

Operation Performance Evaluation Review

Atyrau Airport Project

Kazakhstan

(A Technical Cooperation Operation)

October 2008

Evaluation Department
(EvD)

PREFACE

This evaluation report

The subject of this Operations Performance Evaluation Review (OPER) is a technical cooperation (TC) operation involving the Kazakhstan Atyrau Airport Project. The operation's budget of approximately €653,000 was funded through the European Union (EU) from contributions by the EU-EBRD Cooperation Agreement Bangkok Facility (TACIS programme) and the EU-EBRD Investment Preparation Facility. The related TC assignments were carried out over a period from May to October 2001 and January to November 2006, respectively.

The operation leader (OL) of this TC was Ulf Hindstrom. He also prepared the project completion report (PCR) for the Accounts Strengthening and Business Planning operation as well as the expanded monitoring report (XMR) for the Kazakhstan Atyrau Airport investment project.

The evaluation was carried out by Amélie Gräfin zu Eulenburg, Principal Evaluation Manager at EvD (the OPER team). Information on the operation was obtained from relevant teams and departments of the Bank and its files as well as from external sector and industry sources. Fieldwork was carried out in June 2008. EvD would like to take this opportunity to thank those who contributed to the production of this report.

Post-evaluation selection process

Selection of an operation for post-evaluation by EvD uses the following criteria:

- relevance to the Bank's likely future operations
- lessons-learned potential
- size of the Bank's investment commitment/exposure
- balance among countries of operations
- balance among sectors and types of operations
- relative priority of investment operation OPERs within EvD's overall work programme priorities and resources.

The Bank's post-evaluation process is described in Chapter 8 of the Operations Manual. The responsible OL first writes a TC PCR. The PCR serves a self-evaluation function and establishes the basic facts and lessons from the operation's preparation, implementation and outcome. EvD's independent evaluation follows, using the PCR as one of several inputs.

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ABBREVIATIONS

AREM	Agency for Regulation of Natural Monopolies in Kazakhstan
ATC	Air traffic control (tower)
ATMA	Atyrau Airport & Transport Inc.
CAC	Civil Aviation Committee in Kazakhstan
CSU	Consultancy services unit
EBIT	Earnings before interest and taxes
FY	Fiscal year
GoK	Government of Kazakhstan
ICAO	International Civil Aviation Organisation
IFRS	International Financial Reporting Standards
KMG	KazMunaiGaz
PSC	Passenger service charges
OCE	Office of the Chief Economist (EBRD)
OL	Operation leader
OPER	Operation Performance Evaluation Review
OpsCom	Operations Committee
OT	Operation team
TC	Technical cooperation (project)
TC Com	TC Review Committee
TI	Transition impact
TIMS	Transition impact monitoring system (TIMS)
ToR	Terms of reference
XMR	Expanded monitoring report

DEFINED TERMS

Bank/EBRD	European Bank for Reconstruction and Development
Airport/client	Atyrau International Airport (AIA)
Master plan	Airport physical development plan
Operation	Kazakhstan Atyrau Airport investment project
Operation team	Staff in the Banking Department and other respective departments within the Bank responsible for the operation appraisal, negotiation and monitoring, including the XMR
OPER team	Staff of the Evaluation Department and the independent sector consultant who jointly carried out the post-evaluation

BASIC DATA SHEET

Operation Code TC OPID: 26657 and 21922
Location: Kazakhstan
Operation: Atyrau airport project
Sector: Air transportation
Type: Technical cooperation
Facilitators: EU-Tacis/Bangkok Facility, EU-EBRD Investment Preparation Facility
Bank Unit: Transport Team

A. Funding

TC	TCFP commitment		
	Commitment No.	Commitment title	Amount (€)
TC1	ECT98-98-07-01/06	Atyrau Airport Feasibility Study	43,650
TC2	ECT98-98-07-01/08	Atyrau Airport Feasibility Study	118,867
TC3	EIPF02-2005-12-10	Accounts Strengthening and Business Planning	490,395

B. Procurement

	Mode	Sources by country
Consultant services	Framework contract Competitive selection	United Kingdom United Kingdom/ Netherlands/Kazakhstan

C. Visits

Type of visit	No. of visits	Person-days
EvD/OPER	1	5

1. The project

1.1 Introduction

The city of Atyrau is located in the western part of Kazakhstan at the northern shore of the Caspian Sea.¹ The region includes major oil and gas provinces, such as the Tengiz oil field.² With the exploitation of natural resources the city has developed into a major centre for oil and gas related industries and saw its population grow from 142,500 in 1999 to 154,100.³ The population of the Atyrau region (oblast) amounted to some 463,500 inhabitants in 2007.⁴

In December 2001 the Atyrau International Airport (the airport or the client) obtained financing of US\$ 25 million from the European Bank for Reconstruction and Development (EBRD). This was to assist with the rehabilitation of its runway together with associated investments in line with international civil aviation standards. Strong support was to be provided by technical cooperation (TC) measures. These included preparation activities, that is, the elaboration of a feasibility study as well as implementation facilitation. Due to a change that occurred in the way that domestic taxation laws applicable to grant funding were interpreted, however (see Section 3.1.1), the implementation of EBRD TC projects in Kazakhstan became very difficult in 2002. This continues to be the case. During the starting phase of the investment project, the independent engineers proposed a re-design of the original technical concept. This was proposed because it appeared more favourable to construct a new runway from scratch than to rehabilitate the old one. The procurement process was launched in April 2003, and works were completed at the end of 2005. The runway was officially opened in January 2006. The main TC operation eventually took place at the same time.

1.2 Scope of this study

This OPER aims to evaluate the performance and impact of the entire TC work (TC1-TC5) planned or executed for facilitating the Atyrau airport operation.⁵ Table 1.2 provides an overview on planned and realised TC work for this project.

Table 1: TC work planned/implemented in relation to Atyrau Airport

No.	Commitment number	Amount(€) disbursed	Main focus of activities
TC1	ECT98-98-07-01/06	43,650	1 st and 2 nd phase of elaborating the investment feasibility study and assisting with due diligence
TC2	ECT98-98-07-01/08	118,867	
TC3	EIPF02-2005-12-10	490,395	Financial accounting, management, elaboration of business plan and a physical development (master) plan
TC4	Dutch funding considered	[100,000] ⁶	Development of an airport master plan
TC5	Japanese funding considered	[198,500]	Civil Aviation Committee

¹ Until 1992, Atyrau was called “Guryev”. This name goes back to the 17th century, when the settlement was founded, and stems from the fishing entrepreneur Mikhail Guryev.

² The Tengiz oil field is one of the largest discoveries in recent history (1979). Since 1993 it has been developed by the Tengizchevroil joint venture with the major partners being: Chevron (50 per cent ownership), ExxonMobil (25 per cent ownership), KazMunaiGaz (20 per cent ownership) and Russian LukArco (5 per cent). For further information see en.wikipedia.org/wiki/Tengiz_Field.

³ See en.wikipedia.org/wiki/Atyrau.

⁴ Atyrau International Airport “Business Plan”, September 2006, p. 9.

⁵ In addition, an XMRA has been carried out by the OPER team for the investment project. This is to be found in Appendix 6.

⁶ Numbers in brackets [] point to envisaged budgets

TC1 and TC2

Project preparation measures were financed from the EU-EBRD Cooperation Agreement, Bangkok Facility (TACIS programme) allowing two call-offs from the framework contract *Support for the preparation and Monitoring of Transport Team Projects* to be implemented in two consecutive phases (May to October 2001).⁷

TC3 and TC4

The TC3 project *Accounts Strengthening and Business Planning* was financed by the EU-EBRD Investment Preparation Facility. The project was approved in early 2003, but implementation was not started before 2006 (see Introduction and Section 3.1.2). TC4 originated from a second loan request, forwarded by the client to the Bank in 2005 but not approved.⁸ Thus, its contents were added to the terms of reference (ToR) of TC3 just before implementation.⁹ TC3 is the largest TC project supporting Atyrau and the one with the most challenging expectations in terms of objectives and transition impact. As a result, the OPER team has focused primarily on this TC in carrying out this evaluation.

TC5

This project was intended to assist the Civil Aviation Committee (CAC) within the Kazakh Ministry of Transport and Communications in adopting a modern regulatory framework in civil aviation.¹⁰ It was approved by the Bank's TC Review Committee (TC Com) on 6 June 2001 and was to be funded by Japan. The TC consultant was also selected in 2001, but because of the difficulties described in Section 3.1.1, the commitment had to be cancelled before being implemented.

2. Project rationale

At the time of the investment approval in 2001, Atyrau was the third busiest airport (after Almaty and Astana, respectively) in terms of numbers of passengers. However, both infrastructure and management were recognised as being very poor. The *overall investment rationale* was:

- to create the technical and organisational pre-conditions for securing compliance with international standards
- to develop Atyrau as a Western gateway, becoming one of the three international airport “hubs” in Kazakhstan.¹¹

The TC played a very prominent role in the investment concept as is reflected in the EBRD Board of Directors' report.¹² More specifically, the TC work was:

- to ensure that the client would meet the key covenants laid down in the loan agreement
- to facilitate transition impact (TI) at the institutional and sector levels.

An overview of both key loan covenants and TI are illustrated in Box 2.

⁷ FC85/ECT98-98-07-01/0

⁸ See Concept Review Memorandum of Atyrau Airport Terminal Building, OpID. 35895, April 2005.

⁹ See Memorandum of Operation Leaders to TC Com, 19 May 2005.

¹⁰ This project is included in the Bank's DTM system, Op ID. 19637.

¹¹ Source: Kazakh Transport Strategy (О Транспортной стратегии Республики Казахстан до 2015 года) in accordance with the Presidential Ukaz N 86, 11 April 2006.

¹² The TC support is mentioned in the Board Report (BDS01-132) under the “President's Recommendation”, the “Summary Fact Sheet” and in the draft ToR for TC3 that are attached in one of the Board Report's annexes.

Box 1: Key covenants and TI indicators defined for Atyrau airport project

Loan covenant	Transition impact monitoring system (TIMS)
--	[1.1] Institutional reform of the government in the aviation sector: provide TC to draft improved aviation regulations and to develop measures to improve safety
Prepare and submit to the Bank the annual update of the business plan [...] beginning in the year 2003 ... ¹³	[1.3] Establishment of a business plan: prepare and annually update a business plan (key covenant) ¹⁴
[...] ensuring that airport tariffs are cost-based, non-discriminatory, and set at a sufficient level to ensure that the Borrower achieves financial self-sufficiency; [...] ¹⁵	[1.2] Airport tariff reforms: ensure airport tariffs are cost-based, non-discriminatory, and set at a sufficient level for cost recovery. (key covenant)
Have its records, accounts and financial statements [...] for each fiscal year (FY) audited by independent auditors acceptable with the Bank in accordance with GAAP for the FY 2002 and 2003 and IAS [...] in the year 2004 and thereafter ¹⁶	[2.1] Improvement of accounting standards: Submission of GAAP for FY 2002/2003. IAS accounting for FY 2004 (key covenant)

3. Achievement of objectives

3.1 Issues pertaining to project success

3.1.1 Difficulties in delivering TC projects in Kazakhstan

Unfortunately, the approval of the investment project coincided with a radical change in the way that the government of Kazakhstan (GoK) handled grant-funded consultants in the public sector. According to a resolution from October 2001, a donor coordination role was assigned to the Ministry of Economy and Budget Planning.¹⁷ Whilst the intention was good, the way it was handled led, in practice, to severe difficulties for donors. For instance, in TC projects, which feature public body as the client, the local TC beneficiaries and/or the delivering consultant can face uncertainties with regard to local taxation, that is, for instance value-added tax (VAT). It was also stated by the Kazakh side that some provisions of the Bank's standard documents used for TC purposes (for example, the grant agreement and the consultant services contract) would contradict the local legislation.

Because of the uncertainty of taxation, the TC implementation process faltered and committed projects ready for implementation piled-up from 2002 to 2005.¹⁸ The consultancy services unit (CSU) investigated, consulted and negotiated with players on site in order to find a solution. In this it was supported by the resident offices on site as well as members of the TC Review Committee (TC Com) at EBRD headquarters. Then President of the EBRD, Jean Lemierre, also raised this issue in a meeting with Deputy Prime Minister Mynbayev during the FIC meetings in Almaty in December 2003. However, no immediate action was taken to rectify this situation.

¹³ Loan agreement to operation number 18492, 15 December 2001, Section 3.01 (b).

¹⁴ TIMS project review checklist, No.6, 26 January 2006.

¹⁵ Loan agreement to operation number 18492, 15 December 2001, Section 3.01 (c).

¹⁶ As above, Section 4.01 (b).

¹⁷ The resolution of the government of Kazakhstan, No. 1285, "About the Procedure, Regulating, Mobilization of Grants", 5 October 2001 (translation).

¹⁸ The tax duties are reported to be significant, possibly amounting to 45 per cent of the TC project's value. See TIMS project review No. 4, 13 January 2005.

Eventually, in December 2004 the Bank and the GoK entered into a framework agreement.¹⁹ This agreement, which was ratified by the upper house of parliament (“Mahjlis”) in October 2005, makes all TC work and other grant co-financing provided by or through the Bank formally exempt from all taxes levied by the GoK. Nonetheless, the CSU reports that this agreement is not yet universally implemented in daily practice as opposition appears to continue against some standard provisions laid down in the Bank’s grant agreement and the consultant services contract.

Most recently, it was reported that the GoK has passed a law that it should be the GoK Ministry that selects those projects eligible for external donor funded assistance. In a number of recent projects, the Bank has therefore decided to contract consultants itself in order to save their implementation.

The total number of TC commitments that has suffered from delays or de-commitments over this time period is unclear and a matter beyond this evaluation. In relation to this report, it must be mentioned that the TC work for Atyrau airport was very negatively affected. For example, the implementation of TC3 had been delayed by three years. In the meantime, this caused the non-compliance with a couple of loan covenants (see Section 3.4). Some of the envisaged activities became obsolete, as described in Sections 3.3 and 3.4. This made the *relevance* of this project questionable. TC5, which was regarded as extremely important for the civil aviation reform work, was not implemented at all. The selected consultant and the Kazakh Ministry of Finance could not agree on the wording of the provisions, which grant tax exemption, before the donor funds expired at the end of 2004.

The operation team is convinced of the general appreciation of TC work in Kazakhstan and believes that it is the responsibility of the Bank to try to find ways to continue with TC operations, even if it is difficult.²⁰ The OPER team agrees in principle with this view. However, it is concerned by the number of years that have already passed without finding an effective solution. Hence, it is noted with some surprise that the Bank’s country strategies for Kazakhstan from 2002 and 2004 make no mention of the TC issue at all (see also Sections 6 and 7).

3.1.2 Split ownership and rivalling operators at Atyrau airport

Although the Bank only has one project client, which is the Atyrau International Airport (AIA), there is another important operator at Atyrau Airport, the Atyrau Airport & Transport Inc. (ATMA). The Bank’s client is an open joint stock company owned 100 per cent by the joint stock national company KazMunaiGaz (KMG). The other airport operator, ATMA, was created in 1993 with 50 per cent of the equity being held by a private Turkish company and the other 50 per cent belonging to CASPIY, a national company.

The split between owner and operatorship was discussed in-depth during project appraisal with the OT.²¹ It concluded that, “[...] *the passenger facilities and the air-side operations are separate lines of business and there is no reason why the present structure at Atyrau Airport cannot continue to work satisfactorily.*”²²

Seven years later the views on this topic appear to differ insofar as all interview partners agreed on their preference to deal with one airport operator. It is not only a duplication of activities in

¹⁹ See “Framework Agreement between the Government of the Republic of Kazakhstan and the European Bank for Reconstruction and Development on the Technical Assistance and Cooperation”, 10 December 2004.

²⁰ One of the interviewed team member has also stressed that the grant agreement had a rather intricate wording in parts. This did complicate the situation with the locals because they were not sure what they would sign-up to.

²¹ See minutes of the OpsCom Secretariat, 9 November 2001.

²² See BDS01-132.

sectors, where the two actors at times appeared to compete with one another (as evidenced by fuelling services). More gravely, project-related advice and training do naturally only target one operator, the Bank’s client AIA.

Without suggesting that ATMA should have been involved in the TC work, it is, nonetheless, regrettable that such an institutional limitation must lead to less effective results. What might be successfully introduced in AIA has no effect on ATMA, and the overall development (and perception) of the airport as a service provider is likely to be hampered.²³

3.2 Project preparation: feasibility study and assistance to due diligence (TC1 and TC2)

Box 2: Objectives according to the ToR

Phase I ²⁴	<ul style="list-style-type: none"> • To define the components of an investment programme for Atyrau airport suitable for the Bank’s financing.
Phase II ²⁵	<ul style="list-style-type: none"> • To verify the investment costs in phase I and confirm that the outline design for the rehabilitation of the runway will be satisfactory. • To review AIA’s ability to implement the proposed investment and to service its debts while growing its operations.

Initially, two technical alternatives to strengthen the airport’s operating capacity were discussed. First, the refurbishment of the existing airfield pavements (with the runway keeping its total length of some 2,300 metres) and secondly, the construction of a new runway (with a total length of 3,000 metres). Since the project’s concept review, the first option was preferred, and the feasibility study was to concentrate on the rehabilitation of the old runway. The engineering consultants later produced an inception report that indicated that the construction of a new runway would have several advantages and would also be cheaper.²⁶ This was approved by the Bank.

A number of objectives were met satisfactorily, such as the market analysis and traffic forecast in the Kazakh civil aviation sector. Less definite is whether the feasibility study should not – in the first place – have discovered the better technical option of constructing a new runway, which is the view of the OPER team. On the other hand, the OT might have a point in stressing that the client and the Bank were lucky that the engineers spotted the advantages of a new construction.

3.3 Financial management and accounting (TC3)

Box 3: Objectives according to the ToR

•	To improve the airport’s effectiveness in accounting as well as its management information system (MIS) with particular regard to financial data.
•	To assist the airport to produce reliable and detailed accounts for the financial year 2002 and half year accounts for the financial year 2003, restating them in accordance with international accounting standards (IAS). ²⁷

²³ An example is a passenger rating of the Atyrau airport that was launched on the internet in September 2007. In this survey, people bitterly complained about the poor service on the ground, the inaccessibility of the terminal building and so on. This lies in the responsibility of ATMA and not the client but taints the reputation of the entire Atyrau airport as well as that of the EBRD.

²⁴ See C11460/ECT98-98-07-01/06/FC85/ECT98-98-07-01/0, ToR p. 3. Services commenced on 30 May 2001.

²⁵ The second phase (ECT98-98-07-01/06) was carried out by the same consultant.

²⁶ See 18492 Monitoring report Kazakhstan Atyrau Airport project, 20 June 2003.

²⁷ Original version of ToR (January 2003), this was later revised to provide the airport’s financial year 2005 and half-year 2006 accounts in accordance with IFRS.

The wider objective of this component was to enable the Bank to undertake more effective monitoring with regard to its client's financial performance and debt service capability starting from 2002. However, when the TC project eventually started in 2006, International Financial Reporting Standards (IFRS) were officially required in Kazakhstan.²⁸ The client was well prepared due to its parent company KMG. A new (and internationally acceptable) chart of accounts had already been adopted and the airport's chief accountant had enjoyed a number of training courses on IFRS.²⁹

Consequently, the consultant adapted a new scope of work by focussing on the restatement of accounts for the financial year 2005/06 and on the development of practical working tools related to financial planning, administration and reporting. Substantial achievements are documented even though the Airport chose not to follow a number of recommendations.³⁰

3.4 Business planning and marketing strategy (TC3)

Box 4: Objectives according to ToR

- To match the airport's physical expansion by introducing new and corresponding management practices.
- To elaborate a business plan and a physical master plan as well as a marketing strategy.

3.4.1 Business planning improvement

The annual business plan was set as a loan covenant to start in March 2003. The Bank's monitoring reports, however, repeatedly indicate that the airport was not able to produce a document of satisfactory quality without TC support. Thus, the OT did not request such a document from the borrower until the TC-related problems with Kazakhstan could be solved.³¹

The consultant's inception report in March 2006 revealed that the airport was in possession of a business model, elaborated by a renowned international company for KMG and its subsidiaries. The template was primarily used by the airport in order to report to its parent company. It was not used as a planning tool. The new model business plan, which was elaborated by the consultant, has been described as serving as an efficient planning tool. Nevertheless, there is no indication that the client makes much use of the model.³²

3.4.2 Airport physical development plan (master plan)

As a "physical" part of the annual business plan, the consultant's consortium partner NACO, which was the runway operation's engineering consultant on behalf of the Bank, developed a comprehensive master plan. This was similar to the land use plan and took relevant requirements from the International Civil Aviation Organisation (ICAO) into consideration. Three different

²⁸ Since 1 January 2005, IFRS have been adopted by a number of companies that are regulated and controlled by the National Bank of the Republic of Kazakhstan. These were followed by companies listed at the Kazakhstan Stock Exchange. The Kazakh law on accounting and financial reporting requested joint stock companies to apply IFRS from 1 January 2005 and other companies from 1 January 2006.

²⁹ For example, provided by the KMG Personnel Development Centre. Consultant Inception Report, March 2006, p. 17.

³⁰ Consultant outputs include an IFRS manual, recommendations for improving the MIS (focussing on financial information), restated accounts and others.

³¹ See Project monitoring report 18492, 30 December 2005. Instead of a business plan, it was agreed to deliver a basic fact-sheet on the airport's current and future activities.

³² In the interview with the OPER team, the director and chief accountant of the Airport mentioned that they are happy to use the model developed for traffic forecasts, otherwise they would stick to the reporting template as required by KMG.

development phases are described from short to long-term, based on the assumption that the airport's annual traffic volume would grow from 300,000 passengers in 2006 to 5.75 million beyond 2025.

The investments proposed until 2015 include a new passenger terminal (of at least 20,000 m²), new cargo handling facilities, a new air traffic control (ATC) tower, construction of parts of an additional taxiway, a new fire and rescue station as well as ground service equipment, workshops and maintenance facilities/stores³³. The master plan was approved by the airport's management. However, due to the lack of financial means and the split ownership of facilities, almost none of these elements have been implemented yet.³⁴

3.4.3 *Marketing strategy*

The feasibility study has already identified the reactive stance of the client management to be a problem, and the consultant confirmed that nothing specific would be done in respect of proactive marketing. Elements for a future marketing strategy were, therefore, to be included in Section 4.5 of the business plan.³⁵ The current situation shows no sign of change because there is no marketing department or similar unit in place, nor is there an informative, up-to-date web site for the Atyrau Airport hosted by the client. The existing one is hosted by ATMA with satisfactory design and information provision.³⁶

3.4.4 *Training and staff development*

Apart from daily coaching and on-the-job activities, there was a three-day formal training session conducted for accountants and economists at the airport (for 10 persons in total). The client praised the high level of training and showed full satisfaction. According to the statements of other related parties, however, it appears as if only the chief accountant is sufficiently skilful in preparing reliable accounting data. It also appears that from nine employees in the accounting department at the time of the TC3 project, four have since left their job.

With regard to the business planning, the situation is even more precarious. A number of new economists have been recruited, and it is unclear which responsibilities they hold. Further, unfortunate events – beyond the control of the OT and the consultant – have also negatively affected the project's sustainability.³⁷

3.5 ***Overall rating of the fulfilment of objectives (TC1-TC3)***

The OL has rated TC3 in the PCR in 2006 as *Partly Successful*. Summing up the achievements of the entire TC work leads to the following ratings (overleaf):

³³ The financial resources needed for the investments of Phase 1 were estimated at €82 million. See OJSC Atyrau International Airport, Airport Physical Development Plan, September 2006.

³⁴ Reportedly, only some equipment has been purchased. Whether ATMA's recent activities, especially the refurbishment of the passenger terminal, are in compliance with this document is doubtful. The master plan considers the current terminal building anyway too small to serve the needs until 2015.

³⁵ See consultant's draft business plan, September 2006, p. 20ff.

³⁶ See www.atyrauairport.com.

³⁷ These include the death of the chief economist in 2006 and the change of the airport's director and deputy director in 2007.

Table 2 Fulfilment of objectives

TC1+TC2 - Feasibility study and assistance to DD	Satisfactory ³⁸
TC3 - Financial management and accounting	Marginal
TC3 - Business plan, master plan and marketing strategy	Marginal
<i>Business planning improvement</i>	<i>Marginal</i>
<i>Master plan</i>	<i>Satisfactory</i>
<i>Marketing strategy</i>	<i>Unsatisfactory</i>
<i>Training and staff development</i>	<i>Marginal</i>

The overall *Marginal* rating assigned to the fulfilment of objectives of the TC work reflects that whilst the preparation work has generally been *Satisfactory*, the implementation work was not. This is unfortunate, as the overall performance of the consultant was commendable and the secondary project objectives, that is, the deliverables, were mostly in accordance with the contract and of good quality. The client commitment to institutional reform and transition-related objectives, however, appear less than satisfactory.

The OPER team concludes that the client is foremost interested in the approval of its parent company and feels more relaxed about the accords agreed with the Bank, particularly as regards the envisaged transition impact. The assignment’s primary objectives are, consequently, likely to have failed. This is discussed in greater detail in Chapter 5.

Another aspect is the *relevance* of the TC3 project that could not be implemented before 2006. It appears as if developments between 2003 and 2005 have made parts of the original ToR obsolete. The basic knowledge for complying accounting procedures with IFRS as well as, even if in a rudimentary form, a business plan were in place before the consultant arrived. On the other hand, the TC work was added to its original scope, and carried the physical master plan component. This appears to be a concession to the client. It has no immediate use to the Bank, as it was not relevant for the loan covenants and unlikely to be implemented soon (see Section 6).

4. Overall assessment³⁹

Overall, the project is rated *Unsuccessful*. TI is considered *Marginal*. Although the airport management has improved financial reporting and information systems, it does not appear to follow a new approach in operations, financial management, marketing or service-orientation. Governmental decisions, namely from the civil aviation committee, prevent the airport from competition, and the development of international passenger figures has fallen short of expectations. The overall fulfilment of the TC work is rated *Marginal* as explained above.

Compliance with the Bank’s country strategy and sector policy is *Confirmed* (Section 5.3). The *Additionality* is *Not Verified* since TC core contents, such as business planning and IFRS, had already been introduced by private companies on behalf of the airport’s parent company KMG. Bank handling is rated *Marginal*, mainly pointing to a number of flaws in the design and timing of related TC projects and problems to secure the commitment of the client organisation.

5. Transition impact and additionality

The TI potential of the Atyrau Airport projects is almost entirely vested in the foreseen TC work.

³⁸ Rating scale: Excellent, Good, Satisfactory, Marginal, Unsatisfactory.
³⁹ The environmental performance by the Bank and the airport is not rated, as this was not part of the TC project. The same applied for the extent of environmental change.

Box 5: TI potential as described in Board document

Framework for markets

- initiating institutional reform of the government in the aviation sector
- ensuring that airport tariffs are cost-based, non-discriminatory and set at a sufficient level to ensure that the borrower achieves financial self-sufficiency

Setting standards for corporate governance and business conduct

- improving the airport's accounting and financial management
- facilitating the airport in preparing its business plan and to improve marketing.

The last two points are discussed in Section 3, “Fulfilment of objectives”. Thus, this chapter will mainly pertain to the framework for markets, that is, the reform process in the civil aviation sector and the appropriateness of levied airport tariffs and fees. The latest available TIMS on the investment stems from a time before the TC project took place.⁴⁰ It rated the TI potential as *Satisfactory* and related risk *High* (the original rating was *Good* and *High*, respectively). Eventually, the OPER team assigned a *Marginal* rating to the TI (see below).

5.1 Institutional reform in civil aviation and the role of Atyrau airport “hub”

The planned support of the legal reform in the Kazakh aviation sector did not happen because the TC5 was cancelled before implementation. Instead, the Kazakh authorities have drafted the aviation legislation without external advice. One of the OPER team interview partners described the civil aviation regulations in use to be essentially “Soviet” but featuring a couple of amendments and innovations. The state takes an active role in shaping the development of its civil aviation sector, that is, it supports its national carrier as well as the capital's airport.⁴¹

The approval of international route licences is a responsibility of the CAC. Kazakh destinations (almost exclusively to the biggest hubs: Almaty and Astana) are offered to 27 international airlines including 15 carriers from the Commonwealth of Independent States (CIS), depending on inter-governmental agreements. According to the available timetable (May 2008) the Russian Transaero is the only international carrier at Atyrau airport as the civil aviation policy favours national airlines to service foreign destinations, namely Air Astana and the new capital's airport. At Atyrau, seven foreign destinations are currently offered by local airlines, however, the connections are not all direct and some operate on a charter basis.⁴²

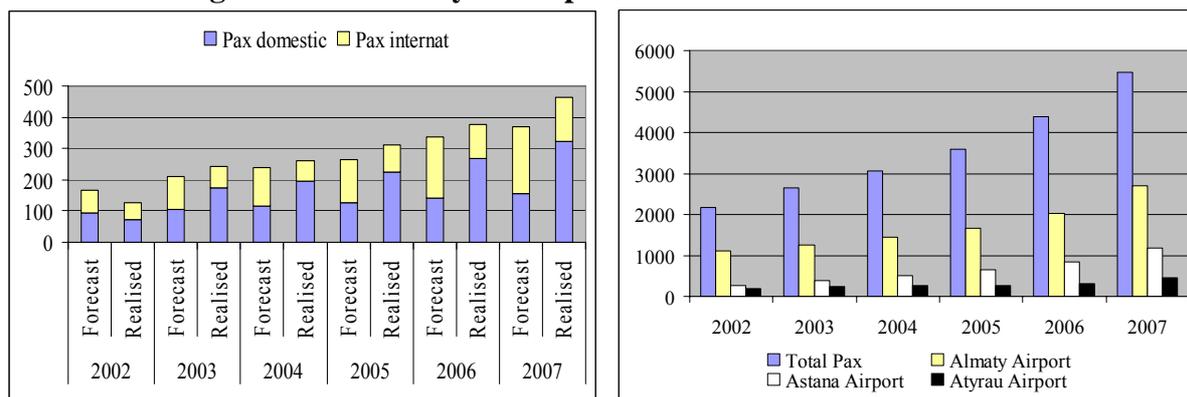
The general passenger development at Atyrau is impressive and exceeded the forecast presented in the Board report by far. This is illustrated by Figure 1 (left graph) on the following page:

⁴⁰ TIMS report 18492/4, 13 January 2005.

⁴¹ As expressed in the Transport Strategy of Kazakhstan until 2020 (p. 37 and p. 44) as well as the Programme for the development of the civil aviation sector 2003-2005 (p. 18).

⁴² The international destinations offered are Minvody, Erevan, Baku, Tbilisi, Moscow, Istanbul and Amsterdam. The Amsterdam flight (Air Astana), however, is operated via Astana.

Chart 1 Passenger volumes at Atyrau airport and its role in Kazakh civil aviation



Note: All passenger (Pax) figures given in '000. Data originate from the Board report, Atyrau Airport and CAC.

As can be seen in the left graph, domestic air passenger numbers developed much more than international ones, which is likely to be the consequence of the GoK's protectionist policy. The original traffic forecast expected international passengers to reach 60 per cent of all Atyrau annual passengers in 2007, but the actual figure is only 30 per cent. In addition, and with regard to Atyrau's rank (third after Almaty and Astana), there are no considerable improvements shown by Chart 1 (right graph).

As a matter of fact, Atyrau's percentage share in all air passengers has even decreased (from 9 per cent in 2002 to 7 per cent in 2006 and an estimated 8 per cent in 2007), while Astana has enjoyed a massive increase of its share from 12 to 21 per cent during the same time.⁴³

With regard to the institutional and political aspects in the framework for markets, the OPER team concludes the following: In line with warnings expressed in the feasibility study as well as the consultant's final report "...the Airport [is] governed by decisions at the central Government level, regarding licensing that curb the opportunities [...] to increase traffic."⁴⁴ It is not clear whether the actual (international) potential of the airport is exploited, despite the technical conditions that have been optimised for this purpose.⁴⁵

Another, rather ironic, issue is that the Bank has supported the state-owned operator of the airport, whilst the partially private operator ATMA is suffering from rivalry and crowding-out attempts. The demonstration effect of this operation could, thus, give a message that is adverse to the Bank's mandate.

5.2 Airport tariff reforms and financial performance of the client

Cost-based and non-discriminatory airport tariffs set at a level sufficient to ensure financial self-sufficiency are defined as a key-covenant and a TI indicator at the same time. Surprisingly enough, however, this issue has not been addressed by a TC project, as it was done with regard to the business plan and accounting requirements. There is a problem here, as the client has no power to determine tariffs with regard to passenger and cargo fees (charged by ATMA).⁴⁶

⁴³ Figures obtained from the CAC and Atyrau airport.

⁴⁴ The feasibility study expresses the "risk of restrictive bilateral air agreements that might restrain services from international carriers". See the Airfield Rehabilitation Feasibility Study, 2001 (Part 1B, page 9). See also Consultant Final Report, December 2006, "Conclusions".

⁴⁵ Atyrau's new runway has been praised on the CAC website as "the only one of its kind in Kazakhstan" that is suitable for full-fledged international aircraft types. The domestic airlines however, with the exception of Air Astana, predominantly use aircraft types of smaller scale, such as Antonov and Fokker.

⁴⁶ See BDS01-132, p. 17.

In addition, the Agency for Regulation of Natural Monopolies (AREM) is in charge of regulating fees.⁴⁷ It regulates the charges related to civil aviation movements in Kazakhstan.⁴⁸ This is done in order to ensure that these are set on a cost-recovery level, and at the same time do not lead to windfall profits. Increases in fees can be applied for at AREM once a year, with the reasoning of keeping up with inflation or to accommodate capital investment obligations.

According to the OPER team's interview with AREM, the fees and charges of Kazakh airports are generally set on a cost-recovery level. The feasibility study noted that Atyrau is at the higher end in terms of charges (in comparison with both, CIS and EU airports). Nonetheless, the client's financial position was described as *Satisfactory* only at the time of the Board approval, and it has been recommended that new revenue sources be identified.

Indeed a sharp increase of revenues took place from 2001 to 2002, which was the result of the introduction of fuel sales. This new activity, launched in competition to ATMA, was quickly rising to contribute to more than half of the client's total income. It was also the cause for an increased earnings before interest and taxes (EBIT) and net profit rate in 2003 and 2004.⁴⁹ 2005 saw a drop in both rates, which is partly caused by the loan interest payments for the runway, starting that year. The financial situation in the last two years allowed for dividend payments to its parent company KMG.

Fuel sales are not "core activities" of airports and should not cross-subsidise other business if these are unprofitable. Whether Atyrau's revenues are in fact distorted could soon show, as it appears that airlines would want to buy kerosene from other sources. This tendency has already caused a decline in airport revenues in 2007 (for the first time since 2000).

It is surprising that the client's expenditures appear to have only attracted little attention. There is neither a comprehensive analysis on the actual (operating) costs recovery of individual tariffs available nor any advice to realise savings. For instance, the airport's business plan for the period from 2007 to 2009 describes an increase of expenditures with regard to staff wages and salaries by 83 per cent within two years.⁵⁰ Instead of screening the cost levels accurately and identify cost saving potentials, the OT and consultants instead chose to think of new revenues sources.⁵¹

They suggested introducing an infrastructure development charge (at project approval and during TC5 implementation). It was apparently not discussed whether this is indeed necessary to recover the current costs or whether it would be fair to customers, who already have to pay the passenger service charges (PSC) to ATMA. In summary, the adequacy of its tariffs and the compliance with the loan covenant's cost recovery remains unclear.

⁴⁷ AREM was created in 2004. The Bank has implemented a TC project for supporting the agency in *Network Infrastructure Regulatory Development*, covering such sectors as telecommunication, energy and rail transport.

⁴⁸ For instance: passenger charges, take-off/landing fees and so on.

⁴⁹ The applied tax schemes appear quite patchy. This is because, amongst other reasons, the introduction of IFRS in 2006 changed the way they were presented. In addition, the client seems to enjoy a tax holiday period for five consecutive years after the opening of the new runway. Taxes included in the statements for 2007 are said to be levied for other activities

⁵⁰ See p. 14, Table 4.3, Position 1.3. The increase resulted to a lesser part from increasing wages, to a larger part from the recruitment of new staff members. Its necessity, however, is doubtful and was not shared by the consultant.

⁵¹ There is only one statement on the landing fees' level, saying that they would not cover the costs of operating the service, Airport Business Plan, September 2006, p. 21.

5.3 Compliance with country strategies and sector policies

The *2000 Country Strategy for Kazakhstan* points to the need to invest in and develop the infrastructure sector on a basis that assures long-term financial viability. Therefore, projects were to be identified (including sovereign lending opportunities) that would support the commercialisation and privatisation of key utilities. In addition, the new potentials for exploiting natural resources, including the Tengiz oil field, required substantial investment support.⁵² The Atyrau airport project design covers both aspects and is, thus, fully compliant with the applicable country strategy for Kazakhstan.

Similarly, the project is in compliance with the Bank's *Transport Operations Policy* from 1997. This document is, moreover, describing an important lesson learned that proved to be relevant for the project in question as well: "*Since the birth of commercial air transport, flag carriers have been viewed by governments as national status symbols (...) [and] Flag carriers are often used as a foreign policy instrument. (...) [such a policy] (...) is inconsistent with the Bank's transition objectives and the application of sound banking principles.*"⁵³

5.4 Additionality

Additionality of TC operations provided by the Bank is usually not questioned. The reason for this is that there would be few agents other than multi donor banks (MDBs) or public donors willing and able to provide advisory and training both free-of-charge and of high international standards. A related issue is, however, whether the client actually required such assistance. In this case, the client's parent company is the largest gas and oil producer in Kazakhstan.

It is strange that the amount of funds financed for the TC3 project (less than €500,000 in total) could not have been made available at KMG. This is especially curious given that important TC-related activities (business plan and IFRS) had already been carried out by renowned international private companies, as reported by the consultant. Such advice was primarily meant for the parent company, but its affiliate, the Bank client, has benefited from this and could have done so to a greater degree. *The Additionality is not verified.*

6. Bank handling

It is difficult to clearly separate the OT's performance in the investment project from the one in the TC operations as both operations are closely intertwined. Moreover, there have been three OLs over the course of this project, from design to elaboration of the PCR. The first two OLs have left the Bank and the last one took over after the TC work was completed.⁵⁴ The OPER team tries to address some key questions, including: Was the TC work fitting to address the important issues/risks related to the underlying investment operation? Is there room for improvement with regard to project design and implementation? What is the quality of the team's self-evaluation, that is, the PCR and related lessons learned?

As described before, the structure and design of the TC work does not appear fully adequate to successfully support the investment operation. For example, the important airport tariff policy was not adequately reflected. The design of the individual TC operations is satisfactory. For TC3 this is only true with regard to its original project documents in 2003 but not for the updated

⁵² Strategy for Kazakhstan, BDS/KA/00-1 (Final), p. 2 and 6.

⁵³ Transport Operations Policy, BDS97-8 (Final), pp. 16-17.

⁵⁴ Nonetheless, the OPER team was able to interview both of them.

version from 2005. This version saw the requirement to elaborate a physical master plan in addition to the original scope of activities, without increasing the financial resources approved earlier.

The PCR describes the consultants' performance as superficial. However, it does not connect this assessment to a possible overload of project activities as per the ToR. Also, another needs assessment of the client together with a coherent adjustment of the project's scope, would have been desirable at this point (see Sections 3.3 and 3.4.1), especially considering that three years had passed between the original project approval and implementation.⁵⁵

The timing of the TC work was not perfect either, which was due to two, very different reasons. The feasibility study (TC1 and TC2) was rushed in order to allow for the approval of the investment project before the end of 2001.⁵⁶ The TC implementation work on the other hand was severely delayed due to difficulties at the political and administrative levels (TC/tax issue, see Section 3.1.1) that were beyond the OT's control. At the same time, the OPER team's impression is that a rather passive approach has been taken in this regard. For instance, the project monitoring reports laconically repeat that the airport was not able to comply with the loan covenants (the business plan) as long as the implementation of TC assistance was still pending.⁵⁷

This should have raised alarm and consequent action should have been taken, preferably by Senior Management. Instead the issue was never even mentioned in the respective country strategies.⁵⁸ Other aspects of project implementation appear to have been handled well, for instance, the procurement, contracting and supervision of the consultant as well as the liaising with the client.

Finally, the PCR text is of good quality with detailed descriptions of objectives, achievements, consultant performance and client commitment. The self-ratings appear at the time realistic, for example, a *Partly Successful* for the assignment's overall outcome. The lessons learned, however, lack clarity, which is evident in statements such as "*the Bank could have taken a more pro-active approach in the TC project*".

7. Lessons learned and recommendations

7.1 Elaborated ex-ante risk assessment

Elaborate ex-ante risk assessment that incorporates relevant lessons learned from the past is crucial when facing a difficult project environment. A number of issues were discussed during project preparation and approval (both investment and TC). For instance, the rivalling owner- and operatorship at Atyrau airport as well as the only partial autonomy of the client in tariff setting were both described in the Board report and the TC project profile for TC3.⁵⁹

⁵⁵ As a matter of fact, it would have been the obligation of the client to tell the OT about the accounting advisory work that had taken place in the meantime.

⁵⁶ Internal correspondence of the OT, 6 August 2001.

⁵⁷ See project monitoring reports 18492, between 20 June 2003 and 30 December 2005.

⁵⁸ Neither the country strategy of 2002 nor of 2004 refers to any problem with TC implementation.

⁵⁹ The TC project profile, Section 6.3 "What are the Risks", states: "KMG confirmed its commitment to improved governance at IAA (former abbreviation of AIA). The Bank is working with the Kazakh Government and KMG to resolve the ownership issue of the airport and the question of functional responsibilities, but these issues are not critical to project success."

Individual issues, such as the commitment of the project stakeholder KMG and the soundness of the government's commitment to reform were judged differently. The OCE's views were more critical – and in hindsight much more realistic than the ones of the OT. The distinction between risks affecting the investment projects and risks (foremost) affecting the TC operations was, however, not addressed.

Lesson learned

The Bank must ensure a professional ex-ante risk assessment of a TC operation in the same way it does for investment operations. Related factors should be clearly determined, and appropriate mitigation measures should be described. It should also be stated explicitly, where risks cannot be mitigated. It is important not to simply apply the same risk factors as identified for the investment to the TC work. In this case, the risk factors proved more troublesome for the TC work and its expected transition impact than for the construction works.

7.2 Adequacy of granting TC funds

It seems as if a public client of a Bank-financed investment is also granted a quasi-automatic right to receive TC activities. One could, in certain cases, question if the client actually required such assistance. In this case, the client's parent company is the largest gas and oil producer in Kazakhstan. Prior to the implementation of TC3, it needed to comply with IFRS and modern business planning methods directly.

For this purpose, the company was able to contract a private, internationally renowned consulting firm that provided its services to the company and its affiliates, including the Bank client. The provision of TC work for the *same* purpose to this client appears, therefore, not justified.

Lesson learned

Manage TC funds in the same *efficient* way as other scarce Bank resources. A client should *qualify* for receiving TC assistance by other means than just being the borrower of the related investment. Financial additionality should be a precondition for granting a TC project to a recipient, followed by other eligibility criteria such as the commitment to transition. All criteria should be monitored over time, especially if delays occur with project implementation. Should TC work be prevented from implementation over a significant time period, in agreement with the donor, the Bank should not hesitate to abort the dormant TC project and to re-commit funds to other opportunities.

7.3 Change in project design to please the client

The final version of the TC3 ToR appears overloaded and lacks clear priorities. The master plan for the airports future physical development was added at the last minute, apparently with the intention to compensate the client for the failed airport terminal project proposal. This work area was not very promising, as it obviously suffered from the rift between the two airport operating companies. Instead, additional activities targeting tariff appropriateness and a more stringent commercialisation of the airport would have served the Bank's interest far better.

Lesson learned

The Bank must act to secure the maximum benefit from TC operations for its related investment project and the intended transition impact. In general, the TC project's scope of work would be congruent with the Bank's and the client's priorities anyway. When these differ, however, the Bank should both defend and effectively communicate its position.

7.4 The importance of sustainable government commitment to reform

Whilst the OT has received some positive signals from the Kazakh government regarding its commitment to civil aviation reform, the 2002 Kazakhstan country strategy states that: "in the financing of airports, Kazakhstan has relied largely on sovereign loans without much attention paid to regulatory issues".⁶⁰ Even worse, the example of Atyrau shows that the attempts for reform aimed at the Bank were overridden by protectionist policies at the central level. It is in this most unfortunate context that the anticipated TC support on regulatory issues could not be implemented.

The view of the OPER team is that further attempts by Senior Management should have been made to compensate this loss by other means. For instance, the Bank was successfully able to implement a TC project at AREM, involving the power, railway, telecoms, and oil and gas transportation sectors. Would it not have been a good idea to include issues of civil aviation into such a project as well?

Lesson learned

Management should show perseverance and creativity in pursuing required sector reform. The OT must carefully monitor the government's commitment to reform. Any developments opposing intended sector reform should be identified and mitigated as soon as possible. These could entail, for instance, asking for an intensified policy dialogue involving the Bank's Senior Management, or the approval of stand-alone TC operations in order to save individual elements of reform.

⁶⁰ Kazakhstan Country Strategy 2002, p. 21, BDS/KA/02-1 (Final).