



Technical Assistance Report

Project Number: 52164-002
Knowledge and Support Technical Assistance (KSTA)
October 2018

Republic of Kazakhstan: Improving Public Debt Management

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Asian Development Bank

CURRENCY EQUIVALENTS

(as of 1 October 2018)

Currency unit	–	tenge (T)
T1.00	=	\$0.00275
\$1.00	=	T363.18

ABBREVIATIONS

ADB	–	Asian Development Bank
GDP	–	gross domestic product
MOF	–	Ministry of Finance
MTDS	–	medium-term debt strategy
NBK	–	National Bank of Kazakhstan
NFRK	–	National Fund of the Republic of Kazakhstan
SBD	–	State Borrowing Department
SOE	–	state-owned enterprise
TA	–	technical assistance

NOTE

In this report, “\$” refers to United States dollars.

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KNOWLEDGE AND SUPPORT TECHNICAL ASSISTANCE AT A GLANCE

1. Basic Data		Project Number: 52164-002	
Project Name	Improving Public Debt Management	Department/Division	CWRD/CWPF
Nature of Activity Modality	Capacity Development, Policy Advice Regular	Executing Agency	Ministry of Finance
Country	Kazakhstan		
2. Sector		ADB Financing (\$ million)	
✓ Public sector management	Public expenditure and fiscal management		0.75
		Total	0.75
3. Strategic Agenda		Climate Change Information	
Inclusive economic growth (IEG)	Pillar 1: Economic opportunities, including jobs, created and expanded	Climate Change impact on the Project	Low
4. Drivers of Change		Gender Equity and Mainstreaming	
Governance and capacity development (GCD)	Public financial governance	No gender elements (NGE)	✓
Partnerships (PAR)	Implementation		
Private sector development (PSD)	International finance institutions (IFI) Conducive policy and institutional environment		
5. Poverty and SDG Targeting		Location Impact	
Geographic Targeting	No	Nation-wide	High
Household Targeting	No		
SDG Targeting	Yes		
SDG Goals	SDG8		
6. Risk Categorization		Low	
7. Safeguard Categorization		Safeguard Policy Statement does not apply	
8. Financing			
Modality and Sources		Amount (\$ million)	
ADB		0.75	
Knowledge and Support technical assistance: Technical Assistance Special Fund		0.75	
Cofinancing		0.00	
None		0.00	
Counterpart		0.10	
Government		0.10	
Total		0.85	
Currency of ADB Financing: USD			

I. INTRODUCTION

1. The knowledge and support technical assistance (TA) will support the Government of Kazakhstan and the Ministry of Finance (MOF) State Borrowing Department (SBD) in improving public debt management and developing the government securities market. The TA will (i) develop a debt management strategy for optimizing debt risks, costs, and coverage of public sector debt; (ii) prepare an action plan to develop the government securities market, including expanding the domestic and international investor base; and (iii) prepare a plan to improve government agency coordination for cash and debt management. The TA will also strengthen MOF capacity for issuing and managing government debt, and identify further reforms for inclusion in a potential subsequent policy-based loan.¹ The TA is included in the country operations business plan, 2019–2021 and is consistent with the Asian Development Bank (ADB) country partnership strategy for Kazakhstan, 2017–2021.²

II. ISSUES

2. **Countercyclical fiscal policy response to economic crises.** Gross domestic product (GDP) growth decelerated to 1.2% (2015) and 1.1% (2016) following a decline in oil prices and recession in the Russian Federation.³ Significant budget expenditure increases from stimulus packages and a slowdown in revenue caused rapid increases in the overall fiscal deficit, reaching 6.3% in 2015 and 5.4% in 2016.⁴ The non-oil fiscal deficit⁵ expanded from 8.3% of GDP in 2013 to 10.0% in 2016 and 12.6% of GDP in 2017.⁶ The GDP growth rate rose to 4.1% in 2017 as oil prices continue to recover and the pass-through benefits of government stimulus spending are realized. However, economic recovery is still fragile as growth is forecast to lower to 3.7% in 2018 and 3.9% in 2019.⁷ In 2018 the government has moved toward fiscal consolidation following the large stimulus packages, and public expenditure is projected to reduce to relatively low levels of 19% of GDP for 2018 and 2019.⁸

3. **Public borrowing to finance macroeconomic stimulus.** The government issued sovereign bonds (eurobonds) of \$6.5 billion in 2014 and 2015, and increased borrowing from international financial institutions (\$7 billion outstanding in 2018). Direct expenditures and transfers from the National Fund of the Republic of Kazakhstan (NFRK) to the budget also significantly increased. As of January 2018, government debt was 19.6% of GDP (Table 1) and total public sector debt, including state-owned enterprise (SOE) debt, was 53.6% of GDP. The proportion of public sector debt that is external has increased to 47.2%. Government debt, excluding National Bank of Kazakhstan (NBK) debt, is expected to remain stable at 20% of GDP in 2018 (footnote 6). New regulations will reduce guaranteed transfers from NFRK to the budget, to be fixed at T2 trillion (\$6.1 billion) from 2020, and off-budget lending from NFRK to SOEs has

¹ The TA first appeared in the business opportunities section of the website of the Asian Development Bank (ADB) on 3 October 2018.

² ADB. 2017. *Country Partnership Strategy: Kazakhstan, 2017–2021—Promoting Economic Diversification, Inclusive Development, and Sustainable Growth*. Manila.

³ World Bank. World Development Indicators (accessed August 2018).

⁴ The fiscal stimulus package exceeds \$20 billion (12% of GDP) over 2014–2017, including the “One Trillion Tenge” program in 2014, and the “Nurly Zhol” stimulus program launched in early 2015 to fund large transport and energy infrastructure investments and support social sectors (e.g., housing), small and medium-sized enterprises, and employment generation.

⁵ Non-oil fiscal deficit is the difference between total public expenditure and non-oil fiscal revenue.

⁶ World Bank. 2018. *Kazakhstan Country Economic Update*. Washington, DC.

⁷ ADB. 2018. *Asian Development Outlook 2018 Update*. Manila.

⁸ International Monetary Fund. 2018. *Article IV Consultation Report*. Washington, DC.

been restricted.⁹ These restrictions could be a risk for increased government or SOE borrowing in the medium term.

Table 1: Public Sector Debt Outstanding, January 2018

Item	Public Sector Debt		Share of External Debt
	(\$ million)	(% of GDP)	(%)
Central government	30,672	19.4	44.8
Local government	384	0.2	0
National Bank of Kazakhstan	9,579	6.1	0
State-guaranteed debt	1,456	1.0	90.3
Total state-owned enterprise debt	42,468	26.9	58.5
Samruk-Kazyna	29,751	18.8	62.2
KazAgro	3,104	2.0	57.4
Baiterek	9,613	6.1	47.4
Total	84,559	53.6	47.2

Note: Domestic debt is held by residents, external debt is held by nonresidents.

Source: State Borrowing Department, Ministry of Finance.

4. **Lack of public debt strategy.** A debt strategy is important to ensure that government financing needs for the budget are met, while minimizing debt service costs and reducing fiscal risk exposure and vulnerability to economic shocks.¹⁰ Debt servicing costs are projected to exceed the government's threshold of 15% of gross annual revenue by 2022. Fiscal risks are not suitably addressed in the debt portfolio, including market risks (i.e., impact of exchange rate fluctuations on foreign currency debt), refinancing risks, interest rate risks (45% of outstanding debt has interest rates adjusted within 1 year), and the realization of contingent liabilities. Significant currency depreciation since the floating of the tenge in 2015 has highlighted Kazakhstan's exposure to foreign currency debt and the need to improve debt management capacity.¹¹

5. **State-owned enterprise borrowing.** The three main SOE holding companies—Samruk-Kazyna, Baiterek, and Kaz-agro—are able to raise debt on international markets. SOE debt reached 26.9% of GDP in January 2018, of which 58.5% is external debt (Table 1). Although outstanding government debt to GDP is modest by international standards, fiscal risks from SOEs are significant and may increase further, based on a planned gasification project and the government's plans to build a fourth oil refinery (footnote 6). Fiscal risks from SOE debt are not currently addressed as part of a comprehensive public debt management plan. The potential debt burden from realizing the government's contingent liabilities (including guaranteed debts of SOEs and other implicit contingent liabilities) are also not taken into account.¹² The Ministry of National Economy has developed new legislation for limiting external debt accumulation by key SOE holding companies.

6. **Government securities market undeveloped.** The investor base for domestic government debt is concentrated, with 45% of domestic debt owned by the unified pension fund as of April 2018 and 34% of domestic debt held by commercial banks. For external government

⁹ Presidential Decree 825 of 8 December 2016.

¹⁰ International Monetary Fund and World Bank. 2009. *Managing Public Debt: Formulating Strategies and Strengthening Institutional Capacity*. Washington, DC.

¹¹ The World Bank Joint Economic Research Program prepared policy notes for the government related to debt management, government securities analysis, and SOE debt.

¹² If they occur, contingent liabilities will increase the government's total liabilities or debt, including explicit contingent liabilities (i.e., with a contract such as government guarantees or deposit insurance) and implicit contingent liabilities (i.e., an expected but not formal obligation, such as bank bailouts and financial support to SOEs in case of default).

debt, 47% comprises eurobonds and 51% is from international financial institutions.¹³ MOF issues mostly medium- and long-term bonds with an average maturity of 8.7 years. MOF Treasury bills (short-term debt) are undeveloped. The absence of a government yield curve creates difficulty for accurate pricing. Auctions for government securities are often unpredictable, arranged at short notice, and sometimes cancelled (e.g., 6 out of 17 auctions cancelled in 2015). This is not conducive to market development where stable and predictable issuance is key.

7. **Institutional coordination issues.** MOF issues government securities for budget financing requirements and NBK issues notes (short-term debt) as a tool for liquidity management. However, coordination is weak, with recent large issuances of NBK notes crowding out demand for MOF securities and vice versa.¹⁴ The Committee for Treasury, which is responsible for cash management, plays a key role in deciding the securities auctions timing (together with SBD) and cutoff prices. As a result, domestic borrowing tends to be volatile throughout the year. Transfers from the NFRK to the budget are front loaded in the first half of the year, which affects the regularity of government securities issuance.

III. THE TECHNICAL ASSISTANCE

A. Impact and Outcome

8. The TA is aligned with the following impact: effective fiscal policy to support economic growth.¹⁵ The TA will have the following outcome: public debt management improved.¹⁶

B. Outputs, Methods, and Activities

9. **Output 1: Medium-term debt strategy prepared.** The TA will support SBD in developing a comprehensive medium-term debt strategy (MTDS) and borrowing program. This will guide state borrowing to meet the government's financing needs at least cost, based on the desired risk profile and diversification of the debt portfolio and composition (i.e., increased share of domestic debt), while ensuring compliance with the government's fiscal rules. The MTDS will cover public sector debt (including SOE debt) and estimate the risk to public debt from government contingent liabilities (including from SOEs and other sources, e.g., systemically important banks). The TA will also provide training and workshops to strengthen SBD staff capacity for preparing and implementing the MTDS, and identify reforms required to operationalize the MTDS and improve debt management.

10. **Output 2: Institutional coordination plan developed.** The TA will assist to improve institutional coordination between MOF and NBK related to debt management, and coordinate fiscal and monetary policy objectives (i.e., finance sector liquidity management). The TA will (i) develop an agreed coordination plan (consistent with the MTDS) for scale and timing of securities auctions to avoid conflicting objectives; (ii) improve consultation and dialogue related to government securities development (e.g., through an MOF–NBK working group); and (iii) provide capacity building to enable SBD to take a lead role in domestic securities issuance and improve coordination with cash management under the Committee for Treasury.

11. **Output 3: Action plan for developing government securities market prepared.** To support MOF and other stakeholders in developing the government securities market, the TA will

¹³ MOF SBD debt data.

¹⁴ NBK notes issuance increased substantially from T0.4 trillion in 2015 to T5.5 trillion in 2017 (MOF).

¹⁵ Government of Kazakhstan. 2017. *Strategic Plan for Development of Kazakhstan until 2025*. Astana.

¹⁶ The design and monitoring framework is in Appendix 1.

prepare an action plan and build capacity through training and workshops for SBD to expand and diversify the investor base (including resident and nonresident investors). The action plan will align with SBD's plans to relocate issuance of MOF securities from the Kazakhstan Stock Exchange to the new Astana International Exchange (majority owned by MOF) and assess infrastructure needs. The TA will support SBD in holding regular securities auctions, developing investor relations, and meeting other preconditions to encourage securities market development. A more developed domestic government securities market will reduce portfolio risks, increase access to funds, reduce financing costs, and provide greater resilience to financial crisis. A more liquid government bond market will enable greater borrowing and lending options for the private sector and increase competition with the banking sector.

C. Cost and Financing

12. The TA is estimated to cost \$850,000, of which \$750,000 will be financed on a grant basis by ADB's Technical Assistance Special Fund (TASF-other sources). The key expenditure items are listed in Appendix 2.

13. The government will provide counterpart support in the form of counterpart staff, office accommodation and supplies, secretarial assistance, domestic transportation, and other in-kind contributions.

D. Implementation Arrangements

14. ADB will administer the TA through its Central and West Asia Department, Public Management, Financial Sector and Trade Division, which will select, supervise, and evaluate consultants; organize discussions; and provide staff to act as resource persons as required. ADB's Kazakhstan Resident Mission will provide local administrative and coordination support as needed.

15. The implementation arrangements are summarized in Table 2.

Table 2: Implementation Arrangements

Aspects	Arrangements		
Indicative implementation period	October 2018–December 2020		
Executing agency	Ministry of Finance, State Borrowing Department		
Implementing agencies	ADB's Central and West Asia Department, Public Management, Financial Sector and Trade Division		
Consultants	To be selected and engaged by ADB		
	Individual consultant selection	International expertise (18 person-months) and national expertise (28 person-months)	\$573,320
Disbursement	The technical assistance resources will be disbursed following ADB's <i>Technical Assistance Disbursement Handbook</i> (2010, as amended from time to time).		

ADB = Asian Development Bank.
Source: Asian Development Bank.

16. **Consulting services.** A total of 46 person-months of consulting services (18 international and 28 national) will be required intermittently. Table 3 provides an overview of the required consulting services. Consultants will be engaged using individual consultant selection and lump sum payments, and output-based contracts will be considered. ADB will engage the consultants

following the ADB Procurement Policy (2017, as amended from time to time) and its associated project administration instructions and staff instructions.¹⁷

Table 3: Summary of Consulting Services
(person-month)

Consultant	International	National
Debt management specialist/project coordinator	8	14
Capital markets specialist	6	8
Public sector management specialist	4	6
Total	18	28

Source: Asian Development Bank estimates.

IV. THE PRESIDENT'S DECISION

17. The President, acting under the authority delegated by the Board, has approved the provision of technical assistance not exceeding the equivalent of \$750,000 on a grant basis to the Government of Kazakhstan for Improving Public Debt Management, and hereby reports this action to the Board.

¹⁷ Terms of Reference for Consultants (accessible from the list of linked documents in Appendix 3).

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
3. Action plan for developing government securities market prepared	3a. Action plan prepared to develop the government securities market, including (i) detailed actions with sequencing and timelines, (ii) an institutional reorganizing plan, and (iii) proposals for legislation and business process changes (2018 baseline: nil) 3b. Training provided to SBD staff for implementing the action plan for government securities development and improved knowledge demonstrated (2018 baseline: nil)	3a. TA consultant report 3b. TA training records and attendance sheets	
<p>Key Activities with Milestones</p> <p>1. Public debt management strategy prepared</p> <p>1.1 Assess the government's current public debt legal framework, policy, and operations; and recommend necessary reforms to legislation and business process changes and capacity development of SBD by Q1 2019.</p> <p>1.2 Develop the MTDS and MOF borrowing program, incorporating the government's borrowing objectives, covering the public sector, with close cooperation and input from SBD staff by Q3 2019.</p> <p>1.3 Provide training activities and workshops to SBD staff on best practices and international experience in preparing and implementing an MTDS by Q3 2019.</p> <p>2. Institutional coordination plan developed</p> <p>2.1 Prepare an institutional coordination plan, consistent with the MTDS and establish working groups or memorandums of understanding between agencies or departments as necessary by Q4 2019.</p> <p>2.2 Facilitate consultations between MOF, the National Bank of Kazakhstan, and the Treasury Committee for improving information exchange by Q4 2019.</p> <p>3. Action plan for developing government securities market prepared</p> <p>3.1 Develop an action plan for government securities market development with guidance on detailed actions needed to achieve SBD's objectives, including relocation of securities to the Astana International Exchange, increasing and diversifying the investor base (including international and domestic investors), and increasing the share of domestic debt. Identify additional reforms that may be required by Q1 2020.</p> <p>3.2 Prepare an auction calendar for government securities issues and meet with investors and potential investors by Q1 2020.</p> <p>3.3 Provide training activities and workshops to SBD staff on implementing the action plan by Q1 2020.</p>			
<p>Inputs</p> <p>Asian Development Bank: \$750,000 (TASF-other sources)</p> <p>Note: The government will provide counterpart support in the form of counterpart staff, office accommodation, office supplies, secretarial assistance, domestic transportation, and other in-kind contributions.</p>			

MOF = Ministry of Finance, MTDS = medium-term debt strategy, Q = quarter, SBD = State Borrowing Department, TA = technical assistance.

^a Government of Kazakhstan. 2017. *Strategic Plan for Development of Kazakhstan until 2025*. Astana. Source: Asian Development Bank.

COST ESTIMATES AND FINANCING PLAN
(\$'000)

Item	Amount
Asian Development Bank^a	
1. Consultants	
a. Remuneration and per diem	
i. International consultants	418.3
ii. National consultants	140.0
b. Out-of-pocket expenditures	
i. International and local travel	55.0
ii. Reports and communications	10.0
2. Training, seminars, workshops, forum, and conferences	
a. Facilitators	75.0
3. Contingencies	51.7
Total	750.0

Note: The technical assistance is estimated to cost \$850,000, of which contributions from the Asian Development Bank are presented in the table above. The government will provide counterpart support in the form of counterpart staff, office accommodation and supplies, secretarial assistance, domestic transportation, and other in-kind contributions. The value of government contribution is estimated to account for 12% of the total technical assistance cost.

^a Financed by the Asian Development Bank's Technical Assistance Special Fund (TASF-other sources).

Source: Asian Development Bank estimates.

LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/LinkedDocs/?id=52164-002-TARreport>

1. Terms of Reference for Consultants