



1. Project Data

Operation ID P154702	Operation Name Kazakhstan Programmatic DPO	
Country Kazakhstan	Practice Area(Lead) Macroeconomics, Trade and Investment	
L/C/TF Number(s) IBRD-85530	Closing Date (Original) 31-Dec-2016	Total Financing (USD) 1,000,000,000.00
Bank Approval Date 03-Nov-2015	Closing Date (Actual) 31-Dec-2016	
	IBRD/IDA (USD)	Co-financing (USD)
Original Commitment	1,000,000,000.00	0.00
Revised Commitment	1,000,000,000.00	0.00
Actual	1,000,000,000.00	0.00

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2. Project Objectives and Policy Areas

a. Objectives

According to the Program Document (page 1), the program development objective (PDO) of the First (and of a planned, but subsequently cancelled, Second) Macroeconomic Management and Competitiveness Programmatic Development Policy Loan (DPL) was "to support the Government of Kazakhstan to implement reforms that: (a) strengthen the sustainability of the macroeconomic framework while protecting the vulnerable, and (b) help improve the competitiveness of the non-oil economy".



b. Were the program objectives/key associated outcome targets revised during implementation of the series?

c. Pillars/Policy Areas

There were two pillars:

Strengthening the Sustainability of the Macroeconomic Framework While Protecting the Vulnerable, focused on fiscal consolidation and monetary policy reform, following the oil price decline of 2014-16 and Kazakhstan's economic downturn in 2015-16. Measures taken aimed to raise non-oil revenues, reduce low priority investment expenditures, and enhance social assistance programs. These were complemented by a number of policy actions affecting monetary policy and the exchange rate regime, aimed at promoting macroeconomic stability.

Enhancing the Competitiveness of the Non-Oil Economy, focused on private sector development, considering the heavy dependence of the economy on the public sector and on the oil and gas industry. Measures taken aimed to improve the external terms of trade to favor tradables other than oil, to strengthen the banking and financial sector, and to enhance the industrial investment, business regulatory, and competition policy regimes.

d. Comments on Program Cost, Financing, and Dates

Program Cost: The program cost was estimated at US\$1.0 billion at appraisal. (The program cost for the cancelled second operation was also estimated at US\$1.0 billion).

Financing: The program was financed by an IBRD loan in the amount of US\$1.0 billion, which was fully disbursed in a single tranche.

Dates: The DPL was approved on November 3, 2015 and became effective a year later on December 31, 2016. The program closed, as scheduled, on December 31, 2016. (The planned second DPL was cancelled in July 2017).

3. Relevance of Objectives & Design

a. Relevance of Objectives

The PDO were relevant to economic and financial conditions in the country at the time of appraisal in 2015. The steep oil price decline beginning in 2014 cut Kazakhstan's oil and gas export revenues (two thirds of export proceeds) by more than half, and oil revenues (half of fiscal revenues), by about half. The current account surplus swung to a deficit, as did the fiscal surplus. The negative supply shock, compounded by a



slowdown in Russia and China, the country's principal trading partners, caused a depreciation of the Kazakhstani Tenge of 84 percent, and a loss of foreign reserves of US\$30 billion. The state-owned enterprise (SOE) sector, a major employer (30 percent of the labor force), but dependent on budgetary transfers, faced difficulty servicing external debt. Bank non-performing loans (NPLs) spiked, heightening corporate solvency risks and hampering bank lending. Overall, economic growth (oil and gas output had been a quarter of GDP) slowed from 6.0 percent in 2013 to 1.2 percent in 2015, and the poverty rate climbed from 16.1 percent in 2014 to 19.5 percent in 2015. In this context, the objective to "strengthen the macroeconomic framework, while protecting the vulnerable" would address the immediate requirement for macroeconomic adjustment following the oil price shock, while the objective to "help improve the competitiveness of the non-oil economy" would begin to address the structural and long-term challenge to diversify the economy away from an over dependence on the oil and gas industry and on the public sector. Macroeconomic conditions continued to be challenging through 2016. GDP growth was subdued at 1.1 percent while global crude oil prices stayed depressed under US\$60 a barrel. Thus, the PDO remained relevant to development priorities at program closure.

The PDO were also aligned to the development objectives advanced in the World Bank Group's Kazakhstan Country Partnership Strategy (CPS) for 2012-17, which committed the Bank to support initiatives that improve competitiveness and create private sector jobs, strengthen governance and improve the efficiency of public services delivery, and ensure that development was environmentally sustainable.

Rating
High

b. Relevance of Design

The Results Framework was logical. The PDO was clearly stated. The two policy areas exactly matched the two objectives of the program. The causal chain from policy areas, to program outcomes, and to the PDO, was basically coherent: (a) in response to fiscal deficits, a program of fiscal adjustment --- the mobilization of non-oil revenues, the reduction of low priority expenditures, and the installation of a more transparent budgetary framework --- would strengthen the sustainability of the macroeconomic framework; (b) similarly, a revised monetary policy regime --- exchange rate flexibility, inflation-targeting, and credible open market operations --- would promote macroeconomic stability; (c) enhanced social spending would help protect the vulnerable amid the economic downturn; and (d) over the medium- to long-term, a policy and institutional reform program --- including trade liberalization, a corporate solvency law, a smaller stock of problem loans, stricter prudential norms and better risk management at banks, a stronger competition law, a corporate governance code for the largest SOE, and the conduct of assessments of regulatory impacts --- would all help improve the competitiveness of the non-oil economy. The DPL was an appropriate instrument. It would provide budgetary support to cover the fiscal deficit, while the reform program would begin to address challenges to the development of the non-oil economy.

Notwithstanding these strengths, the program design suffered from significant deficiencies in key aspects.



First, the Program Document did not systematically present the financing of the fiscal deficit (estimated at 8.7 percent of GDP in 2015 and 5.5 percent of GDP in 2016) and hence a context for the proposed US\$2 billion of IBRD funding. Second, while non-oil revenue mobilization efforts focused on a reform of the value added tax (VAT), could be expected to contribute to narrowing the deficit in the near to medium term, it was not fully clear how a one-time reduction of low-priority capital expenditures in 2015 would help sustain the deficit reduction efforts beyond the program period. Third, the Program Document did not fully explain why changes to the exchange rate and monetary policy framework --- areas normally within the mandate of the International Monetary Fund (IMF) --- were treated as a precondition to the approval of the operation. Fourth, there were no prior actions defined for the objective to "protect the vulnerable." A results indicator covering the extent of employment support for employable targeted social support recipients was cited as the sole target. Fifth, the Program Document did not show why the specific set of measures to "enhance the competitiveness of the non-oil economy" was chosen from a conceivably long list of possible interventions and whether these measures constituted a unified and coherent strategy to diversify the country's resource-dominant economy away from oil and minerals.

Kazakhstan had no program with the IMF when the operation under review was prepared (for reasons unexplained in the PD and ICR). The July 2015 Article IV Consultations confirmed the macroeconomic contraction and its consequences (described in Section 3a above). The Staff Report emphasized the need over the medium term to strengthen further the macroeconomic policy framework in order to bolster resilience to shocks and promote durable growth. While the fiscal stimulus was justifiable on counter-cyclical grounds, fiscal sustainability must be accompanied by credible medium-term fiscal consolidation and more transparent fiscal policy framework. The actions supported by the program were intended to address these needs.

Rating
Modest

4. Achievement of Objectives (Efficacy)

Objective 1

Objective

To support the Government of Kazakhstan to implement reforms that strengthen the sustainability of the macroeconomic framework while protecting the vulnerable.

Rationale

Fiscal Policy: Mobilizing Non-Oil Revenues, Cutting Low-Priority Expenditures, and Reducing the Non-Oil Fiscal Deficit. Revenues slumped with the decline in oil prices, and Kazakhstan posted fiscal deficits of 8.7 percent of GDP in 2015 and 5.5 percent in 2016. The DPL supported: (a) the reduction of the registration threshold for VAT payers, to help raise non-oil revenues (a prior action) --- the Government submitted the draft law to Parliament in August 2015; (b) the reduction of expenditures and net lending in the 2015 central government budget by 8 percent, to contain the non-oil fiscal deficit (a prior action) --- Law 290-V cut the 2015 Republication Budget from Tenge 7.9 trillion to Tenge 7.2 trillion; and, (c) the revision of guidelines



governing the medium term fiscal framework, so that the definition of non-oil deficit more accurately measured the fiscal stance (a prior action) --- the Government revised the definition of non-oil deficit to cover the consolidated Republican Budget, regional budgets, and transfers from the National Fund of the Republic of Kazakhstan (NFRK) and to treat the customs duties on oil exports as a non-oil revenue item.

A number of other measures were taken by the Authorities that would contribute to a reduced non-oil fiscal deficit. Although these were not prior actions, they were specified outcome targets for the second operation, which was subsequently cancelled. They included: (a) a Government mandate that fiscal policy be formulated on the basis of a gradual reduction of the non-oil deficit relative to GDP; (b) discontinued off-budget lending from the NFRK to state-owned enterprises (SOEs) after 2016; (c) reductions in the net acquisition of non-financial assets by SOEs 2016-18; (d) reductions in the guaranteed transfers from the NRKF to the national budget by 20 percent by 2020; (e) setting the minimum balance of NFRK resources at 30 percent of GDP to promote savings; and (f) capping government debt at under the amount of foreign currency assets of the NFRK.

There were two outcome targets relevant to this area. The first was a reduction of the non-oil fiscal deficit from 10.5 percent of GDP in 2014 to no more than 9 percent in 2017. The estimated deficit in 2017 was 8.6 percent of GDP, thus meeting the target. The second was an increase of 24 percent by 2017 in non-oil revenues of the State budget compared to a 2014 baseline of Tenge 4.65 trillion. The actual estimated increase in 2017 was 42 percent. This target was, therefore, also met. The overall fiscal deficit declined from 8 percent of GDP in 2015 to an estimated 6.7 percent of GDP in 2017. Two-thirds of this overall consolidation reflected increases in non-oil revenue, and the balance, reductions in expenditure.

However, as the ICR (page 8) acknowledges, achievement of the non-oil fiscal revenue growth target owed more to inflation in the wake of the Tenge's depreciation than to the reform supported by the program, which was focused on the VAT. The Government actually delayed the reduction of the VAT registration threshold. The staged decrease in the threshold is now to be phased over a five-year period starting in 2018, arguably to allow for a smoother transition to the new regime by micro and small enterprises and for a better administration by the authorities over a larger number of VAT payers. In order to compensate for the effects of inflation, a more appropriate indicator would have been non-oil revenues as a percentage of GDP rather than their nominal value. This showed a much more modest improvement, from 12.4 percent of GDP in 2014 to 13.2 percent in 2017. The 2017 result also represents a reduction from 13.8 percent of GDP in 2016. Within total non-oil revenues, VAT showed little improvement, rising from 3.0 to 3.2 of GDP between 2014 and 2017 (IMF: 2017 Article IV Consultation: Staff Report, page 5). The delayed VAT reform raises the question of whether the lower non-oil fiscal deficit achieved in 2017 can be sustained in the near to medium term.

The objective specifies protection of the vulnerable, though there were no prior actions related to this. There was one outcome target – a rise from a baseline of 34 percent to over 50 percent in the share of persons covered by the active forms of employment support to eligible employable recipients of targeted social support. The target was exceeded, with coverage reaching 89 percent in 2017. However, in the absence of any prior actions or other concrete measures supported by the program, it is difficult to attribute this result to the operation. Moreover, the extent to which this results indicator, even if attributable, adequately reflects the attainment of the social protection objective is unclear. The national rollout of a revamped cash transfer



program, which was to have been supported by the cancelled second operation, had not been implemented by program closure.

Monetary Policy: Adopting a Flexible Exchange Rate, Transitioning toward Inflation Targeting, and Improving Open Market Operations. As oil exports slumped, Kazakhstan suffered current account deficits of 2.8 percent of GDP in 2015 and 6.5 percent in 2016. The authorities drew down US\$30 billion of foreign reserves to defend the exchange rate, which nonetheless depreciated by 84 percent against the U.S. dollar from August 2015 to January 2016. The DPL supported: (a) the adoption of a flexible exchange rate regime (a prior action) --- the NBK switched to the floating exchange rate regime in August 2015, and has since adhered to the new regime by limiting its foreign exchange market interventions; (b) the adoption of a new policy rate in the transition to an inflation targeting framework (a prior action) --- the NBK chose the overnight repo rate as the policy rate in September 2015, and set the target at 15 percent in May 2016 with a fluctuation band of +/- one percentage point; and, (c) the submission to Parliament of a draft law regulating the adoption of rules in the conduct of open market operations (a prior action) --- Parliament passed the law governing open market operations in late 2015.

Progress towards the program's goals were also supported by other measures adopted by the NBK and planned under the proposed second operation, including. (a) creation of the central bank's own platform for classic repo auctions; (b) development of a model to project inflation, forecast liquidity requirements, and estimate the necessary volume of open market transactions; (c) introduction of new instruments for open market operations and standing facilities; (d) expansion of the list of eligible collateral; and, (e) adoption of transparent practices in monetary policymaking, including the publication of statistical information, the preparation of analytical reports, and the issuance of press releases.

There was only one outcome target associated with this area – lowering the volatility of money market interest rates (defined as the standard deviation over a 12-month rolling period) by 10 percent in 2017 from a 2015 baseline of 100. This was easily surpassed with a 90 percent reduction in volatility recorded. In addition, the Tenge's nominal rate stabilized at between 310 and 345 per US dollar in 2017, although this was largely due to recovering oil prices. Inflation, which peaked at 14.6 percent in 2016 (from 6.7 percent in 2014), declined to 7.4 percent in 2017. It is still too early to judge the sustainability of exchange and interest rate stability, and also the effect on external balances and inflation expectations.

In summary, the fiscal outcomes at program closing were favorable, with both the reduction in the non-oil fiscal deficit as a percentage of GDP and the increase in nominal non-oil revenues exceeding their targets. However, once corrected for inflation, the increase in nominal non-oil revenues is considerably more modest, and VAT collection – on which the operation focused – did not improve significantly. The delay in adopting the VAT-related reforms raises a question over the sustainability of the fiscal improvement in the face of possible future shocks. There is little evidence of program-supported measures to protect the vulnerable. The exchange rate stabilized in 2017 following the adoption of a flexible exchange rate regime, and inflation declined after the introduction of inflation targeting by the central bank. Reduction in money market volatility exceeded the target. Again, however, these attainments would be vulnerable to oil price volatility since the economy remains highly oil-dependent (see the World Bank's Country Economic Update, December 2017: "Kazakhstan's Economy Is Rising – It is Still All About Oil").



Rating
Modest

Objective 2

Objective

To support the Government of Kazakhstan to implement reforms that help improve the competitiveness of the non-oil economy.

Rationale

Enhancing the Trade, Industrial, and Investment Regime. Kazakhstan's accession to the World Trade Organization (WTO) in 2015 provided an anchor to the country's efforts to broaden and deepen economic development through trade and international integration. The operation supported amendments to national laws that imposed local content requirements on goods and services and limited and distorted trade, to fulfill the country's commitments to the WTO (a prior action) --- the Government submitted draft legislation to Parliament in September 2015 to ease the local content requirement on works and services, in accordance with the WTO Agreement on Trade Related Measures (TRIMS). According to the ICR, the decision to ease local content requirements has set the stage for the eventual full implementation of the country's WTO commitments, a process that will take several years to complete in view of the transitional arrangements allowed by the WTO agreements

The operation also supported the development of territorial clusters under the State Program for Industrial and Innovative Development (SPIID). There was one outcome target for this area – the approval by the end of 2017 by the Ministry of Investment and Development of two action plans under SPIID out of the 18 received. This target was exceeded with six plans receiving approval.

The Government took a number of additional measures that were indicative targets for the proposed second operation. It: (a) increased the number of pilot territorial clusters under the SPIID; (b) abolished the requirement that enterprises form cluster associations to participate and benefit from the SPIID; (c) made public financing contingent on the preparation of cluster competitiveness action plans; and, (d) expanded the role of the Kazakhstan Industry Development Institute (KIDI) to spearhead territorial clusters development for SMEs beginning in 2016.

Strengthening the Banking System through a Revised Insolvency Framework, Lowering Bank Non-Performing Loans (NPLs), and Increasing Bank Capital. The operation supported, first, the enactment of legislation establishing the legal framework for corporate insolvency to allow for the greater recovery of value from insolvent debtors (a prior action). Parliament approved Law 269-V in December 2014 establishing a stronger legal framework for corporate insolvency and the Minister of Finance issued sub-laws in 2015 to implement the new framework. This enabled the implementation of six provisions including instituting the



rights of bankruptcy administrators in the context of cameral (legislative or judicial chamber) control activities in corporate bankruptcy and rehabilitation. Second, the operation supported the issuance by the NBK of prudential norms, including increases in capital, as well as accounting and financial reporting rules to improve risk management at banks (a prior action) --- the NBK issued regulations in 2014 and 2015: increasing the authorized capital at banks; requiring the banks to form conservation capital buffers; aligning the risk weighting of bank assets with Basel III; requiring banks to submit to International Financial Reporting Standards (IFRS) No. 13 for market-based fair-value disclosure; and, encouraging consistent, frequent and electronically-documented valuations of loan collateral.

There were two outcome targets related to this area. First, at least 10 percent of the 2,262 bankruptcy cases that were declared between January 2016 and August 2017, were to involve the application of rehabilitation procedures under the amended insolvency law. A total 298 rehabilitation procedures were applied, representing 13.2 percent of bankruptcies, exceeding the target. Second, the banking system was to improve its capital adequacy ratio (weighted average Tier-1 capital to risk-weighted assets) from 13.2 percent in 2014 to 15 percent at end-September 2017. The ratio was 16 percent, exceeding the target. The banking system's NPL ratio was also reduced from 33.7 percent in 2014 to 12.8 percent at end-September 2017, although this was not a specified outcome target.

The outcomes, while encouraging, should be viewed with some caution. NPLs were reduced amid a prevailing leniency in loan classification and following the dramatic increase in the sale of distressed assets to special-purpose vehicles. Moreover, NPLs remain generally under-provisioned. Similarly, the NBK deferred the requirement that banks raise their authorized capital from Tenge 30 billion to Tenge 100 billion by January 2016, and relaxed prudential regulations requiring consolidated financial reporting by financial institutions in accordance with IFRS.

Improving the Business Environment through Competition Policy, Regulatory Reform, and the Better Corporate Governance of SOEs. The operation supported three sets of measures in this area. First, both the anti-cartel enforcement provisions of the Competition Law 112-IV and the Code of Administrative Offenses were amended in May 2015 (a prior action). Second, a corporate governance code was adopted for the largest SOE (the sovereign wealth fund Samruk-Kazyna (SK)), with the expectation that private investors would eventually take interest in the SK's portfolio companies (a prior action). Governmental Resolution No. 239 was approved in April 2015, adopting the "Corporate Governance Code of Samruk-Kazyna." Third, a regulatory impact assessment (RIA) mechanism was introduced to study the effects of regulations governing businesses (a prior action). The Ministry of National Economy (MNE) adopted rules for the conduct of RIAs in January 2015 and created an inter-agency regulatory oversight body in September 2015.

There were two outcome indicators related to this area. First, there was to be an improvement in the country's performance on the Citizen Engagement in Rulemaking Indicator from a 2014 baseline of 3 (on a scale of 0-6) to 3.5 in 2017. The actual score was 4.6, exceeding the target. Second, the Government was to implement at least four of the recommendations of the Competition Commission following the subsidiarity principle that SOEs limit their role to the provision of goods and services that could not otherwise be provided by the private sector. In fact, 26 recommendations had been implemented by 2017, far exceeding the target. A number of complementary actions were taken within the context of the program, although they had no associated outcome targets. Competition policy was enhanced with: the passage of the Yellow Page



Rule Law, modeled after Singapore’s, which introduced a positive competition principle to evaluate direct government participation in markets, and which enabled Kazakhstan to reach its goal of becoming one of the 50 most competitive countries by 2013 (according to the Organization for Economic Cooperation and Development (OECD) Investment Policy Review). There was progress in amending the Entrepreneurial Code. The RIA system was pilot tested, with 216 RIA determinations completed by the end of 2016, and made ready for a national rollout. The MNE’s regulatory oversight body reviewed proposed regulations, rejecting some 30 proposals in favor of alternative approaches. Securing construction permits became easier. Kazakhstan’s global ranking in “Doing Business” improved from 77 in 2015 to 35 in 2017.

Notwithstanding these achievements, there were some shortcomings, some actions associated with the cancelled the second operation stalled, most crucially that securing the independence of the Competition Commission from the MNE. And, on corporate governance for the SOE sector, it remains too early to tell whether the transparency gained from the introduction of the new governance code will lead to greater private investor interest in the SK portfolio companies.

Overall, Kazakhstan has made important initial gains in reforming its trade and investment regime with the support of the operation. The corporate insolvency framework has been revised, corporate governance enhanced (particularly in the SOE sector), and regulation reformed. While efforts to raise bank capital and address NPLs enjoyed some success, important underlying issues remain. The strengthening competition policy would be made more robust by greater independence for the Competition Commission.

Rating
Substantial

5. Outcome

The objectives were highly relevant to the country context, and well aligned to the World Bank Group’s Country Partnership Strategy. Relevance of design, however, was modest – the link between prior actions and intended results was less than robust in a number of instances. Efficacy of the first objective – strengthening the sustainability of the macroeconomic framework while protecting the vulnerable – is rated modest. Attribution of fiscal results to the program is weak, and there were no prior actions to protect the vulnerable. Efficacy of the second objective – improving the competitiveness of the non-oil sector – is rated substantial. Important progress was made in trade facilitation, reform of the financial sector, and strengthening the regulatory, institutional and legal framework to encourage competition. Overall, the shortcomings are considered moderate, and outcome is assessed as moderately satisfactory.

a. Outcome Rating



Moderately Satisfactory

6. Rationale for Risk to Development Outcome Rating

The risks are substantial:

Oil price risk: A lengthy period of low oil prices would exert further pressure on Kazakhstan's economy which remains highly dependent on oil production, revenues and exports. The effort to diversify the economy will take time, which implies that the pressure exerted by low energy prices on the oil economy could persist over a lengthy period. A sustained recovery in oil prices, while beneficial to the country, could lull the Government into a complacency with efforts to wean the economy away from oil and minerals.

Other global macroeconomic risks: Economic weakness in the country's principal trading partner, Russia, would affect metal production in Kazakhstan and impinge on economic activity. Slower than anticipated growth in the European Union would hurt Kazakhstan's export performance. Higher than expected rates hikes by the U.S. Federal Reserves could discourage foreign direct investment in Kazakhstan and other emerging markets and make international borrowing more costly. Overall, slower than expected economic growth in Kazakhstan could make structural transformation more difficult.

Political risk: A lack of, or diminished, political will to execute difficult reforms (the planned adjustment to the VAT registration threshold was deferred and stretched over a longer implementation period) could derail the execution of the next steps in the policy and institutional reform agenda supported by the operation.

Institutional risk: Weak capacity to execute reform measures can arise not only from a lack of knowledge and experience but also from an unwillingness by the Government to vest power and grant independence to its operating agencies (the Competition Commission could not secure independence from the MNE).

a. Risk to Development Outcome Rating

Substantial

7. Assessment of Bank Performance

a. Quality-at-Entry

The Bank responded promptly to Kazakhstan's request for support following the steep oil price decline beginning in mid-2014. The Bank discussed the Concept Note in March 2015, three months after receipt of the request, and made a presentation to the Board in November 2015, six months after discussing the Concept Note.

The program was underpinned by analytical and advisory work as part of the Joint Economic Research Program, a multi-year knowledge building initiative. The Program Document lists 17 studies that helped inform the design of the program in topics including fiscal consolidation, revenue mobilization, exchange rate



flexibility, corporate insolvency, prudential norms in banking, the elimination of local content requirement in trade, regulatory governance, competition policy, and the corporate governance code.

The Bank actively consulted with other development partners on program design. It discussed the macroeconomic framework and the first pillar at length with the International Monetary Fund (IMF), which retained its surveillance functions over Kazakhstan. The plan for the inflation targeting regime and flexible exchange rate arrangement benefitted from technical assistance from the IMF. The bank capital increase and the problem loan reduction measures drew from the Financial Sector Assessment Program (FSAP) prepared by the Bank and the IMF in 2012. The policy reform action plans were coordinated with the Asian Development Bank (ADB), which similarly approved a US\$1 billion budget support loan to Kazakhstan in 2015.

Although designed in response to the economic downturn in 2015, the program appropriately combined adjustment measures with a structural effort to begin to wean the economy away from a dependence on oil and gas output and on public sector activity. The second policy area can be characterized as setting the foundation for private sector activity and for non-oil growth over the medium to long term. This dual focus was a strength of the program.

The development policy loan was an appropriate instrument. The loan proceeds would provide budgetary support to the Government --- the non-oil fiscal deficit reached US\$23 billion in 2015 and US\$14 billion in 2016. The prior actions to the first operation required a set of policy and institutional reform measures directed at the program objectives. In addition, indicative targets for the proposed second operation in the programmatic series would broaden the reform effort in the near to medium term.

The Bank clearly identified the principal risks confronting the operation: (a) macroeconomic risk --- a prolonged period of low oil and gas prices, worse than expected economic weakness in the country's principal trading partner (Russia), and faster than expected increase in U.S. interest rates; and, (b) institutional risk --- limited capacity in some agencies implementing complex reforms. The Bank also offered measures to mitigate the risks: a pro-active stance by the Government on stabilization and reform, supported by increased surveillance by the Bank and the IMF; social spending to address the effects of the adjustment on the vulnerable; and, technical assistance and capacity building initiatives directed at implementing units.

Notwithstanding the foregoing strengths, the operation suffered from two moderate weaknesses:

The Program Document did not adequately explain: (a) why there was not an IMF program for Kazakhstan that would have focused on macroeconomic stabilization and initiated changes to the monetary policy and exchange rate framework; (b) why the change to exchange rate arrangement was so vital that approval of the DPL would have hinged on it; or, (c) the extent to which the Bank might have substituted for the IMF on these matters. These questions would only be clarified following consultation with the program team after the completion of the ICR (see Section 14).

Some elements of the reform program either lacked adequate, or could have had better-defined, results indicators (see Section 9.a).



Quality-at-Entry Rating

Moderately Satisfactory

b. Quality of supervision

The Bank used the supervision of the program to engage the authorities in a continuous dialogue over fiscal reforms. In particular, the Bank pursued dialogue over: the Government's fiscal consolidation strategy; the design of an appropriate fiscal framework; and, savings for future generations.

The Bank's supervision mission of June 2016 focused on rising vulnerabilities in the banking industry. The supervision mission: underscored the need for the authorities to undertake an asset quality review of the largest banks, including of their special purpose vehicles; emphasized the importance of requiring the banks to undertake consolidated financial reporting following IFRS guidelines; and offered options for addressing NPLs.

The Bank, during supervision, devised the methodology for identifying barriers to competition in markets dominated by SOE monopolies and for helping build the capacity for industrial cluster development.

Quality of Supervision Rating

Satisfactory

Overall Bank Performance Rating

Moderately Satisfactory

8. Assessment of Borrower Performance

a. Government Performance

The Government strategically combined stabilization policies with structural reforms under the program. The dual focus was a coherent response to the supply shock induced by the steep decline in oil prices.

Despite the cancellation of the second operation, the Government managed to maintain the momentum of policy and institutional reforms begun under the first operation and to meet many of the indicative triggers of the second operation. The Government can be credited with: effecting changes to the NFRK strategies and operations to support fiscal consolidation; taking steps to convert the means-tested TSA into a conditional cash transfer program and social contract; and initiating improvements to the SPIID. The NBK can also be credited with taking measures to improve the efficiency of the monetary policy transmission mechanism.

However, the Government missed completing some reform measures. The Authorities deferred the reduction of the VAT registration threshold, lagged with the prudential supervision of banks, and could not ensure that the Competition Commission had control over the enforcement of its decisions.



Government Performance Rating

Moderately Satisfactory

b. Implementing Agency Performance

According to the Program Document, the Ministry of National Economy (MNE), the Ministry of Finance (MOF), and the NBK were to act as the implementing agencies of the program.

The ICR (page 26) cites the activities of the MOF as implementing agency and credits the MOF with: effective coordination with line ministries; efficiency in implementation; and, transparency. In particular, the State Borrowing Department of the MOF reportedly ensured the participation of all relevant agencies in the program, and promptly raised contentious issues to the attention of senior Government officials (no details were provided about these contentious issues).

The MOF was also responsible for fiscal adjustment measures. It advanced the fiscal consolidation effort over the medium term with changes to the NFRK operations. However, the deferral of the VAT reform reflected adversely on the MOF.

The NBK was responsible for changes to the monetary policy framework. It NBK spearheaded the switch to inflation targeting and to a flexible exchange rate system. However, the NBK deferred the requirement that banks raise their authorized capital and relaxed prudential regulations requiring consolidated financial reporting following IFRS guidelines.

The MNE was responsible for many of the measures aimed to improve the business environment. The MNE adopted rules for the conduct of RIAs and created an inter-agency regulatory oversight body. However, the MNE retained the Competition Commission as a department without granting it any meaningful autonomy.

Implementing Agency Performance Rating

Moderately Satisfactory

Overall Borrower Performance Rating

Moderately Satisfactory

9. M&E Design, Implementation, & Utilization

a. M&E Design

The Bank and the Government agreed on monitoring arrangements that included an assessment of the macroeconomic framework and of progress toward the reform agenda, based on the policy matrix and the Letter of Development Policy. The MNE was responsible for managing the M&E.



The Program Document (page iv) defined nine PDO-level results indicators to monitor progress toward the achievement of the PDOs. These had baselines and targets, and could be tracked and measured using economic statistics produced by the authorities (e.g. non-oil fiscal deficit), data available from the financial market (e.g. volatility of money market interest rates), or from reports prepared by government agencies (e.g. number of recommendations by the Competition Commission implemented by the Government).

However, some elements of the program lacked adequate results indicators to measure progress toward the program objectives. There were no indicators defined for the objective to reduce bank NPLs to improve the banks' financial intermediation function. Progress toward protecting the vulnerable was to be measured by the percentage of eligible employable recipients of the targeted social support program that received active forms of employment support. Yet, this single indicator could not reflect the full breadth of the social protection objective advanced by the program.

Moreover, a few indicators could have been improved on. The nominal value of non-oil fiscal revenues rose as a consequence of inflation and was therefore less appropriate than an indicator allowing for inflation, such as non-oil revenues as a percentage of GDP.

b. M&E Implementation

The program M&E was implemented as planned. The MNE monitored progress with the prior actions. The MOF monitored progress with the larger set of policy and institutional reforms supported by the DPL.

c. M&E Utilization

The Government has started to use the "number of corporate rehabilitation cases", an indicator defined for M&E under the program, as its new metric for measuring the efficiency of the country's corporate insolvency framework.

M&E Quality Rating

Substantial

10. Other Issues

a. Environmental and Social Effects

Environmental Effects: Following the requirements of Bank Operational Policy OP 8.60 (paragraph 9: Poverty and Social Impacts, and paragraph 10: Environmental, Forests, and Other Natural Resource Aspects) which govern DPLs, the Program Document (page 34) made the following determination of the



environmental effects of the program: (a) strengthening the macroeconomic sustainability would have beneficial environmental effects through the better collection of taxes, including environmental taxes; (b) a more competitive non-oil economy would lead to the improved assessment of environmental impacts of economic activity; and, (c) the adoption of by the sovereign wealth fund SK of a corporate governance code would lead the SK to be more transparent with the environmental impact of its investments.

Social Effects: Analysis by the Program Document (page 34) argued that strengthening macroeconomic sustainability and increasing the competitiveness of the non-oil economy would create jobs. In the short-term, however, fiscal consolidation would result in lower government spending and exchange rate depreciation would raise consumer prices.

b. Fiduciary Compliance

The Program Document (pages 34-35) determined that the MOF's public finance management framework and the NBK's foreign exchange management were adequate for the DPL.

c. Unintended impacts (Positive or Negative)

d. Other

11. Ratings

Ratings	ICR	IEG	Reason for Disagreements/Comment
Outcome	Moderately Satisfactory	Moderately Satisfactory	---
Risk to Development Outcome	Modest	Substantial	Political and institutional risks, which derailed the implementation of the VAT and banking capital reforms, remain substantial (see Section 6).
Bank Performance	Satisfactory	Moderately Satisfactory	The Bank did not explain the primacy of the planned changes to the monetary policy framework and did not



			define a prior action for the social protection program (see Section 7.a).
Borrower Performance	Satisfactory	Moderately Satisfactory	The Authorities deferred the implementation of the VAT reform, lagged with the prudential supervision of banks, and did not grant meaningful autonomy to the Competition Commission (see Sections 8.a and 8.b).
Quality of ICR		Modest	---

Note

When insufficient information is provided by the Bank for IEG to arrive at a clear rating, IEG will downgrade the relevant ratings as warranted beginning July 1, 2006. The "Reason for Disagreement/Comments" column could cross-reference other sections of the ICR Review, as appropriate.

12. Lessons

IEG draws the following lessons.

First, a successful DPO strikes a cautious balance between plugging a financial gap and advancing a quality reform program. Some elements of the adjustment plan may not have secured firm political commitment from the Government, as evidenced by the deferral by the Government of VAT reform, and the backtracking by the NBK on capital hikes and consolidated financial reporting by banks. The social protection objective lacked a prior action.

Second, the design of a successful DPO series anticipates roadblocks that may derail the preparation and approval of subsequent operations in a programmatic series and tries to ensure that the commitment to continue with future stages remains strong. Notwithstanding the cancellation of the second operation, the Government pursued a number of measures related to the NFRK that would contribute to a reduced non-oil fiscal deficit in the future. Similarly, the NBK made progress with measures planned under the proposed second operation to improve the central bank's open market operations and strengthen the monetary policy transmission mechanism.

Third, political economy dimensions need to be fully considered when designing a reform program. In this case, for example, vested interests effectively blocked several dimensions of the banking sector reform. To address this, it is often useful to conduct a political economy analysis at the preparation stage and to consult extensively with affected parties regarding the content of the reform program.



13. Assessment Recommended?

No

14. Comments on Quality of ICR

The ICR submitted a comprehensive account of the actions taken by the Government to advance the program objectives --- those required as prior actions to the first operation, the indicative triggers to the proposed but cancelled second operation, and other measures that advanced the reform agenda but were not directly supported by the operation. However, the ICR does not make an explicit determination of whether these latter actions, which lay outside the purview of the DPO as described in the Program Document, could be attributed to the operation, or would have been undertaken by the Government anyway in its absence.

The ICR was candid in its assessment of the efficacy of the reform program, fully discussing the weaknesses in the non-oil revenue outcome and remaining issues in the banking sector. However, the ICR could have provided clearer answers to five key questions that were subsequently resolved by the task team. First, the size of Bank support was determined as a residual after taking account of other financing sources. Second, Kazakhstan had no IMF program, because the Fund had closed its office in Kazakhstan, focusing its efforts on Article IV Consultations and technical assistance. Exchange rate and monetary policies were included under the operation since they were needed to ensure a satisfactory macro framework. Third, no prior actions were specified to protect the vulnerable, because they were foreseen under the auspices of the cancelled second operation. Fourth, the prior actions related to the second objective were chosen because they mitigated identified risks, were already on the country's medium-term agenda, and had strong political commitment. Fifth, the cancellation of the second operation was prompted by a deterioration in the Government's net financial position --- a measure of creditworthiness --- rather than a doubling of the debt/GDP ratio as indicated by the ICR.

The lessons provided by the ICR could have been improved. Rather than lessons, they consisted largely of finding and recommendations.

a. Quality of ICR Rating

Modest