

**DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT**

STRATEGY FOR KAZAKHSTAN

As approved by the Board of Directors on 21 November 2006.

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ABBREVIATIONS / CURRENCY CONVERSIONS

ADB	Asian Development Bank
AIC	Agency of the Republic of Kazakhstan for Information and Communication
AML	Anti-money laundering
BAS	(the EBRD) Business Advisory Services
AREM	Agency of the Republic of Kazakhstan for Regulation of Natural Monopoly
BCC	Bank CenterCredit
BEEPS	Business Environment and Enterprise Performance Survey
BTA	Bank TuranAlem
CACO	Central Asian Co-operation Organisation
CAD	Canadian dollar
CAREC	Central Asia Regional Economic Cooperation Program
CEEB	Central Eastern Europe and the Baltic States
CIS	Commonwealth of Independent States
CPC	Competition Protection Committee of the Ministry for Industry and Trade of the Republic of Kazakhstan
CPI	Corruption Perceptions Index
CSP	ADB's Country Strategy and Programme Update for Kazakhstan
DBK	Development Bank of Kazakhstan
EBRD or the Bank	European Bank for Reconstruction and Development
ECO	Economic Cooperation Organisation
EDB	Eurasian Development Bank
EurAsEC	Eurasian Economic Community
EITI	Extractive Industries Transparency Initiative
EU	European Union
€	Euro
FIC	Foreign Investors Council
FDI	Foreign direct investment
GDP	Gross domestic product
GDR	Global Depositary Receipts
GNPF	Accumulation Pension Fund GNPF, the state-owned pension fund management company
IDB	Islamic Development Bank
IFC	International Finance Corporation
IFI	International Financial Institution
IFK	Investment Fund of Kazakhstan
IMF	International Monetary Fund
IOSCO	International Organisation of Securities Commissions
IPO	Initial public offering
ISO	International Standards Organisation
IT	Information technology
JSC	Joint stock company
KLF	Kazakhstan Loan Fund
KASE	Kazakhstan Stock Exchange
KKB	Kazkommertsbank
KSBP	Kazakhstan Small Business Programme
KTC	Kazakhtelecom
KZT	Kazakhstan Tenge, the national currency of Kazakhstan

Libor	London Inter-bank Offered Rate
LSE	London Stock Exchange
MP	Member of Parliament
MSE	Micro and small sized enterprise
MSME	Micro, small and medium-sized enterprise
NBFI	Non-bank financial institution
NBK	National Bank of Kazakhstan
NBMFI	Non-bank microfinance institution
NFRK	National Fund of the Republic of Kazakhstan
NGO	Non-governmental organisation
NIF	National Innovation Fund
ODIHR	Office for Democratic Institutions and Human Rights
OECD	Organisation for Economic Co-operation and Development
OSCE	Organisation for Security and Cooperation in Europe
PPP	Public-private partnership
RFCA	Regional Financial Centre in Almaty
RZB	Raiffeisen Zentralbank Oesterreich
SCO	Shanghai Co-operation Organisation
SME	Small and medium-sized enterprise
SPECA	(The UN's) Special Program for Economies of Central Asia
S&P	Standard and Poor's
TACIS	(The EU's) Technical Assistance for the Commonwealth of Independent States
TAM	(the EBRD) Turn-Around Management programme
TC	Technical Cooperation
TRACECA	(The EU's programme on) TRANsport Corridor Europe-Caucasus-Asia
TFP	Trade Facilitation Programme
UN	United Nations
UNESCO	United Nations Educational, Scientific, & Cultural Organization
US	United States of America
USAID	US Agency for International Development
US\$	United States dollar
WB	The World Bank
WTO	World Trade Organisation

EXECUTIVE SUMMARY

Over the last two years Kazakhstan has continued to make progress towards implementation of the principles envisaged in Article 1 of the Agreement Establishing the Bank. Economic transition was visible and widely acknowledged, but there are many challenges in the political field. Strong presidential power is not adequately balanced by legislature and judiciary. Corruption and lack of transparency remain a problem, as recognised by the authorities. There are restrictions on the independent media. The latest amendments of the media law represent a setback for media freedom in Kazakhstan. The 2004 parliamentary and the 2005 presidential elections fell short of a number of international standards for democratic elections, although reflecting an improvement over previous polls.

The economy remained robust during the strategy period, underpinned by sound macroeconomic policies. As a natural resource based economy, the medium and long-term macroeconomic challenge is to adopt an appropriate policy mix that will maintain the diversification of the economy and insulate itself from commodity price volatility. Recent tightening of regulations in the financial sector to restrain externally financed credit growth should relieve pressure on the foreign exchange and decelerate the growth in domestic demand. However, further strengthening of banking regulation is needed, as the sector is increasingly vulnerable to shocks. Fiscal policy should also move towards non-oil revenue deficit targeting.

The previous strategy highlighted the importance of a diversified economic structure which will be resilient to oil price fluctuations in line with the objectives of “Industrial-Innovation Development Strategy of the Republic of Kazakhstan for 2003-2015” and the challenge to develop a competitive private sector. In the strategy period, the authorities have demonstrated a great capacity for institutional innovation and adaptation, e.g. through the establishment of the two state holding companies Samruk and Kazyna. While acknowledging the potential of these initiatives to contribute to sustainable development, the difficulties and risks should also be recognised. Institutional experience is not easily transferred across countries and, once established, dysfunctional organisations are not easily phased out.

The overall investment climate for the private sector has improved in some areas, as evidenced by various surveys including the Business Environment and Enterprise Performance Survey (BEEPS) conducted jointly by EBRD and the World Bank (WB). The transparency of revenue flows from the oil and gas sector is expected to improve as Kazakhstan joined the Extractive Industries Transparency Initiative (EITI) in 2005. However, specific challenges identified in the previous strategy are largely unaddressed and should continue to be the focus of the authorities during the forthcoming strategy period in order to achieve the stated medium-term goal for the country to become one of the world’s 50 most competitive economies (under the World Economic Forum’s rankings).

- Create fair and competitive environment for businesses. Ownership of private businesses is increasingly becoming concentrated, potentially stifling competition and entrepreneurship. The authorities should focus on establishing an effective competition policy framework enhancing access for new competitors and protecting markets from restrictive business practices. Efforts must also be made to create an enabling environment for SMEs, in particular by reducing the regulatory burden. Addressing the issue of corruption is critical and essential in order to improve the investment climate.

- Increase openness to foreign trade and investment in order to further strengthen competition and competitiveness of enterprises. WTO accession should be the priority to improve access of local companies to international markets and increase the attractiveness of the country for investments, especially in non-extractive industries. As a landlocked country, increased regional co-operation on trade and transport is also important to improve access to international markets.
- Improve corporate governance of enterprises and banks in order to enhance access to long-term debt and equity capital. As credit conditions ease, banks and enterprises are increasingly gaining access to local and international capital markets, but access to strategic equity continues to be very limited due to lack of transparency and inadequate corporate governance standards. Recent overseas listings by some Kazakh private companies are expected to demonstrate the benefits of increased transparency and corporate governance standards, and similar rigorous disclosure standards should be adopted in the domestic market in order to mobilise savings accumulated in the local pension funds.
- Attract private sector investment in infrastructure services and improve public sector tendering process. As the economy expands, bottlenecks in infrastructure are increasingly becoming evident. Authorities have opted in recent years to address this issue through channelling funding both directly from the budget and investments by state-owned infrastructure companies. However, whilst building on the strengthened capacity of the network infrastructure regulator the authorities should also consider attracting more private sector involvement in infrastructure. This should also help address regional disparities in the availability of basic infrastructure services.

Considering these challenges, the Bank's strategic orientation is to support the Government's priorities by addressing transition challenges in a context of high global and local market liquidity. In particular, the Bank would:

- Engage actively in further reforms by working with both private and public sector.
- Broaden the Bank's operations and increase its impact with a special focus on the corporate sector to support the diversification of the economy of Kazakhstan, and to promote competition.
- Increase its role in financing infrastructure, supporting transport and power sectors.
- Stay engaged in financial sector, enhance competition in the banking sector and develop non-bank financial services.
- Promote higher transparency standards and support foreign direct investment (FDI).

The Bank's main operational objectives for 2007-2008 are the following:

- **Enterprise sector** – Support economic diversification and enhance competition by working directly with corporates across various sectors such as general industry, power, agribusiness, telecoms and property. Promote projects leading to higher energy efficiency and increase the capitalisation of enterprises through equity investments. Increase competition in the natural resources sector by working with smaller operators and on higher risk projects. Dedicate resources in order to directly finance smaller projects and continue to provide micro and small financing and tailored capacity building using Kazakhstan Small Business Programme (KSBP) and leasing facility. Promote high standards of corporate governance, integrity and transparency of ownership, including through FDI to Kazakhstan. Selectively support regional cross-border expansion of reputable Kazakh companies to neighbouring markets.

- **Infrastructure** - Increase its support in transport, energy and telecommunication infrastructure development to satisfy the growing needs of the economy and promote respective sectoral reforms. The Bank will focus on non-sovereign projects. On selective basis, it will take leadership in developing and actively engage in appropriately structured public-private partnerships (PPPs) that involve competitive tender processes. Work with state holding company Samruk on finding synergies between different parts of infrastructure and improving corporate governance in respective of state owned enterprises. Support further regulatory and tariff development that promotes investments and fair access to infrastructure. Given Kazakhstan's remoteness from major markets and low population density, the Bank will continue to work closely with the private sector, government authorities and other IFIs on sustainable solutions for infrastructure, and promote regional co-operation.
- **Financial sector** – To promote strategic FDI to the financial sector, but also open up the capital base of local banks to reputable financial investors through initial public offerings (IPOs) or private placements. To continue to work actively with existing shareholders of the Kazakh banks to achieve better transparency of ownership and corporate governance. Facilitate competition in the financial sector by providing debt and equity, particularly to medium size banks and non-bank microfinance institutions (NBMFIs), supporting additional micro, small and medium-sized enterprises (MSMEs). On debt products, in view of the developed access to capital markets, the Bank will be particularly attentive in developing those projects with specific attributes which meet additionality concerns and contribute to transition. A special emphasis will be on the provision of financial resources outside the capital cities and in the rural areas, as well as improving the efficient delivery of financing to the micro and small sectors. The Bank will support development of financial services such as leasing, mortgages, insurance and pensions, and facilitate the securitisation of assets by Kazakh financial institutions. The Bank will assist the Government in privatising the few remaining state-owned financial institutions concerned with pensions and mortgages.
- **Policy dialogue** – Support the Government in their efforts to improve the investment climate and drive long-term economic diversification, leading to improved global competitiveness. Co-operate with newly created state holding companies Samruk and Kazyna to achieve corporate governance and operational improvements of state-owned enterprises. Promote adequate behaviour and transparent practices and fight corruption to improve the business environment. Promote adoption of the anti-money laundering (AML) legislation, especially in light of the government initiative to create the Regional Financial Centre in Almaty (RFCA).

1. THE BANK'S PORTFOLIO

1.1 Overview over Bank Activities to Date

The Bank continues to be actively involved in Kazakhstan across a number of economic sectors in private and public sector projects with a concentration in the financial sector. Since 1991 the Bank has signed 47 projects in Kazakhstan with the net cumulative business volume of €1.3 billion as at 30 September 2006.

Table 1: Cumulative Business Volume by Industry (€million) as at 30 September 2006

Sector Business Group	Sector Team	No. of projects	Total project value	EBRD finance	Debt	Equity	Per cent share of commitments
Energy	Natural Resources	1	178	64	64	0	5%
	Power and Energy	4	489	115	115	0	9%
<i>Sub-total Energy</i>		5	667	179	179	0	14%
Financial Institutions	Bank Equity	3	55	37	0	37	3%
	Bank Lending	13	492	381	381	0	30%
	Equity Funds	2	138	41	0	41	3%
	Non Bank Financial Institutions	3	18	14	13	2	1%
	Small Business Finance	2	128	128	128	0	10%
<i>Sub-total Financial Institutions</i>		22	831	601	522	80	48%
Infrastructure	Transport	5	442	226	226	0	18%
	Municipal & Environmental	0	0	0	0	0	0%
<i>Sub-total Infrastructure</i>		5	442	226	226	0	18%
Industries	Manufacturing Industry	4	367	62	60	2	5%
	Agribusiness	6	219	77	77	0	6%
	Property and Tourism	2	33	12	12	0	1%
	Telecoms, Informatics & Media	3	183	105	105	0	8%
<i>Sub-total Industries</i>		15	802	257	255	2	20%
KAZAKHSTAN TOTAL		47	2,742	1,262	1,181	81	100%

The Bank's operations have a strong focus on the private sector. The share of private sector operations increased to 70 per cent of portfolio from 57 per cent two years ago, while the share of operations conducted on a non-sovereign basis increased to 71 per cent from 60 per cent as the Bank was lending directly to state-owned utilities without recourse to the Government's funds. The majority of financing (92 per cent) continues to be in the form of debt.

Reflecting the focus on the private sector, the share of infrastructure projects in the Bank's portfolio in Kazakhstan decreased to 18 per cent from 23 per cent at the time of approval of the previous strategy. At the same time, the share of operations with privately-owned enterprises in agribusiness, telecommunications and general industry increased from a total of 13 per cent to 19 per cent. Energy sectors maintained a steady portion of business volume at 14 per cent. Until now, operations in the financial institutions sector remained the main area of activity as the Bank continued its endeavour to develop financial intermediation and provide support to households, micro, small and medium-sized enterprises (MSMEs) and agricultural producers in Kazakhstan.

Table 2: Portfolio (€million) as at 30 September 2006

Sector Business Group	Sector Team	No. of projects	Current portfolio	Undrawn commitment	Operating assets
Energy	Natural Resources	1	64	0	64
	Power and Energy	4	103	68	35
<i>Sub-total Energy</i>		5	167	68	99
Financial Institutions	Bank Equity	2	37	0	37
	Bank Lending	5	150	31	119
	Equity Funds	1	12	7	5
	Non Bank Financial Institutions	4	9	2	8
	Small Business Finance	2	59	0	59
<i>Sub-total Financial Institutions</i>		14	267	40	227
Infrastructure	Transport	4	141	68	74
	Municipal & Environmental	0	0	0	0
<i>Sub-total Infrastructure</i>		4	141	68	74
Industries	Manufacturing Industry	4	21	16	5
	Agribusiness	4	30	13	17
	Property and Tourism	1	5	2	3
	Telecoms, Informatics & Media	2	76	0	76
<i>Sub-total Industries</i>		11	132	31	97
KAZAKHSTAN TOTAL		34	707	206	502

1.2 Implementation of the previous country strategy

The November 2004 Strategy for Kazakhstan outlined the following strategic priorities for the Bank:

- Support economic diversification, advance transition and address increasing regional inequality.
- Promote commercial principles and open, non-discriminatory access to infrastructure; support regional co-operation.
- Diversify financial services, provide local currency lending, facilitate transition in the sector, extend activities to NBFIs, continue to work on integrity, transparency and AML issues.
- Continue to conduct policy dialogue on the investment climate and regional co-operation.

1.2.1 Enterprise Sector

During the strategy period direct financing totalling €78 million was provided to private entities towards financing projects with a total project value in excess of €170 million. The most notable progress was made in the general industry sector : during the strategy period, three new industry projects were signed – a loan to Central Asia Cement, an equity investment in its holding company Steppe Cement, and a loan to Bericap. Further projects in the enterprise sector were signed with entities operating in food production (Savola Kazakhstan and Ülker Kazakhstan), property (Tulpar) and telecoms (KaR-Tel).

Agricultural producers received additional support through various products, including Warehouse Receipts Programme, Agricultural Equipment Financing and Grain Financing First Loss Guarantee. Total financing of €67.6 million has been committed to these programmes.

To support the telecommunications sector, the Bank provided a loan financing to the second GSM standard cellular communication operator KaR-Tel for the total amount of €84.6 million (including €42.3 million on the Bank's own account) in December 2005. By financing this

project, the Bank contributed to the rapid expansion of the company's cellular network and created a viable competitor to the market leader GSM Kazakhstan which would otherwise have continued to dominate the market.

The Bank continued to support MSMEs through financial intermediaries. Two new Kazakhstan Small Business Programme II lines (to ATF Bank and BCC) were committed totalling €15.9 million. A new KSBP III programme started with a specific focus on the rural and agricultural sectors. Two credit lines to two new partners, Kazakhstan Loan Fund (KLF), an NBMFI, and Alliance Bank have been committed totalling €5.7 million. An additional dedicated SME loan through Alliance Bank was signed for financing of €7.9 million.

The Bank has also continued to support SMEs through its Turn-Around Management (TAM) and Business Advisory Services (BAS) programmes. Since the start of TAM operations in 1998, 30 projects have been undertaken. BAS has supported over 383 projects since 2001 (including 155 projects during the strategy period), covering a wide range of sectors. In addition to its office in Ust-Kamenogorsk, BAS have opened 3 new regional offices in Kostanai, Shymkent and Aktobe. Regional offices outside Almaty now undertake 85 per cent of BAS projects. The policy of integrating TAM/BAS as a core activity of the Bank (implemented from January 2005) has resulted in stronger intra-Bank linkages and is increasing the transition impact of the Bank. The synergies between the unique strengths of TAM/BAS (including the skills of the industry-specific, widely experienced TAM Senior Advisors and the BAS databases of competent local consultants in many of the Bank's countries of operation) are now being fully exploited within the Bank's Banking Teams. See Annex 6 for regional coverage of BAS programme.

1.2.2 Infrastructure

The Bank has been assisting the Government of Kazakhstan in the implementation of several important infrastructure projects, including construction of the new runway at Atyrau International Airport, rehabilitation of the Almaty-Bishkek and Atyrau-Aktau roads and construction of the new North-South power transmission line. The financing of €41.9 million was approved by the Bank for the latter project, while parallel funds were mobilised from commercial lenders.

The Bank started co-operation with the city administration of Astana for the construction of a new light-rail transit system in the capital of Kazakhstan. A TC grant mobilised by the Bank has financed the feasibility study, which was completed in 2005. Currently, the investment proposal is going through the approval process by the Kazakh government and Astana city authorities.

1.2.3 Financial Sector

The Trade Facilitation Programme (TFP) remained an important instrument in supporting a wide range of trade transactions of Kazakh enterprises, including long-term intra-regional imports. A new TFP line of €7.9 million was opened to Alliance Bank, the Bank's newest banking client in Kazakhstan. In 2006, the Bank started two new trade finance advisory services projects, funded by the Government of the Netherlands and the EU, under which foreign consultants support Kazakh banks in the development of their domestic and international factoring business and marketing of all type of trade finance services.

The first mortgage loan to a Kazakh bank and additional mortgage loan to BTA Ipoteka were provided with a view to expand access to financing by Kazakhstan's population towards the purchasing of residential property and to enhance standards of mortgage lending.

The agreement to privatise the only state-owned pension fund management company, GNPF, has been signed with the Government of Kazakhstan and National Bank of Kazakhstan (NBK). The Bank will support the privatisation process by providing pre-privatisation equity investment in GNPF and grant-financed institutional building support (€345,000 provided by the Government of Canada).

Local currency funding has been launched by the Bank with a Tenge financing worth €1.8 million extended to KLF.

The Bank has strengthened its efforts to improve transparency of ownership and integrity in Kazakhstan's banking sector. These efforts coincide with the adoption by the Financial Supervision Agency of a new disclosure regulation. Implementation, however, remains a challenge; it requires sensitive and balanced judgement by Management of both the reputation risks involved and the benefits of Bank engagement to help local banks move towards best practice standards of governance.

1.2.4 Policy Dialogue

The Bank actively promoted policy dialogue with the Government of Kazakhstan on improvements in corporate governance, SME development, infrastructure tariffs, banking sector risks and disclosure, capital market development, pensions and other specific sector reforms.

The Bank continued to play a key role in the Foreign Investors Council (FIC). The Bank proposed specific topics to be discussed at the FIC plenary sessions (regional co-operation and WTO accession) and contributed to dialogue between the investors and the Government of Kazakhstan. The Bank participated actively in FIC working groups and round tables concerning various issues, such as the improvement of corporate governance through the establishment of independent directors at board level, human capital development, and the fight against corruption.

Policy dialogue related to infrastructure development continued through various TC programmes, including the Agency for Regulation of Natural Monopoly (AREM) regarding assistance in institutional strengthening and further regulatory development of power, railway, telecoms, and oil and gas transportation sectors (€0.95 million financed by Government of Japan); the Agency for Information and Communications (AIC) for advice in establishing an independent telecom regulator (€80,300 by the Government of Ireland); and the Ministry of Transport and Communications for the identification of potential PPP projects in the roads sector (€100,000 by the EU).

In the natural resources sector, the Bank has promoted the introduction of the EITI, and worked closely with the British Embassy and the WB throughout the process to ensure the full participation of non-governmental organisations (NGOs) in the EITI process of signing-up and implementation.

An important initiative of the Bank was to introduce grain warehouse receipt legislation which is now functional in Kazakhstan following good collaboration between the Bank, the Government of Kazakhstan and local agribusiness companies, as well as local and foreign financial institutions.

The Bank has also played a key role in preventing corruption. In one project, the Bank helped a foreign investor from falling hostage to corrupt practices by state regulators.

1.3 Transition impact of the Bank's portfolio and lessons learned

1.3.1 Financial Performance of Existing Portfolio and Mobilisation of Co-Financing

As at 30 September 2006, the Bank had signed 47 projects (on a net cumulative basis) with a total cost of €2.7 billion, including EBRD financing of €1.3 billion, resulting in a mobilisation ratio (total finance/EBRD financing) of 2.2.

The overall quality of the Bank's portfolio in Kazakhstan remains excellent, with performing assets representing 100 per cent of operating assets. The current portfolio in Kazakhstan has an average risk rating of 5.41. This compares with risk rating of 5.44 for the Bank's overall portfolio and 5.84 for Central Asia. 72.7 per cent of the Bank's commitments have been disbursed. The implementation track record of the Bank projects is satisfactory.

1.3.2 Transition Impact

The Bank's transition impact was primarily achieved through individual projects and associated TC programmes aimed at institutional development of project beneficiaries. The Bank has also mobilised stand-alone TC programmes to strengthen the regulatory capacity, and engaged in policy dialogues to enhance sector reforms, but the effectiveness has been uneven across sectors. The transition impact of the Bank's operations to date is summarised below (Table 3).

In the *enterprise sector*, the Bank had a very significant impact in enhancing provision of financing to MSMEs and agribusiness sectors. Through the provision of funding to local commercial banks that on-lent to MSMEs and agribusinesses, the Bank has strengthened the regulatory and legal environment (e.g. the development of warehouse receipts) and developed specific technical skills and know-how in commercial banks. Further, the Bank has financed its first NBMFI, the Kazakhstan Loan Fund. The Bank also had some success in improving corporate governance and business standards of local enterprises.

In the *infrastructure sector*, the Bank had significant impact in supporting the post-liberalisation regulatory environment in the power sector through the technical support provided to the regulator. In other sectors such as telecommunications and transport, similar regulatory assistance to facilitate liberalisation in the respective sectors had a less tangible impact to date.

In the *financial sector*, the Bank has provided extensive financial and technical support to local commercial banks and non-bank financial institutions (NBFIs) and was successful in helping them improve their business standards. However, although the Bank became a minority shareholder in some commercial banks, its impact on the improvement in corporate governance including ownership transparency has been less successful.

Table 3: The Bank's Impact on Transition

Sector	Impact
Enterprise sector	
Agribusiness	Very Significant
General Industry	Minimal
Micro, Small and Medium Sized Enterprises	Very Significant
Natural Resources	Moderate
Property & Tourism	Minimal
Energy Efficiency	None
Infrastructure sector	
MEI	Minimal
Power	Significant
Telecom	Moderate
Transport	Moderate
Financial sector	
Banking ^{1/}	Moderate
Non-bank Financial Institutions	Moderate
Private Equity Funds	Minimal

Source: *Transition Impact Retrospective 2, Companion Paper*

^{1/} Assessment reflects recent evaluation of the Bank's equity investments in KKB and BTA

1.3.3 Lessons learned

The Bank's experience in Kazakhstan to date has resulted in a number of lessons learned in project design, skills transfer, policy dialogue and Bank handling. The most important are the following:

Project design

- The Bank can consolidate its position with a client, secure a more effective project and improve earnings by seeking realistic ways to adjust project design, based on altered risk perceptions, when external factors change significantly (KKB project PE01-170).
- Improving corporate governance through equity investments requires clear and measurable objectives (BTA project PEX03-190).

Skills transfer

- In downscaling operations, the graduation from technical assistance should be commenced in sufficient time to enable partner banks to internalise the necessary management and control functions. Another lesson from the same project is that partner banks should receive the necessary training in order to enable them to monitor environmental issues and report to the Bank (KSBP PE05-299).

Policy Dialogue

- When dealing with a member state government, the Bank should aim to reach a simple deal that the Bank strongly believes in or else to make no deal at all. Constructing a low risk but complex deal signals little confidence in the project or the reform outlook and should be avoided. Another lesson from the project is that a Memorandum of Understanding with the Government stating the broader reform issues of the Project is an excellent feature (Kazakhtelecom project PE03-253).
- Lack of attention paid to deficiencies in the regulatory framework and disregard of political peril besetting energy sector operations exposes energy sector projects to considerable financial risks that are difficult to manage (Karaganda Power PE04-270).

Bank Handling

- In situations of unwanted external project interference the Bank's reaction must come speedily to (a) reduce the potential damage gaining momentum; and (b) avoid the impression that the Bank is sympathetic to, if not even in agreement with, the disruptive practices (Aktau Port Reconstruction Project -Phase I - PE02-212).

2. OPERATIONAL ENVIRONMENT

2.1 The General Reform Environment

2.1.1 Political Environment

Kazakhstan is a presidential republic with many political parties, a two-chamber parliament and a network of non-governmental organisations. Strong presidential power is not adequately balanced by the legislature and the judiciary. In the past two years the country has undergone two sets of elections - parliamentary and presidential. As Kazakhstan has expressed interest in the Chairmanship of the OSCE in 2009, these elections were seen as an opportunity to demonstrate commitment to democracy. According to international observers, both elections showed some improvement but fell short of international standards for democratic elections in many respects. In December 2005 Nursultan Nazarbayev won the presidential election with an overwhelming majority of 91 per cent of the votes and secured another seven-year term in office. The succession issue will be impacting political developments in the years ahead.

By the end of 2006 the OSCE will be deciding on the candidacy of Kazakhstan as Chairmanship of the organisation in 2009. In this context, any progress in crucial areas such as freedom of the media, the ability of political parties to operate freely and respect for individual human rights would be essential elements in the decision. The country's leadership announced the Government's strategy for becoming one of the world's 50 most competitive countries (Kazakhstan is currently ranking 56th). This strategic vision includes not only important economic aspects but also a strong commitment to democratic principles. However, the latest amendments to the Media Law raised concerns as representing a setback for media freedom in the country.

Externally, the country is doing well by successfully pursuing a multi-dimensional foreign policy aimed at maintaining balanced relations with all its neighbours. A known proponent of regional co-operation, Kazakhstan is active in many regional organisations, including the Commonwealth of Independent States (CIS) of which the country has taken over Chairmanship this year.

2.1.2 Regional Issues

As a land-locked country with a substantial endowment of mineral resources but with a relatively small size of the domestic market, regional issues primarily concern trade and transit matters. Other important regional issues concern resource management issues such as water-energy trade and establishment of water boundaries among the five littoral countries of the Caspian Sea. In order to address these issues, Kazakhstan has been actively seeking both bilateral and multilateral co-operation with its regional neighbours.

In recent years, co-operation has intensified with Russia and China, the two largest regional neighbours, regarding exploration of natural resources, transit and export issues. Russia

remains an important transit country for Kazakhstan's exports to the EU. It is also the largest trading partner accounting for 22 per cent of total trade in 2005. In June 2006, Kazakhstan and Russia reached an agreement for a joint development of the Kurmangazy oil and gas field, a large field located at the disputed Caspian water boundary between the two countries. The countries also agreed to establish a joint venture to expand existing gas processing plant in Orenburg, Russia for the processing of gas supplied from the Karachaganak field in Kazakhstan. The two countries have jointly established Eurasian Development Bank (EDB) which has an authorised capital of US\$ 1.5 billion, is two-thirds owned by the Government of Russia and one-third by Kazakhstan, and will provide finances to the members of Eurasian Economic Community (EurAsEC).

China is quickly becoming an important trading partner, already accounting for 15 per cent of total trade. In recent years, Chinese state-owned oil companies have increased investment in Kazakhstan's hydrocarbon sector through the acquisition of stakes sold by Western investors. Kazakhstan has secured an important oil export route to the east when the Atasu-Alashankou oil pipeline, the first pipeline linking Kazakhstan with China, opened in July 2006. In order to facilitate cross-border trade, the construction of a free trade zone at the Khorgos border began in 2006.

Co-operation with other regional neighbours has also improved. Kazakhstan is one of the key foreign direct investors in the Kyrgyz Republic, especially in the banking sector. However, there has been no concrete breakthrough on the issue of water-energy trade to avoid the release of water by the Kyrgyz Republic during the winter months which cause floods in Kazakhstan. Relations with Uzbekistan have also improved with the reopening of a rail link between Almaty and Tashkent. In the Caucasus, Kazakhstan has officially secured a western route for oil and gas exports by reaching an agreement with Azerbaijan on the Baku-Tbilisi-Ceyhan oil and gas pipeline project. Kazakhstan is also becoming an important foreign direct investor in Georgia.

Kazakhstan is an active member of various regional security and economic organisations including Central Asian Co-operation Organisation (CACO), EurAsEC, CIS, Shanghai Co-operation Organisation (SCO) and the Single Economic Space. The effectiveness of these regional organisations in addressing regional economic issues has so far been limited. CACO members have agreed to merge this organisation with EurAsEC when Uzbekistan joined EurAsEC in 2006.

2.1.3 Social conditions

Robust economy in recent years has improved overall social conditions of the country. Per capita income at current prices has increased from US\$ 1,132 in 1999 to US\$ 3,714 in 2005. The percentage of population living below the subsistence minimum income declined from 19.8 per cent in 2003 to 9.8 per cent in 2005¹. Life expectancy at birth increased from 64.4 years in 1999 to 66.2 years in 2004. School gross enrolment rate increased from 93.3 per cent in 2003 to 95.4 per cent in 2005. Labour market conditions are also improving with unemployment declining from 13.5 per cent and 8.8 per cent in 1999 and 2003, respectively to 8.1 per cent in 2005. The Gini co-efficient² has declined from 0.315 in 2003 to 0.304 in 2005 indicating that there has been a slight decline in the extent of inequality during the

¹ The subsistence minimum income was set at KZT 6,014 (US\$ 45) per month in 2005. The nationally defined poverty line is 40 per cent of the minimum income level. The percentage of population living on less than US\$ 2 a day per person (in 1985 US\$ at purchasing power parity) was 19.8 per cent in 2003, the last survey year.

² The Gini index measured inequality over the entire distribution of income or consumption. A value of 0 represents perfect equality, and a value of 1, perfect inequality.

period. Despite these positive developments, availability of qualified skilled labour, and of basic infrastructure (drinking water, sewage systems, health and education services) are a major problem for Kazakhstan.

There are also important regional disparities. The degree of variation in terms of income, poverty incidence, unemployment, social sectors (health and education) and infrastructure is presented in Table 4 below. The extent of variation is measured by the coefficient of variation, a statistical measure of variance defined as standard deviation divided by the mean and the higher the coefficient, the higher the degree of regional variation. The largest degree of variation within Kazakhstan is found in poverty incidence, access to health service and several essential infrastructure services such as sewerage, clean water and central heating. The lower variation is found in unemployment, gross school enrolment rate and access to electricity supply.

Table 4: Regional differences, 2005

	Average household income (tenge)	Population living below subsistence minimum (%)	Unemployment rate (%)	Gross school enrolment rate (%)	Doctors per 1000 population	Households with telephone (%)	Households connected to sewerage system (%)	Households with access to water mains (%)	Households with central heating	Households with electricity supply (%)
Republic of Kazakhstan	105,598	9.8	8.1	95.4	3.6	59.0	48.9	54.6	43.7	100.0
Akmola Oblast	103,476	10.1	8.9	92.2	3.0	54.9	30.9	32.9	30.3	100.0
Aktobe Oblast	114,661	12.3	9.2	96.6	4.7	65.3	48.8	48.8	42.2	100.0
Almaty Oblast	94,581	8.5	7.3	95.6	2.1	38.2	33.0	33.0	13.0	100.0
Atyrau Oblast	104,252	25.0	9.1	100.7	3.1	58.9	23.0	54.8	43.7	100.0
West Kazakhstan	95,084	14.4	9.0	94.5	3.3	51.9	40.8	43.3	41.3	100.0
Zhambyl Oblast	75,143	10.8	9.8	92.0	2.6	41.9	34.3	34.2	20.7	100.0
Karaganda Oblast	125,300	6.4	7.0	92.4	4.4	74.4	72.1	77.4	66.3	100.0
Kostanai Oblast	93,472	13.4	8.2	86.6	2.5	55.1	48.8	53.3	47.9	100.0
Kzyl Orda Oblast	78,969	16.3	9.7	96.0	3.2	32.5	21.7	37.5	20.3	100.0
Mangistau Oblast	146,096	13.6	9.7	105.9	3.4	63.8	75.0	75.0	75.0	100.0
South Kazakhstan	71,020	13.3	7.5	98.5	2.9	37.7	32.9	40.1	26.5	100.0
Pavlodar Oblast	119,021	4.7	7.6	91.3	2.8	74.0	59.9	59.9	60.7	100.0
North Kazakhstan	99,420	8.2	7.9	90.5	2.4	68.3	32.9	32.9	30.0	99.8
East Kazakhstan	113,186	8.2	7.1	92.1	3.8	57.0	38.9	59.9	42.4	100.0
City of Astana	232,947	1.1	8.2	86.9	5.7	85.4	86.7	90.8	86.7	100.0
City of Almaty	160,330	0.3	8.4	110.4	7.9	92.4	84.1	99.1	79.6	100.0
Coefficient of variation	0.38	0.62	0.12	0.07	0.41	0.29	0.44	0.39	0.51	0.00

Source: The Agency of Statistics of the Republic of Kazakhstan

It is difficult to explain the reasons for regional divergence, but it is clear that the effect of transition within Kazakhstan has been uneven. Bringing the benefits of strong economic growth to the regions has become an important transition challenge.

2.1.4 Environment

Kazakhstan's national priorities and commitments are stated in its National Environmental Action Plan, National Biodiversity Strategy and Action Plan and Conception of Environmental Safety for 2004-2015, approved by Presidential Decree on 03 December 2003. The main areas of concern are the Aral Sea, the Semipalatinsk Nuclear Testing Area, desertification and land degradation, biodiversity protection, forestation in East Kazakhstan and in Pavlodar and Karaganda Oblasts.

Environmental issues associated with exploitation of natural resources are connected with the intensive development of the Caspian Sea oil shelf. Metallurgical industries and power generation cause significant air pollution, resulting in eight of the ten mostly contaminated cities being Balkhash, Temirtau, Ekibastuz, Aksu, Pavlodar, Zhezkazgan and Ust-Kamenogorsk. Surface water protection programmes concentrate on Irtysh, Ili, Syrdarya, Ishim, Tobol, Ural, Turgai, Chu rivers, Balkhash Lake, and the Caspian and Aral seas. Soil

and groundwater protection programmes are under consideration. Industrial and domestic waste disposal is a countrywide problem and special attention is needed for radioactive waste management at Semipalatinsk and Karachaganak.

2.1.5 Legal

While in recent years Kazakhstan has introduced notable reforms to its legal system, the country continues to face considerable challenges in entrenching the rule of law and related institutions upon which its successful transition to a market-orientated economy will depend.

As described more fully in Annex 3, Kazakh commercial laws have improved significantly in recent years and are considered on a par with many other CIS countries. The improvements in recent years extend to securities legislation (including the creation of new unified financial sector regulator in 2004), concessions (in particular the adoption of the new concessions law in 2006) and insolvency (including the 2006 amendments to insolvency legislation). However, Kazakh commercial laws still fall short in certain respects of standards that are generally acceptable internationally. It should be noted that Kazakhstan remains one of the Bank's countries of operation that is yet to approve and implement the AML and anti-terrorist financing laws.

An analysis of key commercial laws that contribute directly to creating a favourable investment climate in Kazakhstan, such as secured transactions, bankruptcy laws, and regulation of financial markets, shows that even relatively good laws often suffer from poor implementation. This implementation gap both undermines the utility of the specific laws in issue and diminishes the confidence that both Kazakhstan and foreign investors and traders have in the legal system as a whole, in particular in its ability to uphold contractual rights. Kazakhstan's poor record of upholding political freedom and civil liberties is also of concern, given the continuing large and unchanging gap between the adoption of new laws and their effective implementation. The President constitutionally holds a vast amount of power, not only over the legislative, but also over the executive branch. The judiciary as well remains under the control of the President and the executive branch.

There is a concern that the level of the country's economic progress is not matched by similar progress in legal reform. Because of the inter-dependence of these two pillars of transition, and given that experience has shown that in transition countries these pillars are mutually reinforcing, Kazakhstan will only be able to maximise its long-term economic potential provided its efforts to advance economically are matched by a commitment to legal reform.

The FIC, set up in 1998 as a consultative body comprising major foreign investors in the region and chaired by the President, shapes further improvements to the legislative environment. As such the Legal Working Group of the FIC has successfully contributed to the strengthening of judicial independence (e.g. increase of judges' salary, reforms aimed at independence of judiciary from local authorities, etc.), creation of Specialized Economic Courts, and drafting laws on maritime, investment, arbitration, etc. The challenge facing Kazakhstan in 2006 and beyond is to further enhance the quality and competence of the judiciary, tackle corruption, upgrade its commercial laws to standards that are generally acceptable internationally and make those laws fully effective through a strengthening of the court system and the rule of law.

2.2 Progress in Transition and the Economy's Response

2.2.1 Macroeconomic conditions for Bank operations

The economy has remained robust during the strategy period. Fiscal prudence has been underpinned by further accumulation of assets by the NFRK – a vehicle to save and invest part of fiscal revenues abroad when commodity prices are high. Monetary policy is based on inflation targeting but, in recent years, the rate of inflation overshoot policy target rates. As a natural resource based economy, medium and long-term macroeconomic challenge is to adopt an appropriate policy mix that will maintain the diversification of the economy and insulate itself from commodity price volatility. Recent tightening of regulations in the financial sector to restrain externally financed credit growth should relieve pressure on the foreign exchange and decelerate the growth in domestic demand. However, further strengthening of banking regulation is needed as the sector is increasingly vulnerable to shocks. Fiscal policy should also move towards non-oil revenue deficit targeting and consider tightening if inflationary pressures persist.

Real economy: The economy grew by 9.6 per cent in 2004, 9.4 per cent in 2005 and 9.4 per cent in the first half of 2006. The share of hydrocarbon sector has remained at around 15 per cent of gross domestic product (GDP) in 2003 prices as growth was primarily driven by the non-oil sector. The income and wealth effects from high oil prices have benefited the non-oil sector – the construction and financial services sector in particular, while real growth in hydrocarbon output slowed due to constraints in export capacity. The rate of unemployment has declined steadily from 8.8 per cent in 2003 to 8.1 per cent in 2005. However, as the domestic demand has been boosted by strong credit growth and higher public expenditures on pensions and public sector wages, inflationary pressure in the economy rose. Consumer price inflation picked up from 6.4 per cent in 2003 to 7.6 per cent in 2005 and exceeded 8 per cent by June 2006. Policy target for inflation was in the range of 4.9-6.5 per cent in 2005.

Economic policies: The general government surplus widened in recent years (reaching 6 per cent of GDP in 2005) while accommodating a sharp increase in fiscal expenditures on pensions and public sector wages as well as various tax cuts. Rising oil prices have boosted revenues from the oil sector which increased from 6 per cent of GDP in 2003 to 7 per cent and 11 per cent in 2004 and 2005 respectively. NFRK had accumulated US\$ 8 billion (14 per cent of GDP) by the end of 2005 and US\$ 11.5 billion by 31 August 2006. The budget for 2006 projects the overall fiscal position as a percentage of GDP to remain similar to that of 2005 and fiscal surplus of 5.6 per cent of GDP is expected in 2006. In July 2006, the NFRK was fully integrated with the budget. Under this new arrangement, all oil revenues will accrue to the NFRK which will then transfer part of the funds to finance investment and programmes for human capital development. The new arrangement should improve fiscal management through targeting of budget deficit excluding oil revenues.

Monetary policy primarily focused on stemming inflationary pressure through monetary tightening and by allowing nominal appreciation of the Tenge against the US dollar. Bank lending primarily funded through external borrowing increased sharply and domestic credit outstanding more than tripled between 2003 and 2005. The NBK gradually increased the refinancing rate from 7 per cent at the end of 2003 to 9 per cent by July 2006, and extended the coverage of liabilities for which banks were required to provide minimum reserves. Higher reserve requirements for foreign liabilities compared to domestic liabilities were also introduced in 2006 in order to stem the growth of external borrowing by commercial banks. The NBK also allowed the Tenge to appreciate against the US Dollar in nominal terms in the first half of 2006 through less intervention in the foreign exchange market. Real effective exchange rate appreciated by 23 per cent between end-2003 and mid-2006.

External sector: The current account recorded a small deficit of 1 per cent of GDP in 2005. A record trade balance surplus of 18 per cent of GDP due to high commodity prices was more than offset by a sharp increase in income payments associated with FDI in the hydrocarbon sector and an increase in imports of services, also linked to investments in the hydrocarbon sector. The current account returned to surplus during the first quarter of 2006. International reserves and NFRK assets amounted to US\$ 22 billion, more than 9 months of imports of goods and services at the end of first half of 2006. Total external debt as a percentage of GDP remained constant at 74 per cent in 2005. While the share of inter-company loans associated with FDI in the hydrocarbons sector in total debt declined, the external liabilities of Kazakh banks increased and accounted for 36 per cent of total external debt at end-2005.

2.2.2 *Transition success and transition challenges*

The previous strategy highlighted the importance of a diversified economic structure which will be resilient to oil price fluctuations in line with the objectives of “Industrial-Innovation Development Strategy of the Republic of Kazakhstan for 2003-2015” and the challenge to develop a competitive private sector. In the strategy period, the authorities have demonstrated a great capacity for institutional innovation and adaptation, e.g. through the establishment of the two state holding companies Samruk and Kazyna. While acknowledging the potential of these initiatives to contribute to sustainable development, the difficulties and risks should also be recognised. Institutional experience is not easily transferred across countries and, once established, dysfunctional organisations are not easily phased out.

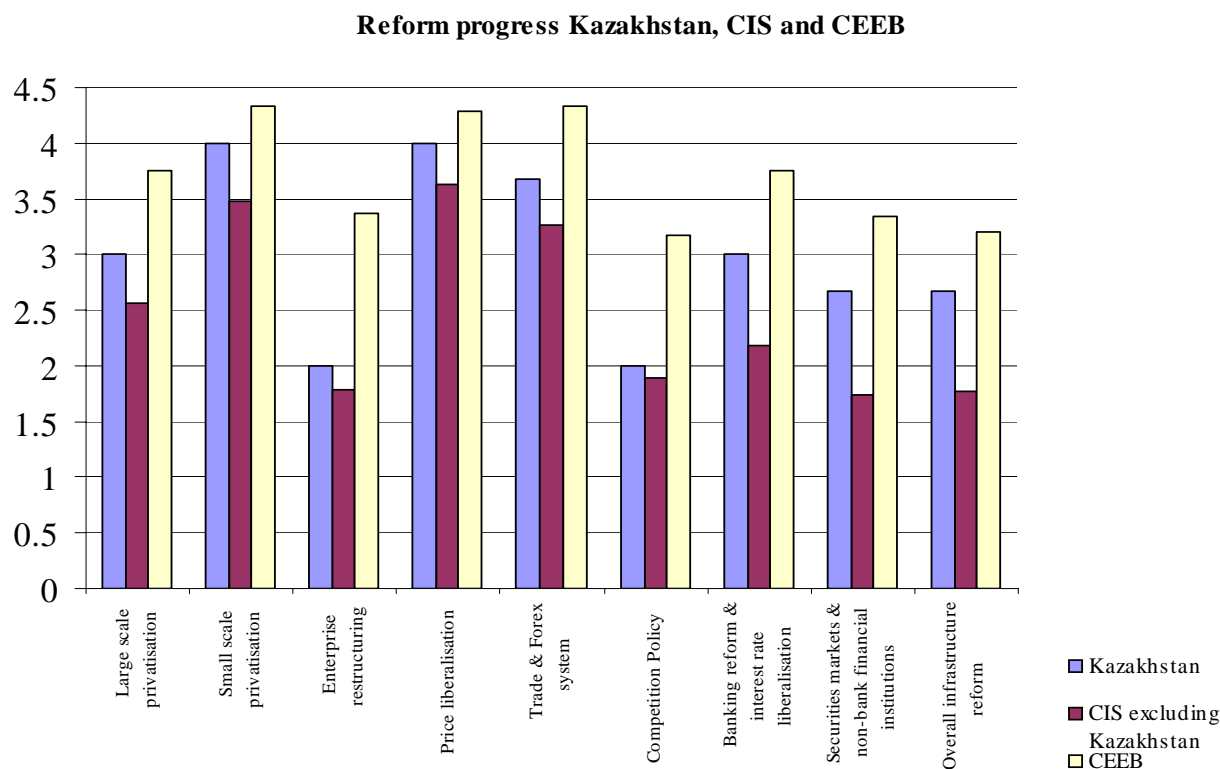
In the forthcoming strategy period, the authorities should continue to focus on addressing challenges identified in the previous strategy:

- Reduce bureaucratic red tape, address the issue of corruption and create fair and competitive environment for businesses in order to foster innovation and entrepreneurship;
- Increase openness to foreign trade and investment in order to strengthen competition and competitiveness of enterprises;
- Improve corporate governance of enterprises in order to enhance access to long-term debt and equity capital;
- Attract private sector investment in infrastructure services in order to reduce infrastructure bottlenecks and narrow inter-regional gaps in service quality.

Progress in transition

Kazakhstan has made some progress and continues to be a lead reformer in the CIS (Table 5). However, reform efforts have clearly lagged behind advanced transition economies in Central and Eastern Europe and the Baltic States (CEEB). In the past two years, progress was most noticeable in the deepening of structure and the extent of provision of market services in infrastructure sub-sectors (telecommunications and railways) as well as in securities markets and NBFIs.

Table 5: Reform progress in Kazakhstan, compared to CIS and CEEB



Source: EBRD Transition Report 2006

- Market liberalisation and small-scale privatisation:* Kazakhstan has reached close to the level of advanced market economies in early years of transition. However, it is yet to become a member of the WTO and the key challenge is to accelerate the accession process. This will not only improve access to world markets, which is particularly important for non-oil and gas sectors, but also improve the investment climate for potential foreign investors as it will demonstrate the country's commitment to international rules and obligations.
- Financial sector reforms:* Kazakhstan has been one of the most advanced reformers in the banking sector in the CIS with the strongest regulatory and supervisory frameworks. In order to curb rapid loan growth predominantly financed by external funding in recent years, reserve requirements has been tightened to increase the costs of external borrowing by banks. Regulation on open foreign currency position has also been tightened. Consolidated supervision was introduced to improve regulatory oversight over related party loans and further efforts are being made to improve ownership transparency of commercial banks. However, as the sector is increasingly vulnerable to shocks, the key challenge is to further strengthen regulation and supervision with a focus on risk management. In securities markets and non-bank financial sector, the regulatory framework is generally in line with international standards, and the challenge is to further strengthen the enforcement capacity of the regulator to ensure rigorous disclosure standards are adopted in practice. Pension legislation should also be modified in order to allow more flexibility in asset allocation.
- Large scale privatisation, enterprise restructuring and competition policy:* Progress in reform has been relatively slow in the enterprise sector. Large-scale privatisation has been put on hold for some time. Recently, a national holding company, Samruk, was established in order to improve the governance of large-scale state-owned companies

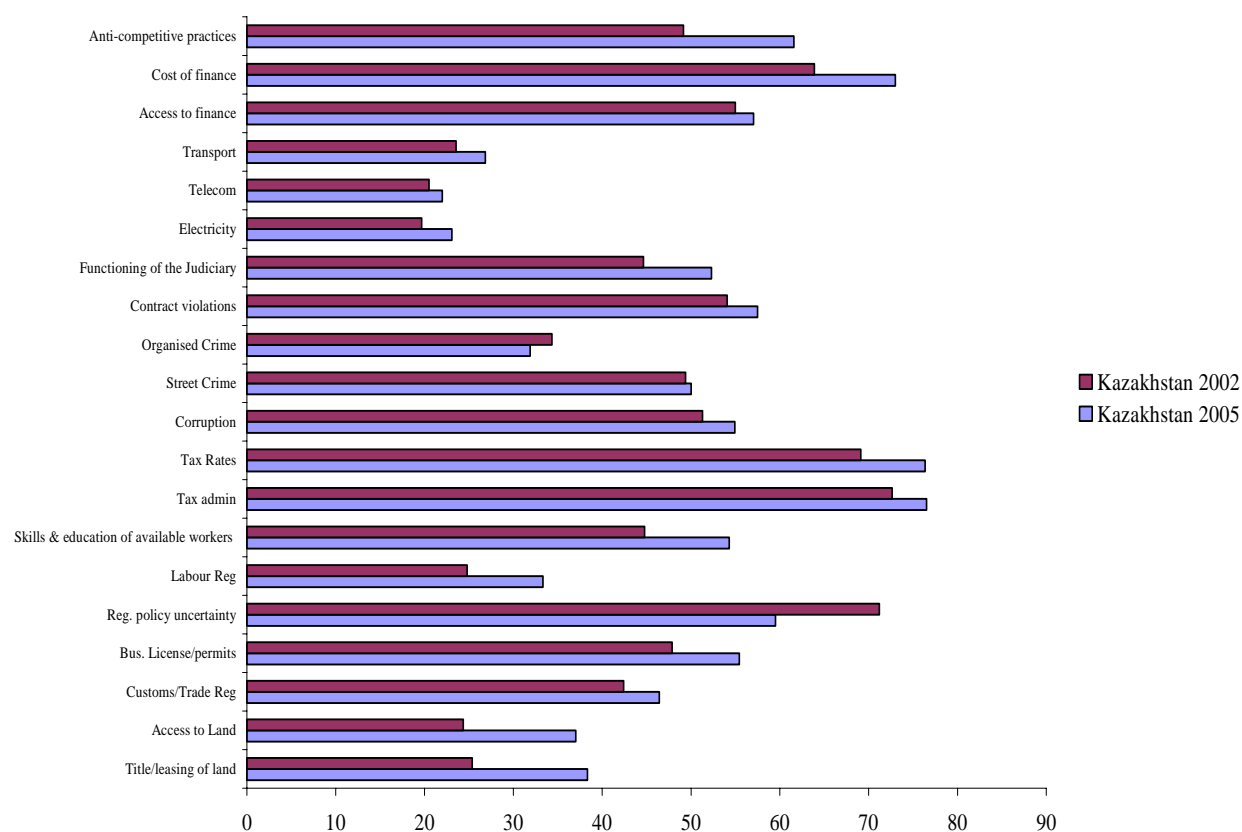
(see section 3.2.2). It is expected that the holding company, the supervisory board of which consists of independent members as well as government representatives, will be more effective in managing state-owned companies. Improvement in corporate governance and transparency of private enterprises has been limited to date, although all joint stock companies are now required to produce their financial statements in accordance with IFRS and also to appoint independent directors to their respective boards. The successful raising of capital through IPO in the overseas market by several Kazakh companies could lead to more companies seeking such avenues to raise long-term funding, improving governance and transparency in the process. The least progress was made in the competition policy. A new competition law that became effective in July 2006 raised the threshold of asset and share acquisitions which require prior approval by the competition authorities. The new law also set a unified definition of a dominant position – a company with a share in the relevant market exceeding 35 per cent. While the new law will relieve small and medium enterprises from ex-ante regulatory approval, given that an increasing number of enterprises perceived anti-competitive behaviour to be an obstacle for businesses (see below), further changes in the legal framework are required in order to promote new business entry and ease exit.

- *Reforms of infrastructure:* In infrastructure, progress has been mixed. While overall regulatory framework for network infrastructure tariffs setting has improved, the extent of market liberalisation and new entry has differed across infrastructure sub-sectors. The most advanced is the electric power sector followed by railways and telecommunications. The least advanced is water and waste water and road sectors. The extent of regional divergence in access to infrastructure services (see Table 4) may be explained by the extent of reforms in infrastructure with less regional divergence in those sectors where reforms are more advanced (electricity and telecommunications). It is important that further efforts are made to advance road sector and municipal infrastructure reforms. In the former, key challenges are to prioritise investment and to separate regulatory functions from project planning and execution functions which could facilitate private sector participation. In the latter, the revenue raising and project implementation capacity of local governments to undertake investment programmes need to be strengthened.

Investment climate

The development of investment climate in recent years has been mixed. The table below (Table 6) is based on EBRD/WB BEEPS and it shows a percentage of firms reporting a minor, moderate or major problem in a number of dimensions that affected businesses in Kazakhstan in 2002 and 2005. Business environment as perceived by surveyed firms has improved in some areas but deteriorated in others. The deterioration was most pronounced in access and title/leasing of land, availability of skilled workers and labour legislation, and anti-competitive practices.

Table 6: Problems in the Business Environment



Source: EBRD/WB BEEPS 2002 & 2005

The WB's Doing Business ranking of Kazakhstan also provides a mixed picture. While the overall ranking has improved from 82nd place among 175 economies in 2005 to 63rd in 2006, this was largely because of a significant improvement in access to credit. In areas such as dealing with licenses, trading across borders and closing a business, businesses in Kazakhstan incur significantly more time and costs compared to other countries in the survey.

Kazakhstan has taken steps to enhance transparency of revenues that accrue from oil and gas sectors. In 2005, the country has officially endorsed the principles of the EITI. The objective of the initiative is to ensure that contractual payments reported by companies match revenues received by the Government. A memorandum of understanding was signed by various stakeholders, including the Government and 28 companies in October 2005. Under this initiative, all revenue flows from oil, gas and mining companies to the Government will be disclosed to the public.

According to BEEPS, corruption is regarded as more of a problem in 2005 compared to 2002 (Table 6). However, the quantitative survey in BEEPS indicates that corruption has declined both in terms of frequency and level. The Corruption Perceptions Index (CPI) score of Kazakhstan published by Transparency International (on a scale ranging from 10 to 0, 0 being highly corrupt) increased from 2.2 in 2004 to 2.6 in 2005, indicating a perception of decreased prevalence of corruption.³ These results may reflect the effectiveness of anti-corruption measures introduced in 2003 when amended anti-corruption law was adopted and a new Agency for Fighting Economic and Corruption Crimes was established. There has been little

³ The CPI score in 2006 released early November remained same at 2.6 and the country ranked 111th out of 163 countries compared to 107th out of 159 countries covered in 2005.

progress in enhancing the transparency of financial interests of public sector officials who are in positions where there could be conflicts of interest with their private interests.

The investment climate for foreign investors has generally remained stable in the past two years although regulatory changes have strengthened the state's control over the oil and gas sector. FDI remains predominantly directed towards oil and gas and related service industries. However, reflecting relative shortage of supply, FDI began to flow into non-tradable sectors such as wholesale and retail trade, utilities and the financial sector. This is positive both from the perspectives of knowledge and skill transfers and maintaining a diversified economy. In order to further attract FDI in non-oil and gas sectors, early accession to the WTO is imperative as it will demonstrate the country's willingness to commit to international rules and obligations.

2.3 Access to Capital and Investment Requirements

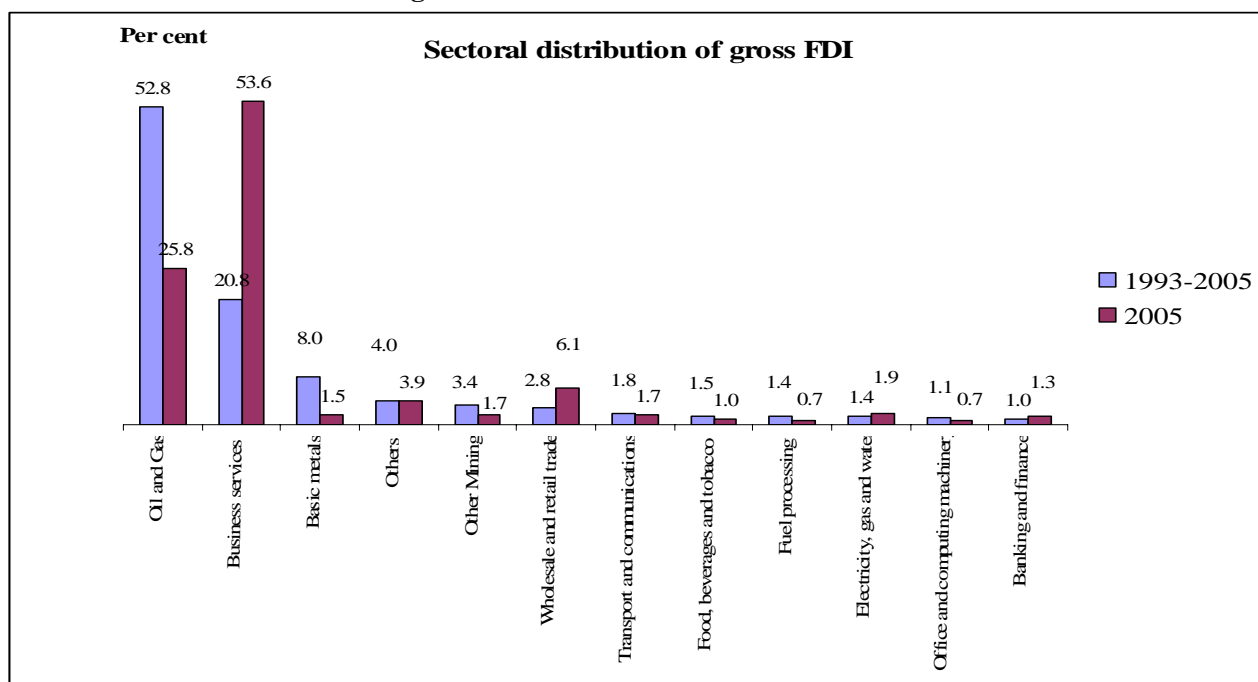
Kazakhstan's access to capital has improved substantially in the past two years. Reflecting buoyant economy underpinned by high commodity prices and prudent macroeconomic policies, all international credit rating agencies rate Kazakhstan's sovereign foreign currency rating at investment grade. It is currently rated "BBB-" by Standard & Poor's, "Baa3" by Moody's and "BBB+" by Fitch. Although the Government has not raised funds from international capital markets in recent years and adopted a policy of repaying maturing debt instead of refinancing them, improvement in sovereign credit rating had beneficial spill-overs on the credit ratings of domestic banks and corporates.

In the past two years, Kazakh issuers (primarily domestic banks and state-owned companies in natural resources and infrastructure sectors) have raised over US\$ 6 billion in international capital markets with maturities of up to 20 years. Major banks (KKB, BTA, BCC and Alliance Bank) were also able to raise a total of US\$ 750 million in perpetual bonds that would count as their capital base. Similarly, access to international loan markets has also improved raising more than US\$ 7 billion in the past two years. The tenor available in the syndicated market has also lengthened with KKB, BTA and BCC raising syndicated loan for up to 3 years. The pricing of BTA's 3-year syndicated loan raised in September 2006 was 65 basis points over London inter-bank offered rate (Libor).

Several Kazakh private companies were also successful in raising equity capital through overseas listing in 2005. Kazakhmys, a copper mining company, raised £600 million through an IPO on the LSE and was subsequently included in the FTSE 100 index of leading shares. KazakhGold, a gold mining company, raised US\$ 196.5 million through an IPO of GDRs, also on the LSE. In October 2006, KazMunaiGas Exploration and Production, a subsidiary of KazMunaiGas (a national oil and gas company) raised over US\$ 2 billion through IPO in London and Almaty. Further IPO plans have been made by other Kazakh companies and banks to boost their equity base.

Kazakhstan continues to attract one of the highest levels of FDI per capita in the CIS countries. FDI remains predominantly directed towards the oil and gas industries. However, in recent years, non-tradable sectors such as business services – predominantly related to oil and gas sector, wholesale and retail trade, utilities and financial sector have been attracting more investments.

Table 7: Sectoral Distribution of gross FDI



Source: National Bank of Kazakhstan

3. STRATEGIC ORIENTATIONS

3.1 Bank's Priorities for the Strategy Period

The strategic priorities for the strategy period will be to:

- Engage actively in further reform process by working with both private and public sector.
- Broaden the Bank's operations and increase its impact with a special focus on the corporate sector, including the SMEs, to support the diversification of the economy of Kazakhstan, and to promote competition.
- Continue to finance infrastructure with strong emphasis on transport and power sectors.
- Stay engaged in the financial sector, with a clear focus on enhancing competition and supporting non-bank financial services as well as capital markets.
- Promote higher transparency and governance standards, and FDI.

In its operations, the Bank will continue to use traditional product instruments to achieve its strategic goals. However, to support the above mentioned objectives, the Bank will emphasise innovation and the use of more sophisticated products, alongside traditional funding instruments:

- Capital market transactions, including equity funds and securitisation
- Energy efficiency related investments
- Adequately structured PPPs
- Equity and mezzanine financing
- Financing micro and small enterprises in the rural and agricultural sectors
- Local currency funding
- Co-financing with domestic banks
- Expansion of TAM and BAS

The Bank will continue to increase the presence and efficiency of the Bank's operations, improve the delivery of the Bank and enhance its policy dialogue by building up the Almaty Resident Office as the regional office for the Bank's expertise to be offered in Central Asia. This will include the strengthening of the skills and seniority of Bank staff based in Kazakhstan, including sector teams' presence and possibly certain support functions, such as economists, located in the field.

3.2 Sectoral Challenges and Bank Objectives

3.2.1 Enterprise Sector

The **general industry sector** has a key role to play in the country's objective to diversify its economy, making it less dependent upon oil, gas and mineral extraction. The Bank is committed to support the competitiveness of the manufacturing industry under growing energy prices. However, the sector remains challenging due to the relatively small and geographically disbursed domestic market, high transport costs, availability of significant liquidity, and issues relating to the transparency of ownership. Outside of the hydrocarbons, metal processing and mining sectors, investments have been limited. This has meant that the Bank's opportunities to support FDI or work with local enterprises have also been limited.

Despite these challenges, opportunities exist to support growth in sub-sectors that are benefiting from rapidly growing economy, such as construction materials (cement, glass, bricks, insulating materials), services related to the oil and gas industry, light manufacturing, packaging and paper production from waste paper recycling. Based upon Kazakhstan's rich natural and mineral resource endowments, the Bank will support viable downstream projects such as chemicals and heavy metals processing. The Bank will continue discussions with potential investors on large investment projects contemplated in the petrochemical sector with a view to supporting bankable projects. The Bank will support the Kazakh Government in their initiatives to introduce commercially viable applications for environmentally safe storage methods of sulphur. The safe disposal or utilisation of sulphur is becoming an increasing concern, as it will be produced in increasing quantities as a by-product of the country's oil and gas sector.

The Bank will support reputable foreign sponsors for political risk mitigation and provide its skills in structuring limited recourse project finance for large and complex projects. It will dedicate more resources to medium sized and large local companies that have outgrown local banking sector and are in preparation of accessing international capital markets. Such companies value long maturities, cash-flow based lending, project structuring skills and general prestige associated with the Bank's funding, the factors that significantly increase their chances of successful listing on international capital markets (i.e. projects involving pre-IPO restructuring) and selectively support regional cross-border expansion of reputable Kazakh companies to neighbouring countries. The Bank will continue to emphasise the importance of higher transparency, energy efficiency and environmental awareness.

The **MSME sector**, which accounts for 99 per cent of total registered enterprises, will remain important for the economy as a source of innovation and entrepreneurship. The Bank will continue to build MSME financing capacity of various financial intermediaries using frameworks such as KSBP. The efficiency of delivery of financial services to micro and small enterprises will be improved through the introduction of new products such as the leasing facility and the usage of local currency instruments. The Bank will continue to focus on the smallest MSMEs via financing local NBMFIs.

The **agribusiness sector** has the potential in contributing to the economic diversification of Kazakhstan. The Bank will shift its attention to local companies displaying good growth potential and willingness to work with the Bank on improvements in corporate governance and business conduct. The Bank will continue to explore ways on taking direct risk on local companies for working capital financing. Further marketing efforts are needed to join forces with any strategic and/or foreign investors in the food sector in Kazakhstan. A scheme to finance purchasing of agricultural equipment in collaboration with local banks initially rolled out in 2004 has been successfully implemented, and the Bank will work with local banks to widen availability under the programme. The Bank will continue policy dialogue with the government on the implementation of key reforms in the agricultural sector such as the introduction of legislation to expand the coverage of warehouse receipts to include other commodities such as cotton in addition to grain.

In the **telecommunications, informatics and media sector**, the Bank is committed to supporting the sector as it faces the challenges entailed in full implementation of market liberalisation, which will foster increased competition and enhance the nature and extent of services available to the population. This includes, among others, continuing work and participation in the further privatisation of Kazakhtelecom. The Bank will support viable projects with fixed line and mobile operators to improve service and enhance competition. Projects which promote the development of data transmission, internet, media and selected informatics projects for example, software development and IT, will be considered.

In recent years, significant legal reforms had been undertaken. A new Communications Law was passed in 2004, formal liberalisation of the market occurred in January 2006 and a new Competition Law became effective in July 2006. These reforms have covered all major areas in the sector, providing a legal basis for liberalisation, equal network access for market participants and universal service provisions. As a result, the environment for communications in Kazakhstan has improved significantly. However, a number of fundamental elements remain outstanding. Going forward, the success of these legal reforms will hinge upon their full implementation over the short to medium term. To help the government to tackle these and other issues at present, the Bank is implementing a technical co-operation project with AREM in the area of tariff reform. In addition, the Bank has assisted AIC with the formulation of a proposal for the establishment of an independent communications regulator and will seek to provide support to the Competition Protection Committee in the area of communications.

In **property and tourism sector**, the Bank will support selective projects that promote better logistic/warehouse, retail, office, hotel, and residential developments through senior debt, mezzanine, and equity instruments. This includes increasing the number of hotels, office and retail premises of international standard, particularly in Almaty; support projects in regional centres with growth potential and giving selective backing to projects with strong sponsors in areas that have the potential to develop; supporting the development of secondary markets by encouraging the growth of established property companies and by creating sector specific funds targeting both domestic and international investors. The real estate financing market has advanced in 2006 with local banks offering longer tenors and few foreign banks making a foray into the market. There remains, however, a need for more flexible and sophisticated financing instruments to tailor the financing to the needs of the projects. Within the sector, the demand for international standard hotel rooms with high quality management and service levels, particularly for mid-range hotels, remains unfulfilled. Existing warehousing stock is inadequate for modern logistics management and proper storage. Inadequate supply of high quality office space does not meet requirements of the companies expanding their operations.

Institutional quality retail centres with efficient concepts and lay outs and entertainment components are scarce.

In the **natural resources sector**, the Bank will promote competition and market expansion by assisting small and medium sized private oil and gas companies enabling access to transportation infrastructure and markets, thus allowing know-how and the use of modern technology to spread more widely. This would include service companies that develop local expertise and capability in support of larger projects. The Bank will also support the mining sector where the above objectives are met as well as finance measures to improve environmental, health and safety standards. Particular attention will be paid to transition objectives related to transparency and governance, notably in the EITI context, and environmental protection and improvement. The Bank will also support projects intended to rehabilitate or expand existing hydrocarbon production or transportation capacity, notably to improve environmental performance (e.g. green house gas emissions related to gas flaring), as well as finance new strategic projects, notably cross-border or contributing to international integration, which ensure a safe, fair and sustainable development by meeting high standards of environmental, health and safety protection as well as guaranteeing transparency and dialogue with civil society. The Bank will finally endeavour to leverage such projects and maximise local SME involvement and community development initiatives.

TAM/BAS programmes will continue to further promote private sector development to assist the growth of SMEs, enabling them to adapt to the free market economy and to be more competitive. TAM plans to implement a minimum of 10 projects in Kazakhstan in the next three years, while BAS Programme, funded by Japan, aims to implement over 100 projects per year. Investment alone cannot answer all of the economic development needs of local companies. Individual enterprises require urgent assistance in order, for example, to develop strategic business and marketing plans, to improve management skills, to develop new products and to raise quality standards for export. These goals can only be reached quickly through provision of customised and focused assistance to individual companies with the explicit objective of achieving such results. TAM/BAS expertise and experience can assist in developing these features, and promote entrepreneurial initiatives.

The integration of TAM/BAS as a core activity of the Bank will continue to enhance the transition impact of the Bank. TAM and BAS will contribute to the project pipeline. This is achieved because working with enterprises on advisory projects pre-investment is an effective screening procedure. Moreover, that same TAM/BAS expertise can also be applied to strengthening a company's performance in the post-investment phase. This integration would be further enhanced by new MSME and equity facilities for SMEs in the country.

A new TAM/BAS Environmental Programme, funded by Japan, will assist Kazakh SMEs to implement environmentally-friendly technologies to reduce pollution and increase energy efficiency, without incurring a heavy financial burden. Initial projects include the Shymkent Mai Wastewater Treatment project and an environmental project in Ust-Kamenogorsk, the main heavy industry hub in eastern Kazakhstan where pollution is most problematic.

3.2.2 Infrastructure Sector

While noting slow progress in reforms, relatively large transition gaps in the sector and misallocation of resources on some projects, the Bank will continue to support transport, energy and telecommunication infrastructure development to satisfy the growing needs of the economy and population. The Bank will take leadership in developing and engage actively in appropriately structured and tendered PPPs with a view to involving private sector in building

and operating publicly owned infrastructure. Support of further regulatory development that promotes investments and equal access to infrastructure will be provided. Given Kazakhstan's remoteness from major markets and low population density, the Bank will continue to work closely with the private sector, government authorities and other IFIs on sustainable solutions for infrastructure and promote regional co-operation.

In 2006, the government created **Samruk**, a state holding company to manage assets of state-owned corporations – such as KEGOC (national electricity transmission monopoly), KazMunaiGaz (national oil and gas company), Kazakhstan Temir Zholy (national railway company), KazPost (national post) and Kazakhtelecom (national telecom operator)⁴. The idea is for Samruk to act in the capacity of the government as a shareholder, with relevant ministries continuing to assume the role of regulators. It gives the management an opportunity to find synergies between various infrastructure enterprises, improve their corporate governance and reporting standards, and prepare them for either partial or full privatisation. The EBRD has started to develop a relationship with Samruk with the objective of identifying areas of co-operation and prioritization of projects for potential EBRD financing.

In the **transport sector**, the Bank will seek to promote the involvement of private sector finance, know-how and risk-taking. The Bank will assist the Government to identify appropriate opportunities for PPPs to serve as pilot projects. Opportunities exist in roads construction and maintenance, railways electrification and construction of new railroads, but also airports and ports. In this respect the Bank will assist with the development of a competitive, quantifiable and transparent process for the award of concessions, and advise on structures which are commercially attractive to bidders while having a reasonable prospect of achieving value for money for the public sector. Additional opportunities will be sought to support and encourage private sector investment in transport infrastructure in the rail operating sector, particularly for the financing of rolling stock, and in the commercial aviation sector for the replacement of outdated aircraft. In the shipping sector, the Bank will support the modernisation of the Caspian fleet and offer financing for port developments in Aktau, Kurik and Bautino to service growth in the region.

However, concessions and PPPs can not be used uniformly for overcoming the deficits in infrastructure. Where the intervention of the private sector might be inappropriate, or unlikely to provide value for money for the public sector, the Bank will continue to encourage reforms through sovereign operations linked to a reform agenda, particularly in the road and rail sectors. Policy dialogue in the context of the Bank's projects will continue to further enhance transparency in the administration of roads and the allocation of public resources.

In the **municipal sector**, legal restrictions on borrowing from and guaranteeing of loans from banks by local authorities prevent the Bank's wider involvement in the sector. The law constitutes an important impediment to economic development of Kazakh regions and local communities. The Bank will continue to maintain its engagement with the government through the provision of technical assistance to promote budgetary independence on a municipal level. It is estimated that the Bank could finance a number of economically and socially beneficial projects in Kazakhstan in such sectors as water supply, wastewater treatment, district heating or public transport. Currently, financing of municipal projects have to be structured as sovereign operations, which provide sub-optimal transition impact. However, in order to maintain a policy dialogue with the Government, the Bank has started to prepare the first project to be based on a sovereign structure, Astana New Transport System,

⁴ Per government resolution of October 24, 2006, Samruk will receive management of 17 more companies with government stake.

to support the Astana city government for construction of light-rail based public transport system. The success or failure of this project is likely to determine the extent to which the Bank can be involved in other municipal projects in Kazakhstan in the future.

The Bank will also explore the viability of PPPs for the provision of municipal services. It is important to note, however, that financing of municipal infrastructure based on PPP model would also require (bar exceptional cases) financial undertakings from local or central governments.

Challenges faced by the **power utilities sector** are outdated assets with under-investment accumulated over past decades, significant investment needs for improved capacity and efficiency, below cost recovery tariff levels, over-lapping tariff setting responsibilities between different government authorities, third party grid access issues, and political sensitivity to the affordability of households preventing adequate tariff adjustments. The Bank will leverage on existing client base and accumulated know-how in the sector. It will support projects and producers contributing to the development of domestic and regional power trade, continue to finance projects with national companies on a non-sovereign basis (including seeking out decentralised projects on “oblast” level), and support cross border investments from reputable Kazakh companies abroad. The Bank will also actively seek renewable projects, in particular hydro-power and wind-power generation, and energy efficiency projects. It will continue to actively pursue policy dialogue with the central and municipal authorities to promote regulatory changes, including through the effective implementation of Technical Co-operation to (i) further improve tariff setting methodologies in line with international practice (e.g. tariff benchmarking) and (ii) clarify and simplify tariff setting responsibilities between different government authorities.

In the **oil and gas infrastructure sector**, the Bank will focus on projects that promote the integration of Kazakhstan in regional markets as a supplier or a transit corridor and enhance the country’s role in, and access to, world markets as a major exporter of hydrocarbons. Firstly, the Bank will support projects intended to rehabilitate or expand existing hydrocarbon transportation capacity, to improve environmental performance (e.g. gas pipeline leakage) or facilitate transit through Kazakhstan *en route* to key consumer markets such as Western Europe, Ukraine and the Caucasus (notably Georgia), which need to diversify supply sources. In this respect, the Bank will continue to promote non discriminatory third party access and a transparent tariff system through policy dialogue, technical co-operation support and conditionality as appropriate. Secondly, the Bank will seek to be involved in the construction of new strategic projects such as the Kazakh-Caspian Oil Transportation System, the Trans Caspian Gas Pipeline or the Kazakhstan-China oil and gas pipelines, with the objective to ensure a safe, fair and sustainable development meeting high standards of environmental, health and safety protection as well as guaranteeing transparency and dialogue with civil society. The Bank will also support the development of marine support basis for off shore oil industry. The Bank will also endeavour to leverage such projects and maximise local SME involvement and community development initiatives.

3.2.3 Sustainable Energy and Energy Efficiency

The energy intensity across all sectors in Kazakhstan is high and there is vast technical potential for improving energy efficiency. Kazakhstan will be a focus for the Sustainable Energy Initiative launched by the Bank in May 2006.

In Kazakhstan, significant barriers exist to the realisation of energy savings measures, most importantly the continued subsidisation of energy costs, as well as information and awareness

gaps, and a lack of technical expertise to assess and structure energy savings projects. The Bank will work to address these barriers partly through policy dialogue, e.g. relating to the Law on Energy Saving, the potential of setting up by the authorities of a national energy saving centre, and taking part in a dialogue on energy efficiency in co-operation with other IFIs.

The Bank's focus will be on industrial energy efficiency projects, and will include examination of the potential for carbon trading (once Kazakhstan will ratify the Kyoto Protocol). The Bank will explore the possibility of structuring smaller projects through co-operation with financial intermediaries on credit lines or other appropriate products. The Bank will also explore the possibility for structuring energy savings projects in other areas, e.g. housing, subject to what can realistically be achieved in the prevailing tariff and institutional framework. On renewable energy, the Bank will continue to work with the government on development of the renewable energy framework and will finance projects where support mechanisms permit.

3.2.4 Financial Sector and Capital Market Development

The Bank will continue to facilitate competition in the financial sector by providing debt, equity, and capacity building technical assistance, particularly to medium sized banks and NBMFIs. On debt products, in view of the very developed access to capital markets, the Bank will be particularly attentive in developing projects with specific attributes meeting additionality concerns and contributing to transition. Such attributes may include long maturities for syndicated loans or specific use of proceeds, such as provision of financing to small and micro businesses, as well as provision of local currency instruments to the non-banks working in the microfinance sector. The Bank will work to improve the instruments to be used for micro and small business lending and will support the sustainability of institutions working in the microfinance field through capacity and institution building during their commercialisation process.

The Bank will promote strategic FDI to the financial sector and support the development of financial services such as leasing, mortgages, insurance and pensions. The Bank will also facilitate securitisation as a source of asset re-financing to Kazakh financial institutions. The Bank will continue to actively work with existing shareholders of the Kazakh banks to achieve better transparency of ownership and corporate governance. Assistance will be provided to the Government in privatisation of the few remaining state-owned financial institutions in pensions and mortgages. The Bank will support the development of a private equity industry in the country by selecting the best credible management teams in the country and providing part of the capital for new private equity funds.

In the **banking sector**, the Bank has already facilitated the financing of more than 200 foreign trade transactions of Kazakh enterprises in the total amount of over €440 million under its Trade Finance Programme (TFP). While foreign commercial banks and export credit agencies have already started to establish own trade finance facilities for the largest Kazakh banks, the Bank's support is still needed for intra-regional trade transactions and larger import transactions with longer tenors, as for example in the case of imports of machinery and equipment from Russia. Kazakh banks are increasingly using the programme also as confirming banks in intra-regional export transactions, financing for example, deliveries of Kazakh grain and oil products to Kyrgyz Republic and Tajikistan.

The Bank will seek equity investments in medium-sized and smaller banks with good management teams to improve transparency and corporate governance. Equity culture and

shareholder control are still largely missing in Kazakhstan and there is a need to develop these important market characteristics.

The Bank will continue to provide standard debt products, such as MSE and SME financing, syndications, mortgages and leasing to increase competition and improve efficiency in the Kazakh banking system. Local currency funding for on-lending to borrowers that have their income predominantly in Tenge will continue. Financing to NBMFIs will be complemented by tailored technical assistance to assist the leading NBMFIs in their process of commercialisation and possibly transformation into microfinance banks, or merger with existing banks. The Bank will also contemplate convertible loans and equity participations in commercial NBMFIs which are in a crucial state of their transformation process and hence capitalise on its extensive experience gained through the establishment of microfinance banks in other countries of operation.

The Bank will continue to support the larger banks due to their importance to the overall banking environment, but the focus will change to innovative and sophisticated products such as securitisation. However, this support will be conditional to improvements in transparency and/or introduction of foreign investors, either via trade sales to strategic investors or via IPOs.

Increase engagement with **non-bank financial institutions** (NBFIs) to further promote leasing, insurance, the pensions sector and mortgages. The Bank will support capital market developments, which will be an important element in pension fund management. The Bank will utilise TC funds for the development of regulations for capital markets and improvement in pension legislation. The Bank will support the second stage in the privatisation of the state-owned pension fund management company, GNPF. The Bank will look to potentially make further investments in the insurance sector which may also include investments in the nascent life sector.

In terms of the capital market development, the Bank will support securitisations of pools of specific assets which will follow the securitisations of future flows transacted by the Kazakh banks over the last couple of years. The Bank will provide support to both off shore securitisations of pools of existing receivables (such as residential mortgage assets), as well as “warehouse” facilities to encourage an accumulation of standardised assets to a certain size to enable term securitisations. The Bank also anticipates that the first on shore securitisations will take place in Kazakhstan using the 2005 law on securitisations, which may provide an additional funding source to the mortgage companies for the refinancing of residential mortgages.

The Bank will engage with leasing companies to expand the outreach of funding to a wider economy. The intention is to establish a framework for Kazakh leasing companies to provide funding against certain key criteria which should encourage a greater standardisation which may potentially lead to refinancing the leasing receivables by way of securitisations.

There is no meaningful **private equity** market with the standards expected by (international) institutional investors in Kazakhstan. In the past, two funds were established with the Bank’s support. The financial result of both funds is considered satisfactory under the given legal economic environment. However, the respective sponsors of those two funds decided not to continue its investments in Kazakhstan by raising private capital for the subsequent funds. There were few initiatives in private equity (such as the Central Asian American Enterprise Fund set up by the US Government) in the past 5 years, but it appears that none of them survived. This has created a vicious cycle because one main reason for the lack of robust

private equity market in Kazakhstan is the absence of strong fund management teams with good track records and substantial private equity experience with high standards. The experience achieved by the management teams of those funds have been lost or largely reallocated to other countries, Russia in particular. Such loss of investment talent cannot be taken lightly as it takes years to develop such skills locally. In addition to the lack of the experienced management talent, it has been perceived that the industries that are attractive to private equity investments, such as media and telecommunications, financial services, consumer related sectors and real estate development that could be targeted for foreign trade buyers are often vulnerable to the regulatory or political interference.

However, rapid economic growth and investment opportunities in the country led to establishment of several locally-based fund management teams. Those groups are different in a sense that they have been developing their investment experience solely on an in-country context, adopting themselves to a fast changing environment. The Bank has recently reviewed those groups with the view that it would develop a new relationship with stronger teams and cooperate in establishing new funds. This is different from a conventional approach where the Bank relies on the credibility of the sponsor to organise funds, including recruitment of the management team and raising private capital. While such groups may have sufficient experience in making successful investments and divestments, they have very limited experience in acting as fiduciary, i.e. responsible manager of other people's money. This requires the Bank to closely work with the managers throughout the life of the fund. Despite such risks in dealing with indigenous teams, the new approach serves well for the Bank's objective in supporting development of the sustainable private equity industry and not just promoting investments.

The Bank will work closely with the **Kazyna Sustainable Development Fund** which was established in 2006. Kazyna has incorporated all 100 per cent state owned domestic development institutions established in 2003-2004, such as the Development Bank of Kazakhstan (DBK), the Investment Fund of Kazakhstan (IFK), and the National Innovation Fund (NIF). IFK provides equity financing to large industrial projects, while NIF invests in the capital of innovative and non-extracting industries in the country. DBK supports various projects with long term debt financing. The Bank is working closely with these institutions in various fields such as equity funds, co-financing with large infrastructure projects (including PPPs).

3.2.5 Investment Climate and Policy Dialogue

The Bank will continue to support the Government in its efforts to improve the investment climate and drive long-term economic diversification, leading to higher global competitiveness and having an important stabilisation effect on both the political and economic development. Relevant initiatives will be pursued either through the FIC structures, or bilateral discussions. The established co-operation with newly created state holding companies Samruk and Kazyna will be maintained to achieve corporate governance and operational improvements of state-owned enterprises forming the holdings. The Bank will further promote adequate behaviour and acceptable standards going forward with a view to minimise the negative impact of corruption and non-transparent practices on the business environment. The Bank will also promote adoption of the AML legislation, especially in light of the Government initiative to create RFCA.

The Bank will continue to increase the presence and efficiency of its operations, improve the delivery of the Bank and strengthen the policy dialogue by building up the Almaty Resident Office as the regional hub for the Bank's activities in Central Asia, increase the number,

qualifications and seniority of Bank staff based in Kazakhstan, including sector teams' presence and certain support functions, such as economists, located in the field.

4. OTHER IFIS AND MULTILATERAL DONORS

4.1 International Monetary Fund (IMF)

Kazakhstan joined the IMF in July 1992 and the Government has worked closely with the IMF on its stabilisation policies. In December 1999, the IMF approved a 3-year credit for Kazakhstan in an amount equal to US\$ 453 million under the Extended Fund Facility in support of the Government's economic programme for 2000-2002. Subsequently, in May 2000, the NBK made an early repurchase of all outstanding balances owed to the IMF, approximately US\$ 385 million. Co-operation with the IMF continues, in particular through policy dialogue on macroeconomic issues, and technical assistance in areas including monetary policy and financial sector development. The Fund continues to conduct surveillance of the Kazakh economy in the context of its annual Article IV consultations.

4.2 World Bank (WB) Group

The WB commenced operations in Kazakhstan in July 1992 and has since provided 26 loans worth a total of almost US\$ 2 billion (US\$ 1.4 billion disbursed). Since 1997 activities have focussed on public resource management, sharpening the focus of welfare and social protection policies, and increasing the potential savings mobilisation of the country. Adjustment lending accounted for more than fifty per cent of the total portfolio. The current portfolio is focused mainly on agriculture, environment projects and energy.

Given Kazakhstan's recent economic growth and reduced need for external financing, the Government of Kazakhstan has refocused the partnership strategy with the WB towards: (i) managing the oil windfall and improving public institutions and policies, ii) developing an appropriate role for the government to foster competitiveness and facilitate business, iii) investing in human capital and infrastructure, and iv) safeguarding the environment.

In the context of the KEGOC non-sovereign power infrastructure loans described in section 1.2.2, the Bank successfully negotiated inter-creditor and security sharing arrangements with the WB.

IFC, the private sector arm of the WB Group started operations in Kazakhstan in September 1993. IFC seeks targeted opportunities to continue developing the financial sector by creating partnerships, supporting SMEs and helping to strengthen and liberalise the leasing industry and housing markets. In addition, IFC is providing assistance to local small and medium enterprise suppliers operating in the oil and gas industry to achieve the internationally recognized ISO 9000 quality certification. In 2005-2006, IFC launched technical assistance programmes focussing on further improvements to the legal and regulatory framework for leasing and mortgage markets as well as corporate governance. Funding has been approved for more than 23 projects, presenting a total value in excess of US\$ 351 million.

4.3 Asian Development Bank (ADB)

Kazakhstan has been a member of the ADB since 1994. Since joining ADB, Kazakhstan has received 14 loans totalling US\$ 483 million and 62 technical assistance projects amounting to US\$ 26.4 million. In 2004-2005, ADB approved 7 technical assistance grants for a total of US\$ 3.0 million.

The ADB's Country Strategy and Programme Update (2006-2008) for Kazakhstan (CSP) was approved in September 2005. The CSP recognises the rapid economic growth in Kazakhstan, its improved fiscal position, and sets knowledge transfer as the main thrust of the ADB's collaboration with Kazakhstan in the medium term. The focus of future ADB operations in the country will be private sector operations, especially in infrastructure and the financial sector. This new focus will be supported by public sector technical assistance and investments to create an enabling environment for the private sector, and selected public sector lending programmes in rural development and water supply. The target annual average of public sector lending in future years is one loan approval a year with indicative planned amount of US\$ 50 million. Indicative US\$ 1.5 million a year is planned for technical assistance. These programmes encompass the areas of natural resources management, rural water supply, regional and rural development, transport, central and local government support, and private sector support.

4.4 Islamic Development Bank (IDB)

As of 1 June 2006, IDB has approved a total of 31 projects for US\$ 185 million, both in public and private sectors. 13 projects have been completed, including Syzganov's Surgery Centre, Almaty-Gulshad and Karaganda-Astana roads, and several technical assistance grants projects. In 2005, IDB approved a technical assistance grant for Capacity Building of the Kazakhstan Investment Promotion Centre KazInvest, which is under implementation. IDB also participated in the modernisation of postal services to KazPost by providing modern equipment and machinery to improve postal saving system. The IDB's first direct investment in the private sector was a US\$ 5 million equity investment in the Central Asian Investment Company, which has already invested in several projects in Kazakhstan and the Kyrgyz Republic. The private sector entities of IDB (Islamic Corporation for the Development of Private Sector and Asset Management Department) also provide project and trade financing to several private sector entities in the country, for improvement in wheat and petroleum production. IDB also provided local commercial banks (KKB, BTA, Halyk Bank, Valut Tranzit Bank, Bank Caspian and Astana Finance) with project and trade credit lines.

The IDB provides assistance in introduction of Islamic Banking and Finance system within the framework of the RFCA. The IDB has organised several study tours and seminars for the concerned governmental authorities and commercial banks.

As part of the assistance to Kazakhstan in joining the WTO, IDB is conducting seminars and consultations on the WTO agreements, as well as courses in international trade policy. IDB plans to expand its trade operations in Kazakhstan and other countries in the region with the introduction of new products.

IDB, through its regional office in Almaty, participate actively in various regional and international organizations, such as CAREC, ECO, TRACECA, SPECA for the promotion of regional co-operation and integration, particularly in the areas of energy/water, transportation, trade and food security matters. Several projects in these areas have been financed in co-operation with other IFIs.

4.5 European Union (EU)

A Partnership and Co-operation Agreement entered into force in 1999. The EU encourages Kazakhstan's accession to the WTO and continues to take measures to encourage EU trade and investments in Kazakhstan, in particular by supporting economic and legislative reforms

through technical assistance. Kazakhstan is now the EU's largest trade partner in Central Asia, and the EU is Kazakhstan's second largest trade partner after the CIS countries.

The EU's main support for Kazakhstan is provided through the TACIS programme where some €53.6 million has been allocated since 1991. The programme for Kazakhstan is based on the Strategy Paper 2002-2006 and the Indicative Programme 2002-2004 for Central Asia, which consists of i) a regional programme, ii) nationally identified regional priorities and iii) poverty alleviation. Over 50 per cent of TACIS funds are aimed at supporting the emergence of a market economy. TACIS has supported the Government in the transformation and privatisation process. It supports a project to diversify the economy. There is an important WTO-accession project as well as projects in the sphere of good governance. Human Resources Development has been at the heart of several TACIS projects in Kazakhstan. About 25 per cent of TACIS funding is allocated to the Small Project Programmes, which are smaller in size, offer greater flexibility and can cross-cut various sectors of co-operation. The port of Aktau has received considerable support under the TRACECA framework (where the EU is supporting the development of new routes over land, sea and air).

Total EU financing budget for 2005 under TACIS programmes amounted to €3.4 million in 2005, consisting of the Tempus Programme III for €2 million, and the Support to Civil Society and Local Initiatives for €1.4 million. The 2006 programme totals €1.5 million and consists of 5 programmes, the largest being the Policy Dialogue Advice support for €0.4 million.

The EU is currently developing a regional development programme. The 2006 priority for Kazakhstan is vocational education. Supporting policy reform in infrastructure, as well as promoting economic diversification, will be part of a major programme in 2007.

ANNEXES

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ANNEX 1 POLITICAL ASSESSMENT

Compliance with Article 1

Over the past two years Kazakhstan has continued to make progress towards implementation of the principles envisaged in Article 1 of the Agreement Establishing the Bank.

Transition to a market-oriented economy has been visible and widely acknowledged but there are many challenges in the democracy field. Strong presidential power is not adequately balanced by the legislature and the judiciary. Corruption and transparency remain a problem, as recognised by the authorities. The recent amendments to the media law represent a setback for media freedom in Kazakhstan. The latest parliamentary and presidential elections, although reflecting an improvement over previous polls, have fallen short of a number of international standards for democratic elections.

Political Environment

Since the last strategy the country has undergone two sets of elections - parliamentary and presidential. As Kazakhstan had expressed interest in the chairmanship of the OSCE in 2009, these elections were seen by many as an opportunity to demonstrate commitment to a democratic election process.

Parliamentary elections were held in September 2004 with a second round, in 22 of the 67 single mandate constituencies, taking place a month later. The elections were observed by the OSCE/ODIHR, which concluded that “while these elections reflected improvement over past parliamentary elections, serious shortcomings remain, and the election process fell short of OSCE commitments and other international standards for democratic elections in many respects”.

The observation mission noted some improvements in the overall election process. The authorities allowed 12 political parties, including the opposition Democratic Choice of Kazakhstan, to contest the election. Several TV debates gave these parties an opportunity to inform the public about their views.

The main shortcomings were lack of transparency in the election administration, unbalanced composition of election commissions, strong media bias in favour of pro-presidential parties and considerable pressure on the voters (especially at the local level) to support these parties.

As a result of the elections, the composition of the newly-elected Majilis, the lower chamber of parliament, is almost exclusively pro-presidential. Only one MP was elected from an opposition party, and he has refused to take up his seat⁵. Zharmakhan Tuyakbai, the Speaker of the lower house of the outgoing parliament, resigned in protest over election irregularities and joined the ranks of the opposition.

Tuyakbai was the main opposition candidate contesting the presidential election in December 2005. Overall, five candidates were registered for the election. According to some international observers, there was no meaningful competition between the candidates as they did not enjoy equal opportunities to convey their views to the electorate.

⁵ Alikhan Baimenov took up his parliamentary seat in October 2006.

Prior to the election, the Election Law was amended to introduce a provision prohibiting election-related public meetings from the end of the campaign until the official publication of the results. The amendment violated the rights of freedom of association, expression and peaceful assembly. Other shortcomings included undue involvement of the authorities in the election campaign and reported pressure in some state companies to vote for the incumbent President. All candidates were provided with free airtime, but there was a strong bias in favour of the incumbent in all broadcast media.

Overall, the OSCE/ODIHR assessed the presidential elections as follows: “Despite some improvement in the administration of this election in the pre-election period, the election did not meet a number of OSCE commitments and other international standards for democratic elections”. This negative verdict was not shared by the CIS monitors who claimed not to have noticed any major irregularities.

Nursultan Nazarbayev won the election with an overwhelming majority of 91 per cent. His closest rival Zharmakhan Tuyakbai finished a distant second with 6.64 per cent of the vote. Alikhan Baimenov of Ak Zhol party garnered 1.65 per cent, while the two remaining candidates received less than 0.5 per cent each. According to the Constitution, the President is elected for seven years and cannot hold office for more than two consecutive terms. The December 2005 election was the second presidential election held under the terms of the Constitution adopted in 1995. This means that the current term, ending in 2012, is the last one for the Kazakh President. There is little doubt that the issue of presidential succession will be impacting political developments in the country in the immediate future.

In the aftermath of the presidential election, the deaths of two well-known Kazakh opposition politicians shocked the country. Zamanbek Nurkadilov, a former government minister, died under uncertain circumstances in his house in Almaty in November 2005. In February 2006 Altynbek Sarsenbayev, a leader of the True Ak Zhol opposition party, was shot dead in an execution-style murder, together with his bodyguard and his driver. The opposition has judged the killing as politically motivated.

By the end of this year the OSCE will have to decide on the candidacy of Kazakhstan for the Chairmanship of the OSCE in 2009. It is clear that any Chair has to comply with OSCE standards, including those in the so-called human dimension of the organisation. In this context, any progress in such crucial areas as the freedom of the media, the ability of political parties to operate freely and respect for individual human rights would be essential element for the decision.

In his State of the Nation address on 1 March 2006, President Nazarbayev laid out the Government’s strategy for becoming one of the world’s 50 Most Competitive Countries. This strategic vision not only included economic aspects but also contained a strong commitment to democratic principles and democratic reforms. The registration of the opposition True Ak Zhol party in March 2006 was a welcome step towards the party’s full participation in the political process. However, the remaining limitations on the free functioning of opposition parties and the latest amendments to the Media Law are not going in the direction of the democratisation of Kazakhstan.

Rule of Law and Human Rights

President Nazarbayev has announced plans for a gradual modernisation of the political system. The National Commission on Democratisation and Civil Society is tasked to lead these efforts. The Commission was established in November 2004 and consists of

representatives of registered political parties, MPs, ministers and key personalities. The latest concept, prepared by the Commission and approved in July 2006, is a five-year plan for the development of the civil society in the country. The Kazakh authorities argue that any attempt to force the pace of democratic reforms could undermine the stability which has contributed to the atmosphere of religious and inter-ethnic tolerance prevailing in the country today. Irrespective of the actual pace of the political reforms, it is essential to continue them so that they match economic achievements of the country. Transparency, predictability, good governance, corruption-free environment, based on strict adherence to the rule of law and respect for individual human rights, are essential ingredients on the path of future progress.

According to various reports, the Government's human rights record remains poor. The US State Department, analysing last year's practices, has singled out three items of legislation, passed in 2005, that have seriously eroded protection for human rights. The extremism law, election law amendments and national security amendments encroached on political rights, freedom of the press and other human rights.

A particular area of concern is the freedom of the media. The changes to the Media Law, introduced in July 2006, multiply the reasons that could be used to deny print press registration and prohibit editors of newspapers that have been closed by a court from working again as editors for other newspapers. Two years ago the Kazakh President rejected a set of restrictive amendments to the media legislation. Regrettably this year the President did not veto the changes approved by parliament in June 2006, notwithstanding an appeal from the OSCE Representative on Freedom of the Media. The Representative urged the courts of Kazakhstan not to interpret the new amendments in a restrictive manner.

There are no serious problems in the area of labour rights. The Constitution and the existing legislation provide for basic workers' rights, including the right to organise and bargain collectively and to form trade unions. Forced and child labour is prohibited by law. Although child labour is routinely used in agricultural areas, especially during the harvest season, abuse of child labour is not a problem.

With regard to human trafficking, Kazakhstan is making efforts to comply with international standards although, according to the 2006 US State Department's Trafficking in Persons Report, it remains "a source, transit, and destination country for people trafficked for the purposes of force labour and sexual exploitation".

External Relations

A vast Eurasian country, Kazakhstan is successful in implementing its multi-dimensional foreign policy, aimed at maintaining balanced relations with Europe and Asia as well as the United States. At a time when energy security has become a pressing global issue, Kazakhstan, possessing significant natural wealth, has cleverly seized opportunities for increasing its co-operation with Russia, China and the states in the Caspian Sea basin.

A known proponent of regional co-operation, Kazakhstan continues its membership in a number of regional economic and security organisations. Amongst them SCO is increasingly important for Kazakhstan because it comprises two of its large neighbours – Russia and China – as well as all other Central Asian states (with the exception of Turkmenistan).

In addition to further improved bi-lateral ties, co-operation with Russia has also continued within the framework of the 'Single Economic Space', which also includes Belarus and, to a

lesser extent, Ukraine. This year Kazakhstan has taken over the CIS Chairmanship and announced plans for reforming this moribund organisation of the former Soviet republics.

ANNEX 2 LEGAL TRANSITION

The EBRD has developed and regularly updates a series of assessments of legal transition in its countries of operations, with a focus on selected areas relevant to investment activities: capital markets, company law and corporate governance, concessions, insolvency, secured transactions and telecommunications. The existing tools assess both the quality of the laws “on the books” (also referred to as “extensiveness”) and the actual implementation of such laws (also referred to as “effectiveness”). All available results of these assessments can be found at www.ebrd.com/law. This annex presents a summary of the results for Kazakhstan, accompanied by critical comments of the Bank’s legal experts who have conducted the assessments.

Capital Markets

The primary legislation governing the securities market includes the Civil Code, the Law on Securities Market (the “SML”) and the Investment Funds Law. The Civil Code was promulgated in March 1995 and last amended in May 2005. The SML came into force on 2 July 2003, replacing its 1997 predecessor and was last amended in July 2005. The Investment Funds Law was enacted in July 2004 and supplemented by a number of regulations in late 2004 setting forth the basic investment rules and limits for investment funds.

The SML regulates the issue, placement, circulation and redemption of securities and other financial instruments, the securities market participants and the protection of investors’ rights and securities holders. The SML also details state regulation of the securities market, special terms for bond issue and circulation and for the placement of securities.

The securities market is supervised by the Agency for Regulation and Supervision over the Financial Market and Financial Organisations (the “Financial Regulation Agency”), which was established in January 2004 pursuant to the Law “On State Regulation and Supervision over Financial Market and Financial Organisations”, adopted in July 2003.

The Kazakhstan Stock Exchange (KASE) was established in November 1993 by the NBK and 23 commercial banks as a currency exchange for the development of the domestic currency market following the introduction of the national currency Tenge. In 1996 the exchange obtained a license for trading securities. KASE is now divided into four major sectors: the foreign currency market, the government securities market, the market of shares and corporate bonds and the derivatives market.

In 2004, the EBRD benchmarked Kazakhstan’s securities markets legislation with the “Objectives and Principles of Securities Regulation” published by the International Organisation of Securities Commissions (IOSCO). The results of this benchmarking demonstrated that Kazakhstan’s legislation is in “medium compliance” with international standards. The assessment was updated in 2005 and the results confirmed the 2004 scoring but with some improvements registered, bringing the scoring very close to the “high compliance” category. Two market regulatory authorities were created in the second half of 2004: the Committee for the Protection of Competition of the Ministry of Industry and Trade and the Agency for the Regulation of Natural Monopolies (AREM), each with clearly and objectively defined responsibilities. Although there are specific new provisions in the general law on advertisement restricting the production, distribution or placement of advertisements on securities, this law does not extend to underwriters or advisors. In the area of Collective Investment Schemes, there has been some improvement in the protection of investors. More

particularly, the regulator now has several means at its disposal for protecting investors in conflict-of-interest situations, such as prohibition of certain transactions, forced disclosure by management companies or verification with the custodian of the composition of assets. Further, operators are now subject to a general disclosure obligation. System operators of secondary markets are now subject to a long list of informational requirements they must provide, and AREM has powers to suspend circulation of securities.

Concessions/Public-Private Partnership (PPP)

The new Kazakh Concessions Law No. 167-III was approved on 7 July 2006 and became effective on 19 July 2006 (the “Concession Law”). The Concession Law was motivated by government policy to promote PPPs (including numerous sector-specific and municipal policy framework documents) and sets forth the legal framework for concession-type arrangements in various industries, except for those involving subsoil use (oil, gas and mining). Subsoil use concessions are specifically exempt from application of the Concession Law and are subject to special subsoil use regulations.

The Concession Law states that the President of Kazakhstan may define a list of assets/facilities which may not be transferred into concession. Only legal entities (presumably, but not explicitly, both foreign and local) may become concessionaires.

The State Property and Privatisation Committee under the Ministry of Finance (the “State Property Committee”) is the principal state authority charged with (i) organising and conducting concession tenders, (ii) executing concession contracts, and (iii) maintaining the register of the executed concession contracts. However, concession of certain assets/facilities as defined by the government is dealt with by the specific industry regulator (e.g., Ministry of Energy and Mineral Resources) rather than the State Property Committee. Similarly, municipal property concession contracts are dealt with by local authorities. The Concession Law entitles the State to offer certain incentives (support) for concession projects (e.g., guarantees on infrastructure bonds, government guarantees of loans, transfer of exclusive rights to operate concession-related facilities). Such state support measures will be offered on a case-by-case basis and will be subject to a common statutory threshold providing that the overall value of such support measures cannot exceed the value of the particular project itself.

Overall, the Concession Law is a long awaited piece of legislation that largely lives up to expectations. However, it does have a number of shortcomings and certain provisions are somewhat ambiguous. It is fairly rigid and lacks flexibility as far as property issues are concerned. For example, ownership (title) of the transferred assets/facilities will remain with the State, and on termination of a concession contract, all rights of the concessionaire with respect to the assets/facilities will be returned to the State. Similarly, in the case of newly constructed facilities, title thereto will be registered in the name of the State immediately after completion of construction. The concessionaire will have no right to pledge the assets/facilities constituting the subject of concession without the State’s prior written consent. All the above may create significant obstacles for the bankability of potential projects. A concession contract must be executed within 30 days of selection of the winner of the tender procedure which may prove unrealistic for some more complex projects.

The Concession Law gives the State the right to unilaterally change or terminate an executed concession contract on the grounds of protecting State/public interests. It is unlikely that any concession contracts will be awarded under the Concession Law until the necessary implementing regulations are adopted, including the list of public assets which cannot be transferred into concession and regulations concerning concession tender procedures

(including a standard concession agreement). There is currently no indication when such regulations will be adopted. Furthermore, the Concession Law does not include a stability clause and it is therefore unclear whether adverse changes in legislation enacted after the date of the concession contract would apply to the concession project and the concessionaire.

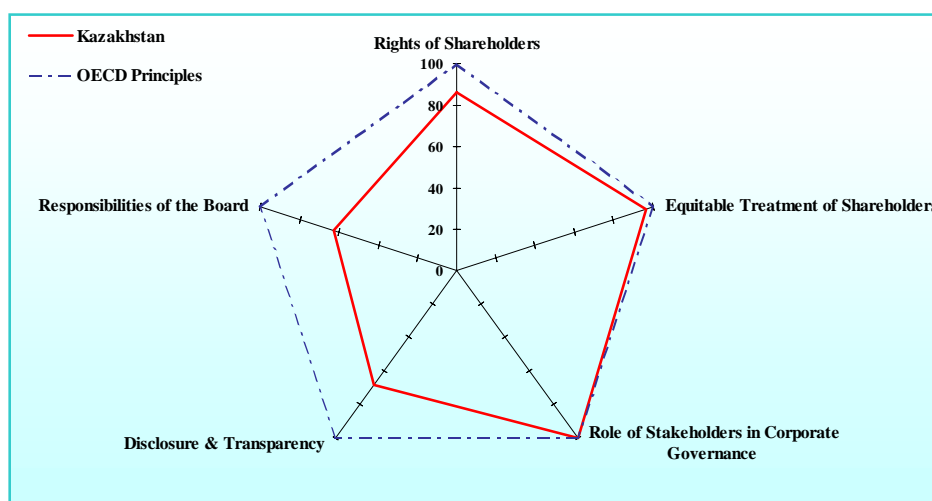
The Concession Law is a bit vague as to whether a particular concession is within the authority of the State Property Committee or a relevant industry regulator. It states that the choice will be made by the government, though it is unclear how that choice will be made. All of the above factors make it difficult to attract investors to long-term concession projects and it is yet to be seen whether the newly adopted legislation will work in practice and to what extent it will require amendments.

Corporate Governance

The principal legislation dealing with corporate governance in Kazakhstan is the Law on Joint Stock Companies (JSCs), which was enacted in May 2003, replacing its predecessor law of 1998. The 2003 Law was last amended in July 2005 in order to improve the system of state regulation of JSC activity and the protection of shareholders' and investors' rights.

According to the results of the 2004 EBRD Corporate Governance Sector Assessment, Kazakhstan is a country whose existing corporate governance related laws (i.e., "law on the books", not how the relevant legislation is being implemented), when compared to the OECD Principles of Corporate Governance, were rated among "high compliance" countries. "High compliance" means that the existing corporate governance related laws in Kazakhstan are relatively sound when compared to the OECD Principles of Corporate Governance. Though in the case of Kazakhstan the assessment identified some weakness in the areas of the board's responsibilities and disclosure and transparency (see chart below). Other deficiencies of the law identified by the Assessment include the fact that the law does not require all shares to be fully paid before they can be transferred and to publish the list of shareholders not having fully paid the amount due. The law is also silent on board responsibilities in ensuring a formal and transparent nomination process for board members; ensuring the integrity of the JSC's accounting and financial reporting systems; and, ensuring that appropriate systems of control are in place - particularly, systems for monitoring risk, financial control, and compliance with the law. Finally, the board is not required by law to have separate committees for dealing with financial reporting, executive and board remuneration and board nominations.

Quality of corporate governance legislation – Kazakhstan (2004)



The extremity of each axis represents an ideal score, i.e., corresponding to OECD Principles of Corporate Governance. The fuller the 'web', the more closely the corporate governance laws of the country approximate these principles
Source: EBRD Corporate Governance Sector Assessment, 2004 assessment

In 2005, the EBRD conducted a survey for testing the effectiveness of corporate governance (how the law works in practice). A case study dealing with related-party transactions was designed. The case study investigated i) the position of a minority shareholder seeking to access corporate information on a presumed related-party transaction by the company and ii) how compensation could be obtained in case damage was suffered. Effectiveness of the system for both questions was assessed based on four principal variables: complexity, speed, enforceability and institutional environment.

The survey revealed that there are a number of procedures for obtaining disclosure in Kazakhstan, but their effectiveness might be undermined by their complexity, the difficulty of the enforcement and the length of the proceedings, which might last more than one year in order to obtain an executable court order. Complexity was also identified as a problem when assessing the procedures for obtaining redress.

When considering the institutional environment, while the survey evidenced that company information is generally of good quality, the statutory auditors fairly independent and the legal framework on related party transactions adequate, the partiality of courts and the market regulator, and corruption are considered to be major problems. Enhancing the experience and competence of courts, prosecutors and market regulators should be tackled as priorities.

Insolvency

Bankruptcy and insolvency are governed by the Law Concerning Bankruptcy, as amended (the “Insolvency Law”). This law scored “medium compliance” when compared with international standards in the EBRD’s 2003 Insolvency Sector Assessment but is amongst the strongest of the insolvency laws in central Asia.

The Assessment showed the Insolvency Law to be relatively weak in addressing reorganisation processes, terminal/ liquidation processes and the treatment of estate assets. A number of flaws were noted, including: the requirement that a debtor’s debts must be three months past due before they can be used as evidence of insolvency; a lack of clarity with regard to the definition of insolvency, the evidence required as proof of insolvency, and the effect of insolvency proceedings on secured creditors; and, a failure to address international insolvencies.

The Insolvency Law was amended on a number of occasions since 2004, most recently in February 2006. The changes do not appear to have addressed many of the flaws noted above, focussing instead on reducing the use of the insolvency system for fraudulent purposes. The major change to the statute is the creation of an institution for external oversight of debtors during liquidation, reorganisation and restructuring processes. Amongst other responsibilities, the administrator of the external supervision will be responsible for ensuring the safe-keeping of the debtor’s property, revealing instances of deliberate bankruptcy and analysing the financial position of the debtor and the debtor’s acts or omissions that had the effect of evading performance of obligations owed to creditors. The external supervision regime came into effect on 19 January 2006, so it is too early to assess the overall effectiveness of the provisions. These provisions provide a third party with substantially more review power than previously available under the law and if properly implemented, they should meet their goal of reducing fraudulent use of the insolvency system.

Recent amendments also provided the Authorised Body (the regulator) with new and expanded powers. The Authorised Body now has authority to approve rules for training

bankruptcy commissioners, administrators of external supervision and rehabilitation managers. Other new powers include the ability to intervene in insolvency proceedings, design the process for approving the application of a rehabilitation proceeding to a debtor, and overseeing/approving the expenses of the insolvency professionals.

Other notable changes to the law include extended periods for the restructuring of companies (now nine months) and for strategically important businesses (three years) and an expansion of the period for reviewing transactions of the debtor from two years to three years.

Several problems with the application of insolvency law in Kazakhstan were revealed in EBRD's 2004 Legal Indicator Survey, which measured the effectiveness of insolvency legislation. In particular, the Insolvency Law appears to be an ineffective weapon, or insufficiently credible threat, for creditors to induce recalcitrant debtors to pay their debts. Access to the insolvency system is overly formal and complex and the process is generally regarded as being expensive and inefficient. Kazakhstan was found to have one of the largest "implementation gaps" (the difference between the overall quality of its insolvency law and the effective implementation of that law) amongst the EBRD's countries of operations. Time will tell whether the new amendments improve the situation.

Secured Transactions

Security rights over movable assets (also referred to as pledges) are regulated by the Civil Code of the Republic of Kazakhstan, adopted in December 1994 and other laws.

There are two main types of security over movable assets under Kazakh law: possessory (where the possession of the collateral is transferred to the creditor) and non-possessory (where the debtor may retain and use the collateral during the life of the security). The registration system is two-tier: there is a mandatory registration, which applies to specific types of assets such as motor vehicles and aircraft. These assets are registered in specific registries and the pledge should be registered there too (e.g. the police for pledges over motor vehicles). For all other types of assets, pledge registration is voluntary only and is conducted in the Centres for Registration of Immovable Property and their subsidiaries. There is no centralised registry but 16 separate centres in two major cities, Astana and Almaty, and in each region. The registries are supervised by the Committee on Registration Service under the Ministry of Justice in Astana. Most of the registries have computerised databases which are accessible through the respective registrar.

Based on EBRD assessment, the secured transactions legal regime is adequate, although not particularly enabling for sophisticated transactions. Some transactions remain complex to achieve. For example, a pledge over assets described generally would not be a viable option to secure a transaction since the law provides that the pledge agreement must *specify* the assets and their value or a method for their valuation. If the pledge is registered, a list and description of the pledged assets must be entered in the registry. General description would be possible for pledges over goods in circulation and processing (merchandise stock, raw materials, materials, semi-finished products, finished products, etc.), where the debtor could change the composition and natural form of the pledged assets provided that their overall value would remain the same as prescribed in the pledge agreement. However, such condition would be difficult to fulfil where a debtor would have to renew its stock on an ongoing basis.

Practitioners have expressed some concerns on the efficiency of the registration process - bureaucracy and a corrupt environment makes it hard to use the system. Search requests take

up to five days, depending on work load, though considerable delays are also reported. The EBRD has, in the past, experienced unacceptably long delays in perfecting its security rights over the borrower's assets in Kazakhstan.

Finally, though the means of enforcement provided by the law seem adequate on the books, in practice, enforcement is reported to be problematic because of deficiencies in the court system; uncertainty regarding the enforcement mechanisms; incidents of non-compliance of the government with enforcement rules and decisions; difficulties in locating and ensuring control of the pledged assets; and, possible application of exchange control rules to repatriation of enforcement proceeds. Serious delays could occur due to the right of the court to postpone the sale of the pledged property by up to one year upon the debtor's request. These problems were confirmed by a survey that the EBRD conducted in 2003, focusing on the enforcement of pledges (charges) in the region. Whereas Kazakhstan provided very encouraging overall results in terms of the return that a lender could expect from enforcing its security over the charged assets and the time and simplicity involved in such process (certainly the best in the region), the survey also highlighted serious problems, in particular the high risk of court corruption and the lack of training of key enforcement officers, such as the bailiffs.

Security over immovable assets (mortgages) is covered primarily by the 1995 Presidential Decree (having the force of law) on Mortgage of Immovable Property. An enterprise can be charged by way of a mortgage, where the security will cover all the enterprise's movable and immovable assets, claims and exclusive rights, including those obtained during the mortgage period, "main and circulating funds", and securities on its balance sheet. Mortgages are not required to be notarised but they have to be registered with the Centre for the Registration of Immovable Property of the Ministry of Justice, as mentioned above. Should the borrower default on its obligations under the relevant mortgage loan agreement, the secured mortgage lender has priority rights with regard to other creditors to be compensated (from the proceeds of the sale of the property) for the principal amount of the mortgage as well as interest and other expenses incurred as a result of the default, such as default penalty, legal and other fees associated with the foreclosure on the mortgaged property. Mortgage foreclosure can be either enforced through court or settled out of court. Settling out of court is the preferred option. The main difficulty stems from the requirement of Kazakh law to notify the borrower in person of the conduct of the auction (failure to do so would invalidate the auction process). If for whatever reason it is impossible to notify the borrower in person, the matter must then be taken to court. If an auction is successful, then the lender is considered to be paid off in full, irrespective of whether the auction proceeds cover the amount claimed/owed on the mortgage. If, however, the auction proceeds exceed the claim, the difference is given back to the borrower.

Telecommunications

The telecommunications sector in Kazakhstan is currently governed by the Communications Law of 2004 (the "Communications Law") and regulation is split amongst three main agencies: the Agency for Information and Communications (AIC), the Agency for Regulation of Natural Monopolies (AREM) and the Competition Protection Committee of the Ministry for Industry and Trade (CPC). AIC was established to replace the Communication and Information Committee of the Ministry of Transport and Communication. Among the areas AIC is specifically responsible for is licensing operations, technical procedures for interconnection and determination of accounting principles for regulated operators. AIC is also responsible for both formulating and implementing policy/strategy in the telecommunications sector as well as responsibility for greater information communications

technology policy making. AREM regulates natural monopolies, which parts of the telecommunications network is still considered to be in Kazakhstan, and is responsible for tariff and cross subsidisation issues. CPC regulates dominant operators in the market and is responsible for retail tariff setting.

The Communications Law represents a significant improvement in the environment for telecommunications in Kazakhstan and covers all major areas in the sector, providing a legal basis for liberalisation, equal network access for market participants, universal service provisions, etc. The passage of the Communications Law was accompanied by additional legislation limiting foreign ownership in Kazakh companies providing international or long-distance fixed-line calls to 49 per cent.

Whilst significant reform has been undertaken, a number of fundamental elements remain outstanding. On the legislative side, the Communications Law requires revision to be made more consistent with international best practice and better support the now liberalised marketplace. Going forward, the success of these legal reforms will hinge upon their full implementation over the short to medium term. The authorities should ensure that such implementing legislation and instruments are adopted and enforced without delay, particularly in the areas of tariff rebalancing and interconnection. On the institutional side, establishment of an independent sector specific regulator is a critical requirement to make liberalisation work in a meaningful way. It is understood that government accepts the case in principle for such a regulator – every effort should now be made to ensure that an appropriately empowered and resourced regulator is established in the quickest reasonable timeframe. Similarly, the continuing regulation of parts of the telecommunications sector by AREM, as a natural monopoly, does not reflect current sector realities. Accordingly, telecommunications should be removed from the list of natural monopolies forthwith and the authority to regulate transferred to an appropriately empowered sector regulator as soon as it has sufficient capacity in this area. In addition to a sector specific regulator, government should ensure that CPC is also provided with sufficient resources to perform its duties in the sector. As an interim step, while a sector specific regulator is becoming operational, the establishment of a joint interim regulatory working group, consisting of AIC, AREM and CPC should be considered. This working group would bring together all the sector regulatory expertise to address sector regulatory issues ahead of appropriate formal reassignment of sector regulatory functions.

The EBRD has been very active in providing technical co-operation in the telecommunications sector in Kazakhstan since 1998. Many of the reforms mentioned above have been facilitated by technical co-operation (TC) assistance from the EBRD's telecommunications regulatory development programme. Among the areas the EBRD has provided assistance with are; revision of sector legislation; interconnection; licensing; tariffs; and, universal service. At present, EBRD is implementing a technical co-operation project with AREM in the area of tariff reform. In addition, EBRD is currently assisting AIC with the formulation of a proposal for the establishment of an independent telecommunications regulator. EBRD is also currently developing a technical co-operation programme for CPC to provide capacity building assistance and support the implementation of the Competition Law.

ANNEX 3 ENVIRONMENTAL ASSESSMENT

Kazakhstan is the largest country in Central Asia and the 10th largest in the world. Being located between the Siberian taiga, the Central Asian deserts, the Caspian Sea and the mountains of the Tien-Shan, the country possesses a great diversity of ecosystems. Lowland plains characterised by steppes, semi-deserts and deserts comprise 60 per cent of the country's surface area, while arid foothills represent 30 per cent and mountains 10 per cent of its territory. Kazakhstan's National Protected Area System, comprises 107 sites and covers nearly 14.5 million ha (about 5 per cent of the territory of the country).

Environmental Legislation The Law on Environmental Protection (1997) is the major framework law for environmental protection in Kazakhstan. The purpose of the law is to prevent pollution and encourage the rational use of the environment and natural resources. The law calls upon local communities and other stakeholders to become involved in the management of natural resources, and institutes the "polluter pays" principle in Kazakhstan's environmental policy. Numerous regulations and agency documents have been prepared to permit the law's implementation. Due to the considerable economic and other changes witnessed in Kazakhstan over the past 10 years, however, this law needs updating, as do the regulations for implementation. The Forest Code sets the framework for the protection, restoration, and rational use of forests. Since its initial adoption in 1993, however, the Code did not include regulatory mechanisms and ties to the Civil or Criminal Codes. Thus, its provisions were not considered in economic or resource use policy and ignored in practice. This resulted in serious negative consequences for the forests, including the loss of over 10 per cent of the nation's forest cover over the past 10 years. The Forest Code was, however, updated by a new draft in 2002 which was approved by the Parliament in July 2003. Specific matters pertaining to the protection of forests and biodiversity are now governed by regulations made under the Code. The Law on Protection, Reproduction and Use of Wildlife (1993) promotes the sustainable use of wildlife, provides specific guidelines on inventorying, establishes the authorities of government agencies, defines the rights of society, and provides for enforcement measures. This legislation has become dated and requires revisions to make it consistent with international conventions and the strengthening of trans-boundary co-operation in the conservation of migratory, rare and endangered species. The Law on Specially Protected Areas (1997) classifies various types of protected areas with reference to international standards. The Land Code (2003) establishes state ownership of lands for defence purposes, protected areas, forests and waters. The Water Code (2003) promotes the use of water resources in a manner that optimizes economic use opportunities for the betterment of conditions for the population while safeguarding the environment. The Code deals with trans-boundary waters, waters of particular significance.

Environmental Issues Kazakhstan's national priorities and commitments are stated in its National Environmental Action Plan, National Biodiversity Strategy and Action Plan and Conception of Environmental Safety for 2004-2015, approved by Presidential Decree on 03 December 2003. The main areas of concern are the Aral Sea, the Semipalatinsk Testing Area, desertification and land degradation, biodiversity protection, forestation in East Kazakhstan and in Pavlodar and Karaganda Oblasts. Environmental issues associated with exploitation natural resources are connected with the intensive development of the Caspian Sea oil shelf. Metallurgical industries and power generation caused air pollution is responsible for eight of the ten mostly contaminated cities: Balkhash, Temirtau, Ekibastuz, Aksu, Pavlodar, Zhezkazgan, Ust-Kamenogorsk. Surface water protection programmes concentrate on Irtysh, Ili, Syrdarya, Ishim, Tobol, Ural, Turgai, Chu Rivers, Balkhash Lake, Caspian and Aral Seas. Soil and groundwater protection programmes are under consideration. Industrial and domestic waste disposal is a countrywide problem and special attention is needed for radioactive waste management at Semipalatinsk and Karachaganak.

Kazakh Participation in International Treaties on Environment Protection Kazakhstan is an active member of the United Nations Convention to Combat Desertification since 1997. Kazakhstan is considering ratifying the United Nations Framework Convention of Climate Change (Kyoto Protocol) in 2006. Kazakhstan ratified the Basel Convention on Hazardous Waste Management Convention in 2003. Kazakhstan signed the Convention on Biological Diversity in 1994 and it is a member of UNESCO World Heritage Convention since 2003. In 2000 Kazakhstan ratified the Aarhus Convention on Public Consultation and Environmental Organisations and three nuclear safety and nuclear fusion agreements (2002-2006). Accession to WTO is a priority for Kazakhstan's government. Becoming a member of the WTO will allow Kazakhstan to participate in global trade on equal terms.

ANNEX 4 SELECTED ECONOMIC INDICATORS

Kazakhstan

	2000	2001	2002	2003	2004	2005	2006
						<i>Estimate</i>	<i>Projection</i>
Output and expenditure <i>(Percentage change in real terms)</i>							
GDP	9.8	13.5	9.8	9.3	9.6	9.4	8.5
Private consumption	1.2	7.8	2.7	11.8	13.9	11.4	na
Public consumption	15.0	19.2	-7.5	8.9	10.6	11.8	na
Gross fixed capital formation	16.1	25.3	10.0	8.0	22.5	11.9	na
Exports of goods and services	28.7	-1.8	16.6	7.5	10.9	1.4	na
Imports of goods and services	26.1	0.3	3.1	-7.6	14.8	13.3	na
Industrial gross output	15.5	13.8	10.5	9.1	10.1	4.6	na
Agricultural gross output	-4.2	17.3	3.4	1.6	1.0	6.7	na
Employment¹ <i>(Percentage change)</i>							
Labour force (end-year)	0.7	5.2	-1.1	3.5	2.4	0.8	na
Employment (end-year)	1.6	8.0	0.2	4.1	2.8	1.1	na
<i>(In per cent of labour force)</i>							
Unemployment (end-year)	12.8	10.4	9.3	8.8	8.4	8.1	na
Prices and wages <i>(Percentage change)</i>							
Consumer prices (annual average)	13.2	8.4	5.9	6.4	6.9	7.6	8.7
Consumer prices (end-year)	9.8	6.4	6.6	6.8	6.7	7.5	8.4
Producer prices (annual average)	38.0	0.3	0.3	9.3	16.7	23.7	na
Producer prices (end-year)	19.4	-14.1	11.9	5.9	23.8	20.3	na
Gross average monthly earnings in economy (annual average)	21.2	20.4	17.5	13.8	22.5	20.3	na
Government sector² <i>(In per cent of GDP)</i>							
General government balance ³	-1.0	2.7	1.4	2.9	2.6	6.0	5.7
General government expenditure ⁴	23.2	23.0	21.0	22.5	22.0	22.6	na
General government debt	25.5	20.4	17.7	15.0	11.4	10.0	na
Monetary sector <i>(Percentage change)</i>							
Broad money (M2, end-year)	45.0	40.2	30.1	29.5	69.3	24.8	na
Domestic credit (end-year) ⁵	57.3	17.1	30.2	24.1	69.6	82.5	na
<i>(In per cent of GDP)</i>							
Broad money (M2, end-year)	15.3	17.1	19.2	20.3	27.1	26.6	na
Interest and exchange rates <i>(In per cent per annum, end-year)</i>							
Refinancing rate	14.0	9.0	7.5	7.0	7.0	8.0	na
Treasury bill rate (3-month maturity) ⁶	6.6	5.3	5.2	5.9	3.3	3.3	na
Deposit rate ⁷	15.6	12.8	11.0	10.9	9.3	9.1	na
Lending rate ⁸	18.8	15.3	14.1	14.9	13.7	13.0	na
<i>(Tenges per US dollar)</i>							
Exchange rate (end-year)	144.5	150.2	155.6	144.2	130.0	134.0	na
Exchange rate (annual average)	142.1	146.7	153.3	149.6	136.0	132.9	na
External sector <i>(In millions of US dollars)</i>							
Current account	366	-1,390	-1,024	-273	455	-486	-2,341
Trade balance ⁹	2,168	983	1,987	3,679	6,785	10,322	11,714
Merchandise exports	9,288	8,928	10,027	13,233	20,603	28,301	31,131
Merchandise imports	7,120	7,944	8,040	9,554	13,818	17,979	19,417
Foreign direct investment, net	1,278	2,861	2,164	2,213	5,392	1,721	2,500
Gross reserves, excluding gold (end-year)	1,594	1,997	2,555	4,236	8,473	6,084	na
External debt stock ¹⁰	12,685	15,158	18,252	22,920	31,941	41,516	na
<i>(In months of imports of goods and services)</i>							
Gross reserves, excluding gold (end-year) ¹¹	2.1	2.3	2.6	3.8	5.4	2.9	na
<i>(In per cent of exports of goods and services)</i>							
Debt service	31.7	37.6	35.4	35.2	35.9	35.5	na
Memorandum items <i>(Denominations as indicated)</i>							
Population (end-year, million)	14.9	14.9	14.9	15.0	15.1	15.1	na
GDP (in billions of tenges)	2,600	3,251	3,776	4,612	5,870	7,457	8,798
GDP per capita (in US dollar)	1,231	1,492	1,657	2,062	2,863	3,714	na
Share of industry in GDP (in per cent)	25.2	25.2	25.3	25.3	25.5	na	na
Share of agriculture in GDP (in per cent)	9.8	10.1	9.5	8.9	8.1	na	na
Current account/GDP (in per cent)	2.0	-6.3	-4.2	-0.9	1.1	-0.9	-3.3
External debt - reserves (in US\$ million)	11,090	13,160	15,696	18,684	23,468	35,432	na
External debt/GDP (in per cent)	69.3	68.4	74.1	74.3	74.0	74.0	na
External debt/exports of goods and services (in per cent)	122.7	148.8	157.8	153.4	141.3	135.9	na

¹ Break in series in 1994 and 1998. From 1998 data based on labour force surveys.

² General government includes the state, municipalities and extra-budgetary funds and is on a cash basis.

³ Government balance includes quasi-fiscal operations and transfers to the National Fund. Balance excludes privatisation revenues.

⁴ Expenditures include extra-budgetary funds.

⁵ Domestic credit from International Financial Statistics. Break in series in 2001. From 2001, data include National Fund from 2001.

⁶ Average effective yield of short-term NBK notes.

⁷ Deposit rate refers to the weighted average of interest rates on deposits of individuals, in tenge by maturity.

⁸ Lending rate refers to weighted average of interest rates on credit to legal entities, excluding banks in tenge by maturity.

⁹ Exports at declared customs prices and are not corrected for under-invoicing of oil and gas exports.

¹⁰ Includes inter-company debt by branches of non-resident foreign and short-term debt.

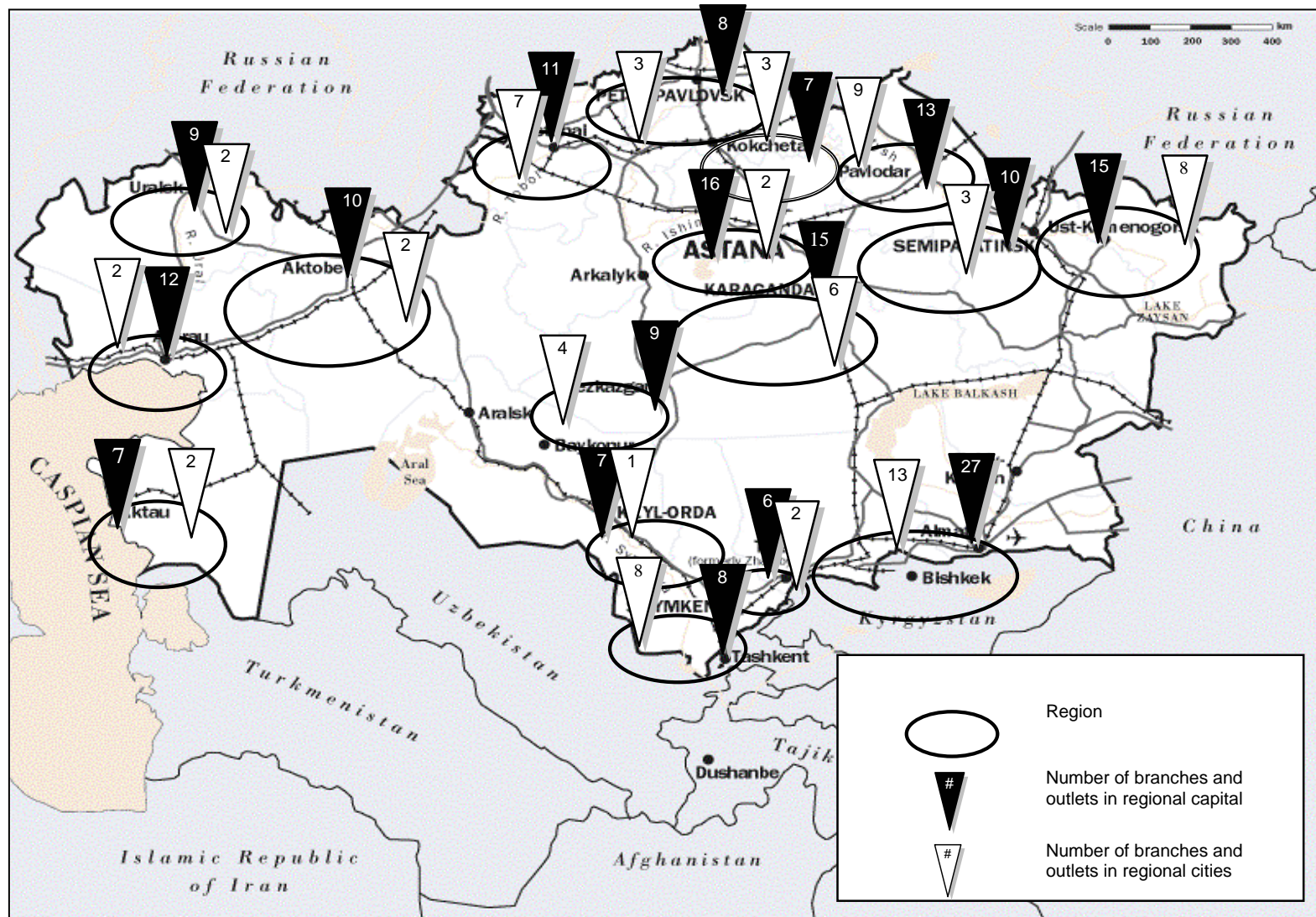
¹¹ Excludes National Fund.

ANNEX 5 OVERVIEW OF SMALL BUSINESS PROGRAMMES (KSBP & BAS)

Kazakhstan Small Business Programme by regions

Region	Total			
	Cumulative number of projects	Per cent of all projects	Cumulative volume of projects, in US\$	Per cent of total volume
Aktau Region	4,727	2.2%	49,311,258	3.0%
Aktobe Region	12,273	5.8%	97,957,073	5.9%
Almaty Region	35,320	16.6%	387,430,368	23.2%
Astana Region	10,298	4.8%	90,735,750	5.4%
Atyrau Region	10,349	4.9%	79,219,293	4.7%
Jezkazgan Region	8,195	3.9%	41,220,834	2.5%
Karaganda Region	22,271	10.5%	148,113,328	8.9%
Kokshetau Region	4,433	2.1%	27,739,173	1.7%
Kostanay Region	8,987	4.2%	66,119,833	4.0%
Kyzyl-Orda Region	6,209	2.9%	33,595,240	2.0%
Pavlodar Region	16,941	8.0%	109,440,165	6.6%
Petropavlovsky Region	8,521	4.0%	49,909,734	3.0%
Semipalatinsk Region	8,477	4.0%	45,882,049	2.8%
Shymkent Region	18,485	8.7%	155,499,469	9.3%
Taraz Region	9,621	4.5%	53,631,095	3.2%
Uralsk Region	10,080	4.7%	80,711,248	4.8%
Ust-Kamenogorsk Region	17,186	8.1%	151,672,317	9.1%
Total	212,372	100.0%	1,668,188,224	100.0%

KAZAKHSTAN SMALL BUSINESS PROGRAMME
LOCATION OF 267 SME DEPARTMENTS IN PARTNER BANK BRANCHES AND OUTLETS
AS AT SEPTEMBER 2006



Overview of the Business Advisory Service Programme (BAS) activities by region

The Regional BAS office is located in Almaty. With the 4 regional offices now fully functional (in Ust-Kamenogorsk, Kostanai, Shymkent and Aktobe), more than 80 per cent of the Kazakhstan BAS projects are expected to be with enterprises outside of Almaty.

BAS activities by regions as of 30 September 2006:

Regional Project locations	Number of projects
Akmola Oblast	22
Aktubinsk Oblast	16
Almaty City	160
Almaty Oblast	22
Atyrau Oblast	5
East Kazakhstan Oblast	35
Karaganda Oblast	21
Kostanai Oblast	34
Kyzyl-Orda Oblast	8
North Kazakhstan Oblast	4
Pavlodar Oblast	12
South Kazakhstan Oblast	31
West Kazakhstan Oblast	9
Zhambyl Oblast	4
Total	383

In 2007-2009, Kazakhstan BAS is expected to initiate an average of 10 new projects per month, which adds up to over 200 projects (216 to be precise, although Kazakhstan BAS usually exceeds its quantitative targets).

ANNEX 6 BILATERAL ASSISTANCE

Canada

Canada's official development assistance to Kazakhstan is delivered through Canadian International Development Agency (CIDA). Since 1991, Canada's bilateral support through all channels amounts to CAD 14 million. However, given the successful economic development of Kazakhstan, CIDA's current bilateral programme is limited to the Industrial Co-operation Programme which assists Canadian firms to establish long-term business partnerships. In addition, CIDA continues to provide support to a variety of multilateral organisations such as the EBRD, UNICEF, UNDP and the OSCE, among others.

Local initiatives are supported by a small grants programme via a decentralised fund operating from the Canadian Embassy. From the Embassy in Almaty, a Canada Fund for local initiatives (CAD 75,000 in 2004-05) is focused on poverty reduction through the social sectors and promoting democracy and is delivered by local NGOs.

Two bilateral regional projects, focusing on agricultural vocational training and water resource management training, that had some activities in Kazakhstan closed in 2005. The regional programme run by Canadian Executive Services Overseas (CESO) has funded about 40 technical support missions by Canadian experts since 1998, mainly in the service and manufacturing sectors. Through the Partnerships for Tomorrow programme, several domains (e.g. higher education, business training, trade and development, environment, marine safety and public health management) have fostered the establishment of long-term relations between universities, municipalities, and other private sector and civil society organisations in Canada and Kazakhstan.

France

During the period 2004-2006, the bilateral assistance from France has been presented by two projects:

- study aiming at the de-pollution of oil lakes in the Uzen area
- study aiming at the improvement of the agricultural downstream channels

These two grant projects were totalling US\$ 500 000.

Germany

Given Kazakhstan's middle-income status, there are currently only two projects by the GTZ (Gesellschaft für Technische Zusammenarbeit), the German agency for technical and development assistance:

- Building Economic Development Structures. The programme started in 2003 and is scheduled to complete by the end of 2006.
- Professional Training for Women and Support of the Education Reform Process. This programme is scheduled to start in March 2007 and be implemented over a six-year period.

Japan

Japan is the largest donor to Kazakhstan. In recent years nearly 20 per cent of total international assistance to Kazakhstan has been extended by Japan. At the end of 2005, total

commitments of loan aid stood at JPY 88.8 billion, and grant aid had reached JPY 5.7 billion. Disbursements of technical assistance amounted to JPY 8.7 billion.

Currently the three priority areas consist of:

- Human resources development to meet the needs of a market economy. The study for the project for the integrated logistics system and the marketing plan for container transportation. Launching Master-Plan for "Caspian Regional Development" focussed on the development of Mangistau Region. Study on Capacity Development on Pollution Prevention and Control in the Petroleum Industry. The study in earthquake disaster risk mitigation for Almaty.
- Development of economic and social infrastructure (Astana Water Supply and Sewerage Project, and a loan aid project for water supply improvement and sewage system rehabilitation in Astana is being implemented under the second priority.).
- Mitigation of hardships caused by transition (assistance in the social sector, redressing regional disparities and preservation/improvement of the natural environment). Technical assistance for the health care system in the Semipalatinsk region is ongoing under the third priority, as are grant aid projects for upgrading medical equipment in the hospital complex in Kyzlorda and for improving water supplies in rural communities.

Others activities include trainee programmes, Grant Assistance for Grassroots Project, and Cultural Grant Aid.

Korea

Currently there are three main projects under the development.

- The project on implementation of the independent system of professional qualitative assessment in technical and service in Kazakhstan.
- The project on foundation of the training centre of processing and information technologies. The project's implementation is planned in 2007.
- The project within the frame of the economic development co-operation focused on the development of effective strategy on export and investments as well as free economic areas in Kazakhstan.

The research programs are carried out in the following arrears as: i) construction of utilities, ii) development of water resources, iii) analysis of mineral resources. In addition, the Korea Trade-Investment Promotion Agency (KOTRA) invites about 50 participants annually to various training courses.

Netherlands

Netherlands is providing limited assistance to Kazakhstan for poverty reduction totalling €20,000 per year for Kazakhstan, Kyrgyzstan and Tajikistan. In addition, the programme to support the civil society will be about €500,000 per year.

United Kingdom (UK)

The UK's bilateral assistance is delivered through the Department for International Development (DFID) programmes. Over the last thirteen years, UK has spent over £17 million on development work in Kazakhstan. DFID's key achievements in Kazakhstan include:

- Assisted in improving the quality and accessibility of primary health care.
- Established a participatory land use planning process for the former nuclear testing site in the Semipalatinsk area, to help environmentally sound and sustainable land use.
- Improved capacity for management of water resources, including a new Water Code.
- Enhanced civil society's understanding of its role in poverty reduction.

List of major projects funded by the UK in 2005-2006:

Project name	Brief description
CLIMATE CHANGE AND ENERGY PROGRAMME	
Policies for Energy Sector Development and Energy Security in Kazakhstan	The key objective of the project was to support a more strategic approach to energy policy by government, which took full account of economic, social and environmental factors.
Implementation of the UK/Kazakhstan MOU in the sphere of energy	By delivering a series of small-scale scoping activities this project aims to identify Kazakhstan's needs for support in the energy sector and also to attract the attention of the Government to such important issues as energy efficiency, climate change and energy security.
SUSTAINABLE DEVELOPMENT PROGRAMME	
Prevention of torture and other cruel, inhuman and degrading treatment or punishment	Promoting human rights, democracy and good governance through developing anti-torture strategy and strengthening national torture and ill treatment preventive mechanisms in Kazakhstan

DFID will be phasing out its country programme in 2007 and the bilateral programme will cease. Existing work in the water and environmental sectors ended in 2005. DFID will continue to provide support on HIV/AIDS prevention, and to work on EITI.

United States

For the past thirteen years, USAID has assisted Kazakhstan in its transition to a market-based economy. Successful past economic programmes include banking reform and supervision, fiscal reform, and pension reform. USAID economic assistance over the period totalled approximately US\$ 500 million for private sector initiatives, economic restructuring and enterprise funds, including US\$ 20 million in 2006. USAID's current programme at roughly US\$ 10 million per year aims to strengthen the competitiveness and growth of SMEs.

Following projects are being implemented by the USAID in 2006:

- Economic Reform (US\$ 8.7 million): programme to improve the environment for the growth of SMEs has three main components: 1) transferring modern business skills and making business information more available; 2) increasing access to finance by enhancing lender knowledge, strengthening financial institutions, and creating alternative sources of finance; and 3) promoting more transparent, systematic implementation of laws and regulations, by strengthening the budget and public sector audit processes, improving monetary and competition policies, customs modernization, reduction of investment constraints, and WTO accession.

- Democracy and Media (US\$ 5.5 million): concentrates on building a democratic culture mainly through support for: 1) civil society organizations; 2) independent media; 3) civic and democratic education, including extracurricular activities reinforcing democratic values; 4) judicial ethics/independence and training; 5) improving local government transparency and openness to citizens; and 6) support for democratic political parties and other institutions committed to democracy. Kazakhstan's human rights organizations receive support to improve public understanding and awareness of abuses.
- Health and Population (US\$ 3.4 million): quality primary health care programme is helping Kazakhstan to reform its health system to ensure utilization of high quality primary health care services. USAID's programme has a special focus on improving the quality of maternal, child, and reproductive health services. Technical and other assistance support the country's efforts to control infectious diseases like HIV/AIDS and tuberculosis, with increasing efforts to reduce the spread of multi-drug resistant tuberculosis.
- Energy and Water (US\$ 0.7 million): Regional Energy Market Assistance Programme will assist in developing a regional electricity market. The project will work to establish a transparent, competitive market; to increase electricity trade; and to introduce market-based solutions for current disputes on hydroelectricity facilities and reservoirs. The Development Credit Authority Programme aims to encourage commercial bank lending to private firms for implementation of energy savings measures.