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

STRATEGY FOR KAZAKHSTAN

As approved by the Board of Directors at its meeting on 5 July 2017

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EXECUTIVE SUMMARY

Kazakhstan is committed to the principles of multiparty democracy, pluralism and market economics in accordance with Article 1 of the Agreement Establishing the Bank, although application of these principles has been uneven.

The legal framework for a multiparty democracy is in place and the separation of powers and guarantees for fundamental freedoms are envisaged in the Constitution. However, the political system continues to operate in a highly centralised manner with power concentrated in the presidency and not sufficiently balanced by the legislature or the judiciary.

In April 2015 President Nursultan Nazarbayev won another five-year term in office with 98 per cent of the vote. He has instructed the Government, currently headed by Prime Minister Bakytzhan Sagintayev, to implement an anti-crisis plan to tackle the negative impact of the economic slowdown. However decentralisation of power in a geographically vast, and economically diverse, country may be crucial to implementing an ambitious reform agenda formulated in the centre, particularly given uncertainty over political succession. In January 2017, President Nazarbayev announced a public consultation on proposals to shift power from the presidency to the government and parliament, with the presidency becoming a "supreme arbiter" focusing on foreign policy and defence. In March 2017 the President signed a decree to amend legislation, among others, enabling the Parliament to dismiss cabinet members.

Kazakhstan's economic growth slowed to 1.2 per cent in 2015 and further to 1.0 per cent in 2016, compared with 4.3 per cent in 2014, largely driven by the decline in oil prices. Although the legacy of high non-performing loans (NPLs) continues to weigh on the banking sector, growth is expected to improve to 2.4 per cent in 2017, supported by recovery in Russia, higher commodity prices and strong domestic and foreign investment. The exchange rate has stabilised, Tenge liquidity has improved, the base rate is declining and inflation is on a downward trend.

Kazakhstan has reacted to the difficult economic environment by accelerating structural reforms and fiscal stimulus, both of which are helping to boost growth. The cornerstone of the reform programme is the Government's effort to boost the competitiveness of the economy, attract investment and streamline the regulatory framework to promote competition and make it consistent with Organisation for Economic Cooperation and Development (OECD) best practices. Ambitious utilities tariff reform in regulated sectors is under way and the Government has also announced a large scale privatisation programme, which aims to offer ownership stakes to foreign investors in strategic state-owned enterprises (SOEs).

Notwithstanding these efforts, a number of important challenges remain. These include the need to boost private sector competitiveness and generate balanced, sustainable growth that extends beyond Kazakhstan's hydrocarbon resources and increases the country's resilience. Further steps are also needed to reduce the state's still-outsized role in the economy, normalise the banking sector as a financial platform and boost regional connectivity and inclusion and adherence to environmental standards in order to create a more vibrant and competitive private sector, particularly in the non-extractive industries.

In this context, the following strategic orientations are proposed to guide the EBRD's engagement with Kazakhstan in the forthcoming strategy period:

- **Balancing the roles of the state and the private sector.** A central pillar of the last strategy, this priority remains highly relevant. The state continues to play a significant role in Kazakhstan's economy, impeding its competitiveness. While the Samruk–Kazyna (SK) companies generate more than half of Kazakhstan's GDP, they are in need of reform in a number of critical areas, including corporate governance and operational planning and efficiency. At the same time, state support and industrial policy, including top-down industrialisation programmes, although supporting the economy through economic downturns, have not led to large scale private sector development outside of the extractive sectors. The Bank will thus continue to work towards achieving a better balance between the respective roles of the public and the private sectors, enhancing Kazakhstan's competitiveness by supporting the growth of private enterprises, including SMEs, in agribusiness and other non-extractives sectors, as well as public sector reform and the commercialisation and privatisation of relevant SOEs.

- **Broadening access to finance, strengthening the banking sector and developing local capital markets.** Securing adequate finance remains a key challenge facing many firms. The banking sector is not sufficiently resilient and money and capital markets in their current state cause additional pressure on the non-extractive sector, with micro, small and medium enterprises (MSMEs) most affected. At the same time, governance and internal practices of firms, particularly MSMEs, often make them un-bankable and constitute a key constraint to their ability to access finance. The Bank will continue to support stabilisation of the bank and non-bank financial sectors, work to resolve legacy NPLs and enhance money markets, and work with the Astana International Financial Centre (AIFC) on development of a new stock exchange as well as other capital market institutions. The Bank will also improve access to finance by providing credit lines and local currency financing through partner banks and microfinance institutions, including on a risk sharing basis, and promote corporate governance initiatives in the AIFC.

- **Enhancing inter-regional connectivity and international integration.** Logistical bottlenecks and barriers to cross-border activity, as well as internal connectivity, remain a major impediment to developing more competitive and innovative companies and increasing trade and growth. Costs of crossing the border are significant, with both "soft" barriers (such as customs procedures and logistics) and "hard" infrastructure underdeveloped. The road sector in particular needs substantial investment along with increased private sector participation, while the long term viability of the national railway company requires investment in modern assets coupled with commercialisation and other reform-oriented measures. Through its projects, technical assistance and policy dialogue, the Bank will seek to usher in commercialisation and upgrade inter-regional and cross-border transport infrastructure, boosting inclusion and enabling Kazakh companies to operate more effectively and efficiently in the domestic market, as well as integrate with the wider region, capitalising on Kazakhstan's geographic position on the new "Silk Road" connecting the two economic poles of European Union and South-East Asia.

- **Promoting green economy transition.** Kazakhstan is the largest emitter of greenhouse gases (GHG) in Central Asia. At the same time, it remains vulnerable to climate change impacts, particularly increased water scarcity and desertification affecting living standards and economic activity. Accordingly, there is substantial scope for energy and water savings across sectors, notably in agriculture, energy and industry. However, despite significant progress over recent years, there remain tangible obstacles to attracting investment in renewable energy, energy efficiency, sustainable water use, waste management and pollution control. More broadly, recognising Kazakhstan's COP21 commitments and also the 'greening' of its main trade and investment partners (and competitors), it will be critical for the country to implement a green economy framework to provide conditions for creating a more competitive private sector under the new 'greener' reality. The Bank will thus continue to assist Kazakhstan's transition toward a low carbon and climate resilient economy by financing projects in the energy, renewables, agriculture, industry and municipal sectors, and helping further develop a supportive regulatory framework for sustainable energy, water and resource use.

Across these four strategic priorities, the Bank will also look for opportunities, through both projects and policy dialogue, to facilitate greater regional integration and inclusion, and address remaining skill mismatches that continue to inhibit the competitiveness of both the public and private sectors.

1 OVERVIEW OF THE BANK'S ACTIVITIES

1.1 The Bank's current portfolio

Private sector portfolio ratio: 42.2%[1], as of 31 May 2017

Sector	Portfolio				
Amount in EUR million	Number of projects	Portfolio	*% of Portfolio*	Operating Assets	*% of Operating Assets*
Energy	**23**	**1,001**	**37%**	**740**	**41%**
Natural Resources	9	526	20%	472	26%
Power and Energy	14	475	18%	268	15%
Financial Institutions	**12**	**174**	**6%**	**174**	**10%**
Depository Credit (banks)	9	170	6%	170	9%
Non-depository Credit (non-bank)	3	4	0%	4	0%
ICA	**29**	**289**	**11%**	**221**	**12%**
Agribusiness	10	168	6%	122	7%
Equity Funds	9	79	3%	68	4%
ICT	1	7	0%	7	0%
Manufacturing & Services	8	31	1%	21	1%
Property and Tourism	1	4	0%	4	0%
Infrastructure	**42**	**1,215**	**45%**	**657**	**37%**
MEI	24	402	15%	93	5%
Transport	18	813	30%	563	31%
TOTAL	**106**	**2,680**	**100%**	**1,793**	**100%**

Source: EBRD Business Performance Navigator

1.2 Implementation of the previous strategic directions

Since approval of the last strategy in November 2013 the Bank has focused on three priorities: (1) diversification and support for the non-resource sector; (2) balancing the role of the state and the market; and (3) promoting low-carbon growth and energy efficiency. Over this period, the EBRD's operating assets increased by 44 per cent, with a cumulative annual bank investment of approximately €2 billion across 77 transactions (excluding TFP exposure of close to €60 million).

A landmark development was the signing of the Enhanced Partnership Framework Agreement ("EPFA") with the Government in May 2014, which took the historic co-operation between the EBRD and Kazakhstan to a new level both in terms of investment and policy dialogue. More than €1.86 billion in new projects have been signed since the conclusion of the EPFA, with an average annual business volume of €650 million.[2] Under the agreement the Government has provided €15.6 million to fund the Bank's technical assistance, as well as US$ 33 million for Advice to Small Business (ASB) programmes. Similar agreements were signed with the World Bank, Asian Development Bank and Islamic Development Bank.

[1] Cumulative Business Volume: 5 year rolling basis.
[2] Annual Bank Investment (ABI) was €576 million in 2014, €709 million in 2015, and €1.051 billion in 2016.

The overarching objective of this high-level platform has been to advance economic reforms through such means as privatisation and/or commercialisation of public sector enterprises, SME development, private investment, a revitalised banking system and an improved business climate. The Government's sponsorship of policy dialogue initiatives under the EPFA has undoubtedly contributed to a stronger commitment to and ownership of reforms. The most important achievements to date include adoption of the new PPP and FDI legislation, advanced discussion of tariff reforms, and expansion of municipal and environmental infrastructure investments into eight regions.

Under the first priority, **economic diversification**, 72 out of the Bank's 77 operations were in the **non-resource sector**, accounting for €1.4 billion (72 per cent of total investments signed during the period). As part of its efforts to help develop Kazakhstan's non-oil and gas corporate segment, the Bank continued to invest in improving the competitiveness of the agribusiness sector, including by developing higher value-added production, as well as through technical advisory programmes. For example, the Bank provided a US $60 million loan to Savola Foods CIS, a leading edible oil producer, to finance expansion of its production and storage facilities, a project which also included a substantial resource efficiency component. Additional Bank investments financed the expansion of other resource efficient and sustainable food and beverage value chains, including for well-established companies such as RG Brands and Soufflet.

The Bank also supported export diversification through foreign direct investment and support for export-oriented SMEs in manufacturing and services. For example, the EBRD signed a €10 million loan with Selena FM, a Poland-based supplier of construction chemicals and materials, to re-finance the acquisition of a local production company and construct a greenfield plant in Kazakhstan. Another local currency loan for €10 million equivalent was signed with Alina Industries, a privately owned local producer of dry-mixes and paints, to finance energy and resource efficiency improvements and dust emission reduction. The Bank also provided a loan to a locally owned pharmaceutical distribution company for construction of a state of the art warehouse, which will be compliant with EU Good Distribution Practice.

Notwithstanding these achievements, the Bank has been less successful that it would have liked in the manufacturing sector, owing primarily to the fact that Kazakhstan's economy continues to be driven disproportionally by the extractive sector and the sheer paucity of bankable private manufacturing corporates, made even more acute by the economic crisis, including the devaluation of the Russian rouble, which rendered many domestic Kazakh companies largely uncompetitive.

The Bank has also promoted a greater role for private business under the second priority, **balancing the role of the state and the market**. A €10.1 million loan to Olzha JSC, the first private deal in the transport sector, financed the acquisition of 200-400 rail wagons, helping improve corporate governance and environmental standards while also decreasing state dominance in the sector. The EBRD also refinanced certain Eurobonds of the state-owned railway company, Kazakhstan Temir Zholy (KTZ), as part of its balance sheet restructuring, with related policy dialogue leading to deregulation of the container transport segment as well as privatisation of KTZ's non-core assets. The associated technical assistance has focused on (i) railway tariff unification (ongoing) and (ii) adoption of a sectoral reform strategy by Kazakh Railways (finalised in January 2016).

The Bank has also worked to increase private sector participation in the road sector, culminating in the adoption of a package of legal amendments in July 2014 that have paved the way for future PPP projects in Kazakhstan. As part of the Shymkent-Tashkent Road project, the Bank was able to enhance the private sector's role in routine maintenance and repairs, as well as establish an independent road agency. A Memorandum of Understanding on cooperation in the road sector was signed between the Government and the Bank in November 2015 which will further advance reforms in the sector. Identifying the right champion within the Government and then engaging in constructive and consistent policy dialogue have been key to this initiative's success.

In the municipal sector, the Bank has provided sub-sovereign support to address key infrastructure bottlenecks through improvements in the regulatory framework, including introduction of cost-reflective tariffs. In the water and district heating sectors these efforts led to improved tariff setting procedures in 2014 for utilities borrowing from IFIs and significant tariff increases in several regional cities, such as Kyzylorda, Kostanai, Aktobe, Semei, Ust-Kamenogorsk, Pavlodar and Petropavlovsk. In the water utility sector, EBRD projects have produced about 267 million cubic meters of potable water every year, improving access to tap water for almost 943 thousand people. The Bank's efforts in supporting municipal clients have also secured appropriate wastewater treatment, ensuring that benefits from improved wastewater services reach more than 1.3 million people across the country.

Over the course of the current strategy implementation, the Bank also deepened its cooperation with the National Welfare Fund, Samruk-Kazyna (SK), a holding company for most of Kazakhstan's SOEs and quasi-state-owned companies to promote good governance at the holding company level, as well as commercialisation of SK-owned entities. To that end, the Bank provided assistance with overhauling SK's procurement policies and rules to promote greater transparency of the public procurement process and increasing private sector involvement. It also engaged in commercialisation of selected SOEs through tariff reform TC across several industries, including power generation and transmission, railways, ports and airports among others, helping create state-owned municipal companies that are more financially viable.

EBRD lending has also improved the financial sector's ability to channel resources to private companies and nurture high-growth SMEs. Approximately 330,000 SME loans totalling €730.7 million have been disbursed over the strategy period. In addition, more than 500 ASB projects have been launched since 2013, which have helped 70 per cent of SME clients in non-extractive industries increase their turnover by a median of 55 per cent and productivity by nearly 50 per cent. A number of ASB clients have also benefited from the Bank's financing, thus strengthening the link between the Bank's advisory and investment activities. The first Women in Business Programme in Central Asia was also launched in 2015, with €5.5 million disbursed in that year alone.

Finally, in order to improve access to finance, which remains one of the key impediments to private sector expansion, the Bank signed a Memorandum of Understanding (MoU) with the Astana International Financial Centre (AIFC) to support good corporate governance in the financial sector, cultivate money markets and capital markets, develop a Green Financial System and advise the Government on how to minimise the impact of non-performing loans (NPLs). Notwithstanding these efforts, banks have continued to face significant challenges due to the high level of deposit dollarisation and increased NPLs in light of the Tenge's depreciation.

Under the third priority, the Bank has **supported low-carbon growth and energy efficiency** through a combination of finance, policy dialogue and technical assistance in line with its Sustainable Resource Initiative and Green Economy Transition approach. Under this priority the Bank has financed a range of projects across sectors. For example, it has continued to implement certain Almaty Urban Transport projects designed to introduce "green" transportation options under an integrated approach combining investments, TC and policy dialogue. During the project period, eight of ten substations of Almaty Electrotrans were modernised, while 395 CNG buses and 200 trolleybuses were procured.

The Bank also demonstrated the attractiveness of renewable energy investments in Kazakhstan through its support to the landmark Yereymentau Wind Farm project and rehabilitation of the 100MW Shardara hydropower plant in the southern region. Under the Clean Technology Fund co-financing scheme, the EBRD signed a loan agreement with Burnoye Solar, a private sponsor pioneering a 50 MW solar power plant in the Zhambyl region, which has generated more than 77,000 MWh/y of electricity. In addition, as part of the Shymkent Cement project, the client committed to use alternative fuels at more than 20 per cent of thermal substitution, setting new energy efficiency and CO_2 emission standards for the cement industry in Kazakhstan. Finally, in the mining sector the Bank provided a loan to Voskhod Chrome that includes energy and resource investments. This included the introduction of the country's first 'shaking tables' technology resulting in waste savings from the processing of tailings. Total GET investments in Kazakhstan have amounted to just over €700 million over the last three years and have resulted in total energy savings of 10,724,894 GJ/y and greenhouse gas emission reductions of 1,817 ktCO_2/y.

With regards to policy dialogue, the Bank has assisted the Ministry of Energy in creating an adequate contractual framework for renewable energy, further developing the regulatory framework under Kazakhstan's Concept for a Transition to a Green Economy and supporting the further development of the Kazakh Emission Trading Scheme and the country's commitments under the Paris Climate Agreement. The Bank also deployed substantial TC resources in undertaking energy audits, policy dialogue and market assessments in support of these investments and regulatory improvements.

1.3 Key lessons

Overall, the Bank's experience in Kazakhstan over the existing strategy period has demonstrated the value of joint ownership of the reform agenda, with all key parties involved, and the Government's strong financial commitment. In particular, the flexible nature of the EPFA has allowed the Bank to stay nimble in an often fluid environment and leverage off external drivers critical to strategy delivery. For example, the EBRD and the Government were able to move quickly to seize upon reform opportunities amid plunging oil prices. A personal commitment to reforms at the highest ranks of the Government has also enabled speedy and effective implementation, and joint funding of projects and technical assistance has created common ownership and a commitment to successful delivery of the development agenda. Streamlining project approval through a framework approach has also greatly increased the efficiency of the process.

That said, many of the transition, as well as strategic/delivery, challenges that have structured the Bank's approach to date will remain highly relevant in the new strategy period. The public sector continues to represent a large portion of the Bank's portfolio. In that regard, the

Bank will likely continue to be constrained in the private sector, due to its inherent shallowness (particularly in the non-extractive sectors), bankability considerations and the presence of connected parties. The Bank's ability to engage with systemic banks will also remain limited. As a result, private sector engagement will primarily be at the SME sector level through second tier banks, which the Bank will help grow to become effective channels for reaching SMEs. Subject to credit considerations, the Bank will also continue to engage with its existing private corporate clients, helping them expand and grow value added.

The Bank's experience in the current strategy period also suggests that, despite limited privatisation of SOEs (which is likely to continue in the next strategy period), it is unrealistic to expect the privatisation process to result in a significant dilution of the dominant role of the state in the short- to medium-term. Rather, the most effective way to "move the needle" towards a better balance between the state and the private sector is to continue working with a targeted private client base to help it grow and increase value, and to promote commercialisation of SOEs and municipal companies as an integral element of the broader reform process.

The Bank will also continue its strong engagement in assisting Kazakhstan's transition to a low carbon economy, including in relation to its COP21 commitments, green legislation and investments in energy efficiency and renewables. While the Bank's work in Kazakhstan to date has been a leading example of its new Green Economy Transition approach, energy and resource efficiency and climate change mitigation will continue to be a major focus of its work.

2 OPERATIONAL ENVIRONMENT

2.1 Political context

Kazakhstan has made good progress on the path of transition to a market economy, but the pace of political transformation has been slower despite the introduction of wide-ranging institutional reforms.

The constitutional framework for a multiparty democracy is in place. The separation of powers is envisaged in the Constitution and relevant laws. However the political system continues to operate in a highly-centralised manner and is not sufficiently balanced by the legislature or the judiciary. In April 2015 President Nursultan Nazarbayev won a fifth term in office with 98 per cent of the vote. In January 2017, President Nazarbayev announced a public consultation on proposals to strengthen the government and parliament by transferring powers, particularly in the social and economic spheres, from the president – who would become a 'supreme arbiter' between the other branches, focusing on foreign policy and defence. He said these changes would help "ensure the stability of the political system for years to come". In March 2017 the President signed a decree to amend legislation, among others, enabling the Parliament to dismiss cabinet members.

A rare wave of social protests over proposed land reforms in April 2016 and strikes in the oil sector revealed the need to address such issues as employment and education at the local level. Decentralisation of power in a geographically vast and economically diverse country is crucial to the success of an ambitious reform agenda formulated in the centre. Early parliamentary elections, which took place in March 2016, were called to consolidate public support for socially-sensitive reform measures. Attracting foreign investment and creating favourable conditions for investors are crucial elements of the government programme, which also envisages a new wave of privatisation of state-owned assets and proposals to strengthen local government.

The government was mostly kept unchanged after the parliamentary elections to provide continuity in the implementation of President Nazarbayev's five institutional reforms embodied in his "100 Steps" national action plan, which he had announced in May 2015. In September 2016, a government reshuffle took place, with Bakytzhan Sagintayev replacing Karim Massimov (who was appointed Chairman of the National Security Committee) as Prime Minister.

Prime Minister Sagintayev has been instructed by the President to implement an anti-crisis plan to tackle the negative impact of the economic slowdown. Budget revenues have significantly decreased amid the ongoing decline in prices of oil and other commodities. The ruling Nur Otan party has also been tasked with mitigating the negative social impact.

Externally, Kazakhstan continues to pursue a multi-vector foreign policy, successfully balancing its relations with Russia, China and the West. Kazakhstan is a founding member of the Eurasian Economic Union (EEU) and an active participant in regional economic and security organisations, including the Collective Security Treaty Organisation (CSTO), the Shanghai Cooperation Organisation (SCO) and the newly-established Asian Infrastructure Investment Bank (AIIB). A significant recent development was the signing of the Enhanced Partnership and Cooperation Agreement (EPCA) with the European Union at the end of 2015, which has upgraded the country's relations with the EU.

2.2 Macroeconomic context

Kazakhstan's economic growth slowed to 1.2 per cent in 2015 and further to 1.0 per cent in 2016, compared with 4.3 per cent in 2014, largely driven by the decline in oil prices. Exports were down by 18 per cent year-on-year in 2016, and by 50 per cent compared to the same period in 2014. Imports declined by 14 per cent and 32 per cent respectively, reflecting weaker domestic demand. The current account went into deficit reaching 2.8 per cent of GDP in 2015 and deteriorated further to 6.4 per cent in 2016. Growth has been supported by strong performance in construction, driven by investment under the Nurly Zhol fiscal stimulus program.

The exchange rate has stabilised and monetary policy has been gradually eased. Since March 2016, the exchange rate started strengthening, appreciating by around 9 per cent from March 2016 to mid-June 2017, with short-term liquidity gradually returning to the market. As a result, the National Bank of Kazakhstan (NBK), in a series of reductions, lowered the monetary policy rate to 10.5 per cent in June 2017, from a peak of 17 per cent at the beginning of 2016. The NBK has also maintained a high level of international reserves (US $30.4 billion or 23 per cent of GDP as of May 2017), up by 6 per cent in May 2017 year on year. National Fund reserves (US $62.7 billion or 46.9 per cent of GDP as of May 2017) decreased by 4 per cent in the same period reflecting the transfers under the fiscal stimulus programs. The NBK has had some success in de-dollarising the economy, by applying higher interest rates on tenge deposits, with the share of dollar deposits decreasing to 56 per cent in April 2017 compared to around 80 per cent in January 2016. Inflation averaged 14.6 per cent in 2016; however inflationary pressures have been on a downward path with year on year inflation reaching 7.5 per cent in May 2017.

The legacy of high non-performing loans continues to weigh on the banking sector. The NPL ratio in May 2017 stood at 8 per cent. While this is well below the 30 per cent level that persisted over the period 2008-2013, the underlying asset quality remains a concern given the share of restructured loans, loans to related parties and loans with waived covenants, as well as the presence of off-balance sheet structures that have absorbed legacy NPLs. Quality of collateral in some of the banks is also not of sufficient quality. In February 2017, the authorities announced plans to provide KZT 2 trillion (US $6.4 billion) to the National Problem Loan Fund ("PLF") to clean the balance sheets of banks with the largest shares of the sector's NPLs. Kazakhstan's two largest banks, Halyk Bank and Kazkommertsbank are in talks for a merger.

Growth is expected to improve to 2.4 per cent in 2017, supported by recovery in Russia, higher commodity prices and strong domestic and foreign investment. However, challenges in the banking sector remain a drag on growth. In terms of FDI, a significant expected increase of investment from China, including development of the Belt and Road initiative, combined with the expected recovery of FDI from the USA/European Union and other countries, can be expected to boost growth and, more broadly, provide a platform for creating better connectivity (including in the non-infrastructure sectors) in the country. Inflation is expected to remain within the 6-8 per cent range set by the NBK in 2017, and decline further in subsequent years.

Kazakhstan: Main macroeconomic indicators

		2011	2012	2013	2014	2015	2016	2017 (proj.)
GDP growth	%, y-o-y	7.5	5.0	6.0	4.3	1.2	1.0	2.4
CPI inflation	%, avg.	8.3	5.1	5.9	6.7	6.7	14.6	7.5
Government balance	% of GDP	5.9	4.3	4.8	1.7	-2.2	-1.7	
Current account balance	% of GDP	5.1	0.5	0.5	2.8	-2.8	-6.4	
Net FDI	% of GDP	4.3	5.5	3.3	2.1	1.7	10.8	
External debt	% of GDP	65.1	65.8	63.4	71.2	83.2	122.5	
Gross reserves	% of GDP	16.7	15.9	12.4	16.1	19.2	22.0	
Private sector credit	% of GDP	29.9	30.9	30.4	29.7	30.0	27.8	
Nominal GDP	US$ bn	200.4	215.9	243.8	227.4	184.4	133.7	
GDP per capita	curr.US$	11,553	12,299	13,786	12,709	10,428	7,453	
Unemployment	per cent	5.4	5.3	5.2	5.0	5.0	5.0	

2.3 Structural reform context

Kazakhstan has reacted to the difficult economic environment by accelerating reforms and fiscal stimulus, both of which are helping to boost growth. The cornerstone of the reform programme is the Government's effort to boost the competitiveness of the economy, attract investment and streamline the regulatory framework to promote competition and make it consistent with OECD best practices. The country's accession to the World Trade Organization, reforms taken with a view of facilitating accession to the OECD, a series of structural reforms across sectors and the introduction of the Nurly Zhol counter-cyclical investment programme are all beginning to create a more conductive environment. The Government has introduced reforms to support a favourable investment climate by adopting rules on the organisation of a one-stop shop activity for investors, amending PPP legislation and the investment law. In addition, the Law on Natural Monopolies was amended in May 2015 to increase the transparency of tariff calculation and the activities of natural monopolies, streamline tariff procedures and ensure consumer protection.

The Government is implementing the “100 Steps” programme introduced by the President in 2015. The programme aims to advance structural reforms by creating a professional government apparatus, ensuring the rule of law, improving industrial policy, and creating a transparent, accountable state. As part of the programme, the AIFC is being established on the site of the Astana Expo 2017.

In January 2017 the President announced the new development strategy, “Third Modernization: Global Competitiveness”, which aims to accelerate modernization and digitalization of key sectors of the economy, increase productivity, diversify the economy away from the hydrocarbons sector, address banking sector weaknesses, reduce impediments to the private sector and reduce the role of the state in the economy by accelerating efforts for successful privatization. The President also announced constitutional reforms aimed at devolving powers from the presidency to parliament and the government in January 2017.

Ambitious utilities tariff reform in regulated sectors is under way. A new tariff-setting framework for regulated sectors has been adopted over the past year; pilot projects moving utility tariffs towards cost recovery levels have been implemented in more than 10 regions. For example, in 2015-16 heating tariffs in Kyzlorda were increased by 90 per cent, water tariffs in Aktobe were increased by 42 per cent, and water tariffs in Shymkent were increased by 30 per cent. While tariffs remain below cost recovery levels, this is a significant step towards overhauling the overall tariff-setting framework towards a more sustainable commercial model.

In November 2015 the Government announced an ambitious privatisation plan 2016-2020, which aims to offer ownership stakes to foreign investors in strategic state-owned enterprises. Among the companies planned for privatisation are the oil and gas conglomerate, KazMunaiGas, the largest telecoms company, Kazakhtelecom, railway giant, Kazakhstan Temir Zholy (KTZ), and the nuclear holding company, Kazatomprom.

2.4 Access to finance

Private sources of capital
Kazakhstan has a reasonably well developed corporate bond market in comparison to many countries in Central and Eastern Europe, although it is still smaller than those in developed countries and emerging Asia. As of the end of 2015, capitalisation was approximately US $25 bln, or c.a. 15 per cent of GDP, which is higher than in Russia (c.a. 13 per cent) or Poland (c.a. 2 per cent). Capitalisation has dropped by 33 per cent since June 2015, with few new issuances to cover the maturity and redemption of existing bonds.

Financial services issuers continue to dominate the market. As of 1H2016, listed corporate bonds issued by the financial industry account for 49 per cent of bonds outstanding, with the energy sector second with 31.2 per cent of the total outstanding.

In 1H2016 the trading volume of corporate bonds on the Kazakhstan Stock Exchange (KASE) totalled KZT 192 bln (US $570 mln), a decrease of 58 per cent compared to the same period in 2015. According to the KASE, the reduction of trading volumes was in part a reaction to the new base rate introduced by the NBK (17 per cent in February 2016 versus 12 per cent in September 2015), which caused KZT bond prices to fall and, subsequently, led to a significant decrease in secondary market activity. However the record high trading volumes on the secondary market in 2015 may also have been driven by devaluation expectations, so the sharp decline in 1H2016 may be partly explained by the market's return to the previous trading volumes observed over the last eight years. Additionally, the costs of bond issuance in KZT (estimated all-in cost of 20 per cent) are on average higher than a bank loan, which is likely to have driven down issuer interest.

Total trading volumes on the KASE across both debt and equity sectors remained stable in local currency terms (KZT 49,234 bln) but fell in hard currency equivalents, down to US $142 bln as a result of the Tenge devaluation.

To improve access to finance, the NBK enhanced investment opportunities for insurance (reinsurance) organisations and insurance holdings. Measures included expansion of eligible financial instruments that the insurance organisations and holdings may acquire. Insurance organisations are now permitted to acquire equity in Exchange Traded Funds (ETFs), as well as Exchange Traded Commodities (ETCs), Exchange Traded Notes (ETNs) rated four stars by the rating agency Morningstar, and interests in open-end mutual funds and Islamic Finance instruments, among others. Insurance holdings are also now permitted to acquire government securities issued by the Ministry of Finance.

The equity market is presently highly concentrated and illiquid. However the recently announced IPOs of large state-owned enterprises via the new AIFC may yet re-energize the equity market. The AIFC exchange aims to align regulation and infrastructure with best international standards, which may spur foreign investment in Kazakh companies and restore confidence in the Kazakh capital market. The full or partial listing of select state-owned enterprises would not only support capital markets development and demonstrate the viability of equity and debt platforms to raise finance, they could also enhance corporate governance through more diversified shareholdings. IPO privatisations of SOEs are expected to have a positive spill-over effect on private sector companies, as experienced in other countries.

Another reason for the underdeveloped local capital market is the limited presence of active institutional and retail investors. Today's equity and corporate bond markets are largely buy-and-hold with the Unified National Pension Fund (ENPF) acting as the major investor. The capital market lacks private sources of capital, especially domestic and foreign institutional investors. In the absence of other investors, the bond and equity issuance process for a company focuses on negotiations with ENPF and some other major state-controlled investors (such as Baiterek) to pre-arrange the offering. Moreover, the ENPF is also the most active player on the secondary bond market, accounting for approximately 60 per cent of trading volumes in 2015. The involvement of leading international management companies in the AIFC will promote local capital and asset management markets, but this will also be predicated on a pipeline of both private and public sector IPOs.

Multilateral and bilateral development bank finance and the EU

The **World Bank** has a US $4 billion loan programme in Kazakhstan. While 90 per cent of its commitments are concentrated in the on-going South-West and East-West roads project, the portfolio remains diverse, with two-thirds focused on institution building. It also includes activities in the areas of competitiveness and innovation, administrative reform and capacity building, skills and jobs, environmental protection and resource efficiency. A US $2 billion loan was approved in 2015 to support the Government in strengthening the sustainability of its macroeconomic framework and improving competitiveness of the non-oil economy. The World Bank also provides extensive advisory and analytical services (AAA) to the Government through the Joint Economic Research Program (JERP), which focuses on financial and private sector development, promotion of science and innovation, sustainable environmental development and regional cooperation.

Since Kazakhstan joined the **Islamic Development Bank** (IsDB) in 1995, the IsDB has provided nearly US $2.1 billion in financing to the country across 31 projects. Significant resources have been dedicated to insurance, and public and private sector development, including establishment of the AIFC. The Bank has also financed US $800 million in foreign trade with the objective of promoting trade among its member countries. Collaboration between the IsDB and AIFC will promote Islamic financial services. The IsDB's presence is especially prominent in the area of food security and the Islamic Infrastructure Integration initiative. Going forward, it may also provide technical support to develop Islamic finance.

The **European Investment Bank** (EIB) launched its lending operations in Kazakhstan in 2014, extending €220 million in loans to date. The EIB has focused on supporting SMEs and midcap companies, social infrastructure development, environmental protection and climate change mitigation. Through its Central Asia framework, EIB also has financed renewable energy, and transportation and storage projects.

The **Asian Development Bank** (ADB)'s cumulative sovereign loan support to Kazakhstan has amounted to approximately US $4.6 billion, with an additional US $455.2 million in non-sovereign loans and guarantees. In the transport sector, the ADB has supported Kazakhstan's integration into global transport networks along CAREC Transport Corridors. It has also extended financial facilities for on-lending, including through the Damu fund. In the energy sector, the ADB is focusing on energy efficiency, modernisation of district heating networks and institutional capacity development. In the urban sector, advisory support is being provided for infrastructure development in secondary cities. Substantial analytical work is being developed under the Knowledge and Experience Exchange Program, with first topics being governance and services competitiveness.

Kazakhstan is the **International Finance Corporation** (IFC)'s largest client in Central Asia. As of September 2016, IFC's committed portfolio in Kazakhstan stood at US $217 million, with investments in 13 projects in financial markets, agribusiness, retail, construction materials, and the railway sectors. Since the beginning of investment operations in 1997, IFC has invested about US $1.4 billion in long term finance, including mobilization from partners of nearly US $300 million, to support 57 private sector projects across various industries, including agribusiness, financial services, manufacturing, and oil and gas. IFC also continues to support trade flows through short term trade finance.

The **European Union** has implemented more than 300 projects totalling more than €140 million. In 2015, it signed an Enhanced Partnership and Cooperation Agreement (EPCA) with Kazakhstan, an important milestone which will strengthen EU and Member State cooperation with Kazakhstan. At the country level, the EU focuses on technical assistance for social and economic development, as well as state and administrative reforms, while regional programmes under the strategy for Central Asia prioritise projects in energy transport, municipal infrastructure, environment and education. The EU has also promoted private sector development by supporting SMEs in Kazakhstan's regions, providing technical assistance to improve competitiveness through better regulation, and strengthening regional capabilities for more equitable development.

The newly established **Asian Infrastructure Investment Bank** (AIIB) focuses on the development of infrastructure and other productive sectors in Asia, including energy and power, transportation and telecommunications, rural infrastructure and agriculture development, water supply and sanitation, environmental protection, urban development and logistics. In May 2016, the AIIB and EBRD signed an MoU to deepen cooperation between the two organizations as they promote economic development and investment across countries where they are both active. Building on the successful launch of the first joint project in Tajikistan, a road linking Dushanbe with the Uzbek border and forming part of the east-west highway in Central Asia, the two banks are considering joint projects with private sector participation, including in Kazakhstan. For example, in December 2016 the AIIB's Board approved a US $69 million private solar energy project that will be co-financed by the EBRD. The project will increase renewable energy capacity in Kazakhstan's remote southern region and reduce the country's dependence on coal to meet increasing demand for electricity.

Kazakhstan is a founder and a major participant in the **Eurasian Development Bank** (EDB). In line with its Strategy for 2013-2017, the EDB aims at supporting investments under the Government's Programme on Accelerated Industrial-Innovative Development and co-financing with IFIs, banks and investment funds. The main focus areas include automobile and machine manufacturing, the petrochemical industry, glass and pipe manufacturing, power generation, agribusiness and light industries. Specific attention is paid to promoting export – oriented and cross-border projects. In this way, the EDB invested in the construction of the North Kazakhstan-Aktyubinsk Interregional Power Transmission Line, development of chrome, uranium and offshore hydrocarbon deposits, as well as utilization of associated petroleum gas. In an effort to help diversify the economy, the EDB supported the launch of a metal tin full-production cycle in Sarymbet, which has fully covered Kazakhstan's internal demand and also enhanced exports to other CIS countries.

2.5 Business environment and legal context

Business Environment
Kazakhstan's business environment has improved over recent years, but obstacles to doing business continue to constrain growth; improvement has come mostly in areas affecting foreign investors, with less progress for SMEs and medium-sized corporates. The country is ranked 35th in the Ease of Doing Business 2017 rankings among 190 countries, with improvements in seven out of ten areas measured by the report: starting a business, dealing with construction permits, getting electricity, protecting minority investors, trading across borders, enforcing contracts, and resolving insolvency. Kazakhstan nonetheless still scores low in trading across borders, getting credit, paying taxes and getting electricity. In BEEPS V (2014), the top three business environment obstacles identified by firms in Kazakhstan were competitors' practices in the informal sector; electricity issues; and access to finance. Notably, over recent years, the marginal source of credit for firms has been financing provided as part of state support programs, with financing from banks constrained and very expensive. For large firms, electricity issues and workforce skills were among the biggest challenges; young firms listed corruption as a major constraint.

Legal Context

Over the last few years there have been significant improvements in crucial areas of Kazakhstan's commercial legislation. Despite significant legislative reforms, Kazakhstan's legal environment still falls short of internationally accepted standards in some respects and continues to remain complex and challenging. Further steps are needed to strengthen the legal framework for investment and well-functioning of markets. In particular, the 2016 EBRD assessment revealed that the corporate governance legislation and practices in Kazakhstan are in need of reform.

The revised Green Economy Law of June 2016 introduces improvements to the legal regulation of renewable energy resources, ecology and subsoil use. More specifically, the amendments provide for regular indexing of feed-in tariffs taking into account foreign currency exchange rate changes, which brings more certainly to producers of renewable energy. The legal framework to support and enhance energy efficiency in Kazakhstan is developing but implementation of regulations has been slow and institutional capacity is low. The focus should be on removing legal and regulatory barriers to the competitive energy market, as well as further support for the sustainable sector development by creating guarantees for the development of renewable energy sources and introducing cost-reflective energy tariffs.

After the adoption of the Public-Private Partnerships (PPP) Law in 2015, a question concerning the interplay of the PPP Law and the Concessions Law arose. There is a lack of clarity in this regard, and it remains to be seen how the two laws will apply in practice, in particular with respect to the ongoing PPP projects. Furthermore, the PPP Law contains very scarce provisions on how the state-owned companies should exercise their rights in PPP projects and PPP companies which may be established for institutional PPPs should operate. It is expected that further legislation may be needed for appropriate implementation of such provisions. It also remains to be seen if the secondary legislation adopted to implement the PPP Law is sufficient and covers the specific aspects of various types of PPPs.

Kazakhstan modernised public procurement by introducing electronic procurement tools, but did not achieve compliance with international best practice and closed the public procurement market to international trade. There is a need for comprehensive sector reform, in particular implementing principles of non-discrimination and fair competition. Increased transparency and accountability of procurement decisions is recommended. A reform of the public procurement review system is also required to implement an accessible and fair procedure for review and remedies in public procurement.

The judicial system of Kazakhstan is undergoing significant changes and recent legislative developments (including the adoption of the new Civil Procedure Code and Law on the Supreme Judicial Council) will contribute to making the judiciary more independent and professional. Further efforts are needed to ensure full independence of the judiciary, increase court efficiency, and improve the quality of court decisions and enforcement by building private enforcement capacity. In addition, Kazakhstan should focus on promoting the use of alternative dispute resolution methods in the business community of the country. In this context it is worth noting that efforts are presently being made to create an independent AIFC court outside of the judicial system of Kazakhstan.

The new Arbitration Law adopted in late 2016 is a step forward in the regulation of arbitration in Kazakhstan, in that it combines rules on international and domestic arbitration, introduces the concept of autonomy of the arbitration agreement and clarifies the grounds for recognition and enforcement of arbitral awards by Kazakh courts. However, the new law also raised concerns among investors because it allows a party to unilaterally withdraw from an arbitration agreement, prohibits foreign investors from choosing foreign law to govern a contract with a state-owned company, and introduces a licensing system for arbitration agreements with state bodies or state-owned companies. These concerns are being considered by the Kazakh authorities.

The country has recently introduced numerous reforms aimed at strengthening reorganisation proceedings and raising the professional standards of insolvency administrators. As the 2014 EBRD assessment showed, Kazakhstan has a developed and insolvency office holder framework which covers some of the key elements of the profession. The focus now should be on effective implementation of the law.

Kazakhstan retains an individual licensing regime for specific telecommunications services, rather than a more open and technology neutral framework. Access to telecoms infrastructure is not straightforward and there are no specific measures for the sharing of broadband infrastructure, even in rural areas. Typical wholesale enabling regulatory mechanisms such as local loop unbundling and wholesale broadband access have not been introduced into the market.

See Annex 4 for a more detailed assessment of the legal environment in specific areas relevant to the Bank's investment strategy.

2.6 Social context

Kazakhstan ranks 56th out of 188 countries on the UNDP 2015 Human Development Index (HDI), qualifying it as a country with 'high human development' on par with Russia and Belarus (jointly 50th), and well above other countries in Central Asia (Mongolia - 90th, Turkmenistan - 109th, Uzbekistan - 114th, Kyrgyzstan - 120th and Tajikistan - 129th). However, its HDI ranking masks substantial ongoing challenges relating to educational quality, youth employment, gender parity and regional equality.

The quality of education in Kazakhstan is variable. According to BEEPS 2008-09 and 2013-14, from 2009 to 2014 the percentage of employees with a university degree increased from 33.8 per cent to 44 per cent, which was higher than the Central Asian average and about 14 percentage points higher than the BEEPS average across the whole EBRD transition region. However, according to PISA results from 2012, 45.2 per cent of 15-year old students are not able to use basic mathematical skills in real-life situations[3] and vocational education programmes have failed to generate the skills required by the labour market. The Ministry of National Economy also reports a deficit of 61-77 per cent in technical specialists, a skills mismatch that may deepen as new sectors of the economy develop and new sets of skills are required for the non-extractive sectors.

There has been improvement in health outcomes in Kazakhstan during the last two decades, a period of secular economic growth and increasing health expenditure: this period has been marked by increased healthy life expectancy and decreased maternal, infant and adult

[3] OECD (2014), PISA 2012 Results: What Students Know and Can Do – Student Performance in Mathematics, Reading and Science (Volume I, Revised edition, February 2014), PISA, OECD Publishing.

mortality rates. However key indicators still show that there is substantial room for advancement in health outcomes. The World Health Organization (WHO) reports that healthy life expectancy at birth[4] stands at 63.3 years, compared to 63.4 in Russia and 65.2 in Belarus. There is a substantial gender gap in healthy life expectancy in favour of women (66.8 years vs. 59.8 for men). Adult mortality ratios[5] as estimated by WHO also stand at 279 and 118 for men and women, respectively. Kazakhstan's adult mortality ratio is on par with Russia but more than four times that of Singapore, Norway or Australia.

Significant regional disparities also remain across Kazakhstan. GDP per capita in the richest region (Atyrau, US $39,072) is more than eight times than that in the poorest regions (South Kazakhstan, US $4,775). Additionally there are significant disparities in youth education and employment across regions. Although youth unemployment, on average, is not high in Kazakhstan, in Zhambylskaya, South Kazakhstan, Karagandinskaya and Kyzylordinskaya, a substantial proportion of young people are disconnected from employment opportunities despite not being enrolled in educational institutions, with NEET rates in these regions well above 10 per cent.[6] Additionally, there is substantial variation across oblasts in per capita health expenditure, indicating differential access to health services at the regional level.[7] The regional disparities in access to health have a disproportionate gender impact. Older women, women with disabilities and rural women have more limited access to health care. As the OECD has noted, reducing regional disparities in public service quality where a small population is spread across a vast geography equal in size to Western Europe is a significant challenge.[8]

EBRD gender gaps for Kazakhstan are medium across Labour Policy, Labour Practices, Employment and Business and Access to Finance. According to the latest World Bank data (2013), women's labour force participation rate in Kazakhstan (68 per cent) and the ratio of women's workforce participation across sectors (47 per cent) is high by regional and international standards. However these figures conceal a very uneven distribution of women's participation by sector. As a result, the gender wage gap, unadjusted for gender differences in human capital, is 32 per cent. This gap emerges in part as a result of fewer women choosing technical subjects at vocational and tertiary levels of education. Women's under-representation in these areas is also a result of restrictions on women's employment in the 2016 Labour Code (carried unchanged from the 2007 Labour Code). Article 16 ('Terms of reference of the state labour authority in the sphere of regulation of labour relations'), section 27 of the new 2016 Kazakhstan Employment and Labour code still bars women from 287 jobs mainly concentrated in the mining, metallurgy, hydrocarbon processing, construction and transportation sectors. As a result of these and other barriers, and despite the fact that women participate almost equally with men in the labour force, over the past ten years the contribution of women to Kazakhstan's GDP has remained almost unchanged, hovering in the 36.6-38.6 per cent range.

Women continue to face challenges in the business sector as well. According to the 2015 Business Environment and Enterprise Performance Survey (BEEPS), only 28.3 per cent of

[4] Average number of years that a person can expect to live in "full health" by taking into account years lived in less than full health due to disease and/or injury. Data is available at http://apps.who.int/gho/data/view.main.HALEXv?lang=en.
[5] The probability of dying between 15 and 60 per 1000 population
[6] OECD (2016), Multi-dimensional Review of Kazakhstan: Volume 1. Initial Assessment, OECD Development Pathways, OECD Publishing, Paris.
[7] OECD (2016), Multi-dimensional Review of Kazakhstan: Volume 1.
[8] OECD (2014), Kazakhstan: Review of the Central Administration, OECD Public Governance Reviews, OECD Publishing.

firms surveyed in Kazakhstan had women among the owners and 18.9 per cent had women in top management, lower than the regional averages of 35.5 per cent and 21.2 per cent, respectively. Likewise, according to the Kazakhstan Statistic Business Register 2013, out of approximately 1.4 million SMEs registered in the country, 560,000 (or 39.8 per cent) are headed by women.

2.7 Green Economy Transition

Kazakhstan's energy intensity is nearly nine times higher than the EU-28 average and over ten times higher in carbon intensity. The industrial sector consumes nearly 60 per cent of the total energy use, followed by the residential (16 per cent) and transport (12 per cent) sectors. Progress in energy efficiency has been slow, due to low energy prices, insufficient awareness and absence of data and benchmarks and weak financial sector to support energy efficiency projects.

Kazakhstan has made some progress in diversifying its fossil fuel dominated energy mix, further tapping into its large renewable energy potential, especially in wind and solar. It also has sizeable bioenergy potential, considering the abundant agricultural land and organic waste from households. The government has put in place a long-term plan to increase the share of renewables in power generation from 0.8 per cent to 3 per cent by 2020 and 50 per cent by 2050, and embarked on some regulatory improvements – the introduction of 2009 Law on the Use of Renewable Energy Sources, followed by amendments in 2013 and 2016. However, those measures have not led to greater uptake in projects, as certain deficiencies remain in tariff policy and the creditworthiness of the Financial Settlement Centre, which is responsible for paying the feed-in tariffs (FiTs) for renewables, grid connection issues and the stability of FiTs against Tenge volatility.

Low energy and water tariffs are significant barriers to improving energy and resource efficiency. Households pay nearly 11 times less for gas than the EU-28 average and six times less for electricity. Although direct consumer subsidies have largely disappeared, indirect subsidies are still provided by the government, such as setting the tariffs below the full cost of energy provision. Some pilot tariff reforms are ongoing to move utility to cost recovery level, such as for heating and water tariffs, and there are plans to abolish cross-subsidisation.

Kazakhstan is vulnerable to climate change impacts especially increased water scarcity and desertification leading to reduced agricultural productivity, as set out in the 2nd National Communication to the UNFCCC[9]. Kazakhstan is not a water-rich country, with precipitation particularly limited in the central and southern regions. Irrigation consumes more than half of total water consumption, followed by industry (24 per cent) and municipal use (3 per cent). Municipal water supply and wastewater treatment services suffer from aged infrastructure, under investment and poor or lack of maintenance, which poses population to health risk relating to water-borne diseases. Despite the increasing need to effectively manage water use – climate change impacts on precipitation and surface runoff, ageing water infrastructure, growing demand and increasing competition with neighbouring countries over water resources – current pricing policies do not reflect this and there is a lack of incentives to improve the management of water resources.

[9] http://unfccc.int/resource/docs/natc/kaznc2e.pdf

Recycling rates in Kazakhstan are very low. According to government statistics, only 2.6% of consumption waste was recycled in 2016 (versus 2.2% and 1.8% in 2014 and 2015, respectively), although the rates were higher for production waste (26.8% in 2016 versus 23% in 2014 and 2015). A number of 2016 amendments to the Green Economy Law provide for the sorting of municipal waste and increased recycling, and road maps have been developed in coordination with local executive authorities for resolution of solid household waste issues. Looking forward, the Government's Concept on the Green Economy Transition envisages the share of waste recycling in Kazakhstan to be 40% by 2030 and 50% by 2050.

Local air pollution imposes a major environmental burden and public health risk, particularly in major cities and industrial areas, where the recorded level of toxic substances is five to ten times higher than maximum permissible concentrations (MPCs). The main source of air pollution is the energy sector (heat and electricity generation using coal), followed by oil and gas and metallurgy. Although the existing legal framework is broadly in line with international practices, there are critical gaps relating to implementation of best available technologies (BATs) and cleaner production, prevention, control and monitoring of industrial emissions.

Following adoption of the Green Economy concept for Kazakhstan in 2013, which aims to diversify the economy and improve living standards and resource efficiency, the Government adopted a number of amendments in 2016 to strengthen the regulatory framework governing the concept. Additional legislative acts have been introduced, such as the Law on Energy Saving and Increasing Energy Efficiency (2012), the Energy Saving – 2020 Programme (2013) and Energy Management Systems Requirements and Guidance Use. In 2013, the Government launched a carbon emissions trading scheme (ETS) covering approximately 170 companies in energy, mining and chemical industry; however, trading and penalties under the scheme have been suspended until January 2018.

Kazakhstan, a signatory to the Kyoto Protocol as an Annex I country, submitted its Intended Nationally Determined Contributions (INDC) to the UNFCCC in September 2015, which commits to an economy-wide emissions reductions target of 15 per cent to 25 per cent by 2030, compared to 1990. The INDC did not include any considerations on climate adaptation issues. Kazakhstan signed the Paris Agreement in August 2016. The EBRD supported Kazakhstan in preparing its INDC.

3 STRATEGIC ORIENTATIONS

3.1 Strategic Directions

Kazakhstan is the second largest EBRD country of operations (by ABI), with annual investment of more than €700 million in 2016. The Government has enacted a number of ambitious structural reforms, including those launched since 2014 under the aegis of the EPFA. At the same time, a number of important challenges remain, including the need to boost private sector competitiveness and generate balanced, sustainable growth that extends beyond the country's hydrocarbon resources and increases its resilience. Further steps are needed to reduce the state's still-outsized role in the economy, normalise the banking sector as a financial platform and boost regional connectivity and inclusion and adherence to environmental standards in order to create a more vibrant and competitive private sector, particularly in the non-extractive industries.

In this context, the following strategic orientations are proposed to guide the EBRD's engagement with Kazakhstan in the forthcoming strategy period:

- **Balancing the roles of the state and the private sector.** A central pillar of the last strategy, this priority remains highly relevant. The state continues to play a significant role in Kazakhstan's economy, impeding its competitiveness. While the SK companies generate more than half of Kazakhstan's GDP, they are in need of reform in a number of critical areas, including corporate governance and operational planning and efficiency. At the same time, state support and industrial policy, including top-down industrialisation programmes, although upholding the economy through economic downturns, have not led to large scale private sector development outside of the extractive sectors. The Bank will thus continue to work towards achieving a better balance between the respective roles of the public and the private sectors, enhancing Kazakhstan's competitiveness by supporting the growth of private enterprises, including SMEs, in agribusiness and other non-extractives sectors, as well as public sector reform and the commercialisation and privatisation of relevant SOEs.

- **Broadening access to finance, strengthening the banking sector and developing local capital markets.** Securing adequate finance remains a key challenge facing many firms. The banking sector is not sufficiently resilient and money and capital markets in their current state cause additional pressure on the non-extractive sector, with MSMEs most affected. At the same time, governance and internal practices of firms, particularly MSMEs, often make them un-bankable and constitute a key constraint to their ability to access finance. The Bank will continue to support stabilisation of the bank and non-bank financial sectors, work to resolve legacy NPLs and enhance money markets, and work with the AIFC on development of a new stock exchange as well as other capital market institutions. The Bank will also improve access to finance by providing credit lines and local currency financing through partner banks and microfinance institutions, including on a risk sharing basis, and promote corporate governance initiatives in the AIFC.

- **Enhancing inter-regional connectivity and international integration.** Logistical bottlenecks and barriers to cross-border activity, as well as internal connectivity, remain a major impediment to developing more competitive and innovative companies and increasing trade and growth. Costs of crossing the border are significant, with both "soft" barriers (such as customs procedures and logistics) and "hard" infrastructure underdeveloped. The road sector in particular needs substantial investment along with increased private sector participation, while the long term viability of the national railway company requires investment in modern assets coupled with commercialisation and other reform-oriented measures. Through its projects, technical assistance and policy dialogue, the Bank will seek to usher in commercialisation and upgrade inter-regional and cross-border transport infrastructure, boosting inclusion and enabling Kazakh companies to operate more effectively and efficiently in the domestic market, as well as integrate with the wider region, capitalising on Kazakhstan's geographic position on the new "Silk Road" connecting the two economic poles of European Union and South-East Asia.

- **Promoting green economy transition.** Kazakhstan is the largest emitter of greenhouse gases (GHG) in Central Asia. At the same time, it remains vulnerable to climate change impacts, particularly increased water scarcity and desertification affecting living standards and economic activity. Accordingly, there is substantial scope for energy and water savings across sectors, notably in agriculture, energy and industry. However, despite significant progress over recent years, there remain tangible obstacles to attracting investment in renewable energy, energy efficiency, sustainable water use, waste management and pollution control. More broadly, recognising Kazakhstan's COP21 commitments and also the 'greening' of its main trade and investment partners (and competitors), it will be critical for the country to implement a green economy framework to provide conditions for creating a more competitive private sector under the new 'greener' reality. The Bank will thus continue to assist Kazakhstan's transition toward a low carbon and climate resilient economy by financing projects in the energy, renewables, agriculture, industry and municipal sectors, and helping further develop a supportive regulatory framework for sustainable energy, water and resource use.

Across these four strategic priorities, the Bank will also look for opportunities, through both projects and policy dialogue, to facilitate greater regional integration and inclusion, and address remaining skill mismatches that continue to inhibit the competitiveness of both the public and private sectors.

3.2 Key challenges and Bank activities

Theme 1: Balancing the roles of the state and the private sector

Transition challenges

- While efforts are made to develop the private sector, the state continues to play a significant role in the Kazakhstan's economy, impeding its competitiveness and resilience in the process. SK companies generate more than half of Kazakhstan's GDP, and retain a dominant position in sectors such as mining, energy, transport and telecommunications. Yet within these entities, a number of critical areas require improvement, including corporate governance, operational efficiency, strategic planning and procurement and accounting practices.
- The management and operational practices of these SOEs inevitably affects their interaction with the private sector, determining, for example, the degree to which procurement practices provide fair competition for tenders and accurate price/quality signals. SOEs such as KTZ, Samruk-Energo and KazakhTelecom are also critical to private sector growth because of the operational platforms they provide to companies.
- State industrialisation programmes have played a role in supporting the economy through economic downturns. However, they have had limited success in achieving their objective of developing selected – typically private sector-dominated – non-extractive industries. The fiscal cost of these programmes is high, and they have also caused distortions within the banking sector, as financing is typically provided at subsidised rates.
- Although the agribusiness sector is largely privately owned with highly fragmented upstream industries dominated by SMEs, it has been affected by state interventions that distort market operations along the value chain. For example, the state-owned Food Contract Corporation, the largest trader and exporter of grain, has priority on direct procurement and access to storage and infrastructure. As a result, its activities cause uncertainty in the market and inhibit competition.

- The hydrocarbons sector, which accounts for more than 30 per cent of the country's GDP and more than half of its export revenues, also remains dominated by SOEs, with around 60 per cent of assets in the oil sector in the hands of the SK Holding companies. Particularly in light of recent turmoil in commodity markets, SOE efficiency needs to be improved and private sector entry and expansion in the sector needs to be encouraged, which will spur competition.
- Private sector participation should also be increased in the infrastructure sector through the use of PPPs, which have not yet been well-tested in Kazakhstan, and various forms of management contracts. With relevant legislation now developed, the challenge is to encourage a move towards wider use of such instruments instead of budget financing or sovereign obligations.
- Building on progress in tariff reform, further regulatory improvements in the municipal sector and a strengthened economic approach to tariff setting to enable sustainable public and private financing of utilities are necessary. Additional private sector participation via performance-based management contracts, deeper cost restructuring, and introduction of formal arms-length relationships between municipalities and utility operators, as well as improved demand-side management, including through more widespread metering and consumption-based billing, are also needed.
- Both SOEs and private sector firms face a shortage of technical workers and specialised professionals, such as engineers. SMEs in particular lack capacity in business strategy, operational management and financial reporting. In the areas of competition for human capital, the relatively more established SOEs often win at the expense of the private sector firms' growth prospects. Modern skill sets will be required to remain competitive as new sectors, such as e-commerce, continue to rise.
- Although the EBRD's gender gap in Kazakhstan is medium, women lag behind men in skills, wages and opportunity in some high-value sectors, and employers have at times struggled to diversify their workforces. The formal labour market in Kazakhstan exhibits occupational segregation, with women representing over 70 per cent of total employees in spheres that are considered traditional for women, such as education and health care. These sectors are paid through the state budget, and offer low salaries and fewer opportunities for career advancement.
- Kazakhstan has attracted more than US $130 billion of inward FDI since 1991, with approximately 60 per cent going into the extractive sector over 2005-15. Outside the extractive sector, large cap foreign investors (e.g., leading global manufacturers) tend to pick large SOEs as prospective partners in their ventures, as local private firms often lack the required scale and access to resources (including big-ticket financing). Additional *Mittelstand* FDI thus remains critical to developing more competitive private industries in Kazakhstan. In that regard, although the country's attractiveness to foreign investment has improved, mid-level investors (who tend to have less political gravitas than large, prominent companies) continue to face challenges, including from local corruption, an underdeveloped judicial system and limited civil service capacity.

Operational Response and Policy Dialogue

- The Bank will continue to support the private sector with a focus on SMEs and high-growth corporates through investment and advisory, enhancing its competitiveness and enabling it to scale-up in order to offset the current dominance of the public sector – thus achieving a better balance between the state and the market. It will support private sector enterprises and SMEs in particular through debt and equity financing, as well as risk sharing facilities, to increase productivity and market expansion.

- At the same time, it will continue to engage selectively with Samruk-Kazyna, Baiterek Holding and other state sector stakeholders where it can promote market-based reform and commercial practices, particularly improvements in corporate governance and environmental standards.
- The Bank will collaborate with Baiterek Holding on private sector project selection, preparation and investment in the general industry sector, including as part of the industrialisation programmes overseen by Baiterek Holding. Among other aspects, this will include support for growth, improvement of governance and other practices as well as pre-IPO preparation of selected companies.
- The Bank will also support the Government, Baiterek Holding and other stakeholders with implementation of selected industrial policy initiatives, with particular focus on effective private sector support.
- The Bank will selectively look at privatisation opportunities within SOEs, including in relation to the Government's efforts to liberalise the power market through privatisation and modernisation programmes for power projects, and provide assistance with pre-privatisation financing through both debt and equity participation.
- In the non-extractive sectors, the Bank will continue to support – through direct as well as intermediated debt and equity finance – local SMEs and other corporates in scaling-up and market expansion, for example along the agribusiness value chain (including processing) and in the pharmaceutical and construction materials sectors. Through its projects and advisory, the Bank will seek to improve corporate governance and business practices and introduce processes and technologies that are new and innovative for Kazakhstan and support its export potential (for example, by supporting modernisation of machinery and improving transport and storage infrastructure in the primary agricultural sector). Investments will be supported by policy dialogue in select agribusiness subsectors, including grain, dairy and bioenergy in close cooperation with FAO.
- The Bank will also assist quality in-bound FDI, including selective assistance to private foreign partners in properly procured joint ventures with state-owned companies, while helping existing FDI clients scale-up and increase the value-added of their products. To that end, the Bank will also work closely with the authorities to improve the investment climate and attract new investment domestically and from abroad, which the Bank seeks to promote through its active role in the Foreign Investors Council and the American Chamber of Commerce in Kazakhstan.
- In the extractive sector, the Bank will provide financial support to independent private operators, including in the service segment and in downstream production. The Bank will seek to improve environmental and health and safety standards, as well as the operational, energy, material and resource efficiency of both private and public operators. The Bank will also promote privatisation of select SOEs in the extractive sector and remain active in supply chain development through an innovative programme funded by Chevron, the largest investor in Kazakhstan. The Bank will also continue its role in subsoil legislation reform.
- In the municipal sector, the Bank will support companies such as KazVodKhoz (KVK) in their efforts towards commercialisation, in particular looking for ways to expand its already robust engagement across Kazakhstan's regions to include smaller municipalities, which are disadvantaged vis-à-vis Almaty, Astana, and other larger cities. Improved tariff-setting, wide spread metering, and introduction of Public Service Contracts (PSCs) will all be supported, including by piloting new methodologies in EBRD projects. The Bank will also engage in policy dialogue with the Government,

relevant companies and other stakeholders to improve the regulatory environment in the water, wastewater and district heating sectors.

- The Bank will support aggregation of small and medium sized utilities into regional companies, and work with the central government to create acceptable templates for tenders and legal agreements to enable efficient mobilisation of private sector expertise for public infrastructure.
- The Bank will also support private providers of municipal services by providing debt financing and, on selected basis, capital contributions, and seek to facilitate expansion of the PPP market by developing and financing new PPPs in municipal infrastructure and healthcare facility management.
- To support women's economic participation in the labour force, the Bank will seek to support its corporate and municipal clients in promoting equal opportunities policies and practices within their operations, as appropriate. To address women's over-representation in the state sector and support employment of women without restrictions, the Bank will continue to support the Government in developing and implementing its *Concept on the Family and Gender in the Republic of Kazakhstan to 2030.*
- The Bank will also continue its policy engagement with Kasipkor, the Kazakh Skills Authority, to expand the base of standardized skills and engage with corporate clients where feasible to enhance inclusion by expanding employment opportunities for youth.

Results Framework for Theme 1: *Balancing the roles of the state and the private sector*

	CHALLENGES	OBJECTIVES	ACTIVITIES	TRACKING INDICATORS
1.1	State dominance introduces distortions in the economy and slows down private sector development Large state-owned enterprises can increase their efficiency through restructuring and corporate reform	**Support for the private sector, privatisation and increased private sector participation in infrastructure as means to reduce state dominance and promote greater economic sustainability** **Promote greater economic sustainability and efficiency through commercialisation and restructuring of the state sector**	▪ Direct/indirect debt and equity financing of private corporates to increase productivity and market expansion, particularly in the non-extractive sector ▪ Support for independent private operators in the extractive sector, including to improve environmental, health and safety standards and operational, energy, material and/or resource efficiency ▪ Increase private sector participation, including through PPPs and management contracts ▪ Promote privatisation of select SOEs and provide assistance with pre-privatisation ▪ Selective financial and policy support to municipal companies and SOEs to improve corporate governance, managerial and operational practices, resource efficiency and environmental standards	▪ Evidence of improved operational and/or financial performance of private corporates supported by the Bank (e.g., increased labour productivity and sales/turnover) *(Baseline – N/A)* ▪ Number of private sector clients in the extractive sector improving environmental, health and safety standards *(Baseline – 0)* ▪ Evidence of improved profitability, efficiency and/or corporate governance of selected SOEs with the Bank's support *(Baseline – N/A)* ▪ Evidence of progress towards privatisation (such as full implementation of pre-privatisation programmes and/or sale of state's qualified majority stakes in client SOEs) *(Baseline – N/A)*
1.2	Lack of specialised skills, lack of good corporate governance practice and existing managerial standards hinder development of a competitive private sector	**Strengthen private sector competitiveness and enhance innovation, corporate governance and business operation practices of clients through targeted investments and increased FDI**	▪ Business advice on improving corporate governance and management practices and introduction of innovative processes and technologies, including in the area of equal opportunities in the workplace. ▪ Policy dialogue, including through the Foreign Investors Council, to promote stable and predictable business environment and attract investment	▪ Evidence of clients' improvement in corporate governance, new technology and business practices, including (as applicable) equal opportunities practices and policies *(Baseline – N/A)* ▪ Evidence of improvements in institutional and regulatory frameworks supporting foreign investment and the business environment (qualitative account) *(Baseline – N/A)*
	Context indicator: *WEF GCI's Intensity of local competition (Baseline 2016-2017 score - 4.6; rank - 106 out of 138)*			

Theme 2: Broadening access to finance, strengthening the banking sector and developing local capital markets

Transition Challenges

- Access to finance remains challenging, particularly in the non-extractive sector, with MSMEs the most affected. Domestic credit to GDP is only 34 per cent, a level that (although the highest in Central Asia) compares unfavourably to emerging Europe. While SK Holding companies and other SOEs are able to source a majority of their financing from external lenders and the state (National Fund, Pension Fund, etc.), private sector companies must rely on the domestic banking sector.
- Overall, there has been a reduction in recent years in the proportion of firms with loans outstanding. According to the 2013-2014 BEEPS, only 19.2 per cent of firms reported that they had a loan or a line of credit, a reduction of over 30 per cent compared to the same survey in 2008-2009. The problem is particularly acute in the regions, outside Almaty and Astana.
- Governance and internal practices of many private firms, particularly MSMEs, often make them un-bankable and constitute a constraint to their ability to access finance and scale up. In order to develop the local consultancy sector, international skills and best practices need to be transferred and institutionalised.
- Legacy NPLs remain, notwithstanding steps towards their resolution. As of end-March 2016, the NPL ratio stood at 8.4 per cent. While this is well below the 30 per cent level that persisted over 2008-2013, underlying asset quality remains a concern given the (1) share of restructured loans, loans to related parties and loans with waived covenants; and (2) presence of off-balance sheet structures that have absorbed legacy NPLs. Collateral in some of the banks is also not of sufficient quality.
- Notwithstanding recent progress made by the NBK, dollarisation of the banking sector remains high (roughly 30 per cent loans and 55 per cent of deposits as of the end of 2016). High dollarisation of deposits affects the availability of local currency liquidity in the market, while the high level of FX loans has affected borrowers, many unhedged, following the significant depreciation of the Tenge over 2014-2015. The policy framework to support de-dollarisation can also be further improved; continued effort towards effective implementation of the inflation-targeting regime is key.
- Long-term Tenge liquidity in the market remains insufficient, reflecting structural challenges related to high level of dollarisation and an underdeveloped equity market as well as the NBK's relatively tight monetary policy. Steps need to be taken to develop a framework for comprehensive money market development. In this context, the NBK continues to develop a risk-free yield curve as an indicator of market expectations regarding interest rates.
- While the corporate governance framework in the banking sector is largely in line with international standards, its implementation has not always been effective.
- Capital markets are at a nascent stage of development, with a small local institutional and retail investor base, and insufficient trading, clearing and settlement infrastructure. There is limited liquidity and trading volumes in the stock exchange. Creation of a comprehensive and actionable capital markets plan, rationalisation of local capital market infrastructure and deepened sources of financing are all needed.
- The institutional investor base in Kazakhstan is dominated by the publicly-managed Unified National Pension Fund (ENPF), which invests almost half of its assets in government securities. Assets of the fund constitute 82 per cent of the total institutional investor base in Kazakhstan, which includes pension funds, investment funds and

insurance funds (and, according to the NBK, totalled approximately 15 per cent of GDP as of June 2016).

- The insurance sector's assets are invested mostly in securities. However, investment opportunities in the sector are limited. As of first half of 2016, 26 per cent of assets were reallocated to bank deposits, 22 per cent to securities held until maturity and 16 per cent to securities ready for sale. According to existing restrictions on reallocation of assets for insurance companies, the companies can invest in securities issued by a limited list of companies, mostly IFIs, with ratings of at least BBB- (by S&P standards) or the equivalent provided by recognizable international rating agencies. The role of the sector as an institutional investor is also limited by the amount of funds available for investments due to transferring of a substantial volume of insurance premiums to reinsurers who are non-residents of Kazakhstan. The reasons for the transfers include small capitalisation of local insurance companies and their limited expertise in specific insurance products.

Operational Response and Policy Dialogue

- To improve access to finance, the Bank will continue to provide credit lines via local partner banks and microfinance institutions (jointly "PFIs") with a special focus on channelling funding into the regions, supporting women-owned and/or managed companies and promoting the transition to a Green Economy. The EBRD will increasingly partner with sound second-tier banks to support their organic growth and add to the stability of the financial system. Credit lines will be accompanied by technical support to assist PFIs with strengthening their internal capacities, including underwriting, risk management and monitoring functions, and introduction of new or improved products and processes to enable PFIs to effectively reach out to SMEs. In parallel, the Bank will continue to provide risk sharing facilities as an inducement for PFIs to *inter alia* increase lending to SMEs (including women-led) and develop products targeting that segment.
- Through its ASB programme, the Bank will provide ongoing support to MSMEs in order to enhance access to finance, foster competitiveness and innovation and strengthen support agencies. Similarly, the Bank's Women in Business program will provide advisory services, entrepreneurial skills training courses, business coaching and mentoring.
- The Bank will also continue policy dialogue with the authorities, IFIs and market players to further strengthen the resilience of the local banking sector and MSME support agencies. In particular the Bank will advise on financial regulation and work with the authorities and relevant banking institutions to resolve the existing NPL problem.
- To support capital market development and reform, as well as accelerate liquidity creation, the Bank will participate in selected corporate bond issues, privatisations, Initial Public Offerings (IPOs) and Secondary Public Offerings (SPOs). To support the upgrade of the capital market infrastructure, the Bank will also consider targeted policy dialogue with a focus on legal and regulatory reform, the upgrade of the trade and post-trade environment, consolidation of the capital market infrastructure and the creation of a resilient institutional investor base.
- In accordance with the MoU signed with the AIFC and TheCityUK in Q1 2016, the EBRD will support the establishment of the AIFC, which will operate under common law and have a preferential tax regime and independent financial court. The EBRD will

chair working groups on development of capital markets, derivative markets and corporate governance. The Bank will provide further policy dialogue support to drive capital market reforms and development and ensure a streamlined capital market infrastructure.

- To mitigate potential FX risks to PFIs and end-borrowers alike, the Bank will provide them with KZT-denominated finance, including with the guarantees of the state Damu fund. To diversify its sources of local currency funding, the Bank will continue issuing KZT denominated bonds, including inflation-linked bonds. The issuance of Tenge bonds by the Bank will test the absorption capacity of the local capital market and showcase an effective channel to attract private financing from domestic and international investors. This is expected to produce a spill-over effect on the corporate bond market resulting in higher issuance volumes.
- To ensure the development of a resilient and diversified institutional investor base, the Bank will continue its policy dialogue with the authorities to allow private asset management companies to manage part of the ENPF's assets. Additionally, the Bank will start policy dialogue on asset allocation for insurance companies based on international experiences to strengthen their role as institutional investor.

Results Framework for Theme 2: *Broadening access to finance, strengthening the banking sector and developing local capital markets*

	CHALLENGES	OBJECTIVES	ACTIVITIES	TRACKING INDICATORS
2.1	Access to finance for MSMEs and other private companies is limited, especially in the non-extractive sectors	**Strengthen the role of SMEs in the economy by re-energising lending for targeted under-served segments**	▪ Credit lines, including on a risk sharing basis, and TC to local partner financial institutions with a special focus on regional development and women-owned businesses ▪ Advisory services through ASB for improving competitiveness and increasing access to finance, including through the Women in Business programme	▪ Volume of partner bank lending in target segments, such as to SMEs, women and remote regions *(Baseline – established at projects' approval)* ▪ Number of ASB clients reporting increased productivity and access to finance *(Baseline – established at project approval)*
2.2	Limited access to local currency financing and nascent capital markets	**Deepen financial intermediation through increased local currency financing solutions and capital markets development**	▪ Local currency financing of PFIs and end clients, as well as issuance of local currency bonds ▪ Participation in selected corporate bond issues, privatisations, IPOs and SPOs ▪ Support for the establishment of the AIFC, including advisory on development of money and capital markets, along with the policy dialogue on strengthening institutional investor base	▪ Number and volume of new issuances (debt and equity) in the capital market with the Bank's support *(Baseline – 0)* ▪ Volume of partner bank lending in LCY *(Baseline – established at project approval)*
2.3	Credit continues to contract and bank balance sheets remain burdened with legacy NPLs	**Support good asset quality and sustainable size and structure of the financial sector, including frameworks for resolution of distressed corporate loans**	▪ Advice on financial regulation and support to the authorities and banks to resolve the existing NPL problem ▪ Technical assistance to banks to strengthen their internal capacity and business practices	▪ Decreased NPL level in loan portfolios of partner banks and/or improved loan-to-deposit ratio *(Baseline – established at projects' approval)* ▪ Improvements in standards and practices of client banks *(Baseline – N/A)*
	Context indicator: % of firms identifying access to finance as a major constraint (*Baseline 2013 – 8.8%, World Bank / EBRD Enterprise Surveys)*			

Theme 3: Enhancing inter-regional connectivity and international integration

Transition Challenges

- Notwithstanding substantial investment over the past years in the road and rail sector, international and inter-regional connectivity remains underdeveloped; the costs of cross-border activity are high (disproportionally so when trading with neighbouring countries, such as Armenia), and logistics and hard infrastructure are in need of upgrading. These challenges have held back private sector development because they constrain the ability of local companies to export and acquire production inputs at competitive terms; they also act as a protectionist measure against imports, hence reducing competitive pressures on local companies. Insufficient connectivity has also inhibited regional inclusion by limiting access to better quality training and jobs in less developed regions.
- "Soft infrastructure" for trade across borders, such as burdensome customs and border administration and costly border transportation and cargo handling services, remains problematic. Kazakhstan ranks 77th out of 160 countries in the World Bank's 2016 Logistics Performance Indicators. The Central Asia Regional Economic Cooperation (CAREC) programme also has identified a lack of border point capacities, inefficiencies in support services and discrepancies in technical specifications of railways and wagons as problematic for the Europe-East Asia Corridor.
- In the railway sector, KTZ has improved its governance, strategic planning and operational efficiency in recent years. However, there remain significant challenges relating to tariff structure, which is not cost-reflective, and cross-subsidies between passenger and freight operations. Resolution will be necessary to create a more commercially driven company, as well as to increase competition in different segments (e.g., freight operations). In addition, rules of access to railway freight operations and related services, particularly those of KTZ Express, are not sufficiently clear and have created competitive distortions.
- The quality of roads is deteriorating fast, in part due to harsh weather conditions but also due to a lack of proper maintenance and quality control. Therefore, new construction alone will not unblock trade bottlenecks; more structural changes are needed. Regional and local roads are of a particular concern, with user charges varying substantially between urban and rural areas. The capacity of KazAvtoZhol, the state agency responsible for road management, construction and repair, is also insufficient: its corporate governance, asset management and procurement practices need to be strengthened.
- Private sector participation in the road sector should also be increased by encouraging PPP operations associated with road construction/rehabilitation and subsequent operation and maintenance.
- While sufficient cargo capacity exists in Astana and Almaty airports, it is limited elsewhere and regional airport capacity needs to be improved. This imbalance has also given rise to certain monopolistic practices in the privately owned Almaty airport (e.g. excessively high charges given the lack of alternatives).
- The distinctive feature of Kazakhstan's airport sector is relatively low traffic (in most regional airports, less than 500,000 passengers per year) and significant need for modernisation, the costs of which are considered to be beyond the cash generating capacity of any particular regional airport. Further tariff reform is needed to ensure cost recovery and attractiveness to the private sector, particularly for large state-owned airports, such as Astana. Potential solutions include adoption of public service

contracts, under which direct budget subsidies could be provided for socially important regional airports, and/or bundling regional airports with Astana or Almaty.
- In the logistics sector, both freight rail and the main port in Aktau would benefit from investment to encourage efficient goods movement, as well as the forging of stronger trade links between Kazakhstan and China, Russia, Iran, the Caucasus and Turkey.
- The Government's development strategy aims at promoting digitalisation and broadband development, including integration of public services administration into a single e-Government system. However, competitive broadband access is not available in more remote areas, while individual government-to-business electronic platforms lack interoperability.

<u>Operational Response and Policy Dialogue</u>

- In the transport sector the Bank will focus on supporting private players, fostering greater private sector participation, including through PPPs, and assisting with skills transfers in regional companies. It will also selectively engage with state actors to promote further commercialisation and privatisation (including pre-privatisation assistance), and, where applicable, enhanced regional inclusion and gender-responsive transport.
- The Bank will provide financial support to private sector companies in the rail sector and logistics, including logistics centres and service providers, in order to address existing bottlenecks, improve their standing and competitiveness through financial restructurings, and assist them in expanding their operations/market share.
- The Bank will explore opportunities with KTZ to finance modernisation of its railway infrastructure, fleet renewal and other priority investments and restructuring needs of the company while continuing to engage with the regulator on further advancing sector reforms and privatisation of KTZ's assets.
- In general, the Bank will continue to engage in policy dialogue with the Government, companies and other stakeholders operating in the railway sector with the objective of improving governance and the regulatory environment and increasing commercialisation. For example, it will support introduction of a balanced and flexible tariff framework that ensures the long-term financial sustainability of the railways and balances the interests of cargo shippers and other market participants, eliminating cross-subsidisation between freight and passenger operations as well as addressing soft infrastructure needs (customs procedures and policies).
- The Bank will also develop an Integrated Approach for the road sector, which would focus on basic road infrastructure at the sovereign level and PPPs in high-traffic segments, underpinned by a strong agenda to support KazAvtoZhol (KAZ) to become an asset manager of the sector as a *bona fide* road agency. Introduction of a country-wide tolling system as a new source of funding will be critical to provide the road sector with sufficient resources to maintain road infrastructure and maximise its economic life. The Bank will also pursue support for environmentally friendly construction standards, road safety improvements, and more widespread use of performance-based contracting.
- To assist population mobility and greater inclusion and as part of transport corridor development, the Bank will selectively finance airport infrastructure modernisation. It will assist the Government with regulatory reform to support development of the main airports in Astana and Almaty, while developing an organisational and funding approach that will strengthen and secure the network of smaller regional airports. To that end, the Bank will seek to address inefficiencies in the regulatory framework,

promote deregulation of non-aviation services and facilitate modernisation of the regional airport network with a view to gradually increasing private sector expertise in the sector, initially in the form of management contracts and, once there is traction in the form of longer term concessions, via privatisation of selected assets.

- In the aviation sector, the Bank will seek to engage with the national carrier, Air Astana, providing finance to expand its fleet and maintenance facilities, as well as TC to the civil aviation authority to strengthen its capacity and assist with issues relating to aviation safety.
- The Bank will selectively engage in port infrastructure improvements with the main port in Aktau to address bottlenecks and revise the regulatory framework, customs processes and procedures. The Bank will also continue policy dialogue and targeted TC support to increase private sector involvement in port sector development.
- The Bank will seek to support preparation of infrastructure projects under the Infrastructure Project Preparation Facility in order to improve efficiency, quality and replicability of infrastructure projects for the benefit of the Bank's clients, including identification of investment components and relevant process technology that would optimise the use of resources and allow for a greater energy and resource efficiency.
- The Bank will also explore ways to support "virtual" connectivity through investments in ICT and broadband infrastructure.

Results Framework for Theme 3: *Enhancing inter-regional connectivity and international integration*

	CHALLENGES	OBJECTIVES	ACTIVITIES	TRACKING INDICATORS
3.1	Regional transport and cross-border infrastructure remains underdeveloped and inefficiently maintained	**Improve key cross-border and internal transport links, with an emphasis on commercial solutions and private sector participation**	▪ Support to private players and greater private sector participation in transportation and logistics centres, including through PPPs ▪ Promote further commercialisation and privatisation of select state actors in the ports, airports and road segments ▪ Leverage investments in the railway sector by promoting regulatory reform, adoption of cost-reflective tariffs, and/or elimination of cross subsidies between freight and passenger operations	▪ Evidence of greater private sector participation in transport infrastructure and services, including through PPP/concession structures *(Baseline – N/A)* ▪ Evidence of improvements in operational efficiency and service delivery at client SOE level in the transport sectors, with a focus on cost recovery *(Baseline – N/A)*
3.2	Difficulties in trading across borders remain, and Kazakhstan is insufficiently integrated into regional and global value chains	**Facilitate greater integration through enhanced trade and investment flows**	▪ Financial support to rail and logistics companies to improve competitiveness and increase the efficiency of transport links ▪ Policy dialogue with the Government, companies and other stakeholders to improve the regulatory environment and address "soft infrastructure," including customs and border procedures	▪ Evidence of improvements in efficiency and service delivery of rail and logistics companies (e.g. labour productivity, profitability, improved collection systems) *(Baseline – N/A)* ▪ Improvements of legal and institutional frameworks, and practices at the border, as well as related to customs procedures (qualitative account) *(Baseline – N/A)*
	Context indicator: *World Bank's Logistics Performance Indicator (Baseline 2016 rank – 77 out of 160; score – 2.75); Doing Business Trading across Borders Indicator (Baseline 2017 rank – 119 out of 190; DTF – 63.19%)*			

Theme 4: Promoting green economy transition

Transition Challenges

- Kazakhstan is the largest emitter of greenhouse gases (GHG) in Central Asia y. The economy is also twice as energy intensive – when measured per unit of GDP – as an average OECD economy. The potential for energy savings is thus large in many sectors, notably energy and industry. Despite substantial efforts of the Government, Kazakhstan remains among the countries with high rates of flaring Associated Petroleum Gas, which increases greenhouse gas emissions in the country.
- The existing Emission Trading Scheme (ETS) carbon market (institutions, regulation and carbon exchange) is not fully developed. Furthermore, key components of the ETS (trading and penalties for non-compliance) have been suspended until 1 January 2018 to allow for the development and adoption of necessary legislative amendments.
- Amendments to the Green Economy law and other relevant laws and technical rules need to be further developed and adopted to attract sustainable energy investments, including an effective roll out of climate technologies. Exchange rate volatility of the feed in tariff and the legal and regulatory underpinnings ensuring the long-term creditworthiness of the renewable Cost Settlement Centre are some of the key issues that need to be addressed to improve the financial viability and bankability of renewable energy projects.
- Transition to a low-carbon economy requires appropriate market incentives in the power sector, including further strengthening of market mechanisms with respect to the power generation capacity. Other challenges include (i) the absence and/or still limited availability of pipeline natural gas which could displace extensively used coal, (ii) reduction in transmission and distribution losses through upgrades of crucial infrastructure, and an improved payment collection, and (iii) introduction of incentive-based distribution tariff methodology that would create incentives for bringing on-line new capacity and rehabilitating old, inefficient and polluting plants.
- Improvements in energy efficiency have been slow, with energy tariffs below costs, especially for households. Insufficient awareness of opportunities, including due to the absence of data and benchmarks, is an important impediment to investments. The financial sector, hit by successive crises, and lacking necessary skills for energy efficiency investments, has not been supportive of this type of investment, especially in the SME sector. In general, market-based incentives for undertaking energy efficiency projects need to be improved. A wider use of metering and other private sector solutions to reduce the still high energy and carbon intensity of public and private assets should be promoted.
- In urban transport, apart from the fleet renewal and promotion of cleaner fuels, the broad transition challenge is to move towards an economic regulation and pricing of resource scarcity and congestion, which would also contribute to "greening" of the sector. This requires strengthening the regulatory framework for improved competition in urban transport, competitive route tendering, facilitating improvements in the procurement of services, introduction of service-oriented and cost-efficient public service contracts, which would serve to decrease congestion and pollution. Increased private sector participation could help improve traffic management and parking systems, while ensuring adequate risk taking in road rehabilitation and management, thus serving to further decrease congestion and reduce pollution through fewer engine starts.

- Water stress varies considerably across the country and is most intense in the central and southern regions – a situation which is expected to worsen as a consequence of climate change. There is scope for introducing more water efficient technologies in a range of sectors, particularly irrigation, power generation (thermal/hydro) and water-intensive industries like mining.
- Drinking water quality and sanitation services suffer from aged infrastructure, under-investment and insufficient maintenance, which exposes public to risk of water-borne diseases.
- Water tariffs are not cost-reflective and there is limited metering, which doesn't provide incentives for more efficient water usage across sectors. Utilisation of more efficient irrigation technologies and loss reduction should be promoted. In rural areas, the broad transition challenge is to move from flat subsidization of tariffs to a market-oriented approach linked to the affordability of resources.
- Economic incentives for waste management are largely absent. Where they exist, there is limited enforcement. Fees for municipal collection services paid by households are low and dumping is common.
- Air pollution is an increasingly important issue in major cities and industrial areas, with significant differences by region and by industry. Ambient air pollution, which is mainly caused by combustion of petroleum products or coal by motor vehicles, industry and power plants, particulates, sulphur and nitrogen oxides, imposes a risk to public health. Workplace is another risk area of air pollution exposure, particularly in extractive and processing industries, which emit dust and hazardous gases at the worksite. The worst polluting industries include coal mining, mineral mining, quarrying, steel industry and cement production.
- Advanced resource efficient techniques are already being applied in some key economic sectors, notably at selected power and energy generating installations, but there are untapped long-term opportunities that could be exploited, such as the use of biomass waste from agricultural and food processing sectors to generate bioenergy. Underdeveloped supply chains further hinder the deployment of advanced climate technologies.

Operational Response and Policy Dialogue

- The Bank will continue to prioritise financing of resource efficiency and renewable energy projects, including wind, solar, small hydro, biomass, biogas and natural gas projects. Substantial potential exists in the power, municipal, mining and energy sectors.
- The Bank will also continue to support development of a regulatory framework for sustainable energy projects with a focus on renewables, industrial energy efficiency, tariff reform, carbon markets and a Green Financial System. The Bank will also support the development of the regulatory framework and strategy for resource efficiency, as well as improvement in environmental standards.
- The Bank will continue to co-operate with the Clean Technology Fund and other sources of climate change funding such as the Green Climate Fund and the Global Environment Facility in order to accelerate Kazakhstan's transition to a low-carbon economy. The Bank will seek to support the development of intermediated financing of sustainable energy projects through its engagement on the Green Financial System with the AIFC and explore opportunities to work with the Kazakhstan Development Bank.

- The Bank will also continue to support the introduction of climate technologies in the corporate and municipal sector through the regional Finance and Technology Transfer Centre for Climate Change (FINTECC) programme. Through this programme, the Bank will offer investment grants to install best resource efficient technologies, coupled with technical support to identify and realize “green” investment opportunities.
- The Bank will support implementation of cleaner and more efficient technologies and pollution prevention and control methods throughout the extractive sector, working with mining and oil and gas companies along the whole value chain. To this end, the Bank will promote the best available techniques, including services targeting energy, material and resource efficiency, reduction of emissions and higher operational efficiency.
- The Bank will continue to support the switch from coal and heavy fuel oil to natural gas by investing in gas generation, storage and distribution facilities and modern natural gas power generation projects compliant with the EU Best Available Techniques standards. It will also back development of pipeline connections to support regional gasification and energy security and integration into regional gas markets. Where feasible energy efficiency enhancements for generation, transmission and distribution, including smart metering programs, will be incorporated.
- The Bank will support utilization of associated petroleum gas to decrease greenhouse gas emission, increase energy efficiency of upstream companies and facilitate production of new products and services.
- Drawing upon its experience with Green Cities framework structures elsewhere, the Bank will foster the conversion to a low-carbon and climate resilient economy, working with municipalities across Kazakhstan to finance green technologies and energy efficient modernisation of water, wastewater, district heating, street lighting, public buildings, urban transport and solid waste management infrastructure and services. In particular the Bank will support modernisation of electric transport, and replacement of outdated diesel buses with modern diesel and compressed natural gas buses in the cities of Kazakhstan. The Bank will also finance traffic management systems that smooth traffic flow and contribute to vehicle emission reduction.
- The Bank will also work with the authorities to improve the gender responsiveness of EBRD power, municipal, mining and energy projects and respective climate change funding by promoting best practices as well as equal opportunities. Where relevant, projects will incorporate stakeholder engagement programmes to ensure they address the needs of different user groups, in particular women.
- The Bank will seek to develop an operational approach to finance environmental and pollution abating projects and energy and resource efficiency projects in the buildings sector, and look to deploy commercial mechanisms for financing energy efficiency improvements and demand side measures in public buildings. The Bank will also explore new opportunities through a targeted TC in such areas of agriculture and urban infrastructure as irrigation, bioenergy and energy efficiency in buildings.

Results Framework for Theme 4: *Promoting green economy transition*

	CHALLENGES	OBJECTIVES	ACTIVITIES	TRACKING INDICATORS
4.1	Energy intensity remains high and efficiency of the power sector suboptimal, imposing environmental and economic costs	**Improve energy and resource efficiency and climate resilience in the private and municipal sectors alike**	▪ Support for a switch from coal to natural gas by investing in gas generation, storage and distribution facilities ▪ Finance energy and resource efficient and climate resilient municipal infrastructure, including under Green Cities frameworks	▪ Volume of energy savings achieved through Bank investments based on EBRD methodology in GJ/y *(Baseline – 0; Volume for 2014-2016: 10,724,894 GJ/y)* ▪ CO_2 emissions reduction as result of the Bank's operation in kCO_2/y *(Baseline – 0; Reduction 2014-2016: 1,817 kCO_2 /y)*
4.2	Private sector participation in the renewable energy sector is limited	**Support energy production from renewable resources and development of a sustainable energy policy**	▪ Direct and intermediated financing of resource efficiency and renewable energy projects, including wind, solar, hydro and biomass ▪ Advice to develop the legal/regulatory regime to incentivise sustainable energy investments	▪ Change in renewable energy generated by private sector led projects supported by the Bank in MWh/y *(Baseline – 0; Δ for 2013-2015:198,400 MWh/y)* ▪ Evidence of targeted legal/regulatory/institutional reforms facilitating sustainable energy investments (qualitative account) *(Baseline – N/A)*
4.3	Resource efficiency remains insufficient, undermining transition to a low-carbon economy	**Promote resource- and material- efficiency across the economy**	▪ Support implementation of cleaner and more efficient technologies throughout the extractive value chains ▪ Promote the use of resource efficient technologies in the corporate and municipal sectors, including through the FINTECC programme, and development of a supportive regulatory framework	▪ Volume of water savings achieved through Bank investments in m^3/y *(Baseline – 0; Volume for 2013-2015: 10,431,742 m^3/y)* ▪ Qualitative account of resource efficient technologies in the corporate and municipals sectors introduced by EBRD clients and beneficiaries of the FINTECC *program (Baseline – N/A)*
	Context indicator: Δ in carbon emission intensity *(Baseline 2014 - 1.21 kgCO2/ 2010 USD GDP)*. Source IEA			

3.3 Potential Risks to Country Strategy implementation

The proposed Country Strategy is ambitious, yet realistic given the Bank's track record in the country and good working relationship with the Government through the EPFA. The EBRD's ability to deliver on its strategy nonetheless will be influenced by a number of factors outside of its control. Where feasible, the Bank will work to address and mitigate these risks through proactive and sustained engagement with its clients, IFI partners and the Government.

Specific risks to the Strategy implementation include:

- **Sustainability of the Government's reform momentum.** The Government remains committed to wide-ranging reforms, including privatisation and commercialisation of state-owned companies and public-private partnerships in the municipal and transport sectors. However implementation remains slow and may be affected by ongoing political developments, including uncertainty over eventual political succession. The These factors, including the extent to which there is policy continuity in a period of political change, may have a major impact on the Bank's ability to deliver under Theme 1 in particular.

- **Macro-economic risks.** The economy is gradually adjusting to external pressures that led to the slowdown. However low oil prices, subdued growth in Russia and economic challenges in China continue to depress growth, which is exaggerated by the negative impact of regional risks and global and domestic security incidents on consumer, business and investor confidence. In the short run, the country will continue to largely rely on state support programmes and state-owned and quasi-state-owned enterprises to drive growth. Internally, the banking sector remains a concern, as the sector faces lack of long-term Tenge liquidity, a high level of dollarisation and legacy NPLs.

- **Continued availability of local currency finance**. Interest rate caps, introduced to stabilise the currency in the aftermath of the Tenge devaluation in August 2015, have put pressure on banks' funding costs in local currency. Although the situation has improved since the NBK announced a package of measures aimed at restoring the banks' access to local currency, and the Bank currently has access to the NBK's Tenge funding facility, local currency liquidity remains constrained. In this environment, the Bank's funding from the NBK has become less flexible. Moreover, in the longer term the NBK may phase out this provision of liquidity at preferential rates, given its distortive effect on market interest rates. In the meantime, any further tightening could have pronounced effects on the Bank's lending to local corporates and SMEs and/or ability to issue additional Tenge-denominated bonds.

- **Increased credit risk in the banking sector.** Given the Bank's limited ability to engage with systemic banks, it will need to channel its lending programmes through second-tier banks and PFIs. However additional credit risks may arise as the Bank begins to engage with these lower tiers of the banking sector, including, for example, high concentrations, potential balance sheet distortions related to recent mergers, acquisition and restructurings, and lack of an established track record.

- **Further regulatory support for Green Economy Transition**. Improved financial viability and bankability of "green" investments in relevant sectors will require further legal and regulatory amendments, including addressing exchange rate risks, off-taker risks and cost-recovery. Any fundamental change in policy supporting these investments, or delay in creating and implementing the necessary supportive framework, could have a dramatic effect on the pipeline of potential projects.

3.4 Environmental and Social Implications of Bank Proposed Activities

Kazakhstan faces a number of significant environmental issues which include desertification and scarcity of water resources; soil and water contamination, waste disposal and air pollution. Kazakhstan's environmental issues mainly originate as a historic legacy of the industrial development in Soviet Union; however some particular challenges are also a result of ongoing development in the country. The main source of air pollution, for example, is the power and energy sector (heat and electricity production using coal). The second largest air polluters are the petroleum and the metallurgy industry. Sources of water pollution include old tailing ponds, disposal of wastewater from municipal utilities and agricultural run-off.

As part of the Government's policy to address environmental issues, Kazakhstan adopted a "Concept for Transition of the Republic of Kazakhstan to Green Economy for 2013-2020", which details the need for sustainable use of water resources, development of sustainable agriculture, energy savings and energy efficiency, the development of low carbon and renewable energy industry, waste management systems, reducing air pollution and the conservation and effective management of ecosystems. A Council for the Green Economy Transition has been established to coordinate and control implementation of these "green" measures in the country.

Kazakhstan has identified clear priorities for sustainable development; however more needs to be done in terms of developing and strengthening an institutional capacity to implement the Green Economy Transition Concept. The Bank has also identified several key priorities, including climate mitigation and adaptation measures; resource efficiency; and reduction of air, soil and groundwater pollution. The Bank will address these priorities through its investment projects and will actively promote implementation of good international practice in areas such as emission limits, waste management, water conservation and biodiversity. It will likewise push for application of international standards within the oil and gas, mining, power and energy, municipal infrastructure and transportation sectors through its investments and relevant Technical Cooperation initiatives.

The Bank will also look for opportunities to assist with the social dimension of Kazakhstan's sustainable development. Reducing regional and urban/rural disparities in employment opportunities, access to basic social services such as housing and utility services, and education and labour force training remains a challenge. Regional disparities are leading to high levels of internal migration with rural residents moving to urban areas to look for jobs. Additionally, due to comparatively high wages in the region, Kazakhstan has become a major destination for predominantly low-skilled migrant workers from neighbouring countries. According to estimates, the vast majority of foreign migrant workers are undocumented. Compliance with laws on minimum working conditions, such as working time and safety issues, remains a challenge. There is also a moderate risk of child and/or forced labour in primary agriculture and construction, especially where there are a high number of migrant and/or seasonal workers. Migrant workers are also more vulnerable to discrimination based on gender and ethnicity. EBRD due diligence will ensure adequate and risk-based reviews of contractors' and suppliers' labour management and performance are carried out to ensure compliance with EBRD performance requirements and international labour standards.

The ILO has raised concerns that the Law on Trade Unions (T.U. Law 2014) may embody certain limitations on freedom of association. The T.U. Law has created limitations to the creation of new independent unions and has tended to limit the working of existing independent unions and union federations by requiring them to re-register. Registration renewal requests of a number of unions as well as the Confederation of Independent Trade Unions of Kazakhstan (KNPRK) have been rejected by the Justice authorities due to the non-conformity of the submitted documents with the requirements of the T.U. Law, and recent judicial decisions on the cancelation of the government registration of the KNPRK have been negatively perceived by individual trade unions. The Government has stated that it intends to continue its consultations with the ILO and is working to resolve this issue. Regardless the Bank will pay particular attention in assessing labour risks in its environmental and social appraisal of projects and emphasise good international practices in labour management, occupational and community health and safety, including in projects requiring land acquisition and relocation of people.

The Bank's environmental and social appraisal will assess in a holistic manner all potential environmental and social risks and impacts, including direct indirect and cumulative biodiversity risks and impacts of EBRD projects. Moreover, due to Kazakhstan's vulnerability to climate change, climate change risk assessment will be an integral part of project level assessments, especially where the projects depend on access to water resources and clean water. PPP projects present specific challenges in assessing and managing environmental and social risks and impacts due to split responsibilities between the granting authority and the private sector concessionaire. Capacity building assignments within the government to transfer know-how on best practices in ESIA preparation and stakeholder engagement as well as on identification and management of environmental and social risks and impacts during project approval and subsequent monitoring the construction and operation of projects will also be promoted by the Bank in consultation with relevant authorities.

3.5 EBRD co-operations with MDBs

The Bank will continue to closely co-operate with other IFIs active in Kazakhstan. In particular, pursuant to the Enhanced Partnership signed with the Government, the Bank works closely with the World Bank, International Finance Corporation (IFC), Asian Development Bank (ADB), Islamic Development Bank (IsDB) and European Investment Bank (EIB), including through Monthly Coordination Council Meetings, where IFIs agree on priority projects and their implementation with the Government. Similarly, the Bank will coordinate policy dialogue activities with its IFI counterparts. In particular the following complementarities will to be pursued:

- World Bank and EU: The World Bank (WB)'s programmatic advisory and analytical services (AAA) and the EU's technical assistance will complement the EBRD's policy dialogue on investment climate and governance issues, creating additional leverage for rebalancing the role of the state and private business in the country. The Bank will also continue its close cooperation with the WB on transport sector reforms, including institutional strengthening of KAZ and development of e-tolling.

- IFC and EIB: The Bank will seek opportunities to mobilise IFI co-financing of corporates and SMEs in agribusiness and other sectors, where commercial funding is limited.
- ADB, IsDB and the Eurasian Development Bank: the EBRD will work jointly with these institutions on integration in global economic corridors and infrastructure investments. This can include investments in networks along the CAREC corridors and financing with technical assistance in district heating and another urban infrastructure.
- Asian Infrastructure Investment Bank (AIIB): The EBRD will explore ways to build on China's One Belt One Road Initiative and potentially launch joint projects with AIIB, particularly in sovereign road or private sector energy and infrastructure projects. One example of such collaboration is the continued implementation of a flagship inter-IFI Western China–Western Europe Road project, which has been co-financed jointly by the EBRD, World Bank, IsDB and ADB.
- UNDP and USAID: The bank will reinforce its policy dialogue on climate change and municipal infrastructure reforms through an additional leverage that UNDP and USAID's programs provide in this area.

ANNEX 1 – POLITICAL ASSESSMENT

Kazakhstan is committed to the principles of multiparty democracy, pluralism and market economics in accordance with Article 1 of the Agreement Establishing the Bank, although application of these principles has been uneven.

Kazakhstan has made good progress on the path of transition to market economy, but the pace of political transformation has been slow with many challenges remaining, including the need to ensure adequate checks and balances in the political system.

The legal framework for a multiparty democracy is in place and the separation of powers and guarantees for fundamental freedoms are envisaged in the Constitution. However, the political system continues to operate in a highly centralised manner and is not sufficiently balanced by the legislature or the judiciary.

The rare wave of social protests over proposed land reforms in April 2016 highlighted the need to address a number of social/economic issues such as employment and education in the regions of this geographically vast country. Decentralisation of power could be a factor contributing to the implementation of the ambitious reform agenda formulated in the centre, and is an element of those reforms.

Free Elections and Representative Government

Free, fair and competitive elections

The Constitution provides for a democratic government with universal suffrage.

General elections are held in the country on a regular basis. Since independence, international observer missions have reported shortcomings in the country's electoral processes and constitutional framework for elections. This was also the case in the most recent presidential and parliamentary elections.

The most recent presidential election was held on 26 April 2015. Presidential elections are mainly governed by the Constitution, the Constitutional Law on Elections and regulations adopted by the Central Election Commission (CEC). The CEC chairperson and two members are appointed by the president, while the Senate and Majilis each appoint two more members. The Organization for Security and Co-operation in Europe Office for Democratic Institutions and Human Rights (OSCE/ODIHR), which had been invited to monitor the elections, concluded that "the preparations for the 26 April election were efficiently administered; however, necessary reforms for holding genuine democratic elections still have to materialize. The predominant position of the incumbent and the lack of genuine opposition limited voter choice."[10] Election day generally proceeded in an orderly manner, but significant procedural errors and irregularities were observed during the voting counting and tabulation.[11]

President Nursultan Nazarbayev won the election against two other candidates, with 97.75 per cent of the votes and on a 95.2 per cent turnout. The OSCE/ODIHR Election Observation

[10] OSCE/ODIHR, Early Presidential Election 26 April 2015, Election Observation Mission Final Report, 29 July 2015, p.1.
[11] OSCE/ODIHR, Early Presidential Election 26 April 2015, Election Observation Mission Final Report, 29 July 2015, p.19.

Mission said that while the participation of three candidates laid the groundwork for political plurality, it did not provide voters with a genuine choice of political alternatives. It noted that the blurred line between the state and the ruling party benefited the incumbent.

Kazakhstan has a bi-cameral parliament, which is elected for five years and consists of a 107-member lower house (Majilis) and an indirectly elected 47-member upper house (Senate). OSCE/ODIHR, which sent an observer to the March 2016 parliamentary elections, stated that they "were efficiently organized, with some progress noted, but indicate that Kazakhstan still has a considerable way to go in meeting its OSCE commitments for democratic elections".[12] On the day of the election, some procedural errors and irregularities were noted by the observers.[13]

In the aftermath of the parliamentary elections, the EU noted the importance of the comprehensive proposal of amendments to the Election Law, which is being prepared by the CEC and will be considered in 2017. These amendments will address previous OSCE/ODIHR recommendations. The EU has expressed its willingness to assist the Kazakh authorities in the spirit of the Enhanced Partnership and Cooperation Agreement (EPCA) between the EU and Kazakhstan in taking forward this work.[14]

Separation of powers and effective checks and balances

According to the Constitution, Kazakhstan is a presidential republic, with the presidency exercising significant influence. Neither the country's legislature nor the judiciary have sufficient powers to hold the presidency to account.

President Nazarbayev has been in power since the country's independence in 1991, and enjoys the title of the First President of Kazakhstan. Based on the constitutional amendment of 2010, there is a constitutional limit of two consecutive presidential terms that can be served by any one individual except for the First President, who has also been conferred the title of the Leader of the Nation.

In January 2017, President Nazarbayev announced proposals to transfer powers from the presidency to the government and parliament, with the presidency becoming a "supreme arbiter" focusing on foreign policy and defence. In what was regarded as a reference to succession, he said that the changes would ensure political stability into the long term.

Effective power to govern of elected officials

Kazakhstan's elected officials have effective power to govern.

The military is under civilian control and does not play a significant role in the country's political decision-making process. Although big business plays a significant role in the country, it does not possess excessive powers to influence elected officials.

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[12] OSCE/ODIHR, Early Parliamentary Elections 20 March 2016, Election Observation Mission Final Report, 27 June 2016, p.1.
[13] OSCE/ODIHR, Early Parliamentary Elections 20 March 2016, Election Observation Mission Final Report, 27 June 2016, p.20.
[14] European Union External Action, Statement by the Spokesperson on the Parliamentary Elections in the Republic of Kazakhstan, 21 March 2016.

Civil Society, Media and Participation

Scale and independence of civil society

Civil society in Kazakhstan is relatively strong and diverse, with CSOs engaging in a wide range of activities, from the promotion of human rights and monitoring of democratic progress, to the delivery of social services and advocacy for environmental causes. However, the influence and reach of CSOs is low outside urban areas. According to Article 251 of the Enhanced Partnership and Cooperation Agreement, the EU and Kazakhstan shall strengthen their dialogue on the role of civil society and the development of relations between non-governmental organisations.[15]

Civil society organisations (CSOs) enjoy relative freedom to operate, investigate and publish their findings; however, there are significant restrictions over politically sensitive issues. In December 2015, a new law on funding CSOs introduced tightened government control over the operations of civil society groups. The law established a single state operator through which funding for non-governmental organisations (NGOs) must be channelled. The OSCE Representative on Freedom of the Media warned that this legislation could limit civil society activities.[16]

Recent years have seen a surge in formal cooperation arrangements between CSOs and the government, such as the advisory councils. The government is hosting high-profile bi-annual civic forums, which serve as platforms to develop specific recommendations for cooperation between CSOs and local and national government bodies. The “Civil Alliance” (created with government support in 2005), a federation of more than a thousand CSOs, is formally consulted by the government and contributes to legislative initiatives in the Parliament. How these arrangements will affect the ability of CSOs to operate independently remains to be seen.

Independence and pluralism of media operating without censorship

Freedom of the press and freedom of expression are enshrined in the Constitution and are guaranteed by law. However, in practice the government uses various means to exert influence on media and internet content.

According to OSCE/ODIHR, the media environment has been characterised by a lack of independent sources, while the state exercises its influence over the press through a widespread system of public tenders administered by central and local authorities to implement state informational policy.[17]

Amendments to the criminal code in 2014, which increased the penalties for defamation, and amendments to a communications law in the same year, which allow the prosecutor general to temporarily shut down websites if they are harmful to individuals, state or the society, restricted the actions of independent and critical journalism.

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[15] Official Journal of the European Union, Enhanced Partnership and Cooperation Agreement between the European Union and its Member States, of the one part, and the Republic of Kazakhstan, of the other part.
[16] OSCE, Representative on Freedom of the Media, Press Release: Draft law in Kazakhstan could seriously restrict NGO activities to promote freedom of the media, 19 October 2015
[17] OSCE/ODIHR, Early Parliamentary Elections 20 March 2016, Election Observation Mission Final Report, 27 June 2016, p.14.

There are over 150 television and radio stations and over 1,000 daily and weekly newspapers in the country, which rely on state subsidies due to low advertising revenues. Television remains the main source of information, while the internet penetration rate is growing rapidly, with 73 per cent of Kazakhs having web access in 2015 compared to 18 per cent in 2009.[18] During the widespread land reform protests in 2016, social media users reported difficulties in accessing web material. The prosecution of individual users for posting critical political or social commentary online continues to be an issue; with charges usually being brought under laws, which ban extremism.

Multiple channels of civic and political participation

The government is required by law to provide citizens with information regarding policies and subjects that affect them. However, in practice, citizen requests are not properly fulfilled with CSOs reporting problems with access to information from government agencies. Parliamentary sessions on controversial legislation are not systematically made public through live video and transcripts.

Freedom to form political parties and existence of organised opposition

The law on political parties provides the legal framework for the formation and functioning of political parties. Political parties must be registered with the Ministry of Justice in order to participate in the elections. To qualify for registration, a political party must have at least 40,000 members, with branches in every region and at least 600 members per branch. A number of OSCE/ODIHR interlocutors have noted that this does not encourage political pluralism.[19]

Six parties contested in the 2016 parliamentary elections, which was a positive development according to OSCE/ODIHR Election Observation Mission.

The political opposition in Kazakhstan remains fragmented and largely marginalised. The court-ordered closure of the Communist Party of Kazakhstan in August 2015 left less political space for alternative views.

Rule of Law and Access to Justice

Supremacy of the law

The Constitution is the supreme law of the country and is accepted by all political forces.

The right to a fair trial is envisaged in the legislature, although the strong position of the prosecutor and the lack of independence of the judiciary continue to undermine this right. All defendants enjoy a presumption of innocence and are protected from self-incrimination.

[18] International Telecommunication Union (ITU) Statistics, "Percentage of Individuals Using the Internet," 2000-2015
[19] OSCE/ODIHR, Early Parliamentary Elections 20 March 2016, Election Observation Mission Final Report, 27 June 2016, p.10

Independence of the judiciary

The law provides for an independent judiciary.

In practice, however, the judges remain subject to political bias and subservient to the executive, with corruption being evident throughout the judicial system. Prosecutors continue to have the power to authorise investigative actions, such as search and seizure.

Government and citizens equally subject to the law

The Constitution guarantees the equality of all citizens before the law.

The right to access public information is provided by law but the number of unanswered or refused requests has been relatively high. The 100-Steps programme, announced by President Nazarbayev in 2015, specifically included plans to hold officials to account by improving online reporting on the use of public funds and creating a state body (Government for Citizens) to integrate public services.

Effective policies and institutions to prevent corruption

According to the 2016 Transparency International Corruption Perceptions Index (CPI), Kazakhstan's score increased slightly in 2016 over 2015, although its overall ranking dropped (to 131 out of 176) because other countries improved more quickly.[20] Corruption remains widespread and is acknowledged by the authorities as a grave problem.

The Criminal Code of Kazakhstan criminalises active and passive bribery, attempted corruption, extortion, money laundering, abuse of office and bribe facilitation by third parties. The amendments to the code toughened criminal liability and punishment for crimes related to corruption. Kazakhstan has made fighting corruption a key priority and the government prosecutes officials who commit abuses. However, despite frequent prosecutions on corruption charges, high-level officials are rarely the targets.

The Agency for Civil Service Affairs and Counteracting Corruption is the main body tasked with dealing with corruption; however its efforts are hindered by vested interests. The Agency, which was established in 2014 and replaced the Financial Police, was assigned functions and duties in preventing, identifying, disrupting, detecting and investigating corruption crimes and offences. It is a state authority that is directly subordinate to and reports to the President. The Head of the Agency and his deputies are political officials and are appointed by the President. The OECD notes that "it is particularly essential to ensure a transparent and proper selection and dismissal process for the leadership of the anti-corruption agency".[21]

Anti-corruption is also one of the priorities listed under the Kazakhstan 100-steps programme, which seeks to adopt various economic, social and political reforms with an overall aim of joining the group of the world's 30 most developed countries by 2050. According to Article 242 of the EPCA, cooperation between the EU and Kazakhstan may

[20] Transparency International, Corruption Perception Index (CPI), 2016
[21] OECD, Anti-Corruption Reforms in Kazakhstan, Round 3, 10 October 2014, p.30

include accession to and implementation of relevant Council of Europe instruments on preventing and combating corruption by the country.[22]

Civil and Political Rights

Freedom of speech, information, religion, conscience, movement, association, assembly and private property

As a member of the UN and the OSCE, Kazakhstan has developed a strong legal basis for the protection of civil and political rights by ratifying the core UN Human Rights Conventions and the fundamental conventions of the ILO. The law provides for freedom of association, although there are restrictions on the exercise of this right. The Constitution provides for freedom of religion and belief, as well as the freedom to decline religious affiliation. Nevertheless, some religious groups have experienced heightened scrutiny. According to the EPCA, the EU and Kazakhstan will cooperate in the promotion and effective protection of human rights and the rule of law, including through relevant international human rights instruments.[23]

The latest assessment of Kazakhsan's track record in the area of human rights in the framework of the United Nations Universal Periodic Review (UPR) was adopted in 2014. In the course of this cycle, the top three recommendations included International Instruments (22.73 per cent); Women's Rights (17.17 per cent); and Rights of the Child (11.11 per cent). Kazakhstan accepted 74 per cent of a total of 198 recommendations.[24]

The right to assemble and hold meetings, rallies and demonstrations is guaranteed by the Constitution. However, in practice this right is restricted, as according to the 1995 Law on the Procedure for Organising and Holding Peaceful Assemblies, holding a public assembly requires 10-days-notice and formal approval prior to the event. After his visit to Kazakhstan in 2015, the UN Special Rapporteur on the Rights to Freedom of Peaceful Assembly and of Association stated that he was "concerned that the State's current approach to the rights to freedom of peaceful assembly and of association has had an adverse effect on public discourse".[25]

The law provides for the right to form trade unions. The legislation requires existing independent labour unions to affiliate with larger unions at the industry, sector, or regional level, thus introducing barriers to the creation of new independent unions. In his report, the UN Special Rapporteur recommended that the authorities revise the new law on trade unions to bring it in line with international standards, as highlighted by the International Labour Organisation in its memorandum of technical commitments on the draft law on trade unions on Kazakhstan.[26] The Kazakh Government has stated that it intends to continue its consultations with the ILO and is working to resolve this issue.

[22] European Union External Action, Press Release EU and Kazakhstan sign Enhanced Partnership and Cooperation Agreement, Article 5, 21 December 2015, available at http://eeas.europa.eu/statements-eeas/2015/151221_02_en.htm
[23] European Union External Action, Press Release EU and Kazakhstan sign Enhanced Partnership and Cooperation Agreement, Article 5, 21 December 2015, available at http://eeas.europa.eu/statements-eeas/2015/151221_02_en.htm
[24] United Nations, Universal Periodic Review (UPR), Kazakhstan and UPR Info Statistics available at http://www.upr-info.org/database/statistics/index_sur.php?fk_sur=87&cycle=2
[25] UN Report of the Special Rapporteur on the rights to freedom of peaceful assembly and of association, Maina Kiai, 16 June 2015, p.8
[26] UN Report of the Special Rapporteur on the rights to freedom of peaceful assembly and of association, Maina Kiai, 16 June 2015, p.8

The law protects the right to strike, although certain restrictions make strikes less effective.

Political inclusiveness for women, ethnic and other minorities

The law prohibits discrimination based on race, gender, disability, language, or social status. Many observers have noted that the application of laws against discrimination of all kinds is patchy, with local bodies not always taking full responsibility, leaving minorities open to maltreatment and even violence. This situation is often exacerbated by conservative social attitudes.

There are no legal restrictions on the participation of women in politics. However their representation in high-level positions is quite low. The Election Law does not provide gender quotas or other explicit measures to promote the participation of women in parliamentary elections and OSCE/ODIHR has included this issue in the priority recommendations of its latest report on Kazakhstan.[27] In the last parliamentary elections 20 per cent out of a total of 234 candidates on party lists were women.

Freedom from harassment, intimidation and torture

Kazakhstan is a party to the main UN human rights treaties, provisions of which prohibit torture and ill-treatment. Kazakhstan is also a member of the 1949 Geneva Conventions and complimentary Protocols. In 2008, Kazakhstan ratified the Optional Protocol to the Convention against Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment, which stipulated establishment of a two-tier (international and national) mechanism to prevent torture and other cruel, inhuman or degrading treatment or punishment. Prohibition of use of torture and integrity of human dignity is regulated by article 17 of the Constitution.

In March 2014, the National Preventive Mechanism (NPM) against Torture, which is part of the Office of the Human Rights Ombudsman, came into force. Following the NPM's detention visits, some police officers were accused of torture, while in its first report the NPM states that the risk of human rights violations was high at temporary detention centres, especially in the first few hours when the detainee is particularly vulnerable. The report also adds that there is a possibility of abuse of powers by police officers to obtain testimony from a detainee along with poor imprisonment conditions, while many facilities lack basic imprisonment conditions and incarceration norms are not respected.[28]

[27] OSCE/ODIHR, Early Parliamentary Elections 20 March 2016, Election Observation Mission Final Report, 27 June 2016, p.23.
[28] Consolidated Report of the National Preventive Mechanism members on the preventive visits carried out in 2014, Astana 2015, p.24-25

ANNEX 2 – SELECTED ECONOMIC INDICATORS

Kazakhstan

	2011	2012	2013	2014	2015	2016
Output and Expenditure			*(Percentage change in real terms, sa.)*			
GDP	7.5	5.0	6.0	4.3	1.2	0.7
Private consumption	10.8	9.5	11.8	-3.2	-2.6	na
Public consumption	11.2	11.8	1.0	8.9	4.1	na
Gross fixed capital formation	3.8	7.7	4.1	-1.0	4.5	na
Exports of goods and services	0.3	3.4	-0.9	-5.8	-2.5	na
Imports of goods and services	2.7	19.4	5.0	-16.7	-5.5	na
Industrial gross output	3.8	0.7	2.5	0.3	-1.6	na
Labour market			*(Percentage change)*			
Gross average monthly earnings (annual average)	15.9	13.5	6.8	10.7	4.8	na
Real LCU wage growth	14.1	0.9	2.6	5.0	-10.2	na
			(In per cent of labour force)			
Unemployment rate	5.5	5.4	5.3	5.2	5.0	5.0
Prices			*(Percentage change)*			
Consumer prices (annual average)	8.3	5.1	5.9	6.7	6.7	8.5
Consumer prices (end-year)	7.4	6.0	4.8	7.4	13.6	14.6
Fiscal Indicators			*(In per cent of GDP)*			
General government balance	5.9	4.3	4.8	1.7	-2.2	-1.7
General government revenues	26.0	25.4	24.0	23.1	16.6	18.0
General government expenditure	20.4	21.1	19.2	21.4	22.9	22.4
General government debt	11.6	12.3	12.3	14.3	21.9	21.1
Monetary and Financial Sectors			*(Percentage change)*			
Broad money (M2, end-year)	14.1	7.9	10.2	10.5	7.9	46.4
Credit to the private sector (end-year)	29.9	30.9	30.4	29.7	30.0	27.8
			(In per cent of total loans)			
Non-performing loans ratio	35.0	36.7	31.2	23.5	8.0	6.7
Interest and exchange rates			*(In per cent per annum, end-year)*			
Local currency deposit rate (individuals)	6.4	6.7	6.3	7.0	8.0	12.0
Foreign currency deposit rate (individuals)	6.1	4.7	4.2	3.9	2.9	2.6
Local currency lending rate (individuals)	20.4	21.2	20.3	18.9	17.2	18.4
Foreign currency lending rate (individuals)	13.9	13.6	11.4	9.5	11.6	11.5
Policy rate	na	na	na	na	16.0	12.0
			(KZT per US dollar)			
Exchange rate (end-year)	148	151	154	182	339	333
Exchange rate (annual average)	147	149	152	179	222	342
External sector			*(In per cent of GDP)*			
Current account	5.3	0.5	0.5	2.7	-2.8	-6.4
Trade balance	23.3	18.3	14.7	16.4	6.9	7.1
Merchandise exports	44.2	41.8	36.2	36.3	25.2	27.9
Merchandise imports	209.	23.5	21.5	19.9	18.4	20.9
Foreign direct investment (net)	4.3	5.5	3.3	2.1	1.7	10.8
Gross reserves, excluding gold (end-year)	16.7	15.9	12.4	16.1	19.2	22.0
External debt stock	65.1	65.8	63.4	71.2	83.2	122.5
Public external debt	2.3	2.3	2.2	3.6	10.6	9.6
Private external debt	62.7	63.5	61.2	67.8	77.1	112.8
			(In months of imports of goods and services)			
Gross reserves, excluding gold (end-year)	6.9	5.5	4.7	6.2	6.9	9.4
Memorandum items			*(Denominations as indicated)*			
Population (end-year, millions)	16.7	16.9	17.2	17.4	17.7	17.9
GDP (in billions of KZT, nominal)	28,243	31,015	35,999	39,676	40,884	46,193
GDP per capita (in USD, nominal)	11,553	12,299	13,786	12,709	10,428	7,453
Share of industry in GDP (in per cent)	30.7	30.1	27.8	27.3	24.7	25.8
Share of agriculture in GDP (in per cent)	4.9	4.2	4.5	4.4	4.8	4.6
Net FDI (in billions of USD)	8.6	11.9	8.0	4.8	3.4	14.4
External debt - reserves (In US$ billion)	96.0	108.6	125.3	128.5	127.7	133.4
External debt/exports of goods and services (per cent)	140.0	149.2	165.1	181.1	290.4	375.5
Broad money (end-year in per cent of GDP)	33.2	32.7	31.3	31.4	33.1	27.3

ANNEX 3 – ASSESSMENT OF TRANSITION CHALLENGES

Market Structure	Market Institutions	Key challenges
CORPORATES		
Agribusiness		
Medium	Medium	▪ Closing significant yield gap for grain production by supporting modernisation of machinery, skills transfer, and access to finance; ▪ Improving transport and storage infrastructure in the primary agricultural sector.
Manufacturing and Services (M&S)		
Large	Large	▪ Reducing the role of the state in the sector to create room for small and medium-sized companies to enter and develop; ▪ Developing a modern competition policy under the auspices of the Customs Union.
Real Estate		
Medium	Small	▪ Increasing the penetration of modern construction techniques and technologies, including energy efficiency and sustainability; ▪ Increasing the availability of modern commercial property and modern tourism infrastructure, especially in the regional areas; ▪ Improving access to land and further developing property-related bureaucracy.
Information & Communication Technologies (ICT)		
Medium	Medium	▪ Privatising the fixed line incumbent Kazakhtelecom (KTC); ▪ Increasing competition in the fixed line segment; ▪ Further developing the telecommunications infrastructure (broadband internet in the regions); ▪ Ensuring the independence of the telecommunication regulator; ▪ Further developing the regulatory framework (especially implementing and enforcing competitive safeguards).
ENERGY		
Natural Resources		
Large	Large	▪ Increasing private sector involvement and competition in the upstream and downstream oil and gas sector, and reduce the dominance via its subsidiaries of the state-owned company KazMunaiGaz; ▪ Increasing the transparency of revenue flows from extractive industries.
Sustainable Energy		
Large	Large	▪ Introducing cost reflective tariffs for end consumers; ▪ Strengthening legal and institutional framework for supporting sustainable energy.

Market Structure	Market Institutions	Key challenges
Power		
Large	Medium	▪ Creating an effective functioning wholesale market for both energy and capacity that provides sufficient investment signals for new generation; ▪ Ensuring effective independent regulation; ▪ Removing cross-subsidies and introducing cost reflective tariffs for consumers; ▪ Modernising the generation and distribution through improved efficiency.
INFRASTRUCTURE		
Water and wastewater		
Large	Large	▪ Improving technical and price regulation; ▪ Developing contractual arrangements between the owner/policy maker and the company; ▪ Further increasing tariff and improving collection rates; ▪ Corporate restructuring and further commercialisation; ▪ Further increasing in meter-based billing in smaller municipalities; ▪ Increasing private sector participation and introducing PPP structures in the water sector.
Urban Transport		
Medium	Large	▪ Developing city-wide urban transport policy (i.e. integrated urban transport strategy); ▪ Introducing competitive bus route tendering; ▪ Increasing autonomy of publicly owned companies and development of contractual arrangements with the municipalities; ▪ Improving quality of services and operational performances; ▪ Introducing robust contractual arrangements through Public Service Contracts to allow for the financing of new urban rail systems and financing of bus operations; ▪ Further enhancing private sector participation in service provision; ▪ Introducing integrated e-ticketing systems and improvements in collection rates.
Roads		
Medium	Medium	▪ Capacity building of the newly established road agency; ▪ Restructuring of the incumbent maintenance company; ▪ Meaningful introduction of competition and performance measures in routine maintenance; ▪ Further improvements in road sector financing; ▪ Capacity building of the PPP related authorities and the development of sensible PPP projects in line with best international practice.

Market Structure	Market Institutions	Key challenges
Railways		
Medium	Medium	▪ Completing the institutional restructuring; ▪ Securing open access and introduction of competition; ▪ Developing rail related businesses (e.g. wagon leasing, container leasing, etc.) in commercial terms; ▪ Establishing business oriented passenger services and full implementation of PSO contacts; ▪ Establishing the proper independent regulation.
FINANCIAL INSTITUTIONS		
Banking		
Medium	Medium	▪ Facilitating reduction of NPLs at banks; ▪ Strengthening the overall regulatory framework and its enforcement in the banking sector; ▪ Facilitating recovery of assets/GDP ratio.
Insurance and other financial services		
Medium	Medium	▪ Broadening access to insurance, including widening a range of product available in the market; ▪ Broadening access to leasing, including increasing a range of products available in the leasing market; ▪ Improving regulatory framework for pension fund management (asset allocation policies).
Micro, small and medium-sized enterprises		
Large	Large	▪ Expanding MSME lending capacity building of financial institutions towards sustainable MSME financing; ▪ Improving delivery of financing to MSMEs in regions outside the capital city.
Private equity		
Large	Medium	▪ Broadening companies' access to PE and VC financing; ▪ Facilitating the launch of first-generation PE and VC funds; ▪ Facilitating improvements in the governance standards, transparency and investment principles in the Fund sector; ▪ Increasing interest in Kazakhstan (outside minerals) among reputable international Sponsors and LPs.
Capital markets		
Large	Medium	▪ Facilitating increase in liquidity in local capital markets; ▪ Improvement of trading, clearing and settlement infrastructure and operations; ▪ Clarifying the legal framework governing repos and derivatives; ▪ Developing the local institutional investor base.

ECONOMIC INCLUSION[29]		
Inclusion gap dimension	**Inclusion gap**	**Key challenges**
Regions		
Institutions	Large	▪ Increased anti-corruption efforts in administrative, health and education systems in order to improve trust at local level ▪ Improving the quality of, and satisfaction with, administrative, health and education services at the local level through enhanced standards
Access to Services and Education	Medium to Large	▪ Improving regional access to social infrastructure (such as local healthcare and education)
Youth		
Youth Employment	Medium	▪ Establishing work based learning opportunities (i.e. internships, apprenticeships, trainee programmes) through collaboration between the private sector and education providers to improve vocational education and technical training outcomes in line with employer requirements ▪ Introducing skills standards and verification mechanisms that reflect employer requirements
Quality of Education	Medium	▪ Improving the quality and relevance of education to respond better to labour market needs ▪ Ensuring a strong institutional basis and private sector input in formulating curriculum content and learning objectives to reflect labour market requirements
Financial Inclusion	Medium	▪ Improving access to finance for young people and the availability of financial and business advisory services targeted at young entrepreneurs
Gender		
Labour Practices, Policies and Legal Regulations and Social Norms	Medium	▪ Incentivising private sector clients to improve equal opportunities practices, including: equal pay practices; access to employment; access to quality child care; and adoption of female leadership programmes.

[29] Inclusion methodology is available at http://tr.ebrd.com/tr13/index.php/en/economic-inclusion.

Employment and Business	Medium	▪ Improving entrepreneurial opportunities and training for women, particularly in relation to financial literacy, business training and access to employment ▪ Improving client HR policies with regards to increasing female employment in sectors and types of positions with low female participation, including technical positions, as well as progression routes into management roles
Access to Finance	Medium	▪ Building the capacity of local banks to develop credit lines aimed at women-led SMEs, combining access to finance, training and business advisory services
Health Services	Medium	▪ Supporting better access to quality health services for women

ANNEX 4 – LEGAL TRANSITION

Introduction

This annex offers critical analysis on selected legal topics relevant to the Bank's investment strategy in Kazakhstan during the forthcoming period. It is based on the assessments of commercial laws conducted by the EBRD Legal Transition Programme. For ease of reference, the analysis is presented along the main strategic orientations defined in this country strategy, in particular the actions proposed under 'Policy dialogue and TC'.

Theme 1: Balancing the roles of the state and the private sector

Public Private Partnerships (PPP)

Adoption of the Public-Private Partnerships (PPP) Law is an important development in Kazakhstan's legal system. Compared to the Concessions Law which historically concentrated mostly on build-operate-transfer projects, the PPP Law attempts to create a more extensive legal framework. Compared to the Concessions Law, under which only governmental institutions may act as grantors, the PPP Law has extended the notion of public partner to include Kazakhstani state-owned companies acting as public partners in PPP projects.

The PPP Law distinguishes between institutional and contractual PPPs and covers both types. Furthermore, the PPP Law provides for a non-exhaustive list of PPP agreements which can be concluded for the implementation of PPP projects in Kazakhstan. Any PPP agreements meeting the requirements of PPP legislation can be used for this purpose and this provides additional flexibility for private investors.

Another important development introduced by the PPP Law is the provision allowing industry operators and financial and other organisations providing PPP project financing to become parties to PPP agreements which might be a good sign for lenders who could potentially use this as an alternative instrument to direct agreement. It is hugely important for bankability that the PPP Law not only permits lenders to be a party to a PPP agreement but also allows them to request substitution of a private partner in certain PPP projects (step-in rights). The law also provides for the possibility to pledge rights under a PPP agreement and/or assign rights of claim or debt of a private partner subject to a public partner's consent.

The parallel operation of the Concessions Law and the PPP Law may well create regulatory uncertainty and may be resolved, if required, in one of the following ways: either by revocation of the Concessions Law or adoption of legislative amendments to draw clear distinction between the scopes of their application. It remains to be seen how the new legislation will be implemented in practice.

Public Procurement

Kazakhstan's new public procurement legislation has been adopted in 2015 to implement the requirements of the Eurasian Economic Union Treaty on public procurement. The law is comprehensive, regulates full public procurement process and provides for several procurement methods. Competitive procedures with electronic reverse auction are default procurement methods, but major part of the public sector in Kazakhstan, the utilities sector and state-owned enterprises, are not required to use public procurement procedures.

Kazakhstan also operates a comprehensive electronic procurement system, covering all stages of public procurement process and integrating local e-government services. However, due to requirements of local registration, local commercial presence and Kazakhstan-issue electronic certified signature the public procurement market in Kazakhstan is generally closed to international trade.

Public procurement legislation in Kazakhstan remains non-compliant with international regulatory standards, the 2012 WTO Agreement on Government Procurement (WTO GPA) in particular. Although Kazakhstan significantly modernised public procurement system by introducing comprehensive electronic procurement, it did not achieve compliance with international best practice. To progress the WTO GPA negotiations, Kazakhstan government should undertake a comprehensive review of the legislation and other related local policies and procurement practices.

Theme 2: Broadening access to finance, strengthening the banking sector and developing local capital markets

Leasing and Factoring

Specific legal provisions on financial leasing are found in the Civil Code and the Law on Financial Leasing (2000). Financial leasing services are not regulated and there is no registry for leasing agreements to be registered. The repossession process is perceived to be simple and quick. Factoring is a regulated industry in Kazakhstan. The factoring companies are supervised and they need a license to operate. There is no special legislation on factoring apart from general “assignment of claim by contract” provisions of the Obligations Law which provides basis for assigning account receivables. Introducing a definition of factoring services or types of factoring transactions would help increase legal certainty of the factoring transactions and hence reduce involved costs and risks of re-characterisation of transactions. Specific legislation on factoring would increase the predictability of factoring as a very useful financing tool for efficient and, in certain cases, off balance sheet access to working capital, especially for small and medium-sized enterprises.

Insolvency

As a positive feature, the Bankruptcy Law does not allow for the unilateral right of a creditor to terminate the agreement upon the initiation of bankruptcy proceedings. In addition to this, according to the Bankruptcy Law, secured creditors’ claims retain priority over claims tax authority claims, which is an important safeguard for secured creditors’ interests. However, claims for “…compensation for harm to life and health, alimony recovery, labour remuneration, compensation under employment agreements, social contributions to the State Social Insurance Fund, mandatory pension contribution, mandatory professional pension contribution and compensation due under copyright agreements” are at the top of priorities when distributing the assets and the law does not provide for any cap amounts to this category of claims. This is potentially a cause for concern since an unlimited cap on such claim amounts may be harmful to secured creditor interests. Administrative expenses and taxes incurred during the period of bankruptcy proceedings are outside of the order of priority for creditor claims and must be paid ahead of all creditor claims.

In 2014, EBRD published the Insolvency Officeholder Assessment which evaluates the insolvency office holder profession’s (IOH) state of development and performance in 27 countries of operation. The assessment showed that Kazakhstan has a developed IOH framework which covers some of the key elements of the profession. Nevertheless, the key areas where reforms are particularly needed, include: regulation, supervision and discipline; work standards and ethics; and legal powers and duties of IOHs.

Corporate Governance

The EBRD assessment on the corporate governance legislation and practices of companies in the EBRD region, published in 2016, revealed that the corporate governance framework and practices in Kazakhstan are in need of reform. The law seems to be overly prescriptive in requiring all joint-stock company (JSCs), of any size and business activity, listed or not, to have independent directors and committees. Among other shortcomings, it is worth mentioning that the law does not refer to key functions that should be performed by the board such as, such as oversight of the management, budget approval and risk management. In addition to that, the general shareholders' meeting can overturn any board decisions is also a major shortcoming and should be tackled. Gender diversity on boards is very limited. When looking at the ten largest companies, only five of them have women in their boards and only 6 out of 58 board members are women.

On the positive side, despite the lack of legal requirement regarding board members' qualification (except for banks), boards appear to have a diversified mixed of skills. Boards appear to be small with an average of 5.8 members and legal entities cannot serve as board members. All JSCs and banks are required to prepare their financial statements in line with IFRS and largest listed companies appear to comply with this requirement

The law requires all companies to have internal audit committees and compliance with this requirement is limited (only five out of ten largest listed companies disclose having such committee). It appears that outsiders (i.e., non-board members) and executives can be members of the internal audit committee. External audit seems to be a well-established practice and in line with IFRS. External auditors are also required to be independent; however, it is not clear who in the company is in charge of this "independence test".

Theme 3: Enhancing inter-regional connectivity and international integration

Telecommunications

In its regulation of the internet and online media, the state retains a controlling and restrictive role. For example, there are estimated to be 300 legislative acts that expressly or implicitly control the ICT environment. All telecommunications operators are legally obliged, as part of their licence requirements, to connect their channels to a public network controlled by Kazakhtelekom. State control of the main market players and the use of multiple regulatory agencies have not provided the most conducive environment for the development of effective competitive markets in electronic communications. Competitive broadband access is available in the main cities, but has not properly emerged in the more remote towns and rural areas.

The introduction of mobile number portability in late 2015 should provide an opportunity for a significant boost in competition within the mobile sector. Similarly, the recent adoption of a technology-neutral approach to the mobile sector, allowing operators to use any second, third or fourth generation technology regardless of the spectrum they hold, should also boost sector attractiveness of the sector from an investment perspective.

Systemic reform is still required to bring about an effective market in electronic communications with full consumer choice and market safeguards for investors. To achieve this, the priority is to create an effective wholesale market, placing dominant operator's existing and new infrastructure investment at the service of competing retail service providers.

Theme 4: Promoting green economy transition

Renewable Energy/Energy Efficiency

Legal regulation of renewable energy resources, ecology and subsoil use was significantly improved with the adoption of recent amendments to the Green Economy Law. Such amendments provide for regular indexing of feed-in tariffs taking into account foreign currency exchange rate changes, which brings more certainly to producers of renewable energy. The Accounting and Finance Centre will pay the feed-in tariffs to producers through the establishment of a special reserve fund. A longer deadline for filing applications of new operators and a special model agreement to connect facilities using renewables are expected to facilitate investment. As a next step, authorities would need to focus on the implementation of the new rules, capacity building and adapting technical rules to enable rolling out of renewable energy.

Kazakhstan's state policy continues focusing on the increase of efficiency across the entire economy of the country. Such policy is directed toward modernising various energy-consuming sectors of the economy, introducing audits and energy accounting systems at major enterprises, improving management quality, increasing public awareness of the importance of energy efficiency, and encouraging investment in energy-saving technologies. The legal framework is developing but implementation has been slow. With the energy tariffs below cost level, especially for households, plans for rolling out energy efficiency measures would be hindered. Kazakhstan should focus on removing legal and regulatory barriers to competitive energy market and introducing cost-reflective energy tariffs.

ANNEX 5 – GENDER PROFILE

Gender Inequality and Human Development

According to the UNDP 2015 Human Development Index (HDI)[30], Kazakhstan is among the countries with a 'high human development.'[31] It is ranked 56th out of 188 countries, which is above the regional average for countries in the Europe and Central Asia region. The country ranks slightly better in terms of the UNDP Gender Inequality Index (GII)[32], at 52nd globally out of 155 countries. According to the World Economic Forum Global Gender Gap Report (2015), Kazakhstan is ranked 47th out of 145 countries[33].

Labour force participation and gender pay gap

Women's participation in the labour force is lower than men's in Kazakhstan. According to the World Bank, in 2014, the proportion of women aged 15 and older in the labour force was 68 per cent[34] compared to 78 per cent[35] for men in the same age category. This is nonetheless the highest participation rate in Central Asia. According to the United Nations Economic Commission for Europe (UNECE), in 2012, the gender pay gap in Kazakhstan was 6.5 per cent as it has steadily been lessening over recent years (the gender pay gap was 8.5% in 2010; and 7.8% in 2011).[36] Unadjusted for gender differences in human capital, however, the gender wage gap is 32% in Kazakhstan.[37] According to World Bank data from 2014, the unemployment rate for women is 4.9 percent[38], compared to 3.2 percent for men[39].

Indicator	Female	Male	Year
Labour force participation	68%	78%	2014
Unemployment rate	4.9%	3.2%	2014
Gender Pay Gap	6.8%		2012

Source: World Bank 2014; UNECE Gender Database, 2012

According to UNECE, in 2014-2015, the proportion of women in tertiary education in Kazakhstan was higher as compared to that of men (55.5 per cent for women compared to 44.5 per cent for men)[40]. However, in 2013-2014 academic year, 73.7 percent of all university graduates in the field of education were women while only 25.2 percent of women students were enrolled in engineering programmes.[41] This gender segregation in education then contributes to occupational segregation in the labour market:

[30] The HDI is comprised of three dimensions: health, education and decent standard of living.
[31] http://hdr.undp.org/sites/all/themes/hdr_theme/country-notes/KAZ.pdf
[32] The GII is a composite measure, which captures the loss of achievement, within a country, due to gender inequality, and uses three dimensions to do so: reproductive health, empowerment, and labour market participation.
[33] http://reports.weforum.org/global-gender-gap-report-2015/economies/#economy=KAZ
[34] http://data.worldbank.org/indicator/SL.TLF.CACT.FE.ZS/countries?display=default
[35] http://data.worldbank.org/indicator/SL.TLF.CACT.MA.ZS
[36] http://w3.unece.org/PXWeb2015/pxweb/en/STAT/STAT__30-GE__03-WorkAndeconomy/017_en_GE_GPG2_r.px/table/tableViewLayout1/?rxid=313ba02d-3517-4c73-b7dc-1cbdd385aa12
[37] https://www.adb.org/sites/default/files/publication/31167/gender-equality-cambodia-philippines-kazakhstan.pdf
[38] http://data.worldbank.org/indicator/SL.UEM.TOTL.FE.ZS
[39] http://data.worldbank.org/indicator/SL.UEM.TOTL.MA.ZS
[40] http://w3.unece.org/PXWeb2015/pxweb/en/STAT/STAT__30-GE__04-EducatAndcommunicat/006_en_GEECTertStud_r.px/table/tableViewLayout1/?rxid=9df5401a-5ac8-47a1-aee4-af2d1e334421
[41] http://w3.unece.org/PXWeb2015/pxweb/en/STAT/STAT__30-GE__04-EducatAndcommunicat/006_en_GEECTertStud_r.px/table/tableViewLayout1/?rxid=eb1189e2-8b52-4910-a506-f95ea729ee96

Kazakhstan: total employment by economic activity	Male (%)	Female (%)
Mining	77	23
Construction	76	24
Transport and Communications	75	25
Electricity, gas and water	69	31
Manufacturing	63	37
Public Administration	57	43
Agriculture, hunting and forestry	52	48
Real Estate, Rending and Business Activities	49	51
Trade, cars and home activities	41	59
Financial activities	30	70
Hotels and Restaurants	30	70
Education	27	73
Public Health and social services	24	76

Source: Women and Men in Kazakhstan, Agency of Statistics of the Republic of Kazakhstan, 2010

Barriers to women accessing finance and employment and skills are also reflected in the strongly gendered division of domestic labour, where women have primary responsibility for household and care work (creating an unpaid work gap of about 2.7 hours per day compared to men). Gendered social norms contribute to women having greater responsibility for and time commitments to domestic and care work, which has persisted notwithstanding women's increased participation in paid work. Relatively high fertility rates and low provision of child care services also contribute to this dynamic.

According to the 2016 World Bank/IFC Women, Business and the Law database, the mandatory minimum length of maternity leave in Kazakhstan is 126 days which is fully paid by the employer. The law does not provide for paternity leave. There is no legislation mandating equal pay for work of equal value, although there is legislation mandating non-discrimination in hiring practices on the basis of gender.

Women in decision-making

Following the latest elections for Lower House representatives in 2016, women occupy 27 percent of seats (29 seats out of 107). Since 2014, women occupy 6.4 percent of the seats (3 out of 47 seats) in the Upper House.[42] Out of the 7 constitutional court judges, only one is a woman.

Access to finance and Entrepreneurship

According to the 2014 World Bank's Global Financial Inclusion database, 55.6 per cent of women and 52 per cent of men aged 15 or over own an account at a formal financial institution,[43] an increase from 44 and 40 per cent, respectively, in 2011.

According to the Statistic Business Register 2013, out of around 1.4 million SMEs registered in the country, 560,000 (or 39.8%) were headed by women. In terms of active SMEs, 40.7%

[42] http://www.ipu.org/wmn-e/arc/classif010416.htm
[43] http://databank.worldbank.org/data/reports.aspx?source=1228

of active SMEs (330,000 out of 810,000 total active SMEs) are headed by women. The two top sectors for SMEs headed by both men and women are retail and agriculture (with more women-led SMEs in trade and more men-led SMEs in agriculture). The third most popular sector for SMEs is transport and warehousing for men and real estate for women. Men-headed SMEs are generally larger than women-led SMEs, with an average of 3.73 employees for the former and 2.32 for the latter. This difference is consistent throughout sectors (with a few exceptions, including the energy and financial sectors).

The 2015 Business Environment and Enterprise Performance Survey (BEEPS) reveals that only 28.3 percent of firms surveyed in Kazakhstan had women among the owners and 18.9 percent of firms had women in top management. Of the firms within the BEEPS survey sample that applied for a loan in Kazakhstan and had women among its owners, 6.9 percent of these firms were rejected for loans. In comparison, 2.9 percent of firms with no female owners that applied for loans were rejected.

Indicator	Kazakhstan	Central Asia
Per cent of firms with female participation in ownership	28.3	35.5
Per cent of firms with a female top management	18.9	21.2
Proportion of full-time workers that are female	35.5	36.9

Source: BEEPS 2015

ANNEX 6 – EBRD AND THE DONOR COMMUNITY

Donor funded technical cooperation assignments (TC), co-investment grants (in the form of a investment grants, risk sharing facilities and incentive payments) and concessional loans have allowed the Bank to support mainly Sustainable Energy and Resource Efficiency, Green Economy Transition as well as Entrepreneurship and SME development in Kazakhstan.

In addition, Kazakhstan has benefited from transactional and non-transactional TC assignments that have contributed to the development of SME competitiveness through a range of advisory and investment programmes, including the Business Advisory Services and first loss risk cover through Women in Business Programme in Kazakhstan.

Significant amount of resources channelled through TCs and co-investment grants in Kazakhstan were in support in of infrastructure and energy projects in the form of investment co-financing alongside of Enhanced Partnership Framework Agreement (EPFA).

The focus of donor grants is expected to remain on developing core infrastructure, enhancing sustainable energy and increasing the competitiveness of SMEs. To sustain these needs, the EBRD will rely on a number of donor funds administered by the Bank, in addition to resources made available by its shareholders:

- **Kazakhstan as a donor** first emerged in 2013 by establishing bi-lateral cooperation accounts in support of BAS activities and policy dialogue support in Kazakhstan. Since then, the Government, with contributions totalling over €50 million to date, has established other cooperation accounts in support of Women in Business in Kazakhstan. Additionally, the Government has replenished their bilateral account to support projects under the EPFA in the amount of €11.5 million and their BAS account in the amount of €22.1 million. The Government is interested in continuing to provide TC grants support across a range of sectors, focusing mainly on priorities such as infrastructure.

- **Other Bilateral donors:** grants will be sought from donors through their bilateral accounts administered by the EBRD, who have expressed interest in supporting activities in Kazakhstan across main strategy themes. Historically, Japan, USA, Korea and Taipei China have been particularly active donors in Kazakhstan.

- **Private donors: BG Kazakhstan** (before its merger with Shell) has provided almost €1 million to support ASB and **Chevron** has also supported local advisory in Kazakhstan.

- **The EU Investment Facility for Central Asia (IFCA)** has been an important source of funding for TC assignments under "Framework for Technical Assistance in Kazakhstan" in the recent years.

- **EBRD Shareholder Special Fund (SSF)** endowed by the Bank's net income. The SSF is a complementary facility to donor resources and will provide TC and co-investment grant support in areas where there is a shortage or lack of support, but where it remains as a priority area for the Bank to advance transition.