

Dinara A. Amerzhanova¹

ANALYTICAL EVALUATION OF POSSIBLE OUTCOMES FROM CONSOLIDATION OF KAZAKHSTAN'S PENSION FUNDS

This article discusses and analyses the relevance of the new pension reform in the Republic of Kazakhstan for the improvement of investment efficiency of pension assets. It reveals the key advantages and disadvantages of the pension market restructuring. An attempt is made to assess the possible impact of pension funds consolidation in the United Accumulation Pension Fund.

Keywords: pension reform; assets; investments; pension fund; consolidation.

Динара А. Амержанова

АНАЛІТИЧНЕ ОЦІНЮВАННЯ ПЕРСПЕКТИВ ОБ'ЄДНАННЯ ПЕНСІЙНИХ ФОНДІВ РЕСПУБЛІКИ КАЗАХСТАН

У статті з позиції підвищення ефективності інвестування пенсійних активів розглянуто та проаналізовано питання актуальності проведення реформи пенсійного забезпечення в Республіці Казахстан. Розкрито основні переваги і недоліки реструктуризації пенсійного ринку. Зроблено спробу оцінити можливі наслідки консолідації пенсійних фондів до Єдиного накопичувального пенсійного фонду.

Ключові слова: пенсійна реформа; активи; інвестиції; пенсійний фонд; консолідація.

Табл. 2. Рис. 1. Літ. 17.

Динара А. Амержанова

АНАЛИТИЧЕСКАЯ ОЦЕНКА ПЕРСПЕКТИВ ОБЪЕДИНЕНИЯ ПЕНСИОННЫХ ФОНДОВ РЕСПУБЛИКИ КАЗАХСТАН

В статье с позиции повышения эффективности инвестирования пенсионных активов рассмотрены и проанализированы вопросы актуальности проведения новой реформы пенсионного обеспечения в Республике Казахстан. Раскрыты основные достоинства и недостатки реструктуризации пенсионного рынка. Сделана попытка оценить возможные последствия консолидации пенсионных фондов в Единый накопительный пенсионный фонд.

Ключевые слова: пенсионная реформа; активы; инвестиции; пенсионный фонд; консолидации.

Problem statement. Importance of performance and reliability of Kazakhstan's savings-based pension system is not limited to its social value, but has a significant impact on the country's economy as a whole. Pension assets exceeding 23 bln USD (Current state of the accumulative..., 2014) that are accumulated in the system allowed pension funds to become the largest domestic institutional investors. Effectiveness and rationality of their investment activities affect not only the well-being of future retirees, but the development of non-fossil-fuel based economy.

Recent research and publications analysis. Theoretical and practical aspects of the use and distribution of pension savings of accumulated pension system's participants are reflected in the works of A.B. Alibayev (2013), G. Marchenko (2013) etc.

The research objective is to determine the justification for the restructuring of the pension sector of the Republic of Kazakhstan at the present stage of its development.

Key research findings. It is necessary to rationally assess the current state of Kazakhstan's pension system, the assets of which are supposed to fuel the economy if invested rationally. By now the most discussed topic in this context is the introduc-

¹ Ekibastuz Engineering and Technical Institute named after K. Satpayev, Kazakhstan.

tion of the new law "On Pension Provision in the Republic of Kazakhstan", which provides creation of the United Accumulation Pension Fund. This Law came into force this year (2013) on July, 2. The law provides that the United Accumulation Pension Fund (UAPF) will be created by the Government of the Republic of Kazakhstan within one month from the date. After its establishment the existing accumulation pension funds will hand over all pension assets and liabilities to the UAPF according to the schedule ratified by the authorized body.

The research on Kazakhstan's pension market, which was formed a little over 15 years ago, aroused interest of analysts, who are now divided into supporters and opponents of these new changes. The discussion of this issue is purely scientific and theoretical in nature, since the law has already passed and became effective. It is known that the major problem of the previous model of pension system was poor investment performance of accumulative funds, which implies that the purpose of the current reform and establishment of the United Accumulation Pension Fund is to resolve the problem. Most financial analysts are convinced that the increase of efficiency of Kazakhstan's pension system could be achieved within the framework of the previous system. It does not seem very convincing that fundamental restructuring of the system was necessary. We argue that, the only correct decision would be temporary delegation of rights to manage pension assets in the hands of the state, in order to improve the efficiency of investment management, whilst preserving ownership of current accumulation pension funds to those who applied tremendous efforts to accumulate and maintain them for 15 years. Putting everything upside down was not necessary; it was enough to expand investment opportunities for pension funds, and to revise some aspects of state regulation concerning their activity, prudential regulation in particular.

Recent investment performance demonstrates the inability of private pension funds to yield profits exceeding inflation in the long run. Some private pension funds managed to get profit that exceeded inflation in short term; however no pension fund could achieve a real positive return in the long run. The reason is very simple, it is impossible to get a return exceeding inflation with limited investment options available (permitted by the government) to the funds and the current inflation rate. Pension savings grow annually at 34.38% (Information for entities of financial market...2005–2014), but new issuers and new bond issues are not available at the Kazakhstan Stock Exchange. Having no choice, the pension funds increased investments in government securities (GS), which led to excess demand, and as a consequence to lower interest rates on them. Thus, the average total effective rate on them (according to official figures on Kazakhstan Stock Exchange) was 4% for the last 3 years. And only 20% of government securities at the market were adjusted for inflation. The state might increase the volume of these issued securities allowing accumulation pension funds (APFs) improve profitability of investment portfolios. These conclusions are based on the official statistics, according to which the state budget deficit in recent years was in the reasonable range, and could be financed through domestic borrowing without much stress to the economy. Moreover, considering the decline in interest rates on government securities, debt servicing costs the state very cheap. Therefore, the Ministry of Finance could allow an increase in the volume of the issued inflation-indexed bonds, despite the fact that it will increase the cost of debt servicing. However, they chose not to increase spending now, when the budget

deficit is small, but decided to put it back for further future, when they would have to repay the real value of their pensioners' savings in the future. Along with the increase of the share of securities adjusted for inflation in the structure of issued GS, relaxation of restrictions on the investment of pension assets at foreign markets could help achieve more effective results.

Under the pension legislation in 2012, APFs could invest no more than 10% of the available pension assets in foreign instruments with rating not below "AA-". In fact, this limited their ability to invest in stocks of foreign developing countries, where they could get a decent return. Moreover, in the absence of new bond issues at the domestic market, foreign investment could be a good alternative to investments in government securities with low yield.

Conclusions of supporters of the restructuring claiming the ineffectiveness of the existing National Pension Systems are at least premature and unfounded, if not to say wilful or even lobbied for certain groups. The fact that the total equity of all APFs at the market over the past 5 years has increased almost threefold invalidates the claims about the ineffectiveness of the existing pension system. The equity increased not only by profits capitalization, but also due to periodic cash infusions by shareholders. The average size of APFs' equity was 8.3 bln at the beginning of 2013, which means that owners (shareholders) of the APFs were determined to invest their own money in their business development and it is what they did.

Let us examine the changes resulted from the reform:

1. The United Accumulation Fund was created and the state provides guarantees for the pension assets managed by it.
2. Rights of privately owned accumulation pension funds to attract the mandatory pension contributions were abolished.

Obviously, this situation does not favour private funds. Pros and cons of the incoming changes in the structure of the pension system are presented in Table 1.

Table 1. Positive and negative aspects of creating the united accumulation pension fund, summarized by the author

Creation of the UAPF	
Pros	Cons
The state provides guarantees for people's pension assets	Monopolization of the pension market and thus the lack of competition
Indexation of pension assets of each contributor of the fund to the amount of accumulated inflation when they reach the retirement age (if inflation rate exceeds the return on pension assets)	Citizens no longer can freely choose a pension fund, nor the way their pension assets are managed
Reduction of operational costs due to decreased number of entities	Lack of a worked out mechanism to consolidate 11 private pension funds into the UAPF
Reduction of possibilities for fraud and abuse in management and use of pension contributions	Tight schedule for consolidation does not allow accurate and correct transfer of retirement savings. There is a high probability of pension assets loss, especially the accrued investment income
Increase of available financial tools for the government in management of public economy that will be particularly important in the case of future economic (financial) crises	There is an unresolved issue of drawing citizens into the accumulation pension system, even worse, there is a decrease in the number of contributors

Continuation of Table 1

Pros	Cons
-	The core problem of low return on pension assets still remains unresolved
-	Closing private APFs will cause job loss. Already at the beginning of June 2013 the number of staff in all APFs had significantly reduced

From Table 1 it follows that the drawbacks of the previous pension system remain in the new one. The only tangible and measurable benefit is the reduction of administrative costs for the maintenance and operation of the United Accumulation Pension Fund instead of 11 private funds. Major problems: inability to provide real returns on assets in the long term and the slow growth of pension savings still remain unsolved. Hence, the question arises about the necessity of reforms. We consider it important to note that at the current amount of gross salary in the Republic of Kazakhstan, as stated in the official statistics, the total volume of pension assets in the pension system should be about 60 bln USD, instead of 23 bln USD that we have today (National accounts of the ..., 2013). In this case we have a situation in which the share of wages in GDP of Kazakhstan is about 32%, while under market economy wage workers should account for 40% to 60% of GDP (Global Wage Report..., 2013).

Another problem that remains unsolved is the development of the real economy. In the pre-reform period (before July 1, 2013) independent accumulative pension funds invested pension assets in government securities within the framework of compliance with prudential regulations. In that case the government could count on "cheap" pension money available only with minimum legal requirements; today it has unrestricted access to pension money. According to the Law, "Investment declaration of the united pension fund, as well as amendments thereto shall be approved by the board of the National Bank of Kazakhstan". However the law does not provide any restrictions on timing, nor on changes in the investment declaration – the document defining the list of investments, objectives, strategies, conditions and restrictions on investment activities of pension assets, as well as the conditions of hedging and diversification of assets. Such situation may result in a sharp increase of the share of government securities in the investment portfolio of the UAPF. Pension assets are no longer managed by independent pension funds, and thus the state has the ability to manipulate pension assets to cover budget gaps and finance government programs. The problem of pension funds relating to the transactions with related parties had been resolved in the past. Regulations stipulated by the Law on the minimization, and the measures taken by the National Bank, greatly reduced the number of dubious deals involving pension assets. The system consisting of private APFs worked and is working quite stable. Officials need a clear understanding of the concepts of effective investment of pension assets, which implies the achievement of two parallel goals: first one, as already mentioned, is providing people in old age, the second is implementing mechanisms of financing domestic real economy. Thus, we see that achieving one goal does not exclude, but complements the other. With the right and proper management of investment portfolios of APFs the goals are achievable, as it is shown by Chilean experience, whose model was adopted as the basis for Kazakhstan's pension system. It should be understood that solutions for the problems of low yield

investment activities of pension funds, should be sought primarily at macroeconomic level. Numerous scientific studies, both domestic and international, that investigated the problems of investment activities of accumulative pension funds showed that it is necessary to create favourable conditions for the quantitative growth of economy. In particular, it is necessary to increase macroeconomic indicators, such as employment levels, wage level, which is almost impossible and ineffective without the development of real, not fossil-fuel based economy.

We can certainly assert that the UAPF won't solve the problem low return of pension assets, because the scheme of investment of pension assets remains the same in the new system despite all other changes. Under the new framework the situation with investment income and investment approach remains unchanged; this situation is comparable to the actions of a doctor who relieves the symptoms of a disease, instead of finding and eliminating its causes.

Also we find the argument that the state represented by the trustee of the National Bank of the Republic of Kazakhstan is more experienced and competent investor. From the first day of creation of the accumulation pension system in Kazakhstan, there existed the State Accumulative Pension Fund (SAPF) owned by the government, which cannot be called a success, as the yield gained by SAPF never been exemplary. Another example of state management is the National Fund, where the situation is not good either. According to official figures, the yield of the National Fund in 2011 amounted to 1.37% (Approval of the report..., 2012), while the adjusted weighted average nominal income of private APFs, for the same period was 2.59% (Current state of the accumulative..., 2012). The yield of pension assets managed by criticized APFs was almost twice the yield obtained by the National Fund, managed by government officials. If the "experts" from the National Bank would manage pension assets, it would be natural to expect a reduction of investment incomes compared with the activities by private APFs.

In the light of recent events eradicating competition at the pension market becomes an issue. As a result of the restructuring the pension market becomes monopolised, which conflicts with the basic principles of market economy. The chairman of the Association of pension funds of Kazakhstan, the author of 5 books and brochures about pension system of Kazakhstan, as well as more than 70 publications on the problems of the pension system of Kazakhstan described the consequences of the issue during his interview with *Zakon.kz* information agency as follows: "Single monopolistic fund, needless to say, will result in increased service costs and low quality. Transparency of the pension system will fall to zero... We have seen it in the case of other monopolists, we have the whole country – whole of Kazakhstan consisting of monopolies... We have monopoly everywhere and we constantly see unnecessarily increasing tariffs and decreasing quality of service everywhere for the last 15–20 years. As all of it happens in a very non-transparent medium, it is very hard to delve into the truth. Consumers will not have access to any information, which is a direct consequence of lack of competition" (Alibayev, 2013). Confirmation of these assumptions is the new pension legislation itself, which clearly states the rights of the UAPF again and again, whilst there are virtually no articles mentioning its responsibilities. There is only a government guarantee for the safety of pension assets adjusted for accumulated inflation that favours the contributors.

In order to justify the restructuring government officials only quote nominal correlation between accumulated inflation and accumulated yield, instead of real correlation. The numbers say quote contradict statements of government officials about the ineffectiveness of investments activities of private APFs and confirm that accumulated inflation rate is much lower than the accumulated income. Even the chairman of the National Bank G. Marchenko agreed that pension system consisting of private funds was quite effective. According to him, "for the entire period of the operation of the pension system, return on investment of pension assets is positive in real terms", i.e. significantly exceeds the cumulative inflation rate. We can clearly see the real situation by comparing cumulative return and accumulated inflation for the period 1998–2012: return for the moderate investment portfolio amounted to 366.15% (a conservative portfolio – 356.07%) and the accumulated value of inflation – 236.31% (Drozd, 2013). Looking at the numbers we wonder whether there was any urgent need for this restructuring. On the other hand, considering these ratios, it is necessary to borne in mind the total value of pension assets accumulated in the respective periods, their values in first and last years are not comparable as you can see in Table 2.

Table 2. Number of personal retirement accounts and the total amount of pension assets by year

Year	1998*	1999	2000	2001	2002	2003	2004	2005
Number of accounts	3752412	3001876	3732469	4652276	5424397	6191680	6191680	7007358
Total amount, mln USD	310,57	632,62	801,34	1249,93	1772,24	2414,53	3683,90	5016,58
Year	2006	2007	2008	2009	2010	2011	2012	2013**
Number of accounts	7649002	8572833	9268464	9658641	7777886	8033361	8179815	8422512
Total amount, mln USD	7370,94	10072,30	10514,09	12597,05	15392,35	17746,58	20895,66	20895,66

Note: * The data presented in the first reporting period; ** as of January 1, 2013.

Source: Annual Statistical Reports of National Bank of Kazakhstan (Approval of the Program..., 2004; Information for entities of financial market..., 2005–2014).

The data presented in Table 2 are collected and summarised as a result of statistical compilations for the relevant periods and the official data of the Agency for Statistics of the Republic of Kazakhstan. As we can see the greatest rates of return fell to the early years, and the value of pension assets between the first and the fifteenth year vary almost 70 times. Having higher return on small amounts and having low return on big amount of money does not seem reasonable. On the other hand, these figures indicate that the existing system worked very productively and managed to accumulate more than 23 bln USD attracting about 8.5 mln contributors (Current state of the accumulative..., 2014). Looking into these figures a question that comes to mind is "what is the real reason for the low income of private APFs?". The answer is obvious – the rigidity of regulation system of investment activities of APFs. Reasons for the low return on pension assets were as follows: first, lack of good investment options due to weak development of the national stock market; second, forced investment in low-yielding government securities to comply with the regulations set by the Committee on Control and Supervision of Financial Market and Financial Organizations of the National Bank of Kazakhstan which require pension funds to invest in government securities, which simply increase the amount of public

debt, and are a source of financing budget deficit. Pension funds had to create portfolios that were low-risk and could provide return in short term.

In our opinion, consolidation of APFs is not the best solution in the current situation. More reasonable action would be to review the legal framework and make necessary changes concerning laws governing their activities to grant them more investment options, as well as to reduce the amount of assets required to be invested into government securities. As a result, we would get a wider and therefore more diversified field for investment, with softer rules, which in turn would provide us with efficient and less painful solution for the problem of low return on pension assets. Thus, there was no need to change the structure of the reliably functioning system. Instead, it was more important to increase investing opportunities to pension funds.

We would like to note that the roots of the problem of low efficiency of investment activities are much deeper than the inefficient management of private APFs. As noted above, private pension funds were able to obtain higher returns than the National Fund managed by the government, despite very harsh regulations imposed on them. Instead of carrying out a detailed analysis of investment activities of APFs and the reasons for their low performance, the state chooses the easiest and most convenient solution, and which is not the most reasonable and justified one. Former pension system managed to accumulate enough funds over 15 years to cover foreign debt of the state and fully resolve the problems of external borrowings, which can be avoided with a right placement of pension assets. We came to the conclusion analysing the data on the country's external public debt and its comparison with the value of pension assets, as shown in Figure 1.

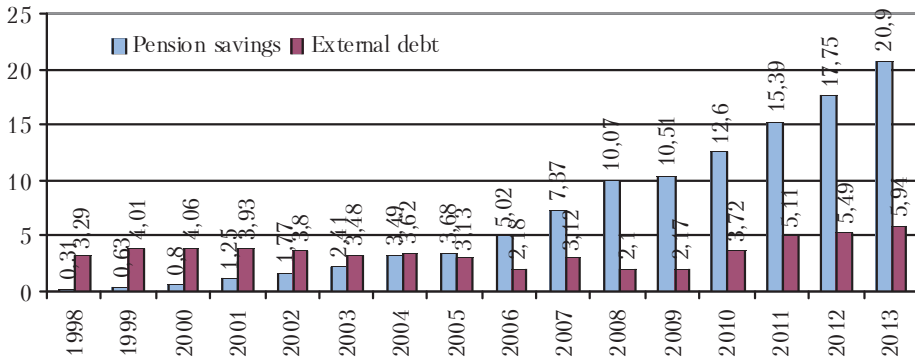


Figure 1. Ratio of pension assets and external public debt for 15 years, made by the author (Agency for Statistics of the Republic of Kazakhstan, 1999–2002; 2012)

As follows from Figure 1, the value of accumulated pension assets by the old pension system has grown from 0.1's portion of the external debt of the state to the value that exceeds it 3.5 times in 15 years of operation! The chart is based on the data from the official reports of the National Bank of the Republic of Kazakhstan. This data confirms that the problem was not in low-skilled management of private pension funds, but in the absence of favourable conditions for investment activities. As a result of the pension funds consolidation, we have a very narrow investment field with only one player – the UAPF that has very limited investment instruments.

From a myriad of options to optimise the pension market, the state has chosen not the most optimal one. Accumulation pension system established in 1998 is very sophisticated and constructive, and claims about its failure are at least premature and unjustified, because it is known that the implementation of the process was long term by its nature with late manifestation of effectiveness that would have a ripple effect on the economy.

Conclusion. As of today we witness that the state, who is the major and largest borrower of APFs, claims about their inefficiency, whilst continuing to borrow from them on very favourable conditions. Moreover, we should not forget the Soviet experience, which has shown that most of state-owned enterprises are not efficient. More than 70 years the Soviet Union has shown that state-owned is synonymous to ownerless, hence there is no incentive to work efficiently. Employees of state-owned enterprises receive their wages regardless their performance, and there are only few who work consciously for public benefit. International, as well as domestic experience has proven that private enterprises are more efficient and perform better overall. We should not forget that timely and competent decision of the government to implement privatization in the 1990s allowed Kazakhstan to become one of the most successful and fastest growing countries in the former Soviet Union. Private ownership encourages owners for efficient work and motivate employees perform their duties faithfully and diligently, which results in good yields for enterprises.

References:

О пенсионном обеспечении в Республике Казахстан: Закон Республики Казахстан от 21.06.2013 №105-V // adilet.zan.kz.

Об утверждении отчета о формировании и использовании Национального фонда Республики Казахстан за 2011 год: Указ Президента Республики Казахстан от 3.05.2012 №313 // adilet.zan.kz.

Об утверждении Программы развития накопительной пенсионной системы Республики Казахстан на 2005–2007 годы: Постановление Правительства Республики Казахстан от 24.12.2004 №1359 // adilet.zan.kz.

Алибаев А.Б. Пенсионная реформа, создание ЕНПФ // *Курсив.kz: Электронный журнал.—Материалы конференции.— 15.07.2013 // www.kursiv.kz.*

Доклад «Заработная плата в мире в 2012–2013 годы»: Заработная плата и справедливый рост / ГТПДТ и Бюро МОТ для стран Восточной Европы и Центральной Азии. — М.: МОТ, 2013 // www.ilo.org.

Информация для субъектов финансового рынка // Накопительная пенсионная система // Текущее состояние // Комитет по контролю и надзору финансового рынка и финансовых организаций Национального банка Республики Казахстан за 2005–2014 годы // www.afn.kz.

Казахстан в цифрах: Статистический сборник / Агентство Республики Казахстан по статистике; Под ред. А.А. Смаилова. — Алматы, 2001. — 216 с.

Казахстан в цифрах: Статистический сборник / Агентство Республики Казахстан по статистике; Под ред. А.А. Смаилова. — Алматы, 2000. — 163 с.

Казахстан в цифрах: Статистический сборник / Агентство Республики Казахстан по статистике; Под ред. А.А. Смаилова. — Алматы, 2002. — 226 с.

Марченко Г. Низкие темпы инфляции наблюдаются в странах, центральные банки которых наиболее независимы (авт. Н. Дрозд (по материалам онлайн-конференции)) // *Панорама.— 21.03.2013.— № 10 // panoramakz.com.*

Накопительная пенсионная система // Комитет по контролю и надзору финансового рынка и финансовых организаций Национального банка Республики Казахстан // www.afn.kz.

Национальные счета внутренней экономики за 2010 год (окончательный расчет), за 2011 год (уточненный расчет), за 2012 год (по отчетным данным) // Счета внутренней экономики Республики Казахстан за 2010–2012 годы. 1 серия // Статистический бюллетень.— №Б-05-03/678.— 26.11.2013 // www.stat.gov.kz.

Национальные счета Республики Казахстан 2006–2010 годы: Статистический сборник (на казах. и русс. языках) / Агентство Республики Казахстан по статистике; Под ред. А.А. Смаилова. – Астана, 2012. – 91 с.

Официальные пресс-релизы Национального банка Республики Казахстан // www.nationalbank.kz.

Социально-экономические характеристики населения Республики Казахстан: Статистический сборник / Агентство Республики Казахстан по статистике; Под ред. А.А. Смаилова. – Алматы, 1999. – 211 с.

Текущее состояние накопительной пенсионной системы по состоянию на 1 января 2012 года // Комитет по контролю и надзору финансового рынка и финансовых организаций Национального банка Республики Казахстан // www.afn.kz.

Текущее состояние накопительной пенсионной системы по состоянию на 1 января 2014 года // Комитет по контролю и надзору финансового рынка и финансовых организаций Национального банка Республики Казахстан // www.afn.kz.

Стаття надійшла до редакції 27.02.2014.