



Pension Reform and the Development of Pension Systems: An Evaluation of World Bank Assistance

***Background Paper* Kazakhstan Country Study**

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Acronyms and Abbreviations

ADB	Asian Development Bank
AFP	Accumaltion Pension Funds
AMC	Asset Management Company
CIS	Commonwealth of Independent States
FDC	Financial Defined Contribution
FSU	Former Soviet Union
GDP	Gross Domestic Product
GNI	Gross National Index
IEG	Independent Evaluation Group (formerly OED)
IMF	Interntional Monetary Fund
KASE	Kazakhstan Stock Exchange
MOF	Ministry of Finance
MOLSP	Ministry of Labour and Social Protection of Population
MIS	Management Information System
NBK	National Bank of Kazakhstan
NGO	Non-governmental Organization
NSC	National Securities Commission
OED	Operations Evaluation Department (changed its name to IEG in December 2005)
PAYG	Pay-as-you-go
PRAL	Pension Reform Adjustment Loan
PROST	Pension Reform Options Simulation Toolkit
SAPF	State Accumaltion Pension Fund
SPPC	State Pension Payment Centre
USAID	United States Agency for International Development

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Preface

This paper belongs to series of 19 country and regional case studies commissioned as background research for the World Bank's Independent Evaluation Group (IEG) report "Pension Reform and the Development of Pension Systems." The findings are based on consultant missions to the country or region, interviews with government, Bank, donor, and private sector representatives involved in the pension reform, and analysis of relevant Bank and external documents.

This case study was authored by Edward Palmer in 2004. Edward Palmer is a professor of social insurance economics at Uppsala University and head of the Division for Research at the Swedish Social Insurance Agency.

1. Introduction

1.1 This document is an evaluation of the World Bank's support in pension reform to Kazakhstan during the period following the break-up of the Former Soviet Union (FSU) in 1991. The major reform work was undertaken in 1997, and in January 1998 Kazakhstan began with the implementation of a new mandatory financial account defined-contribution pension scheme.

1.2 The evaluation begins with a general country background and overview of pension data, followed by a summary of the Kyrgyz's pension reform and a discussion of the World Bank's technical assistance in this process. The final sections contain the evaluation of the Bank's and country performance and lessons and recommendations.

1.3 The evaluation is based on World Bank documents and interviews with World Bank staff, IMF and other reports, and interviews with Government officials and involved in formulating and implementing reform policy in Kazakhstan, as well as persons outside the policy circle, such as representatives of NGO's, academic experts and journalists. There is a Data Annex at the end of the report which provides a statistical overview of the country's economy, key demographic and pension data. A list of persons interviewed in performing the evaluation is also provided in the Annex.¹

¹ I am particularly grateful to Baktybek Zhumadil at the World Bank office in Astana for arranging the program for the evaluation mission and providing invaluable help as a liason thereafter.

2. Overview of the Economy

2.1 Kazakhstan's Parliament declared independence from the FSU in December 1991. Its population was 16.7 million persons in 1991, but it has decreased steadily to 14.8 million persons in 2002, due mainly to migration out of the country of the Russian-speaking population.² The Kazaks are the largest ethnic group and Russians are the second largest. Together these two groups account for around 80 percent of the population, with a relative shift during the 1990s in favor of Kazakh ethnics due to the considerable migration of the Russian-speaking population. The population is well educated.

2.2 The landmass of the country is five times the size of France, but with only one-third of France's population. In 2002, GDP per capita was about US\$1,500. Data based on a household survey in 1996 found a poverty rate of 30 percent for the population at large. More recent, comparable calculations are not available, but an indirect indicator of poverty, the share of food in total household consumption, decreased from 74 percent in 1996 to 66 percent in 2001.³

2.3 The share of value added accounted for by industry has increased steadily from 31 percent in 1998 to 43 percent of value added in 2002. Agriculture has consistently constituted about nine percent of valued added since the mid-1990s, and services account for the declining remainder. The country is practically self-sufficient in food production and is endowed with considerable natural resources, the most important being oil reserves.

2.4 Kazakhstan is developing its oil reserves rapidly and in 15-20 years is expected to be one of the world's top 10 oil exporters.⁴ Tax and other revenue flows from the petroleum sector to the government budget are on a level of about 3 billion,⁵ which can be compared with GNI of US\$20 billion in 2001 and US\$22.3 billion in 2002.⁶

2.5 By 1996 the level of GDP and wages had fallen by around 40 percent from 1991, and inflation was rampant. Growth came first slowly from the mid-1990s and then fell with the Russian crisis in 1998. It became positive again in 1999, and since 2000 GDP has grown at an annual rate of around 10 percent or more.

2.6 In 1998 gross capital formation was 16 percent of GDP, while in 2002 gross capital formation and saving were 27 percent.⁷ There was a government deficit of about four percent of GDP in 1998, in part exacerbated by the Russian crisis and consequent negative growth. By 2002 the deficit was less than a half percent of GDP. To date, the evidence indicates that national saving and capital formation have

² Sabit Khakimshanov and Kairat Mynbaev, *Old Age Poverty and the Pension System in Kazakhstan 2001*, Mimeograph August, 2003, p. 10.

³ *Ibid.* page 7.

⁴ Republic of Kazakhstan: Selected Issues and Statistical Appendix. IMF Country Report No 03/211, July 2003, p. 5.

⁵ *Ibid.*

⁶ World Bank Country Profile Table. Kazakhstan Data Profile. <http://devdata.worldbank.org>.

⁷ IMF Country Report No 03/211, *op.cit.* Statistical Appendix.

followed on the heels of the 1998 pension reform, with a relatively balanced budget sustained by substantial oil revenues. In the six-year period following the pension reform in 1998, the country has moved into a phase with high investments and growth.

2.7 In sum, in the short period since 1998, the country's economic statistics have become extremely favourable. Already in the early 1990s the top leadership of the country declared its commitment to a market-based and externally oriented development strategy,⁸ and it has adhered strictly to a program designed to decrease reliance on the state and promote individual private initiative. Between 1994 and 1996, the country had already taken a number of major steps towards privatization of the economy. Thereafter, additional, considerable progress has been made, and Kazakhstan is generally considered to be a leader in the region.

⁸ Kazakhstan – The Transition to the Market Economy. World Bank Country Study. The World Bank, 1993, page ii.

3. Overview of the Old Pension System

3.1 With independence, Kazakhstan inherited the pension system of the FSU. Pensions were calculated as a fixed component and a component based on service years. The pre-1997 pension formula provided a benefit based on 60 percent of the individual's highest wage, with one percent extra for years of service over 25 years for men and 20 years for women. Service years consisted of years of employment, child care and could even be augmented through a host of special rights.⁹ The maximum number of years that could be included in the calculation of a benefit was 40, and normally people have had close to 40 years of rights, one way or another. The pension age was 55 for women and 60 for men.

3.2 In line with the principles of the old FSU system, special pension rights were awarded in lieu of better working conditions and/or higher current wages for working in unpleasant or dangerous occupations. In addition to providing service years, a special right could mean the right to receive a pension prior to the normal pension ages for men and women. They could be granted in full from age 40, if the claimant had enough years of coverage according to a specific rule for a particular occupation. There was no restriction on working and receiving a special pension, and most who received an early pension as a special right continued to work.

3.3 Together with the low pension age, the institution of special rights contributed to the large number of pensioners. In the mid-1990s, about 19 percent of old-age pensioners had pensions granted on favourable terms with supplementary years of credited service, and received a benefit that was higher than average. According to the household survey of 1996, 32 percent of old age pensioners were under 60 years of age.¹⁰

3.4 The pre-reform data is not good, and especially statistics on the number of contributors seem unreliable. The first year for which statistics on contributors were made available for this evaluation was the year 2000 and in this year the ratio of the number of contributors to the number of persons estimated to be in employment was 52 percent. A rough estimate of the number of contributors in earlier years can be made applying this ratio to the number of persons employed from the mid-1990s. This has been done to derive a rough picture for the pre-reform years. This procedure gives about 3.9 million contributors in 1996 compared to around 2.8 million recipients of old age, disability and survivor benefits, of which roughly 2.2 million were old age pensioners, also a rough estimate derived using the distribution of pensioners from later years. (See the Data Annex.)

3.5 As Table 3.1 shows, in 1996 although there were about 5.3 persons age 20-59 per person 60 and older, there were only something like 2.4 contributors per person age 60 and older and something around 1.8 contributors per old age pensioner.

⁹ Special rights were given to people working in listed occupations such as milkmaids, bus drivers, aviation employees, the police, the military, theatre performers, wind instrument players, etc.; dwarfs; persons working in hazardous working conditions – e.g. in chemical, metallurgical and mining industries; and persons working in climatically extreme conditions.

¹⁰ Sabit Khakimzhanov and Kairat Mynbaev, *op.cit.* p 13.

3.6 The low retirement age of women, together with the low ages at which persons with special rights qualified for a benefit, was responsible for the low system dependency ratio; while the low compliance rate of roughly a little over 50 percent was responsible for the large discrepancy between persons reported as employed and persons contributing. Certainly this was not a financially sustainable situation.

3.7 In spite of the generous pension formula, with replacement rates at retirement of 60 percent and higher, the ratio of an average old age benefit to an average wage was 46 percent in 1996. In the pre-reform formula, the size of pensions reflected both varying individual wages and service years, but by the mid-1990s actual individual benefit payments no longer reflected previous individual wage differences. This is because the government was forced to flatten benefits of pensioners at the higher end of the scale to keep expenditures in line with declining revenues in the early 1990s.

3.8 Working with the data in the Data Annex it is possible to see that from 1998 the average old age pension increased approximately with the rate of inflation, which increased by about 50 percent from 1998 to 2002. On the other hand, the average wage increased by about 110 percent, due to considerable real wage growth of almost 47 percent. Whereas pensions maintained their purchasing power, the rapid increase in the real wage per capita “deflated” the ratio of an average benefit to an average wage between 1996 and 2002. Hence the fall in the ratio of an average benefit to an average wage from around 46 percent in 1996 to 35 percent in 2002.¹¹

3.9 In 2003, many pensions were increased considerably in an attempt to compensate a large group of pensioners for the necessary benefit reductions during the difficult first half of the 1990s. This measure will be discussed in more detail in the next section under pay-as-you-go reform measures undertaken to date.

3.10 During the 1990s there was an upward drift in the number of persons age 60 and older and a slight decline in the number of persons under 60, which explains the why the demographic dependency ratio fell in the 1990s. (See the Table in the Annex.) There was a considerable increase in unemployment immediately following the Russian crisis, but employment picked up again from the year 2000, and the ratio of persons employed to persons 60 + has remained generally stable.

3.11 Finally, there occurred a remarkable increase in contributors on the heels of the 1998 pension reform. This must be attributable to the modernization of collection procedures and administration, which were part of the institutional reform program initiated in 1998, and the new system design which so clearly links future benefits to current contributions. The fact that the pay-as-you-go scheme does not provide rights from 1998 most undoubtedly encourages people to contribute to the new financial scheme, and since these contributions are processed through the State Payment Pension Center, which is responsible for the administration of the pay-as-you-go benefits, it must be difficult to declare different covered wages for different purposes.

3.12 Prior to the reform, the administrative system for collection contributions and payment of benefits was decentralized and ineffective, a problem that was addressed

¹¹ The ratio of the average benefit to an average wage based on all benefits is lower. Calculated on the basis of macro data in the Table in the Data Annex it is 32 percent. Other sources have put it as low as 28 percent (Kazakhstan, Selected Issues and Statistics, 2003, the IMF, p 65). The difference is probably due to a more inclusive definition, e.g. the inclusion of social pensions, disability and survivors.

as a part of the reform. Prior to 1998, the Ministry of Labor and Social Protection (MOLSP) bore the overall responsibility at the national level, but the local departments of social protection collected contributions and paid benefits. With some exceptions, each raion¹² had its own pension fund. In principle, 70 percent of contributions were deposited in the local office's account and 30 percent were to be sent to a central account for redistribution. In practice, the local offices retained their funds until their regional benefits had been paid. In addition, at a time when collection was difficult anyway, a richer community like Almaty had little incentive to go about the difficult process of collecting more revenues when it already had enough to pay its own pensioners.¹³ In sum, the old collection model provided an incentive for local offices to collect revenues, but only up to the amount needed to fund local commitments.

Table 3.1: Kazakhstan-Key Pension Ratios

	1996	2000	2002
(1) Ratio of Working age Population (20-59) to Population 60 +	5.3	4.8	4.7
(2) Ratio of Persons in Employment to Population 60 +	4.3	3.9	4.1
(3) Ratio of Contributors to Population 60 +	(2.4)	2.3	3.3
(4) Ratio of Contributors to Old Age Pensioners	(1.8)	2.0	3.2
(5) Ratio of Contributors to Old Age and Disability Pensioners	(1.5)	1.7	2.6
(6) Average Old Age Benefit/ Average Wage	0.46	0.38	0.35

¹Based on the ratio old age pension payments per recipient divided by the average wage in the Data Annex. The ratio of all benefits (old age, disability and survivors) to the average wage is: 0.41 for 1996; 0.31 for 2000 and 0.29 for 2002.

3.13 All in all, the old model was unfair in two respects and, for the same reasons, did not provide sufficient incentive to pay contributions. First, there was no direct link between contributions and benefits. Second, the collection mechanism was potentially arbitrary because contributions were negotiable at the margin. The latter either benefited profits of employers who succeeded in evading or enhanced the pocket earnings of their employees, or both. In addition, the incentive to collect mounting arrears was greater in poorer than in richer communities. Also, something had to be done about the large number beneficiaries resulting from the low pension age and widespread use of special privileges.

¹² Raions consist of municipal and rural localities. Oblasts are larger, regional localities and are comprised of a number of raions.

¹³ Emily S. Andrews, Kazakhstan: An Ambitious Pension Reform, Social Protection Discussion Paper No. 0104, The World Bank, 2001.

4. The Pension Reform of 1998

Introduction

4.1 Kazakhstan implemented a financial defined contribution (FDC) scheme on January 1, 1998. This scheme is to gradually replace the pay-as-you-go scheme that was in place previous to this date, and beginning in 1998, people no longer received new rights in the pay-as-you-go scheme. However, rights acquired in the old scheme through 1997 will continue to provide a part of the retirees pension until only new entrants from 1998 remain, at which time the new scheme will have completely taken over.

4.2 Under the reform, a 25.5 percent social tax on the wage bill was replaced by a 15 percent tax paid by employers based on individual wages. In addition an employee contribution of 10 percent of wages is transferred to the worker's individual account. To the extent that the 15 percent contribution to the PAYG scheme does not cover costs, the remainder is covered by the Republican budget. The overall payroll tax is 21 percent after the reform. As the new financial system is phased in and the old PAYG system is phased out, the 15 percent contribution rate for employers will be reduced, implying that the overall payroll tax will also decline.

4.3 The financial account system can be viewed as a forced lifecycle saving program, where participants accumulate savings during their working careers, which are converted into annuities at retirement. There is a transition period beginning with the discontinuation of rights in the old PAYG system from 1998, and continuing until all participants are fully in the financial account scheme. This is augmented by a guarantee minimum pay-as-you-go benefit. To the extent that the total costs of the PAYG commitments can not be covered by the employer contribution rate of 15 percent, they are borne by the Republican budget.

4.4 In principle, as the PAYG component based on rights acquired prior to 1998 shrinks, the employer contribution rate earmarked to pay for this system should fall accordingly. If the general budget is in balance, except for capital expenditures, this implies an increase in saving equal to the increase in the pension funds assets.¹⁴ Whether this translates into national saving depends on the development of the Republican budget and the net flow of capital abroad. The Republican budget has been – and will continue to be – bolstered by oil revenues. Saving and capital formation have increased, since 1998, as has already been discussed. Given a sustained increase in saving, growth will depend on the capacity of the country to channel money into profitable (productive) physical investments.

4.5 Government estimates using a model created through USAID projected a loss in pension revenues due to the decrease in the payroll tax of 1.7 percent of GDP. By 2026 the total cost of the PAYG pension system was originally projected to be 2 percent of GDP. More recent calculations (2000) using the World Bank's PROST model and revised data show PAYG pension payments dropping from about 7 percent

¹⁴ Presently, the government foresees an overall budget deficit of 1.9 percent of GDP for 2004, 1.0 percent of GDP for 2005 and 0.5 percent of GDP for 2006. Midterm Fiscal Policy of the Republic of Kazakhstan for the Years 2004-2006., The Ministry of the Economy and Budget Planning of the Republic of Kazakhstan, Mimeograph. 2003.

of GDP in 1998 to around 4.5 percent from 2010-2020, dropping gradually to around 2.5 percent of GDP after 2030.¹⁵ One of the issues of the Kazakh reform is whether a scenario with such a low state component is actually reasonable in the medium to long term, as will be discussed below.

4.6 The following two sections describe and discuss the design and institutional setting of both the new pay-as-you-go formula and the new financial account scheme.

The Pay-as-you-go (PAYG) system

4.7 The minimum age from which a pension can be claimed was increased in steps of a half year at a time from 55 to 58 for women and from 60 to 63 for men, where they have been since July 1, 2001. This minimum applies both to the PAYG and the new financial account scheme. Men and women working in hazardous conditions, and women with five or more children can still retire five years earlier, which are the remaining special privileges.

4.8 The “old” PAYG formula is

$$B = (\sum w_t/T) \times [[60\% + 1\% \text{ for every year past 20 for women and 25 for men, up to a maximum of 15 additional percentage points}]$$

where B = the benefit; w = the individual’s own average wage for any three consecutive years. To obtain a benefit a female applicant needs to have full 20 years and a male applicant 25 years. For less than 20/25 years, benefits are prorated. There is a ceiling of 15 x the MRP on the maximum individual wage, which in 2004, with an MRP of 919, is 13 785 (= 15 x 919) Tenge per month.

4.9 Persons whose old-law pensions had been whittled down during the 1990s lobbied effectively to have their pensions recalculated, and in June 2003 pensions for a little over a million persons – 64 percent of all old age pensioners - were increased. The increase applied to everyone below a ceiling, using a new version of the old formula and information in individual pension files. The formula used was:

$$B = [(\sum w_t/T) / w_{\text{branch, final year}}] \times [[60\% + 1\% \text{ for every year past 20 for women and 25 for men, up to a maximum of 15 additional percentage points}] \times [\text{previous year's average wage in the branch when the individual retired}]$$

where the difference is that branch wages entered into the recalculations.

4.10 Persons whose benefits have been and will be granted after the cut-off for the recalculation will receive benefits according to the “old” formula.

4.11 As a result of the June 2003 recalculation, the average pension increased from 6,485 to 7,927 Tenge per month, that is, by a little over 22 percent, in June. (The average old age pension is higher than the average pension, which includes disability recipients and survivors.) Persons who already had pensions over 9,810 Tenge or whose benefit qualifying wages and service records did not provide grounds for an

¹⁵ The information in this paragraph is from Emily Andrews, *op. cit.* pp 8-11. It is noteworthy that these projections are updated regularly by the Ministry of Finance.

increase did not receive an increase.¹⁶ This measure helped to reduce a discrepancy in the benefits of older and newer pensioners. It is noteworthy that the State Pension Payment Center recomputed this large number of individual benefits, based on individual records, and executed payments within the short time of a couple of months.

4.12 Persons with a full service record (20 years for women and 25 years for men) are entitled to at least a minimum pension. The minimum was introduced with the new reform. In addition, persons with work histories that lead to a pension of less than 3 x MRP receive a social benefit. Table 4.1 shows the relation between these and the average benefit.

Table 4.1: The Minimum Pension and the Social Benefit

	1999	2000	2001	2002	2003
Minimum Pension	3 000	3 500	4 000	5 000	5 500
Social Benefit	2 112	2 175	2 325	2 469	2 616
Average Old-age Pension ^a	5 130	5 490	6 370	7 050	n.a.

^aBased on the ratio of old age benefit payments per recipient in the table in the Data Annex.

Source. Ministry of Labor and Social Protection.

4.13 The PAYG formula can be interpreted as follows. Assume there is no real growth in wages, and that the individual's average wage always equals the branch average, that is, he or she is the average wage earner. With 30 covered years for a man (25+5) and 25 for a woman (20+5), the old formula gives a benefit of 65 percent for a unit wage, but the three-year average yields a lower rate, since there is no real indexation of the wage during the period used for the average.

4.14 With price indexation of benefits, real wage growth will yield an even smaller macro ratio of an average benefit to an average wage, with higher real rates of growth yielding smaller ratios. For example, with a system dependency ratio of two contributors per old age beneficiary and a real rate of growth in the average wage of five percent per annum, the value of an average benefit to the average wage eight years later will be reduced by about half (to around 32 percent – in line with the current level in Table 3.1), requiring a contribution rate of 16 percent. Lower growth requires a higher contribution rate, and higher growth a lower contribution rate.

4.15 In addition, since the system is being phased out, people will begin to receive pro-rated benefits below today's maximum. This is an additional factor that will further reduce costs as benefits converge with the level needed to support the cost of the minimum guarantee, which is a discretionary parameter.

The New Financial Account System

4.16 **Institutional overview.** The new system, introduced in January 1998, is a financial defined contribution (FDC) scheme, with a contribution rate of 10 percent,

¹⁶ This information is contained in a press release of the MLSPP of the Republic of Kazakhstan, October 11, 2003.

explicitly paid from employee wages, but administered by employers.¹⁷ It is a mandated scheme for employees and the self-employed.

4.17 Presently workers can choose between the *state accumulation pension funds* (SAPF) and one of 15 privately managed *accumulation pension funds* (APF). The SAPF is also the default fund for non-choosers. Employees have the right to contract with their pension fund of preference. Participation grew from 20 percent of the labor force in 1998 to almost 75 by 2002.¹⁸

4.18 Participants have the right to switch funds, which they may want to do on the basis of fund yields and costs. A participant interested in switching submits an application to his/her current fund, specifying the new fund to which his/her savings are to be transferred. This was required to occur within 30 days. To date the majority of switching has been from the state run default fund to the other funds.

4.19 Initially, the private funds played a major role in educating the public about the new system, which was clearly in their own interests. They are still important information sources for individual account holders; however, information is also available more generally through mass media.

4.20 Each APF must hire one *asset management company* (AMC); however, an asset management company can manage assets for more than one fund. There are presently eight asset managing companies. Every fund must have an authorized *custodian bank* that accounts for and reports to the funds regarding all operations with fund assets, their allocation and investment income. According to interviews performed during the evaluation, the custodians provide fast computerized information and are performing well in their capacity.

4.21 The *National Securities Commission* (NSC) licenses AMCs. In practice the NBK is responsible for regulation and supervision of funds and AMCs (see below). It can be noted that, to date, only one (original) AMC has had its license revoked as the result of a supervisory measure. The assets of that company were transferred to other companies.

4.22 The *National Bank of Kazakhstan* (NBK) is responsible for licensing and regulating the custodian banks. It is also the custodian bank for the SAPF, which in principle signals a conflict of interests. In the capacity of custodian bank it should be independent in its views regarding purchases of government debt instruments, and be in a position to question the soundness of a purchase of a government debt issue.

4.23 Since August 2002 the NBK has had the full responsibility for regulation and supervision of both pension funds and AMCs. These responsibilities are currently being integrated into a system of consolidated financial supervision, which will

¹⁷ A case can be made that even employer contributions are paid at the expense of employee wages, but in Kazakhstan the 10 percent contribution rate to the FDC scheme is an explicit employee contribution.

¹⁸ Program Performance Audit Report, Asian Development Bank, IN.233-03, September 30, 2003, page 13. The figure for 2002 is substantiated in the Data Annex to the present report. According to the figures in Table 1 in the Data Annex there are even more contributors 6.1 million compared to 5.4 in Table 2 in the Data Annex. The latter is based on persons who actually pay contributions during a given year, whereas the fund data includes all persons who have accounts, in addition to possible duplicates, if participants are not taken out of the system when they switch funds.

become separated from the NBK during 2004. However, even when the independent agency has been created, two functions, the legal department and accounting departments, are to remain with the NBK.

4.24 The *State Pension Payment Center* (SPPC) was also created as a part of the reform process in 1998. It calculates and pays the pay-as-you-go pension and child benefits. All benefits are paid through banks, which is a considerable accomplishment in view of the fact that many of the FSU countries still use the postal services. If they arise, deficits are covered by loans taken up by the government. Since 2000 there has been no deficit, and benefits are paid on time.

4.25 Payroll tax collection and enforcement were originally with the SPPC, but have been transferred to the state revenue collection service. However, contributions to the mandatory financial account scheme are channelled through banks from employers and the self-employed through the SPPC. The SPPC executes money transfers to individuals' funds within 24 hours.

4.26 The SPPC has 220 local offices that provide individual and employer based information. Individual information can be obtained upon presentation of proper identification. All persons from the end of the mandatory school age are now required to have a Social Individual Code number, which can be obtained at a local office. All participants in the financial account scheme already have such a number,¹⁹ and from 2005 everyone in the country will have to have a number to receive a benefit.²⁰

4.27 *The State Accumulation Pension Fund*. The SAPF is publicly managed. It can be a fund of choice, but it also functions as a default fund. The Ministry of Finance provided the initial capital for the state fund, and members on the Board of Directors come from the NBK and Ministry of Finance. The NBK originally provided asset management and custodian services, but now provides only custodian services for the SAPF. The SAPF has its own investment unit. On January 1, 2003 the SAPF was put on equal status with the privately managed APFs, giving it the same portfolio and other asset management rights. There is presently a discussion about privatizing the SAPF, which would put it on a wholly equal status with other APFs.

4.28 On January 1, 1999, over 76 percent of all assets were held by the SAPF.²¹ There has been a continuous drift of participants from the SAPF to the privately managed funds. In 2003, the SAPF still had the largest number of participants, about 40 percent, but at the same time it held only a little over a quarter of total assets. The main reason why the share of assets is smaller than the share of participants in the total is that, as the default fund, the SAPF picks up many-low income participants, who in addition may not be contributing on a regular basis. The SAPF maintains its own database.

¹⁹ The issuance of numbers was initially impeded by problems in meeting the World Bank SIC conditionality that only 10 % of persons could be identified as working in the informal sector. These conditions of the initial PRAL were eventually relaxed. See the following section on the Bank's country assistance strategy.

²⁰ People also have numbers for tax purposes and with internal affairs, which means the typical resident/citizen has three numbers vis á vis the public sector.

²¹ Andrews, *op.cit.* p 30.

4.29 *Private Accumulation Pension Funds.* APFs are joint stock companies. They can be open to all participants, or be available only to certain company employees. To date, there is only one closed fund, Kazakhmys.

4.30 *Employer APFs.* Employer liability is unlimited in the event that the option to form a company exclusive APF is chosen, which may explain why there has been little interest in forming company-related APFs.²² Another could be that there is no large efficiency gain for the company, since information on individual contributions and financial payments are already made through one channel, via a bank and through the SPPC to APFs, forming a company-based fund entails no substantial gain for the employer, while it leaves open the individual choice alternatives of the participants.

4.31 *Ownership.* Initially the ownership of funds was unclear.²³ Pension accounts were not clearly the property of the contributor. This was changed, and, in addition, the law now states that these property rights may not be used to cover debts of the participant, the pension fund, the AMC or the custodian bank in the case of liquidation or bankruptcy.

4.32 *Guarantee.* Pension fund participants are guaranteed a rate of return at least as great as the lesser of two indices.²⁴ These indices are: (i) 50 percent of the average real returns of all asset management companies, or (ii) the index of average real returns of all asset management companies less two percent. These norms are specified by regulation and approved by the Cabinet of Ministers. The NSC publishes the index on a monthly basis. Deficiencies are to be covered by additional reserve capital, principal reserve capital or, as a last resort, AMC equity.

4.33 *Statements to participants, information.* The pension funds send out statements to their participants showing account values, contributions and returns on investments. Local offices provide individual and employer based information. The major newspapers report on fund performance, so participants have access to general information on funds through mass media, as well as directly through their own funds.

4.34 *Public Awareness.* According to journalists interviewed during the mission people know that there is a 10 percent contribution rate to the FDC scheme, they know that the FDC scheme is replacing the pay-as-you-go scheme and understand and accept the principle that benefits should be linked to contributions.

4.35 There is public awareness and concern about the consequences on individual benefits of unemployment and more generally disrupted careers. In addition, there is an impression, fuelled by the discussion of experts in mass media, that the government (pension funds) does (do) not know what to do with all the money that is accumulating. This is a result of the generally high level of public discussion and debate, as a result of mass media coverage of the growth of funds and the rates of return they are producing. Following the publication of annual reports from 2003, it became clear that 13 of 16 APFs had a negative return, which led to considerable discussion in mass media in early 2004 about investment strategies.

²² Andrews, *op cit.* p 21.

²³ Andrews, *ibid.* p. 23.

²⁴ Andrews, *ibid.* p. 24.

4.36 *Recent changes in the Pension Law.* On January 1, 2003 a number of changes in the pension law went into effect. These are summarized here. First, the portfolio requirements of the APFs would also apply to the SAPF. Second, a guarantee of contributions which previously applied to the SAPF was extended to all funds. Third, it became possible for non-resident foreign interests to set up in Kazakhstan.

4.37 Fourth, from June 2003, in accordance with the new legislation, fund assets are evaluated at market values. The valuation of fund assets was an issue for a number of years. The switch to market values revealed immediately that two funds had a negative yield, a situation which caused public concern and discussion that had to be met by public statements from the Chairman of the Securities Commission, who emphasized the long-term nature of fund investments.

4.38 Fifth, in an attempt to avoid the high fees charged in Chile, Kazakhstan set a maximum fee for pension funds. The maximum fee was initially based on contributions and the volume of assets, with one percent of contributions and 10 percent of pension assets. From 2003 the fee structure is related to investment returns and assets, with 15 percent of investment income and 0.02 per cent monthly from pension assets.

4.39 Sixth, the removal of the legal separation of pension funds from asset managers. This recognized the reality that large financial groups controlled both pension funds and asset management companies, anyway.

4.40 *Portfolio requirements.* Pension portfolio regulations were altered in December 2003. The share of state securities that pension funds are required to hold was decreased from 35 to 25 percent. The maximum limit on holdings of mortgage-backed and bonds issued by the Development Bank of Kazakhstan was increased from 10 to 15 percent. A maximum of 40 percent of the portfolio can be held in foreign issues of a high rating, and 30 percent in foreign non-government securities with a rating of AA or Aa2, not more than 20 percent in foreign issues with a rating of A or A2 and not more than 10 percent with a rating of BBB or Bb2. Funds are now allowed to hold up to 5 percent of their portfolio in gold.

4.41 Institutions and financial instruments have been developing at a rapid pace. Mortgages and mortgage backed bonds have developed, and reinsurance is in the process of developing. Syndicated bonds for business borrowing have developed. Municipal bonds are still judged to be very risky, and municipal bond financing has not been encouraged. To date there are two municipal bonds on the market. Large businesses have tended to borrow through bonds rather than equities, and normally Eurobonds denominated in US\$. Even the large banks have raised funds by borrowing on the international capital market. Eurobonds denominated in dollars are also purchased by the pension funds.

4.42 Although Kazakhstan is a leader in Central Asia, the scale of commercial banking in relation to GDP in Kazakhstan is below that in the Baltic States and Central Europe.²⁵ There is presently considerable discussion of the role of the banking system in developing local business lending and the role of pension funds in providing money for lending through banks, while at the same time there is concern

²⁵ Republic of Kazakhstan: Selected Issues and Statistical Appendix, IMF Country Report No. 03/211, July 2003, p 56.

about the threat of corruption at the micro level. One of the obvious domestic uses of pension fund money is the provision of funds to banks and investment companies, who screen and rate risks and are primary lenders.

4.43 The insurance industry is small. Insurance premiums amounted to only 0.6 percent of GDP in 2002.²⁶ To date there has been little demand from private individuals for individual property and life insurance, and the insurance business that exists is mainly focused on the needs of businesses.

4.44 The players in the market do not see near-term prospects for any significant development of the stock market. In April 2003, the IMF analyzed the situation of the Kazakhstan Stock Exchange as follows: “Despite its name, the Kazakhstan Stock Exchange (KASE) remains primarily an organized place for trade in government securities (81.4 percent of total turnover in 2002), foreign exchange (12.1 percent) and corporate securities (3.1 percent). In 2002, the total KASE turnover amounted to US\$24.6 billion, an increase of 140 percent compared with 2001.”²⁷ To date, the privatization process has not fuelled growth of the equity market, and the borrowing of larger enterprises has been predominantly on the bond market, as has already been noted.

4.45 For several years, USAID has financed a successful project focused on the development of skills needed in creating, evaluating and trading financial instruments, the development of accounting and risk evaluation and management skills, and other financial training, with a focus mainly on banks and the bond market. As a result, institutions have developed professionally, especially in the area of bonds.

4.46 One of the comments on the present situation coming from many sources is that there is too much money and too slim a domestic market for the growing pension funds. Many experts, joined by the NBK, suggest that the pension funds will have to become more aggressive investors in international equities. There is already a high degree of dollarization of the Kazakh financial system. The pension fund’s holdings denominated in foreign currency have decreased from 87 percent at the end of 2000 to 52 percent at the end of 2003 (Data Annex). Pension funds hold Eurobonds issued by domestic borrowers denominated in dollars. There is a more general exchange risk that will have to be managed as funds look abroad for new investment opportunities, and this will bring a new challenge to the system.

4.47 The assets of Pension Funds grew from 4.3 percent of GDP in 2000 to 7.2 percent by the close of 2002.²⁸ In summing, it is clear for all, the major players in the financial market, the government and the international organizations that the main challenge facing Kazakhstan’s new financial account scheme is the pace of evolution of the domestic financial market, and the investment strategy for rapidly growing pension funds, especially given their central role as the future major, and eventually sole providers of old age pension security.

²⁶ *Ibid.* p 61.

²⁷ *Ibid.* p 61.

²⁸ *Ibid.* p 60.

5. The Bank's Country Assistance Strategy

5.1 Between 1991 and 1996, GDP had declined by almost 40 percent, with a similar decline in tax and contribution revenues. By 1994, the Pension Fund was running a deficit of around 2.2 percent of GDP, and this was expected to increase to 2.5 percent in 1995 and 1996.²⁹ This deficit placed additional burden on an otherwise strained government budget. In spite of this, a main focus of Bank policy was on key programs to reform health and education, which together accounted for 25 percent of government expenditures and 70 percent of government employment.³⁰

5.2 In its 1994 Economic Report on Kazakhstan, the Bank's pension policy recommendations were focused on:³¹

- As a temporary cost saving measure, collapsing pension entitlements to a flat rate. This meant redistributing dwindling pension contributions from persons with higher to persons with low pensions, which could be accomplished by price indexation only up to a specified maximum benefit level. All persons above this level would receive the same benefit, while persons originally below it would approach the maximum.
- Tightening special benefits, and introducing a maximum earned income threshold for working pensioners (around 31 percent of pensioners were below the minimum pension age and working).
- Giving high priority to measures improving tax payer compliance, which was estimated to be around 50 percent.
- Consideration of how, over the long-term, the system could move in the direction of creating a tighter link with earnings and contributions. The Bank suggested considering a dual system “in which the state pays a minimum basic social security pension out of general budget revenues or payroll taxes and individuals can supplement this pension through savings in a private scheme.”³²

5.3 In sum, as early as mid-1994 the Bank had identified the pension system as a problem area, had suggested possible short-term measures to create financial balance and a general long-term approach to reform. Nevertheless, the Bank was not instrumental in the formulation of the new pension system, passed in Parliament in July 1997. In fact, the reform was driven by the government as a part of a strategy promoting privatization and development of Kazakhstan's financial market, which emerged rapidly in the first half of 1997, and apparently without consultation with the World Bank, the ADB or other aid institutions.³³

²⁹ Republic of Kazakhstan: Transition of the State. Volume 1, Report No. 15353-KZ, The World Bank, 1996, pp 32-34.

³⁰ *Ibid.*

³¹ Kazakhstan Economic Report. Volume 1: Main Report, July 7, 1994, Report No. 12856-KZ, The World Bank, pp 21-22 and Volume 2: Annexes pp 78-80.

³² *Ibid.* p. 22.

³³ Program Performance Audit Report, September 30, 2003, IN.233-03, Asian Development Bank, p 2.

5.4 In the late 1990s, the World Bank considered that the reform of the social sector raised two principal concerns: First, the social costs of transition; and, second, the possible negative impacts of growth on income distribution. A main issue identified for social sector reform was insolvent entitlement programs, including the state pension system. The well-being of vulnerable groups, particularly the elderly, was another.

5.5 The Bank recognized that Kazakhstan had opted to become the first CIS country to undertake a sweeping reform of its pension system, under which the country would shift from a pay-as-you-go system inherited from the Soviet Union to a privately managed funded system akin to the one developed in the 1980s in Chile.

5.6 The Bank's assistance strategy indicated that the new pension loan (see below) designated to aid for pension reform and social assistance in FY98-99 was to have been a "marginal" loan, to be granted depending upon the fulfilment of requirements not having directly to do with the pension reform itself.

5.7 Based on Kazakhstan's extensive program for institutional reform, of which the pension reform was viewed as a vital component, the government of Kazakhstan negotiated with the Bank to obtain a Pension Reform Adjustment Loan (PRAL) in June 1997.

5.8 **The PRAL.** The PRAL was to support the implementation of pension reform in four areas:

- *Macro-economic stability and structural reform.* The government's was committed to maintaining medium and long-term *macroeconomic stability* by strengthening tax and revenue collection, with the help of technical assistance. This goal would be strengthened by the establishment of a government body to make long-run actuarial projections of the expenditures and costs of the public system, given that the increased costs for pensions associated with the introduction of the FDC scheme. *Structural reform* was foreseen to take the form of continued privatization with listings on the Kazakh stock exchange, the development of government borrowing instruments and an insurance market the emergence of a strong insurance industry.
- *Social protection and public information.* The government calculated that a full career worker would achieve a 60 percent replacement rate when fully covered by the FDC scheme. On the basis of these calculations, the new pension legislation was believed to provide *adequate protection* and a smooth transition from the old to the new system. The government's intention was to introduce regulations to ensure full inflation indexation of pay-as-you-go benefits, in order to maintain a stable minimum benefit. The government also recognized the need to conduct ongoing analysis of the impact of the reform on benefits. It was envisaged that survivor and disability benefits would be eventually provided through licensed insurance companies, although this would not be achievable until an insurance market had developed. The government noted the need to review the procedures for disability certification. Also, the government recognized the importance of continuing to provide information to the public on the new reform, and alluded to recent concerns about the process of privatization and the stability of the banking

system as an impediment that the reform was hoped to remove with time.

- *Governmental Management and Operations.* (i) *Information systems.* The State Pension Payments Center was established as a part of the reform (the SPPC's responsibilities are enumerated above). The goal was to develop a plan to automate the calculation and payment of pay-as-you-go benefits, and generally to improve IT and communications capacity to achieve the goal of providing better information. (ii) *Monitoring and service standards.* The government's goal was to establish measures to monitor tax collection and to introduce and use personal identification numbers. Modern accounting and auditing standards and a yearly, independent audit were to be introduced to monitor the business of the SPPC. In addition, a management information system (MIS) would be introduced at the SPPC to monitor revenue receipts and participation in the FDC and PAYG schemes. The MIS would be implemented by mid-year 2000.
- *Legal Institutions and Regulatory Framework.* The goal of the government was to establish training in pension fund and asset management, and institute programs for the NSC, NBK and NPA staff in making rules and performing regulatory duties. In addition, there remained a need to specify annuity products in the new system, and to adopt regulation for insurance companies regarding payments of these. The performance of the system would be monitored through quarterly reports to be developed by the NSC, the NBK and the NPA

5.9 The PRAL included three tranches of US\$100 million each. There were 19 conditions to be met prior to Board presentation, eight conditions to be met for the second tranche and nine conditions for the third tranche. The loan became effective in June 1998 and closed on June 30, 2001, one year later than scheduled. The third tranche was cancelled, because the government did not meet two tranche conditions: 1) an annual audit of the SPPC, whereas only an audit (for 1998) was performed, and 2) the issuance of 3-year or more inflation-indexed government bonds, which turned out not to be needed because a favourable development of oil revenues left the government without a need to borrow. The government did not request a waiver for these two conditions.

5.10 **Summary Evaluation of the Objectives of the PRAL.** For each of the four areas of the PRAL, one can ask, to what extent were the objectives met?

- *Macroeconomic stability and structural reform.* Tax and revenue collection was definitely strengthened. However, a government body to make long-term actuarial projections was not established. Continued privatization with listings on the Kazakhstan Stock Exchange has been weak and a private insurance market and emergence of a strong insurance industry has not happened at all. On the other hand, government borrowing instruments have developed, and there is a blossoming mortgage market and hopes for advancements in bank lending to private business.
- *Social protection and public information.* On the basis of the government's calculation that a full-career worker would receive a replacement rate of 60

percent, it was concluded that coverage would be adequate. As we will return to this topic below, one of the major remaining issues of the reform is coverage of persons with non-steady careers and women, who together constitute more than half the population. It was believed that survivors and disability benefits would eventually be provided through private insurance companies. This has not happened. The government has accomplished the objective of providing information to the public. The public is well informed, and accepts the principles of the reform.

- *Government management and Operations.* All of the objectives of this component were met.
- *Legal institutions and regulatory framework.* These objectives have been and/or are in the process of being met. Legislation for the financial account scheme has been further developed since 1997; institutions have developed and are manned by trained and skilled staff. The process of regulation and supervision is still evolving, and is planned to be consolidated into a single agency in 2004, although some functions will remain at the NBK. Here it must be noted that it remains to decide and legislate on the provision of annuities in the new financial scheme. This is a major outstanding issue of the reform

5.11 **The PRIL.** In 1998, upon the request of the government, a loan for a Finance and Development Project was restructured, reallocating funds for stock market development, pension reform and modernization of the tax administration. This restructuring reflected new priorities for the government, in line with the Bank's 1997 country strategy. US\$12.7 million were allocated to the Pension Reform Adjustment Loan (PRIL).

5.12 The objectives of the PRIL covered six areas: (1) a macro-economic policy component, (2) a regulatory structure component, (3) a public administration component, (4) an information technology component, (5) a public information component and (6) a project administration and management (PCU) component. The PCU was placed at the MLSP. The PCU was staffed with local experts who were supported by the international TA. The focus of the PCU was on development of programs to support the PRAL, which was beneficial for the pension reform, but unrelated to the PRIL.

5.13 Only US\$2.46 million of the loan was disbursed, mainly for TA to support the implementation of the PRAL, and for goods and operating costs of the PCU in the MSLP. On the one hand, the two main pension administrations, the SAF and the SPPC, began immediately to work outside the project and were self-financing. On the other hand, the policy development, the regulatory structure and public information components went forward with a combination of grant and government budget funds.

5.14 The limited disbursement of money made available through the PRIL reflected the government's change in policy with regard to the use of TA. The PRIL was used to a great extent in assisting the government in meeting the second tranche conditions of the PRAL. Although the individual objectives of the PRIL were met largely using other means, many of the policy refinements of the pension legislation came about as a direct result of the PRAL and PRIL Bank teams working on supervision missions.

5.15 The outcome of the PRIL in terms of the loan objectives was affected by a) three changes of ministers and deputy ministers in the projects three years of operation, which caused project delays; b) a government pronouncement that it would no longer borrow for TA and c) all ministerial spending, including spending from loans, was taken under the control of the yearly budget, meaning that each year's spending had to be programmed into the budget before the MLSP could proceed with any procurement. What's more, initially, the government's tight deadlines forced the establishment of the pension administration before the project could provide the right level of introductory TA.

5.16 The Bank's strategy as of 2001 was not focused on pensions. In the area of social services and social protection, the Bank focused on the policies to improve the protection of the poor by developing work programs, better procedures for licensing local businesses, an adequately funded and well-targeted safety net and the government's capacity to evaluate and monitor poverty data.

5.17 Pensions were addressed indirectly within the context of issues and strategies for the new financial account scheme. The Bank intended to assist the Government in designing and implementing a program to manage state assets by restructuring and privatizing of Blue Chip companies through the sale of residual State shares, a divestiture program for other large enterprises and accelerated sales of municipally-owned companies. Success in this area would have increased the scale of operations on the Kazakhstan Stock Exchange. To date, the Kazakhstan Stock Exchange deals almost exclusively in bonds and foreign exchange, as has been discussed above, and experts are generally pessimistic about the prospects for the rapid development of an equity market. One important reason for this is that large private borrowers are using the bond market, rather than issuing equities.

6. Performance Evaluation

Outcomes

Overall Objectives

6.1 The main objective of short-term pension policy up to 1997 was to bring expenditures into line with what was affordable. The Bank's 1994 Economic Report on Kazakhstan (see above) outlined the following strategy. For the short and medium term the objectives should be to:

- compress existing pensions into an affordable flat rate benefit;
- reduce the number of pensioners by cutting back on special rights and increasing the pension age;
- create an efficient administration of benefits and contributions; and increase compliance.

In the long-term the Bank recommended

- creating a dual system with a minimum basic benefit combined with an individual financial account scheme. The latter would create a link between contributions and benefits, and help promote a change in philosophy to one of self-reliance.

6.2 The Kazakh pension legislation that was created in 1997, in the complete absence of involvement of international organizations, was designed primarily to fulfil the objective of creating an individual financial account scheme.

6.3 The government and the Bank agreed on the following objectives:

- Provision of adequate retirement income for old-age pensioners.
- Provision of a minimum standard for old-age pensioners.
- Achievement of a financially stable pension system.
- Development of the financial market, institutions and instruments through the mandatory financial account scheme.
- The fostering of greater individual responsibility in providing for their own social protection.
- The reduction of the cost of financing social policy placed on business.
- The improvement of regulation of financial institutions.

6.4 Presently, benefits are still largely determined by the old formula. In addition, there is a minimum benefit, which was a feature of the reform pushed hard by the Bank, and the minimum benefit has been increased annually since 1998. Although there is poverty among pensioners, poverty among pensioners is not greater than poverty among other segments of the non-pensioner population, including families with many children, and poverty among pensioners has not become worse since 1996,

in fact it may have improved.³⁴ In this sense benefits appear to be “adequate” in the short and medium term, especially since policy was driven through 1998 by a need to bring financial balance into a system that had collapsed in the initial half of the 1990s.

6.5 The condition of adequacy is not likely to be met in the three or four decades, however, under the present reform legislation. Both external experts, including the Bank in the analysis underlying the PRAL, and domestic experts have expressed concern that the financial account system is not likely to provide adequate benefits in the long term for a large number of persons, especially persons with disrupted careers and women, contrary to the view held by the government when the reform was legislated. This is discussed in more depth below under the heading of relevance.

6.6 The reform achieved financial stability. The increase in the pension age and reduction in special privileges are two major factors that yield this result, although the pension age of women is still too low, which is one of the reasons why women can be expected to have poor benefits in the future.

6.7 The financial account scheme is stable by definition. The pay-as-you-go scheme will be scaled down to the level required to finance the minimum benefit. Since this benefit may not be sufficient, improvements aimed at creating adequacy will probably entail less of a cut in the PAYG component(s) than originally envisaged. There is no reason why new components to create greater adequacy cannot be introduced in a manner that maintains long-term financial stability.

6.8 The financial account scheme certainly fulfils the aim of fostering individual responsibility. It presents a clear message that benefits are linked to payments. People appear to be well-informed and understand the implications of this message, and the data indicates that compliance has increased dramatically, although certainly also owing to greatly improved administration resulting from the institution building pushed forward by the reform. In addition, the direction of the reform has been to reduce the social tax burden on employers, and shift it to employees, also fulfilling the objectives set out in the PRAL.

6.9 A clear success of the reform is the development of financial market institutions, financial know-how and financial instruments, and this would not have occurred without the pension reform as a vehicle for development. The immediate results are the development of a domestic mortgage market, and the foundation is there for banks to intermediate and transform saving created by the pension reform into loans for small business projects. This can be accomplished as today through fund purchases of bank bonds. There are other mechanisms for accomplishing this, too.

6.10 To date, the NBK has been the main supervisor of the financial market in Kazakhstan, de facto. Many of the functions of supervision are to be moved to a new consolidated financial market supervisory agency during 2004. The NBK has also functioned as a training school, so it is arguable that if the creation of this financial supervisory agency in 2004 “simply” entails moving trained staff over to the new agency, a process which should go smoothly.

³⁴ Sabit Khakimzhanov and Kairat Mynbaev, *Old Age Poverty and the Pension System in Kazakhstan* 2001, July 7, 2003, processed by the World Bank.

6.11 In sum, the objectives of the Government, as supported by the Bank, have been fulfilled, viewed in the short term. Yet, it remains to specify changes that will lead to more adequate coverage for the whole population from the medium to long-term. Also, the nascent institutions of the financial market need to develop further, and financial supervision and regulation still needs to become more independent from the central bank.

Relevance of Objectives

6.12 The government's policy evolved in a logical sequence, focusing first on measures to improve short-term affordability following the extreme drop in the contribution base in the first half of the 1990s, then on measures to address the structural problem of too many "young" pensioners by reducing special privileges and increasing the pension age, and on creating a sustainable pension system in which the state pays a minimum, basic social security pension out of general budget revenues or payroll taxes and individuals supplement through savings in a private scheme. These objectives are all relevant and were supported by the Bank, and, in fact, coincided with the objectives set out in the Bank's 1994 Economic Report on Kazakhstan³⁵ (see Section 3 above). They have all been achieved.

6.13 The financial account system is in place and running smoothly. The first grants from the financial scheme have been lump sum payments, because of their small size. New pension grants are still based largely on the old pay-as-you-go formula, for many with a recalculation in 2003, and/or the minimum benefit. The new financial scheme will gradually increase in importance, and for this reason it is becoming critical to resolve the issue of what annuities are to be offered and how they will be provided, and, once again the issue of adequacy needs to be revisited soon.

6.14 The financial infrastructure has developed rapidly in a relative short span of time. Problems in the original legal structure governing the financial account scheme have been identified and remedied, and necessary changes were introduced in 2003. The pension funds and asset managers have been in operation for over six years and are manned by well-trained staff. Financial instruments, especially bonds, have developed, as have skills in working with these. Other institutions and financial instruments are emerging.

6.15 Initially, there were high hopes that the pension reform would spur development of the equity market. This has not occurred, and the near-term prospects do not look so hopeful. Big borrowers have preferred to issue bonds or access capital outside the equity market, and with so few big traders, the holdings of equities are viewed as being hard to trade.

6.16 A major accomplishment was the creation of The SPPC, beginning in 1998. The government borrowed to finance commitments to individuals supported by unpaid arrears of employers, and all benefits payments have been paid on time since 2002. The administration of contributions and payment of benefits improved dramatically compared to the pre-reform years. Collection of social taxes has been put under a single roof with the collection of other taxes. Benefits administered by the

³⁵ Kazakhstan Economic Report. Volume 1: Main Report no. 12856, July 7, 1994, *op. cit.*, pp 21-22 and Volume 2: Annexes pp 78-80.

State Pension Center are now paid through the banking system, and individuals receive transaction statements.

6.17 Unique individual identification numbers were introduced for working age persons. From 2005 even all benefit recipients will be required to have an identification number to receive a benefit.

6.18 A modern accounting system has been installed and is in use. Information is provided by the SPPC to the offices of the MOLSP, MOF and President's office on a monthly basis, and electronic reports are exchanged with the tax authorities. Internal system audits are performed. A recent internal audit of about 90,000 cases in 2003 revealed mistakes in only 0.17 percent of the audited cases.

6.19 It is likely that the increase in compliance that has occurred since 1998 is at least partially a result of the more efficient administration, although it is arguably also due to the design of the new pension reform, and the information campaign around this.

6.20 *Outstanding issues.* In spite of the major accomplishments, there remain four important outstanding issues. The first is the adequacy of benefits. The second is the investment opportunities and returns on funds. The third is the absence of an annuity market. A fourth, technical issue, is the question of how to provide cost-effective accounts for the entire financial system.

6.21 The first major concern of analysts, both domestic and international (IMF, World Bank, ADB, USAID) is the future *adequacy of benefits*. At the present scale the system will provide very low benefits for well over half the population in the not so distant future. These are persons with broken careers and sporadic wages, but also women in general, given current work patterns and wages. Implicitly, well over half the population will be reliant on the minimum benefits with the present overall system design. Table 6.1 provides estimates assuming a 5 percent real rate of return during the accumulation phase.

Table 6.1: FDC Replacement Rates

	<i>Replacement rate</i> <i>(on retirement/at time of death)</i>	
	Men	Women
20 covered years	23/14	11/6
30 covered years	33/20	17/8
40 covered years	45/27	22/10

Source: Kazakhstan. Selected Issues and Statistical Appendix, IMF, 2003, p. 56. The table is based on World Bank staff calculations.

6.22 Since rights are not accrued in the pay-as-you-go scheme from 1998, the scale of that scheme is gradually decreasing, as has already been discussed above. At the same time, the scale of the FDC scheme is inadequate with a contribution rate of 10 percent and a real rate of return of five percent or less even for the career worker with 40 years of coverage, and only a small portion of the population, mainly male career workers, can be expected to achieve a replacement rate at retirement of 40-45 percent. If the picture for women presented in the above calculations were to become reality, well over half the population will have a replacement rate of 20 percent or less at

retirement. A remaining problem is the low pension age of women at 58, which affects the size of an actuarial benefit through life expectancy from retirement.

6.23 A second issue is the return on funds. In the loan documentation for the reform, a replacement rate of 60 percent was foreseen for the new financial account scheme. Table 6.1 illustrates the importance of a high rate of return, even with many years of work.

6.24 Two of the claims frequently made in conjunction with the return on funds are that there is too much money, and/or too few domestic investment opportunities. A major reason why the return on funds is presently low is that the real rate of return on state securities, which by law comprised at least 35 percent of portfolios in 2003, is low. Funds had much larger shares of their portfolios in securities, however, so the overall impact of low real rates of return on government securities has been considerable. In 2003 the average rate of inflation was 6.8 percent and the rate of return on government securities 6.20-6.50 percent, which yielded a negative return.

6.25 The decrease in the required holdings of government securities to 25 percent from January 2004 may help somewhat if funds divest themselves of government securities, although this may be difficult to accomplish in the short run, since the funds themselves are the major financial players in the country.

6.26 There is a clear conflict of interest between the NBK's and government's interest in keeping the borrowing rate low to stimulate investments in the economy, and the pension system's need of a high real rate of return. It is not in the interests of the country to provide government securities with real rates of return of five percent or more, so pension funds will have to find other alternatives, logically in domestic and foreign equities. On the other hand, investments that offer a higher return also bring greater risk and volatility to the financial pension system. This raises the question of whether it is prudent to have such a large percentage of an individual's pension based on the outcome of the financial market, and in Kazakhstan's position, a significant exchange rate exposure. This means that exchange rates and the government's exchange rate policy will also affect returns on pension funds. To date there is no analysis of this problem and its possible consequences.

6.27 The third issue is that there are presently *no annuity providers, and no legislation or regulation on annuity provision*. Benefits paid out from the FDC scheme are presently so small that they can be paid out as lump sums; however, this will begin to change soon.

6.28 Given the very small scale of the market, there is little incentive for annuity providers to enter, or for the small nascent insurance industry to develop annuity products. On the other side of the coin, when annuity providers do enter, with a small market, the cost of operation will eat up an unduly large percent of the pensioner's accumulated capital. Operations will be expensive per customer, and with few annuity customers, companies will have to worry about adverse selection and will in general have reason to be conservative on mortality estimates, all of this at the expense of beneficiaries. Given typical insurance products, this suggests providing phased withdrawals to avoid expensive annuities. However, a phased withdrawal means that the beneficiary is no longer covered after the contracted number of years, leaving

many with no coverage in extreme old age. There is a critical need to address and resolve this problem relatively soon.

6.29 A final issue is that the *administration of the APFs* is unduly expensive due to inadequate coordination of individual account data. In addition, the software used by the individual funds, which is pre-1998 software from Chilean adapted for use in the Kazakhstan setting is outdated, difficult for local IT expertise to work with and, for these reasons, needs to be replaced. A clear way forward is to replace individual fund accounting systems with a clearinghouse for all accounts. There is presently a discussion in Kazakhstan to this effect, although the issue needs to be brought up to the policy level.

6.30 The Kazakh reform evolved extremely fast in 1997 and, in the initial stages, in the absence of advice of the World Bank or Asian Development Bank, or for that matter, apparently, any other international organization. The World Bank, the ADB and USAID all decided to support the reform and offered technical and financial assistance for its implementation. The activities and involvement of these three major international players were coordinated, and all were relevant for achieving the objectives set out in the PRAL.

6.31 The primary objective of the Bank's lending activity and technical assistance since 1997 has been to support the implementation of the new financial defined contribution pension system. World Bank documents from recent years discuss the issue of adequacy of benefits, but do not suggest alternative ways forward. Likewise, the annuity question is frequently noted by the various players as a crucial issue to resolve. In spite of this unfinished business, the Bank's country strategy has no reference at all to the pension system.

6.32 The measures applied to achieve the immediate objective of implementing the new pension system and creating an efficient institutional infrastructure for this purpose were timely and relevant, and the objectives are consistent with the country assistance strategy as set out already in 1994 and as expressed in later Bank documents. The long-term objective of providing adequate benefits needs to be revisited, however. Therefore the rating on relevance of objectives is *substantial*.

Efficacy of Objectives

6.33 Kazakhstan's pension reform was a major accomplishment, and with its implementation in 1998, Kazakhstan became a leader in the region. The accomplishments include the pension reform itself, the development of legislation, the development of public and private institutions needed to operate and oversee the new pension system, strong progress in developing the capital market and creating public awareness and acceptance of the reform and its underlying principles.

6.34 The new pension system introduces a system of forced saving that can be translated into productive investments in Kazakhstan. To the extent that the reform leads to investments in human and physical capital that otherwise would not have arisen, it will foster economic growth and increase the income of the population. If this occurs, then an expected result is that per-capita incomes and overall welfare will be higher than in the absence of the reform.

6.35 Higher per-capita income and welfare are general objectives. Was the policy successful in meeting its more specific objectives? There are two answers, a short-term answer and a long-term answer.

6.36 The short-term answer is, yes, policy was successfully designed to meet the objectives in the short and medium-term. First, pre-reform policy was directed at compressing benefits to create a *de facto* flat rate benefit prior to 1997, easing the pressure on dwindling revenues. Second, the reform legislation of 1997 succeeded in improving the system dependency ratio and with this affordability. This was accomplished by reducing the number of special privilege pensioners, increasing the pension age and improving compliance. The latter appears to have occurred as a result of improved administration, an important means of achieving the objectives, but is also arguably a result of the introduction of the contribution-linked FDC scheme – with the message that rights would no longer be earned in the PAYG scheme from 1998. Overall, the pay-as-you-go system was brought into financial balance, the costs for the government budget have fallen and the social taxes (“demands”) levied on business have been reduced.

6.37 Was short and medium-term financial balance achieved at the expense of adequacy of benefits? Benefits kept up with inflation from 1998, but fell behind the development of real wages, which caused the macro ratio of the average benefit to an average wage to fall after 1998. The radical improvement in the system dependency ratio from 1998 to 2002 together with the strong increase in real wages helped to ease the pressure on finances, creating scope for a considerable *ad hoc* improvement in benefits, which the government did in June 2003. The recalculation in 2003, improved benefits overall by 22 percent, with the improvements skewed in favour of lower income pensioners due to the cap for benefits subject to recalculation.

6.38 The high level of development of institutions in the public and private sectors achieved in relatively a short time span is impressive. Although there is always room for improvement, the overall operations of the financial institutions and the SPPC are modern and efficient, and ministerial competence in the area is high.

6.39 The NBK has retained a tight reign during the initial stage of development, which overall appears to have provided a guarantee for the development of nascent institutions in an environment where corruption is otherwise a recognized problem. Also, there is considerable evidence that the reform has been instrumental in developing an individual philosophy of self-reliance, moving away from the environment of reliance on the state carried over from the Soviet era.

6.40 The failure to create from the outset an overall system that would provide adequate benefits to all the population was certainly a function of the speed of the reform process, and the fact that the reform was as much a tool for developing the financial sector as for providing pension benefits. As a result, not enough attention was devoted to developments of the system that would assure more adequate general coverage of the population. On the other hand, the transition into the full-fledged mandatory FDC scheme is long, and system deficiencies can be reduced, given a renewed effort focused on doing this.

6.41 One of the objectives of the PRAL was to establish a government actuarial body. The purpose of such an agency would be to provide professional calculations

regarding the financial status of the system, and the expected results for participants as the system develops. This makes the system transparent, and affords the possibility to consider possible adjustments in the system. This agency was not established.

6.42 In sum, the objectives have been achieved in the short-term. Nevertheless, there remain three problems: a) There is a conflict of interests between keeping Kazakhstan's borrowing rate low to provide finances for the country's infrastructure and to encourage the development of business activity, and securing a high rate of return on pension funds, given the present portfolio "bias" towards domestic securities; b) large segments of today's working aged population will have very poor pensions in the coming two to three decades, namely persons with sporadic contributions, which is a likely result of the transition process from agrarian to non-agrarian economic activity, and, according to World Bank calculations (Table 4.1) women; and c) there is no mechanism for converting some of general economic growth into better pensions outside the framework of the financial account scheme, *i.e.* other than through the improving wages (and contributions) of FDC scheme participants. The second and third problems, as well as possible solutions, are related.

6.43 The overall rating efficacy is *substantial* on the basis of the long list of accomplishments. A higher rating would have required a system design that from the beginning addressed the outstanding problem of long-term adequacy.

Efficiency

6.44 It is impossible to compute a rate of return on a project of this nature. What can be said is that the likelihood of sustainability is high and the accomplishments are important both for the future framework of pensions and the development of the financial market. The accomplishments to date are also likely to improve the overall functioning of the economy, and, thus, will contribute to general growth and prosperity. Efforts among lenders were well coordinated so as to complement each other thus it is reasonable to set a **rating of substantial on efficiency**, too.

Outcome

6.45 Further work must be done to resolve the issues affecting adequacy. Presently, this shortcoming has only a small effect, if any, on new grants, since benefits are still based largely on the PAYG formula. What's more, there is a minimum guarantee that has been improved annually since 1998. However, to the extent that a large segment of the population is insufficiently covered, there is a problem emerging that has to be dealt with. This issue is recognized by the government, and work will be done to address the problem.

6.46 The pension reform is a major achievement. In addition, some very difficult political decisions were taken, such as increasing the pension age and discontinuing a large number of special privileges, both of which are normally very unpopular. The project has achieved a large number of relevant objectives, and some of those that have not yet been achieved are likely to be achieved in the not so distant future. For example, the financial market and financial instruments will continue to develop, and a unified regulatory agency will emerge. On the basis of the large number of achievements, **the outcome rating is satisfactory**.

Institutional Development

6.47 The pension reform was and is a component of an overall effort to shift the focus from state to individual responsibility. The introduction of a pension system that links benefits directly to contributions was an appropriate instrument for promoting this process. The changes coming with the pension reform signalled a change in the rules of the game. The focus has been shifted from benefits to work, and now that the overall pension system has been working and delivering benefits for several years after the reform, confidence in the system has improved. The public is aware of the principles of the reform and accept the change in direction.

6.48 The pension reform was the initiative of the Kazakh Government, and the Government has driven the process from the very beginning. Government ownership is complete, and pension funds and asset management companies are certainly strong supporters of the reform, by definition. The pension reform affects all segments of the financial sector and, as has already been discussed, has contributed to rapid institutional development of the financial market. The reform also brought development of the SPPC, and improvements in the institutional framework around collecting contributions and paying benefits.

6.49 Present discussions about the reform are about how to move the reform forward by improving its content. The biggest challenge is to consider how to deal with the projected low replacements rates for a large segment of the population. The problems have been identified and have been known for some time, what remains is for the government to organize a new effort around finding solutions to the remaining that are suitable for Kazakhstan.

6.50 When the reform process was in its most intensive phase supported by the Bank through the PRAL and PRIL, with additional substantial aid from the ADB and USAID, technical assistance in actuarial calculations and modelling was provided. Even if the present system had no shortcomings, it would be important for the government to analyze and publish the results of analysis of the pension system, which is not presently done. This would have been the function of the actuarial body that did not get established.

6.51 Presently, the Ministry of the Economy (MOEBP) is responsible for long-term calculations in Kazakhstan, but the responsibility for the calculations for pensions is with the MOLSP. The analysis group at the MOLSP has continued to use the Bank's PROST model, but only for demographic projections. It performs the basic financial calculations without the use of this or a similar tool. The MOLSP submits its calculations to the MOEBP as an input in their decision process.

6.52 Given the shortcomings of the present system, there is a more fundamental need to develop analytical capacity with the goal of further developing the mechanisms to improve overall pension coverage. During the course of the evaluation it became clear that more technical assistance would be welcomed to move forward with new analysis. This is an indication that the process of transferring analytical skills to the Government was incomplete.

6.53 **The overall institutional impact rating is *high*.** The new financial account pension system has already established itself and will establish itself remain an

important component of the overall pension system, although amendments to the overall system have to be made to improve adequacy. The governmental and financial market institutions that have developed through the vehicle of the pension reform will make a critical contribution to the country's ability to use its human and financial capital, and its natural resource endowment.

Sustainability

6.54 The principles of the reform and the new financial pension scheme have become well anchored in the eyes of the public. The governmental and financial institutions supporting the pension system are functioning well, and there appears to be broad political support of the reform. Also, measures undertaken to date have created a financially sustainable system, in fact the major worry for the future is that not enough will be spent on pensions. For all of these reasons, even though the reform only has a few years of operation behind it, it is safe to say that the likelihood that the reform is sustainable is very high.

6.55 The issues that remain outstanding, *i.e.* adequacy, portfolio investment policy and the creation of annuities, are all vitally important for the long-term success of the system. These could all be viewed as risks in the sense that if they are not solved satisfactorily they could undermine the system.

6.56 The question of adequacy has to do with a) the overall scale of the system; b) the pensions of women, and c) establishing rules around the guarantee, taking into consideration other government support systems for the elderly, in order to provide an integrated policy approach to the provision of benefits and services. The latter would provide the safety net for persons whose careers are disrupted due to the transition process and the conversion from informal or semi-formality to formality in the economy.

6.57 Overall system adequacy, the scale of the system and portfolio options of pension funds are interrelated issues. The major risk for the system would be a scenario where the pension funds consistently produce low rates of return, together with continued downsizing of the PAYG system, combined with poor pensions for women. On the other hand, there is no reason why adequate solutions should not emerge, once the government begins to deal with them. The aim of the next step in reform would be to move forward on the outstanding issues, in order to assure that the system delivers both financial sustainability and benefit adequacy.

6.58 **Overall sustainability is *highly likely*.** Kazakhstan can afford to finance improvements that lead to improved adequacy, and the government has expressed its intention to seek solutions. It is likely that the development of the domestic financial market will continue, broadening opportunities for domestic investments. At the same time it is possible for funds and asset managers to acquire skills in working with international portfolios with the aim of achieving higher returns on funds. The government is committed to the new system, as are the other institutional stakeholders, which provides the right environment for agreeing on and making the necessary changes.

7. Attribution of Results

Bank Performance

7.1 Bank performance is evaluated in terms of quality at entry (project concept, technical aspects, poverty reduction and social aspects, institutional aspects, financial management aspects, readiness for implementation, and assessment of risk and supervision) and supervision (focus on development impact and adequacy of supervision of inputs and processes). These are discussed separately.

7.2 *Quality at entry.* The pension reform was driven by the government as a part of its strategy to develop financial markets. It emerged on the agenda in early 1997 with no apparent consultation with the World Bank, Asian Development Bank³⁶ or other international agency. The proposed pension reform was not in conflict prescription in earlier bank documents, especially the 1994 Economic Report on Kazakhstan, however, there was little written explicitly in World Bank documents on pension reform and lending for pension reform was even viewed as marginal. However, upon the initiative of the government, a relatively large loan, the PRAL, was negotiated.

7.3 The reform was likely to have gone on without the support of the World Bank or other international agencies. The Bank's efforts focused on the implementation of the reform, rather than the design. Although, according to Bank sources, the minimum guarantee became a part of the reform package as a result of the Bank's entrance into the reform process. The Bank performed financial analyses of the reform, and even an analysis that explicitly points out the problems women and persons with disrupted careers would likely have in the new system. As has been discussed above, the objectives of the reform were generally in line with the philosophy of the Bank's strategy, including the focus on development of the financial market. So, in this sense, the Kazakh pension reform was on course.

7.4 The late entry of the Bank combined with the speed of implementation decided by the government made it difficult to realize the physical investments. The intention was that the equipment for the new pension institutions would be purchased through a Bank loan. In practice, all the institutions bought equipment using their own resources. In part, this can be attributed to the urgency that was attached to getting the system started according to schedule, while at this time the Bank took too much time in processing the loan intended to be used for this purpose. When the loan eventually came through, it was no longer needed.

7.5 Considerable staff time went into the identification/preparation and appraisal/negotiation phases but was reasonable given the scale of the PRAL. The technical assistance provided under the umbrella of the PRAL was comprehensive, encompassing:

- I. Macroeconomic, Sectoral and Structural Policy
 - Actuarial Modelling
 - Data Base Development

³⁶ ADB Program Performance Audit Report, op. cit. page 2.

- Insurance Law and Regulations
- II. Structure of Pensions and Public Information
 - Socio Demographic Studies
 - Disability Assessments
 - Public Information
- III. Regulatory Structure
 - Training program
 - Reviewing regulations
- IV. Human Resources
 - Establishing job description and pay scales
 - Establishing training programs
 - Training the trainers
- V. Public Administration and Software Development
 - Redesigning administrative practices
 - Establishing business practices
 - Developing software
 - Establishing training programs
- VI. Information technology – Implement broader IT and communication network
- VII. Security – Implement physical and electronic security systems
- VIII. Project Management

7.6 All of these items are relevant undertakings in a large institutional development project designed to establish and develop private and governmental institutions involved in a pension reform as ambitious as the Kazakh reform. What appear to be missing, at least in the official documentation surrounding the project, are measurable outcomes and a follow up to determine whether these were met. This would certainly be a help for the Bank in evaluating in greater detail the factors leading to relative degrees of success of project components, which, in principle, could provide guidance in new projects and in the skills of the World Bank staff in developing and managing projects.

7.7 Not all of these tasks were completed, as is indicated by the fact that the third tranche of the PRAL was allowed to expire. Moreover, it is impossible to perform a detailed cost-benefit analysis of a project of this nature. However, the implementation of the Kazakh financial pension reform was successful, the technical assistance provided under the PRAL to build up institutional capacity was a part of generating the success, and on the basis of this the overall benefit to Kazakhstan was large. The quality of the Bank assistance was also confirmed by discussions with government officials involved in the process.

7.8 In sum, although the Bank was apparently dormant in the initial design discussions, the Bank did pinpoint the more important potential shortcomings of the reform design in the analysis for the PRAL. The technical assistance that was provided was significant, and in addition, it was well coordinated with the activities of

the ADB and the USAID programs. Once the intentions of the Kazakh government were known, the Bank responded quickly and with considerable support. In addition, these ambitions were largely in line with the previous recommendations of the Bank. **The overall rating for quality at entry is thus *satisfactory*.**

7.9 *Supervision.* **The overall rating for the quality of supervision is *satisfactory*.** Taken as a whole, the reform presented a large number of challenges in a broad range of areas, from system design, to development of financial institutions to development of governmental administrative and analytical capacity. The points in the PRAL are all necessary for the type of reform implemented in Kazakhstan. In this sense, problems were identified in the project assessment phase and the Bank's technical assistance was designed to work with the challenges presented by each point. The Bank followed up the project on a regular basis through December 2000 under the umbrella of the PRAL.

7.10 The major shortcoming of the project is the question of adequacy. This problem is discussed in recent documents from the World Bank, the Asian Development Bank and the IMF, and is a topic of discussion in the government. In this sense, the reform is unfinished, but the ball is still in play. Likewise, the questions of annuity provision and the question of whether to create a clearinghouse are questions discussed among the relevant actors. In other words, the unfinished business is recognized, and the government intends to address them. Another shortcoming of the overall project was that an official actuarial body was not established. On the other hand, the project led to the development of skilled analytical capacity at the MOLSP, although the PROST model fell into disuse, and was not replaced by a similar tool. Nevertheless, during the course of evaluation, the Minister in responsible for the MOLSP expressed a need for additional assistance to develop capacity.

Borrower Performance

7.11 Borrower performance is rated according to preparation, implementation and compliance.

7.12 *Preparation and implementation.* The reform design originated with the government, and in this sense, the government had set the goal. The preparation phase prior to implementation was extremely short, perhaps around half a year. As a result, most of the preparation occurred during the implementation phase.

7.13 Generally speaking, it is difficult to draw a definite line of demarcation between preparation and implementation for a project of this kind. A project of this kind requires most the components comprised in the PRAL. The question becomes rather, how much of the infrastructure should be in place prior to the implementation of the reform, and how much can be a part of the implementation process itself? This depends on the weight attached to the risks involved in developing the infrastructure largely after the date of implementation.

7.14 The answer of how large a weight to set on the "risk of confusion and mistakes" depends on the country environment. Still in the second half of the 1990s, public – and hence political – tolerance for "bureaucratic confusion" was high in transition countries. The entire transition period up to 1997-98 had been riddled with disorder. In fact, the entire Kazakh project involved creating a modern, well-

functioning market-based infrastructure where this did not previously exist, and could be viewed as a project to create order where it did not previously exist. For this reason, the “weight” of the risk of confusion and mistakes in the transition development environment is lower than the weight one would set in more developed non-transition environments.³⁷

7.15 If there is little or no infrastructure in place prior to implementation, as in the case of Kazakhstan, one should expect confusion and mistakes during the initial period of implementation, but also public tolerance for this.

7.16 In principle, the question that should be asked *ex ante* is not whether problems, including serious problems, will arise, but first, what are the risks involved if they occur and how can they be managed, and, second, are the known risks so great that they will jeopardize the overall success of the project? The latter should steer the line of demarcation between preparation and implementation. *Ex post*, one can ask whether the risks were foreseen and managed well, and whether poorly managed risks reduced the value of the outcome.

7.17 The IT component(s) of a project of this kind is(are) definitely the major implementation challenge(s).³⁸ There were two software components in the Kazakh project that involved large risks in the sense that they could have jeopardized the success of the project. The first was the IT software for the funds, and the second, the software for the SPCC, since contributions are channelled through it.

7.18 The first risk was managed by adapting technology already developed in Chile, an initiative that was taken by the borrower. The second risk was managed as an implementation component under the PRAL. Since this involved the development of a new organisation encompassing more than the financial account scheme, new software etc. it was reasonable to expect problems with such a short time span between the passage of legislation and the date of implementation. In other words, some degree of confusion was to be expected, and occurred, but this was clearly a calculated risk, and the value set on the risk should be seen in the development setting just described. Viewed *ex post* the infrastructure in the overall system was functioning smoothly by 2003, in a short time span of five years after the inception of this far reaching project.

³⁷ The rapid implementation projects typical for transition countries in the 1990s can be compared with the implementation project in Sweden. The entire IT project for the overall Swedish reform replaced an outdated structure (for all of social security) and took over two years to develop from beginning to end. In addition, new legislation took much more time to develop because of a desire not to unconsciously create losers in the construction of transition rules. The development of the IT procedures had to wait for this arduous legislative process to come to its conclusion. As a result legislation largely passed in 1994 took until 1999 to implement institutionally. However, once the new system was implemented, there were no setbacks, and business went on as usual the day before and after.

³⁸ For example, the introduction of Sweden’s new mandatory individual financial account scheme was delayed by a year when a contract with an international software supplier had to be cancelled, and a (much less expensive) in-house solution was developed instead. Implementation of a similar scheme in Latvia was impeded by the inadequate performance of the international software contractor, but nevertheless several years after the start up of the State Social Insurance Administration and the consolidation of revenue collection at the State Revenue Service. In the end, software for the financial scheme was adapted Estonian software developed locally for the Estonian scheme. On the other hand, the Polish financial account scheme was implemented on time, but was burdened by (indigenous) IT problems for several years, and this created considerable political repercussions.

7.19 Summing up, a longer preparation phase might have led to a better use of resources during the implementation phase. On the other hand, much preparation occurred *de facto* during the implementation phase. ***Borrower performance in preparation prior to and during implementation was satisfactory***; all the components of a successful project of this scope were identified, with the assistance of the Bank and other international agencies. Judging from the outcome, ***borrower performance in the implementation phase was highly satisfactory***, in terms of the development of relevant institutions, and is clearly the accomplishment of the Kazakhs.

7.20 *Compliance.* Borrower compliance to loan conditionality was satisfactory, as has already been discussed. However, as has also been discussed in a previous section, the technical assistance provided was not used optimally due to delays introduced directly or indirectly by the government. Of course, this was to the detriment of the borrower, since money borrowed could have been used more efficiently. Although formal compliance to lending conditions was high, the borrower could have made better use of borrowed funds and gotten more out of the project, and for this reason, ***compliance was satisfactory***, but not highly so.

7.21 The government's solicitation of the large amount of technical assistance for the overall implementation project attests to its commitment to the goals of the project. In fact, the fact that the government is still soliciting international technical assistance attests further to its commitment. The major deficiencies, given the goals of the project, are the failure to devote more attention to design issues that influence pension adequacy, and the development of annuities. These deficiencies are recognized, and are likely to be dealt with soon. In sum, ***the overall rating for borrower performance is satisfactory***.

Coordination with Other Agencies

7.22 The World Bank worked together with the IMF, the Asian Development Bank (ADB) and USAID in different phases of this project. The World Bank team worked carefully to coordinate activities through overlapping missions during the program years.

7.23 The ADB provided a Program Loan of US\$100 million to support pension reform, and an additional amount of US\$0.68 million for country training in the principles of asset and portfolio management for the staff of the regulatory authority, and another loan of US\$ 1 million for consulting services and computer software for the NPA, training in accounting and reporting systems, training of the MOF to develop their monitoring capacity, etc. The Bank project was also coordinated with a long-standing USAID program supporting pension reform, and which has covered legal, regulatory, actuarial, and administrative TA. Additional resources were provided by the Japanese government through the PHRD program, aimed at fiscal and actuarial modelling, financial evaluation and regulatory analysis.

7.24 To date, USAID has continued with its TA to Kazakhstan, providing TA to financial institutions in evaluating risks and pricing bonds, and in portfolio management. This assistance has proven crucial and timely as various types of instruments have developed, including corporate and mortgage-backed bonds. As a result, the skills of the key institutional performers have advanced with the

development of the market, which has been a very important follow-up of the creation of institutions in the early stages of the reform.

7.25 Finally, it is important to reemphasize that it is likely that the reform would have been implemented even in the absence of the support of the World Bank or other international agencies. The international agencies were not directly involved in the formulating the reform, but once it was clear that the government intended to implement it, the World Bank, in cooperation with other international agencies, provided valuable technical assistance focused on the development of institutions. The main policy contribution of the World Bank was insuring that the minimum guarantee became a part of the reform package, and the provision of assistance in performing the financial analyses for the reform.

7.26 Summing up, the Kazakh pension reform was in line with the objectives of its country assistance strategy, including the focus on development of the financial market. To date, the development of the financial pension scheme, and with it the institutions of the financial market, appears to have been an overall success. Kazakhstan was the recipient of considerable support from the World Bank, the ADB and international donors. Judging by the outcome to date, the return on the investment appears to be good.

8. Lessons and Recommendations

Lessons

8.1 There are three main lessons from the Kazakh experience. The first is that it is important for the Bank to be on board when important policy decisions that might require Bank assistance are being formulated. Issues as significant as an overall pension reform should be easy to identify in time in the course of Bank discussions with the government. It is more difficult for all parts if the Bank enters the design discussion at too late a stage in the planning process.

8.2 A second lesson is that the training involved in actuarial modelling and policy analysis requires a major commitment from both Bank TA and the domestic counterpart. If either is absent, there will be no permanent build up in capacity. Training in this area should also be followed up with additional TA support on a less intensive basis until it is likely that the necessary level of competence has been institutionalized.

8.3 A third lesson appears to be that there could be a need consider how procurement procedures can be streamlined to better help the customer. It is not obvious why a small investment project such as purchasing hard and software to support the business of ten or twenty pension funds, and perhaps a supervisory agency, should take so much time that the client is forced to find other resources.

8.4 An observation is the fact that the USAID project has continued until the present time has meant that qualified technical assistance has been at hand even after the major projects were concluded. The nature of the assistance has changed with the needs, but the services have been there throughout. This presence has helped to foster high quality in the continued development of financial institutions, and could be seen as an essential follow-up for a project of this nature. Without this presence, implicitly, it would have been impossible for Kazakhstan to accommodate these needs itself, by contracting international assistance directly, or alternatively, for the World Bank or the ADB to have covered this area to ensure continued quality in the more advanced phases of the implementation process.

8.5 A final observation, rather than lesson, is that it would be helpful for purposes of evaluation, especially for large loans with many components, if the loan documents themselves included monitorable outcomes for individual components, and summary risk analyses.

Recommendations

8.6 The main outstanding issues identified in the course of the evaluation are: 1) adequacy of benefits, 2) the rate of return, 3) the construction of the annuity and 4) the advantages of a clearinghouse for accounting. These are discussed briefly here.

8.7 *Adequacy of benefits.* There are two issues here. The first is the adequacy of benefits for persons in general with disrupted careers, persons making the transition from the informal or semi-formal economy (perhaps from agriculture) to the formal economy during the course of the coming two or three decades. Here the solution

must lie in considering to what extent the minimum benefit will be adequate in the future, with a legislative solution.

8.8 The second adequacy issue has to do more generally with women. Three possible changes can be recommended: 1) a minimum pension age of 63 for women as well as men, 2) mandated unisex life tables in the computation of annuities, and 3) the introduction of budget financed transfers to the financial account scheme for child care years.

8.9 With an actuarial system, a low pension age for anyone is extremely disadvantageous. For women who may find leisure at a younger pension age attractive and economically feasible as long as their spouse is alive, will end up in poverty if they have to live on a single benefit claimed too early. The life expectancy of women at age 60 is presently almost 18 years (see the table in the annex). The obvious first step is to schedule an increase in the minimum pension age of women to age 63.

8.10 Many countries have chosen to mandate unisex life expectancy in the computation of annuities. Insurance companies may think this is difficult, which is one of the advantages of a single annuity provider for the whole system, to be discussed below.

8.11 A major reason for the disrupted careers of women is childbirth and care of children in the early ages. It is a simple matter to construct child care rights that are financed with general budget revenues, and which are transferred to the individual accounts of participants.

8.12 *The rate of return on funds. There is a discussion about issuing better government instruments for the funds, an example being long-term (10-15 year) inflation guaranteed or real interest bonds. The bottom line is that with interest of 1-3 percent on government securities, the return on the remainder of the portfolio must be much higher to achieve the average return of five percent assumed in Table 4.1, and much better than this if higher replacement rates are to be achieved.*

8.13 The only alternative for achieving an adequate portfolio rate of return is to invest considerable shares of funds in equities, domestic and foreign. In the near term, which may be the next decade or more, the domestic equity market is small, undeveloped, and illiquid. Since there are few traders, and the pension funds themselves are the biggest potential customers, a significant position taken in the domestic equity market is not easily changed. However, pension funds could contribute towards stimulating new issues and trading in equities through marginal investments, which, given that they are marginal, would not significantly affect overall portfolio performance. Moreover, there is an obvious need of more investment bank/company services to screen risks and provide bundled equity investments for pension fund portfolios.

8.14 Upward pressure on the exchange rate is projected to continue due to the pressure exerted by oil exports. The Kazakh government has stated its commitment to a floating exchange rate, although managed. One line of discussion is the possible negative effect on the overall economy of an exchange rate that is driven up by a strong, single export sector, in Kazakhstan's case-oil. This is the so-called Dutch

Disease. The other line of discussion has to do with the effect of an upward drift in the exchange rate of the returns of pension funds.

8.15 Pension commitments are denominated in Tenge, and as the Tenge appreciates, the return on foreign investments must both cover this and provide a relatively high real rate of return. Assuming a modest rate of appreciation in the Tenge of 2-5 percent on an average annual basis, yields on bonds denominated in foreign currencies must surpass both this level and in addition yield a high enough rate of return to help compensate for the low domestic rate of return. This is unrealistic if the target real rate of return is five percent or more.

8.16 In sum, the sole means to achieve a high rate of return seems to be through increasing holdings of foreign equities, at least in the near term, and domestic and foreign equities in the long-term. This will require a considerable rearrangement of portfolios and will lead to an increase in the volatility in fund returns. Of course, indirectly, the domestic interest rate and exchange rate policy are parts of the puzzle. Given the pension system's potential financial volatility, it is evident that there is a need to have a stable pay-as-you-go component at the foundation of the system.

8.17 *Annuities.* The saving accumulation scheme is to provide the single most important source of income in old age in Kazakhstan in the future. Since it is the most important component of social security, it seems unreasonable to offer participants lump-sum payments or to offer or force them to take phased withdrawals with a finite contract period. This will only lead to poverty in old age for a large number of persons, namely, those who live too long. Since the state provides the safety net, eventually it will have to pick up the costs. For these reasons, it is logical to mandate that participants must be provided annuities when they convert their accumulated capital in to some form of benefit.

8.18 As has been discussed insurance companies are not presently in the market for annuities, and once they are it will be very expensive to administer annuities until there is a large number. It will be expensive for administrative reasons, but in addition, actuaries will have to be conservative since the variance around a small number may cause losses. These two aspects mean that annuities will be unduly expensive for quite some time. In addition, it is not clear whether participants as a group can really benefit from possible product differentiation, other than joint life annuities, which together with a single life annuity could be one of the two mandated choices. Certainly, one would have to prove that the overall welfare of participants could be increased by product differentiation to justify it. In addition, there are good reasons for mandating unisex life tables in the calculation of annuities.

8.19 For all the reasons presented here, it seems that a clear recommendation is to introduce an annuity monopoly that provides single or joint life annuities, calculated with unisex life tables and with the whole country as the insurance group. This is the model chosen by Sweden in introducing its FDC scheme. Later, when the insurance collective has become large, the issue of allowing competition among private insurance providers could be revisited.

8.20 *Accounts: A Single Clearinghouse?* Presently, information on payments goes through the SPPC to the individual pension funds, and each fund keeps its own accounts. This raises the question as to whether costs could be cut and information

efficiency gains could be achieved by creating a single clearinghouse for the entire system, an idea that has come up in discussions on possible paths forward in the development of the Kazakh system.

8.21 The clearinghouse would be responsible for keeping accounts during the accumulation phase of participation, using one accounting method, one method of recording returns on individual accounts. This would guarantee complete compatibility and, hence, comparability between APFs, would eliminate the chance for participant's being registered at two or more funds, etc. The clearinghouse could also keep accounts during the payout phase, and even be responsible for payments, if the single monopoly annuity provider is chosen. However, as an alternative, it would also make sense to have a single payout function for both the PAYG and the FDC benefits.

8.22 Of course, unified accounting and reporting procedures can be implemented without establishing a clearinghouse. There are even practical reasons why the formation of a clearinghouse for account keeping should be considered at the present juncture. The first is that it is time to invest in new technology. The APFs are experiencing both hardware and software problems. The software, which is adapted Chilean software from pre-1998, is outdated, difficult for local IT expertise to work with, and, thus, needs to be replaced for this reason alone. The second is that one investment instead of sixteen or more in the same technology and trained in-house staff would save on overall administration costs, which is to the clear advantage of the participants.

Appendix: Data Annex

Annex Table 1: Basic Data for Kazakhstan

<i>GDP, Wages, Employment, Prices</i>	1996	1997	1998	1999	2000	2001	2002
Wage bill, mln tenge	335339	339301	331512	328196	389491	491685	610357,0
1 GDP current prices, billion tenge	1415,7	1672,1	1733,3	2016,5	2599,9	3250,6	3747,2
2 GDP current prices, billion US\$	21,0	22,2	22,1	16,8	18,3	22,1	24,4
3 GDP, rate of real growth, %	0,5	1,7	-1,9	2,7	9,8	13,5	9,5
4 GDP per capita, thousand tenge	90,9	109,0	115,0	135,0	174,8	219,1	259,1
5 Nominal monthly wage, tenge	6841	8541	9683	11864	14374	17303	20323
6 Real monthly wage, %	102,6	106,4	105,9	113,1	107,1	111,1	110,9
7 Number of employed, thousands	6518,9	6472,3	6127,6	6105,4	6201,0	6698,8	6708,9
Labour force, thousands	7489,5	7440,1	7052,6	7055,4	7107,4	7479,1	7399,6
8 Inflation, %	28,7	11,2	1,9	17,8	9,8	6,4	8,4
Demographic Statistics							
9 Total population, thousands, beginning of year	15676	15480,6	15188,2	14957,8	14896,1	14841,9	14854,2
10 Population 20-59, thousands	7990,8	7922,1	7785,1	7689,9	7703,0	7722,1	7809,2
11 Population 60 + , thousands	1519,9	1532,2	1551,7	1570,9	1604,3	1621,9	1655,7
12 Life expectancy age 60, unisex						15,78	15,28
13 Life expectancy age 60, men						13,34	13,17
14 Life expectancy age 60, women						18,03	17,97
15 Population 20-59/ Population 60+	5,3	5,2	5,0	4,9	4,8	4,8	4,7
16 Period fertility rate	2,0	1,9	1,8	1,7	1,8	1,8	1,8
Pension Statistics							
17 Contributors (covered workers), thousands					3715,5	4669,3	5424,4
18 All benefit recipients, thousands	2771,1	2670,3					
19 Old-age pensioners, thousands			2026,5	1921,0	1830,1	1749,1	1690,6
20 Disability pensioners, thousands, end of year			346,6	361,2	386,16	388,7	391,65
21 Survivor pensioners, thousands, end of year							
22 Survivor pensioners, thousands, end of year			232,2	237,7	243,4	245,8	247,2
23 Contributors/ old age pensioners					2,030	2,669	3,209
24 Contributions, million tenge					85438	129561	195470
25 Old age, disability, survivors, mln tenge	70593	124501					
26 Old age benefits, million tenge			92039,3	98534,6	100561,1	111398,8	119170
27 Disability benefits, million tenge			10545,7	14448,8	14366,3	15102,5	17914,8
28 Survivor benefits, million tenge			9120,7	13764,4	14177,8	13430,2	14165,3
29 Benefits from Funded pensions, mln tenge					22121,0	8072,0	14611,0
27							
28							
30 Ratio of an average pension to an average wage	0,405	0,406	0,394	0,351	0,310	0,285	0,285

Annex Table 2: Number of Contributors and Total Assets. Kazakhstan Pension Funds January 1, 2004

<i>Fund Name</i>	<i>Number of contributors</i>	<i>Total pension assets (thousand tenge)</i>
Valut Tranzit	410,963	13,821,223
named after Kunaev	34,284	1,034,730
Narodnyi	198,212	7,838,957
Kazakhstan	127,914	10,606,167
Fund of Narodnyi Bank of Kazakhstan	1,068,609	89,001,786
Kazakhmys	99,559	10,672,155
UlarUmyt	911,543	63,060,411
NefteGazDem	165,084	9,296,082
Kurmet	313,025	15,613,295
ABN-AMRO KMG	141,724	26,288,500
Senym	148,363	16,369,924
Korgau	83,907	5,581,595
Philip Morris Kazakhstan	1,222	845,518
Otan	69,588	5,807,283
Capital	57,419	2,392,352
SAPF*	2,332,900	90,414,261
Total	6,164,316	368,644,240

* SAPF – “State Accumulation Pension Fund”.

Annex Table 3: Distribution of Assets of Asset Companies December 31, 2000

<i>Name of Pension Assets Managing Company (PAMC) and Pension Accumulation Fund</i>	<i>Ministry of Finance of RK Securities</i>		<i>Securities of National Bank of RK</i>	<i>Non- Government securities</i>	<i>Bank deposits in the National Bank of RK and second tire banks</i>	<i>in foreign currency</i>
	long- and midterm	shortterm				
	in tenge	in tenge	in tenge	in tenge	in tenge	
PAMC"ABN AMRO ASSET MANAGEMENT":	2.54%	0.30%	0.65%	2.70%	0.00%	93.81%
Narodnyi	3.44%	0.36%	2.08%	2.50%	0.00%	91.62%
"CaspiMunaiGaz"	4.30%	0.00%	0.54%	2.89%	0.00%	92.27%
" ABN AMRO"	1.19%	0.45%	0.13%	2.67%	0.00%	95.55%
PAMC "ZhetySu"	4.12%	0.62%	2.97%	5.21%	1.04%	86.04%
"ULAR"	4.02%	0.52%	3.50%	5.75%	1.03%	85.18%
Kazakhmys	4.32%	0.84%	1.85%	4.08%	1.07%	87.84%
PACM" Narodnyi Bank of Kazakhstan"	0.00%	0.00%	1.31%	8.15%	0.00%	90.54%
Fund of Narodnyi Bank of Kazakhstan	0.00%	0.00%	1.31%	8.15%	0.00%	90.54%
PAMC "Akniet"	0.85%	2.81%	0.83%	7.65%	0.00%	87.86%
"UMIT"	0.85%	2.81%	0.83%	7.65%	0.00%	87.86%
PAMC "BTA Asset Management"	8.08%	0.99%	0.00%	6.31%	0.00%	84.63%
"Kazakhztan"	8.14%	0.65%	0.00%	8.65%	0.00%	82.55%
Kurmet	10.17%	1.88%	0.00%	8.53%	0.00%	79.41%
NefteGazDem	5.10%	0.13%	0.00%	0.51%	0.00%	94.27%
PAMC " ActivInvest"	33.51%	9.10%	0.27%	8.71%	5.45%	42.95%
Valut Tranzit	32.20%	9.16%	0.00%	8.99%	6.60%	43.05%
named after Kunaev	39.75%	8.79%	1.57%	7.40%	0.00%	42.49%
PAMC "BESTINVEST"	0.00%	0.90%	0.70%	10.45%	3.25%	84.70%
"Senim"	0.00%	0.18%	0.24%	10.51%	2.93%	86.15%
"Korgau"	0.00%	6.23%	4.12%	10.03%	5.63%	73.99%
SAPF	0.94%	1.02%	9.08%	0.00%	1.06%	87.89%
Total pension assets	2.32%	1.01%	4.24%	4.26%	0.82%	87.34%

Table 4: Distribution of Assets of Asset Companies December 31, 2001

<i>Name of Pension Assets Managing Company and Pension Accumulation Fund</i>	<i>Ministry of Finance of RK and National Bank of RK Securities</i>		<i>Bank deposits in the National Bank of RK and second tire banks</i>	<i>in foreign currency</i>
	long- and midterm	shortterm		
	in tenge	in tenge	in tenge	
PAMC"ABN AMRO ASSET MANAGEMENT":	10.14%	0.00%	0.73%	89.13%
Philip Morris Kazakhstan	9.95%	0.00%	0.00%	90.05%
Narodnyi	12.22%	0.00%	0.00%	87.78%
ABN-AMRO KMG	9.65%	0.00%	0.92%	89.42%
PAMC "ZhetySu"	6.93%	0.00%	0.00%	93.07%
UlarUmyt	7.25%	0.00%	0.00%	92.75%
Kazakhmys	5.72%	0.00%	0.00%	94.28%
NefteGazDem	6.37%	0.00%	0.00%	93.63%
PACM" Narodnyi Bank of Kazakhstan"	17.31%	0.00%	0.27%	82.42%
Fund of Narodnyi Bank of Kazakhstan	17.11%	0.00%	0.27%	82.62%
"OTAN"	90.87%	0.00%	0.00%	9.13%
PAMC "Akniet" Has no Pension Assets in Investment Management				
PAMC "BTA Asset Management"	14.21%	0.00%	1.38%	84.41%
"Kazakhztan"	17.29%	0.00%	0.00%	82.71%
Kurmet	12.10%	0.00%	2.32%	85.58%
PAMC " ActivInvest"	27.56%	1.24%	5.12%	66.08%
Valut Tranzit	28.44%	1.32%	5.00%	65.23%
named after Kunaev	20.72%	0.58%	5.99%	72.70%
PAMC "BESTINVEST"	8.57%	2.05%	0.00%	89.39%
"Senim"	7.86%	2.29%	0.00%	89.84%
"Korgau"	11.43%	1.03%	0.00%	87.54%
SAPF	8.44%	15.52%	1.69%	74.35%
Total pension assets	10.95%	5.16%	0.87%	83.02%

Table 5: Distribution of Assets of Asset Companies December 31, 2002

<i>Name of Pension Assets Managing Company and Pension Accumulation Fund</i>	<i>Ministry of Finance of RK and National Bank of RK Securities</i>		<i>Bank deposits in the National Bank of RK and second tire banks</i>	<i>in foreign currency</i>
	<i>long- and midterm</i>	<i>shortterm</i>		
	<i>in tenge</i>	<i>in tenge</i>	<i>in tenge</i>	
PAMC"ABN AMRO ASSET MANAGEMENT":	14.72%	0.33%	5.22%	79.73%
Philip Morris Kazakhstan	25.85%	0.00%	0.00%	74.15%
Narodnyi	16.31%	1.65%	2.46%	79.59%
"CAPITAL"	23.92%	0.00%	0.00%	76.08%
ABN-AMRO KMG	13.63%	0.00%	6.30%	80.07%
PAMC "ZhetySu"	12.64%	0.56%	2.41%	84.39%
UlarUmyt	12.39%	0.65%	1.93%	85.03%
Kazakhmys	14.72%	0.00%	3.67%	81.61%
NefteGazDem	11.51%	0.70%	4.10%	83.69%
PACM" Narodnyi Bank of Kazakhstan"	13.87%	2.11%	1.97%	82.05%
Fund of Narodnyi Bank of Kazakhstan	12.67%	1.90%	1.80%	83.64%
"OTAN"	41.95%	7.05%	5.87%	45.13%
PAMC "Akniet"	11.85%	1.93%	9.03%	77.20%
"Korgau"	8.21%	2.33%	9.36%	80.10%
named after Kunaev	29.30%	0.00%	7.43%	63.27%
PAMC "BTA Asset Management"	19.04%	0.87%	3.35%	76.74%
"Kazakhztan"	17.95%	1.37%	3.02%	77.66%
Kurmet	19.76%	0.54%	3.57%	76.13%
PAMC " ActivInvest"	15.30%	5.95%	8.91%	69.84%
Valut Tranzit	15.30%	5.95%	8.91%	69.84%
PAMC "BESTINVEST"	16.65%	0.18%	9.28%	73.89%
"Senim"	16.65%	0.18%	9.28%	73.89%
PAMC "NURTRAST"				
SAPF	10.13%	40.77%	19.53%	29.57%
Total pension assets	13.10%	12.43%	8.10%	66.37%

Annex Table 6: Distribution of Assets of Asset Companies December 31, 2003

<i>Name of Pension Assets Managing Company and Pension Accumulation Fund</i>	<i>by 01/012004</i>		<i>Bank deposits in the National Bank of RK and second tire banks</i>	<i>in foreign currency</i>
	<i>Ministry of Finance of RK and National Bank of RK Securities</i>			
	<i>long- and midterm</i>	<i>shortterm</i>	<i>in tenge</i>	
	<i>in tenge</i>	<i>in tenge</i>		
PAMC"ABN AMRO ASSET MANAGEMENT":	28.28%	8.16%	8.94%	54.63%
Philip Morris Kazakhstan	24.79%	9.35%	8.43%	57.43%
"CAPITAL"	30.19%	7.91%	8.61%	53.29%
ABN-AMRO KMG	28.22%	8.14%	8.98%	54.66%
PAMC "ZhetySu"	25.24%	13.72%	9.48%	51.56%
UlarUmyt	25.24%	13.72%	9.48%	51.56%
PAMC "Akniet"	0.00%	0.00%	0.00%	
PAMC "BTA Asset Management"	12.16%	23.97%	9.56%	54.30%
"Kazakhztan"	6.47%	27.00%	9.49%	57.03%
Kurmet	16.56%	14.78%	9.55%	59.11%
"OTAN"	10.72%	43.24%	9.71%	36.34%
PAMC " ActivInvest"	22.99%	17.67%	1.55%	57.79%
Valut Tranzit	22.99%	17.67%	1.55%	57.79%
PAMC "BESTINVEST"	18.02%	7.61%	7.84%	66.53%
"Senim"	15.99%	9.17%	9.02%	65.82%
"Korgau"	19.95%	10.21%	7.39%	62.45%
Kazakhmys	17.80%	2.52%	6.84%	72.84%
NefteGazDem	20.66%	9.16%	7.21%	62.97%
PAMC "NURTRAST"	24.08%	6.27%	9.65%	60.01%
Narodnyi	25.52%	4.40%	9.64%	60.44%
named after Kunaev	13.12%	20.39%	9.73%	56.77%
PAMC "Alfa-Trast"	0.00%	0.00%	0.00%	
"Narodnyi Bank of Kazakhstan"	13.96%	15.48%	6.40%	64.16%
SAPF	8.55%	57.27%	4.05%	30.14%
Total pension assets	16.59%	24.58%	6.89%	51.94%

List of Persons Interviewed

Banks, Pension Funds and Asset Management Companies

Alina Aldambergen	Chairman of Board of the ABN-AMRO Asset Management Company
Natalya Brezhneva	ABN-AMRO Asset Management Company
Gulnara Alimgaziyeva	First Vice President, ABN-AMRO Asset Management Company
Argyn Toktamyssov	Head of Analytics Department ABN-AMRO Asset Management Company
Serik Suleimenov	Deputy Chairman of the Board, Temir Bank and former Vice-Minister, Ministry of Labor and Social Protection
Daulet Sembaev	Chairman of Kazakhstan's Financiers' Council and Former Chairman of the National Bank of Kazakhstan
Talgat K. Kamarov	Vice Chairman of the ZHETYSU Asset Management Company
Saltanat K. Yelshibekova	President of the Ular Umit Accumulative Pension Fund
Omirlan K. Aimagambetov	Managing Director of Marketing and Sales, Ular Umit Accumulative Pension Fund
Zhanat B. Kurmanov	Director General of the State Accumulation Pension Fund

Ministries

Mrs. Karagusova	Minister of Labor and Social Protection
Kulpash Temirbekova	Head of the Division of Forecasting and Social Pensions, Ministry of Labor and Social Protection
Mr. Oinarov	Deputy Minister of Finance
Mr. Isaev	Deputy Minister of the Economy
Ms. Ashirova	Head of the Division for Healthcare and Social Protection, Ministry of the Economy

Members of Parliament

Ualikhan A. Kaisarov	Senator and Secretary of the Social-Cultural Development Committee
Sanya M. Kaldygulova	MP and Secretary of the Committee on Social and Cultural Development of Majilis
Alikhan Baimenov	MP and Co-chairman of the Democratic Party of Kazakhstan and Former Minister of Labor and Social Protection

National Bank of Kazakhstan

Daniyar Akishev	Director of the Department of Research & Statistics, National Bank of Kazakhstan
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State Pension Payment Center

Almas Kurmanov	Director General of the State Pension Payment Center Staff Members of the State Pension Payment Center
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Other Government Agencies

Oraz Jandosov	Chairman of the Agency of the Republic of Kazakhstan on Regulation of the Natural Monopolies and Protection of Competition, Former Assistant to the President
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World Bank

Pedro Rodriguez	Economist, World Bank
Madi Umbetaliyev	Economist, World Bank

Independent Consultant

Stephen Moody	PRAGMA, USAID Consultant
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Independent Academic Economist

Sabit Khakimzhanov	KIMEP
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Journalists

Alevtina Donskikh	KAZPRAVDA
Andrei Zhdanov	EXPRESS-K
Nikolai Drozd	PANORAMA
Larissa Uvalieva	CARAVAN

NGOs

Vasily F Khristenko	General Director Special Olympics
Zeinep Imazhanova	Director of League “Akh Bota” President of Pensioners Organisation