PROGRAM INFORMATION DOCUMENT (PID)
Appraisal STAGE

September 25, 2015
Report No.: 100539

Operation Name	Kazakhstan First Macroeconomic Management and Competiveness Programmatic Development Policy Financing
Region	EUROPE AND CENTRAL ASIA
Country	Kazakhstan
Sector	Central government administration (100%)
Operation ID	P154702
Lending Instrument	Development Policy Lending
Borrower(s)	GOVERNMENT OF THE REPUBLIC OF KAZAKHSTAN
Implementing Agency	Ministries of Finance and National Economy
Date PID Prepared	September 25, 2015
Estimated Date of Appraisal	October 1, 2015
Estimated Date of Board Approval	November 3, 2015 (tentative)
Corporate Review Decision	September 22, 2015

I. Key development issues and rationale for Bank involvement

Kazakhstan has achieved impressive gains in growth and poverty reduction, supported in part by successful management of its extensive oil resources. A large oil exporter in Central Asia, Kazakhstan has successfully leveraged its oil resources to reduce poverty and increase shared prosperity. The country's real GDP growth averaged 6.5 percent between 2010 and 2013, buoyed by higher oil prices and healthy growth in the non-oil sector. Kazakhstan's poverty rate (at the international poverty line of $5 a day) has dropped from 54 percent in 2006 to 18 percent in 2014 and the size of the middle class has increased from 8 percent to 28 percent of the population. The Government of Kazakhstan has placed a high priority on prudent fiscal management, and on policy reforms to stimulate growth in the non-oil sector. While the state enterprise sector accounts for a large share of GDP, a number of initiatives have been implemented recently to stimulate private investment, including government support programs providing subsidies and financial support, and flagship initiatives to promote the development of priority industries.

An adverse global environment has weakened macroeconomic sustainability and prospects for non-oil growth. The recent fall in oil prices has affected fiscal and external balances, and put pressure on the exchange rate. Overall GDP growth slowed to 4.3 percent in 2014 due to weaker domestic demand following the devaluation of the tenge in February 2014, the oil price shock during the second half of the year, and weaker external demand by China and Russia for Kazakhstan's crude oil, iron ore, and metal products. The economy is expected to weaken further in 2015 to an estimated to be 1.5 percent; the current account deficit is projected to widen to 1.2 percent of GDP, the non-oil fiscal deficit is estimated at 10.8 percent of GDP. While the Government of Kazakhstan initially responded to the oil price fall by launching a counter-cyclical program in the hopes that the external shock was temporary, it reversed its fiscal stance in 2015 and moved to consolidate its budget given the persistence of low oil prices and weak external demand, which together constituted a significant external shock. The current crisis presents a strong opportunity to refocus the development agenda on the need to strengthen the non-oil economy.

II. Proposed Objective(s)

The objective of the operation is to help support the Government of Kazakhstan to implement reforms to (i) strengthen the sustainability of the macroeconomic framework while protecting the vulnerable and (ii) improve the competitiveness of the non-oil economy. The design of the program reflects the Government's priorities, as stated in the Kazakhstan 2050 development strategy as well as recent initiatives to stimulate private sector investment and reform public administration. The first pillar of the DPF includes fiscal consolidation measures as well as steps to enhance transparency of budget operation, revenue mobilization measures, the rollout of an enhanced social protection strategy, as well as measures to support the transition to a new monetary policy regime. The second pillar focuses on a range of measures to promote private investment, including financial sector reforms, measures to improve regulatory governance, the business environment and steps to rationalize the role of the large public sector in Kazakhstan.

III. Rational for Bank Involvement

The proposed DPF series responds to the Government's request for financing, underpinned by a strong set of policy responses to address the challenges created by an adverse economic environment. The Government has an extensive agenda on structural reforms, human and institutional capacity building. The DPF program includes reform measures related to this reform agenda, and focusing on two pillars. Pillar one, **strengthening macroeconomic sustainability while protecting the poor,** supports measures on the macroeconomic framework (fiscal management, monetary policy reforms), expenditure efficiency and protection of the vulnerable groups. Pillar two, **enhancing the competitiveness of the non-oil economy**, measures that strengthen the financial sector by improving the prudential oversight of the National Bank of Kazakhstan; implement a strong legislative agenda to improve the business environment, and rationalize the role of SOEs to create space for private sector led-growth in the non-oil sector. World Bank has worked closely with the GoK on a wide ranging knowledge and investment agenda which has resulted in strong analytical work in the areas under consideration and is used to inform the programmatic operation. The Government's fiscal management efforts are also being supported by the IMF and ADB, and its transition to a new monetary and exchange rate regime (inflation rate targeting and floating exchange rate) is supported by IMF policy advice and technical assistance.

IV. Tentative Financing

Source:	($m.)
Borrower	0
International Bank for Reconstruction and Development	1,000

V. Institutional and Implementation Arrangements

The Ministry Finance has responsibility for the coordination, monitoring, and ensuring completion of the prior actions under the DPF. However, it works in very close collaboration with the Ministry of National Economy and the Ministry of Industry as these agencies have a strategic view of the economy and support many of the actions in this series. In addition, the Ministry of Finance has set up an inter-ministerial working group that is actively coordinating the program of reforms to be supported by the DPF. The Bank has an extensive program in a number of the reform areas, and monitoring of results of the DPF actions will be continued through ongoing Bank engagement.

As this is the first loan of a programmatic series, the World Bank team will continue its close monitoring of this program as it prepares the second loan in the series. In parallel the monitoring will take place through engagement through AAA and on-going projects.

VI. Risks and Risk Mitigation

The overall risk rating of this operation is moderate and reflects political, governance, macroeconomic, and capacity and implementation risks in determining the success of this programmatic operation. The political and governance risk is rated as moderate. The April 2015 re-election of the president by an over-whelming margin and his re-nomination of the government led by Prime Minister Massimov ascertain continuity of political leadership and the structural reform agenda. On the macroeconomic front, the actions of the authorities is expected to put the economy on a more sustainable medium term growth path. The reform program requires the implementation of several legislative and institutional reforms, which will test the implementation capacity of the government. To address implementation issues and improve the business environment to support economic diversification the Government launched the "one hundred concrete steps, modern state for all" reform program in May 2015, focusing on institutional and legal reforms. Nonetheless, there is a risk that exogenous shocks and regional instability and geo-political developments related to Ukraine and Russia may weaken pace of reforms. While all the identified risks cannot be mitigated, they are being managed by a close partnership with the client that provides technical assistance and advice and supports and monitors the implementation of the reforms, including through a WBG technical assistance project in the justice sector.

VII. Poverty and Social Impacts and Environment Aspects

Poverty and Social Impacts

Overall, the policies supported by the DPF series are expected to have positive poverty and social impacts. Despite the decline in oil prices the Government's fiscal adjustment measures that explicitly protect the expenditure allocations in social sectors will help mitigate negative impacts of lower growth and reduced economic activity on the vulnerable. Measures related to inflation targeting would help control food price inflation, while those related to revenue mobilization would strengthen Government's ability to finance social expenditures. Policies supported under Pillar 2 will have a positive social impact as they should help increase access to credit, enhance the business environment and support job creation. Prior actions related to corporate and personal insolvency as well as measures to strengthen financial stability will support provision of credit to firms and household. The measures to enhance the investment climate – including are expected to help boost firms competitiveness through improved access to more cost-efficient and higher quality inputs, leveling the playing field through competition policy reforms that could lead to significant savings for business and consumers. Improving the government's cluster development program by implementing more market-based approaches will help to generate more sustainable growth throughout regions of the country, including (but not limited to) more under-developed regions.

Environment Aspects

The measures supported by the DPF are expected to have mostly positive effects on the environment, natural resources and forestry. As shown in the World Bank Toolkit "Assessing the environmental, forest and other natural resource aspects of development policy lending" (2008), strengthening fiscal and macroeconomic sustainability would have beneficial effects through promoting and better collection of taxes, including environmental taxes as well as through more efficient use of the existing funds. At the same time, enhancing the competitiveness of the non-oil economy would contribute to further improving assessment of environmental impacts and the decision-making on financial allocations, in particular of the state-owned enterprise group KazAgro. The environmental impact of the action related to Samruk Kazyna's adoption of a Corporate Governance Code is likely to be also positive. To the extent that this code implies greater efficiency and transparency in operating this Fund, it might also include greater transparency on the assessment and management of the environmental impacts of what it invests in.

VIII. Contact Point

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