure. The bank has negative equity, continues to sustain losses and is in default. Umut Shayakhmetova, CEO of Halyk argues, the Committee for Financial Control and Supervision\(^{243}\) has not only tolerated the incompetence of the bank’s management, but violates the banking law by allowing a bank with negative equity to accept deposits from retail customers. In her estimate, the total cost of nationalization of BTA, “this nightmare with no end,” as she called it, may exceed US$12 billion.\(^{244}\)

The high cost of the inept management of BTA by the regime loyalists was acknowledged by President Nazarbayev. At a government meeting in January 2013, he said the following about the US$10 billion channeled to the banking sector at the height of the crisis: “We don’t see them [US$10 billion], they disappeared somewhere” though “everyone said they would be paid back.”\(^{245}\)

7.1. KKB and Nurzhan Subkhanberdin: uncertainty continues

Like Mukhtar Ablyazov, Nurzhan Subkhanberdin was identified by name in the 2003 Super Khan paper as an oligarch who posed a threat to Nazarbayev’s regime and who should

\(^{243}\) In 2011, the FSA was brought back into the NBK under a different name – the Committee for the Control and Supervision of the Financial Market and Financial Organizations of the National Bank of Kazakhstan.


be divested of his assets. Attempts to cast him as a “Kazakhstani Khodarkovsky” failed and were abandoned after the 2004 Mazhilis elections. In 2009, he and KKB avoided the fate of Mukhtar Ablyazov and BTA, arguably, because of the protection of Karim Masimov, Prime Minister of Kazakhstan in 2007-2012. Masimov, who as a significant shareholder in KKB (28.76% of shares) had a personal interest in maintaining its stability. He offered a personal guarantee of Subkhanberdin’s loyalty and the regime settled for the capital infusion of … for 21.26% shares in the bank.246

Nevertheless, to avoid Ablyazov’s fate, Subkhanberdin moved to London at the turn of this decade. He rarely visits Kazakhstan and even skips annual meetings of the Board of Directors of KKB, which he continues to chair. According to senior bank management, however, Subkhanberdin continues to “show interest in the bank.”247

Subkhanberdin may now be forced to make more frequent visits to the country. For many years, Samruk-Kazyna attempted to find a foreign investor or a buyer for BTA to avoid its bankruptcy. Having failed to generate any interest outside Kazakhstan, Samruk-Kazyna approached Halyk in 2013 with an offer to sell it the bank, which Halyk turned down. Finally, on December 27, 2013, Samruk-Kazyna “persuaded” a consortium of KKB and Kenis Rakishev, a Kazakhstani businessman and son-in-law of Imangali Tasmagambetov, a former Prime Minister and a Nazarbayev loyalist, to buy 93% (46.5% each) of its shares in BTA for


US$930 million. The sale of BTA to the consortium would be the last chapter in the history of the once biggest private bank in the former Soviet Union. After the sale it would be absorbed by KKB.

The sale, however, is not a done deal as there are a number of BTA creditors, bond holders, and minority shareholders, who did not accept the terms of the second debt restructuring and have already filed lawsuits in U.S. courts against BTA and Samruk-Kazyna in an attempt to block the sale of BTA.

The scheduled sale and merger with BTA may also create additional problems for KKB given BTA’s problems with liquidity, asset quality, and non-performing loans (NPLs). KKB’s loan portfolio is high-risk and of “very poor quality” with 54% of the portfolio concentrated in real estate, which accounts for high level of NPLs (31%) and restricted loans. As a result, the NBK ordered the bank in December 2013 to make loan loss provisions in the amount of US$3.75 billion, which might create problems with its capital adequacy ratio and adversely impact its liquidity flows.

On top of that, Nurzhan Subkhanberdin and Nina Zhusupova, founding CEO of KKB, will run into greater difficulty to maintain control over the bank, which had already been undermined in 2009. It is estimated that after the merger the pair would have a 38-40% of shares in the new KKB, while Karim Masimov (through Alnair Capital Holding) will have 20-22%, Samruk-Kazyna – 9-10%, and Kenes Rakishev will have 21-23%. It is alleged that the latter is a front for Timur Kulibayev, Nazarbayev’s son-in-law and a competitor of KKB as

---

248 The value of 100% shares of BTA is thus valued by the government at US1 billion, which is significantly less than US$1.7 billion it paid got 75.1% shares at the times of nationalization in February 2009.

the majority shareholder of Halyk. Not only will Subkhanberdin and Zhusupova will lose operational control over the bank, but the new mix of its shareholders, such as it is, may create a potential for permanent conflict, and this undermine the bank’s stability. The change in the shareholder structure, however, allows Nazarbayev another avenue to exercise control over the bank and guarantee Subkhanberdin’s loyalty.

7.2. The regime takes control over the banking sector

The fact that Samruk-Kazyna decided to keep 7% of its shares in BTA and announced that it would exercise its option under the 2008 financial stability law to hold on to 21.26% of its shares in KKB means not only that the government would increase its share in the bank’s equity. It also signals the regime’s intention to maintain control over KKB and the banking sector in general.

The latter is evident from the decision to sell only part of Samruk-Kazyna shares in Alliance Bank and Temirbank and to sell them to a Nazarbayev loyalist and a member of his inner circle, billionaire Bulat Utemuratov. The agreement to sell 79.88% of Samruk-Kazyna shares in Temirbank and 16% of its shares in Alliance bank was reached on December 11, 2013. Samruk-Kazyna will continue to own 51% shares in Alliance Bank.

Simultaneously, in 2013, Samruk-Kazyna sold all of its common shares of Halyk Bank back to the majority shareholders, Nazarbayev’s daughter and her husband, who now own 72.3% of the bank’s shares. As mentioned above, the decision to have Samruk-Kazyna acquire shares in Halyk was made to divert attention from the true motive behind the 2008 “capital infusion for 25% bank shares” program – nationalization of BTA. The political

---

Adilov (2014).
loyalty of Nazarbayev’s daughter and her husband has never been questioned. Still, as an added layer of control over the bank’s activities, Alexander Pavlov, a Nazarbayev loyalist and former First Deputy Prime Minister and Minister of Finance, was installed as the Chairman of Halyk’s Board of Directors as of 2004.

With the sale of 99.75% of shares in ATF Bank, the 5th biggest bank in Kazakhstan, in March 2013 to Galimzhan Yesenov, the son-in-law of Nazarbayev’s nephew Akhmetzhan Yesimov, the akim (mayor) of Almaty, the regime accomplished its goal of taking control of the banking system. Through direct or indirect ownership or shareholding in the five biggest banks (KKB, Halyk, BTA, Alliance, and ATF), the regime now controls about 75% of assets in Kazakhstan’s banking system (see Figure 5).

Figure 5. 5-Bank concentration, 1997-2011

A qualitative distinction between the notions of “state controlled” and “regime controlled” should be emphasized. In the case of the Kazakhstani banking sector, political
control over the banking sector was established primarily through keeping private ownership of the banks and resorting to their partial or full nationalization only as a temporary measure. That allows the government to claim that the dynamics in the banking sector are still driven by market economic principles, as was the case before 2009. The problem of uncertainty about the political loyalty of the top Kazakhstani bankers was thus resolved by changing the ownership structure of the biggest banks to ensure that these banks are owned, completely or partially, by Nazarbayev’s relatives and loyalists from his inner circle. Just opting for state control over the biggest banks – and the banking sector – through their nationalization, full or partial, did not, in the minds of Nazarbayev and entourage, guarantee the resolution of this problem to their full satisfaction.

7.3. The Kazakhstani banking sector since the financial crisis

Though the international rating agencies assess the general outlook for the banking sector as stable, a number of serious problems remain. The major problem plaguing the banking sector since the global financial and economic crisis is non-performing loans (NPLs). In 2013, according to the World Bank, Kazakhstan’s banking sector with 31% of NPLs had the highest percentage of NPLs in the world. Moody's Investors Service puts it even higher – at 45%. The trend in NPLs remains upward as the banks are becoming more transparent about their loan portfolios.
Initially, the government planned to assist the banks with their NPLs. In October 2008, it announced the creation of the Fund of Troubled Assets with initial capitalization of US$1 billion, which was to buy defaulted mortgages and those NPLs which had real estate as collateral. The fund was not activated, as the regime opted for nationalization or partial nationalization of the biggest banks. However, in January 2012, the idea was revived, this time as the Fund of Troubled Loans within the NBK. Although the fund has been formally established, it has yet to start its operation.

Even though the problem of NPLs remains unresolved, the banks continue with the same credit policy model, focusing on consumer loans and credits to highly volatile sectors such as trade, construction and services, which has caused the banks to have the highest share of NPLs in the world.

Apart from the growing NPL problem, other negative trends in the Kazakhstani banking system include the low quality of bank management and operational transparency,
low diversification of credit policy, and high ratio of credits to affiliated persons and businesses.\textsuperscript{251} Since the start of the crisis the banks have been largely cut off from international liquidity markets, which has prevented further borrowing and thus has had a positive effect on their foreign debt ratio. As a result, the banks have to rely mostly on domestic corporate and retail deposits, which are primarily short-term, to raise capital that leads to further decline in the long-term crediting of the economy.

7.4. Banks and the real economy: to intermediate or not to intermediate?

Low diversification of credit policy is a mirror image of the low degree of the diversification of Kazakhstan’s economy as well. Since independence Kazakhstan has emerged as the world’s 12\textsuperscript{th} biggest producer of oil, the world’s biggest producer of uranium, etc. The share of the oil and gas sector in GDP has been steadily increasing, from 10.9\% in 2001 to almost 22\% in 2011. The processing of mineral commodities, which likely makes up a significant share of manufacturing, accounts for up to 11.4\% of GDP.\textsuperscript{252} The overall share of natural resource rents in GDP (the sum of oil, natural gas, coal, mineral, and forest rents) in Kazakhstan was 38.2 \% in 2011 (compared to 22\% in Russia). The share of oil, other mineral products and metals in exports equaled 88.2\% in 2013.\textsuperscript{253}

\begin{thebibliography}{99}


\end{thebibliography}
In 2012, President Nursultan Nazarbayev inaugurated “Kazakhstan-2050” program, the goal of which is to make Kazakhstan one of the 30 most developed countries by 2050. To achieve it, a new strategy of economic development has been adopted. Its centerpiece is diversification of the economy through the creation of small- and medium-sized enterprises (SME) in non-extractive sectors of the economy.

As of January 1, 2013, the share of SMEs in the country’s GDP is only 17.8%, compared to the Organization for Economic Cooperation and Development (OECD) member countries, where it is over 95%. The goal set by “Kazakhstan-2050” is to increase their share to 35-36% by 2020 and by 2050 to 50% of GDP.

Achieving this goal for Kazakhstan should not be a problem, at least in one respect: a poll conducted in 2012 showed that 89% of Kazakhstani would like to start their own business, whereas today the SME sector employs only 28% of the workforce. The fact that 89% of the Kazakhstani want to start their own business shows no shortage of their enthusiasm for risk-taking and entrepreneurship. The same poll, however, revealed the reasons why the Kazakhstani were reluctant to start their own businesses—30% cited high administrative and tax burdens, while 59% pointed to the lack of government help with startup capital. The latter figure demonstrates that the Kazakhstani do not expect any help from the banking sector to start their business. According to the World Bank, in 2009, only 18.8% of SMEs had a line of credit or loan from a financial institution in Kazakhstan.

The need for the diversification of the economy is partly driven by the growing dependence on imports of consumer goods and particularly foodstuffs, which before independence Kazakhstan used to produce and export. The share of light industry (clothes,
shoes, furniture, consumer electronics and home appliances) in total industrial output has decreased from 2.3% in 2000 to 0.4% in 2009. As a result, today Kazakhstan imports 92% of its consumer goods.  

Kazakhstan is becoming increasingly dependent on imports of foodstuffs, except for wheat production, where the country has succeeded in becoming one of the top 10 world suppliers of high quality wheat and the top world exporter of flour. Lack of investment in other segments of agriculture, however, has made the country heavily dependent on food imports, which is a reversal from the Soviet period. While in 1990, Kazakhstan exported 180,000 tonnes of meat, in 2011, it imported about 20,000 tonnes. The country now imports 67% of its cheese and yogurt, 80% of its milk, and 40% of its butter.  

President Nazarbayev has spoken on numerous occasions about economic diversification, the importance of SMEs, and the need for the banks to extend credit to the real sector of the economy. In October 1995, he met with the bankers and criticized them for not performing their main task – issuing credits to the real sector of the economy to revitalize it.

---


257 Real economy is usually defined as the part of the economy that produces goods and services and that excludes the financial sector. However, Nazarbayev uses the term to mean only physical production of goods (material’noe proizvodstvo), which reflects the definition widely used by politicians, economists, and scholars in the former Soviet Union.
“Bank lawlessness (bespredel),” he said, “forces manufacturers and businessmen to create their own institutions to accumulate capital.”

In the 1990s, there were objective reasons why banks were hesitant to credit the real sector of the economy: high inflation, lack of long-term capital, difficulty with assessing the true credit-worthiness of borrowers since many enterprises and businesses had liquidity problems owing to nonpayment or were start-ups.

Table 2. Banking system, 1993-2000

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Banks</td>
<td>204</td>
<td>184</td>
<td>130</td>
<td>101</td>
<td>81</td>
<td>71</td>
<td>55</td>
<td>48</td>
</tr>
<tr>
<td>Number of Foreign Owned Banks</td>
<td>5</td>
<td>8</td>
<td>8</td>
<td>9</td>
<td>22</td>
<td>20</td>
<td>18</td>
<td>16</td>
</tr>
<tr>
<td>State Owned Banks % of Assets</td>
<td>24.3</td>
<td>28.4</td>
<td>44.8</td>
<td>23.0</td>
<td>19.9</td>
<td>1.9</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bad Loans % of Total Loans</td>
<td>14.9</td>
<td>19.9</td>
<td>6.0</td>
<td>4.7</td>
<td>5.5</td>
<td>2.1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Credit to Private Sector % of GDP</td>
<td>49.3</td>
<td>26.6</td>
<td>7.1</td>
<td>6.3</td>
<td>4.3</td>
<td>5.4</td>
<td>7.4</td>
<td>10.6</td>
</tr>
<tr>
<td>Broad Money % of GDP</td>
<td>27.9</td>
<td>13.1</td>
<td>11.4</td>
<td>9.5</td>
<td>10.3</td>
<td>8.6</td>
<td>13.6</td>
<td>15.3</td>
</tr>
</tbody>
</table>

Source: John Bonin and Paul Wachtel (2002)

Since the beginning of the 21st century, Kazakhstan’s economy has achieved a remarkable growth fueled primarily by the sharp increase in oil production. It is reflected in the constant growth of GDP, GDP per capita, broad money, and other indices (Figures 7, 8, 9).

258 “President N. Nazarbayev vstretilsya s veduschimi bankirami respubliki.” Kazakhstanstanskaya pravda, October 6, 1995.
Figure 7. GDP of Kazakhstan, 1990-2011

Figure 8. GDP per capita in Kazakhstan, 1990-2011
As the economy grew, Kazakhstan achieved macroeconomic stability, which in theory should have encouraged economic actors, including banks, to invest long-term (Table 3). By 2003, banking sector reforms were completed as well, raising the expectation that crediting of the real sector of the economy by the banks would finally take off.

Table 3. Macroeconomic stability, 2006-2013

<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rank</td>
<td>14</td>
<td>25</td>
<td>74</td>
<td>59</td>
<td>26</td>
<td>18</td>
<td>16</td>
<td>23</td>
</tr>
</tbody>
</table>


---

260 Liquid liabilities are also known as broad money, or M3. They are the sum of currency and deposits in the central bank (M0), plus transferable deposits and electronic currency (M1), plus time and savings deposits, foreign currency transferable deposits, certificates of deposit, and securities repurchase agreements (M2), plus travelers checks, foreign currency time deposits, commercial paper, and shares of mutual funds or market funds held by residents.
In 2008, Nazarbayev reminded the bankers of the favorable conditions the government created for the development of the banking sector and said “Now that the banking sector is firmly established, I think it will be fair to request similar help from it in the future to keep the development of the country’s economy on track. What I have in mind here is the concept of “social responsibility” in business.” Pointing to the stability of the economy and of personal incomes, he argued that “The time has passed when the high interest rates were justified by the high level of credit risk” and expressed his surprise that “our banks are still not ready to move on from this period of high rates.”

The expectation that the banks would start crediting the real sector of the economy also rested on the steady growth in bank deposits and bank loans in the years preceding the global financial crisis (Figures 10 and 11).

Figure 10. Bank deposits to GDP ratio, 1994-2011

---

The banks, however, showed no sign of moving in the direction of diversification of their loan portfolios away from consumer lending, trade and construction sectors before or after the global financial crisis (Tables 4 and 5). The share of credits to the real sector of the economy remained low. Moreover, the share of small business loans in the total volume has decreased from 11.7% to 5.8% in 2007 to 2012.²⁶²

---

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total, including:</strong></td>
<td>974,621</td>
<td>1,502,418</td>
<td>2,588,744</td>
<td>4,803,649</td>
<td>7,242,981</td>
<td>7,385,680</td>
<td>7,609,178</td>
<td>7,572,930</td>
<td>8,793,207</td>
</tr>
<tr>
<td><strong>Nonbanking legal entities</strong></td>
<td>850,629</td>
<td>1,192,508</td>
<td>1,911,800</td>
<td>3,205,192</td>
<td>4,685,205</td>
<td>5,072,179</td>
<td>5,412,733</td>
<td>5,459,115</td>
<td>6,451,499</td>
</tr>
<tr>
<td><strong>Individuals</strong></td>
<td>123,992</td>
<td>309,910</td>
<td>676,943</td>
<td>1,598,457</td>
<td>2,557,776</td>
<td>2,313,502</td>
<td>2,196,445</td>
<td>2,113,814</td>
<td>2,341,709</td>
</tr>
<tr>
<td><strong>By economic sector:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Industry</td>
<td>271,507</td>
<td>311,705</td>
<td>430,231</td>
<td>514,332</td>
<td>687,961</td>
<td>704,040</td>
<td>719,393</td>
<td>748,421</td>
<td>1,069,263</td>
</tr>
<tr>
<td>Agriculture</td>
<td>110,989</td>
<td>123,310</td>
<td>159,148</td>
<td>211,830</td>
<td>262,490</td>
<td>256,258</td>
<td>315,348</td>
<td>299,462</td>
<td>317,306</td>
</tr>
<tr>
<td>Construction</td>
<td>78,491</td>
<td>150,655</td>
<td>316,958</td>
<td>653,254</td>
<td>1,256,951</td>
<td>1,473,576</td>
<td>1,432,038</td>
<td>1,372,123</td>
<td>1,309,802</td>
</tr>
<tr>
<td>Transport</td>
<td>30,471</td>
<td>57,094</td>
<td>92,429</td>
<td>118,997</td>
<td>144,745</td>
<td>169,123</td>
<td>212,432</td>
<td>260,645</td>
<td>352,165</td>
</tr>
<tr>
<td>Communication</td>
<td>7,539</td>
<td>17,733</td>
<td>20,980</td>
<td>27,994</td>
<td>35,554</td>
<td>42,767</td>
<td>60,977</td>
<td>67,509</td>
<td>45,109</td>
</tr>
<tr>
<td>Trade</td>
<td>274,750</td>
<td>387,160</td>
<td>640,592</td>
<td>1,134,674</td>
<td>1,527,669</td>
<td>1,671,559</td>
<td>1,776,169</td>
<td>1,758,813</td>
<td>1,829,281</td>
</tr>
<tr>
<td>Other (consumer loans, including mortgages)</td>
<td>200,874</td>
<td>454,759</td>
<td>928,406</td>
<td>2,142,569</td>
<td>3,327,610</td>
<td>3,068,358</td>
<td>3,092,820</td>
<td>3,065,957</td>
<td>3,870,281</td>
</tr>
</tbody>
</table>
Table 5. Bank loans by the economic sector, 2004-2012, %

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total, including:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nonbanking legal entities</td>
<td>87%</td>
<td>79%</td>
<td>74%</td>
<td>67%</td>
<td>65%</td>
<td>69%</td>
<td>71%</td>
<td>72%</td>
<td>73%</td>
</tr>
<tr>
<td>Individuals</td>
<td>13%</td>
<td>21%</td>
<td>26%</td>
<td>33%</td>
<td>35%</td>
<td>31%</td>
<td>29%</td>
<td>28%</td>
<td>27%</td>
</tr>
<tr>
<td>Economic sector, Including:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Industry</td>
<td>28%</td>
<td>21%</td>
<td>17%</td>
<td>11%</td>
<td>9%</td>
<td>10%</td>
<td>10%</td>
<td>10%</td>
<td>12%</td>
</tr>
<tr>
<td>Agriculture</td>
<td>11%</td>
<td>8%</td>
<td>6%</td>
<td>4%</td>
<td>4%</td>
<td>3%</td>
<td>4%</td>
<td>4%</td>
<td>4%</td>
</tr>
<tr>
<td>Construction</td>
<td>8%</td>
<td>10%</td>
<td>12%</td>
<td>14%</td>
<td>17%</td>
<td>20%</td>
<td>19%</td>
<td>18%</td>
<td>15%</td>
</tr>
<tr>
<td>Transport</td>
<td>3%</td>
<td>4%</td>
<td>4%</td>
<td>2%</td>
<td>2%</td>
<td>2%</td>
<td>3%</td>
<td>3%</td>
<td>4%</td>
</tr>
<tr>
<td>Communication</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>0.4%</td>
<td>0.5%</td>
<td>0.8%</td>
<td>1%</td>
<td>0.5%</td>
</tr>
<tr>
<td>Trade</td>
<td>28%</td>
<td>26%</td>
<td>25%</td>
<td>24%</td>
<td>21%</td>
<td>23%</td>
<td>23%</td>
<td>23%</td>
<td>21%</td>
</tr>
<tr>
<td>Other (consumer loans, including mortgages)</td>
<td>21%</td>
<td>30%</td>
<td>35%</td>
<td>44%</td>
<td>46%</td>
<td>42%</td>
<td>41%</td>
<td>41%</td>
<td>44%</td>
</tr>
</tbody>
</table>

It is reasonable for President Nazarbayev to expect the Kazakhstani banks to behave no different than banks in any other country with a market economy, i.e., act as financial intermediaries: accumulate deposits, convert them into loans, and channel those to economic agents who are short of funds.

On the face of it, if we look on the quantitative side, the banks were quite successful in fulfilling the task of financial intermediation – its ratio before the crisis, as measured by the private bank credit to GDP, was approaching to that of the United State. At its peak in 2009, it was 50.6% of GDP compared to 61.6% in the U.S. (Figure 12).
If we take into the account that the end goal of financial intermediation is to have a positive impact on economic growth through efficient allocation of capital, the banks have been successful too: about 25% of GDP growth before the crisis can be attributed to the growth in the banking sector and another 25% to the growth in the construction sector, which was largely supported by bank loans.

If, however, we look on the qualitative side, it is clear that the financial intermediation provided by the banks did not meet the specific goal set by Nazarbayev – economic growth through diversification of the economy and the growth of the SME sector.

The question is why have the Kazakhstani banks shunned and continue to shun the real sector of the economy? The standard explanation is that before the global financial crisis the banking system has largely capitalized itself through borrowing in the international financial markets, where it has been able to attract mostly short-term capital. Since the crisis began in 2007, the banks have been relying mostly on short-term domestic deposits that cannot be
converted into long-term loans, which crediting the real sector of the economy requires. Another reason offered is that individual banks do not have large enough capital to provide long-term credit for big enterprises, which forces the latter to raise capital in the international markets.

While the latter is true, the standard explanation does not account for the fact that after the crisis the banks continue with the same business model – issuing mortgages, other types of consumer credits, lending to the trade and construction sectors. As discussed above, such a credit policy model has led to the accumulation of the highest percentage of NPLs in the world (Figure 13) and put the entire sector at risk. In other words, it does not provide an explanation why the banks would not diversify their loan portfolios to spread the risk rather than compound it. Besides, for the Kazakhstani banks credits to SMEs in the real sector of the economy will not be much different term-wise from mortgages as offer the latter with a maturity of 20 years.

Figure 13. NPLs to gross loans ratio, 2008-2011, %
Part of the explanation is that SMEs themselves do not turn to the banks for loans because the latter have continued with the same predatory behavior vis-à-vis the real sector of the economy President Nazarbayev spoke about in 1995. In part, their predatory behavior has been enabled by the NBK, which in 2012 formalized the high cost of bank loans by setting their interest rate ceiling at the annual 56%. High interest rates on loans exacted by the banks have been a major disincentive that explains why the real sector of the economy, particularly SMEs, avoid banks and look elsewhere to fund their operation and growth. Only 22 to 24% of enterprises seek loans from banks, the rest resort to self-financing.

A poll conducted in 2012 among the businessmen and entrepreneurs revealed that in 14% of cases the banks asked them to pay kickbacks to get a loan that ranged from US$2,700 to US$40,000, and to provide gifts or various services. Banks often demand that businessmen transfer shares in their SMEs with voting rights as a collateral, which effectively means alienation of control over their businesses.

The banks not only avoid crediting SMEs, but also divert state funds allocated for the development of the SME sector for prokrutka (diversion of state funds allocated for a specific purpose for profit), fraudulent behavior which was rampant in the first years of independence. To support the development of the SME sector, the government allocated KZT40 billion (US$300 million) in low-interest-rate credits to the sector. The funds were distributed to the banks, which were supposed to channel them to small and medium size businesses. However, it was established that the banks used these funds for prokrutka. The bank with highest

---


percentage of the credits issued to SMEs was TsentrKredit bank (40%), while BTA and Kaspisiki bank directed only 16% of the funds for the intended purpose, Eurasian bank 6%, Astana Finans 5%, Tsesnabank 0%.\textsuperscript{265}

Economists identify a number of economic and non-economic variables that determine the depth of financial intermediation. The former include the level of NPLs, the structure of the market, and stability of macroeconomic environment. The latter includes the influence of the legal environment and the share of the shadow economy. Their effect, however, is difficult to model or measure.\textsuperscript{266}

In the case of Kazakhstan, the level of NPLs before the crisis was negligible (3-5%), while the macroeconomic environment has been stable, both before and after the crisis. Only the structure of the market, i.e., the degree of bank concentration, has been and continues to remain high (Figure 14), which, as the theory predicts, should have had a negative effect on the deepening of financial intermediation. In the case of Kazakhstan, however, it has not as the ratio of private bank credit to GDP continued to grow until 2009.

\textsuperscript{265}“Neosvoyennye dengi u bankov zaberut,” \textit{KazTAG}, November 3, 2008.

That leads to the conclusion that economic variables cannot explain why, despite the growth of intermediation before the crisis, it has not led to economic development of Kazakhstan, i.e., diversification of its economy through the development of its real sector, sought by President Nazarbayev and his government. Economic variables do not capture an important characteristic that can explain the phenomenon – the quality of financial intermediation, i.e., what sectors of the economy banks credit. It is the latter that can help explain why despite the growth in intermediation, it has not yielded the results sought by the government.

If we analyze two non-economic variables – the influence of the legal environment and the share of the shadow economy – we will get a better understanding of the reasons for disintermediation of the real sector of the economy, especially, in its SME segment. The size of the shadow economy in Kazakhstan has persistently remained high at around 41.1% of
GDP in 1999-2007. That means that many businesses, particularly small, do not and, in the foreseeable future, will not turn to the banks to finance their operations and expansion.

The rule of law in Kazakhstan remains low, as measured by different international organizations and think tanks. According to the World Bank’s Rule of Law index, which grades countries on the +2.5 to -2.5 point scale, Kazakhstan has been among the countries where the law has been consistently sidestepped.

Figure 15. Rule of law index, 1996-2012

According to The Heritage Foundation’s *Index of Economic Freedom*, Kazakhstan has improved its overall standing in over 20 years since its independence, now ranking 67th out of 178 countries. However, the rule of law index, measured as protection of property rights and freedom from corruption, reveals that the country has been lagging behind, particularly in

---

protecting property rights, making no progress since 1991 (Figures 16 and 17).\textsuperscript{268} The importance of the property rights index for understanding the investment behavior of the Kazakhstani banks is that it measures the likelihood of the expropriation of private property.\textsuperscript{269}

![Figure 16. Property rights protection, 1995-2014, 0-100points](image)

- Kazakhstan
- World average

Source: Index of Economic Freedom, The Heritage Foundation


\textsuperscript{269} Overall, the property rights index measures the degree to which laws protect private property rights, the government and the judiciary enforce these laws, and the likelihood that private property will be expropriated. Points are deducted from the ideal score of 100.
The investment freedom index, which evaluates investment restrictions, also measures the likelihood of expropriation of investments without fair compensation. As with the rule of law index, it reveals high costs of investing in Kazakhstan’s economy (Figure 18).
Another factor is political pressure. Nazarbayev’s repeated threats to take the
Kazakhstani bankers and businessmen to court; explicit reference to the bankers as a threat to
the regime in the Super-Khan papers, which outline the strategy of divesting them of the
ownership of their banks; nationalization of BTA as a concrete step in that direction; and the
regime forcing its way into becoming a shareholder in other leading banks, have not been
conducive to making bankers contemplate long-term investments in the real sector of the
economy.

Instead, they favor investments that can ensure an easy flight to liquidity. As a result,
banks have favored and continue to favor issuing short-term credits such as consumer credits
and loans to the trade sector. Even mortgages and loans to the construction sector, which may
have a longer maturity, are preferable to crediting the real sector, because real estate serves as
a collateral and, if needed, could be sold off much faster than any real sector enterprise.

Adam Przeworski observed that authoritarian politicians abhor uncertainty
ideologically, psychologically, and politically. In their drive to eliminate uncertainty
regarding political loyalty of the top bankers and ensure Nazarbayev’s de facto presidency for
life, the president and his loyalists have succeeded in achieving a paradoxical outcome.
Instead of certainty they have created pervasive uncertainty that affects the economic
development of the country. Pervasive uncertainty in the economy manifests itself, primarily,
in the absence of the rule of law, corruption, and high risk of expropriation of private
property. It leads, as a result, to the decline in bank deposits despite the growth of incomes,

---

the growth in dollarization of the economy (50%),\textsuperscript{271} the size of the shadow economy, and the flight of capital (US$168 billion since independence).\textsuperscript{272} Thus it can be argued that non-economic factors offer a better explanation for the low level of financial intermediation of the real sector of the economy and the general decline of financial intermediation in Kazakhstan (Figure 19).

Figure 19. Bank Capital to Total Assets for Kazakhstan, 2000-2010

![Bank Capital to Total Assets for Kazakhstan](image)

When he calls on the bankers and the rest of the business elite to fulfill their “patriotic duty” to invest in the real sector of the economy rather than real estate abroad Nazarbayev, on the one hand, acknowledges the negative impact pervasive uncertainty he and his regime have created on the economy. His repeated assurances to the business elite that the sanctity of


private property is upheld in Kazakhstan and that there would be no redistribution of property are an admission that the business elite expectations are anything but. On the other, he displays a remarkable lack of understanding that it is the actions of his own regime – and indeed of his own family – that prompt the elites do exactly the opposite – invest abroad and avoid long-term investment in the country’s economy.

7.5. Conclusion

Political pressure and interference in the Kazakhstani banking sector that followed top bankers’ participation in or support for the Democratic Choice of Kazakhstan and Aq Zhol has lead to the reversal of the positive trajectory in the sector’s development set in 1994. The banking sector is essentially back to where it was at the time of the collapse of the Soviet Union and the first years of independence. If until 2009 there was only one state-owned bank in Kazakhstan, following forced nationalization or purchase of shares in the top banks that year virtually the entire sector is under the control of the regime, given the high ratio of bank concentration.

Systemic uncertainty created by the regime about the ownership of the banks and their operational control, about the legal framework that regulates banking activities, and about the personal freedom of the bankers, have resulted in the choice of high-risk and high loan turnover model of financial intermediation. In that respect, the Kazakhstani bankers have reverted to much the same behavior as in the first years of independence and transition to the market economy, a period similarly characterized by high degree of uncertainty. As a result of

pursuing high-risk investment strategies, the number of banks that violate prudential norms has risen since 2004, as did the number of violations (Table 5).

Table 6. Violation of prudential norms and regulations, 2002-2010

<table>
<thead>
<tr>
<th>Year</th>
<th>Violations</th>
<th>State</th>
<th>Foreign Ownership</th>
<th>Total Violations</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>44 (16 with foreign ownership), 1 interstate, 2 state</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td>38 (17 with foreign ownership), 2 state</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td>35 (15 with foreign participation), 1 state</td>
<td>6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td>34 (24 with foreign participation), 1 state</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td>34 (14 with foreign ownership), 1 state</td>
<td>20 (with 91 violations)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td>33 (14 with foreign ownership), 1 state</td>
<td>21 (with 44 violations)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2008</td>
<td>35 (22 with foreign ownership) 1 state</td>
<td>22 (with 41 violations)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2009</td>
<td>37 (16 with foreign ownership), 1 state</td>
<td>30 (with 76 violations)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td>38 (17 with foreign participation), 1 state</td>
<td>27 (with 68 violations)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: *NBK Annual Reports, 2002-2010*

The quality of the bank management has deteriorated and the transparency of bank operations is low, while corruption and fraud, including the resurgence of *prokrutka*, have become widespread. Because of high political risk, i.e., pervasive uncertainty, S&P’s Banking Industry Country Risk Assessment now ranks Kazakhstani banking sector as high-risk, placing it together with Uzbekistan, Egypt, Nigeria *et al.* in country group 8.\textsuperscript{274} International

\textsuperscript{274} The countries are divided into 10 groups according to the level of risk with 1 being the lowest and 10 being the highest. See Yekaterina Balayeva (2012). “Kredity i korruptsiya ugrozhayut bankam.” May 25, 2012.
rating agencies also note the low quality of bank regulation and supervision by the NBK. 275

Kazakhstan, which had once been ahead of Russia in reforming the banking sector and in reforming the rest of its economy, is now lagging behind. The Russian banking sector is considered to be at a lower risk than the Kazakhstani (Russia is in group 7 according to S&P’s Banking Industry Country Risk Assessment). The level of NPLs in the Russian banking sector has been less than 10%, even at the height of the global financial crisis (Figure 20). It also lags behind Russia in other banking indices, such as bank deposits to GDP ratio (Figure 21) and bank credit to GDP ratio, i.e., financial intermediation (Figure 22).

Figure 20. NPLs in Kazakhstan and Russia, 1998-2011

\[\text{Figure 20. NPLs in Kazakhstan and Russia, 1998-2011}\]

\[\text{275 Anna Karr, op. cit.}\]
Figure 21. Bank deposits to GDP ration, 1994-2011

Figure 22. Bank credit to GDP ration, 1994-2011
Thus, Kazakhstan’s banking sector, which was considered to be the most institutionally developed and sound among countries of the former Soviet bloc in the early 2000s, has regressed to the level of countries with high degree of government participation and control over the banking sectors and countries, like Uzbekistan, where no meaningful market-oriented reforms have been undertaken.
The reversal of the banking sector reforms in Kazakhstan was set in motion in 2001 when the technocratic reformers, the top bankers, and the new business elite decided to enter politics and form an opposition political party, the Democratic Choice of Kazakhstan. Their entry into politics was prompted by their desire for greater transparency in political and economic decision-making, greater accountability, establishment and enforcement of clear-cut rules in the economy. They wanted not only deepening of the market-oriented economic reforms, but also the beginning of the promised political reforms, which, in their opinion, was warranted by the threat to the political and economic future of Kazakhstan that came from Nazarbayev’s family (Rakhat Aliyev) and the traditionalist political and statist economic elites who opposed the reforms.

The regime succeeded in splitting the DVK into two groups: the DVK, which it labeled extremist, and Aq Zhol Democratic Party, which it labeled moderate. Initially, Nazarbayev’s attitude toward Aq Zhol was neutral, if not positive, since he re-appointed a number of its leaders into the government, albeit to second-tier positions. This modus vivendi, however, did not last long and ended in 2004 as the September parliamentary elections approached, despite Aq Zhol’s claims that its program was consistent with Nazarbayev’s statements on the political and economic reforms and Nazarbayev’s own acknowledgement of the fact. That same year the regime launched its full-scale campaign to roll back the banking
sector reforms and reassert its control over the sector, which culminated with the partial re-nationalization of the biggest banks in 2009.

Two questions arise that require answers. The first one is why, despite the shared reform agenda, Nazarbayev fell out with the technocratic reformers, whom he nurtured, promoted, and entrusted with reforming the economy, and the bankers, whose businesses he had helped to establish and grow. The second is why Nazarbayev acquiesced to, if not initiated, the reversal of the banking sector reforms, given his oft-stated pride in the Kazakhstani banking system, which was considered the best in the former Soviet Union. To answer these questions, apart from analyzing actions taken by the key actors that have led to the outcomes in question, we need to put these actions in the specific context of Kazakhstani politics. Nazarbayev, the technocratic reformers, the bankers, and other political and economic actors are not generic actors with generic preferences, operating in a generic setting. They have been acting in a culture-specific context and their utility maximization (policy choices and practical steps toward their implementation) should be analyzed with that factor in mind.

With the collapse of the Soviet political system, the Kazakhstani political context, to a large degree, has been shaped and determined by political culture, which following Almond and Powell is defined here as the “set of attitudes, beliefs, and feelings about politics current in a nation at a given time.” The important role of political culture in structuring political processes and determining their outcomes is explained by the fact that actors in any political system “face institutional pressures to conform to cultural rules, norms, and expectations,

---

regardless of the efficiency implications of the practices that they are adopting.” Thus, the actors who seek legitimacy and want their actions to be effective are often compelled to behave following the logic of appropriateness rather than purely instrumentally.

8.1. Kazakhstan’s political culture

Defining Kazakhstan’s political culture is challenging for many reasons. The first one is the multi-ethnic composition of the country, which is a mix of different religious, cultural, and historic traditions and experiences. The second is that Kazakhstan, as an independent state, has existed for only two decades, which is a short period to develop a new and distinct political culture. It can be argued that the shared experience of the two major ethnic groups, the Kazakhs and the Russians within the Russian Empire and then within the Soviet Union has led to common attitudes toward politics and expectations vis-à-vis political elites.

However, the Russian imperial and Soviet communist rule have not stamped out traditional political beliefs and attitudes among the Kazakhs, which resurfaced after independence. Soviet attempts at nation-building and social modernization failed to overcome the traditionalist nature of the Kazakh society and reshape its social structure based on tribal divisions. Shortly after independence, the Kazakhs became the dominant group in the political and economic elite, which is why Kazakh political culture is used here as the political culture

\[\text{End of Document}\]
of Kazakhstan. It is difficult to identify what attitudes, beliefs, and feelings about politics define Kazakh political culture. It is not just the issue of the paucity of studies on the subject, which became the object of scholarly inquiry only after independence. Defining political culture of any nation is a challenge because of the vagueness of culture as a unit of analysis. Nevertheless, basic characteristics of Kazakh political culture relevant for this study have been parsed together from the studies of the tribal values, elite interviews and statements, as well as public opinion polls.

As the Kazakh elites engaged in state-building their search for institutional building blocks was both spatial, i.e., looking at the Western democratic institutions, and temporal, i.e., looking back into their own history in search of institutions that could fit the design of the new state. Debates over the draft of the first constitution of Kazakhstan (1993) revealed that some elites conceived of modern Kazakhstan as a successor state to the Empire of Genghis Khan, the progenitor of the modern Kazakhs. They proposed that following the Genghizid tradition, the head of state, i.e., Nazarbayev, should be called a Khan (a sovereign or military ruler), the governor of a province a sultan, and the head of a district (raion) a bek (chieftain of a small tribal group). 279

Invocation of Genghis Khan was not coincidental as the Kazakhs trace their national identity, social structure, and political organization to the Great Khan. His Yassy (laws) established that only the tore, his direct descendants, had legitimate claim on power and could be elected as Khans. The second stipulation was that the Khans should be elected by the kurultai, an assembly of aristocracy known as aq suyek (white bone), which included the tore

279 Sergei Kozlov (1992). “Nazarbayev sozdayot svoyu partiyu.” Nezavisimaya gazeta, September 26. It is not coincidental that the Super-Khan papers derive their name from the traditional title of a Kazakh (and Mongol) ruler.
and kozha (Muslim leaders). The Khan’s power was hereditary; however, the successor had still to be endorsed by the kurultai and was usually chosen based on the meritocratic principle. For a long period of time, until 1869, the Russian colonial administration recognized the fact that political legitimacy among the Kazakhs rested solely on the notion of the direct lineage from the Great Khan by endorsing the election of the Genghizids as local rulers.\(^{280}\)

Once elected, the Khan’s power was absolute and was vested not only in him, but also members of his family. Family members were appointed as sultans, who acted as provincial governors and Khan’s political representatives. The vertical of power ended with the aqsaqals (grey beards), leaders, whose power over their commune (usually, an aul, a village) was equally absolute. “The word of aqsaqal had the force of law for the inhabitants of the aul and his orders were followed automatically; those who disobeyed were subjected to the wrath and ostracism of their kinsmen.”\(^{281}\)

The Kazakhs upheld their loyalty to the legacy of Genghis Khan and the political tradition of his Yassa in their Zhety Zhargy set of laws. In the Soviet period, they maintained loyalty and devotion to Genghis Khan’s legacy through the oral tradition and every Kazakh schoolboy, including Nazarbayev, according to his official biography, “was taught that all

---

\(^{280}\) The Genghizid political primogeniture and legitimacy of their claim on power were reflected in the names of other Central Asian states that existed before Russian colonization. Khanates of Khiva and Qoqand were ruled by the Qundrat and Ming dynasties respectively, which were direct descendants of Genghis Khan and thus could use ‘Khanate’ in the names of their states. The Mangyt dynasty that ruled the Emirate of Bukhara was not. It legitimized its power by claiming the leadership of the Muslim community in their state. Thus, the rulers were called Emirs (commanders of the faithful), not Khans, and the state was called Emirate rather than Khanate.

Kazakh khans … were direct descendants of Genghis Khan’s eldest son.”

Socialization into the norms of a hierarchical social order inaugurated by Genghis Khan and based on strict subordination and submission to the will of the ruler, who was expected to be efficient at the expense of human needs and values, and treatment of his opponents as heretics to be put to death, was reinforced among the Kazakhs by the Soviet totalitarian political model.

Both models of a political system left no room for such institution as the opposition, which is part and parcel of the democratic and authoritarian political models. The Kazakh traditional – and Soviet – polity was expected to speak with one voice and rally around one leader who was at the apex of the vertical of power and of one political institution (party or tribe).

8.2. Nazarbayev, Kazakh political culture, and Kazakhstani politics

Based on one of his discussions with Nazarbayev, James Baker observed that the Kazakhstani leader did not seem particularly interested in issues related to democracy-building (rule of law, free and fair elections, human rights, etc.). Indeed, the economy was Nazarbayev’s primary focus, both in the Soviet period and the first years after independence. His frustration with the parliament (communists, red directors, Soviet-era intellectuals) and opposition political parties led him to the conclusion that the implementation of economic reforms in Kazakhstan would require concentration of power in his hands. The opposition as

well was driven primarily by its hostility to the market-oriented reforms and objections to the breakneck speed of their implementation rather than political motives.

In the first years of independence, there was a tentative consensus about the new political system of Kazakhstan. Verbally, all the elites expressed their commitment to building Kazakhstan as a democratic state. Nazarbayev’s agenda for Kazakhstan was not only economic reforms, but also the overall transformation of Kazakhstan, including political modernization, and as such was open to the introduction of some elements of democratic government. In that sense, Nazarbayev might have accepted some form of democratic government and implemented necessary political reforms to that effect, had it not been for the opposition to his economic reform agenda.

The president of Kazakhstan, however, believed that the attempts to “transfer Western liberal ideas directly to Kazakhstan would run up against cultural difficulties in the broadest sense, including political culture as well. It would be impossible to instantly change its character and ideals. Political culture had to be transformed gradually and in a civilized manner by carrying out real reforms.” Nonetheless, he rejected suggestions to restore traditional political institutions, because traditionalism, in his opinion, important as it might have been for preserving cultural identity, was not “a valid option in politics. I was often obliged in those days to explain that a political ideology of a traditional type based on reviving archaic forms of social organization and on ‘tribalistic’ psychology was definitely not right for us. I was already well aware of all the dangers of various ‘tribalistic’ attitudes

and issues. All my practical political work over one and a half decades had been firmly focused on suppressing all kind of tribal sentiments.”

Though he refused to be named a khan, Nazarbayev opted for establishing strong presidentialism as the form of government Kazakhstan. It was legitimized in the 1995 Constitution that granted him unlimited powers, which was endorsed by the popular referendum. Popular support for authoritarianism was evident in a poll conducted in 1997, which revealed Kazakhstani’s belief that a strong authoritarian leader was better for Kazakhstan than a government with power dispersed among the executive, legislative and judicial branches (54% to 32%). The same poll revealed that the Kazakhstani preferred a society with strict order to the one with unlimited freedom (58% to 37%). The majority of the Kazakhstani also accepted Nazarbayev’s argument that concentration of power in his hands was needed to overcome parliamentary resistance and speed up the economic reforms: a 51% majority agreed that economic reforms were introduced too slowly against 19% who thought that they were happening too quickly.

To bolster popular support for the concentration of power in his hands, particularly among the Kazakhs, Nazarbayev appropriated a number of important political symbols that linked him directly to the first Genghizids. Thus, he called his presidential palace in Astana Aq Orda, which means the headquarters or palace of the Supreme Khan of the White (Golden) Horde. The White Horde was the state established by Khan Batu, the eldest son of Genghis

286 Nazarbayev, op. cit., p. 13.
Khan’s eldest son, i.e., the progenitor of the Kazakh khans. The flag and the coat of arms of Kazakhstan prominently feature the color blue, a reference to Tengrism, the official religion of the Genghizids and the Kazakhs who worshiped the sky.

Gradually, Nazarbayev has acquired the functional status of a khan. In 2007, the Mazhilis passed a law de facto making him president-for-life by granting him the right to get elected as many time as he wished. Some among the traditionalist elite occasionally refer to him as “the truly God-sent Nursultan Nazarbayev.” In 2010, the Mazhilis passed a law bestowing on Nazarbayev the title of Yolbasy, the Leader of the Nation. His birthday, July 6, is an official holiday celebrated as the Day of the Capital. In June 2008, 90% of the Mazhilis deputies went as far as to vote to change Astana’s name to Nурсultan, but Nazarbayev turned down the offer. Since 2011, December 1 is the Day of the First President, also an official holiday.

Thus, Nazarbayev has not only concentrated power in his hands, which is expected of an authoritarian ruler in any political culture. He has also sought to legitimize his authoritarianism in the eyes of the majority of the population by appropriating political symbols rooted in traditional Kazakh political culture.

8.3. Political elite

After independence, three elite groups emerged in Kazakhstan – Kazakh traditionalists, Soviet-era socialists and communists, and Western-oriented liberals. The majority of the elite belongs to the first two. Ethnically, by 2001, the elite was predominantly


215
Kazakh (85%) from rural areas (66.3%). The early socialization of the Kazakh elite into the values of traditional society was not significantly altered by their college education: 71.9% of the elite received their higher education in universities and colleges in Kazakhstan, mostly provincial, as only 17.8% graduated from the elite Kazakh National University. Nor did it change as a result of migration into cities. In fact, the movement of the rural Kazakhs into cities had the opposite effect: it led to the ruralization of urban areas rather than urbanization of the migrants.

The remaining 28.1% of the elite were educated outside of Kazakhstan, primarily in Russia. Almost half of them, 13.4%, were graduates of the elite universities and colleges in Moscow, who became known as *Moskvichi* (Moscovites). The latter included the future members of the NBK reform team and its Governors – Oraz Jandosov, Kadyrzhan Damitov, and Grigoriy Marchenko – as well as Galymzhan Zhakihanov, Mukhtar Ablyazov, Nurzhan Subkhanberdin, Yerzhan Tatishev and others who made up the liberal group in the Kazakhstani elite.

In pursuing his economic reform agenda, Nazarbayev turned to the younger generation of the Kazakhstani technocrats and businessmen in their thirties as he understood the futility of relying on the Soviet-period cadres and the red directors. He rationalized his decision as follows: “We promote the young ones, who are not blinded by the old practices like we do,

---


292 Tulegulov, *op. cit.*, p. 35.
but are trying to move things forward, do things in a new way.”

He appointed these technocrats and businessmen to senior government positions and delegated them power to draft and implement radical reforms. As he put it, he gave “a great many young businessmen and specialists free rein. Thirty-year-olds have become government members and ministers, senior provincial officials and managers of departments and major companies.”

Nazarbayev’s enthusiasm for the market-oriented reforms and his reliance on the young technocrats and businessmen in their implementation was not matched by similar enthusiasm for democratic reforms or recruitment of those political activists who, like the technocrats were not “blinded by the old practices” and could do for transforming the political system what the technocrats did for transforming the economic. First, Nazarbayev saw that to move economic reforms forward he needed to concentrate political power in his own hands, not to diffuse it. The experience of the first years of the economic reforms turned him against the idea of a functioning parliament. Second, he capitalized on the fact that there was little public demand or expectation for democratic reforms in Kazakhstan.

Nazarbayev, however, sought to recruit Kazakhstani academics and politicians of the same generation as the technocratic reformers and the new business elite to implement political reforms. In 1991, Sabit Zhusupov, Kazakhstan’s leading sociologist, introduced Nazarbayev to Marat Tazhin, a fellow sociologist. Nazarbayev was so impressed that in a short period of time Tazhin became Nazarbayev’s chief political adviser and strategist, as well as the ideologue of the regime. Nazarbayev’s other appointment as political advisor was Yermuhamet Yertysbayev, whose portfolio included suppression of organized opposition and

---

293 Sergei Gorbunov (1996).

294 Nazarbayev (2008), p. 188.
manipulation of the electoral process. In that capacity, he became the regime’s frontman in repressing the DVK in 2001 and intimidating and harassing the leading bankers and the Aq Zhol in 2004 and beyond.

To consolidate Nazarbayev’s power, Tazhin suggested to cast aside the democracy talk, arguing publicly that “enlightened authoritarianism” was the “rational choice” and the only viable option as the political system for Kazakhstan. He justified this, albeit with a caveat, by pointing to the dominant political culture: “The prevalence of authoritarian mentality among the majority of ethnic groups in the republic, in principal, has been conducive to a stable political situation. Tendencies toward strengthening of enlightened authoritarianism, which has objective economic and political basis, are evident in Kazakhstan. But it should be mentioned that this authoritarianism has its limits. If it counteracts the needs of ethnic modernization in a broad sense, then its expediency becomes problematic.”

Enlightened authoritarianism as the political system appealed to Nazarbayev, who rationalized it as “economic reforms first, political reforms second.” The response of the population and the elite was overwhelmingly positive, including the liberals, i.e., the young technocrats and the new business elite. The latter supported enlightened authoritarianism because it allowed them to be shielded from the public and elite disapproval and attacks on economic and focus on their implementation, for which they were grateful to Nazarbayev. Prime Minister Kazhegeldin even suggested abolishing his post, making President Nazarbayev the head of the government as well.


296 Akezhan Kazhegel’din, op.cit., pp. 112-113.
The elite consensus on the “enlightened authoritarianism” model, however, was transient. There were three major factors that set traditionalist and Soviet-era elites, on the one side, and the liberals, on the other, apart, putting them on a collision course. The first two related to ideological and cultural differences while the third was rooted in the Soviet-era bureaucratic culture.

Ideological differences stemmed from the fact that the Moscow period in the lives and education of the liberals coincided with perestroika and exposure to ideas alternative to communism, which were actively debated in Moscow intellectual circles. It also provided them with access to western literature, particularly on economics, that was stored in spetskhrans (special book depositories) at major Moscow libraries. Exposure to alternative ideas about politics and economics, which was virtually nonexistent in Kazakhstan, was what set the Moskvichi apart from their cohorts, who, like Tazhin and Yertsbayev, were graduates of Kazakhstani universities, and from the older generation of the elite. It was that exposure, after all, that drew Nazarbayev to them and led him to appoint them to senior positions in his government and delegate to them the authority to implement economic reforms.

Culturally, the conflict between the Kazakh traditionalist elite and the liberal technocrats was further exacerbated by social distance and cultural-linguistic gap that had long existed between the two groups. The Kazakh traditionalist elite was predominantly rural and Kazakh speaking. The liberal technocrats were several generation urban dwellers and predominately Russian speaking. Rural Kazakhs “decried the Soviet-era Russification of urban dwellers by calling them manqurt (one who does not know his or her roots); on the

---

other hand, urban Kazakhs increasingly depicted their country co-ethnics as uncivilized by calling them _mambet_ (roughly: country bumpkin)."²⁹⁸

Finally, the Soviet-era elite resented the elevation of the technocrats and the new business elite to power because it upset the existing system of promotions and denied it its chance to reach the top of the bureaucratic ladder. As a rule, in the Soviet system senior government bureaucrats reached the peak of their careers at the age of 50-60, having gone through all the levels of the career ladder. After their appointment to the government, the technocratic reformers brought with them their cohorts, appointing them to senior positions in the ministries or national companies they oversaw, and setting in motion a revolving door between the government and the business community. That system excluded the Soviet-era bureaucratic elite and further undermined its chances of promotion, antagonizing them vis-à-vis the liberals even more.

8.4. The revenge of Genghis Khan

For Nazarbayev, the appointment of thirty-something technocratic reformers to senior positions in the government carried some risk. He could have alienated the majority of the elite who were opposed to the liberals on ideological, cultural, and personal grounds. However, the enlightened authoritarianism based on Kazakh political culture with its traditional deference and subordination to the ruler played its role as a safety mechanism that allowed Nazarbayev a great degree of freedom in his cadres policy and the choice of economic policies.

Yet, neither enlightened authoritarianism nor the prevailing political culture has room for opposition as a concept, much less as an institution. In the context of Kazakhstani political culture, the Otan (Fatherland) party, established in 1999, was considered to be the party of all citizens of the country because it was the party of President Nazarbayev.\(^{299}\) When Dariga Nazarbayeva, president’s elder daughter, created Asar (All Together) party in 2003, she was criticized for it, albeit sotto voce, by the Kazakh traditionalist elite for effectively counterposing herself to her father, which was unacceptable not only politically, but also from the point of view of the norms of traditional society. In 2006, Asar was folded into the ruling Otan party, which changed its name to Nur Otan (The Light of the Fatherland).

In the context of Kazakh political culture – and hence the context of modern Kazakhstani politics – the majority of the Kazakhstani elite and public view political opposition as a challenge to Nazarbayev’s rule on personal, not ideological or policy grounds. “In Kazakhstan, political opposition is viewed as an enemy,” suggests Alikhan Baimenov, one of the leading technocrats and the long-time leader of Aq Zhol party.\(^{300}\)

Nazarbayev’s attitude toward opposition has been identical. Yet he has been ready to accept the existence of political parties other than his own, provided that they not challenge him personally. Gani Kaliyev, the Chairman of the Auyl (Village) Agrarian Party, who has known Nazarbayev since 1986, recollects that when the party was created in 2000,

“Nazarbayev was concerned that the all the [Kazakh] intelligentsiya [intellectuals] was joining the Auyl. But I told him that I was not planning to become the President or a Prime Minister. We did not establish the party for that purpose. We would not engage in a spiteful confrontation. We would criticize the government as it relates to its

\(^{300}\) Interview with Alikhan Baimenov. Astana, April 1, 2011.
agricultural policy. Nazarbayev calmed down. He said: “That’s right. Go, criticize the government.”

Political parties in Kazakhstan require registration by the Ministry of Justice to legally function and run in the Mazhilis elections. There are no ideological restrictions, except for the ban on parties that adhere to extremist ideologies (racism, fascism, etc.). There is, however, one – informal – requirement: personal assurance, if not a public proclamation, of allegiance to President Nazarbayev and support for his policies. Hence, the registered political parties in Kazakhstan, which can technically be considered opposition since they position themselves against the ruling Nur Otan and the government, are, at the same time, pro-Nazarbayev, and by extension, pro-regime.

The veneer of a nominally multiparty political system has suited Nazarbayev well as it helped obfuscate the reality that Kazakhstani politics is, in fact, court politics, where different elite factions squabble with each other, not with Nazarbayev, and where, as Gani Kaliyev attests, even his hand-picked government is fair game for attacks. Nazarbayev’s role in that system is that of the supreme arbiter who is open to influence, but holds the dominant position in policy-making. Aq Orda, the khan-president’s palace, not the parliament or the government, is where policy is made and where politics happens. That makes access to the ruler more important than engaging in politics through institutional channels, such as political parties or parliament. Access to the ruler is thus of the essence, because it allows an elite faction to exert influence on him in order to achieve a preferred policy outcome or adjudication of an intra-elite conflict. Marchenko’s multiple accounts of appealing directly to Nazarbayev to resolve conflicts with the government or have the Mazhilis pass a banking

301 Interview with Gani Kaliyev. Astana, April 2, 2011.
sector law over its opposition illustrates this argument as does his judgment that “reforms in Kazakhstan are possible only through Nazarbayev.”

Talking about the decision-making process in Kazakhstan in general and about the decisions to crackdown on political dissent, Amirzhan Kosanov, a veteran opposition politician, observes that “Nazarbayev is not the problem, the problem is who talks to him last.” Based on many accounts I have heard, it appears that this observation is generally correct, though sometimes the opposite is true (see below). In that sense, Kazakhstani politics is not much different than politics in Tudor England where the monarchs “governed their dominions through a network of nobles and gentry rather than solely through institutional bodies like the privy council. Not only did this mean that the court was the main forum for policy-making, but that issues of access to, and intimacy with, the monarch were crucial.”

On the surface, the DVK and Aq Zhol followed the established rules by never openly challenging or criticizing Nazarbayev, at least until after 2004, and repeatedly stating that their platform was consistent with that of the president. Nazarbayev acknowledged the fact by reappointing some of them to the government and calling them “my people.” However, in 2004, he banished the technocratic reformers from the government for good and withdrew his support from the reformers and reforms in the banking sector, sanctioning their reversal.

Nazarbayev’s actions vis-à-vis the technocratic reformers and the new business elite were a consequence of their decision to enter Kazakhstani politics, which was ill conceived for a number of reasons. First, the technocratic reformers and the new business elite failed to

---

appreciate that the Kazakh social norms, which consider family and relatives, i.e., the kin (clan) network, as the two most important social groups (Table 6) and which largely structure

the lives of the Kazakhs, impose life-long obligations on their members. Therefore, kin network membership requires those members who achieve positions of political or economic power to provide other network members with access to the resources under their control, including employment. Kin favoritism is the behavior expected and endorsed by the overwhelming majority of the Kazakhs even though it disadvantages all, but the members of a specific clan.³⁰⁶ Thus, in 2001, Nazarbayev could not have acted otherwise, but to provide Rakhat Aliyev, his son-in-law, with another job. However, Nazarbayev chose to give him a job in the President’s administration (Deputy Head of the Presidential Guards), i.e., his own office, rather than appoint him to another job in the government. The technocratic reformers should have recognized the social obligation that Nazarbayev had to meet vis-à-vis his son-in-

Table 7. Importance of social circles or groups in Central Asia³⁰⁵

<table>
<thead>
<tr>
<th>Family</th>
<th>Relative</th>
<th>Work</th>
<th>Area of origin</th>
<th>Language*</th>
<th>Neighbourhood</th>
<th>Religion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kazakhstan</td>
<td>85.3</td>
<td>7.8</td>
<td>2.1</td>
<td>1.3</td>
<td>0.1</td>
<td>0.3</td>
</tr>
<tr>
<td>Kyrgyzstan</td>
<td>90.4</td>
<td>4.0</td>
<td>1.3</td>
<td>1.5</td>
<td>0.3</td>
<td>1.0</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>84.6</td>
<td>6.5</td>
<td>4.3</td>
<td>0.1</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Turkmenistan</td>
<td>55.1</td>
<td>25.9</td>
<td>1.5</td>
<td>5.8</td>
<td>3.3</td>
<td>3.3</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>92.6</td>
<td>1.9</td>
<td>1.6</td>
<td>0.9</td>
<td>0.3</td>
<td>–</td>
</tr>
</tbody>
</table>

*Language = ‘people who speak the same language’.

³⁰⁶ Edward Schatz, op. cit., pp. 149-156. Schatz argues that partial monetization of the economy, particularly in urban areas, has marginally weakened kin networks vis-à-vis other forms of assistance networks, e.g., those based on common interest. He nonetheless admits that the trend is suggestive rather than statistically significant (p. 147).
law as well as the fact that Aliyev was removed from the government as the president promised. Yet, they failed to do so just as they failed to reflect on the significance of the fact that all elite factions opposed Rakhat Aliyev’s quest for power and his ruthless business practices. The latter meant that should he have attempted a political comeback it would have been opposed by the entire Kazakhstani elite once again. In other words, his dismissal from the government in November 2001 meant an effective end to any future political or government career for Rakhat Aliyev. In fact, four months later, President Nazarbayev exiled him to Vienna to serve as Kazakhstan’s ambassador to Austria. Thus, by establishing an (opposition) political party in response to what they perceived as Nazarbayev’s backtracking on his promise, the technocratic reformers revealed themselves to be acting as emotionally driven political amateurs rather than politicians capable of rational analysis and action.

Second, the technocratic reformers did not fully appreciate that they were able to function as senior government officials only within the bubble of autonomy from the rest of the Kazakhstani political elite and society that was provided to them by President Nazarbayev. Thus, they were not independent actors, and whatever political legitimacy they had rested on their membership in the president’s reform team and on Nazarbayev’s continued support and endorsement, absent which they had virtually none.

Third, they attempted to redefine the role they were assigned in the Kazakhstani political system. They ignored the warning of Akezhazan Kazhegeldin, their former boss and predecessor as Nazarbayev’s opponent, that “In accordance with our constitution, the government should be regarded as a group of managers. The popularly elected President hires a government. There is nothing more to it than that. As soon as the government thinks
otherwise, problems begin to surface...” By overstepping the clearly defined boundaries and assuming political roles, i.e., becoming technopols, the technocratic reformers burst their autonomy bubble and drew themselves into the direct confrontation with their adversaries from the other two elite groups. Unlike them the technocratic reformers lacked political skills and experience and proved ill prepared to effectively navigate Kazakhstani court politics.

Fourth, they clearly overestimated their political weight by overlooking the fact that they were a tiny minority within the Kazakhstani elite, not more than 10%. They also overestimated their own influence over the president and underestimated the power and influence of the two majority elite groups over Nazarbayev and the political system. These groups, who resented the liberals and looked for any opportunity to have them removed from power, capitalized on the strategic mistake made by the technocratic reformers in deciding to establish the DVK without getting Nazarbayev’s prior consent, explaining their motives, and providing the necessary assurance of personal loyalty.

The mistake, later admitted by Alikhan Baimenov, presented their adversaries with the window of opportunity to be the first to speak to Nazarbayev and convince him that the technocratic reformers had committed the cardinal sin, which Baimenov explained as follows, “some of the people around the president convinced Nazarbayev that the founders of Democratic Choice were opposing him **personally.**”

---

308 The liberals, i.e., the technocratic reformers and the new business elite who were between 30-39 years of age, accounted only for 10.3% of the Kazakhstani elite. See Tulegulov (1998), p. 33.
The Kazakh traditionalist and Soviet-era elites built their case against the technocratic reformers and the new business elite around Kazhegeldin’s case. Like the DVK leaders, Kazhegeldin, who became the Prime Minister in 1994, was Nazarbayev’s protégé. Nazarbayev appointed him because of his business credentials, to speed up transition to market economy. At first, after he resigned in 1997, Kazhegeldin swore allegiance to the president and dismissed any notion of joining the opposition. However, in October 1998, he established a political party (the Republican People’s Party of Kazakhstan) and declared his intention to run against Nazarbayev in the 1999 presidential election. Prevented from running in the election, Kazhegeldin fled to the West where he became an outspoken critic of Nazarbayev’s regime.

It was easy for the traditionalist elite to draw parallels between Kazhegeldin and the technocratic reformers and emphasize the issue of personal disloyalty and ingratitude. It was equally easy for Nazarbayev to accept their argument. The policy of elite replacement adopted by Nazarbayev in the early 1990s – removal of the old Soviet-era economic and political elite and promotion and empowerment of the young technocrats and businessmen – carried a certain risk for Nazarbayev’s political future. Failure by his protégés to transform Kazakhstan’s economy might have cost him the presidency. Nevertheless, Nazarbayev stuck by his policy of the market-oriented economic reforms and by the technocratic reformers and the new business elite as the agents of the reforms. To Nazarbayev they were more than like-minded associates and executors of his vision of the economic future of Kazakhstan.

Politically, he viewed the liberal elite as his loyalists and supporters, expecting them to be the catalyst for the emergence of an even wider pro-Nazarbayev constituency – the new capitalist middle class. As Yertysbayev, Nazarbayev’s domestic policy advisor recalled, at
one of the banquets in the mid-1990s, Nazarbayev “came up to the table where the businessmen (Bulat Abilov, … Mukhtar Ablyazov and others) were seated. Everyone stood up. In a heartfelt and confidential manner the head of state told them, “You are my pride, my hope and my support.”\(^{310}\)

Moreover – and this is key to understand why he chose to break with the technocratic reformers – Nazarbayev had both publicly and privately voiced his expectation that his successor as president would come from their midst. In a 1998 interview to Izvestiya, a Russian newspaper, Nazarbayev expressed his hope that the next president would come from the group of his “young protégés, well educated, [and] not burdened by the legacy of the past.”\(^{311}\) Dulat Kuanyshev, Nazarbayev’s press secretary in the 1990s, remembers a social gathering similar to the one attended by Yertysbayev, at which the president said, talking to a group of the technocratic reformers that included Oraz Jandosov and others, “It is you, to whom I will hand over the country.”\(^{312}\) Nazarbayev never referred to any other elite group or faction in these terms.

Thus, given Nazarbayev’s feelings, hopes, and plans for the technocratic reformers and the new business elite, the issue of what he regarded as personal betrayal weighed heavily on his mind. He already had to deal with two major personal betrayals, those of Kazhegeldin and Aliyev, his son-in-law who was plotting to overthrow him. For the technocratic reformers, whose meteoric rise to senior government positions he enabled and whom he was grooming to be his successors, to go behind his back, form a political party and demand change of the

---

\(^{310}\) Yermukhamet Yertysbayev (2002). “Pryamoi put’ ne vsegda samyi korotkii (an interview).” Vremya, August 9.


\(^{312}\) Interview with Dulat Kuanyshev, February 8, 2001.
political system was unforgivable. The technocratic reformers were the one group he least expected to turn against him, which is what he was led to believe by their opponents. The moment the technocratic reformers turned into the technopolis his support and trust in them were undermined.

Nevertheless, Nazarbayev did not sever ties to the technocratic reformers until before the 2004 Mazhilis elections. Developments in Russia allowed the traditionalist and Soviet-era elite factions to build a stronger case against the liberals, which proved to be successful. They used the case of Mikhail Khodorkovsky, who in 2002 set up the Open Russia Foundation (a clear reference to George Soros’s Open Society Foundations) and in 2003 declared his intention to finance liberal opposition political parties (SPS and Yabloko), which precipitated his falling out with President Putin, arrest and imprisonment. The anti-liberal elite argued, and finally convinced Nazarbayev, that the liberals, the union of the technocratic reformers and democratic oligarchs, posed a similar threat to the regime, particularly with the pending Mazhilis elections. The billionaire banker Subkhanberdin was chosen by the anti-liberal elite to play the part of Kazakhstani Khodorkovsky to Kazakhstan’s SPS and Yabloko – the Aq Zhol party.

While Kazhegeldin, who used his own money to establish a political party, the RNPK, failed to unite other opposition parties and groups, Aq Zhol, even in its truncated post-DCK shape, was different. Aq Zhol, with its reported 100,000 members, was supported by the cohorts of the technocratic reformers and the younger generation of the Kazakhstans who

---

313 SPS (Soyuz Pravykh Sil) and Yabloko are liberal political parties in Russia, which advocate market economic reforms and democratic form of government.

314 As discussed earlier, this idea was imbedded and further developed in the Super-Khan papers.
worked in the President’s Administration and the government, by the new economic elite, and by the emerging middle class. In an election year, the alliance of the best and the brightest, who embodied Kazakhstan’s future, and the money posed, as Yertysbayev argued, a serious threat to the survival of the regime.

That it was a threat to the political survival of the Kazakh traditionalist and Soviet-era elites was certainly true. Whether it was a threat to Nazarbayev personally is highly questionable. However, presented with the politician’s dilemma as defined for him by the anti-liberal elite – political survival or continued support for the technocratic reformers and market economic reforms – Nazarbayev chose the former. To him, the “Orange” revolution in Ukraine, which started at the end of 2004, validated the choice since its success, to a great degree, depended on the support of the Ukrainian oligarchs, a class of politically active and independently wealthy people that the market economic reforms created.

In the end, the technocratic reformers proved themselves amateurs in politics. Their biggest mistake was to ignore the logic of appropriateness dictated by Kazakh political culture in engaging President Nazarbayev on political issues that were outside the scope of their clearly defined mandate. Recognition of its importance came ex post facto. Pondering on the resilience of authoritarianism in Kazakhstan, genuine popularity and electoral support for Nazarbayev, Alikhan Baimenov said, “Since the days of Genghis Khan, [the Kazakhs’] most sacred value is power. Our population looks favorably on the rule of one man over a long period of time.”

8.5. Elite cohesion and economic reforms

---

315 Interview with Alikhan Baimenov, April 1, 2011.
The twists and turns of the banking sector reform in Kazakhstan raise the issue of whether ideological coherence of the economic reform team, appointed by the chief executive and given a high degree of autonomy to draft and implement reforms, and of the political team, which assists the chief executive in managing politics, is a necessary condition for a successful reform outcome. The correlation between the ideological coherence of the economic and the political teams, which both work for the chief executive, particularly in authoritarian systems, and the outcome of economic reforms has not been widely studied. In that respect, a comparison of Kazakhstan’s banking sector reform and Chile’s radical economic reforms may serve as a starting point for exploring whether such correlation exists.\(^{316}\)

The majority of studies of Chile’s radical market economic reforms under the authoritarian regime of General Augusto Pinochet attribute their success to the cohesiveness of the reform team headed by Sergio de Castro and the coherence of its policies. The cohesiveness is explained by the fact that the majority of the reform team members were trained at the Department of Economics of the University of Chicago under Milton Friedman, which explains their moniker “the Chicago Boys.” As the argument goes, the Chicago Boys were not interested in politics beyond the dismantling of President Allende’s socialist legacy in the economy and establishing a capitalist, i.e., market economy in Chile; and that they worked independently of the political team.\(^{317}\) The latter, headed by Jaime Guzman, worked

\(^{316}\) The NBK reform team members visited Chile in the mid-1990s to study its pension system reform. In 1998, Kazakhstan became the first Asian and post-Soviet country to introduce the Chilean-style cumulative pension system based on personal pension contributions.

on the institutional design of the regime, its legitimation, and the extension of its longevity. The political team focused exclusively on politics and played no part in reforming the economy. Some scholars, like Patricio Silva, even talk about “completely different intellectual traditions” of the two groups.  

Carlos Huneeus, however, suggests that the established point of view misses an important factor that explains the success of market economic reforms – the ideological cohesion of the economic reform and the political reform teams: “the coherence of the economic model inherent in the implementation of its policies is not to be found … in the rigid adhesion to a recipe of neo-liberal measures, but rather in the integration of the economic policies with a political project, articulated by young men belonging to the same political movement. This cohesion was driven principally by politics, and to a lesser degree by economics.”

The majority of the economic reform team members received their graduate education mostly in the U.S. (University of Chicago, Harvard, Columbia), while political reformers were educated in Chile (Pontificia Universidad Católica de Chile (The Pontifical Catholic University of Chile (PUC). Nevertheless, the ideological link and cooperation between the two groups, who belonged to the same generation, were established in the 1960s, when a number of the future economic reformers did their undergraduate studies in economics at the

---

*Political Economy of Transformation in Argentina, Brazil, and Chile since 1960*. New York: Palgrave Macmillan.


PUC at the same time as the future political reformers, who studied at La Facultad de Derecho (Law Faculty) of the PUC. Following the electoral defeat of the right in the 1964 presidential election, Jaime Guzman, a student and then Professor of Law at the PUC, established Movimiento Gremial de la Universidad Católica de Chile (Gremialist Movement of the Catholic University of Chile). The Gremialist (Guildist) Movement was a right-wing conservative political movement, which was critical of liberal democracy, and sought inspiration in authoritarian corporatism. The Gremialists actively participated in the elections of university authorities and political conflicts that, at the time, were rocking the PUC.

Guided by their shared opposition to the leftist, socialist, and Christian democratic ideologies, a number of the future technocratic reformers either became supporters or active members of the Gremialist Movement. Miguel Kast, who went on to get an M.A. in economics from the University of Chicago, would become the key figure in bringing the two elite groups together following the 1973 military coup. For their part, Jaime Guzman, who would become one of the key Pinochet advisors and policy-makers, and his followers departed somewhat from their original ideology, rooted in the Catholic social teachings, and became converts to neoliberal economics and ardent supporters of the market economic reforms. Thus, the process of ideological homogenization of the two groups, which had begun before the military coup, was completed shortly thereafter.

The Gremialists and the Chicago Boys decided to participate in the Pinochet regime from within, “giving their support without vacillation. They understood that the military mentality would not accept any support that was not unconditional, which meant having to stifle possible criticism of coercive irrationality. You were either with them through thick and thin or you were against them, but the military regarded half-heartedness or dilatoriness as
Participation in the junta provided them with an opportunity to pursue their own goals. For the economic reformers, it was an opportunity to put their economic beliefs into practice.

For the Gremialists, who were aware that the military regime would not last forever, it was an opportunity to acquire legitimacy and to establish themselves as a dominant political force before the inevitable transition to democracy. Guzman, a constitutional lawyer, was one of the authors of the 1980 Constitution, which established the legal framework for transition to a political system he labeled the “protected democracy,” and which assigned the military the role of the guarantors of the Constitution. The goal of the new system outlined in the Constitution was to protect junta’s policies from being overturned and to keep Pinochet a de facto president for life. 321 On the last point, Guzman was very vocal, arguing that Pinochet should lead the political process after transition to democracy and guide the country towards a complete institutionalization of democracy: “To separate the transition from the definitive institutionalization would be to deprive it of its greatest fruit and meaning.” 322 In 1983, anticipating the transition, Guzman transformed the Gremialists into the Union Demócratica Independiente (Independent Democratic Union (UDI), a right-wing conservative political party.

The Gremialists understood the importance of a successful outcome of economic reforms for legitimization of the authoritarian regime and for ensuring their own electoral support after transition to democracy. They expected the majority of those, who would benefit

320 Ibid., p. 482.

from the reforms, to vote for policy continuity. Mindful of the disastrous effect of President Allende’s socialist economic policies, the Gremialists threw their support behind the Chicago Boys’ advocacy of transition to a market economy. The emergence of the Gremialists as the dominant political faction of the new regime helped the Chicago Boys in becoming the economic policy-makers of the junta, which, in turn, was looking for economic policy proposals they could support ideologically.323

In fact, their cooperation with the anti-Allende faction of the military began before the coup. In 1972, Roberto Kelly, a retired naval officer acting on behalf of Admiral José Toribio Merino, the Commander of the Chilean combat fleet and one of the four coup leaders, asked the Chicago Boys to draft an alternative economic program, nicknamed el ladrillo (the brick) because of its size. After the coup, Medrino, who became one of the four members of the governing junta, was put in charge of “the economic front,” while Roberto Kelly was appointed the head of the ODEPLAN (Office of National Planning). Miguel Kast, the Gremialist Chicago Boy, became his deputy. Other neoliberal economists were appointed to senior positions in ministries of the economic block initially headed by the military before replacing them.

The ODEPLAN, which worked in close coordination with other economic ministries, became the nerve center of market economic reforms. It was there that some of the most important reforms were drafted, including reforms of the pension and healthcare systems, and privatization of the state-owned enterprises (SOEs). The Office was also put in charge of

323 The junta outlawed political parties, but did not establish its own, which opened the door for various informal groups, such as the Gremialists, to vie for the political influence over the regime. The Gremialists, who were the first in line at the Pinochet’s door, emerged as the winners.
junta’s social policy, which was important for the military regime given the populist image it cultivated. The involvement of the economic reform team in designing and implementing new policies and initiatives aimed at combatting the extreme poverty was uncharacteristic of the majority of neo-liberal economic reformers and of their reform projects.\textsuperscript{324} It helped the economic reform team to legitimize itself both in the eyes of the junta and of the population: “By focusing on the “social” evaluation of public spending, the neo-liberal model acquired a more political connotation, with a slightly populist orientation, since it directed a significant proportion of public spending towards “social projects.” That balanced out the conservative connotations that had dogged neo-liberalism from its inception, and countered the image that the model tended toward an extreme concentration of wealth.”\textsuperscript{325}

Simultaneously with implementing its policy of poverty reduction, the ODEPLAN was tasked with the reform of the local governments, the purpose of which was to transfer responsibilities over health, education, and social assistance to individual municipalities. The implementation of this policy allowed the economic reformers to establish important links to regional and local political and economic elites and garner their support.

Apart from the ideological cohesion of the economic and the political reform teams, there was another important factor that explains Chile’s success with implementing market-oriented reforms – the coherent government cadres training policy. The policy pursued by the two teams was aimed at safeguarding the continuity of economic reforms and polices and, by extension, the continuity of the Pinochet regime for decades. The PUC, particularly its Institute of Economics (IE PUC), as well as the School of Administration, both at the Faculty

\textsuperscript{325} Huneeus (2000), p. 498.
of Economic and Administrative Sciences, became the center for graduate and undergraduate studies in economics and public administration, and for training cadres for the ODEPLAN and other economic ministries. After the coup, the PUC came under the complete control of the Gremialists, who purged it of the leftist, Christian Democratic, and independent academics, and forced the resignation of its Grand Chancellor Archbishop of Santiago Cardinal Silva Henriquez, despite the fact that the university was under the Vatican’s jurisdiction.

The ODEPLAN helped establish at the IE PUC a number of post-graduate training courses designed to replicate the University of Chicago economics program. An “adequate knowledge of [neo-liberal] economics,” based on the evaluation done by the IE PUC, was a prerequisite for any applicant for a government job. Similarly, the ODEPLAN established a course at the School of Administration to train regional level civil servants, who, upon graduation, spread neo-liberal thinking in rural areas. Not only was undergraduate or graduate education at the Faculty of Economic and Administrative Sciences a prerequisite for a government job, but it also guaranteed job security and a possibility of promotion within the civil service. Training local government employees provided the economic and the political reform teams with another avenue of establishing links and a support base among the regional elites.

The joint Gremialist-neo-liberal educational scheme relied on both political stimuli and material incentives, such as the Presidential scholarships for post-graduate studies abroad. Upon completion of their studies, the recipients had to work for the government for twice the amount of time they spent abroad. Applicants for the scholarships had to go through the process of meticulous political evaluation. Candidates with high grades and other scholarly achievements who had shown signs of opposition to the military government were
automatically disqualified. Between 1981 and 1990, a total of 479 Chileans received Presidential scholarships.\textsuperscript{326}

Thus, the coalition of the economic and the political reformers, who shared the same concept of Chile’s economic future, provided the military regime with a politically reliable network of technocrats, who penetrated all state institutions, particularly those responsible for economic policy-making. Their influence, perpetuated by the system of recruitment and training, accounts for the coherence of economic policies and success with their implementation. By the end of the Pinochet era, “the predominance of free-market ideas in Chile was overwhelming.”\textsuperscript{327}

After transition to democracy in 1990, successive governments irrespective of their ideological orientation continued, on the whole, with economic policies put in place by the neo-liberals and the Gremialists, providing the free-market economic model with democratic legitimization.\textsuperscript{328} Throughout the 1980s and 1990s, the continuity and stability of economic policy-making provided for a sustained annual GDP growth of 7%; a drastic drop in inflation, which Chile suffered since the 19th century; the emergence of a solid business community; and an impressive diversification of exports. In 2010, Chile became the first South American country to join the OECD. For the foreseeable future, “Reflecting decades of prudent

\begin{flushright}
\textsuperscript{326} Ibid., p. 494.
\textsuperscript{327} Hojman (1993), p. 25.
\end{flushright}
economic management, Chile will continue to stand out as the economy in Latin America with the soundest macroeconomic fundamentals.”

Diversification of Chile’s economy has been one of the most important accomplishments of transition to market economy and of the coherence and continuity of economic policy. For a very long time, Chile, like Kazakhstan, has been a mineral economy and depended on mining and exporting copper. However, since the 1980s, the share of copper in Chile’s exports has been stable, fluctuating annually within the 40% range, which was achieved as a result of economic diversification. Today, in addition to copper, exports include value-added industrial goods (about 27%), services (13%), and agricultural goods (5%). Chile emerged as the world’s 6th biggest wine exporter, ahead of France, Spain, and Italy. It is the world’s 2nd biggest exporter and 3rd biggest producer of farmed and wild caught salmon.

Meanwhile, Kazakhstan has been moving in the opposite direction. The share of oil and raw metals in its exports has been constantly increasing, pointing at the lack of diversification of its economy. If, in 1995, the share of oil and metals in Kazakhstan’s total exports was 42.3%, in 2007 it was already 76.4%, and by 2014 it has increased to 89.2%. This negative trend cannot be explained by an increased production or high oil and raw metals prices in the world commodity markets. When the world copper prices reached record highs in 2006-2007, its share in Chile’s exports went up to 55.7%. However, subsequently it went down, while in Kazakhstan, the share of minerals in its exports has been growing consistently. Thus, while Chile has succeeded in decreasing its dependence on copper price fluctuations,

Kazakhstan’s economic performance is directly tied to price fluctuations on its main export commodities.

As argued above, economic development of Kazakhstan since 2004 has been in the direction of the gradual abandonment of market economic principles and bringing the state back in not only as the manager of the economy, but also as an owner of previously privately-owned businesses, such as banks. Lack of a coherent economic policy, growing political risks, and uncertainty, have all discouraged domestic borrowing and investment beyond mortgages and loans to finance trade and purchase of consumer goods. As a result, thus thwarting diversification of the economy.

Huneeus’s argument that success with market economic reforms in Chile can be explained by the ideological cohesion of the economic and the political reform teams, de facto resulting in them working as one team, opens a new line of inquiry into the politics of economic reforms. Specifically, it raises the question of whether such cohesion is a necessary condition for a successful outcome of an economic reform project, particularly a radical one. Finding a definitive answer would require comparative analysis of more than two cases, it is clear, however, that the lack of such cohesion played a key role in the (partial) reversal of market economic reforms in Kazakhstan and its banking sector in particular.

From the start, the economic reform team had a different set of values and ideas about the future economic and political system of Kazakhstan than the political reform team. Technocratic reformers did acquiesce to President Nazarbayev’s regime of “enlightened” authoritarianism for two reasons. First, they went along with it as long as it allowed them “free reign” in designing and implementing market-oriented economic reforms and as long as it benefitted their allies among the new business elite. Second, they expected Nazarbayev to
live up to his end of the “authoritarian bargain,” i.e., launch democratic political reforms upon the completion of the economic. When they felt that their power and interests were threatened they had no other choice but to challenge the political status quo.

For their part, Nazarbayev’s political advisors and inner circle have consistently preferred an authoritarian political system to a democratic. They tapped into Kazakh traditional political culture to rationalize and legitimize it, while giving authoritarianism a modern touch by casting it as “enlightened.” Except for one case – in 2001, when they sided with technocratic reformers against Rakhat Aliyev, Nazarbayev’s son-in-law, whom they perceived as a threat to the authoritarian status quo and their personal interests – the two teams did not cooperate and worked independently of each other, strictly observing the division of functions imposed by Nazarbayev.

When technocratic reformers ventured into politics that inevitably created a conflict between them and the political team (as well as the president’s inner circle), whose job it was to maintain stability and ensure the longevity of Nazarbayev’s regime. The ouster of technocratic reformers from the government led to a (partial) reversal of market-oriented economic reforms and restoration of the regime’s control over the economy. Both were needed to prevent any future incidence of an elite group with economic and other resources independent of the regime, which could be used to challenge the status quo.

8.6. Conclusion

The politician’s dilemma in Kazakhstan was resolved in favor of the longevity of Nazarbayev’s regime rather than further pursuit of market economic reforms. The technocratic reformers were ousted from the government and replaced by a mixture of former red directors,
Soviet apparatchiks, and the younger generation technocrats selected for their loyalty to Nazarbayev rather than meritocratic credentials.

The mistake the technocratic reformers made was to become politicians, i.e., technopols, having no prior political experience and not fully understanding the inner workings of Kazakhstan’s political system. They failed to realize that “Politics is organized by a logic of appropriateness. Political institutions are collections of interrelated rules and routines that define appropriate action in terms of relations between roles and situations. The process involves determining what the situation is, what role is being fulfilled, and what the obligations of that role in the situation are.”

By violating the rules and the norms of Kazakhstan’s traditional political culture, the technocratic reformers found themselves outside of the government and with no regular access to Nazarbayev. That allowed the traditionalist and Soviet-era elites a monopoly influence on president’s decision- and policy-making. Nurlan Balgimbayev, a former Prime Minister and Nazarbayev loyalist, argues that as a result of this monopoly, the president, without realizing it, has become a hostage to a group of people who attempt to limit his outside contacts and access to unfiltered information. These elite groups, which partially overlap with Nazarbayev’s inner circle, are not interested in reforms, economic or political, but “in having their personal axes to grind,” which, warns Balgimbayev, may “reap a revolution.”

---


Chapter IX. Conclusion

The choices that Kazakhstan’s president and elites had to make about the political and economic future of their country following its independence in 1991 were momentous. Kazakhstan was facing multiple transitions – political, economic, and social – that posed countless challenges, but also created opportunities for modernization and institutional innovation. It was argued at the beginning of this dissertation that at a critical historical juncture, such as 1991, agency of Kazakhstan’s key decision-making actors became crucial and consequential. Policy choices, and the capacity to enact and implement them, often determine the success or failure of the reform goals that key decision-making actors seek to achieve.

Reforms, be they political or economic, require the presence of a political leader with a vision of their end goal, along with capacity to offer a set of policies to make their achievement possible, and the commitment to see through the implementation of these policies. To realize his vision and carry out reforms, the leader needs a reform team of experts in various fields, i.e., technocrats, who share his ideas and goals and whom he can entrust with the design and implementation of the reforms. Synergy between the political leader and the technocratic reform team, based on the division of functions, whereby the politician manages the politics of economic reforms while the reform team performs the technocratic function – i.e., designs and implements the reforms – is key to ensuring a successful reform outcome. Depending on the political system, reforms require legitimization, either by the leader seeking popular mandate through the electoral process, or by concentrating the executive power in his hands, suppressing politics, and creating a coalition of the reform “winners” that would be a proxy for the popular mandate.
The choice of the particular developmental trajectory that the Kazakhstani political elite had to make in 1991 was, in fact, self-evident. Communism as an ideology, totalitarianism as a political system, and central planning as an economic system had all discredited themselves in the eyes of the majority of the elites and society. At the time, there was no plausible alternative to the democratic government and market economy. Kazakhstan, however, had to tackle the dearth of bureaucratic and institutional capacity that imperiled its transition to independence and implementation of political and economic reforms.

The complexity of the reform process was exacerbated by the systemic, i.e., revolutionary, character of transformation that Kazakhstan was going through. Building democracy and a market economy required not only changing formal political and economic institutions, but also changing or adapting informal institutions (political culture, bureaucratic standard operating procedures, etc.) to bring them in tune with the rules of the new institutional matrix and modes of behavior. Kazakhstan had also to combine institutional reforms with the creation of those state institutions, which, as a Moscow-ruled dominion, it lacked, despite its nominal status as a republic.

There was, in addition, another layer of complexity: multi-level changes happened simultaneously and could not be easily controlled. Thus, a degree of coordination and sequencing of the reforms was needed to avoid complete chaos.

The revolutionary change that Kazakhstan experienced post-1991, and the uncertainty this engendered, rendered particularly salient and consequential the role of its political leader – and the actors charged with building the new Kazakhstani state while reforming its Soviet-era institutions. It required a strong, visionary leader capable of presenting a compelling and coherent plan for the country’s future, and steering the state and society onto a new
developmental trajectory. Of the reformers it required the ability to operate as a cohesive team, the capacity to learn on the job, and flexibility in implementing the reforms.

9.1. Leadership, reformers, and reforms

Kazakhstan’s early success with its banking sector reform, which became emblematic of its success with building a market economy, confirms a number of theoretical assumptions drawn from cases of radical economic reform in Asia and Latin America. First, the role of the chief executive was crucial. Following independence in 1991, Nursultan Nazarbayev, Kazakhstan’s chief executive, opted for a radical break with the Soviet economic system, its practices, and the mentality of dependence it engendered, and quickly moved to introduce market-oriented economic reforms.

Second, the transition to a market economy – including the successful creation of the most institutionally developed banking sector in the former Soviet Union – would not have been possible without the establishment of a “strong” authoritarian regime. In the Kazakhstani case, authoritarianism was necessitated by opposition to reforms on the part of the Soviet-era communist nomenklatura and economic elite (“red directors”), rather than from the public, which supported Nazarbayev. Kazakhstan’s leadership in building a market economy was recognized by the European Union and the United States, which in 2001 and 2002 respectively noted its market economy, the first among the former Soviet Union states, including Russia.

Third, the initial success with banking sector reform was predicated on the existence of a cohesive reform team, whose members succeeded each other as Governors of the National Bank of Kazakhstan (1994-2004). Their collective tenure at the NBK allowed them
to accomplish the task set by the president – to transform the Soviet-era banking sector into a sector capable of acting as a financial intermediary of Kazakhstan’s nascent market economic system.

Fourth, Nazarbayev demonstrated visionary qualities not only in terms of charting Kazakhstan’s new developmental trajectory, but also by identifying mechanisms to accomplish the reform goals. Thus, in an attempt to break with Soviet institutional legacies, get rid of Soviet-era government bureaucracy, and empower the new generation of bureaucrats, Nazarbayev moved Kazakhstan’s capital. He entrusted the drafting and implementation of economic reforms to young technocrats and businessmen unencumbered by Soviet mentality and practices. He launched the Bolashak program to educate the next generation of Kazakhstani elite in the West and thus build up the country’s bureaucratic and technocratic capacity to continue and deepen market-oriented economic reforms.

Fifth, technocratic reformers enjoyed autonomy from contending political, societal, and special interest groups and interests – along with wide powers to draft and implement market-oriented economic reforms. In the case of the NBK reform team, the president emerged as a firm supporter of Central bank independence; he also backed team members in their disputes with the government and the parliament. The robust synergy that developed between the president and the NBK team, as well as its internal cohesion and ideological cohesiveness, allowed the reformers successfully to undertake the most radical, market-oriented bank restructuring in the entire former Soviet Union. The banking sector also became the only sector of Kazakhstan’s national economy where comprehensive market-oriented economic reforms took hold, and which embraced best international practices that allowed its integration and expansion in the global financial system.
9.2. A “politician’s dilemma” Kazakhstan-style

The abovementioned synergy and presidential support lasted until the NBK reformers, whom President Nazarbayev promoted to senior government positions, decided to enter politics. This they did in order to publicly oppose members of Nazarbayev’s own family and inner circle whom they considered a threat to the irreversibility of market economic reforms – as well as to their hopes for democratic political reforms, and the business interests of their supporters among the new business elite. The transformation of technocratic reformers into technopols upset the authoritarian bargain earlier struck with Nazarbayev, which was based on an agreement that completion of market-oriented economic reforms would precede democratic political ones. Thus, the technocrats-turned-politicians put President Nazarbayev before what Barbara Geddes identified as the “politician's dilemma” – a conflict between the chief executive’s need for immediate political survival, the longer-term collective interest in economic performance, and his own interest in maintaining stability of the regime.333

Geddes suggests that when a politician faces the dilemma he may (a) forgo economic reforms that cost him political capital, i.e., electoral votes; and (b) he would use the appointment resource as a political rather than an economic investment, i.e., chose top economic officials and managers of the national companies on the basis of their political loyalty rather than technocratic expertise. The concept is rooted in economic reform cases of Latin American countries with a democratic political system. I argue that the Kazakhstani case broadens its applicability to include, potentially, (a) countries with authoritarian regimes, and (b) instances when a politician faces internal threats to his survival.

Kazakhstan, however, presents a case of the false politician’s dilemma. President Nazarbayev’s survival was not threatened, in the immediate or long-term, by the decision of technocratic reformers and the new business elite to create a political party (the Democratic Choice of Kazakhstan). As a minority elite and social group they could not contest his presidency, nor did they have plans to do that – indeed they professed their loyalty to Nazarbayev and support for his policies.

Nevertheless, Nazarbayev perceived the threat to be real, and reacted in the same fashion as Latin American presidents who operated in a democratic political system, and whose tenure in office was threatened by the opposition. As a result, since 2001 the president of Kazakhstan has increasingly made economic policy decisions based on political calculations, rather than the economic rationale characteristic of his earlier policy choices (which, in turn, stemmed from his desire to turn Kazakhstan into a fully-fledged market economy).

Since then, Nazarbayev has chosen cadres, including the economic block of ministries and national companies, based on personal loyalty rather than technocratic expertise and reformist potential. He no longer showed interest in delegating power, or creating centers of independent decision-making, but looked instead for those who would take orders and execute his will. However, Nazarbayev’s attempts to find a new group of loyal technocrats to replace the technocratic reformers of the 1990s and the early 2000s have failed.

Kazakhstan is different from most cases where the chief executive faces the politician’s dilemma, in that that the economic reform, per se, was not an issue: the reforms had already been initiated. Nor were reforms simply discontinued or scaled down. It is a rare case when reforms are reversed in order to restore a regime’s control over the economy, and
to exclude the emergence of an independently wealthy group of Kazakhstanis who could use their economic resources to challenge the political status quo, as had happened in the early 2000s. The institutional ingenuity of the regime is that control has been reasserted not only by restoring the leading role of the state in the economy, but also through the ownership by Nazarbayev’s family and loyalists of nationally important businesses, as has happened in the banking sector. That allows the regime to maintain the trompe l’oeil of private ownership, and claim that the country’s economy is still driven by market principles.

Was the reversal of the reforms inevitable? In other words, did President Nazarbayev have to face the politician’s dilemma? A number of factors contributed to the emergence of the dilemma. The main factor was the decision of the technocratic reformers and the new business elite, including the bankers, to become politicians and create a new political party. This decision as subsequent events revealed, was ill conceived, since it exposed the technocrats’ lack of political skills and understanding of how politics worked in their society. Betting on their and Nazarbayev’s shared economic beliefs and vision of the country’s future, they discounted the fact that unlike the economy, where they had worked hard to embed formal (market) institutions, Kazakhstani politics was based on, and driven by, informal institutions. These institutions, rooted in the traditional character of the Kazakhstan’s society and authoritarian political culture, limit the choice of goals and determine the appropriate means of their attainment. By violating these informal rules and not following the logic of appropriateness in launching their careers, the technocratic reformers, and the new business

---

334 The issue of why he preferred his political survival to the common good of economic reforms is, in a sense, a non-issue. Any rational actor whose occupation is politics would rather prefer to maximize his tenure in office than not.
elite, allowed the two majority elite groups to outmaneuver them and provoke a split with Nazarbayev.

Grigoriy Marchenko once noted that the success of banking sector reform in Kazakhstan rested on the fact that the government was kept out of the reform process, and out of the sector itself. He also observed that for the banking sector to function effectively at least two conditions have to be met: (1) the sector has to politically independent; (2) effective supervision has to be in place.\textsuperscript{335} By entering politics the technocratic reformers and the bankers invited politics to enter the banking sector. Nazarbayev could not afford to lose control over the banking sector assets to his potential political opponents. The reversal of banking reforms and restoration of regime control over the sector was therefore inevitable.

Thus, the suggestion that technocratic reformers, who are appointed by the chief executive to carry out economic reforms, have a better chance to implement them if they assume political roles -- is not borne out in the Kazakhstani case. Rather the case supports the conclusion drawn by Robert Bates from his study of the politics of failed economic reforms: even those technocrats who turned out politically more successful “often appeared to be politically less insightful.”\textsuperscript{336} The Kazakhstani example makes a case for the division of functions between the politician and the technocratic reformers, with the former managing the politics of economic reforms, and the latter focusing on performing the technocratic role, i.e., the drafting and implementing of the reforms.

The second factor that contributed to the emergence of the dilemma was the absence of ideological cohesion among the elites, particularly vis-à-vis economic policy, and their fragmentation. The technocratic reformers whom Nazarbayev put in charge of reforming the

\textsuperscript{335} Marchenko (2008), chapter 4, loc 1439.
banking and other sectors of the economy were a minority, numerically and ideologically. The two majority elite groups, Kazakh traditionalists and the Soviet-era nomenklatura, opposed the technocratic reformers, based on ideological and cultural differences, as well as for personal reasons. Neither did they play a major role in the market-oriented economic reforms initiated in the 1990s, nor were they receptive of liberal economic and political ideas. In the context of a traditional society, with a deeply ingrained Soviet bureaucratic culture, the traditionalists and the former nomenklatura frowned on the technocratic reformers as being parvenus, and looked for every opportunity to oust them from the government. While all three groups cooperated in 2001 in the attempted ouster of Rakhat Aliyev, President Nazarbayev’s son-in-law, their eventual clash was inevitable because Nazarbayev’s favoritism toward the technocratic reformers and the new business elite – he aspired for someone in their ranks to be his successor as president – ran contrary to the ideological preferences, and to the personal, political, and economic interests of the two majority groups.

A comparative analysis of Kazakhstani and Chilean radical market-oriented economic reforms suggests that the ideological cohesion of the economic reform team and the political team working for the chief executive may be a necessary condition for a successful reform outcome. This, however, requires further research through analysis of a wider range of cases.

Third, President Nazarbayev’s perception of the causes of the 2001 political crisis, and his handling of it, played an important role in the reversal of the banking sector – and, more broadly, market economic – reforms in Kazakhstan. Though it took him years to resolve the politician’s dilemma definitively, Nazarbayev did allow, against his better judgment, the anti-liberal elite groups to exploit his autocratic tendencies and convince him that his protégés
presented an imminent threat to the longevity of his rule, despite the latters’ assurances to the contrary.

Nazarbayev’s personal disappointment with his protégés arose from their perceived disloyalty, coupled with the authoritarian consolidation of his regime – and eventually resulted in his disenchantment with liberalism. In 2009, in the midst of the global financial and economic crisis, Nazarbayev, who once championed market ideology and wanted his country to be run by Kazakhstanis with a different mindset, shaped by western education, said the following: ‘Today, all kinds of ‘isms’ lost their authority – for example, liberalism, including economic. Liberals themselves say that one cannot rely on it … The graduates of Harvard and Oxford are now equals with the graduates of Shymkent university.’

9.3. Quo vadis

Nevertheless, despite the abandonment of his earlier economic policies, President Nazarbayev still demonstrates no shortage of vision vis-à-vis the future economic development of Kazakhstan – though this is dissonant with the increasing role of the state and his regime in the economy. Back in 2009, the same year Nazarbayev renounced his believe in the merit of economic liberalism and western education, Kazakhstan’s leader announced that the country would adopt a new strategy of economic development – one based on the Finnish model of a knowledge-based economy. Among his recent initiatives is the development of the renewable energy sector in Kazakhstan. Nazarbayev has set a goal of powering the 2017

World Expo, to be held in Astana, the Kazakhstani capital, exclusively by alternative sources of energy.

In the 1990s and early 2000s, the banking sector and other market-oriented economic reforms succeeded in large measure because Nazarbayev entrusted their implementation to young Kazakhstani technocrats, mostly graduates of elite Soviet universities, where they had discovered and internalized ideas that differed from those dominant in Kazakhstan. The ouster of technocratic reformers from the government, which triggered the exodus of many of their associates and assistants, has diminished the state’s capacity to implement further economic reforms – as, for example, is clear from the failure of the 2003-2015 Strategy of industrial and innovative development. It is therefore difficult to imagine that President Nazarbayev will accomplish his current and future developmental goals by relying on graduates of Shymkent university. Higher education has not only been left unreformed in Kazakhstan since independence, it is the nation’s third most corrupt sector, following law enforcement and the justice system.\(^{338}\)

The reversal of banking sector reform in Kazakhstan, which is emblematic of the country’s market-oriented economic reforms in general, has proven two things. First, politicization of economic reforms – which in Kazakhstan was due as much to the actions of technocratic reformers as to President Nazarbayev’s counteractions – can derail their successful outcome. Second, the Kazakhstani case proves the argument that while authoritarian regimes can initiate radical economic reforms (through their ability to solve the collective action problem, overcome political and bureaucratic opposition to change, as well

---

as their ability to recruit and empower a reform team to draft and implement a cohesive reform program) – over the long run, authoritarian regimes, even if they are “enlightened,” undermine economic stability and effective economic management by creating uncertainty among the economic actors.\textsuperscript{339} Consolidating economic reforms and making them irreversible ultimately requires political reforms to move away from the uncertainties of autocratic decision-making, and towards stability and transparency in policy-making and the application of laws.

Appendix A. List of interviews

(Unless otherwise stated, the job titles below are listed according to the time of the interview)


Jandosov, Oraz; Sarsenbaiuly (Sarsenbayev), Altynbek (Co-Chairman, Aq Zhol party); Abilov, Bulat (Co-Chairman, Aq Zhol party); Tuyakbai, Zharmakhan (Chairman, For a Just Kazakhstan political movement). Almaty, April 23, 2005.


Karagusova, Gul’zhana. Senator; Chairwoman, Senate Economy, Finance, and Budget Committee (1996-2001); Chairwoman, Mazhilis Finance and Budget Committee (2007-). Astana, April 5 and 9, 2001; Almaty, May 7, 2001; April 2, 2011.

Karibzhanov, Aidan, Managing Director, VISOR. Almaty, July 16, 17, and 26, 2001.


Suleimenov, Maidan. Member of the Academy of Sciences of the Republic of Kazakhstan; Professor, Kazakhstan State Law University. Almaty, July 26, 2001.


Yertlesova, Zhanat. Deputy Head of the President’s Administration. Astana, April 3, 2001.


Bibliography

Books


Dawisha, Karen and Parrott, Bruce, eds. *Conflict, cleavage, and change in Central Asia and the Caucasus*. Cambridge: Cambridge University Press.


Skocpol, Theda, Evans, Peter and Rueschemeyer, Dietrich, eds. (1985). *Bringing the State Back In*. New York: Cambridge University Press.


**Articles and reports**


Friends of Ablyazov (2011). “Mukhtar Ablyazov has experienced first-hand the political persecution and absence of law in Kazakhstan under President Nursultan Nazarbayev.”


“Kazakhstan: New Kazakh PM Appointed Due to Experience In Oil.” *INTERFA$, October 10, 1997 as transcribed in *FBIS-SOV-97-283*.


Objections of the Association of Financiers of Kazakhstan to the Draft Law on Consolidated Supervision (2001). Personal copy provided to the author by Daulet Sembayev.


278


