I. Project Context

Country Context

Kazakhstan is the ninth largest country in the world—it has a land area equal to that of Western Europe. The Kazakhstan economy has almost doubled since the country emerged from the break-up of the Soviet Union two decades ago. Kazakhstan experienced a strong economic performance through efficiency gains from increasing its market orientation, and from expansion of hydrocarbon output amidst rising prices during 2000-2007. The non-oil fiscal deficit was maintained at 3 percent of GDP—with savings being transferred to a stabilization fund. However, economic diversification proved elusive in the face of booming oil prices. The role of the State in industrial policy and in management of large enterprise remains dominant—with an annual investment program by State investment holding company Samruk-Kazyna of about 7-10 percent (versus Government fixed capital investment of 5-6 percent of GDP).

Kazakhstan withstood the effects of the global financial crisis of 2008-2009, through a rapid response combining fiscal stimulus with bank stabilization measures amounting to US$17 billion. The authorities implemented a fiscal stimulus package directed to agriculture, small business, infrastructure and construction. Key financial sector stabilization measures included a recapitalization of three major banks and reduction of the external debt of banks by more than US$10 billion. The decisive approach to macroeconomic and financial sector management contributed to a quick recovery in output: 7.3 percent in 2010, and a 7.5 percent in 2011, which also benefited from high oil prices. A gradual fiscal adjustment is expected to be achieved mainly through a declining share of total capital spending from about 8.0 percent of GDP in 2010 to below 6.0 percent of GDP by 2015—partly by elimination of crisis-spending programs with fixed capital spending remaining at its pre-crisis level. It is assumed that non-oil revenue will remain approximately flat as a share of GDP (at about 14.3 percent), while oil-related Government revenue will decline as a share of GDP from 13.8 percent in 2011 to about 10.0 percent by 2015.

Real annual growth is projected at around 5.5-6.0 percent in the medium term. The oil sector is estimated to grow in the range of 2.5-6.0 percent, and the other sectors at 6.0 percent (below pre-crisis highs of 9.0-11.0 percent). The external current account is expected to remain comfortably in surplus. Gross international monetary and fiscal reserves stood at US$75 billion (over 40 percent of GDP). Inflationary pressures have emerged from commodity price shocks and an accommodating fiscal stance. The authorities intend to reduce the non-oil fiscal deficit over the medium-term. Based on Kazakhstan’s recovery record and stable outlook, Standard & Poor’s raised its long- and short-term foreign currency sovereign credit ratings for Kazakhstan from ‘BBB/A-3’ to ‘BBB+/A-2’ on November 8, 2011.

The Government of Kazakhstan established a customs union (CU) with Belarus and Russia in 2000—signaling a major change in the path of regional integration, with significant implications for Kazakhstan. The customs union should allow Kazakhstan to benefit from greater access to the larger Russian and Belarusian market and the eventual free movement of labor and capital, totaling a population of about 150 million through easier transportation of goods and people through the territory of Russia and Belarus with the abolishment of border crossing points between the countries. Issues related to non-tariff measures need to be addressed to maximize the benefits of Kazakhstan’s participation in the CU. Trade diversion and related long-term productivity losses due to increase in Kazakhstan’s external tariffs on most goods from outside the union raise some concerns (weighted average tariff rose from 5.3 percent to 10.4 percent). Kazakhstan’s accession to the World Trade Organization (expected in 2012-2013) would deliver significant benefits.

Economic linkages with China have grown in recent years. China is now Kazakhstan’s biggest trading partner (24 percent of total trade or US $14 billion in 2010) and the fourth largest foreign investor (nearly 10 percent of total foreign investment). There is no agreement in place between the two countries targeting the reduction of tariffs and the elimination of non-tariff barriers. Nonetheless, trade volumes are expected to reach up to US$17.5 billion in 2011, surpassing the pre-financial crisis record. In June 2011, the Governments of China and Kazakhstan signed an agreement to increase the trade volume to US$40 billion by 2015. Most commodities exported from Kazakhstan to China are either oil products or raw materials (mainly transported by rail over long-distances) while imports remain mainly consumer products manufactured in China. The share of non-oil exports (such as construction material, chemicals, machinery and equipment, and other manufactured and consumer goods) is rapidly increasing (see Annex 8). Non-oil products are mainly transported by short-distance road haulage.

The Government’s stabilization efforts have placed the economy on a recovery path as growth has resumed. The post-crisis development vision
of the Government (detailed in the Strategic Plan for Development 2020) is to base sustained growth on improved competitiveness, increased productivity, and diversification of output in the non-oil sector. Successful implementation of this vision would require the relieving of infrastructure constraints to growth in the medium-term. Diversified growth would require reduction in economic distances and greatly improved connectivity between cities. A shift towards managing infrastructure assets more efficiently would reduce the costs of business and trade. If the country is to realize its potential as a major transit country between Western Europe and Western China, there is a need to focus on improvements in infrastructure, trade facilitation and reductions in non-tariff barriers.

II. Sectoral and Institutional Context

The economic and geographic features of Kazakhstan pose significant transport challenges. The country is vast, landlocked, with uneven spatial distribution of the population and natural resources. These characteristics result in a high dependence on the efficient movement of people and goods. At the same time, Kazakhstan is strategically located between Western China and Western Europe — as well as within Eurasia — and is thus a key transit country. Travel distances within the region are substantial (e.g. 2,000 km from the Kyrgyz Republic to Russia), which results in increased travel times and costs for accessing wider markets of the region or beyond. Transport costs account for 8-11 percent of the final cost of goods, which is about double the cost in most industrialized countries. Within this context, the development of transport infrastructure combined with efforts to increase the efficiency of the sector itself are seen as enabling factors for the development of the country — in particular, for the Government’s drive towards economic competitiveness, increased productivity and diversification.

The Government’s Strategy for Transport Sector Development (TSD) from 2010-2014 — which was approved in September 2010 — identifies the short- to medium-term objectives for the Kazakh transport sector. This Strategy envisages the development of an efficient transport system (including infrastructure, services and administration) that is integrated into the international transport system. The TSD recognizes rail transport’s dominant role for heavy bulk goods, and calls for the road network to be developed so as to serve higher-value goods and support better connection with neighboring countries. The TSD also aims to transform the transport sector to meet the country’s development objectives by: (i) improving managerial and strategic planning capacity; (ii) enhancing safety and maintenance standards; and (iii) promoting market reforms and private sector participation, with a view to fully realize the country’s transit potential.

Kazakhstan has a developed land transport network of about 84,000 km of roads and 14,000 km of rail tracks. The road network consists of about 21,000 km of republican roads, and 63,000 km of local roads. The former are managed by the Committee for Roads (CR) of the Ministry of Transport and Communications (MoTC). Four of the six major transport corridors designated by countries of the Central Asia Regional Economic Cooperation (CAREC) traverse Kazakhstan. This includes the CAREC corridor 1b, also called the Western Europe-Western China Corridor, and which is the main corridor in Kazakhstan. Although current trade movements are relatively low, the trade directions indicate significant potential for trade with Europe, China and South Asia, in addition to the current thriving trade with Russia. This perceived trade potential is the main reason for the establishment of the six CAREC corridors. Between January and July 2011, the total freight turnover in Kazakhstan was 231,557 billion ton-km — with a rail freight turnover of 121.30 billion ton-km, and a road transport turnover of 50.339 billion ton-km. Rail transport accounted for 71 percent of all freight transportation in 2010 (total freight turnover, excluding pipeline), with road transport accounting for the remaining 29 percent. Nevertheless, trends show a substantial increase in road freight per annum since 2002 (e.g. a 45 percent increase for the period of January to July 2011 as compared to the same period in 2010).

The main road corridor in Kazakhstan is the WE-WC Road Corridor, which functions as the major link to 7.9 million people, about half of Kazakhstan’s population. It crosses the entire country from Khorgos on the border with China in the south east, through Almaty, Taraz, Shymkent, Kyzylorda, and Aktobe, to the border with Russia (a total of 2,787 km). The upgrade of the Road Corridor is a major objective of the Government. Construction started in 2009. The Road Corridor promotes internal and external trade by providing more efficient transport and logistics services. Overall, about 63 percent of the total financing needed to complete the WE-WC program is co-financed by the following organizations: (i) the Asian Development Bank (ADB); (ii) the European Bank for Reconstruction and Development (EBRD); (iii) the Islamic Development Bank (IsDB); (iv) the Japan International Cooperation Agency (JICA); and (v) the International Bank for Reconstruction and Development (IBRD or ‘the World Bank’).

The World Bank, through the South-West Roads Project (SWRP), is already providing a US$2.125 billion loan to upgrade 1,065 km of the WE-WC Road Corridor within the South Kazakhstan and Kyzylorda Oblasts and to improve the management of the road transport sector. In addition to capital investment, the SWRP finances the preparation of action plans to improve road safety and roadside services, and institutional changes aiming at: (i) strengthening the CR, and enhancing the capacity of its staff in project management; and (ii) implementing a Road Management System. A Framework of Actions was signed in December 2010 by the MoTC to detail the strategy for implementing the institutional reforms financed out of the SWRP. The Framework of Actions focuses on the areas of human resources, organizational effectiveness and management systems. Achievements to date include increase of salary of CR and Oblast Department staff (by 30 percent), the appointment of a Road Reform Advisor to lead institutional change, establishment of a Unit responsible for Road Management, and initiation of amendments into legislation and normative acts to transfer functions from the CR at the central level to its oblast departments. Additional activities are also ongoing, mainly the preparation of a Road Asset Management System, and studies on road safety and road side services. The implementation of the Framework of Actions has been supported by international consultant teams which also provided on-the-job training.

Funding for the road sector has increased substantially since 2001, but budget allocations for maintenance are still inadequate. Kazakhstan’s rapid growth over the past decade was accompanied by a substantial increase in total road sector expenditures. Despite the budgetary constraints posed by the crisis, the planned budget for 2011 shows total expenditures of KZT223 billion (US$1.5 billion equivalent) — which is about ten times the 2001 level. However, an insufficient portion of those funds are allocated to maintenance. It is estimated that road maintenance allocations from the Republican budget amounted to only about 50 percent of the amount deemed necessary according to Kazakh norms. The Government has started to focus on network programming and planning so it will be able to allocate more efficiently its resources.

The Bank is supporting this effort through the implementation of the already-mentioned Road Management System under the SWRP. In addition to inadequate funding for maintenance, the MoTC is constrained by: (i) a lack of modern skills and absence of an incentive system for staff; (ii) the need for major maintenance or full rehabilitation for 40 percent of roads; (iii) outdated road maintenance practices and management (reactive rather than preventive); (iv) a poor road safety record; and (v) a lack of modern highway services along road corridors.

III. Project Development Objectives

The project development objectives (PDOs) are to increase transport efficiency along the Western Europe-Western China Road Corridor within Almaty Oblast and to modernize highway management on sections of the Western Europe-Western China Road Corridor.
IV. Project Description

Component Name

Component 1: Upgrade and construction of road sections within Almaty oblast (total 305 km)
Component 2: Modernize highway management of sections along the WE-WC international transit corridor

V. Financing (in USD Million)

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<th>For Loans/Credits/Others</th>
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VI. Implementation

The MoTC will have responsibility for implementation of the Project, with the CR directly responsible for day-to-day management. The MoTC is experienced in implementing World Bank transport projects. The proposed Project would partly replicate the implementation arrangements of the ongoing SWRP. The MoTC would implement the Project through the CR. A Project Management Consultant (PMC) is currently supporting the CR in the implementation of the SWRP, allowing the CR to gain enough experience and skills. The CR is now ready to endorse the responsibility for day to day management of the Component 1 of the Project. Additional external consultant will be hired mainly for financial management and procurement activities (about 5 in total). PMC staff will still be present for 18 months as the implementation of the two projects will overlap. The Governance and Anti-Corruption Action Plan under the SWRP has been updated based on experience from the implementation of the SWRP.

The RRA team would support the MoTC in the road sector reform process. The RRA team would be asked to support reforms and transfer skills to MoTC staff through training and day-to-day operations. The appointment of the RRA and the RRA team would focus MoTC attention on institutional strengthening activities and reform efforts including the pilot operation and maintenance activities financed under the Project. Through the RRA team, the proposed Project would also strengthen partnership arrangements with other Government Ministries and agencies — such as the Ministry of Economic Development and Trade, the Agency for Civil Service, Prime Minister’s Office, the Ministry of Finance, and the Ministry of Justice.

VII. Safeguard Policies (including public consultation)

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VIII. Contact point

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