



# Country Partnership Strategy

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## Kazakhstan 2012–2016

This document is being disclosed to the public prior to Board consideration in accordance with ADB's Public Communications Policy (2011). Subject to any revisions required following Board consideration, this document is deemed final.

Asian Development Bank

## **CURRENCY EQUIVALENTS**

(as of 1 August 2012)

Currency unit	–	tenge (T)
T1.00	=	\$0.00667
\$1.00	=	T149.98

## **ABBREVIATIONS**

ADB	–	Asian Development Bank
CAREC	–	Central Asia Regional Economic Cooperation
COBP	–	country operations business plan
CPS	–	country partnership strategy
CSP	–	country strategy and program
EBRD	–	European Bank for Reconstruction and Development
GDP	–	gross domestic product
GNI	–	gross national income
IED	–	Independent Evaluation Department
IFC	–	International Finance Corporation
KEEP	–	knowledge and experience exchange program
LPI	–	logistics performance index
MDG	–	Millennium Development Goal
SMEs	–	small and medium-sized enterprises
TA	–	technical assistance
UNDP	–	United Nations Development Programme

## **NOTE**

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

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## COUNTRY AT A GLANCE

<b>Economic</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
GDP (\$ billion, current)	104.8	133.4	115.3	148.1	186.2
GDP per capita (\$, current)	6,626.3	8,570.6	7,251.6	9,253.1	11,494.0
GDP growth (% , in constant prices)	8.9	3.3	1.2	7.0	7.5
Agriculture	9.7	(6.1)	13.8	(11.6)	26.7
Industry	9.2	2.7	(0.3)	9.6	3.5
Services	12.8	4.7	(0.2)	7.1	7.7
Gross domestic investment (% of GDP)	35.5	27.5	28.1	22.1	...
Gross domestic saving (% of GDP)	27.6	32.2	25.8	27.2	...
Consumer price index (annual % change)	10.8	17.3	7.3	7.1	8.3
Liquidity (M3) (annual % change)	25.9	35.3	19.5	13.3	15.0
Overall fiscal surplus (deficit) (% of GDP)	(1.7)	(2.1)	(2.9)	(2.4)	(2.1)
Merchandise trade balance (% of GDP)	14.4	25.1	13.0	19.5	25.1
Current account balance (% of GDP)	(7.9)	4.7	(3.5)	2.0	7.3
External debt service (% of exports of goods and services)	49.0	41.7	63.2	32.4	...
External debt (% of GDP)	92.4	80.9	98.2	80.5	66.5
<b>Poverty and Social</b>					
Population (million)	15.9	[2009]	16.0	[2010]	
Population growth (annual % change)	1.6	[2009]	1.3	[2010]	
Maternal mortality ratio (per 100,000 live births)	59.0	[2000]	38.0	[2009]	
Infant mortality rate (below 1 year/per 1,000 live births)	38.0	[2000]	25.6	[2009]	
Life expectancy at birth (years)	65.5	[2000]	68.4	[2010]	
Adult literacy (%)	99.5	[1999]	99.7	[2009]	
Primary school gross enrollment (%)	105.2	[2005]	108.4	[2009]	
Child malnutrition (% below 5 years old)	...		...		
Population below national poverty line (%)	46.7	[2001]	6.5	[2010]	
Population with access to safe water (%)	77.0	[2000]	86.0	[2010]	
Population with access to sanitation (%)	73.0	[2000]	81.0	[2010]	
<b>Environment</b>					
Carbon dioxide emissions (million tons)	246.1	[2010]			
Carbon dioxide emissions per capita (tons)	14.2	[2010]			
Forest area (million hectares)	3.3	[2010]			
Urban population (% of total population)	53.7	[2010]			
<b>ADB Portfolio</b> (sovereign loans, as of 31 December 2011)		<b>OCR</b>	<b>ADF</b>	<b>Total</b>	
Total number of loans		7	-	7	
Net loan amount (\$ million, cumulative)		1225.3		1225.3	
Disbursements					
Total funds available for withdrawal (\$ million)		846.4		846.4	
Disbursed amount (\$ million, cumulative)		406.9		406.9	
Percentage disbursed (disbursed amount/total available)		48.1		48.1	

... = not available, ( ) = negative, [ ] = latest year for which data are available, ADB = Asian Development Bank, ADF = Asian Development Fund, GDP = gross domestic product, M3 = broad money, OCR = ordinary capital resources.  
Sources: ADB. 2011. *Basic Statistics*. Manila; ADB. 2011. *Asian Development Outlook 2012*. Manila; United Nations. 2011. United Nations Data Online; United Nations. 2011. *State of the World's Forests 2011*; United Nations Data Online; and World Bank. 2011. World Development Indicators. <http://data.worldbank.org/data-catalog/world-development-indicators>.

## I. DEVELOPMENT TRENDS AND ISSUES

### A. Country Background

1. **Progress.** Kazakhstan is an upper middle-income country.<sup>1</sup> Its per capita gross national income (GNI) of \$8,220 in 2011 was above the income threshold of the policy for graduation of developing member countries of the Asian Development Bank (ADB) from ordinary capital resources assistance.<sup>2</sup> Its investment grade rating provides it with access to international capital markets. Kazakhstan is ranked as “high human development” on the human development index.<sup>3</sup> By 2010, the percentage of its population living below the poverty line had fallen to 6.5% from 31.8% in 2000.<sup>4</sup> It has consequently met its poverty reduction target under the Millennium Development Goals (MDGs) and has achieved gender equality and primary education targets.<sup>5</sup> During the proposed country partnership strategy (CPS) period, ADB will dialogue with the government on the issue of future graduation from ADB’s regular assistance.

2. **Prospects.** Kazakhstan’s prospects are strong. It has abundant oil, gas, and mineral reserves. It also has a forward-looking development strategy that focuses on industrialization and diversification of the economy. It has a vast arable area for agriculture. A young and educated population supports its economic future, and its strategic location provides a land bridge between Europe and Asia. Kazakhstan is transforming from a landlocked to a landlinked country, building an affluent and modern state, and it occupies a prominent position on the global stage. It needs to accelerate and expand its economic and social progress to become a high-income developed country by the end of this decade.

3. **Challenges.** The global financial crisis of 2008–2009, which interrupted Kazakhstan’s growth, was a reminder of the need to sustain gains of the past to improve prospects for the future. It also brought to light the importance of strengthening institutions and implementing reforms in the financial and other sectors. The present European debt crisis and chances of renewed global recession could adversely impact Kazakhstan’s economy through financial contagion and/or impact on oil prices. This risk reinforces the need for Kazakhstan to diversify its economy and reduce its dependence on oil and other extractive minerals (these comprised 22% of gross domestic product [GDP] and 63% of exports in 2010). To diversify, the productivity and competitiveness of the economy have to be increased.<sup>6</sup> Kazakhstan’s productivity level is still low by developed countries’ standards (one-third of the levels of the Republic of Korea and Japan and one-fourth of the United States level).<sup>7</sup> Higher productivity will prevent a possible growth slowdown and help Kazakhstan transcend its middle-income country challenge.

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<sup>1</sup> World Bank. World Development Indicators Online. <http://data.worldbank.org/country/kazakhstan> (gross national income [GNI] Atlas method). The GNI per capita figure is different from the gross domestic product (GDP) per capita figure because (i) a difference exists in the coverage of GDP (domestic production) and GNI (total income of citizens, including from abroad) concepts; and (ii) the GNI Atlas method applies a special conversion factor to the official exchange rate for GNI estimation.

<sup>2</sup> ADB. 2010. Classification and Graduation of Developing Member Countries. *Operations Manual*. OM A1/BP. Manila. This states that graduation from ordinary capital resources assistance normally happens within 5 years after the country crosses the income threshold for graduation. Kazakhstan crossed this threshold in 2010.

<sup>3</sup> United Nations Development Programme (UNDP). 2010. *Human Development Report 2010*. New York.

<sup>4</sup> Government of Kazakhstan. Agency of Statistics. <http://www.eng.stat.kz/>

<sup>5</sup> UNDP. 2010. *Millennium Development Goals in Kazakhstan*. Astana.

<sup>6</sup> ADB. 2011. *Kazakhstan’s Twin Development Challenges: Economic Diversification and Avoiding the Middle Income Trap*. Central and West Asia Department (unpublished).

<sup>7</sup> Government of Kazakhstan. 2010. *Government Program on Accelerating Industrial-Innovative Development of the Republic of Kazakhstan, 2010–2014*. Astana.

4. A modernized infrastructure base is strongly correlated with economic diversification and higher growth.<sup>8</sup> Ranked 86th out of 155 countries on the 2012 logistics performance index (LPI), Kazakhstan needs to catch up to the infrastructure standards of other developed or fast-developing countries, such as the Republic of Korea (ranked 21st), the People's Republic of China (26th), Malaysia (29th), and new European Union countries such as Poland (30th) and Slovenia (34th).<sup>9</sup> Strong public sector investments are needed to modernize the infrastructure base, as the private sector's investments alone will be insufficient to meet this challenge. Despite its impressive growth and poverty reduction, regional and rural–urban disparities within Kazakhstan remain significant. More jobs also need to be created. These are crucial for inclusive growth. Growth and industrialization need to be underwritten by strong governance and environmental sustainability, achievement of health-related MDGs, and the mitigation of greenhouse gas emissions that contribute to global warming.

5. The private sector will ultimately lead transformation of the economy by increasing productivity and diversity via innovation and entrepreneurship. For this to happen, a sustained improvement in the business environment to promote greater private investment is needed. This is a key issue for Kazakhstan as it rationalizes the role of the public sector and expands the private sector to attain its growth objectives. These challenges together constitute the rationale for ADB's engagement with Kazakhstan under the proposed CPS.

## B. Economic Assessment and Outlook

6. **Economic assessment.** Aside from the 2 years of the global financial crisis, Kazakhstan has remained a strong growth performer with an average growth rate of 8.8% since 2005. In 2010 and 2011, its economy rebounded sharply after the crisis to grow by over 7%. High growth in the country has been propelled by oil, gas, and mining, and a robust services sector. Oil revenues provide support for the fiscal and external account balances. These revenues have resulted in a significant buildup of the oil fund (the National Fund of the Republic of Kazakhstan) and have boosted foreign reserves—together these totaled over \$72 billion in 2011. Annual transfers from the oil fund to the budget, capped at \$8 billion annually, will increase by \$1.2 billion in 2012 and 2013 to support expanded public investments.

7. **Impact of global financial crisis.** The global financial crisis, coupled with lower external demand and tumbling oil prices, disrupted economic activity in Kazakhstan. Growth faltered, fiscal and external account surpluses turned into deficits, and the financial sector witnessed an increase in nonperforming loans. The government responded with an anti-crisis program comprised of fiscal and monetary policy measures, and a bailout package for the banking sector. Besides reviving the economy, the program helped restructure the banking sector. Tax disincentives that were impeding write-off of bad loans were reduced through a new law passed in December 2011. However, nonperforming loans remain very high (about one-third of the total asset portfolio), credit to the private sector remains weak, and the financial sector's regulatory framework needs significant strengthening.

8. **Macroeconomic outlook.** Kazakhstan expects to sustain its growth over the medium term based on an expanding oil and gas sector, and public and private investments to support economic diversification. Oil production will grow to 95 million tons by 2015 from 72 million tons in 2011.<sup>10</sup> The services sector is also expected to grow robustly. However, recessionary global

<sup>8</sup> S. Straub and A. Terada-Hagiwara. 2010. *Infrastructure and Growth in Developing Asia*. ADB Economics Working Paper Series, No. 231. Manila: ADB.

<sup>9</sup> World Bank. 2012. *Logistics Performance Index*. <http://lpiurvey.worldbank.org/international/global/2012>

<sup>10</sup> Economic Intelligence Unit. 2011. *Kazakhstan Country Report*. London (May).

conditions leading to lower oil prices represent a downside risk to Kazakhstan's prospects. To mitigate this risk, the government needs to maintain public investments to protect growth and develop close collaboration with the private sector to accelerate economic diversification.

9. Kazakhstan's fiscal situation is expected to remain stable, assuming oil revenues remain strong. The non-oil deficit will further shrink as tax administration improves and non-essential expenditures are restrained. The current account will remain in surplus as higher oil production and economic diversification boost oil and non-oil exports. Inflation is expected to remain in single digits backed by an appropriate monetary policy stance, although vulnerabilities exist because of continued volatility in global commodity prices.

### C. Highlights of Previous ADB Country Strategy

10. **Previous country strategy and program.** The country strategy and program (CSP) for Kazakhstan, 2004–2006 supported (i) economic growth, (ii) human development, (iii) environmental management, and (iv) regional cooperation.<sup>11</sup> The premise of the strategy was that Kazakhstan needed external assistance to (i) reduce its dependence on the oil sector, and (ii) accelerate progress on the MDGs. As Kazakhstan was benefiting from an oil boom and had a comfortable fiscal position, the CSP proposed modest annual public sector assistance of \$50 million. Even so, the strategy recognized the risk associated with the government's uptake of this assistance as a surge in oil revenues would reduce the need for external borrowing.

11. **Assessment of performance.** The CSP's priorities were consistent with the government's development program. But the government did not utilize sovereign assistance offered under the CSP during 2004–2006, as oil output remained steady and prices high. However, Kazakhstan availed of private sector assistance, and five operations for a total of \$375 million were approved in 2006–2007. The results were mixed. Two loans defaulted and had to be restructured, two were fully repaid, while one is being repaid. Although adequately administered, the performance of ongoing public sector projects during the CSP period was affected by delays and cost overruns (for reasons explained in para. 42). Based on these considerations, a final review report rated the Kazakhstan CSP's performance *partly satisfactory*.<sup>12</sup> A report of the Independent Evaluation Department (IED) validated this assessment.<sup>13</sup>

12. **Lessons learned.** Lessons for the new CPS include the following: (i) recognize Kazakhstan's differentiated needs to design a demand-driven assistance strategy and be flexible and adaptive to changing country circumstances, (ii) institute regular policy dialogue with the government on critical development issues, (iii) understand that the strategy cannot rely just on providing finances—it has to deliver value addition to support Kazakhstan's development, (iv) the strategy needs to prioritize nonsovereign and public–private partnership (PPP) modalities, and (v) synergy with other development partners needs to be developed. The IED report supported these lessons and suggested defining a low-lending scenario that emphasizes knowledge products and policy advisory support, renewing focus on regional infrastructure, improving the enabling environment for private sector development and PPPs while increasing synergies between public and private sector operations, and rethinking relations with Kazakhstan as an upper middle-income country.

<sup>11</sup> ADB. 2003. *Country Strategy and Program: Kazakhstan, 2004–2006*. Manila.

<sup>12</sup> Country Partnership Strategy Final Review (accessible from the list of linked documents in Appendix 2).

<sup>13</sup> Country Partnership Strategy Final Review Validation (accessible from the list of linked documents in Appendix 2).



## II. THE COUNTRY STRATEGY

### A. Government National Strategy

13. **Highlights.** Kazakhstan in 1997 adopted a 2030 strategy to raise the standard of living of citizens through economic growth, social and infrastructure development, and promoting domestic stability. A strategic plan of development of Kazakhstan until 2020 was adopted in 2010.<sup>14</sup> This plan was conceived in the backdrop of the global financial crisis. It focuses on (i) post-crisis development, (ii) accelerated economic diversification, (iii) access to social services, and (iv) a stable external environment for development. To ensure successful implementation, the plan pledges enhancing the effectiveness and accountability of government institutions.

14. Economic diversification is a key aspect of the Government's development strategy. It is being led by a program for accelerated industrial development for 2010–2014 (industrialization program).<sup>15</sup> This program recognizes the continuing role of the oil sector in the economy. But it focuses on developing nontraditional new industry and service sectors that afford the greatest possibility for diversification. The program's goals include a rise in the shares of manufacturing in GDP and non-commodity exports in total exports, reduced transportation costs, and lower energy intensity. An estimated \$50 billion (most of which is to be financed by Kazakhstan) is planned to be spent on infrastructure and industrial development during 2010–2014 to realize these goals. Nevertheless, economic diversification needs to be accelerated, even though some progress is reported. The share of manufacturing in GDP increased to 12.4% in 2011 from 11.3% in 2010. To support the industrialization program, 609 new projects were under way (as of December 2011), mostly in the private sector.

15. **ADB's Strategy 2020.**<sup>16</sup> Strategy 2020 is consistent with the government's 2020 plan and the industrialization program. It commits ADB to support growth through investments in sectors such as transport and energy—the government's strategy flags these sectors as critical to its industrialization program. Private sector development and knowledge solutions, identified as key drivers of change in Strategy 2020, are also important pillars of the government's strategy. Strategy 2020's emphasis on regional integration resonates with the government's objective of securing a stable external environment for development.

16. **Ongoing support.** ADB's support is helping Kazakhstan upgrade its transport network along the Central Asia Regional Economic Cooperation (CAREC) transport corridors and strengthen its regional trade and transport links. Support for increasing access to finance for small and medium-sized enterprises (SMEs) is helping create businesses and jobs. ADB's knowledge support in areas of energy efficiency and logistics improvement has helped the government find innovative solutions to important development challenges.

17. **Role of other development partners.** The European Bank for Reconstruction and Development (EBRD) supports Kazakhstan's diversification strategy, financial restructuring, capital markets, and infrastructure. The International Finance Corporation (IFC) fosters private sector-led growth through advice and investments in the financial sector, manufacturing, and agribusiness. The World Bank supports a Joint Economic Research Program, cofinanced by the government, besides assisting governance, infrastructure, and social sector development. The European Union supports economic reforms, health, and vocational education. The Islamic

<sup>14</sup> Government of Kazakhstan. *Kazakhstan 2020 – new social turn*. <http://egov.kz/wps/portal/>.

<sup>15</sup> Government of Kazakhstan. 2010. *Government Program on the Accelerated Industrial-Innovative Development of the Republic of Kazakhstan, 2010–2014*. Astana.

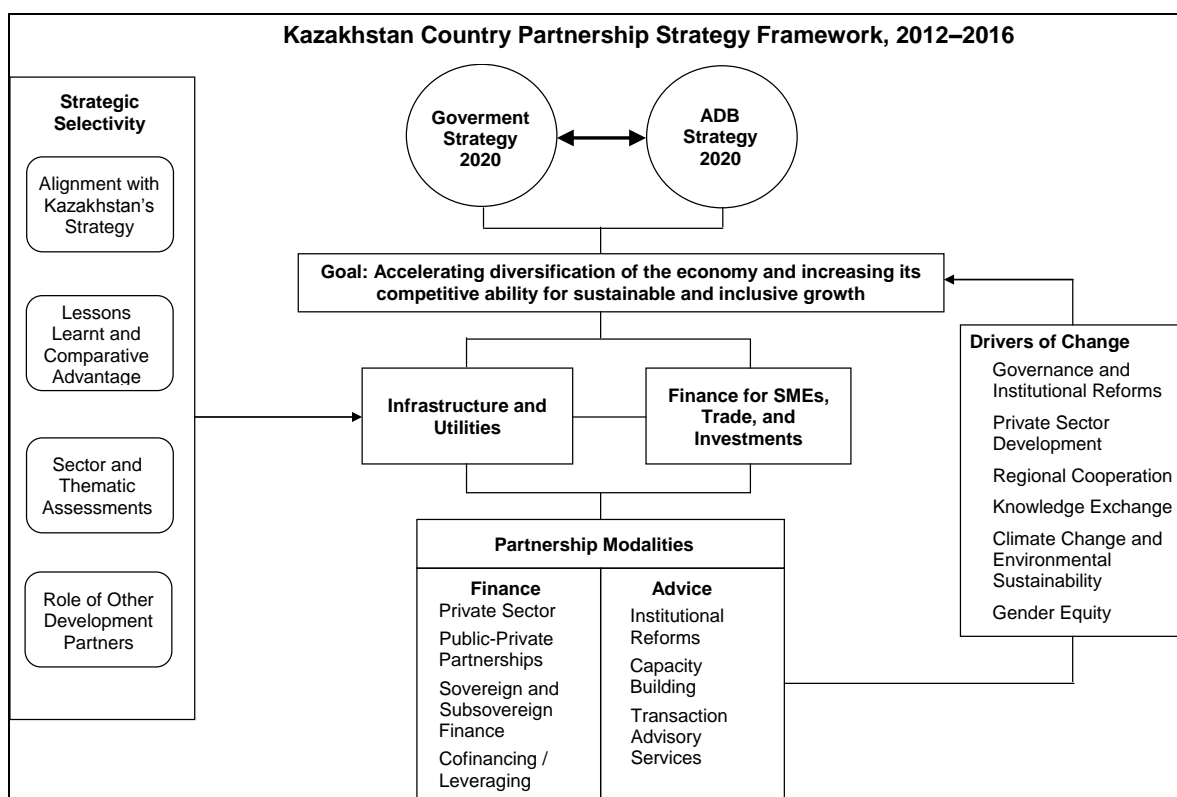
<sup>16</sup> ADB. 2008. *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank, 2008–2020*. Manila.

Development Bank provides project finance through its public and private sector windows. The United Nations program supports achievement of the MDGs, energy efficiency, and environmental sustainability. Bilateral partners including Japan and the United States provide capacity enhancement support. In the absence of a formal development partners' coordination mechanism, informal meetings at heads of agencies and technical levels are regularly held. Sector and thematic working groups of development partners also meet regularly.

## B. ADB Country Strategy

18. **Goal.** The CPS supports Kazakhstan's goal of accelerating the diversification of the economy and increasing its competitive ability for sustainable and inclusive growth (figure).

19. **Emphasis on value addition.** The emphasis of the CPS is on adding value to the government's development priorities and their implementation. To this end, ADB will support capacity development, knowledge building, and policy dialogue through technical assistance (TA) and other means to promote economic diversification and private sector development. Lending support to the public sector will be selective, depend on demand, and focused on areas where private sector financing is not available. Subsovereign and nonsovereign finance will over time become the main support modalities. However, this will require significant improvements in the operating climate for the private sector, including a more predictable policy and decision-making environment (para. 29).



ADB = Asian Development Bank; SME = small and medium enterprise  
Source: Asian Development Bank.

20. **Premise and focus.** The CPS recognizes Kazakhstan's differentiated needs as an upper middle-income country, and embeds lessons learned from ADB's previous country strategy. In selecting sectors for assistance, the CPS builds on ADB's comparative advantage

and ongoing operations, aligns with the government's strategy and ADB's Strategy 2020, and develops synergy with other development partners. The CPS introduces a sharpened operational focus on two key areas to support diversification and industrial development: (i) modernizing infrastructure and utilities while seeking innovative and flexible solutions to narrow investment and viability gaps; and (ii) improving access to finance for SMEs, trade, and investment in infrastructure through PPPs. Governance and institutional reforms, private sector development, regional cooperation, knowledge exchange, climate change and environmental sustainability, and gender equity are the main drivers of the CPS.

21. **Infrastructure and utilities.** The CPS builds on ADB's experience to support rehabilitation and development of infrastructure and utilities, with a focus on transport, energy, and municipal services sectors. This will help infrastructure and utilities become operationally efficient and adopt a quality of service delivery orientation, improve the business environment, and create opportunities for the private sector. Such support will be based on policy and transactions advice, institutional and sector governance reforms aimed at fuller cost recovery, capacity building, and knowledge services. Selective project support will be provided for highly visible projects with strong demonstration impacts. Such support could be through loans, guarantees, and other structured products that target select risks, achieve leverage to catalyze further investments, and help mobilize local currency finance through the development of municipal and project bond markets.

22. **Transport.** ADB will provide continued support to modernize Kazakhstan's transport and logistics system. Much of the road network is in poor condition—about 60% of republican roads require major rehabilitation and proper maintenance. Revenues from transit are low, affecting cost recovery and reinvestment capabilities. Inefficient cross-border procedures increase the burden on trade. Findings from a national logistics study supported by ADB will be used to determine bottlenecks, identify critical reforms, design interventions, and foster policy dialogue to improve the country's logistics chain. CAREC road and rail corridors are clear priorities for investments in the sector.

23. **Energy.** ADB will support Kazakhstan's energy sector, with the aim of modernizing the country's aging energy infrastructure. Almost 45% of its generating plants are over 30 years old. The transmission network is also dilapidated and needs significant rehabilitation. ADB will support replacement of obsolete energy infrastructure and technologies, and upgrade the transmission network mainly through private sector or subsovereign modalities. The government is concerned that the country's high energy intensity is a major impediment to improving the competitiveness of its economy, and wants to reduce this by 10% over 5 years. ADB has assisted with an energy-efficiency diagnostics study and will support efficiency-enhancing investments that will improve competitiveness and reduce greenhouse gas emissions. Given that most of the power generation is coal-fired, this may include funding for clean coal technologies.

24. **Municipal services.** Assistance will be provided to develop Kazakhstan's cities as centers of economic growth. Kazakhstan's current low level of urbanization as measured on the agglomeration index<sup>17</sup> (which ranks urbanization on population size, density, and travel time) suggests that it could benefit from economies of scale by developing its cities. ADB will provide support to help Kazakhstan plan and implement a city-specific approach to municipal development and support reforms to improve governance and cost recovery. Project assistance will help build the competitiveness of cities and improve the environment by strengthening urban

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<sup>17</sup> World Bank. 2009. *World Development Report: Reshaping Economic Geography*. Washington, DC.

transportation, water supply and sanitation, solid waste management, and district heating systems. Subsovereign financing for such services could be extended, predicated on prudent increases to local government borrowing ceilings. Improvement in heating and water supply services are particularly important areas for women.

25. **Access to finance.** The global financial crisis of 2008–2009 forced banks to deleverage and restrict their capacity to provide finance for SMEs, trade, and investment. Bank lending for SMEs fell to only \$1.2 billion in 2009 from a high of \$5.2 billion in 2007.<sup>18</sup> The financial access survey of 2010<sup>19</sup> showed that the share of SME lending to GDP in Kazakhstan was only 6.4%, significantly less than in the People’s Republic of China (48.7%), the Republic of Korea (37.4%), and new European Union countries such as Estonia (31%). Besides high tax rates and corruption, access to finance was among the top obstacles identified by firms in doing business in Kazakhstan in a 2009 enterprise survey.<sup>20</sup>

26. To improve access to finance for SMEs, ADB’s public sector lending assistance will primarily be channeled through the current multitranche financing facility (footnote 18), which provides liquidity support to financial institutions through local currency-denominated fixed-rate loans to overcome currency and interest rate risks. An important focus of the facility is on expanding credit to women entrepreneurs running SMEs. To help develop the securities market as a source of long-term capital for investment, increase liquidity, and give pension funds and other savers new investment opportunities, ADB might fund new tranches under the facility or other projects with strong demonstration impacts through a local currency bond issue. In addition, ADB will provide TA on a cost-sharing basis to develop the securities markets in general and the municipal and project bond market in particular, and strengthen the regulatory capacities of the pension and insurance subsectors.

27. ADB’s private sector operations in the financial sector will focus on trade finance and lending and securitization for high-impact sectors including SMEs, energy efficiency, agribusiness, and well-structured mortgage lending. On a selective basis, ADB may consider equity investments in banks, and equity and debt financing of investment funds.

28. **Governance and institutional reforms.** Reforms will be supported to strengthen (i) sector performance through improving efficiency, sustainability and cost recovery, and introducing innovative financing modalities (paras. 21–24 of the CPS); (ii) PPPs and private sector development through deepening financial and bond markets and improving the regulatory and business environment (paras. 26 and 29); and (iii) project management and portfolio performance through improved financial management, audits, and procurement (para. 42).

29. **Private sector development.** This is a key driver for diversification, and will be a strong focus of ADB’s support. Private sector participation in Kazakhstan has increased and was estimated to account for 65% of GDP in 2010.<sup>21</sup> However, the business environment needs substantive improvements for private sector investments to increase, as constraints to running businesses remain, and laws and regulations need streamlining and stronger enforcement.<sup>22</sup>

<sup>18</sup> ADB. 2010. *Report and Recommendation of the President to the Board of Directors: Proposed Multitranche Financing Facility to the Republic of Kazakhstan for the Small and Medium Enterprise Program*. Manila. The first tranche under the facility for \$150 million was disbursed on 30 September 2011.

<sup>19</sup> World Bank. *Financial Access 2010: The State of Financial Inclusion Through the Crisis*. Washington, DC.

<sup>20</sup> IFC. 2009. *Enterprise Surveys. Kazakhstan Country Profile*. Washington, DC.

<http://www.enterprisesurveys.org/Data/ExploreEconomies/2009/kazakhstan>.

<sup>21</sup> EBRD. 2010. *Transition Report 2010: Recovery and Reform*. London.

<sup>22</sup> This is notwithstanding Kazakhstan’s demonstrated improvement on the 2011 Doing Business Survey. See World Bank. 2011. <http://www.doingbusiness.org/rankings>.

Legislative reform to protect creditors and promote PPPs is also needed. Progress on privatization of large state-owned enterprises and development of a strong competition policy has to be accelerated. Besides, an overall rebalancing of the roles of the public and private sectors is required to promote competition and industrial development. Critical problems in the banking system need to be resolved. The challenges notwithstanding, the potential for expanding the role of the private sector and PPPs exists. To help Kazakhstan capitalize on this potential, ADB will work alongside other development partners to support improvements in the business environment. ADB is collaborating with IFC to explore how best to help Kazakhstan attract greater private sector investment, including through PPP modalities. ADB will consider supporting private sector participation in infrastructure through upstream TA and advisory work to strengthen investor confidence, including implementation of a national PPP strategy, and improvement of PPP policy, legislative, regulatory, and institutional frameworks; and downstream transaction advisory services, as well as participation in carefully selected PPP projects. The transaction advisory work will focus on ADB obtaining government mandates for placing projects in the private sector and attracting strategic investors and key institutional investors.

30. **Private sector operations.** In addition to investing in the financial sector (para. 27), ADB's private sector operations will support private infrastructure through loans to (i) private sector entities, and (ii) entities partially or fully owned by the government (when borrowing without government guarantee). Private infrastructure operations will focus on electricity (generation, transmission, and distribution); transport (roads, rail systems, airports, and ports); logistics; municipal services; and gas transmission and distribution. Natural resource projects (inclusive of gas production) will be considered based on high standards of energy efficiency and environment improvement. These shall be inclusive of downstream processing of oil, gas, and metals. Support for agribusiness and cement are also important areas for private sector operations.

31. **Regional cooperation.** This is important for Kazakhstan and other countries in the region to expand their markets and diversify their economies. Kazakhstan will gain from leveraging its strategic location to facilitate trade and transit between Asia and Europe along CAREC transport corridors passing through its vast area. Capitalizing on this potential is important as Kazakhstan moves toward a common economic space with the Russian Federation and Belarus under the customs union, and possibly accedes to the World Trade Organization in 2012. Under CAREC 2020, a strategic framework for economic cooperation in Central Asia, ADB will support transforming Kazakhstan's transport corridors into economic corridors to open up new trade and business opportunities. This can take the shape of transport and trade facilitation, and industrial and urban development projects in selected cities. Support for improved cross-border infrastructure and customs control will bring down transaction costs for trading across borders. The possibility of enhancing energy trade will also be explored. Regional cooperation between Kazakhstan and other Central Asian countries on common environmental challenges will be encouraged.

32. **Knowledge exchange.** Demand-based knowledge products are important tools with which ADB will seek to add value to Kazakhstan's development. To step up collaboration on knowledge management, the government and ADB are initiating a joint knowledge and experience exchange program (KEEP) in 2012. Specific areas for knowledge collaboration under KEEP will be jointly identified and financed. Possible topics include industrial policy and economic diversification, transforming CAREC transport corridors into economic corridors, creation of subnational debt markets, and resource-revenue management to stabilize income streams. Knowledge products linked to ADB's operational focus could include developing

innovative approaches to infrastructure financing and assets management. The ADB-assisted long-term strategic road maps for infrastructure sectors will identify important investment and reform areas for future support. Analysis to help the country improve its business environment, focused on improving regulatory and institutional frameworks at the sector levels, will be also supported.

33. **Climate change and environmental sustainability.** These are key challenges. Climate impacts pose risks to Kazakhstan's economy and human welfare, and aggravate environmental pressures. Other environmental challenges include inadequate sanitation and wastewater management, land degradation, and deforestation. ADB will support climate change mitigation and adaptation, awareness raising, and capacity building, through regional TA. The proposed support for improving energy efficiency will help reduce carbon emissions and mitigate climate change impacts. Possible assistance for improving water and wastewater services will help support urban environmental improvements. Assistance to develop an integrated disaster risk management program might also be considered.

34. **Gender equity.** Gender equity will be supported as, despite progress, inequities prevail. Women in Kazakhstan continue to trail men in labor market participation and access to jobs. Women's representation in legislative and executive bodies is also low. ADB will support application of gender mainstreaming in projects and pilot test innovative approaches to promote gender equality, and build capacity to collect sex-disaggregated economic and social data. Support under the CPS for municipal services will improve the quality of life of women and men. Assistance for small enterprises will provide livelihood opportunities for women and men.

### III. STRATEGY IMPLEMENTATION

#### A. Indicative Resource Parameters

35. The CPS adopts a flexible approach to resource planning, premised on the government wanting ADB to be ready to provide assistance on demand when it cannot commit to firm amounts as its needs might change over the CPS period. Flexibility is also needed because assistance to the private sector is deal-based, for which it is difficult to plan precise amounts in advance. Assistance amounts will, therefore, be decided annually in the process of updating the country operations business plan (COBP). With this proviso, the CPS provides for indicative public sector lending assistance to Kazakhstan of \$1.6 billion for 2012–2016. In addition, nonlending TA to support knowledge management, policy reforms, and project preparation will be provided. As part of this, the government will meet 50% of costs of the TA-based KEEP program to support knowledge solutions. Direct private sector assistance will be an additionality. Besides, ADB will leverage its support to raise additional resources through partnerships and cofinancing from other development partners.

36. Public sector assistance to Kazakhstan during this CPS is warranted because (i) the enabling environment for the private sector needs to be substantially improved for larger non-oil private investments to take off and replace public investments, (ii) the present difficult global economic environment requires public sector support to optimize risk-sharing between the public and the private sectors and improve the viability of PPPs, and (iii) Kazakhstan's public investment requirements are still too large for the private sector alone to finance.

37. Under the new cost-sharing arrangements for Kazakhstan, approved by ADB Management on 15 May 2012, ADB will increase its cost share to 85% of the total cost of projects on an overall portfolio-wide basis. Cofinancing from the EBRD and other development partners will be actively mobilized to support infrastructure projects in the public and private

sectors. The successful implementation of this CPS is expected to pave the way for Kazakhstan's graduation from ADB assistance (footnote 2).

## **B. Program Overview**

38. The COBP for 2012–2014 provides details of the operational program.<sup>23</sup> Public sector projects in the COBP include those for (i) roads and CAREC corridors, (ii) Astana urban transport, (iii) energy efficiency, and (iv) access to finance for SMEs. These projects constitute the base lending scenario. A “low case” lending scenario (recommended by IED), on the other hand, is one under which these operations are not realized and there are no new public sector projects. This would effectively become a zero public sector lending scenario during the CPS. In this case, private sector operations and TA to support reforms and knowledge management will sustain ADB's support to Kazakhstan. To this end, the COBP includes TA in these areas.

39. The present performance of the ADB-assisted portfolio of projects in Kazakhstan is satisfactory. Its disbursement and contract award ratios are above ADB-wide averages and no loans are at risk. However, some potential risks to project implementation have been identified and mitigating measures suggested (para. 42).

## **IV. RESULTS MANAGEMENT**

### **A. Monitoring**

40. The CPS results framework is closely aligned with the government's 2020 plan and the industrialization program (Appendix 1). It specifies clear indicators of progress and provides baselines and numeric targets for these indicators. Using country systems, results will be monitored on this framework on an annual basis during country portfolio review missions. Modifications to the results framework may be made annually and the updated framework will be reported in the ensuing COBP. ADB will also build on its work on managing for development results to assist Kazakhstan to develop structured approaches to results-based management.

### **B. Risks**

41. Kazakhstan's need for sovereign borrowings could remain subdued if high oil prices continue to drive public revenues. Consequently, this CPS emphasizes nonlending support for capacity building and knowledge management. It also supports PPPs and nonsovereign projects while recognizing the risk that these too could fail to take off in case of non-improvement in the business environment. To mitigate this risk, the CPS supports improvements in the business environment.

42. Risk assessment and risk management plans identify governance risks and mitigating actions for ADB's project operations in Kazakhstan.<sup>24</sup> A disconnect between planning and budgeting, weaknesses in initial project designs, and lack of adjustment for inflation lead to cost escalations, inflating project costs over the original estimates. Audit functions also need to be strengthened for improved accountability. Procurement processes need improvement through strengthening competition and transparency. ADB will support the government to produce credible project cost estimates and establish performance indicators to monitor budget execution. ADB will ensure international competitive bidding and other best practices for procurement on its projects. Regular audits, full disclosure of information, and transparency in decision making will be supported.

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<sup>23</sup> Country Operations Business Plan (accessible from the list of linked documents in Appendix 2).

<sup>24</sup> Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

## COUNTRY PARTNERSHIP STRATEGY RESULTS FRAMEWORK

<b>Country Development Goals</b>			
1. Steady and balanced growth of the economy through diversification and increased competitive ability. GDP in 2015 to have increased by 50% in nominal terms and 15% in real terms over 2008 levels (from T16 trillion to T23 trillion in nominal terms). 2. Productivity of the labor force to increase 1.5 times by 2015 over the 2008 level of \$22,600 per person on a purchasing power parity basis. 3. Share of the manufacturing industry in GDP rises to 12.5% by 2015 from 11.3% in 2010.			
<b>Sectors Selected for ADB Support</b>			
<b>Government Sector Objectives</b>	<b>Sector Outcomes that ADB Contributes to and Indicators</b>	<b>ADB Areas of Intervention</b>	<b>ADB Indicative Resource Allocation in the Next Pipeline (2012-2014) and Thematic Priorities<sup>a</sup></b>
<b>1. Transport and Information and Communication Technology (2020 Core Area 1: Infrastructure and Core Area 3: Regional Cooperation and Integration)</b>			
Develop an efficient transport and logistics system that is integrated with, and on a par with, the international system	1. Increased and more efficient movement of people and goods to domestic and international markets:  Transport cost in the final cost of goods reduced to 5% by 2016 (2011 baseline: 10%)  Traffic volume increased to 3,500 vpd on Mangystau Oblast section of CAREC Corridor 2 by 2016 (2009 baseline: 1,000 vpd)  Travel time between Aktau and Beineu reduced to 4 hours by 2016 (2009 baseline: 12 hours)	National roads and improvement of cross-border infrastructure  Logistics improvement  Sector-wide institutional and governance reforms  PPPs  Knowledge support, capacity development, and policy dialogue	\$605 million, 54% of public sector resource envelope for 2012–2014, of which:  GRO: 100%  PSD: 38%  RCI: 100%
<b>2. Energy (2020 Core Area 1: Infrastructure and Core Area 2: Environment)</b>			
Modernize energy infrastructure and systems and develop renewable energy to achieve higher energy efficiency, reduced energy intensity, and lower greenhouse gas emissions	2. Efficient use of energy and reduced energy intensity:  Energy content of GDP decreased by at least 10% by 2016 (to 0.50 terawatt-hour per \$1 billion GDP on a purchasing power parity basis) (2008 baseline: 0.56 terawatt-hour per \$1 billion GDP)  Average thermal power generation efficiency improved to 34% in 2016 (2009 baseline: 31%)  Carbon intensity of GDP reduced by at least 10% by 2016 (2008 baseline: 5.41) <sup>b</sup>	Energy efficiency  Electrical power transmission  Emissions reduction  Private sector operations and PPPs  Knowledge support, capacity development, and policy dialogue	\$110 million, 10% of public sector resource envelope for 2012–2014, of which:  GRO: 100%  ENV: 100%



Government Sector Objectives	Sector Outcomes that ADB Contributes to and Indicators	ADB Areas of Intervention	ADB Indicative Resource Allocation in the Next Pipeline (2012-2014) and Thematic Priorities <sup>a</sup>
<b>3. Multisector [Urban Transport, Water supply and Sanitation, and Other Municipal Services] (2020 Core Area 1: Infrastructure and Core Area 2: Environment)</b>			
Improve urban environment and living conditions in an energy-efficient manner to support economic growth	<p>3. Enhanced access to municipal services to improve quality of life of citizens:</p> <p>25% of Astana's population is served by the new light rail transit by 2016 (2011 baseline: 0%)</p> <p>100% of urban residents with access to improved water and sanitation by 2020 (2010 baseline: 86% for water and 81% for sanitation)<sup>c</sup></p>	<p>Public transport</p> <p>Drinking water and sanitation systems</p> <p>Waste disposal and transport and other municipal services</p> <p>Sector-wide institutional and governance reforms</p> <p>PPPs</p> <p>Knowledge support, capacity development, and policy dialogue</p>	<p>\$300 million, 27% of public sector resource envelope for 2012–2014, of which:</p> <p>GRO: 100%</p> <p>ENV: 100%</p> <p>GEN+EGM: 100%</p>
<b>4. Finance (2020 Core Area 4: Finance Sector Development)</b>			
Strengthen access to finance for SMEs, trade, and investment in infrastructure	<p>4. Greater access of SMEs to financial services and increased infrastructure investments by private sector:</p> <p>Share of bank loans to SMEs increases to 20% of GDP in 2016 (2011 baseline: 15%)</p> <p>Proportion of loans going to women entrepreneurs under DAMU (Entrepreneurship Development Fund) programs increases to 23% of loans by 2014 (2009 baseline: 16%)</p> <p>Overall bank loans increase to 50% of GDP by 2016 (2011 baseline: 39%)</p>	<p>Access to finance for SMEs</p> <p>Capital markets development</p> <p>Local currency finance</p> <p>Private sector support for trade finance</p>	<p>\$100 million, 9% of public sector resource envelope for 2012–2014, of which:</p> <p>GRO: 100%</p> <p>GEN+EGM: 100%</p> <p>PSD: 100%</p>

ADB = Asian Development Bank, CAREC = Central Asia Regional Economic Cooperation, CPS = country partnership strategy, EGM = effective gender mainstreaming, ENV = environmental sustainability, GDP = gross domestic product, GEN = gender equity, GRO = economic growth, PPP = public–private partnership, PSD = private sector development, RCI = regional cooperation and integration, SMEs = small and medium-sized enterprises, vpd = vehicles per day.

<sup>a</sup> This indicative resource allocation is consistent with the first country operations business plan for 2012-2014 under the present country partnership strategy (accessible from the list of linked documents in Appendix 2)

<sup>b</sup> Carbon intensity is defined as kilograms of carbon dioxide emissions per unit of gross domestic product in 2000 prices.

<sup>c</sup> The baseline figures for access to improved water supply and sanitation for 2010 refer to the total population since separate data on access of these services for the urban population are not available.

Source: Asian Development Bank analysis.

**LIST OF LINKED DOCUMENTS**

<http://www.adb.org/Documents/CPS/?id=KAZ-2012>

1. Economic Analysis (Summary)
2. Poverty Analysis (Summary)
3. Gender Analysis (Summary)
4. Environment Assessment (Summary)
5. Private Sector Assessment (Summary)
6. Sector Assessment (Summary): Transport, and Information and Communication Technology
7. Sector Assessment (Summary): Energy
8. Sector Assessment (Summary): Multisector (Urban Transport, Water Supply and Sanitation, and Other Municipal Services)
9. Sector Assessment (Summary): Finance (Summary)
10. Risk Assessment and Risk Management Plan (Summary)
11. Country and Portfolio Indicators
12. Country Cost-Sharing Arrangements and Eligible Expenditure Financing Parameters
13. Country Partnership Strategy Formulation
14. Country Strategy and Program (2004–2006) Final Review
15. Country Operations Business Plan
16. Kazakhstan: Country Strategy and Program (2004–2006), Final Review Validation

**Supplementary Documents**

17. Regional Cooperation and Integration Assessment (Summary)
18. Kazakhstan's Twin Development Challenges: Economic Diversification and Avoiding the Middle Income Trap