

**PROJECT INFORMATION DOCUMENT (PID)**  
**APPRAISAL STAGE**

Report No.: 48280

<b>Project Name</b>	South West Roads Project: Western Europe – Western China International Transit Corridor (CAREC 1b & 6b).
<b>Region</b>	EUROPE AND CENTRAL ASIA
<b>Sector</b>	Roads and highways (100%)
<b>Project ID</b>	P099270
<b>Borrower(s)</b>	Republic of Kazakhstan
<b>Implementing Agency</b>	Committee for Roads (the Committee) Ministry of Transport and Communications Astana Kazakhstan
<b>Environment Category</b>	<input checked="" type="checkbox"/> A <input type="checkbox"/> B <input type="checkbox"/> C <input type="checkbox"/> FI <input type="checkbox"/> TBD (to be determined)
<b>Date PID Prepared</b>	April 18, 2009
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<b>Date of Board Approval</b>	April 30, 2009

## 1. Country and Sector Background

1. Kazakhstan enjoyed strong economic performance between 2000 and 2007, with average real GDP growth of 10.1 percent. The Government maintained a healthy fiscal surplus during that period, accumulating over US\$27 billion in the National Fund of the Republic of Kazakhstan (NFRK), about 21 percent of GDP by mid-2008. However, the economy is highly resource-dependent, with manufacturing accounting for only 11 percent of GDP in 2008, and agriculture 5 percent. In contrast, minerals, oil and gas, accounted for 73 percent of exports, amounting to around 39 percent of GDP. Consequently, the Government has made diversification of the economy a development priority. Trade expanded rapidly from 2004 to 2008 with external trade orientation gradually changing towards China and other markets outside the Former Soviet Union (FSU) although Russia remains the largest single trading partner. The rapid economic growth has facilitated a sharp increase in income per capita, which reached US\$6,200 in 2008 (GNI per capita by Atlas methodology). With a population of 15.7 million in 2008 and an annual population growth rate of about 1.2 percent, income per capita is expected to rise. Despite this, the overall poverty headcount ratio was estimated at 13 percent of the population, indicating some inequalities in income, particularly for the population living in rural areas.

2. Despite the strong overall economic trends in Kazakhstan, a spiral of growth in commercial lending and foreign borrowing in the context of a real estate boom from 2005 until mid-2007 set the stage for difficulties in the financial and construction sectors after August 2007. The banking sector had built up a substantial foreign debt burden of US\$46 billion, primarily from early 2005 to mid-2007. However, since mid-2007, problems in the global financial markets significantly reduced access of the local banks to cheap external financing. In Almaty, the largest city, real estate prices have since declined by almost 40 percent in 2008, causing

further difficulties for commercial banks with significant exposure to the real estate sector. The National Bank of Kazakhstan spent about US\$6 billion or 25 percent of its foreign reserves (not including the NFRK) to support the Kazakh Tenge (KZT) between August and October 2007. In this context, Kazakhstan's sovereign rating was downgraded in October 2007. The Government and National Bank succeeded in stabilizing expectations about the exchange rate in late 2007 and 2008, but received a major boost from a strengthening of oil and other commodities export price, which brought the current account into surplus. Gross reserves of the National Bank actually increased in January-June 2008 by US\$3.6 billion. The Kazakhstan banking sector has also been managing its substantial burden of foreign debt service without extensive support from the government or National Bank, although it is possible that even a few larger banks could experience some serious liquidity or capital adequacy problems in the next few years if portfolio quality significantly declines.

3. The deepening of the world economic crisis since September 2008 has had very negative repercussions in Kazakhstan. Sharp declines in commodity export prices since the fourth quarter of 2008 hit Kazakhstan with a major terms-of-trade shock and tighter financial markets have prevented commercial banks from rolling over their sizeable debt repayment obligations. Pressures for devaluation became insurmountable in early February 2009, leading to an 18 percent devaluation as part of an exit from an explicit peg of the KZT to the US\$ to a corridor plus or minus 3 percent. Balance of payments pressures may persist further, as Kazakhstan needs about 30 percent decline in imports to bring the current account back to a reasonably sized deficit. Falls in commodity prices and the economic downturn present problems for the state budget as well, as revenues should decline by 6-7 percent of GDP. The devaluation has further complicated the situation in the Kazakhstan banking sector, as over 40 percent of loans are denominated in foreign currency and most revenue flows for Kazakhstan businesses are in KZT. In light of these difficulties, the Government nationalized the two most problematic large banks on February 4, 2009.

4. The geography, population, economy and trade flows of Central Asia have an important bearing on transportation challenges. Within the region, distances are substantial (2,000 km from Kyrgyzstan to Russia) and access to the major markets involves very long distances. There are also significant non-physical barriers to trade, including inefficiencies at border crossings, unofficial payments, and the lack of harmonization of basic transit documents and regulations, all of which have been subject of discussion at the Central Asia Regional Economic Cooperation (CAREC). In addition, the region has several challenging mountain passes that have to be traversed by road or rail and often become impassable during winter. For the region and Kazakhstan itself, trade with Russia continues to be important. Much of this trade transits through Kazakhstan mainly due to historical reasons, and the availability of transport infrastructure. China is growing in importance as a trading partner for Central Asia with Kazakhstan taking the largest share. Other significant trading partners of the CAREC countries include Japan, Korea, and Turkey, and trade with the EU countries is also increasing.

5. The short- to medium-term objectives for transport in Kazakhstan are identified in the Government's Transport Sector Development Strategy 2006-2015 (TSDS) and the Road Sector Development Program 2006-2012 (RSDP). These transport sector strategies define investment programs that include rehabilitation of the Republican (National) road network and the provision of selective additional infrastructure, particularly along the CAREC corridors, totaling 8,920km.

This includes the corridor linking Western Europe to Western China (WE-WC), which is the focus of this Project. The Ministry of Transport and Communications (MOTC) has estimated the total cost of investments required for the WE-WC Corridor (the Corridor) development to be US\$7.5 billion for the 2,840 km. This would be co-financed by the IFIs, including the Bank, over the period 2009 – 2014. The transport strategies also support the harmonization of current legislation with international norms and standards and the promotion of innovative technologies. Lastly, they promote the provision of services to users along the corridors including improvements in road safety.

## 2. Objectives

6. The proposed project is part of the Government's plan to upgrade and improve the road corridor linking Western Europe to Western China through Kazakhstan. The overall objective of the Government's WE-WC Corridor development program is to improve transport efficiency and safety, and promote development along one of Kazakhstan's main strategic road transport corridors. Transport and trade efficiency will be improved through provision of better infrastructure and services along the entire corridor to reduce transport costs, and through gradual reform of the entities responsible for all categories of roads.

7. The proposed project will be financed through a Specific Investment Loan (SIL) for the construction of approximately 1,062 km of road sections between Aktobe/Kyzylorda oblast border and Shymkent (including a northern bypass to the city). **The development objective for the project is to increase transport efficiency along the road sections between Aktobe/Kyzylorda Oblast border and Shymkent, and to improve road management and traffic safety in Kazakhstan.**

## 3. Rationale for Bank Involvement

8. Improving the administrative structure for managing roads in Kazakhstan will require careful planning and implementation. The experience of the Bank from several countries shows that reforms cannot be imposed from outside; they must be home grown taking into account the experiences of other similar countries. This proposed Project will initiate the dialogue with the government on the extent and type of institutional changes in the roads sector that would be sustainable in the context of Kazakhstan. The Bank has significant experience in implementing similar institutional reforms in several countries, and this will guide the development of policy reforms tailored to Kazakhstan.

9. The Bank is well placed to coordinate with other IFIs to ensure that: (i) parallel financing for the corridor will be synchronized; (ii) uniform technical standards will be applied, and (iii) the technical assistance components will complement the investments and the restructuring program. The very large program of proposed investments for the corridor (comprising approximately US\$7.5 billion and over 120 separate contracts) will take several years to implement and will require the integration of the fiduciary and safeguards standards of all IFIs and of Kazakhstan.

10. Also, the Bank hosts the Global Road Safety Facility (GRSF) that has been utilized in several countries to conduct a road safety management capacity review and to prepare second

generation road safety projects. The GRSF is financing a road safety capacity review in Kazakhstan aimed at reaching consensus with the government on a multi-sectoral strategy and an action plan for road safety to be financed through this Project.

#### 4. Description

11. The project is expected to be implemented in five years. It comprises five components:

- (a) **Component 1:** Upgrade and reconstruction of road sections within Kyzylorda Oblast (excluding the bypass to Kyzylorda), estimated at a total cost of US\$1,334.5 million equivalent. The estimate excludes physical and price contingencies, and the costs of consulting services for supervision of the construction. This component will finance the upgrade and reconstruction of about 788.5 km of road sections in Kyzylorda oblast with a modern structural design to lower the life-cycle cost of the road asset, including road safety features. Land acquisition and road design costs have been or will be financed by the Borrower's own funds. The list of civil works contracts was agreed with the Committee and accepted by the Bank.
- (b) **Component 2:** Upgrade and reconstruction of road sections within South Kazakhstan Oblast, including the bypass to Kyzylorda, at an estimated cost of US\$879.1 million equivalent, excluding physical and price contingencies, and the costs of consulting services for construction supervision. This component will finance the upgrade and reconstruction of about 273.4 km of road sections, all of which will be dual carriageways with 4 lanes. Land acquisition, and road design costs will be financed through the Borrower's own funds. The list of civil works contracts was also agreed with the Committee and accepted by the Bank.
- (c) **Component 3:** Project Management Consultants estimated at US\$6.5 million equivalent. The consultant services will assist the Committee with the management of all activities associated with the projects, including the supervision of all safeguards and fiduciary aspects, as part of a joint effort by all IFIs and the Government to ensure efficient and transparent implementation of the WE-WC Corridor program. Additional financing towards the full PMC costs will be made by the other participating IFIs, estimated at another US\$6 million. The main beneficiaries will be the Committee as well as the MoTC due to improved efficiency in project implementation and management of the Republican road network.
- (d) **Component 4:** Institutional Development and preparation of action plans to improve road safety and road services estimated at US\$3.5 million equivalent. The component comprises consulting services for: (i) a study to review options for strengthening the Committee for Roads and improving the overall condition of the road network; (ii) a training program to enhance capacity of Committee staff in project management with particular emphasis on procurement, financial management and safeguards; (iii) the development and implementation of a road management system; (iv) the preparation of a road safety improvement plan; and (v) the preparation of an action plan for the development of services along the Project road sections. The component also includes the provision of goods and equipment for the road management system. Additionally, a grant

from the Bank's Institutional Development Fund (IDF) has been received to complement the activities under this component in order to enhance monitoring and evaluation. The main beneficiaries will be the Committee and other organizations within MoTC. With regard to road safety, the Bank is financing a study on Road Safety Management Capacity Review through the GRSF. The main output from the Road Safety Capacity Review study will be a medium-term action plan for achieving road safety improvements in the form of a qualitative road safety investment strategy together with an action plan. The component will also finance the preparation of a road services action plan to facilitate private sector investments in the provision of services to transporters along the corridor. The Project will assist in developing incentives to the private sector for investments in roadside services. Funds for public sector investments, such as improvements of links to local roads, construction of bus terminals, road/rail terminals, etc., will be provided through the Budget.

- (e) **Component 5:** This will finance consulting services for supervision of civil works under Components 1 and 2 estimated at US\$55.0 million. This will also include review of detailed engineering designs and supervision of the implementation of Environment Management Plans prepared for each road section.

## 5. Financing

Source:	(US\$ millions)
Borrower	375.0
International Bank for Reconstruction and Development	2,125.0
Total	2,500.0

## 6. Implementation

12. The Government invited the Bank, ADB/JICA, EBRD, and IDB, to co-finance in parallel separate sections of the WE-WC corridor. In order to formalize this collaboration, a Memorandum of Understanding (MOU) was signed by the MOTC and all participating IFIs. The MOU specified the mechanisms for collaboration, an outline of the financing, joint project implementation arrangements, and the commitment to uniform design standards. The Ministry of Transport and Communications (MOTC), through the Committee for Roads, will be the implementing entity for the Project. The MOTC has requested Bank advice on options for reforming the Committee, including: (i) the re-establishment of a Project Implementation Unit (PIU) within the Committee; (ii) outsourcing some of the Committee's functions to consultants to assist with management of projects; (iii) transformation of the Committee into a semi-autonomous Road Agency that can hire staff at market remuneration rates; and (iv) transformation of the Committee into a State Owned Enterprise (SOE) with a defined income and full autonomy. The MOTC selected option (ii) above as an initial step, and hence the concept of a Project Management Consultant (PMC) was developed. The role of the PMC will be to provide technical assistance to the Committee for management and administration of all projects, quality control of road works and oversight of supervising engineers employed under separate consulting services contracts. The proposed project will finance a technical study to review if options (iii) or (iv) would be viable in the context of Kazakhstan with recommendations for the MOTC on how the preferred option could be implemented.

13. The Government's plan to implement road works along the entire corridor within the period 2009–2013 puts significant pressure on the procurement of the works. The Committee has designated one Deputy Chairman as the Project Director to oversee the implementation of all WE-WC road corridor projects. In addition, the Committee will outsource some of its functions to the PMC who will assist them with the coordination and implementation of all projects along the WE-WC corridor as mentioned above. The PMC will comprise teams dedicated to each IFI project under the overall management of a PMC manager who will report to the Project Director. The objective is to establish a road management environment consisting of the Committee as the Employer, the PMC as an arm of the Employer, with supervision consultants and civil works contractors as suppliers/service providers. The detailed design for civil works, preparation of tender documents and the first prequalification for civil works are expected to be completed by March 2009. In addition, as most of the activities on the critical path relate to the procurement of civil works, the packaging of the works has been designed to address this constraint with few contracts in order to minimize the procurement process, but with several bidding lots in order to promote competition.

## **7. Sustainability**

14. The issuing of the Transport Sector Development Strategy for 2006-2015 and the Road Sector Development Program for 2006-2012 provides strong evidence of the Government's commitment to the WE-WC Corridor development program, and to the Bank financed Project within this. These strategies include indications of long-term financing to the roads sector with the objective of attaining acceptable levels of service along the corridor and throughout the Republican road network. The budget foreseen for this purpose is forecast until the year 2012 incorporating an 8–10 percent increase each year, with the maintenance of the six CAREC road corridors assigned the highest priority. The Project is designed to support the implementation of the RSDP through Component 4, which will finance updates to design standards, introduction of modern road management systems, and the training of MoTC staff. Participation of the PMC in the implementation of the WE-WC Corridor development program represents a significant step towards sustainability of Project outcomes as it is expected that by the end of the Project, most local staff at the PMC will join the successor organization to the Committee following its reform, thereby ensuring transfer of knowledge to MoTC.

## **8. Lessons Learned from Past Operations in the Country/Sector**

15. Main lessons learned include the following:

- The implementation of large transport investments requires significant institutional capacity and incentives for staff in relevant departments to support Project implementation and coordination, and to monitor Project impact. Institutional development is a process that requires buy-in from the affected institutional leaders, the scope of which should be limited to concerned organizations.
- Weak institutional capacity affects Project implementation and jeopardizes fiduciary control. The Committee is a unit within the civil service structures of the MOTC and consequently has not been able to attract and retain qualified staff with the necessary experience to manage large projects and complex fiduciary processes. Disbursements

under the previous Road Transport Restructuring Project (RTRP) Loan (IBRD-44370) were delayed on several occasions due to poor record keeping and lack of staff with the necessary skills to meet all Bank fiduciary requirements.

- Supervision of civil works was weak due to the shortage of experienced engineers within the Committee. Some of the rehabilitation works carried out under the previous project were of poor quality, due to insufficient supervision of the contractors. There is a need for close oversight of supervising engineers by the Committee. Hence, under this Project, this function will be carried out with the assistance of PMC. As part of this agenda, it is also proposed to introduce longer term defect liability (warranty) periods for road construction, from the present 2 years up to 5 years, during which the construction company will be responsible for maintenance activities.
- Road construction costs are very high in Kazakhstan, demonstrating the lack of a competitive construction industry in the country and the region as a whole. It is therefore important to encourage more effective and efficient contracting practices, including widespread use of international bidding, use of local sub-contractors, and exposing the state owned enterprise Kazakhkavtodor to competition.
- The rapid economic growth in Kazakhstan over the past two decades led to very high rates in traffic growth, with consequent high rates of traffic injuries. The rapid increase in traffic will require longer term planning of development projects and improvements in the technical design standards for roads and bridges. The Soviet SNIP standards are not suitable for the modern fleet of heavy vehicles that use the Republican road network.
- Concerns with poor governance and corruption in the construction industry require special attention to be paid to fiduciary management of projects. The Project incorporates a Governance and Anti-Corruption action plan, implementation of which has been discussed and agreed with the MOTC and the Committee.

## 9. Safeguard Policies (including public consultation)

<b>Safeguard Policies Triggered by the Project</b>	<b>Yes</b>	<b>No</b>
<a href="#">Environmental Assessment (OP/BP 4.01)</a>	[X]	[ ]
Natural Habitats ( <a href="#">OP/BP 4.04</a> )	[ ]	[X]
Pest Management ( <a href="#">OP 4.09</a> )	[ ]	[ ]
Physical Cultural Resources ( <a href="#">OP/BP 4.11</a> )	[ ]	[X]
Involuntary Resettlement ( <a href="#">OP/BP 4.12</a> )	[X]	[ ]
Indigenous Peoples ( <a href="#">OP/BP 4.10</a> )	[ ]	[X]
Forests ( <a href="#">OP/BP 4.36</a> )	[ ]	[X]
Safety of Dams ( <a href="#">OP/BP 4.37</a> )	[ ]	[X]
Projects in Disputed Areas ( <a href="#">OP/BP 7.60</a> )	[ ]	[X]
Projects on International Waterways ( <a href="#">OP/BP 7.50</a> )	[ ]	[X]

## 10. List of Factual Technical Documents

16. The consulting firm KazDorProekt carried out a feasibility study of the entire corridor with the assistance of Saty-Invest Ltd (Kazakhstan), Asia Megatransit (Kazakhstan), TASC (Israel) and BCEOM (France). The detailed designs for the various civil works contracts that will be financed under the project are being finalized.

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