

**ASIAN DEVELOPMENT BANK**

**STS:KAZ 96031**

**KAZAKSTAN**

**COUNTRY OPERATIONAL STRATEGY**

**Programs Department (East)  
Division III**

**December 1996**

## CURRENCY EQUIVALENTS

(as of 30 November 1996)

Currency Unit	-	Tenge
T1.00	=	\$0.0145
\$1.00	=	T69.00

The exchange rate for the Tenge is determined at regular auctions for foreign exchange conducted by the Central Bank.

## ABBREVIATIONS

APB	-	Agroprombank
ASF	-	Agriculture Support Fund
CAAEF	-	Central Asian-American Enterprise Fund
CG	-	Consultative Group
CUFC	-	Committee for the Utilization of Foreign Capital
EBRD	-	European Bank for Reconstruction and Development
EFF	-	Extended Fund Facility
EU	-	European Union
FSU	-	Former Soviet Union
GDP	-	Gross Domestic Product
HDI	-	Human Development Index
IDB	-	Islamic Development Bank
IFC	-	International Finance Corporation
IMF	-	International Monetary Fund
MOE	-	Ministry of Education
MOTC	-	Ministry of Transport and Communications
MOU	-	Memorandum of Understanding
NAFI	-	National Agency for Foreign Investment
NBK	-	National Bank of Kazakstan
PIP	-	Public Investment Program
PRC	-	People's Republic of China
SDP	-	Sector Development Program
SOE	-	State-owned enterprise
TVE	-	Technical and vocational education
UN	-	United Nations
UNDP	-	United Nations Development Programme
UNESCO	-	United Nations Educational, Scientific and Cultural Organization
UNFPA	-	United Nations Fund for Population Activities
UNICEF	-	United Nations Children's Fund
USAID	-	United States Agency for International Development
WHO	-	World Health Organization

## MEASURES

km	-	kilometer
km <sup>2</sup>	-	square kilometer
ha	-	hectare
GWh	-	gigawatt-hour

## NOTES

- (i) The fiscal year (FY) of the Government ends on 31 December.
- (ii) In this Report, "\$" refers to US dollars.

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## COUNTRY PERFORMANCE INDICATORS

## EXECUTIVE SUMMARY

During the Soviet period, the Republic of Kazakhstan enjoyed a full employment economy and considerable subsidies from the rest of the former Soviet Union (FSU). Its economy was closely tied to that of the rest of the FSU, with production specialization and trade connections determined in Moscow. With the breakup of the FSU, Kazakhstan lost its subsidies, its trade was disrupted, and much of its industrial capital became worthless.

As a result and in common with other FSU states, after independence, Kazakhstan experienced a severe depression. Output declined sharply and continuously after 1990 to about half of its earlier level by 1995, though there are signs that the contraction is coming to an end. Employment has fallen less than output, but an estimated 9.0 percent of the labor force lacked full-time employment in mid-1996. Open unemployment is expected to increase with continuing restructuring in industry. The contraction in aggregate demand and output has been particularly severe in the many company towns in Kazakhstan—isolated urban areas developed around large integrated industrial activities, often tied to the former Soviet military-industrial complex.

Starting from the relatively low per capita income level the country had before independence, and with the drastic decline in real output, the incidence of poverty has increased. In 1995, 37 percent of the households had incomes below the poverty line. The impact of this difficult transition period has been particularly severe for elderly pensioners and for children in poor households. Pensioners have seen their savings destroyed by rapid inflation and the real value of their pensions decline. The condition of children in poor households has dramatically declined with growing poverty and the deterioration and closure of social service facilities such as schools, daycare centers, hospitals, and clinics. The fall-off in family and social service support has increased the difficulties for many women, reducing economic opportunities and complicating child care. Detailed discussions of these problems are found in the three appendixes to this document, on: (i) The Social Costs of Transition, (ii) Gender-Related Transition Issues, and (iii) The Impact of Transition on Children. In addition, issues concerning sustainable development are discussed in Appendix 4, Environmental and Natural Resources.

In response to the economic difficulties, the Government has committed to a program of macroeconomic stabilization and structural reform. After more than three years of very high inflation, serious anti-inflation actions began in the second half of 1994. By the end of 1995, inflation had fallen to single-digit monthly levels. Fiscal imbalances have also been a problem, but as one indication of progress, the Government and the International Monetary Fund (IMF) are planning to shift from the current Stand-by Arrangement to an Extended Fund Facility, which would be a three-year program emphasizing structural adjustment policy reforms, in addition to continued macroeconomic stabilization.

Since independence, there has been considerable progress in institutional reform towards a market-based economy. The Government has freed most prices and allocation decisions. The Government's privatization program has transferred to the private sector (i) housing assets, (ii) most enterprises in the service sector, and (iii) a considerable portion of the small and medium-scale enterprises. In spite of this, progress in taking on real ownership functions, including internal restructuring and labor rationalization, has been slow. Moreover, many large enterprises remain under state ownership. The reform process has not promoted a financial sector that can support the nascent market system. Nearly all banks are burdened by large portfolios of nonperforming loans and most are technically insolvent. The incomplete structural reforms will delay any recovery from the current depressed economic conditions.

The main objectives of Bank activities in Kazakhstan follow closely from the developmental needs for the country:

- (i) supporting the Government's reform agenda, encouraging institutional change, and strengthening the provision of public services;
- (ii) promoting the rehabilitation of the environmental resource base of the country;
- (iii) strengthening the long-term potential for the country by investing in physical infrastructure and in human resource development; and
- (iv) encouraging the creation of a new structure of output and new production capacity through private sector investment.

Kazakhstan's developmental needs are vast, but the Bank's resources and experience in working with the country are limited. Moreover, other funding agencies provide extensive support and technical assistance. Therefore, it is suggested that Bank activities focus on a limited number of strategic sectors and subsectors:

- (i) strengthening the management of reform at the Central Government and local government levels;
- (ii) infrastructure, especially rehabilitation projects;
- (iii) education and training;
- (iv) industry, focusing on the problems of medium-sized enterprise reform; and
- (v) agriculture.

In implementing this strategy, a number of strategic considerations must be addressed, including coordination with the European Bank for Reconstruction and Development (EBRD) and subregional activities. With respect to the EBRD, the strategy calls for progressive Bank involvement in the private sector. In few countries outside of the FSU, is there such a compelling case for private sector activities to be directly supported by multilateral funding agencies such as the Bank. In Kazakhstan, under three generations of Soviet rule, almost no private sector had been allowed to develop. Thus, the Bank should develop a carefully designed program of support for the private sector. The Memorandum of Understanding signed in 1994 with the EBRD delineating areas of responsibility for the two regional development institutions should be revised accordingly. The Memorandum specifically envisages that its guidelines would be reviewed after completion of the first programming cycle.

Several of the sectors in which the Bank will be active involve cross-border issues within the subregion of Central Asia. Notable examples are transport, electric power, the environment, and water resources. Beyond ensuring that its activities in each country are consistent with what is being done in the others, the Bank should endeavor to undertake regional investment and policy coordination, and promote efforts to ensure a rational pattern of resource use in the area as a whole.

**MAP**

## I. THE ECONOMIC AND SOCIAL CONTEXT

### A. Macroeconomic Developments of the Transition

#### 1. Production and Output

##### a. Aggregate Output

1. As a constituent republic of the former Soviet Union (FSU), the pattern of output and trade in Kazakhstan had been determined in Moscow. The decisions flowed from central planning considerations and often had little relation to economic efficiency or rational regional specialization in light of international markets or world prices. A large fraction of Kazakhstan's industrial output had been tied to the Soviet military-industrial complex. Kazakhstan received considerable subsidies from the rest of the country, but even so had a per capita income level below that of the Soviet Union as a whole and one of the lowest rates of growth of income. With the breakup of the Soviet Union, Kazakhstan suffered a severe shock from the disruption of trade, much of its industrial capital lost its economic rationale, it lost the subsidies it had enjoyed, and it faced the task of developing market institutions and economic policy with little knowledge or experience.

2. These changes plunged the country into a severe depression. Output declined sharply and continuously after 1990, though there are signs that the contraction is coming to an end.<sup>1</sup> As measured by the official statistics, aggregate output fell by 57.3 percent between 1990 and 1995. Data on gross domestic product (GDP) are extremely uncertain, partly because the reporting system covering enterprise operations has weakened with the breakdown in the former centralized planning system. The State Committee on Statistics and Analysis (Goskomstat) has not yet been able to provide comprehensive coverage of activities in the newly emerging private and informal sector, especially in services. Moreover, data on international trade are very incomplete owing to a lack of customs posts between FSU republics and the complications introduced by the growing importance of barter trade. In particular, tax evasion in the export trade, made simple by the lack of customs controls, has distorted statistics.

##### b. Industry

3. The economic depression after independence has affected all sectors, but especially industry. In 1995, industrial output was approximately 68.9 percent below the 1990 level. There are many specific reasons for the near collapse of industrial production. With independence, the regular supply of inputs was suddenly interrupted as formal marketing arrangements within the FSU countries unraveled. Output marketing was similarly disrupted. Final demand in Kazakhstan contracted as financial support ceased from the FSU. The collapse in Soviet defense industry purchases also had a severe impact on industries in Kazakhstan. In some industries, the output decline was exaggerated by monopolistic structures and administered prices that translated weak demand into a fall in output instead of prices. The construction industry has also been severely affected by the ongoing weakness in economic activity, compounded by reduced public investment. The construction of dwellings in 1995, for example, was only 19.7 percent of the 1990 level.

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<sup>1</sup> Detailed discussion of the economy can be found in ECR KAZ 94019: *Economic Report on Kazakhstan*, October 1994 and in EBO KAZ 95014: *Economic Review and Bank Operations, Kazakhstan*, October 1995.

4. The impact of the economic developments have been particularly severe in the many company towns in Kazakhstan. These are 40 to 50 isolated urban areas developed around large integrated industrial activities, often tied to the former Soviet military-industrial complex or designed to supply inputs to enterprises in the rest of the FSU. In these towns, one enterprise provided nearly all employment in the area plus a whole range of social infrastructure, including schools, health facilities, and urban utilities. These company towns provide few alternative livelihood opportunities and many of their inhabitants have emigrated to other countries.

5. At the end of 1994, from a very low level, activity began to increase in some subsectors. In December 1995, the index of industrial production was 10.3 percent above the comparable figure for 1994. Iron ore, cast iron, benzene, bauxite, lead, zinc, electricity, and natural gas production all increased in 1995 compared with 1994.

6. From a longer-term perspective, sustainable recovery in Kazakhstan's traditional industrial base will not come simply with a revival in aggregate demand. These industries were established under the Soviet central planning system with little regard to underlying comparative advantage. Industries were implicitly subsidized through the low prices for inputs and transport. The sharp increase in energy and transport prices after independence has revealed a lack of competitive advantage for much of Kazakhstan's industrial base. Sustainable growth will come to the sector only when new investments allow expansion in industries where the country enjoys some comparative advantage. United Nations Industrial Development Organization (UNIDO) suggests, for example, that agro-processing industries, including food and textiles, could grow and provide a strong sustainable export base for the country.

7. Kazakhstan also has a comparative advantage in the energy subsectors. The country has vast exploitable oil and natural gas reserves. Estimates of potential reserves vary, but conservatively are on the order of 3.5 billion tons of oil and 2 trillion cubic meters of gas. There are severe difficulties in realizing this potential wealth. In particular, the infrastructure reflects the older organization of economic activity in the FSU. Most Kazak crude oil, for example, had been refined in what is now the Russian Federation, and increased production and sales of Kazak oil would require increased use of Russian pipeline facilities. New markets for the extensive energy resources can only be developed through the costly, time-consuming construction of new pipelines—a process complicated by the geographical location of the country.

### **c. Agriculture**

8. Grain and the related livestock subsector account for the major portion of activity in agriculture; approximately 80 percent of agricultural land in Kazakhstan is used for grazing. Under the previous command economy, the agriculture sector expanded by increasing the use of land and other inputs. The Virgin Land campaign of the 1950s greatly expanded the arable land, bringing into use approximately 25 million hectares (ha) of the present 35 million ha.

9. The most critical and urgent problem in the agriculture sector today, and thus a serious concern of the Government, is the unprofitable farming throughout the country. The Ministry of Agriculture estimated that about 80 percent of all farms in the country were loss-making in the 1995 growing season. Such a wide scope of unprofitable farming is the result of a combination of many factors, including an inappropriate farm structure, poor farm management, low output prices at the farmgate, and a collapse of the rural banking system. These factors have led to a liquidity crisis in the rural area, where most farms have neither cash nor credit to finance their input purchase. Consequently, the use of purchased inputs has virtually ceased, except for a minimal amount of fuel that is absolutely necessary to enable planting and

harvesting. The problems have then led to a “low-input, low-output” pattern of subsistence farming. The weak demand for agricultural inputs has imposed a serious constraint to input producers and suppliers, restricting the recovery of agro-industry.

10. In addition to a lack of inputs, the sector was also affected by output price interventions that discouraged production. The state orders system and the later state needs system, were examples of such interventions, obligating farms to provide the state with specified levels of output at administered prices. In 1990, for example, the state allocated to itself almost 56 percent of total wool production and 53 percent of the total cereal crop. State orders were paid for at administered prices that, before 1993, were set 30 to 50 percent below world prices. The combination of a lack of inputs, constrained marketing, and low output prices discouraged production and inhibited the development of new farm activities. The system of state orders has dramatically changed, with much smaller purchases and prices set closer to market levels. For example, the state purchase of wool in 1995 was only 11 percent of its 1990 purchase. In a major step towards liberalizing the agricultural output markets, an open auction market for grain, was established in 1995, allowing the Government to purchase grain at market prices.

## **2. External Sector**

11. Kazakstan’s trade, like that of the other FSU republics, was disrupted considerably by events surrounding independence. The breakup of the interrepublican payments system, the downward spiral of aggregate demand, and the collapse of the Soviet defense industry all took their toll on trade. There has been some recovery. Kazakstan has benefited from the overall increase in energy prices in the region. Energy and mineral resources now dominate export trade. In 1995, the main exports were oil and gas condensate, and nonferrous and ferrous metals.

12. Kazakstan has developed a deficit in merchandise trade.<sup>1</sup> The Government estimates that the merchandise trade deficit in 1995 was approximately \$668 million, approximately 4 percent of GDP. The current account deficit was 6.2 percent of GDP, reflecting considerable transfers associated with emigration and interest payments on external debt. The analysis of this sector is complicated because trade data in the Central Asian Republics are highly uncertain—a result of the lack of customs posts between FSU republics and complications introduced by barter trade. International barter transactions amounted to approximately 19 percent of total trade. The valuation of this trade is extremely difficult to ascertain. The Government has taken administrative steps to discourage the use of barter trade, but it remains to be seen if enforcement is possible.

13. Reflecting locational advantages and historical marketing patterns, the main trading partners of Kazakstan are the FSU republics. Among these, the Russian Federation is the most important: in 1995, the Russian Federation alone accounted for approximately 44 percent of total trade turnover. Within the FSU, trade with regional neighbors such as Turkmenistan and Uzbekistan continues to be important, but since independence nonFSU markets have opened up and markets in People’s Republic of China (PRC), Germany, Netherlands, Switzerland, and United Kingdom have become significant.

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<sup>1</sup> There are serious difficulties in collecting external sector statistics. Estimates within the Government concerning the trade balance vary considerably. This report relies upon information supplied by other multilateral agencies particularly the IMF.

14. The capital account activities include medium- and long-term loans, trade credits, and foreign direct investment. The last reflects investments in agro-processing (such as tobacco and leather); energy (particularly oil); and minerals (including gold mining). Reported agreements on the construction of an oil pipeline around the Caspian Sea through the Caucasus to transport oil to Russian ports on the Black Sea may increase the prospects of foreign investment in oil production and transport.

15. Disbursements from official loans have been somewhat slower than anticipated, increasing pressure on the Government's fiscal resources, particularly for development projects. Kazakhstan's external foreign debt results from medium- and long-term loans extended by bilateral and multilateral agencies; but also from interrepublican agreements regarding the distribution of the FSU's debts and assets. The stock of external debt increased in 1994, from \$1.8 billion to \$2.8 billion, equivalent to 25.5 percent of GDP. In the beginning of 1995, the external debt declined as a result of an agreement with the Russian Federation. This agreement canceled \$1.4 billion in outstanding obligations to Russia and resolved issues concerning the continued usage of the FSU space center at Baikonur. Of the outstanding external debt of \$2.0 billion at the end of 1995, over one third is from multilateral sources.

### **3. Macrostabilization: Progress on Inflation and Fiscal Imbalances**

16. The macroeconomic stabilization program has been drawn up with the support of the International Monetary Fund (IMF). The present program utilizes the Stand-by Arrangement approved on 5 June 1995. This program continued a previous Stand-by Arrangement and support extended by IMF in July 1993 under the Systemic Transformation Facility. The programs have targeted a reduction in inflation and fiscal imbalances through tighter credit creation and monetary policy, and a reduction in the fiscal deficit.

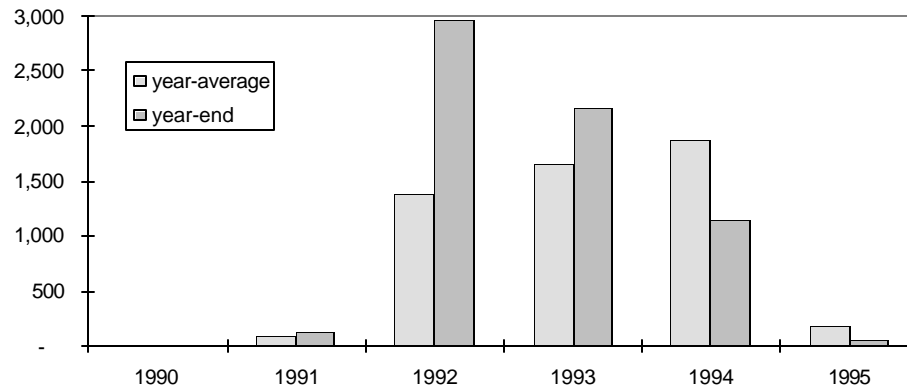
#### **a. Inflation and Monetary Policy**

##### **i. Inflation**

17. The evolution of annual inflation in Kazakhstan reflects much of the broader economic crisis. In 1990, the reported annual inflation rate was 4.2 percent. With the breakup of the FSU, however, inflation jumped to nearly 3,000 percent (see Figure 1). Hyperinflation characterized all the FSU economies using the Russian currency, the ruble, after the breakup of the Soviet Union, and annual inflation in Kazakhstan remained above 1,000 percent through 1994. The establishment of a national currency, the tenge, in November 1993, and the development of the tools of monetary control by the central bank, offered the Government the opportunity to target a reduction in inflation. Serious anti-inflationary action began in the second half of 1994, and, over the year, price increases began to slow. By the end of 1995, inflation had fallen to 60 percent (on a 12-month basis). The Government is targeting annual inflation rates of 26-28 percent in 1996 and continued moderation to the 9 to 12 percent range by 1998.<sup>1</sup>

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<sup>1</sup> Government of the Republic of Kazakhstan. *Program of the Actions of the Government on Deepening the Reform for 1996-1998*. Almaty. November 1995, p. 6.

**Figure 1: Consumer Price Inflation**

18. After independence, some increase in inflation in Kazakhstan was unavoidable as prices moved up to world market levels. The pressure was most obvious on the prices of tradable goods such as mineral and energy products. The continued control over enterprises by Government ministries sometimes dampened price adjustments; however, over time, prices of urban services and other nontradable goods rose when limited fiscal resources began to preclude the continued subsidization of loss-making enterprises. Most price controls had been lifted by mid-1995. Most notably, the prices of bread (the staple food in the region), grain products, and livestock fodder were freed in 1994, and progress was made on the liberalization of energy prices, particularly oil and coal. Fixed prices for crude oil and oil products were eliminated, as were controls on profit margins for refinery operations.

## ii. Monetary Policy

19. Price adjustments, however, were not the major factor behind three years of hyperinflation. Hyperinflation is a monetary phenomenon. In 1994, for example, base money expanded by more than 680 percent, and broad money by 710 percent. The major cause of the monetary expansion in Kazakhstan was the growth in credit extended to loss-making enterprises. Credit was provided either at the direction of the Government through the central bank or from suppliers. This credit expansion was an essential part of the interenterprise arrears problem, common in all FSU republics.

20. The lack of discipline in the financial system encouraged the continued delivery of credit to large enterprises regardless of the commercial viability of the underlying activity. Firms arranged for credit in order to continue the production of goods and services even though final market demand had collapsed. A failure to reform the financial sector was a fundamental factor inhibiting any improvement in the overall economy. Moreover, the Government contributed to this situation by directing credit to avoid closing firms and farms facing difficulties, and thus avoid unemployment. Consequently, inventories of unsaleable goods built up, financed by nonperforming debt. The debt overhang ultimately became a barrier to the successful reform of firms and farms—privatization exercises had to address the existing debt burden in order to transfer ownership.

21. The Government periodically attempted to deal with the interenterprise arrears through clearing operations. In early 1994, the Government assumed debts or other obligations

equivalent to more than 7percent of GDP. Clearing operations continued in 1995, with the transfer of nonperforming loans to specific institutions for debt resolution. These operations included transfers of debt from large loss-making firms to the Rehabilitation Bank, farm debts to the Agricultural Support Fund, and export credit-based debts to the Export-Import (EXIM) Bank. The operations provided a clear balance sheet for firms and financial institutions, but exacerbated existing fiscal and monetary difficulties by ratifying the debt-associated credit creation. In addition, these operations present a moral hazard by signaling that the Government will periodically clear the arrears of an enterprise and accept debt resulting from the improper extension of credit: clearing exercises discourage good corporate governance. The problem is serious and continuing. Through the first 11 months of 1995, aggregate losses by enterprises represented approximately 22 percent of GDP.

22. Parallel to efforts to resolve interenterprise arrears problems, the monetary authorities continued to develop their instruments for conducting monetary policy. Auctions of National Bank of Kazakstan (NBK) credits had been introduced in 1992, and their importance has increased alongside diminished use of directed credit. "As a result [of the development of credit auctions and foreign exchange auctions], directed credits are no longer a principal instrument of economic policy."<sup>1</sup> Auction credit rates and the NBK refinance rate, the rate that would be attached to directed credit, were progressively raised. This was done alongside a successful action to moderate credit creation. To complement credit auctions, NBK began to develop the financial securities markets by issuing state treasury bills. Overall, since 1994, the development of money markets and policy tools has resulted in generally tighter monetary policy. The growth of the money supply in 1995 was still rather high, with base money expanding by 105 percent and M2 by 136 percent. This does, however, represent progress over the performance in earlier years.

23. The relatively tighter monetary policy has aided in stabilizing the exchange rate of the tenge. The tenge was introduced in November 1993 at a rate of T1 to 500 rubles and \$0.21. NBK utilized foreign exchange auctions to set a price for the tenge and the hyperinflation in the country was rapidly reflected in the auction rate. The tenge steadily depreciated against the US dollar until mid-1995, when some stabilization could be seen. The rapid reduction in inflation in 1995 has removed the most obvious signal leading to currency depreciation although Kazakstan's inflation rate is still above that for dollar-denominated goods and services in world markets. In 1996, as a result of this inflation, the tenge depreciated, and in mid-1996, was trading at T65 to T67 per dollar.

#### **b. Public Sector Spending and Resource Mobilization**

24. Prior to 1991, fiscal policies and operations in Kazakstan were largely determined by Soviet Union authorities in line with the State Economic Plan. The central authorities enacted fiscal legislation and controlled the state budgetary process. Revenue-sharing schemes were adjusted annually in accordance with the revenue-raising capacity and expenditure needs of each FSU republic. State budget deficits at the republic level were covered by transfers from the central budget. Kazakstan received considerable fiscal support through these union transfers, providing for substantial expenditures in the social sectors and for public investment. By 1989, Union transfers accounted for about 10 percent of GDP. This centralized fiscal system did not contribute to economic efficiency because there was little incentive for the Kazakstan

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<sup>1</sup> Republic of Kazakstan, Cabinet of Ministers, *Main Results of the Policy Reforms during 1994-1995 and the Program of Systemic and Economic Transformation in the Republic of Kazakstan for 1995-1997*, p. 4.

government to improve resource mobilization or rationalize expenditures on the basis of resource availability and sectoral priorities.

25. The breakup of the FSU had a severe impact on the fiscal balance. The generation of adequate Government revenues became difficult as output at state enterprises declined because of the disruption of trade and the downward spiral of aggregate demand. Kazakhstan also lost the Union budgetary transfers. The consolidated state budget moved from a rough balance in 1990 to a deficit of over 12 percent of GDP in 1991.

26. During 1992-1993, the Government took a number of steps to control expenditures and raise tax revenues. Expenditure cuts were accomplished by (i) curtailing Government consumption by over 20 percent in real terms, (ii) reducing the real remuneration and benefits of civil servants, (iii) containing transfers and subsidies, and (iv) cutting public investment outlays. Although the Government also introduced new taxes, tax revenues fell through 1993 because of weak economic activity and increasing problems in tax collection and administration especially connected with the collection of the value-added tax.

27. In 1994, the Government's fiscal position deteriorated sharply, mainly because of its quasi-fiscal operations designed to reduce the debt overhang of interenterprise arrears (see para. 21). As a result of limited revenues and the need to finance the quasi-fiscal debt clearing operations, the Government reduced expenditures further: spending fell for most major budget categories, particularly for infrastructure investment and maintenance.

28. Significant progress was made in improving fiscal performance in 1995: the budget deficit was reduced sharply, from 6.8 percent of GDP in 1994 to 3.7 percent. This was achieved by raising Government revenues and restricting support for quasi-fiscal operations. An improved revenue position resulted largely from non-tax sources, including privatization, tax efforts remain somewhat weak. To enhance tax revenue, the Government introduced a new comprehensive tax code. The new code reduces the number of taxes from 46 to 11 in an effort to simplify and rationalize administration and collection. The inclusion of preferential tax treatments in the new tax code will, however, initially result in a lower overall tax effort than under the old system. Revenue actions also provided for an expansion of the value-added tax base, a tax on automobile ownership, an increase in property taxes, and taxes on petroleum products.

29. The 1996 budget provides for a continued reduction in the overall deficit to 3.3 percent of GDP. This will be achieved mostly by reducing expenditures. Expenditures, as a whole, are expected to decline as a share of GDP; however, increasing expenditures are projected for defense, public order and safety, and public administration.

## **B. Population and Labor Markets, Employment, and Wages**

### **1. Population**

30. The economic structure inherited from the FSU and the ongoing transition for the economy have had major demographic consequences. More than 56 percent of the population live in urban areas and gain their income from industrial activities in the formal sector. The population as a whole is declining because of high rates of emigration, shrinking birth rates, and increasing death rates. The population in the end of 1995 was 16.6 million people, down 1.6 percent from 1994.

31. Emigration is particularly noticeable. Since independence, approximately 10 percent of the labor force has emigrated, and the émigrés have often been the more highly

trained professional and skilled workers. Emigration has been high among ethnic Germans and Russians. The German community of nearly 1 million people in 1989 has declined by nearly one half. The Russian community, comprising 37.8 percent of the total population in 1989, has also experienced a large decline with slightly more than 600,000 people emigrating. The emigration has partly been the result of the depressed economic conditions.

32. The changing economic conditions have also had an impact on the rate of natural population growth. Birth rates have declined from about 25 per 1,000 in the mid-1980s to 16.7 in 1995,<sup>1</sup> while death rates have increased from 7 to 8 per 1,000 in the mid-1980s to 10.2 in 1995. The deteriorating health system lies behind much of these adverse changes, but they also reflect the strain on the family system resulting from increased unemployment and poverty.

## 2. Employment

33. The economic decline and industrial restructuring since independence have resulted in a dramatic increase of unemployment from negligible levels to about 9 percent as of mid-1996. This estimate includes official or open unemployment and hidden unemployment, with the latter accounting for more than one half of the total. These are people with formal working contracts, but actually on uncompensated, forced leave or working without choice in part-time arrangements. Hidden unemployment results from the reluctance of the enterprise and the individual to separate openly. Companies are reluctant to terminate employees, partly to avoid mandatory severance payments. In addition, there are social and political pressures on firms to avoid mass labor shedding. The large semi-privatized enterprises in Kazakhstan are particularly sensitive to this sort of political pressure. Individuals accept this situation partly because unemployment carries a social stigma. In addition, while on leave, these individuals and their families can often continue to enjoy some of the social benefits traditionally provided by enterprises, including schools, daycare, and clinics. Government unemployment compensation appears to be too little, paid only after a relatively lengthy waiting period, and too uncertain to encourage people to formally register their unemployment.<sup>2</sup>

34. Further economic reforms and privatization will probably cause more open unemployment. As the budgets facing firms harden and competitive forces grow, labor retrenchment will become inevitable. In the coming years, major layoffs can be expected in (i) the large-scale industries currently being privatized, (ii) the social sectors now moving to local government control, and (iii) public administration. The large-scale heavy industries in company towns face particularly bleak futures. In these towns, 80-100 percent of the workers depend on one company, with a very limited scope for diversification. Other urban centers, like Almaty or Shymkent, face smaller unemployment problems because of their more diversified economic base and growing service sectors.

35. Women accounted for 51.3 percent of the population and 44.7 percent of the total labor force in 1995. They are working mainly in the social sectors, public administration, finance, and trade. Protection against formal gender discrimination in the labor market was a major FSU achievement. In support of employment for women, the State also provided substantial support for the family through public assistance and social services. The transition to a market economy, with its reduced social support and social service spending, has contributed to a sharp

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<sup>1</sup> The statistics on mortality and birth are still based on Soviet definitions, which differ from internationally accepted standards, but other measures would likely still show a similar pattern of change.

<sup>2</sup> Unemployment compensation is paid from the Employment Fund which, in 1995, was an extrabudgetary fund supported by a tax of approximately 1 percent of the wage bill.

deterioration in the condition of women in the economy. Unemployment appears to be gender-biased, as women accounted for 56.4 percent of the officially registered unemployed in 1995. A more comprehensive discussion of gender issues is in Appendix 2.

### **3. Wages**

36. Under the FSU, cash wages were relatively low, but also relatively equal across sectors. Wage payments were augmented by a comprehensive system of transfers, including social security and special allowances. As a result of the economic distress since independence, real wages have fallen by more than one half. Moreover, wages are often paid in kind or in arrears. Reported wage arrears in Kazakhstan amounted to approximately \$0.5 billion at the beginning of 1996, or approximately 25 percent of the monthly total wage bill for the country. Noncash benefits, such as subsidized housing, health facilities, utilities, kindergartens, and transport, had previously been provided by the state enterprises to their employees and were estimated to comprise over 40 percent of total labor compensation. With the deterioration of the economy, the provision of these services has declined dramatically.

37. The former rough equality across sectors of wages has changed in response to developing market relationships. In December 1995, the average monthly wage was T7,231 (roughly \$110), but the average wage in the agriculture sector was less than half of this while that in industry was more than 50 percent above the average. This wage structure results not only from the changing terms of trade for the different sectors but also from the different market structures: prices and wages in agriculture reflect depressed market demand faster than in industry, where noncompetitive market structures insulate prices and wages from changing demand. Because women are prevalent in sectors and occupations receiving relatively low compensation, their average wages are lower than that for men.

### **C. Socioeconomic Review: The Social Costs of Transition**

38. Given the country's relatively low per capita income level before independence and the drastic decline in real output, measures of household welfare have fallen to levels that result in an acute problem of poverty. If the official estimate of GDP per capita is translated to dollars at the 1995 exchange rate, the figure is slightly below \$1,000.<sup>1</sup> The Human Development Index (HDI) of the United Nations Development Programme (UNDP) reflects the extent of the social costs of this difficult transition period. The HDI for 1990 was 0.848, and ranked Kazakhstan 53 of 170 nations, however, by 1994 the HDI had fallen to 0.685 and the rank to 100.

39. In 1995, 37 percent of the households lived in poverty, with 21 percent of the households in severe poverty. The corresponding poverty threshold was defined at \$31 per person per month, and extreme poverty at \$23. The 1995 figure for the incidence of severe poverty in households of 21 percent should be compared to the 1992 estimate of 10 percent.

40. Poverty in Kazakhstan, although severe and growing, has been cushioned to some extent by the formal social safety net with comprehensive transfer payments from the social security system, local governments, and enterprises. The fiscal crisis, however, limits the assistance from this system. The share of Government expenditure on social protection declined from 4.4 percent of GDP in 1990 to 3.1 percent of a much smaller GDP in 1995.

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<sup>1</sup> The latest World Bank estimate of per capita GNP is \$1,110 for 1994, down from \$1,410 in 1993. The estimation method uses a rolling average of exchange rates and the latest figures continue to be influenced by unrealistic, but official ruble-dollar exchange rates.

41. Pensioners and children have been especially affected. Pensioners' savings have been destroyed by rapid inflation and the real value of pension support decline.<sup>1</sup> The current minimum pension of T1,522 per month is well below the minimum consumption basket. The condition of children in poor households has dramatically declined with growing poverty, and the deterioration and closure of social service facilities such as schools, daycare centers, hospitals, and clinics. There are reports of growing malnutrition conditioned by the growing poverty. School attendance is down, particularly in rural areas where schools cannot be heated in winter and meals cannot be supplied to students.

42. Severe economic depression and fiscal cutbacks have meant particularly hard challenges for women. The closure of social service facilities has meant increased unemployment in fields where women have traditionally been predominant. The restricted provision of social services has also increased the burden on women as traditionally they have accepted the primary responsibility for raising and caring for children and the elderly. Thus the closure of kindergartens, daycare centers, and clinics has reduced their employment opportunities and at the same time increased the difficulties of carrying out the domestic work in their household.

## II. DEVELOPMENT NEEDS AND CONSTRAINTS

43. The development needs and constraints of Kazakstan's economy in transition are vast. The economy is in deep depression while it is making a systematic change to a market-based system. This chapter below starts by focusing on the deteriorating infrastructure systems, particularly transport and energy. Deteriorating infrastructure systems suggest a decline in the long-term growth potential for the country; when growth resumes, the existing infrastructure may prove to be a barrier to sustainable significant growth. In a similar fashion, the deteriorating health and education systems have meant poorer human resource development. This, too, suggests a decline in the long-term growth potential for the country. Beyond these problems are significant constraints on the development of a new structure for production in industry and agriculture. New investment is lacking and a thorough restructuring of the existing enterprises and farms is proceeding only slowly. Moreover, the country must contend with a legacy of environmental neglect and damage so that the environmental resource base has deteriorated significantly, the water supply cannot be efficiently managed, and much rangeland is severely degraded. Finally, the discussion reviews the considerable unfinished reform agenda. The lack of a policy environment that can support private sector development is itself a barrier to development.

### A An Extensive but Deteriorating Physical Infrastructure

44. The Central Asian Republics inherited an extensive physical infrastructure system built largely through subsidized investment from the FSU's central government. Kazakstan benefited from large-scale systems providing energy, transport and communications, and water. These systems are deteriorating because of the economic and fiscal problems. Infrastructure facilities and equipment are not being maintained in a timely fashion and new investment

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<sup>1</sup> Pensions are provided from the Pension Fund, which since 1995 is an extrabudgetary fund administered by the Ministry of Social Protection. The Fund is supported with 85 percent of the revenues of a wage tax of 30 percent of an enterprise's wage bill. The remaining 15 percent of the wage tax revenue is directed towards the Social Insurance Fund which supports sanatoria and will provide for the newly established Medical Insurance Fund.

projects are not undertaken on a large enough scale. Many systems were formerly the responsibility of the large state enterprises. During transition, these firms face budget constraints, increasingly competitive markets, and often are incurring losses and severely in debt. Concurrently, the public sector fiscal crisis has resulted in a sharp reduction in the Government's spending for almost all major budget categories, but particularly so for capital expenditures. Capital investment declined from 7 percent of GDP in 1992 to about 3 percent in 1994 and an estimated 0.1 percent of GDP in the 1996 budget. This declining share of a shrinking GDP is too low to sustain economic growth. In general, the overriding need is for infrastructure maintenance and rehabilitation, not for new infrastructure. One important exception to this is in the energy sector.

45. Running across the discussion on infrastructure are the issues of subnational and Central Asian regional cooperation. Kazakhstan is a large country, geographically fragmented into several distinct regions that are poorly integrated both politically and economically. There is great variation in the resource base of the subregions, and together with the great distances separating them, this means that subnational regions are oriented toward other countries as much as to each other. Improved internal infrastructure for transport, communications, energy, and water supplies is important both politically and economically to tie the country more tightly together.

46. Just as important is the need to foster Central Asian regional integration. In Kazakhstan, as indeed in all of the countries in Central Asia, the economic structure was formed as a constituent part of an autarkic Soviet economy. The resulting pattern was likely to ignore possible customers beyond Soviet borders, and the potential gain from integration into the world economy. The Central Asian economies are all landlocked, with limited access to the outside world. Although some modest trade diversification is noticeable, the countries are highly dependent upon trade within the Central Asian region and with the Russian Federation. The domestic market within each Central Asian country is quite small. Recovery and future growth in all these economies is likely to be affected as much by developments within the region and the adjacent countries as by purely domestic developments. Infrastructure development that eases barriers to regional trade and communications would benefit all the countries in Central Asia.

## **1. Energy**

### **a. Reserves and Trade Balances**

47. Kazakhstan is well-endowed with oil, gas, and coal reserves. Kazakhstan's oil production, at 29 million tons per year, is second only to the Russian Federation among the FSU republics, but is only a fraction of proven recoverable reserves in the country. The situation in natural gas and coal is similar. With respect to coal, Kazakhstan accounted for as much as a quarter of the FSU's production and one fifth of its exploitable reserves. Exports of oil and coal more than offset the imports of natural gas and electricity, making Kazakhstan a net exporter of energy. The potential for the further development of domestic oil and natural gas reserves is considerable if marketing problems, especially pipelines to West European markets or to Japan, can be resolved. Development of the coal industry is likely to be limited. Despite the vast coal deposits and relatively low production costs, Kazak steam coal's export potential is limited by its high ash content (40-50 percent).

48. The country is a net importer of electricity. As a result of weak revenue collection and a failure to pay foreign suppliers, imports from regional neighbors have been sharply reduced and Kazakhstan is experiencing severe electricity shortages.

## **b. Oil and Gas**

49. The favorable potential for Kazakhstan's large oil and gas reserve has not been realized because of difficulties in production and marketing. The upstream and downstream oil and gas sectors are not well integrated with the national economy or world markets. Oil produced in the northwest region must be exported through Russia, whereas oil supplies for the Kazak refineries at Pavlodar in the northeast and Shymkent in the south come from western Siberia. This would not be a problem if, in general, the FSU republics followed market-based pricing for energy; however, energy trade is highly politicized among the republics. Pricing and purchase decisions are determined largely through intergovernmental negotiations reflecting energy market conditions, debt problems, ethnic tensions, water rights, and interrepublican payments problems. Currently, Kazak oil exports are arbitrarily set below the capacity to produce and market by Russian decisions amounting to an "administrative export barrier".<sup>1</sup>

50. Given the political reality, more competitive markets for oil and gas will likely develop only with additional infrastructure development linking markets and suppliers and reducing the influence of the present noncompetitive marketing infrastructure. Consequently, the Government's strategy is to concentrate on making economically feasible investments for transmission and distribution facilities to integrate the domestic industry and markets better and to gain access to international markets. Particular potential may exist for expanding the capacity for the domestic natural gas industry.

51. The Government has devoted considerable energy in encouraging the development of the Tengiz oil field in western Kazakhstan. The oil from this enormous field could be marketed in Western Europe, but only if pipeline facilities can be built. In the best of situations, the construction of long oil pipelines is expensive and time consuming. In addition, pipelines from Kazakhstan to Western Europe must traverse regions with extremely unsettled political conditions, which raises costs and introduces considerable risk. In mid-1996, a consortium of international oil companies and Governments announced agreement on a plan for pipeline construction. However, this is the latest in a series of agreements that have not borne results, and it remains to be seen if it will be more successful than the previous ones.

52. In addition to the development of new fields, there is considerable scope for investment in older fields that are experiencing declining production. New technology and increased maintenance could reverse some of the production decreases. Partly because the investment needs in oil and gas are so large, the Government has encouraged foreign investors to participate in these and other activities in the sector.

53. The Ministry of Oil and Gas has responsibility for the production of energy whereas the Ministry of Geology is responsible for oil and gas exploration. In mid-1996, the Government has moved to substantially transfer ownership or control of production and marketing to the private sector (see para. 116).

## **c. Electric Power and District Heating**

54. Kazakhstan's sizable electric power industry includes 38 thermal (mainly coal-fired) power stations; 24 hydropower stations; and 1 nuclear power station with a combined

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<sup>1</sup> United Nations Development Programme, *Economic Transformation in Kazakhstan: Issues of Macroeconomic Policy, Foreign Economic Relations and Restructuring of the Banking System*, 22-23 May 1996, Almaty.

installed capacity of close to 18.0 gigaWatt (GW). Of the thermal plants, 34 are combined heat and power plants that also produce industrial steam and hot water for district heating. Most residences and industrial enterprises in major urban centers are supplied with heat and hot water through district supply systems. The urban power and heating plants are a significant source of air pollution, particularly ash, but also sulfur and nitrogen oxides.<sup>1</sup> As a result of deficient maintenance programs, considerable generating capacity is not operating and supply interruptions are common. Kazakhstan does not have an integrated electric power system; rather, its power system is comprised of three regional grids each integrated with other FSU republics. System losses in transmission and distribution are also high due to lack of proper maintenance and extensive transmission distances.

55. Since independence, the demand for electricity has fallen with the contraction in economic activity, particularly that of the country's heavy industries. Electricity sales have fallen by 30 percent between 1990 and 1995. A power system development study, financed by the European Bank for Reconstruction and Development (EBRD), projects a continuing fall in demand that is expected to bottom out in the late-1990s, followed by modest growth. It is expected that peak demand will only reach its 1990 level again in 2010. The demand for district heating has also declined since independence, but to a lesser extent owing to more stable winter heating needs.

56. In spite of the depressed electricity demand, Kazakhstan is not self-sufficient in electricity and used to import about 14,300 gigaWatt-hours (GWh) of energy from Russia and other Central Asia Republics. This declined to 7,395 GWh in 1995, but Kazakhstan remains a net importer. The economy is highly energy intensive, with per capita energy consumption similar to that of industrial economies despite a far lower per capita GDP. The high energy intensity and inefficient electricity supply, together with inappropriate energy pricing that encourages wasteful energy consumption, have exacerbated the need to import electricity.

57. The institutional weaknesses in the sector are reflected in the interrepublican trade in electricity. Kazakhstan's electricity debts to Russia and other Commonwealth of Independent States (CIS) countries are reported to be on the order of \$350 million. As a result of nonpayment, the Russian Federation, Uzbekistan, and the Kyrgyz Republic have reduced their electricity supply to Kazakhstan. Consequently, the country is experiencing power outages; in the capital, Almaty, residential users sometimes lack electricity during several hours each day.

58. Interrepublican payment difficulties are exacerbated by the poor revenue flow for utility companies. The structure of the power sector was reformed in 1995. It now comprises independent power generating companies; Kazakhstanenergo (which operates the high voltage network); and regional energy companies (power and heat distribution). The power sector entities are now all independently responsible to the Ministry of Energy and Coal and a number of these have been privatized or facilities leased on management contracts (see para. 116). The utility companies have considerable difficulty in collecting accounts receivable from residential and industrial customers. Residential customers are often not individually metered, and service cut-off is often impractical. Further, some service payments are due from local government administrations as part of the social assistance program. The current fiscal crisis has led local governments to delay utility payments in favor of other needs. Industrial customers are often state enterprises and simply do not pay their utility bills.

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<sup>1</sup> Well-maintained district heating systems produce less air pollution than would be the case if households and industries produced their own space heating and hot water.

59. Compounding the revenue problems, tariffs for electricity and district heat are set below the long-term costs of service provision. Indeed, residential demand for electricity has actually increased since independence, in part due to the relatively lower real costs of electricity usage compared to other fuels. At the end of December 1995, a Presidential decree declared that electricity and district heat tariffs should cover long-term supply costs. An independent regulatory board is expected to be set up to determine the appropriate tariff levels. In moving towards cost-based pricing, the Government has noted some important reservations, including (i) maintaining uniform national tariffs for electricity in spite of regional differences in production costs; and (ii) budgetary assistance for socially vulnerable groups in purchasing utility services, especially natural gas for heating and cooking.<sup>1</sup>

#### **d. Coal**

60. Coal production has decreased since independence; no significant expansion in the exploitation of coal resources is expected for the remainder of the 1990s. Export demand as well as domestic consumption have both declined. Up to 40 percent of coal output was exported to the Russian Federation in the past. This coal market has become increasingly uncertain. Because much of Kazakstan's coal has a high ash content, environmental issues may curb the pace of recovery in its market, although it may be economically feasible to upgrade the quality of some of its coal through the use of coal beneficiation equipment.

61. The Ministry of Energy and Coal has responsibility for the operations of the state-owned coal enterprises.

## **2. Transport and Communications Sectors**

62. Because of its large size (2.7 million square kilometers [km<sup>2</sup>]) and low population density (6.3 inhabitants per km<sup>2</sup>), Kazakstan depends heavily on transportation infrastructure. This dependency is heightened by widely distributed natural resource processing sites. The economy is extremely transport-intensive, as shown by high rates of freight moved per person or per unit of GDP.

63. The road and rail subsectors are the most important transport subsectors. As a result of Soviet planning concerns, Kazakstan possesses an extensive road and rail network, with 87,841 kilometers (km) of roads and 14,148 km of rail.<sup>2</sup> The main rail lines and highways were situated in a northwest to southeast direction to transport freight and passengers between Russia and Central Asia. In addition, there is significant air transport. Water transport is negligible, with the only major port being Aktau on the Caspian Sea. Port facilities on the Aral Sea have become unusable with the decline in the level of the sea (see para. 145).

64. In line with the general decline in economic activity, transport demand has contracted sharply since independence. The 155.2 billion freight ton-km recorded in 1994 was roughly one third the 1990 figure of 455.8 billion ton-km, and the 68.8 billion passenger-km in 1990 fell to 36.7 billion passenger-km in 1994.<sup>3</sup>

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<sup>1</sup> Government of the Republic of Kazakstan, *Program of the Actions of the Government on Deepening the Reform for 1996-1998*, Almaty, November 1995, p. 117.

<sup>2</sup> World Bank, *Transport Sector Review*, 1 August 1995, Table A2.

<sup>3</sup> World Bank, *Transport Sector Review*, 1 August 1995, Table 2.3 and 2.4.

65. This severe contraction in service, however, should be carefully interpreted. In the FSU, tariffs and fares were set at very low levels with little consideration given to the underlying cost of the services provided. Production and processing sites were often separated by vast distances, their location often being determined by political considerations without regard to economic costs. As the economy moves through the current transition period, transport demand in many subsectors of the economy will probably not recover to levels seen before independence. While the economy as a whole may become less transport-intensive, a successful early restructuring of the transport sector is essential to provide the appropriate price signals and encourage a wider restructuring of the broader economy.

## **a. Road Transport**

### **i. Sectoral Structure and Developments**

66. Although the road system is extensive, it is increasingly in poor condition. The funds for maintenance and rehabilitation have been insufficient, FSU technical standards continue to be used, and institutional mechanisms for the proper support of an extensive infrastructure system are weak. The first problem of underinvestment is the most important.

67. Public investment in the road system has dropped from about 1.2 percent of GDP in 1990 to less than 0.3 percent of a much smaller GDP in 1995.<sup>1</sup> As a result of underinvestment, many roads will require major reconstruction unless adequate funds begin to be allocated for rehabilitation and maintenance. The World Bank has estimated that an additional 1,500 km of road are being rendered in need of major rehabilitation each year as a result of deferred maintenance activities.<sup>2</sup>

68. Fiscal problems and incomplete policy reform have affected most subsectors. As result of undermaintenance and shortages of spare parts, urban transport and inter-city bus systems have deteriorated. The impact of declining service is particularly severe for poorer families.

69. The Ministry of Transport and Communications (MOTC) is formally responsible for much of the sector. Within MOTC, the Department of Roads has the responsibility for funding road construction and maintenance on national roads. MOTC also operates numerous trucks on a common carrier basis; however, most of the trucking fleet in the country is owned and operated by other ministries or Government enterprises for their own use. Other levels of governments also have responsibilities in the sector—provinces are responsible for regional roads while municipalities are responsible for municipal roads. *Kazakstan Zholdary*, the successor holding company to the former Ministry of Construction, is responsible for much of construction and maintenance activities.

### **ii. Sector Policy Reform**

70. Privatization exercises have proceeded in the sector largely through the sale of trucks. However, as of mid-1995, only about 10 percent of the truck fleet is in private hands.<sup>3</sup> The privatization of transport enterprises also lags and there is little real competition in the formal

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<sup>1</sup> World Bank, *Transport Sector Review*, 1 August 1995, p. 11 to 16.

<sup>2</sup> One problem is that while roads were designed for heavier volumes of traffic than economically necessary, they were also designed for relatively light vehicles and not the heavy trucks that are becoming common. World Bank, *Transport Sector Review*, 1 August 1995, p. 1, data in Table A2.

<sup>3</sup> World Bank, *Transport Sector Review*, 1 August 1995, p. IV-10.

sector. At best, enterprises have moved towards privatization through some sort of corporatization. These exercises have generally left the state with considerable ownership and control.

71. Despite slow privatization, there is a growing informal service sector providing transport services with small, often unregistered firms providing cost-based services. There are, for example, firms providing taxi service in the larger cities, especially in Almaty, and private truck services in the rural areas. However, the entrepreneurs responsible for the new activities must operate in a regulatory environment that still maintains protected markets for state companies. Licensing requirements, for example, appear excessively restrictive. The failure to privatize support services such as maintenance and supply centers has inhibited the growth of these small enterprises.

72. Current policies do not encourage resource mobilization or conservation in the use of equipment and facilities. Tariffs for intercity bus and urban transport are typically below the levels required for cost recovery. Road user fees are not related to usage and gasoline prices have often been subsidized by the state energy firms. The importation of new or second-hand trucks would improve the fleet fuel efficiency by changing the existing, relatively old mix of equipment. The importation of non-FSU vehicles, however, especially trucks, is inhibited by imprecise registration procedures.

#### **b. The Railways**

73. Rail services are provided by three state railway corporations operating under MOTC. The three railways serve different parts of the country, providing for 90 percent of all freight movement.<sup>1</sup> The rail lines offer little direct competition with each other, and in a number of freight markets such as for coal or grain, there is little competition, even potential, from other forms of transport. The rail lines provide important international links for this landlocked country. Recent developments have opened rail links from Kazakhstan to the PRC and, through other Central Asian Republics to Iran and other countries in the Middle East.

74. Fares are determined by MOTC, subject to approval by the Cabinet of Ministers. The railways do cover their immediate operating costs; however, maintenance on the major rail network has been deficient. World Bank staff estimates suggest that significant rehabilitation work is required on nearly one third of the infrastructure. Moreover, passenger traffic is subsidized by freight charges. This discourages the development of intercity bus traffic and distorts transit decisions by travelers.

75. Economic reforms have lagged in the sector, with little restructuring in the actual organization of the railways or in service provision. Few incentives exist for railway management to move through productivity increasing activities such as labor shedding and there is little in the way of capital resources for investment. Moreover, management lacks the expertise to develop market-related services and pricing.

76. In some instances, policy is constrained by interregional agreements. For instance, interrepublican rail tariff decisions are determined by the Organization of Cooperation of Railway Corporations of the FSU in Moscow. Cross-border shipping is complicated by the difficulties by the general lack of effective interrepublican payments systems.

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<sup>1</sup> World Bank, *Transport Sector Review*, 1 August 1995, p. III-2.

### **c. Air Transport**

77. Kazakstan Air, the successor company to the Soviet Aeroflot, enjoys a virtual monopoly position providing domestic air travel and is also responsible for airports and air traffic control. Air travel and air freight have decreased to a fraction of their pre-independence level, reflecting the economic disruption and the political separation from the FSU which encouraged air travel through highly subsidized fares and charges.

78. The country is well-served by regional airports; however, maintenance activities have often been deferred. Air traffic equipment does not conform to international standards, and this limits international traffic and over-flights. In addition, the air fleet is composed generally of Soviet-era planes that are rapidly aging and expensive to maintain and operate. Kazakstan is serviced by regular flights by international airlines from European airports including Frankfurt, Istanbul, and Zurich. From Asia, currently, the only connection on an international carrier is a flight once every week from Islamabad.

79. MOTC has established a small department, the Civil Aviation Department to determine national air policy and to monitor compliance with national standards. In practice there is considerable overlap of responsibility with Kazakstan Air.

### **d. Communications**

80. MOTC is responsible for communications, including telecommunications, postal services, and radio and television broadcasting. Some major enterprises have been privatized or leased under management contracts (see para. 116). As in transport, there is an extensive infrastructure system built under the central planning system of the FSU.

81. The telephone system was designed to satisfy the needs of communications within the FSU, not to facilitate communications between Kazakstan and non-FSU locations. In Almaty and some other major urban centers, however, it has become relatively easy to place international, non-FSU calls through recently installed satellite links. In addition, in Almaty and other major urban centers, computer-assisted internet connections are possible. The telephone system reaches most locations within Kazakstan, serving 13.5 people for every 100 people. In Almaty, the phone system reaches 37 of every 100 people. New connections are not universally available as the base trunk system has little excess capacity. Partly as a result, cellular phone companies established in urban centers have become popular. Commercial credits have been received from Germany, the Republic of Korea, and Turkey for system improvements. Kazakstan is also participating in the regional project to link with a fiber optic cable, the PRC and Europe, through Central Asia and the Middle East. The Government has completed 400 km of an estimated 1,700 km needed for the Kazak portion of this information Silk Road and the remainder is expected to be completed by early 1997.

82. Tariff setting for telephones is done by MOTC and reviewed by the Anti-Monopoly Committee. Currently the Government estimates that revenue collections cover one half of current expenditures with some cross-subsidization between international calls and domestic service. Payments arrears are a considerable problem for the state-owned telephone companies, with Government agencies and other state-owned enterprises owing the industry an estimated \$90 million (T6 billion) in 1995.

### **3. Water Supply and Sanitation**

#### **a. Water Supply**

83. Urban cities are generally well covered by a water supply system. Approximately two thirds of the water supply comes from deep wells with the rest from surface water. Except in Almaty, urban areas have water only for a few hours each day. The lack of constant pressure in the systems increases the risk of contamination from inflow and regular testing suggests substantial biological contamination. The Ministry of Communal Services is responsible for urban water systems.

84. Less than one half of all people living in rural areas have piped water. Most people are served by communal water systems supplied from deep wells. The most serious problems appear to be in rural areas in desert regions, where water supplies are often highly saline. These areas need to tap deep water supplies, but this has been precluded by the limited public fiscal resources. The Ministry of Agriculture and the Ministry of Water Resources are collectively responsible for rural water supplies.

85. Water is the property of the state, and since 1992, fees should be assessed for all use. The Government realistically does not foresee complete cost recovery in water supply, in the near term, but does see increasing resource mobilization in the sector. As one indication of future policy directions, some public utilities have recently been privatized or leased under management contracts.

#### **b. Sanitation**

86. Almaty has an extensive sewerage system, supported by a wastewater treatment center. The fiscal crisis has, however, resulted in a deterioration of operating conditions. In other large cities somewhat under two thirds of the population have access to sewerage systems. Only a small fraction of smaller urban communities have such systems, and then generally only for apartment buildings.

87. Except in some apartment buildings in administrative centers, the rural populace is without sanitation facilities other than the most primitive. The systems provided in apartment buildings require considerable and regular maintenance, which has declined since independence and the development of fiscal difficulties.

### **B. Weakness in Human Resource Development**

#### **1. The Impact of Transition**

88. Equally important to maintaining an adequate physical infrastructure system is developing the human resources necessary for sustained economic growth. The FSU provided broad access to social services and a significant degree of social protection. There was an extensive public medical system that provided for the elimination of many health problems found in other low-income countries. Life expectancy at birth, for example, at 69 years in 1992 was comparable to that in medium human development countries. Similarly, educational attainment and literacy was high relative to most Bank Developing Member Countries (DMCs) and compared with many industrialized countries. In education, adult literacy was comparable to that in high human development countries. The underlying systems for providing social service were, however, inefficient in the use of resources. In particular, overstaffing was commonplace. Before independence, inefficiency was not a local concern because of soft budget constraints and generalized subsidies from the FSU's central government.

89. With independence and the concurrent economic and fiscal crises, Government financing for the basic social services of health and education has been sharply reduced. The fall in the share of GDP allocated to education has been especially severe, from 6.8 percent in 1990 to 3.3 percent in the 1996 budget. Formally, public expenditure on health has suffered less of a relative cutback; the budget share devoted to health drifted down from 3.3 percent of GDP in 1990 to about 3 percent in 1996. However, the health sector too clearly lacks fiscal resources for operations. Even a constant share of GDP translates into a large decline in real resources because GDP has fallen by more than one half.

90. Because of fiscal constraints, the public health and education systems are losing skilled personnel and closing facilities. The situation is particularly critical in rural areas where many preschools, schools, daycare centers, hospitals, and clinics have closed because of the lack of funds to pay staff, provide heat in the winter, and maintain and repair deteriorating buildings. Owing to a shortage of operational facilities, primary and secondary schools often operate in two shifts. Health indicators have clearly worsened; between 1990 and 1995, the mortality rate per 1,000 persons has worsened from 7.7 to 10.1 and a similar change can be seen in infant mortality. There are particularly serious declines in health indicators for women, children, and the handicapped.

91. Because of fiscal constraints, user fees are being introduced. While in general, sectors should be encouraged to mobilize their own resources, in the current economic environment user fees should be introduced with care: new fees for school meals, textbooks, or medical supplies have resulted in restricting social service access to the poorer and most vulnerable in society.

92. Most social services are the responsibility of local governments, and social service provision issues are inseparable from issues concerning local governments. In 1995, local governments accounted for approximately 81 percent of public education expenditures and 85 percent of public health spending.<sup>1</sup> Although there are overlapping expenditure assignments, local governments tend to be responsible for primary service provision in their locality (clinics and elementary schools for example) while the Central Government budget supports more specialized facilities and tertiary services (research hospitals and higher education). One overall concern is that the financially and institutionally weak local governments are unequipped to deal with the changing set of public sector responsibilities during the transition to a market-based economy.

93. These issues are complicated by the ongoing divestiture of social service assets. Before independence, many social service assets had been the responsibility of state enterprises. These enterprises maintained facilities for workers and the community at large as a budgetary responsibility of the firm. As a result of restructuring, however, state-owned enterprises are withdrawing from the provision of social services such as primary health care and kindergartens. With increasingly hard budgets and weak markets, with privatization and increasing competition; the responsibilities for providing social services are being transferred to local government bodies. The local governments concerned vary greatly in their concern for and capacity to maintain the facilities and provide the services.

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<sup>1</sup> RETA No. 5616 on Public Finance Issues in the Transition Economies of Asia, draft final report on Kazakstan, Table 2-2.

94. One result of this devolution is that slender social sector budgetary resources are shifting towards the tertiary sectors and away from the primary sectors. In health, the World Bank suggests that resources are shifting towards institutions directly maintained by the Central Government (including specialized hospitals and research facilities) from those maintained by local governments (including clinics). The issues are particularly acute with respect to pre-school education—as firms have divested themselves of the responsibilities for supporting pre-school facilities, many have been closed. Between the 1991/92 and the 1994/95 school years, the enrollment in preschools declined by 47 percent from approximately one million in the earlier period.<sup>1</sup> Although some rationalization of the system was probably required, the closures are being undertaken without a systematic examination of the sectoral needs.

95. An additional aspect of the budget system affecting social service provision is that there continues to be a systemic predilection towards allocating resources on the basis of existing facilities. The World Bank has noted, for example, that slender budgetary resources are allocated across the sector to specific institutions on the basis of physical characteristics such as the number of beds or classroom size, rather than need. Both the Ministry of Health and the Ministry of Education are moving towards developing greater flexibility in budget exercises.

## **2. The Problems in Education**

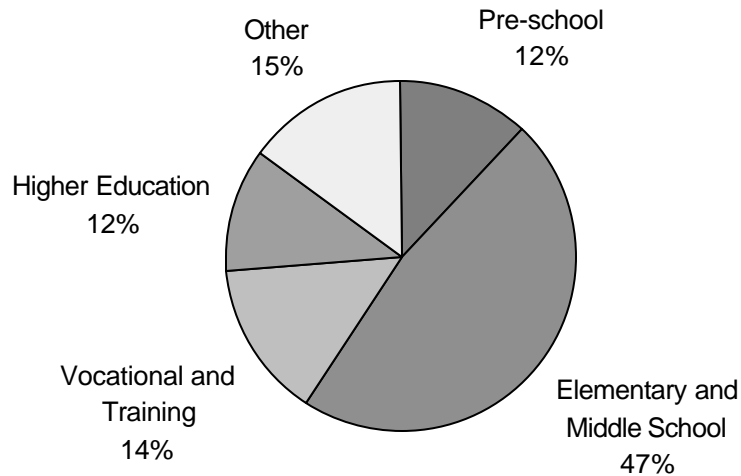
96. Resource constraints and cutbacks in public spending have resulted in a severe deterioration of educational facilities and equipment, and low and delayed compensation payments that have led to an attrition of qualified teachers and staff. At the same time, rapid changes in the labor market are placing new demands on the system and highlight the crucial role that education and training should play in facilitating the country's economic transition.

97. Figure 2 provides a breakdown of public expenditure by level of schooling in 1994. The resources are usually focused, through local governments, at general education, for primary and secondary schools. The emphasis on vocational education and training (16 percent in 1994 of total public expenditure) is consistent with the Soviet legacy that emphasized the movement of people through the education system into lifetime employment in a state enterprise. The Soviet system was characterized by long-term training in rather narrow specializations, with limited flexibility to adapt to changes in labor needs.

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<sup>1</sup> TA No. 2308-KAZ: *Education and Training Sector Study*, December 1995. Synthesis Report, p. 7.

**Figure 2: 1994 Public Education Expenditures by Level of Schooling**



98. The Ministry of Education (MOE) is responsible for most aspects of the education system. MOE operates through a network of provincial departments of education as well as in municipal and district education offices. MOE is responsible for the construction of education institutions, provision of equipment, design of curriculum, examination, and teacher and staff training. In MOE, the capability to proceed with reforms is limited by severe resource constraints and the need to improve educational management and training for teachers and staff.

99. As in the case with other FSU republics, much of the existing educational curriculum has become obsolete as it reflects the FSU ideology and is not compatible with the evolving political or economic environment. The Government is developing a new curriculum, but comprehensive curriculum reform involves reviewing and revising the curriculum at all levels, developing new textbooks and instructional materials, and training and retraining teachers at all levels.

100. The education system is hampered by a severe shortage of textbooks, which is due to financial constraints on textbook imports and the weakness of the domestic capacity to develop and publish textbooks. Instructional materials (and basic classroom equipment) at the general school level are urgently needed. Prior to independence, approximately 80 percent of all textbooks used in the country were imported from other parts of the FSU. The Government is strengthening the role of the Kazak language and culture in education, and textbooks for the new curriculum are required in the Kazak and Russian languages. These efforts will, among other things, require a substantial growth of the domestic textbook publishing industry.

101. A small private education sector has emerged since independence, mainly at the tertiary level. In 1994, there were 38 registered private institutions of higher education. These institutions operate amid uncertain rules and regulations. It is in this area that Ministry of

Education and provincial Departments of Education must develop their capability to undertake and fulfill regulatory responsibilities. The private sector both complements and competes with public sector education. This complementarity and competition must be encouraged not stifled, regulated not controlled.

102. The Bank has, at the request of the Government, taken the lead in supplying foreign assistance to the sector. The Educational Rehabilitation and Management Improvement Project, approved in January 1996, provided for:

- (i) urgently needed equipment for 180 priority comprehensive schools (providing education at the primary and secondary levels) throughout the country;
- (ii) approximately one million textbooks to meet basic educational needs, supporting the introduction of a new, learner-based curriculum, and contributing to the development of a private textbook publishing industry;
- (iii) establishment of a computerized management information system in MOE and 21 provincial departments of education throughout the country, to provide key management data on the sector as a basis for broader reforms; and
- (iv) strengthening of staff development, including the upgrading of teacher improvement institutes, and training for more than 1,000 teachers and staff.<sup>1</sup>

### 3. The Problems in Health

103. The extensive health system developed under the Soviet Union did manage significant accomplishments. Five years into the transition, it is clear, however, that the Government faces significant challenges; resource efficiency must be improved, more efforts must be made to improve sectoral resource mobilization, and expenditures must be more carefully targeted. The efficient use of resources is particularly important: the country has one of highest ratios of doctors and hospital beds per person in the world, but health indexes have dropped throughout the transition period.<sup>2</sup> As the UNDP noted, “Although the extent of the service availability is good, the problem lies in the quality of care.”<sup>3</sup> Changes to the system will require reorganizing of the health care system with, for example, more emphasis on ambulatory care. This will require decentralization of some of the decision-making process—decentralization that will encourage the provision of flexible appropriate health care.

104. Specific problems include the supply of medicines and medical equipment. As a result of dictates of the central planning system of the FSU, a pharmaceutical industry never developed in the country. Even by the beginning of 1995, more than 98 percent of the medicines and medical supplies were imported. This dependency on imported supplies proved to be a problem with independence, as immediately after the breakup of the FSU, the supply of medicines and medical equipment was hindered by the economic chaos. The breakdown of the interrepublican payments system interrupted the delivery of medicines especially in 1993.<sup>4</sup> Humanitarian assistance and commercial credit lines from non-FSU countries and the recovery of interrepublican FSU trade have helped provide for a minimal level of medical supplies. The

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<sup>1</sup> Loan No. 1420(SF)-KAZ: *Educational Rehabilitation and Management Improvement*, for \$20 million, approved on 11 January 1996.

<sup>2</sup> UNDP, *Kazakhstan Human Development Report 1995*, Almaty 1995, p. 30.

<sup>3</sup> UNDP, Op. cit. p. 34.

<sup>4</sup> UNDP, Op. cit. p. 38.

long-term amelioration of the situation will, however, require improvements in trade, including opening further to competition the pharmaceutical industry.

### **C. Barriers to the Recovery of Current Output**

105. Recovery of the economy to its pretransition level of output will require the successful completion of the transition to market institutions. The country requires the creation of a new structure of output and the creation of new production capacity. Poverty and unemployment will be reduced only by the creation of new jobs, which will have to come from new investment. Crucial to an early appearance of sustainable growth will be continued management of the transition and reform in industry, the financial sector, and agriculture.

#### **1. The Need for Enterprise Reform**

106. Kazakstan possesses a highly diverse industrial sector based on extensive natural resources including large hydrocarbon reserves of oil, gas, and coal; and minerals including deposits of chromium, copper, iron ore, magnesium, lead, zinc, silver, and uranium. In addition, the agriculture sector supports extensive agroprocessing of grain and livestock products, including wool and meat. Finally, many capital-intensive processing centers were developed under central planning as integral parts of the FSU's economy. These enterprises provided their products to Soviet enterprises and were highly dependent upon input supplies from the FSU. In many cases, industries were established as part of the military-industrial complex of the Soviet Union. Manufacturing centers are concentrated in the northern cities (such as Karaganda, Pavlodar, and Semipalatinsk) and around the southern city of Shymkent.

107. The disruption to the economy represented by independence resulted in a sharp contraction in output in the sector. Firms in the Soviet Union were designed to satisfy the needs of the autarchic command economy in isolation from world markets and world prices. Energy products, capital goods, and transport services were heavily subsidized, resulting in widely dispersed, capital intensive facilities that were inefficient by world standards. This complex system was severely disrupted with the general decline in FSU trade, the breakdown in the interrepublican payments systems, and the opening of domestic markets to competition from non-FSU countries.

108. Recovery of the industrial sector will require the general rebound of aggregate demand in the country and the region. More importantly, however, sustainable recovery will require a thorough restructuring. The restructuring must move production techniques and products away from that designed for the Soviet command economy and towards responding to newly emerging market demands. Restructuring will require substantial completion of the unfinished reform agenda, particularly for (i) improvement of the legal environment, (ii) price liberalization, (iii) trade liberalization, and (iv) privatization.

##### **a. Legal Environment**

109. Considerable progress has been made at establishing a legal framework conducive to private sector activity. Actions in 1995, for example, included new licensing and registration arrangements for foreign investors to ease their entry into Kazak markets, and a comprehensive tax code was enacted simplifying the tax structure and broadening the tax base.

##### **b. Price Liberalization**

110. Market support has also been accomplished by the liberalizing of nearly all prices. The most difficult steps politically were the 1995 freeing of prices for bread, oil and oil products.

Prices of so-called monopoly producers remain subject to administrative control as do tariffs for public utilities. The designation of a firm as a monopoly producer, done largely on the basis of market share, has changed, with progressively fewer enterprises considered as monopolies. The Anti-Monopoly Committee is responsible for monitoring prices by monopolies and state enterprises. As a related matter, the tariffs for public utilities have generally moved towards cost recovery levels, although significant problems and instances of cross-subsidization remain.

### **c. Trade Liberalization**

111. In addition to price liberalization, other restrictions on domestic and external trade have been eased. An important step was taken in January 1995 to grant all enterprises the right to engage in foreign trade, ending the monopoly previously exercised by a small number of state trading companies. Shortly thereafter, the compulsory surrender requirement for foreign exchange earnings was reduced from 50 percent to 30 percent.<sup>1</sup> Export quotas were completely eliminated in 1995 and the number of goods requiring export licensing severely limited. In principle non-tariff restrictions are to be maintained only for international security, environmental protection, or preservation of the cultural and historical heritage of the country.<sup>2</sup> At the same time, the Government has announced plans to develop "anti-dumping" legislation which has protectionistic overtones. Moreover requirements for the registration of export contracts could act as a barrier to trade.<sup>3</sup> On balance, there is a strong commitment towards establishing and maintaining a liberal trade regime. As one indication, the Government has applied for membership in the World Trade Organization.

112. Anti-monopoly activity is an essential part of trade liberalization. In this area, the Government has targeted the dismantling of the more than 80 stateholding organizations formed in 1993 and 1994, especially those in grain processing and petroleum distribution. The Bank is supporting the dismantling of 13 state-holding companies in agroprocessing and agriculture trade through the Agriculture Sector Program.<sup>4</sup>

### **d. Privatization**

113. An important step in enterprise policy reform includes completing the transfer of public, productive assets to the private sector. The Government's privatization program has transferred to the private sector, housing assets, most small enterprises in the service sector, and a considerable portion of the small- and medium-scale enterprises. Two phases of the privatization process can be identified. The first, 1991-1992, focused on small-scale asset transfers, mostly of service enterprises to existing employees.<sup>5</sup> The second phase, 1993-1995, moved to include mass privatization, the transfer of agriculture property, and the privatization of large-scale enterprises. The transfer of small assets has progressed significantly, with the Government reporting that by the end of 1995 11,000 assets, approximately two thirds of all

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<sup>1</sup> Ministry of Economy, *Kazakstan Economic Trends*, February 1996, p. 27.

<sup>2</sup> Government of the Republic of Kazakstan, *Program of the Actions of the Government on Deepening the Reform for 1996-1998*, Almaty, November 1995, p.10.

<sup>3</sup> United Nations Development Programme, *Economic Transformation in Kazakstan: Issues of Macroeconomic Policy, Foreign Economic Relations and Restructuring of the Banking System*, 22-23 May 1996, Almaty, Section 6.2.1.

<sup>4</sup> Loan No. 1406-KAZ: *Agriculture Sector Program*, for \$100 million, approved on 24 November 1995.

<sup>5</sup> *The National Program of Privatization and Restructuring of the State Property in the Republic of Kazakstan for 1996-1998*, draft, p. 1, 14 February 1996.

former public assets, have been transferred to private ownership. In some instances, responding to the lack of true restructuring in the privatization exercises, some relatively small assets have been resold to new owners who are proceeding with new investments and market-oriented business plans. During the first half of 1996, small-scale privatization continued with the transfer of an additional 1,980 objects. Gasoline stations and pharmaceutical firm assets accounted for most of the sales.

114. Mass privatization has involved creating investment funds as intermediaries between households and firms, and, in early 1996, these funds had acquired shares in more than 1,700 enterprises.<sup>1</sup> In spite of this, progress in taking on real ownership functions and internal restructuring and labor rationalization has been slow. Moreover, many enterprises remain under effective state ownership or control and are heavily in debt, inhibiting new investment. As of the end of 1995, of the slightly under 1,700 enterprises that had then moved through mass privatization auction exercises, the state had retained majority ownership in more than 700. Sales of state-owned shares are, however, ongoing through a variety of mechanisms including open auctions or commercial tenders.

115. The most difficult problems surface in the privatization of the largest firms. These are to be privatized by individual sale and have been offered to foreign investors. As of February 1996, of 180 enterprises, only 5 had been sold and 44 had been leased under management contracts (12 to foreign managers).<sup>2</sup> Perhaps the most difficult issue has been how to deal with the largest, loss-making enterprises. These are often firms with limited commercial viability. Approximately 30 of these firms have been placed under the control of the specially created Rehabilitation Bank. Utilizing funds from a World Bank loan, these firms will be supported through either restructuring or liquidation. The continuing impact on the state budget will be limited to the use of World Bank funds and only for the duration of the program. This program will involve politically difficult steps—the likely need for massive layoffs will be an important test of the Government's commitment to structural reform. In addition, the difficulty of transferring the social assets previously maintained by enterprises (see para. 93) slows the successful restructuring of many firms

116. In mid-1996, the Government accelerated its program for the transfer of control or ownership of large enterprises. Assets including public utilities that had previously not been slated for privatization in the near-term, were in a very short period of time sold to foreign investors or leased to management groups. Among the reported transactions: (i) the huge Vasilkovskoye gold mining operation was sold under tender to a consortium led by Teck of Canada; (ii) a large copper mine and smelter, Zhezkazkantsvetmet in central Kazakstan, was given under management contract to a German subsidiary of the Korean Samsung; and (iii) Deutsche Telekom was reported to have been given substantial minority ownership and management control in the state telecommunications firm, Kazakhtelecom. The most vigorous program is found in the energy sector. In mid-1996, for example: (i) the Ekibastuz Power Plant and coal facility in Karaganda was sold to a U.S. firm; (ii) a United Kingdom firm purchased a power facility in Pavlodar; (iii) a Belgian firm purchased facilities of the Almaty power and heating utility. The Government now projects that by mid-1997 there will be no effective public management of any major oil and gas activity.

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<sup>1</sup> *Kazakstan Economic Trends*, February 1996, chapter 10.

<sup>2</sup> *The National Program of Privatization and Restructuring of the State Property in the Republic of Kazakstan for 1996-1998*, draft, p. 2., Feb. 14, 1996.

117. The accelerated transfer of assets raises a number of issues related to governance. In some instances, the circumstances surrounding the transactions have lacked transparency: even the concerned Ministries were unaware of potential activities until the final decisions had been taken. This has resulted in some cases in a misallocation of resources particularly foreign assistance grants. Governance issues have also arisen in a number of instances where management contracts or purchases were announced but were unable to be finalized. These type of problems have been noted in other countries of the former Soviet Union and in Eastern Europe.

118. In the near-term this accelerated asset transfer will obviate the need for public investment in many sectors. From a developmental perspective, however, it is important to note that the accelerated privatization alone does not necessarily solve many policy issues. Nor do these actions provide for all of the capacity building that will be necessary to ensure restructuring and institutions that are responsive to the emerging market-based economy. There is for instance an increased need to provide government with the capacity to regulate the enterprises, particularly public utilities, now transferred to the private sector. Decisions regarding tariff structures, investment, service provision, contract adjudication, labor restructuring, and compensation all must be determined giving due weight to the legitimate concerns of both private and public sectors.

119. Firms, either big or small, that could compete in the developing market economy face significant challenges, including a lack of modern business skills and underdeveloped capital markets. The skill mix is a particular problem—few firms, for example, have staff with experience in marketing, and accounting conventions reflect the concerns of the FSU and do not yet provide management with the tools to make informed business decisions. Particular problems exist for medium-sized industries that lack attraction for international investors and lack internal funds for successful restructuring. Mitigating these problems, business support centers are being established, sometimes financed by foreign funding agencies such as United States Agency for International Development (USAID). In urban centers, there are firms that can provide at least a modicum of training in computer services, management, and accounting; and can provide consulting services to develop business plans.

## **2. Financial Sector Reform**

120. At independence the branch and regional units of the FSU's banking organizations were restructured to form the basis of the banking industry in Kazakstan. This included the central bank (NBK) and five state-owned specialized banks: Agroprom (focusing in agriculture); Turan (industry); Kresots (small and medium-sized enterprises); Alem (foreign trade); and Sber/Narodni Bank (commerce). The Government has also created specialized state banks, including an export-import bank. These banks continue to be state owned or controlled and dominate the industry, supplying more than 80 percent of the credit originating in the sector.

121. Private banks were also encouraged, and through the middle of 1995, approximately 150 banks received charters. The majority of these private banks were established by enterprises and served mainly to get direct access to centralized credit resources allocated by the NBK. These banks are burdened with nonperforming loans and have little institutional capacity to function in a commercial environment. In mid-1996, in spite of debt-clearing exercises (see para. 21), nearly one half of all bank loans were non-performing.

122. The successors to the state banking enterprises are, however, in little better condition. Most banks are technically insolvent and few of them have the institutional capacity to

evaluate lending or borrowing on commercial terms. The situation in the rural sectors of the country is particularly serious (see para. 138).

123. In addition to the banking firms, through the middle of 1995, there were non bank financial institutions, including informal household saving organizations, small insurance firms, and 169 privatization investment funds.

124. In 1994, the Government moved to strengthen the financial sector through several strong policy steps. Most importantly, NBK increased its supervision and regulation of banks. Sending strong signals to the sector, in 1995 NBK withdrew the operating licenses of nearly one third of the commercial banks. Restructuring is expected to continue in the sector through liquidation and forced mergers and acquisitions. As part of the NBK's strengthened supervision and regulation (i) new minimum capital requirements were introduced; (ii) programs were initiated to convert accounting procedures to international standards; (iii) attempts were made to encourage prudential lending by banks through restrictions on single-borrower exposure; and (iv) the largest commercial banks have been audited.

125. Long-term strengthening of the banking industry will necessitate an improvement in domestic resource mobilization, particularly in deposit mobilization. Until recently, private depositors have been discouraged from using the banking industry for savings because of the high rates of inflation and negative real interest rates. Past banking policies, on occasion freezing funds, also discouraged depositors. More recently, the attachment of bank accounts to collect overdue taxes has discouraged the use of the banks. Finally, the general awareness of the financial weakness of the banking system itself discourages the deposits that could provide a basis for change.

### **3. A Struggling Agriculture Sector**

#### **a. Structure and Development**

126. Agriculture contributes approximately 15 percent of overall national output and provides employment for about 17 percent of the population. Most of the country's poor live in rural areas. Ensuring that production stabilizes and growth revives in the rural sector is crucial to the overall reform process and to a successful transition to a market economy. A vibrant agriculture sector is needed to support overall economic recovery and sustained growth over the medium term and to help set the stage for growth in related fields such as agroprocessing.

127. Kazakstan has varied agricultural resources. The northern part of the country has rainfed grain and other crop farming as well as livestock grazing. The central part of the country, semi-desert steppe, supports extensive livestock grazing. Southern Kazakstan has a large irrigated crop area. The dependency on rainfed cropping and grazing and the relatively low quality soil combine to make the sector extremely sensitive to weather conditions; low rainfall is accompanied by a sharp fall-off in productivity and in output. Moreover, much of the land devoted to crop production, especially grain, was converted from open range livestock grazing in the Virgin Land Campaign in the 1950s. This land is not very fertile and the fertility has been declining because of inappropriate soil conservation techniques. The contraction of output since independence is allowing some marginal land to be taken out of cultivation.

128. Following independence, major external shocks were experienced by the agriculture sector with the disruption of traditional market linkages with FSU countries, the breakdown of trade financing arrangements, and the loss of large public subsidies (see paras. 8-10). Farms face shortages of spare parts and inputs such as fertilizers and pesticides, and a

lack of credit facilities. Additionally, an incomplete policy reform agenda was drawn up and the implementation of major reforms in the sector delayed. These factors combined to cause a downward trend in agricultural production, rural incomes, and living standards. Between 1991 and 1995, agricultural output contracted 40 percent. The problems of supply and marketing are severe enough so that farms appear to be retreating into a “low-input subsistence-oriented form of agriculture” that minimizes dependency upon uncertain markets and Government programs.<sup>1</sup>

129. The sector depends on rainfed cropping and grazing with extremely large yield fluctuations caused by changes in the weather. There is little potential for expanding irrigation. However, there is scope for improving the existing irrigation system, which is largely in the southern part of the country. The existing system is highly inefficient and has contributed to the serious environmental problems in the country. Of the 2.3 million hectares (ha) of irrigated land, approximately one half suffer from low productivity. One particularly widespread problem is high salinity occasioned by poor water management and insufficient drainage. Poor water management, particularly poorly designed and operated irrigation systems, is a factor behind the catastrophic shrinkage in the Aral Sea (see para. 145) and contributes to the ongoing desertification of agriculture land.

130. Because of major structural features, unlike other Asian economies in transition, the sector cannot be expected to play a lead role in the economy. Unlike countries such as Viet Nam or the PRC, agriculture production was organized in a highly capital-intensive fashion on large farms under the FSU, utilizing considerable capital investment in a wide variety of infrastructure. Farms were often extremely large—the state farms (sovkhoz) in Kazakstan averaged 35,000 to 40,000 ha. Symptomatic of Soviet central planning, much of the capital was inefficiently invested or maintained.<sup>2</sup> Inefficiency was also noted in the use of labor inputs. Agriculture was considered a residual employment locus. Partly in response to low productivity and excess labor, private farming on small plots was an important part of the sector; providing a major portion of crops as vegetables, but depending on the state and collective farms for inputs and marketing. The highly specialized and highly organized farm organizations face difficult restructuring and retrenchment in the same manner as needed for the industrial enterprises. As in the industrial sector, many of the activities are not viable at prevailing or likely world prices. Some parts of the extensive irrigation system are too costly to maintain and will not support internationally competitive farming.<sup>3</sup> The inappropriate productive structure offers scant potential for a swift supply response to the initial reforms.<sup>4</sup>

## **b. Policy Reforms**

131. Faced with the persistent decline in agricultural production and living standards, the Government greatly accelerated the pace of policy reforms in the sector towards the end of 1994, and a number of major reforms covering virtually the entire sector have been undertaken

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<sup>1</sup> Euroconsult BV, Arnhem Netherlands, “Support for the Privatization of State and Collective Farms and Agricultural Processing and Service Enterprises,” April 1995, p. 1.

<sup>2</sup> Brooks, Karen, J. Luis Guasch, Avishay Braverman, and Csaba Csaki, “Agriculture and the Transition to the Market,” *Journal of Economic Perspectives*, (5/4) Fall 1991, pp. 149-161, see especially p. 152.

<sup>3</sup> World Bank, Staff Appraisal Report, The Republic of Kazakstan, Irrigation & Drainage Improvement Project, September 22, 1995, p. 6.

<sup>4</sup> In this, the experience under transition in Kazakstan differs sharply from that found in PRC and Southeast Asia. See David Jay Green and Richard W. Vokes, “Agriculture And The Transition To The Market In Asia,” paper prepared for the Pacific Rim Allied Economic Organizations Conference on Economies in Transition’, Hong Kong, 10-15 January 1996.

since then. Policy reforms have been undertaken in (i) land use, (ii) farm privatization, (iii) agricultural trade, and (iv) agro-enterprise privatization.

**i. Land Reform**

132. The most fundamental reforms involve the provision for individual control over land use. From explicit recognition in early 1994 of the rights of inheritance, transfer, and lease of agricultural lands, the Government's land reform policy progressed to grant the rights of land ownership to private individuals by the end of 1995. There are still, however, questions over the extent to which these new rights apply to different types of agriculture land. Moreover, there is a lack of clear procedures regarding agriculture land-use rights with the need of further reform concerning the registration procedures, dispute settlements, Government repossession processes, and the use of land for loan collateral.

**ii. Farm Privatization**

133. Farm privatization has progressed in a formal manner with approximately 94 percent of all former state agricultural assets including farms transferred to private hands by the beginning of August 1996. However, the transfer has not resulted in substantial restructuring. Generally, a cooperative ownership structure has been adopted and preexisting management and customary operating procedures remain unchanged. The process is complicated because huge farms cannot be divided simply among the workers many of whom have no agricultural background and worked in the large social and the farms' logistical support systems. Moreover, skills related to the new market environment are often lacking: for example, newly privatized farms often lack marketing staff. In addition, the infrastructure and equipment are all designed for large-scale operation and centralized decision-making. There are few good models for the farmers to follow in restructuring, but World Bank economists have noted considerable ongoing experimentation—often an initial restructuring effort is followed by another, which provides for increased asset division.

### **iii. Trade Liberalization**

134. As part of the program to encourage the development of competitive supply and output markets, the external trade regime was liberalized substantially by eliminating all direct controls and reducing the export tax on grain. These reforms supported the general liberalization of domestic trading established with the freeing of most prices and the phasing out of the state order and state needs system involving the appropriation of agricultural output at nonmarket prices.

### **iv. Agro-Enterprise Privatization**

135. Uneven progress has been achieved in developing competitive markets for agroprocessing enterprises. Assets were transferred to private entities on a large scale through the national privatization program. However, a small number of holding companies were given monopoly control over their markets. Significant demonopolization in the agroprocessing sector has taken place, 13 out of 14 formerly vertically integrated monopoly holding companies have been dismantled. The residual companies, however, often continue to wield substantial monopoly power in the agricultural input and output markets.

136. Although, on balance, reform actions represent considerable movements away from the Soviet command economy, there are problems in implementation. Most particularly, local officials (contrary to the spirit and the letter of reform legislation) continue to interfere with farm management decisions, including the determination of sales and prices, especially in grain production and marketing. Local officials often act to protect local producers. In some instances, restrictions on management decision-making have been incorporated—implicitly or explicitly—into privatization agreements such as those for grain handling enterprises.

### **v. Public Expenditure**

137. On the public expenditure side, all price subsidies on agricultural commodities, including bread and flour, were eliminated by the end of 1994. However, some subsidies were reintroduced through the Agriculture Support Fund (ASF) in the following year. Expenditures in 1995 under the ASF totaled more than \$50.9 million (T3.4) billion covering a wide range of activities from fertilizer and seed subsidies to livestock support. A similar amount has been allocated in the 1996 budget. The funds are distributed by the Ministry of Agriculture as grants or loans at low interest rates. These subsidies are expected to be phased out with the development of a viable system for providing agriculture credit on market terms.

### **vi. Rural Finance**

138. The development of a viable agricultural credit system may require considerable time. The rural credit system had virtually collapsed by 1994. Previously, credit had been obtained under Government-directed lending programs. In these, Agroprombank (APB), the dominant rural finance institution, was used as a conduit for extend heavily subsidized loans to state farms and state-owned agroprocessing industries. These programs did not focus on loan repayments and, partly as a result, APB's loan arrears were estimated at \$225 million (T15 billion) in June 1995.

139. Major policy actions have been undertaken since early 1995 to reform the APB. All Government-directed credit, including credit extended through the APB, was discontinued as

part of the country's macroeconomic stabilization program. Since then, commercial banks, including the APB, have been required to obtain funds from competitive auctions of the Central Bank or from savings mobilized from the public. APB has also been restructured substantially in order to strengthen its financial viability. The Government transferred \$82 million (T5.5 billion) of APB's nonperforming assets to the ASF in July 1995 and is expected to transfer additional debt in the near future. Thus, the ASF is expected to provide two roles, holding APB's nonperforming debts and providing direct subsidies to the agriculture sector.

140. The development of a rural credit sector is hampered by a large number of institutional problems, including (i) the possibility that existing farms may undergo further restructuring; (ii) farms are often heavily in debt; (iii) sensitivity to weather conditions results in a high risk of region-wide crop failure; (iv) the use of land or equipment as collateral rests on an uncertain legal framework; and, (v) limited farm experience with commercial lending practices.

## **D. The State of the Environment**

### **1. The Soviet Legacy**

141. During the Soviet period, Kazakstan was a major source of mineral and agricultural resources for the FSU.<sup>1</sup> Soviet industry and agricultural policies failed to account for the cost of environmental resources such as land, water, and air. Massive widespread environmental degradation and overused natural resources were characteristic operating conditions. The lack of environmental concern was also apparent in the provision of public utility services including power, water, and sanitation services. In some instances, the combination of these failed policies has resulted in true environmental catastrophes, such as the desiccation of the Aral Sea, and the pollution and the rise in the level of the Caspian Sea. In addition, Soviet nuclear testing has left the country with additional environmental problems.<sup>2</sup>

142. Particularly serious pollution problems are present in the industrial sector. The country has extensively developed mining, chemical, metallurgical, and coal industries utilizing relatively low levels of technology by international standards. The situation is particularly worrisome in some industrial centers where emissions of pollutants routinely exceed maximum standards, for both water and air pollution. Improper waste disposal has led to water and soil contamination reducing the potential of the agriculture sector. The old Soviet system that linked Kazak mines with Soviet factories has not been replaced with new marketing arrangements and production has fallen off, attenuating some of the environmental damage caused by mining and industry operations. Oil, gas, coal, and metallurgy are, however, sectors likely to resume growth and the question of preserving and rehabilitating the environment must be addressed.

143. Agriculture practices have also taken a toll on the environment. Improper irrigation and land use has resulted in extensive soil degradation. Topsoil loss has been considerable and in many cases erosion may be irreversible. The excessive use of agrochemicals and lack of drainage have added to the destruction of the soil resources. World Bank staff estimate that

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<sup>1</sup> A more detailed discussion of environmental problems is in Appendix 4.

<sup>2</sup> There has been considerable publicity concerning radiation problems resulting from the widespread nuclear testing in the Semipalatinsk Nuclear Testing Region. The current available data show that there is no general health risk from radiation in Kazakstan as a whole. Problems remain in a 13 km<sup>2</sup> area near the Semipalatinsk range, which still registers radiation above ambient soil and air levels. Negative health affects from past testing may, however, afflict future generations with genetic problems.

606,000 hectares of agricultural land is unusable because of salinity, poor drainage, unusable irrigation systems, or lack of proper inputs.

144. Surface water resources include the Caspian Sea, Aral Sea, Lake Balkash, and 85 other lakes and rivers. Approximately one half of the surface water resources are in rivers originating in other Central Asian countries. Surface water use is heavily regulated through a system of reservoirs and storage facilities. As a result of improper water management, the Aral and Caspian Seas have been considerably damaged and are the sites of some of the largest environmental catastrophes in the FSU.

**a. Aral Sea**

145. In 1960, the Aral Sea was the fourth largest inland lake in the world. By 1989, the water level had fallen 14.3 meters, the surface area had shrunk by 45 percent, and salinity had increased 2.8 times to approximate that of sea water. The once sizable fishing industry has collapsed and the ecosystem of the sea and the associated river deltas have been destroyed. The exposed seabed releases into the air salts toxic to humans and agriculture crops, and causes extensive pollution of nearby surface and groundwater. The environmental problems of the entire basin are serious and have reached disaster levels close to the sea. Some of the major problems for the people closest to the sea are lack of potable water, high incidence of waterborne diseases, the adverse effects of sand and salt storms, and a severely depressed economy.

146. Within recent history, the Aral Sea has experienced similar changes, however, the main cause of the current shrinkage is generally thought to be the diversion of water from the two major rivers—the Amu Darya and Syr Darya—for irrigation and other purposes. Inefficient irrigation practices, the excessive use of chemicals, the growth of water-demanding crops such as cotton and rice, and a lack of adequate drainage have restricted downstream water flows and increased pollution. Urban and industrial wastes have aggravated the pollution problems. The republics in the Aral Sea basin have established an intergovernmental coordinating committee, two river basin commissions, and a number of other supporting organizations to examine water allocation and for designing and implementing development projects. These efforts are receiving considerable support from the international funding community (see para. 178).

**b. Caspian Sea**

147. Pollution in the Caspian Sea has become a major problem. During the 1980s, oil-based pollution increased 25-30 times and the copper content of the sea has increased 11.5 times, zinc 9.8 times, cadmium 4.9 times, and lead 5.6 times. In addition, neighboring Azerbaijan is the source of highly polluted wastewater.

148. A second issue with the Caspian is that the sea is flooding. The sea level has risen nearly 3 meters in the last several years and has flooded industrial estates, residences, farms, and oil production facilities built since World War II. The natural consequences of the rise include rising groundwater levels and soil salinization. The main cause for the variation is increased runoff from the Uralsk and Volga rivers in the Russian Federation, although the exact cause for this is yet unknown. The World Bank, UNDP, and United Nations Environment Programme have submitted an action program to the Global Environment Fund for financial support to address the problems.

## 2. Environmental Implications of Economic Reform

149. Given the current industrial and agriculture practices inherited from the FSU, the Government's program of reform, particularly price liberalization, should provide for increased efficiency in energy and materials use and directly improve environmental performance. The reform agenda includes a progressive elimination of subsidies to energy-intensive heavy industries, and economic pricing of natural resources including price increases for raw materials, energy, and water to recover long-run economic costs.

150. One problem—the environmental liability for accumulated pollution or waste sites—may become important. The guidelines for sharing known and potential pollution costs between the State and prospective new enterprise owners have not been clearly determined and could delay privatization or retard the restructuring of enterprises and post-privatization activities. For example, the Government's national program on privatization states simply that any restructuring plan, prior to actual sale, must include recommendations “on the environmental rehabilitation of production.”<sup>1</sup>

151. Looking forward, one necessary set of economic instruments for environmental management is a system of fines levied on polluters. Currently the fine and fee rates are very low, partly because of high inflation in previous years. Moreover, the responsibility for establishing and collecting fees has been devolved to local authorities, and there is no certainty that the local charges will reflect full economic costs to the environment of polluting and that minimum environmental standards will be met.

## 3. Institutional Structure for Environmental Protection

152. The Ministry of Ecology and Bioresources is broadly responsible for setting policy, coordinating activities, and monitoring compliance. The Ministry maintains offices in each province and district to provide for local inspection. Beyond this broad assignment, other government organizations are heavily involved in environmental protection, including the Ministry of Water Resources (responsible for irrigation systems); the Department of Hydrometry (maintaining testing facilities for water, soil, and air quality); the Ministry of Geology (responsible for water supply allocations); the Ministry of Public Health (responsible for public water quality monitoring); the Ministry of Agriculture (responsible for rural water supplies); and the State Committee for Mining Supervision (responsible for monitoring environmental impact of mining activities). In addition, local governments agencies play important roles in monitoring and enforcement. One consequence of these split responsibilities is serious problems in coordinating policy and in monitoring developments.

153. Additional problems include a lack of data. The data on environmental compliance vary in quality between agencies, and there are gaps—for instance, wastewater discharge is not monitored. Air pollutants from industry are also seldom monitored as, under the Soviet system, industries were expected to monitor their own pollution. Budgetary problems also hinder environmental protection activities. The government regulatory agencies, for example, lack the portable monitoring equipment necessary to document noncompliance and enforce industrial air quality standards.

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<sup>1</sup> Government of the Republic of Kazakstan, *The National Program of Privatization and Restructuring of the State Property in the Republic of Kazakstan for 1996-1998*, draft, p. 6, 14 February 1996.

## **E. The Policy Environment: A Summary of the Reform Program**

154. The ongoing transition for Kazakhstan involves a period of reform and institution building. The previous sections have discussed many of the elements of the necessary changes, especially those related to macrostability, industry, and agriculture. The following sections summarize this discussion in an effort to provide a perspective on the state of reform and the progress through this period of transition. Three elements are particularly important: (i) macrostability, (ii) structural reform including the creation of markets and the development of competitive markets, and (iii) the capacity to manage reform and governance.

### **1. Macrostability**

155. Improved macroeconomic stabilization is a prerequisite for a successful transition from a centrally planned to a market economy in Kazakhstan. In particular, the significant results achieved in reducing inflation must be maintained and extended. Progress will require actions to reduce inflationary pressures arising from interenterprise arrears and fiscal imbalances. The interenterprise arrears problem involves a particularly difficult set of issues. The large state-owned and controlled firms must move to operating under hard budget constraints. This must be supported by a financial system that extends credit on commercial terms and a payments system that can buttress trade, including interrepublican trade.

156. Fiscal imbalances must also be addressed: large budget deficits increase inflationary pressure, but also (i) reduce budgetary flexibility impeding the Government's ability to finance necessary spending on social services, social protection, and capital investment; and (ii) constrain the availability of adequate and timely counterpart funds for externally assisted development projects. A common theme running through much of the discussion of fiscal issues is the need to resolve revenue and expenditure assignments between the Central Government and local governments (province, district, and municipality). The Central Government has committed to a program of fiscal devolution. The success of such a program will depend crucially on institutional development of the local governments.

### **2. Structural Reform**

157. Since independence, there has been considerable progress in structural reform towards developing a market economy. In terms of creating markets, the Government has freed most price and allocation decisions. The dismantling of the state needs system for agriculture goods was especially important. However, considerable administrative interference is still exercised through Government-owned or controlled enterprises and by local governments, often in conflict with existing law. In terms of creating competitive markets, the Government's privatization program has transferred to the private sector housing assets, most enterprises in the service sector, and a considerable portion of the small- and medium-scale enterprises and farms. In spite of this, progress in transferring control and ownership functions that would result in internal restructuring and labor rationalization, has been slow. Moreover, many large enterprises remain under state ownership.

158. Many of the reform actions thus far have resulted in formal changes in law and in structure but not in behavioral changes. Firms and farms have failed to substantively restructure to improve productivity. Most worrisome, the reform process has thus far failed to promote a financial sector that can support the nascent market system. These incomplete structural reforms will delay any recovery from the current depressed economic conditions. Reform has

focused on legislation and decisions by the Central Government. A major challenge is to implement the reform process through institutional change and behavior.

### **3. The Capacity to Manage Reform**

159. The comprehensive reform program being implemented by the Government directly addresses many of the Bank's concerns on good governance. Most importantly, the Government has made considerable progress in establishing many of the elements of a legal system that can encourage private sector development. The privatization exercises that are a central feature of the reform program have transferred many public assets to private hands and are an important step towards refocusing Government activities. As the transfer of assets progresses and the public sector becomes more defined, there will be the opportunity for long-term civil service reform that provides for accountability and public participation in decision making.

160. The next stage will place a heavy burden on the Government's capacity to manage reform. General problems include the limited fiscal resources and a weak understanding of market principals by public officials. The latter problem should form an important element in technical assistance (TA) programs.

161. One problem has been the lack of stability resulting from changes in the institutional arrangements for coordinating foreign assistance and for decentralized implementation of development projects. This work is an important part of development management. Several aspects are important, including the (i) determination of an adequate and fiscally responsible public investment program; (ii) coordination of external technical assistance, grants, and loans; (iii) management of external debt; and (iv) oversight of foreign-funded project implementation.

162. Independence found the Kazakstan Government with scant experience in these matters and institutional development has been slow. At the time that Kazakstan joined the Bank, most of these responsibilities were to have been carried out by the National Agency for Foreign Investment under the Ministry of Economy. In the following year, in 1995, the Agency was abolished and a new agency, the Committee for the Utilization of Foreign Capital (CUFC) was established as a successor organization. CUFC was initially established as an independent organization reporting to the Cabinet of Ministers; however, the Government was not satisfied with this arrangement, and, in October 1995, CUFC was made a subordinate department within the Ministry of Finance. A final Government decision on this issue has not yet been taken, and the division of responsibility concerning external aid coordination between the Ministry of Finance and the Ministry of Economy has yet to be finalized. It appears that at the end of 1996, the Ministry of Economy will be charged with preparing the public investment program and the programming issues related to foreign assistance, and CUFC will likely be in charge of implementing and administering the processes that follow, in close coordination with the line ministries.

### III. THE GOVERNMENT'S MEDIUM-TERM STRATEGY

#### A The Formal Development Plans

163. The Government does not have a formal development plan. To prepare one, in early 1996, the Government established the Supreme Economic Council, a new policy-advisory unit attached to the office of the President. This council will draw up a comprehensive long-term economic planning document, which will complement work being done in the Ministry of Economy on the public investment plan, in the Ministry of Finance on the use of foreign assistance, and in the EXIM Bank on foreign direct investment.

164. Existing formal statements regarding development strategy include documents prepared for the 1995 Consultative Group (CG) Meeting in Paris. At that time, the Government of Kazakhstan expressed its medium-term development goals as follows:

- (i) to stabilize production,
- (ii) to create conditions for the resumption of sustainable economic growth and the improved welfare of the population, and
- (iii) to implement an active social policy while keeping inflation low.<sup>1?</sup>

165. In the context of the CG documents, the first condition clearly refers to macroeconomic stabilization, the second to structure reforms, and the third to the need for a fiscally responsible social safety net. Progress towards these goals will demand a wide variety of actions across many different sectors, particularly to follow-up initial steps towards structural reform.

166. Reflecting progress towards macrostability, in November 1995, the Government issued a new document, the *Program of the Actions of the Government on Deepening the Reforms for 1996-1998*, with an increased emphasis on structural reforms.<sup>2</sup> The main objectives are to strengthen the results achieved in 1994 and 1995 in macroeconomic stabilization and structural reforms, restore positive economic growth, and increase the living standards of the people. The detailed tasks of the program include (i) reducing the rate of inflation from 26-28 percent in 1996 to 9-12 percent in 1998; (ii) achieving output stabilization in 1997 and economic growth in 1998; (iii) increasing real average wages, (iv) strengthening targeted social support to vulnerable groups; (v) deepening financial sector and enterprise reforms; (vi) modernizing production infrastructure; (vii) continuing to implement policy reforms to create incentives for investment activities (including foreign direct investment); (viii) supporting entrepreneurship and small- and medium-size business; (ix) strengthening institutions in areas such as state administration, legal enforcement, payment, and finance; and (x) decentralizing management and reform implementation to local authorities. Table 1 summarizes the sectoral policy concerns, other than macroeconomic.

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<sup>1</sup> Government of the Republic of Kazakhstan, Cabinet of Ministers, *Main Results of the Policy Reforms during 1994-1995 and the Program of Systemic and Economic Transformation in the Republic of Kazakhstan for 1995-1997*, p. 7.

<sup>2</sup> Government of the Republic of Kazakhstan. Almaty. November 1995, p. 6.

**Table 1: The Government's Sectoral Policy and Investment Program**

Focus/Sector	Policy Program of the Government	Investment Program
<b>Productive Capacity</b>		
Agriculture	Extend land reform Encourage land markets Complete privatization of agro-industry Develop water users association	Agriculture machinery supply stations (PF) Irrigation systems (GF) Formation of equipment leasing firms (GF) Land registration (GF) Agroprocessing (PF)
Coal	Rationalize industry, strengthen SOEs	Investment for improving productivity (PF)
Industry	Complete small-scale privatization Strengthen SOE fiscal performance Develop post-privatization support Increase anti-monopoly activity	Formation of equipment leasing firms (GF) Light industrial equipment (GF) Gold industry (PF) Chemical industry (PF) Machine building (PF) (GF) Construction material supplies (PF)
Oil and Gas	Increase production and exports Privatize SOEs	Encourage Caspian pipeline (PF) Extend exploration (PF) Internal pipeline (GF) Gas scrubbers (GF) Refinery, petroleum transport (PF)
<b>Infrastructure</b>		
Air Transport	Regionally reorganize operations	Navigation services (GF) Leasing new airplanes (GF) Rehabilitation of Almaty, Akmola airports (GF)
Communications	Improve service by strengthening SOEs and encouraging private sector investment	Satellite links (PF)
Electric Power	Increase production, reduce supply constraints Reorganize and strengthen SOEs Tariff reform	Modernization of equipment (GF) Energy conservation program (GF) New generating and transmission equipment (PF)
Rail Transport	Strengthen SOE fiscal performance Tariff reform	Improve rail connection at Chinese border (GF) Rehabilitate railway cars (GF)
Road Transport	Privatize trucks Increase road rehabilitation	Road rehabilitation (GF)
Water Supply and Sanitation	Increase cost recovery	Urban water supply and sanitation projects (GF)
Water Transport		Improve Aktau port facilities (GF)
<b>Social Sectors</b>		
Education	Rationalize services Maintain free primary/secondary education Institute self-financing for pre-school	Establish management, training centers (GF) Encourage <i>production-oriented</i> research (GF)
Health	Institute medical insurance and fees Rationalize service provision and costs	Production of medical supplies (GF)(PF)
Housing	Increase credit provision	Credit provision (GF)
Social Protection	Improved benefit targeting Increase funding for social protection	Management Information System for pensions (GF) Public works projects (GF)
Strengthening Local Government	Capacity building Transfer social assets	Pilot projects on improving service provision at provincial levels (GF)
<b>Environmental Improvements</b>		
Aral Sea	Arrest continued desiccation. Mitigate environmental impact on health and livelihood.	Provision of water supply and sanitation (GF) Water management (GF)
Caspian Sea	Reduce flooding and pollution.	Construction of housing, rural infrastructure (GF)
Rangeland protection	Arrest continued land degradation and erosion.	Reforestation and replanting (GF)
Semipalatinsk nuclear testing facility	Monitor genetic damage from nuclear testing.	Health programs (GF)

## Notes:

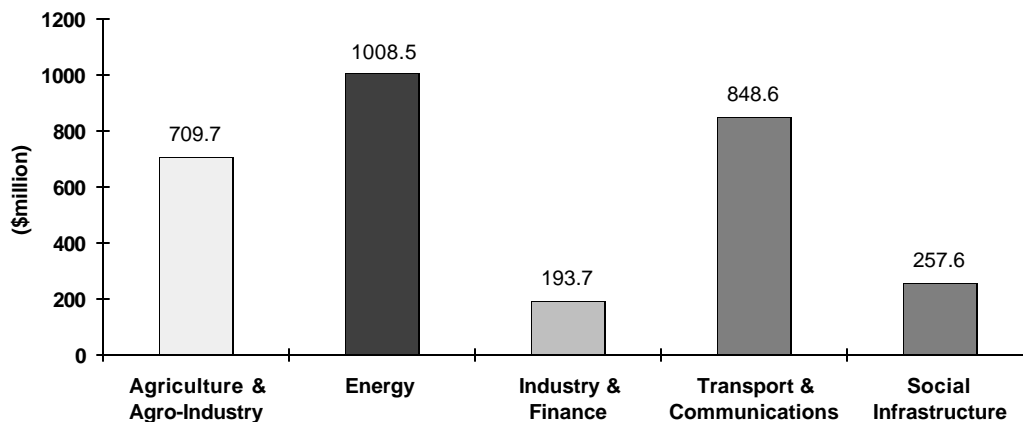
- GF indicates funds are expected to come from Government budget, PF indicates private funds, especially foreign direct investment are expected.
- Information is from Government of Kazakstan, *Program of the Actions of the Government on Deepening the Reforms for 1996-1998*, November 1995 and *Program of Investment Priorities*, Consultative Group Meeting, May 1995. The investment program list does not include a number of projects expected in social sectors, and is subject to review and modification.

167. A recurring theme in the Government's policy planning is the need to strengthen the performance of state-owned enterprises. The Government recognizes that this will involve increased financial and management autonomy but also increased market-based regulation. One aspect of this plan is the commitment to have successfully divested by 1998 all social assets from the operational control of enterprises and transferred the responsibility for them to local governments.<sup>1</sup> As a follow-up to this divestiture, there is clear need for institutional strengthening of local governments.

168. As of mid-1996, a full public investment program is still in preparation. Utilizing materials provided for the 1995 CG meeting and preliminary public investment program materials, some sense of the public investment priorities can be determined. The right-hand column of Table 1 summarizes capital projects by sector that appear in the Government's planning documents. The list includes both those projects to be financed with public funds and those to be financed privately but requiring public support through state-owned enterprises or a government guarantee.

169. Some further sense of the Government's priorities for investment is given in Figure 3, which provides a breakdown of the dollar value of externally assisted investment projects projected by the Government, by sector. Energy is anticipated to capture the largest share of investment funding, followed by transport and communications, and then agriculture and agro-industry. However, this indicative list does not include some likely projects in the social sector, and the capital budget in 1996 provides little support for a comprehensive investment program.

**Figure 3: Externally Assisted Priority Investment Programs By Sector for 1996-1998**



## B. The Evidence from the Budget

170. The 1996 budget provides additional information concerning the Government's development planning, indicating in what fashion the Government is willing to commit scarce

<sup>1</sup> Government of the Republic of Kazakstan, *Program of the Actions of the Government on Deepening the Reform for 1996-1998*, Almaty, November 1995, p. 6.

resources. The budget documents provide important information on (i) social sector spending, (ii) capital investment programming, and (iii) the planned use of foreign resources.

171. Social sector spending in the 1996 budget is targeted for 10.0 percent of GDP, little changed from the 10.6 percent of GDP in 1995. Expenditures from extrabudget funds supporting pensions, unemployment assistance, and the new medical insurance fund also are planned to increase. If the decline in real GDP is, as expected, less than 6 percent in 1996, the budget would provide for a constant level of real resources in the sector, the first such year since independence.

172. The capital budget for 1996 totaled T4.2 billion or 3.2 percent of GDP. This represents a real increase over the T2.7 billion in 1995. The implementation of this public investment program is heavily dependent upon external support. The Government expects that foreign funding will support approximately two-thirds of public investment spending explicitly noted in budget documents. There is evidence that complementary activities such as maintenance continue to be underbudgeted. Given this budget planning, the shortage of counterpart funding, whether for investment or recurrent cost purposes, may limit absorptive capacity.

### **C. External Assistance**

173. Kazakstan has been receiving considerable support from external funding agencies. The activities of the major external funding agencies are described here and the activities of the major multilateral agencies other than the Bank are summarized in Table 2. The IMF's program of assistance was described in para. 16. The substantial progress on macrostabilization has led the IMF and the Government, in July 1996, to agree to replace the current Stand-By Arrangement with an External Fund Facility that would focus on structural reforms in addition to macroeconomic balances.

174. The EBRD has a program based on a line of credit for small- and medium-scale enterprises, and investments in private enterprises engaged in agro-processing, light industry, nonferrous metals, petroleum, power, and transport, particularly air and rail. In mid-1996, the accelerated privatization program in energy has prompted a review of planned energy projects. The EBRD is also processing a large public sector infrastructure project in the city of Aktau for the rehabilitation of port facilities.

175. The United Nations (UN) has extensive programs in Kazakstan. The UNDP has focused on TA for industry, including oil and gas, and environmental rehabilitation programs, particularly those in the Aral Sea region. The UNDP is also cofinancing with the Bank a TA project for aid coordination. In addition, there are local offices and staff directing programs of United Nations Educational, Scientific and Cultural Organization (UNESCO), United Nations Fund for Population Activities (UNFPA), United Nations High Commission for Refugees (UNHCR), United Nations Children's Emergency Fund (UNICEF), and the World Health Organization (WHO). The UN activities have been particularly effective in directing attention towards the very difficult issues concerning industrial or company towns and the very distressed rural areas. In addition, the UN has provided support for Aral Sea initiatives and has a particular interest in health problems.

176. The World Bank has the largest program of external assistance for Kazakstan. The World Bank's activities focus on supporting macroeconomic stabilization and structural reforms. Policy-related and investment credits have been made available or are being processed

in agriculture, energy, enterprise reform, employment services, environmental rehabilitation, finance, health, road rehabilitation, social protection, urban transport, and in

**Table 2: Summary of Sectoral Activities by Multilateral Funding Agencies other than the Bank**

<b>Focus of Involvement</b>	<b>Existing and Planned Activities by Multilateral External Funding Sources</b>
<b>Support for Macroeconomic Stability</b>	
Macroeconomic Policy	<b>IMF:</b> Stand-by Arrangement followed a Systemic Transformation Facility, and planned Extended Fund Facility <b>OECD:</b> TA in finance and banking <b>World Bank:</b> Rehabilitation Credit, Structural Adjustment Loan, Planned Structural Adjustment Loan II, planned treasury modernization loan
<b>Providing for Current Output</b>	
Agriculture	<b>EBRD:</b> Line of credit <b>EU:</b> TA for agro-business privatization <b>World Bank:</b> Planned land and real estate registration; planned irrigation project; planned agriculture-privatization
Finance	<b>EBRD:</b> NBK line of credit for banks; planned investment fund <b>EU:</b> TA for banking sector and central bank strengthening <b>World Bank:</b> Policy-based finance and enterprise restructuring; TA for banking and accounting; planned financial sector adjustment
Industry	<b>EBRD:</b> SME credit line; investment projects in household appliances, planned in copper, confectionery, and others; TA for privatization and for post-privatization support <b>EU, UN:</b> TA for pre and post-privatization support <b>World Bank:</b> Finance and enterprise development for restructuring large, loss-making firms; planned enterprise support; TA for privatization and post-privatization support
<b>Infrastructure</b>	
Communications	<b>EU:</b> TA
Energy	<b>EBRD:</b> Planned investment in pipelines, petroleum production and power <b>EU:</b> TA <b>UNDP:</b> TA <b>World Bank:</b> Petroleum TA loan, planned Uzen oil project
Transport	<b>EBRD:</b> Aktau port rehabilitation; planned project in airlines, railways <b>EU:</b> TA <b>IDB:</b> TA for road feasibility <b>World Bank:</b> Urban transport project; planned highways infrastructure project
Water Resources	<b>IDB:</b> TA for rural water supply <b>World Bank:</b> Water supply and sanitation project
<b>Human Resource Development</b>	
Education	<b>EU:</b> TA for higher education
Health	<b>World Bank:</b> Planned health project <b>UN:</b> Policy, project support
<b>Cross-Sectoral Activities</b>	
Environment	<b>EU, World Bank, UN:</b> See Aral Sea Fund, below <b>International Atomic Energy Agency:</b> Support for nuclear safety and waste management and technology transfer
Government Services	<b>EU, UNDP:</b> TA <b>World Bank:</b> Social protection project; TA for unemployment, social assistance, and related sectors
<b>Regional Activities</b>	
Aral Sea Fund	<b>EU, UN, World Bank:</b> Support for stabilization and reconstruction of the environment surrounding the Aral Sea
TRACECA	<b>EU:</b> Facilitation of trade and communications between Central Asia and Europe

EBRD - European Bank for Reconstruction and Development

EU - European Union

IMF - International Monetary Fund

UN - United Nations

Note: The organization of the sectors and subsectors is somewhat arbitrary, reflecting the different structural arrangements by the various funding agencies.

water supply and sanitation. The World Bank is currently reviewing its strategy for the country. Preliminary suggestions include shifting towards a larger number of smaller projects, especially pilot projects, in order to speed processing and to gain experience in project implementation.

177. Among the bilateral programs of assistance, Japan and the United States (US) have large programs. Japan has provided support for World Bank and IMF structural adjustment programs and is planning to provide considerable funding for infrastructure activities, including the rehabilitation of a large bridge, roads in west Kazakhstan, the airport at Akmol, and a dam in Aktau. The US provides support through USAID and through the Central Asian-American Enterprise Fund (CAAEF). USAID concentrates on activities affecting three areas: economic restructuring, democratization of society, and social sector restructuring. Concerning the first, the focus has been on encouraging privatization with TA. In the social sectors, important activities have been in health and in support of the Aral Sea program. The CAAEF has supported post-privatization activities with loans directly to private enterprises. In addition to these activities, programs of support are maintained by Austria, Germany, Turkey, and the United Kingdom.

178. Kazakhstan also receives assistance organized to address regional problems, especially the environmental problems of the Aral Sea. The European Union, UN, and World Bank are all providing programs to help rehabilitate the Aral Sea environment. The World Bank's Aral Sea Basin Program involves assistance for (i) stabilization of the level of the sea, (ii) the rehabilitation of the disaster zone immediately surrounding the sea, (iii) strategic planning and management of the Amu Darya and Syr Darya, and (iv) the building of institutions for planning and implementation. At least 12 bilateral funding agencies have been involved in project design and implementation for this and other activities in the region.

#### IV. THE BANK'S STRATEGY

##### A Overall Strategic Goals

179. The Bank's initial program of assistance in Kazakhstan, after the country became a Bank member in January 1994, has been guided by an interim operating strategy.<sup>1</sup> The primary objective of the interim country strategy was to facilitate the transition to a market economy. The objective involves (i) achieving macroeconomic stabilization, (ii) sectoral policy reform, (iii) strengthening institutions and human resource development, and (iv) selected infrastructure investment. Because of the very severe economic depression, an overriding short-term concern had been, after providing special assistance, to support sector policy reform through quick-disbursing program loans; support the importation of essential inputs, raw materials and consumer goods; revive production; and minimize economic and social hardship.

180. Since the interim strategy for Kazakhstan was drafted, the Bank has provided Kazakhstan with three loans (a special assistance loan [\$60 million], a program loan in agriculture [\$100 million], and a loan in the education sector [\$20 million]), 14 TA projects plus a

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<sup>1</sup> See Informal Board Paper on "The Bank's Interim Country Operational Strategies in Kazakhstan and the Kyrgyz Republic" circulated on 23 December 1993.

supplementary TA, Seminars on Bank Operational Policies and Procedures.<sup>1</sup> The Bank prepared the initial Economic Report<sup>2</sup> and subsequently an Economic Review and Bank Operations Paper.<sup>3</sup> This work has provided Bank staff with considerable experience in the country. Moreover, the country's situation has changed with progress on macrostabilization. It is timely for the Bank to review its strategy to guide the Bank's assistance over the next 3-5 years. In this work, it is important to establish clear priorities and coordinate the Bank's activities closely with those of other funding agencies.

181. The main objectives of Bank activities in Kazakhstan follow closely from the country's developmental needs:

- (i) encouraging the transition to a market-based economy, supporting the Government's reform agenda, encouraging institutional change, and strengthening social protection;
- (ii) promoting the rehabilitation of the environmental resource base of the country;
- (iii) strengthening the long-term potential for sustainable growth in the country by investing in physical infrastructure and in human resource development; and
- (iv) encouraging the creation of a new structure of output and new production capacity through private sector investment.

182. The developmental needs of the country are vast, and the Bank's resources are limited. Other funding agencies provide extensive support and TA and have undertaken substantial programs in a number of sectors. Thus, it is suggested that the Bank focus its loan and TA activities in the following sectors as detailed below:

- (i) strengthening the management of reform at the central and local government levels;
- (ii) human resource development through education and training;
- (iii) agriculture, to provide the economic base for sustainable recovery;
- (iv) industry, focusing on the problem of reform of medium-sized enterprises, especially in company towns; and
- (v) infrastructure, especially rehabilitation projects.

## **B. Sectoral Strategies**

183. The following sections discuss sector strategies using the organization suggested by the developmental goals. The organization used is to simplify the presentation and does not indicate an order of importance. The first section covers activities designed to support reform and development management. The second discusses the rehabilitation of the environment. The third and fourth detail activities to arrest the decline in the long-term growth potential through support for physical infrastructure systems and for human resource

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<sup>1</sup> TA No. 2174-KAZ: *Seminar on Bank Operational Policies and Procedures*, for \$85,000, approved on 28 September 1994.

<sup>2</sup> ECR KAZ 94019: *Economic Report on Kazakhstan*, October 1994.

<sup>3</sup> EBO KAZ 95014: *Economic Review and Bank Operations*, October 1995.

development. The fifth and sixth sections outline programs to enhance the productive capacity of the economy through activities to support agriculture and industry. In addition, specific references are made on those sectors in which the Bank will not be undertaking large-scale activities, including health and water supply. In general, the sectoral strategy discussions cover (i) the unfinished reform agenda, (ii) institutional reform and capacity building, (iii) investment and project priorities, and (iv) the potential for improving the environment. The final sections of the paper discuss regional cooperation and the relationship between the country operational strategy and the Bank's strategic framework.

## **1. Supporting Reform Activities And Development Management**

184. As noted in para. 159, the importance of continuing reform activities and strengthening the Government's ability to manage reform are similar to general issues of development management or governance. Improving governance and the management of reform is a primary concern of the Government and a primary focal point for Bank operations. This section (i) summarizes the issues of good governance, particularly the need for capacity building; (ii) elaborates on the need to support reform through policy-based lending; and (iii) discusses a strategy to strengthen local governments, particularly to improve the delivery of public services that can minimize the inequitable distribution of the costs of the transition.

### **a. Governance**

185. The reform programs being implemented by the Government directly address many of the Bank's concerns on good governance, including (i) establishing appropriate legal institutions; (ii) increasing participation in economic decision-making, especially through privatizing public assets; (iii) building government capacity; and (iv) providing for an increasing flow of information.

186. An overriding concern with respect to good governance and the management of reform and development is the need for long-term capacity building. TA directed towards capacity-building activities should focus primarily on the sectors in which the Bank is expected to conduct broad-based, long-term programs. Additional TA efforts should only be made in support of Central Government operations such as aid management or policy analysis—areas that provide for an improvement in governance. Further, this assistance should only be provided if a significant impact can be made on the problem.

187. It may not be possible to mount successful capacity building programs in even the limited number of areas suggested. Successful capacity building demands a responsive atmosphere or environment in the targeted Government agencies. Government personnel must be receptive to the process. The Bank must assess the potential for capacity building and act accordingly; only when the opportunity for successful interventions is present should TA programs be initiated or implemented.

### **b. Support of Policy Reforms**

188. A large unfinished reform agenda needs to be completed. This difficult task is made more difficult by the economic depression and the Government's fiscal difficulties. Policy-based program loans supported through TA can encourage and support the Government to further its ongoing reforms. The Bank has already assisted to the Government through a policy-based program loan in agriculture and is processing a program loan focusing on enterprise reform. Reforms in these sectors are unlikely to be completed at the end of the program period, and additional program loans may be necessary in the future.

189. The Bank's first priorities to support policy reform should be in sectors where a sustained assistance can be maintained. The management of the transition through broad changes in institutions cannot be accomplished simply or quickly. Successive programs accompanied by appropriate TA must be adopted. In a transition economy such as Kazakhstan, investment projects should also be seen as and designed to be an integral part of support for policy reform. Investment projects can help test the extent of successful reform and uncover implementation problems.

190. The Bank's new sector development program (SDP) could be a very useful tool in assisting the Government in this area. An SDP could allow simultaneous support for policy reform and specific project investment such as for funding infrastructure rehabilitation. The ability to assist the Government in both policy reform and infrastructure investment would lower the risk of project failure associated with activities that tackle only one area of the problem. Possible sectors for an SDP would include agriculture, education, and infrastructure.

### **c. Strengthening the Capacity of Local Governments**

191. Improved public provision of local government services is an important element of the country's reform program and an essential part of any overall program for human development. This is particularly true for services providing for social support, including social insurance (for pensioners and the unemployed); social assistance (direct support for the poor); social infrastructure (district heating, power, sanitation, water); and social services (health and education). The concern regarding social services reflects the very nature of the transition period characterized by widespread and heavy economic and social costs, which are borne often by those least able to bear them. With support from the World Bank, the Government has begun to deal with social insurance through reform of the pension system and a program of unemployment benefits and services that reflects emerging labor market needs.

192. However, much is left to be done in this important area. In particular, the many local government units—province, municipality, and district—face unprecedented challenges to provide fiscally sustainable services that are responsive to the growing need for such services. Support for improved delivery of government services at the local level would be an important contribution by the Bank to further reform management and ease the difficulties of transition. Several strategic elements are important in this area, including the necessity to (i) improve the appropriate targeting of services and the transparency of the system to increase beneficiary participation, (ii) increase the efficiency of service provision, (iii) enhance local Government revenues and the capacity of public agencies to redress problems and initiate and implement reforms, (iv) review and redress the role of the public sector vis-à-vis private sector or nongovernment organizations, and (v) provide active support for private sector involvement.

193. Care must be exercised in designing specific projects for this sector as the activities required are administratively costly. Programs can, however, be identified and should incorporate three elements: (i) TA to build institutional capacity and improve resource mobilization, (ii) investment in equipment and small infrastructure needs, and (iii) financing for nonrecurrent restructuring expenses. TA is a priority, especially for local governments that lack the ability to initiate or implement needed changes. TA can, however, proceed only after a needs assessment in agencies and with personnel that recognize the need for change and have the political support to undertake this change. Most areas will need upgrading of equipment and investment in relatively small, dispersed infrastructure—school buildings, for example, need rehabilitation and social infrastructure, such as water supply and sanitation facilities, need maintenance. Finally there are many nonrecurrent expenses, such as those related to employment retrenchment. A failure to provide for the financing of these activities would inhibit

any real reform. A number of different means could be employed to utilize Bank resources in this sector. Program loans could be used to support policy reforms with funds earmarked for specific interventions such as TA or small infrastructure purchases. However, sector loans or the Bank's new SDP may be more applicable, targeting a limited number of local government bodies for TA and associated investment activities including infrastructure and restructuring expenses.

## **2. An Environmental Action Program**

194. Few countries face the range of environmental problems that exist today in Kazakhstan. Environmental problems stem originally from improper industrial and agricultural practices or from improper operating practices by public utilities in energy, water supply, and municipal waste. As noted, in some instances the combined result of different environmental problems has assumed catastrophic proportions, including the desiccation of the Aral Sea and in pollution and the rise in the level of the Caspian Sea.

195. The environmental catastrophes in the country have proven to act as focal points for international concern and assistance (para. 178). In particular, large Aral Sea programs are sponsored by the European Union, World Bank, and UN. These programs, in combination with the interrepublican institutions, have resulted in a complex administrative structure. Because of ongoing intensive attention and support, there appears to be no immediate need for Bank participation in these programs.

196. Given the Bank's limited financial and staff resources, the coverage of environmental issues by other members of the international community, and a number of major initiatives already under way, the Bank's direct operational involvement in addressing environmental concerns will remain limited. As a minimum, the Bank will see to it that none of the operations it supports will have negative environmental effects. Whenever possible the Bank will include proactive environmental components in its operations. For instance, in agriculture, Bank projects supporting improved water resource management and rangeland protection can aid in reducing water pollution and soil degradation, and ease pressures on the Aral Sea (see para. 244). In industry, an active investment program in medium-sized industries can reduce pollution through technology transfers (see para. 235). With respect to public utility practices, Bank activities in support of power and heating plant rehabilitation and transport policy can reduce air pollution (see para. 205 and para. 212). Within the context of improving local government services, water pollution from municipal waste may be addressed (see para. 191 and para. 193).

197. In addition to the sectoral-based activities, the Bank should provide an integrated TA program to the Government to strengthen reforms aimed at environmental rehabilitation and protection. The program could be directed towards the Ministry of Ecology and Bioresources to provide capacity building, especially in environmental impact assessment, cost/benefit analysis, policy development, and policy coordination. In terms of policy analysis, particular areas of emphasis might include the use of internationally acceptable techniques for environmental and resource valuation, and pricing and pollution fees. Environmental agencies could further be assisted in monitoring pollution through the provision of small equipment and TA.

## **3. Physical Infrastructure**

198. As institutional reform proceeds, real resources must be found to maintain the physical infrastructure systems. In particular, it is vital to rehabilitate and modernize the physical infrastructure needed to support private economic activity. These systems are deteriorating in the face of deficient public funds for maintenance and support. A small amount of resources

provided in a timely fashion will preserve these significant economic assets; conversely, the lack of timely maintenance and rehabilitation risks their loss. If these assets are not preserved, the long-run growth potential for the economy will be lowered. Thus, Bank activities should focus on rehabilitation rather than new construction. Careful thought needs to be given to establishing priorities ? not all the infrastructure developed during the Soviet period merits preservation as some will be of little use in supporting the emerging market-based economy. In addition, there should be a firm program of policy reform in each subsector to ensure that, through resource mobilization and demand management, infrastructure resources are conserved and maintained. By subsector, there is considerable scope for project investment in the rehabilitation of roads and power systems.

**a. Energy: A Cautious Approach is Warranted**

199. In the hydrocarbon subsector, the Government has achieved considerable success in attracting foreign private investment and this is likely to continue. The Government has indicated that it expects complete privatization of all major oil and gas assets by mid-1997. Privatization is also proceeding rapidly in the electric power subsector, however, here its scope is likely to be less complete with some utilities and transmission facilities remaining in the public sector. Accelerated privatization alone does not solve all policy issues; nor do these actions provide for all of the capacity building necessary to give the sector institutions a market-based outlook. Consequently, the Bank should consider maintaining attention to the power subsector and recognize that there may also be a need for public support in natural gas transport and in facilities for natural gas purification. The Bank should assess the scope for assistance in natural gas transport, especially to facilitate the access of private sector gas producers to domestic markets.

200. In addition to these efforts focused on Kazakstan, the Bank should make efforts to improve intraregional cooperation in energy in Central Asia. Particular attention should be given to any areas in which the provision of infrastructure could increase cross-border trade and exploit regional economies of scale. For Kazakstan, this could include additional gas pipelines and power transmission lines to neighboring countries such as the PRC and the Kyrgyz Republic. In this connection, the Bank should be ready to provide assistance for specific studies and for resolving cross-border policy issues including improving the payments systems.

**i. The Unfinished Reform Agenda**

201. An important policy issue is the development of a viable regulatory framework for the power and natural gas subsectors. Government plans for these subsector emphasize privatization; however, widespread and transparent privatization of public utilities will be extremely difficult in the absence of deep capital markets and a well established regulatory structure.<sup>1</sup> Even in the event of extensive privatization, institutional strengthening is necessary. Needed reforms include tariff adjustment to improve resource mobilization, improving revenue collection, and reducing the interenterprise debt overhang in the sector. These measures must be complemented with efforts to improve efficiency and reduce costs. Furthermore, the Bank should assist the Government to undertake policies that will encourage energy conservation, environmental protection, and social considerations such as life-line tariffs.

**ii. Institutional Reform and Capacity Building**

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<sup>1</sup> *The National Program of Privatization and Restructuring of the State Property in the Republic of Kazakstan for 1996-1998*, pp. 9-11.

202. It is important to establish a regulatory environment that will encourage market-based behavior in state-owned enterprises or in newly privatized firms. A first step is the establishment of an independent regulatory body to determine tariff rates and monitor enterprise financial performance and service provision. The Government has announced plans to establish two regulatory bodies, the State Power Inspection Commission and the State Commission for Electric Power Pricing. Regulatory bodies require considerable time and institutional support to become effective. In particular, a supportive legal system is necessary to provide institutional support to the operation of tariff-setting administrative bodies. The Bank may consider providing TA to enable these regulatory bodies to become established and to become effective.

### **iii. Investment and Project Priorities**

203. In Kazakhstan, energy planning is complicated by the difficulties inherent in projecting demand in the present chaotic transition period. Where possible, least-cost energy planning should be done on a regional basis. Given the large investment needs and the shift towards a market-driven economy, private sector involvement and financing must continue to be sought. Priority needs for public investment appear to include

- (i) rehabilitation and retrofitting to improve capacity, availability, efficiency, and environmental performance, and to extend the useful life for those energy facilities which cannot be privatized;
- (ii) better integration of the national electric supply system through investments in transmission facilities;
- (iii) new construction in natural gas transport systems, particularly those investments that could act as catalysts for private sector investments in gas field development and production; and
- (iv) system loss reduction, demand side management and optimization of system operations for those public utilities that will not be privatized.

204. It should be stressed that the rapidly changing policy environment, particularly the privatization exercise, calls for a cautious approach to developing a public investment program. The needs of the Government must be assessed and the ability of the Bank to provide appropriate assistance constantly reevaluated. In view of the recent experience with the privatization of the power and district heating system in Almaty that led to the halt of Bank processing of a project loan at an advanced stage, extreme caution in committing to projects is warranted. Close monitoring of developments will be essential.

### **iv. Potential for Improving the Environment**

205. Power generation is one of the most important sources of urban air pollution, because coal with a heavy ash content is the most important generating fuel. Within an integrated package of rehabilitation and upgrading of power generating facilities, a significant decrease in urban air pollution can be achieved.

#### **b. Transport and Communications: A Focus on Roads**

206. The transport sector's present declining potential to support economic development needs to be reversed by (i) overcoming the institutional and policy constraints resulting from the sudden change from centrally planned to market-oriented systems; (ii) strengthening institutional capacity, particularly by ensuring more efficient operation of state enterprises; and (iii) resolving the funding constraints on rehabilitation and maintenance of

existing assets. In view of the limited Bank resources, and at the request of the Government, the Bank will focus on road transport and not conduct operations in communications or in other transport areas. Exceptions may be made in the event that regional infrastructure projects are put forward and Bank resources could then be used to further regional cooperation efforts (see para. 246).

### **i. The Unfinished Reform Agenda**

207. In the road subsector, the policy program should specifically include increasing road funding and improving cost recovery practices. The World Bank estimates that \$600 million would be required each year to finance maintenance of the existing road network. This is 8-10 times the funds currently committed.

208. A review and restructuring of subsector taxes is imperative. No significant taxes or fees currently relate road usage to resource costs. Charges should be set for vehicle use in proportion to the increased maintenance incurred by road usage. In particular, fees should be assessed on heavy trucks in proportion to the infrastructure costs of their operation. Road tolls should be considered where and when traffic levels are sufficient to cover the administrative costs.

209. Encouraging the development of competitive markets will require a wide range of market-opening activities. First and foremost, would be accelerating the privatization of trucks and transport enterprises and removing licensing arrangements that restrict regional competition. In addition, in the provision of civil works such as road rehabilitation and maintenance, maintenance contracts will have to be awarded competitively. Currently, competition is restricted among construction firms by barriers that reflect the older system of control and not the emerging market system.

### **ii. Institutional Capacity Building**

210. The development of the sector will depend crucially upon the institutional strengthening of the public sector policy-making and regulatory institutions, in MOTC, and upon the improved corporate governance of state-owned corporations. It is important to begin with basic long-term assistance towards establishing MOTC's planning and management capacity and staff training, particularly with respect to policy analysis, maintenance, and project management. Important training actions will be exposing staff to international practices, particularly those related to international tendering and project management. The first step should be a needs assessment and organizational review of the MOTC.

### **iii. An Investment Program**

211. The most important investment task is to fund rehabilitation activities. The Government, supported by Bank TA, has identified the north-south corridor centered on the road between Almaty and Karaganda as the most urgent rehabilitation project. This corridor is an important link between the capital and the northern industrial areas and provides important regional links between, for example, the Kyrgyz Republic and the Russian Federation. The Government has announced plans to move the country's capital from Almaty to Akmola, which is north of Karaganda, connected by this road to the southern part of the country. The Bank is expected to provide a loan to support rehabilitation on nearly 200 km of the most deteriorated sections of this corridor. The World Bank is considering a follow-up project to rehabilitate additional segments. TA accompanying the proposed project will help the Government to establish priorities for additional road rehabilitation projects.

#### **iv. Potential for Improving the Environment**

212. The World Bank notes that approximately one third of Kazakhstan's air pollution is accounted for by vehicle emissions. An aging vehicle fleet, improper maintenance, unrealistic standards, and limited financial support for monitoring all contribute to the problem. In the near term, transport programs can contribute to ameliorating the problem by assisting in the review and revision of environmental legislation to move towards realistic emission standards and legal provisions for pollution control.

#### **c. Water Supply and Sanitation**

213. While recognizing problems in the water supply and sanitation sector the Government is cognizant of the aggregate resource constraint. Assistance in this sector is being provided to the Government by the World Bank, the Islamic Development Bank, and KfW. The international community has been particularly active in addressing water and sanitation problems in communities in the Aral Sea region. Bank activities must, of necessity, be carefully targeted to reflect the activities of other funding agencies and the priorities of the Government. It may be advisable, for example, to target some of the more important problems, such as rural water supply and sanitation among others, in conjunction with agriculture development projects. For instance, low-cost technologies are available for waste treatment in rural areas and could be introduced through farm restructuring projects. In addition, deep well water supplies could be provided if Bank agriculture activities are located in areas in need of this service. These activities would be effective in reducing health risks and improving the environment and economic condition of the poor in small towns and villages in rural areas. Water supply and sanitation issues may also need to be addressed in the context of programs to improve local government services. Capacity building of local governments and policy reforms, particularly on pricing and cost recovery, are essential to ensure long term sustainability of local services improvement programs and proper operations and maintenance of local infrastructure. Finally, water supply and sanitation projects may need to be initiated in parallel to activities directed towards industrial pollution control.

### **4. Human Resource Development**

214. From the standpoint of ensuring the country's long-term potential for growth, the system for developing human resources, through support for education and health activities, must be reformed to meet the needs of an economy in transition. With the economic and fiscal crisis, social service systems are deteriorating; in some rural areas, they have collapsed. The developmental consequences are clear—the current generation of children is not receiving the same investment in human resources or skills training that previous generations acquired. If this situation continues, as in the case with the deteriorating physical investment, the long-run growth potential for the economy will be lowered.

#### **a. Education**

##### **i. The Unfinished Reform Agenda**

215. There is an urgent need to enhance the efficiency of systems for developing human resources through education and training. Over the longer term, there will be no substitute for increasing real resources to the sectors. It will be particularly important to ensure that teachers' salaries are increased sufficiently to maintain a well-qualified and motivated staff at all levels of education. Gradually increasing resource allocation will need to be accompanied by improving the efficiency of resource usage through reforms of the existing systems. The education and training systems must become responsive to the needs of the emerging market-

based economy. At the Government's request, the Bank has taken the lead in providing assistance to the education sector, to which no other significant external assistance has been available. The Bank has provided support for the development of a sector review and formulation of a strategic plan for reforms and development in the sector.<sup>1</sup> The Bank is playing a similar role in the Kyrgyz Republic and thus is developing staff skills that will provide a comparative advantage relative to other funding agencies for activities in the sector.

216. The Government is currently formulating its National Plan for Education, covering 1996 to 1998. Among the key policy issues being actively pursued are

- (i) rationalizing the institutional structure of the system,
- (ii) encouraging decentralization of management,
- (iii) encouraging domestic production of educational materials, and
- (iv) restructuring local government financing for education.

217. Policy actions in these areas should include strengthening budget and financial management; improving cost recovery where feasible; and improving the efficiency of education by systematically reviewing such issues as school closures, staffing, class size, and student-teacher ratios. Concerning the mix of expenditures, public sector expenditures should focus on basic education, with other services being provided increasingly with cost recovery through user fees. The budgetary process should move towards programs based on needs analysis and away from norm-based budgeting.

218. Appropriate policies should be devised to encourage private education, particularly in higher education and technical and vocational education (TVE). TVE suffers currently from programs that are poorly suited to provide the skills in demand by the emerging labor market.

219. Specific issues related to the curriculum include the need to (i) support ongoing efforts to revise the curriculum to reflect the new political and economic environments, (ii) incorporate instruction in the Kazak language, (iii) modernize foreign language instruction, (iv) reform and upgrade computer-oriented instruction, and (v) involve private sector commercial and industrial establishments closely in the planning and provision of TVE. These will need to be accompanied by teacher training programs to ensure that the teachers are able to implement the curriculum changes.

## ii. Institutional Capacity Building

220. Capacity building at all levels of government will be required to ensure that policy can be defined and implemented. In particular, there is a need to strengthen local authorities and provide for financial autonomy—to provide for continued decentralization of decision-making authority.

221. The structure and organization of the administration system needs review. There is considerable scope for decentralizing educational management from MOE to the province level. The organization of TVE will need to be reviewed and the flexibility of program content increased to bring it more clearly in line with labor market needs. At the same time, MOE's capacity to formulate and coordinate education sector policies and set and implement standards

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<sup>1</sup> TA No. 2308-KAZ: *Education and Training Sector Study*, for \$875,000, approved on 7 March 1995.

should be strengthened. One important aspect is management and staff development, which has been limited by a lack of equipment, training, and exposure to methodologies developed in other countries. A management information system is being put into place to provide essential data to support sector reforms through Bank assistance.<sup>1</sup>

### iii. An Investment Program

222. Education sector management, curriculum development and reform, teacher training, and the provision of instructional materials, textbooks and educational equipment are all urgently needed. In January 1996, the Bank has provided a \$20.0 million loan to fund the purchase of instructional materials and equipment for priority schools, and to establish the foundation for education sector reforms. A follow-up program is being developed in the context of an overall strategy for the development of the sector.

#### b. Health

223. Deteriorating health indicators for children and adults are worrisome and the policy environment is rapidly changing. The Bank should closely monitor the situation. The recently implemented health insurance scheme, for example, has the potential for guiding reform of the policy environment, and Bank activities should be coordinated with those of other external funding sources that operate in Kazakhstan and provide considerable assistance. The World Bank is processing a substantial project in the sector. USAID has also provided some TA and humanitarian assistance in the form of equipment and supplies to some areas of the countries. The European Union (EU) and bilateral agencies have also been active in the sector. While there is no call for the Bank to adopt large initiatives in the sector, health sector concerns should be addressed to improve the ability of local level governments to provide public services in general.

## 5. Encouraging the Private Sector in Industry and Finance

224. Recovery of the economy to its pre-independence level of output will require more than successful completion of the transition to market institutions. The country requires the creation of a new structure of output and new production capacity. Poverty and unemployment will be reduced only by the creation of new jobs and the productivity required for sustainable recovery and growth demand new investment. The Government has acknowledged the importance of this in its statement to the Consultative Group Meeting in 1995, noting that “the strategic purpose of the Government’s structural adjustment policy is to create a system of competitive domestic industries which will provide sustainable economic growth of the country.”<sup>2</sup>

#### a. The Unfinished Policy Agenda

225. The task of building a legal environment conducive to the development of a private sector is considerable for an economy in transition. The Government plans for the near term illustrate the challenge being addressed. New laws are planned on bankruptcy, real estate, intellectual property, currency exchange and regulation, business licensing, and stock exchange development. Continued trade liberalization will be important and will demand a reduction in administrative and financial controls, including registration requirements, export duties, and average import tariffs.

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<sup>1</sup> Loan No. 1420(SF)-KAZ: *Educational Rehabilitation and Management Improvement*, for \$20 million, approved on 11 January 1996.

<sup>2</sup> Government of the Republic of Kazakhstan, Cabinet of Ministers, *Main Results of the Policy Reforms during 1994-1995 and the Program of Systemic and Economic Transformation in the Republic of Kazakhstan for 1995-1997*, p. 7.

226. Accelerated privatization is another crucial need, with specific actions needed to eliminate residual state ownership of enterprises previously transferred to the private sector. The present World Bank-supported program to move through restructuring or liquidating the largest loss-making firms must be carried out resolutely in spite of possible political difficulties involved in the loss of jobs.

227. For enterprises not privatized, mechanisms must be adopted to improve corporate governance. This should include improved accountability through improved accounting practices, the use of performance-based management contracts, and the elimination of soft credit from banks and state enterprises.

228. Building a financial sector that can support the development of a private sector is a high priority. The four broad areas of concern are (i) resolving the payments crisis and reducing the debt; (ii) strengthening the banking system; (iii) establishing the other institutions of a fully functioning capital market, such as a stock exchange; and (iv) reforming insurance. These four areas are presented approximately in the order of priority for the country. The immediate problem is to limit the interenterprise arrears from again threatening macroeconomic stability. Continuing to increase the Government debt, as practiced in the 1994 clearing operation, is clearly not a viable strategy for resolving the problems on a long-term basis. More strict supervision of the banking system is one element of a program to address this problem. However, without further reforms improving corporate governance, the problem is unlikely to be resolved.

#### **b. Capacity Building and Institutional Strengthening**

229. Capacity building in this sector must include more than public sector institutions. Three generations of control through the central planning agencies of the FSU have left few human or institutional resources in the private sector. Only a scant commercial tradition honed under the informal economy that developed in the FSU remains, and few industries possess the many skills to compete in internationally open markets. The small number of training centers now operating need to be supported and supplemented.

#### **c. An Investment Program**

230. Activities in the sector could include assistance to the Government to accelerate the privatization program through TA, support for the divestiture of social assets, and post-privatization support including credit programs.

231. There is no substitute for increased private sector investment. The situation in Kazakhstan is unlike other countries where development issues surround a private sector that had been repressed by inappropriate public policies. In Kazakhstan, under three generations of Soviet rule, with few exceptions, no private sector had been allowed to develop. Private sector activities were found in agriculture, based on the cultivation of private plots, and in the pervasive informal sector in the FSU. The former activity provided substantial quantities of certain crops, but depended crucially upon inputs and marketing from the state sector. The informal sector in the FSU was quite large and included considerable quasi-legal or illegal activities. Neither of these institutional experiences provide the entrepreneurial skill to restructure the industrial or financial sectors.

232. In few countries outside of the FSU is there such a compelling case for private sector activities to be directly supported by multilateral funding agencies such as the Bank, EBRD, or the International Finance Corporation (IFC). The Bank's private sector strategy

recognizes the importance of assistance to the private sector in transition economies.<sup>1</sup> EBRD has been operating in the country and has experienced considerable difficulties in its operations. Partly this reflects the problems facing private sector activities in an incompletely supportive policy environment. As the unfinished reform agenda is eliminated, there should be increasing opportunities for private sector projects. These activities call for a revision in the Memorandum of Understanding (MOU) signed with the EBRD that delineates areas of responsibility for the two regional development banks. Under the MOU, the Bank was to be responsible for taking the lead in public sector investments and EBRD for private sector activities. The MOU specifically envisages that the memorandum's guidelines be reviewed after completion of the first programming cycle.

233. To be responsive to the changing environment and the needs of the economy, alongside the proposed industrial sector program in 1997, the Bank should develop a private sector strategy guiding an active program for the medium term. Potential focal points of this strategy should include (i) investment in agriculture-based industries that could reflect and support the Bank's public sector programs in the sector, (ii) direct support for commercial or investment banking, (iii) encouragement of the private sector in the provision of social services, (iv) support for privatization programs for public utilities, and (v) pre- and post-privatization support especially for medium-sized enterprises. The development of such a strategy for the Bank should be done taking into consideration the lessons learned by other funding agencies and maintaining a responsible division of labor between the different multilateral funding institutions.

234. Banking reform is the subject of the recently approved World Bank Financial Sector Adjustment Loan, which targets policy reform and strengthening 5-6 commercial banks up to international standards within the program period. Because of this, no Bank activities are contemplated for the subsector over the next few years, except for possible action to promote rural finance. Over time, however, to provide the necessary support for private business, complementary actions will be needed to develop other financial institutions such as the stock market, investment banks, and the insurance industry, and the Bank may be called upon to assist in these areas.

#### **d. Potential for Improving the Environment**

235. Reducing industrial and municipal pollution is particularly important in urban centers to ameliorate the adverse health impact of air, water, and soil pollution. This is particularly important in the company towns and with medium-sized enterprises that are receiving little or no substantive financial support for sustainable restructuring. These enterprises affect the surrounding populace not only through their productive activities, but also because they formerly had the responsibility for maintaining communal services such as water supply, sanitation, district heating, and electricity. Pollution control has been lacking, partly because, under the Soviet system the responsibility for monitoring pollution was given to the industries themselves. Local public authorities lack effective monitoring and enforcement mechanisms. Bank activities should act to (i) assist in developing new institutional arrangements to monitor emissions and enforce pollution standards; (ii) encourage private investment in new equipment and technology, thereby reducing pollution; (iii) support the restructuring of public utility services in a fashion that will also reduce pollution; and (iv) provide assistance to local governments in reducing municipal waste and improving waste treatment facilities. Support for public utility

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<sup>1</sup> *Strategy for the Bank's Assistance for Private Sector Development*, R56-95, 17 February 1995.

restructuring may require assistance to local governments either in their capacity of operating these utilities or in the position of providing effective regulation for privatized utility operation.

## **6. A Program for Agriculture**

236. The agriculture sector will be important for the recovery and sustainable growth of the Kazak economy. The country probably has a comparative advantage in grain, livestock and livestock products, and agro-industrial processing.<sup>1</sup> Policy reforms, institutional strengthening, and active investment should be directed to encourage the development of a new productive base that can realize this developing comparative advantage.

237. Past agricultural practices have been very destructive to the environmental resource base of the country. The ongoing desertification and destruction of range land and water resources such as the Aral Sea must be arrested and reversed.

### **a. The Unfinished Policy Agenda**

238. There is an urgent need to widen and deepen the policy reform process. Continued strong commitment to policy reform will not only reduce the social and economic costs of adjustment in the rural sector but will also establish an appropriate incentive structure for the private sector.

239. A comprehensive policy reform agenda supported by an agriculture sector program loan is scheduled for implementation in 1996/1997. The Program's reform measures focus on clarifying key land rights and facilitating the creation of a market for agricultural lands, transferring ownership of state farms to private entities, liberalizing external trade, dismantling monopoly state-owned holding companies to promote competition, restructuring agricultural finance, and strengthening environmental management in agriculture. Although the envisaged program touches on the most important elements, further reforms will likely be necessary. Until now, the agricultural reform process has been largely concerned with creating the necessary legislative and administrative framework, which has enabled enterprises to change their status. The next and most important stage is concerned with (i) improving the supply response of those enterprises; and (ii) developing an operational capacity to implement the policy reforms at the local levels, with a view to transform farming structures into profitable enterprises.

240. The importance of providing reform for agriculture finance cannot be overstated. The lack of credit on commercial terms has encouraged the drift away from market-oriented production towards self-sufficiency, limiting productivity and farm income. The lack of commercially oriented agriculture financial institutions discourages new investment. The agriculture sector faces a major debt problem that, if unresolved, will continue to hinder macroeconomic stability. A comprehensive reform of the Agroprombank should receive high priority, as should pilot projects designed to encourage the development of new financial institutions in the sector.

### **b. Capacity Building and Institutional Strengthening**

241. There is a strong need for capacity building in the public institutions that support agriculture, most particularly the Ministry of Agriculture. A beginning has already been made in this regard through the two TAs being implemented in conjunction with the Agriculture Sector

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<sup>1</sup> The close determination of long-term comparative advantage is a difficult matter in the absence of stable domestic price relations and in the midst of the long downward spiral of output.

Program. The first of these TAs is designed to strengthen the capacity of the Ministry of Agriculture to manage information and formulate and analyze policies. In this work, it will be important to ensure that the role of the Ministry is defined properly to support the development of a market-based sector and move away from the previous role of dictating economic decisions. The institution needs critical skills to strengthen its new role in the emerging market economy. The second TA will strengthen the Government's capacity in rural credit sector assessment and planning.

242. TA may also be needed for local administrations to help farms resolve their continuing operational responsibility for infrastructure and social assets such as rural roads, heating systems, sewerage, kindergartens, and hospitals. This assistance should be provided in conjunction with investment projects in the sector or those designed to improve the provision of government services.

### **c. An Investment Program**

243. The investment program will focus on the three important areas: (i) water resources management, (ii) farm systems development, and (iii) rural credit. Water is a scarce agricultural resource and its sustainable management is of immediate concern. An integrated farm systems approach, which combines, for example, grain, fodder, and livestock production activities, supported by credit facilities, would appear to be most appropriate. The farm systems approach will include (i) developing alternative marketing channels for agricultural products, (ii) restructuring farm production, and (iii) changing farm management and organizational structure. A broader project, while more complex, would provide scope for addressing the wide range of problems in the sector. The Bank's new Sector Development Program (SDP) would be an appropriate funding facility in the agriculture sector to combine policy reforms with investment programs to address the urgent sector need of farm restructuring. As a first step, an integrated regional approach to agricultural reforms will be implemented on a pilot basis. This approach will combine policy coordination at the central level with direct links to regionally focused implementation capacity building, as well as a regional investment program, which will fund an integrated package rather than isolated elements. Care must be taken to ensure that water management projects be undertaken within the broader context of the need to protect and rehabilitate the environmental resource base of the country. The Bank is also providing TA for strengthening rural credit provision. This subsector should also receive continued support, beginning with a pilot project aimed at developing rural financial institutions.

### **d. Potential for Improving the Environment**

244. Focusing on water management and farm systems development addresses key environmental problems, including poor water conservation and rangeland preservation. Work in these areas would have to be coordinated with actions on a broader front to provide for improved environmental protection. This would include especially redressing the continued degradation of the Aral Sea—efforts to improve water management along the major irrigation and riverine waterways should help arrest the continued desertification in the Aral Sea region.

## **C. Additional Strategic Considerations**

245. The Bank's program for assisting the Government includes the following strategic considerations: (i) regional initiatives towards improving economic coherence within Central Asia, and (ii) consistency with the Bank's overall strategic framework.

### **1. Subregional Cooperation**

246. Several of the sectors in which the Bank will be active involve cross-border issues within Central Asia. Notable examples are transport, electric power, and water resources. Beyond ensuring that its activities in each country are consistent with what is being done in the others, the Bank should endeavor to undertake regional investment and policy coordination and promote efforts to ensure a rational pattern of resource use in the area as a whole. All the economies of Central Asia were strongly integrated into the FSU economy, with little thought given to rational specialization, rational trade, or even integration across republican borders within Central Asia. These economies are all landlocked, which limits their choices of trading partners; furthermore, the size of the domestic market within each country is limited. Future growth is likely to be enhanced by regional economic integration within the Central Asian Republics, and between these republics and neighboring countries such as the PRC. The Bank currently operates in three of the Central Asian Republics; Kazakhstan, the Kyrgyz Republic, and Uzbekistan. It should take care that in its investment activity and in its policy advice, it supports rather than interferes with rational regional cooperation.

247. Reflecting these concerns, the Bank has initiated a regional TA, to facilitate a resolution of cross-border issues and promote subregional economic cooperation among Kazakhstan, the Kyrgyz Republic, Uzbekistan, and Xinjiang Uygur Autonomous Region of the PRC. The approach calls for two phases of activities to support subregional cooperation in Central Asia: (i) a preparatory study to review existing needs, institutions, and activities, and to narrow the focus of Bank activities to a small number of sectoral programs; and (ii) actual operations within specific sectors to encourage regional cooperation and resolve cross-border issues. For issues that involve countries that are not Bank members, the Bank could seek cofinancing from other multilateral institutions.

248. The Central Asian Republics know the importance of regional trade and a supportive regional policy environment. The three regional Bank member have taken a number of concrete steps to facilitate regional trade and cooperation. The initial international agreements called for the creation of a customs union and tariff harmonization within the broader framework of the Commonwealth of Independent States. Kazakhstan has also signed agreements to create a customs union with the Russian Federation and Belarus, which the Kyrgyz Republic and Uzbekistan have agreed to join. These compacts follow earlier ones establishing the Commonwealth of Independent States after the FSU broke up.

249. The latest agreements appear to call for a shift towards the trade regime found in the Russian Federation. Moreover, provisions of the agreements reportedly call for a return of control of some parts of the economy to the Russian Government: for example, selling industrial enterprises to Russian state firms. Although these trade compacts focus on economic issues, much of the impetus for and import of these agreements relates to the political relationships between the Russian Federation and the other countries. The exact nature of commitments under the existing agreements is still subject to negotiation. Considerable time will be required before these agreements have any real impact on interregional commerce.

## **2. The Bank's Strategic Framework**

250. The proposed strategy is fully consistent with the Bank's *Medium-Term Strategic Framework 1995-1998*. The strategy would promote efficient economic growth by supporting continued policy reform through investment in infrastructure, and by projects in agriculture and the restructuring of medium-sized industries to set firm the base for future growth. Poverty alleviation is a direct target of actions designed to increase social protection by improving the provision of local government services, but will also be approached through projects in education. The strategy directly calls for investment in human resource development, primarily

through projects in education. An improvement in the condition of women in development is targeted through actions to improve social services delivery, but will also be effected through activities that will improve the condition of children, such as education. The latter is particularly important; developments such as the restrictions on the provision of social services for children have been among the most important factors contributing to the deterioration in the situation of women in the country. Finally, the sound management of natural resources and protection of the environment will be furthered through sustainable development in agriculture, selective aspects of infrastructure investment projects, and projects working to restructure industrial activities in company towns, particularly those that contribute to the more efficient use of energy and water. Governance was discussed in paras. 185 and 159.

**APPENDIXES**

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## THE SOCIAL COSTS OF TRANSITION: ISSUES OF SOCIAL POLICY IN KAZAKSTAN

### A. Social Investment In the Soviet Period

1. The social and economic costs of transition for Kazakhstan have been immense. Average incomes have fallen by more than one half. The contraction in output has lowered incomes so that by the end of 1995 approximately two out of every three people were living below the poverty line. Large state enterprises and farms have been privatized, restructured, or closed. Lifetime employment for virtually all labor force participants has been replaced by widespread insecurity, as 9 percent of the labor force lacked full-time employment in mid-1996. The attendant fiscal crisis has severely restricted the Government's ability to alleviate these problems. Social spending, including social insurance, social assistance, and the provision of social services such as health and education, has declined sharply in real terms. The deterioration in public support mechanisms comes at a time of great need and has had particularly severe impacts on the most vulnerable, including the elderly, the poor, and families headed by women.

2. This Appendix highlights the major issues concerning the social costs of transition in Kazakhstan. It discusses the (i) situation in the labor market, (ii) declining provision of social services, (iii) weakening social safety net, and (iv) eroding living standards and increasing poverty. The final sections discuss the Government's and the Bank's strategy for sustainable social development in Kazakhstan. This Appendix supplements the main text and the three other appendixes on the impact of transition on women, on children, and on the environment.

### B. Population and Labor Market Developments

#### 1. Increasing Unemployment

3. Kazakhstan has traditionally had a large proportion of economically inactive people in the population, and the experience of transition has further reduced the number of people in active work. In 1995, the proportion of people available to work in the total population was only 38.1 percent, down from 45.3 percent in 1990. Overall, the economic difficulties have reduced the working force engaged in the registered economy from 6.5 million in 1990 to 4.3 million at the end of 1995 (see Table 1).

4. The economic decline and industrial restructuring since independence has dramatically increased unemployment. In mid-1996, 9 percent of the labor force were without a full-time job; a sharp change from the negligible unemployment before independence. Open unemployment, at 4 percent of the economically active population, is still relatively low, but likely to increase as enterprise restructuring continues.<sup>1</sup>

5. About 78 percent of the unemployed accounts for the "hidden" unemployed. They have formal working contracts, but are forced to take leave or work part-time for minimal compensation. In the first quarter of 1995, only 807 people were officially registered as newly

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<sup>1</sup> Unemployment data have been revised downward in the beginning of 1996, thus the data for 1995 and earlier are not fully consistent with the most recent figures.

unemployed; however, more than 82,000 persons are estimated to have been placed on forced leave. Hidden unemployment results from the reluctance of both the enterprise and the individual to openly separate. Companies are reluctant to fire employees because keeping employees on tax rolls at minimum wages can reduce the tax base for the enterprise, apart from social and political reasons. Workers also prefer forced leave in comparison to open unemployment because (i) unemployment compensation is uncertain, payments come only months after registration, and are relatively meager; (ii) extended leave without pay allows them to continue to receive social benefits traditionally provided by enterprises; and (iii) unemployment maintains some of the social stigma attached to it under the Soviet system.

**Table 1: Population and Labor Market**

Item	1985	Dec-90	Dec-93	Dec-94	Dec-95
<b>Population</b>					
population ('000)	15,720	16,690	16,914	16,870	16,607
rural population (percent)		42.7	43.2	44.3	46.7
ethnic background (percent)					
Kazak		39.7 (1989)	43.1	44.3	46.0
Russian		37.8 (1989)	36.5	35.8	34.7
German		5.8 (1989)	4.1	3.6	3.0
Other		16.4 (1989)	16.3	16.3	16.3
emigration (no.)			222,101	410,307	
Russians			123,777	251,934	
Germans			84,123	89,796	
<b>Labor Resources<sup>a</sup> ('000)</b>					
economically active population <sup>b</sup>		9,175	9,380	9,436	9,307 (May)
registered labor force <sup>c</sup>	6,500	6,476	5,631	5,256	4,330 (Nov)
women (percent)		49.0	47.1	45.2	44.7
<b>Employment by Sector (percent of total)</b>					
industry	21.6	21.0	21.2	22.0	23.4
agriculture	19.8	18.6	19.7	22.1	14.1
health and social protection	5.8	6.8	7.5	8.0	9.4
education		11.4	13.0	12.5	15.2
private sector employment		7.0		17.7	22.7
<b>Unemployment</b>					
percent of economically active population	0.1	0.1	3.0	8.0	14.5
officially registered unemployed (numbers)			40,517	70,078	203,200
percent of economically active population	0.1	0.1	0.7	1.3	3.2
women (percent of registered unemployed)		49.0	47.1	45.2	44.7
youth (percent of registered unemployed)			54.1	51.4	43.6
estimated hidden unemployment (numbers)			160,000	450,000	712,800
percent of economically active population			2.3	6.7	11.3

<sup>a</sup> People of working age.

<sup>b</sup> Labor resources minus full-time students and people unemployed due to physical disabilities, plus people beyond working age who are yet employed.

<sup>c</sup> Employment in the formal sector.

Sources: Goskomstat, Ministry of Labor, UNDP, staff estimates

## 2. Declining Wages

6. In the former Soviet Union (FSU), wages were low, but were supported by a comprehensive system of transfers, social security, and special allowances. Non-monetary income (including inexpensive access to housing, health facilities, kindergartens, transport, and public utility services) was estimated at over 40 percent of total labor compensation. This

situation was supported by a complex system of implicit and explicit subsidies from the Central Government of the FSU, a system that proved unsustainable with independence. With

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independence and the concurrent deterioration of the economy, income declined dramatically with real (monetary) wages falling by more than one-half.

7. The economic and fiscal crises have also resulted in seriously delayed wage and benefit payments. Wage arrears in Kazakhstan amounted to \$0.6 billion in mid-1996 (see Table 2). Wage arrears are expected to increase, with further enterprise reform especially in agriculture and heavy industries. In 1994, rural workers and farmers received less than 61 percent of their expected salaries and approximately 61 percent of this was released in-kind. In-kind wage and benefit payments are often of little real utility.

**Table 2: Wages and Expenditures in Kazakhstan**

Item	1985	1990	1992	1993	1994	1995	Dec-95
Nominal Wages (year-average, Tenge; 1985-92 in Rubles)	187	265	4,625	128	1,726	5,064	7,231
real average wage (percent changes over previous year)			-30	-7	-32	+6	
index of real annual average wage (1990=100)		100	70	65	44	47	
industry	212	216	6,161	171	2,801	8,012	11,232
agriculture	198	292	4,834	101	1,038	2,509	3,936
health and social protection	125	178	2,199	66	797	2,594	3,249
education	139	182	2,484	81	893	2,858	3,488
Income							
average labor pensions (Tenge, December)				121	1,035		
average child allowance (Tenge, December)					250		
wage arrears (million \$)				14.7 <sup>a</sup>		485 <sup>b</sup>	638 <sup>c</sup>
Composition of Average Household Money Income (percent)							
wages					76.1		
urban/rural					81 / 61		
social transfers (pensions, allowances)					8.0		
urban/rural					7 / 11		
other income (bazaar economy and informal sector)					15.9		
urban/rural					12 / 28		
Average Household Expenditure (Tenge, 1990-93: Rubles)		4,040		1,606	6,771	13,820	
food (percent)					48		
urban/rural (percent)					48 / 50		

<sup>a</sup> March 1993, <sup>b</sup> December 1995, <sup>c</sup> mid-1996,

Sources: Goskomstat, Ministry of Labor, Ministry of Economy, Ministry of Social Protection, and staff estimates

8. With the ongoing shift from a command economy to a market driven economy, the wage structure has also changed: a rough equality has been replaced by increasing dispersion across sectors and regions. In December 1995, the average monthly wage was Tenge 7,231 (approximately \$110). Agricultural wages were less than 47 percent of this average but wages in industry were more than 150 percent of the national average. By region, the lowest average wages are paid in the southern part of the country.

9. As a result of these developments, the distribution of income has worsened, exhibiting increasing inequality. The poorest 20 percent of the population received 9.6 percent of the national income in 1989, but only 6.3 percent of a much smaller total in December 1994.

### **3. Company Towns**

10. There are some 57 company towns in Kazakstan. In most of these medium-sized urban centers, constructed during Soviet times, more than three quarters of the population and more than two thirds of the urban utilities and social services depend on the economic performance of a small number of large-scale enterprises. With the break-up of the FSU and the loss of input supply and markets, most of these specialized company towns face

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severe social and economic problems. At present, unemployment in many of these centers reaches 50 percent, and wage and pension arrears amount to eight months. With diminished enterprise funding, social services, including schools, medical services, and urban infrastructure are deteriorating. Due to a lack of effective demand from both households and enterprises, public utilities face particular problems in sustaining operations and there are shortages of electric power, district heating, and water. It is expected that continued restructuring could result in higher unemployment, especially in those centers characterized by extreme product specialization.

#### **4. Emigration and Changes in the Population Structure**

11. With a territory of 2.7 million sq. km, Kazakstan is bigger than Western Europe or India. However, the population density is only 6.13 people per sq. km compared with 2,908 in India and 1,291 in Western Europe. More than 53 percent of the population live in urban areas.

12. Emigration has been one aftermath of independence and the worsening socioeconomic situation. Since independence, more than 1 million people, nearly 10 percent of the labor force, have emigrated, especially to Germany, Russia, and the Ukraine. Many of the emigrants are highly educated and held key positions in the economy, the social sphere, and in public administration.

13. High rates of emigration, along with declining birth rates and increasing death rates, have occasioned major changes in the population structure. The population of Kazakstan comprises more than 100 nationalities, but ethnic Kazaks and Russians are the major ethnic groups. Since independence, as a result of emigration, ethnic Kazaks accounted for 46 percent of the total population in 1995 compared with 39.7 percent in 1989, while ethnic Russians accounted for 34.7 percent, in 1995, a decrease from 37.8 percent in 1989.

#### **C. Declining Provision of Social Services**

14. Since independence, social infrastructure services such as education, health, kindergartens, sanitation and water supply, have declined considerably. Partly, this is traceable to the decrease in national income and public revenues since 1990. As a share of gross domestic product (GDP), government spending on health and education, for example, has fallen from 11.8 percent in 1991 to 6.3 in the plans for 1996. The impact of this decline is exacerbated as GDP fell by more than 60 percent during the same period. An additional problem, however, stems from the peculiarities of the social system in the FSU, where farm and industrial enterprises were the major providers of social services. Enterprise restructuring and privatization during transition and the weak local government financial structure have deprived people of access to social infrastructure. Social service policy reform is one of the major challenges facing the Government. There are problems in maintaining the former communal infrastructure, especially in education and health.

##### **1. Social and Communal Infrastructure Services and Divestiture**

15. At the end of 1991, social assets accounted for approximately 31 percent of the country's total capital assets. These assets consisted of the housing stock, health care facilities, education facilities, subsidized canteens, libraries, sports and cultural centers, and public utility infrastructure including heating, water, and transport facilities. Previously

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maintained by State enterprises, privatization and the emerging market economy, however, have required large-scale divestiture of most of these social assets. Housing has largely been successfully transferred, in most cases to the previous occupants. Other facilities, however, have often been closed or transferred to public authorities with an insufficient revenue base to maintain the facilities. The Government, in January 1996, approved a Program of Stage-by-Stage Divestiture of Social Assets and Transfer to the Local Authorities to reduce the social costs of this transition. In addition, it committed itself to preserve some of the most needed specialized institutions for orphans, the mentally retarded, the aged, and the disabled under the central budget. However, there is an urgent need to rationalize and improve the delivery of social services at the local level.

## 2. Weakening Human Resource Development through Reduced Access to Education

16. The country enjoys high educational standards. The literacy rate is about 97.3 percent (see Table 3), and the teacher-pupil ratio of 1 to 11.3 is one of the highest in the world. But the system is rapidly being eroded, because of (i) cutbacks in public expenditure and enterprise support to pre-schools, (ii) delayed payment of teachers' salaries and low earnings, (iii) problems in revising the educational curriculum, (iv) limited resources for new instruction materials, and (v) lack of funds for maintenance and repair. Public education expenditures dropped from 20.1 percent of the 1990 budget to 13.6 percent in 1995. As a percentage of GDP, it declined in the same period from 6.8 to 3.3 percent.

**Table 3: Reduced Access to Education**

Item	1985	1991	1993	1994	1995
School-year beginning in:					
Adult Literacy (percent)		97.5 (1989)			97.3
Number of children attending kindergarten ('000)	986.2	1,067.8	868.3	538.8	426.1
number of kindergartens	7,988	8,743	8,083	6,561	5,225
Number of children attending primary and secondary schools ('000)	3,348.2	3,101.9	3,113.9	3070.9	3,036.5
number of schools	8,724	8,446	8,740	8,710	8,573
Pupils in special secondary education ('000)	277.6	247.6(1990)	222.1	214.2	
number of schools	246	247(1990)	247	247	235
Students in higher education ('000)	273.3	288.4	280.7	266.7	256.7
number of schools	55	51	68	69	50
Students attending vocational training ('000)		203.1(1990)	188.7	160.0	142.0
number of schools		478	438	422	404
Children in special boarding schools (number)		107,454			66,664
number of schools		1,540			982
Public Education Expenditure (percent of the budget)		20.1 (1990)	16.7	13.4	13.6
local Government Share in total education budget (percent)			81	83	39.3

Sources: Ministry of Education, Ministry of Finance, and staff estimates.

17. One particularly difficult problem is the fiscal weakness of local governments. Local governments are typically expected to finance more than 80 percent of total education expenditures. However, a lack of funds makes this task unlikely to be fulfilled. In 1995, the actual expenditures of local governments amounted to only 39.3 percent of total spending.

18. Due to restricted public fiscal resources, in 1994/95, approximately 11 percent of all schools were reported in need of serious repair, 28 percent were in critical condition, and

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30 percent were in non-school buildings as a result of a lack of facilities. Institutions for pre-school child care and for the handicapped, formerly financed by enterprises and farms, face especially severe problems. The number of children attending pre-school institutions declined by more than one half; and more than 3,500 kindergartens since 1991 have been closed, many in rural areas. Children with special problems, the handicapped and orphaned have suffered in this transition period (see Appendix 3). The enrollment of children needing special care has contracted by 38 percent since 1990, and the conditions in boarding schools for the mentally retarded and handicapped have greatly deteriorated.

### 3. Worsening Health Conditions

19. Before independence, Kazakstan had an extensive medical system, with one of the most favorable doctor to patient ratios in the world, a large network of in-patient facilities for adults and children, and a comprehensive system of preventive health care and monitoring. But the system has deteriorated in the last five years. At present, the medical establishment often lacks medicine, equipment and specialized personnel. Increasing transport costs and lack of public transport facilities make the access to hospitals and doctors difficult especially for the poor. Costs for medical treatment have greatly increased. Although the sector has received an increasing share of the Government's budget, between 1990 and 1995 (see Table 4), actual expenditure as a share of GDP fell from 3.3 to 2.9 percent. Taking into account the high inflation, Government expenditure on health for 1995 in real terms was less than half of the 1991 expenditures. As part of the general reform program, the Government is introducing a compulsory health insurance scheme. In addition, private health care schemes are to be allowed. However, due to the difficult situation of many enterprises, the introduction of health insurance schemes face considerable difficulties.

**Table 4: Worsening Health Situation in Kazakstan**

Item	1985	1991	1993	1994	1995
<b>Health Indicators</b>					
crude birth rate (per 1,000 inhabitants)	24.9	21.0	18.6	18.2	16.7
crude mortality rate (per 1,000 inhabitants)	8.0	8.0	9.2	9.5	10.2
maternal mortality rate (per 100,000 live births)	66.6 (1987)	67.2	62.8	69.4	77.3
infant mortality rate (below 1 year; per 1,000 live births)	30.1	27.4	28.2 <sup>a</sup>	27.2 <sup>b</sup>	27.3 <sup>b</sup>
life expectancy at birth (years)	67.7	68.6 (1990)	68.7 (1992)	66.8	66.1
women/men	73.1/63.9 (1987)	73.1/63.8		71.1/60.7	
<b>Health Infrastructure</b>					
doctors (per 10,000 population)	37.6	38.5		36.7	
nurses (per 10,000 population)		123.9	38.3	105.4	
hospital beds (no. per 1,000 population)	13.1	15.2	13.1	13.4	12.4
<b>Registered Diseases (numbers)</b>					
infections and parasitogenic		1388.9 (1990)		2,714.9	
circulatory system		222.6 (1990)		627.6	
respiratory system		13,836.1 (1990)		21,623.5	
incidence of diphtheria		0.2		2.9	
syphilis		1.4 (1990)		32.6	
<b>Health Expenditures (percent of budget)</b>					
local budget (percent of total health budget)		10.0		13.6	12.8
				67.9	81.8

<sup>a</sup> The US Center for International Research estimates infant mortality rates at 44 per 1,000 live births, for 1993.

<sup>b</sup> Alternative estimates suggest that the official figures should be revised upward by 30-35 percent.

Source: Ministry of Health, Goskomstat, Ministry of Finance, UNDP, UNICEF, and staff estimates

20. The adverse impacts of the transition process on the health situation are quite visible. Mortality rates, for example, have increased.<sup>1</sup> The maternal mortality rate is very high by international standards; often caused by complications related to abortion. Anemia and gynecological problems are spreading. The incidence of tuberculosis has increased from 43 to 50 per 100,000 inhabitants.

#### **4. Environmental Health Problems**

21. Environmental degradation, especially (i) the shrinking and salinization of the Aral Sea, (ii) the industrial pollution in the company towns, (iii) radioactive contamination due to improper nuclear waste storage facilities and the nuclear tests near Semipalatinsk, (iv) the excessive use of chemicals in agriculture, and (v) the deterioration of the urban infrastructure have contributed to a worsening of basic health conditions. According to the Ministry of Health, up to 90 percent of health problems require some attention to the environment. In 1993, for example, the incidence of chronic, non-infectious diseases in the highly polluted Aral Sea region was about two times higher than the national average. Up to 80 percent of pregnant women in the Aral Sea area suffer from anemia, compared with 60 percent nationwide. Similar problems are reported from the industrial zones in the company towns. In Jambyl, for example, the incidence of spontaneous abortion (attributed to air pollution) is 12.5 times higher than in the country as a whole. About 2 million people are still affected by the estimated 450 nuclear tests of the FSU conducted in the region of Semipalatinsk. In this region, the reported incidence of malignant tumors per individual grew by 22 percent between 1970 and 1993.

#### **D. The Weakening Social Safety Net**

22. The two components of the social safety net in Kazakstan are (i) the four extra-budgetary social security funds covering pensioners, the unemployed, social support, and medical treatment; and (ii) the budget-based social protection transfer program (see Table 5). As a result of constrained fiscal resources, expenditures for the social safety net decreased dramatically from 17.6 percent of the GDP in 1990 to 7.4 percent in 1995 (see Figure 1). However, from the household perspective, social safety net payments provide an important source of income for the majority of the poor in the population. In 1994 pensions, unemployment compensation, and other social allowances and subsidies accounted for 8 percent of average household income, 6.8 percent in urban areas and 11.4 percent in rural areas. It is reported that, in many villages, pensions and family allowances are the major source of cash-income for families. Without the comprehensive coverage of the social safety net, the incidence of poverty in Kazakstan would be much higher.

##### **1. The Underfunding of Social Insurance**

23. An important component of the social safety net is the obligatory social insurance system, covering pensions, unemployment, social assistance, and (from April 1996) health.

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<sup>1</sup> Due to underreporting, the child and maternal mortality statistics are thought to mask the likely extent of deteriorating health condition (see Table 3).

### a. Pensions

24. In 1991, the Government introduced a social insurance tax on employers equal to 30 percent of wages and a one percent tax on employees, to finance pensions and social security. Of the revenues of this social insurance tax, 85 percent should go to the Pension Fund, with the remaining 15 percent going to the Social Insurance Fund. In January 1995, about 2.8 million persons were entitled to pensions. At the beginning of 1996, the average monthly pension was T1,760 (\$27) which is considerably below the minimum consumption basket. Moreover, actual pension payments are often delayed for months. In Kokshetau province, for example, out of the total amount of pensions to be paid during the first five months of 1996, less than 50 percent was actually released. By mid-1996, the outstanding debts to pensioners for the nation as a whole amounted to T5 billion. With decreasing employment expected and outstanding enterprise payments ranging between 27 percent and 40 percent of obligations, the Pension Fund is not financially viable at present.

**Table 5: Social Insurance**

Item	1993	1994	1995	1996 (plan)
<b>Social Insurance</b>				
Revenue of all non-budgetary insurance funds (Tenge billion)		23.4	77.9	138.5
Expenditure of all non-budgetary insurance funds (Tenge billion)		22.9	74.1	132.2
as percent of GDP		5.1	6.8	11.0
<b>Pension Fund (expenditures Tenge billion)</b>	1.7	20.7	66.6	116.2
old age/labor pensions (number, '000)		2,142		
<b>Social Insurance Fund (Expenditures Tenge billion)</b>		2.2	7.5	5.5
temporary disability allowance (percent)			56.4	66.1
maternity leave allowances (percent)			3.0	3.6
sanitarium and resort treatment (percent)			22.8	11.4
other allowances, including family allowances (percent)			10.4	5.7
<b>Employment Fund (Expenditures in Tenge billion)</b>	0.0	0.0	1.8	6.4
unemployment allowances (percent)			31.9	50.9
retraining (percent)			23.3	18.7
public works and employment programs (percent)			1.1	5.4
others, including employment services (percent)			43.7	25.0
<b>Health (Medical) Insurance Fund (Expenditures, Tenge billion)</b>	0.0	0.0	0.0	10.5

Source: Ministry of Finance, Ministry of Social Protection, Goskomstat, staff estimates

### b. Unemployment Compensation and Labor Market Policies

25. The Employment Fund is financed by a 2 percent payroll-tax compulsory for all formal sector employees. During 1995, 70-80 percent of projected revenues was collected but much of the potential revenue base remains untapped due to collection problems. This fund provides support for the unemployed, as well as financing a variety of labor market programs such as training and public works. In 1996, about 51 percent of total expenditures was allocated for unemployment compensation, although at the beginning of 1996 only about one half of the 103,000 registered unemployed received unemployment benefits. With the expected increase in formal unemployment, the fiscal pressure on this fund will increase. Currently, the Government is developing more effective active labor market policies including (i) reforms in labor administration and labor market services; (ii) strengthening professional training and retraining

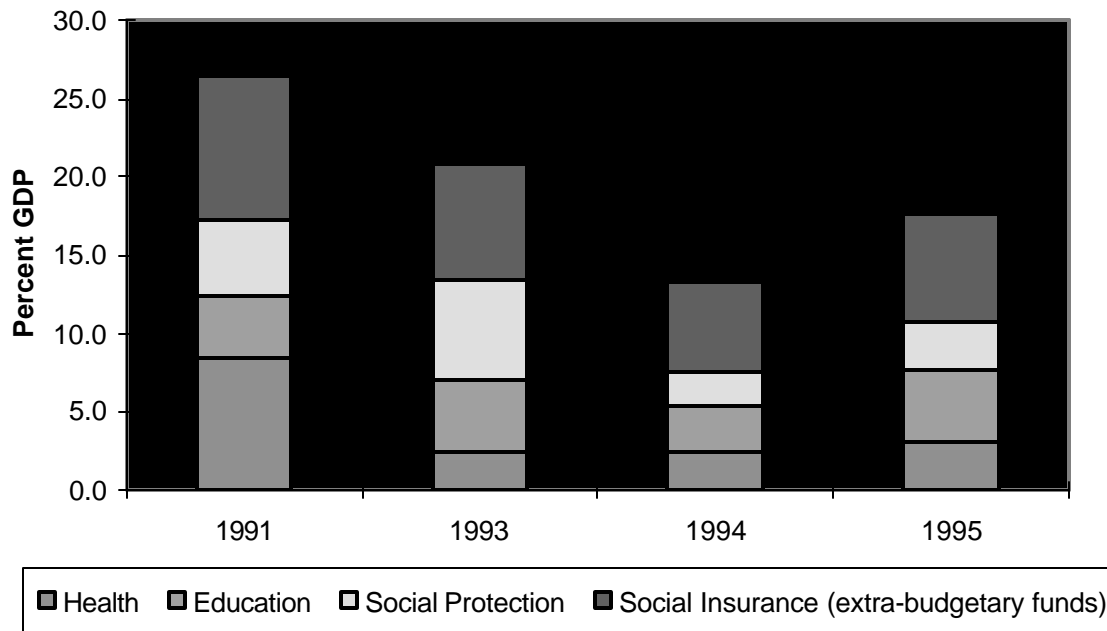
programs; (iii) the promotion of self-employment and entrepreneurship; (iv) enlarging existing public work programs; (v) developing labor market policies to respond to

industrial restructuring, especially in the company towns; and (vi) reforming the unemployment insurance system.

### c. Social and Health Insurance Funds

26. The Social Insurance Fund coordinated by the Ministry of Social Protection finances the maintenance of sanatoria and supports allowances in the case of maternity leave and work related accidents. In the beginning of 1996, the collection rate in relation to projected revenues was approximately 66 percent. Activities in this area are expected to change with the implementation of reform in health care financing. To enable efficient delivery of effective health care at competitive prices, the Government in 1996 established the compulsory Medical Insurance Fund. This fund will operate through individual contracts with hospitals, pharmacies, and personnel to finance health services. As such, it is a major and innovative step to reform the health sector; however, it faces major challenges in establishing (i) coverage, (ii) contribution compliance, (iii) market-based service provision, and (iv) popular acceptance.

## Social Expenditures



## 2. Problems of Targeting Social Assistance

27. In addition to extra-budgetary social insurance, social safety net support includes budget-based welfare benefits and allowances for persons who are unable to work; for children, mothers, invalids and handicapped persons (see Table 6). In addition to allowances, there are subsidies for electricity, heating, housing and public transport.

28. According to official figures, the Government provided in 1995 social assistance in various forms to about 1.6 million people. Eight types of family allowances amounting to T4.3 billion were allocated in the 1995 budget for mothers, children and invalids. In addition, T1.7 billion has been allocated to regional charity funds and milk kitchens, and T22.1 billion for subsidies for invalids. The major portion of these social transfers do not go to the poor, but are paid directly to industries providing communication, electricity, coal, gas, transport, and other public utilities.

29. Although the total sum of allowances is large, the actual impact is less than needed. Individual benefits are generally low, sometimes the costs of application or registration (especially transport) exceed the amount of the allowances. Women, children and pensioners are most affected by the rapidly deteriorating social system and increasing poverty. As the poor can most effectively be protected at the local level, decentralizing social assistance payments and service delivery to the province, district and city administrations is a major thrust of the Government's reform agenda.

**Table 6: Social Protection**

Item	1994	1995	1996 (rev. plan)
Social Protection Expenditures (Tenge million)	8,882.4	34,433.4	20,664.6
percent of GDP	2.2	3.1	1.1
social security	8,882.4	10,571.1	9,542.3
family allowances		4,302.4	
social welfare		23,862.3	11,122.3
privileges to invalids for public transport, fuel, housing, etc.		22,140.9	11,122.3

Source: Ministries of Finance, UNDP, World Bank, staff estimates

## **E. Eroding Living Standards and Rising Poverty**

30. The impact of the difficult economic circumstances since independence and the rising social costs of transition can be seen in the declining UNDP Human Development Index (HDI). The 1996 Kazakhstan Human Development Report calculates the national HDI at 0.681 in 1995, down from 0.873 in 1990. The favorable 1990 HDI was caused by the high social index (especially life expectancy and schooling) and the relatively high GDP. Using the internationally comparable data in the 1995 UNDP report, in 1990 Kazakhstan ranked number 53; for 1995 it had slipped to number 100.

31. As is the case in many countries, alternative poverty-line indicators are in use by different national and international organizations. According to the Ministry of Labor, since February 1996, the poverty line is defined as a monthly income of T2,700 (\$41) per capita. However, the calculations for Government assistance to the poor have been based on T1,280 per person per month (twice the minimum wage) (see Table 7). Based on this line, at the end of 1995, 22.6 percent of the population lived below the poverty line. The national statistical office (Goskomstat) has used since 1994, a minimum expenditure level of T2,500 (\$ 38) as a poverty line for its statistical collection purposes. As of mid-1996, Goskomstat estimated that roughly 64 percent of the total population had income of less than T2,500. The World Bank fixes the poverty threshold level at \$31 per month and severe poverty at \$23. According to these base lines, in 1995 about 37 percent of the households lived in poverty and 21 percent

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in severe poverty. Whatever the exact poverty line used there is every indication of a substantial increase in poverty during the transition period.

## F. Strategies for Social Development

### 1. The Government's Program to Address Social Development

32. A comprehensive program of structural reforms for a socially oriented market economy has been in formulation since independence. Despite budgetary constraints, the Government's commitment to maintain high social standards remains strong. Reform of social policy including labor market development, social protection reforms, strengthening the insurance systems, reforming the health and education sectors, and better targeting of social protection, are major components in the late 1995 Program of Government Actions to Deepen the Reforms for 1996-1998. Decentralizing social policy, moving decision-making to the local level and reducing enterprise responsibility for social service delivery are major pre-requisites to achieve these goals.

**Table 7: The Incidence of Poverty in Kazakhstan**

	1989	1993	1994	1995
Poverty lines (Tenge, per month, per capita)				
Goskomstat	75 rubles		2,500 (May 95)	2,500 (mid-1996)
percent of population living below the poverty line	15.5	25 (May 1992)	51.3 (May 95)	64
rural				84
urban				44
Ministry of Labor (poverty assistance cut-off)				1,280
percent of population living below assistance line	15.5	20 (1992)		22.6
rural / urban (percent)				35.0 / 7.6
World Bank (\$ per month and head)				
poverty				\$31
percent of households living below				37
severe poverty				\$23
percent of households living below		10 (1992)		21
GNP per capita (US\$)		1,410	1,100	
Human Development Index	0.848 (1990)	0.752	0.697	0.685
World rank according to 1995 Human Development Report	53 (1990)	82	99	100

Sources: Ministry of Labor, Goskomstat, UNDP, World Bank, staff estimates

### 2. Self-help and NGO Activities

33. Since independence a considerable number of private charity organizations have emerged in order to improve the protection for a number of particularly vulnerable groups. These organizations are important, as they are beginning the process of promoting private activities in the social sphere. Education (including pre-school facilities) and the health system, having previously provided universal coverage, are no longer free of cost to the user and provide scope for future private sector development. Currently, however, nongovernmental organizations (NGOs) are not in a position to materially compensate for the weakening of the former public social service system.

### **3. Reforming the Social Safety Net: A Niche for Bank Involvement**

34. Employment generation, education, and improved social services delivery at the local level, are priorities of the Bank's strategy to assist in overcoming the heavy social costs of transition. To prepare human resources for the emerging market society, the Bank as

lead external assistance agency in the education sector, focuses on priority investments for primary and secondary schools and sector policy issues. In social protection, the Bank will support selected local governments to (i) rationalize the provision of social services provision, (ii) further decentralize planning and finance, and (iii) improve private sector and NGO participation in social policy. Further, labor market and environmental issues can be positively addressed in agriculture and industry projects. Measures to mitigate the social costs of transition in regard to heating and transport can be incorporated in the Bank's envisaged growth-oriented infrastructure projects. In addition, the Bank will ensure that social dimensions concerns are incorporated in its capacity building activities.

## **GENDER-RELATED TRANSITION ISSUES**

### **A Introduction: Transition and Gender Roles**

1. The Bank has adopted a policy which requires that specific consideration be given to human resources development and cross-cutting social issues in program and project activities. Encouraging the participation of women in development and promoting gender sensitive policies, programs, and projects are key strategic objectives in the Bank's cooperation with the Government of Kazakhstan. The Bank therefore, in 1996, conducted a separate study on the impact of transition on women. This Appendix provides a summary of this study with the key recommendations for the Bank's programming and project activities.

2. Transition is affecting men and women differently, because of existing gender roles and gender disparities in society and in the labor market. Some existing political and gender inequalities have remained in force, and new gender-specific inequalities have developed in the transformation process. Family structures and gender roles are changing rapidly and new social problems have emerged. This is not only an issue for social concern, but the emerging problems are hindering investment in human capital, which is urgently needed for a sustainable restructuring of the economy. Any strategy to support the transformation process should therefore take into account gender issues.

3. The following sections provide a discussion of (i) women's position in society, (ii) the shifting parameters in the economy and labor market, (iii) the impact on women of changes in the social sectors, and (iv) specific recommendations for the Bank's strategy. Since reliable gender-disaggregated data are not always available, the discussion sometimes relies upon anecdotal evidence from field research.

### **B. Women's Social Status**

#### **1. Demographic Aspects: Declining Birth and Increasing Mortality Rates**

4. Women and girls accounted for 51.3 percent of Kazakhstan's population in 1995, and 48.7 percent of the working-age population (16 to 54 years). As a consequence of demographic changes, dating back to World War II, the proportion of females in the working-age population is declining while the number of older women in the population is growing. From 1990 to 1994, for example, the increase in the number of elderly people was 4 percent, but the female elderly grew by 7.5 percent.

5. Birth rates are falling as a consequence of the economic and social changes. The number of births per 1,000 people, which remained stable during the 1980s, decreased from 21.8 in 1990 to 16.7 in 1995. Accordingly, the number of children per family and the number of large families is decreasing. In 1989, women had an average of 2.9 children, in 1995, only 2.4; in urban areas women had an average of 1.8 children and in rural areas 2.8. The number of big families with four and more children decreased from 200,000 in 1989 to an estimated 160,000 in 1996. However, there are major regional and ethnic differences. More than 60 percent of all children are born to ethnic Kazak women, but their fertility rates also decreased between 1989 and 1994 from 3.6 to 3.1. In contrast, ethnic Russian, urban, and women in the northern part of the country limit themselves to between one to two children. Whereas overall birth rates have decreased, the percentage of births by women under 20 increased between 1991 and 1995 from 10.9 to 13 percent of all births.

6. Crude death rates went up from 7.7 per 1,000 inhabitants in 1990 to more than 10 in 1995. Life expectancy has also fallen, from 68.6 years in 1990 to 66.1 years in 1995. Women are, however, still expected to live nine years longer than men. This is a large difference compared with most other countries. Men in the cities and women in the Aral Sea area have shorter life expectancies, because of severe industrial and environmental pollution.

## **2. Legal and Cultural Aspects: A Gender-Egalitarian Society**

7. In the FSU, women's general position in society was often far better than in most developing countries. Discrimination for reasons of origin, sex, race, language, religion or any other circumstances was prohibited by the Constitution. In the FSU, women played a strong public role in nearly all spheres of society. Marriage and family, motherhood and fatherhood were protected by the State. Labor legislation and social protection laws and policies recognized women as a vulnerable group with a right to special benefits.

8. Soviet practices in this respect appear to have been well suited to the country. The nomadic, ethnic Kazak culture also encouraged a degree of independence for women. Women work alongside men in all sectors of society. In the family, it is not unusual that women manage the household's financial resources.

9. With respect to their role in public life, the present difficult transition has reduced the participation of women in the higher decision-making bodies. Before independence, 30 percent of the seats in parliament were reserved for women; this share dropped sharply to under 10 percent in the 1996 elected parliament. There are no women ministers at the moment, and all provincial governors (Akims) are men. Since independence, the Government of Kazakhstan has signed only very few international conventions concerning gender issues; the Convention for the Elimination of All Forms of Discrimination Against Women, for instance, has not been signed.

## **3. Women's New Lifestyles and Increasing Pressures on the Family**

10. The transition is having a considerable impact on marital circumstances. The number of marriages decreased by 25 percent between 1990 and 1995, whereas the number of divorces remains high, at 24 percent of contracted marriages in 1994. In a considerable number of urban families, married women are evolving into the family's bread-winner, as husbands lack employment.

### **C. Women's Position in the Economy**

#### **1. Women in the Labor Market**

11. Women are actively involved in almost all spheres of the economy. Their participation in the labor force was between 47 and 49 percent before 1990 and, in spite of the sharp contraction in output, has declined only to 45 percent in 1994. It is generally perceived that Kazakhstan women are active, flexible and entrepreneurial by nature, habits encouraged both by the Soviet experience and earlier, nomadic traditions.

12. There is a certain gender division of labor. For example, 70-80 percent of the staff in education, culture, communication, health, public administration, services such as trade and canteens, and parts of industry such as textiles, food processing and electronics are women. Women were, however, present in all sectors, nearly 50 percent of the scientists in

former State institutes were women, and 20 percent of employees in construction and transport.

13. Within sectors there was also sometimes a division of labor across gender-lines. Women's work in agriculture was mainly unskilled or semiskilled. Tasks combining a maximum of physical effort with low productivity, like the "milkmaids", were often assigned to women. Men dominated in agricultural crop production which is usually highly mechanized in Kazakhstan. The top management in most sectors were generally considered as male spheres.

## **2. High Female Unemployment**

14. Although proportional labor force representation remains high, since transition there has been an outflow of women from practically every sector to the household and the informal sector. The total number of women employed decreased from 3.2 million in 1990 to less than 2.7 million in 1993. In 1993, more than one half of the officially registered unemployed were women (see Figure 1). Since 1993, with increasing restructuring and male unemployment, the share of women among the total unemployed has decreased, but women still account for the majority of the 260,000 unemployed persons registered with the labor offices in 1996. A 1996 Government survey on working conditions showed that women comprise 60 percent of the unemployed and 65 percent of those receiving unemployment benefits. More seriously, nearly 80 percent of the long-term unemployed are women, and more than 50 percent of the officially unemployed women have children of school-age and considerable domestic responsibilities. The number of women among the unofficial or hidden unemployed is not known, but it is generally acknowledged that forced leave and part-time jobs affect women more than men.

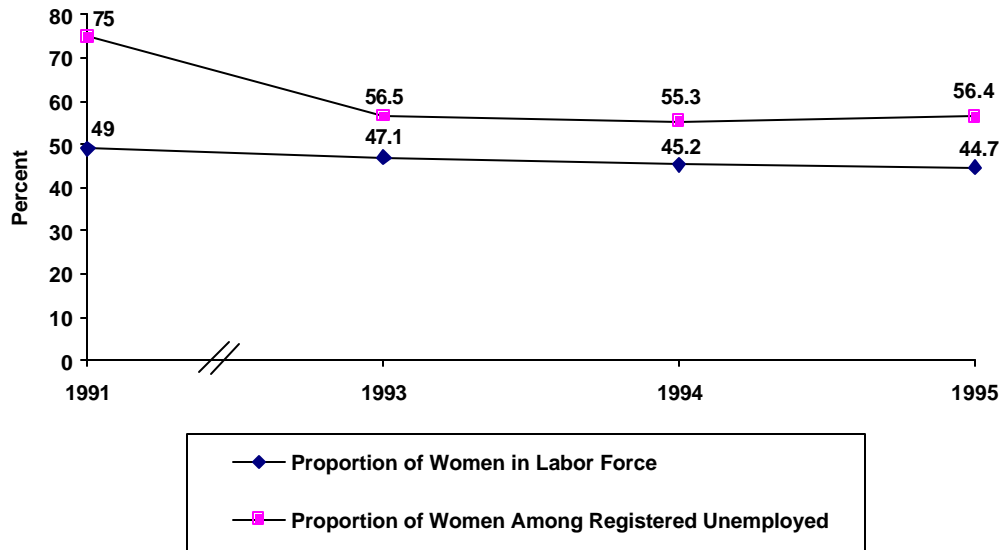
15. In the forthcoming years, unemployment is expected to increase with continued pressure on women. The divestiture of social assets and the rationalization of social services in health and education have just started. Many privatized light industries will not be competitive without restructuring. Communal services such as tailoring workshops employing women under district governments will also move through privatization and restructuring exercises. Finally, with decentralization, privatization and restructured service provision, public administration will also reduce labor and female employment.

16. The Government has adopted proactive employment policies, but they are increasingly difficult to implement. Since 1991, for example, large enterprises have been obliged to employ a certain percentage of persons otherwise facing difficulties in finding employment. Apart from other social groups, an employment quota applies to single mothers and to mothers with many (four and more) children. Officials admit that the quota regulations are increasingly difficult to implement, especially with reference to women, because (i) many large enterprises to which the law might be applied are in the process of restructuring; and (ii) due to the prevailing gender division of labor, in many factories of light industry the majority of employees are, in any case, women.

17. Although women do well in the informal economy, they face serious difficulties in the formal labor market. Only 15 percent of private businesses are managed by women. A 1995 Goskomstat survey of new private enterprises in seven provinces showed that among these businesses only one third of the employees are women with a tendency for them to be found in agriculture and trade and not in industry. Female mobility is increasingly limited by the declining supply of child-care facilities and transport especially in rural areas. Women trying to

enter private business face difficulties stemming from the lack of small-scale credit. Collateral arrangements, for example, suitable for small-scale businesses have not yet been developed.

**Figure 1: Women in the Labor Market**



### 3. Government Programs and NGOs

18. The public Council on Women, Family and Demographic Problems (see para. 31) established a high priority regarding the protection of women's employment. Consistent with this, the Government forecasts the creation of up to 200,000 new jobs in small-and-medium size businesses by 1998, through the medium-term State Program of Entrepreneurship Support and a Network of Small Business Centers. Concrete plans are still, however, to be developed. So far, no gender-specific affirmative action has been developed by the Government to actively promote women's participation in the market economy. Given the tight budgetary allocations, the declining revenue basis, and the increased expenditures for unemployment benefits, it is unlikely that the Employment Fund will be able to implement a more active and gender-targeted employment policy.

19. Since 1992, three private women's associations have been founded to promote women's business and employment. Like other non-governmental institutions, the associations promoting women's entrepreneurship are facing severe difficulties in being recognized as non-profit organizations. To some extent, this is because the registration process for non-profit organizations is administratively unclear. Partly as a result, the three associations focus on the exchange of information, legal assistance and research and have limited proactive programs.

## **D. The Deterioration of Social Services**

### **1. Gender Impacts of Transition in Education**

20. During the FSU period, significant progress had been made in education for women in Kazakhstan. In 1989, about 1 percent of males and less than 4 percent of females aged 15 years and above were considered illiterate. In proportional terms, progress in women's education has continued during the transition period, in spite of an overall contraction in the sector. In secondary education, for example, the percentage of women attending school was 50.1 percent in 1994/95. Some long-standing gender-biases remain in the sector. In secondary and higher education, for example, female students account for 96 percent of all students in pedagogical schools that train primary school teachers. In university education, women dominate in the fields of health (89 percent of students) and home economics (79 percent) but are strongly represented in most fields.

21. As indicated in other sections of this Report (particularly Appendix 3), the transition period has resulted in severely reduced access to pre-school and childcare facilities. The reduced availability of child facilities has considerably limited women's mobility. The reduced availability and higher cost of school meals has increased the pressure on limited family budgets. With the reduction of pre-school education the primary health care services delivered by these institutions has also disappeared. Equally important, the closure of facilities, has limited income opportunities for women teachers.

### **2. Women's Health and Family Situation**

22. Despite the extensive public health care system built under the FSU, health care resources were used in an inefficient manner. Since independence, with the restructuring of enterprise-provided social services and with limited public resources, the health care system has deteriorated as reflected, for example, in increasing maternal mortality rates (see Table 1). Two gender-related issues are important: (i) nutritional deficiencies, and (ii) reproductive health care. With increasing economic difficulties, the overall level of women's nutrition has deteriorated. A USAID-sponsored survey among several thousand women with small children revealed that malnutrition is emerging as a significant problem, especially in the rural southern and western parts of the country. The average caloric intake in all provinces was less than 2,200 kilo-calories per day compared to internationally acceptable standards of 2,400. In one district of Kzyl-Orda province, the average calorie, protein, and iron intake were only 60-69 percent of the recommended levels. In that district, there was virtually no vitamin C available and a severe deficiency of Vitamin A was noted. Nationwide, up to 60 percent of pregnant women are suffering from anemia, in poor regions and those areas suffering from ecological disasters such as the Aral Sea the incidence can be as high as 80 percent.

23. Reproductive health is of special concern. Though almost all women give birth in hospitals under medical assistance, even in Soviet times the maternal mortality rate was high by international standards. Simply put, the quality of care was not adequate in many respects. For instance, every year several hundred women die during delivery because the particular hospital is not equipped for caesarian surgery. Officials acknowledge that consultation centers for pregnant women are not well equipped and medical supplies are often unavailable.

**Table 1: Women's social situation**

Item	1985	1990	1993	1994	1995
<b>Demography</b>					
women as percent of population	51.6	41.5		53.6	51.3
women as percent of working age population		48.7		47.5	48.7
Life expectancy (women/men)	73.1/63.9	73.1/63.8		71.1/60.7	
<b>Reproduction</b>					
births (number per 1,000 population)	24.9	21.8	18.6	18.2	16.7
children born to women under 20 (percent of all birth)		10.9 (1991)	13.0		
children per family (number)		2.9			2.4
rural/urban					2.8/1.8
Ethnic Russian		2.2			1.7
Ethnic Kazak		3.6			3.1
<b>Marriages and Divorces</b>					
number of marriages (per 1,000 inhabitants)	10.1	9.8	8.6	7.3	7.0
number of divorces (per 1,000 inhabitants)	2.6	2.6	2.7	2.5	
number of single mothers ('000)				155.0	
<b>Crimes</b>					
persons older than 30 convicted of crimes ('000; women/men)		21.6/12.7	36.2/12.0	35.5/13.5	
<b>Health</b>					
maternal mortality rate (per 100,000 live births)	66.6 (1987)	67.2 (1991)	62.8	69.4	77.3
number of hospital beds for pregnant women	17,066	18,950	18,238	17,451	
number of midwives		17,343	14,576	13,535	

Sources: Goskomstat, Ministry of Health, Ministry of Labor, UNDP 1996, UNICEF, staff estimates

24. Reflecting these problems, death after abortion is one of the four main causes of women's mortality during child-bearing age. In the Soviet period, abortion was a principal form of birth control. In Kazakhstan until 1994, abortions far outnumbered births delivered. Women underwent three abortions on average; however, there was considerable ethnic and regional variation in the use of abortion. In the more ethnic Kazak dominated southern part of the country, fewer abortions were practiced and more in the Russian dominated north. Regional surveys suggest that abortions are decreasing since 1995 as the knowledge and usage of contraceptives increases.

### **3. Social Protection Programs**

25. Kazakhstan has inherited from Soviet times a complex social safety net which, in theory, principally targets mothers and children. However, the provision of social protection is rapidly declining, and the access progressively more limited.

#### **a. Budget Financed Welfare Benefits and Allowances**

26. Five out of the ten budget-financed welfare benefits and allowances are specifically targeted to women and two to children. They cover benefits for (i) childbirth, (ii) single mothers, (iii) mothers of more than four young children, and (iv) childcare. Although the variety of allowances appears comprehensive, the welfare net cannot provide effective social protection to women and children in need. Indeed, in some cases the costs of registration or application exceed the amount of expected allowances.

#### **b. Declining Social Insurance Payments**

27. The standard retirement age is 60 years for men and 55 years for women. Because of this differential, and because women's life expectancy exceeds men's life

expectancy by about nine years, the majority of pensioners are women. As a result of limited public financial resources, pension support, however, is insufficient to keep pensioners above the poverty line. In addition, pensions are often not paid in a timely manner.

28. Under practices originating in the FSU, women have a right to paid maternity leave of 112 days and, at their discretion, can go on child-care leave for an additional three years with a right to return to their former job, receiving child-care allowance during one-half of this period. However, with growing underfinancing of the Social Insurance Fund, increasingly reduced income sources, the very limited public support actually available, and with decreasing employment opportunities, few women voluntarily leave the work place for an extended period of time.

### **c. Government Reforms and NGOs Involvement in Social Protection**

29. In an attempt to rationalize social protection services and improve beneficiary targeting, the Government is considering a number of social policies including (i) a unification of the welfare benefits system, (ii) an increase of pension age for men from 60 to 63 and for women from 50 to 58, (iii) a gradual abolishment of employment quotas, and (iv) the gradual abandonment of communal services privileges. In addition, a revision of the Employment Law is currently being processed to simplify unemployment registration, increase unemployment benefits, and introduce financial incentives for public work programs. If completed successfully, these reforms could bring about a social protection system that provides more carefully targeted support.

30. Women play a crucial role in the recently emerging private initiatives for social protection and child-oriented support. Some of these support organizations have been founded to promote very specific groups and issues such as "mothers of large families" or "handicapped mothers", but most have developed a broader approach. In Kazakhstan these voluntary social organizations are considered as "women's NGOs", although they often attend to men as well.

## **E. Gender-Sensitive Assistance**

### **1. Government and Private Sector Initiatives**

31. The Government is concerned to prevent the deterioration of women's status, protect families, and develop a coherent national demographic policy. In March 1995 a Council for Problems of Women, the Family and Demographic Problems was formed as a coordinating consultative body under the President of the Republic with active participation of the sectoral ministries. The Council has the task to identify problems and propose solutions. In the first annual report the following sectoral priorities were formulated: (i) the protection of women's health, (ii) the protection of women's employment, and (iii) the protection of the morals of children and prevention of crimes. In order to improve women's representation in high positions, the Council also suggested the introduction of a quota for women of between 30 to 50 percent of the office holders in public decision-making bodies.

32. Complementing public sector activities, as indicated above, there are increasing numbers of NGOs focusing on gender-related issues. The League of Muslim Women, for example, has extensive contacts and the support of Muslim organizations in different countries. The organization provides help to poor families and sponsors training of young women in the reading of the Koran. Apart from women's organizations, and social and

environmental oriented NGOs, there are also a number of newly created private initiatives promoting issues such as "women and law" or "women and culture".

## **2. Scope for Bank Involvement**

33. In response to the gender-related issues identified above, the Bank's strategy emphasizes investment in human resource development of women, recognizing their role as skilled and active members of society, assisting in the economic and social transformation of the country. The Bank will monitor the activities of the newly formed Council for Women, Family and Demographic Problems under the President, and ensure that, where relevant, gender issues form an integral part of the Bank's program and project work. The Bank will especially consider gender issues in the following fashion, constituting the strategic orientation of the Bank's assistance program:

### **a. Promoting Gender in Education**

34. The Bank will review gender issues and incorporate appropriate approaches in its education sector projects. Among the concerns being developed in the Bank's program are: (i) strengthening management systems so that problems of bias and access can be more accurately identified and necessary remedial action initiated; (ii) maintaining the high quality of formal education in rural areas, including access for female students; (iii) enhancing the relevance of primary and secondary education, as the basis for both further education and employment; and (iv) strengthening teacher training and retraining teachers (80 percent female) in line with the needs of the economic transition.

### **b. Creating Employment for Women in Agriculture and Industry**

35. In view of the high percentage of female labor in agriculture and light industry and the substantive female unemployed, the Bank will address gender issues in various project components promoting enterprise and agricultural reforms. Among the concerns to be developed in the Bank's program are: (i) promoting small-scale enterprise development; (ii) strengthening the diversification in agriculture and industry (especially in the company towns); (iii) supporting food and agriculture processing in rural and home based enterprises; and (iv) promoting training for women. In addition, the Bank will consider supporting the development and management of small-scale credit schemes. Issues such as land ownership rights for women, the provision of agricultural credit and agricultural marketing services, and the promotion of microenterprise development will be some of the mechanisms through which women will be assisted in these sectors. Bank assistance to the sector will overtly explore opportunities for targeting women.

### **c. The Rationalization of Social Services Delivery**

36. The Bank will protect gender interests in its projects through activities to improve the delivery of social services delivery by local governments. Particularly important are those sectors where service deterioration has had marked impacts on the family and on the ability of women to participate in the labor force. This includes; childcare, health services, water supply and sanitation, district heating, and transport.

**d. Policy Dialogue**

37. The Bank will include in its regular policy dialogue, discussion of the impacts on women of the new economic policies and programs and closely monitor the situation of women. Where relevant gender will be included in transition policy dialogue. The progress of the new formed Council for Women, Family and Demographic Problems under the President, for example, will be monitored and opportunities to support policies to reduce gender-related problems will be explored.

## **GENDER-RELATED TRANSITION ISSUES**

### **A Introduction: Transition and Gender Roles**

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8. Soviet practices in this respect appear to have been well suited to the country. The nomadic, ethnic Kazak culture also encouraged a degree of independence for women. Women work alongside men in all sectors of society. In the family, it is not unusual that women manage the household's financial resources.

9. With respect to their role in public life, the present difficult transition has reduced the participation of women in the higher decision-making bodies. Before independence, 30 percent of the seats in parliament were reserved for women; this share dropped sharply to under 10 percent in the 1996 elected parliament. There are no women ministers at the moment, and all provincial governors (Akims) are men. Since independence, the Government of Kazakstan has signed only very few international conventions concerning gender issues; the Convention for the Elimination of All Forms of Discrimination Against Women, for instance, has not been signed.

## **3. Women's New Lifestyles and Increasing Pressures on the Family**

10. The transition is having a considerable impact on marital circumstances. The number of marriages decreased by 25 percent between 1990 and 1995, whereas the number of divorces remains high, at 24 percent of contracted marriages in 1994. In a considerable number of urban families, married women are evolving into the family's bread-winner, as husbands lack employment.

### **C. Women's Position in the Economy**

#### **1. Women in the Labor Market**

11. Women are actively involved in almost all spheres of the economy. Their participation in the labor force was between 47 and 49 percent before 1990 and, in spite of the sharp contraction in output, has declined only to 45 percent in 1994. It is generally perceived that Kazakstan women are active, flexible and entrepreneurial by nature, habits encouraged both by the Soviet experience and earlier, nomadic traditions.

12. There is a certain gender division of labor. For example, 70-80 percent of the staff in education, culture, communication, health, public administration, services such as trade and canteens, and parts of industry such as textiles, food processing and electronics are women. Women were, however, present in all sectors, nearly 50 percent of the scientists in

former State institutes were women, and 20 percent of employees in construction and transport.

13. Within sectors there was also sometimes a division of labor across gender-lines. Women's work in agriculture was mainly unskilled or semiskilled. Tasks combining a maximum of physical effort with low productivity, like the "milkmaids", were often assigned to women. Men dominated in agricultural crop production which is usually highly mechanized in Kazakhstan. The top management in most sectors were generally considered as male spheres.

## **2. High Female Unemployment**

14. Although proportional labor force representation remains high, since transition there has been an outflow of women from practically every sector to the household and the informal sector. The total number of women employed decreased from 3.2 million in 1990 to less than 2.7 million in 1993. In 1993, more than one half of the officially registered unemployed were women (see Figure 1). Since 1993, with increasing restructuring and male unemployment, the share of women among the total unemployed has decreased, but women still account for the majority of the 260,000 unemployed persons registered with the labor offices in 1996. A 1996 Government survey on working conditions showed that women comprise 60 percent of the unemployed and 65 percent of those receiving unemployment benefits. More seriously, nearly 80 percent of the long-term unemployed are women, and more than 50 percent of the officially unemployed women have children of school-age and considerable domestic responsibilities. The number of women among the unofficial or hidden unemployed is not known, but it is generally acknowledged that forced leave and part-time jobs affect women more than men.

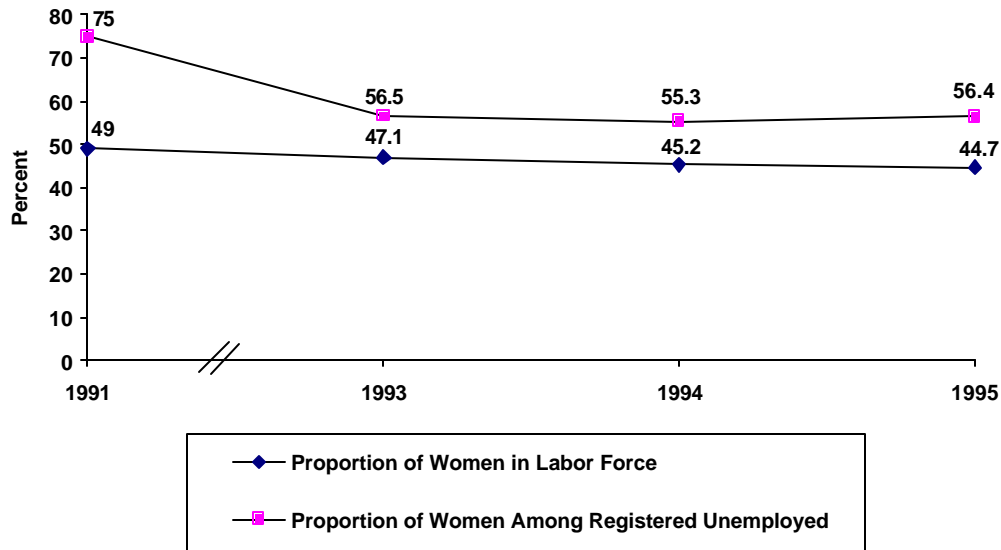
15. In the forthcoming years, unemployment is expected to increase with continued pressure on women. The divestiture of social assets and the rationalization of social services in health and education have just started. Many privatized light industries will not be competitive without restructuring. Communal services such as tailoring workshops employing women under district governments will also move through privatization and restructuring exercises. Finally, with decentralization, privatization and restructured service provision, public administration will also reduce labor and female employment.

16. The Government has adopted proactive employment policies, but they are increasingly difficult to implement. Since 1991, for example, large enterprises have been obliged to employ a certain percentage of persons otherwise facing difficulties in finding employment. Apart from other social groups, an employment quota applies to single mothers and to mothers with many (four and more) children. Officials admit that the quota regulations are increasingly difficult to implement, especially with reference to women, because (i) many large enterprises to which the law might be applied are in the process of restructuring; and (ii) due to the prevailing gender division of labor, in many factories of light industry the majority of employees are, in any case, women.

17. Although women do well in the informal economy, they face serious difficulties in the formal labor market. Only 15 percent of private businesses are managed by women. A 1995 Goskomstat survey of new private enterprises in seven provinces showed that among these businesses only one third of the employees are women with a tendency for them to be found in agriculture and trade and not in industry. Female mobility is increasingly limited by the declining supply of child-care facilities and transport especially in rural areas. Women trying to

enter private business face difficulties stemming from the lack of small-scale credit. Collateral arrangements, for example, suitable for small-scale businesses have not yet been developed.

**Figure 1: Women in the Labor Market**



### 3. Government Programs and NGOs

18. The public Council on Women, Family and Demographic Problems (see para. 31) established a high priority regarding the protection of women's employment. Consistent with this, the Government forecasts the creation of up to 200,000 new jobs in small-and-medium size businesses by 1998, through the medium-term State Program of Entrepreneurship Support and a Network of Small Business Centers. Concrete plans are still, however, to be developed. So far, no gender-specific affirmative action has been developed by the Government to actively promote women's participation in the market economy. Given the tight budgetary allocations, the declining revenue basis, and the increased expenditures for unemployment benefits, it is unlikely that the Employment Fund will be able to implement a more active and gender-targeted employment policy.

19. Since 1992, three private women's associations have been founded to promote women's business and employment. Like other non-governmental institutions, the associations promoting women's entrepreneurship are facing severe difficulties in being recognized as non-profit organizations. To some extent, this is because the registration process for non-profit organizations is administratively unclear. Partly as a result, the three associations focus on the exchange of information, legal assistance and research and have limited proactive programs.

## **D. The Deterioration of Social Services**

### **1. Gender Impacts of Transition in Education**

20. During the FSU period, significant progress had been made in education for women in Kazakhstan. In 1989, about 1 percent of males and less than 4 percent of females aged 15 years and above were considered illiterate. In proportional terms, progress in women's education has continued during the transition period, in spite of an overall contraction in the sector. In secondary education, for example, the percentage of women attending school was 50.1 percent in 1994/95. Some long-standing gender-biases remain in the sector. In secondary and higher education, for example, female students account for 96 percent of all students in pedagogical schools that train primary school teachers. In university education, women dominate in the fields of health (89 percent of students) and home economics (79 percent) but are strongly represented in most fields.

21. As indicated in other sections of this Report (particularly Appendix 3), the transition period has resulted in severely reduced access to pre-school and childcare facilities. The reduced availability of child facilities has considerably limited women's mobility. The reduced availability and higher cost of school meals has increased the pressure on limited family budgets. With the reduction of pre-school education the primary health care services delivered by these institutions has also disappeared. Equally important, the closure of facilities, has limited income opportunities for women teachers.

### **2. Women's Health and Family Situation**

22. Despite the extensive public health care system built under the FSU, health care resources were used in an inefficient manner. Since independence, with the restructuring of enterprise-provided social services and with limited public resources, the health care system has deteriorated as reflected, for example, in increasing maternal mortality rates (see Table 1). Two gender-related issues are important: (i) nutritional deficiencies, and (ii) reproductive health care. With increasing economic difficulties, the overall level of women's nutrition has deteriorated. A USAID-sponsored survey among several thousand women with small children revealed that malnutrition is emerging as a significant problem, especially in the rural southern and western parts of the country. The average caloric intake in all provinces was less than 2,200 kilo-calories per day compared to internationally acceptable standards of 2,400. In one district of Kzyl-Orda province, the average calorie, protein, and iron intake were only 60-69 percent of the recommended levels. In that district, there was virtually no vitamin C available and a severe deficiency of Vitamin A was noted. Nationwide, up to 60 percent of pregnant women are suffering from anemia, in poor regions and those areas suffering from ecological disasters such as the Aral Sea the incidence can be as high as 80 percent.

23. Reproductive health is of special concern. Though almost all women give birth in hospitals under medical assistance, even in Soviet times the maternal mortality rate was high by international standards. Simply put, the quality of care was not adequate in many respects. For instance, every year several hundred women die during delivery because the particular hospital is not equipped for caesarian surgery. Officials acknowledge that consultation centers for pregnant women are not well equipped and medical supplies are often unavailable.

**Table 1: Women's social situation**

Item	1985	1990	1993	1994	1995
<b>Demography</b>					
women as percent of population	51.6	41.5		53.6	51.3
women as percent of working age population		48.7		47.5	48.7
Life expectancy (women/men)	73.1/63.9	73.1/63.8		71.1/60.7	
<b>Reproduction</b>					
births (number per 1,000 population)	24.9	21.8	18.6	18.2	16.7
children born to women under 20 (percent of all birth)		10.9 (1991)	13.0		
children per family (number)		2.9			2.4
rural/urban					2.8/1.8
Ethnic Russian		2.2			1.7
Ethnic Kazak		3.6			3.1
<b>Marriages and Divorces</b>					
number of marriages (per 1,000 inhabitants)	10.1	9.8	8.6	7.3	7.0
number of divorces (per 1,000 inhabitants)	2.6	2.6	2.7	2.5	
number of single mothers ('000)				155.0	
<b>Crimes</b>					
persons older than 30 convicted of crimes ('000; women/men)		21.6/12.7	36.2/12.0	35.5/13.5	
<b>Health</b>					
maternal mortality rate (per 100,000 live births)	66.6 (1987)	67.2 (1991)	62.8	69.4	77.3
number of hospital beds for pregnant women	17,066	18,950	18,238	17,451	
number of midwives		17,343	14,576	13,535	

Sources: Goskomstat, Ministry of Health, Ministry of Labor, UNDP 1996, UNICEF, staff estimates

24. Reflecting these problems, death after abortion is one of the four main causes of women's mortality during child-bearing age. In the Soviet period, abortion was a principal form of birth control. In Kazakhstan until 1994, abortions far outnumbered births delivered. Women underwent three abortions on average; however, there was considerable ethnic and regional variation in the use of abortion. In the more ethnic Kazak dominated southern part of the country, fewer abortions were practiced and more in the Russian dominated north. Regional surveys suggest that abortions are decreasing since 1995 as the knowledge and usage of contraceptives increases.

### **3. Social Protection Programs**

25. Kazakhstan has inherited from Soviet times a complex social safety net which, in theory, principally targets mothers and children. However, the provision of social protection is rapidly declining, and the access progressively more limited.

#### **a. Budget Financed Welfare Benefits and Allowances**

26. Five out of the ten budget-financed welfare benefits and allowances are specifically targeted to women and two to children. They cover benefits for (i) childbirth, (ii) single mothers, (iii) mothers of more than four young children, and (iv) childcare. Although the variety of allowances appears comprehensive, the welfare net cannot provide effective social protection to women and children in need. Indeed, in some cases the costs of registration or application exceed the amount of expected allowances.

#### **b. Declining Social Insurance Payments**

27. The standard retirement age is 60 years for men and 55 years for women. Because of this differential, and because women's life expectancy exceeds men's life

expectancy by about nine years, the majority of pensioners are women. As a result of limited public financial resources, pension support, however, is insufficient to keep pensioners above the poverty line. In addition, pensions are often not paid in a timely manner.

28. Under practices originating in the FSU, women have a right to paid maternity leave of 112 days and, at their discretion, can go on child-care leave for an additional three years with a right to return to their former job, receiving child-care allowance during one-half of this period. However, with growing underfinancing of the Social Insurance Fund, increasingly reduced income sources, the very limited public support actually available, and with decreasing employment opportunities, few women voluntarily leave the work place for an extended period of time.

### **c. Government Reforms and NGOs Involvement in Social Protection**

29. In an attempt to rationalize social protection services and improve beneficiary targeting, the Government is considering a number of social policies including (i) a unification of the welfare benefits system, (ii) an increase of pension age for men from 60 to 63 and for women from 50 to 58, (iii) a gradual abolishment of employment quotas, and (iv) the gradual abandonment of communal services privileges. In addition, a revision of the Employment Law is currently being processed to simplify unemployment registration, increase unemployment benefits, and introduce financial incentives for public work programs. If completed successfully, these reforms could bring about a social protection system that provides more carefully targeted support.

30. Women play a crucial role in the recently emerging private initiatives for social protection and child-oriented support. Some of these support organizations have been founded to promote very specific groups and issues such as "mothers of large families" or "handicapped mothers", but most have developed a broader approach. In Kazakhstan these voluntary social organizations are considered as "women's NGOs", although they often attend to men as well.

## **E. Gender-Sensitive Assistance**

### **1. Government and Private Sector Initiatives**

31. The Government is concerned to prevent the deterioration of women's status, protect families, and develop a coherent national demographic policy. In March 1995 a Council for Problems of Women, the Family and Demographic Problems was formed as a coordinating consultative body under the President of the Republic with active participation of the sectoral ministries. The Council has the task to identify problems and propose solutions. In the first annual report the following sectoral priorities were formulated: (i) the protection of women's health, (ii) the protection of women's employment, and (iii) the protection of the morals of children and prevention of crimes. In order to improve women's representation in high positions, the Council also suggested the introduction of a quota for women of between 30 to 50 percent of the office holders in public decision-making bodies.

32. Complementing public sector activities, as indicated above, there are increasing numbers of NGOs focusing on gender-related issues. The League of Muslim Women, for example, has extensive contacts and the support of Muslim organizations in different countries. The organization provides help to poor families and sponsors training of young women in the reading of the Koran. Apart from women's organizations, and social and

environmental oriented NGOs, there are also a number of newly created private initiatives promoting issues such as "women and law" or "women and culture".

## **2. Scope for Bank Involvement**

33. In response to the gender-related issues identified above, the Bank's strategy emphasizes investment in human resource development of women, recognizing their role as skilled and active members of society, assisting in the economic and social transformation of the country. The Bank will monitor the activities of the newly formed Council for Women, Family and Demographic Problems under the President, and ensure that, where relevant, gender issues form an integral part of the Bank's program and project work. The Bank will especially consider gender issues in the following fashion, constituting the strategic orientation of the Bank's assistance program:

### **a. Promoting Gender in Education**

34. The Bank will review gender issues and incorporate appropriate approaches in its education sector projects. Among the concerns being developed in the Bank's program are: (i) strengthening management systems so that problems of bias and access can be more accurately identified and necessary remedial action initiated; (ii) maintaining the high quality of formal education in rural areas, including access for female students; (iii) enhancing the relevance of primary and secondary education, as the basis for both further education and employment; and (iv) strengthening teacher training and retraining teachers (80 percent female) in line with the needs of the economic transition.

### **b. Creating Employment for Women in Agriculture and Industry**

35. In view of the high percentage of female labor in agriculture and light industry and the substantive female unemployed, the Bank will address gender issues in various project components promoting enterprise and agricultural reforms. Among the concerns to be developed in the Bank's program are: (i) promoting small-scale enterprise development; (ii) strengthening the diversification in agriculture and industry (especially in the company towns); (iii) supporting food and agriculture processing in rural and home based enterprises; and (iv) promoting training for women. In addition, the Bank will consider supporting the development and management of small-scale credit schemes. Issues such as land ownership rights for women, the provision of agricultural credit and agricultural marketing services, and the promotion of microenterprise development will be some of the mechanisms through which women will be assisted in these sectors. Bank assistance to the sector will overtly explore opportunities for targeting women.

### **c. The Rationalization of Social Services Delivery**

36. The Bank will protect gender interests in its projects through activities to improve the delivery of social services delivery by local governments. Particularly important are those sectors where service deterioration has had marked impacts on the family and on the ability of women to participate in the labor force. This includes; childcare, health services, water supply and sanitation, district heating, and transport.

**d. Policy Dialogue**

37. The Bank will include in its regular policy dialogue, discussion of the impacts on women of the new economic policies and programs and closely monitor the situation of women. Where relevant gender will be included in transition policy dialogue. The progress of the new formed Council for Women, Family and Demographic Problems under the President, for example, will be monitored and opportunities to support policies to reduce gender-related problems will be explored.

## THE IMPACT OF TRANSITION ON CHILDREN

### A Introduction

1. Transition policies to promote a market economy in Kazakhstan have so far attempted to maintain a certain level of protection for children. However, as a result of the weak economy and constrained public resources, the condition of children and young people has deteriorated. Of particular concern is the worsening labor market for young adults, the reduced access to education, and the eroding social protection system. Children are severely affected by changing family structures and their parents' struggle to adapt to the new environment. The negative social impact of transition on children is resulting in inefficiencies in the use and development of human capital--human capital that will be urgently needed for a sustainable restructuring of the economy. Children and young people are in danger of becoming "a lost generation." Any strategy meant to support the transformation process should, therefore, take into account the human development of the younger generation. New investments in children and youth in transition are necessary to correct the existing market failures and prevent obstacles to future economic prosperity.

2. In order to monitor the impact of transition on children and to better assist the Government of Kazakhstan, the Bank, in mid-1996, conducted a study to obtain operational recommendations for its country strategy and future programs and projects. This Appendix provides a summary of that study. It needs to be read in conjunction with the appendixes on social costs and on the impact of transition on women. The following sections discuss the most immediate concerns relating to the socioeconomic costs of transition on children: (i) the changing family context and children's position in society, (ii) social sector investments to protect human development in children, and (iii) a child sensitive Bank strategy.

### B. The Changing Family Context and Children in Society

3. Children and teenagers account for 33 percent of the population in Kazakhstan. As a result of changes in the birth rate and emigration, the population is getting older, and the proportion of young people is decreasing. However, the proportion of young ethnic Kazaks is growing, because of the higher birth rates among this population group and due to limited emigration.

4. During the period of the former Soviet Union (FSU), the official status of children in Kazakhstan had a number of progressive aspects. Education was mandatory through grade 8 and children were not allowed to enter the work force until the age of 16. Education for both girls and boys was generally considered important, and girls were often better educated than boys. Child labor was unknown in the formal sector. Such problems as "street children" were simply not seen. It was generally perceived that childhood and youth should be a protected phase of life and that the Government had to take an active part to develop their full human potential.

5. Notwithstanding the continued high societal value given to child development, the actual condition of children has deteriorated considerably since 1991. In the most extreme circumstances, city administrations have to deal with a growing number of neglected children who are without homes. Though still small in number compared with the situation in other countries, street children are now appearing.

6. Crimes committed by young people have increased dramatically in recent years. In 1994, 11.3 percent of all crimes were committed with the participation of teenagers (see Table 1). Further imperiling child development and increasing strains on families, drug use and alcoholism are on the rise. Reflecting these problems and difficult economic circumstances, prostitution of young girls is now becoming a problem. Recently, the Government has declared the fight against criminality a priority and severe penalties have been established for crimes committed by teenagers. A special police unit responsible for dealing with problems involving children under 14 has been created. It is generally perceived that the existing system is inadequate either for crime prevention or for social rehabilitation. However, planned reforms are facing severe budget constraints.

7. Reflecting the difficult and changing social and economic situation, the number of suicides of children and teenagers has been increasing. From a level of 6.1 suicides by boys and 2.6 girls per 100,000 population in 1990, the incidence of suicides had already risen to 8.3 for boys and 2.9 for girls in 1992. The severity of the problem has led to the creation of an emergency hot-line operated by the Almaty city administration in an attempt to provide counseling.

**Table 1: Children in the Changing Family Context**

Item	1989	1990	Dec. 93	Dec. 94
Demography (percent of total population)				
children younger than 5	11.8			9.4
children between 5 and 14	10.3			11.0
youth between 15 and 19	9.8			10.3
Children in the family				
number of families with many children ('000)			160	
percent of all families			12.6	
number of children raised by single mothers ('000)			200	
percent of all children				24.6
children born outside marriage (percent of all newborn)				10.4
Youth crime (percent of all convicted persons)				
age of 14-17		14.2	11.3	
age of 18-29		47.5	47.2	
incidence of drug related crimes (1990=100)		100	350	

sources: Ministry of Interior, Goskomstat, Council on Women, UNDP

8. As a result of growing economic difficulties, an increasing number of young people leave school early to enter the labor market. Formally, there exist employment quotas favoring the employment of young people: large enterprises are expected to employ a certain percentage of persons facing difficulties in finding employment. However, as a result of the ongoing contraction in output and enterprise restructuring, these formal employment programs are not being implemented. A high proportion of young people, under 30 years of age, are among the unemployed: at the end of 1995, young people accounted for 43.6 percent of the officially registered unemployed. Due to their limited work experience few teenagers have access to unemployment benefits. Conversely, child labor, especially in the service sector and in agriculture, may also be an emerging issue.

## **C. Promoting Social Sector Investments in Children**

### **1. Worsening Children's Education**

9. During the FSU period, a comprehensive education for children from 1 to 15 years of age, for both boys and girls, was considered a priority. Early childhood development through kindergartens and other child care arrangements, and the support of health and nutrition facilities for children, was heavily supported by State enterprises. Schooling was compulsory through grade 8 and there was a huge network of education facilities. The formal education system extended even to remote and sparsely populated areas. The system targeted providing children according to their needs. Systems of boarding schools, special facilities for helping different kinds of handicapped children, facilities for sports, recreation, music and the arts were supported and maintained. In 1985, more than 50 percent of the children from 1 to 6 years had access to pre-school education. The literacy rates in 1989 were 97.5 percent with less than 1 percent of men and less than 4 percent of women being illiterate. Teacher-student ratios were generally favorable for all educational levels. Before independence, the teacher-student ratio for pre-schools was 1:7.6, for general education it was 1:10.7, for vocational and technical schools 1:6.0, and for higher education 1:7.4. Since independence, however, the education system has been deteriorating with severe consequences for children of all ages.

#### **a. Reduced Access to Pre-School Education**

10. Due to the closure of public pre-schools previously operated by communal governments or enterprises, the number of pre-school facilities (including crèches, nurseries, kindergartens, and day-care) has dropped by 40 percent to 5,225 in 1995. In many rural areas, pre-schools are virtually non-existent. The enrollment of children has decreased accordingly from about 51 percent in 1990 to about 25 percent in 1995 (see Table 2). As kindergartens are integral parts of the education process, the most serious impact has been on children from poorer families who cannot afford to pay the relatively high fees now charged for child-care facilities.

11. The loss of pre-school facilities goes beyond the reduced access to early education. Many pre-schools also acted as community centers, for culture and sports. More importantly, pre-schools provided 3-4 meals a day, often compensating for poor nutrition in low-income households. Kindergarten and pre-schools also provided access to primary health care services such as immunization, generally free of charge. Though the system might have been over-protective, diseases were recognized at an early stage.

#### **b. Erosion in the Quality of Education**

12. Despite the severe budgetary problems, enrollment in primary and secondary schools has almost remained stable during the transition. This reflects the priorities of the Government towards primary and general secondary schools, to guarantee access to free general education in all parts of the country. To cope with the limited fiscal resources, efficiency has been increased by the amalgamation of some facilities but there has also been recourse to the use of second and third schooling shifts. On balance, budget constraints have resulted in severe problems in (i) purchasing new teaching materials and school books, (ii) providing school heating and electricity, (iii) maintaining school meals, (iv) supporting boarding schools for children with special problems, and (v) providing for necessary school transport.

13. The transition has provided other challenges to the education system, particularly in maintaining teaching quality. Many highly skilled teachers have emigrated or otherwise left the profession. The fact that some teachers are working double shifts or must work at second jobs to maintain household income is also seriously affecting the quality of teaching. Moreover, as new demands are placed on the education system there is a need to provide a different skill mix. There is a growing need for skilled teachers for foreign and Kazak languages, computer sciences, and business-related specialties.

14. Most negatively affected by these developments are the children of poor families and in rural areas, as well as children with special problems, the handicapped or otherwise disadvantaged. Between 1991 and 1995, for example, 558 boarding schools have been closed, and the number of children attending these institutions declined during the same period by 38 percent. Many of the remaining facilities are deteriorating physically and in need of increased financial support. Only 22 of the 122 facilities for children with mental or psychological disabilities are located in rural areas, and as a result handicapped children in rural areas face particularly difficult circumstances.

**Table 2: Children and Young People in Education and the Labor Market**

Item	1985	1989	1993	1994	1995
<b>School year beginning in:</b>					
Number of children attending pre-schools ('000)	986.2	1,067.8(1990)	868.3	538.4	426.1
children with access to pre-schools (percent)		51	42 (1992)		25
Children attending boarding schools (numbers)		107,454(1991)			66,664
number of boarding schools		1,540(1991)			982
Students attending vocational training schools		203.1(1990)	188.7	160.0	142.0
Graduates from vocational schools ('000)		112.9	85.6	79.1	
finding employment in the formal labor market (percent)		94.8	71.6	64.8	
Youth as percent of registered unemployed			54.1	51.4	43.6

sources: Ministry of Education, Ministry of Labor, Goskomstat, UNDP, ADB reports

15. The technical and vocational school system (VTS) provided for extensive training and guaranteed employment after graduation. The schools were tightly linked to enterprises both for program design and for employment planning. With the large contraction in production and enterprise closure and restructuring since 1991, the existing institutional structure lost much of its previous viability. Reflecting these difficulties, the number of vocational schools has decreased since independence by 20 percent and school enrollment has fallen by almost 25 percent. As early as 1994, before the beginning of much of the ongoing enterprise restructuring, more than one third of vocational school graduates failed to find formal employment.

## 2. Children's Health

### a. Worsening Children's Health

16. The FSU established an extensive public health-care system with one of the most favorable doctor-to-patient ratios in the world, a broad network of facilities, and a well developed system of preventive health care including immunization. However, the system was not efficient in its use of resources nor was there a concern for resource mobilization within the sector through, for example, cost recovery mechanisms. As a result of the economic difficulties of the transition period, children's health status has generally deteriorated with an increase in

the incidence of childhood diseases, worsening childhood nutrition, and infant mortality figures that are high and likely rising (see Table 3).

**Table 3: Indicators of Children's Health**

Item	1985	1989	1993	1994	1995
Infant mortality rate (per 1,000 live births) <sup>a</sup>	30.1	27.4(1991)	28.2	27.2	27.3
caused by respiratory diseases (percent)		32 (1991)			
caused by prenatal conditions (percent)		30 (1991)			
caused by diarrhea (percent)		13.5 (1991)			
congenital abnormalities (percent)	10	12 (1991)			
rural areas		28.2 (1991)	28.6	26.2	26.3
Health Infrastructure for Children					
number of hospital beds for children	44,950	47,010	43,927	38,953	
vaccination of 1 year old children (percent, girls/boys)				25.3/21.4	
Child nutrition					
milk kitchens for children (number)	1,014	721(1990)	608	498	
underweight newborn (percent)		6	6.0(1991)		
anemia (percent)		4.7	25-40(1992)		
Children's Health Status in the Aral Sea Region					
incidence of anemia		100			300
incidence of circulatory diseases		100			160
infant mortality rate (per 1,000 life births)					38.2

sources: Ministry of Health, Goskomstat, UNDP, UNICEF, Council on Women and Family, staff estimates

<sup>a</sup> There is likely underreporting of infant mortality. Actual figures maybe 30-35 percent higher.

17. The incidence of childhood diseases is increasing due to deteriorating family circumstances, continued environmental problems, as well as erosion of the formal health system. Two thirds of the growing number of tuberculosis cases are reported among children and youth. Nearly one half of the growing incidence of infant mortality is traceable to diarrhea and acute respiratory diseases, closely related to environmental problems, as well as the weakening support from the health system.

18. The situation surrounding child nutrition is particularly worrisome. Severe cases of vitamin C deficiency, problems related to a lack of protein, and general malnutrition are emerging. The most basic problem is, of course, the increasing incidence of poverty. In many poor families, declining real incomes result in decreased availability of protein and vitamins within a diet that increasingly relies upon bread and tea. The worsening situation for children is directly linked to the closure of kindergartens, milk kitchens, public canteens, and the decreased availability of meals in schools. A related concern is the poor nutrition status of pregnant women, often resulting in the birth of anemic children and difficulties in breast feeding.

19. Although nearly all children are born under medical assistance in hospitals, infant mortality remains high. According to official figures infant mortality has remained relatively stable, but experts admit that this is caused by substantial underreporting and that the situation is worsening. In a study by the US Central Bureau of Statistics, infant mortality rates were estimated to be as high as 44 per 1,000 live births in 1993. Alternative estimates for later years place actual figures 30-35 percent higher than the reported data.

### **b. The Impact of Environmental Degradation on Children's Health**

20. Children are more vulnerable than adults to air pollution, toxic chemicals, and polluted water. Many childhood diseases now being seen in Kazakhstan are directly caused by the poor environmental conditions. In schools and day care centers as well as in homes, a lack of clean drinking water and poor sanitation retard child development. The extreme cases are found in regions of environmental catastrophes. Near the Aral Sea, for example, the reported infant mortality rate is nearly one-quarter greater than the national average and intestinal diseases such as viral hepatitis are considerably more pronounced. In the Semipalatinsk nuclear testing region, a high incidence of diseases of the circulatory system and a high proportion of children born with inherent anomalies are reported.

21. The Government has begun to develop initiatives to prevent a further deterioration of children's health. Particularly noteworthy is the Ministry of Health Program for the Welfare of Mothers and Children with a special focus on the poorer rural regions. Major changes are also expected in public health care with the introduction of a compulsory health insurance scheme covering especially primary health care. However, due to the difficult economic and fiscal situations the introduction of these programs faces considerable difficulties.

### **3. The Eroding Social Protection System**

22. Kazakhstan has inherited from the FSU, a complex network of social protection providing, in theory, considerable support for children and their parents. The most important components to this social safety net are: (i) welfare benefits and allowances for children; (ii) special facilities for orphans, the handicapped or disabled children; and (iii) subsidized privileges for poor families with respect to the use of public transport or municipal services such as heating or electricity.

23. Four out of nine major types of social allowances benefit children directly, another four are directed towards their mothers. The most important ones are: (i) a one time allowance for the birth of children; (ii) monthly allowances for children from 3 to 18 years of age, single mothers, and mothers of more than four young children; (iii) expenses related to the education of handicapped or invalid children; (iv) mothers on child-care leave, and (v) the families of veterans.

24. Although the variety of child-care support appears comprehensive, the welfare net is progressively less capable of providing effective social protection to children and parents in need. One basic problem concerns targeting. For example, allowances to support families with children covered 2.6 million families, irrespective of their income. A lack of clear targeting reduces the impact of limited fiscal resources. One result is that benefits are generally considered to be low. Sometimes the costs of registration (especially transport) exceed the expected amount of allowances.

25. The Government is considering reforms in all spheres of social protection, the majority of which would affect children or their parents. In particular, a unification of the welfare benefit system is being considered. In addition, raising the statutory retirement age is planned and privileges with respect to the use of municipal services are gradually being abandoned. As a result of all these reforms, social protection expenditures could be better targeted; the

number of children considered as needy will decrease but the benefits allocated to these children could increase.

26. Some private charitable organizations have emerged to improve social protection of children. These organizations are often led by women and many focusing on special interests such as those of handicapped children. The semi-private Bobek Foundation, for example, collects funds from the local business community to improve health and education services.

#### **D. Consequences for a Child Sensitive Strategy**

27. The Government has given priority to child development and family problems by establishing the Council for Women, Family and Demographic Problems under the President. The signing of the International Convention on Child Rights, one of the very few international conventions the Government has approved since independence, also indicates the importance assigned to child development.

28. The Bank, in its country operational strategy, targets improved human resource development as an essential part of its country assistance. Urgently needed investments in children during this transition period are necessary through activities in education, social protection, and labor market reform and development.

29. The Bank will actively cooperate with the newly formed Council for Women, Family and Demographic Problems under the President in order to increase the efficiency of its technical and financial cooperation. The Bank wishes to cooperate with selected private and voluntary sector initiatives focusing on child development and youth promotion, in order to strengthen new forms of public-private partnership in social protection, social services delivery, and education. In addition, the Bank will also promote sustainable development through environmental related social interventions. Issues of child development will be approached by the Bank in the following strategic sectors: (i) education, (ii) agriculture and industry, (iii) social services and infrastructure.

##### **1. Education**

30. The Bank has taken the lead among the international funding community in the education sector. As a result of the development of a sector study and Government efforts to develop a sector strategy for education, a number of important considerations have emerged to ensure that the specific needs of children are given priority consideration, including: (i) maintaining the high level of formal education, especially in rural areas; (ii) improving access to pre-school education and after-school care supplemented by nutrition and feeding programs; and (iii) promoting a public-private partnership, especially in pre-school education and after-school care.

##### **2. Restructuring the Economy: Programs in Agriculture and Industry**

31. In view of the limited of employment possibilities, particularly in rural areas and company towns, and the high percentage of out-of-school youth among the registered unemployed, there is a need to improve young people's chances to participate actively in the restructuring of the economy. In programs in agriculture and in industry, there is a need to provide young people with (i) training in business administration, (ii) special technical training

for newly emerging sectors such as in the services, (iii) programs in family enterprises and cottage industries, and (iv) an extension of public work programs for young people in order to provide work experience.

### **3. Improvements in Social Service and Infrastructure**

32. Children are severely affected by the closure of education facilities, by the deterioration in health care, and by increased real costs of transport and energy. Efforts to reverse the negative impact of the transition on children are particularly important at the local level to (i) more adequately identify beneficiaries; (ii) more efficiently plan, budget and manage social services facilities; (ii) supply affordable child-care facilities; and (iii) strengthen targeting of social assistance allowances and social protection programs.

33. In regard to infrastructure services, the Bank can act to support the fiscally sustainable provision of public utility services to social service facilities and to poor families. The lack of heating in winter and transport are the key problems affecting children's health and their access to rural schools. Public finance reforms at the local level to maintain utility services are particularly needed. In addition, Bank programs in the energy sector can be linked to improvements in the supply of heat to poorer families through the use of, for example, life-line tariff structures. Bank activities in the transport sector should consider the potential for improving school transport.

## ENVIRONMENTAL AND NATURAL RESOURCES

### A Introduction

1. Kazakstan has a surface area of 2.7 million square kilometers (272 million hectares), and is comparable in size to Western Europe or India.<sup>1</sup> The country extends 2,925 kilometers (km) in the east-west direction and 1,660 km in the north-south direction. Kazakstan is exceptionally well endowed in terms of its natural resources. The country contains large reserves providing for the production of coal, chrome, gold, lead, manganese, molybdenum, oil, phosphate, and tungsten.

2. Before independence, Kazakstan was a major source of mineral and agricultural resources for the former Soviet Union (FSU). However, Soviet industrial and agricultural practices used the natural environment beyond its assimilative capacity to absorb pollution or to regenerate renewable resources. Central planning failed to account for the environmental degradation of the land, water, and air resources. For instance, poor irrigation practices supporting extensive crop production schemes have caused salinization over wide tracts of arable land. Massive chemical and industrial complexes have polluted the air, soil, and water. The desiccation of the Aral Sea, the rise in level of the Caspian Sea, and massive desertification are all urgent concerns for the Government.

3. To facilitate the rehabilitation of the environmental resource base and to reduce environmental degradation, there is a need for strengthening of environmental agencies within the country. Specialists need to be trained for environmental impact assessment and data collection. Environmental laws need to be reformulated to reflect the new commitment to a market economy, and the air and water quality standards revised to reflect practical norms. While public and private commitment in the country to redress environmental problems is high, financial resources are limited.

4. The focus on sustainable human development within the Bank's strategic objectives requires that specific consideration be given to the environment. This Appendix highlights the major areas of concern within Kazakstan and outlines the strategies that will need to be adopted. The following sections detail (i) the current state of the environment, (ii) the implications for the environment of the new economic reforms, and (iii) strategies to protect the environment and to alleviate the environmental costs of the transition.

### B. The Current State of the Environment

5. The following discussion of the current state of the environment covers: (i) land and soil resources, (ii) water resources, (iii) issues concerning air pollution, and (iv) residual problems from extensive nuclear testing by the FSU. A common theme running through the separate sections is that the legacy of the FSU is one of institutions that did not provide for sustainable economic activity.

#### 1. Soil Resources: Limited Arable Land

6. The country extends across a very diverse set of geographical zones with 34 percent of the land being steppe or forest steppe, 22 percent desert or semi-desert, and 8

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<sup>1</sup> The material in this Appendix has, in many instances, been obtained from the ongoing work by the Bank for preparation of an updated environmental profile of Kazakstan.

percent high mountains. Only 13 percent of the territory is arable with approximately 6 percent of this irrigated (see Table 1). Forest covers only 3.6 percent of the country.

7. The country's position in the center of the Eurasian continent provides it with a generally arid climate. This is one reason that so little land is arable. The natural grassland in the north can be used for cereal production. The east and southeast parts of the country, that have higher and more reliable rainfall and good quality soils, can be used for intensive farming. The large areas of semi-arid pasture land in the center, south, and west of the country can, however, only be used for limited livestock production.

8. The vast country has very diverse natural and biological conditions. Because of the very low population, currently only 6.3 persons per square kilometer (km<sup>2</sup>), the natural diversity was relatively untouched until recently. However radical changes have taken place since the late 1950s, starting with the Virgin Lands Campaign in northern Kazakhstan which brought into cultivation huge areas of the former steppe, the construction of huge irrigation channels, and the establishment of large agro-industrial complexes.

9. The Virgin Lands Campaign initiated in 1954 aimed to achieve Soviet self-sufficiency in grain by bringing into cultivation land formerly used for extensive livestock grazing. Due to improper irrigation and land use, soil degradation has been extensive. Of the 187 million hectares (ha) of rangeland in Kazakhstan, approximately half are at risk of desertification. Topsoil loss is considerable and in many areas erosion may be irreversible. Excessive use of chemicals to control pests and promote crop growth and drainage has further adversely affected soil quality.

**Table 1: Land use in Kazakhstan, 1991**

Total Land Area (in million hectares)	271.7
Agricultural Land	197.6
Arable Land	35.5
Irrigated arable land	2.3
Meadows and pastures	162.1
At risk from wind and water erosion	88.0
Population total (million)	16.7
Population density (persons/sq. km.)	6.1

Source: World Bank, Food and Agricultural Policy Reforms in the Former Soviet Union-An Agenda for Transition

## **2. Endangered Water Resources**

10. Kazakhstan borders two of the largest inland seas of the world, the Caspian Sea and the Aral Sea, and contains many other large lakes such as Lake Balkash. Most of these water bodies have suffered degradation due to industrial pollution and water diversion. The sections below discuss (i) the irrigation systems which are important to the agriculture sector, but suffer from poor design and improper maintenance; and (ii) the Caspian and Aral Seas which have suffered considerable ecological damage.

**a. Irrigation: The Need to Increase Efficiency**

11. Kazakhstan's irrigation system seeks to move water over great distances from the southern part of the country to the north. The irrigation system is inefficient, poorly designed and maintained. As early as 1991, only 0.62 million ha of land, 26 percent of the total irrigated land, had a functioning drainage system. An additional 1 million ha needed significant restructuring or rehabilitation of the irrigation network. As a result, agriculture productivity suffers, there is substantial waste of water, and a loss of soil resources due to salinization and erosion.

12. Kzyl-Orda province near the Aral Sea provides an illustration of the general problems associated with inefficient water management. Before independence and the breakdown of the central planning system, the region, being mainly steppe land, provided 25 percent of the rice grown in the FSU. Intensive irrigation was practiced, in part to combat salinity. However, rice yields were quite low. Partly because of inadequate drainage, water logging affects 70-80 percent of the farmed area and the estimated overall water efficiency is only 28 percent.

**b. The Aral Sea: A Shrinking Body of Water**

13. The Aral Sea is considered to be one of the world's most serious ecological catastrophes. In 1960, the Aral Sea with 1,090 km<sup>2</sup> of surface was the fourth largest inland lake in the world. By 1989, the water level had fallen 14.3 meters from 53.4 meters, and the surface area had shrunk by 45 percent. Studies suggest that the Sea could disappear completely by 2010, if present trends continue. As a result of the shrinkage, the salinity of the water has increased three times and is now little different than that of sea water. Within recent history, other periods of declining water levels have been observed and there is still much that is not understood about the phenomena. It is, however, generally considered that the current problem is a result of massive water diversion throughout the region by Soviet central planners to feed large-scale irrigation systems and hydropower facilities. Water pollution from urban and industrial wastes are additionally damaging this important resource.

14. As a result of the shrinking of the Sea, the complex ecosystem of the region, including the two principal rivers (Amu Darya and Syr Darya), has been severely damaged. The fishing industry has nearly vanished. The access to potable water has fallen sharply. In several parts of the region the consumption of potable water per day is only 5 liters per person, a small fraction of the normal consumption elsewhere in the country. Sand and salt storms are present in many regions. The blowing salts from the exposed seabed present a clear health hazard to humans, animals, and crops.

15. As a consequence of these environmental problems, the health conditions in the Aral Sea region are extremely poor (see Table 2). The constrained public financial resources exacerbate the problem, limiting the provision of public health services and social assistance. By 1993, the incidence of chronic, non-infectious diseases was already approximately two times higher than the national average. Mortality rates, especially maternal and infant, are high and increasing.

16. The Republics in the Aral Sea basin have responded to the growing environmental problems by establishing an inter-governmental Coordinating Committee and two River Basin Commissions to monitor water use and quality, for data collection, and

analysis. The international funding community has responded strongly. Multilateral organizations such as the World Bank, the UNDP, and the EU and bilateral agencies such as USAID have provided considerable support. The overall strategic approach calls for (i) stabilization of the sea level; (ii) rehabilitation of some of the surrounding areas; (iii) strategic planning and management of the two major rivers, the Amu Darya and Syr Darya; and (iv) building institutions for planning and program implementation.

**c. The Caspian Sea: Imperiled by Flooding and Pollution**

17. Kazakstan also borders the Caspian Sea, one of the largest inland bodies of

**Table 2: Selected Health Indicators in the Aral Sea Region**

	1995
Incidence of Mortality (index 1970=100)	390
Incidence of Disease (index 1970=100)	
cancer of the esophagus	145
asthma and heart diseases	100
circulatory diseases (index 1991=100)	160
among children (index 1991=100)	520
anemia among children (index 1991=100)	300
anemia among women (percent of women)	70
anemia among pregnant women (percent)	50
Infant mortality rate in relation to average for country (percent)	131.7

Source: Ministry of Health, UNDP, UNICEF, World Bank, staff estimates

water in the world, along with the countries of Azerbaijan, Iran, the Russian Federation, and Turkmenistan. The protection of the region's environment and the management of the resources are hampered by political difficulties. As a result, there is a growing problem of pollution. In addition, the Caspian Sea has been subject to flooding which has resulted in severe economic and social costs in the low-lying coastal regions.

18. Concerning pollution, reports indicate that between 1981 and 1990, oil-based pollution in the Caspian Sea increased 25-30 times. Since the early 1980s, the presence of copper in the waters of the Sea has increased by 11.5 times, zinc by 9.8 times, cadmium 4.9 times and lead 5.6 times. Serious problems result from the dumping or spillage of oil and petrochemicals from the oil fields, transport facilities, and refineries. In addition, neighboring Azerbaijan is the source of highly polluted municipal wastewater.<sup>1</sup>

19. Compounding the problem of surface pollution, the Caspian Sea is reversing the more than three meter fall in level which occurred in the 1940s. The nearly three-meter rise in the last several years has flooded industrial estates, domestic establishments, farms and oil production facilities that were built in the last 50 years on the previously exposed lake bed. The natural consequences of the rise are higher groundwater levels, salinization of soils in some areas and damage to man-made structures. The main cause for the variation is not well

<sup>1</sup> Water pollution is common to other bodies of water in Kazakstan. Lake Balkash and the Irtys and Ili rivers, for example, suffer from copper, zinc, cadmium and arsenic pollution from industrial processing centers.

understood but said to be related to increased runoff from the major Uralsk and Volga river catchments.

### **3. Air Pollution: An Urban, Industrial Problem**

20. The large industrial centers established in Kazakstan by Soviet planners are characterized by significant levels of air pollution. Of the urban and industrial pollutants air contamination through soot, dust, and fly ash seem to be the greatest concern. Industrial towns such as Shymkent, Karaganda, or Pavlodar routinely experience air pollution at levels that are several times the maximum allowable levels. In addition, fly ash as a residue of district and individual space heating is a problem in smaller towns in the winter.

### **4. Nuclear Radiation**

21. Between 1949 and 1989, some 490 nuclear tests were conducted in the Republic, including 26 above-ground tests, 87 atmospheric tests, and 354 underground tests. The available data show that there is no longer a general health risk from radiation in Kazakstan as a whole. There remains, however, a 13 square kilometer area near the Semipalatinsk testing range which still registers radiation above ambient soil and air levels. An official study of 10,000 people who had been exposed to this testing showed cancer and mortality rates 30-40 per cent higher than among those who had not been exposed. Negative health effects from past testing may well continue to affect future generations as a result of genetic damage. The area around Semipalatinsk has been declared by the President to be an ecological disaster area and the Government has committed itself to providing financial compensation and relocation to the most severely affected populace. Another area of concern stems from the improper management and transport of nuclear waste material.

## **C. Environmental Issues for the Current Transition Period**

22. There is a wide range of environmental issues that will have to be addressed as Kazakstan makes the transition to a market economy. The general thrust of the reform program provides, on balance, a shift towards a sustainable development path. Price liberalization, enterprise restructuring, and the institution of regulatory agencies, encourage more efficient use of energy and materials and should improve environmental performance. The elimination of the subsidies, both implicit and explicit, that supported much of the energy-intensive heavy industry during the Soviet period will do much to reduce the widespread environmental damage. The broader reform agenda aims at economic pricing of natural resources and also will help to reduce pollution as farms and enterprises are called upon to face the full cost of environmental damage.

### **1. Pollution from Industry**

23. The transition period poses serious challenges to the Government in successfully implementing environmentally supportive reforms. The country has large mining, chemical, metallurgical, and coal industries characterized by relatively low levels of technology and a costly impact on the environment. Soviet industry was typically wasteful in the use of natural resources, producing severe air and water pollution, and was negligent in the disposal of solid wastes. These industries have experienced sharp output contractions as the old Soviet system, which linked Kazak facilities to other parts of the broader Soviet economy, has not yet been replaced with new production and marketing arrangements. The output contraction itself

has lowered the level of pollution, but this is an unsatisfactory solution to environmental problems. Within the program of reform and restructuring there is simply no substitute for investment in new technology, both to allow firms to reach new markets and to shift to production techniques with less detrimental impact on the environment. One hopeful sign, is that enterprise reforms are encouraging joint ventures with companies from non-FSU countries. These companies have access to new technology which can reduce industrial pollution at the same time that productivity is increased.

## **2. Problems in Agriculture**

24. The transition has had a major impact on agriculture with important implications for the environment. As with industry, the current contraction in output has reduced the impact on the environment. The breakdown of the supply relationships of the FSU markets has, for example, reduced the use of fertilizers and agrochemicals. In 1995, it was estimated that only 36,000 tons of inorganic fertilizers were used on 0.3 million hectare of agricultural land, compared to 665,000 tons on 9.2 million hectare before independence. Before 1990, about 18 million hectares of land were treated with herbicides and pesticides; in 1995 the use of these chemicals in agriculture was insignificant.

25. The reduction in deleterious activities because of a fall-off in national output, however, cannot be the basis for protecting the environment. The basis for protecting the environment must be found in a sustainable restructuring of farming and farm-related activities. Important issues concern the (i) use of agrochemicals, (ii) soil conservation, and (iii) pricing of water and the maintenance of the irrigation systems.

26. As noted, the use of agrochemicals has declined to negligible levels with the current fall-off in production. This has sharply reduced yields and is not, on balance, desirable. Comprehensive standards on the use of agrochemicals and a set of institutions that can monitor and enforce these standards are required. As in so many other areas of reform, the capacity of local level government agencies will be crucial to the eventual success of the transition.

27. Soil conservation involves a number of different problems. Soil resources suffer from erosion, improper chemical use, and poor water management. Erosion is common especially with the land brought under cultivation in the 1950s Virgin Land Campaign. Much of the former steppe land brought into cultivation for grain production suffered from improper land use and poor water management—much soil was simply blown away by wind once the natural cover was removed. Inadequate water management, lack of appropriate crop rotation, and improper use of agrochemicals resulted in further damage.

28. The key to reversing the serious soil degradation lies in proper farm restructuring. Incentives must be provided for farms to move towards sustainable agricultural practices. Moreover, farm support services must be in place. Farm establishments need access to technical assistance, perhaps through extension workers. Market-based credit also needs to be available to allow for the proper husbanding of resources including those of the soil.

29. Improved water management is an essential part of restructuring the agricultural sector to support sustainable development. At present, farmers pay only a negligible share of the costs for water, drainage, and the restoration of environmentally damaged resources. Despite the introduction of the water code in 1993, water for irrigation and household

consumption purposes is basically free. In mid-1995, the Committee on Water estimated that the price for maintaining the country's huge water infrastructure system was T200-300 per cubic meter, whereas the Government was able only to charge rates averaging T1.24 per cubic meter. These rates are, however, considerably higher than the nominal rates charged in previous years. Higher water rates are, however, only one element of the overall package of reforms that is needed, including (i) a rationalization of the existing water allocation systems, (ii) a proper decentralization of the responsibility for maintaining water systems, and (iii) investments in rehabilitation and improvements.

### **3. The Need for Improved Urban Management**

30. The counterpart to improvements in the environmental practices of the newly emerging private sector in industry and agriculture is analogous changes in the institutional behavior of the public sector. One important area concerns the provision of social infrastructure. Public authorities are either directly responsible for social infrastructure or are responsible for regulating privately owned utility companies.<sup>1</sup> Public authorities are therefore ultimately accountable for provision of basic services in such area as urban water supply, sanitation, and power generation—services that have great impact on the environment.

31. Under the Soviet system, the provision of public utility services was through communally organized systems supported by various inter-linked subsidies from the large state farms and industries. These formerly communal systems are now the responsibilities of local governments. These systems are important elements in the provision of social infrastructure and their proper function is crucial to the development of improved environmental protection. A survey at the beginning of the 1990s revealed, for example, that of nearly 1,200 major industrial enterprises in the country discharging wastewater through the communal system, less than one half had functioning pre-treatment facilities. Since independence, farms and enterprises no longer can subsidize these essential communal services, but most local governments have yet to develop sufficient alternative revenue sources. The situation is especially severe in the company towns and in the rural areas.

32. One barrier to adequate resource mobilization for environmental infrastructure such as water supply is the long tradition of providing these services to households either free of charge or for nominal fees. In some cases, due to lack of concern for service billing, there is inadequate metering, for instance for district heating. As a consequence, there is little incentive for conservation and inadequate revenue flow to the utility which hampers maintenance efforts and the introduction of new technologies. Reversing this situation is a long-term process, especially given the current conditions of growing poverty and falling income. Price reforms for services will be held back also by the lack of public sector experience in working with market-based prices and the absence, in many cases, of effective regulatory institutions.

### **4. An Unfinished Reform Agenda**

33. Beyond the specific issues in industry, agriculture, and municipal services, several general sets of problems need addressing: (i) the assignment of responsibility for remediation of existing environmental problems; (ii) the reduction of ongoing polluting

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<sup>1</sup> Until recently, all public utilities were publicly owned. However, in mid-1996, the Government embarked on an accelerated privatization program that resulted in the transfer of some power and district heating utilities and some water utilities to private investors.

activities; and (iii) developing the institutional capacity to design, monitor, and enforce environmental regulations.

34. Dealing with liability for existing environmental problems is particularly difficult. State-owned firms under the FSU were responsible for improperly managed solid and liquid waste disposal sites. However, responsible firms are either no longer operating or are incapable of absorbing the cost of potential clean-up. A large number of problems exist: (i) the legal basis for apportioning responsibility is ill-defined, (ii) the capacity of the State or enterprises to pay for existing damage is quite limited, (iii) valuation principles are not generally accepted, and (iv) the institutional capacity of public agencies charged with protecting the environment is limited. It is important to make some progress on this issue: the failure to develop clear guidelines on apportioning environmental liability could delay privatization or discourage new investment in privatized firms.

35. The issues surrounding the more visible problem of reducing ongoing pollution are no less challenging. The Government has accepted the general set of principles that (i) realistic environmental standards should be set; (ii) public agencies should have the responsibility of monitoring and enforcing these standards; and (iii) in the case of violations, the polluter should pay according to a viable and economically rational set of charges. Although conceptually clear, the implementation of this arrangement will take time. Currently, for example, the fine and fee rates for violating emission standards are very low, partly due to high inflation. Consequently, local charges do not reflect full economic costs of environmental damage and there is no certainty that minimum environmental standards will be met. A compounding factor, flowing from Soviet practices, is that emission standards are often unrealistically stringent and unrelated to economic principles. Compliance is therefore extremely difficult and could prove burdensome as output begins to recover. Public institutions lack the technical expertise, the legal authority, and the budgetary resources to enforce compliance with environmental standards. Much of the responsibility for environmental protection must rest with local authorities and here the needs for institutional strengthening are large.

36. Responsibilities for the design, monitoring, and enforcement of environmental regulations are currently fragmented among various institutions. As a consequence, for example, data on environmental problems vary in quality and coverage. For instance, the monitoring of wastewater discharge and air pollution emission monitoring for industry is almost totally lacking, as the Soviet system relied upon self-monitoring. Local government agencies generally lack portable monitoring equipment and have difficulties documenting non-compliance and enforcing industrial air and water quality standards. Where fixed monitoring stations exist, equipment breakdown and lack of budgets hinder routine monitoring. For example, industrial wastewater discharge in Almaty is monitored only for a few select parameters by the Ministry of Ecology. The Ministry does not possess any portable monitoring equipment to enforce environmental standards compliance.

## **D. Strategies for Environmental Protection**

### **1. The Legal Structure for Environmental Protection**

37. Six major environmental laws have been passed since 1990. The legal framework provides general direction, but has yet to adequately address the regulatory needs. The six main laws are: (i) Environmental Protection in the Kazak SSR, 1991; (ii) The Land

(Agrarian) Code of the Kazak SSR, 1990; (iii) Protection, Reproduction and Use of the Animal World, 1993; (iv) Forestry Legislation for the Republic of Kazakhstan, 1993; (v) Water Legislation for the Republic of Kazakhstan, 1993; and (vi) Processing Mineral Resources, 1992.

## **2. Key Donor Programs**

38. Many of the international funding agencies have active programs to assist the Government in addressing environmental problems (see Table 3). Many have chosen to tackle the more serious problems, such as those concerning the Aral Sea. The World Bank, UNDP, and EU have large programs directed at reversing the environmental degradation of the Aral Sea region. These programs are supported by a large number of bilateral funding agencies such as the United States Agency for International Development (USAID).

39. The World Bank also provides assistance to other efforts by the Government in environmental protection. Of the \$38 million credit which the World Bank is providing to assist transition \$1 million, for example, is earmarked as a TA Loan to the Ministry of Ecology for institutional support. In addition agriculture projects target water management and the improvement of irrigation.

40. The European Bank for Reconstruction and Development (EBRD) has a number of projects concerned with natural resource use, especially in mining and energy. Environmental improvements are expected through technology transfer.

41. In addition to its active involvement in Aral Sea activities, the UNDP is also involved in the clean-up of radioactive "hot spots" and in water quality management in the Caspian Sea, with emphasis on flood management and the control of industrial pollution.

42. USAID has a comprehensive environmental program with a regional focus. The program has three large components: (i) the development of an Aral Sea Basin Plan; (ii) the Environmental Policy and Technology (EPT) Project for enterprises; and (iii) a program of training, public awareness, and participation in environmental management implemented principally through NGOs and local communities.

## **3. Scope for Bank Involvement**

43. The Bank follows an integrated approach to incorporating environmental issues directly in its operational activities. A summary of the proposed activities is given below:

- (i) irrigation and water management will be advanced in the Bank's agriculture sector projects;
- (ii) in industry and enterprise reform activities, the Bank will encourage the transfer of technology to reduce pollution;
- (iii) the improvement of municipal services will directly target the capacity of local governments to protect the environment, through, for example, better waste management; and
- (iv) an agenda in energy that promotes increasing efficiency, reductions in pollution, encourages conservation, and provides support for the development of regulatory institutions.

**Table 3: Summary Of Aid Activities In The Environment**

<b>Area of Focus</b>	<b>Existing External Support</b>
Aral Sea Basin	Germany Sweden World Bank UK UNDP USAID
Caspian Sea	UNDP
Industry and/or Agriculture	EBRD USAID World Bank
Institutional Support and Capacity Building	Germany UK UNDP USAID World Bank
Lake Balkash Basin	UK
NGO participation	UNDP USAID
Radioactive Waste Management	UK UNDP
Waste water treatment	France Germany Great Britain

Note: The categories used do not always correspond with the structure used by the specific funding agencies. The table does not include the Bank's activities.

The Aral Sea project is supported by more than ten bilateral programs.

44. As described above, many important areas are already being addressed by the assistance program of other multilateral or bilateral agencies. Given the Bank's limited financial resources, there is no immediate advantage to seeking active involvement in such programs as those relating to the Aral Sea. The Bank will, however, continue to closely monitor the activities of the other funding agencies.