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MEMORANDUM OF THE PRESIDENT

OF THE

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

AND THE

INTERNATIONAL FINANCE CORPORATION

TO THE

EXECUTIVE DIRECTORS

ON A

COUNTRY ASSISTANCE STRATEGY

FOR

THE REPUBLIC OF KAZAKHSTAN

January 16, 2001

Central Asia Country Unit
Europe and Central Asia Region

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Currency Equivalents
(Exchange Rate Effective December 4, 2000)

Currency Unit	= tenge
1 tenge	= US$ 0.007
US$ 1.00	= 144.15 tenge

Weights and Measures

Metric system

Fiscal Year

January 1—December 31

	IBRD	IFC
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Abbreviations and Acronyms

AAA	-	Analytical and advisory activities
ADB	-	Asian Development Bank
APPAP	-	Agricultural Post Privatization Assistance Project
CAS	-	Country Assistance Strategy
CEM	-	Country Economic Memorandum
CIS	-	Commonwealth of Independent States
CPC	-	Caspian Pipeline Consortium
CPPR	-	Country Portfolio Performance Review
CSAL	-	Consolidation Structural Adjustment Loan
EBRD	-	European Bank for Reconstruction and Development
EFF	-	Extended Fund Facility
EU	-	European Union
FBS	-	Family Budget Survey
FDI	-	Foreign direct investment
FEDL	-	Finance and Enterprise Development Loan
FIAS	-	Foreign Investment Advisory Service
FSU	-	Former Soviet Union
FY	-	Fiscal year
GDP	-	Gross domestic product
GEF	-	Global Environmental Facility
IBRD	-	International Bank for Reconstruction and Development
IDF	-	Institutional Development Facility
IFC	-	International Finance Corporation
IMF	-	International Monetary Fund
IsDB	-	Islamic Development Bank
JBIC	-	Japan Bank for International Cooperation
KLSS	-	Kazakhstan Living Standards Survey
MIGA	-	Multilateral Investment Guarantee Agency
NBK	-	National Bank of Kazakhstan
NGO	-	Non-governmental organization
OED	-	Operations Evaluation Department
OEG		Operations Evaluation Group of IFC
PPP	-	Purchasing power parity
PSA	-	Private Sector Assessment
PSD	-	Private sector development
PSRMAL	-	Public Sector Resource Management Adjustment Loan
SME	-	Small- and medium-scale enterprise
SOE	-	State-owned enterprise
SPRAL	-	Social Protection Reform Adjustment Loan
TA	-	Technical assistance
TAL II	-	Second Technical Assistance Loan
TACIS	-	Technical Assistance for the CIS (EU)
UK	-	United Kingdom

Abbreviations and Acronyms

UN	-	United Nations
USAID	-	United States Agency for International Development
VAT	-	Value-added tax
WBI	-	World Bank Institute

This Country Assistance Strategy was produced by a team that included Arup Banerji, Kristin Hallberg, Fred King, Rossana Polastri, and K. Tanju Yurukoglu, with assistance from Zhanar Abdildina, Roman Solodchenko, Andrew Baldwin, Anthony Gorman, Jariya Hoffman, Carolyn Jungr, Ernestina Madrona, Gorton de Mond, and Van Roy Southworth. Other members of the Bank-wide Kazakhstan Country Team also made valuable contributions throughout the process of developing the strategy.

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EXECUTIVE SUMMARY

1. Kazakhstan was one of the leading reformers in Central Asia in the 1990s. Nevertheless, growth in the non-extractive sectors has not yet taken off – partly because many of the measures were taken too recently to yield results, and because stronger reforms are needed to improve the environment for the entry and growth of private enterprises. In fact, in some areas, the pace of structural reform has slowed down. The privatization program for the large blue-chip companies has stalled, important fiscal measures have been delayed, land and social sector reform has slowed down, and there have been some reversals in trade policy with increased restrictions on exports of petroleum and petroleum products.

2. In addition, the economy remains vulnerable to external shocks. Oil and metals account for about four-fifths of total exports, so that changes in international prices for key export commodities significantly affect year-to-year economic performance. Economic growth may be fueled even more by oil revenues in the near future, as the completion of the Caspian Pipeline Consortium (CPC) oil pipeline will substantially increase oil exports and therefore fiscal revenues. The recent discovery of large oil reserves in the Caspian area raises the possibility of an oil boom late in this decade. Appropriate management of oil revenues will become critical, and avoiding Dutch Disease impacts on the non-oil economy will be a challenge.

3. For the majority of the population, macroeconomic and structural reforms have not yet translated into improved living standards. Real GDP in 1999 was only about 60 percent of its 1990 level, and real wages fell by over 75 percent between 1990 and 1997. While Kazakhstan is better off in terms of absolute poverty than most of the other countries in the former Soviet Union – only 6 percent of the population live on incomes below US$2.15 per day (in 1996 Purchasing Power Parity value) – there is some evidence that poverty has increased in recent years as a result of low rates of growth of GDP and employment as well as the decline in real wages and continuing wage arrears.

4. Thus, despite the prospects for oil-fueled growth in the future, Kazakhstan faces two main challenges: avoiding the volatility inherent in commodity-led growth, through careful management of oil revenues and promoting growth in non-extractive sectors; and ensuring that growth is widely shared, thereby improving living standards for the majority of the population and reducing poverty.

5. Consistent with the Government's priorities, the overarching objective of the Bank Group's Country Assistance Strategy is poverty reduction and the improvement of living standards. Key inputs to the process of developing the CAS came from discussions with clients and stakeholders in Kazakhstan, the Bank's own analytical work, lessons from the regional crisis, and diagnoses of the performance of the Bank's portfolio in Kazakhstan. The strategy is also guided by the findings of a recent Country Assistance

Evaluation that was prepared jointly by OED, OEG, and MIGA. The CAS focuses on four main areas:

- **Reforming the public sector** so that fiscal resources are managed in a transparent manner, and public services are effectively and efficiently delivered to the people. One of the primary impediments to growth in Kazakhstan is the lack of public sector institutional capacity. At the same time, the Government is falling behind in its central role as a provider of public services. The Bank Group's strategy for public sector reform has two main objectives: to help the Government reduce public sector constraints to private sector development -- including corruption -- and improve the efficiency of public services. The strategy focuses on assisting the Government in (i) fiscal stabilization, (ii) strengthening transparency and accountability, and (iii) putting in place the institutional and administrative mechanisms to improve the quality of public services.

- **Promoting broad-based private sector-led growth** to increase employment opportunities and incomes across a broad segment of the population. Kazakhstan's prospects for stable and widely-shared growth hinge on generating employment opportunities and incomes in the non-extractive sectors. Efforts must concentrate on (i) improving the business environment through an improved legal and regulatory framework, a more friendly environment for the creation of new enterprises, and reducing the high cost of setting up and doing business that affects SMEs in particular; (ii) continuing the privatization agenda in an open and transparent manner and restructuring or closing non-performing enterprises; and (iii) addressing the problem of declining productivity in the farm sector. The assistance of the Bank, IFC, and MIGA are all directed to foster a dynamic private sector, particularly in the non-extractive sectors.

- **Supporting the most vulnerable** through the enhancement of both temporary and permanent programs of income support for the poorest. While improvements in living standards are expected to result from increased growth and employment, there is still a need for targeted assistance to the poor. Central to this strategy is reform of the social assistance system. Improving the targeting of interventions will be supported by regular monitoring of poverty and living standards. The Bank would support additional measures to improve social protection, including an efficient public works program, reforms in the health and education sectors, rural roads, and improvements in the delivery of municipal and industrial water supply and sanitation.

- **Protecting the environment,** to reduce the damage to the quality of life for current and future generations. Despite Kazakhstan's wealth of natural resources, environmental problems could limit the country's growth potential. Addressing environmental degradation will require cleaning up contaminated rivers and water sources, restoring marginal lands, and improving management practices for water and sewerage. The Bank's strategy concentrates on addressing industrial pollution in the Northeastern industrial area and the marginal agricultural lands.

6. Transparency, accountability, and effectiveness in the management of public financial resources are central to the CAS. Particularly in an environment of increasing fiscal resources from the oil sector the Government needs to pay more attention to overall public financial management and hold itself accountable for the use of public funds. Consistent with the recommendations of a recent review of the Bank's fiduciary arrangements for adjustment lending, the Bank will assist the Government in improving its public financial management arrangements, reducing the risks that these arrangements may pose to Bank programs and funds. In addition, to guide the allocation of public resources and to improve project design, more attention will be paid to monitoring and evaluating the development impact of interventions.

7. To be most effective, the Bank's approach needs to be selective. The Bank will focus its assistance on areas in which the motivation for reform is driven by the Government, not the Bank, and where there is demonstrated commitment and consensus for reform.

8. The Bank Group's assistance strategy for FY01-03 depends on three critical sets of issues:

- **The macroeconomic framework:** the lending program is predicated upon an appropriate macroeconomic environment. Transparency is required with respect to the contribution of the oil sector to fiscal revenues -- to allow for due diligence in fiscal analysis -- and with respect to the design and operation of the National Fund (oil fund) to ensure the quality of expenditure and investment of oil-related revenues. A sound macroeconomic framework would be evidenced by the satisfactory completion of the IMF review of the current EFF. If the EFF is not in place, satisfactory review of the macroeconomic framework under an IMF Staff Monitored Program would be required.

- **The reform agenda:** the Government's commitment to a continuing agenda of policy and institutional reforms. Bank Group support for some elements of the reform program takes the form of investment operations, and for others – particularly in social protection, public sector management reform, legal reform, and private sector development – support is in the form of adjustment lending.

- **Financing needs:** The amount of adjustment lending in particular will depend upon fiscal needs, which in turn depend upon the price of oil and the fiscal impact of reforms.

9. The Bank lending program has three possible cases:

- A **low case** would occur if policy and institutional reforms are delayed, and there is a continuing lack of transparency in the management of oil revenues. In this case, the Bank lending strategy would focus on a small number of carefully-targeted investment and technical assistance operations to achieve poverty, governance, and environmental objectives. Given the current status of structural reforms, the starting point for the CAS is the low-case scenario.

- A **base case** is predicated upon sound fiscal management and would respond to a moderate pace of reform. The lending program would contain a social protection adjustment loan in the first year of the CAS period, but in outer years would shift from adjustment lending to investment and technical assistance loans.

- A **high case** would be pursued if the pace of structural reform is accelerated, and the management of oil revenues is sound – i.e., the National Fund is cast in a medium-term fiscal framework and is subject to public accountability. Predicated upon financing needs, the high-lending strategy includes a mix of investment, technical assistance, and adjustment loans supporting policy and institutional reforms across several sectors.

10. The level of IFC's investment operations and activities will be determined by further strengthening of the macroeconomic framework as well as the extent to which the country undertakes actions to reform the framework and environment for the private sector activities, particularly for the development of SMEs.

11. The operations of the Bank Group will be guided by analytical and advisory activities – studies of cross-cutting policy issues, sectoral studies, and rapid-response notes. The World Bank Institute's services will include in-country and regional seminars, workshops, and conferences.

12. Improved portfolio management will be essential to reach the objectives of the CAS. To date, implementation of projects has been slowed by a lack of understanding of Bank procurement and disbursement procedures and a lack of counterpart funds. The Government and the Bank are determined to work together to improve project implementation, and will improve the monitoring of projects by holding annual CPPRs as well as semi-annual "mini-CPPRs".

Agenda for Discussion

13. Board members may wish to consider the following questions:

- Are the strategic priorities outlined in the CAS appropriate?

- Does the proposed mix of operations (adjustment, investment, and technical assistance) and non-lending services adequately address the policy and institutional reform challenges facing Kazakhstan?

- Do the proposed lending scenarios appropriately reflect the strength of the reform program and the need for Bank financing?

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FOR THE REPUBLIC OF KAZAKHSTAN

I. KAZAKHSTAN'S DEVELOPMENT CHALLENGES

1. Kazakhstan was one of the leading reformers in Central Asia in the 1990s. Over the past five years, the Government has stabilized the macroeconomy, liberalized the financial sector, comprehensively transformed the pension system and streamlined the public sector. Prices have been liberalized so that, on the whole, economic agents respond to market signals. Most small- and medium-scale enterprises and farms are now privately owned. Foreign investment per capita is high compared to the rest of the region, although it has mainly been limited to the oil and gas sector. To most observers, the process of market-oriented reform is now seen to be irreversible. Yet despite impressive reforms, growth in the non-oil and non-mineral sectors has not yet taken off – partly because many of the measures were taken too recently to yield results, and because more reform is needed to improve the environment for the entry and growth of private enterprises. In some areas, the pace of structural reform has slowed down – for example, there have been delays in the privatization of blue chip companies, delays in important fiscal measures, a slowdown in land and social sector reform, and reversals in trade policy.

2. Institutional reforms have lagged behind macroeconomic stabilization and policy reforms. The institutions and legal framework necessary for a market economy to function are not fully developed; governance and accountability issues in the public sector hinder the efficient allocation of public resources; and corruption and a lack of transparency raise the cost of doing business, constraining private sector development. Implicit subsidies to enterprises as well as wage and pension arrears create an environment of "unpaid bills" that slows the process of transition.

3. The economy remains vulnerable to external shocks. Oil and metals account for about four-fifths of total exports, so that changes in international prices for key export commodities significantly affect year-to-year economic performance. Ongoing oil exploration and the opening of export routes is likely to increase the economy's dependence on oil in the next several years. The completion of the CPC oil pipeline, expected in end-2001, will substantially increase oil exports and fiscal revenues, and the recent discovery of large oil reserves in the Caspian area raises the possibility of an oil

boom late in this decade. Appropriate management of oil revenues will become critical, and avoiding Dutch Disease effects on the non-oil economy will be a challenge.[1]

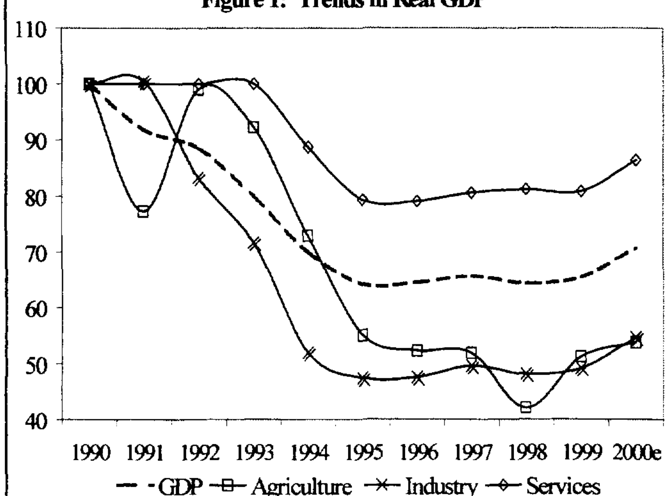
4. Thus, despite the prospects for oil-fueled growth in the future, Kazakhstan faces two main challenges: avoiding the volatility inherent in commodity-led growth, through careful management of oil revenues and promoting growth in non-extractive sectors; and ensuring that growth is widely shared, thereby improving living standards for the majority of the population and reducing poverty.

II. RECENT MACROECONOMIC AND SOCIAL DEVELOPMENTS

A. External Shocks and Economic Growth

5. Since independence in 1991, Kazakhstan has made significant progress in macroeconomic stabilization and economic reforms: price liberalization, a reduction in trade distortions, privatization of small- and medium-scale enterprises, and the introduction of a new tax code and bankruptcy law. However, the collapse of the Soviet system had caused severe disruptions in input supplies and production, as well as major fiscal imbalances due to the loss of budgetary transfers from the Soviet Union. As a consequence, the initial years of transition were characterized by a persistent decline in output and living standards. By 1995, output had dropped to about 60 percent of its 1990 level (Figure 1). Industry and agriculture declined even further – to 47 percent and 55 percent, respectively, of their 1990 levels – compensated by growth in the services sector.

Figure 1: Trends in Real GDP



6. Modest growth was recorded for the first time during 1996 and 1997 (0.5 percent and 1.7 percent respectively).[2] The short-lived recovery was interrupted in 1998: output fell by 1.9 percent due to the impact of the Russian financial crisis and a severe drought that caused agricultural output to fall by 19 percent in real terms. Growth was restored in 1999 with the help of higher oil prices, the devaluation of the *tenge*, and a strong grain harvest. Prospects for 2000 are even more

[1] The Dutch Disease hypothesis is that a positive shock (boom) to an important primary product causes an appreciation of the real exchange rate. This results in a movement of resources to the non-tradeable sector and the boom sector, and away from tradeable manufacturing and agricultural products. The exchange rate shifts can cause problems in promoting competitive diversification into non-commodity sectors.

[2] The previous CAS had expected a continuation in this trend, predicting real GDP growth of 4.6 percent per year for 1998-2000.

positive: boosted by record high oil prices, the economy is expected to grow by 8 percent in real terms. During the first nine months of 2000, industrial output increased by 15.5 percent in real terms, and agriculture by 5.5 percent.

7. The shocks to growth in 1998-99 resulted in a fiscal crisis. In 1998, the overall deficit reached 7.7 percent of GDP. Fiscal contraction was achieved in 1999 by slashing expenditures, including social sector spending and public investment, and by accumulating arrears. Tax revenues in Kazakhstan remain low at 17.4 percent of GDP in 1999 (compared to 22 percent in 1993). External public debt rose to 25.3 percent of GDP in 1999 from 17.9 percent of GDP in 1998, mostly due to the devaluation of the *tenge*.

TABLE 1: KEY ECONOMIC INDICATORS

	1996	1997	1998	1999	2000p
GDP growth	0.5	2.0	-1.9	2.7	8.0
GDP per capita (US$) [1]	1,351	1,446	1,469	1,059	1,031
Oil Production (000 barrels per day)	459	517	518	602	676
PRICES					
CPI (% change Dec-Dec)	28.7	11.2	1.9	17.8	9.0
Exchange Rate (tenge/US$, year avg.)	67.3	75.4	78.9	119.9	142.5
Refinancing Rate (%, year-end)	35.0	18.5	25.0	18.0	14.0
Oil export price (US$ per barrel)	12.0	14.2	13.1	18.1	28.0
EXTERNAL SECTOR					
Exports FOB (US$m)	6,292	6,899	5,871	5,986	8,981
o/w Oil exports (US$m)	1,257	1,671	1,650	2,318	4,256
Imports FOB (US$m)	6,617	7,176	6,672	5,645	6,602
Current Account Balance (% of GDP)[2]	-3.6	-3.6	-5.6	-1.1	4.1
External Debt (% of GDP)	20.0	28.6	37.5	47.4	43.6
NBK Foreign Exchange Reserves (months of imports)	2.0	2.3	2.8	3.4	2.5
PUBLIC SECTOR					
Overall Balance (% GDP)	-3.1	-5.6	-3.3	-3.4	3.9
Overall Balance exc. Privatization revenue(% GDP)	-5.3	-8.9	-7.7	-5.2	1.2

1/ Includes effects of exchange rate changes.
2/ Includes under-invoicing of oil exports.

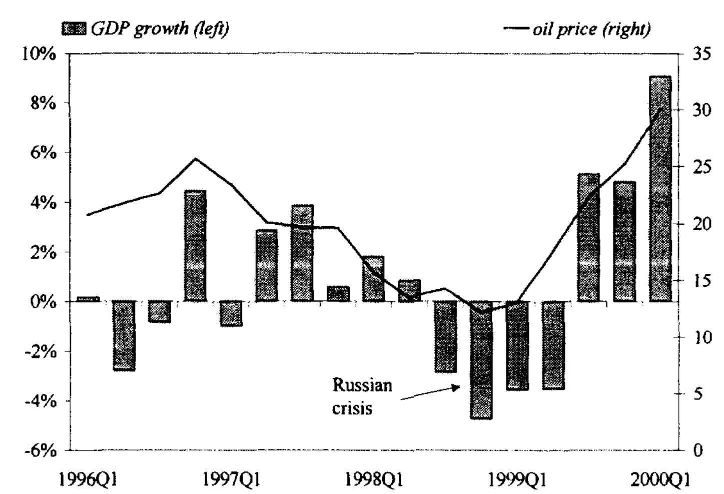
8. In 1999, the growing fiscal deficit and overvalued exchange rate caused delays in reaching agreement on an economic program supported by the IMF, and in disbursement of the Bank's adjustment loans. With capital markets also reluctant to lend, the 1999 cash deficit fell to 5.2 percent of GDP. The financing situation improved in late 1999

with a Eurobond issue of US$300 million, followed by another US$350 million in April 2000.[3]

9. To address the fiscal imbalance, the Government embarked on a fiscal adjustment program supported by the IMF. The program attempts to lower the fiscal deficit until the stock of public debt stabilizes (expected in 2002). During the first half of 2000, larger than expected revenue collections (mainly due to high commodity prices) and low levels of expenditures (around 40 percent of the initial budget allocation) contributed to a cash budget surplus. However, this is a temporary improvement and does not reflect a fundamental change in the fiscal policy stance.

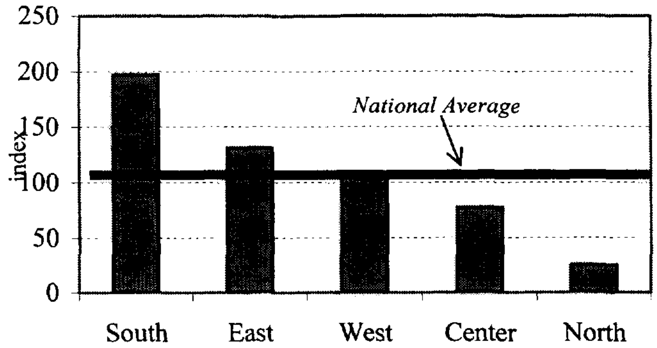
10. The previously tight monetary policy was relaxed in early 2000 through a reduction of reserve requirements and lending rates. From a high of 25 percent, the refinancing rate fell to 14 percent by June 2000. Inflation has been kept under control as higher tax revenues reduced the need for deficit financing, and the increase in government deposits in the NBK acted as a *de facto* sterilization of capital inflows. In addition, the NBK has intervened in the foreign exchange market to counter upward pressure on the *tenge* from higher oil exports. As a result, the *tenge* has remained stable in nominal terms at about 142.5 per U.S. dollar since March 2000. In real terms, however, the *tenge* has appreciated against the U.S. dollar by about 5 percent since early 2000.

Figure 2: GDP Growth and Oil Prices



[3] The 1999 placement came at a high premium—825 basis points over US five-year Treasuries, compared with only 245 basis points prior to the Russian crisis, as Kazakhstan became the first country in the region to tap the market after the 1998 crisis. The April 2000 placement, however, was at 500 basis points over Treasuries, reflecting both a reduction of the market's uncertainty about emerging economies and improved prospects for Kazakhstan due to the commodity boom and its own economic adjustment.

Figure 3: Poverty Incidence by Region, 1996



11. Kazakhstan's economy is highly dependent upon the export of a few commodities, and thus remains vulnerable to external shocks. Since independence, industrial production has become less diversified, with the two main export commodities – oil and semi-processed metals – dominating industrial production. The share of resource-based industries accounted for about 65 percent of industrial production in 1999 and increased to an estimated 70 percent in 2000; more than half of this corresponds to crude oil and derivatives production. As a result, fluctuations in international oil prices have a strong impact on economic growth (Figure 2).

B. Poverty and Inequality

12. For the majority of the population, macroeconomic and structural reforms have not yet translated into improved living standards. Real wages fell by over 75 percent between 1990 and 1997[4], and per capita income (PPP) fell from $6,547 in 1989 to $4,372 in 1999. Average wages in 1998 ranged from US$50 per month for workers in agriculture, forestry and fishery to US$180 for those employed in industry.[5]

13. Kazakhstan is better off in terms of absolute poverty than most of the other countries in the former Soviet Union. Only 6 percent of the population live on incomes below US$2.15 (in 1996 PPP value) per day. The Bank's last Poverty Assessment found that, in 1996, about a third of the population lived below a "subsistence minimum" income.[6,7] More striking is the regional dispersion of poverty (Figure 3). The northern part of the country, which is more industrialized and better endowed with natural resources, has a much lower poverty rate than the south – whose residents are, for the most part, extremely poor. Rural poverty is more severe than poverty in urban areas. (Box 1).

14. Although data are scarce, anecdotal evidence suggests that poverty has increased as a result of stagnant growth of GDP and employment as well as the decline in real wages and increasing wage arrears. The problem is most evident in rural areas and in the

[4] ECA Labor Market Study. This measure puts Kazakhstan as the fifth worst among the former Soviet countries in terms of real wage decreases.

[5] These official figures only cover larger enterprises, and exclude payments in-kind on the one hand, while obscuring delayed payments on the other.

[6] *Kazakhstan: Living Standards During the Transition.* Report No. 17520-KZ, March 23, 1998. The analysis was based on data from the Kazakhstan Living Standards Survey (KLSS), carried out in July 1996. See Box 1.

[7] This situation was better than that in Russia in 1995, but worse than in Ukraine. The depth of poverty, however, while still better than in Russia, was comparable to that in Ukraine at the same time.

Box 1: Poverty, Living Standards and Gender in Kazakhstan

Analysis of the data from the 1996 Kazakhstan Living Standards Survey (KLSS) found that over a third of the population lived below a "subsistence minimum". Poverty varied greatly by region, with two out of three poor people living either in the south or the east of the country. Rural poverty was more severe than poverty in urban areas.

The study did not find that female headed households were more likely to be poor, but some indicators of female well-being, such as maternal mortality rates have deteriorated. Female life expectancy has also fallen in the last ten years, but less than that for males and male life expectancy is more than ten years less than females. Anecdotal evidence has shown that while gender-based discrimination in the formal labor market is not extensive, women may be increasingly at risk of being excluded in access to credit and areas of public service delivery. At the same time there is no evidence that girls school attendance rates are lower than boys.

While almost half the unemployed were poor, poverty was also marked among the self-employed—demonstrating that in transitional Kazakhstan, employment itself was not a guaranteed escape from poverty. As in other parts of the world, the poor are especially at risk of receiving low levels of public services. A major factor affecting the quality of life for the poor in Kazakhstan is the extensive environmental degradation in such areas as water supply that is its legacy from the Soviet and early post-Soviet era.

A fundamental problem in accurately gauging the impact of recent socio-economic changes on poverty in Kazakhstan is the poor quality of available data. The Government has committed itself to implementing household surveys on a regular basis and using them as input to its policy decisions.

southern part of the country, as many farm workers lost their ownership shares in farm restructurings and face the threat of unemployment as labor shedding accelerates. In both rural and urban areas, services previously provided by enterprises – including electricity, heat, health facilities, and kindergartens – are no longer reliably available.

15. The provision of social services has also suffered from the fiscal constraints of the post-independence years. However, the health sector has become more diversified and decentralized, moving away from the Soviet system of centrally administered, hospital-dominated, and inefficient health care. Yet the transformation that is taking place is often driven at the local level by fiscal constraints, rather than a coherent strategy coordinated among oblasts. Morbidity indicators have worsened, and while infant mortality has declined -- from 28 per thousand in 1993 to 22 per thousand by 1998—the prevalence of diseases, including sexually transmitted diseases and tuberculosis, has risen.[8]

16. The well-developed, high-enrollment education system inherited by Kazakhstan at independence is being challenged by the lack of funding and remaining inefficiencies. Enrollment rates have declined, from 93 percent in basic education in 1990 to 89 percent by 1997. Enrollment in secondary, vocational and technical education has also declined. In higher education, however, enrollment has remained fairly steady, due to the rise of

[8] The official infant mortality figures are contested by some international agencies, which quote figures up to three times that amount.

private providers of higher education. Access to education by the poor is, however, in question, as the drop-off in public funds for education have been accompanied by a corresponding rise of formal fees in higher education and the existence of informal charges in some schools. At the same time, the poorest sections of the population have not been protected effectively by social assistance. In 1999, as a result of the fiscal crisis, in 1999 the social assistance system paid out only a fraction of what was budgeted.

III. THE GOVERNMENT'S DEVELOPMENT STRATEGY

17. Kazakhstan, like most former Soviet republics, has a political system dominated by the president. President Nursultan Nazarbayev has been leading the country since even before independence. The January 1999 presidential elections, won by the incumbent, and the Parliamentary elections of fall 1999 were criticized by many outside observers including the Organization for Security and Cooperation in Europe, but they have solidified the political landscape. With the Parliament and political process also dominated by the pro-presidential Fatherland, Agrarian and Civic parties, Kazakhstan has a political consensus, at the highest levels, on economic liberalization and reforms. The stability of the President and Parliament is in sharp contrast to the frequent changes in the Prime Minister and other cabinet officials in the Government. For example, in the last three years there have been four ministers of finance. Almost all officials below the national level are still appointed, but elections of local officials are likely to be introduced in the near future. The Government of Kazakhstan remains committed to building a democratic system and has continued discussions on this topic with internal and external critics.

18. The Government's vision for the development of Kazakhstan, described in *Kazakhstan 2030—Prosperity, Security and Improvement of the Welfare of All Kazakhstani People*, is to "build an independent, prosperous and politically stable state with its inherent national unity, social justice and economic welfare of all the population."[9]

19. Key goals were set in seven areas:

- **National security**: to ensure the development of Kazakhstan as an independent and sovereign state with the maintenance of complete territorial integrity.

- **Internal political stability and consolidation of society**: to maintain and strengthen the internal political stability and the national unity, enabling the country to achieve its strategic goals.

- **Economic growth based on an open-market economy with high levels of foreign investment and internal savings**: to achieve higher and more sustainable economic growth.

[9] The detailed development agenda of the Government is presented in Annex 16.

- **Health of the nation and citizen welfare:** to improve the living standards, health, education, and abilities of all Kazakhstan people, and to improve the environment.

- **Energy resources**: to efficiently use the country's energy resources through a rapid increase in the extraction and export of oil and gas, in order to receive revenues promoting sustainable economic growth.

- **Infrastructure, particularly transport and communications**: to strengthen national security, political stability, and economic growth.

- **Professional government**: to create an effective and present-day corps of committed civil servants in Kazakhstan capable to act as representatives of the nation while achieving priority goals.

20. The medium-term priorities are determined in the Program of Actions of the Government for 2000-2002. The main objective of the Government in the economic field is to ensure sustainable economic growth through careful management of the exchange rate, inflation, and external and fiscal balances. The Program projects real GDP growth of 3 percent per year, a decline in the inflation rate to 5 percent by 2002, and a reduction of the fiscal deficit to 1.2 percent of GDP in 2002.

21. To achieve these objectives the Government intends to:

- Maintain macroeconomic stability and strengthen sustainable economic growth with a tight monetary policy, restrained fiscal policy, and a floating exchange rate.

- Ensure dynamic development of the real sector of the economy with an emphasis on agriculture, energy and infrastructure.

- Continue improving the investment climate of the country in order to increase direct external and internal investment into the economy.

- Reduce poverty by improving the provision of health care and rendering of social assistance.

- Pay close attention to improving the environmental conditions in the country.

- Continue developing internal financial markets and capital markets for the sustainability of the banking system of the country and expanded lending to economic entities.

- Continue improving the public sector management system -- its transparency, decentralization, and planning.

- Prudently manage public debt, including close monitoring and prioritization of the public investment program.

22. Despite agreement on this overall development strategy, there are some areas where the Bank Group and the Government differ:

- In private sector development, the Bank Group feels that a key obstacle that deserves more emphasis is the unfriendly business environment, particularly the high incidence of corruption and the underdeveloped legal and regulatory framework.

- While the Bank supports the Government's overall plans for the reduction of poverty and unemployment, it is concerned about implementation issues in targeting of social assistance and in development of a public works program. Moreover, given the regional disparities in poverty, increasing employment and development of rural areas will be necessary.

- The Bank is also concerned about some of the Government's investment priorities, particularly some large infrastructure investments such as a proposed refinery in Atyrau. Many investments are associated with the development of the new capital of Astana and are seen by the Bank as being of lower priority compared to improving the investment environment in general and investment in human capital in particular.

IV. THE BANK GROUP STRATEGY

23. The overarching objective of the Bank Group's Country Assistance Strategy is poverty reduction and the improvement of living standards. (The proposed program of lending and non-lending services are contained in Annexes 9 and 10, and highlighted with underlining in the section below.) This section presents the issues and the Bank Group strategy for assisting the Government in each of four areas:

- **Reforming the public sector** so that fiscal resources are managed in a transparent manner, and public services are delivered effectively and efficiently.

- **Promoting broad-based private sector-led growth** to increase employment opportunities and incomes across a broad segment of the population.

- **Supporting the most vulnerable** through the enhancement of both temporary and permanent programs of income support for the poorest.

- **Protecting the environment,** countering environmental damage that has a negative impact on the quality of life of current and future generations.

24. The current CAS period is a critical window of opportunity for the Bank to work with the Government to support this reform agenda. The completion of the CPC pipeline and the possibility of exploiting newly discovered oil reserves later in this decade create opportunities for increased growth driven by the oil sector. However, there is also a risk that the availability of increased oil revenues will slow the momentum of structural reforms and make fiscal management more difficult. In addition, the possibility of Dutch Disease effects of the oil boom may reduce the competitiveness of non-oil sectors. It will

be important for the Government to improve mechanisms for expenditure management and financial accountability before increased revenues are available to be spent, and continue to move on the reform agenda to ensure that barriers to investment and growth in the non-extractive sectors are removed.

25. The Bank's strategy recognizes that ownership of the policy and institutional agenda – by both the Government and civil society – is critical for the success of reforms.[10] Therefore the Bank will focus its assistance on areas in which the motivation for reform is driven by the Government, not the Bank, and where there is demonstrated commitment and consensus for reform. This implies that the Bank will be selective in choosing specific reforms to support in the four main areas described above.

A. Reforming the Public Sector

26. The Bank Group's strategy for public sector reform has two main objectives: to help the Government manage increased oil revenues in a transparent and efficient manner, and to improve the efficiency and effectiveness of public services. These will require efforts to address the root causes of corruption and lack of transparency; continuing administrative and civil service reform; restoring fiscal stability through tax reforms and expenditure realignment; and increasing the efficiency of delivery of public services -- health, education, water, and transportation -- to those who need them most. Reforms are needed at both the national and local government levels.

27. **Resource management.** Macro-fiscal stability is a precondition for private sector growth, reduced poverty and improved living standards. Fiscal stabilization, through an improved revenue system, is key to this effort. It is also important <u>how</u> fiscal stability is achieved: it can be temporary and illusory if achieved through ad-hoc measures. In the past, expenditures were often reduced in response to lower-than-expected revenues and budget targets. In the future, the Government needs to implement a more strategic fiscal policy. The Bank's recent Public Expenditure Review (FY00) identified key areas to help move in this direction (Box 2).

28. The <u>Second Public Sector Resource Management Adjustment Loan (PSRMAL II)</u> in FY02 and an associated <u>Technical Assistance Loan (TAL II)</u> would support the Government's policies on intergovernmental fiscal reform and tax reform issues, civil service reform, and budget management at local levels. A <u>Financial Infrastructure Project</u> in FY03 will help consolidate the financial stability of the country, by helping the creation of long-term financial instruments, while addressing the pressing issue of housing construction through improved housing finance. Once the legal and regulatory framework is put in place through this project to support private sector investment in the housing finance market, IFC would support experienced sponsors that undertake to make investments in this field. Finally, analytical work done in the recent Public Expenditure Review will be followed by a <u>Note on Revenues</u> in FY01 that will examine issues related to the management of oil revenues.

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[10] Key inputs to the process of developing the CAS came from discussions with stakeholders in Kazakhstan. The participatory process followed in shaping the CAS is summarized in Annex 17.

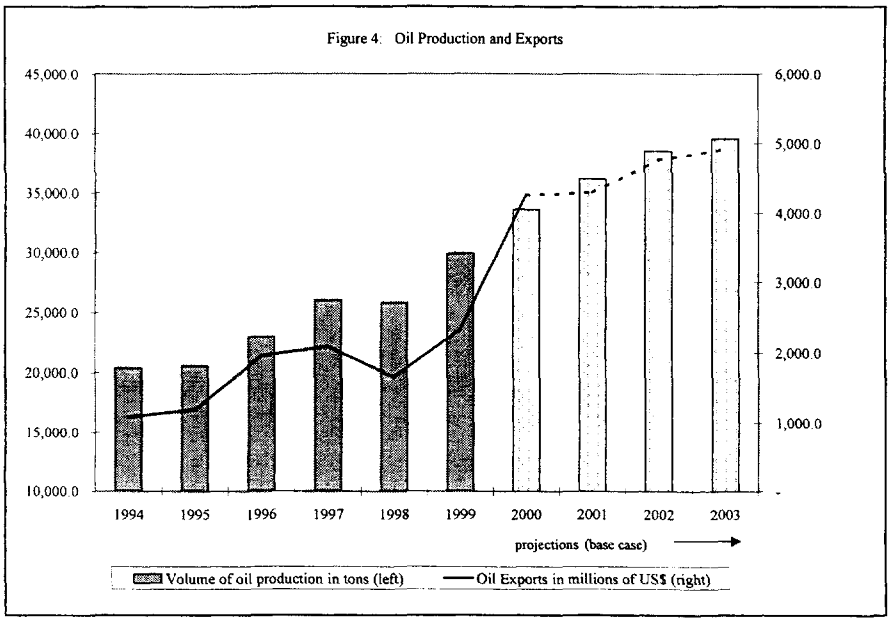
29. **Managing increased oil revenues.** A key component of public resources will come from the oil and gas sector. At the end of 1999, Kazakhstan had proved oil reserves of 8 billion barrels, including 6 billion in the Tengiz oil field. This compares with 7 billion barrels in Azerbaijan, and 48.6 billion in Russia.[11] A new discovery has been made in the Kashagan structure in the Northern Caspian Sea. While it is too early to determine the size of the reserves, the structure itself is more than twice the size of Tengiz, suggesting that this could result in a significant addition to Kazakhstan's reserve base.

30. The Government, through the state-owned oil company Kazakhoil, owns about 30 percent of current production, with the balance in the hands of foreign investors. The oil sector has attracted over 80 percent of cumulative foreign direct investment since 1993. Investor ownership is a mixture of joint venture/equity ownership (e.g., Tengizchevroil) and production sharing agreements (e.g., Karachaganak, and the Offshore Kazakhstan International Oil Co., or OKIOC).

31. Oil production in 2000 is projected to total about 34 million tons (Figure 4); exports could exceed 27 million tons. Production and exports are forecast to increase to 77 million tons and 66 million tons, respectively, in 2010. The projected doubling of Kazakhstan's production of crude oil and gas condensate implies that current proved reserves could be depleted in 43 years.

32. Currently, Kazakhstan transports crude oil for export through the Atyrau-Samara link with connects to Russia's Transneft pipeline network. Capacity is about 10 million tons per year, but is expected to increase to about 15 million tons per year. The Caspian Pipeline Consortium (CPC) pipeline is expected to come on stream in mid-2001 and provide 28 million tons of additional capacity to the Russian Black Sea port of Novorossyisk. Phase 2 of the CPC, expected by 2010, will increase capacity further to 67 million tons. Substantial volumes of crude oil have been exported by rail (more than 7 million tons in 1999). The start-up of CPC will cut the transportation costs associated with these exports in half, from about $50 to $25 per ton.

[11] Source: British Petroleum and Amoco, Gas and Oil Journal.



33. The oil sector is becoming more dominant in the Kazakhstan economy, reflecting the increasing share of oil revenues in both foreign exchange earnings and fiscal revenues. During the first half of 2000, exports of crude oil and oil products accounted for almost half of total merchandise exports, up from 40 percent before recent increases in oil prices. Fiscal revenues from oil (corporate taxes, royalties, and bonus payments) may have been as high as 6 percent of GDP in 2000 (or about 26 percent of total fiscal revenue), up from 1.7 percent of GDP before 1999. Even under conservative oil price forecasts, the expansion of exports due to the CPC pipeline imply that oil-related fiscal revenues will remain at over 5 percent of GDP for the next ten years.

34. To ensure that higher oil revenues do not become a mixed blessing for the economy, the government faces several challenges. The first is to avoid the Dutch disease syndrome: a loss of competitiveness of the non-oil sectors resulting from real exchange rate appreciation. The second is to stabilize the impact of volatile oil prices on fiscal revenues. And finally, recognizing that oil is a stock natural resource, the government may choose to save part of the revenues from oil for future generations.

35. The Government has prepared a draft decree creating a National Fund for oil-related revenues. In this current proposal, the objectives of the Fund are to ensure sustainable social and economic development, reduce the negative impact of oil revenues on the domestic economy, and provide for the welfare of future generations. It is not yet clear what rules will govern the transfer of fund resources to the budget, and how spending priorities will be chosen. The National Fund would receive all or a portion of oil-related revenues and would transfer some of those funds to the budget for expenditure. The central bank is responsible for managing the assets of this fund.

36. It is important that the National Fund be designed and operated in a transparent way – i.e., that expenditures are subject to the budgetary process, cast in a medium-term fiscal framework, and subject to public accountability. In addition, accurate fiscal analysis and macroeconomic monitoring require transparency with respect to the

Box 2: Public Expenditure Review

The recent Public Expenditure Review for Kazakhstan[1] identifies five priority areas for fiscal and institutional reform:

Fiscal sustainability and resource mobilization: The management of domestic resource mobilization remains inefficient. Reforms should be geared towards achieving fiscal sustainability by enhancing domestic resource mobilization without discriminating against domestic savings, capital accumulation, and the development of non-oil sectors. Among the policy options suggested are: focus on fiscal deficit reduction to stabilize the public debt to GDP ratio at the current level; complete the implementation of ongoing structural reforms, such as large scale privatization, public employment and wage reform, and financial sector reform; adopt and implement a new Tax Code; and establish an independent and accountable oil stabilization fund.

Role of Government and spending priorities: The involvement of the state in the economy is still sizeable. The public sector share of the wage bill is large, and public debt is rising at a fast pace. At the same time, capital investment and maintenance outlays are low, and social expenditures are unstable. Reforms in this area should focus government intervention in few areas of market failure and social equity.

Expenditure management: Both the formulation and execution of public expenditure suffer from serious weaknesses: lack of coordination and clear definitions of functions; lack of budget transparency; the accumulation of arrears, soft loans, and tax offsets; and lack of accountability. Reforms calls for a new budgeting approach based on program outcomes, multiyear budgeting, and performance evaluation.

Fiscal decentralization: The system of intergovernmental relations lacks formal central coordination, and the tax sharing system is inefficient. Fiscal decentralization should proceed by extending the scope of decentralization, but enhancing central control and coordination of the process; clearly specifying funded mandates, increasing managers' autonomy to perform, and making local authorities accountable for results; and adjusting tax sharing and transfer mechanisms.

Social sector expenditures: Disparity in per capita social expenditure across regions in Kazakhstan is a reflection of the inverse correlation between local fiscal capacity and social needs. These disparities are felt on social assistance, healthcare, and education sectors. Reforms should aim at increasing the efficiency of spending and the quality of service delivery and access, while compensating for regional inequalities.

[1] "Kazakhstan: Public Expenditure Review." Report No: 20489-KZ, June 27, 2000.

contribution of the oil sector to fiscal revenues. Both the Bank and the IMF have underscored the importance of these transparency issues for sound fiscal analysis and offered assistance to the Government in this area.

37. **Transparency and accountability.** The Government has begun to take measures to improve performance, transparency, and accountability of the public sector – including reforms in auditing, procurement, and civil service. PSRMAL II will build on PSRMAL I to support the Government's efforts to provide the checks and balances, institutional

restraints, and accountability that constitute the central pillars of good governance. A Governance and Service Delivery Survey, requested by the Government for FY01, will (i) identify the main areas and causes of corruption; (ii) recommend public sector/governance reforms to address more directly the underlying causes of corruption; and (iii) identify ways to broaden the participation of civil society and other stakeholders. These measures would complement other actions—preventive, educative, and enforcement-oriented—aimed at addressing the phenomenon of high-level corruption. These include the declaration of assets and incomes of civil servants to the tax authorities. The adoption of these reforms would be supported by the second tranche of PSRMAL II and by the proposed Consolidation Structural Adjustment Loan (CSAL) in FY03. The TAL II would also support a follow-up survey to gauge progress made under the first round of reforms. A public sector Financial Accountability Assessment will also be included in the Bank's analytical work program in early FY02.

38. **Institutional and administrative mechanisms.** The Government is moving public expenditures away from non-priority areas and towards investment in infrastructure and social assistance, informed by the findings of the PER and supported by the proposed Social Protection Reform Adjustment Loan (SPRAL) in FY01. Such budget reforms, including intergovernmental finance reforms, will also be supported by PSRMAL II. PSRMAL II will also support the continuing agenda of civil service reform, including institutional reform at the local level, to improve the efficiency of the public sector and to decrease waste and fraud. Moreover, it will support the extension of administrative reorganization and realignment to local levels, and the strengthening of resource management institutions, such as audit and procurement. The TAL II and possible IDF grants will help finance the investment in institutional and human resources needed for these reforms.

B. Stimulating Broad-Based Private Sector-Led Growth

39. Kazakhstan's prospects for stable and widely-shared growth hinge on generating employment opportunities and incomes in the non-extractive sectors, even as the potential Dutch Disease effects of increased oil exports make this objective more difficult to achieve. Efforts must concentrate on continuing the privatization agenda and restructuring or closing non-performing enterprises; improving the business environment to encourage the entry and growth of efficient enterprises; promoting agricultural growth and rural development; upgrading infrastructure through focused public investment; improving access to financing; and fostering a flexible labor market.

40. **Privatization and restructuring.** The private sector accounts for 60 percent of GDP, a share that about average for the region, but considerably smaller than that in the Baltics or Central Europe.[12] The privatization of small- and medium-scale enterprises (SMEs) and farms is nearly complete, but about 100 large and 260 medium enterprises remain under public ownership. In addition, the State has minority holdings in about 2,000 enterprises, is the most important shareholder among large transport, oil and gas sector firms, and maintains considerable control in the industrial sector through shareholding in joint ventures with foreigner investors.

[12] EBRD Transition Report 2000.

41. The pace of privatization has slowed, due to a lack of political will and effective bankruptcy mechanisms, corporate governance issues, and the availability of other sources of budgetary expenditure financing. The slow progress in privatization of larger enterprises has come at a cost to the economy and to society, since many of the large state-owned firms are inefficient. While their assets are deteriorating, these enterprises survive only by building up large arrears to their workers, creditors, and suppliers. The privatization of "blue-chip" enterprises is likely to begin in 2001 as the environment for foreign investment improves. Shares in Kazakhtelekom, electricity generation companies, regional power distribution companies and other large and medium-sized enterprises (mainly in the extractive sector) are planned for full or partial privatization.[13] However, finding good strategic investors for these companies has been a challenge due in large measure to the non-transparent privatization process, the absence of a good legal and regulatory framework, and the hostile private sector environment. An improved business environment and a more transparent privatization process should lead to more IFC investment activity in projects outside the extractive industries, either through direct lending or credit lines through financial intermediaries.

42. Although privatization of SMEs is more advanced, in many cases this has not led to improved corporate governance, efficiency, and growth – a likely cause of the lack of supply response to liberalization. Many enterprises sold under the mass privatization program remain without a majority owner, and investment funds have been ineffective in consolidating ownership and forcing improved efficiency on such firms. The need for effective corporate control and monitoring of management is acute.

43. The Bank will assist the Government in designing and implementing a program to manage state assets: a program for restructuring and privatization of Blue Chip companies, sales of residual State shares, a program of divestiture of other large enterprises, and accelerated sale of municipally-owned companies. Through the CSAL and the TAL II, the Bank will support these reforms and help the Government devise guidelines on the necessary sector restructuring and an appropriate regulatory framework. These operations will also support measures to improve corporate governance and facilitate the creation of an effective framework for bankruptcy and liquidation of non-viable enterprises. They will also provide support for the development of transparent procedures for the sale of SOE's as well as the remaining Government interest in enterprises which have undergone partial privatization. If these reforms succeed in improving the institutional mechanisms governing Kazakhstan's market, there would be scope for increased IFC and MIGA operations involving loans to larger enterprises.

44. **Business environment.** New start-up companies, especially SMEs, have been constrained by an unfriendly business environment arising from corruption, weak legal enforcement, and high transactions costs. Pervasive licensing requirements and regulatory practices increase immensely the cost of doing business and provide opportunities for corruption. Licensing procedures are often complicated and involve

[13] It was recently announced that the EBRD is planning to acquire a 30-percent stake in Kazakhtelecom -- 15 percent from Kazakhstan's largest bank, Kazkommertsbank, and 15 percent from the Government's share. As a result, the Government's stake will fall from 50 percent to 35 percent.

several state authorities. In many cases, the legislative framework for licensing has not been followed up by promulgation of relevant implementing regulations. Where such regulations exist, lack of dissemination enhances opportunities for corruption.

45. Licenses and the associated complexity of procedures also add greatly to transactions costs, and a weak real estate system in many regions has led to high formal and informal costs of acquiring premises for operating businesses. Moreover, the application of the existing legal and regulatory framework is sporadic, with even the administration and implementation of adopted legislation (including those for taxation) depending greatly on the regional governors' attitude toward individual entrepreneurs. While the key pieces of legislation needed in a market economy are in place and conform with international standards, enforcement has been uneven because of the weak courts. The quality of governance in Kazakhstan, as measured by EBRD indicators, is lower than the region as a whole, and considerably lower than that in Central Europe and the Baltics.

46. The Government is making progress in reducing excessive and overlapping licensing requirements to ensure greater transparency and accountability. A Justice Ministry review of 6000 state enterprises to identify and remove the remaining regulatory functions, both at the republican and local levels, has been completed and 284 entities that have regulatory functions have been identified. A new labor law was approved in late-1999 and came into effect in 2000. Judicial review of bankruptcy, leasing, and collateral laws has been completed, but only the new leasing law has been approved by parliament.

47. The Bank Group will assist the Government in its efforts to improve the business environment through an improved legal and regulatory framework, a more friendly environment for the creation of new enterprises, and reducing the high cost of doing business that affects SMEs in particular.[14] In FY98, the IBRD, IFC, and FIAS carried out a joint assessment of the policy environment and constraints to private sector development in Kazakhstan. The document has provided valuable background for the Bank's dialogue with the Government on business environment issues. In the future, the Bank will work with the Government to diagnose remaining impediments to private sector activity through a series of studies, beginning with the Growth Strategy Study and a Governance and Service Delivery Survey, both in FY01. Some elements of the reform package to remove these impediments—de-licensing, reduced interference from civil servants, improving transparency in public procurement and reducing other public sector impediments—will be supported PSRMAL II and TAL II. A second group of reforms, pertaining more directly to the private sector environment—for example, financial sector issues, the regulatory framework, and leasing laws—would be supported by the CSAL. The Bank will work in partnership with the EBRD, USAID, and TASCIS in this area.

48. In the mining sector, which has suffered from the legacy of non-transparency in early privatization efforts, the Bank will prepare a Mining Sector Note in FY01 to provide recommendations on improving the investment climate. The IFC and MIGA will also examine potential operations in the mining sector and will continue their support of selected investments in the oil and gas sector both upstream and downstream.

[14] See Annex 14 for a more detailed description of the PSD strategy.

49. Assistance to SMEs is most efficiently channeled through local financial intermediaries. IFC has taken a leading role in the area of institution building in the financial sector and this activity will continue during the next three years. It is expected that IFC will provide investment and technical assistance to additional local banks in order to strengthen their financial position and develop their management and lending capacity to service SME borrowers. In addition, IFC will work to develop new institutions and financial vehicles, such as leasing and equity funds, to open additional opportunities for access to investment capital by SMEs. In the agricultural sector, the Second Agricultural Post Privatization Assistance Project (APPAP II) in FY03 supports financial services for rural enterprises.

50. The IFC will continue its ongoing activities in the SME sector, attempting to alleviate the financial constraints faced by SMEs. Through a planned new SME project facility, it will also provide technical assistance to SMEs to develop their business plans, establish local consulting and training capacities, support overall Bank efforts aimed at bringing about improvements in the business environment, support new information and technology initiatives of relevance to SMEs, and attempt to forge linkages between SMEs and large enterprises. Related to this, the Bank Group will discuss with the Government the possibility of grant-financed programs that help in the diffusion of information and technology and upgrading of technical and managerial skills.

51. Thus, IFC's investment program is likely to include one to two loans annually to banks for on-lending to SMEs and the private sector, direct investment in additional financial institutions, possible investments in leasing, an equity fund, and housing finance, as well as one to two loans annually to medium/large sized projects in the private sector, primarily in extractive sectors. As the legal and regulatory framework is developed and reputable strategic investors express a desire to invest, IFC would also be willing to support infrastructure projects, primarily those in telecommunications and power. The IBRD will also consider activities to follow up on its KEGOC electrical transmission project.

52. MIGA's on-line information services, IPAnet and PrivatizationLink, feature information on the investment climate and investment opportunities arising from the national privatization program in Kazakhstan. MIGA has also partnered with the OECD and other donor agencies through the Private Sector Development Center in Istanbul to provide training in investment promotion strategies and techniques to Central Asian Republics. The key focus has been on attracting investment in mining and tourism and the use of information technology for effective research and outreach.

53. Finally, the Bank Group will develop the Global Development Gateway Project to increase access in emerging economies to knowledge and information, bringing these economies into the world market and spurring economic growth. Kazakhstan is one of 15 pilot countries selected to participate in this initiative.

54. **Agriculture and rural poverty.** At independence, Kazakhstan inherited a state-owned farm sector characterized by large rain-fed grain farms in the north and smaller, largely irrigated, mixed farms in the south. Since then, the Government has launched

successive reforms in the sector—price and trade reform, privatization of farms and agro-business, and the creation of land markets based on fully tradable long-term leases—aimed at halting uneconomical farming and improving productivity and corporate governance on the remaining farms. All too often, however, privatization was non-transparent and led to poor corporate governance and declining productivity, exacerbated by a lack of hard budget constraints.

55. During the past two years, the Government has imposed hard budget constraints on farm enterprises by reducing subsidies and eliminating directed credit programs, and has strengthened the management of the Ministry of Agriculture. It has also supported financial restructuring through bankruptcy proceedings for non-viable farms and the take over of badly managed, though potentially viable, farms by creditors or strategic investors. The results of these initiatives are encouraging. The retreat from marginal areas is nearing completion, corporate governance is improving, there are signs of renewed investment in the sector (especially in the north), and there is hope that last year's yield increases signal the beginning of agricultural recovery.

56. A significant reform agenda remains, with the greatest challenges in the northern marginal lands and the irrigated southern farms. Land reform needs to be completed by converting remaining certificates of entitlement to land into actual land titles. The availability of farm credit, a key constraint especially for the smaller farms, must be increased. For both the northern and southern farms, efficiency and profitability must be improved by improving agricultural services (extension, marketing, and research). In addition, the overall policy framework encouraging hard budget constraints and aggressive use of bankruptcy needs to be maintained.

57. The Bank's strategy focuses on addressing the problem of declining productivity in the farm sector. The first phase of the Agricultural Post Privatization Assistance Project (APPAP I) supported the development of rural advisory services and financial services for rural enterprises through commercial banks in Almaty (a smallholder area) and Akmola (large farm) oblasts. The second phase of the project (<u>APPAP II</u>) will expand program activities to additional oblasts, including oblasts in poorer areas. The project also promotes the use of recently promulgated legislation on bankruptcy and registration of liens on moveable property, especially important in the North. Additional interventions in the second phase will focus on broadened support for development of rural financial markets, including equipment leasing—an approach where the IFC also has an interest—and microfinance, which will be particularly important for smallholders in the south.

58. In addition, an <u>Agricultural Services Project</u> in FY03 will assist in delineating public and private sector roles in the provision of services to farms and provide targeted investment in infrastructure and training to demonstrate delivery of services to clients in the areas of farm production and marketing. Although the Project will be national in scale, it will provide support for selected agricultural services, the focus of which will differ from region to region according to differences in farming systems. A pilot Drylands Ecosystem Management Project, to be supported through a Global Environmental Facility (GEF) grant, would seek to restore marginal dry lands to natural vegetation and seek more sustainable uses of such lands. A proposed <u>Rural Roads</u>

Project in FY03 would lower marketing costs in rural areas. Land registration is a critical element in Kazakhstan's land reform program, and will be supported by a Real Estate Registration Roll-Out Project in FY02, following the Real Estate Pilot Project initiated during the previous CAS period. It will build on the lessons of the pilot, and aim to improve the quality of services provided to clients. There is an on-going Irrigation and Drainage Improvement Project and the Syr Darya and North Aral Sea Project in FY01 which would improve irrigation and water control along the river. In order to assist the farm sector to increase yields and thus profitability, IFC will examine the possibility of establishing a model leasing project which would provide farmers with access to financing for needed farm machinery and equipment.

59. The work on this extensive program aimed towards restoring agricultural viability and growth will be supported by analytical work, including (i) the completion of an examination of the marketing infrastructure for grain; (ii) inclusion of Kazakhstan in a Regional Study of Farm Debt; and (iii) an analysis of the efficiency of the various farm structures emerging from the Government's farm restructuring as part of the Growth Strategy Study. A Livestock Study in FY03 will examine the possibilities for growth and development of the livestock industry in Kazakhstan on marginal farming lands.

C. Social Services and Social Protection

60. While improvement in living standards is expected from increased growth and employment opportunities, there is still a need for targeted assistance to the poor. A key objective of the social assistance strategy is improving targeting so that transfers reach the poorest. Given the regional dimensions of poverty, attention should be focused the poorer regions of the country. For the working poor, whose jobs in unrestructured enterprises or self-employment are unable to provide them with support, "workfare" programs could provide subsistence incomes until economic growth offers better opportunities.

61. **Reform of the social protection system.** The PER and other studies have found that the poorest do not receive the largest share of transfers, and social assistance payments are often not made due to fiscal constraints at the local level. The Government and the Bank have been developing a set of policies and reforms to improve social protection of the poor for over a year. It would be supported by the SPRAL to help offset the increased costs of the reforms. The SPRAL's objectives would include (i) developing policies to provide the population with an adequately funded and well-targeted safety net; (ii) ensuring that budgets for social assistance are adequate, are not transferred to other uses, and account for regional differences in poverty; (iii) developing self-targeting public works programs; (iv) improving both the efficiency and equity of social assistance administration ; (v) instituting a comprehensive labor market policy that will increase labor market flexibility; (vi) developing policies towards the private sector to facilitate and rationalize business licensing and registration procedures; and (vii) developing Government's capacity to monitor and evaluate poverty data, trends in household income and consumption, labor market trends and efficiency and effectiveness of the Government's social policies. In addition, PSRMAL II will support reforms to improve the administrative structure to deliver social assistance.

62. **Access to markets and jobs.** To help the working poor through the process of transition, the SPRAL would support an efficient public works program to provide employment opportunities at minimum wages. The Rural Roads Project aims to increase the access of the poor to employment opportunities, education, and health care, as well as market access for buyers and sellers of agricultural products. The Poverty Assessment and Labor Market Study in FY02 will also investigate the labor market opportunities available for the poorest, and propose options for reform. The Livestock Study will examine options for the improved living standards of the poor in some of the most depressed areas. A proposed IDF Grant on the Silk Road in FY01 will attempt to stimulate economic activity in economically depressed communities.

63. **Health and education.** The inefficient post-Soviet social structures will need to be reformed so that critical services are delivered to the poor. In the education sector, the lead has been taken by the Asian Development Bank, which currently plans a follow-up lending operation in the sector. In the health sector, the ongoing first-phase Health Project focuses on two pilot oblasts and addresses problems of under-funding and inefficiencies. The project promotes better use of resources, supports health promotion activities, strengthens the primary health care system, improves information systems, provides training in new treatment protocols, improves clinical capability for general practitioners, and upgrades practitioner skills. The second phase of the project (Health II), planned for FY04, would extend reforms in health financing, primary health care, and hospital restructuring to the cities of Astana and Almaty and six other oblasts. The Poverty Assessment and Labor Market Study will also examine the central issue of access to social services by the poor.

64. **Water supply and wastewater services.** Currently, water systems fail to deliver services to those who need it because of poor institutional capacity, inefficient operations of plants and networks, severe financial shortfalls due to low tariffs and collection rates, undersized and unfinished wastewater treatment facilities, and limited access to investment financing. The Northeast Vodokanal Project in FY02 will support reforms to improve services by creating better performing institutions, putting the sector on a financially viable footing, and ensuring cost effective utilization of the scare financial resources available. Safety net arrangements will be developed to allow the poor to pay for water and waste disposal. Concurrently, a Water Sector Strategy Note in FY02 will examine this critical issue by identifying needs for reform and investment across the nation.

65. **Gender issues.** Gender issues will be explored in the Poverty Assessment and Labor Market Study and a proposed IDF Grant on Gender and Violence in FY01. Participatory workshops may be used to identify gender issues and integrate a gender perspective into the Bank's policy dialogue with the Government.

D. Protecting the Environment

66. Despite Kazakhstan's wealth of natural resources, environmental problems could limit the country's growth potential. Addressing environmental degradation will require

cleaning up contaminated rivers and water sources, restoring marginal lands, and improved management of water use and sewage practices. The Bank's strategy initially concentrates on addressing industrial pollution in the Northeastern industrial area and the marginal agricultural lands.

67. **Industrial pollution in the Northeast.** The Nura River Cleanup Project in FY02 will address the issue of mercury contamination of the river. Other outstanding issues, which will be tackled by bilateral and multilateral partners, include mercury and kerosene contamination of the river Irtysh.

68. **Pollution in the Northern Caspian Sea.** The fragile ecosystem of the area is suffering from oil spills and the encroachment of the Sea into numerous abandoned oil fields. This poses a threat to marine life, especially the sturgeon, for which it is the only remaining spawning ground. Technical assistance from TACIS, USAID, the GEF, and others in the areas of bio-monitoring, development of hatcheries, etc. will continue to play a critical role in addressing these issues.

69. **Water shortages and water pollution in the South** are caused by inefficient irrigation and livestock practices as well as run-off of non-treated waste water from cities, as well as a lack of coordination of water sector activities in the region. An acute water shortage, contamination of the Syr Darya River, and an acceleration of desertification are occurring in the Southern regions. These are likely to increase the tradeoff between potable water for human consumption on the one hand, and irrigation, livestock, and agricultural production on the other. The Syr Darya and North Aral Sea Project, which is part of the transnational effort for the Aral Sea basin, is the Bank's primary new instrument in this region. The Bank will also look for other ways to improve regional coordination in water and energy issues.

70. **Restoring marginal lands.** In the marginal lands which are being taken out of cultivation, reclaiming and restoring the lands will provide for a better ecosystem and livelihood opportunities. The Drylands Ecosystem Management Project will pilot an effort, with GEF funds, to support the Government's policy to restore marginal dry lands that are agriculturally unsustainable back to natural vegetation and seek more sustainable uses of such lands.

E. Fiduciary Framework

71. Assisting the Government to strengthen transparency, accountability, and effectiveness in the management of public financial resources is a central objective of the CAS. In an environment of increasing fiscal resources from the oil sector there is an increased urgency to improve overall public financial management and accountable for the use of public funds.

72. Consistent with the recommendations of a recent review of the Bank's fiduciary arrangements for adjustment lending, [15] measures have been and will be taken to improve

[15] "Fiduciary Framework for Adjustment Lending", OCS /PREM draft, September 13, 2000.

the Bank's dialogue on the Government's public financial management arrangements. These include:

- The recently completed Public Expenditure Review (see Box 2), which identified priorities for reform in the management of public expenditure. This report is now being widely disseminated in the country and while still very recent, it has already had an impact on the budgetary process, e.g., encouraging the move to a medium term framework. It also has provided insights on the role and operation of a National Oil Fund and helped the Government in their work on reforming the financial relations between the central and local governments.

- PSRMAL I, a Country Procurement Review (FY00), and an IDF Grant on Procurement (FY00) all contributed to recent improvements in the procurement law and the establishment of a State Procurement Agency. It is estimated that improved procurement practices saved the Government almost 5 billion *tenge* in 1999, about 5 percent of the total value of contracts passing through the agency.

- A Financial Management Assessment (FY98) has contributed to strengthening of the supreme audit authority in the country.

- The proposed public sector reform loan (PSRMAL II and/or TAL II) in FY02 will support further reforms in public administration and civil service, public expenditure management, accounting and internal/external audits, and tax and customs policy and administration. In addition, in FY01 an evaluation of the auditing capacity of local accounting firms will be carried out using Rapid Response funds.

- The Governance and Service Delivery Survey planned for FY01 will propose public sector governance reforms to address corruption issues.

- A Financial Accountability Assessment in early FY02 is intended to be a complement to the Public Expenditure Review.

73. In addition, the Bank will place more emphasis on monitoring and evaluating development impact, particularly with respect to poverty and inequality, by strengthening M&E components in individual projects and building institutional capacity to conduct ongoing impact evaluations. The SPRAL provides for the establishment of periodic household surveys to monitor poverty and inequality; PSRMAL II will support collection of governance indicators, and it is expected that the CSAL will include measures to evaluate improvements in the business environment and enterprise performance.

F. Applying Lessons from the Previous CAS

74. The CAS is guided by the findings of a recent Country Assistance Evaluation that was prepared jointly by OED, OEG, and MIGA (Box 3). Looking at the period since the last CAS, performance has been mixed. Lending targets were met in the early years, but by the end of the CAS period lending slowed significantly as a result of changed circumstances, fiscal difficulties, and policy differences. In some cases, reforms have

moved more quickly than the Bank anticipated, making components of projects obsolete and leading to restructuring. Project implementation often has been slow. The importance of economic and sector work was recognized in both the previous CAS and the CAE, but the quantity and depth of the Bank's ESW has been limited by tight budget constraints.

75. One of the key lessons learned from the previous CAS period is the need to ensure sustained ownership in the Bank financed projects in an environment where the changes in the government personnel are very often. First, it is critical that the projects to be financed by the Bank are included in the Public Investment Program and widely reviewed within the Government at various stages of preparation. In order to sustain ownership and support, Bank task teams will also be expected to carry out periodic broad based consultations during the project implementation. Second, the transition from the Project Implementation Units (PIUs) to streamlining project management into the line ministries – a decision taken by the Government last year which the Bank supported-demonstrated the need to build capacity during the preparation phase by focussing on financial management and procurement functions.

76. Another lesson learned is the importance of projecting and budgeting disbursements and counterparts fund adequately every year. In Kazakhstan, the proceeds of Bank loans run through the republican Budget and are subject to budget rules. If adequate amounts are not budgeted, project implementation may run the risk of suspended until the beginning of the next budget cycle. The annual consultation mechanism to agree on next year's budget proposals will be strengthened to avoid disruptions. Furthermore, a semi-annual review of emerging issues on project preparation and implementation will be undertaken at senior levels.

77. Finally, there is a need to facilitate NGO participation in design and implementation early on during the project cycle. This would involve developing with the Government ground rules for increased NGO participation.

Box 3: Country Assistance Evaluation

A Country Assistance Evaluation was recently prepared by OED, OEG, and MIGA to assess the relevance and efficacy of World Bank Group assistance in Kazakhstan.1/ The report concludes that IBRD adjustment lending since 1991 was successful in promoting policy reforms, and project outcomes were rated satisfactory by OED. The Bank supported price and trade liberalization, privatization, financial sector reform, and improvements in the legal framework. Despite these achievements, per capita GDP dropped by 40 percent, poverty grew significantly, major social indicators deteriorated, and public financial accountability remains poor.

In hindsight, the report notes, the Bank and other donors were overly optimistic in their expectation that transition could be accomplished in a relatively short time and with low costs. The Bank's assistance strategy did not focus enough on the protection of the poor and gender issues. Although the Bank emphasized public sector reform, there is an unfinished agenda to strengthen systems of public financial accountability that help ensure effective use of public resources. The report finds that privatization outcomes were mixed, with poor corporate governance contributing to decapitalization.

On the whole, investment projects have not fared as well as adjustment lending, some because of weak commitment. Together, the outcomes of the Bank's adjustment and investment lending are rated partially satisfactory. The role of the IFC, particularly in the financial sector, was found to be generally timely and effective.

For the future, the report recommends that the Bank Group focus on the protection of the poor, strengthening public financial accountability, and improving the environment for private sector development. The Bank needs solid analytical work to focus its assistance, including periodic reviews of public expenditures, a financial accountability assessment, and an updated poverty assessment. The report recommends that the CAS incorporate lessons from IFC and MIGA transactions experiences and exploit fully the mix of instruments available to the World Bank Group.

1/ "Republic of Kazakshtan: Country Assistance Evaluation." CODE 2000-108 (December 2000).

V. MEDIUM-TERM PROSPECTS AND PROPOSED LENDING PROGRAM

78. The proposed lending program for FY01-03 depends on three critical sets of issues:

- **The macroeconomic framework:** the lending program is predicated upon an appropriate macroeconomic environment. In addition, the program requires greater transparency of the fiscal accounts, both with respect to the contribution of the oil sector to fiscal revenues -- to allow for due diligence in fiscal analysis -- and with respect to the design and operation of the National Fund (oil fund) to ensure the quality of expenditure and investment of oil-related revenues.

- **The reform agenda:** the Government's commitment to a continuing agenda of policy and institutional reforms. Some elements of the reform program are associated with particular investment projects, and others – particularly in social protection, public sector management reform, and private sector development – are associated with adjustment lending.

- **Financing needs:** The amount of adjustment lending in particular will depend upon fiscal needs, which in turn depend upon the price of oil and the fiscal impact of reforms.

79. The Bank lending program has three possible cases:

- A **Low Case** would occur if policy and institutional reforms are delayed, and a lack of transparency in the management of oil revenues implies that it is difficult to understand how oil revenues are being used. In this case, the Bank lending strategy would focus on a small number of carefully-targeted investment and technical assistance operations to achieve poverty, governance, and environmental objectives. The volume of lending would be $271 million over the three-year CAS period. Given the current status of structural reforms, the starting point for the CAS is the low-case scenario.

- A **Base Case** is predicated upon sound fiscal management and would respond to a moderate pace of reform. The lending program would contain a social protection adjustment loan in the first year of the CAS period, but in outer years would shift from adjustment lending to investment and technical assistance loans. Lending volume would total $566 million over the three-year CAS period.

- A **High Case** would be pursued if the pace of structural reform is accelerated, and the management of oil revenues is sound – i.e., the National Fund is cast in a medium-term fiscal framework and is subject to public accountability. Predicated upon financing needs, the high-lending strategy contains a mix of investment, technical assistance, and adjustment loans supporting policy and institutional reforms across several sectors, totaling $816 million over the three-year CAS period.

Lending operations will be complemented by a program of non-lending services (paras. 90-91).

A. Macroeconomic Simulations

80. A macroeconomic consistency model was used to simulate the effects of different combinations of oil price and policy reform assumptions, roughly corresponding to the three lending scenarios described above. The assumptions and results of the macroeconomic simulations are contained in Annex 8.

81. In the Low Case, it is assumed that policy and institutional reforms stagnate. The unfavorable business environment results in a standstill of domestic and foreign private investment (as a share of GDP), and slow growth of non-oil exports. Progress on privatizing the remaining state-owned shares in blue-chip companies continues but at a slow pace, and tax collection fails to improve. As a result, GDP growth is driven by the oil sector. Under the assumption of continued strength in oil prices (US$25-30 per

barrel), the current account is in surplus through 2002, turning to a deficit of -0.7 percent of GDP in 2003. Fiscal account deficits are small, ranging from -0.4 percent of GDP in 2001 and 2002, to -1.1 percent in 2003.

82. The Base Case assumes a moderate pace of policy and institutional reforms, as well as moderate oil prices. Fiscal deficits lie between the Low and High cases, at -1.8 percent of GDP in 2001 and -2.0 percent of GDP in 2003. The Bank's lending program includes one adjustment loan (the SPRAL in 2001) with the remainder in investment and technical assistance. While the projects in the first two years of the program are firm, the lending program for FY03 is more tentative in nature and some of the projects may be subject to change as the Government revises its rolling Public Investment Program. In the event that there would be significant changes to the projects in the FY03 program, a CAS update would be presented.

83. In the High Case, the pace of structural reforms accelerates: privatization moves more quickly, improvements in the business environment lead to an increase in private investment and non-oil exports; tax collection improves, and there is an increase in capital expenditure for priority public investments. Under the assumption that oil prices return to a historical average, the current account goes into deficit, and the fiscal deficit rises to -3.2 percent of GDP in 2001 and 2003. External financing is assumed to include three adjustment loans from the Bank (SPRAL, PSRMAL II, and CSAL).

84. The simulation results are particularly sensitive to oil price assumptions, which are an important determinant of both export and fiscal revenues. Table 2 illustrates the impact of oil price assumptions on fiscal revenues (corporate taxes, royalties, and bonus payments). Using production quantities in the Base Case scenario, a US$1 decrease in the price of oil results in a fiscal loss of US$97 to US$117 million each year.

Table 2: Fiscal Impact of Oil Price Assumptions
(US$ million)

	2000	**2001**	**2002**	**2003**
Oil price assumptions and fiscal impact				
Oil price (US$ barrel)	28.0	25.0	21.0	21.0
Production (tons)	33,648	36,626	38,544	39,598
Oil-related fiscal revenues	1,288.6	1,062.0	1,125.8	1,048.8
Tax	713.5	704.3	586.3	733.3
Non-tax [a]	575.1	357.7	539.4	315.5
Impact of a US$1 per barrel decrease in the price of oil				
Oil price (US$ barrel)		24.0	20.0	20.0
Production Tons		36,626	38,544	39,598
Fiscal revenue loss		96.7	109.0	116.6
Tax		73.3	84.6	92.6
Non-tax		23.4	24.4	23.9

[a] Non-tax oil revenues include royalties and bonus payments.

B. Lending Program and Triggers

85. The program of loans in the three lending cases is detailed in Table 3. The triggers for the lending cases relate to the macroeconomic framework, the reform agenda, and project implementation (Table 4). The triggers shown are additive – in other words, all triggers in the first column are required for the Base Case lending program, and all shown in the second column are necessary for the High Case. In order to judge whether the triggers are being met, the Bank will seek from the Government a statement of policy and institutional reforms taken or underway, and evaluate the status of the reform program against this plan.

86. The types of lending instruments chosen and the amount of lending are also dependent upon overall and incremental financing needs. Even under an aggressive reform program, the overall demand for external financing may be limited by external developments (e.g., high oil prices). In the absence of financing needs, reforms will be supported by investment and technical assistance loans (the Base Case) and by non-lending services (in the Base and Low Cases).

87. The High Case supports an aggressive reform program – evidenced by significant progress in public sector reform, private sector development, and social protection – as well as the need for external financing. It requires a sound macroeconomic framework, evidenced by (i) satisfactory reviews by the IMF under an EFF or Staff Monitored Program, (ii) full and transparent accounting of the oil sector's contribution to fiscal revenues, and (iii) operation of the National Fund such that it is a transparent part of the budget, cast in a medium-term fiscal framework, and subject to public accountability. Predicated upon financing needs, the High Case lending program includes three adjustment loans: the SPRAL ($200 million) in FY01, PSRMAL II ($150 million) in FY02 and the CSAL ($100 million) in FY03. These would be complemented by investment loans in the areas of agriculture, health, tax reform, rural roads, housing finance, financial infrastructure, and the environment.

88. The Base Case includes the SPRAL in FY01, triggered by significant social protection reforms and financing needs based on increased social assistance expenditure. After FY01, the Bank's lending program shifts toward non-adjustment lending instruments. Policy and institutional reforms in public sector management and private sector development are supported through a technical assistance loan (the TAL II in FY02) and possible investment loans. The Base Case requires a satisfactory macroeconomic framework and transparent management of oil revenues.

89. The Low Case excludes adjustment lending in all three years, and in addition trims the number of investment loans in FY03. These projects focus on the priority areas of environmental protection, rural development, governance, and financial infrastructure.

Table 3: Proposed IBRD Lending Program, FY01-03 (US$ million)			
	High Case	**Base Case**	**Low Case**
FY01			
Social Protection Reform Adjustment Loan (SPRAL)	200	200	--
Syr Daria and Northern Aral Sea	78	78	78
Subtotal	**278**	**278**	**78**
FY02			
Northeast Vodokanal Water Supply	80	80	80
Second Public Sector Resource Management Adjustment Loan (PSRMAL II)	150	--	--
Second Technical Assistance Loan (TAL II)	10	10	10
Nura River Cleanup	42	42	42
Real Estate Rollout	16	16	16
Subtotal	**298**	**148**	**148**
FY03			
Agricultural Services	40	40	--
Second Agricultural Post-Privatization (APPAP II)	35	35	--
Consolidation Structural Adjustment Loan (CSAL)	100	--	--
Financial Infrastructure	15	15	15
Rural Roads	50	50	30
Subtotal	**240**	**140**	**45**
Total FY01-03	**816**	**566**	**271**

Table 4: Lending Program Triggers

Base Lending Case	High Lending Case
Macroeconomic Framework	
Sound macroeconomic framework evidenced by the satisfactory completion of the IMF review of the current EFF. If the EFF is not in place, satisfactory review of the macroeconomic framework under an IMF Staff Monitored Program.	Same as Base Case, plus: Operation of the National Fund such that it is a transparent part of the budget, cast in a medium-term fiscal framework, subject to public accountability, and invested professionally abroad.
Governance	
Implementation of measures to tackle high-level and low-level corruption: (i) implementation of annual declaration of assets and incomes of civil servants to the tax authorities; (ii) establishment of clear rules for the interests of public sector officials and their direct families in the private sector, and development and enforcement of regulations dealing with conflicts of interest; (iii) effective enforcement of code of ethics for civil service; (iv) public declaration of all significant new government contracts (defined, e.g., by size, procurement, privatization, etc.); and (v) assessment of public financial accountability by 2001 followed by implementation of reforms.	Same as Base Case.
Private Sector Development	
Revision of licensing, registration, and land acquisition rules/regulations and other bureaucratic barriers to entry, particularly for SMEs; limits on audits and inspections of private businesses.	Same as Base Case, plus: Acceleration of the sale of remaining state shares in privatized enterprises; vigorous implementation of bankruptcy and liquidation laws.
Social Sector Reform	
Improved poverty monitoring: (i) design of a household consumption survey and progress in its implementation on at least an annual basis; (ii) establishment of a poverty line; (iii) continuous monitoring of poverty levels and health indicators.	Same as Base Case, plus: Enforcement of new labor and employment laws. Adequate budgeting and improved targeting of social assistance; implementation of a poverty-targeted public works program.
Project Implementation	
Implementation of actions agreed during the latest CPPR; adequate budgetary allocations for project funding. Improvements in disbursement levels (indicative targets: at least 10% by end-FY01, at least 12% by end-FY02, and at least 15% by the end of the CAS period).	Same as Base Case, plus: further improvements in disbursement levels (indicative targets: at least 12% by end-FY01, at least 15% by end-FY02, and at least 20% by the end of the CAS period).

C. Non-Lending Services

90. The operations of the Bank and IFC will be guided by the Bank's analytical and advisory activities (AAA). Economic and sector work was identified as a key area in the last CAS and some major work has been done, including a Public Expenditure Review and a Poverty Assessment. Over the current CAS period, four types of AAA are planned:

- Major studies to analyze cross-cutting policy issues, prepare detailed sets of options for the Government, and contribute to the design of adjustment loans. This group will include the Growth Strategy Study in FY01, the Poverty Assessment and Labor Market Study in FY02, and a Country Economic Memorandum in FY03.

- Studies which would inform decisions regarding the desirability and need for the Bank to provide future lending, and help the design of future loans. These would include the Note on Revenues in FY01 and the Water Sector Strategy Study in FY02. The note on revenue issues, for example, would help define the extent and scope of the planned Revenue Project. Due diligence requires the early conduct of a country Financial Accountability Assessment jointly with the Government and the donors in FY02. Other studies, as needed, would be carried out using grant funding.

- Sectoral studies to update the state of the client's knowledge on specific issues. This will include a Governance and Service Delivery Survey and a Mining Sector Note in FY01, and a Livestock Study in FY03.

- Specific focused notes produced on demand from the client, and informal reports on trends in economic and financial sectors, social and environmental indicators, institutional development and the like. In the past, the Government has found these "rapid response" notes quite useful. In the low-lending case, more resources would be devoted to these rapid-response policy notes.

91. The World Bank Institute's activities complement the rest of the Bank Group's program by expanding knowledge and enhancing the capacity of Kazakhstan's policymakers to best implement their development objectives. WBI will conduct in-country and regional seminars, workshops, and conferences in close consultation with the authorities in Kazakhstan and the Bank's country team. The thematic areas of WBI training are aligned with the priorities of the CAS. The objective of private sector development is supported by Corporate Governance and Business Ethics program and a course on Global Integration and the New Trade Agenda. Health Sector Financing, Pension Reform, and Poverty Analysis initiatives are aimed at social assistance reform and capacity building to conduct poverty analysis and to link analytical work to policy formulation. The continuation of Intergovernmental Fiscal Relation Program will support the envisaged reforms in the area of public sector and governance. Environmental concerns will be incorporated in the newly developed Rural Development and Natural Resource Management Program that will be launched in FY02.

Table 5: Areas of Activity of Principal Development Partners

Policy Objectives /	Growth / PSD					Public Sector Reform / Governance				Environment		Social Sectors		
Partners	Macro Frame-work	Financ-ial Sector	Legal Reform	PSD/ Invest. Climate/ SMEs	Infrastr-ucture	Fiscal Reform	Modern. of State	Anti-Corruption	Capacity Building	Environ./ Forestry/ Water	Irrigation/ Agric.	Health	Educa-tion	Social Protec-tion
Government	High Activity	Some Activity	High Activity	High Activity	Some Activity	High Activity	High Activity	Some Activity	Some Activity	Some Activity	Some Activity	Some Activity	Some Activity	Some Activity
Bilateral	Little or No Activity	Some Activity	Some Activity	Little or No Activity	High Activity	Some Activity	Some Activity	Little or No Activity	Some Activity	Some Activity	Some Activity	Some Activity	Some Activity	Some Activity
Multilateral other than World Bank	High Activity	Some Activity	Little or No Activity	High Activity	Some Activity	High Activity	Some Activity	Some Activity	Some Activity	Some Activity	Some Activity	Some Activity	Some Activity	Some Activity
World Bank Group	Some Activity	Some Activity	High Activity	High Activity	Some Activity	High Activity	High Activity	High Activity	Some Activity	High Activity	High Activity	Some Activity	Little or No Activity	High Activity
NGOs and Civil Society	Little or No Activity	Some Activity	Some Activity	Some Activity	Little or No Activity	Little or No Activity	Little or No Activity	Some Activity	Little or No Activity	Some Activity	Some Activity	Some Activity	Some Activity	Some Activity
Private Sector	Little or No Activity	High Activity	Little or No Activity	Some Activity	Some Activity	Little or No Activity	Little or No Activity	Little or No Activity	Little or No Activity	Little or No Activity	Little or No Activity	Some Activity	Some Activity	Little or No Activity

Note: High Activity; Some Activity; Little or No Activity

D. Partnerships

92. The Bank has a close working relationship with other donors in Kazakhstan. Table 5 shows the major areas of activity of the partners in Kazakhstan's development process, including the Government, the private sector and groups in civil society.

93. Four Consultative Group Meetings were held between 1992 and 1996. Since that time there has not been a formal consultation forum, as Government has not felt the need for such a meeting. Informal meetings and coordination among donors takes place in Kazakhstan. However, there is a need for the Government to be more pro-active in coordinating external assistance.

94. A central part of the Bank's strategy is to be selective in choosing the niches where its support is needed and where the Bank has a comparative advantage. The Bank will operate within areas consonant with each of the four objectives of the CAS. However, within these areas, it will both complement and supplement the activities of other foreign partners, including Japan, USAID, the IMF, ADB, EBRD, and other bilateral and multilateral partners. Within social services, for example, the Bank will concentrate on the health and social protection sectors, while the Asian Development Bank will focus on investments and reforms in education. The Bank's partnership with the IMF has major complementarities in the fiscal and banking sectors. While active in some parts of the transport sector, the Bank has not been in the railways sub-sector, where Japan (JBIC), ADB, EBRD and France are all involved. The EBRD has a major role in private sector development and infrastructure provision, and other major actors include the Islamic Banks and Funds, USAID, the UN System, ADB, the IMF and Japan. In public sector reform, the Bank's work is harmonized with major inputs from USAID, the EU and the UN. Finally in environment, the most active partners are the UN, the EU,

the UK, France and Japan, and the Bank is working with the Global Environmental Facility on a number of activities. The Bank will not invest in areas where the private sector is active (e.g., oil and gas). The Bank has played a limited role in the rest of the energy sector, and has not been involved in urban development.

95. Technical assistance for Kazakhstan is increasingly being provided on a grant basis by bilateral partners. Agencies such as EU/TACIS, UK Know-How Fund and USAID, which provide targeted technical assistance through grant financing, have joined with the Bank in supporting areas such as governance, fiscal reform (including decentralization), legal reform, and private sector development. The mantle of providing technical assistance, therefore, is increasingly moving to such bilateral aid agencies, and away from IBRD loans.

E. Project Implementation

96. Improved portfolio management will be essential to enable the attainment of the CAS goals. To date, portfolio performance has been disappointing. Implementation of investment projects has been slow. Disbursement ratios, during the period of the last CAS, FYs 1998-2000, have been from 8.5 to 10.6 percent per annum, well below the expected rate of 15 to 20 percent. Annex 7 presents a summary of the latest Country Portfolio and Performance Review (CPPR), which was held in Astana in July 2000.

97. While project specific issues affected individual projects, there were some overriding problems as well. Three recently held Country Portfolio Performance Reviews (CPPRs) found that Government officials felt that Bank procurement and disbursement procedures were cumbersome and poorly understood. However, the steady replacement of Government officials and reorganization of Government structures have contributed to this problem, resulting in the appointment of officials who are unfamiliar with Bank procedures to implement Bank-financed projects. A major transitional cost has been the elimination of project implementation units (PIUs) at the end of 1999, and the associated mainstreaming of project management responsibilities to the ministries. Although this move is a welcome increase in ownership and accountability structures for projects by the Government itself, there have been implementation delays caused by the relatively slow integration of project management responsibilities into the existing ministerial structures and associated staff changes. Previously, reorganizations of the Government and movement of the capital to Astana in 1998 also had an adverse effect on project implementation.

98. Implementation of projects also has been slowed by the Government's budgetary difficulties, which has reduced the allocation of counterpart funds. In addition, the Government feels that in some cases Government agencies were not ready to implement projects when they had been approved by the Bank's Board.

99. Delays in project effectiveness have continued during the last three years, with the average time from board approval to effectiveness being 171 days. This is a high figure, but still an improvement on the average of 197 days in the previous three years. In addition, requirements of financial management systems being in place have delayed effectiveness, given the serious lack of financial management skills within the country.

Improved project preparation, including increased Government participation and putting more conditions up front instead of at effectiveness should decrease these delays in the future.

100. The Government believes that the Bank has at times been slow in processing applications or giving no objections. In most instances Bank service standards have been met, but there have been occasional failures. To deal with this issue, the Bank has strengthened the capacity of the Country Office.

101. The Government and the Bank are determined to work together to improve project implementation. CPPRs will continue to be held annually, but in addition semi-annual "mini CPPRs" will be held to monitor implementation in between the annual CPPRs. The role of the Country Office will increase as staff posted there receive additional training. In addition, the Bank will work with the new Ministry of Economy to improve the monitoring of projects, especially the attainment of development objectives. Moreover, the Bank is taking concrete measures to address the problems identified above:

- The Bank has conducted seminars and other training for Government officials and also strengthened the Country Office to help with project processing, particularly with the capacity for pre-screening of withdrawal applications in the Country Office with a view to significantly reducing processing delays. Seminars on procurement, disbursements and financial management will be repeated as necessary in FY01 and beyond.

- A process has been in put place to review the financing requirements of projects for the coming fiscal year during the budget preparation process. Bank staff will work more closely with their Government counterparts to ensure timely availability of counterpart funds.

- Processing delays will be reduced in the future, and more responsibility has been given to Country Office staff who are most able to deal quickly and directly with Government officials.

F. Performance Indicators

102. The Bank has agreed with the Government on a set of country performance indicators which provide critical benchmarks towards achieving Kazakhstan's four-pillar development strategy outlined in this CAS (Table 6). The set of benchmarks are closely aligned with the set of Government, Bank and other donor initiatives planned over the CAS period, and will be developed and adapted in line with the major initiatives in each area.

103. Indicators to monitor progress in poverty alleviation will be taken from the Household Budget Survey, now being reformulated. A feasible target would be a reduction in the poverty rate by five percentage points over the next three years. Macroeconomic growth and stability would be measured by targets agreed with both the

Bank and the IMF. In the social sectors, targets would be agreed upon for primary and secondary education rates, child and mother mortality rates, and life expectancies for men and women. Governance improvements would be tracked by the regular Transparency International survey. Progress on environmental goals would be measured by access to clean water.

104. For its own portfolio, the Bank will continue the practice of annual CPPRs and semi-annual "mini-CPPRs", and will condition future disbursement to an adequate disbursement ratio, as shown in the triggers in Table 3 above. The Bank will also continue the process of regular consultations with other donors and members of civil society, and incorporate the feedback from these parties as well as the Government to update the strategy as the socio-economic milieu and outlook for Kazakhstan evolves over the CAS period.

Table 6: Performance Indicators

	Government benchmarks	Bank benchmarks
Poverty	Poverty head count ratio—reduce by 5%; One quarter of those in extreme poverty escape that level by 2003; Unemployment rate—reduce by one-fifth	Poverty Assessment completed; poverty monitoring system in place and results publicly disseminated.
Macro	Growth rate of 5% per annum and inflation rates averaging less than 10%	Improved macro-monitoring and data systems developed and data made available publicly.
Social Sectors	Primary and Secondary School enrollment rates—(gender disaggregated) return to 1990 levels by 2003 Maternal, peri-natal and Infant Mortality rates—reduced by one-quarter by 2003	TB infection rate monitoring and mortality rates; reduce latter by one-third by 2003.
Governance	TI and other annual surveys show annual improvement	Successful implementation of Governance and Service Delivery diagnostic recommendations
Environment	Environmental assessments carried out for all major projects Half of NEAP projects underway	Increase population with access to clean water by 2 percent.
Implementation	Agreed funds budgeted and spent; effectiveness times reduced to Bank average	M&E systems in place—development objectives met; disbursement targets met

VI. RISK AND CREDITWORTHINESS

105. The macroeconomic scenario underpinning the Bank's assistance strategy is predicated on: (i) sustained strong policy performance, laying the foundation for realizing the full potential of the country's resource base and for encouraging growth in the non-extractive sectors; and (ii) a relatively benign external environment. Slower than envisaged progress on policy reforms and/or unfavorable external shocks could therefore

result in less favorable macroeconomic outcomes and adversely affect Kazakhstan's creditworthiness.

106. There are a number of key risks in terms of policy performance. There is, for example, a risk that the government may slow the pace of fiscal adjustment and stabilization, including delaying fiscal consolidation, failing to clear budgetary arrears, and reversing the commitment to liberalization of trade and the exchange rate. Such a policy stance would increase vulnerability of the economy to external shocks. Similarly, on the structural side, slower progress on privatization and restructuring would imply lower growth, constrained access to needed foreign investment, and would add to government financing costs. Development of the non-extractive sectors is also important. Failure to stimulate growth in the non-extractive sectors and to limit Dutch disease would reduce the potential for broad-based economic development. In the extreme, the oil and gas sector could be reduced to an enclave industry, with adverse consequences for income distribution and poverty alleviation.

107. On the external side, Kazakhstan is highly vulnerable to adverse commodity price and volume shocks and this vulnerability is expected to increase over the medium term with the growing dependence on hydrocarbon exports. As borne out by recent experience, an adverse oil price shock directly impacts the government budget and balance of payments position, and can therefore lead to sharp increases in the country's financing needs. Kazakhstan's current foreign exchange reserves and debt profile also suggest limited capacity to withstand exogenous shocks. The current level of foreign exchange reserves (equivalent to 3.5 months of imports) provides only a limited liquidity cushion in the event of financing difficulties. The government has already built up a relatively high external debt burden (debt to GDP exceeds 30 percent) and a sustained improvement in the trade balance--which would, over the CAS period, mostly come from a growth in commodity exports--will be required to reduce the stock of external debt to a more manageable level.

108. Delays in completing oil export pipelines would slow progress towards debt sustainability and imply a heavier fiscal burden. Even if oil revenues increase as projected, a large external financing requirement will persist over the medium term owing to large amortization payments falling due and persistent capital flight. While Kazakhstan can meet its current financing requirement by attracting significant inflows of foreign direct investment and by borrowing from private and official sources, access to international capital markets in the future is not assured and could be constrained by global economic conditions or by a loss of confidence in prospects for the Kazakh economy.

James D. Wolfensohn
President

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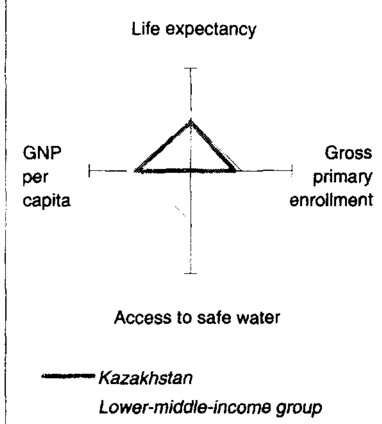
Kazakhstan at a glance

1/16/01

POVERTY and SOCIAL	Kazakhstan	Europe & Central Asia	Lower-middle-income
1999			
Population, mid-year *(millions)*	14.9	475	2,094
GNP per capita *(Atlas method, US$)*	1,300	2,150	1,200
GNP *(Atlas method, US$ billions)*	19.4	1,022	2,513
Average annual growth, 1993-99			
Population *(%)*	-1.7	0.1	1.1
Labor force *(%)*	-1.5	0.6	1.2
Most recent estimate (latest year available, 1993-99)			
Poverty *(% of population below national poverty line)*	35	..	..
Urban population *(% of total population)*	56	67	43
Life expectancy at birth *(years)*	65	69	69
Infant mortality *(per 1,000 live births)*	20	22	33
Child malnutrition *(% of children under 5)*	8	8	15
Access to improved water source *(% of population)*	..	..	86
Illiteracy *(% of population age 15+)*	1	3	16
Gross primary enrollment *(% of school-age population)*	98	100	114
Male	97	101	114
Female	98	99	116

Development diamond*

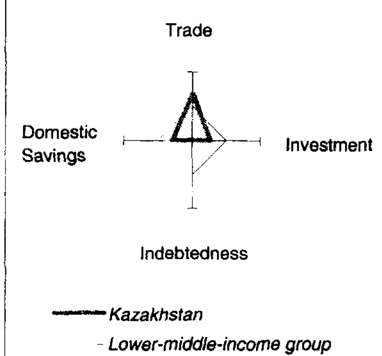


KEY ECONOMIC RATIOS and LONG-TERM TRENDS

	1979	1989	1998	1999
GDP *(US$ billions)*	..	..	22.1	16.9
Gross domestic investment/GDP	..	..	14.3	14.6
Exports of goods and services/GDP	..	..	30.3	42.5
Gross domestic savings/GDP	..	..	9.8	16.9
Gross national savings/GDP	..	..	8.8	14.7
Current account balance/GDP	..	..	-5.4	-1.0
Interest payments/GDP	..	..	1.1	1.8
Total debt/GDP	..	..	25.8	47.4
Total debt service/exports	..	..	13.0	18.9
Present value of debt/GDP	..	..	..	..
Present value of debt/exports	..	..	..	..

(average annual growth)	1979-89	1989-99	1998	1999	1999-03
GDP	..	-0.2	-1.9	2.7	4.9
GNP per capita	..	-1.5	-1.8	7.5	5.1
Exports of goods and services	..	5.8	10.1	12.7	8.7

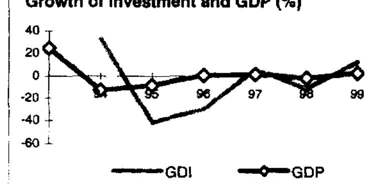
Economic ratios*



STRUCTURE of the ECONOMY

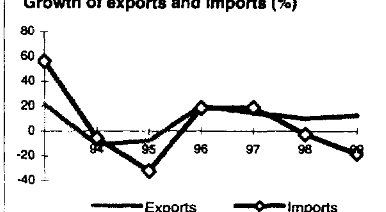
(% of GDP)	1979	1989	1998	1999
Agriculture	..	..	9.1	10.5
Industry	..	..	31.2	34.9
Manufacturing	..	..	..	..
Services	..	..	59.7	54.6
Private consumption	..	..	79.4	72.5
General government consumption	..	..	10.8	10.6
Imports of goods and services	..	..	34.9	40.1

Growth of investment and GDP (%)



(average annual growth)	1979-89	1989-99	1998	1999
Agriculture	..	-2.9	-18.9	21.6
Industry	..	-0.7	-0.1	3.6
Manufacturing	..	..	..	..
Services	..	0.5	-0.1	-1.0
Private consumption	..	-4.8	-7.0	-24.1
General government consumption	..	-4.9	-14.5	7.7
Gross domestic investment	..	-13.0	-11.4	12.6
Imports of goods and services	..	2.3	-2.6	-18.3
Gross national product	..	-2.9	-2.4	2.0

Growth of exports and imports (%)

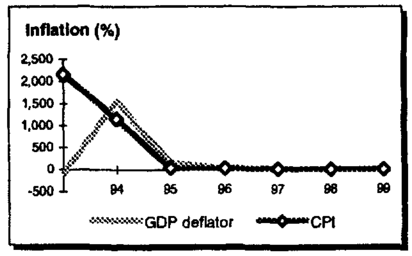


Note: 1999 data are preliminary estimates.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

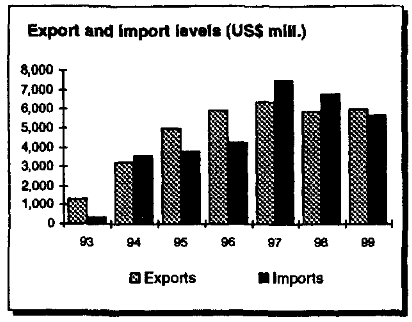
PRICES and GOVERNMENT FINANCE

	1979	1989	1998	1999
Domestic prices				
(% change)				
Consumer prices	..	..	7.1	8.3
Implicit GDP deflator	..	..	5.7	13.3
Government finance				
(% of GDP, includes current grants)				
Current revenue	..	..	18.0	17.8
Current budget balance	..	..	-5.1	-2.5
Overall surplus/deficit	..	..	-7.6	-5.2



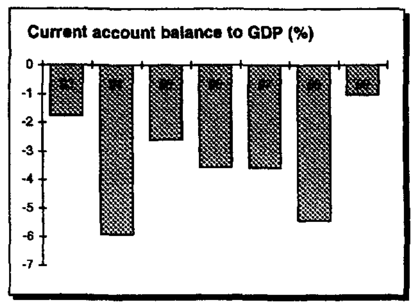
TRADE

	1979	1989	1998	1999
(US$ millions)				
Total exports (fob)	..	..	5,839	5,989
Commodity 1	..	..	2,068	2,288
Commodity 2	..	..	771	886
Manufactures	..	..	1,356	1,377
Total imports (cif)	..	..	6,780	5,645
Food	..	..	617	893
Fuel and energy	..	..	618	341
Capital goods	..	..	1,124	1,276
Export price index *(1995=100)*	..	..	100	0
Import price index *(1995=100)*	..	..	118	0
Terms of trade *(1995=100)*	..	..	85	106



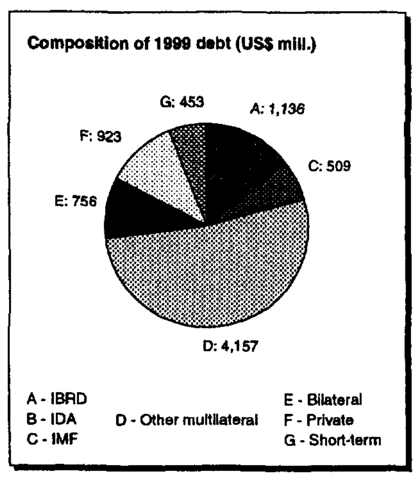
BALANCE of PAYMENTS

	1979	1989	1998	1999
(US$ millions)				
Exports of goods and services	..	..	6,735	6,921
Imports of goods and services	..	..	7,716	6,749
Resource balance	..	..	-981	172
Net income	..	..	-298	-500
Net current transfers	..	..	78	157
Current account balance	..	..	-1,201	-171
Financing items (net)	..	..	778	247
Changes in net reserves	..	..	423	-76
Memo:				
Reserves including gold *(US$ millions)*	..	..	1,901	2,003
Conversion rate *(DEC, local/US$)*	..	2.10E-3	78.3	119.5



EXTERNAL DEBT and RESOURCE FLOWS

	1979	1989	1998	1999
(US$ millions)				
Total debt outstanding and disbursed	..	..	5,715	7,934
IBRD	..	..	899	1,136
IDA	..	..	0	0
Total debt service	..	..	884	1,326
IBRD	..	..	44	95
IDA	..	..	0	0
Composition of net resource flows				
Official grants	..	..	..	..
Official creditors	..	..	339	226
Private creditors	..	..	925	-573
Foreign direct investment	..	..	..	..
Portfolio equity	..	..	..	..
World Bank program				
Commitments	..	..	315	0
Disbursements	..	..	211	256
Principal repayments	..	..	0	20
Net flows	..	..	211	236
Interest payments	..	..	44	75
Net transfers	..	..	167	161



ANNEX 2: KEY ECONOMIC INDICATORS

Indicator	Actual				Estimate	Projected		
	1996	1997	1998	1999	2000	2001	2002	2003
National accounts (as % of GDP)								
Gross domestic product[a]	100	100	100	100	100	100	100	100
Agriculture	13	12	9	10	9	8	8	8
Industry	27	27	31	33	35	37	39	38
Services	60	61	60	52	56	55	53	53
Total Consumption	87	87	87	84	72	74	77	77
Gross domestic fixed investment	17	16	17	15	15	15	16	16
Government investment	..	..	..	2	2	2	2	2
Private investment (includes increase in stocks)	..	..	..	13	14	14	14	14
Exports (GNFS)[b]	33	35	31	41	59	57	56	54
Imports (GNFS)	36	37	35	40	45	46	48	47
Gross domestic savings	13	13	13	16	29	25	23	23
Gross national savings[c]	13	12	12	14	22	18	16	15
Memorandum items								
Gross domestic product (US$ million at current prices)	21035	22166	21979	16870	17423	18062	19366	20644
GNP per capita (US$, Atlas method)	1270	1340	1320	1260	1250	1160	1210	1280
Real annual growth rates (%, calculated from 1993 prices)								
Gross domestic product at market prices		1.7	-1.9	2.7	8.0	4.0	4.5	4.0
Gross Domestic Income	-1.3	3.2	-11.9	3.3	16.7	2.9	2.3	4.0
Real annual per capita growth rates (%, calculated from 1993 prices)								
Gross domestic product at market prices		2.5	-1.3	7.2	8.4	4.2	4.5	4.0
Total consumption	7.8	3.6	-10.5	-9.3	9.4	5.5	3.7	3.6
Private consumption	10.6	4.5	-10.4	-14.8	7.1	4.0	3.7	3.4
Balance of Payments (US$ millions)								
Exports (GNFS)[b]	6966	7741	6735	6921	10225	10249	10751	11137
Merchandise FOB	6292	6899	5839	5989	9265	9246	9619	9953
Imports (GNFS)[b]	7546	8300	7716	6749	7906	8394	9250	9697
Merchandise FOB	6618	7176	6589	5645	6698	7129	7599	7923
Resource balance	-580	-559	-981	172	2319	1856	1502	1440
Net current transfers	50	75	78	105	140	140	140	135
Current account balance	-750	-794	-1201	-171	1082	490	9	-91
Net private foreign direct investment		1320	1149	1583	1400	1300	1500	1500
Long-term loans (net)	335	713	632	114	182	-158	88	136
Official	334	434	339	234	218	241	283	72
Private	1	279	293	-53	175	165	-394	-587
Other capital (net, incl. errors & ommissions)		-749	-1004	-416	-1190	-1197	-1104	-787
Change in reserves[d]	-54	-490	423	-76	-1083	-185	-133	-157
Memorandum items								
Resource balance (% of GDP)	-2.8	-2.5	-4.5	1.1	13.3	10.3	7.8	7.0
Real annual growth rates (YR93 prices)								
Merchandise exports (FOB)	..	..	..	..	..	..	..	..
Primary	..	..	..	..	..	..	..	..
Manufactures	..	..	..	..	..	..	..	..
Merchandise imports (CIF)	..	..	..	..	..	..	..	..

Kazakhstan - Key Economic Indicators

(Continued)

Indicator	Actual 1996	1997	1998	1999	Estimate 2000	2001	Projected 2002	2003
Public finance (as % of GDP at market prices)[e]								
Current revenues	13.2	13.2	18.2	17.8	24.7	21.9	22.6	21.4
Current expenditures	..	18.4	23.3	20.3	21.3	22.0	21.8	21.6
Current account surplus (+) or deficit (-)	..	-5.2	-5.1	-2.5	3.5	-0.2	0.8	-0.2
Capital expenditure	..	2.1	2.8	2.4	3.3	3.1	3.0	2.7
Foreign financing	2.6	2.7	2.8	2.4	2.7	0.7	-1.0	0.2
Monetary indicators								
M2/GDP	9.5	10.2	8.6	13.5	14.4	15.1	15.3	15.1
Growth of M2 (%)	13.8	27.6	-13.1	83.4	30.5	16.5	11.3	7.9
Private sector credit growth / total credit growth (%)	..	..	..	..	78.8	75.5	76.3	74.0
Price indices(YR93 =100)								
Merchandise export price index	..	..	..	..	.	..	..	..
Merchandise import price index	..	..	..	..	.	..	..	..
Merchandise terms of trade index	..	..	..	..	..	..	..	..
Real exchange rate (US$/LCU)[f]	142.3	162.4	175.5	250.4	261.2	266.7	274.9	282.3
Real interest rates								
Consumer price index (% change)	39.3	17.4	7.1	8.3	9.0	6.5	5.5	5.0
GDP deflator (% change)	38.9	16.1	4.9	13.3	13.7	6.5	5.5	5.0

a. GDP at factor cost.
b. "GNFS" denotes "goods and nonfactor services."
c. Includes net unrequited transfers excluding official capital grants.
d. Includes use of IMF resources.
e. Consolidated central government.
f. "LCU" denotes "local currency units." An increase in US$/LCU denotes appreciation.

Annex 3: Social Indicators

	Latest single year			Same region/income group	
	1970-75	1980-85	1993-98	Europe & Central Asia	Lower-middle-income
POPULATION					
Total population, mid-year (millions)	14.1	15.6	15.6	474.7	886.5
Growth rate (% annual average)	1.5	1.0	-0.9	0.1	0.9
Urban population (% of population)	52.2	55.9	56.4	66.2	57.7
Total fertility rate (births per woman)	3.3	3.1	2.0	1.6	2.5
POVERTY					
(% of population)					
National headcount index	..	..	34.6	..	..
Urban headcount index	..	..	30.0	..	..
Rural headcount index	..	..	39.0	..	..
INCOME					
GNP per capita (US$)	..	..	1,340	2,200	1,740
Consumer price index (1995=100)	..	..	175	155	131
Food price index (1995=100)	..	..	150	..	..
INCOME/CONSUMPTION DISTRIBUTION					
Gini index	..	..	35.4	..	..
Lowest quintile (% of income or consumption)	..	..	6.7	..	..
Highest quintile (% of income or consumption)	..	..	42.3	..	..
SOCIAL INDICATORS					
Public expenditure					
Health (% of GDP)	..	..	2.1	4.0	3.0
Education (% of GNP)	..	..	4.4	5.1	4.9
Social security and welfare (% of GDP)	..	..	..	8.8	..
Net primary school enrollment rate					
(% of age group)					
Total	..	..	..	100	94
Male	..	..	..	100	95
Female	..	..	..	99	93
Access to safe water					
(% of population)					
Total	..	..	..	..	..
Urban	..	..	..	..	..
Rural	..	..	..	..	..
Immunization rate					
(% under 12 months)					
Measles	..	..	97	91	89
DPT	..	..	96	89	89
Child malnutrition (% under 5 years)	..	..	8	..	..
Life expectancy at birth					
(years)					
Total	..	69	65	69	68
Male	..	64	59	65	65
Female	..	73	70	74	72
Mortality					
Infant (per thousand live births)	..	30	22	22	35
Under 5 (per thousand live births)	..	..	29	26	44
Adult (15-59)					
Male (per 1,000 population)	318	312	382	283	244
Female (per 1,000 population)	149	140	167	120	137
Maternal (per 100,000 live births)	..	..	70	..	..

2000 World Development Indicators CD-ROM, World Bank

Annex 4: Bank Group Portfolio

IBRD: Ongoing and Recently Closed Projects

Projects	Fiscal Year Approved	Total Amount US$ (M)	Disbursed as of Dec. 31, 2000 US$ (M)
Technical Assistance Loan	1994	38.0	37.1
Petroleum Technical Assistance Loan	1994	15.7	13.4
Finance & Enterprise Development Loan (FEDL)*	1995	62.0	12.5
Social Protection Loan*	1995	41.1	19.9
Irrigation & Drainage Loan	1996	80.0	29.0
Uzen Oil Field Rehabilitation Loan*	1997	109.0	22.2
Treasury Modernization Loan	1997	15.8	8.6
Pilot Water Supply Loan	1997	7.0	6.5
Real Estate Registration Pilot Loan	1997	10.0	5.7
Public Sector Resource Management Adjustment Loan (PSRMAL)	1998	230.0	230.0
Agriculture Post Privatization Loan (APPAP)	1998	15.0	4.1
Pension Reform Adjustment Loan (PRAL)	1998	300.0	200.0
Road Transport Restructuring Loan	1999	100.0	10.9
Health Restructuring Loan	1999	42.5	2.2
Legal Reform Loan	1999	16.5	0.9
Atyrau Pilot Water Supply Loan	1999	16.5	1.9
Electricity Transmission Rehabilitation Loan	2000	140.0	1.9

* These loans have been restructured recently

IFC and MIGA Programs, FY97-00

	1997 *US$ (M)*	*1998* *US$ (M)*	*1999* *US$ (M)*	*2000* *US$ (M)*	*Total* *US$ (M)*
IFC approvals	**9.1**	**30.7**	**49.6**	**19.5**	**108.9**
Sector:					
Mining & Extraction of Metals & Other Ores	-	30.7	-	-	30.7
Cement & Construction Materials	-	-	1.1	-	1.1
Financial Services	9.1	-	17.5	15.0-	41.6
Industrial and Commercial Services	-	-	11.0	4.5	15.5
Infrastructure	-	-	20.0	-	20.0
MIGA guarantees	-	-	**14.3**	-	**14.3**

Annex 5: Status of Bank Group Operations

As of January 9, 2001

Closed Projects: 7

Board Date Fiscal Year		Active Projects	Last PSR Supervision Rating: Development Objectives	Last PSR Supervision Rating: Implementation Progress	Original Amount in US$ Millions: IBRD	IDA	Cancel.	Undisb.	Difference Between Expected and Actual Disbursements [a/]: Orig.	Frm Rev'd
1995	P008508	FINANCE & ENT. DEVEL	S	S	62	0	0	49.5	49.5	31.4
1995	P008506	SOCIAL PROTECTION	U	U	41.1	0	14.2	6.9	17.1	0
1996	P008510	IRRIG. & DRAINAGE	S	S	80	0	0	51.0	21.8	0
1997	P045303	PILOT WATER SUPPLY	S	S	7	0	0	0.5	0.5	0
1997	P037960	TREASURY MODERNIZATION	S	S	15.8	0	0	7.2	7.2	0.2
1997	P008507	UZEN OIL FIELD REHAB	S	S	109	0	0	86.8	64.8	3.1
1998	P008503	AG POST PRIVATIZATION ASST.	S	S	15	0	0	10.9	5.5	0
1998	P050780	PENSION REF SAL	S	S	300	0	0	100	100	0
1999	P008500	ATYRAU PILOT WATER	S	S	16.5	0	0	14.6	4.9	0
1999	P046499	HEALTH RESTRUCTURING	U	U	42.5	0	0	40.3	9.7	0
1999	P046046	LEGAL REFORM	S	U	16.5	0	0	15.6	4.8	0
1999	P008499	ROAD TRANSPORT RESTRUCT.	S	S	100	0	0	89.1	22.1	0
2000	P065414	ELEC. TRANSMISSION REHAB.	S	S	140	0	0	138.1	3.1	0

a/ Intended disbursements to date minus actual disbursements to date as projected at appraisal.

Kazakhstan
Statement of IFC's
Held and Disbursed Portfolio
As of June 30, 2000
(In US Dollars Millions)

		IFC Held				IFC Disbursed			
FY Approval	**Company**	**Loan**	**Equity**	**Quasi**	**Partic**	**Loan**	**Equity**	**Quasi**	**Partic**
1994/95/98/00	ABN AMRO Kazak	0.00	4.57	0.00	0.00	0.00	4.57	0.00	0.00
1999	Alautrangas	20.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
1998	Ispat Karmet	29.60	0.00	0.00	0.00	29.60	0.00	0.00	0.00
1994/96	Kazgermunai	0.00	0.68	35.30	0.00	0.00	0.38	17.25	0.00
1997/98/99	Kazkommertsbank	9.7	1.00	0.00	0.00	9.7	1.00	0.00	0.00
1999	Rambutya LLP	11.00	0.00	0.00	0.00	11.00	0.00	0.00	0.00
1999	SEF Const. Mat	0.88	0.25	0.00	0.00	0.68	0.00	0.00	0.00
1999	TuranAlem	15.00	0.00	0.00	0.00	15.00	0.00	0.00	0.00
2000	SEF LP-GAZ	2.00	0.00	0.00	0.00	2.00	0.00	0.00	0.00
	Total Portfolio:	**86.18**	**6.50**	**35.30**	**0.00**	**65.98**	**5.95**	**17.25**	**0.00**

Approvals Pending Commitment

FY Approval	Project Name	Loan	Equity	Quasi	Partic
2000	ABN Amro Standby	15.00	0.00	0.00	0.00
2000	Agrokaz	3.50	0.00	0.00	0.00
2000	FIOC	0.00	0.01	0.00	0.00
2000	Sazankurak	15.00	0.00	5.00	0.00
2000	SEF-Helios	2.50	0.00	0.00	0.00
	Total Pending Commitment:	**36.00**	**0.01**	**5.00**	**0.00**

Annex 6: Indicators of Bank Portfolio Performance and Management

Indicator	1997	1998	1999	2000
Portfolio Assessment				
Number of Projects Under Implementation [a]	11	13	16	15
Average Implementation Period (years) [b]	1.8	2.3	2.4	3.0
Percent of Problem Projects by Number [a, c]	9.1	23.1	12.5	6.7
Percent of Problem Projects by Amount [a, c]	10.4	19.4	13.7	4.1
Percent of Projects at Risk by Number [a, d]	9.1	23.1	12.5	13.3
Percent of Projects at Risk by Amount [a, d]	10.4	19.4	13.7	14.2
Disbursement Ratio (%) [e]	18.1	9.4	10.6	8.0
Portfolio Management				
CPPR during the year (yes/no)	No	Yes	Yes	No
Supervision Resources (total US$)	820.5	857.0	1067.9	1735.0
Average Supervision (US$/project)	74.6	65.9	66.7	115.7

Memorandum Item	Since FY 80	Last Five FYs
Proj Eval by OED by Number	6	6
Proj Eval by OED by Amt (US$ millions)	822.36	822.36
% of OED Projects Rated U or HU by Number	0	0
% of OED Projects Rated U or HU by Amt	0	0

a. As shown in the Annual Report on Portfolio Performance (except for current FY).
b. Average age of projects in the Bank's country portfolio.
c. Percent of projects rated U or HU on development objectives (DO) and/or implementation progress (IP).
d. As defined under the Portfolio Improvement Program.
e. Ratio of disbursements during the year to the undisbursed balance of the Bank's portfolio at the beginning of the year: Investment projects only.

Annex 7: Country Portfolio Performance Review 2000

Government of Kazakhstan and the World Bank
Fourth Country Portfolio Performance Review
July 4-5, 2000

The Fourth Country Portfolio Performance Review (CPPR) for Kazakhstan was held in Astana on July 4 and 5 of 2000. The meeting was co-chaired by Mr. E. Utembayev, Deputy Prime Minister of the Republic of Kazakhstan and Mr. Kiyoshi Kodera, Director of the Central Asia Country Department of the World Bank.

It was stressed that improving project implementation was a major goal of the Government. The current budget situation required that projects were effective or they be closed. The Government plans to finalize the revision of the current portfolio by the end of July and will officially inform the Bank on the proposed changes in the program. It was agreed that the last year had been disappointing and frustrating with project implementation poor with low disbursements and therefore limited development impact. It is likely that the portfolio is starting to stabilize at a level of about 15 projects, a challenging, but manageable number. The need to go beyond disbursements and do more work on developing effective Monitoring and Evaluation systems to track development indicators was stressed,

Figures for the low disbursement rates were given. It was stated that now factors such as changes in Government personnel, organization and procedures have been overcome and disbursements should pick up as the increase in the fourth quarter seemed to portend. It was pointed out that there had not been enough follow up on last year's review of budget cycle and project allocations. Bank staff should be more proactive in working with Government on realistic budget allocations. There has been an improvement in the number of problem projects, but some projects now rated "Satisfactory" are in danger of falling into the "Unsatisfactory" category unless corrective actions were taken.

The change in project implementation arrangements was very detrimental to 3rd quarter results, but things were seen to be picking up. The Bank fully supports the rationale for these changes and there was general agreement that the system had led to better Government controls, more ownership and improved implementation. To help the new implementation groups, Ministry of Finance has approved by the Minister's Orders the Standard form of contract, roster and salary scale for consultants as well as Instruction for opening the special account. At the moment these documents are pending registration by Ministry of Justice and will become effective right after that. The Bank has asked the Government to send the Standard form of contract for Bank's "no objection" to simplify clearance of the individual contracts in the future.

The rules on special accounts were discussed and it was explained that their placement was agreed during loan negotiations. The use of commercial banks was found to be the most efficient way to get funds disbursed, but Government could request other arrangements during negotiations. The Department of State Borrowing, which has taken over from the previous Committee on External Loans explained its organization and role. Similarly, the organization and roles of the

Ministry of Economy were explained. In addition to medium term planning and budgeting, (including the development of the Public Investment Program) the ministry had an important role in project monitoring and evaluation. This meant the development and tracking of better indicators than were now available. The PIP should include all loans, grants and Government guarantees. Projects could be initiated by sector ministries, local governments, corporations and others. In the end the MOE would be sure that a consistent program that fit within the macro-framework was developed. It was agreed that it was important for all visiting Bank missions to keep the Ministries of Economy and Finance involved in their work.

There was agreement that there was insufficient dialogue between the Ministries of Finance and Economy and the sector ministries and agencies on budget allocations. The Ministry of Finance stressed that this year they were sending many more questions and clarifications to the sector ministries and the tight budget ceiling will require some projects to be restructured and cut. The Government agreed to investigate making changes in procedures which would allow re-allocation of the loan funds from one project to another at least within one sector.

Bank courses on procurement and disbursement were welcomed and regular presentations, both by local staff and by HQ staff were agreed to on a regular and more frequent basis, especially by Country Office staff. The Bank explained the rationale and some examples of Bank rules and procedures on procurement. It was pointed out that a recent study showed that ICB saved on average 20% for borrowers. It was recognized by the meeting the Government's concern about using more local firms and contractors, but this can be done without changing Bank rules. Project design and TORs for consultants often excluded local participation. Qualifications should be the criteria, not foreign or local registration.

In order to speed up the disbursement process and reduce the number of withdrawal applications that are rejected, the role of the Country Office has been increased and they will help by pre-screening applications and conducting periodic workshops. Increased use of e-mail and other electronic means should help to accelerate processes and improved use of special accounts would be encouraged.

A review of developments in financial management since the last meeting showed that only limited progress has been made. Both the Bank and the Government need to improve the overall financial management situation and implement some of the more important activities identified at last year's CPPR. A practical seminar involving accountancy staff will be carried out and increased use of local auditing companies will be investigated.

A detailed review of each of the projects in the portfolio was carried out and a detailed Action Plan was drawn up.

In summing up, the Government expressed a better understanding of each of the projects in the portfolio. This would help as the country moved to a three year rolling budget. A whole range of procedures would be reviewed to improve the budgeting and implementation process. More involvement of the Ministries of Economy and Finance would take place as projects were developed. The overall portfolio must fit within the ever changing budget limits and Government priorities.

The Bank expressed its view that the negative impact of recent changes was now behind us and improved implementation could be expected. The number of problem projects was dropping and should be kept down. It was agreed that the Government and the Bank will work jointly on restructuring or canceling projects if this is needed. The Bank will work with the Government to increase the use of local consultants and contractors, but ICB was in the best interest of the borrower. It was agreed that a mini-CPPR would be done in six months and another full CPPR would be held next year.

Annex 8: Macroeconomic Simulations 2001-2003

1. A macroeconomic consistency model (RMSM-X) was used to simulate the effects of different oil price and policy reform scenarios:

- In the **Base Lending Case** (B), it is assumed that the Government continues to move forward on its policy reform agenda at a moderate pace. Oil prices remain relatively high, based on World Bank price forecasts. In this scenario, there is little financing need for adjustment lending in outer years. Bank operations include investment and T.A. loans but only one adjustment loan (the SPRAL in 2001).

- The **High Lending Case** (C) assumes that world oil prices fall gradually from current high levels to a historic average, resulting in larger fiscal deficits. The reform agenda is pursued more aggressively, and is supported by adjustment lending over the entire CAS period.

- The **Low Lending Case** (A) assumes high oil prices and that policy reforms are delayed or insignificant. In this case, there is no adjustment lending from the Bank. In addition, the number and volume of investment loans are smaller than in the Base Case.

2. The assumptions made in the three scenarios are shown in Table A8.1, and the simulation results in Table A8.2. In all three scenarios, it is assumed that the CPC pipeline becomes operational as scheduled (mid-2001), non-tax oil revenues (royalties and bonuses) are captured in the fiscal accounts, and domestic consumption of oil is driven by economic growth. In addition, it is assumed that the National Fund accumulates part of each year's oil revenues to reach 10 percent of annual oil exports by 2004. As modeled in the simulations, the National Fund as included in the model plays the role of a price stabilization fund only, and does not include further savings for future generations or revenues (and associated fiscal expenditures) for development projects.

3. The Base Case assumes a moderate pace of policy and institutional reforms: compared to the High Case, privatization is slower, moderate improvements in the business environment lead to smaller increases in private investment and non-oil exports, and tax revenue increases are less significant. Oil exports increase somewhat, but less than in the Low Lending Case, and the current account moves into deficit in 2002. The fiscal balance is in surplus until 2003. The Bank's lending program includes one adjustment loan (the SPRAL in 2001) with the remainder in investment and technical assistance.

4. In the High Lending Case, privatization moves more quickly, resulting in greater fiscal receipts; improvements in the business environment lead to an increase in private investment and non-oil exports; improved tax collection raises tax revenues; budget discipline leads to a reduction in current government expenditure, but this is balanced by an increase in current expenditure on social protection programs; and there is an increase in capital expenditure for priority public investments. However, under the assumption

that oil prices return to a historical average (i.e., from $28 per barrel in 2000 to $18 per barrel in 2003), the fiscal take from oil rises by only about $200 million between 2000 and 2003. There is a fiscal deficit in years 2001 and 2003. Oil exports actually decline between 2000 and 2003, and the current account moves into a deficit between 0.4 and 1.4 percent of GDP. External financing is assumed to include three adjustment loans from the Bank.

5. In the Low Lending Case, it is assumed that policy and institutional reforms stagnate. The business environment remains unfavorable, with the result that both domestic and foreign private investment do not increase as a share of GDP, and non-oil exports grow at a relatively low rate of 2 percent per year in U.S. dollar terms. Progress on privatizing the remaining state-owned shares in blue-chip companies (valued at approximately 5 percent of GDP) continues but at a slow pace, and tax collection fails to improve. Higher rates of GDP growth are driven by the assumption of continued strength in oil prices and increased dominance of the oil sector in the economy. High oil prices also result in a current account surplus throughout the period, as well as a fiscal surplus until 2003.

6. The simulation results are particularly sensitive to oil price assumptions, which are an important determinant of both export and fiscal revenues. Table A8.3 shows the impact of the three sets of oil price assumptions on fiscal revenues. A continuation of current high oil prices results in a fiscal take between $1.3 and $1.7 billion per year. Compared to the high-price scenario, moderate oil prices lower oil-related fiscal revenues by $266 million to $566 million per year during 2001-03, and low oil prices cost the fiscal budget $658 million in 2001, falling to $606 million in 2003.

Table A8.1: Simulation Model Assumptions			
Low Lending Case (A)	**Base Lending Case (B)**	**High Lending Case (C)**	**Assumption Variables Affected**
Overall Description:			
High oil prices, delayed policy reform, lack of transparency	Moderate oil prices, moderate policy reform, transparency	Low oil prices, faster policy reform, transparency	
Oil Sector Assumptions:			
• Oil prices remain high and stable in 2001-03	• Oil prices remain relatively high	• Oil prices gradually drop to levels consistent with historical averages	• Oil prices
• Higher oil revenues allow a significant increase in public investment	• Higher oil revenues allow a moderate increase in public investment	• Due to lower oil revenues, public investment remains at current levels	• Capital expenditure/GDP
Policy Assumptions:			
• Slow progress on privatization	• Faster progress on privatization	• Faster progress on privatization	• Privatization receipts/GDP
• Continuation of unfavorable business environment	• Moderate improvement in business environment	• Significant improvement in business environment	• Private investment/GDP • Non-oil export growth
• No reforms in public sector management	• Improved fiscal discipline • Greater investment in public goods • Moderate improvements in tax collection	• Improved fiscal discipline • Greater investment in public goods • Significant improvements in tax collection	• Current expenditure/GDP • Capital expenditure/GDP • Tax revenue/GDP
Growth Assumptions:			
• Higher rates of economic growth driven by oil sector	• Moderate increase in growth rates driven by oil sector	• Slower economic growth due to lower oil prices	• GDP growth
Financing Assumptions:			
• No adjustment lending • Reduced investment lending	• Adjustment lending in 2001 only • Full investment lending program	• Adjustment lending in 2001-03 • Full investment lending program	• External borrowing • Interest on external debt

Table A8.2: Simulation Results

	1999	2000	2001	2002	2003
Oil Prices (US$ brl) [a]					
Low lending case (A)	18.1	28.0	28.0	25.0	24.6
Base lending case (B)	18.1	28.0	25.0	21.0	21.0
High lending case (C)	18.1	28.0	22.0	20.0	18.0
GDP Growth [a]					
Low lending case (A)	2.7	8.0	6.5	5.5	5.0
Base lending case (B)	2.7	8.0	4.0	4.5	4.0
High lending case (C)	2.7	8.0	3.5	4.0	3.5
Inflation [a]					
Low lending case (A)	8.4	9.0	6.5	5.5	5.0
Base lending case (B)	8.4	9.0	6.5	5.5	5.0
High lending case (C)	8.4	9.0	6.5	5.5	5.0
Per Capita Income					
Low lending case (A)	1,133	1,170	1,247	1,352	1,455
Base lending case (B)	1,133	1,170	1,217	1,308	1,394
High lending case (C)	1,133	1,170	1,212	1,295	1,374
Current Acct./GDP					
Low lending case (A)	-1.0	6.2	4.9	3.7	3.4
Base lending case (B)	-1.0	6.2	2.7	0.2	-0.4
High lending case (C)	-1.0	6.2	-1.8	-0.2	-2.7
Oil Exports (US$m)					
Low lending case (A)	2,318	5,020	5,382	6,114	6,222
Base lending case (B)	2,318	5,020	4,806	5,136	5,311
High lending case (C)	2,318	5,020	4,229	4,891	4,552
Fiscal Balance/GDP [b]					
Low lending case (A)	-3.5	3.5	-0.4	0.1	-1.1
Base lending case (B)	-3.5	3.5	-2.0	-0.9	-1.7
High lending case (C)	-3.5	3.5	-3.4	-1.4	-3.6
External Debt/GDP					
Low lending case (A)	47.4	43.8	40.7	35.5	32.7
Base lending case (B)	47.4	43.8	41.6	39.2	36.6
High lending case (C)	47.4	43.8	43.8	42.1	42.5

a: Assumed values.
b: Includes privatization receipts.

Table A8.3: Fiscal Impact of Oil Price Assumptions (US$ million)				
	2000	**2001**	**2002**	**2003**
High oil prices (A)				
Oil price (US$ barrel)	28.0	28.0	25.0	24.6
Oil-related fiscal revenues	1,288.6	1,356.4	1,682.7	1,315.8
Tax	713.5	904.3	928.7	1,045.4
Non-tax [a]	575.1	427.7	637.3	401.8
Moderate oil prices (B)				
Oil price (US$ barrel)	28.0	25.0	21.0	21.0
Oil-related fiscal revenues	1,288.6	1,062.0	1,125.8	1,048.8
Tax	713.5	704.3	586.3	733.3
Non-tax [a]	575.1	357.7	539.4	315.5
Low oil prices (C)				
Oil price (US$ barrel)	28.0	21.0	20.0	18.0
Oil-related fiscal revenues	1,288.6	697.9	1,014.8	709.2
Tax	713.5	433.7	499.8	465.6
Non-tax [a]	575.1	264.9	515.0	243.6
Difference in fiscal revenues (A-B)	0.0	294.4	556.9	266.9
Difference in fiscal revenues (A-C)	0.0	658.5	667.9	606.6

[a] Non-tax oil revenues include royalties and bonus payments.

Annex 9: Proposed IBRD Lending program, FY 2001-2003

Proposed IBRD Lending Program, FY01-03 (US$ million)			
	High Case	**Base Case**	**Low Case**
FY01			
Social Protection Reform Adjustment Loan (SPRAL)	200	200	--
Syr Daria and Northern Aral Sea	78	78	78
Subtotal	**278**	**278**	**78**
FY02			
Northeast Vodokanal Water Supply	80	80	80
Second Public Sector Resource Management Adjustment Loan (PSRMAL II)	150	--	--
Second Technical Assistance Loan (TAL II)	10	10	10
Nura River Cleanup	42	42	42
Real Estate Rollout	16	16	16
Subtotal	**298**	**148**	**148**
FY03			
Agricultural Services	40	40	--
Second Agricultural Post-Privatization (APPAP II)	35	35	--
Consolidation Structural Adjustment Loan (CSAL)	100	--	--
Financial Infrastructure	15	15	15
Rural Roads	50	50	30
Subtotal	**240**	**140**	**45**
Total FY01-03	**816**	**566**	**271**

Annex 10: Non-Lending Services

Product	Completion FY	Cost[a] *(US$ 000)*	Audience[b]	Objective[c]
Recent Completions				
Rapid Response Policy Notes	1998-00	252	G,B	PS
Private Sector Assessment	1998	146	B,G,D	KG
Living Standards Study	1998	161	G,D,B,P	KG,PD
Farm Restructuring Study	1999	125	G,B,D	KG,PS
National Environmental Action Plan	1999	520	G,B,D,P	KG,PS,PD
Public Expenditure Review	2000	448	G,B,D,P	KG,PS
Procurement (IDF)	2000	75	G,B,	KG,PS
Financial Sector Study (FSAP)	2000	350	G,B,D	KG,PS
Underway				
Growth Strategy Study	2001	366.4	G,B,D	KG,PS,PD
Wheat Seed Industry (IDF)	2002	47.6	G,B	KG,PS
Mining Sector Study	2001	250	G,B,D	KG
Planned				
Policy Notes	Upon Request	375	G	PS
WBI courses	Upon Request	n/a	G	PS,KG
Governance Survey	2001	159	G,B	KG,PS
Note on Revenue Reform	2001	32	G,B,D	KG,PS
Silk Road (IDF)	2001	25	G	PS
Gender and Violence (IDF)	2001	25	G	KG,PS
Financial Accountability Assessment	2002	150	G,B,D,P	KG,PS,PD
Poverty Assessment/Labor Market	2002	200	G,P,B,D	KG,PS,PD
Water Sector Strategy Study	2002	200	G,B,D	KG,PS
Livestock Study	2003	150	G,B,D	KG,PS
Country Economic Memorandum	2003	250	G,B,D,P	KG,PS,PD

Notes:

a. Figures for first seven items are direct costs, all others are full costs
b. G=Government; B=Bank; D=Donors; P=Public Dissemination
c. KG=Knowledge Generation; PD=Public Debate; PS=Problem Solving

Annex 11: Exposure Indicators

	1996	1997	1998	1999	2000	[illegible]	[illegible]	[illegible]	[illegible]
Total debt outstanding and disbursed (TDO) (US$m)[a]	2922	4078	5715	7934	7662	7662	7231	7169	7513
Net disbursements (US$m)[a]	730	1214	1379	238	-386	0	-431	-63	343
Total debt service (TDS) (US$m)[a]	322	483	885	1376	1618	1076	1291	846	1282
Debt and debt service indicators (%)									
TDO/XGS[b]	41.6	52.1	83.7	112.6	80.2	78.4	74.1	69.8	71.7
TDO/GDP	13.9	18.4	26.0	50.8	48.4	45.9	41.2	39.3	39.6
TDS/XGS	4.6	6.2	13.0	19.5	16.9	11.0	13.2	8.2	12.2
Concessional/TDO	..	..	..	4.9	6.4	7.8	9.0	9.5	9.0
IBRD exposure indicators (%)									
IBRD DS/public DS	9.1	9.9	8.5	8.5	9.8	23.1	18.6	43.1	23.9
Preferred creditor DS/public DS (%)	31.6	21.1	34.3	35.0	58.3	33.5	26.0	59.7	32.6
IBRD DS/XGS	0.3	0.4	0.6	1.0	1.0	1.5	1.7	2.0	2.2
IBRD TDO (US$m)[c]	490	648	899	1082	1234	1408	1578	1658	1729
Of which present value of guarantees (US$m)									
Share of IBRD portfolio (%)	0	1	1	1	1	1	1	..	..
IDA TDO (US$m)[c]	0	0	0	0	0	0	0	0	0
IFC (US$m)									
Loans	0	0	0	8.1	30.7	49.4	19.0		
Equity and quasi-equity /d	4.6	0	0	1.0	0	0.25	0.5		
MIGA									
MIGA guarantees (US$m)									

a. Includes public and publicly guaranteed debt, private nonguaranteed, use of IMF credits and net short-term capital.
b. "XGS" denotes exports of goods and services, including workers' remittances.
c. Includes present value of guarantees.
d. Includes equity and quasi-equity types of both loan and equity instruments.

Annex 12: CAS Program Matrix 2000-2003

Analysis	Strategic Objectives	Strategies	Performance Indicators	World Bank Group Instruments	Activities of Other Donors
Stimulating Broad-Based Private Sector-Led Growth: *The economy's heavy bias towards the extractive sector has to be reduced, by stimulating private sector led growth in other parts of the economy, including small and medium enterprises and agriculture—thus reducing vulnerability to commodity shocks and wider opportunities for remunerative employment.*					
✓ The operational environment for small and medium enterprises, even when privatized, is extremely difficult. ✓ New enterprises are not being formed in great numbers. When they are, they have large incentives to remain in the informal sector. Constraints to their growth need to be identified and removed.	✓ Establishment of an enabling environment for post privatization restructuring and SME development.	✓ Removing or simplifying tax, regulation, licensing and control burdens. ✓ Ensuring a competitive environment. ✓ Reforming the bankruptcy and liquidation process, and establishing functioning capital markets.	✓ Improved business environment shown in follow-up survey under TA loan. ✓ Number of new enterprises registered per year increased by 10 percent.	<u>Lending:</u> ✓ PSRMAL II ✓ CSAL ✓ TA loan ✓ IFC loans ✓ IFC equity ✓ IFC support – general leasing ✓ IFC support – equity funds <u>Guarantees:</u> ✓ MIGA <u>Non-lending:</u> ✓ Growth Strategy Study ✓ Note on Revenues ✓ Governance Survey ✓ CEM ✓ WBI seminars ✓ IPAnet & Privatization Link (MIGA) ✓ SME Dept. CABSS	<u>Lending</u> ✓ EBRD <u>Technical Assistance</u> ✓ Tacis ✓ UNDP ✓ USAID
✓ Some large and medium enterprises which are functionally bankrupt need to be closed or restructured. Others need improved corporate governance.	✓ Accelerating the privatization process with an emphasis on improving the quality of privatization. ✓ Deciding on the appropriate methods to attract and maintain quality owners.	✓ Privatization of the remaining large and medium enterprises and the minority shareholdings of the State in about 2,000 privatized enterprises. ✓ Instituting clear policies on financial discipline, restructuring prior to privatization, liquidation of non-privatizable enterprises, natural monopolies, property rights and adjudication of contractual disputes.	✓ Bankruptcies effected for loss-making medium and large firms more than four years old.		

Analysis	Strategic Objectives	Strategies	Performance Indicators	World Bank Group Instruments	Activities of Other Donors
✓ Current labor laws may prove to be too restrictive once the economy expands.	✓ Amend laws to make them more flexible.	✓ Identify constraints as they manifest themselves and institute appropriate amendments.	✓ Passage of a new Labor Law acceptable to the Bank	Lending: ✓ SPRAL Non-lending: ✓ Poverty Assessment and Labor Market Study	
✓ Agricultural growth is constrained by low credit availability and lack of access to technology and marketing opportunities. ✓ There is very little non-agricultural rural development. ✓ Marginal agricultural land is being taken out of cultivation. ✓ Weak land rights do not provide a source of collateral.	✓ Make agricultural support services, including credit, more widely available to those who need them, including non-farm rural enterprises. ✓ Find alternative sources of rural income generating activities. ✓ Alternative uses and employment opportunities need to be developed there. ✓ Devise procedures to have efficient, low-cost land registration.	✓ Continue concentration on rural finances, including increased commercial bank financing and development of micro-credit initiatives. ✓ Help provide marketing services. ✓ Devise measures to mitigate the social impact of the transition on rural communities. ✓ Restore drylands back to natural vegetation and seek sustainable uses for such lands. ✓ Follow up on lessons from pilot land registration exercise, including more affordable fee structure.	✓ Increase in rural credit by 20 percent a year from 2001. ✓ Household survey results shows declining rural poverty. ✓ Successful implementation of proposed GEF project on marginal lands. ✓ Land reform law acceptable to Bank is passed.	Lending: ✓ APPAP II ✓ Real Estate Rollout Proj. ✓ Agricultural Services Project ✓ CSAL ✓ IFC lending for agric. equip.leasing Grant: ✓ Drylands Ecosystems Mgmnt. Proj. Non-lending: ✓ Growth Study ✓ Reg. farm debt study ✓ Livestock st.	Lending ✓ ADB ✓ IFAD Technical Assistance ✓ Tacis ✓ FAO/UNDP ✓ Germany ✓ UK Knowhow Fund ✓ Israel
✓ Towards the end of the CAS period, greater oil revenues need to be managed and redirected towards sustainable uses.	✓ Ensuring adequate reform of the mining sector. ✓ Ensuring that oil flows are used in a pro-development manner. ✓ Prevention of an enclave economy.	✓ Identify options for reform of mining sector ✓ Identify options for use and management of oil wealth, e.g., offshore funds. ✓ Advise Government on best use of increased public resources.	✓ Agreed plan on reform of the mining sector ✓ Agreed plan on use and management of oil revenues	Lending: ✓ CSAL Non-lending: ✓ Mining Sector Study ✓ Growth Strategy St. CEM	Lending ✓ EBRD ✓ Japan Technical Assistance ✓ Tacis

Analysis	Strategic Objectives	Strategies	Performance Indicators	World Bank Group Instruments	Activities of Other Donors
Enabling a Solvent and Efficient Public Sector *Macroeconomic and fiscal stabilization, a pro-growth private sector environment, and effective delivery of critical services to the people will only be possible if there are deep and systemic institutional reforms. A key element in that is reducing the level of corruption.*					
✓ Macro-economic stability and a low-inflation, creditworthy economy need to be maintained, as preconditions for growth, reduced poverty and improved living standards.	✓ Support the Government in devising a sustainable growth and macro-financing policies, including fiscal reforms (below). ✓ Support the deepening of the financial sector.	✓ Advise the Government on optimal growth strategies. ✓ Support efforts to create a longer-term financing market for housing.	✓ Adherence to a macroeconomic framework endorsed by the IMF	Lending: ✓ PSRMAL II ✓ CSAL ✓ Financial Infrastructure project Non-lending: ✓ Growth Strategy Study ✓ Revenue note ✓ CEM	Lending: ✓ IMF Technical Assistance ✓ UNDP ✓ USAID
✓ Public debt is rising to unsustainable levels. Medium-term fiscal sustainability is only possible through lowering the fiscal deficit. ✓ Increasing the efficacy of the tax and customs system is essential to attain this goal. ✓ Public expenditures will need to be realigned away from non-priority areas and towards investment in infrastructure and people, so as to improve delivery of public services.	✓ Support the Government's fiscal reforms, as the primary component of its macroeconomic stabilization program. ✓ Support reform of the policy, procedures and administration of revenues.	✓ Analyze and help to implement inter-governmental fiscal reforms, to enable better sharing of resources and improved financing of locally delivered services. ✓ Provide options for more efficient integrated tax and customs system. ✓ Provide support for overhaul of tax and customs systems. ✓ Support public expenditure rationalization goals through sectoral operations, especially in social sectors.	✓ Tax and custom collection levels increased by 0.2 percent of GDP per year. ✓ Public Expenditure levels and mixes agreed with the Bank, monitored through SPRAL and PSRMAL II operations.	Lending: ✓ SPRAL ✓ PSRMAL II ✓ CSAL ✓ Revenue Mobilizn. project Non-lending: ✓ Growth Strategy Study ✓ Revenue note ✓ CEM	Lending: ✓ IMF Technical Assistance ✓ Tacis ✓ UNDP ✓ USAID

Analysis	Strategic Objectives	Strategies	Performance Indicators	World Bank Group Instruments	Activities of Other Donors
✓ Corruption in the public sector, at all levels—local and Republican—is a key barrier to private sector growth.	✓ Identify major areas and causes of corruption. ✓ Extend institutional reforms at Republican levels to local governments. ✓ Tailor public sector reforms to continue to address the underlying causes of corruption.	✓ Conduct survey of private sector and civil society to identify key areas of intervention. ✓ Build commitment from the Government to address significant problems. ✓ Devise policy actions for the public sector that increase accountability and institutional restraints.	✓ Follow-up survey shows improvement in level of corruption.	Lending: ✓ PSRMAL II ✓ CSAL ✓ TA loans for PSRMAL II and CSAL Non-lending: ✓ Governance Survey	Technical Assistance ✓ UNDP ✓ USAID
✓ The quality of delivery of public services in Kazakhstan is declining, due to both fiscal constraints and lack of institutional reforms.	✓ Ensure adequate fiscal resources at the local level are found to assure the quality of social services, including health and education. ✓ Improve the quality of municipal and industrial water and wastewater services.	✓ Help to implement inter-governmental fiscal reforms, with a particular emphasis on an adequate funding formula for social services. ✓ Ensure more equitable cost and tariff structure of services. ✓ For water, improvement of institutional arrangements, introduction of commercial principles and systems, and adoption of safety net arrangements.	✓ Successful implementation of PSRMAL II. ✓ Improvement in life expec-tancy, child mortality, enrollment rates. ✓ Survey of water customers and others using social services shows improved quality of service.	Lending: ✓ SPRAL ✓ PSRMAL II ✓ Health II (FY04) ✓ Northeast Vodakanal proj. Non-lending: ✓ PER ✓ Poverty Assessment and Labor Market Study ✓ Water Sector Strategy note	Lending: ✓ ADB (possible in education) ✓ France (in water) ✓ Germany (KFW--in water) ✓ Kuwait Fund (in water) Technical Assistance ✓ Tacis ✓ Germany (GTZ) ✓ UK Knowhow Fund ✓ UNDP ✓ USAID

Analysis	Strategic Objectives	Strategies	Performance Indicators	World Bank Group Instruments	Activities of Other Donors
Supporting the most vulnerable: ***The poorest in society would need to be protected through targeted income transfers (both transitional and longer-term), and improved access to opportunities and services.***					
✓ Many of the poor in Kazakhstan are already employed.	✓ Provide income support to cushion the transition to more remunerative employment opportunities.	✓ Devise guidelines for a poverty-targeted public works program, with appropriate (below-market) minimum wage.	✓ Successful implementation of agreed public works program.	<u>Lending:</u> ✓ SPRAL <u>Non-lending:</u> ✓ Labor market component of the Poverty Assess-ment and Labor Market Study	
✓ Income transfers need to be re-oriented towards the poorest ✓ There needs to be adequate budgeting for social protection, both at local and Republican levels.	✓ Use poverty as the sole criterion for determining eligibility for social transfers. ✓ Ensure adequate public finances are available for social assistance.	✓ Support the setting up of legal and administrative framework to give social assistance to the neediest. ✓ Ensure that local budgets allocate sufficient "non-sequester-able" funds to social assistance.	✓ Successful implementation of SPRAL	<u>Lending:</u> ✓ SPRAL ✓ PSRMAL II <u>Non-lending:</u> ✓ PER ✓ Poverty Assessment and Labor Market Study	<u>Technical Assistance</u> ✓ UNDP/ILO ✓ USAID
✓ One effect of the transition experience in the social sectors is that critical public health and education services do not always reach the poorest.	✓ In both sectors, work out efficient mechanisms of targeting assistance and discounted fees for the poorest.	✓ Devise a planned sector rationalization strategy in health, so that the poor are adequately protected. ✓ Work with the Asian Development Bank in the education sector to ensure that access by the poor is protected as well.	✓ Poverty survey questions on poor's access to social services shows improved access between 2001 and 2003.	<u>Lending:</u> ✓ SPRAL ✓ PSRMAL II ✓ Health II (FY04) <u>Non-lending:</u> ✓ PER ✓ Poverty Assessment and Labor Market Study	<u>Lending:</u> ✓ ADB (possible in education) <u>Technical Assistance</u> ✓ Tacis ✓ Germany (GTZ) ✓ UK Knowhow Fund ✓ UNDP ✓ USAID

Analysis	Strategic Objectives	Strategies	Performance Indicators	World Bank Group Instruments	Activities of Other Donors
✓ The poor in remote areas may not be able to access employment opportunities and public services.	✓ Increase access by selectively renovating or building rural transportation systems.	✓ Identify building and rehabilitation needs in poorest regions. ✓ Support construction and repair of these roads.	✓ Successful initiation of Rural Roads Project	Lending: ✓ Rural Roads project	

Analysis	Strategic Objectives	Strategies	Performance Indicators	World Bank Group Instruments	Activities of Other Donors
Protecting the Environment: *Environmental cleanups and transformation of unsound environmental practices would improve both the current quality of life and future opportunities.*					
✓ In the Northeast, industrial pollution has raised the contamination level to a point where it threatens to limit the future growth potential of the area and poses a public health threat.	✓ Cleaning contaminated rivers and water sources, thereby providing sustainable sources of water supply.	✓ Clean mercury from the Nura river. ✓ Work with partners to address mercury and kerosene contamination of the Irtysh river.	✓ Periodic surveys on water quality in the river systems show improvement in water quality.	<u>Lending:</u> ✓ Nura River cleanup project ✓ North-east Vodakanal Project ✓ Syr Daria Project	<u>Lending:</u> ✓ France <u>Grant:</u> ✓ GEF <u>Technical Assistance</u> ✓ Tacis ✓ UK Knowhow Fund ✓ UNDP ✓ USAID
✓ In the South, inefficient irrigation and livestock practices as well as run-off of non-treated waste water from cities are creating an acute water shortage, and contamination of the Syr Darya river.	✓ Clean up contamination while ensuring better water use by farmers and other consumers.	✓ Clean the Syr Daria river and promote better water management and irrigation practices in the region.	✓ Successful implementation of Syr Daria Project		
✓ The Northern Caspian Sea is suffering from oil spills from offshore oil exploitation, posing a threat to marine life, especially the is the sturgeon.	✓ Work on preserving the habitat for sturgeon and other marine life. ✓ Clean up oil-related damage.	✓ Provide technical assistance in the areas of bio-monitoring, development of hatcheries etc. ✓ Work with private sector to clean up oil spills and prevent future damage.	✓ Development of suitable technical assistance projects.		

Annex 13: Summary of Development Priorities

Network area	*Country performance*	*Major issue*	*Country priority*	*Bank priority*	*Reconciliation of country and Bank priorities*
Poverty Reduction & Economic Management					
Poverty reduction	Fair	Regional Poverty	Medium	High	Dialogue in context of CAS, proposed SPRAL and Poverty Assessment
Economic policy	Good	Fiscal contraction, management of oil funds	High	High	
Public sector	Good	Improving governance, civil service reform	High	High	
Gender	Fair	Intra-household violence	Low	Medium	Dialogue spurred by IDF on gender and violence
Human Development Department					
Education	Fair	Restructuring sector for improved efficiency and service delivery	Medium	Low	Dialogue led by the ADB
Health, nutrition & population	Fair	Restructuring sector for improved efficiency and service delivery	Medium	High	Dialogue in context of Health APL
Social protection	Poor/Fair	Targeting social transfers to the poorest	Medium	High	Dialogue in context of proposed SPRAL and Poverty Assessment
Environmentally & Socially Sustainable Development					
Rural development	Fair	Providing adequate and accessible agricultural services	High	High	
Environment	Fair/Good	Realizing the National Environmental Action Plan	High	High	
Social development	Poor/Fair	Building community-level management resources	Low	Low	
Finance, Private Sector & Infrastructure					
Financial sector	Good	Deepening the financial market	High	High	
Private sector	Fair	Improving corporate governance and ease of entry and exit	High	High	
Energy & mining	Fair	Improving governance in the mining sector	Medium	Medium	
Infrastructure	Fair/Good	Building adequate and reliable transportation and energy network	High	Low	Infrastructure projects from the EBRD, ADB and bilateral donors.

Annex 14: Private Sector Development Strategy

Introduction

1. The private sector in Kazakhstan has about a 60% share of GDP compared to the 70-80% share in the more advanced reformers in the ECA. But enterprise restructuring performance in Kazakhstan has not progressed as much, hindered by a poor corporate governance framework. Since 1990, there has been major changes in the structure of GDP, notably the fall in the share of agriculture from 34% to around 10% between 1990 and 1999 and the doubling of the share of the trade sector.

Privatization, Governance, and Restructuring

2. *Privatization.* Kazakhstan has utilized multiple methods of privatization since 1991, including mass privatization, agricultural and small scale privatization, and case by case privatization. In the process, some 13,000 small establishments were transferred to private owners, about 1,700 enterprises were included in the mass or voucher privatization, and shares in about 1,600 companies were sold in cash auctions or negotiated sales. Under the "blue chip" program, the Government planned to sell shares in 56 large enterprises in the stock market, but this program has stalled, first due to unfavorable market conditions and then due to a reassessment of the privatization experience. The Government also entered into management contracts covering 94 large enterprises and trust management contracts for about 21 enterprises, but these contracts will not be renewed due to negative experience with this initiative.

3. Despite the above accomplishments (including the completion of small scale privatization and most of farm privatization) about 100 large and 260 medium SOEs were yet to be privatized by end-1999 and this has changed little in 2000. These large and medium SOEs account for about a third of GDP. In addition, the State has minority holdings in about 2,000 enterprises. Completing the privatization process remains a major task for the Government, and while the Agency for State Property and Privatization has been developing a program for selling state holdings in these enterprises, progress has been very slow. The Agency is also reviewing plans for privatizing some of the so-called "national companies" in the infrastructure, transport, energy, and telecommunications. The Government is now proceeding to initiate consultant contracts for preparing a sub-set of the blue-chip enterprises for privatization.

4. The method and preconditions for the privatization of the remaining SOEs are critical to ensuring good governance, restructuring, and investment after privatization. In the case of the privatization of the "national companies", there may need to be a review of the respective sectors to determine whether prior sector restructuring is necessary (e.g. the break-up of a monopoly operator and sale of all or part of the separate pieces) and whether there is a need to put in place a legal and regulatory framework that enables private ownership/participation and ensures improved sector efficiency. The large enterprises and perhaps some of the medium SOEs may require investment bankers to handle the case by case privatization, although some SOEs may be placed in privatization pools where each pool is handled by one investment banker or privatization agent who may recommend breaking up certain enterprises prior to sale. Sale to foreign investors would most likely be the preferred route for most of large enterprises.

The smaller enterprises and the minority holdings could be sold in cash auctions or through the stock market. Of critical importance with regard to any privatization is that the process be very open and transparent. This has not been the case with large scale privatizations in the past and has precluded involvement of IFC.

5. With the exception of the national companies, the Bank recommends that the Government privatize the remaining SOEs within a reasonable period of time (e.g. 18 months) and to possibly liquidate (i.e., sell the assets separate from the liabilities – a form of privatization) these enterprises if the sale of the enterprise as an ongoing concern does not occur. The organization of the privatization process is also important – in many countries, decentralizing the privatization to the line ministries have resulted in delays since the ministries do not have the proper incentives to pursue privatization. Fragmenting the privatization process also causes problems with respect to the provision of technical assistance.

6. Given that it will most likely take up to two years to complete the privatization process, the Government will need to formulate an explicit policy to manage the SOEs in the interim. The most important consideration is the maintenance of financial discipline. As discussed later, in the section on industrial policy, initiatives by sector ministries to subsidize losses and restructure SOEs are worrisome. These initiatives tend to worsen the fiscal situation, weaken the banking system, and delay the privatization process.

7. The Bank, in coordination with IFC, could send its top experts on privatization to assist the Agency for State Property and Privatization design the program for completing the privatization process. This would enable Kazakhstani officials to receive the benefits of the recent lessons of experience. The remaining funds under the existing Finance & Enterprise Development Loan (FEDL) for the privatization component could be used to design and partially fund the implementation of the program.

8. *Corporate Governance.* Corporate governance has been identified as a major issue in Kazakhstan. The EBRD rates governance and enterprise restructuring in Kazakhstan as a 2—indicating "Moderately tight credit and subsidy policy but weak enforcement of bankruptcy legislation and little action taken to strengthen competition and corporate governance." Many enterprises sold under the mass privatization program remain without a majority owner. Investment Funds have been ineffective in providing governance to privatized firms. Many enterprises have complained that the State has been blocking important decisions through its minority ownership. In a survey of firms in Central Asian Republics and Russia in 1998, Kazakh firms have the highest share of non-insider ownership. This requires effective mechanisms for corporate control and monitoring of management. Improving corporate governance mechanisms would also encourage foreign investment which has been absent in most privatizations to date.

9. One of the building blocks for good corporate governance is the establishment of good accounting and auditing (internal and external) systems to ensure the provision of information on a timely basis that adequately reflects the financial condition of an enterprise. The laws and regulations on corporate governance should ensure that stockholders and board members have access to appropriate information and that there exists a mechanism for independent reviews or audits.

10. Once major gaps in governance have been identified, the Government could address them with Bank support. Funds available under the capital markets component of the FEDL could be used finance implementation of recommended reforms, and policy reforms could be supported by the CSAL. Better accounting and auditing standards, improved corporate governance , and a more developed legal and regulatory framework will improve the business environment and lead to a greater involvement of the IFC in the development of Kazakhstan's private sector.

11. *Bankruptcy and Liquidation.* The process of bankruptcy and liquidation in Kazakhstan is long and arduous. Many bankrupt SOEs have not been liquidated which prevents the sale of the assets to those who can make best use of them. In the meantime, these assets are deteriorating. There are two areas of reform. First, the relevant laws, procedures, and institutions need to be reviewed and analyzed as a basis for defining fundamental reforms to the bankruptcy and liquidation framework. Second, an interim fast track process should be introduced to deal with existing bankrupt or nonprivatizeable SOEs.

12. Over the past few years, the Bank has developed expertise and experience in bankruptcy and liquidation, mainly due to the work in East Asia. Reform of bankruptcy and liquidation laws is also under way in some ECA countries, notably Bulgaria and Macedonia. In Bulgaria, the Bank made the assessment and provided the conceptual design, while donors funded the more detailed design work and implementation. In the case of Kazakhstan, the Bank could send its experts to evaluate and develop recommendations for improving the legal framework and the FEDL could finance the implementation of the Bank recommendations, which would then be supported by the CSAL.

Small and Medium Enterprises

13. SMEs today play a much less important role in Kazakhstan compared to developed countries or advanced transition economies. The potential contribution of SMEs to growth is well recognized by the Government, and for the past few years there have been two Presidential Decrees, four laws, ten Government decrees, and seven regulatory acts that deal with SME development. In November 1998, the Government approved the "National Program for the Development and Support to Smaller Businesses in Kazakhstan, 1999-2000". The new program recognizes that in the past, substantial financial resources have been expended by both the Government and donors, with little impact on SME development. The new program tries to focus on establishing an entrepreneurship mentality, building business skills, and encouraging SME creation. The new instruments include developing the franchising of existing businesses, increasing the availability of consulting services, simplifying the tax system (e.g., the use of the patent system), and introducing a mechanism for certifying goods. While all of these potential instruments are beneficial, little progress will be made on stimulating SME growth without substantial improvement in the private sector business environment.

14. There is considerable scope for increasing the number and contribution of SMEs, especially in non-trade sectors of the economy. However, maximizing the contribution of SMEs requires innovative organization arrangements to allow for the formation of linkages among SMEs and with larger enterprises, such as the program being developed by IFC with Ispat Karmet – the experience in countries such as Italy Denmark and South Africa are also

worth noting. In addition, SME programs should also focus on other determinants of SME growth, such as diffusion of information and technology and upgrading of technical and managerial skills. Programs such as the Central Asian Business Support Services being developed by the Bank Group SME Department should support this effort.

15. Access to medium- and long-term financing is also very important for SME growth. Generally, SME access to financing is most efficiently channeled through financial intermediaries. IFC has taken a leading role in the area of capacity building in the financial sector to support the financing of SMEs and this activity is expected to be expanded during the next three years.

16. The Private Sector Assessment (PSA) recommended the development of leasing as a means of increasing the flow of financial resources to SMEs. Unfortunately there has been little investment in leasing due to the weak civil code provisions pertaining to leasing activities. The PSA recommendation to develop a leasing law was finally implemented with the adoption of the leasing law, drafted by the National Bank, on July 5, 2000. The passage of this law should give impetus for the development of leasing companies in Kazakhstan, once implementing regulations are adopted. Development of leasing is an area of focus for IFC activity in Kazakhstan which will be developed together with foreign technical sponsors. There is also a need to review the legal and institutional framework for secured lending.

17. The most pervasive constraint to SME development continues to be the high transaction cost resulting from the difficult business environment. Licensing requirements and regulatory practices in Kazakhstan increase immensely the costs of business activities and provide opportunities for corruption. A wide range of activities require licensing before an entrepreneur can commence activity. The procedures are often complicated and involve several state bodies. The approval process is lengthy and some state bodies charge significant fees for their services. Interviews at the Congress of Entrepreneurs[16] suggest that there are currently 26 different state bodies authorized to supervise business activities (State Committee for Standards, Fire Inspection, Tax Inspection, Energy Inspection, Sanitary Inspection, etc.). By some accounts a business can be subjected to 20 inspections a month and more than one hundred agencies can control, inspect and monitor SMEs. Several attempts have been made to limit the number of supervisory bodies that deal with the private sector in order to shield entrepreneurs from excessive interference and rent seeking (including the Presidential Decree of June 14, 1996 on SME Regulations, the "Law On State Support to Small Entrepreneurship" of June 19, 1997, the April 27, 1999 Presidential Decree "On the Protection of Rights of Citizens and Legal Entities to Freedom on Entrepreneurial Activity", and the "Law On the Introduction of Changes and Amendments to Some Legislative Acts of the Republic of Kazakhstan Concerning Questions of Protection of November 29, 1999). Unfortunately these laws and decrees have failed to bring tangible results, in many respects due to the lack of implementation at the regional level.

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[16] Two additional sets of issues were identified. First, the administration and implementation of adopted legislation depends greatly on the regional governors' attitude towards them. Second, dissemination of information on new regulations and entrepreneurs' rights is not adequate, and often comes with a significant lag after a law is actually implemented, resulting in penalties for businesses.

18. The licensing regime needs to be streamlined by reducing the range of activities for which licenses are required, simplifying filing procedures, and shortening the time involved for licensing approval. Business regulations should be reviewed with the goal of eliminating unnecessary regulations and simplifying those that are required. Work done by the Bank in conjunction with the Growth Strategy Study and PSRMAL II will present, in a systematic manner, a more detailed analysis together with recommendations as to which licensing requirements should be eliminated and with regard to the licensing that remains, which procedural steps or procedures could be eliminated. PSRMAL II will then support the reform of the licensing and regulatory regime.

Foreign Direct Investment

19. Due to the low levels or private and public savings in Kazakhstan, growth prospects in the short and medium term, outside the oil and gas sector, are dependent on the level of foreign investment.. While the level of FDI in Kazakhstan on a per capital basis is higher than that of its neighbors such as Russia, Uzbekistan, and Azerbaijan, more than 80 percent of such investment has been in oil, gas, minerals and metallurgy. In 1998, Kazakhstan attracted $1.2 billion of FDI compared to a $1.4 billion annual average during the period 1994-97, due in great measure to the financial crisis' in Asia and Russia. South Korea, a major investor in previous years, significantly reduced its investment flows in 1998. The US, Japan, and the UK have increased investment activity in Kazakhstan, however, very little is invested in activities outside natural resources.

20. The survey of foreign investors conducted by the International Tax and Investment Center in 1997 identified the important factors influencing investment decisions and the investor perceptions of the investment climate in Kazakhstan. Investor interest was driven by access to raw materials and natural resources, market potential, a desire to preempt competitors, and Kazakhstan's strategic location. The study noted that while many investors considered the changes in the investment climate as generally positive, about a third of the respondents viewed the investment climate as negative. The most significant barriers to investment were identified as: excessive bureaucracy and corruption, complex and burdensome tax regime, the absence of good legal infrastructure, and poor physical infrastructure. The PSA and FIAS reports of 1998 both identified the immediate and high priority FDI issues as the improvement in the legal and regulatory regime and the elimination of rampant corruption. These findings were further confirmed by the Bank/IFC/MIGA OED/OEG team during their March 2000 mission. They surveyed foreign firms operating in Kazakhstan and found that the significant problems with the business environment included: (I) a weak regulatory framework with a lack of clarity combined with constant amendments and changes in policies, personnel and responsibilities; (ii) arbitrary tax laws including an overlapping of taxes; and, (iii) ad-hoc decision making due to the absence of a well structured legal and tax framework. The active and unrestrained intervention of Akims (Regional Governors) in the investment process and the operation of private firms was also mentioned as a major impediment.

21. In order to attract more foreign investment, Parliament passed the "Law on Foreign Investments" which provides guarantees for foreign investors against changes in legislation, expropriation, illegal action by state agencies and officials, as well as guarantees of unrestricted

use of income and currency convertibility for dividends and other specified uses. In addition to the guarantees, the promotion of FDI basically uses two types of incentives. First, the "Law on the State Support of Direct Investment" grants state assets and concessions, income, land and property tax holidays for five years with an additional period of reduced rates, as well as duty and VAT exemption on imported machinery and raw materials, for varying periods. Second, the "Decree Concerning the Creation of Economic Zones" reduces the corporate income tax rate by 10 percentage points. In both cases, the incentives are granted on an arbitrary and non-transparent case by case basis and are included in a contract signed between the investor and the granting authority. There is a list of priority sectors that include electricity and telecommunication, domestic market oriented manufacturing, advanced technologies in agriculture, and development of special economic zones. The 2000 revision of the Tax Code is expected to take a fresh look at these tax incentives..

22. The Bank will engage the Government in a dialogue to rationalize the incentives, define the role of the Agency for Investments, and assist the Agency in designing a set of instruments to support FDI promotion. Reform should move away from discretionary incentives which distort the market and instead focus on improving the overall investment and business climate. It should also be directed toward development of programs that provide support and assistance to investors in the form of facilitation services and the dissemination of information.

Financial Sector

23. *Banking.* Banking reform over the past five years has focused on: (a) establishment of the legal and regulatory framework for the banking system; (b) upgrading of supervision capacity; (c) consolidation of the banking system; (d) privatization of banks; and, (e) entry of foreign banks. The legal and regulatory framework for banking is basically in place, supervision capacity is continually being upgraded with technical assistance from the Bank and USAID. The consolidation of the banking system has resulted in the reduction of banks from184 in 1995 to 70 in March 1999.

24. There has been significant progress in bank privatization. In 1998, two large banks – TuranAlemBank and Zhilstroibank – were sold to private investors. While EximBank has been on the market for several years, there has been no success in selling the bank after discussions with Bank Bumiputra of Malaysia collapsed due to the Asian crisis. There are continuing talks on the merger of Kazkommertzbank and Savings Bank, which would result in a bank with more than 50% of banking assets and more than 60% of total deposits (but more than 80% of household assets) if the merger materializes. With respect to Eximbank, the liquidation route should be seriously considered.

25. The banking system seems to have withstood, at least in the short term, the 1999 floating of the *tenge*. However, the impact on the portfolio will not be evident for some time to come. A major problem for the large banks (about 80% of the banking system) is the concentration of the loan portfolio. The top ten borrowers account for 30 to 50 percent of the loan portfolio of five of the largest banks; the top twenty borrowers account for 40 to 75 percent of the loan portfolio. A review of the impact of the floating of the *tenge* on the banks' portfolio is necessary to determine what actions the National Bank of Kazakhstan (NBK) should take if the review projects a high increase in bad loans. The table below already

indicates a deterioration of loan portfolios during 1998. On a more fundamental level, a vulnerability analysis is recommended to identify the risks to which banks are exposed and to recommend appropriate risk management measures.

Table 1: Loan Classification (in percent)

	As of December 31, 1997	As of December 31, 1998
Standard	72.5	63.7
Substandard	15.1	25.6
Unsatisfactory	4.7	3.4
High Risk	1.7	2.6
Loss	6.0	4.7
Total	100.0	100.0

26. *Capital Markets.* There have not been any new initiatives or activities in the area of capital markets development. The Blue Chip program, which envisioned the listing of 56 companies, has stalled, and equity market activity is basically dead. While the problem one year ago was an absence of securities available for purchase, the problem this year also includes a absence of demand – there is little interest from foreign portfolio investors in Kazakh securities. The lack of movement in the development of capital markets is of concern for the success of the pension reform program. However, should there be progress in the privatization of large and medium size firms, including the national companies, coupled with corporate governance reform, such actions would lay the foundation for further development of capital markets. The Bank's role in capital markets development, should the Government request assistance, would be undertaken through its activities under the FEDL and CSAL.

Industrial Sector

27. *Background.* The industrial sector accounts for about 22 percent of GDP and 12 percent of employment. Power, oil, gas, and coal account for more than 50% of GDP, with mining and agriculture/food processing each having a 21% share. There are about 9,400 enterprises listed as being in the industrial sector, of which about 7% are state owned and another 7% with foreign participation. Only 515 industrial enterprises are classified as large. An analysis of performance of industrial enterprises showed that for the first nine months of 1998, the consolidated financial statements of the enterprises showed losses, compared to profits during the years 1995-97.

28. *Industrial Policy.* The policy initiatives being envisioned by the Government to restructure the industrial sector are disturbing. Three initiatives are being contemplated or implemented which will focus on three major sub-sectors – chemicals, machine building, and light industry. First, a credit program is being developed where funding from the Government will be provided to commercial banks which will choose worthwhile projects, subject to approval by the Ministry of Energy, Industry, and Trade. Second, protectionist measures in the form of high tariffs and quantitative restrictions were imposed on some products, although most

of these have been eliminated after the floating of the *tenge*. Third, the Ministry of Industry plans to propose VAT and other tax holidays for *selected* sub-sectors and enterprises.

29. Government policies to promote industrialization can be divided into two types: (a) those that influence the factors that would facilitate industrial growth without prejudging the resulting industrial structure; and, (b) those that attempt to target a certain industrial structure. The former uses general or functional incentives such as tax measures to encourage savings and investment, public investment in education, general FDI promotion, etc. The latter utilizes industry-specific (and sub-sector specific) incentives and subsidies, such as the ones currently being envisioned by the Ministry of Industry, Trade, and Energy. In the case of Kazakhstan, there should be a strategic shift in the focus of government policy from industry specific targeting towards general incentives. This shift should take place not only because the mixed performance of current industrial targeting, but also due to the lack of institutional capacity and the absence of transparency which had led to significant corruption.

30. The proposed shift to general incentives would change the role of the Industry Department of the Ministry of Industry, Trade, and Energy to one of promotion and advocacy, rather than the design of industry specific policies. In addition, there may be a role for the Ministry in the: (i) setting of product quality standards (e.g. introduction of ISO 9000); (ii) dissemination of information related to new technologies, information exchange and marketing (e.g., trade fairs, MSTQ, etc.); and, (iii) fostering of industry wide organizational arrangements (clusters, improved transport logistics, etc.). Pursuant to such a revised focus, industrial structuring would be driven by market forces that could be supplemented by improved economy-wide polices to support privatization and post-privatization activities.

PSD Strategy for Kazakhstan

31. The recommended PSD strategy focuses on the completion of structural reforms and the establishment of policies and institutions that would facilitate restructuring, increase investment, and improve productivity. The components of such a strategy would include the following.

(i) Privatization of the remaining large and medium size enterprises as well as the Government's divestiture of its minority shareholdings in about 2,000 privatized enterprises. Such action would require decisions on the most appropriate methods and organizational arrangements to maximize the potential for strategic ownership positions in such privatized enterprises. Clear and transparent policies on financial discipline, restructuring prior to privatization, liquidation of non-privatizable enterprises, and natural monopolies must be developed. A framework for the regulation of property rights and the adjudication of contractual disputes must be developed if foreign investors are to be encouraged to participate in the privatization process.

(ii) Establishment of the enabling environment for post privatization restructuring. This could be accomplished by ensuring a competitive and transparent business environment, improving corporate governance, reforming the bankruptcy and liquidation process, as well as the establishment of functioning and active capital markets. An important building block of corporate governance reform is the adoption by enterprises of international accounting and auditing standards.

(iii) Sustaining the current pace of banking sector reform with special emphasis on: (i) the privatization of Halyk Bank: (ii) liquidation of the Exim Bank: (iii) upgrading of supervision capacity;, (iv) elimination of current restrictions on the share of foreign banks in the banking system; and, (v) encouraging institution and capacity building in the banking sector, especially in the area of risk management. A vulnerability analysis of the general banking system together with a review of the impact of a floating *tenge* on the portfolio of the banks' should also be implemented.

(iv) Improving the business environment by reforming the licensing, regulatory, tax and customs procedures as well as the institutions which administer these areas in order to reduce the high transaction costs and reduce the opportunities for corruption. Specific reviews should result in the elimination of many of the existing licensing and regulatory requirements as well as simplify current tax and customs procedures.

(v) Defining the role of government in the design and implementation of programs that would upgrade the structural determinants of competitiveness. Apart from reinforcing sound macro economic policies, there are four areas that need attention: (i) skills development (education, training, etc.); (ii) information and technology diffusion (intellectual property rights, MSTQ, etc.); (iii) physical infrastructure and logistics development; and (iv) organization (clusters, etc.).

Annex 15: Poverty and Living Standards

The last accurate and comprehensive survey of living standards in Kazakhstan was undertaken in July 1996, with the Kazakhstan Living Standards Survey (KLSS). Analysis of the data, summarized in the report *Kazakhstan: Living Standards During the Transition* (1998), found that *over a third of the population lived below a "subsistence minimum"*. The most striking difference in poverty incidence in Kazakhstan is its variance by region (Figure 2 in the main report). In terms of the number of poor, two out of three poor people lived either in the south or the east of the country. Rural poverty was higher, deeper and more severe than poverty in urban areas. There was not much differentiation in poverty across gender, although any difference may have been obscured due to methodological issues.

While almost half the unemployed were poor, poverty was also marked among the self-employed—demonstrating that in transitional Kazakhstan, employment itself was not a guaranteed escape from poverty. This is because employment in traditional enterprises often provided low and delayed wages, while incomes from self-employment or start-up businesses were fraught with uncertainty. Alleviating poverty will entail the creation of broad-based remunerative employment for the population, and a more efficient public sector to facilitate the provision of fundamental social infrastructure and social protection. Once again, *growth will need to be diversified—away from dependence solely on a dynamic extractive sector and including rural development—to provide increased incomes for the poor in the most vulnerable regions, which have little mineral wealth.*

As in other parts of the world, the poor are especially at risk of receiving low levels of public services. Access to education and health services are worse among the poor. This is compounded in parts of Kazakhstan by the enormous distances that they may need to travel to reach facilities, and the increasing cost of the services due to the ongoing fiscal crisis, which has resulted in both *de facto* and *de jure* privatization of provision. Public delivery of health and education in Kazakhstan will need to improve, to enable the poor to best avail of income opportunities in Kazakhstan's growing economy. *Part of the solution is to build better access systems. Another is to ensure a more effective and focused public sector delivery system, that the poor are assured of an affordable minimum package of services, and targeted social protection.*

A major factor affecting the quality of life for the poor in Kazakhstan is the extensive environmental degradation that is its legacy from the Soviet and early post-Soviet era. Chemical contamination of rivers in the industrial zones, and inefficient irrigation and livestock practices have created a problem with both the quantity and quality of water in the northeast, as well as in the south, where much of the poor live. Oil exploration and production practices have made the Caspian Sea region vulnerable to possible major environmental catastrophes. *The cleanup of toxic wastes and efforts to manage drylands and control desertification are imperative to improve the quality of life for the poor.*

A fundamental problem in accurately gauging the impact of recent socio-economic changes on poverty in Kazakhstan is the poor state of available data. For example, the poverty head-counts mentioned above, from the KLSS, are substantially *lower* than poverty estimates based on the existing and ongoing Family Budget Survey (FBS) in Kazakhstan, due to problems in measuring income correctly in the FBS. The Government, with help from the Bank, is intending to address this problem with immediate effect. In 2000, it has begun designing and intends to implement a new Household Budget Survey. *The Government has also committed itself to processing and analyzing the data from the survey, and, by early 2001, disseminating a profile of poverty in Kazakhstan on a regular basis and using it as input to its policy decisions.*

Annex 16: The Government's Development Program

A. The Long-Term Development Vision to 2030[17]

1. **The longer term vision for the development of Kazakhstan is embodied in** *Kazakhstan 2030 – Prosperity, Security and Improvement of the Welfare of All Kazakhstani People*. This vision was articulated by the President, Nursultan Nazarbayev on October 6, 1997, and it declared "building an independent, prosperous and politically stable state with its inherent national unity, social justice and economic welfare of all population" as Kazakhstan's longer-term mission.

2. Developments were foreseen in seven areas, in order to ensure:

- **National Security**. To ensure the development of Kazakhstan as an independent and sovereign state with the maintenance of complete territorial integrity.
- **Internal Political Stability and Consolidation of the Society**. To maintain and strengthen the internal political stability and the national unity which will enable Kazakhstan to realize the national strategy during the present and following decades.
- **Economic Growth Based on the Open Market Economy with High Level of Foreign Investments and Internal Savings**. To achieve real, sustainable and increasing economic growth.
- **Health of the Nation and Welfare of Kazakhstani Citizens**. To improve the living standards, health, education and abilities of all Kazakhstan people, to improve the environment.
- **Energy Resources**. To efficiently use the energy resources of Kazakhstan by rapid increase in extraction and export of oil and gas in order to receive revenues promoting the sustainable economic growth and improvement of the life of the nation.
- **Infrastructure, in Particular, Transport and Communications**. To develop these key sectors so that to help to strengthen the national security, political stability and economic growth.
- **Professional State**. To create an effective and present-day corps of committed civil servants in Kazakhstan capable to act as representatives of the nation while achieving priority goals.

B. The Medium-Term Program

3. The medium-term priorities are determined in the Program of Actions of the Government for 2000-2002 approved by the Decree of the President. The implementation of this Program, developed on the basis of "Kazakhstan-2030" Strategy, is supported by international financial organizations, agencies and donor countries. The main objective of the Government of the Republic of Kazakhstan in the economic field is to ensure sustainable economic growth whilst maintaining a balance of the most important macroeconomic parameters: exchange rate of tenge, inflation and deficit of the international balance of payments of the country. The Program provides for achievement of annual three-percent growth of the

[17] This section was written by the Government of Kazakhstan.

real GDP, decrease in the inflation rate to 5% in 2002 and reduction of the deficit of the Republican budget to 1.2% of the GDP in 2002.

4. To achieve the objectives set forth the Government intends to:

- **maintain the macroeconomic stability** and strengthen the principles of sustainable economic growth;
- ensure dynamic development of the **real sector** of the economy;
- continue improving **the investment policy of the country** and active attraction of direct external and internal investments into the economy of Kazakhstan;
- switch over to **targeted rendering of social assistance** based on the poverty criteria; and transfer the core work on rendering social assistance to the regions;
- continue developing **internal financial markets and capital markets** for the sustainability of the banking system of the country and expanded lending to economic entities;
- **continue improving the public sector management system**, its transparency, decentralization, and strengthening of the planning system.

5. In the monetary field, the policy will be aimed at maintaining low inflation and stability of the financial market, further consolidating of the banking system, developing of the insurance market and creating conditions for increased lending to the real sector of economy. The authorities of Kazakhstan intend to follow the policy of floating exchange rate of tenge and maintain the financial sustainability of operations in the open market, regulation of official rates and two-tier bank refinancing as the key instruments. Special attention will be given to the actions related to creation of new types of financial institutes such as investment funds and agencies authorized to have transactions with corporate bills. Also assistance will be given to creation of an organized real estate market and development of mortgage lending. Particularly, the system of obligatory collective insurance of individuals' deposits, which is being created by the National Bank, is designed to raise confidence of the population in banks and increase the funds attracted to the banking sector as the ensuing consequence. The consolidation of the banking system will be continued. The two-tier banks should be transferred to international standards by the end of 2000. The prudential supervision will be made stricter including active use of check-ups on sites and improvement of the risk evaluation system. Active development of financial leasing instruments is planned to expand lending to small and medium-size enterprises including in rural areas. The stock market will be highly stimulated by a security mechanism for banks' assets and expansion of activities of banks with corporate securities. The state intends to create necessary conditions for increased supply of non-state securities on the Kazakhstani organized stock market. Special focus will be made on increasing information transparency of activities of organizations– issuers of non-state securities and organizers of security sales.

6. In fiscal policy the actions of the Government will be aimed at increasing the revenues to the state budget, and equitable distributing of the tax burden between the population and economic entities. Provided the stability of taxation, the transparency and comprehension of the tax legislation will be improved, tax privileges will be regulated and eliminated in the perspective, and the tax legislation administration will be controlled stricter. In the near future, with the participation of international and domestic experts and active discussions with all interested parties, the Government of the country will develop and submit a new Tax Code to the Parliament, which will become a single codified legal act reflecting all issues of relations

between the budget and a taxpayer at the same time strengthening its role as of the Law of direct effect. While ensuring continuity in the structure of basic taxes and payments, the world experience in the tax practice will be taken into account as well as the current economic situation in Kazakhstan. Special significance will be given to the improvement of tax administration procedures with a clear-cut regulation of relations between fiscal bodies and taxpayers as well as promotion of small business. The main purpose of the Tax Code is moving away from the practice of giving tax privileges to special categories of taxpayers and creation of equal conditions for taxation. The budgetary policy of the Government in the medium term will be aimed at deepening budgetary system reforms on the basis of perspective budget planning, transferring inter-budgetary relations between the center and regions to the principles of mid-term stable norms, increasing the efficiency of state borrowings, managing state expenditures on the basis of budgetary programs and strict regulation of the budgetary process, priority financing of socially significant budgetary programs, applying stricter approaches to the recovery of budgetary loans by borrowers within the current legislation, steady reducing the deficit of the budget and stabilizing the state debt to the GDP correlation.

7. In the field of <u>state debt management</u>, during the period of gradual reduction of the deficit of the Republican budget, the Government of the Republic of Kazakhstan intends to:

- expand and improve the lending tools in operation in order to reduce the liabilities of the state and promote direct investment flows into the economy of Kazakhstan;
- ensure the development of criteria and strict observation of the procedure for selection and control of investment projects funded within the Public Investment Program as well as further monitoring over fulfillment of obligations by borrowers;
- ensure strict agreement of the Public Investment Program funding with the Republican budget of a relevant year;
- create a centralized system of monitoring and management of loans and debts of local bodies, and to exercise stricter control over issuance of governmental guarantees.

8. The Government of the Republic of Kazakhstan will undertake measures to complete the <u>program of privatization</u> of the Republican state property, to increase their efficiency and to ensure full transfer of dividends to state share packages while implementing a single policy aimed at increasing the discipline of organizations—issuers of non-state securities regarding charges and payments of income on shares and bonds.

9. The <u>investment climate</u> will be improved and direct investments will be increased through further improvement of the legislation, development of the private sector, development and introduction of mechanisms ensuring effective use and protection of deposited investments, and transparency of investment tenders. The state investment policy will be determined by the Public Investment Program within the annual limits of the Republican budget. In addition to that the work will be carried out to develop mechanisms for attraction of investments with no direct participation of the state, including through active development of the Kazakhstani insurance and stock markets.

10. In regard to the <u>stock market</u> the policy of the state will be focused on its development as an effective mechanism for mobilization and re-distribution of internal savings and funds of potential foreign investors with creation of necessary conditions for attraction of portfolio investments into the real economy. Issuance of shares and bonds by Kazakhstani

organizations, issuers of non-state securities should become one of the key mechanisms for attraction of investments into the economy of Kazakhstan.

11. The policy in the agricultural sector will be developed through promotion of competitive industries. For the purpose of comprehensive development of industries of the agroindustrial complex, the agrarian policy will be planned and coordinated with the Program of development of the light, food processing, pharmaceutical industries, and the agricultural machinery building industry and the industry of construction materials. The Government will continue land reform aimed at improvement of the land legislation and land relations in the Republic, development of the land market, creation and improvement of the normative and legal framework and the system of state registration of rights for real estate, and development of mortgage lending against pledged land and land titles. The process of technical demarcation of lands of farming units will be completed followed by registration of land titles in the justice bodies.

12. In the field of housing construction the authorities of Kazakhstan intend to develop new methods of mortgage lending to the population and commercial builders including provision of housing for long-term lease with the right of subsequent purchase. Pilot projects will be developed and introduced to create a system of construction savings.

13. The regional policy in the medium-term perspective will be aimed at ensuring effective interaction between the central and local management bodies in implementation of the social and economic reforms, development of the principles of territorial self-government with corresponding legal and financial provisions. The Government of the Republic of Kazakhstan is to improve the current system of formation and execution of the budget at all levels whilst strengthening the power of local executive bodies. It is expected to expand the competence of Akims in regard to determination of the size and types of social assistance. To solve the social problems of the population of the least developed districts the Government will continue the microcrediting program using grants and loans of international financial agencies. The Government also intends to increase the interregional competition on the financial markets, on the markets of labor and investments by promoting free movement of labor, capital and investments.

14. In the field of social protection and fight against poverty the Government of the Republic of Kazakhstan will pursue the policy aimed at stabilizing the living standards of the population by effective realization of the labor potential, timely payment of salaries, pensions, allowances and targeted social assistance to the poor. The social assistance will be targeted to the really needy, and the poverty level will be the only criteria for its provision. The Government of the Republic of Kazakhstan confirms its commitment to the Pension Reform started in 1997 and absolute and timely fulfillment of its obligations on payment of pensions and allowances. The fully-funded system will be strengthened through improvement of the pension asset recovery, strengthening of prudential control over activities of pension funds based on internationally accepted accounting standards, and expanded supplies of first-rate assets for investments,. One of the most important conditions for successful implementation of the Pension Reform is creation of a sustainable and stable insurance market capable to ensure life annuities for the participants of the fully-funded pension system and creation of a system for payment of allowances on disablement and loss of a bread-winner.

15. In the employment field the Government of the Republic of Kazakhstan intends to establish permanent monitoring of the poverty and unemployment levels, to improve the system of

public works with an allowance to the change of their payment system and source of financing; to improve and develop the system of microcrediting to the poor unemployed citizens; develop and implement a number of measures aimed at encouraging employers who create jobs, especially in rural areas as well as promote business in the Republic in order to provide employment for the unemployed. A social insurance system will be developed.

16. In healthcare the efforts of the Government of the Republic of Kazakhstan will be focused on the implementation of the State Program "The Health of the Nation"; introduction of cost recovery mechanisms for medical assistance and restructuring of the sector in order to develop a free market of medical services and keep the healthcare affordable to large groups of the population.

17. The main aspects of the activities include:

- stage-by-stage transfer from in-patient to out-patient principles of treatment through arrangement of day-time in-patience, at-home in-patience and further introduction of the institute of family doctors;
- as well as further development of the non-state healthcare sector and stage-by-stage privatization of treatment-and-preventative institutions.

18. In the field of environment the Government of the Republic of Kazakhstan intends to optimize the nature management system, to expand the participation of the state in international environmental programs, to create conditions to transfer to ecologically safe technologies and increase the level of recycling. The work will be continued on creation of an effective system of nature management, subsurface use and environmental control on the Republican and local levels. Within this work it is expected to modernize the production of cartographic and topographic and land-surveying products with the help of international financial institutions.

19. One of the key priorities of the authorities of the country in the real sector of the economy is development of the transport infrastructure, reduction of the transport component in the cost of the domestic production and further development of the transit capacity of the Republic. For this purpose the Government will improve the legislative framework for carriers and operators on the transport and communications market of the country and will continue its policy of sectoral reform implying narrowing of the sphere of activities of natural monopolists and transfer of special functions to the private sector.

20. The energy policy will be aimed at developing a competitive and technologically connected fuel and energy complex. For this purpose active measures will be undertaken for the development of the fuel and energy complex of the country to ensure energy independence and delivery of energy resources to the world consumption markets. The Government intends to determine its position with the layout of export gas and oil pipelines and proceed to the design and construction of its separate parts taking into account creation of multi-optional ways of energy resource transportation. For the purpose of further reformation of the energy sector, the Government of the Republic of Kazakhstan intends to complete privatization of energy producing capacities by 2002, and create a competitive wholesale energy market. In 2002, the Government will develop and introduce a new tariff policy which will fully cover the cost and aimed at reducing the independence of the tariff on electricity transmission distance which will create stricter competition between energy sources in distribution of the generated energy and ultimately will reduce energy prices.

21. The Government will continue improving the public sector management system, inter-departmental and inter-sectoral coordination; will undertake further steps to restructure the civil service and increase professionalism of the central and local executive bodies. For this purpose a Program will be developed and introduced on decentralization of the functions of state bodies, functional analysis of each central state body and further functional codification of state bodies and civil service positions; improvement of the civil service law and increase in the efficiency of the state decision-making procedure.

22. Within the Anticorruption Program the work will be carried on disclosure of corruption, and acts will be developed and adopted to regulate the procedure for imposition of disciplinary penalties, taking oath by civil servants and observation of the ethic code. The Government of Kazakhstan is assured that the measures proposed in the Program will help to put the economy on the path of sustainable economic growth. The implementation of the Program will help to correct the existing imbalances in the economy, to create conditions for the development of domestic commodity producers, to expand the taxable base and expedite solution of social problems on this basis.

23. The cooperation with the World Bank Group will be implemented on the principles of partnership and active involvement of financial, administrative and intellectual capacity of the Group in solution of urgent issues related to the development of the economy of Kazakhstan. The authorities of the Republic will specially focus on optimization of the current credit portfolio of the country, the balance of investment and adjustment loans and improvement of the management and implementation of the projects both on the level of individual borrowers and the level of the Government on the whole.

Annex 17: The CAS Consultation Process

Between November 1999 and June 2000, several rounds of consultations took place with different members of the civil society in Kazakhstan. These included non-governmental organizations (NGOs), focus groups of citizens in Kostanai, Ust Kamenagorsk, Astana, Karaganda and Zhambul oblasts of the country, the donor community, Parliamentarians, and representatives from the private sector.

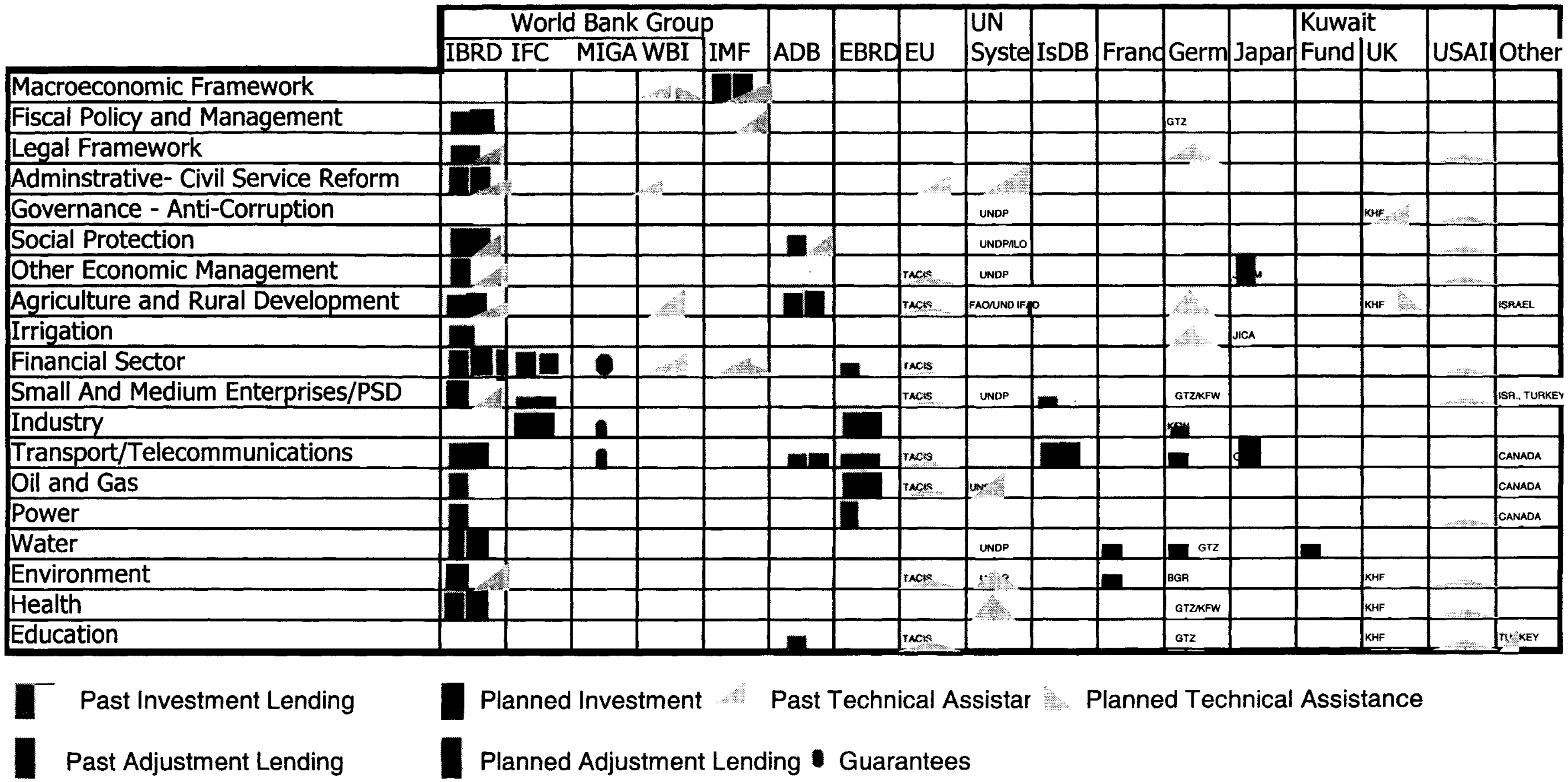
The following table is a summary of the comments raised by the groups, and Bank staff responses to the comments and issues as it relates to the strategy.

	Comments from Civil Society	*Bank Staff Response/Proposals*
A.	***Stimulating broad-based private sector led growth***	
	1. Address the problems dealing with a lack of credit in the economy, especially for longer than 9-12 months. This is especially true for agriculture, but also for small and medium enterprises.	*1. The Bank would address these issues in agriculture through the APPAP II and agricultural services projects. The Financial Infrastructure project would also help deepen the market for financial instruments. IFC would continue to support medium and long term credit lines for on-lending to SMEs.*
	2. Collateral requirements of the commercial banks are too strict and limits credit to agriculture. Land registration and re-registration is too expensive to be affordable for farmers, specifically the issue is vital for re-settlers.	*2. The APPAP II will explore lending through cooperatives and the Real Estate Registration Project would roll out the infrastructure for registering property rights to the entire country. Work carried out under the Rapid Response to help design a "warehouse receipts" scheme would help address the collateral concerns.*
	3.Broader instruments are needed for the investments of the Pension Funds to make effective use domestic financial savings.	*3 Continued implementation of the Pension Reform Loan by pushing forward the "blue-chips" privatization and the Financial Infrastructure project would help develop new instruments such as mortgage.*
	4. Services needed for development of rural businesses such as transporting products to market, procurement of elite seeds, accessible veterinary services, business consulting for beginning farmers and managers of farming entities are weak or not available.	*4. Agricultural Support Services Project would focus on streamlining delivery of services to the farmers, including the seed sub-sector and veterinary services Rural Roads project is expected to help ease transport constraints.*
	5. Lack of legal knowledge and unaffordable consulting services discourage many people from their own business.	*5. Public information component of the Legal Reform project which is under implementation would focus on disseminating basic legal information. The Bank Group SME Dept. is working on the development of CABSS to provide pre- and post-project support to SMEs.*

B.	***Enabling a reformed public sector***	
	1. Local officials are not accountable, and need to be made so. Activities of akimats (provinces) are to be transparent, open to public scrutiny.	*1. The civil service reforms supported by PSRMAL II are aimed to increase the system of accountability for local officials.*
	2. Doing business is made difficult because of numerous licensing, auditing requirements imposed by Government officials Lack of transparency and impunity of government officials lead to bribery and corruption especially in getting licenses or credits. Abuse of power by government officials lead to collapse of some businesses.	*2 Survey on Governance and Service Delivery is expected to identify impediments to the private sector development originating from excessive controls and audits.. Streamlining excessive controls would be addressed under the programs supported by SPRAL, PSRMAL II and CSAL.*
	3. Stability of legislation is critical. Very often laws are adjusted to convenience of the government officials. Vague parameters allow free interpretation of legal and normative acts. No consistency and little public knowledge of legislation.	*3. Training of judges and improvements in the court administration as well as elimination of inconsistencies in the legislation are handled under the judicial strengthening and legislative drafting components of the Legal Reform Project respectively.*
	4. Though petty corruption is more visible, it can not be dealt separately from high level corruption.	*4. Actions agreed by the Government as CAS triggers such as the public declaration as well as clear separation of private sector activities by government officials would help set examples. Further actions such as public disclosure of all government contracts will be discussed with the Government during PSRMAL preparation.*
C.	***Supporting the most vulnerable***	
	1. The income to pay for social services, such as health and education, were lacking.	*1. The Health II project would take special care to make essential services affordable to the poor. The policy conditionalities associated with SPRAL would allow better targeting of social protection expenditures to the poorest.*
	2.Health indicators and the quality of health services are deteriorating rapidly	*2. The restructuring effort of the primary care which was initiated under the Health I project in two oblasts will be expanded by six more oblasts under the proposed Health II project, covering more than 60 percent of the population.*
	3. The quality of education is in the decline. There are concerns about the coverage, decline in enrollment rates, relevance of the curricula.	*3. The Bank is in dialogue with the Asian Development Bank which is taking the leadership in providing external assistance to the sector.*
	4. Unemployment is very high in rural areas. Young people leave for cities, old people have	*4. Discussions are underway on the development of a sensible public works*

	to let out their land under crushing terms. 5. Pension payment is regular, however, the assigned amounts are discriminatory. Earlier retired are under unfair payment.	*program in the context of the SPRAL preparation. The proposed Rural Roads project would be designed with a view to providing jobs in the rural areas for the rehabilitation and the maintenance of rural roads. Housing Finance component of the proposed Financial Infrastructure project would be, inter alia, creation of employment in the construction industry.* *5. Agreements under the Pension reform Loan provide for indexation of pensions from the old system to cost of living changes.*
D.	***Protecting the environment***	
	1. There is a need to coordinate the array of activity by donors on various environmental projects. 2. Degradation of land is a problem. In dry years the areas of alkali soil are growing fast 3. Water and sewerage systems are a threat to environment and health of people. 4. Solid waste and dumping sites including disposal of poisonous chemicals are a problem. It also has impact on water in rivers. 5. Semipalatinsk test site problem has not been resolved.	*1. The Bank has, and will continue to, work closely with other donors to ensure that our efforts are complementary to those by the others, and provide added value.* *2. The proposed GEF grant for Drylands Management would pilot conversion of virgin lands taken out of production to pastures in two rayons in Northern Kazakhstan.* *3.Reform of the urban water sector would be undertaken in a number of cities under the proposed Northern Vodocanal project based on the experience developed though the Atyrau Pilot Water Supply project.* *4. Nura River Clean-up project will address the issues of pollution of water bodies together with the multi-donor financed projects in Zone B* *5. A UNDP/Japan led multi-donor program (including a component of the Health I project) is underway to address the issues of Semipalatinsk.*

Annex 18: Partnerships



MAP SECTION

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