WORLD BANK GROUP

A NEW GROWTH MODEL FOR BUILDING A SECURE MIDDLE CLASS

Kazakhstan Systematic Country Diagnostic

April 2018

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Acknowledgments

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Global Practice/Cross-cutting area	Team member
Agriculture	David Neilson; Talimjan Urazov
Climate Change	Yevgen Yesyrkenov
DEC	Mustafa Dinc
Education	Dingyong Hou; Alexandria Valerio; Aliya Bizhanova; Keiko Inoue
Energy and Extractives	Husam Beides; Yabei Wang; Tatiana Sedova; Mitsunori Motohashi
Environment and Natural Resources	Katelijn Van den Berg; Qing Wang
Finance and Markets	Colleen Mascenik
Governance	Alma Nurshaikhova; Arman Vatyan; Aliya Kim; Ahmed Merzouk; Nurbek Kurmanaliev; Garik Sergeyan
Health, Nutrition, and Population	Marcelo Bortman; Baktybek Zhumadil
IFC	Aimilios Chatzinikolaou
Macroeconomics and Fiscal Management	Ilyas Sarsenov; Julio Revilla; Azamat Aldiyarov
MIGA	Persephone Economou; Gero Verheyen
Poverty and Equity	William Seitz; Sarosh Sattar
PPP	Jyoti Bisbey
Social Protection and Jobs	Katerina Petrina; Victoria Strokova; Oleksiy Sluchynskyy
Trade and Competitiveness	Yeraly Beksultan; Gaukhar Ospanova; Stefka Slavova; Christopher Miller
Social, Urban, Rural, and Resilience	Janelle Plummer; Valerie Santos; Dmitry Sivaeva; Sofia Zhukova
Transport and ICT	Jaques Burre; Aliya Karakulova
Water	Bakyt Arystanov

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Abbreviations

CAREC	Central Asia Regional Economic Community
CIS	Commonwealth of Independent States
DALY	disability-adjusted life years
EBRD	European Bank for Reconstruction and Development
ECA	Europe and Central Asia
ECU	Eurasian Customs Union
EEU	Eurasian Economic Union
EU	European Union
FDI	foreign direct investment
GDP	gross domestic product
ICT	information and communications technology
IFC	International Financial Corporation
IMF	International Monetary Fund
KASE	Kazakhstan Stock Exchange
LFS	Labor Force Survey
MSHI	Mandatory Social Health Insurance
NBK	National Bank of Kazakhstan
NPL	nonperforming loan
OECD	Organization for Economic Co-operation and Development
PISA	Programme for International Student Assessment
PPP	public–private partnership; purchasing power parity
R&D	research and development
REER	real effective exchange rate
SCD	Systematic Country Diagnostic
SEZ	special economic zone
SHIF	Social Health Insurance Fund
SME	small and medium enterprise
SOE	state-owned enterprise
SSN	social safety net
TEU	twenty-foot equivalent units
TIMSS	Trends in International Mathematics and Science Study
TFP	total factor productivity
TSA	Targeted Social Assistance
US$	United States dollar
WBG	World Bank Group
WTO	World Trade Organization

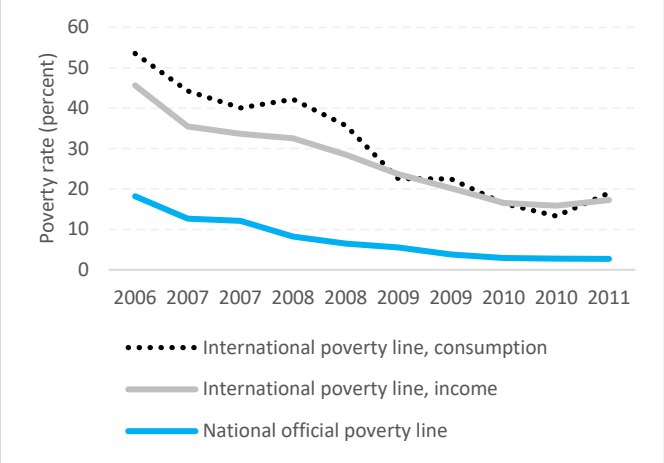
Executive Summary

Four mutually supportive strategic pillars and related policy priorities would help Kazakhstan continue the structural transformation that stalled during the oil booms, in order to eliminate poverty and build a large and secure middle class: 1. economic management for diversification, to strengthen economic management in support of outward diversification of the economy; 2. private sector development, with the state disengaging from its active role in the economy and instead becoming an enabler for a competitive private sector, including a strong small and medium enterprise sector; 3. integration and connectivity, to expand the capability for external trade and the ability of economic regions to respond to external and domestic opportunities, while strengthening institutions for national integration and citizen participation; and 4. productive and adaptive human and natural capital, to enhance human capital so that workers can attain higher levels of productivity and respond more agilely to market developments, while improving natural resource management to strengthen resilience and support sustainability. To deliver on all these priorities, Kazakhstan needs to continue to modernize and build the capacity of its institutions, making them more open, responsive, and effective.

The record on poverty reduction and expansion of the middle class

Since 2000, Kazakhstan has made impressive progress in reducing poverty and building a middle class. Kazakhstan's economy grew at an average annual rate of 6.8 percent between 2001 and 2016. Kazakhstan's poverty rate dropped from 55 percent of the population in 2006 to 20 percent in 2015 (figure 1), as the middle class grew from 10 percent to 25 percent.[1] These gains have varied considerably across the country, however. In 2015, the poverty rate was 8 percent in Almaty and Astana cities (average for the two cities), 15 percent in other urban areas, and 25 percent in rural areas. Similarly, close to half (45 percent) of the population in Almaty and Astana is estimated to have been in the middle class in 2015, compared with 28 percent in other urban areas and 18 percent in rural areas.[2]

Figure 1: Kazakhstan has made good progress against poverty, 2006–15



Data source: World Bank estimates based on Household Budget Surveys.
Note: International poverty line based on US$5 a day at 2005 purchasing power parity.

[1] In this report the poor are the share of population living below $5 per person day using 2005 PPP, while the middle class are those living with more than $10 per person per day using 2005 PPP. The $10 per person per day is a frequently used benchmark for international comparisons. The report adopts the shared prosperity concept to the middleclass measure, which is more relevant for Kazakhstan.

[2] The 2015 rates mark a reversal in progress made through 2014 when GDP growth rates were high, as a result of 1.2 percent GDP growth in 2015.

Improvements in economic well-being were mainly the result of income gains from wage employment. Over 2006-16, Kazakhstan created about 1.1 million jobs in a labor force of 9.0 million people (in 2016), well above the increase in the working age population over that period. In 2015, the unemployment rate was just 5.9 percent for women and 4.4 percent for men, while labor force participation was high, at 60.3 percent for women and 72.6 percent for men. Moreover, in the decade through 2013 (just before the decline in oil prices in 2014), average real wages rose 7.7 percent annually. These labor market gains were the main driver of large-scale poverty reduction and more inclusive growth. Earnings of the poorest 20 percent of households in Kazakhstan grew 90 percent over 2006–15, with labor earnings accounting for more than three-quarters of the growth;[3] earnings of the richest 20 percent of households grew just 29 percent.

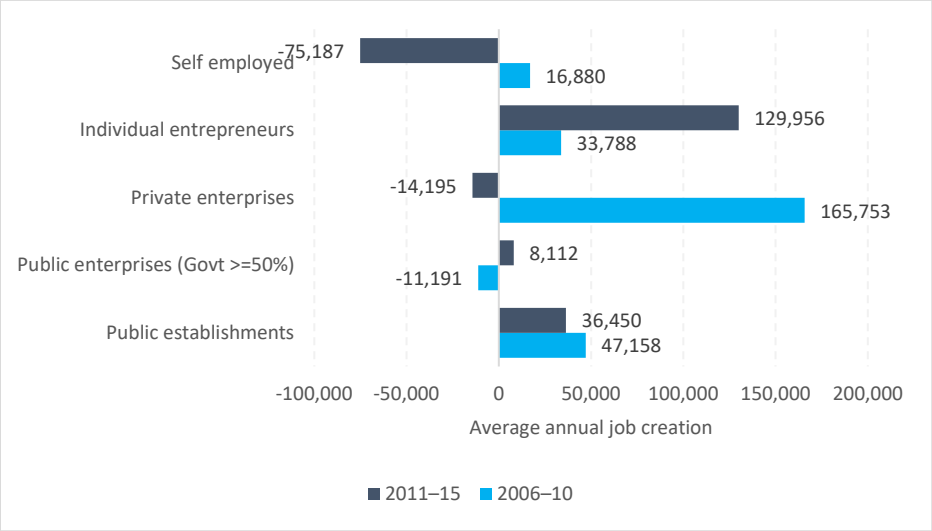
However, Kazakhstan's growth model led to job creation that was concentrated in low-productivity nontradable services sectors. Kazakhstan experienced significant structural transformation over 2001–16, with low-productivity agriculture shedding jobs and the resulting reallocation of employment contributing to productivity growth. However, most new jobs were in nontradable services, where productivity growth was slow. The largest job-creating sectors (with double-digit growth) included publicly provided services like education, health, and other social services, along with construction, trade, and transport and storage on the private sector side.

While private enterprises contributed to job creation in the first part of the 2000s, job creation slowed after 2011 and came largely from the public sector and individual enterprises. Private enterprises created more than 165,000 jobs annually (around two-thirds of all jobs) over 2006–10. Since then, however, private enterprises have shed 70,000 jobs (figure 2). The public sector, meanwhile, remained a steady, if limited, source of new jobs, creating around 45,000 jobs (including in state-owned enterprises—SOEs) annually since 2011. Lacking access to good quality jobs, people have created their own opportunities; self-employment has long been a central feature of the labor market in Kazakhstan. In recent years, however, there has been a large shift from self-employment to employment in individual entrepreneurships.[4] The heavy reliance on individual employment has implications for productivity and labor market adaptability, as self-employed workers are less likely to benefit from specialization, collaboration, and knowledge exchange and may have less opportunity to develop the soft skills that are critical for employment in larger entities.

[3] 57 percent from wages, 15 percent from self-employment, and 5 percent from agricultural earnings.

[4] An "individual entrepreneur" is a legal entity under specific tax treatment that can hire up to six individuals; on average, statistics suggest that such entities comprise 1.6 people.

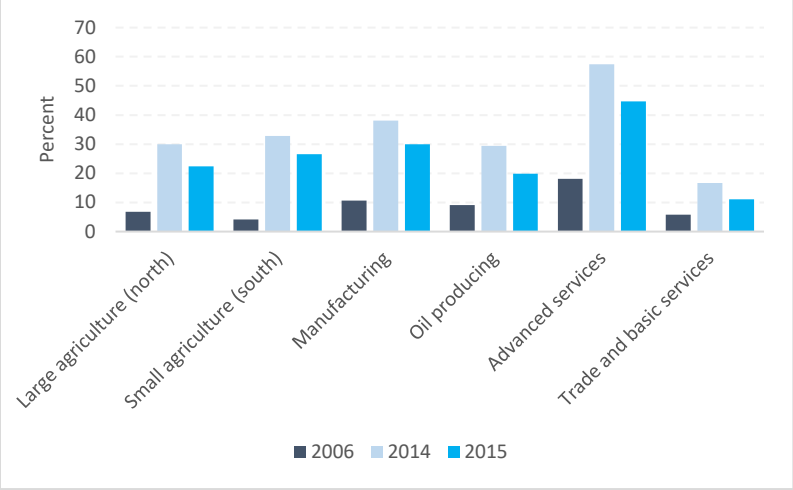
Figure 2: Between 2011 and 2015, private enterprises shed jobs



Data source: Agency of the Republic of Kazakhstan on Statistics.
Note: Individual entrepreneurs includes staff employed by establishments registered as individual entrepreneurs.

The 2014 decline in oil prices was a wakeup call that intensified the urgency of addressing the weaknesses of a growth model based on oil and nontradable services. The fall in oil prices in 2014 led to a reversal in 2015 of some of the poverty gains (see figure 1) and the middle-class expansion of the previous decade (figure 3). Between 2014 and 2015, poverty rose almost 6 percentage points overall—8 percentage points in rural areas and 4 percentage points in urban areas. These unfavorable outcomes are due primarily to falling wages. Average wages fell almost 9 percent in real terms between 2013 and 2016, after having grown more than 7 percent annually over the previous decade. While most of the impact in 2016 was due to rapid price inflation, the main driver before then was the sharp slowdown in nominal earnings growth. Making matters worse, the earnings decline was concentrated in the poorest 60 percent of the population. Overall, the situation reflects an inability of the current economic model support income growth at lower oil prices.

Figure 3: Shares of the middle class population shrank in all economic regions in Kazakhstan from 2014 to 2015



Data source: Household Budget Surveys.
Note: See table 1.2 in chapter 1 for composition of economic regions.

For the purpose of economic transformation, structural reforms are now an imperative, not an option. The decline in oil prices revealed that while Kazakhstan's economic model was inclusive, it was not sustainable. Structural reforms are necessary to shift the base of economic growth from nontradables to the production of tradables. These reforms are critical for Kazakhstan to return to a sustainable growth path consistent with the country's long-term goals. With oil prices expected to remain low and Kazakhstan's demographic profile intensifying labor market and social pressures, the challenges will only become greater. Recapturing the poverty gains and expanding the middle class will likely be impossible unless Kazakhstan achieves more diversified, higher productivity growth. Unless Kazakhstan confronts these challenges head-on, the country will struggle to reach its goal of being among the 30 most developed countries in the world.

Four mutually reinforcing strategic pillars are proposed to help Kazakhstan continue the structural transformation of its economy, which stalled during the two oil price booms of the 2000s. Under strategic pillar 1, Kazakhstan would strengthen its economic management to support economic diversification by reducing the nonoil deficit in a way that limits state intervention in the economy. Under strategic pillar 2, the government would shift from being the driver to being the enabler of economic development, putting the private sector—operating on a level playing field—at the forefront and reforming the financial sector by requiring shareholders to assume greater responsibility for bank losses and by developing nonbank financial institutions. Under strategic pillar 3, Kazakhstan would strengthen its capabilities for external trade and the ability of the regions to respond to external and domestic opportunities, while strengthening institutions for national integration. Under strategic pillar 4, Kazakhstan would manage the transition to this new economic model by continuing to build human capital to support a more productive and adaptable workforce, strengthening the system of social protection to manage economic dislocations, and improving natural resource management to build resilience and support sustainability. Underpinning each of these pillars is the critical platform of governance and public sector capacity, which must be improved radically to enable the transition to a new economic model.

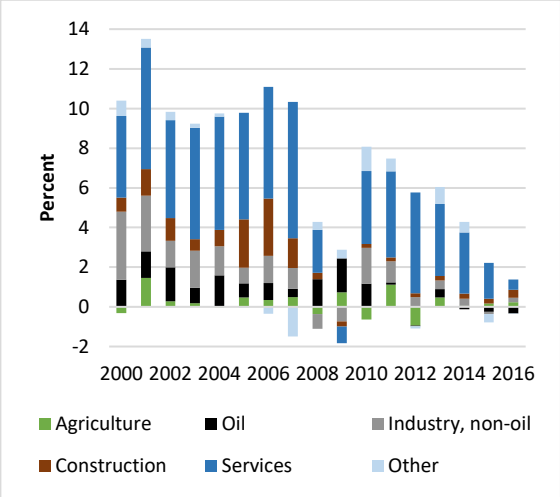
Strategic pillar 1: Economic management for diversification

Kazakhstan's economic growth during the 2000s has been driven primarily by natural resources. During that time, Kazakhstan's economy experienced two economic booms, one in 2001–07 based on both expanded oil output and rising oil prices, and one in 2010–14 (figure 4), based on resurgent oil prices. During the first boom, growth came from the mining sector, but also from low-end services (trade and transportation) and high-end services (professional, information and communication technology, and financial, all mostly in Astana and Almaty cities). During the second boom, oil production stabilized and growth came mainly from nontradable services, driven by government and household consumption; private investment played a marginal role. To support the economy, the government accelerated development of the country's infrastructure, but also sought to ease the burden of the 2007 banking crisis on the private sector through support programs and lower taxes.

Sterilization of foreign exchange inflows proved insufficient to shield the economy from real currency appreciation and loss of competitiveness in non-commodity tradables, while at the same time it biased growth toward services. Kazakhstan's first boom was accompanied by a prudent fiscal policy with low deficits. But the boom resulted in the growth of net foreign borrowing from the banking sector, which reached 20 percent of GDP in 2006, and was a pretext for Kazakhstan's banking crisis in 2007. During Kazakhstan's second boom, looser fiscal policies resulted in a non-oil deficit of 14 percent of non-oil GDP, funded by oil revenues and debt. Over the period 2001–16, net foreign exchange inflows (from the banking sector and the National Fund of the Republic of Kazakhstan, known as the Oil Fund), averaged about 8 percent of GDP. The real exchange rate appreciated rapidly against the US dollar and the Chinese yuan through 2007 and stayed at an appreciated rate through 2015. Non-oil

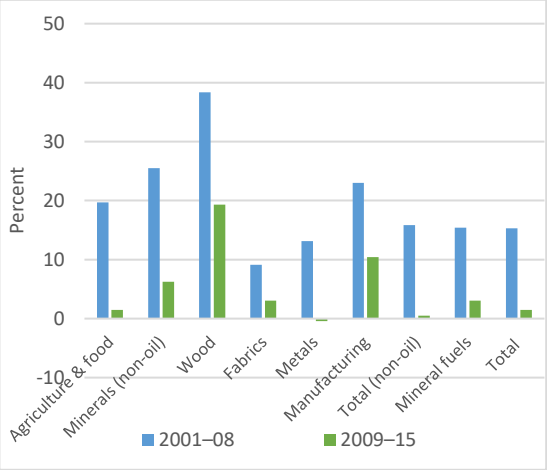
exports grew sluggishly over 2009–15, at an annual average of less than 1 percent, against nearly 16 percent in 2001–08 (figure 5).

Figure 4: Kazakhstan experienced two growth periods over 2000–16



Data source: Agency of the Republic of Kazakhstan on Statistics.

Figure 5: Kazakhstan's growth in non-oil exports fell from 16 percent in 2001–08 to almost nil in 2009–15



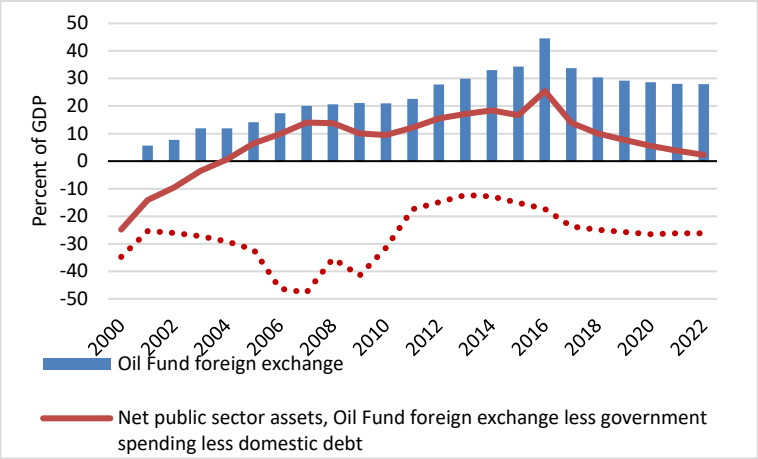
Data source: UN Comtrade.

Fiscal measures supported the economy during the second boom during 2010–14. Fiscal consolidation is now a necessity, and it must be done in a way that supports structural transformation. In 2016, Kazakhstan's non-oil deficit was 12.2 percent of non-oil GDP. With a sustainable non-oil deficit estimated by the World Bank at about 5 percent of non-oil GDP, fiscal consolidation of 6-8 percent of non-oil GDP is in order. Part of the deficit reduction should be covered by increasing non-oil revenues, which have lost about 10 percentage points of non-oil GDP since 2007, when the government sought to reduce the tax burden on the private sector. The other part of the fiscal consolidation should come from a reduction of substantial spending that supports the established structure of the economy which needs to change (liabilities of SOEs and the banking sector and subsidies to SOEs, the private sector, and the banking sector). These changes may help make fiscal consolidation more palatable because they would alter the distortions in the economy when aggregate demand is undermined by the absence of a well-functioning financial sector.

The Oil Fund, which has been the cornerstone of Kazakhstan's creditworthiness, is at risk. As of 2016, Kazakhstan had accumulated in the Oil Fund about 45 percent of GDP in foreign exchange assets, held mainly in foreign government bonds. Yet, as a result of the fiscal deficits over 2010–16 and the devaluation of the tenge in 2015, a stock of government and state-guaranteed debt doubled to about 20 percent of GDP. Thus, net financial assets of the government were equal to 25 percent of GDP in 2016. As the government continued drawing down fiscal reserves from the Oil Fund and the tenge appreciated, net financial assets fell to about 16 percent of GDP in 2017. World Bank estimates suggest that in the absence of fiscal consolidation, net financial assets of the government could be depleted almost completely in 5 to 10 years (figure 6), hurting the country's ability to borrow at more advantageous rates.[5]

[5] In 2016, the government developed a new Concept of Accumulation and Utilization of Assets of the National Fund of the Republic of Kazakhstan, which targets a reduction in the non-oil deficit to 7 percent of GDP by 2020 and 6 percent of GDP by

Figure 6: Without a policy change, Kazakhstan's net financial assets could be depleted in 5 to 10 years



Data source: Agency of the Republic of Kazakhstan on Statistics.

Managing the economy, as well as public service delivery, requires further strengthening of public sector institutions. It is necessary to intensify work in the areas of planning, financial management, project management, and the development of a corporate governance culture. The traditional command and control management style, which so far has been applied by the state apparatus, should be reoriented towards a system of incentives and talent management. The adoption of these measures, along with improvement in transparency and accountability of the state, will facilitate implementation of the government's ambitious long-term strategies, state programs and policies.[6]

Summary of key constraints in the area of economic management. The key constraints that Kazakhstan faces in economic management are: a need for strengthening government's and central bank's capacity for implementing prudent and well-coordinated macroeconomic policies; unsustainable level of non-oil deficit; and large contingent liabilities of the banking and SOE sectors.[7]

Strategic pillar 2: Private sector development

Kazakhstan has not effectively leveraged its economic potential to transform the structure of the economy. Kazakhstan has extensive mineral resources throughout the country, vast agricultural land, substantial industrial capacity, and an emerging high-end services sector in Almaty and Astana cities. It also has significant potential to develop as a regional trading hub, leveraging regional and global schemes like China's "Belt and Road Initiative". This potential is still largely untapped due to poor incentives created by earlier macroeconomic policies, state control of the economy, and other challenges discussed throughout this report. Kazakhstan's indicators of economic complexity have trended downward, suggesting that the country has been adding less rather than more value to its export bundle over time (in both resource-based sectors and other sectors). The devaluation of the tenge in 2015 created new opportunities for Kazakhstan to compete in tradables, by reducing the relative attractiveness of nontradable services, which have dominated growth.

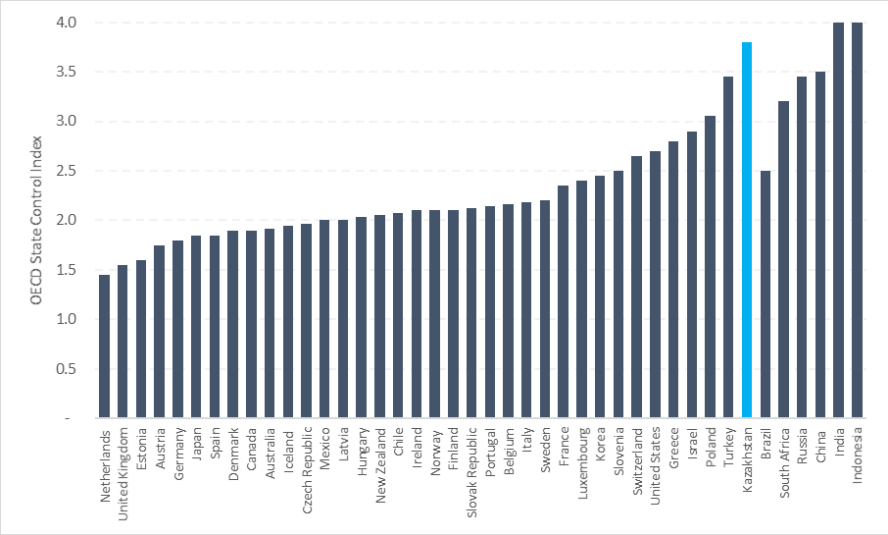
2025. At the same time, the Ministry of Finance is developing a plan targeting an increase in the tax to revenue ratio of GDP by 2025. These measures are aimed at fiscal consolidation to prevent further reduction in National Fund assets.

[6] To address some of these concerns, the government developed and began to implement the 100 Steps program. One of the five areas of institutional reform included in the program is the formation of a professional state apparatus.

[7] These challenges were recognized in recently adopted Strategic Plan for Development of Kazakhstan to 2025.

State-owned enterprises dominate the economy, and state intervention is pervasive. This large state presence in the economy weakens incentives for private investment and thwarts competition. The government owns directly or indirectly the main network sectors of the economy. The Organisation for Economic Co-operation and Development (OECD) reports that the state has full ownership and control of the largest firms in the gas sector, in several transport sectors, the post, mobile services, and electricity (distribution, supply, and generation) and has a majority stake in firms in other sectors. The state's presence in the economy is considerably larger than the OECD average and is even larger than in resource-intensive economies like the Russian Federation and Venezuela (figure 7). In addition to state ownership, price controls are much more pervasive in Kazakhstan than in any OECD country. The challenges posed by government ownership are many, including weak incentives to modernize and innovate, as well as obstacles to private investors (due to the public sector's advantageous access to finance and to regulators through positions on corporate boards).[8]

Figure 7: Kazakhstan has a greater SOE presence in the economy than OECD members and most large non-OECD economies, including Brazil and China, 2013



Source: OECD State Control Index.
Note: Index scale ranges from 0 (least restrictive) to 6 (most restrictive).

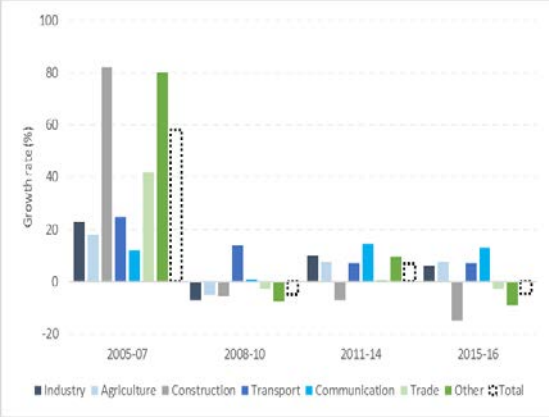
For structural transformation to take place, Kazakhstan's major markets need to work efficiently, transparently, and fairly. Greatly reducing the state's role in the economy is a prerequisite. So is building contestable markets, to ensure a level playing field for the private sector. Considerable state intervention in key product markets (including heavy manufacturing and network services sectors) and the financial market (mainly banking) results in inefficiencies, distorts incentives, and thwarts new investment. Moreover, the interests of state businesses are closely intertwined in key sectors and firms, contributing to a concentration of power within a narrow business elite. Low trust in courts' fairness and impartiality creates additional constraints for businesses.

The banking sector has not yet recovered from the 2007 crisis and is not performing its allocative function. The sector has also been a source of considerable volatility in the economy. In 2005–07, total credit grew at an average annual rate of nearly 60 percent in nominal terms (figure 8), reaching 61 percent of GDP in 2007. Since 2017, however, credit growth (relative to GDP) has stagnated, due in

[8] Kazakhstan's president ordered a reduction in the share of state participation in the national economy, to a target of 15 percent of GDP by 2020. To achieve this goal, the authorities plan to reduce the cost of doing business, facilitate competition, continue the privatization of state-owned enterprises, strengthen the investment and macroeconomic climate, and improve customs and tariff regulation.

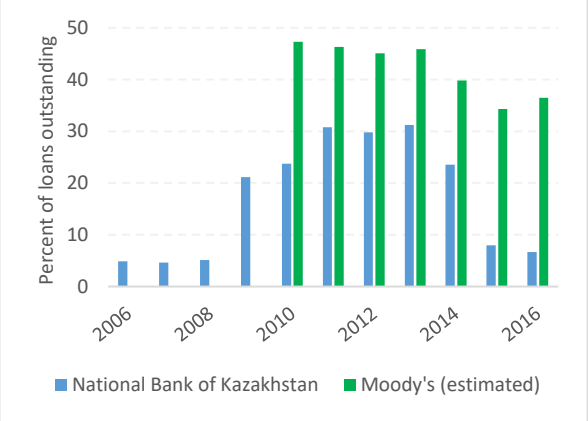
large part to the ongoing problem of nonperforming loans (NPLs) (figure 9). The banking sector has been bailed out three times using public funds (2008, 2015, and 2017). Despite various efforts including recapitalization and the closure of some problem banks, the problem NPLs in the sector have not been resolved, and underlying issues such as ownership structure and regulation have not been addressed. While the National Bank of Kazakhstan (NBK) estimates NPLs at around 25 percent of total outstanding loans at end-2016 (if the bailout support is excluded), international credit agencies' estimates are significantly higher (in the range of 35–45 percent). The challenges facing the banking sector are highlighted by the approaches taken to continue expanding credit to households and SOEs, government and SOE holdings. Funds have been sourced from international creditors, but also the Oil Fund and the state pension fund at attractive rates of return on capital and have been advanced at favorable rates to recipients. This approach has on the one hand created fiscal costs and on the other distorted investment incentives for recipients. It also cannot address the fundamental shortage of credit to the economy.

Figure 8: Credit to the economy in Kazakhstan has shrunk dramatically in nominal terms, 2005–16



Data source: National Bank of Kazakhstan and World Bank staff estimates.

Figure 9: Nonperforming loans surged in Kazakhstan's after the banking crisis, 2006–16



Data source: National Bank of Kazakhstan's estimate of loans 90 days overdue and Moody's estimate capturing retail and corporate loans based on surveys of nine banks that account for 65 percent of commercial banks' portfolio.

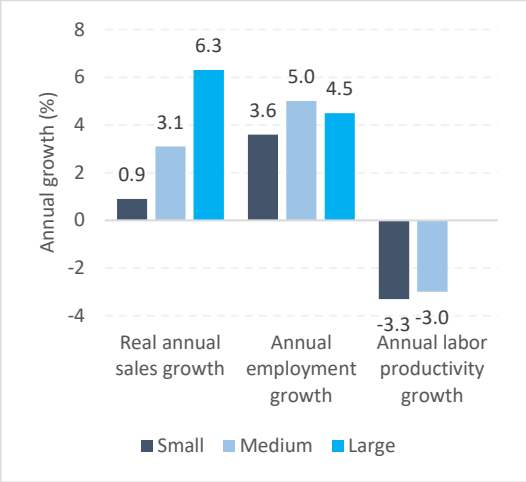
Many of Kazakhstan's initiatives to support the development of the private sector development include state support programs that lessen the role of the market and distort incentives. Kazakhstan's many private sector development programs rely heavily on import tariffs, soft loans, subsidies (including transport subsidies, operational subsidies, and subsidized loans), SOE support, export taxes or restrictions, and localization requirements, among others. This creates an uneven playing field for the private sector, which is exacerbated by the lack of transparency in the allocation of subsidies. These private sector development programs also bias the incentives of firms toward capturing subsidies rather than improving competitiveness.

Two implications of the current approach to growth are high perceived risk to private foreign investors and insufficient attention to domestic SMEs. The heavy state control of the economy and the government's interventionist approach to supporting the private sector contribute to an environment in which mostly large-scale, well-connected and supported firms thrive. As a result, foreign investors outside the oil and gas sector rank Kazakhstan on par with the Kyrgyz Republic, the Russian Federation, and Ukraine because of the business risks that come with weak competition policies (price controls, vested interests distorted decision-making, unfair competitive practices, and

discrimination against foreign companies). At the same time, domestic SMEs, which typically drive innovation and growth in transition economies, contribute very little in Kazakhstan (as measured by their share of GDP) relative to peer countries (figures 10 and 11).

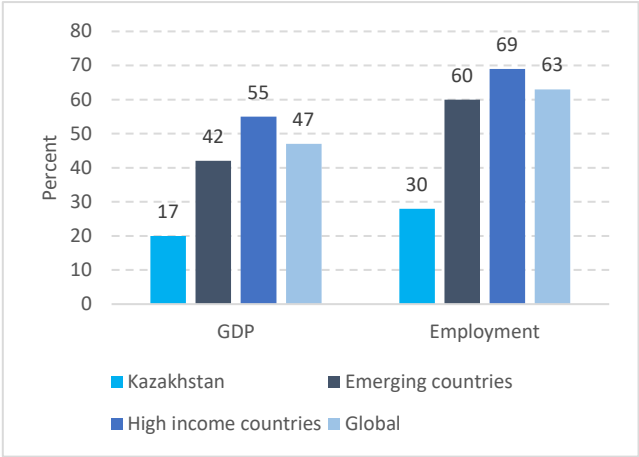
Summary of key constraints for private sector-led economic growth. The key constraints that Kazakhstan faces in adopting an approach to economic growth based on private sector development are the prolonged process of financial sector rehabilitation which does not ensure an active support of investors; wide state presence in the economy affecting the competition in individual sectors of the economy; effect of state support measures on creation of level playing field for business. Unless these constraints are addressed, private investment in the tradables sector, which is required to drive structural transformation and put the economy on a higher growth trajectory, is unlikely.

Figure 10: Annual sales, employment, and productivity growth of Kazakhstan SMEs lag, 2013



Data source: World Bank Group Enterprise Surveys Kazakhstan, 2013.

Figure 11: SME shares of GDP and employment in Kazakhstan lag shares in emerging and high-income countries, 2013



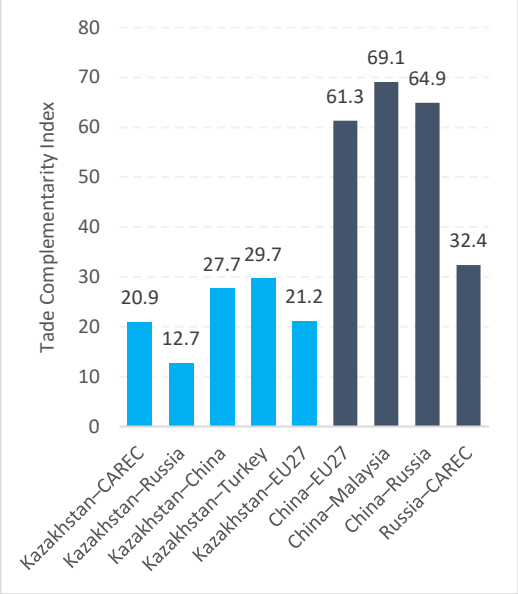
Data source: World Bank Group (*2013b).*

Strategic pillar 3: Integration and connectivity

Kazakhstan's economy is small (in terms of population and domestic demand), and it needs to integrate into the regional and global economy to expand its markets and increase its growth prospects. Kazakhstan's geographic position offers many potential benefits. Exploiting this potential will require first integrating further with its Central Asian neighbors. Central Asia Regional Economic Cooperation (CAREC) partners accounted for just 5 percent of Kazakhstan's exports in 2015, mainly due to low levels of trade complementarity[9]; complementarity with the Russian Federation is even worse (figure 12). However, Kazakhstan's trade with regional partners is much more important for non-extractive industries (figure 13), highlighting the importance of regional markets for supporting Kazakhstan's diversification efforts.

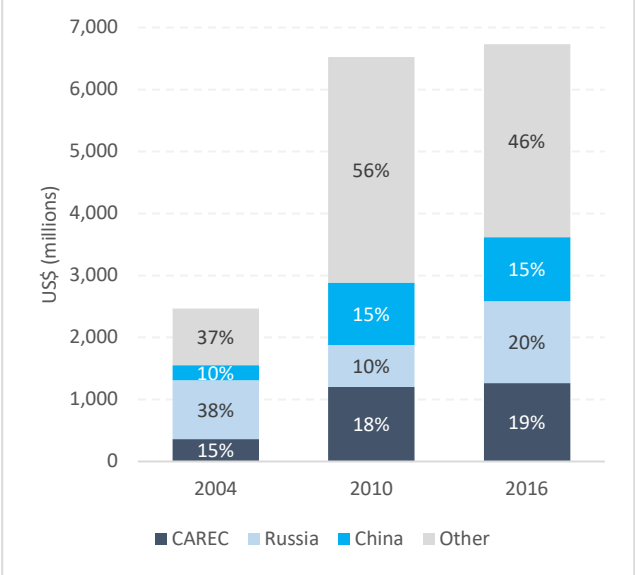
[9] The bilateral complementarity index is a measure of the similarity between the export basket of one country and the import basket of another. The value of the index ranges from 0, representing no complementarity, to 100, a perfect match.

Figure 12: Kazakhstan's trade complementarity with regional partners is low, 2015



Data source: UNComtrade via WITS.
Note: Index ranges from 1 (low) to 100 (high). CAREC is Central Asia Regional Economic Cooperation.

Figure 13: Trade with regional partners is much more important for non-extractive industries, 2004, 2010, and 2016



Data source: UNComtrade via WITS.
Note: CAREC is Central Asia Regional Economic Cooperation.

Over the medium term, Kazakhstan will need to be much more active in developing trade relationships outside the subregion. Proximity to the Russian Federation and China is a critical advantage for Kazakhstan. Trade and investment relations with the Russian economy will continue to deepen through the Eurasian Economic Union (EEU). This should pay dividends as the Russian economy improves, but Kazakhstan also needs to continue to improve its trade policy and firm competitiveness in order reap the full benefits of participating in the EEU. Kazakhstan sees its membership in the EEU as an opportunity for the free movement of goods, services, capital, and labor to the major market of Russia as well as to the markets of Armenia, Belarus, and Kyrgyzstan. This will require a barrier-free environment in the internal EEU market. The digitalization of EEU economies, which can be an important factor in driving innovation, is also being prioritized. Kazakhstan's trade relationship with China is evolving around that country's westward movement of products by land as part of the Belt and Road Initiative. Over the medium term, Kazakhstan needs to improve trade facilitation and develop its logistics sector, while also adding much more value to westbound trade. In the longer term, as China becomes wealthier, products and services can move eastward along international land transport corridors.

Kazakhstan's administrative regions (oblasts) have demonstrated economic potential, but their capabilities, infrastructure, and administrative capacity vary considerably. Based on the uniqueness and complexity of each region's products, processing capabilities, and services support, almost half of Kazakhstan's 16 regions (14 oblasts and 2 major cities) have the capability to diversify, according to analysis by the European Bank for Reconstruction and Development.[10] Yet, only one region, Almaty oblast, managed to move up the value chain in manufacturing over 2003–16. Depending on capabilities, cost factors, and sustainability considerations, some regions may merit vertical support to specific industries or sectors to improve products, while others may merit horizontal support to

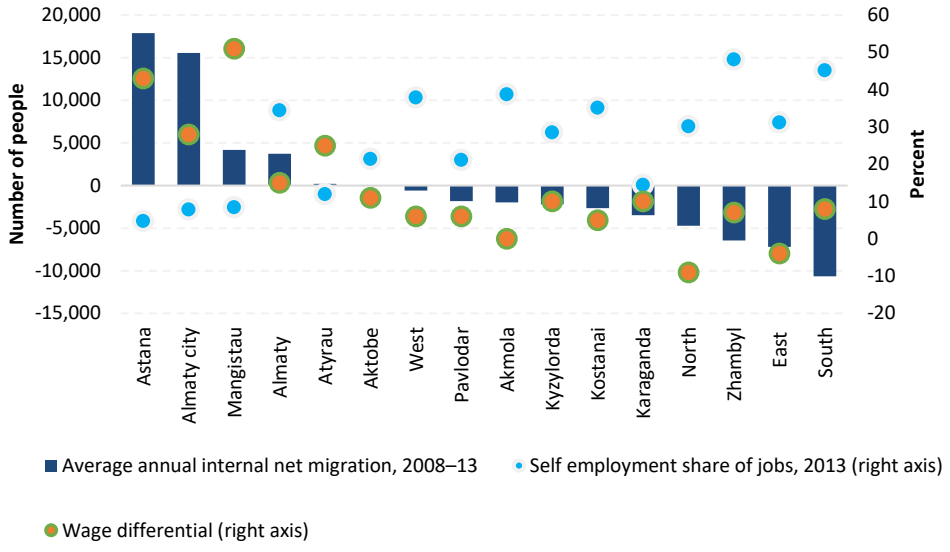
[10] Diversification of Kazakhstan's economy: a capability-based approach (Whiteshield Partners, 2015).

improve the business environment or private–public partnerships. In other regions, especially peripheral and sparsely populated ones, and depending on economic and social circumstances, the focus may be less on driving investment and more on ensuring the delivery of good quality public and social services.

A region-centered response is required to support regional development, underpinned by local voice and capacity. As is evident from the contextual factors noted above, regional support programs need to be coordinated with strategic regional development plans with corresponding market incentives. Support needs to take into account Kazakhstan's fiscal reality and must include significant capacity building that reflects regional administrative, fiscal, and regulatory capabilities. It also needs to be administered within a decentralized fiscal and budgetary system that allows for exchanges between regions and the center. Such a response also requires enhanced use of voice in local government and an approach to accountability that is based on program or regional performance and delivery of inputs (such as credit and infrastructure).

Building competitive regions and promoting labor mobility go hand-in-hand; achieving both requires strengthening urbanization. Along with strengthening regional economies, Kazakhstan must do more to facilitate mobility to enable people to seek out opportunities across the country. During 2003–16, Kazakhstan experienced substantial migration from lower to higher wage regions (figure 14). However, there was less internal migration than might have been expected considering the large variability in growth and income across regions. Several factors limit the internal mobility, including labor supply and demand mismatches, high housing costs in the cities, and poor access to certain services (for example, preschool education and health care) in the absence of residence registration. This is a missed opportunity for Kazakhstan to support productivity growth while facilitating opportunities for development in regions outside of Astana and Almaty cities. As a result, Kazakhstan is failing to capture the productivity benefits of agglomeration. This is true in Astana and Almaty cities, but even more so in Kazakhstan's secondary cities, where underinvestment has been much more acute. Investing in urban agglomeration and linking cities with their hinterlands should be at the heart of Kazakhstan's regional development efforts.

Figure 14: Internal migration is responding to wage differences, but remains small in scale, 2008–13



Data source: ERI/McKinsey (n.d.), World Bank Group (2015), Agency of the Republic of Kazakhstan on Statistics.

Summary of key constraints to integrating more fully into the global economy and better connecting and integrating Kazakhstan's regions into the national and global economy. The key integration

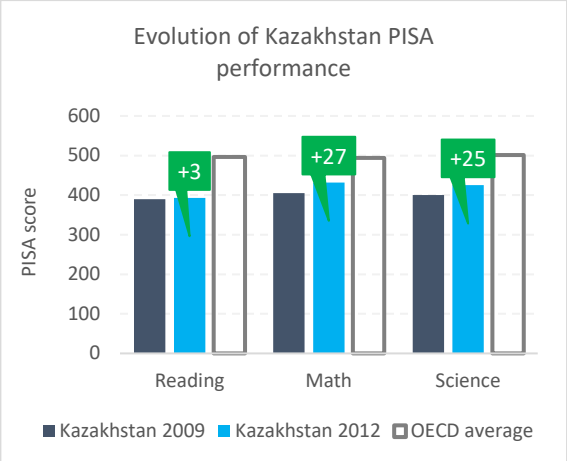
constraints that Kazakhstan faces include: low level of trade complementarity with regional trade partners; tariff and non-tariff barriers; weaknesses in trade facilitation and logistics, low impact of programs to support regional development, poor connectivity across the country, and limits to internal migration including to urban areas, particularly secondary cities, where significant underinvestment in infrastructure and public services is undermining potential.

Strategic pillar 4: Productive and adaptive human and natural capital

Delivering on the challenges outlined in this report and managing the transition to a new economic model will require Kazakhstan to strengthen its human and institutional capital and to manage its natural resources sustainability and efficiently. Kazakhstan needs to strengthen its human capital and establish an environment that enables workers and citizens to adapt to rapidly changing economic, social, and technological conditions and that supports them through the transitions. Moreover, while Kazakhstan has benefited enormously from its natural resource wealth, it should consider sustainability and efficiency in managing its natural resources to reduce the vulnerabilities and negative side effects of the current resource-intensive growth model.

Educational attainment has increased in the last decade, but further improvements in quality, relevance, and equity are required to allow young people's transition to productive employment. The share of the youth population with more than a general secondary education rose from 32 percent in 2001 to 62 percent in 2015. The quality of education has improved as well, as measured by scores on international achievement tests (Programme for International Student Assessment, PISA). However, performance gaps with OECD countries remain substantial (figure 15), particularly in reading, where the gap with the OECD average in 2012 was 2.5 years of schooling. There are also wide gaps in access to a high-quality education, especially for students in technical and vocational education and training schools, students in Kazakh language schools, and students from lower socioeconomic households. Access to good quality education beyond the secondary level is increasingly important, especially in rural areas, where 25 percent of wage workers and 63 percent of self-employed workers have a general secondary education or less. Nationally, the wage premium for having an upper secondary education rather than a general secondary education or less is around 10 percent, but the premium jumps to more than 40 percent for a tertiary education.

Figure 15: Despite improvements, Kazakh students trail the OECD average in reading and math on the PISA, 2009 and 2012

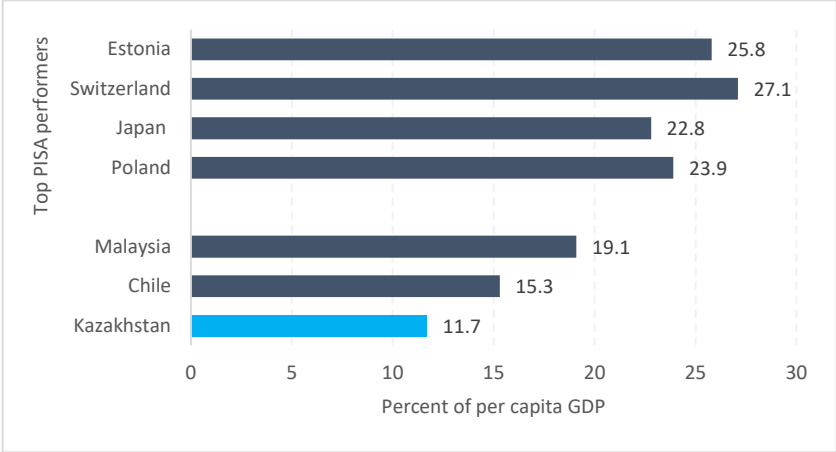


Data source: OECD Program for International Student Assessment (PISA) 2009 and 2012.

To meet the requirements of a new growth model, Kazakhstan needs to invest more in developing the technical skills of its workforce, as well as non-cognitive and socioemotional skills through a lifecycle approach to education and skills development. To do this, the country will need to expand access to preschool education and further reduce regional differentiation in preschool coverage. In 2010, the enrollment rate for 1 to 6-year olds was just 17.7 percent in South Kazakhstan oblast but more than 90.8 percent in Kostanay oblast; the national average was 41.6 percent. However, by 2016 the coverage in South Kazakhstan had risen to 59.4 percent. The lowest figure among regions exceeded 50 percent and was reported in the cities of Almaty (53.8 percent) and Astana (51 percent), which, most likely, is due to internal migration and higher birth rates. Overall, in 2016 all regions of the country had coverage of more than 50 percent and the average national figure was 64.5 percent. Kazakhstan needs to continue improving preschool coverage and reducing gaps between regions.

Delivering on education will likely require higher funding and greater local autonomy. Kazakhstan's spending per pupil (at 11.7 percent of GDP per capita) is less than half that in top PISA–performing countries, such as Estonia, Japan, Poland, and Switzerland (figure 16). And the system remains highly top-down, leaving little autonomy and accountability at the local level.

Figure 16: Per pupil expenditure on education in Kazakhstan is well below that in peer countries, 2015



Data source: OECD and World Bank Group (2015).

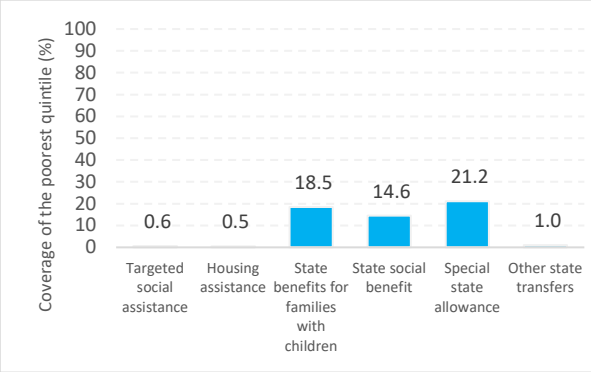
While Kazakhstan has made solid gains in health outcomes, further improvements are needed to improve the quality of life and to ensure a workforce that can deliver sustainable productivity gains. Male life expectancy at birth is just 68.1 years in 2016 (67.44 in 2015) in Kazakhstan, far behind most of its peers (with the exception of the Russian Federation) and almost 10 years less than the OECD average. Infant mortality and deaths from cardiovascular disease and some forms of cancer are far higher in Kazakhstan. Two of the 10 leading causes of disability adjusted life years in 2010 did not appear among the top 10 in 1990: chronic obstructive pulmonary disease and cirrhosis of the liver, both especially prevalent among men, highlighting the impacts of alcohol and tobacco consumption on health outcomes. Air pollution, too, is having deleterious health and environmental impacts, particularly in urban and highly industrialized areas. Delivering good quality healthcare equitably across the country is a major challenge, with heavy fiscal implications. The government plans to introduce a mandatory social health insurance system (from 2020) and will address issues of its financial sustainability (taking into account lessons from the previous system, which collapsed in 1998).

Kazakhstan's social protection systems do not adequately support the poorest and could be more effective in promoting labor market participation and mobility. In 2014, means-tested programs accounted for just 1 percent of social safety net spending and reached less than 1 percent of the bottom quintile of the population (figure 17). A recently piloted conditional cash transfer program

(Orleu) shows considerable potential to improve outcomes for poor families while also promoting labor market activation. Furthermore, it is necessary to develop a support system that would allow workers to adapt to labor market conditions by moving to the sectors and activity areas with better prospects of job placement. For example, 2.8 million workers (most of them self-employed) are ineligible for social insurance benefits because they do not contribute to the social insurance program. Strengthening the incentives for formal employment will require widening the gap between social insurance and social assistance benefits while ensuring an adequate level of social protection for the whole population.

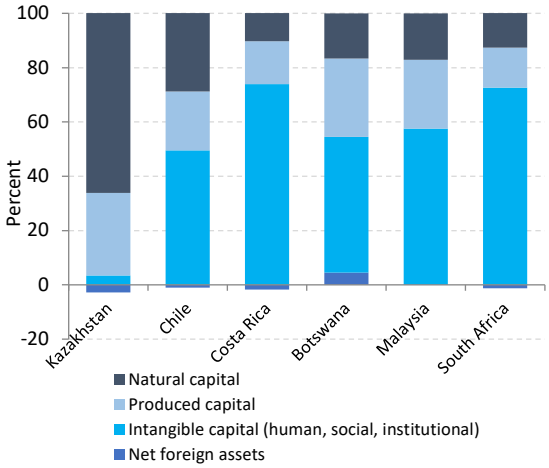
Kazakhstan's natural capital wealth, which almost tripled in nominal terms during the first decade of the 2000s, needs to be converted effectively into human and institutional capital. Despite huge natural resource rents over the decade, the country has added little to its stock of human and institutional capital, threatening the sustainability of growth and of poverty reduction propelled by the resource gains (figure 18). This failure to convert natural capital to human and institutional capital poses a threat to the sustainability of Kazakhstan's growth model. In addition, the growth model's reliance on extractives has damaged the environment and has implications for increased vulnerability to climate change and the transition to a low-carbon economy. Indeed, Kazakhstan is one of the most vulnerable countries in the world to this transition.

Figure 17: Social safety net coverage of the bottom 20 percent is low in Kazakhstan, 2013



Data source: Household Budget Survey 2013 and ADEPT Social Protection module.
Note: Targeted social assistance results must be interpreted with caution, due to small sample size.

Figure 18: Unlike some other resource-rich countries, Kazakhstan has yet to convert its natural capital into human and institutional capital, 2010



Data source: World Bank Group, Wealth of Nations database, 2011.

Addressing environmental sustainability is critical for diversified, competitive sectors. In agriculture, water and soil degradation are major concerns. Competitive industrial production is held back by an increasingly strained electricity network and lack of investment in energy efficiency, both outcomes of long-standing subsidies in the energy sector. Kazakhstan uses 1.7 times as much energy per unit of GDP (based on purchasing power parity) than the OECD average, which means that more efforts should be made to improve energy efficiency in key energy-consuming sectors and simultaneously to reduce energy subsidies. Kazakhstan is addressing these vulnerabilities and mapping a path to the green economy, including through its Green Economy Concept and Action Plan, and setting targets for greenhouse gas emissions and energy efficiency. However, it is unclear how green economy concept will advance from strategy to action. Much remains to be done to meet these targets and to manage

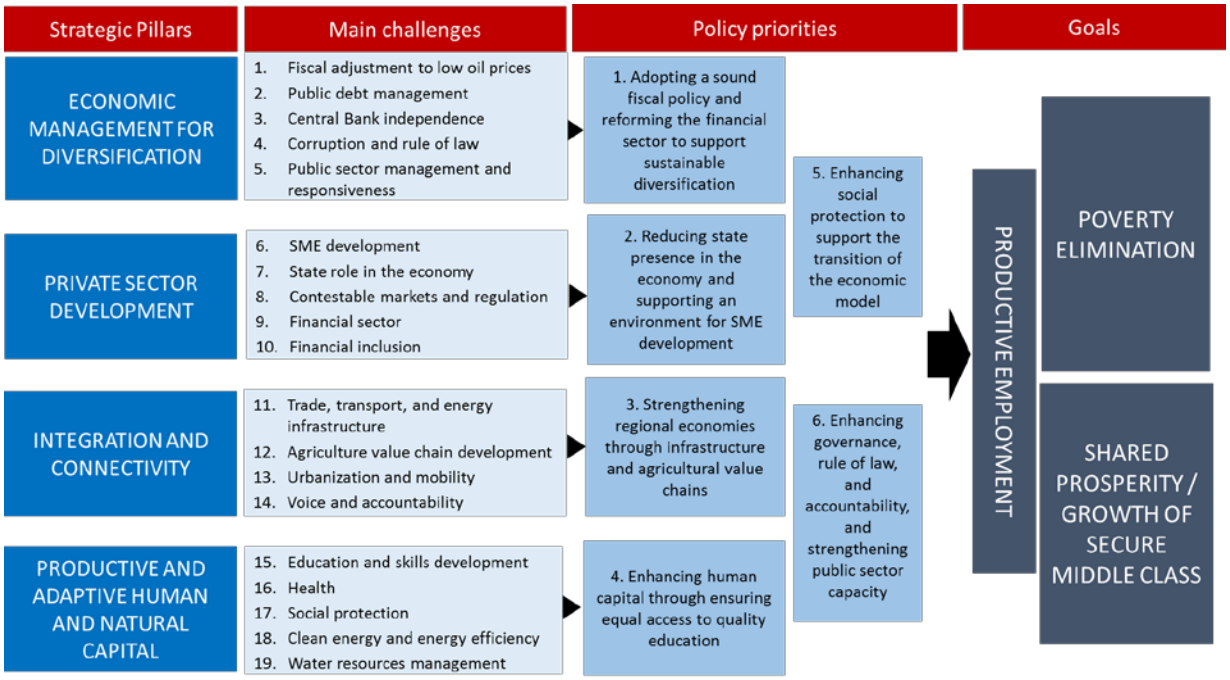
resilience, including coordinating actions across government agencies, stakeholders, and development partners.

Summary of key constraints to developing productive and sustainable human and natural capital. The key constraints that Kazakhstan faces to developing productive and sustainable human and natural capital are uneven delivery of education and health services to urban and rural areas across Kazakhstan's vast landscape; insufficient quality and relevance of education and skills training to employers' needs; inadequate education financing and unsustainable health financing; persisting poor health outcomes, particularly for men; fragmented and insufficient social safety net coverage, with minimal use of means testing; and sizable environmental constraints, including air pollution and, increasingly, the sustainability of water resources.

Looking ahead: policy priorities and implementation

This Systematic Country Diagnostic identified six broad priority areas for policy intervention. This report argues that eliminating poverty and building a large and secure middle class will require restoring the process of structural transformation and reform that stalled during the economic booms, so that the economy generates more productive employment opportunities. Getting reforms back on track and achieving the transition to a new growth and governance model will require addressing the challenges discussed above across each of the four strategic pillars. Given the scale and scope of the challenges, it will be important for the government to set priorities and sequence reforms in a way that addresses critical binding constraints as quickly as possible at each step, easing the way for other reforms to follow. Figure 19 highlights six proposed broad policy priorities, linked back to the four pillars and forward to the achievement of the twin goals of poverty elimination and shared prosperity through the channel of productive employment.

Figure 19: Mapping challenges in Kazakhstan to interventions, strategic pillars, and goals



1. **Adopting sound fiscal policy and reforming the financial sector to support sustainable diversification**: Building a diversified economy, driven by the private sector and competitive tradable sectors, requires a predictable macro-fiscal environment that ensures a stable,

appropriately valued exchange rate and a financial system that responds to market signals in allocating and pricing credit. Achieving this will require ongoing management of the monetary framework, fiscal consolidation, and development of sustainable, non-oil sources of revenue. It will also require reassessment of the government's ownership and financial support of sectors and firms (see policy priority 2, below). Finally, delivering on and sustaining these reforms will require strengthening macro policymaking at the senior level of government (see policy priority 6, below).

2. **Reducing state presence in the economy and supporting an environment for SME development**: The need to develop a more competitive, diversified private sector is well understood in Kazakhstan, and strategies and programs are in place to support the needed policies. But these efforts have been undermined by a macroeconomic environment that weakens competitiveness, a financial sector that fails to price and allocate resources effectively, and a governance environment that has created an uneven playing field, with SOEs and connected firms crowding out SMEs and potential innovators. Building a competitive, diversified private sector will require reducing the presence of SOEs, including in key network sectors like electricity. But it will also require wider measures to support contestable markets, by facilitating foreign direct investment (FDI) and opening markets to import competition, among other means. Finally, it will require more effective support of SMEs by enhancing the business regulatory environment and facilitating the development of competitive value chains in place of credit subsidies.

3. **Strengthening regional economies through the development of infrastructure and agricultural value chains**: This report highlights the widening disparities in economic outcomes and access to services between Astana and Almaty cities and the rest of the country. Greater attention to developing sustainable regional economies will need to accompany support for worker mobility and the continuing emergence of Astana and Almaty as regionally as well as nationally competitive cities. Strengthening regional economies means developing hard and soft infrastructure to help Kazakhstan take advantage of regional and global opportunities like the Belt and Road Initiative, as well as completing critical corridor developments and addressing deteriorating urban infrastructure (including roads and electricity), particularly in secondary cities. Finally, and perhaps most important, it will require developing a more diversified and competitive agricultural sector that includes opportunities for smallholders by strengthening agricultural value chains.

4. **Enhancing human capital by ensuring equal access to high quality education**: Kazakhstan's success in diversifying its economy and improving its governance will depend in large part on the ability of its people to compete and adapt to the economy envisioned by the new growth model. Enhancing human capital will require addressing significant regional disparities in education quality. It will also require modernizing the education and skills development system to emphasize the types of knowledge and skills that can adapt to changing technologies and work environments.

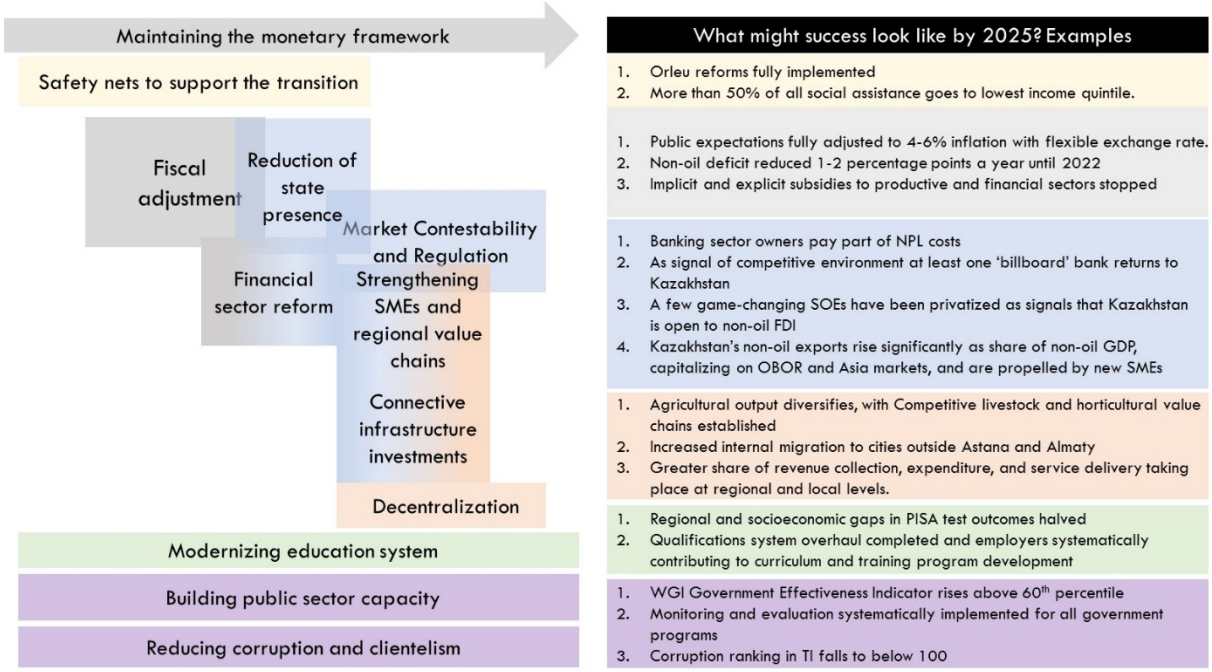
5. **Enhancing social protection to support the transition of the economic model:** The macroeconomic and structural reforms required to shift Kazakhstan's economic model will change the relative prices of tradables and nontradables, inducing large sectoral reallocations of labor. Similarly, SOE reform and privatization will result in shifts in the workforce. Transition assistance for dislocated workers will be critical to mitigate risks of poverty and exclusion and to ensure the social sustainability of the reforms. But structural transformation will also require changes to the social protection system, including targeting social assistance more closely to the poorest, reforming the pension system, and improving the reach and effectiveness of public employment services.

6. **Enhancing governance and strengthening public sector capacity***:* Delivering on all of these priorities will require modernizing and transforming Kazakhstan's institutions, making them more

open, adaptable, and effective. Enhancing governance will require a wide-ranging set of actions to reduce corruption, strengthen justice institutions, and bolster the rule of law. Governance reforms can be supported by increasing transparency and reinforcing the voice of citizens and accountability of government, including through decentralization. Finally, delivery of these priorities will require strengthening the capacity of government to prioritize, implement, and monitor progress against clear objectives.

Figure 20 outlines a proposed sequencing of the priority policy reforms and breaks out the priorities in more detail. It also includes examples of indicators of success that could be used to assess whether Kazakhstan has achieved the intended outcomes from these reforms.

Figure 20: Proposed sequencing of the priority policy reforms for Kazakhstan



Fiscal, financial sector, and safety net reforms need to come first as the foundation for a more diversified and competitive private sector. The starting point is the monetary framework, continuing the policies for maintaining a flexible exchange rate and an inflation targeting regime. In the short term, the emphasis should be on fiscal adjustment, keeping government spending sustainable in an environment of long-term low oil prices. A strategy to reduce public spending would depend largely on eliminating supports that reinforce the old structure of the economy, especially by imposing hard budget constraints on SOEs and the banking sector and sharply reducing or eliminating subsidies to traditionally protected sectors and companies. Complementing reduced spending must be a robust program to increase non-oil revenues over the next few years. Closely following and linked to these fiscal reforms are the substantial financial sector reforms needed to establish a more competitive environment for the private sector: overhauling and strengthening bank regulation, developing debt markets and credit markets, and strengthening nonbank financial institutions. The potential transitional impacts of these fiscal and financial sector reforms, along with the recent rise in poverty, make strengthening social safety nets a parallel top priority. Doing so should include rolling out a nationwide program of conditional cash transfers to the poorest households (Orleu reforms), developing a more robust unemployment insurance program, and strengthening employment services and active labor market programs to support the transition of workers across jobs and sectors.

Building a diversified, competitive private sector, in an environment free of major macro-fiscal and financial sector distortions and with a level playing field and contestable markets, is at the heart of the reforms required to transition Kazakhstan's economic model. Key activities would be establishing a regulatory environment that enables SMEs to emerge, grow, and attract FDI and substantially reducing the state presence in the economy. Privatization is part of the process, but a prerequisite is to clarify the regulatory environment, pricing policies, and government ownership goals in each sector. Bringing the competition and regulatory frameworks up to OECD standards will need to take place in parallel to ensure that privatizations reduce the concentration of market power rather than simply transfer rents from the public sector to state-supported private or public enterprises. In addition, programs for state support of the private sector should end the role of preferences and subsidies (introducing sunset clauses, as needed) and include only programs that support products in competitive markets. Support to SMEs should replace subsidized credit with measures to create an effective regulatory environment (which requires improving the inspection and tax administration systems), foster a domestic market for business development services, and encourage exports, including by encouraging participation in global value chains.

Measures to strengthen regional economies should be taken in parallel with efforts to transition the growth model, as many of the priority activities cross over both objectives. Value chain development should be linked to reforms in the agricultural sector. In addition, investments in the connectivity infrastructure—connecting the cities within the country with the rest of the world through better access to regional transport corridors—will be critical for capturing the medium-term opportunities of initiatives like Belt and Road and for supporting the growth of agglomerations outside Almaty and Astana cities. A related short-term priority is upgrading urban infrastructure and public services. Finally, progress on decentralization, supported by capacity building of local officials, will be an important priority over the next five years.

Expanding and accelerating reforms to modernize and upgrade the education system should be part of a longer-term plan to build more adaptable human capital. Kazakhstan needs to accelerate efforts to build a lifecycle approach (i.e. continuous life-long improvement of skills and competences) to education and skills development, to better equip citizens to adapt to a changing labor market. Important steps required over the next 5–7 years include: building stronger cognitive and socioemotional skills, starting with expanding access to early childhood education; revision of the advanced training system; and deepening collaboration between advanced training educational institutions and employers to improve the relevance of skills and competencies that are in demand on the labor market. Another top priority over the next five years is investment to achieve more equal outcomes across socioeconomic and demographic groups and regions. Investments to improve the quality of healthcare services across the country will be an important complement to education to improve human capital.

Delivering the reforms discussed above and achieving the objectives discussed in this report will require fundamental improvements in governance, perhaps the most urgent priority over the next few years. As with human capital, improving governance in Kazakhstan must be an ongoing effort, one that bears fruit over a generation. Two areas of focus are: addressing corruption and the rule of law and improving the efficiency of public administration.[11] Reducing corruption will require increasing the transparency of government actions and decisions, including on public procurement and state support to individual sectors and firms. Enhancing public sector capacity will require increasing decentralization of the decision-making system (through increasing economic independence and accountability of regions), building and realizing the potential of civil service in the area of analysis and strategic

[11] The government's 100 Steps program also identified these two areas as most important for institutional reforms.

planning, strengthening financial management skills and accountability, and establishing rigorous performance accountability processes, including systematic monitoring and evaluation of government programs and budgets. A number of additional governance reforms are vital to the delivery of the other priorities outlined in this report, including creating more space for citizen voice through decentralization and other actions that increase government transparency and accountability, and establishing a more transparent competition and regulatory environment to level the playing field for firms.

1. Setting the stage: Poverty, shared prosperity, and jobs in a changing economic context

Identifying the challenges to eliminating poverty and promoting shared prosperity requires an understanding of recent trends in poverty and the development of the middle class in Kazakhstan. Over the past decade, Kazakhstan has made major strides in reducing poverty and building a middle class, driven by strong economic growth and gains in job creation and earnings. However, since the oil price collapse in 2014, there have been sharp increases in poverty and a decline in the middle class. These reversals are accentuating the already large regional divides in prosperity and the underlying weaknesses of Kazakhstan's economy, characterized by low-quality/low-productivity job creation and unsustainable wage growth. With rapidly changing regional and global environments that present both opportunities and threats, Kazakhstan faces an urgent need for reforms that will support a new growth model built around a competitive private sector.

This chapter reviews Kazakhstan's recent economic history and structural features (box 1.1), trends in poverty reduction and shared prosperity, and the job creation and earnings that are central to delivering that shared prosperity. It concludes with a snapshot of the challenges and the broad strategic pillars for addressing them.

Kazakhstan has a highly ambitious long-term growth strategy. Kazakhstan Strategy 2050 sets long-term goals, including being one of the top 30 economies in the world with opportunities for all, an efficient state, an open economy, and open political space. With high levels of institutional and human capital, solidly grounded in a strong and vibrant middle class, such an economy and society could adapt and respond to the uncertainties in the external environment. Kazakhstan's long-term goals are a good fit with the twin goals of the World Bank Group—eliminating absolute poverty and boosting shared prosperity.

The economic growth and social gains made since 2000 augur well for reaching the goals set for 2050. Poverty rates fell sharply until 2014, and the middle class expanded. Growth was inclusive, with the income of the bottom 40 percent of the population growing above mean income growth. Access to basic services widened, and the gap in nonwage incomes narrowed. These gains were driven by rapid growth in productivity and even more rapid growth in earnings.

However, the sharp drop in oil prices in 2014 and the likelihood that oil prices will remain low over the long term necessitate reexamining the country's growth model. The decline in oil prices derailed the country from its high-growth trajectory and depleted the country's net wealth. In the absence of diversified revenue sources, Kazakhstan suffered a fiscal hit. Poverty gains were partially (but not substantially) reversed. The impacts of the oil price collapse exposed an inability of the current growth model to respond to changing market conditions because of stalled structural reforms during the periods of high oil prices, which led to shortfalls in market development and competitiveness.

Other countries are jockeying to consolidate their market positions in response to the changing external environment. The center of gravity of world economic activity and trade is shifting toward Asia, a region that grew by looking outward and that is increasingly becoming a pole of attraction for the rest of the world. Countries that will be able to take advantage of the new channels of trade and economic activity—embodied in mega-projects like the Belt and Road Initiative—are those that succeed in diversifying their economic structure by entering new areas of economic activity, acquiring new technologies, training their population, carving market niches, and building strategic partnerships. One of the lessons of Asia's earlier experience is that the gains often go to the swift and agile countries that establish the right enabling economic environment. Responding rapidly to new opportunities requires overcoming the inertia of the past and the vested interests that protect short-term gains at

the expense of a brighter future. Countries need to adopt a growth mindset and experimental approaches that favor learning and eschew pursuits that defy comparative advantage.

This Systematic Country Diagnostic identifies priorities that Kazakhstan can adopt for its reform agenda of eliminating poverty and building a secure middle class. The government developed and started to implement the long-term Kazakhstan 2050 development strategy with very ambitious development goals. Some practical steps in this area are outlined in the 100 Steps program and the Strategic Plan for Development of Kazakhstan to 2025. While these initiatives cover a wide range of objectives, they should also be more selective and focus on key priorities. Preemptive actions, such as explaining the potential benefits and the costs of inaction to the public, should be taken to counter resistance to reforms. This will allow to follow the strategic path chosen by Kazakhstan.

Box 1.1: Kazakhstan's recent history and distinctive structural features

Recent economic history

After independence in 1991, Kazakhstan endured a period of economic instability, recession, and hyperinflation. By 1995, the economy had contracted by a third due to the rupture of historic commercial and industrial links within the former Soviet Union and to the emigration of skilled labor. Improved economic policymaking in the second half of the 1990s reined in inflation, setting the stage for a restoration of growth led by the oil, gas, and mining sector, which rapidly replaced the collapsed manufacturing sector. Contagion from the Asian financial crisis of 1997–98 meant a sharp decline in mining prices that put pressure on the balance of payments and the fixed exchange rate regime (formally, a managed float). Growth remained slow during the late 1990s as oil prices remained low. Devaluation of the tenge in 1999 provided some relief. The commodity supercycle that began in the early 2000s, along with new oil and gas fields coming online, triggered a decade of rapid growth in Kazakhstan.

Distinctive structural features

Kazakhstan's distinctiveness as a unique country in a unique part of the world shapes its economic opportunities and its political responses to them. Three key aspects of Kazakhstan's distinctiveness are its natural resource wealth, its internal and external geography, and its history as a transition economy.

Natural resource wealth

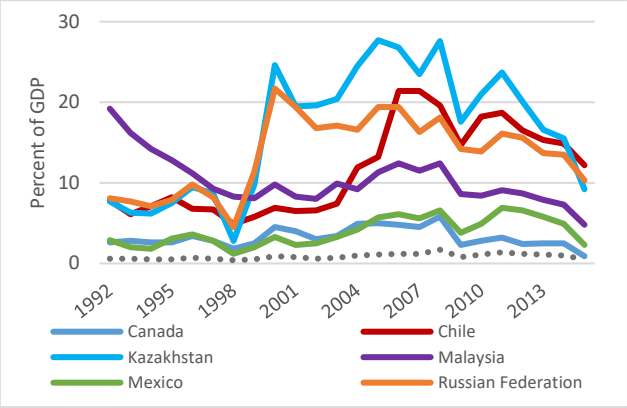
Kazakhstan's enormous stores of oil, gas, and minerals have enabled it to develop and reduce poverty sharply. For most of the last decade, natural resource rents accounted for 40–50 percent of GDP, a rate even far higher than in other resource-rich countries (box figure 1). Managing natural resource wealth is challenging. It requires adapting to commodity price shocks and translating natural resource endowments into other productive forms of capital. Natural resources can make it more difficult to diversify, boost productivity, and create jobs. This "paradox of plenty" includes risks of volatility, overvalued real exchange rate, weak governance, and institutional undercapacity.[12]

Internal and external geography

Kazakhstan is shaped by its geography. It is the ninth largest country by land mass, but its small population makes it one of the least densely populated, with just 6 people per square kilometer (box figure 2). Moreover, its people are dispersed across the country, and its commercial capital, political center, and oil region are separated by thousands of kilometers. Harsh climate conditions limit connectivity and isolate parts of the country.

[12] World Bank Group (2013).

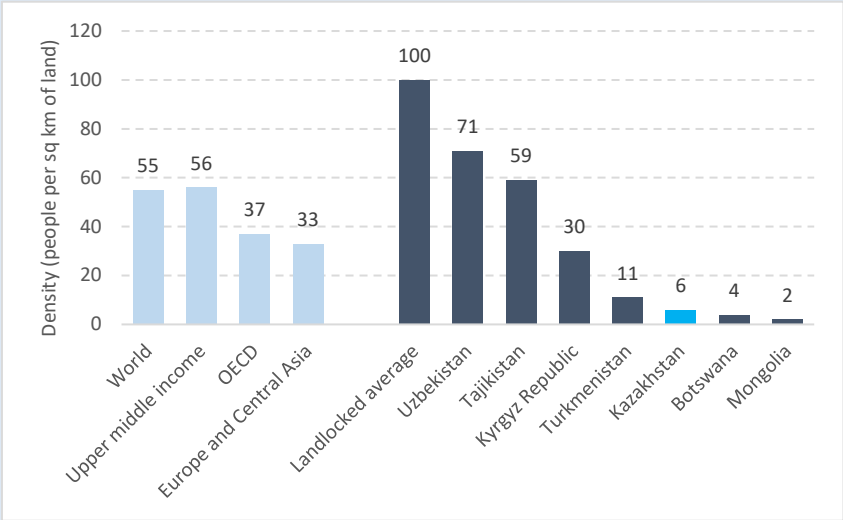
Box figure 1: Kazakhstan's natural resources rents exceed those of other resource-rich countries, 1992–2015



Data source: World Bank Group, World Development Indicators 2016.

Kazakhstan's internal geographic challenges are aggravated by its landlocked position, which raises the costs and challenges of trading in regional and global markets. Kazakhstan sits in a strategic position between China and the Russian Federation, regional markets with Central Asian neighbors are thin, and core markets in China (east), Russia (northwest), and the European Union are distant. These geographic facts of life make it tougher for Kazakhstan to compete in trade.

Box figure 2: Kazakhstan is one of the world's most sparsely populated countries



Data source: World Bank Group, World Development Indicators 2016.

Transition economy

Like other countries in Central Asia, Kazakhstan has gone through massive political, economic, and structural changed in a short period. In the transition from a socialist to a market economy, some countries in the region implemented reforms more comprehensively or rapidly than others. Kazakhstan, a "late modernizer,"[13] is among countries that initiated reforms more slowly or unevenly and therefore that have a less receptive business environment, a substantial public sector role in industry, a less well-developed financial sector, and weaker global integration.

[13] World Bank Group (2014a).

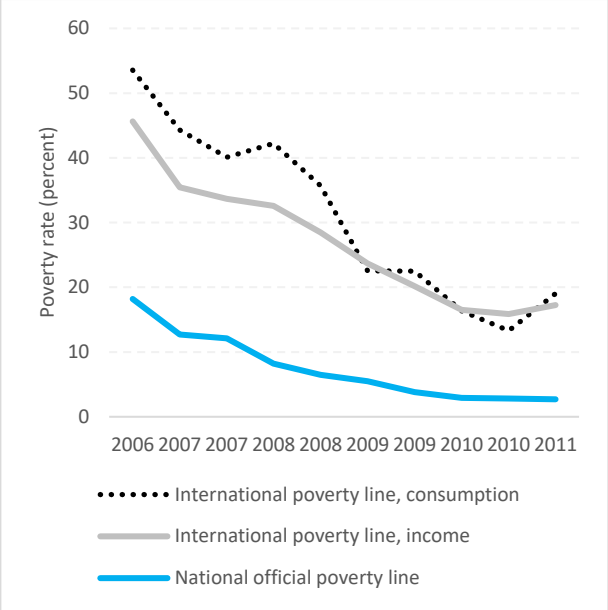
1.1 Trends in poverty reduction and shared prosperity

Substantial poverty reduction and gains in shared prosperity, but sharp recent reversals

Since 2006, poverty has fallen and the middle class has expanded.[14] Poverty incidence has fallen steadily, however measured: by internationally comparable consumption and income indicators (based on the US$5 a day international poverty line at 2005 purchasing power parity, or PPP) and by official national estimates based on income per adult equivalent (figure 1.1).[15] Some 4–5 million people were pulled out of poverty over 2006–15 alone.[16] Similar sharp improvements were also seen in nonmonetary dimensions of poverty (box 1.2).

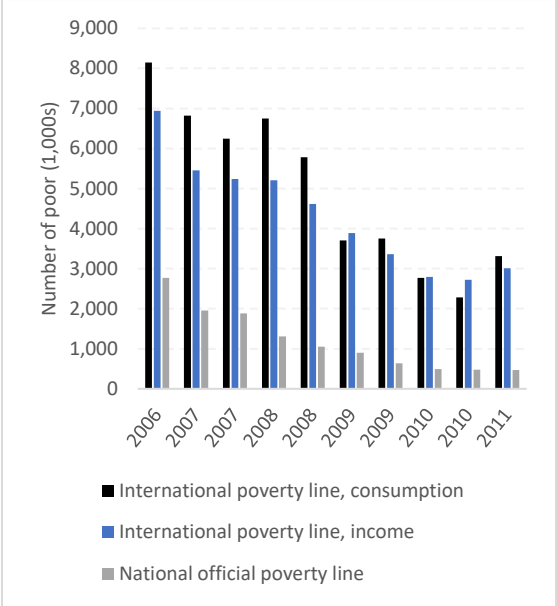
Recent years have seen reversals. Poverty rose sharply in 2015, however, following the oil price collapse of 2014 (see figures 1.1 and 1.2). Poverty incidence (measured by consumption) rose almost 6 percentage points from 2014 to 2015, as the number of poor people rose by almost 1 million.

Figure 1.1: Lower poverty rate, 2006–15



Data source: Household Budget Surveys.
Note: International poverty line based on US$5 a day at 2005 purchasing power parity.

Figure 1.2: Fewer poor people, 2006–15



Data source: Household Budget Surveys.
Note: International poverty line based on US$5 a day at 2005 purchasing power parity.

Robust poverty reduction before 2014 contributed to a tripling of the middle class (share of the population living on US$10–US$50 a day in 2005 PPP). According to World Bank calculations, the middle class grew from 8.5 percent of the population in 2006 to about 25 percent in 2015 (figure 1.3). Despite these gains, and Kazakhstan's aspirations for widespread prosperity and a thriving middle class, the country has yet to attain the middle-class economic security found in peer countries such as the

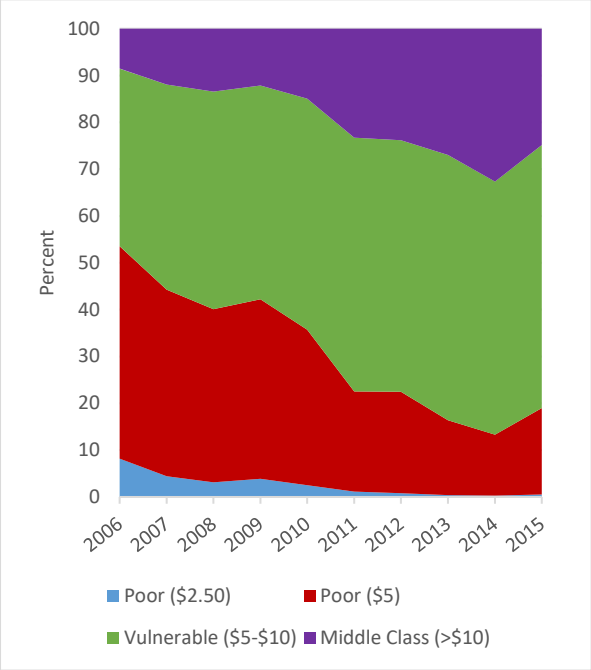
[14] Unless otherwise stated, the standard poverty measure used throughout the text is defined as the share of the population living below the $5-a-day per capita line in 2005 purchasing power parity based on consumption. The consumption welfare measure used in this report excludes observed and imputed rent.

[15] All three approaches are measured using data gathered in the Household Budget Survey of Kazakhstan. The national poverty line is estimated at 40 percent of the official "minimum living standards basket" established quarterly by the Ministry of Economy. In 2015, the basket was 21,364 tenge (T) per person per month, and thus the poverty line was T 8,546 per person per month. However, the statistical agency documents elsewhere on its website that the official poverty rate is estimated in adult equivalent terms. This discrepancy is unresolved, and the official national poverty estimates reported here have not been independently validated.

[16] Based on the US$5 per day international poverty line for consumption and income, respectively.

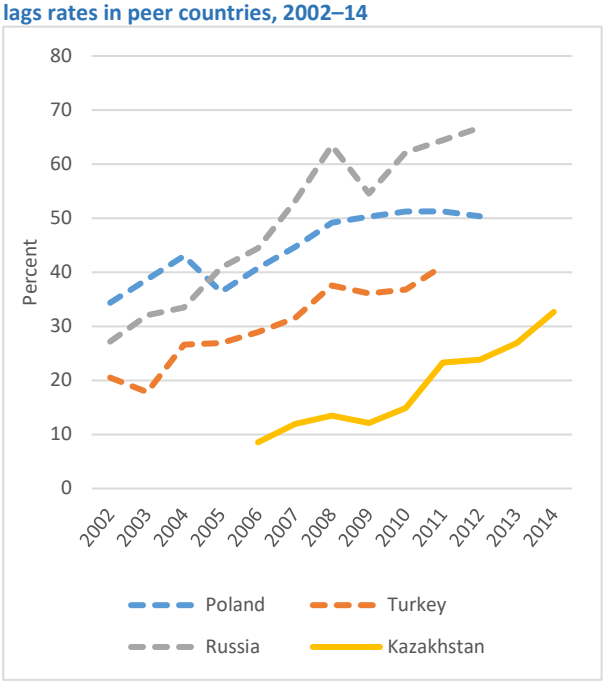
Russian Federation and Turkey (figure 1.4). Moreover, while the middle class grew rapidly, most people who moved out of poverty did not attain the security of the middle class. According to World Bank calculations, the share of the population earning US$5–US$10 a day grew from 38 percent in 2006 to 56 percent in 2015, meaning that more than half the population remains close to the poverty line and thus vulnerable to slipping into poverty again. The 6-percentage point increase in the incidence of poverty and the shrinking of the middle class by almost 8 percentage points between 2014 and 2015 highlights this fragility (see figure 1.3). To put this recent contraction in perspective, the middle class shrank by just 1.4 percentage points during the 2008–09 financial crisis.

Figure 1.3: Kazakhstan's middle class has grown, 2006–15



Data source: Household Budget Surveys.
Note: Based on US$2.50 and US$5 a day international poverty line at 2005 purchasing power parity.

Figure 1.4: But growth of the middle class in Kazakhstan lags rates in peer countries, 2002–14

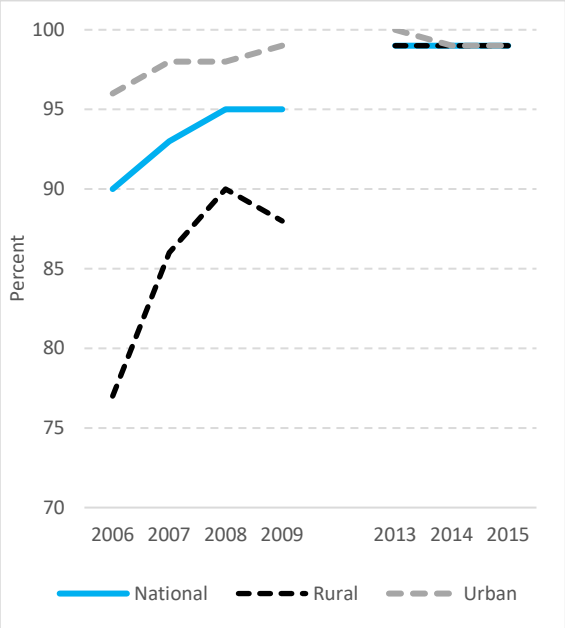


Data source: Household Budget Surveys.

Box 1.2: Nonmonetary dimensions of poverty in Kazakhstan

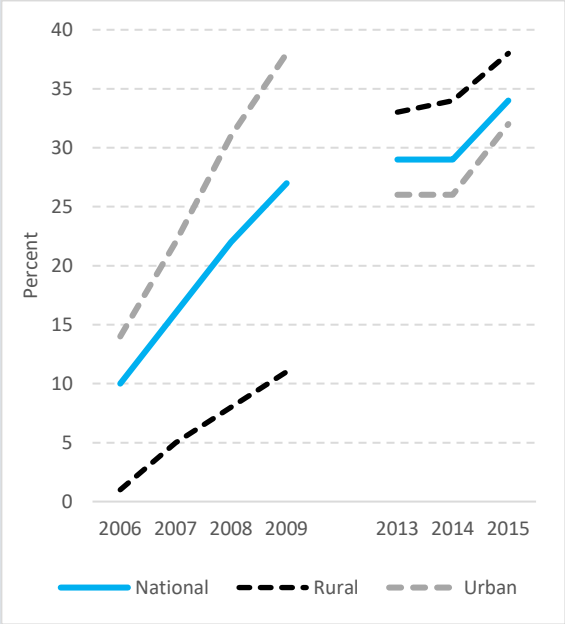
Since 2006, the living conditions of the population have been improving. Nearly all residents have access to electricity, almost half the population has access to network gas and district heat, and access has increased by 10 percentage points for centralized piped water and by 6–10 percentage points for central sewerage. The use of washing machines has also risen quickly, and both low- and high-income households benefited from better access to amenities and household durables, such as refrigerators (box figure 1). In rural areas, access to a car increased and by 2013 had overtaken access in urban areas (box figure 2).

Box figure 1: Kazakh households that own or can access a refrigerator



Data source: Household Budget Surveys.
Note: Differences in questionnaire design over time render many questions on asset ownership incomparable across years. This indicator is believed to be comparable for 2006–15. There is a gap in the data for 2010–12.

Box figure 2: Kazakh households that own or can access a personal automobile



Data source: Household Budget Surveys.
Note: Differences in questionnaire design over time render many questions on asset ownership incomparable across years. This indicator is believed to be comparable for 2006–15. There is a gap in the data for 2010–12.

Despite these improvements, important differences remain in living conditions and access to services between income groups and regions. Some 12 percent of households in the poorest 40 percent reported an electricity outage in the preceding 30 days in 2014, which was almost twice the rate of the top 60 percent of households.

Despite relatively low energy prices and energy resource abundance, energy poverty remains a serious concern, due to combination of income inequality, high demand, and inefficient housing construction. A recent study based on a survey of 12,000 households finds that 28 percent of households in Kazakhstan are energy poor (using the energy poverty indicator of 10 percent of household income expenditure on energy). Most of those households are rural (68 percent), and the highest numbers of energy poor are in the oblasts (administrative region) of Akmola, Kostanai, and North Kazakhstan. Access to clean fuel for household heating is unavailable to about one-fifth of the rural population. Despite widespread access to district heating and natural gas networks even outside of urban areas, the study estimates that 30 percent of households use coal as a primary heating source—67 percent in rural areas. Heating with coal leads to indoor air pollution, with the negative health impacts borne disproportionately by women and children. In addition, access to improved water sources declined from 97 percent in 2000 to less than 86 percent in 2015.

Between 2006 and 2016, declining poverty and a growing middle class contributed to gains in shared prosperity. Consumption among the bottom 40 percent of the population grew by more than the national average, leading to a decline in inequality: the Gini consumption index fell from an already low 0.30 in 2006 to about 0.27 in 2015 (table 1.1). The ratio of consumption per capita of the top 10 percent of the distribution to the bottom 90 percent fell from 3.6 in 2006 to 3.2 in 2015, while the ratio of the top 25 percent to the bottom 75 percent fell from 1.9 to 1.8. Income growth over 2006–15 reveals similar patterns. Though measured inequality of income is higher than that of consumption, and more volatile, the Gini index for income also fell, from 0.324 in 2006 to 0.291 in 2015. Likewise, the ratio of income per capita of the top 10 percent of income distribution to the bottom 10 percent fell from 4.24 in 2006 to 3.7 in 2015.

Table 1.1: Consumption inequality measures for Kazakhstan, 2006–15

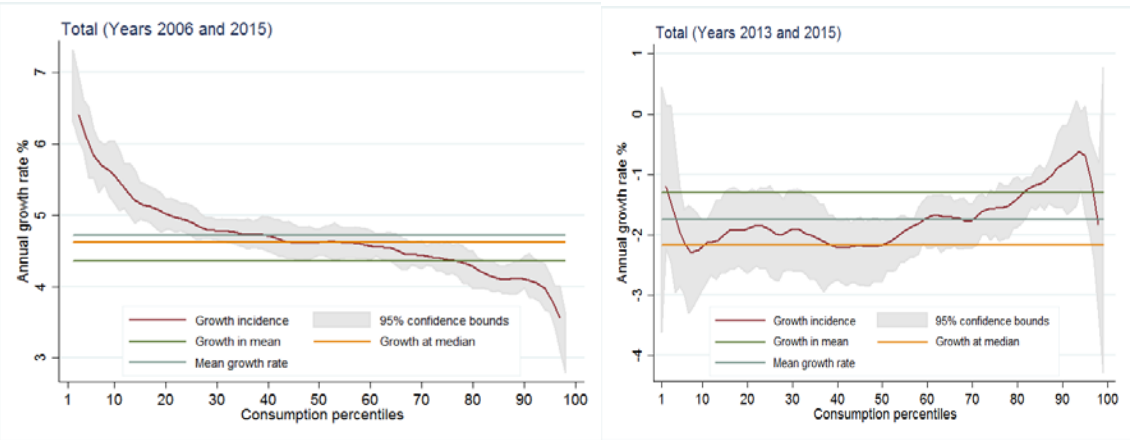
Year	Gini	Top 10 percent/ bottom 90 percent	Top 50 percent/ bottom 90 percent	Top 25 percent/ bottom 75 percent	Top 50 percent/ bottom 75 percent
2006	0.299	3.587	1.980	1.926	1.413
2007	0.295	3.487	1.953	1.906	1.400
2008	0.286	3.352	1.962	1.894	1.410
2009	0.278	3.355	1.933	1.877	1.401
2010	0.279	3.287	1.949	1.872	1.401
2011	0.273	3.291	1.920	1.882	1.393
2012	0.274	3.321	1.922	1.899	1.400
2013	0.262	3.097	1.849	1.831	1.368
2014	0.272	3.249	1.892	1.880	1.383
2015	0.271	3.184	1.898	1.844	1.385

Data source: Household Budget Surveys.

But this pattern of pro-poor growth has reversed starkly in recent years. The poor and the bottom 40 percent of the consumption distribution benefited more from consumption growth over 2006–15 than did people at the top of the distribution (figure 1.5, panel A). But the effect of the oil price collapse of 2014 was dramatic. Not only did consumption growth turn negative overall over 2013–15, but the trend of pro-poor growth was reversed, with the largest declines in consumption coming among the bottom 40 percent (figure 1.5, panel B). The net effect was a small but perceptible increase in inequality, with the Gini value (consumption) increasing by about a point between 2013 and 2015. A similar relationship holds for income.

Figure 1.5: Distribution of consumption growth in Kazakhstan, 2006–15 and 2013–15

A. 2006–15 **B. 2013–15**

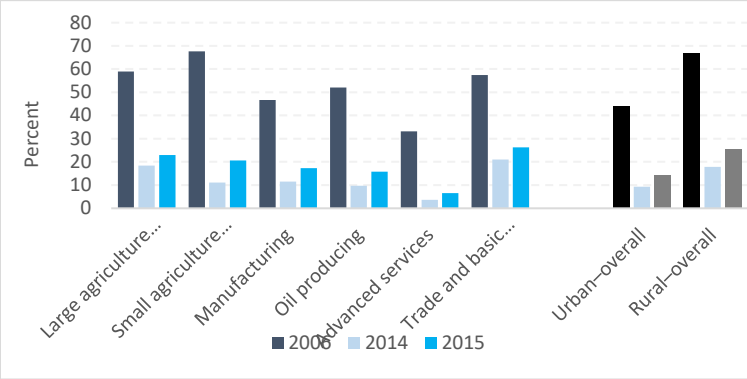


Data source: Household Budget Surveys.

Who and where are the poor and the bottom 40 percent?

Poverty rates differ widely across economic regions, with a sharp rural–urban divide. Poverty fell across the country over 2006–15, declining fastest in Almaty and Astana cities, followed by oblasts in the small agriculture economic region in the south and in the oil-producing region. Oblasts in the trade and basic services economic region experienced the least poverty reduction (although still considerable) over the decade. Despite nationwide declines in poverty, notable concentrations of poverty remain at the household level and, especially, at the regional level. In 2015, poverty was 80 percent higher in rural areas (25.3 percent) than in urban areas (14.1 percent), using the international poverty line of consumption of US$5 a day. But the differences are even greater across the country's six economic regions (also called "region types" and "regional economies" in this report) and oblasts (administrative regions) (figure 1.6 and table 1.2). In 2015, the poverty rate was just 6.6 percent in the economic region specializing in advanced services activities, such as professional, information and communications technology, and financial services (average for Almaty and Astana cities), while it was nearly four times as high, at 26.3 percent, in the economic region specializing in basic trade and transportation services (Kyzylorda, South Kazakhstan, and West Kazakhstan). The poverty rate was also above 20 percent in both large (north) and small (south) agricultural regions. Manufacturing and oil-producing economic regions have poverty rates above the national average, at 17.3 percent and 15.8 percent. Among oblasts, Zhambyl had the highest poverty rate in 2015, at 36 percent. Only Almaty (5.9 percent) and Astana cities (7.9 percent) and three oblasts had poverty rates below the national average of 19 percent: oil-producing Mangystau (8.9 percent) and Atyrau (7.9 percent) and small agriculture-producing Almaty (11.8 percent).

Figure 1.6: Poverty rates and trends vary by economic region type in Kazakhstan, 2006, 2014, and 2015



Data source: Household Budget Surveys.
Note: Poverty is measured using the international poverty line of consumption of US$5 a day in purchasing power parity.

Table 1.2: Summary statistics for oblasts by economic region, most recent available

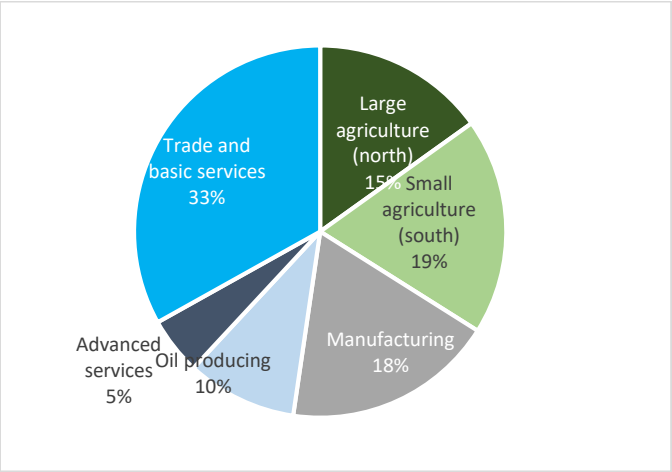
Economic region type	Oblast or city	Population, 2014 (million)	Poverty rate, 2015 (US$5/day, %)	Self-employment, 2016 (%)	Public sector share of wage employment, 2015 (%)
Large agriculture (north)	Akmola	0.7	28.1	35.5	46.6
	Kostonai	0.9	18.5	32.5	38.6
	North Kazakhstan	0.6	22.7	28.7	50.4
Small agriculture (south)	Almaty	2.0	11.8	27.1	54.2
	Zhambyl	1.1	36.0	44.7	63.5
Oil producing	Aktobe	0.8	24.3	18.5	36.8
	Atyrau	0.6	11.1	10.2	30.4
	Mangystau	0.6	8.9	6.6	33.3
Trade and basic services	Kyzylorda	0.7	33.1	37.1	53.7
	South Kazakhstan	2.7	25.7	43.2	54.3
	West Kazakhstan	0.6	20.8	37.2	51.3
Manufacturing	East Kazakhstan	1.4	16.9	29.6	46.1
	Pavlodar	0.8	15.3	17.2	39.7
	Karaganda	1.4	18.6	9.5	38.1
Advanced services	Astana City	0.8	7.9	5.1	28.4
	Almaty City	1.5	5.9	7.5	20.2

Data source: Agency of the Republic of Kazakhstan on Statistics.

Note: Poverty is measured using the international poverty line of consumption of US$5 a day in purchasing power parity.

Poverty rates reversed in many oblasts and economic regions in 2015. All oblasts were hit by the slowdown in growth in 2014, although poverty rates worsened more in predominantly rural oblasts. The most vulnerable oblasts, such as Kyzylorda and Zhambyl, experienced more than a doubling in poverty rates from 2014 to 2015 (15.8 percent to 33.1 percent, and 17.9 percent to 36 percent). Predominantly rural oblasts with lower average incomes and histories of higher poverty rates experienced larger increases in poverty in 2015 than did urban areas. In 2015, about one-third of the poor were concentrated in the economic region specializing in trade and basic services, while another one-third were in agricultural regions, and 28 percent were in manufacturing or oil producing regions; just 5 percent of the poor were in the region specializing in advanced services (Almaty and Astana cities), which had nearly 15 percent of the population (figure 1.7). Although urban areas were less affected by increasing poverty (largely because less of the population was near the poverty line in 2014), poverty increased even in the most economically prosperous areas of Astana (from 3.6 percent to 7.9 percent) and Almaty City (from 3.5 percent to 5.9 percent). Moreover, the largest reversal in poverty gains from 2014 to 2015 (nearly 10 percentage points) came in the small agriculture regions of the south. This, coupled with the fact that the region had experienced rapid poverty reduction prior to 2014's oil price shock, suggests that the oblasts in the southern small agricultural region may be becoming increasingly integrated with metropolitan regions, benefiting from spillovers during growth periods but also suffering from demand-side shocks during downturns.

Figure 1.7: About two-thirds of the poor in Kazakhstan were concentrated in trade and basic services and agricultural regions in 2015



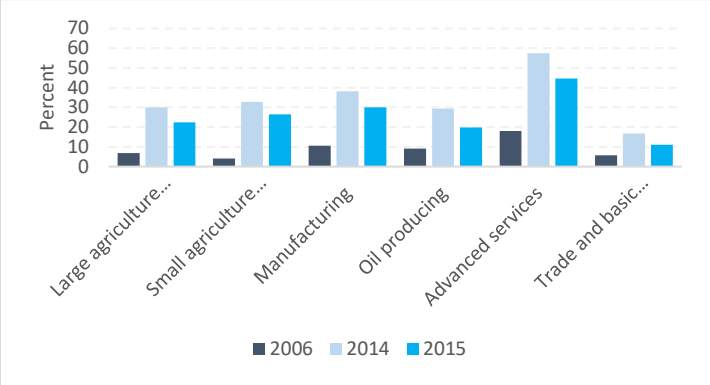
Data source: Household Budget Surveys.
Note: See table 1.2 for composition of economic regions.

Trends in the share of the bottom 40 percent of the population highlight large variations and specific vulnerabilities across oblasts arising from the oil price shock in 2014. Oblasts' share of the bottom 40 percent of national population in 2015 ranged from 17 percent in Almaty City to nearly 62 percent in Zhambyl and Kyzylorda oblasts. Almaty oblast's share of the bottom 40 percent declined from 51.6 percent in 2006 to 28.3 percent in 2015, while South Kazakhstan oblast's share increased from 32 percent in 2006 to 56 percent in 2015. The share in oil-producing Mangystau oblast jumped from 23 percent in 2013 to almost 36 percent in 2015, suggesting that the impact of the oil price shock is hitting the region hard.

The impact of the oil price shock is also evident in the declines in the share of the middle-class population by economic region. Oblasts in the oil-producing economic region experienced an almost 10 percentage point decline in the share of the middle class between 2014 and 2015 (figure 1.8). The advanced services economic region had more than half its population in the middle class by 2013, but experienced sharp declines after 2014, as the middle-class share dropped almost 13 percentage points, wiping out five years of gains.

After location, education is the most important factor determining poverty status. In 2006, the poverty rate among households varied by the education level of the household head, from about 60 percent for a primary school education or less (but this category was small), to about 58 percent for a secondary school education and about 38 percent for a tertiary education. In 2015, poverty rates declined for households headed by someone with a secondary level education (to about 21 percent) and for those with a tertiary education (to about 14 percent).

Figure 1.8: Shares of the middle class population shrank in all economic regions in Kazakhstan from 2014 to 2015



Data source: Household Budget Surveys.
Note: See table 1.2 for composition of economic regions.

Poverty is less prevalent among people with a tertiary education. About 33 percent of adults with a tertiary education were poor in 2006, a rate that fell to about 12 percent in 2015. This contrasts with a poverty rate of about 52 percent for people with a secondary or professional education in 2006, which fell to about 19 percent in 2015. In 2015, nearly 71 percent of adults had a maximum of a secondary or professional education, but more than 80 percent of poor people were in this category. Poverty also varies by the type of job and occupation: it is lower for those employed by public or private institutions, and higher for the self-employed, occasional workers, and farm workers.

Other household characteristics also affect poverty status. As in most countries, poor households in Kazakhstan are much larger and have more dependent members than nonpoor households. In 2006, the poverty rate among households with only one member was 10.4 percent, which fell to less than 5 percent in 2015. In contrast, the poverty rate among households with seven members or more was about 89 percent in 2006, and 42 percent in 2015. While about 63 percent of the population lives in households with four or more members, more than 85 percent of the poor live in households that size.

Poverty rates also decline with age. In 2006, the poverty rate for children under age 6 was more than 66 percent; by 2015 this had fallen to about 26.5 percent. In contrast, for people 65 or older, almost all of whom receive some form of pension, the poverty rate was about 39 percent in 2006 and about 12 percent in 2015. Poverty peaks in households whose head is between ages 30 and 49, which also coincides with the lifecycle when household sizes are largest on average.

Growth and jobs have been the key drivers of poverty reduction

Poverty reduction has been almost fully the result of economic growth, not of redistribution. Decomposing the drivers of poverty reduction between growth and redistribution components shows that between 2006 and 2015 economic growth explains fully 31.7 percentage points of the 34.5 point decline, while the distribution of consumption explains just 2.8 points.

Income from employment has been been the major driver of household earnings growth. Household incomes rose 50 percent on average between 2006 and 2015, with income from wage employment accounting for around three-quarters of this growth (table 1.3). Old age social pensions were the second largest contributor to earnings growth, followed by nonagricultural self-employment. Across all sources of earnings, growth was higher in rural areas than in urban areas, with overall household earnings rising by 66 percent in rural areas versus just 45 percent in urban areas. Earnings declined across both urban and rural areas, and across all income sources except pensions, in 2014–15.

Table 1.3: Contributions to change in real household income between 2006 and 2015 (percent)

Contributor to household income change	2006–15			2014–15		
	Total	Rural	Urban	Total	Rural	Urban
Wage employment	37.9	42	37	-1.2	-0.7	-1.8
Self-employment (nonagricultural)	4.4	7	3	-0.1	-0.3	-0.1
Agricultural income	0.4	2	0	-0.1	-0.1	-0.2
Old age social pension income	8.6	9	9	0.6	0.2	0.8
Social/subsidy benefits	0.4	2	0	-0.1	-0.1	-0.3
Private transfers (remittances)	0.7	2	0	-0.2	-0.2	-0.3
Other	-2.2	1	-3	0.0	-0.2	0.0
Total	50.3	65.7	45.2	-1.1	-1.5	-1.8

Data source: Agency of the Republic of Kazakhstan on Statistics.

Variations in household earnings patterns across the income distribution had important implications for poverty and inclusion. The lower income quintiles benefited from rapid growth in earnings from wage employment and self-employment over 2006–15 (table 1.4). For example, earnings from wage employment grew 51 percent in the bottom quintile compared with 29 percent in the top quintile. Lower income quintiles also benefited from higher growth in earnings from social benefits and private transfers (remittances). This pattern contributed to declining poverty and greater inclusion. In 2014–15, however, declines in earnings from both employment and nonemployment sources were much greater among lower income quintiles, while earnings from all sources but wages grew for the top two income quintils. The large role of wage earnings for poverty reduction makes it important to understand recent labor market trends and their implications for the sustainability and inclusiveness of poverty reduction and middle class attainment.

Table 1.4: Household earnings growth by source and income quintile, 2006–15 and 2014–15 (percent)

Income source	2006–15 (quintile)					2014–15 (quintile)				
	Bottom	Second	Third	Fourth	Top	Bottom	Second	Third	Fourth	Top
Wage employment	51	45	43	36	29	-4	-2	0	0	0
Self-employment (nonagricultural)	13	9	6	2	0	-4	-2	-1	1	4
Agricultural income	4	2	2	0	-2	-3	-2	-1	1	3
Old age social pension income	8	7	7	8	11	-2	-2	-1	1	6
Social/subsidy benefits	5	3	1	-1	-2	-3	-2	-1	1	3
Private transfers (remittances)	5	3	2	0	-1	-3	-2	-1	1	3
Other	4	2	0	-4	-6	-3	-2	-1	1	4
Total	90	71	61	42	29	-23	-14	-6	5	24

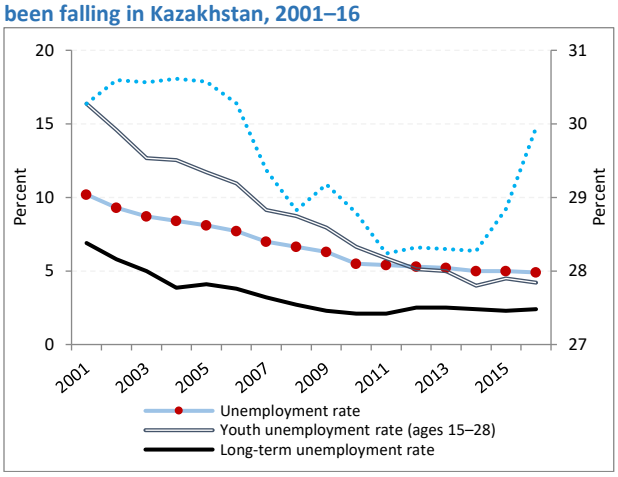
Data source: Agency of the Republic of Kazakhstan on Statistics.

1.2 Jobs, earnings, and productivity

Job growth was strong and labor market outcomes were largely inclusive through the first part of the 2000s

Substantial job creation accompanied the rapid GDP growth during the 2000s. Over 2003–13, around 150,000 net new jobs were created each year in a market where the labor force was expanding by around 130,000 people a year. As a consequence, the unemployment rate fell steadily throughout the decade, from 10.4 percent in 2001 and 8.4 percent in 2004 to 5 percent in 2016 (figure 1.9). Long-term unemployment has been virtually eliminated. And labor force participation—already among the highest in upper-middle-income countries for both men and women—increased steadily.

Figure 1.9: Unemployment and economic inactivity rates have been falling in Kazakhstan, 2001–16

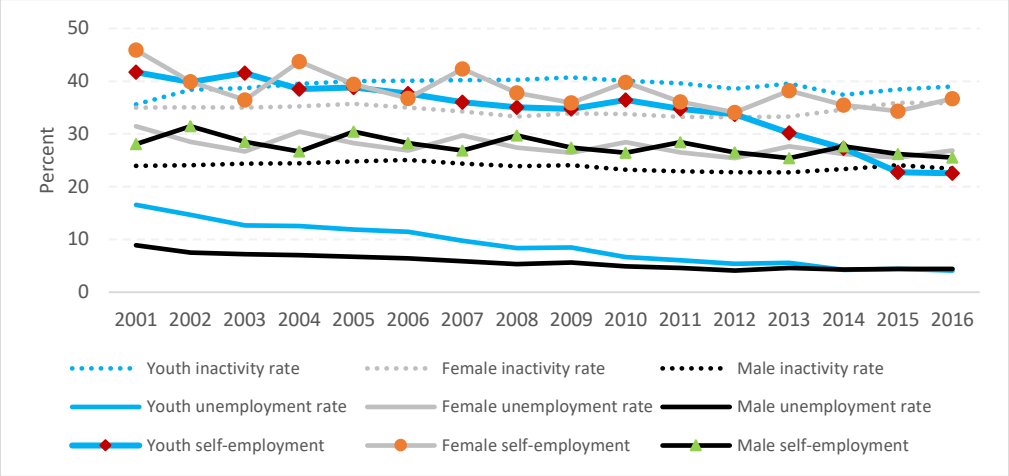


Data source: Agency of the Republic of Kazakhstan on Statistics.
Note: Youth refers to ages 15–28.

Labor market gains have been inclusive. Unemployment and self-employment rates of men, women, and youth have been converging since 2001 (figure 1.10). For youth, for example, the unemployment rate was 60 percent higher than the national average in 2002; by 2016 it had fallen to 18 percent below the average. In contrast, economic inactivity rates, which increased by 1.5 percentage points after the economic slowdown that began in 2015, have diverged, with women[17] and youth appearing to bear the brunt of worsening labor market conditions.

[17] The labor force participation rate of women is some 10 percentage points lower than that of men (driven mainly by a participation rate that is around 10 percentage points lower). This gender gap is, however, well below the OECD average.

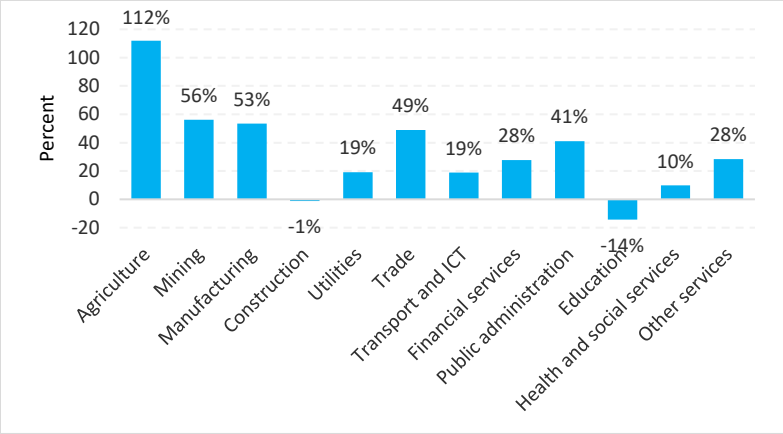
Figure 1.10: Male, female, and youth unemployment, economic inactivity, and self-employment rates have been converging in Kazakhstan, 2001–16



Data source: Agency of the Republic of Kazakhstan on Statistics.

Despite women's extensive participation in the labour market, a gender wage gap persists. As in many countries, the wage structure in Kazakhstan reveals a significant gender gap, which results from both individual selection and legal restrictions. According to the Ministry of Labor and Social Protection, the employment of women is prohibited in 287 occupations considered to be harmful, dangerous, or require heavy physical labor.[18] In addition, women are more likely to be employed in lower-paying sectors such as education, healthcare, and social services (where women make up more than 70 percent of employees). According to World Bank calculations, even controlling for characteristics like skills and geographic location, wages for male workers were 27–31 percent higher than those for female workers in 2011–13. The gap varies across sectors and is particularly large in agriculture, manufacturing, mining, and commerce (figure 1.11). The most recent data (2013) indicate that just 19 percent of firms in Kazakhstan have women in top management positions.[19]

Figure 1.11: The gender wage gap in Kazakhstan varies considerably by sector, 2013



Data source: World Bank Group (2015).
Note: The analysis uses data from the 2011–13 Household Budget Surveys to estimate the determinants of wages, overall and by sector, and controls for worker characteristics.

[18] https://www.zakon.kz/4863734-v-kazahstane-peresmotryat-spisok.html.
[19] World Bank Group, World Development Indicators.

But the quality of job creation has been weak, especially since 2011

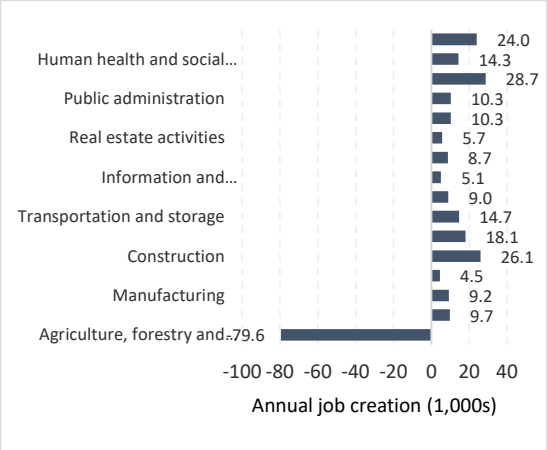
Job creation during the first part of the 2000s came overwhelmingly in nontradable services. Manufacturing and mining each contributed less than 10 percent to new job creation, with more than 90 percent accounted for by construction and services (figures 1.12). And within the services sector, the main contributors to job growth came in public and social services (public administration, health, education), along with trade and transport. Business and financial services have also grown strongly in recent years, but their share of employment remains small, and job opportunities are highly concentrated in Astana and Almaty cities. Indeed, while wage growth has been strong in the economy overall, a large number of workers, mainly the self-employed, still earn very low wages. Around 28 percent of all employed workers earn below two-thirds of the median earnings—a higher share than in any OECD country.[20]

This growth dynamic means that while jobs have been transitioning rapidly out of low-productivity agriculture, they are shifting mainly into nontradable services, many of which also have low productivity profiles (figure 1.13). The implication is that the wage gains from the transition are likely to be short-lived if productivity growth cannot be increased because many workers will remain in activities with earnings potential that may leave them vulnerable to poverty. Indeed, this appears to be precisely what happened during the recent crisis.

The sustainability of labor market outcomes is also in doubt, given the weak job performance of the private sector since 2011. The private sector share of overall employment stood at 73 percent in 2015 (63 percent, excluding the self-employed), but its share of employment has not grown over the decade (figure 1.14). While private enterprises created more than 165,000 jobs annually (around two-thirds of all jobs) over 2005–10, they shed a little more than 14,000 annually over 2011–15 (70,000 overall; figure 1.15). The public sector, meanwhile, continued as a relatively steady, if limited, source of new jobs, creating around 45,000 jobs (including in SOEs) annually since 2011.

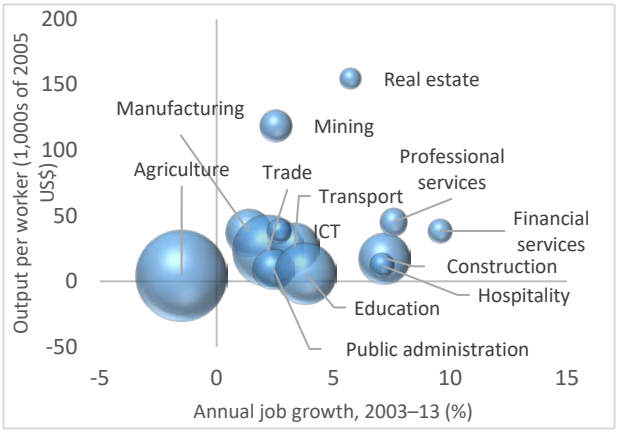
[20] OECD (2017).

Figure 1.12: Construction and services accounted for more than 90 percent of job creation, 20013–16



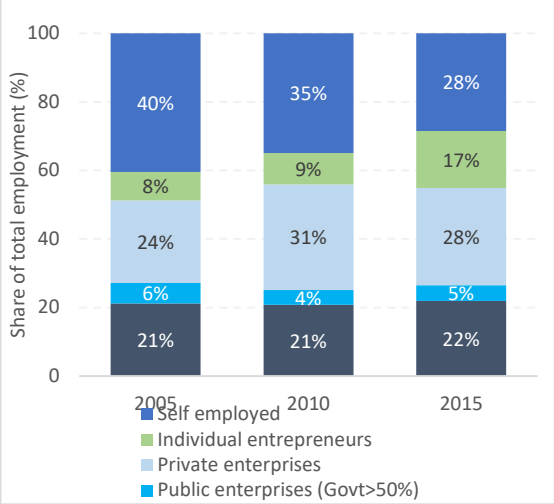
Data source: Agency of the Republic of Kazakhstan on Statistics.

Figure 1.13: The job shift from low-productivity agriculture has been mainly into low-productivity nontradable services, 2003–13



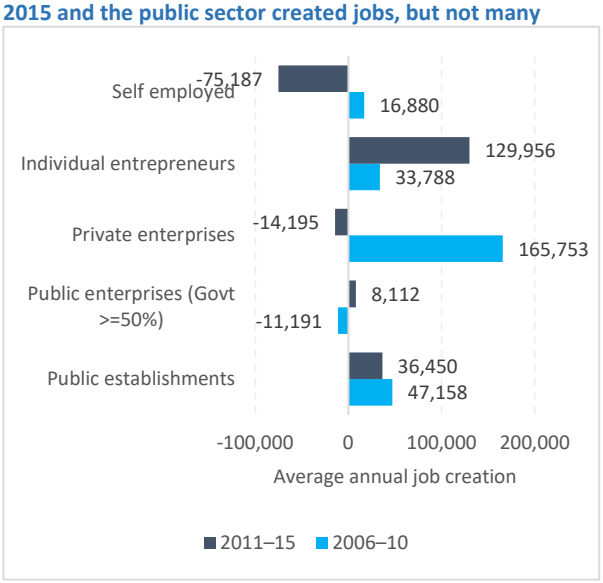
Data source: Agency of the Republic of Kazakhstan on Statistics.

Figure 1.14: The share of jobs in the private sector and state enterprises declined in Kazakhstan between 2010 and 2015



Data source: Agency of the Republic of Kazakhstan on Statistics.

Figure 1.15: The private sector shed jobs between 2010 and 2015 and the public sector created jobs, but not many



Data source: Agency of the Republic of Kazakhstan on Statistics.

Lacking access to good quality jobs, people are creating their own opportunities through self-employment. Nonwage employment (self-employment and individual entrepreneurs) accounted for 45 percent of jobs in 2015. This is down only slightly over the decade, although there has been a large shift in employment between self-employment and establishments set up as individual entrepreneurs. This share of self-employment and microenterprise employment is far above OECD shares and has ramifications for productivity and labor market adaptability. Self-employed workers are less likely to benefit from specialization, collaboration, and knowledge exchange and may have less opportunity to develop the soft skills that are critical for employment with larger entities.

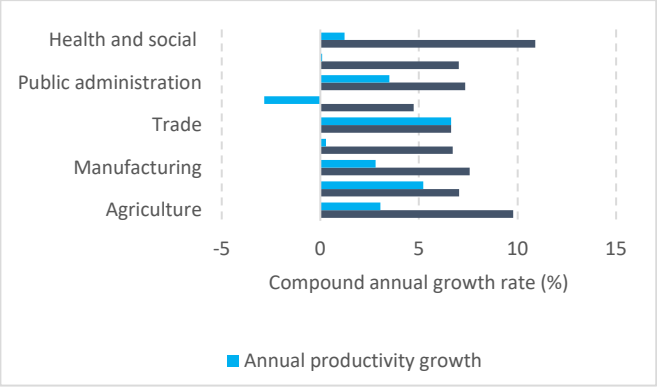
Moreover, self-employed workers are among the least productive and most vulnerable in Kazakhstan. Members of households in the bottom 40 percent are much more likely than the rest of

the population to be in self-employment, both agricultural and other. In the decade before 2013, around one-third of self-employed workers were categorized each year as in unproductive self-employment (delivering earnings below the subsistence level). Reclassifications in 2013, which changed the definition, reduced the share classified as "unproductive" by more than half in just three years (2013–16). But this still means that more than 350,000 self-employed workers make only poverty-level earnings, with most others at the low end of the earnings distribution.

Faster wage growth than productivity growth

Wage growth far outstripped productivity growth across the labor force until recently. While growth in value added per worker averaged a fairly robust 4.9 percent annually between 2004 and 2013, wage growth far outstripped it—at 7.7 percent annually in real terms. Wages grew rapidly in sectors with low productivity growth, including agriculture, construction, education, and health and social services (figure 1.16). As these sectors are also among the lowest paying, rising wages supported convergence in earnings but also created an unsustainable wedge between productivity and wages that increased rapidly after 2009 to a peak of 38 percent in 2013. More recently, productivity has declined considerably, to just 2.6 percent over 2014–15, while wage growth has halted almost completely. This suggests that prices may be adjusting sharply, with potentially serious effects on the poorest workers.

Figure 1.16: Annual wage and productivity growth varied widely by sector in Kazakhstan, 2004–13



Data source: Agency of the Republic of Kazakhstan on Statistics.

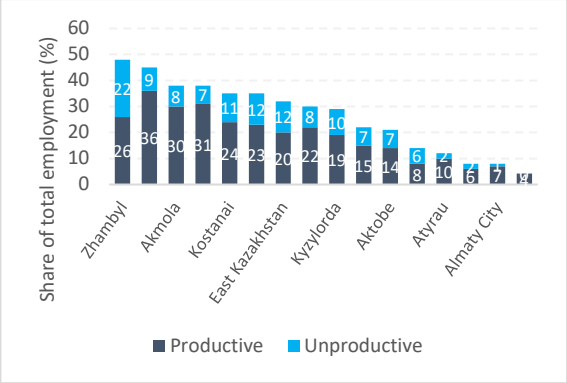
Regional disparities in poverty are closely linked to job outcomes

Geography plays a big part in the distribution of good quality jobs. Self-employment is concentrated in rural areas. It accounts for almost half of all rural jobs, but less than 5 percent of jobs in Astana and under 10 percent in Almaty City and Mangystau oblast. By contrast, almost half the jobs in Zhambyl and South Kazakhstan oblasts are in self-employment, many of them unproductive (figure 1.17). Rural and peripheral areas are also where most of the households in the bottom 40 percent are located. In these oblasts, the private sector is extremely thin on the ground, making self-employment among the few earning opportunities, whether in agricultural or in nonagricultural activities.

Regional disparities in access to good quality jobs can also be gauged by youth unemployment and inactivity rates. Rates of youths (15–28 years old) who were inactive (not in employment, education, or training) in 2014 and 2016 show major discrepancies across oblasts, with rates in Zhambyl, Kyzylorda, Karaganda, South Kazakhstan, and Mangystau oblasts some 50 percent higher than in other oblasts (figure 1.18). Moreover, while these rates have risen across all oblasts since the crisis, the impacts were much greater in some. The starkest example is oil-producing Mangystau, where the rate of youth inactivity rose from 7.9 percent to 17.1 percent in just the two years from 2014 to 2016; in small-agriculture Zhambyl, the rate rose from 12.4 percent to 17 percent. Contrasts between

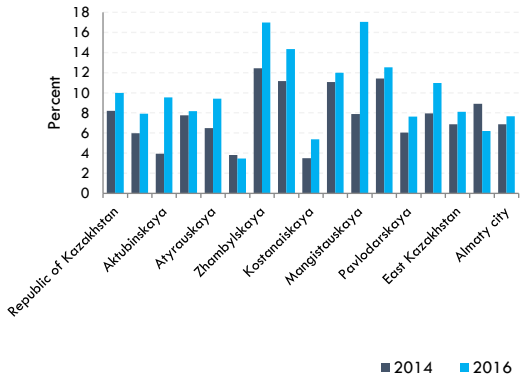
metropolitan parts of Kazakhstan (notably Astana, where the rate even declined during this period) and other parts of the country are also stark, raising concerns about the risk of social instability.

Figure 1.17: The share of jobs in self-employment varies considerably by oblast in Kazakhstan, 2015



Data source: Agency of the Republic of Kazakhstan on Statistics.

Figure 1.18: Rates of youth not in employment, education, or training in Kazakhstan are much higher in some oblasts, 2014 and 2016



Data source: Agency of the Republic of Kazakhstan on Statistics.

Addressing rising poverty and inequality requires creating productive jobs

The case for economic transformation. The increasingly strong association between economic growth and wage earnings and poverty has important implications. First, given the sharp response of poverty rates and the size of the middle-class to the growth slowdown since 2014, there is a high risk that continuing slow growth could worsen poverty, especially in already poor and rural areas. From 2014 to 2015, the number of poor people in Kazakhstan rose by more than 1 million. Slow growth will also push the middle-class dream further away for all Kazakhs, particularly in urban areas, where the growing middle class has been experiencing considerable regression. At the very least, absent a rapid (and not yet discernable) recovery in growth, it will take some years to recover the gains lost in the recent downturn. Second, if the number of poor people rises, mitigating the impact will likely require boosting social assistance. But this redistribution can go only so far and may be unsustainable because of the tight fiscal constraints following the oil price collapse. The economy requires a shift toward one where jobs are created by a competitive, outward-looking private sector, and wage growth is supported by robust productivity gains.

1.3 Looking ahead—four mutually reinforcing strategic pillars for building a secure middle class

The need for a new growth model. Although Kazakhstan has experienced excellent economic growth and poverty reduction over the long term, the 2014 drop in oil prices has had a profound impact on economic and social outcomes, exposing structural weaknesses that have been building. Job creation, already stagnant in the years before the oil price drop, is in retreat. Since 2014, poverty has increased sharply and a substantial share of the population has fallen out of the middle class or has found the dream of joining the middle class increasingly elusive. The economic slowdown has hit vulnerable populations, especially those in rural areas, particularly hard, further distancing the city economies of Astana and Almaty from much of the country. Both spatial and interpersonal inequalities are growing.

Structural reforms are likely an imperative, not an option. Kazakhstan faces tough decisions in delivering inclusive growth and returning to a trajectory that is consistent with the long-term goals of Kazakhstan Strategy 2050. With oil prices expected to remain low and demographic change creating

further labor market and social pressures (box 1.3), challenges to achieving more diversified, higher-productivity growth, recapturing poverty gains, and expanding the middle class may become insurmountable, at least in certain occupations and geographic areas. Unless Kazakhstan confronts these challenges head-on, the country will struggle to reach its goal of being among the 30 most developed countries in the world.

This Systematic Country Diagnostic (SCD) argues that creating high quality, high-productivity private sector jobs across Kazakhstan is critical to moving people from poverty or vulnerability to a secure, middle-class status. Doing so will require a fundamental change in the growth model. It will require developing the tradable sector, by realizing the potential of the private sector (see chapters 2 and 3) and continuing to develop high-quality, adaptive, and mobile human capital. The SCD also highlights critical regional dimensions of the structural transformation, which require building strong integrated markets that enhance the mobility of goods and production factors and creating growth poles than can profit from new opportunities throughout the country. Challenges of internal market connectivity and connectivity with external markets will need to be met (see chapter 4).

The SCD also argues for emphasizing resilience. Beyond resilience of human capital (as noted above and detailed in chapter 5), a focus on resilience includes ensuring attention to environmental sustainability, including the impacts of climate change, in developing economic sectors, transport corridors, and urban areas. Finally, the emergence of a secure, middle-class society requires a social cohesion grounded in transparent institutions that support widespread voice and accountability. Improving the quality of governance is critical for overcoming challenges.

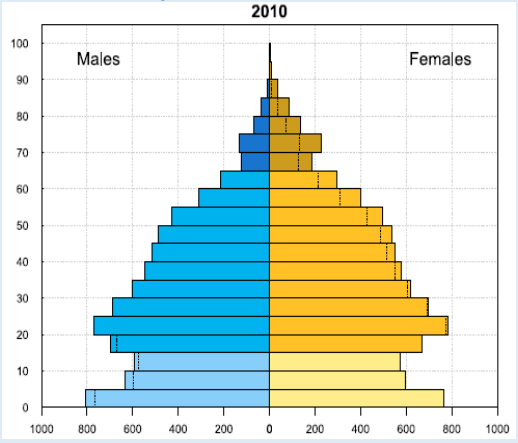
Box 1.3: Kazakhstan's "mini-baby boom" and its demographic implications

Like most post-Soviet states, Kazakhstan recorded sharp declines in fertility rates in the 1990s and 2000s. However, with rising incomes, a brief baby boom began in 2005, peaking in 2010 at 2.5 children per woman. After 2010, however, fertility declined again and is expected to return to the levels of the early 2000s (around 2.0 children per woman). This pattern of bust, boom, and return to more normal levels has created an unusual demographic profile (box figure 1), with effects on the size of the labor force in the short and medium terms and thus on the number of jobs that the economy will need to create.

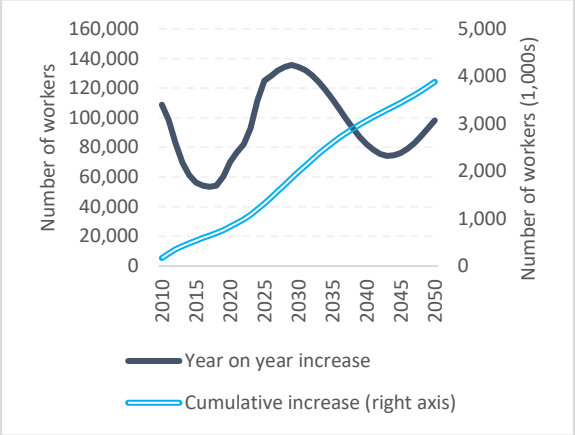
In the next few years, Kazakhstan will continue to experience relatively slow labor force growth,[21] but in the medium-term labor force growth will accelerate as the baby boom generation enters the labor market, leading to a peak in around 2030. In 2025–2030, the labor force will grow by as many as 135,000 people a year, double the rate of a decade earlier (box figure 2). While this should deliver a demographic dividend to the economy, it also means more pressure on job creation beginning in 2025.

[21] This assumes that the labor force participation rate remains steady at the current 72 percent. Given how high this rate is in international comparison, it is not expected to increase.

Box figure 1: Kazakhstan' population profile reflects the baby boom of 2005–10



Box figure 2: Kazakhstan's labor force growth Is projected to peak in 2030



Data source: UN projections from World Population Prospects (left); World Bank Group (2015b) (right), based on data from the Agency of the Republic of Kazakhstan on Statistics.
Note: Labor force projections (right) for a working age population 16 and older assuming a 72 percent labor force participation rate.

The next four chapters are organized around ***four mutually reinforcing strategic pillars*** for delivering sustainable growth, jobs, and a secure middle class, each of which requires institutional modernization:

- *Chapter 2: Economic management for diversification* reviews growth trends, challenges stemming from the past model of economic management, and critical issues for shifting to a new growth model supporting diversification toward tradables.
- *Chapter 3: Private sector development* assesses the structure and nature of the private and financial sectors and identifies key reforms to unleash a more competitive job-creating private sector and to support the development of sustainable national and regional economies.
- *Chapter 4: Integration and connectivity* flags opportunities and challenges to support the development of tradable sectors through enhanced regional and global integration, and assesses the same for internal integration, including connectivity, urbanization, and social cohesion.
- *Chapter 5: Productive and adaptive human and natural capital* highlights key challenges to develop more adaptive and productive human capital through reforms in education, health, and social protection, and analyzes the key challenges of natural resource sustainability.

Chapter 6 summarizes the main challenges and identifies key short- and medium-term priorities for meeting the aims of reducing poverty and building a secure middle class in a sustainable way.

2. Strategic Pillar 1: Economic management for diversification

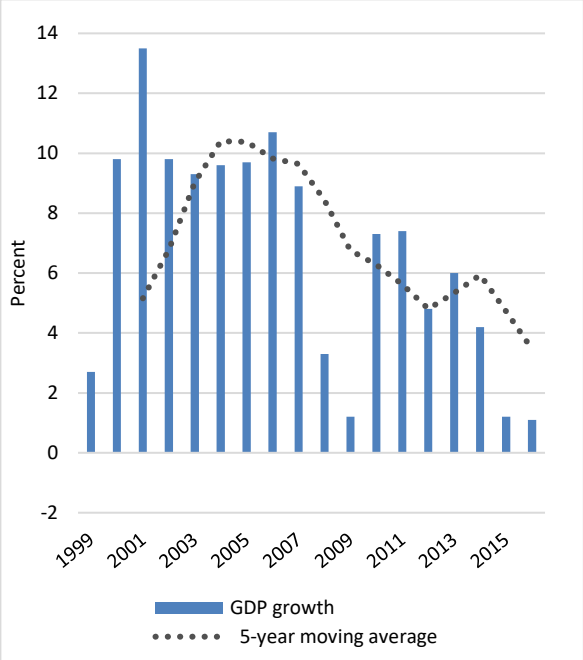
Economic growth in Kazakhstan has relied extensively on the availability of oil resources. Macroeconomic analysis suggests that inadequate sterilization of oil revenues caused the tenge to appreciate, which incentivized growth in services rather than tradables (especially non-commodity exports). Extensive foreign borrowing by the banking sector though 2007 and high non-oil deficits after 2010 contributed to a strong tenge, which did not favor outbound diversification. Floating the tenge in mid-2015—a first step in macroeconomic adjustment to the new external reality of lower oil prices—brought significant depreciation. The next step is regaining credibility for the monetary and fiscal frameworks, employing a sound deficit reduction strategy that brings fiscal sustainability, and shifting more broadly from the old growth model. Enhanced capacity among policymakers will be critical for all steps.

This chapter examines the components of economic growth in Kazakhstan, fiscal and monetary policy, and governance and public sector effectiveness.

2.1 Understanding the components of economic growth in Kazakhstan

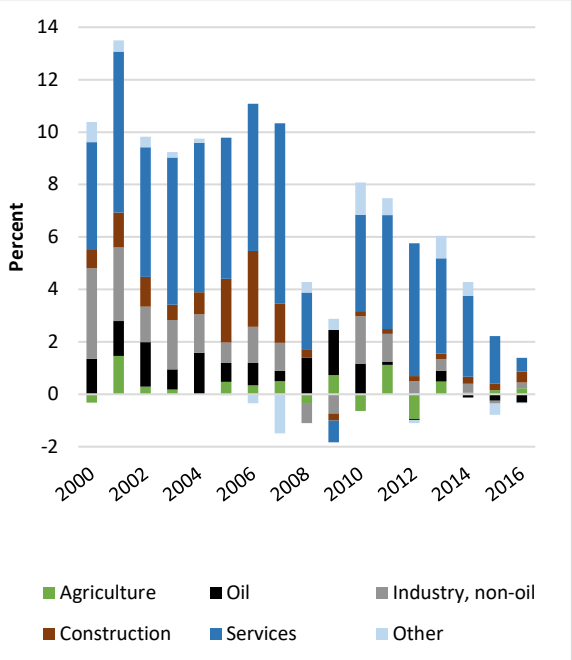
Kazakhstan has achieved high rates of GDP growth, averaging 6.9 percent a year over 2000–16. There were two growth periods over that time (figure 2.1). The first, 2000–07, is associated with increased oil production as oil prices rose. The second, 2010–14, coincided with the most recent commodity price boom. Despite the high growth, however, the five-year moving average of the GDP growth rate has been declining. A recent study found that Kazakhstan's trend GDP growth is down from 10 percent in 2004 to 3.5 percent in 2016; potential GDP growth was about 3 percent in 2016.[22]

Figure 2.1: Kazakhstan experienced two growth periods over 2000–14



Data source: Agency of the Republic of Kazakhstan on Statistics.

Figure 2.2: Services were the largest contributors to growth in Kazakhstan over 2000–16



Data source: Agency of the Republic of Kazakhstan on Statistics.

[22] IMF (2017, pp. 56-57).

Services drove growth over the entire period under review, while the contribution of tradables to growth diminished over 2010–14. Over 2000–07, the economy was going at full speed, probably above potential, and the largest contributors to GDP growth were services (5.5 percentage points), non-oil industry (1.8), construction (1.4), and oil (1.1) (figure 2.2). In the second boom period, 2010–14, services were again the largest contributor to GDP growth (4 percentage points), while the contribution of tradables all but dissipated (0.8 percentage point for non-oil industry, 0.3 percentage point for oil, and no growth contribution from agriculture).

Growth decomposition with natural resources and productivity

Natural resources and productivity growth have been the primary factors driving GDP growth. A decomposition of growth by factors of production rather than sectors—physical capital, labor (employment), (quality of) human capital, and natural resources (proxied by oil extraction)—indicates that more than half of economic growth over 2003–08 was explained by natural resource growth; other factors made significant but much smaller contributions (figure 2.3). The unexplained portion of GDP growth—total factor productivity (TFP) growth—was substantial, accounting for just under half of all growth.

Over 2009–15, the results are less clear. Natural resource growth was as important as capital and employment growth in this period, but the unexplained (TFP) portion of GDP growth was the largest. Revenues from oil had a significant stimulating effect on the economy, but through indirect channels rather than through the direct channel of growth in oil output (see below).[23]

Relative to country peers, Kazakhstan has done less well than anticipated. As many other oil-producing countries, Kazakhstan felt a significant shock from the drastic decline in oil prices which led to the reduction in growth rates of the economy by more than twice (figure 2.4). A growth decomposition exercise for 2001–10 shows that the part of GDP growth explained by changes in growth of capital, employment, and the quality of human capital is 80 percent for Indonesia and 70 percent for Malaysia but only 30 percent for Kazakhstan, underscoring the country's heavy reliance on oil.

Slower growth of oil production and declining oil prices contributed to lower GDP growth in 2009–15. During 2000–10, Kazakhstan's economy benefited from more than double-digit growth in its oil sector and (at least through mid-2008) from high oil prices (figure 2.5). The gradual weakening in oil growth and prices largely explains the faltering of growth since 2010.[24]

Growth and macroeconomic management

In the late 1990s, Kazakhstan followed best international practice to prepare for the coming oil boom, establishing a sterilization and savings fund. Established in 2000, the Oil Fund of the Republic of Kazakhstan (also known as the Oil Fund) has served its savings purpose fairly well. In terms of savings, Oil Fund assets are larger than Russia's but smaller than Azerbaijan's and Saudi Arabia's. Over 2001–16 Kazakhstan earned US$196 billion in oil revenues, or about 9 percent of cumulative GDP over that period.25 By the end of 2014, after oil prices had fallen steeply for a second time, the Oil Fund had

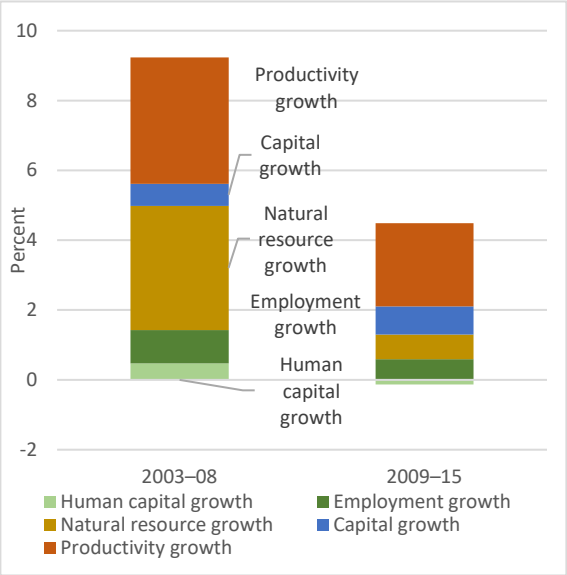
[23] Three indirect channels stand out: impacts on oil sector production on other sectors, such as transportation and other extraction-related services, and construction; higher fiscal revenues from oil, which contribute to increases in public spending, both investment and consumption; and greater economic activity from state enterprises (corporates and SOEs), which take a large share of investment in the economy and whose expanded funding comes from the Oil Fund, the budget, and their ability to borrow from state agencies and international markets, based on explicit or implicit state guarantees.

[24] Oil is not Kazakhstan's only commodity, of course. The country is rich in metals and minerals, whose prices have been largely correlated with oil prices. We do not spend much time on these commodities in this part of the report (see Chapter 3 for that) because we consider oil to be the main commodity that has driven the economy in the past.

[25] Oil Fund earnings and customs duties on oil exports combined.

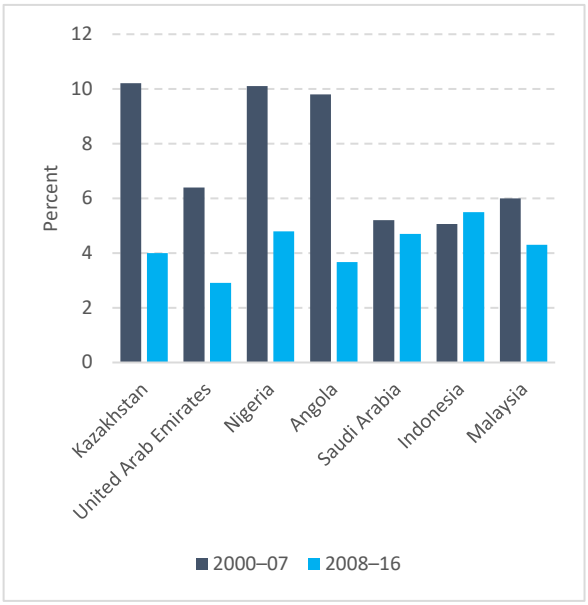
accumulated US$73 billion, or about 34 percent of GDP (figure 2.6). Oil Fund assets relative to GDP increased in 2015–16 after devaluation and floating of the tenge (see below), which caused GDP to shrink in US dollar terms.

Figure 2.3: Natural resources explained more than half of economic growth in Kazakhstan, 2003–08



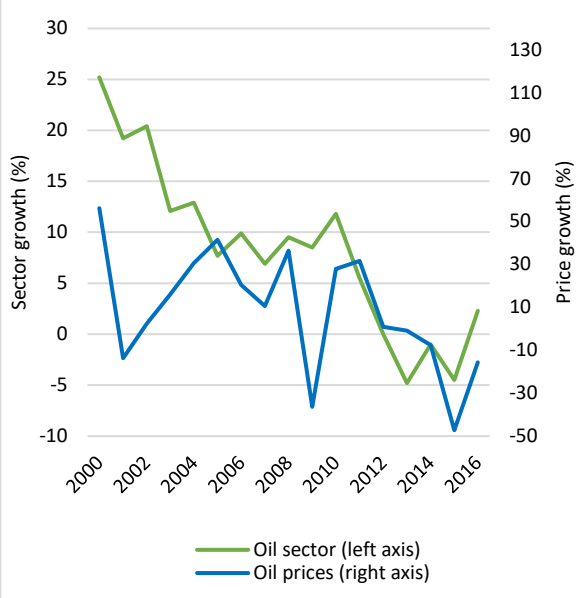
Data source: Agency of the Republic of Kazakhstan on Statistics and OGR Research.

Figure 2.4: Average GDP growth in Kazakhstan was worse than in some other oil-exporting countries, 2000–07 to 2008–16



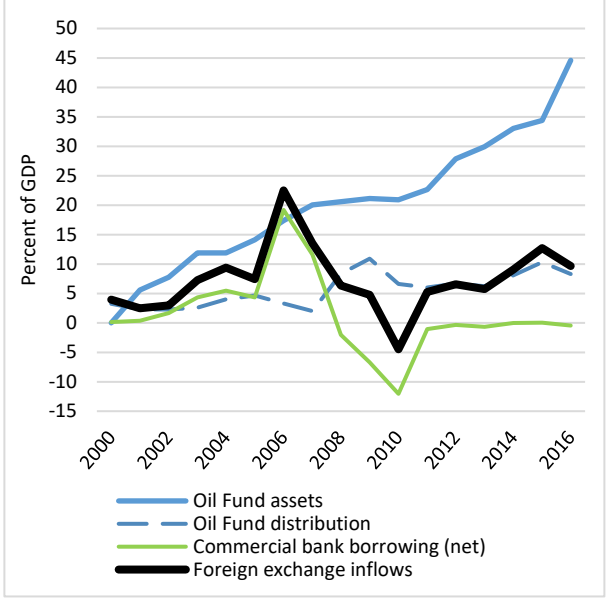
Data source: MFM Growth Accounting Tool, Agency of the Republic of Kazakhstan on Statistics.

Figure 2.5: Kazakhstan's oil sector grew, and oil prices rose through 2008 then weakened



Data source: Agency of the Republic of Kazakhstan on Statistics.

Figure 2.6: Savings, sterilization, and foreign exchange inflows in Kazakhstan, 2000–16

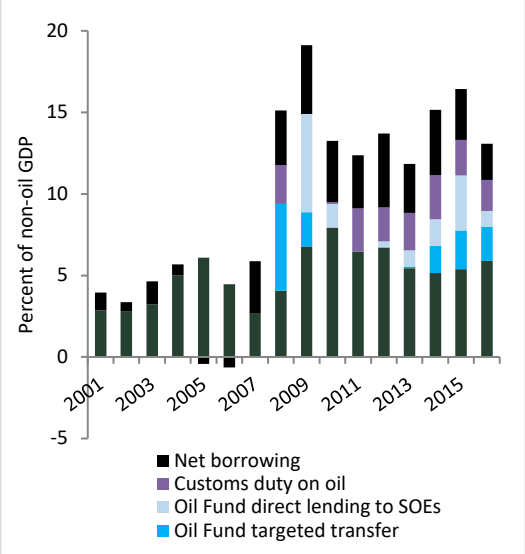


Data source: National Bank of Kazakhstan, National Fund of the Republic of Kazakhstan, and Agency of the Republic of Kazakhstan on Statistics.

Despite those efforts, Kazakhstan did not sterilize foreign currency inflows enough. Kazakhstan enabled sizable foreign exchange resources to enter the economy initially by allowing large commercial bank external borrowing through 2007 and later by maintaining larger fiscal deficits after 2010, as growth of oil revenues slowed. In 2006, for example, external net borrowing by commercial banks came to nearly 20 percent of GDP (see figure 2.6). While Kazakhstan was sterilizing a major share of oil revenues after 2010 (when oil was averaging US$100 per barrel) than before, it was probably not enough relative to the size of the economy. Foreign exchange inflows averaged about 8 percent a year over 2001–16. After Kazakhstan's banking crisis in 2007, the government dramatically loosened fiscal policy, increasing its non-oil fiscal deficit from an average of 4 percent GDP over 2001–07 to 14 percent over 2008–16 (figure 2.7). Financing of non-oil deficit at the expense of oil income (transfers from the Oil Fund and revenues from customs duties on oil export) and external loans (external government debt and debt guaranteed by the state) partially offset efforts to sterilize foreign currency and thereby put pressure on the tenge towards its appreciation.

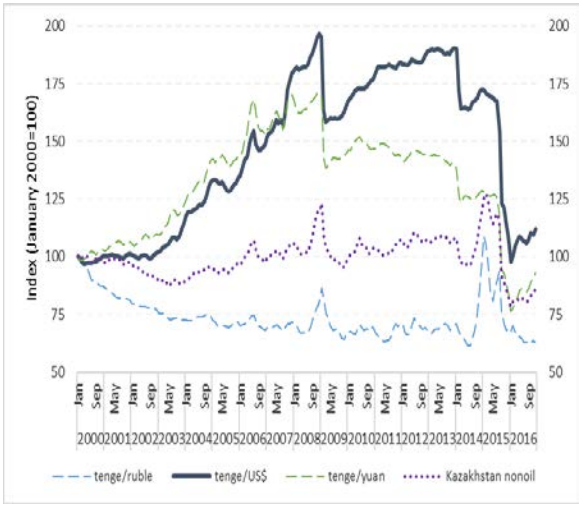
The foreign currency inflows led to an appreciation of the tenge against the US dollar. As expected, the course of the tenge largely mirrored foreign exchange inflows. The tenge appreciated against the US dollar and the Chinese yuan through 2008, though the trends diverged following the 2009 devaluation of the tenge (figure 2.8). The tenge demonstrated a different course against the ruble, as the Russian economy benefited from its own oil revenue boom, while also experiencing economic sanctions. From about 2008 to mid-2014, when the Russian Federation began to depreciate the ruble, the real exchange rate was largely unchanged. This was fortunate, because Kazakhstan's exports remained competitive in Russia over this period. Kazakhstan's exports became more competitive in China as well over this period, as the real exchange rate of the tenge to the yuan depreciated, and China surpassed Russia as the most important destination for Kazakhstan's exports. Russian's decision to devalue its currency in the early stages of the oil price collapse (July 2014) put Kazakhstan's exports at a disadvantage until Kazakhstan successfully floated its currency a year later, in August 2015 after an earlier devaluation in February 2014.

Figure 2.7: The non-oil fiscal deficit increased after Kazakhstan loosened fiscal policy in response to the 2007 banking crisis



Data source: Agency of the Republic of Kazakhstan on Statistics.

Figure 2.8: Tenge real exchange rates began to rise against the US dollar and Chinese yuan in 2003 (Jan 2000 = 100)



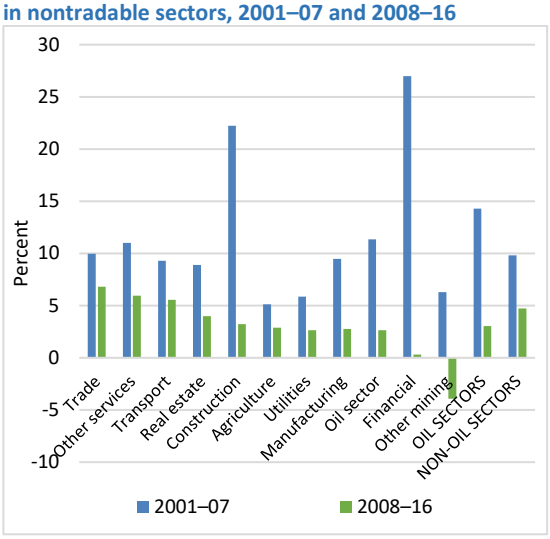
Data source: National Bank of Kazakhstan.

Appreciation of the tenge and change in the structure of the economy

A strong tenge for most of the 2000s favored growth in nontradable sectors relative to tradable sectors. The most favored nontradables sectors were wholesale and retail trade, construction, transport, and other services, and the tradable sectors that suffered most were agriculture and non-oil industry, including manufacturing. In 2008–16, the sectors with the highest growth rates were trade, other services, transport, and real estate (figure 2.9). Non-oil exports grew sluggishly in 2009–15, at an annual average of less than 1 percent, against nearly 16 percent in 2001–08 (figure 2.10).

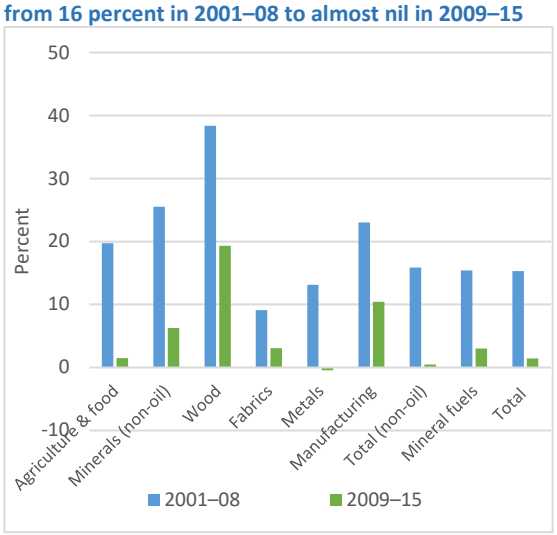
Despite the appreciating tenge, the economy could have been more competitive if it had become more productive. The rate of productivity growth of the non-oil economy kept pace with the tenge's appreciation against the US dollar and the Chinese yuan through 2006 (figure 2.11). Subsequently and through February 2014, however, appreciation against the US dollar outpaced non-oil productivity growth.[26]

Figure 2.9: Growth rates in Kazakhstan have been higher in nontradable sectors, 2001–07 and 2008–16



Data source: Agency of the Republic of Kazakhstan on Statistics.

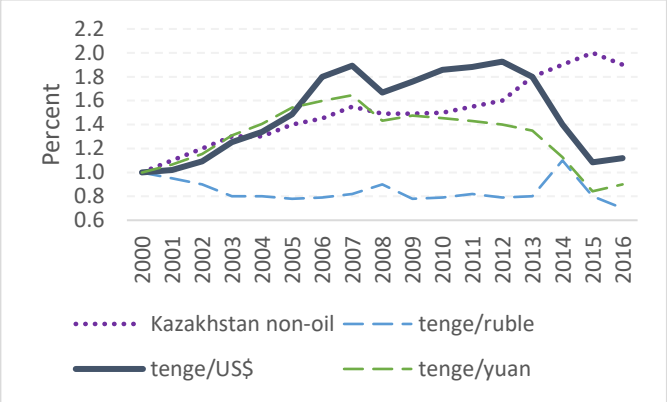
Figure 2.10: Kazakhstan's growth in non-oil exports fell from 16 percent in 2001–08 to almost nil in 2009–15



Data source: UN Comtrade.

[26] Another possible explanation for the high rate of growth of the services sector is that it is part of the natural restructuring of the economy after the transition. While plausible, statistical observation suggests that the correlation of services sector growth to currency appreciation is higher for resource-rich countries than for other former Soviet Union countries.

Figure 2.11: Productivity growth in non-oil sectors in Kazakhstan kept pace with real exchange rate appreciation against the US dollar, 2000–16



Data source: National Bank of Kazakhstan.
Note: Kazakhstan non-oil is non-oil GDP productivity growth.

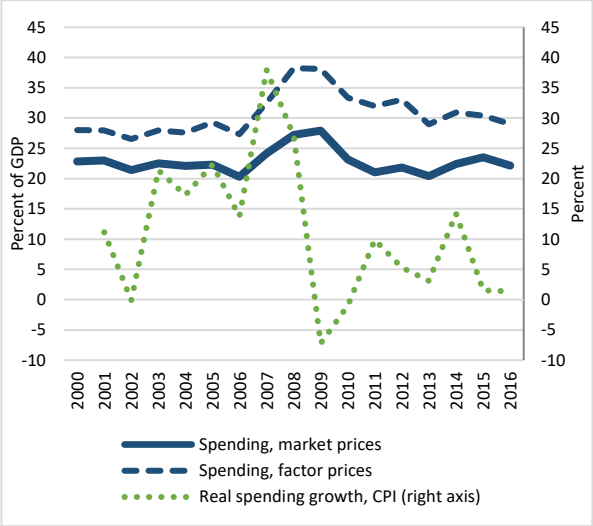
2.2 Fiscal and monetary policy during commodity cycles

Fiscal policy and the need for fiscal consolidation

Kazakhstan's fiscal policy has varied over the two boom periods in the 2000s, being accommodative through 2007 and stimulative thereafter. The main targets of fiscal policy have been to develop the country's infrastructure, which became dilapidated in the decade after independence in 1991; to reestablish the country's education system; to provide social assistance and pensions to the poor; and to develop the private sector. To fund these programs, government sharply raised public spending, at a real average annual growth rate of 14 percent of GDP in 2001–06 (figure 2.12). Over this period, the government maintained an average overall surplus of 3.3 percent of GDP and a non-oil deficit of 3.6 percent of GDP (figure 2.13), mainly financed from the Oil Fund. In response to Kazakhstan's banking crisis of 2007 and the weakening of the global economy following the global financial crisis, the government increased spending and reduced non-oil taxes. From 2007 onward, the overall surplus declined to 0.5 percent of GDP, with the non-oil deficit widening to 9.7 percent of GDP, or 12.4 percent of non-oil GDP, which was financed from both the Oil Fund and external and domestic borrowing (see figure 2.13).

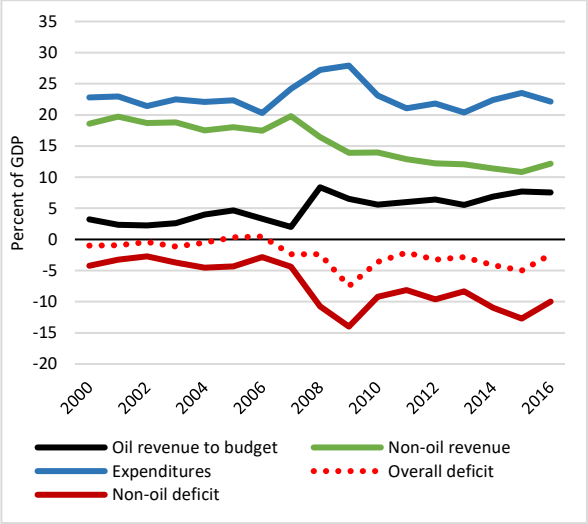
As the economic environment weakened after 2007, Kazakhstan reduced the non-oil tax burden, significantly reducing non-oil revenues. During the 2008–09 global financial crisis, the government reduced the corporate tax rate from 30 percent to 20 percent as a temporary measure, but never reversed it. It also cut other tax rates and introduced new exemptions. Kazakhstan's non-oil revenue fell from an average of 26 percent of non-oil GDP during 2000–06 to an average of 18 percent during 2009–16 (see figure 2.13). Revenues fell precipitously for all major taxes except those on international trade (figure 2.14). Receipts from corporate income tax as a share of non-oil GDP slumped by half between 2006 and 2009 and have virtually flatlined since. The corporate income tax falls mainly on the 300 largest Kazakh enterprises, many of which are in energy (and derived products) and mining. Tax revenues from small and medium-size enterprises (SMEs) is limited, and personal income taxes were just 2 percent of GDP in 2016. Moving forward, Kazakhstan will need to rebuild its non-oil tax base if its non-oil deficit is to become sustainable.

Figure 2.12: Government spending rose sharply over 2001–06 in Kazakhstan



Data source: Agency of the Republic of Kazakhstan on Statistics.

Figure 2.13: As spending rose and tax revenues fell, the non-oil deficit widened in Kazakhstan, 2000–16



Data source: Agency of the Republic of Kazakhstan on Statistics.

Maintaining a high non-oil deficit has an effect on fiscal sustainability. Kazakhstan will need to rebuild the non-oil tax base to make its non-oil deficit more sustainable (see figure 2.13).[27] The debt is small and sustainable at face value, but the government's ability to borrow and its sovereign ratings (Fitch: BBB Stable; Moody's: Baa3 negative) rest, to a degree, on the buffer created by the Oil Fund. Kazakhstan accumulates significant debt, undermining the net value of the Oil Fund. In 2016, net financial assets of the government accounted for about 25 percent of GDP, calculated as gross foreign exchange assets of the Oil Fund (45 percent of GDP) net of total government and state-guaranteed debt (20 percent of GDP). As the government continued drawing down fiscal reserves from the Oil Fund and the tenge appreciated, net financial assets fell to about 16 percent of GDP in 2017. According to World Bank calculations, net financial assets of the government could be completely depleted in 5 to 10 years if the government does not take immediate measures to reduce the non-oil deficit (figure 2.15). Moreover, a cautious investor might compare Oil Fund assets not only against domestic and external public and publicly-guaranteed debt but also against Kazakhstan's corporate debt, which is mainly state-owned enterprise (SOE) debt and therefore a contingent liability for the government.[28] This alternative perspective (again, with no policy change) suggests much greater concern over fiscal sustainability (especially because fiscal consolidation efforts were previously stymied by the surfacing of contingent liabilities in 2015 and 2017).

Thus, Kazakhstan needs sharp fiscal consolidation. World Bank estimates suggest that Kazakhstan has to reduce its non-oil fiscal deficit by about 7-8 percentage points of non-oil GDP in order to return to fiscal sustainability.[29] The duration and strength of the adjustment will depend on fiscal policy choices.

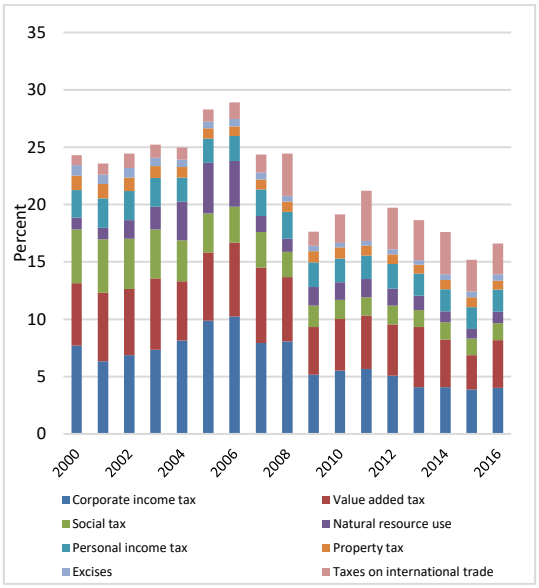
[27] The decline in oil prices and the devaluations that followed had a positive effect on oil revenues relative to GDP in 2015 and 2016. However, for Kazakhstan to finance its non-oil deficit, it has drawn on the Oil Fund and accumulated external and domestic debt.

[28] A similar approach was also reflected in the new Concept of accumulation and utilization of assets of the National Fund of the Republic of Kazakhstan.

[29] In accordance with the new Concept of Accumulation and Utilization of Assets of the National Fund of the Republic of Kazakhstan, the government plans to reduce the non-oil deficit to 7 percent of GDP by 2020 and 6 percent of GDP by 2025 to strengthen fiscal sustainability. In 2017, the government took specific steps toward fiscal consolidation. In the budgetary legislation, it was mandated that the non-oil deficit be approved by Parliament. The Republican budget for 2018–20 provides

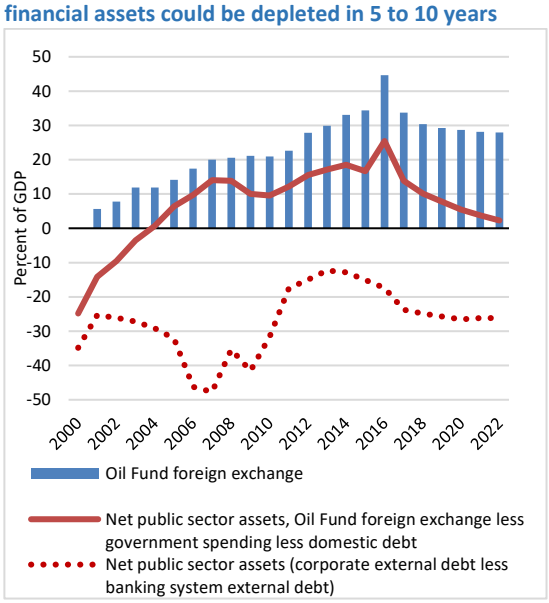
A recent Kazakhstan Public Finance Review argues that fiscal consolidation should be driven by removing distortions in the fiscal framework for the private sector.[30]

Figure 2.14: Non-oil tax revenues plunged in Kazakhstan after 2006 as a share of non-oil GDP



Data source: Agency of the Republic of Kazakhstan on Statistics.

Figure 2.15: Without a policy change, Kazakhstan's net financial assets could be depleted in 5 to 10 years



Data source: Agency of the Republic of Kazakhstan on Statistics.

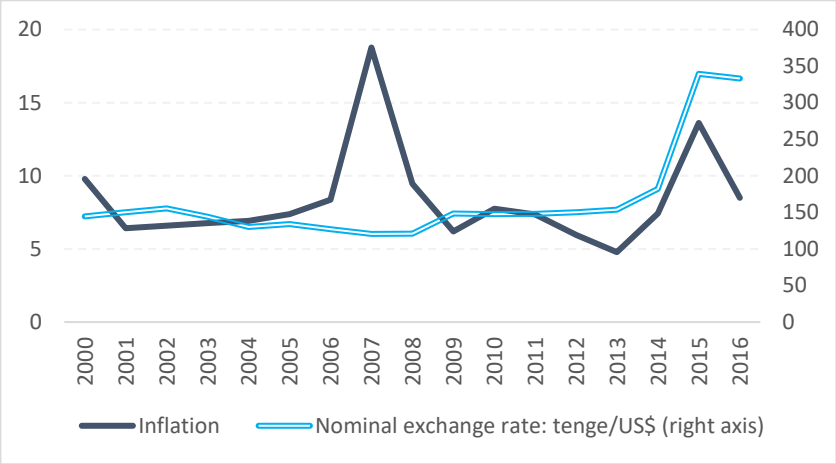
Monetary policy stabilized the exchange rate, but the real exchange rate appreciated and credit expanded then collapsed

Kazakhstan's exchange rate regime and monetary policy framework sought to maintain economic stability by supporting a stable currency during much of the time between 2001 and August 2015. The authorities formally supported a managed float for most of that time, except during the banking crisis in 2007. The tenge was, in nominal terms, stable for almost 15 years. Between January 2001 and January 2014, it averaged 141 tenge per US dollar with a standard deviation of just 0.07, starting at 145 tenge per US dollar and ending 14 years later at 154 (figure 2.16).

for a considerable reduction in the non-oil deficit (to 7.1 percent of GDP as early as in 2018), but the actual outcome will only be able to be verified in a year (following budget execution).

[30] World Bank Group (2017c).

Figure 2.16: Inflation and the nominal exchange rate in Kazakhstan, 2000–16



Data source: Agency of the Republic of Kazakhstan on Statistics.

Kazakhstan's monetary policy sought primarily to preserve the exchange rate regime and was generally accommodative before the 2007 banking crisis. Over 2001–07, the tenge appreciated by about 20 percent in nominal terms and 50 percent in real terms, undermining the economy's competitiveness. Simultaneously, Kazakhstan's oil revenues were flowing into its international reserves and accelerating money growth and inflation. Efforts to reduce money growth were not very successful in the face of these foreign reserve increases. During the 2007 banking crisis, precipitated by liquidity shortfalls induced by the global financial crisis, the central bank and government reacted swiftly to defend the currency with support from the International Monetary Fund.[31]

Although the nominal exchange rate was fairly stable over this period, the real exchange rate was not, and it was the real exchange rate that drove the deteriorating competitiveness of the country. As in many resource-rich countries, fiscal policy (high rates of growth in public spending financed by oil revenues) and banking sector policy (credit boom backed implicitly or explicitly by oil revenues) led to rising demand and domestic prices, real appreciation of the tenge (see figure 2.6), and loss of external competitiveness. The sterilization of foreign currency inflows was insufficient to prevent appreciation of the tenge. Over 2008–10, monetary policy was contractionary, aiming to restrain credit growth. From 2010 to mid-2015, monetary policy was again generally accommodative, reflecting in part the need to monetize the economy, and the tenge strengthened as commercial bank borrowing accelerated, leading to Kazakhstan's most recent banking crisis in 2016.

But with monetary policy focusing on the tenge, inflation rose quite high. Under the fixed exchange rate regime (formally, a managed float), the nominal exchange rate could not absorb the impact of shocks to the economy (essentially foreign exchange inflows), so the impact was transmitted through the domestic price level. The authorities used foreign exchange reserves to smooth the exchange rate, though monetary policy efforts were largely aimed at maintaining the peg. While credit to the economy expanded (based on foreign borrowing) through 2007, after the domestic banking crisis and the global financial crisis, overall credit to the economy shrank (figure 2.17).

Adjusting policies to the new external environment

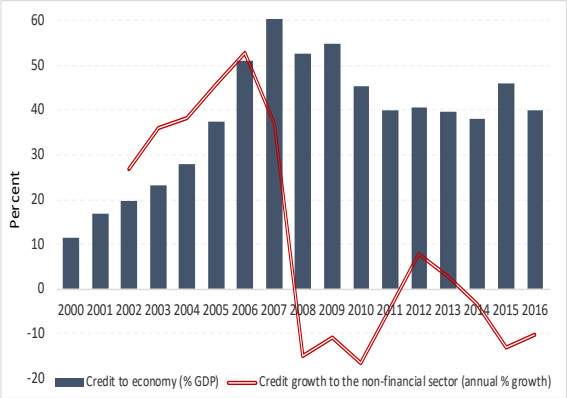
In 2015, Kazakhstan began to adjust its policies to the environment of lower oil prices, first by floating the tenge in August 2015 and moving to an inflation targeting regime. Two years later, the change in regime has served the country well. Foreign exchange losses to manage the currency have

[31] IMF (2008, p. 15).

stopped (figure 2.18), citizens and markets are getting accustomed to the floating tenge, and the National Bank of Kazakhstan is putting together the building blocks for managing monetary policy against the new economic backdrop. The first block, the floating tenge, has resulted in a real depreciation of nearly 37 percent since mid-2007, yielding a welcome boost to competitiveness.

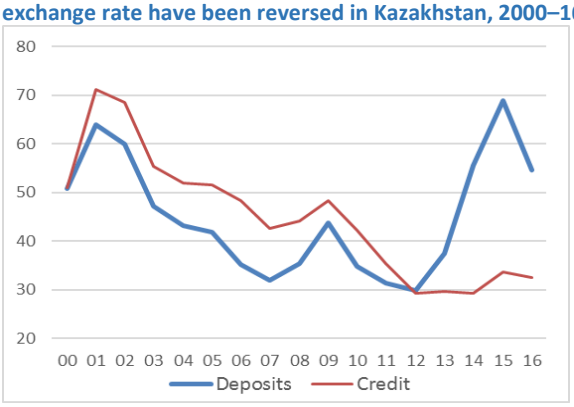
The second building block is the new Oil Fund Concept, approved in December 2016, which aims to dramatically reduce annual transfers to the budget and to limit extrabudgetary projects supported by the fund. The Concept aims to reduce the non-oil deficit from 10 percent in 2016 to 5 percent of GDP by 2020. It also seeks to keep Oil Fund assets above 30 percent of GDP. Kazakhstan faces a considerable policy and institutional challenge to meet the Concept's targets. The institutional challenge reflects the failure of Kazakhstan's previous efforts to reduce the deficit. Adjustments to meet the Oil Fund Concept targets include raising non-oil revenues, reducing public spending, and curtailing spending on SOEs.

Figure 2.17: Credit to the Kazakhstan economy shrank after the banking crisis of 2007



Data source: Agency of the Republic of Kazakhstan on Statistics.

Figure 2.18: Foreign currency losses to manage the exchange rate have been reversed in Kazakhstan, 2000–16



Data source: Agency of the Republic of Kazakhstan on Statistics.

The third building block of adjustment to the new external economic environment is a change in the scope of expenditure and revenue policies. Fiscal policies historically supported extensive state involvement in the economy through SOEs and the private sector through subsidies and tax breaks. Reductions in subsidies and tax breaks will allow resources to shift to tradable sectors, following the incentives created by the real depreciation of the currency.

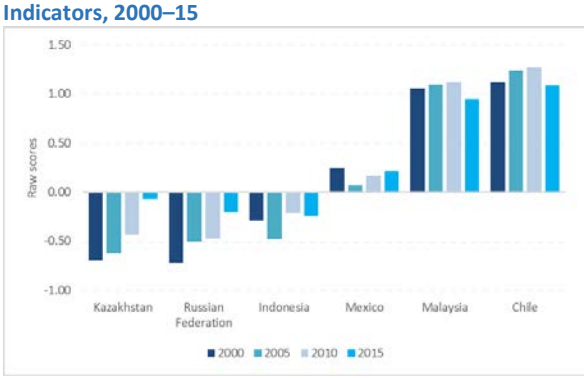
Kazakhstan faces huge institutional and macroeconomic policy challenges to meet the Oil Fund Concept targets. Kazakhstan's macroeconomic policy challenge is to ensure that, as it adjusts to the new external environment, it does not lose sight of the big picture: the economy needs to improve external competitiveness and productivity. Key outcome indicators are a competitive real exchange rate and improvement in productivity measures. The government controls these indicators only indirectly, through effective design and implementation of policies and regulations. From this perspective, addressing barriers to effective governance will be critical to supporting economic management for a more diversified and competitive economy. Addressing these barriers will also be critical for the State Program for Industrial and Innovative Development (SPIID) for 2015-2019 to succeed in diversifying the national economy and attracting FDI into non-oil export-oriented tradable sectors.

2.3 Governance and public sector effectiveness

Progress on public service delivery

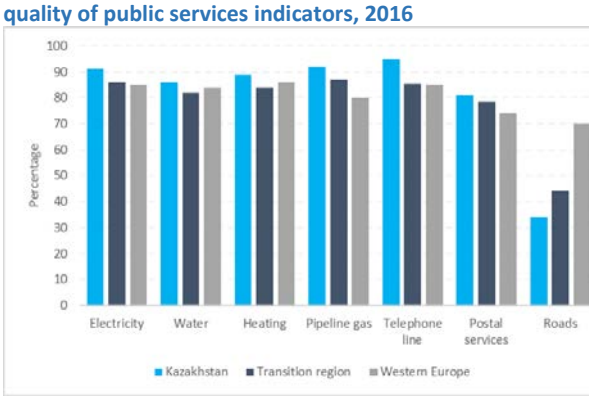
Kazakhstan has shown marked improvement on measures of government effectiveness since 2000 (figure 2.19). In 2000, Kazakhstan was rated in the 25th percentile globally on government effectiveness in the World Bank's Worldwide Governance Indicators. By 2015, it had improved to the 50th percentile, although still far from OECD levels and well behind the Europe and Central Asia regional average rank in the 69th percentile. This improvement reflects generally better delivery of public services. Other evidence also supports the upgrade in ranking. For example, in the annual survey commissioned by the Kazakhstan Agency for Civil Affairs and Anticorruption, 73 percent of respondents in 2016 indicated satisfaction with the quality of public service. And in the European Bank for Reconstruction and Development's 2016 Life in Transition Survey III, Kazakh respondents rated their country better than respondents in other transition or Western European countries in almost all areas of public service delivery (with the notable exception of roads) (figure 2.20).[32]

Figure 2.19: Government effectiveness has improved in Kazakhstan, as measured by Worldwide Governance Indicators, 2000–15



Data source: World Bank Group, Worldwide Governance Indicators.
Note: Raw scores range from –2.50 to +2.50.

Figure 2.20: Kazakhs rate their country highly on most quality of public services indicators, 2016



Data source: EBRD (2016b).
Note: Figure shows the percent of respondents who are satisfied with the quality of public services

Despite considerable progress establishing an enabling environment for the delivery of public infrastructure and services through public–private partnerships (PPPs), activities have been limited. Starting with the 2006 Concession Law, Kazakhstan has passed legislation to support concessions and PPPs, and established responsible public institutions to support PPPs, notably Kazakhstan Public-Private Partnership Center (PPPC) and Public-Private Partnership Advisory Centre (PPPAC). A new PPP Law was passed in 2015 that includes more ways government can partner and support private sector participation. A Roadmap for PPP Projects was also established. However, while there are more than 100 projects in the government's Master PPP Pipeline, implementation has been very limited.

Overcoming institutional constraints in moving from planning to implementation

Kazakhstan has a comprehensive system of state planning. It has a strategic framework based on a long-term strategic vision, Kazakhstan Strategy 2050, that guides its 10-year national development strategies. Priorities for the upcoming period are identified in the annual President's Message and reinforced in the government's action plan. Acknowledging the abundance and at times the duplication of national and sectoral programs, policymakers have dramatically cut the number of national programs. Still, the need remains for stability of priorities and a tighter focus on implementation.

[32] EBRD (2016b).

At the same time, the state apparatus, with highly hierarchical decision-making structures, is still process oriented and often focused on immediate- and medium-term tasks. The requirement for senior-level approvals slows down the technical decision-making process, hindering the ability to respond to changing circumstances. Units of central ministries and other entities lack internal or external cross-communication and coordination. Administrative structures are generally well designed, but staff management, policymaking, and service delivery are problematic, as the government is still a centralized, top-down structure.[33] In 2015, Kazakhstan ranked in the 51st percentile on the government effectiveness indicator of the Worldwide Governance Indicators project, well below the Europe and Central Asia regional average of the 69th percentile.

Kazakhstan has to overcome institutional constraints in implementing its ambitious long-term development strategies, programs, and policies. Institutional processes are evolving more slowly than the country's development needs require.[34] The "control and punish" monitoring mode of reform implementation should be abandoned; instead, it is necessary to instill the culture of learning lessons and taking mid-course corrections. Lack of attention to change-management techniques and capacity building for reforms has led to occasional resistance to reforms at the implementation level and low public trust in public institutions and governance reforms. Kazakhstan scored 4.3 out of 10 in 2016 on the Management Index of the Bertlesmann Transformation Index.[35] Post-Soviet Eurasia's average score was 5.04.

Government spending needs to be appraised and rigorously monitored to ensure that scarce resources are well used to stimulate growth in the nonresource economy. Stronger process and program reviews are needed to build up Kazakhstan's rules-based budgeting reforms. Considerable effort will be required over the next several years to build capacity in both central and line ministries to prepare and appraise programs, establish performance accountability processes, and develop program statements to accompany the Annual Budget Law.

The civil service still faces problems of uneven capacity. A cohort of young professionals, mainly graduates of western universities and the Academy of Public Administration, is highly qualified and reform-oriented, but their share in the civil service is too small (around 2 percent) to achieve positive spillovers, and turnover rates are high. It would be beneficial to expand this cohort, which is primarily concentrated in central and executive positions, to the subnational level.

Transforming the civil service requires not only a technically top-notch cadre, with judgment and leadership, but also an institutional structure that encourages civil servants to develop their potential. The capacity of the subnational civil service, responsible for implementing the largest part of government functions, is much weaker. Line ministries' mid-level staff are overloaded by daily correspondence and urgent directives from the center with very tight deadlines, leaving little space for developing analytical and policymaking capacity in the ministries. Low salaries also undermine the attractiveness of a civil service career.

Although transparency in the public sector is improving, additional work is needed in this area. The government works on expanding the list of publicly available budget information and promotes the «Open Government» module on its e-government web portal. However, the popularity of these services among the population is still low. Draft budget programs are published with delays and only

[33] The government is attempting to address these issues through a series of public administration reforms. This includes the 2017 constitutional reform aimed at redistributing powers among branches of power and delegating some powers of the President to the Government and the Parliament, as well institutional reforms under the "100 specific steps" addressing strategic planning, performance evaluation of state agencies and audit procedures.

[34] Kazakhstan started to implement the Plan of the Nation - «100 specific steps» aimed at improving the institutional environment.

[35] This index rates the determination and consistency of countries' elites in supporting market-based democracy.

for single state agencies. Additional efforts are required for development of budget literacy of the population, including in settlements with local self-governance.

3. Strategic Pillar 2: Private sector development

Achieving a diversified, job-creating economy will require massive strengthening of the private sector, including growth-oriented small and medium-size businesses focused on tradables. Building a competitive private sector entails a substantially smaller role for the state as a direct actor in the economy, combined with ensuring greater market contestability to break down existing oligarchic markets. It also requires a more conducive environment for investment, by strengthening competition, eradicating corruption, reinforcing the rule of law, improving private sector governance, and reducing the pernicious effects of poor regulatory implementation. And it requires reinventing the financial sector.

This chapter examines diversification and competitiveness of the economy, state intervention in the economy, the business environment, and the financial sector.

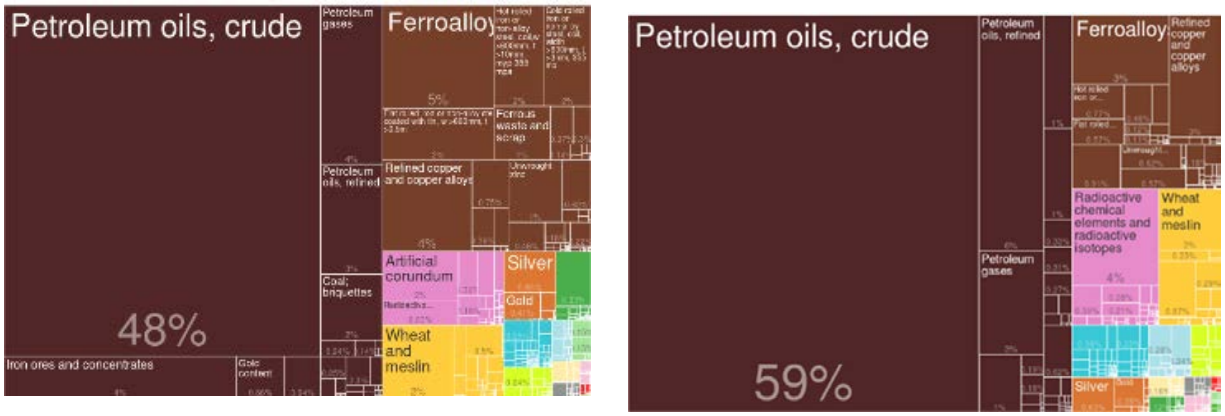
3.1 Diversification and competitiveness: results and opportunities

Limited progress in taking advantage of the depreciating tenge and diversifying exports

So far, diversification of the economy has meant mainly a shift to nontradable services; neither export products nor their destination markets have been diversified. Kazakhstan has experienced some diversification, mainly in nontradables, driven by household and government consumption and fueled by an inflated tenge. The quality and sustainability of the shift are therefore dubious. The fundamental problem is that the diversification has not been matched by increased competitiveness outside the extractive sectors, as evidenced by patterns of trade performance. Both exports and imports are critical for nurturing competitiveness, through access to the technology and knowledge that drive productivity gains.

The structure of exports has changed little in 15 years. Exports have grown rapidly, from US$8.8 billion in 2000 to US$45.9 billion in 2015 (more than 10 percent annual growth), but the export basket has become more concentrated, with petroleum products increasingly dominant (figure 3.1). The vast majority of other exports are also minerals and metals, and they have failed to expand their meager share of the export basket. Exports are also concentrated in certain markets: the Russian Federation and China are the main export markets, although the Netherlands and Turkey have more recently become important buyers of raw materials.

Figure 3.1: Sectoral composition of Kazakh exports, 2004 and 2014



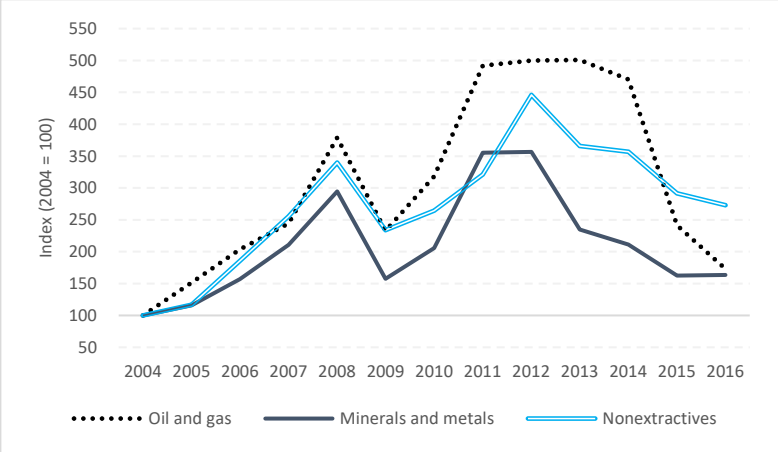
Source: Hidalgo and Hausmann, Atlas of Economic Complexity.

While Kazakhstan should be competitive in some areas of manufacturing, exports have not picked up as much as would be expected after the recent depreciation of the tenge, and export quality remains low. A sector-wide assessment of export competitiveness highlights the high and rising

revealed comparative advantage in oil, gas, metals, and other extractive industries. Kazakhstan has built moderate capacity in a few new, more complex industries, such as electrical equipment and other machinery, while declines in fitness are evident in other industries, including wood processing, leather, textiles, and transportation, indicating a loss of international competitiveness. This pattern suggests that the economy is undergoing a steady, if slow, process of specialization from labor-intensive toward natural resource- and capital-intensive products.

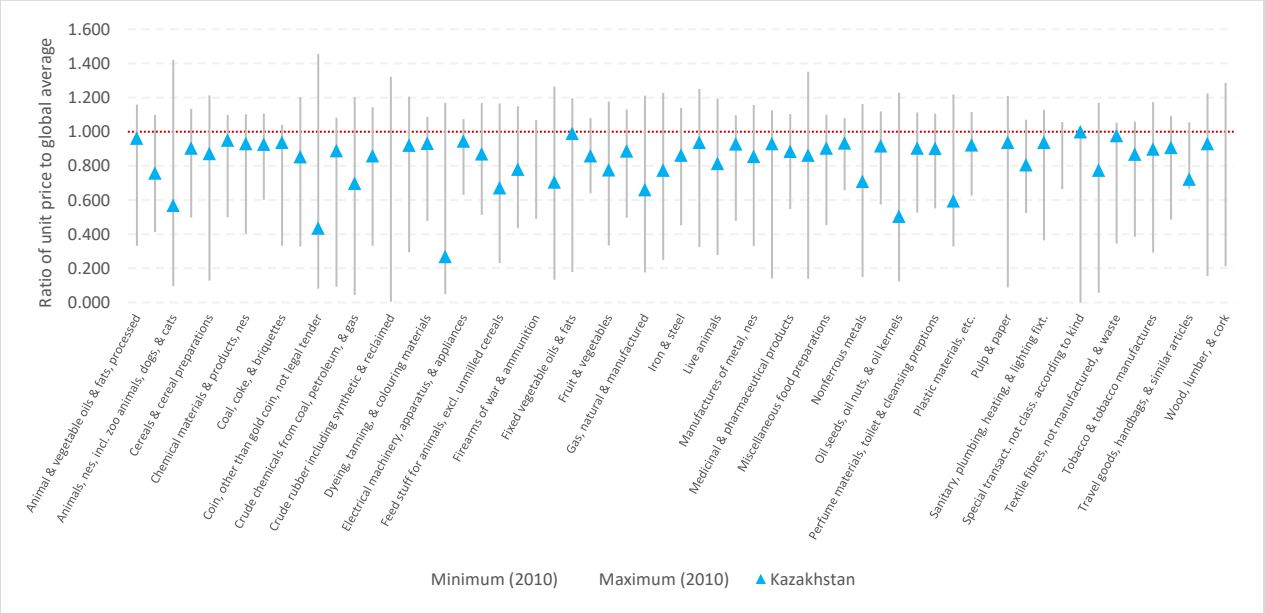
Kazakhstan has not taken advantage of the depreciating tenge to expand non-extractive exports. To the contrary, exports have declined sharply in recent years. Non-extractive exports have trended closely with exports of oil, gas, minerals, and metals over the past decade (figure 3.2). While the recent sharp decline in exports in US dollar terms reflects in part the depreciation of the tenge, it also reflects the failure of the export sector to respond to increased international competitiveness. Moreover, while exports have improved in quality (as measured by average unit price) since the 1990s, particularly food products (figure 3.3), quality remains below the global average in all sectors. This pattern suggests that Kazakhstan's export products are oriented toward (lower value-added) commodities, even in non-extractives.

Figure 3.2: Kazakhstan's exports in non-extractives have closely tracked exports of extractives, 2004–16 (in 2004 US dollars)



Data source: UN Comtrade via WITS.

Figure 3.3: The quality of Kazakhstan's exports remains below the global average in almost all sectors, 2010



Data source: IMF Diversification Toolkit.

Where to diversify? A brief review of sectoral opportunities

Where are the opportunities for Kazakhstan to diversify and add value? While solid arguments may be made to support many sectors, it also matters how much a sector's growth will contribute to broad-based job creation and to the sector's sustainability.

Agriculture has enormous potential but has long underperformed and faces increasing climate vulnerabilities. Agriculture is at the heart of the traditional economy and culture and remains a critical sector for growth and jobs and an anchor for developing local and regional economies. Close to one in four workers relies on the sector for employment, and it is the main economic activity in a majority of rural communities. With around 25 million hectares suitable for mechanization and another 180 million hectares of pasture, Kazakhstan is one of the world's leading wheat exporters, has a long-established livestock sector (box 3.1), and has emerging potential in horticulture. Agriculture also benefits from proximity to huge food-importing markets, including the Russian Federation, China, India, and the Middle East; a flexible rural labor market; and private land ownership. However, the potential for improvement in the sector's efficiency is high. Productivity and yields are well below global averages. In the past decade, Kazakhstan became a net food importer; further development of the agri-processing sector will be necessary.[36]

It is also necessary to pay attention to the structure of agricultural enterprises and their productivity. Kazakhstan emerged from the privatization of collective farms inherited from the Soviet era with an agricultural system comprising large agricultural enterprises (with an average size of 8,000 hectares), individual farms (270 hectares), and household farms (around 0.13 hectares). About 2 million household farms work around 1 percent of the cultivated land but account for more than half of agricultural GDP (35 percent of crops and 74 percent of livestock). Most subsidiary farms need to be reoriented from subsistence farming, where low-level technologies are applied, to operations with higher productivity and production of quality value-added goods.

[36] The approved State Program for Agriculture Development for 2017–21 aims to increase production of key agricultural products, with a focus on processed products with high domestic and export demand.

Box 3.1: Exploiting opportunities for private sector-driven growth in agribusiness: wheat and livestock

Recent analysis for the World Bank Group's *Country Private Sector Diagnostic* in Kazakhstan highlighted wheat and livestock as tradables with considerable potential to attract private sector investment and support diversification.

Wheat

Kazakhstan is one of the leading global wheat producers, but productivity is extremely low. Rapidly growing in middle-class consumption across Asia, especially in China, will drive up demand for wheat, creating an opportunity for Kazakhstan if it can raise productivity. Doing so, will require broad reforms to attract private investment and usher in efficiencies and productivity improvements. Most notably this will require corporate restructuring and subsidy reform. It will also require improved transport and logistics and trade facilitation to increase competitiveness and market access.

Livestock

Expansion of the middle class in Asia will also fuel demand for meat products. With vast expanses of rangeland, availability of feed (including wheat), low production costs, and proximity to potential markets, Kazakhstan is well-positioned to expand its livestock exports and livestock food-processing industry. As for wheat, taking advantage of this opportunity will require restructuring in the sector, which is dominated by thousands of small-scale producers and suffers from large gaps in upstream parts of the value chain, to capture economies of scale and meet quality standards. And, as with wheat, it will require improving transport, logistics, and trade facilitation.

Source: World Bank Group (2017a).

The State Program for Agriculture Development (2017–21) calls for an 80 percent increase in public spending on the sector. However, a large majority of public spending for agriculture still goes to subsidies and financing of KazAgro Holding Joint Stock Company, which supports the industrial development of agribusiness (see Section 3.2: "Reforming the financial sector"). There are missed opportunities to support the development of competitive agricultural value chains and to strengthen the critical household farms segment through improved public services, infrastructure, and innovative financial instruments. Kazakhstan must also address environmental risks to the sector's sustainability (see chapter 5).

The minerals sector has much potential, but investment has been unimpressive. Kazakhstan is the world's leading producer of uranium, with close to 40 percent of global reserves; it also has 30 percent of the world's reserves of chrome, 25 percent of manganese, 13 percent of lead and zinc, 10 percent of iron ore, and 10 percent of copper.[37] In addition to this enormous potential for further development, Kazakhstan's geographic location positions it to take advantage of China's Belt and Road Initiative to become a larger hub for the mineral industry in providing goods (machinery, equipment, and related spare parts) and in transforming more of its minerals into added-value products for export to Europe and Asia. At present, however, investment is scarce, with current mining production derived largely from operations developed during the Soviet era.

Leveraging its geological endowment and minerals to drive employment generation (especially in lagging subregions and local areas), skills development, value addition (especially downstream), and economic diversification, will require overcoming several obstacles:

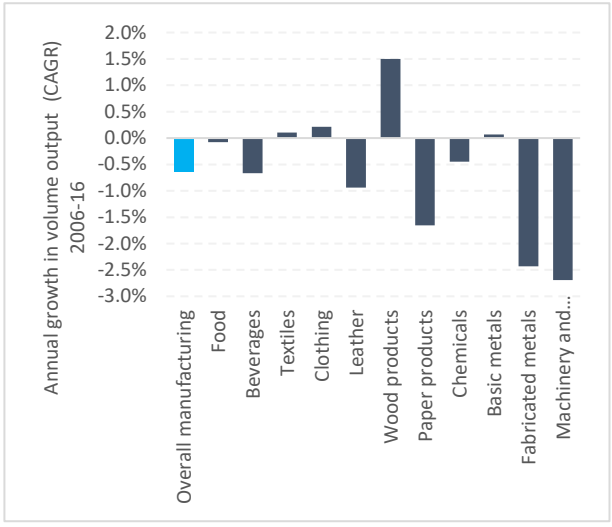
[37] http://gbreports.com/wp-content/uploads/2015/09/Kazakhstan_Mining2015.pdf.

- Outdated subsoil use laws and bureaucratic processes, which constrain the country's attractiveness for exploration.
- Shortage of skilled technical professionals, even though human capital development for the minerals sector is being partially addressed through public–private initiatives and programs such as mining/petroleum engineering education at the School of Mines at Nazarbayev University.
- Absence of a clear framework for local economic development that addresses socioeconomic needs in a way that aligns local needs/priorities with national ambitions.
- Inadequate attention to sustainability in environmental and social legislation and regulations and to resilience (including against climate change impacts).

The energy sector, particularly renewables, offers opportunities. As electricity consumption rose rapidly over the past decade, Kazakhstan shifted from a large electricity surplus to a much tighter supply–demand equation. Substantial annual investments (0.8–1.4 percent of 2013 GDP) will be required in the next 30 years to modernize and expand the power sector to maintain reliable energy services. Development of renewable energy shows particularly high potential for diversifying energy resources and the power generation mix. With adoption of the "green economy concept" in 2013 and the Green Economy Law in 2016, Kazakhstan set targets on the use of renewables in electricity production of not less than 3 percent by 2020, the share of all alternative energy sources should reach 30 percent by 2030 and 50 percent by 2050.

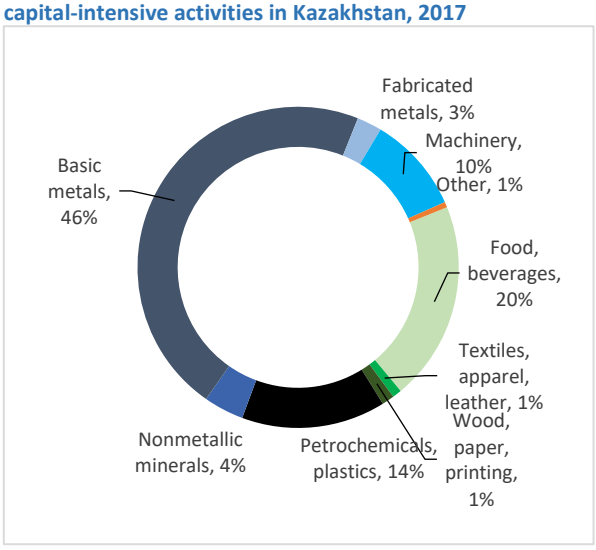
Manufacturing remains highly concentrated in resource-based and capital-intensive sectors, but some niches elsewhere are emerging. While growth in manufacturing has benefited slightly from the depreciating tenge in recent years, output in volume terms declined across almost all subsectors between 2006 and 2016 (figure 3.4). Manufacturing is concentrated in resource- and capital-heavy activities, with petroleum-based products and basic metals and minerals accounting for close to two-thirds of manufacturing output (figure 3.5). However, food and beverage production—mainly meat, dairy, and starches—remains an important sector. Productivity in manufacturing appears to be conducive to growth.

Figure 3.4: Manufacturing sector output declined between 2006 and 2016



Data source: Agency of the Republic of Kazakhstan on Statistics.

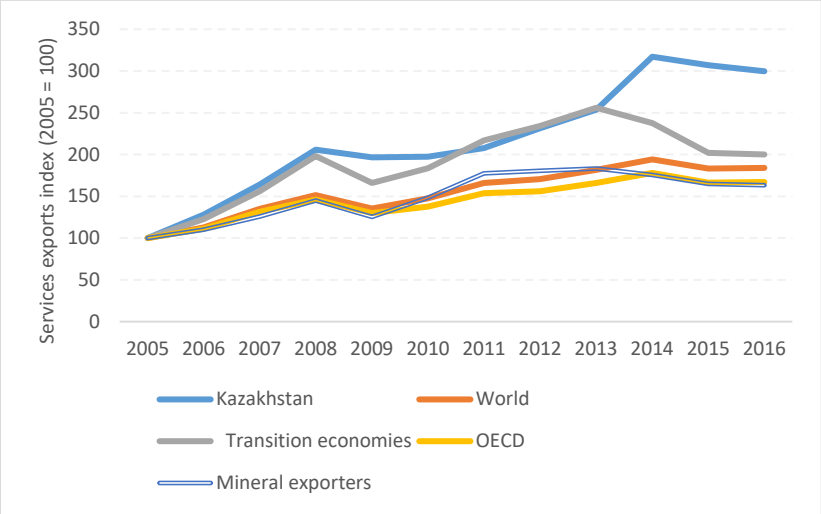
Figure 3.5: Manufacturing output is concentrated in resource- and capital-intensive activities in Kazakhstan, 2017



Data source: Agency of the Republic of Kazakhstan on Statistics.

While much of the growth in services has been in nontradables, knowledge-intensive, tradable services have also experienced strong growth, but from a small base. By the end of 2016, information and communications technology (ICT), finance, and business services accounted for almost 700,000 jobs, with employment growing at an annual rate of 3.5 percent in 2010–16. Exports grew even faster, with overall services exports expanding by more than 7 percent a year over the period. In the decade to 2016, Kazakhstan's services exports grew 80 percent faster than the OECD average (figure 3.6). These sectors remain very small, however, together accounting for just 8 percent of jobs. While this is more than the employment contribution of both manufacturing and mining, it is less than half the rate in more advanced natural resources economies like Australia and Canada.[38] Realizing potential in these sectors will require investment in innovation, development of regional exports, and, most likely, more FDI. More broadly, it will require an investment climate that supports risk-taking entrepreneurs, cultivates start-ups, and facilitates the growth of established SMEs.

Figure 3.6: Kazakhstan's services exports grew 80 percent faster than the OECD average, 2005–16



Data source: UNCTAD.

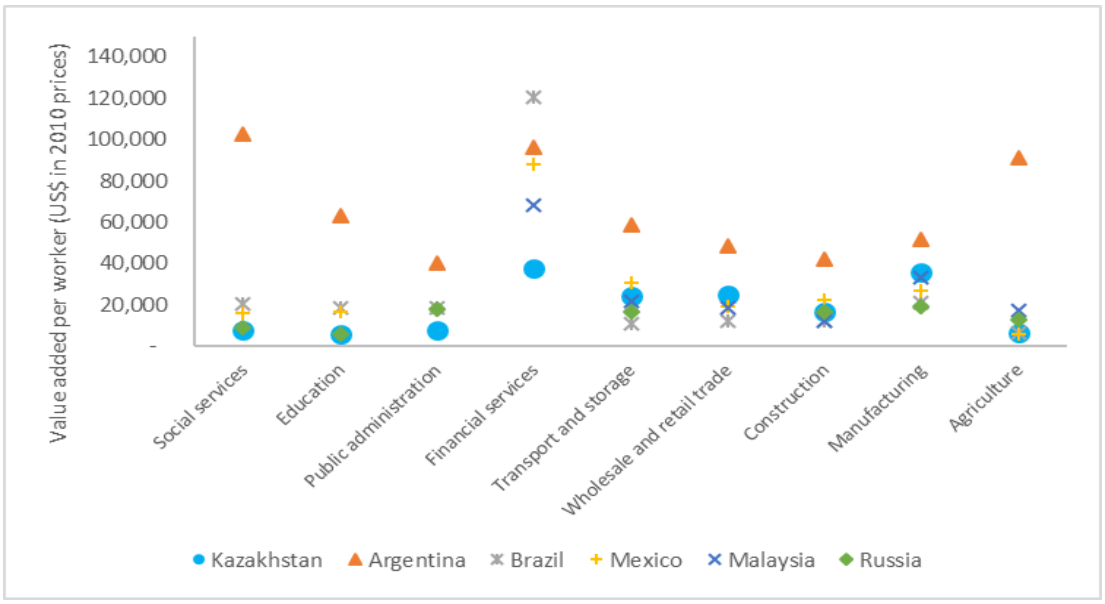
Weak productivity and innovation impede diversification

Productivity growth has been inadequate to support high wage growth but is relatively competitive in some sectors. Productivity per worker is much lower in many sectors than in peer countries. Labor productivity is lowest in education, agriculture, health care, and public administration (figure 3.7, panel a). While not all of these are export sectors, their outputs are important for the economy's competitiveness. Large gaps are evident between wages and productivity in some key sectors (figure 3.7, panel b). High wage growth is probably linked to fiscal policy (see chapter 2), which has kept wages up, while lagging productivity stems in part from currency appreciation and the overall low level of competition, especially in 2010–14. Still, productivity is relatively higher in some key tradable sectors, such as manufacturing, trade, and transport, than it is in some other upper-middle-income countries (figure 3.7, panel b) indicating that Kazakhstan's manufacturing wages are in line with expectations for its productivity (figure 3.7, panel b). Thus, while the overall productivity story is a concern, the story for manufacturing, and possibly trade and transport, bodes well for potential diversification.

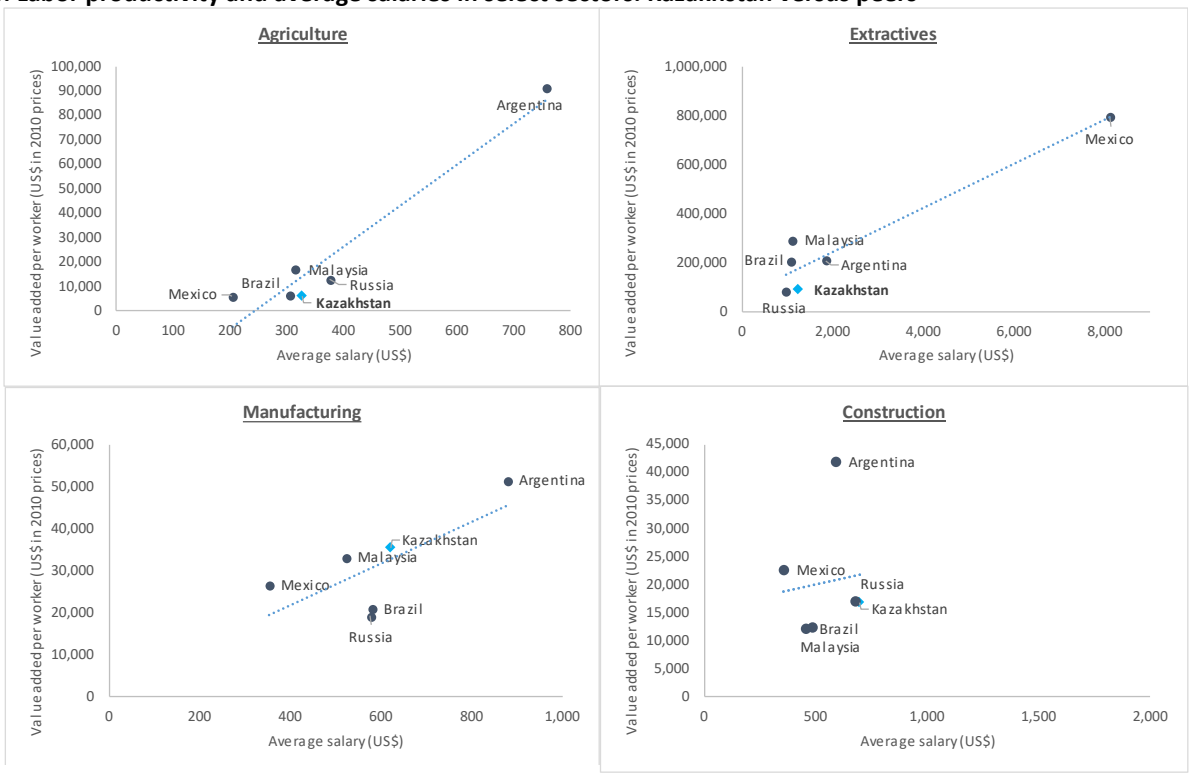
[38] OECD (2016).

Figure 3.7: Kazakhstan trails its peers in labor productivity in most sectors, although manufacturing, transport, and trade are relatively competitive

a. Labor productivity: Kazakhstan versus peers



b. Labor productivity and average salaries in select sectors: Kazakhstan versus peers



Source: Boston Consulting Group and Kazakhstan Strategic Plan 2025; based on data from Oxford Economics, Agency of the Republic of Kazakhstan on Statistics, and Economist Intelligence Unit

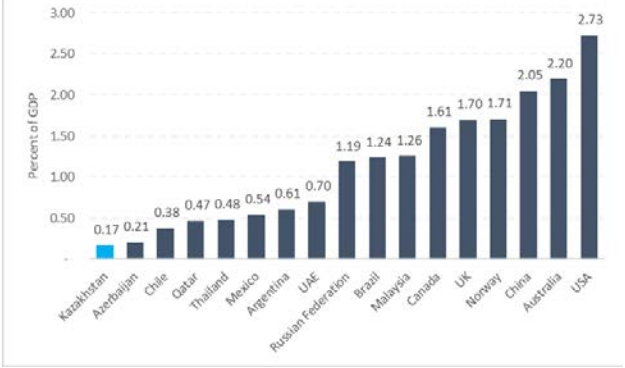
Low productivity and concentration in low-value-added segments reflect too little investment in innovation. Competitiveness and the potential to diversify into higher-value-added activities are held

back by a weak environment for innovation. On the World Economic Forum rankings of global competitiveness, Kazakhstan does poorly on innovation, business sophistication, and financial market development (where performance lags most—see later in this chapter) (figure 3.8). One reason for the low rates of innovation is the lack of investment. Research and development (R&D) spending by government and firms stands at just 0.17 percent of GDP (figure 3.9), no doubt owing in part to lack of economy-wide competition, little contestability of markets, and easy access to government finance for many well-connected firms (see below).

Figure 3.8: Global Competitiveness Index scores for Kazakhstan are especially low in some areas, 2016–17

Data source: World Economic Forum (2016).

Figure 3.9: R&D spending in Kazakhstan is below that of its peers



Source: Boston Consulting Group and Kazakhstan Strategic Plan (2025).

Where are the dynamic, small and medium-size private enterprises?

A major constraint to innovation and value-added growth, and thus to diversification, is the lack of dynamic small and mid-sized private companies. About one-fourth of Kazakhstan's 8.6 million employees in 2016 worked in public establishments (state education, health, research, or administrative organizations) or in SOEs (corporatized entities). Another 49 percent were individual entrepreneurs or worked for them (with on average 1.5 workers per entrepreneur), were self-employed, or were informally employed. The domestic private enterprise sector accounts for just 23 percent of jobs, with another 3 percent coming from foreign enterprises. Within the private sector, SMEs, which tend to drive innovation globally, are particularly underdeveloped. While SMEs might be expected to have a small footprint in a resource-rich economy, their contribution is particularly low in Kazakhstan: for example, in Kazakhstan, SMEs (including both private and public sector SMEs) account for 20 percent of GDP but just 28 percent of jobs (figure 3.10), while in Saudi Arabia, SMEs account for 20 percent of GDP but 51 percent of jobs, and in the United Arab Emirates, they account for 30 percent of GDP but 86 percent of jobs.[39]

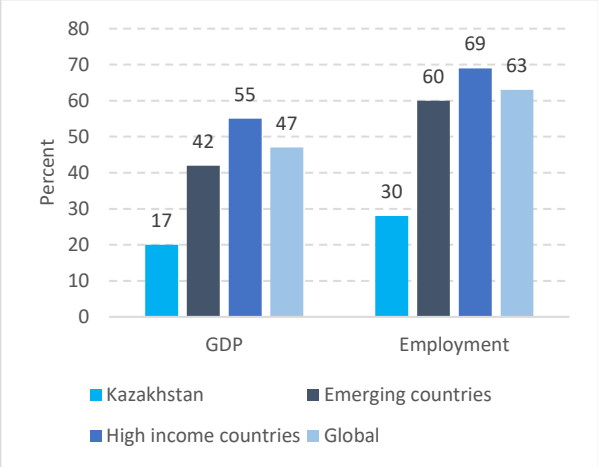
Small and medium-size private firms account for 30 percent of total jobs and had the fastest jobs growth among newly-registered firms in 2005–13 (figure 3.11). According to data provided by the Ministry of National Economy, about three-quarters of registered SMEs were active in 2017. However, the problem of pseudo-enterprises established for purposes other than operating a business (as tax-avoidance vehicles or financing instruments, for example) remains an issue.[40]

As with private sector development more broadly, the government has long emphasized development of SMEs to support diversification. It has set 2050 as a target for raising the economic contribution of SMEs to 50 percent of GDP. Its Business Roadmap 2020 and Productive Employment

[39] World Bank Group (2015e).
[40] World Bank Group (2014a).

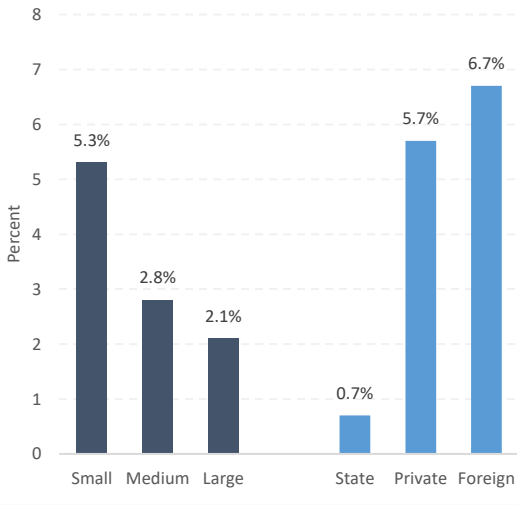
and Mass Entrepreneurship Program (2017–20) include provisions for subsidized loans and business advisory support to the SME sector. Yet the DAMU Entrepreneurship Development Fund (which implements Business Roadmap 2020) estimates that its support reached just 4.6 percent of active SMEs in 2014.[41] Various programs have been set up across multiple government agencies to support SMEs, pointing to fragmentation in support and weak coordination.

Figure 3.10: SME shares of GDP and employment in Kazakhstan lag shares in emerging and high income countries, 2013



Data source: World Bank Group (2013b).

Figure 3.11: Private SMEs had the fastest job growth among registered firms in Kazakhstan over 2005-13



Data source: World Bank Group Enterprise Surveys Kazakhstan, 2013.

Women-run SMEs face significant hurdles. Involving women in business promotes female employment, thereby improving their social status and individual development and providing a means to earn an income. Women in Kazakhstan are more likely than men to operate microenterprises and small businesses and, in rural regions, often engage in home-based production or other entrepreneurial activities that are compatible with household duties. Women often face numerous obstacles despite the fact that women entrepreneurs represent a significant share of beneficiaries in government programs.[42] However, with the exception of microcredit programs and some training, most SME development programs have taken a gender-blind approach and have not addressed the underlying disparities that put female entrepreneurs at a disadvantage.[43]

A need to rebalance the approach to private sector development

The government has long targeted economic diversification as a priority to ensure sustainable development. The government program for industrial and innovation development is designed to promote diversification, 11 special economic zones have been established, and cluster initiatives and innovation systems approaches have been introduced to develop competitive, non-extractive sectors. Nevertheless, price distortions and macroeconomic volatility remain significant impediments to diversification (see discussion on implementation in chapter 2).

Supporting growth of the SME sector will require cross-cutting reforms. The SME sector, and the private sector more widely, are held back in part by some of the structural factors touched on early in

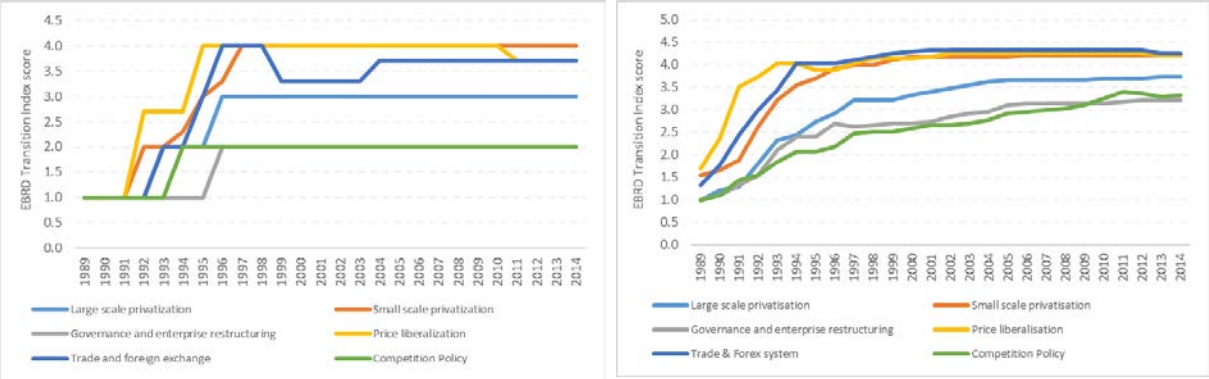
[41] "Development strategy of DAMU Entrepreneurship Development Fund JSC for 2014-2023" (PowerPoint presentation).
[42] Women account for 35 percent of participants in financial programs under the Business Roadmap 2020 and 45 percent of trainees under the Productive Employment and Mass Entrepreneurship Program.
[43] Asian Development Bank (2013).

this report, including geography, scale, and the resource-based nature of the economy. However, with oil prices expected to remain low in the medium term, an important step is to maintain the lower real exchange rate. That should establish a more competitive macroeconomic environment if accompanied by the dismantling of a host of barriers, including widespread informality, corruption and clientelism, red tape, lack of access to finance, and a dearth of professional and managerial skills.[44]

The sluggish development of a competitive private sector reflects the slow pace of reform in the transition to a fully functioning market economy. Until 2015, the EBRD and the World Bank produced transition indicators to assess the transformation of economies from central planning to a market economy. Though no longer updated, these indicators are still an informative tool for comparing progress. Outpacing Central Asia countries, Kazakhstan still lags behind the EU-9 (Bulgaria, Croatia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, and Slovenia) on all indicators. The largest gaps between Kazakhstan and the EU-9 are on large-scale privatization, governance and enterprise restructuring, and price liberalization (figure 3.12). Thus, moving forward requires reducing the large state presence in the economy and promoting market contestability; improving governance of the private sector and removing cross-cutting business environment constraints, including corruption and inefficient regulation; and reforming the financial sector.

Figure 3.12: Kazakhstan increasingly trails the EU-9 on EBRD indicators of transition reforms, 1989–2014

Kazakhstan **EU-9 average**



Source: EBRD (2016b).
Note: Score ranges from 1 (low) to 4+ (high). EU-9 comprises Bulgaria, Croatia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, and Slovenia.

3.2 Reducing the state presence in the economy: State-owned enterprises and contestability

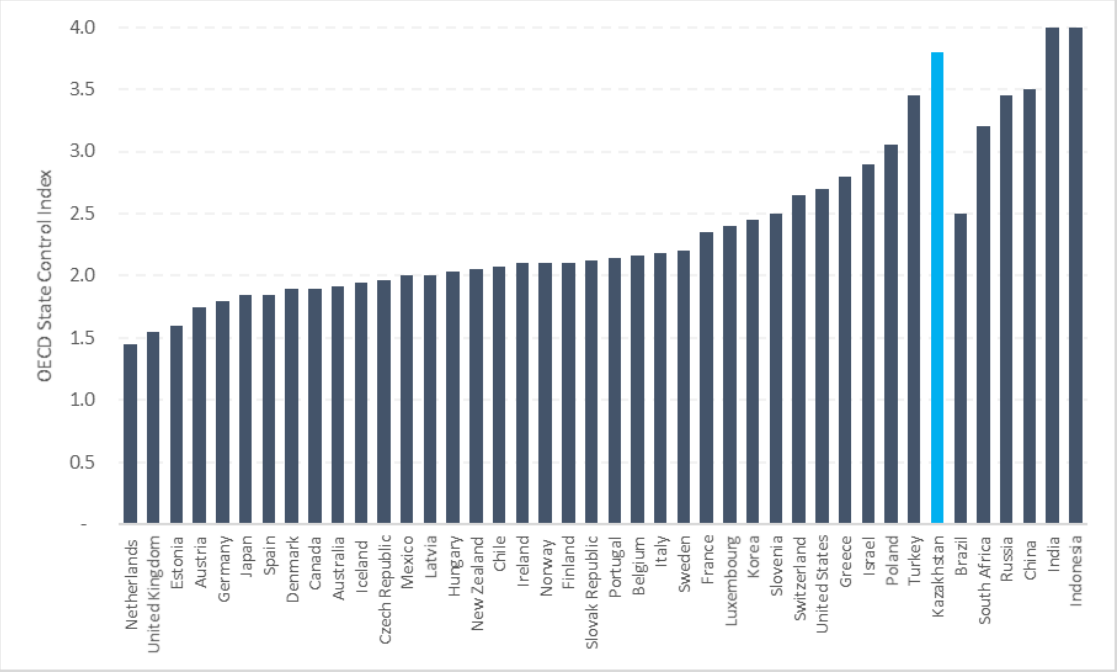
A large state presence in the economy is blocking full development of the private sector

State-owned enterprises still dominate the economy. In an economy heavily reliant on extractives, a large role for SOEs is perhaps not surprising, but what is surprising is just how pervasive SOEs are in all sectors, including in critical enabling network services like electricity and in products and services that have traditionally supported a broad set of diverse suppliers at all enterprise levels.[45] The assets of the more than 750 national and municipal corporatized SOEs in operation are valued at 30–40 percent of

[44] ADB (2014).
[45] The government recognizes the need to reduce the state's role in the economy in order to facilitate competition and private sector development and attract investment in the modernization and development of various economic sectors. The share of the quasi-public sector in GDP was 19.1 percent in 2015 and 18.6 percent in 2016. The government intends to reduce state participation in the economy to OECD levels (that is, 15 percent of GDP). To achieve this reduction, the government adopted the Comprehensive Privatization Plan for 2016–20 that includes the privatization of state property and partial IPOs of major national SOEs. For this program to succeed the government should avoid the participation of politically-exposed people in the privatization process.

GDP and the share of the quasi-public sector in GVA is about 19 percent.[46] Using a broader definition of SOEs that includes all public establishments, not just corporatized enterprises, brings the total to more than 25,000, though about 13,000 of these are schools and hospitals. Three public holding structures—Samruk Kazyna,[47] KazAgro, and Baiterek Holdings, along with their more than 600 subsidiaries—dominate the economy, controlling energy, transport, utilities, SME financing, and agriculture finance and product development. These public holding structures and SOEs dominate in sectors and market segments that, in other countries, are typically open to private participation, such as oil and gas production, electricity, transport, and telecoms. According to the OECD's Index of State Control, Kazakhstan has a greater presence of SOEs in the economy than any OECD member and most large non-OECD economies, including Brazil and China (figure 3.13).

Figure 3.13: Kazakhstan has a greater SOE presence in the economy than OECD member1 and most large non-OECD economies, including Brazil and China, 2013



Source: OECD.
Note: Index scale ranges from 0 (least restrictive) to 6 (most restrictive).

The state is involved in all network sectors. Beyond the very large firms that dominate the economy, SOE presence is relatively limited (figure 3.14). In manufacturing—one of the sectors targeted for diversification—most large and medium-size firms are in the private sector. But SOEs have a heavy presence in key services sectors; more than half of all SOEs are in ICT, transport, professional services, electricity, water supply and sanitation, education, and health. Close to one in three large and medium-size ICT firms are SOEs.

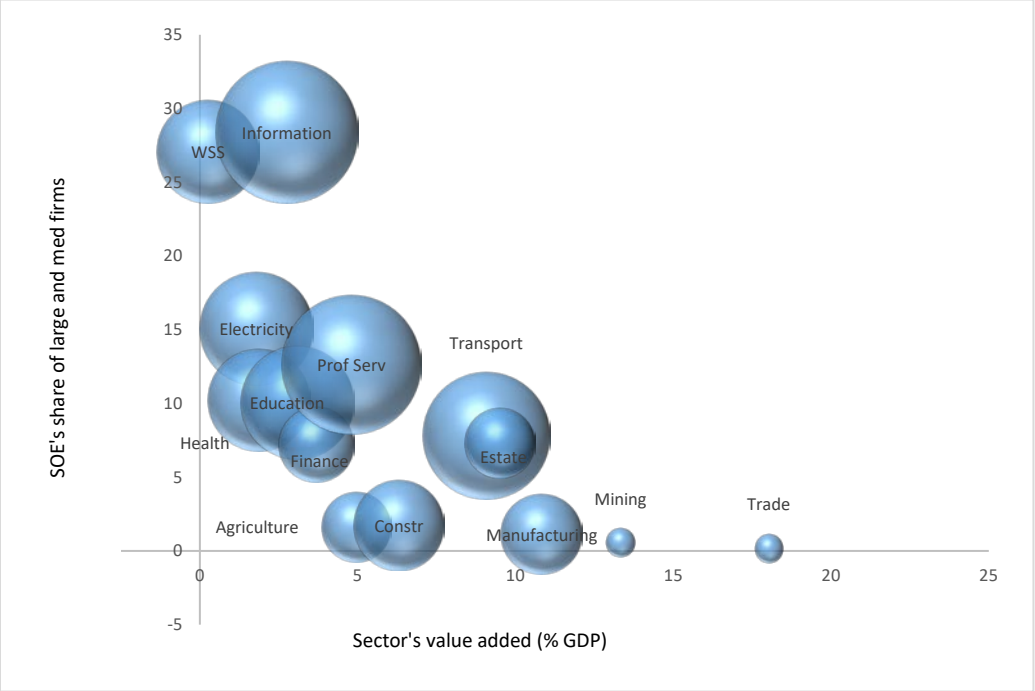
State-owned enterprises can influence policies and competition in individual sectors and economywide. SOEs have influence not only through their direct presence, but also through their ability to influence policy—for example, through their privileged access to government, which participates directly in their management boards. The strong presence of SOEs in key product markets

[46] OECD (2016).
[47] Samruk Kazyna was created in 2008 to foster economic diversification and increase corporate governance. It employs 340,000 people.

may be discouraging the emergence of private sector firms, through crowding out, their access to subsidized loans, and an undermining of competition policy and the wider pro-competition landscape.

Governance of SOEs, although improved through corporatization, remains a challenge. A large number of SOEs that are not part of three major holding companies are not corporatized.[48] Government is heavily represented in the governance structures of major holding companies, with high-level officials assigned to serve as board members and heads. Moreover, there is no systematic assessment of fiscal risks and no comprehensive oversight and monitoring of SOE debt.

Figure 3.14: SOEs dominate in sectors comprising mainly large and medium-size firms in Kazakhstan, 2015



Data source: Agency of the Republic of Kazakhstan on Statistics.
Note: The size of a balloon represents the share of SOEs in the sector (as a share of total firms); for example ICT, the largest bubble, accounts for 12 percent of all the SOEs in the sectors shown. SOE's share of output, by sector or overall, is unavailable. WSS is water supply and sanitation.

An ambitious privatization plan for 2016–20 aims to reduce the state's role in the economy. The government plans to reduce SOE assets as a share of GDP from 60 percent in 2015 to 30 percent by 2022. In a December 2016 decree, it approved a new list of privatizations in the public and quasi-public sectors covering more than 700 SOEs, including the 65 largest companies that are part of holdings such as Samruk Kazyna Sovereign Wealth Fund, Baiterek Holdings, and KazAgro Holdings, and 173 subsidiaries and affiliates in Samruk Kazyna. At the time of the decree, the government noted that large-scale privatizations were its top priority.[49] The government also noted that the new privatizations are intended to set in motion a process that would see central and local public sector executive bodies focusing primarily on developing competition and supporting private investment.

Sector visions and plans are needed to ensure that privatization does not simply transfer rents to a small set of elites. Reducing the role of the state requires not only eliminating private sector distortions and favorable treatment of SOEs, but also creating a level playing field for diversified private investment. This requires the government to develop and share a vision for its plans in each subsector

[48] This undermines the effort to establish centralized ownership function, and dual legal form (with different governance requirements) of SOEs that are undertaking economic activities.
[49] http://astanatimes.com/2016/01/government-approves-new-privatisation-plan-for-2016-2020/.

or major market in the economy, such as wheat, electricity generation, rail freight, and road management—prerequisites for successful privatizations and PPP projects. Unless plans are developed for each subsector or major market in the economy, privatization and deregulation efforts may not succeed (see box 3.2 for an example from the electricity sector), and the risk is high that the benefits of privatization will be captured by a small set of established businesses.

Box 3.2: Electricity reform and reversal in Kazakhstan

After independence in 1991, Kazakhstan became one of the first countries of the former Soviet Union to embrace a market-oriented strategy to reform the electricity sector. Radical market reforms were prompted by the deep financial and operational crises in the sector following the collapse of the Soviet Union and its interconnected power system. The country became an early adopter of a liberalized multimarket model. The formerly vertically integrated state monopoly was unbundled into separate electricity generation, transmission, and distribution units. Markets were introduced, including bilateral, spot, balancing, ancillary, and capacity submarkets. The wholesale electricity market was liberalized and operated mainly through bilateral contracts between generators and large consumers and regional electricity distribution companies for direct sales of power. The government established the legislative, technical, and organizational infrastructure for a functioning electricity spot market, which increasingly supplemented bilateral contracts as a liquid trading floor for short-term transactions.

A key obstacle to investment across the entire electricity chain, however, was the quality of legal and regulatory processes. The poor investment climate led to several high-profile departures from the sector by foreign strategic investors, and almost no major modernization and expansion investments took place during the 2000s in generation and distribution.

Sector reforms are unfinished. As the investment crunch unfolded in the mid-2000s, when projected reserve margins became dangerously tight, concerns arose that the additional capacity of existing and planned generation might not be sufficient to keep pace with surging demand for power. The government reverted to command-and-control measures, including regulating energy generation tariffs, renationalizing power generation, restricting electricity spot-market transactions, eliminating zonal transmission tariffs, and postponing the planned real-time balancing market.

Especially under the 2008 amendments to the Electricity Law, many essential reforms were rolled back, including sector unbundling, a liberalized wholesale market, a spot market, and distribution tariffs. The government introduced an administrative generation tariff regulation in 2009, which imposed tariff caps on all major generators to make new investments in modernizing and extending capacity. The tariff increases allowed under the scheme have been substantial. To its credit, the government program produced a mini-investment boom of 28 percent per year on average between 2009 and 2015—a steep increase over the previous period. However, a government audit of the program, covering 2010-14 found several shortcomings including economic inefficiency. Moreover, the government's Energy Concept 2030, adopted in 2014, envisages prolonging state-led management of the sector. A key obstacle to private investments in the sector remains high uncertainty with the investment climate. A stable environment is needed to foster investor interest in the sector and mobilize much-needed private investment to support the ambitious investment programs.

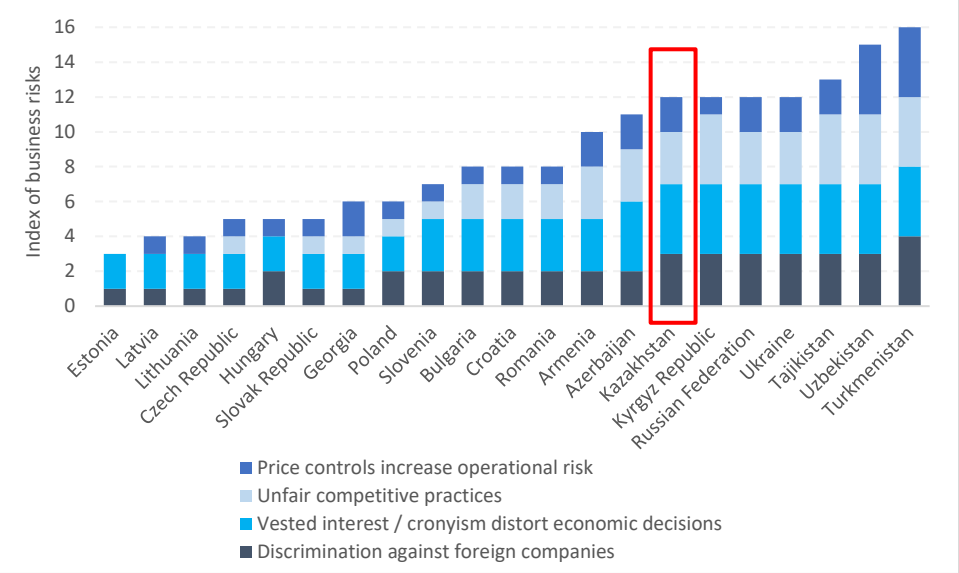
Source: Aldayarov et al. (2017) "Stuck in Transition: Reform Experiences and Challenges Ahead in the Kazakhstan Power Sector."

A weak competition environment deters FDI and SME expansion

Kazakhstan lags on market competitiveness measures. Competitive markets, achieved largely through domestic regulation and openness to imports, facilitate sustainable productivity growth by driving the allocation of capital and labor toward more productive sectors and firms. Despite progress, Kazakhstan compares poorly with regional peers, including Russia, by parameters of the competitive environment. *The Global Competitiveness Report 2016–17* ranks Kazakhstan 106th of 138 countries in the intensity

of local competition and 83rd in the effectiveness of antimonopoly policy.[50] Business risks related to lack of competition are perceived to be high, as in the Russian Federation and other Central Asian neighbors, relative to other regional peers (figure 3.15). According to the Global Competitiveness Report, these risks are elevated in all areas, including vested interests distorting economic decisions, discrimination against foreign companies, unfair competitive practices, and price controls.

Figure 3.15: Business risks related to weak competition policies are perceived to be high in Kazakhstan, 2016



Data source: Economist Intelligence Unit.
Note: Highest risk = 16

The playing field is uneven. While many SOEs are submitted to the scrutiny of competition law, key public operators receive laxer regulatory treatment. For instance, Samruk Kazyna and its subsidiaries—the largest buyer of goods and services in the economy—are exempt from public procurement procedures. In June 2017, the Agency for Civil Service Affairs and Anticorruption reported that 94 percent of Samruk Kazyna's procurement was on a sole-source basis. And despite evidence of tightening competition scrutiny, SOEs still enjoy preferential access to credit from the Republican Budget and the Oil Fund, state guarantees, and other public resources, making it difficult for private operators to compete.[51] Yet private sector firms considered "dominant"[52] face extensive reporting obligations and have little ability to compete efficiently in the market.[53] This focus on dominance has prevented more active efforts against cartels, which engage in the most egregious antitrust actions.

Promoting market contestability through a more effective competition and regulatory policy framework—applied equally to public and private operators—is necessary for enhanced private sector participation in diversified product markets. Achieving this entails, in part, penalizing anticompetitive behavior, which will require strengthening the enforcement capacity of the

[50] Indicators are perception-based indicators derived from an Executive Opinion Survey. For more information on the overall methodology see http://reports.weforum.org/global-competitiveness-report-2015-2016/appendix-methodology-and-computation-of-the-global-competitiveness-index-2015-2016/

[51] For example, in 2015 KazMunayGas, the National Oil and Gas Company and major subsidiary of Samruk-Kazina holding, received US$2.7 billion in public funds to refinance its foreign debt.

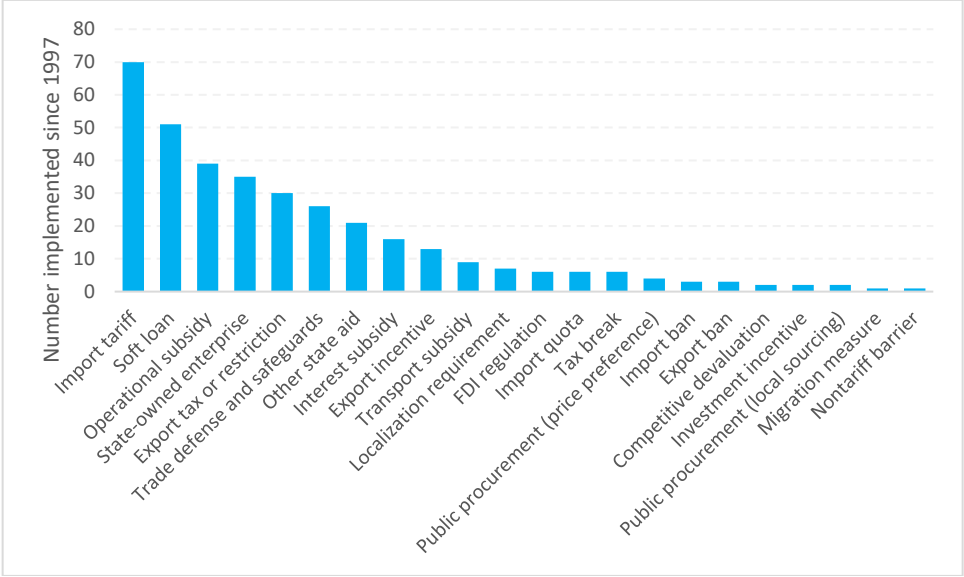
[52] The Competition Law of Kazakhstan considers as dominant firms with market shares beyond 30 percent or even less than that depending on market structure. This definition of dominance can severely threaten competition on the merits since so-called "dominant" operators will be precluded from engaging in fully legitimate business conducts for non-dominant firms such as offering discounts or entering into efficiency-enhancing vertical restraints such as exclusive dealing.

[53] As of 2017 this registry is expected to be restricted to legal monopolies, however, significant limitations toward firms considered dominant will persist.

Competition Authority and ensuring greater transparency and predictability of enforcement of competition policy. Even more important is consistent application of the "competitive neutrality" principle, grounded in an institutional setup that can foster and guarantee healthy market conduct, by limiting state interventions that enable anticompetitive market outcomes. Draft regulations need to be scrutinized systematically for economic impact, including on competitiveness and investment.

Industrial policy instruments inhibit competition. Strengthening the business environment to support the emergence of a competitive private sector requires establishing a level playing field across firms and sectors. Over the past two decades, Kazakhstan has developed an extensive program of industrial support that channels heavy subsidies to firms by providing credit, inputs, and other supports (figure 3.16). These subsidies are more likely to go to larger companies and existing sectors, thus reinforcing the status quo. Indeed, the most common industrial support instruments are wielded through trade protection. Such trade-related subsidies tend to benefit SOEs and established sectors, limiting their effectiveness to facilitate diversification of industries and firms and promote competitiveness. For example, in agriculture, government expenditures on essential public services and infrastructure are dwarfed by spending on production- and trade-support measures, which on their current trajectory will account for 81 percent of industrial policy spending by 2020.

Figure 3.16: Kazakhstan has an extensive array of industrial policy instruments and has used them frequency since 1997



Source: EBRD (2017).

3.3 Improving the business environment and private sector governance

Business climate improvement has been undermined by stalled efforts on market and cross-cutting regulatory management reforms

Kazakhstan has put considerable effort into becoming business friendly, with some success. For example, Kazakhstan is ranked 53 out of 138 countries on the Global Competitiveness Index, just behind Mexico (51), and ahead of Turkey (55), which is known for being competitive and attracting FDI. Relative to commonly referenced peers, however, such as Korea (26), China (28), Chile (33), Thailand (34), Indonesia (41), and the Russian Federation (43), Kazakhstan has a way to go.[54]

Over the past decade, Kazakhstan has made progress in varying degrees on all business climate

[54] World Economic Forum (20016).

fronts, though it faces setbacks on macroeconomic policies and financial sector policies. Kazakhstan has also improved its ranking on the Doing Business Index, moving up almost 40 places over the past decade to 35 out of 190 economies. Kazakhstan introduced the "Yellow Pages" rules and initiated a second wave of privatization aimed at reducing state participation in the economy. However, despite substantial procedural and regulatory improvements, gaps remain in some fundamental aspects of private sector development. Moreover, the pace of reform has slowed related to EU-9 transition countries during the 2000s, especially in competition (and state presence in the economy) and trade (see figure 3.12).

Continued reforms of Kazakhstan's regulatory management system can ease cross-cutting concerns related to competitiveness, regulatory efficiency, and implementation. Over the last five years, Kazakhstan has developed and tested tools and approaches to systematically consult with businesses and assess the impacts of proposed new regulation. For example, Concept of State Regulation of Entrepreneurship 2020[55] calls for three implementation phases for regulatory impact assessment. Further progress can be made. In particular, the current Regulatory Impact Assessment requirements could be expanded to consider impacts on competitiveness, investment, and foreign trade obligations, reflecting practices in other countries.

Regulatory enforcement and inspection remain a major concern for investors and businesses. In addition to concerns about traditional administrative burdens, there are also concerns about the uncertainty and unpredictability of enforcement. This uncertainty is partly owing to a heavy reliance on the discretion of inspectors' interpretations—a situation that creates opportunities for rent-seeking behavior. Over the past decade, the government has repeatedly attempted to address this problem, mainly through legislation and control measures led by the Prosecutor's Office. While minor improvements have been observed, businesses still perceive significant problems with the inspection system.

A different reform approach may be required. It seems unlikely that an inspection and enforcement system based on legalism and formalism, including detailed and numerous requirements and heavy-handed controls and sanctions, can be transformed effectively using those same methods. International experience suggests that command-and-control regulations are ineffective. Rather, transformation of inspection and enforcement practices in Kazakhstan requires profound changes in the administrative culture, staff, and practices of inspectorates. Possible measures used successfully in other countries include:

- A policy framework for inspection and enforcement practices that relies principally on support for compliance and risk-mitigation, as opposed to control and prohibition.
- A new performance management framework with performance indicators that support the reform's objectives and with greater use of resource allocation and salary levels in the pursuit of targets.
- Gradual reduction in the overall number of inspectors, and a fundamental overhaul of staff profiles.
- Introduction of real risk-based planning and management of inspections, including use of new information technology tools.
- Strong institutional oversight with sufficient capacity, skills, and powers to promote changes in a sustained way.

[55] Approved by Government of Kazakhstan Decree #380, dated April 18, 2014.

A stronger institutional framework is needed to support good corporate governance

The Corporate Governance Code lacks effective implementation, and inconsistencies remain across laws and regulations. Thus, compliance by firms is patchy. A recent EBRD study noted that insufficient attention has been paid to monitoring and enforcing corporate governance laws.[56]

Similarly, corporate financial reporting has made some progress, but improvements in implementation are needed. The Accounting and Auditing Report on the Observance of Standards and Codes, published in 2007 after two years of work, identified weaknesses in the corporate financial reporting architecture and offered policy recommendations. While the government achieved results in some areas, it did not take a comprehensive approach to reform corporate financial reporting. The quality of financial reporting needs to be upgraded, both in enforcement (including oversight of auditors) and capacity building for compliance.

Court reforms have made progress, but accountability remains weakened by corruption and clientelism

Kazakhstan comes in ninth on the Doing Business rankings for ease of enforcing contracts, a critical benchmark for the business climate. It has earned this ranking by introducing an electronic filing system for court users and a simplified fast-track procedure for small claims and by adopting a new code of civil procedure. According to the World Bank's Doing Business survey, it takes 36 procedures and 370 days to enforce a contract in Kazakhstan and costs 22 percent of the value of the claim.[57] On Doing Business's quality of judicial proceedings indicators, the country outperforms its regional peers, scoring 13 out of a maximum of 18. Case management and court automation require further attention.

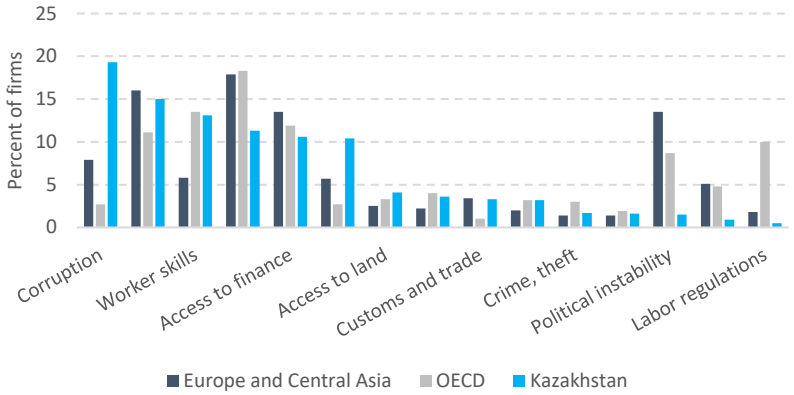
Kazakhstan has also moved toward better procedures for resolving investment disputes. In 2016, Astana City Court was designated the first-instance court for investment disputes, and the newly created specialized judicial collegium at the Supreme Court was designated the first-instance court for large investors. There is now a need to develop capacities of the investment court judges in analyzing complex investment cases. The new Astana International Finance Center will have its own arbitrage system based on common law, and authorities are considering options for introducing some aspects of British common law into the national justice system.

Nonetheless, only 40 percent of firms indicated that the court system is "fair, impartial, and uncorrupted," according to the Business Environment and Enterprise Performance Survey 2014.[58] This again reflects a situation in which gains in regulatory and procedural issues are partly undermined by a broader lack of accountability.

Corruption is the most commonly cited major constraint facing firms, as reported in the World Bank's Enterprise Surveys (figure 3.17). Corruption is also an area in which Kazakhstan stands out as having a much worse business environment than peers in the Europe and Central Asia region and OECD, according to the World Bank Enterprise Surveys. This finding is supported by other indices, such as Transparency International's Corruption Perceptions Index, which ranks the country 122 out of 180.[59] Corruption and clientelism retard the growth of the private sector by imposing heavy transaction costs on firms and, more important, by reducing allocative efficiency in the economy by enabling the most well-connected firms, rather than the most productive, to capture credit, contracts, and other favors. Corruption and clientelism can prevent the emergence of smaller firms and establish barriers to investment and growth.

[56] EBRD (2016a).
[57] World Bank Group (2017b).
[58] World Bank Group (2014b).
[59] Transparency International (2016a).

Figure 3.17: Corruption is the most often cited business environment constraint in Kazakhstan, 2013



Data source: World Bank Group Enterprise Surveys 2013.

The government recognizes the challenge and takes active measures for reducing corruption.[60] Efforts to improve the business environment, such as the moratorium on inspections of SMEs introduced in 2014–15, can have substantial knock-on effects in reducing corruption. External assessments of Kazakhstan's progress in reducing corruption and increasing transparency are mixed. While the country's ranking improved on transparency indicators according to four organizations (the International Institute for Management Development, the World Justice Project, the Varieties of Democracy Project, and Political Risk Services), the its ranking deteriorated on the rankings of four other organizations (Freedom House, the World Economic Forum, the Bertelsmann Foundation, and IHS Global Insight).

3.4 Reforming the financial sector

The financial sector is the Achilles' heel of Kazakhstan's private sector development. Enterprises need access to a robust and competitive financial sector to develop and grow. Kazakhstan has yet to recover from the massive credit expansion of the 2000s and the banking sector crisis in 2007. As a result, access to credit by the private sector, other than through government subsidy programs, is patchy, particularly for SMEs (see box 3.3 on financial inclusion). Other financial products, such as insurance or leasing, are underdeveloped or in the government's hands. To deepen structural reforms in the financial sector, Kazakhstan should adopt the Basel III standards, improve financial institution capital adequacy, and apply risk-based approaches to regulation.

Box 3.3: Financial inclusion in Kazakhstan

Access to credit is critical to enable people in lower socioeconomic groups, especially in rural areas, to create opportunities where they live or migrate to other areas. While Kazakhstan compares well against global peers on broad measures of financial inclusion (for example, more than 40 percent of the population over age 15 has an account at a financial institution), it trails the OECD average on some key indicators (box table 1). And just 1.5 percent of the population has borrowed to start, operate, or expand a farm or business (by far the lowest among peers, except the Russian Federation). Among the bottom 40 percent of the population, the share drops to 0.5 percent, or just one-seventh the OECD average and

[60] Since 2015, a modern anti-corruption legislation based on the laws On counteraction to corruption and On civil service has been in force, a number of policy documents associated with implementation of the new anti-corruption policy of the state conceptually based on the Anti-corruption Strategy for 2015-2025 and the Plan of the Nation - «100 specific steps» were implemented.

less than half the rate of the next lowest peer country. This suggests there may be barriers preventing microenterprises and SMEs from borrowing.

Financial inclusion has a notable gender gap. Access to financial accounts by women is just 60 percent that of men, which may keep many women from entrepreneurship and SME options, consigning them to low-productivity self-employment.

Box table 1: Selected indicators of financial inclusion

	Kazakhstan	Chile	Mexico	Malaysia	Russian Federation	Upper middle income	OECD	Ratio: Kazakhstan / OECD
Account at a financial institution (% age 15+)	**42.1**	42.2	27.4	66.2	48.2	57.4	90.0	0.5
- ratio: top 60% to bottom 40%	*0.6*	*0.4*	*0.3*	*0.6*	*0.5*	*0.5*	*0.9*	0.6
- ratio: rural to urban	*0.9*	*0.9*	*0.5*	*0.8*	*0.9*	*0.9*	*1.0*	0.9
Borrowed any money in the past year (% age 15+)	**43.4**	28.6	50.8	56.1	30.2	37.7	39.8	1.1
- ratio: bottom 40% to top 60%	*0.9*	*0.7*	*0.9*	*1.0*	*1.0*	*1.0*	*1.1*	0.8
Borrowed from a financial institution (% age 15+)	**13.1**	7.8	7.6	11.2	7.7	7.9	14.2	0.9
- ratio: bottom 40% to top 60%	*0.9*	*0.9*	*0.6*	*0.2*	*0.7*	*1.0*	*0.8*	1.1
Borrowed to start, operate, or expand a farm or business (% age 15+)	**1.5**	3.0	9.5	6.1				

Source: World Bank Global Findex.

Kazakhstan made progress in expanding financial inclusion before the 2008–09 global financial crisis, but the government response since then has created an environment that severely reduces private access to finance. The ratio of domestic bank deposits to GDP hovers near 40 percent, nearly half the high-income country average; private credit to GDP is 36 percent, likewise falling short of high-income and peer group countries.[61]

The government plans a further round of subsidized credit for microenterprises (as part of the Productive Employment and Mass Entrepreneurship Program), as well as other measures to develop diverse financial services, particularly for rural markets. These include enhancing credit information; introducing nonbank financial services, including leasing and insurance; and launching financial mechanisms to leverage agricultural resources, such as crop insurance, risk-based loans, warehouse receipt systems, and communal land ownership as collateral. There may also be opportunities to introduce or expand value chain finance to reach larger groups of smaller farmers more efficiently.

Overhauling the concentrated, volatile, and poorly performing banking system

Kazakhstan's financial sector is thin. Total credit to the private sector was equivalent to 34 percent of GDP in 2016, against an average of 106 percent for middle-income countries and 102 percent for upper-middle-income countries. Credit is highly concentrated, dominated by a few commercial banks. The banking sector has 33 licensed banks, with about US$81 billion in assets as of January 2017, and US$49 billion in lending. The top 10 banks by asset size account for 84 percent of bank lending and 82 percent of deposits.[62] Concentration increased in June 2017 with the merger of the first- and second-largest banks by asset size (Kazkommerzbank and Halyk Bank), together representing more than 40 percent of banking sector assets.

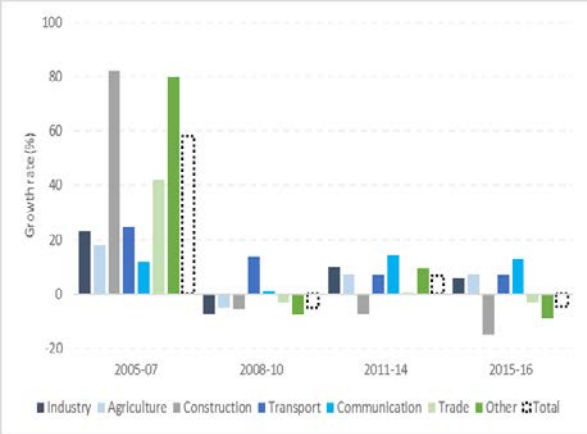
The banking sector has been a source of considerable volatility in the economy. In 2005–07, total credit grew at an average annual rate of nearly 60 percent in nominal terms (figure 3.18), reaching 61 percent of GDP in 2007. Then in 2008, credit growth contracted sharply after Kazakhstan's banking crisis. The banking crisis and the global financial crisis led to a surge in nonperforming loans (NPLs) in 2009, which Kazakhstan's economy has been unable to resolve (figure 3.19).

[61] Bankscope.

[62] Halyk Bank, Kazkommerzbank (owned by Halyk), Tsesnabank, ATF, Bank CenterCredit, Sberbank, Forte, Kaspi Bank, Bank RBK, and Eurasian Bank. None of the large international banks is present in Kazakhstan.

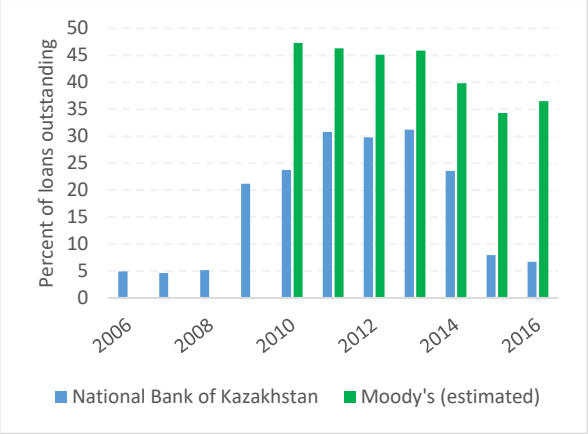
The institutional structure of the central bank should be strengthened to prevent political decisions from influencing the operations of the regulator. The financial regulator—the Governor of the National Bank of Kazakhstan—is appointed by the president. In addition, the flow of information between operating units in NBK is restricted by workflow practices, internal culture, and explicit rules. It is not surprising, therefore, that its mandate is weakened by unreliable reporting from financial institutions and inadequate supervisory powers. Under International Financial Reporting Standards, banks have broad leeway in reporting practices, especially in classifying and valuing loans. In July 2015, the NBK further relaxed constraints on creative accounting by dropping prudential provisions for consolidated financial reporting. In just a few months, reported NPLs system wide fell below 10 percent, even as the price of oil fell and the tenge depreciated sharply against the US dollar. Efforts by the NBK to identify problems and take corrective action can be forestalled by influential banks.

Figure 3.18: Credit to the economy in Kazakhstan has shrunk dramatically in nominal terms, 2005–16



Data source: National Bank of Kazakhstan.

Figure 3.19: Nonperforming loans surged in Kazakhstan's after the banking crisis, 2006–16



Data source: National Bank of Kazakhstan's estimate of loans 90 days overdue and Moody's estimate capturing retail and corporate loans based on surveys of nine banks that account for 65 percent of commercial banks' portfolio.

Efforts to reduce the NPL burden in 2007–17 were slow and largely ineffective. The government bailed out the banking sector three times. First, in 2008, the Oil Fund helped settle most of the banking sector's foreign obligations, though banks were still required to collect on NPLs from domestic borrowers to repay the Oil Fund. Second, in 2015, the National Fund recapitalized the Problem Loans Fund by 250 billion tenge, equivalent to US$ 1.4 billion at the time, to reduce NPLs accounting for about 23.5 percent of total bank loans in December 2014.[63] Finally, in 2017, half of the US$6.5 billion needed to recapitalize Kazkommertsbank was expected to come from the Oil Fund. With the NPL issue unresolved, credit to the economy contracted in real terms (see figure 3.19). The authorities recently adopted a banking-sector rehabilitation program to address the NPL issue and revive credit growth.

Activities of the quasi-public banking sector dwarf those of commercial banks. Because of the weaknesses of the banking sector, quasi-public banks have been booming. Their activities have included the economic stimulus program, lines of credit from international institutions, and allocation of Unified Pension Fund assets to commercial banks. Baiterek Holdings includes 11 subsidiary quasi-state entities that allocate grants and loans to development projects and another 11 projects for constructing infrastructure and stimulating jobs, entrepreneurship, and regional development. The enormous scale of government participation in the financial sector is especially evident when set

[63] The authorities also extended tax exemptions for NPL write-offs and strengthened prudential regulation by introducing new requirements for calculation of capital adequacy in accordance with Basel III, in effect from January 2015.

against the volume of commercial bank lending. Government program grant and loan disbursements under Baiterek Holdings, for example, were 15,553 billion tenge as of January 2016, according to NBK. KazAgro Holding Joint Stock Company includes seven subsidiaries that support industrial development of agribusiness through lending, leasing, and guarantees.[64] Sources of funding include the Oil Fund, the pension fund, national budget, and funds raised by KazAgro itself. Its loan portfolio in 2016 totaled 585 billion tenge, equivalent to 1.3 percent of GDP.

The large state economic stimulus programs, along with inadequate development of credit risk management capacity, have contributed to the poor risk management strategy of banks. Although this weakness is not evident from the official NPL rate (see figure 3.20), it is clearly evident in comparisons of banks' interest accrued and interest income in cash-flow statements. For some of the larger banks, this gap is as high as 50 percent. In 2016, however, banks retreated from lending, shifting their attention to collections. The few opportunities for new lending are afforded by special programs through Baiterek Holdings.

An underdeveloped nonbanking financial sector limits capital availability

A still nascent nonbanking financial sector restricts capital availability and the options open to enterprises seeking alternative instruments to raise capital or hedge risk. The sector has three main components:

- *Insurance*: Insurance company assets, at 2.2 percent of GDP, are less than one-quarter of the average for high-income countries and one-third that for income-peer countries. The market is undersized, despite rapid growth during 2009–12,[65] with premium volume in January 2017 at around US$63 per capita, two-thirds of it in the cities of Astana and Almaty.
- *Securities markets*: Stock market capitalization is 19 percent of GDP, against an average of 66 percent in high-income countries and 32 percent in the income-peer group. The stock market turnover ratio is 7.6 percent, less than one-fifth and one-third of the two groups' averages.[66] Kazakhstan's 10 largest companies represent 90 percent of Kazakhstan Stock Exchange (KASE) capitalization, and the share of value traded of the top 10 traded companies is just under 10 percent (against more than 50 percent by value of the top-traded companies in high-income country exchanges).
- *Pension funds*: Bringing state pensions under the Unified Pension Fund in 2013 raised Kazakhstan's pension fund assets to 9.8 percent of GDP, exceeding the 8.4 percent average of its income-peer country group, but governance and allocation of the fund are concerns. In May 2016, in response to worrying signs of commercial banks' deteriorating portfolios, weakening capital, and declining profitability, the president directed the pension fund to lend to commercial banks in support of SMEs and key economic sectors. Despite a statement released at the time by NBK that fund lending would take into consideration a bank's credit rating and other economic factors, allocations have often been made to banks with weakening financial metrics.

[64] Food Contract Corporation (manages state reserves of grain, including purchases and sales, develops domestic and foreign markets), Fund for Financial Support of Agriculture (credit for dairy and livestock), Kazagrofinance (credit and principal leasing organization in agriculture), Agrarian Credit Corporation (lending for entrepreneurship in rural areas), Kazagrimarketing (improves competitiveness by providing access to market information and support for implementation of government programs), Kazagragaranti, and KazagroOnim (supports implementation of investment projects, promoting the export of animal products, the introduction of innovations in the livestock industry).

[65] NBK.

[66] World Bank, World Development Indicators 2015.

4. Strategic Pillar 3: Integration and connectivity

Kazakhstan's geography has shaped the country's development opportunities, obstacles, and outcomes. In building a more diversified and competitive non-extractives-based economy, this landlocked country must integrate and connect better within and beyond its region. Across almost all aspects of the economy and society, regional and urban–rural disparities persist. If Kazakhstan is to sustainably reduce poverty and nurture a strong middle class, it must find a way to connect residents outside the growth poles of Astana, Almaty, and Mangystau to economic opportunities.

This chapter examines the role of integration and connectivity within the country and with the rest of the world.

4.1 Regional and global integration offer expanding market opportunities

Prospects for developing a diversified, job-creating, private sector-driven economy hinge on the economy's integrating into regional and wider global markets. With the small size of the domestic market, Kazakhstan needs to realize its export market potential by enabling firms to grow and exploit scale economies. Beyond commodity sectors, making the most of trading opportunities in Central Asian regional markets is an important starting point, and beyond this, Kazakhstan's location offers the potential to become a strategic trade hub along corridors between China, Europe, and Russia.

Deeper regional integration in Central Asia could greatly expand the size of the available markets

Kazakhstan is pursuing trade integration through an active policy of regional integration. Kazakhstan is a member of the Eurasian Economic Commission, the Central Asian Cooperation Organization, the Economic Cooperation Organization, the Shanghai Cooperation Organization, and the Commonwealth of Independent States Free Trade Area. It is also a participant in the Central Asia Regional Economic Cooperation (CAREC). Deeper integration with its closest Central Asian neighbors—in particular the Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan—could enable firms in Kazakhstan to tap into larger markets. While these are small markets, with a combined population of around 50 million, access would greatly expand the size of available markets, especially for non-commodity products and services.

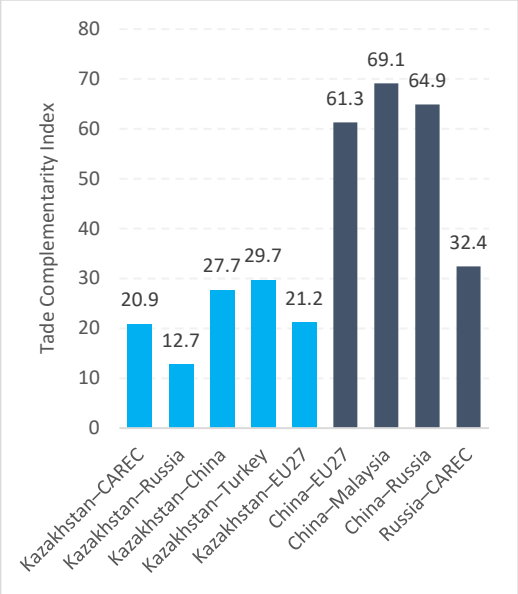
Intraregional trade is still small, and trade complementarity is low. In 2016, exports to Central Asian partners totaled US$1.9 billion, down from US$2.2 billion in 2010 (broadly in line with Kazakhstan's overall trade decline in US dollar terms over the period). As a share of total exports, Central Asian partners accounted for just 5 percent in 2015 (up from 4 percent in 2010). This low rate is unsurprising, given the natural resource focus of Kazakhstan's exports. In fact, one of the main barriers to regional trade integration is that all Central Asian economies rely heavily on natural resource exports. Kazakhstan's trade complementarity[67] with CAREC partners is very low in global comparative terms, at 20.9 (figure 4.1). Complementarity with the Russian Federation is even worse (12.7) and that with other global growth poles, such as China and Turkey, is not dramatically better.

For non-extractive industries—including agricultural products, construction materials, machinery, and transport equipment—trade with regional partners is much more important. Kazakhstan's exports of non-extractive products accounted for two-thirds of its exports to CAREC countries in 2016, close to two-fifths of exports to the Russian Federation, and one-quarter of exports to China. Although the volume of non-extractive exports remains small, and (in line with all of Kazakhstan's exports) these

[67] The bilateral complementarity index is a measure of the similarity between the export basket of one country and the import basket of another. The value of the index ranges from zero to one hundred, representing no complementarity and a perfect match, respectively

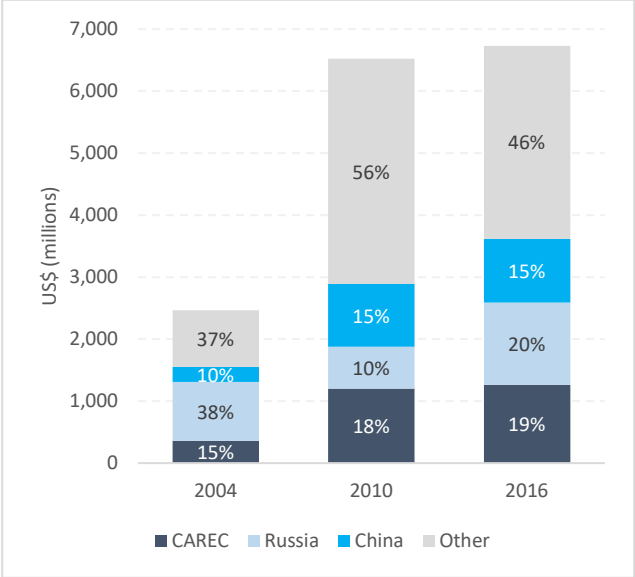
exports have not experienced nominal growth since 2014, the longer-term trend is positive (non-extractive exports to CAREC countries grew 18 percent a year over 2004–14) (figure 4.2).

Figure 4.1: Kazakhstan's trade complementarity with regional partners is low, 2015



Data source: UNComtrade via WITS.
Note: The Trade Complementarity Index ranges from 1 (low) to 100 (high). CAREC is Central Asia Regional Economic Cooperation.

Figure 4.2: Trade with regional partners is much more important for non-extractive industries, 2004, 2010, and 2016



Data source: UNComtrade via WITS.
Note: CAREC is Central Asia Regional Economic Cooperation.

Trade facilitation shortcomings aggravate distance-related obstacles between Central Asian partners, raising trade costs. Border procedures in Kazakhstan are often problematic, and restrictions on the movement of trucks and drivers remain. Moreover, restrictive trade policies, including complex tariff structures, lack of transparency, and most notably, nontariff measures, disrupt regional trade and undermine the potential for developing more integrated regional value chains.

Opportunities for broader regional and global integration through the Eurasian Economic Union and the World Trade Organization

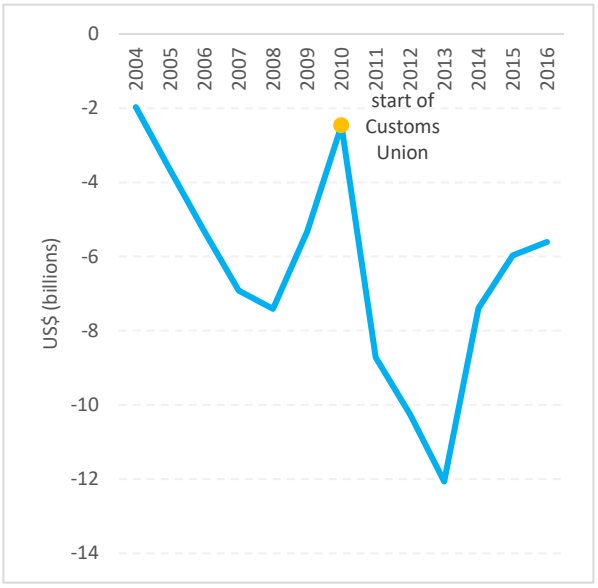
The Eurasian Customs Union (ECU) of 2010 among Belarus, Kazakhstan, and the Russian Federation marked a major step in trade integration that was extended in 2015 by the Eurasian Economic Union. Customs duties within the ECU were eliminated, and a common external tariff, based mainly on the Russian tariff, was put in place, leading to steep tariff increases in Kazakhstan. Regional economic integration was deepened in 2012 with the establishment of the Eurasian Economic Space—a single market providing for the free movement of persons, goods, services, and capital. On 1 January 2015, the Eurasian Economic Union (EEU) was formed, incorporating both the ECU and the Eurasian Economic Space. The EEU was enlarged to include Armenia in January 2015 and the Kyrgyz Republic in August 2015.

While initial outcomes have been disappointing, there are opportunities to leverage the Eurasian Economic Union for diversification. The EEU has increased bilateral trade between Kazakhstan and its original ECU trading partners—the Russian Federation and Belarus—but mainly on the import side, resulting in a deteriorating trade balance for Kazakhstan (figures 4.3). The trade balance improved after 2013 with Russia and 2014 with Belarus, the result of sharply reduced imports rather than increased exports: trade with the original ECU partners fell by almost 40 percent (in US dollar terms) in 2014–16. Moreover, rising trade within the EEU has been the result mainly of trade diversion as EEU trade

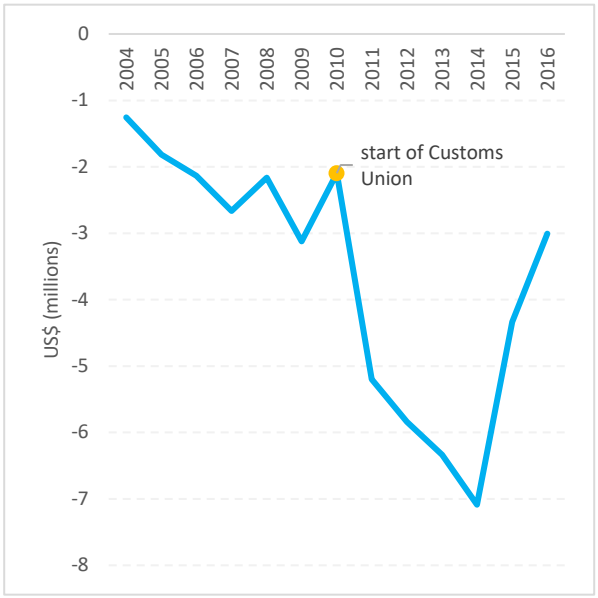
partners adopted higher external tariff and nontariff barriers. The sharp growth in Kazakhstan's non-extractive exports to Russia, for example, reflects a shift from other markets rather than additional volumes overall. As with Central Asian partners, trade with EEU partners will likely be important in the types of goods and services that will enable Kazakhstan to diversify. Moreover, many of the same de facto barriers to trade remain within the EEU. Taking maximum advantage of opportunities in the EEU, by pushing for trade policy and trade facilitation reforms across members, will be an important part of Kazakhstan's diversification agenda.

Figure 4.3: Kazakhstan's trade balance with the Russian Federation and Belarus reflects mainly changes in imports, 2004–16

a. Russian Federation



b. Belarus



Data source: UNComtrade via WITS.

World Trade Organization (WTO) accession has created further opportunities. If supported by reforms, Kazakhstan's accession to the WTO in November 2015, after 20 years of negotiations, offers the potential to expand access to global markets and support diversification. Not only can WTO membership help to rebalance some of Kazakhstan's trading relationships, but it has the potential to support much wider trade and investment integration. The transparency and nondiscriminatory obligations that come with WTO accession, along with the binding commitments, offer foreign investors guarantees of fair competition and of a predictable and more liberal environment. This may encourage stronger FDI flows. To take full advantage of WTO membership, the government needs to deepen structural reforms in the business environment, logistics, and infrastructure.

Global integration through trade corridors—the Belt and Road Initiative

China's Belt and Road transportation infrastructure project would enable Kazakhstan to leverage its location as a key transit hub. Kazakhstan is well placed to act as a land bridge between Asia, Europe, and the Middle East. China's Belt and Road Initiative, announced in 2013, is an ambitious transportation infrastructure project that aims to accelerate delivery of goods and reduce costs between China, Europe, and the Middle East. The Belt and Road overland route through Kazakhstan is expected to cut delivery times between China and Europe from 40–60 days (when transported by sea) to 13–14 days.

Transportation is a low-hanging fruit. Several new international corridors that have been built or are under construction are strengthening Kazakhstan's transit position. A key project is the construction of the transit hub between China and Europe, the Western Europe–Western China corridor, from Orenburg, Russia, to Khorgos, China, just over the border with Kazakhstan. A special economic zone (SEZ) established in Khorgos-Eastern Gate includes a logistics and industrial zone, a railway station, and the Kazakh-Chinese Khorgos International Centre of Boundary Cooperation. In July 2015, Kazakhstan's first dry port was launched in the SEZ. Another project was the construction of a railway link between Uzen into Turkmenistan along the international north–south corridor to connect China and Iran, via Kazakhstan and Turkmenistan. A new container train service was launched on February 1, 2016. The 9,000-kilometre route reduces transit time between China and Iran from 25–30 days (when transported by sea) to 10 days.

Improving intermodal transport connectivity can enhance efficiency. These efforts are seeing returns, but more could be done to improve intermodal infrastructure. Containerized cargo transiting from Asia to Europe via Kazakhstan increased 34 percent, to roughly 47,000 twenty-foot equivalent units (TEUs) in 2014, and the number of container trains transiting Kazakhstan increased 57 percent, to 1,290 from 2014 to 2015, according to the national railway operator. Kazakhstan is gradually becoming one of the biggest transit hubs between Asia and Europe and the Gulf countries. Improving the interconnections between road, rail, and water transport could boost the efficiency of the transport network and increase the competitiveness of the transit corridor.

Inadequate attention to trade facilitation remains a constraint. While Kazakhstan outperforms its regional peers on the overall business environment, it ranks poorly on measures of trading across borders. Total logistics costs are about 22 percent of the cost of the final product in Kazakhstan, at least double the average in OECD countries. More remains to be done to take full advantage of the opportunities for Kazakhstan to become a regional transit, business, and logistics hub:

- Streamlining and expediting customs procedures, increasing transparency, improving risk management, enhancing freedom of transit, and further harmonizing procedures across the Eurasian Economic Union.
- Upgrading infrastructure and enhancing the competitiveness of the logistics sector.
- Developing intermodal facilities and logistics centers, adopting modern logistics, developing multimodal transport, and promoting ICT and electronic data interchange systems.

Kazakhstan is also well positioned to bridge energy trade within Central Asia and with neighboring regions. The country is endowed with huge energy resources, particularly oil and coal, and is connected to neighboring regions through oil and natural gas pipelines. The Caspian Pipeline Consortium and Atyrau-Samara oil pipeline transport oil to the Russian Federation, and the Kazakhstan-China oil pipeline connects to China. The country is also a key transit hub for oil and natural gas flows between Turkmenistan, Uzbekistan, the Kyrgyz Republic, Russia, and China.

Increased regional electricity trade would benefit Kazakhstan. The country is connected to the integrated Central Asia Power System, which originally covered all five Central Asian countries. Until recently, differences in domestic interests, priorities, and natural resource endowments among the independent countries led to difficulties in adhering to agreed energy-trade levels and water-release volumes. Recent rapprochement presents an opportunity for more intraregional trade that optimizes the use of natural resources, including trade in electricity. Kazakhstan has also expressed interest in the Central Asia–South Asia power project (CASA-1000), which envisages electricity transmission from Central Asian countries to South Asia. And once the country's third north–south interconnector is completed and transmission capacity constraints are eased, the way is open for connecting and potentially exporting electricity to western China. Kazakhstan is working to establish a unified regional electricity market under the Eurasian Economic Union.

Matching regional and global integration to Kazakhstan's regional capabilities

Kazakhstan's oblasts are critical links to its global integration. The opportunities arising from regional and global integration need to be viewed in the context of the regional disparities and differences discussed throughout this report. Regional integration and the development of Kazakhstan as an international trade corridor has the potential to create sustainable economic anchors for job creation in some of Kazakhstan's peripheral regions. For example, oblasts in the north, with strengths in grain and cattle production, are well located to serve Russian markets, while regions with smaller-scale, diversified agriculture are well placed to serve Chinese and Central Asian markets. Kazakhstan's (non-oil) manufacturing centers are well located along the key north–south trade corridors.

The oblasts represent diverse opportunities and needs. Recent research ranked Kazakhstan's oblasts by "revealed capabilities" and categorized them by performance ("winning," "losing," and "stagnating"), indicating which oblasts should be in the best position to develop (non-oil) exports.[68] The eastern part of the country, especially the Astana–Almaty corridor is rated as having the strongest capabilities. Some oblasts are rated as having high capabilities but stagnating performance, notably Karaganda, Pavlodar, and Akmola. In contrast, Zhambyl, North Kazakhstan, and Atyrau are rated as having weaker capabilities but strong recent performance. Almaty oblast is among the highest capability and highest performing oblasts. These regional variations in capabilities, as well as in location and connectivity, not only structure what opportunities are available for regional and global trade, but also highlight the importance and challenges of internal integration.

4.2 Internal integration—connecting people and markets

Kazakhstan's thinly scattered population, with just six people per square kilometer, creates multiple difficulties (see box 1.1 in chapter 1). By comparison, OECD countries average 37 people per square kilometer. Moreover, Kazakhstan's people are dispersed across the country, with its commercial capital, political center, and oil region separated by thousands of kilometers. This dispersion contributes to fragmentation of domestic markets and high transaction costs for the private sector and boosts the costs of providing public and social services. In addition, the sectoral structure of employment varies by economic region type. Kazakhstan's six regional economy types differ by location, economic specialization, employment structure, and poverty outcomes. Table 1.2 in chapter 1 provides summary data on each oblast organized by region type to give a perspective of how different the economies and socioeconomic outcomes are across oblasts. Certain region types—especially trade and basic services and both large and small agriculture regions—are highly reliant on self-employment and jobs in the public sector. Only in the advanced services region type (Astana and Almaty cities) and in the oil producing region type are more than half the jobs in private sector wage employment.

Weak internal connectivity inhibits market integration and access to services

Sprawling territory and poor transport infrastructure hinder integration of regions and markets in Kazakhstan. The core transport network, a single-corridor structure, stretches along thousands of kilometers through sparsely populated regions. While the country has a large stock of roads, 21 percent of national roads and 47 percent of local roads are in unsatisfactory condition. Institutional inefficiency and underinvestment, along with the sheer size of the network, contribute to its rapid depreciation. About 2,000 rural villages do not have hard-surface roads to connect with rayon (subregional) and oblast centers, making access to schools and hospitals difficult. Weather conditions often cut off many rural communities from even their closest neighbors—which may be a considerable distance away.[69]

[68] Whiteshield Partners 2015.

[69] The government has allocated significant budget funds to address these issues. In 2017, under the State Program "Nurly Zhol," 255.6 billion tenge was allocated and disbursed for the construction and reconstruction of roads nationally.

Connecting to domestic markets is difficult. Large land areas and fragmented populations make it hard for many regions to connect to wider markets in the country. For more than 40 percent of the rural population it takes over three hours on average to reach a city of more than 100,000 inhabitants and more than five hours to reach one of more than 250,000 inhabitants (figure 4.4). This weak market accessibility is reflected in findings from a recent survey of entrepreneurs, which showed that just 7 percent of businesses sold beyond local markets.[70]

Figure 4.4: Rural travel time is long to closest cities of more than 100,000 and 250,000 inhabitants, 2015

Data source: Agency of the Republic of Kazakhstan on Statistics, Business Registry 2015.

Corridor development is central to the government's efforts to integrate the regions. Improved connectivity can make a positive difference for jobs and earnings in rural areas. Believing that efficient transport is an essential component of economic growth, the government has made upgrading the corridors linking the main centers of economic growth a prominent part of two major policy initiatives: the Regional Development Plan 2012–20 and the Nurly Zhol economic stimulus program, introduced in 2014. The government is taking a growth poles approach to regional development by combining transport infrastructure investments with improvements in the investment climate along key corridors, with the aim of stimulating agglomeration effects.

Along with building roads, connecting and upgrading the national electricity infrastructure are critical to deliver services and support economic development nationally. Huge investment is needed each year over 2015–45 to create a fully integrated national grid and connect the three electricity zones (Western, Northern and Southern) that operate largely independently. Modernization of the national power infrastructure would also enable more effective use of domestic energy resources, shift electricity from a predominantly coal-based system toward more use of natural gas, and allow increased uptake of renewable energy.

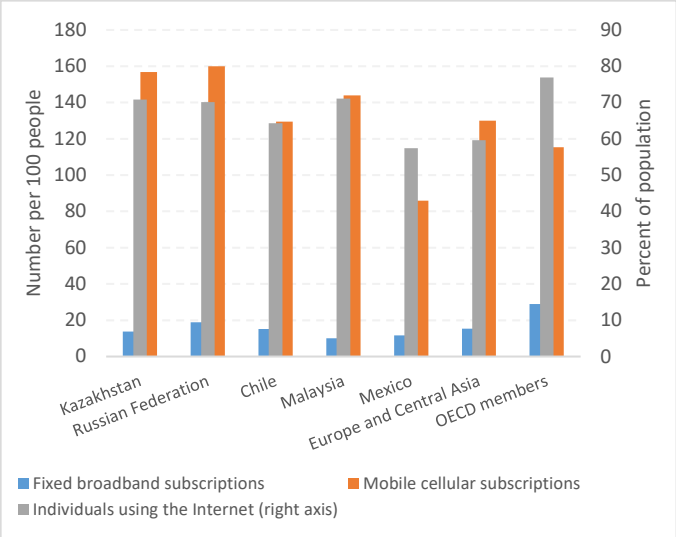
Information and communication technology can advance more efficient integration

Investments in ICT can contribute to overcoming the "tyranny of distance." ICT is critical for competitiveness and economic integration. For Kazakhstan, with its fragmented and sparsely populated rural areas, ICT may also be a way to deliver integration more efficiently. The country compares favorably with peers on ICT indicators, and except for fixed broadband access (which is accessible to less than 14 percent of the population), it also meets or exceeds OECD averages (figure 4.5). Kazakhstan has raised its position to 39 of 139 countries on the 2016 Networked Readiness Index,

[70] ADB (2014).

leading the Commonwealth of Independent States (CIS) region. On the 2016 ICT Development Index of the International Telecommunication Union, Kazakhstan stands 52nd out of 175 countries—after Belarus (31) and the Russian Federation (43) in the CIS region.

Figure 4.5: Kazakhstan compares favorably with other countries and regions on most ICT indicators, 2015



Data source: World Bank Group, World Development Indicators, 2016.

Rural areas still lag well behind urban areas in connectivity, however. Coverage of optical fiber and broadband is much lower in rural areas than in urban areas. Geography is a large part of the challenge. There are more than 6,600 rural communities in Kazakhstan, many of which are located in remote areas. The government is focusing on providing fiber optic links to the most economically viable of these communities, targeting 1,249 communities with a total population of more than 2 million people. However, limited market competition also restricts rollout. There are major issues in delivering broadband circuits even between urban government centers for connecting regional hubs back to the main government facilities in Astana.

The telecom regulatory framework needs to advance. Kazakhstan should adopt a progressive regulatory environment that encourages digital service adoption and mandatory infrastructure sharing across public and private providers. The government has introduced amendments into the Law of the Republic of Kazakhstan *on communication*s aimed at improving the efficiency of resources use with simultaneous reduction in current costs of construction of the network.

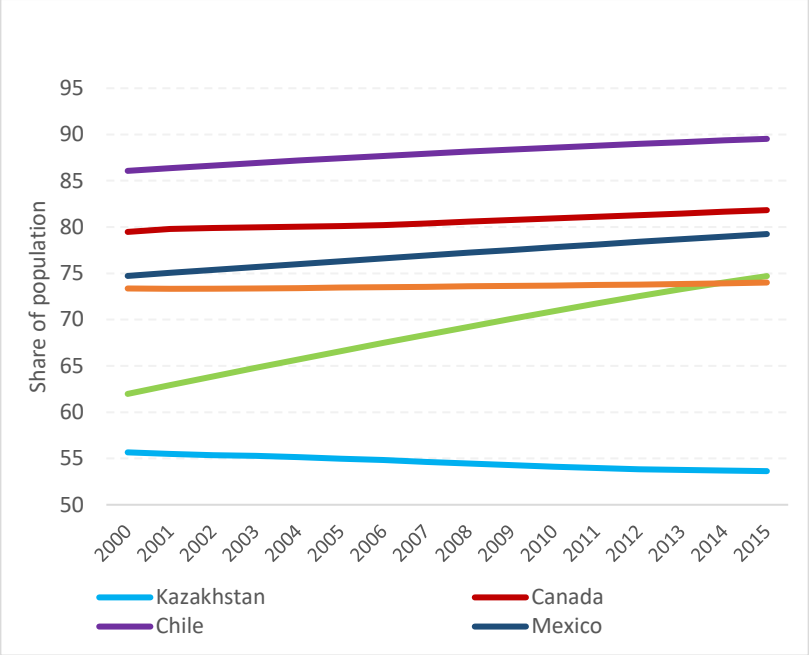
The country is becoming more rural alongside increasing, but still restricted, internal migration to cities

The state of transport and ICT connectivity highlights the difficulty of integrating rural and urban parts of the country. It also highlights the difficulty of more broadly linking peripheral regions to the growth poles of Almaty and Astana cities and oil-producing Western Kazakhstan. Doing this will require not only improved transport and communications links, but also a modernized urban infrastructure to support rural–urban migration and to facilitate agglomeration.

Going against global trends, Kazakhstan has become less urbanized in recent decades. For example, the gap in the urban population share between Kazakhstan and Malaysia, which was less than 7 percentage points in 2000, grew to 20 percentage points by 2015 (figure 4.6). Kazakhstan's rural population share—close to 50 percent—is almost four times as high as Chile's and more than twice that in Canada and Mexico. This apparent ruralization reflects the much slower growth of the urban

population than of the rural population, particularly because urban population growth declined during the post-Soviet transition. However, the trend of relatively higher rural growth has reversed somewhat since 2001. While almost 70 percent of cities were losing population in the first decade of transition, only 22 percent did so in the second. In fact, many of Kazakhstan's largest cities are growing rapidly, particularly cities with more than 500,000 inhabitants, including Shymkent, Almaty, Aktobe, and Astana.

Figure 4.6: Urban population share has been declining in Kazakhstan, counter to trends in peer countries, 2000–15



Data source: World Bank Group, World Development Indicators 2016; World Bank Group (*2016b).*

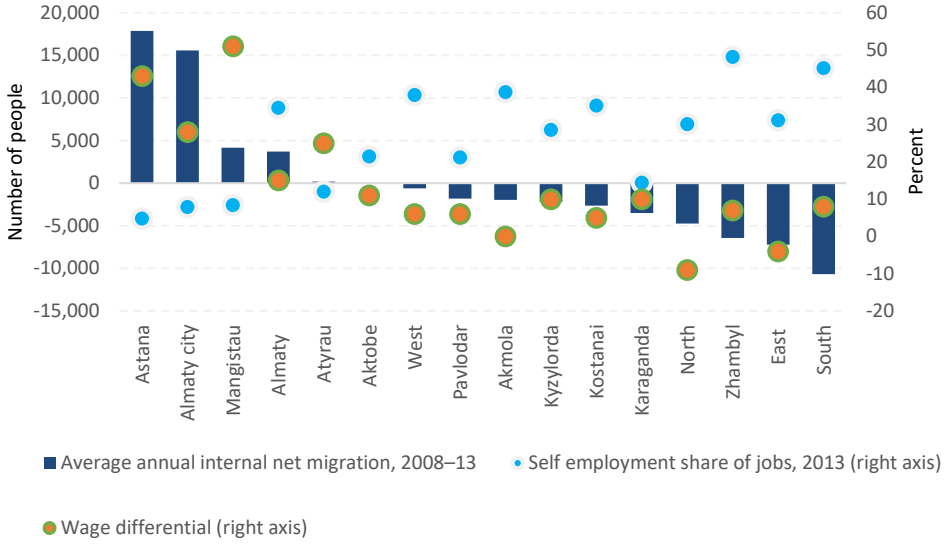
Kazakhstan has developed extensive plans to promote urbanization in targeted growth poles. The 2014 Regional Development Program, which consolidated several programs, aims to develop urban agglomerations through an integrated approach to infrastructure development and modernization, human capital strengthening, and a more favorable investment climate.[71] The program focuses on four "first-tier" urban agglomerations: Almaty, Astana, Aktobe, and Shymkent (South Kazakhstan). It also identifies "second-tier" cities—the administrative centers of 12 oblasts plus two cities identified as having broader regional importance (Semey, East Kazakhstan, and Turkestan, South Kazakhstan). The government sees these locations (especially the first-tier agglomerations) as growth poles for the economy and is concentrating investment for and connectivity among them. The programs are extensive, covering all aspects of infrastructure (economic and social), the business climate, and business investment (through existing instruments like the Business Roadmap 2020).

Recent growth of cities suggests that internal migration is picking up. Relationships are strong between an oblast's average net annual internal immigration (immigration minus emigration) over the period 2008–13 and its wage premium over the national average and its self-employment rate (as a proxy for job quality) (figure 4.7). People are moving from oblasts with lower wages and high levels of self-employment to those with higher wages and low levels of self-employment. While some people are responding to the market, not enough are doing so. Migration in response to regional differences in opportunity is more prevalent among workers with a tertiary education than among those with a

[71] World Bank Group (2015e).

secondary education. Overall, household migration remains fairly low. On average, just 2.2 percent of households in Kazakhstan migrate internally each year, compared with 14 percent in Canada, 11 percent in the United States, and 2.6 percent in the Russian Federation.[72]

Figure 4.7: Internal migration is responding to wage differences, but remains small in scale, 2008–13



Data source: ERI/McKinsey (n.d.), World Bank Group (2016a), Agency of the Republic of Kazakhstan on Statistics.

Lower-skilled workers, particularly, face high barriers to mobility. There are multiple barriers to migration in Kazakhstan. Surveys suggest that the most constraining are housing, finance, and social networks. A recent analysis of urban–rural variations in cost of living found that imputed rental prices were around 310 percent higher than the national average in Almaty City and around 460 percent higher in Astana.[73] Along with lack of access to owner-occupied housing and much higher food costs, this represents a potentially high barrier to internal migration.

Kazakhstan's challenge of low density is not unique. As in most countries, distance is the single biggest barrier to migration in Kazakhstan. Recent research for Kazakhstan shows a particularly strong relationship of distance to migration: each 1 percent increase in distance reduces the flow of migrants by roughly 1.3 percent, [74] which is stronger than seen in many other countries, including the Russian Federation and China. As a result, most migrants do not move from distant oblasts to Almaty or Astana cities; rather, they migrate from rural villages in distant oblasts to secondary cities in the same oblast and only later to large cities or to one of the growth poles. This means that not only is transport connectivity important, but so too is developing urban infrastructure and services, including in secondary cities.

Barriers to urban in-migration include deteriorating urban infrastructure

Uncoordinated implementation of the Land Code provision on free land for housing construction has resulted in poor land availability in a land-rich country and has further stressed deteriorating urban infrastructure. Growth of major cities, fueled predominantly by rural–urban migration, is straining urban land markets, housing, and infrastructure, already in poor condition. The guarantee of 1,000 square meters of free land per person for housing construction was expected to address housing shortages, but implementation has not been well organized or incorporated into the planning process. Most land applications were concentrated in Almaty and Astana cities, which quickly ran out of

[72] ERI / McKinsey (n.d.).
[73] Seitz (2017).
[74] Aldashev and Dietz (2011).

available land. Today in both cities, more than 50,000 people are in a queue for free land. Simultaneously, the allocation of free land in *akimat*s (municipalities or districts) on the periphery of the major agglomerations has allowed unregulated urban sprawl. There were instances of land being distributed without provisions for connection to water, sewerage, and electricity networks, which is required by law.

The 2030 Development Strategy recognizes housing as a national priority. Soon after independence, Kazakhstan privatized most of its public multifamily apartment housing stock. There are some 169,000 multifamily buildings nationwide, which account for 79 percent of the housing stock. Nearly all urban residents (98 percent) own their apartments and own shares in the common areas of their apartment buildings. With management and financing of maintenance neglected since privatization, these buildings have deteriorated. Since the 2000s, "KSKs" (a form of homeowner cooperatives) have become the established means of managing and maintaining common areas, but their performance has been deficient. The government estimates that 30 percent of these apartment buildings are either unsuitable for habitation or in urgent need of heavy repairs.

Urban infrastructure is also dilapidated. Utilities manage degraded and inefficient systems, with mediocre service. Regulated tariffs are very low and do not cover costs. In 2010, only 36 percent of water supply networks were working properly, and about 70 percent needed overhaul, repairs, or complete replacement. Water losses in water supply and sanitation networks amounted to 40 percent, 11 percentage points more than a decade earlier.[75] And public transport services are almost completely absent in cities. This creates a tremendous challenge for municipal governments to provide and improve local public services.

Urban infrastructure investment needs are estimated at US$24 billion,[76] but financing falls far short. The majority of local infrastructure investments are funded from national budget programs, to which local governments submit project proposals through their oblast government. Local and regional funds for capital investment are limited. Municipal utility companies lack access to medium- or long-term investment funds from the domestic banking sector; they can get only short-term (one-year) loans as working capital. Although Astana and Almaty cities and the oblast governments may issue bonds, in accord with the Budget Code they have issued only bonds with short tenor (up to five years). Private investments in municipal utilities through public–private partnerships remain uncommon.

Beyond infrastructure—the role of "spatially blind" and mobility-promoting public services

Global experience suggests that equitable delivery of public services countrywide is key to economic integration. Public and social services are important for equalizing key development outcomes and for facilitating individual mobility to regional or national urban agglomerations. As discussed in *World Development Report 2009*, the delivery of equal-quality public and social services across the country ("spatially blind")—crucially, education and health—is critical for territorial integration.[77]

Helping workers find productive employment is constrained by low-capacity public employment services with very limited outreach to rural areas. In 2015 just 12 percent of the unemployed were registered with Employment Centers, and as the public employment services provided no support for the self-employed until recently, they were not eligible to access public employment services. The government has rolled out several programs, notably the Employment Roadmap 2020 (operational in 2011–16), replaced in 2017 by the Productive Employment and Mass Entrepreneurship Program (2017–20), to support employment through supply-side measures such as short-term training, public

[75] MoRD (2014).
[76] World Bank estimates.
[77] World Bank Group (2008).

works, and subsidized workplaces. To date, however, the impact appears limited, but no rigorous impact evaluation has been undertaken.

Spatially blind institutions are critical not only for territorial integration and social sustainability, but also for geographic mobility. Given the high cost of housing in major urban agglomerations and weakly functioning labor markets outside these regions, greater efforts are needed to overcome mobility barriers. Kazakhstan provides direct support to internal mobility through the Productive Employment and Mass Entrepreneurship Program (2017–20), which provides information on labor market opportunities and relocation subsidies, but the program reaches only a small share of potential migrants.[78]

Beyond land access and housing shortages, rural–urban migration is restricted by the internal household registration system (*propiska*). Kazakhstan formally abolished the household registration system following the collapse of the Soviet Union, but internal migrants are still required to register (under penalty of fine) within 10 days at their permanent or temporary address. This requires consent of the legal owners of the dwelling where the migrant resides, who may not want to disclose the fact that they are renting property. Registration, which is tied up in bureaucratic procedures, can be tedious. Unregistered migrants lack access to critical public services, including health care, education, and employment services. The system places tight restrictions on internal migrants' access to formal labor markets. The process could be improved by making access to services dependent on citizenship or residency rather than place of registration or by streamlining registration through better use of ICT systems.

4.3 Governance and social cohesion

Challenges of ethnic diversity, social cohesion, and stability.

Kazakhstan is home to a highly diverse population. In the territory of Kazakhstan there are over 100 ethnic groups, including 24 percent ethnic Russians mainly in northern Kazakhstan, 3 percent Uzbeks, 2 percent Ukrainians, and 4.5 percent other (2009 census). Southern Kazakhstan, near Uzbekistan, is also a melting pot, with the majority Kazakhs living alongside ethnic minority Uzbeks, Uighurs, Tajiks, Tartars, Russians, and Koreans. Since independence, the government has taken an incremental approach to nation-building and has promoted a "Kazakhstani" identity separate from that of ethnicity.[79] To promote an inclusive and multiethnic society, the National Assembly of the Peoples was established in 1992. The assembly has 300 representatives of ethnic groups and has branches at the district level across the country.[80] Although it lacks legislative powers, it symbolizes Kazakhstan as a multiethnic state.[81] All ethnic groups have a legal right to establish ethno-cultural centers and Sunday schools, with the aim of promoting the revival and development of languages, cultures, traditions, and customs of the country's diverse ethnic groups.

Rising ethnic tensions are an increasing risk. Kazakhstan has avoided the major interethnic clashes that have plagued some other parts of Central Asia, having experienced none of the major outbreaks of violence seen in the Kyrgyz Republic and Uzbekistan in the early post-independence years. Kazakhstan's economic growth and economic freedoms in recent years have benefited ethnic minority

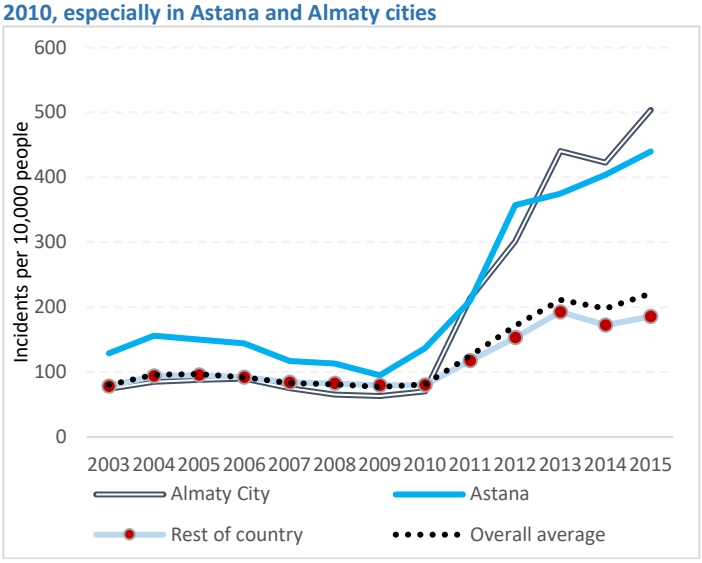
[78] Under the Employment Roadmap 2020 program, which operated over 2011–16, 19,300 people were helped to relocate from economically depressed areas. http://www.enbek.gov.kz/en/node/343418.
[79] Olcott (1997, p. 213).
[80] Membership in the Assembly is defined as an honor personally bestowed by the President that the recipient may not refuse. The President also serves as its Chairman.
[81] Jones (2010).

populations, but more recent economic challenges and a growing rich–poor divide can cause grievances among ethnic minority groups.[82]

Kazakhstan is ranked 113 on the Fragile States Index, with a score of 66.5, which is in the "warning" zone. Weak areas on the index are group grievance, the economy, state legitimacy, human rights and the rule of law, and factionalized elites. Violence and crime are less serious impediments to economic activity, although crime has increased sharply since 2010 throughout the country, especially in Astana and Almaty cities (figure 4.8). One interpretation is that social cohesion may be breaking down in the face of changing economic and social structures.

Of great concern are the increased number of reported terrorist attacks and, more broadly, the radicalization of youth. With a paucity of employment opportunities, radicalization of young people is creating a volatile social situation, particularly in rural areas and in border cities and towns. Notable was a major foiled terrorist plot in summer 2016 in Aktobe, a region of wide income inequalities. Freedom House reported that the death toll since 2011 in terror-related incidents is at least 67, mostly terror suspects and law enforcement officers.

Figure 4.8: Crime has increased sharply throughout Kazakhstan since 2010, especially in Astana and Almaty cities



Data source: Agency of the Republic of Kazakhstan on Statistics.

The response to such incidents may further dent cohesion and public trust. There has been an increasing focus on security and intelligence and a general emphasis on "law and order." Authorities have embarked on special measures, including even more control over the Internet and mass media. The Ministry of Religion and Civil Society was established in an attempt to mitigate radicalization and social tensions. If the authorities suppress alternative voices and prevent solutions based on political consensus, they risk undermining cohesion over the longer term.

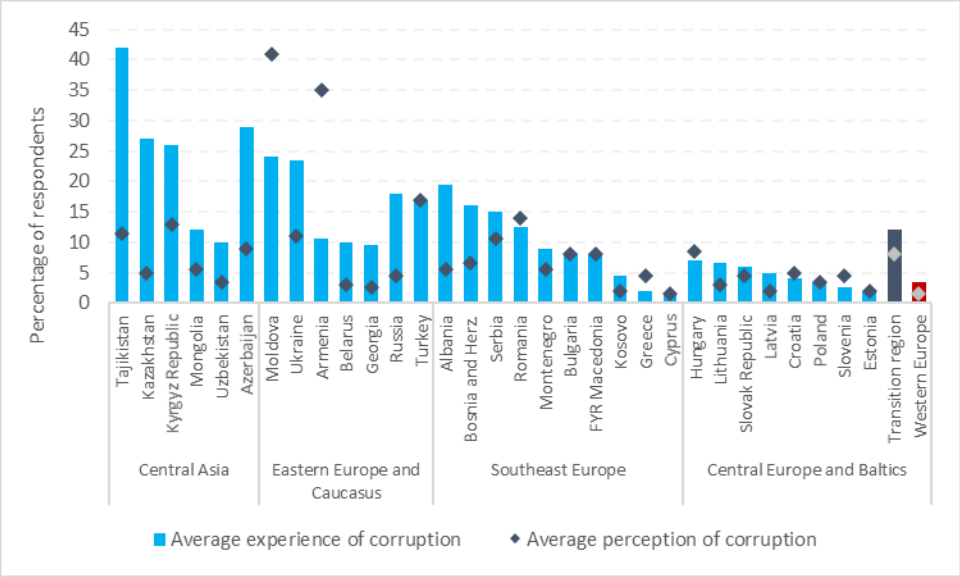
Improved governance is vital to social cohesion

Integrating the country sustainably will require a more transparent and equitable model of governance. This is likely to be increasingly important as risks to social cohesion may grow due to rising poverty and regional disparities, uncertainties over the future political transition, and external factors.

[82] Stronski (2016).

Pervasive corruption remains a major barrier to social cohesion. Kazakhstan was ranked 131 of 176 countries in 2016 on the Corruption Perceptions Index,[83] only a marginal improvement since 2012. Among respondents in Kazakhstan surveyed by the Corruption Barometer in 2016, 37 percent cited corruption as one of the three biggest problems facing the country.[84] Nearly a third of public service users reported paying a bribe to get access to or speed up the delivery of public services. In the 2016 Life in Transition Survey III, 27 percent of respondents said they or a member of their household made unofficial payments or gifts in the previous 12 months, making Kazakhstan the third-worst performer (after Tajikistan and Azerbaijan) among countries in transition (figure 4.9). Households reported having to make payments in almost all areas of public service, including the traffic police (47 percent), civil courts (30 percent), unemployment benefits (30 percent), public health care (19 percent), and education (21 percent).[85]

Figure 4.9: Kazakhstan is the third worst performer among former transition countries on experience and perception of corruption, 2016



Source: EBRD (2016b).

The government has acknowledged the need for radical measures to combat corruption, by creating the Agency of Civil Service and Anticorruption and adopting the Anticorruption Strategy in 2014. Anticorruption measures focus mainly on investigations leading to criminal sentences, which have become more frequent in recent years. Investigations have extended to high-level officials, including an ex-prime minister, deputy ministers, and local government officials. Still, 46 percent of the population rate the government "bad" in fighting corruption.[86]

Pervasive rent-seeking and clientelism are exacerbated by a political environment that provides little space for opposition voices or the voice of the average citizen. Kazakhstan is ranked lowest among peers (and in the 16th percentile globally) on the Worldwide Governance Indicators measure of voice and accountability. Its relative position deteriorated over 2000–15.

Effective and transparent judicial institutions are vital for good governance, investment, and well-functioning markets. In recent years, Kazakhstan has taken a wide range of steps to reform its justice system. It is the first country in the region to establish a jury system for criminal trials, and it introduced

[83] Transparency International (2016a).
[84] Transparency International (2016b).
[85] World Bank calculations based on the Life in Transition Survey III (EBRD 2016b).
[86] EBRD (2016b).

legal frameworks for juvenile justice, administrative courts, and probation services. A raft of new codes came into effect on January 1, 2015: the Criminal Code, Criminal Procedural Code, Criminal Executive Code, and Administrative Code.

Enforcing the rule of law is one of the "Five Institutional Reforms" announced in 2015 (see below). The introduction of a three-tier judicial system in 2016 cut the time for ruling on a case in half, with more than 82 percent of cases now resolved at the first hearing. The new Civil Procedure Code, in force since January 2016, has increased the number of cases resolved using summary procedures and alternative dispute resolution measures, including mediation. An e-justice model is under development.

Still, low trust in courts, limited judicial independence, and slow and nontransparent judicial proceedings remain problems. Kazakhstan was rated 2.8 out of 10 on the Rule of Law subindex of the Bertelsmann Transformation Index in 2016, lagging behind other countries in post-Soviet Eurasia. The 2016 Life in Transition Survey III indicates that less than half the population agree that the country has a fair justice system.[87] Irregular payments, including to civil courts, appear to be increasing: 13 percent of respondents in the 2010 Kazakhstan Life in Transition Survey II reported that unofficial payments were usually or always needed, against 27 percent in the Life in Transition Survey III. Judicial independence is slowly improving: Kazakhstan's score on that indicator on the Global Competitiveness Index rose from 3.3 (rank 94) in 2012 to 3.9 (rank 68) in 2016–17. But the legal and institutional framework for legal aid fails to meet the expectations of the public and the authorities: the cost of administration is high, program information and awareness are limited, and eligible beneficiaries in remote and rural areas are in effect cut off from the legal aid they are entitled to.

Decentralization could be a centerpiece of governance reforms

Recently, the government has encouraged civil society, the business community, and citizens to participate in drafting laws.[88] After adoption of the Law on Public Councils in 2015, public councils, consisting of civil society members and public officials, were created in each line ministry and akimat. In practice, however, it is often the case that insufficient time and resources are allocated for full-fledged consultations. Guidelines to ensure better responsiveness and accountability to the public are yet to be established. An online platform for dialogue on draft legislation was launched in 2016, but it has not yet caught on among the public and requires targeted campaigning to increase awareness and participation.[89] Moreover, despite this commitment to transparency, openness, and consultation restrictions on rights to public assembly remain.[90]

Given the need for greater citizen engagement and for national spatial integration, the concentration of power in the executive is increasingly seen as an impediment. Kazakhstan concentrates vast decision-making power within the executive. Parliament focuses mainly on legislation initiated by the government after national addresses by the president.

Authorities have implemented the Concept of Local Self-Government Development, which was adopted in 2012 and is intended to bring the delivery of public functions closer to recipients. Major

[87] EBRD (2016b).

[88] Public consultations received prominence after wide public protests against land reform in May 2016. Compulsory public discussion of draft regulatory legal acts was introduced.

[89] The open government portal launched in 2016 has five modules: open data, open legislation, open budget, open dialogue, and evaluation of state bodies' effectiveness. There are 494 legal acts available for public discussion in the Open Legislation database but only 90 comments have been received.

[90] The Law on Public Assembly requires protesters to seek permission from the government 10 days in advance for any public gathering with more than 20 participants. According to experts on the Bertelsmann Transformation Index, permission for opposition rallies is often refused, and, if granted, they are only allowed to take place in remote locations outside the city center.

implementation functions (in education, health care, labor, environmental protection, architecture and construction, agriculture, and land management, etc.) were transferred from the central level to the oblast level and from the oblast to the rayon level. A legislative basis for local self-government was created. *Maslikhats* (local representative bodies) were defined as the bodies of local self-government, and indirect elections of *akims* (heads) of district towns, rural districts, and villages was introduced.[91]

The Five Institutional Reforms and the 100 Steps pay special attention to the development of local governments' autonomy and local self-government. The Five Institutional Reforms announced in 2015 include a modern and professional civil service, rule of law, industrialization and economic growth, a unified nation for the future, and transparency and accountability. The government is considering further reforms to increase the financial independence of local governments. Authorities have already pledged to work to build local capacities in budget formulation, implementation, and monitoring. Other needed supportive measures include greater local financial independence, increased authority, stronger coordination and cooperation between local governments and local self-government authorities, and support for citizen engagement.

Successful devolution of power will also strengthen government checks and balances and broaden participation and local authority. Key institutions require further strengthening. A combination of dominant state power and weak civil society bodies means limited scrutiny of a powerful executive. Accountability institutions outside the executive, such as the Accounts Committee (external audit), ombudsmen, and parliamentary oversight bodies, need reinforcement to move toward international good practices and standards.

[91] Under the 100 Steps program, the foundations were established for the strengthening of the fiscal independence of local self-government through the devolution of a number of tax and non-tax revenue streams to rural districts.

5. Strategic Pillar 4: Productive and adaptive human and natural capital

The core of a modern democracy and competitive economy is an educated, healthy, informed, and engaged population. Kazakhstan has made progress on all these fronts over the past decade. However, delivering on the aspirations and challenges outlined in the previous chapters will require further strengthening human capital and establishing an environment where workers and citizens can readily adapt to what will likely be a more rapidly changing economic, social, and technological environment, while having the agency to shape personal outcomes. Moreover, while Kazakhstan has benefited enormously from its natural resources wealth, it will need increasingly to consider sustainability and efficiency in managing its natural resources to reduce vulnerabilities and negative side-effects of the current resource-intensive growth model.

This chapter examines the role of education and health care in creating a more productive and secure workforce, social protection for easing economic dislocations, and natural resource management for wealth conversion and environmental sustainability.

5.1 Education and skills development to achieve desired labor market outcomes

Continued upgrading of human capital is essential to enable the country's workforce to adapt to changing labor market conditions. Kazakhstan's vision of a highly competitive and productive economy under the Kazakhstan 2050 Strategy demands a workforce with flexible skills to adapt to structural shifts in the economy, rapid technological change, and massive information flows. Indeed, Kazakhstan's labor market is already undergoing a shift from jobs that require unskilled labor (routine and manual tasks) to skilled labor (nonroutine cognitive tasks). This calls for a thorough assessment of the education and training systems in the country and their links to labor demand.

Demographic changes highlight the importance of education and skills development. After sharp declines in the 1990s, fertility rates peaked in 2008. Currently, a quarter of the population is school-aged (under 15 years old), compared with the OECD average of less than one-fifth. Kazakhstan's school-age population is projected to grow more than 20 percent between 2015 and 2030, a challenge to school capacity and quality improvement. At the same time the youth bulge is an unprecedented opportunity to accelerate growth and alleviate poverty (see box 1.3 in chapter 1). To reap the benefits of this demographic dividend, Kazakhstan can act today by developing the human capital of its youth.

Education and skills are critical determinants of labor market outcomes

Education is by far the most important determinant of labor market outcomes and therefore of earnings and poverty outcomes. While 33 percent of household members in the top 60 percent of the income distribution have a tertiary (technical vocational and higher) education, only 20 percent in the bottom 40 percent do. The bottom 40 percent of households have a higher share of low-skilled workers at the upper secondary level than the top 60 percent (63 versus 56 percent), lower secondary level (14 versus 9 percent), and primary level or below (4 percent versus 2 percent).

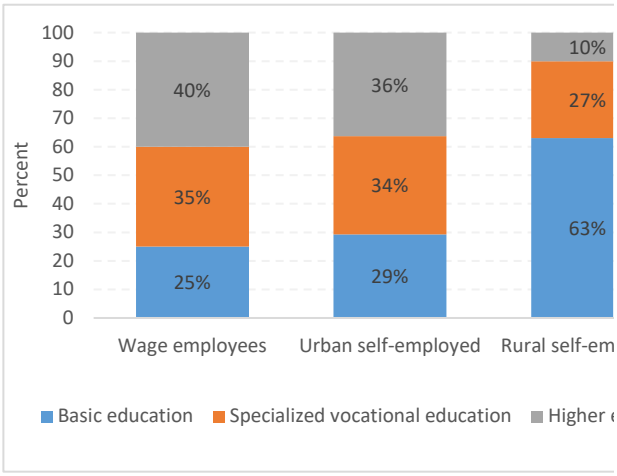
Boosting educational attainment is critical to creating opportunities for higher quality, higher paying jobs. While the national unemployment rate is low, the rate for those with a basic secondary education or less (9 percent) is double the average for those with specialized vocational or tertiary qualifications. What is more, 60 percent of workers with less than a secondary education are in self-employment, with the majority in agriculture. Reliance on self-employment drops for those with a secondary education, but only to around 50 percent. Vocational education, particularly having a specialized vocational qualification, reduces self-employment substantially, to below 30 percent. These patterns linking educational attainment to job types are also reflected in wages. The wage premium for an upper secondary education relative to workers with a general secondary education or less is small, at just 7–12 percent, but the premium jumps to 39–48 percent for a tertiary education.

The skills challenge also maps closely with the spatial challenge, aggravating demand side deficiencies in rural parts of Kazakhstan. The education profile of the labor force in rural Kazakhstan, particularly in agriculture, differs markedly from that of the urban labor force. Just half as many (37 percent) of the rural self-employed as of the urban self-employed (70 percent) have an education beyond the secondary level. Indeed, the self-employed in urban areas have an education profile similar to that of wage employees, 75 percent of whom are educated beyond the basic secondary level (figure 5.1). Thus, addressing gaps in educational outcomes and stimulating greater job creation outside of Almaty and Astana cities, and making it easier for workers to move to the regions or sectors where the jobs are, will be central to addressing the spatial disparities that define the poverty and inclusion challenges.

Educational outcomes have improved significantly, but gaps remain.

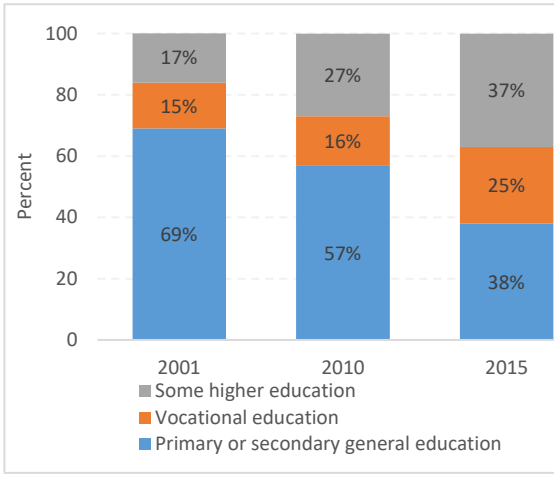
The educational attainment of the labor force is rising rapidly. Kazakhstan has achieved almost universal access to primary and secondary education, strengthening the human capital base of the pipeline of future workers. Tertiary education, including technical vocational and university education, has also maintained high enrollment ratios over the decade. As a result, the share of the youth population (ages 15–28) with an education beyond the secondary level doubled from 32 percent in 2001 to 62 percent in 2015 (figure 5.2).

Figure 5.1: Employment status in Kazakhstan varies by level of education and location, 2015



Data source: Agency of the Republic of Kazakhstan on Statistics.

Figure 5.2: Youth (ages 15–28) educational attainment has risen in Kazakhstan, 2001, 2010, and 2015



Data source: Agency of the Republic of Kazakhstan on Statistics.

Math and science have also seen sharp gains in quality. Between 2009 and 2012, the performance of 15-year-old students learning math and science on the OECD Programme for International Student Assessment (PISA) improved by the equivalent of more than half a year of schooling (figure 5.3).[92] Similarly, Kazakhstan saw substantial increases in both the math and science achievement of eighth graders on the Trends in International Mathematics and Science Study (TIMSS) since it first participated in 2011. As a result, Kazakhstan's eighth graders were ranked seventh in mathematics and ninth in science among 39 countries in 2015. In addition, there were no statistically significant differences

[92] World Bank Group (2014c). Kazakhstan participated in PISA 2015 but according to the OECD, "in Kazakhstan, the national coders were found to be lenient in marking. Consequently, the human-coded items did not meet PISA standards and were excluded from the international data. As a result, Kazakhstan's results may not be comparable to those of other countries or to results for Kazakhstan from previous years" (OECD 2016).

between boys and girls in indicators of mathematical competencies. Overall, Kazakhstan performs well above a number of OECD countries, though substantial gaps remain with the OECD average.

The Achilles' heel of Kazakhstan's education system is reading, particularly for boys, whose performance is about one year of schooling behind that of girls. Kazakhstan's PISA reading score improved marginally between 2009 and 2012, and the performance gap with the OECD average in 2012 was equivalent to 2.5 years of schooling. About 57 percent of Kazakh students lacked basic reading skills. Students in technical vocational education and training schools are behind their peers in basic and general secondary schools by more than 1.5 years of schooling.

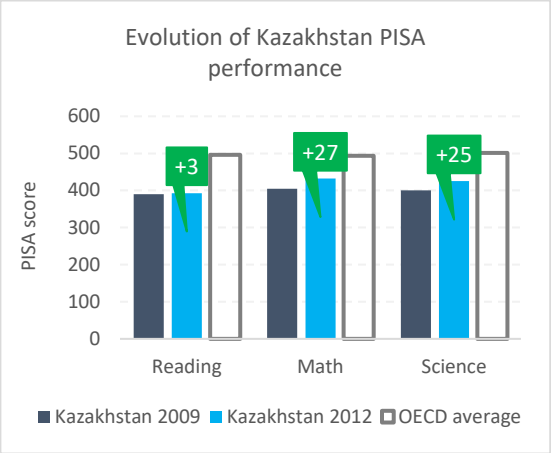
Socioeconomic, demographic, and geographic disparities in educational outcomes persist. PISA 2012 results show a gap of 1.5 years of schooling between students from families in the highest and lowest socioeconomic quintiles, and between students in Russian (higher) and Kazakh (lower) language schools. On the TIMSS, most of the improvements in eighth grade math between 2012 and 2015 were in the richest 10 percent of households, leaving behind a large contingent of lower-performing students (figure 5.4), mainly from rural areas and from low-income households.

These equity challenges are also reflected in students' transition to higher education. A study by the National Center for Educational Statistics and Assessment showed that Unified National Testing scores (which determine eligibility for a free university education and access to financial aid) are correlated with regional poverty: scores are highest on average in Astana and Almaty cities and considerably lower in oblasts with high poverty rates.[93] More than 90 percent of youth in Astana and Almaty cities have attained some level of higher education, while less than 50 percent have done so in Zhambyl, Almaty, and East Kazakhstan. Given the effects of higher education on labor market outcomes, these inequalities in educational outcomes could entrench socioeconomic and spatial disparities.

Pronounced gender differences in fields of study at secondary and vocational levels translate into high levels of occupational segregation. Young men are much more likely to pursue technical training and to study subjects such as energy, transport, and construction, while young women predominate in traditionally female areas of study, such as the humanities, health, and education. In 2011, men made up around 90 percent of students in vocational schools and colleges specializing in subjects such as oil and gas, geology, electrical engineering, transport, and construction. More than two-thirds of university students specializing in natural sciences were men, while 75 percent of those specializing in humanities and 90 percent of those specializing in health were women. This segregation in education choices contributes to the high level of occupational segregation, with women being concentrated in lower paid public and social sector jobs, while men are concentrated in higher paid sectors.

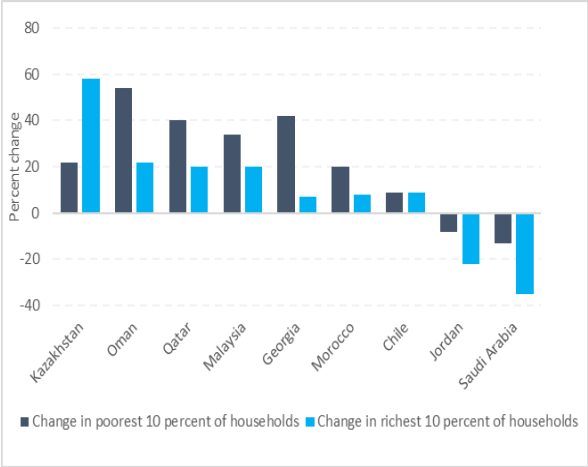
[93] NCESA (2014).

Figure 5.3: Despite improvements, Kazakh students trail the OECD average in reading and math on the PISA, 2009 and 2012



Data source: OECD Program for International Student Assessment (PISA) 2009 and 2012.

Figure 5.4: Improvements in TIMSS 8th grade math were much higher in the richest 10 percent of households than in the poorest 10 percent, 2011–15



Data source: Trends in International Mathematics and Science Study (TIMMS) 2011 and 2015.

Developing a lifecycle approach for adaptive skills

The government is increasingly emphasizing adaptive skills. It aims to ensure that workers can respond to rapidly changing technologies and difficult-to-anticipate labor market demands, as well as that the education system can deliver a workforce with relevant foundational skills. It is necessary to teach non-cognitive and socio-emotional, flexible skills and implement a life-cycle approach to education and skills development, starting with elementary education and developing skills for students to enter the labor market.

Strengthening pre-primary education is a critical starting point. Global evidence suggests that early childhood education and care are linked to better cognitive and developmental outcomes, especially for children from the most disadvantaged backgrounds.[94] Although access to pre-primary education has been expanded in recent years mainly due to public-private partnership, Kazakhstan still lags behind the OECD average (73 percent in Kazakhstan compared to 90 percent in OECD members). Staffing is another serious challenge, a result of the declining status of the teaching profession in terms of pay and working conditions. The State program for development of education and science for 2016-2019 acknowledges the deficit and aims to raise the percentage of pre-primary enrolment to 100 percent, increase the share of pre-primary teachers with the highest level of certification from 34 to 50 percent, and increase the share of pre-primary inclusive schools from 15 to 30 percent.

Access to pre-primary education has not improved consistently across the country. In 2010, when the national average for pre-primary enrollment for 1 to 6-year olds was 41.6 percent, it was just 17.7 percent in South Kazakhstan oblast, but more than 90.8 percent in Kostanay oblast. However, in 2016, the national average rose to 64.5 percent and the lowest value exceeded 50 percent (in Astana, at 51 percent), mainly owing to internal migration and demographic changes. In 2010, 47.7 percent of 1 to 6-year olds in urban areas were enrolled in pre-primary education, compared with only 34.6 percent in rural areas; in 2016, the coverage was 57.7 and 42.3 percent, respectively. Pre-primary education curricula have been revised to include a greater focus on the development of cognitive skills. The revised curricula were piloted in 77 pre-primary schools. A system of indicators for tracking of pre-primary students' skills development has been developed and introduced. However, a comprehensive

[94] OECD and World Bank Group (2015).

assessment of learning outcomes (particularly primary school readiness) has not been completed; without one, it is unclear whether the additional investments are producing results.

The higher education curriculum needs to align better with changing labor market requirements. Kazakhstan needs, in particular, to refocus teaching and learning on the 21st-century skills, knowledge, and competencies that prepare graduates for the labor market and lifelong learning.[95] This will require better aligning higher education curricula, teaching approaches, and assessment methods to the needs of employers. Greater autonomy has been granted to higher education institutions to better shape the educational context and institutional arrangements and develop a competency-based curriculum to boost relevance. Most higher education faculty (51 percent) hold qualifications equivalent to a master's degree or less; just 12 percent hold a degree equivalent to a PhD. This pattern is similar in public and private institutions, but again with uneven distribution across regions.

Modernizing the vocational and training system is essential to bring skills in line with demand. The large numbers of graduates who enter the labor market each year from vocational colleges and universities lack the right skills to meet the needs of a diversifying and modernizing economy. This mismatch is the result of predominately supply-driven curricula, weak links between education and training providers and the labor market, obsolete education standards, curricula not based on occupational and functional analysis, and virtually no attention to lifelong learning. Since 2012, Kazakhstan has embarked on a modernization drive to align its vocational education and training and higher education system to labor market demand. It has launched pilots to boost partnerships with employers and the private sector to define occupational standards and modernize the training curriculum, assessment, and qualifications systems.[96] Still missing, however, is a functioning and independent qualifications system.

With jobs shifting from manual to skilled labor, lifelong learning becomes critical. Once in employment, workers have few opportunities for training, retraining, and upgrading qualifications. Formal training in the workplace is rare. In 2013, only 3.4 percent of workers had taken training, retraining, or upgrading qualification courses in the previous 12 months.[97] Work-based training should be considered as an integral part of overall workforce development (on and off the job) and not simply for a qualifications upgrade.

More funding and greater autonomy are needed to deliver better and more inclusive outcomes

Education spending per student needs to be increased. Public financing for education has increased by 5 times over the past decade and totals around 3 percent of GDP. Expenditure on secondary education as a share of GDP is on a par with OECD countries. However, at 11.7 percent of GDP per capita, expenditure per student is less than half that in top-performing countries on PISA (figure 5.5). Other upper-middle-income economies with similar economic development indicators, like Chile and Malaysia, also devote far more resources to education than Kazakhstan.[98]

Kazakhstan has a highly centralized, top-down education system that leaves little autonomy or accountability at lower levels. Schools have little administrative and fiscal authority.[99] A 2013 study

[95] OECD (2017).

[96] For the systematic and structured description of qualifications by levels, the National Qualifications Framework (NQF)—compatible with the European Qualifications Framework—has been approved for implementation in Kazakhstan. By 2020, 550 occupational standards will be developed that will cover eight levels of NQF for many professions.

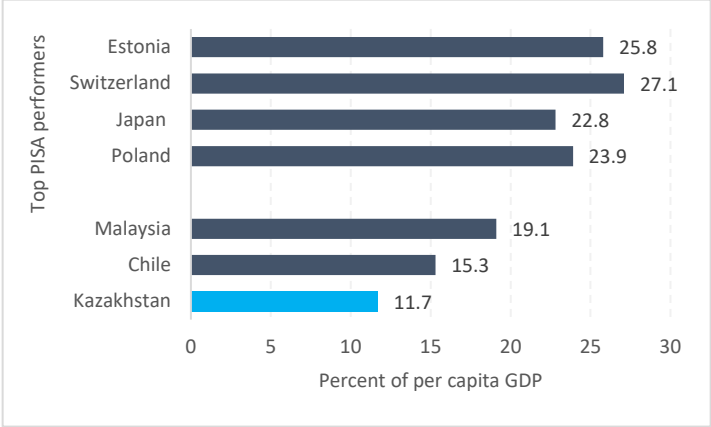
[97] Estimates differ depending on whether employees or firms are surveyed but are consistent that training opportunities are not abundant. According to 2013 Business Environment and Enterprise Performance Survey, only 30 percent of all firms offered formal training, and only about 20 percent of small firms (5–19 employees).

[98] In order to equalize public expenditure per student regardless of his place of residence, a per capita financing formula is being piloted and adapted in urban schools for rollout in 2019.

[99] OECD and World Bank Group (2015).

found that the country needs to strengthen parents' participation in school governance and enhance accountability to stakeholders.[100] In recent years, the Ministry of Education and Science has made efforts to increase transparency through the greater dissemination of information via its website, but more systemic efforts must be made. The School Board of Trustees is not fully functioning. Parents have little power, and there is a lack of clarity in the delineation of accountability on key issues such as budget and personnel management, teacher performance, and student learning results. The School Inspection System needs to redefine its functions, shifting from control to quality assurance and support for school accountability and autonomy in achieving learning for all.

Figure 5.5: Per pupil expenditure on education in Kazakhstan is well below that in peer countries, 2015



Data source: OECD and World Bank Group (2015).

5.2 Health care for better quality life and higher quality workforce

As the population ages, addressing health-related issues will be critical not only to improve the quality of life but also to ensure a workforce that can deliver sustainable productivity gains.

Health outcomes lag well behind the country's economic achievements, despite recent progress

Health achievements are not on a par with the county's economic performance. With life expectancy at birth of just 68.1 years for males, Kazakhstan trails far behind its peers (with the notable exception of the Russian Federation). This figure is almost 10 years less than the OECD average (figure 5.6). With the exception of the mortality rate for cancer in the population under 65 years of age, other health indicators lag behind those of countries with similar socioeconomic conditions (table 5.1). The infant mortality rate, deaths from cardiovascular diseases, and deaths from cervical cancer (avoidable in a well-performing health system) are substantially higher in Kazakhstan. Injuries account for more than 70 percent of disability-adjusted life years (DALYs) among young people (under 39 years of age). Two of the 10 leading causes of DALYs in 2010, but not in 1990, were chronic obstructive pulmonary disease and cirrhosis of the liver, particularly prevalent among men, highlighting the impacts of tobacco and alcohol consumption on health outcomes. Linked to social patterns is gender-based violence, which research in 2010 indicated was experienced by more than half of women in Kazakhstan.[101]

Still, some health outcomes have improved. Male life expectancy has risen by eight years since 2005, faster than in all peers (but from a far worse base; see figure 5.6). The maternal mortality ratio declined from almost 90 (per 100,000) live births in 1997 (three times the OECD average and the worst among all peers) to 12 by 2015, better than the OECD average (figure 5.7). Infant mortality also declined sharply, from 44.7 per 1,000 live births in 1990 to 12.6 in 2015. Continuing to improve health outcomes

[100] World Bank Group (2013c).
[101] http://www.stopvaw.org/kazakhstan.

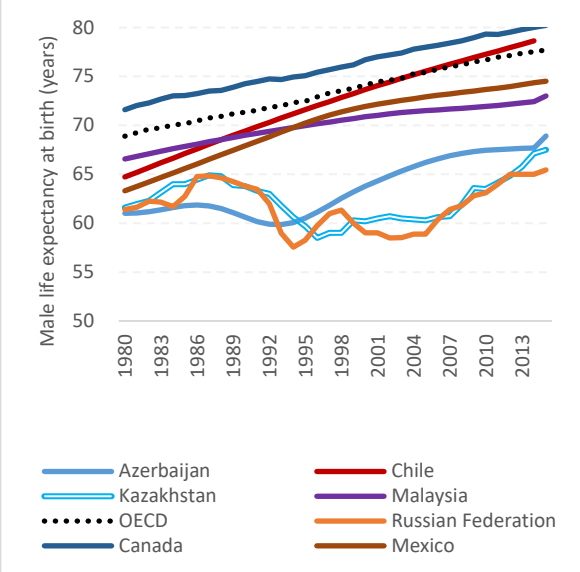
is critical not just for quality of life but also for productivity and poverty reduction. For example, poor health outcomes may be a partial explanation for why the typical age of withdrawal from the labor market is low in Kazakhstan. And low life expectancy for men may contribute to the fact that female pensioners have among the highest poverty rates.

Table 5.1: Health indicators in Kazakhstan and peer countries, most recent year available

Indicator	Kazakhstan	Belarus	Bulgaria	Croatia	Estonia	Hungary	Serbia
Real GDP (thousand PPP$ per capita)	13.7	15.3	16	21	23.6	22	11.8
Infant mortality rate	8.59	4.7	7.8	3.6	2.4	4.9	6.2
Cardiovascular disease under age 65 (per 100,000 population)	178,92	191.3	148	60.8	80.6	92.9	84.7
Cancer under age 65 (per 100,000 population)	88,16	93.1	85.8	90.6	78.6	122.4	103.2
Cancer of the cervix (per 100,000 population)	3.6	5.1	7.3	3.4	7.4	6.2	9.3

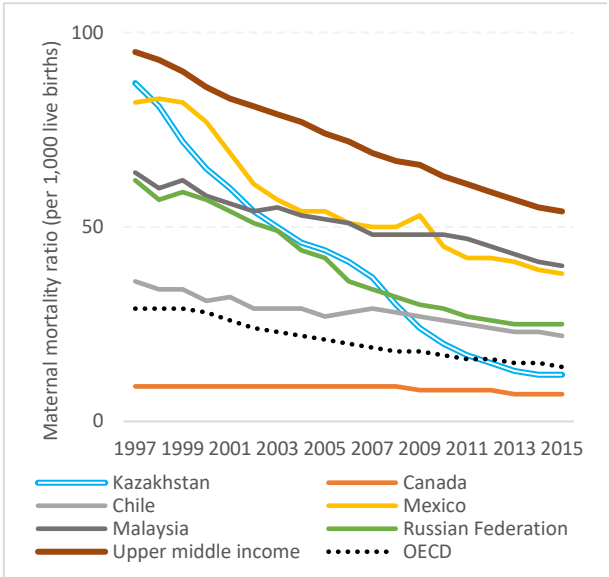
Data source: World Health Organization Regional Office for Europe, European Health for All Database.

Figure 5.6: Kazakhstan lags most of its peers on male life expectancy at birth, 1980–2015



Data source: World Bank Group, World Development Indicators.

Figure 5.7: Kazakhstan has made great improvements in maternal mortality, 1997–2015



Data source: WHO (2015); modeled estimate.

Disparities in health access and outcomes are still wide

National averages in health outcomes mask troubling regional differences in health care access and utilization, health outcomes, and out-of-pocket expenditures. For example, in 2015 there were three times the number of physicians per 100,000 population in Almaty City than in Almaty oblast; death rates from cardiovascular disease in Karaganda were twice the national average and more than five times the rate in Mangystau; and maternal mortality in Atyrau was 70 percent above the national average and five times higher than in North Kazakhstan (table 5.2). Indeed, except for life expectancy,

variation across oblasts in the outcomes and services shown in table 5.2 was higher in 2015 than in 2000.

Table 5.2: Selected health outcomes and services in Kazakhstan, by oblast, 2000 and 015

	LIFE EXPECTANCY AT BIRTH			MATERNAL MORTALITY*			DEATH RATE FROM CV DISEASE			DEATH RATE FROM CANCER			PHYSICIANS PER 100,000			PEDIATRIC BEDS PER 10,000		
	2000	2015	Δ ('00-15)	1998-00	2013-15	Δ ('00-15)	2000	2015	Δ ('00-15)	2000	2015	Δ ('00-15)	2000	2015	Δ ('00-15)	2000	2015	Δ ('00-15)
Akmola	64.3	70.7	10%	71	17	-76%	608	310	-49%	158	127	-20%	26.6	29.6	11%	14.3	11.7	-18%
Aktobe	63.9	72.3	13%	85	10	-88%	484	183	-62%	132	84	-36%	42.3	43.6	3%	9.6	7.9	-18%
Almaty	66.8	71.9	8%	51	7	-86%	485	152	-69%	106	72	-32%	19.7	24.1	22%	7.5	7.9	5%
Atyrau	64.4	72.5	13%	76	21	-73%	341	129	-62%	106	95	-11%	30.1	28.8	-4%	13.5	9.9	-27%
East-Kazakhstan	64.5	70.8	10%	99	9	-91%	641	234	-63%	167	139	-17%	34.6	42.1	22%	10.6	8.8	-17%
Zhambyl	65.5	71.9	10%	75	12	-84%	435	190	-56%	97	89	-8%	25.4	27.5	8%	11.6	11.2	-3%
West-Kazakhstan	65.3	72.1	10%	54	10	-81%	537	221	-59%	143	98	-32%	32.4	30.8	-5%	12.2	10.6	-13%
Karaganda	64.1	70.8	10%	57	16	-71%	626	368	-41%	147	100	-32%	41.6	45.3	9%	15.0	10.1	-33%
Kyzyl-Orda	65.6	72.0	10%	36	20	-46%	314	135	-57%	98	83	-15%	30.8	31.4	2%	13.4	11.0	-18%
Kostanay	64.9	70.6	9%	97	8	-92%	584	186	-68%	159	96	-40%	23.9	25.8	8%	11.1	9.6	-14%
Mangystau	64.2	73.2	14%	116	12	-89%	291	68	-77%	88	63	-29%	35.7	29.4	-18%	13.7	8.8	-36%
Pavlodar	64.8	71.5	10%	66	16	-76%	501	248	-50%	154	146	-5%	33.5	38.3	14%	13.0	11.4	-12%
North-Kazakhstan	65.0	70.6	9%	60	4	-93%	573	318	-44%	182	145	-20%	23.0	30.7	33%	12.6	11.6	-8%
South-Kazakhstan	67.3	72.3	7%	66	13	-81%	353	147	-58%	67	61	-9%	26.1	31.0	19%	11.0	10.1	-8%
Almaty city	67.8	75.2	11%	52	13	-75%	574	140	-76%	168	96	-43%	61.7	74.7	21%	19.5	11.2	-43%
Astana city	69.2	74.8	8%	67	11	-83%	383	157	-59%	148	96	-35%	67.8	87.1	28%	18.4	20.9	14%
Republic of Kazakhstan	**65.5**	**72.0**	**10%**	**68**	**12.4**	**-82%**	**502**	**194**	**-61%**	**130**	**94**	**-28%**	**33**	**39.5**	**20%**	**12.4**	**10.5**	**-15%**
coefficient of variation	*2.3%*	*1.9%*		*29.3%*	*36.1%*		*24.2%*	*40.2%*		*25.7%*	*27.1%*		*38.5%*	*45.8%*		*23.3%*	*27.5%*	

Source: http://medinfo.kz/medstat.jsp

Note: Maternal mortality rates are shown as three-year averages to smooth significant annual variation.

Financial barriers to access are also a concern. Total health expenditure per capita has been rising since the mid-1990s, reaching US$538.8 in 2014. Although public health spending as a share of GDP rose sharply, from 1.8 percent in 2007 to 2.4 percent in 2014, the private out-of-pocket share of health spending still rose, from 43.3 percent to 45.1 percent over this period. This proportion is more than three times higher than the OECD average (13.6 percent in 2014). According to recent World Bank and Ministry of Health estimates, the bottom 40 percent of the population incurred out-of-pocket expenses on health care in 2013 that exceeded 10 percent of total non-food-related household spending over a 12-month period.

These findings highlight the importance of improving the quality and equity of distribution of health services. Health sector reform is a key component of the Kazakhstan 2050 Strategy, which proposes to modernize health care by introducing standards for clinical protocols, medical equipment, and medical supplies across health care institutions.

Fiscal and environmental factors threaten the sustainability of health outcomes

To address concerns about fiscal sustainability, the government is planning to introduce a mandatory social health insurance system, which will enable the transition from the budget model to the mixed model of financing of the health care system.[1] The Social Health Insurance Fund (SHIF) was established in September 2016 as a noncommercial joint stock company under the Ministry of Health. The Law on Mandatory Social Health Insurance (MSHI) of November 2015 established the contribution rates to the system and a timeline for phasing them in beginning in 2017.[102]

The postponement of the MSHI is an opportunity to use the time gained to create the conditions for successful implementation and avoid a repeat of the problems that led to the collapse of the previous mandatory social medical insurance system in 1998. In response to economic challenges and demands from the employers' association, the draft amendment provided for a reduction in the social tax rate of 1.5 percent. As a result, the burden on employers will remain the same. Recent analysis suggests that there was a risk of a financing shortfall in the mandatory medical insurance system under

[102] The introduction of the MSHI was delayed, however, and a subsequent 2017 law provided for the postponement of the start of contribution payments by individuals (employees and the self-employed) and state contributions for preferential categories of the population from January 1, 2018, to January 1, 2020. Accordingly, the start date of medical care provision to MSHI participants is now January 1, 2020.

the original design, with additional budget requirements for the initial two years. Therefore, the reductions in contribution rates are likely to increase the risk that the health care system will still require additional financing.

Environmental factors, notably air pollution, also threaten the sustainability of health improvements. While there are significant market costs of outdoor air pollution, through reduced labor productivity and additional health expenditures, these pale in comparison with the direct health impacts. According to the World Health Organization (WHO), in the world, the mortality rate attributable to household and ambient air pollution stood at 93.3 per 100,000 population in Kazakhstan in 2012, while DALYs attributable to ambient air pollution were 269,757.[103] According to the WHO, particulate matter air pollution annually causes an estimated 2,800 premature deaths and costs the economy more than US$1.3 billion (or 0.9 percent of GDP) in increased health care costs. Reducing particulate matter concentrations by even one microgram per cubic meter could save US$57 million in annual health care costs through lower rates of premature mortality and improved worker productivity. Nonmarket impacts include premature deaths and pain and suffering due to illness. Evidence shows that exposure to air pollution in Kazakhstan is causing serious health and environmental impacts, particularly in urban and highly industrialized areas.[104]

5.3 Social protection for reducing poverty and raising productivity

Social safety net coverage is fragmented and insufficient, with minimal use of means testing

A sound social protection system is critical for reducing poverty and for raising the productive potential of individuals to arrest the intergenerational transmission of poverty. Kazakhstan's social safety net (SSN) system is fragmented, and most of it is not means tested. Kazakhstan spent around 1.2 percent of GDP (506 billion tenge) on its SSN system in 2014, with close to 60 percent of this on old age social pensions (table 5.3). Social allowances, special allowances, and benefits for families with children are the three main categorical programs. The social allowances program provides disability and survivor allowances, as well as an old age allowance for those who, at retirement age, are either ineligible for pension payments from the accumulation system or whose pension entitlement is below the guaranteed minimum. The special allowances are monetized benefits and subsidies, formerly called "privileges." In 2014, means tested programs represented only around 1 percent of SSN expenditure. [105] Among these, Targeted Social Assistance (TSA) is the "last-resort" minimum income guarantee program that provides a cash payment to families with average per capita monthly income below 40 percent of the subsistence minimum.

Coverage of the social protection system puts Kazakhstan in the lower range of upper-middle-income countries in Europe and Central Asia. Under current contributions, the SSN system is insufficient to reach most of the poor (figure 5.8). Around 25 percent of the population receives some form of social assistance (categorical and means tested),[106] but only around 1 percent receives TSA because of the low value of the eligibility threshold, based on the subsistence minimum established by costing out a nutritionally appropriate consumption basket and inflating it to account for a "subsistence amount" of

[103] The data in this paragraph are from Global Health Observatory data (World Health Organization 2017).

[104] Using Kazhydromet fixed station data, in 2017 the Ministry of Health made preliminary health risk estimates for the populations of Almaty and Astana posed by particulate matter PM10 and PM2.5 in the atmosphere and undertook risk mapping. These estimates were used to justify the selection of priority activities and managerial decisions regarding both health and environmental protection. The following determinations were made: (i) Zones were identified in Kazakhstan where respiratory system dysfunction is a risk; airborne dust particles were identified as a possible cause. Risk mitigation measures are required; (ii) Several zones of high and moderate risk were identified in individual cities; planned sanitary measures must be developed and implemented by 2020.

[105] TSA and HA, administrative data, ASPIRE.

[106] 2014 Household Budget Survey.

nonfood consumption. The TSA, at 40 percent of this subsistence minimum, is currently about 310 tenge per person per day, or around $1.[107] This eligibility threshold for the last-resort program is too low for a middle-income-country like Kazakhstan.

Table 5.3 Social safety net expenditure in Kazakhstan, by category, 2014

Broad category	Category	Expenditure (million tenge)	% of GDP
Family, maternity, and child support	1. Family and child allowance (including orphans' and vulnerable children's benefits)	104,901	0.257
Special allowances, social assistance to the poor	2. Poverty targeted social assistance (Targeted Social Assistance and Conditional Cash Transfers)	1,824	0.004
	3. Housing/utility assistance	2,688	0.007
Social allowances, state support against social risks	4. Emergency support in cash	0	0
	5. Old age social pensions	232,573	0.571
	6. Disability social pensions, allowance, benefits	137,084	0.336
	7. War veterans' benefits	18,580	0.046
	8. Noncontributory funeral grants, burial allowances	0	0
	9. Other cash transfers	9,184	0.023
Total		506,835	1.244

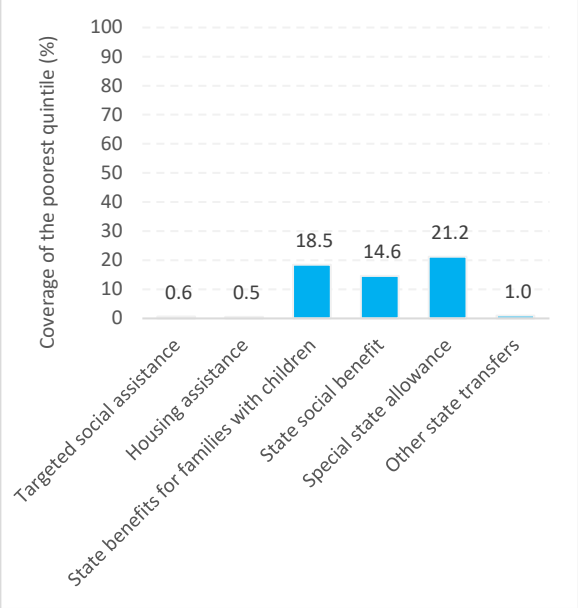
Data source: Government of Kazakhstan.

Given the narrow coverage and small scale of SSN payments, it is unsurprising that they have done little to raise incomes. The 2013 Household Budget Survey shows that social subsidies raised real income by just 0.4 percent over 2006–15, while old age social pensions raised them by 8.6 percent. The impact of these social payments on poverty reduction was 0.77 percentage points over the period (compared with 23 percentage points from rising wage and self-employment earnings).

Performance among SSN programs is uneven. While TSA has extremely low coverage, it is better targeted toward the poor than any other SSN program analyzed. With 65 percent of beneficiaries among the bottom 20 percent, these targeting results are good relative to international benchmarks. Overall, however, just 37 percent of beneficiaries across all SSN programs are among the poorest 20 percent of the population (figure 5.9).

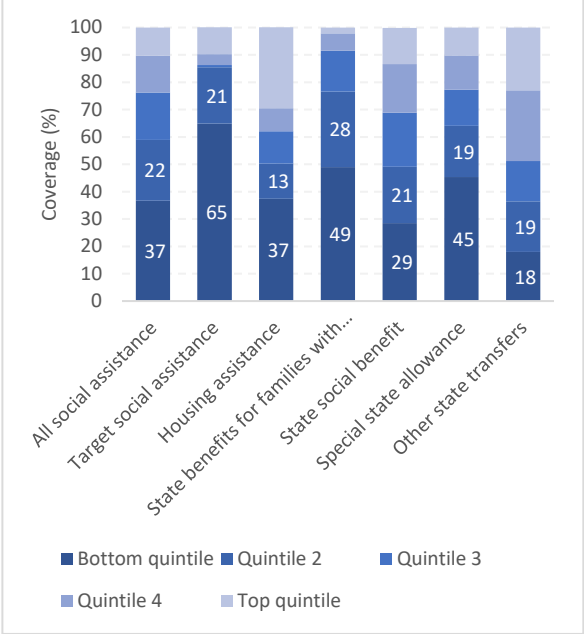
[107] Fourth quarter of 2016.

Figure 5.8: Social safety net coverage of the bottom 20 percent is low in Kazakhstan, 2013



Data source: Household Budget Survey 2013 and ADEPT Social Protection module.
Note: TSA results must be interpreted with caution due to small sample size.

Figure 5.9: Most social safety net transfers are not well targeted to the bottom 20 percent in Kazakhstan, 2013



Data source: Household Budget Survey 2013 and ADEPT Social Protection module.
Note: TSA results must be interpreted with caution due to small sample size.

Introducing a social contract with conditional cash transfers: Orleu reforms

In 2012, the government launched a program to expand the TSA program by increasing the eligibility threshold from 40 percent of the subsistence minimum to 60 percent by 2015 and to 100 percent by 2020. The government also introduced conditionality for TSA program participants in the form of a social contract following a mutual obligations principle. The idea of a social contract is based on both the conditional cash transfers approach that is widely used in Latin America and on the activation or "work first" approaches widely used in Europe and the United States. Conditions are linked to participation in the labor market and related to behaviors that positively affect the long-term well-being of household members. This expanded program, branded Orleu, integrates three types of assistance for vulnerable people—TSA, child allowance, and a special state allowance for large families. The intention is to reduce SSN program fragmentation and expand the coverage of means tested programs. Following successful initial piloting in February 2014 in three oblasts, the pilot was expanded in mid-2015 to selected rayons in all oblasts, to be paid for out of local budgets. Orleu is expected to be rolled out nationwide in 2018.

Pensions, unemployment benefits, and active labor market programs are not supporting a formal, mobile workforce

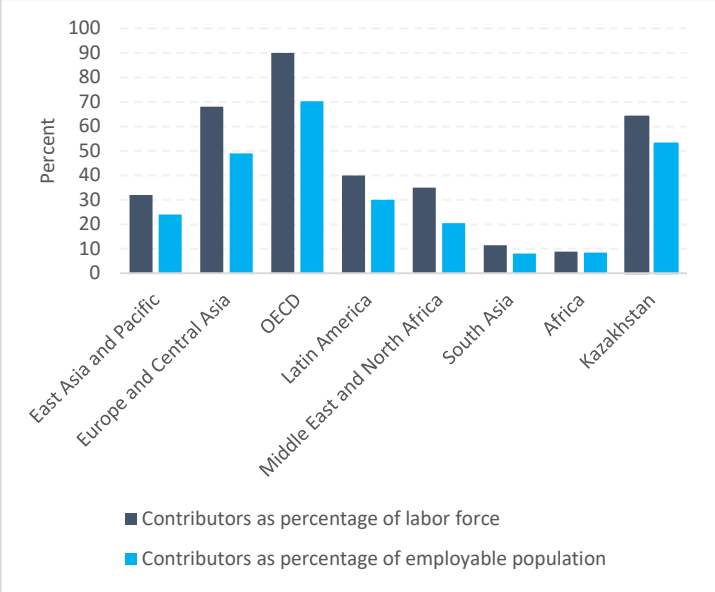
With meager pensions and unemployment benefits, the social protection system provides few benefits to support flexibility and adaptability in the labor market. Some 2.8 million workers, notably the self-employed, are ineligible for pension benefits because they do not contribute to the insurance

scheme (as they have no employer who contribute to the scheme for them, as in the case of wage employees).[108] This places a large group of vulnerable workers at an elevated risk of poverty.

Kazakhstan's contributory pension system needs reform to deal with large deficits and emerging demographic pressures. Expenditure on contributory pensions is more than in some but less than in other global regions, though far below the OECD average. The contributory pension is barely adequate and is becoming less so (to the particular detriment of women). Each new generation of pensioners retires with still-lower pensions (relative to wages). The average pension of new pensioners was 12 percent lower in 2014 than that of pensioners who retired before 2014. The current basic old age social pension (eligible to everyone who reaches the retirement age regardless of employment history and pension contribution record) amounts to 43 percent of the average salary. Over the next 30 years, as fewer people are collecting the pre-reform pension and as inflation-indexing applies to the old age social pension, the pension level will drop to just 10 percent of the average salary,[109] seriously testing the social sustainability of the pension system.

Another concern is low pension coverage of the employable population. Employer contributions to the pension system covered only 53 percent of the working-age population, or 67 percent of all employed people in 2014, putting Kazakhstan in the middle of its global region but still far behind developed countries (figure 5.10). The concern is that while 97 percent of the elderly population is covered by the pension system, low contribution rates will translate into much lower coverage in the future. In response to these concerns, the government is considering ways to make the pension system sustainable. One option being considered is to introduce worker contributions (currently workers do not contribute); another is using more means testing.

Figure 5.10: Kazakhstan is in the middle of its region but behind the OECD average on pension system coverage, 2014



Data source: World Bank Group, Pension System database, 2014.

[108] These are primarily subsistence farmers working on personal farmsteads (Rutkowski 2011). While technically the self-employed are meant to contribute to the social insurance fund, some may not if the cost outweighs perceived benefits. In particular, the minimum payment is calculated on the basis of minimum wage. While it is low (T 19,966 or approximately $60 per month), those who work in subsistence activities do not have much disposable income and may find the contributions prohibitively expensive.

[109] Rutkowski (2011).

The coverage and degree of unemployment insurance remain limited. Those who contribute to the social insurance fund for at least six months are eligible for a modest unemployment benefit of up to 30 percent of average monthly insured earnings in the previous 24 months.[110] However, the amount and duration of payments depend on the length of contributions, with those contributing for 6–12 months eligible for just 70 percent of the payment amount, and for only one month.[111] The basic benefit duration is four months for those with three years of contributions or more, with a maximum benefit duration of six months for some categories of unemployed. Due to the limited coverage and benefit duration, the number of people receiving unemployment benefits is very low (18,846 people in 2013[112] compared with roughly 471,000 unemployed that year). While this design is unlikely to create disincentives for job search by the unemployed, it is likely to leave some of the unemployed more vulnerable than others, especially those with short job tenures.

The design of the social protection system does not provide adequate incentives for workers to contribute, and thus encourages informality. Low-income self-employed workers do not gain much in social security benefits by paying contributions. For such workers, the difference between noncontributory universal social assistance benefits and contributory social insurance benefits is small. Strengthening the incentives for formal employment would require a widening of the gap between social insurance and available social assistance benefits, with adequate social protection for the whole population.

Finally, coverage of active labor market programs remains insufficient and minimally effective. The (discontinued) Employment Roadmap 2020 and the Productive Employment and Mass Entrepreneurship Program (2017–20) offer little coverage, focusing mainly on public works or self-employment. Moreover, public employment services reach only a small share of the unemployed and self-employed.

5.4 Managing natural resources for wealth conversion and environmental sustainability

There has been rapid growth in natural capital but limited wealth conversion and increasing vulnerability

Measuring capital using wealth accounting. Wealth accumulation is fundamental to ensuring sustainable growth and development. But wealth comes in many forms—natural capital (including oil and gas, minerals, croplands, and forests), produced capital (machinery, equipment, and infrastructure), human capital, and social capital—all of which can be built up *and* depleted. Growth that simply runs down assets is, therefore, obviously less sustainable than growth associated with maintaining and building assets. Natural capital is most critical in this assessment, as once it has been depleted, it cannot be replaced. Thus, the sustainability of growth and of poverty reduction depends on converting natural resources into renewable assets, including high-quality human capital, financial reserves, and physical assets. This is measured through an indicator of changes in wealth per capita.[113]

[110] Generally, systems with contributory unemployment benefits should provide a replacement rate at no less than 50 percent of previous earnings, in case of full unemployment (Kuddo, Robalino, and Weber, 2015).

[111] While there are no universal standards for the duration of benefit reception and the level of the replacement rates, the ILO suggests at least 13 weeks of benefit reception within a period of 12 months as well as replacement rates of at least 45 percent of the previous earnings of the beneficiary (Kuddo, Robalino, and Weber, 2015).

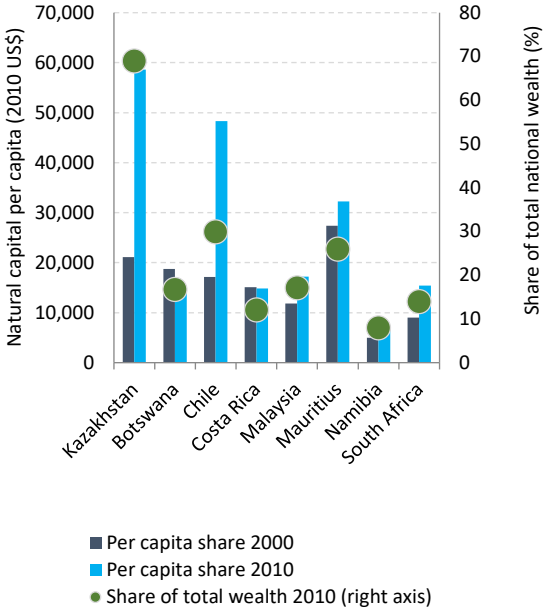
[112] http://www.gfss.kz/ru/statistic/569/52831/

[113] With annual wealth data not readily available, change in wealth per capita can be calculated based on the investments in and depreciation of capital based on the concept of adjusted net savings (which is already estimated). Where the population is not static, however, population growth needs to be factored in, because by the end of the year total tangible wealth would be shared by a larger national population. Therefore, the measure is calculation as follows: Change in Wealth Per Capita = Gross Saving – Consumption of Fixed Capital + Education – Natural Capital Depletion – Population Adjustment. Negative

A wealth accounting assessment over 2000–10, before the collapse in oil prices, shows that Kazakhstan's natural capital wealth almost tripled in nominal terms to nearly US$60,000 per capita (figure 5.11). By 2010, natural capital accounted for almost 70 percent of total national wealth, against just 30 percent in Chile and around 15 percent in South Africa and Malaysia. This highlights Kazakhstan's reliance on natural resources and explains the vulnerability seen after the oil price collapse in 2014.

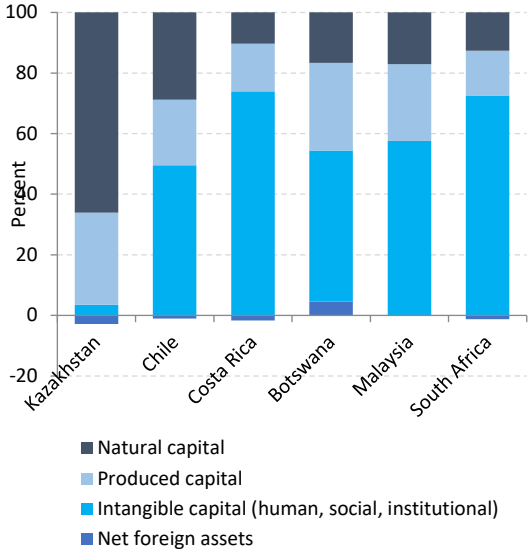
Some resource-rich countries have converted natural capital into human and institutional capital, but Kazakhstan has not yet done so. Despite huge natural resource rents over the decade, the country has added little to its stock of human and institutional capital, threatening the sustainability of growth and of poverty reduction propelled by the resource gains (figure 5.12).

Figure 5.11: Natural capital's share of total wealth, at nearly 70 percent, is higher in Kazakhstan than in peers, 2000 and 2010



Data source: World Bank Group, Wealth of Nations database, 2011.

Figure 5.12: Unlike some other resource-rich countries, Kazakhstan has yet to convert its natural capital into human and institutional capital, 2010



Data source: World Bank Group, Wealth of Nations database, 2011.

In addition to the opportunity cost of Kazakhstan's natural resources use, Kazakhstan faces the real costs of environmental damage and increased vulnerability to climate change. Its resource wealth has contributed to it being among the most energy-intensive and carbon-emitting economies in the world. This is already having public health effects due to high levels of energy-related pollution and, over the medium and long terms, will have substantial effects on the sustainability and adaptability of the economy.

The economy has high vulnerability to a low-carbon transition. Kazakhstan stands out as being one of the two economies in the world (with Kuwait) most vulnerable to a low-carbon transition because of the structural decline in prices and demand for fossil fuels and carbon-intensive goods associated

changes in wealth per capita could be caused by either a decrease in total wealth (i.e., increases in income are generated at the expense of asset depletion) or by growth of total wealth at a rate lower than the growth of population (i.e., the savings rate does not keep up with population growth).

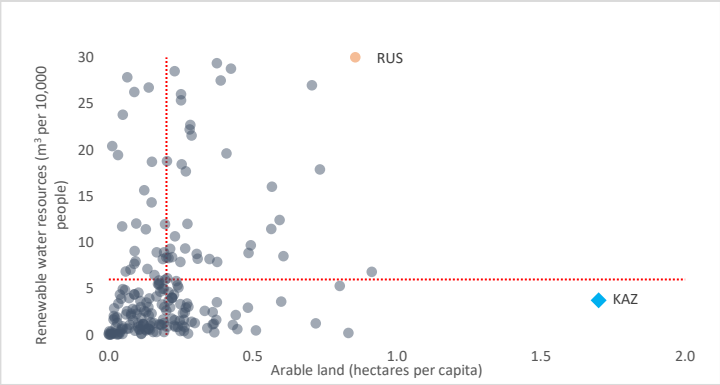
with climate policy action or disruptive technologies. Not only is Kazakhstan highly exposed—due to the structure of the economy—but it is among the least economically resilient.

In any review of the country's natural resource vulnerability, two issues are particularly important for diversification: agricultural development and climate vulnerability, and clean energy and the green economy, discussed below.

Agricultural development and climate vulnerability

Kazakhstan is land rich but water scarce (figure 5.13). Water availability can be volatile and is under increasing risk from climate change. Vulnerability mapping highlights Almaty, East Kazakhstan, Kostanai, Kyzylorda, Zhambyl oblasts as the most susceptible to climate change. Almost all agricultural activities take place in at-risk areas.

Figure 5.13: Kazakhstan is land rich but water poor, 2014



Data source: World Bank Group, World Development Indicators.

The impact of rising temperatures on agriculture will vary across the country. For wheat crops, rising temperatures could initially mean higher crop productivity. However, a projected shift in spring/summer precipitation points to lower soil moisture during the critical growing season. Spring wheat yields could fall as much as 37 percent by 2030 and 48 percent by 2050 unless adaptive measures are taken. In addition to droughts, climate change could increase the prevalence of pests (e.g., locusts) and diseases (e.g., rust). Livestock would also be affected, through increasing pressure on pastures (already often subject to overgrazing and degradation) and detrimental health effects from higher temperatures. Inter-annual climate variability is also reducing fodder availability (and affordability). Finally, farmers in the foothill zones in southern and eastern parts of the country will likely face increased risks of floods, landslides, and mudflows due to the mountainous terrain and such effects of climate change as glacier lake outbursts, more frequent mudflows/landslides caused by intense rainfall and snowmelt during spring, and extreme floods of meltwater during spells of hot weather.

Agriculture is also vulnerable for legacy reasons related to technical and institutional factors. Along with climate factors, legacy issues are important drivers of the climate vulnerability of agriculture in Kazakhstan. Among these are the dominance of crops unsuited to local (and changing) conditions; aging infrastructure, machinery, and equipment; unsustainable water and land management; and environmental degradation. This list indicates large potential for "no-regret" measures (measures that are cost effective and resistant to long-term uncertainties in climate and development scenarios) for incorporating climate change considerations into investments for modernizing and expanding the agriculture sector. Examples, as identified in the country's National Communication to the United Nations Framework Convention on Climate Change, include crop diversification and cultivation of varieties more suited to changing climate conditions; conservation agriculture; modernization of

machinery and equipment, including for adoption of precision agriculture and more efficient land and water management; pasture restoration and community-based pasture management; increased fodder production; and improved storage capacity.

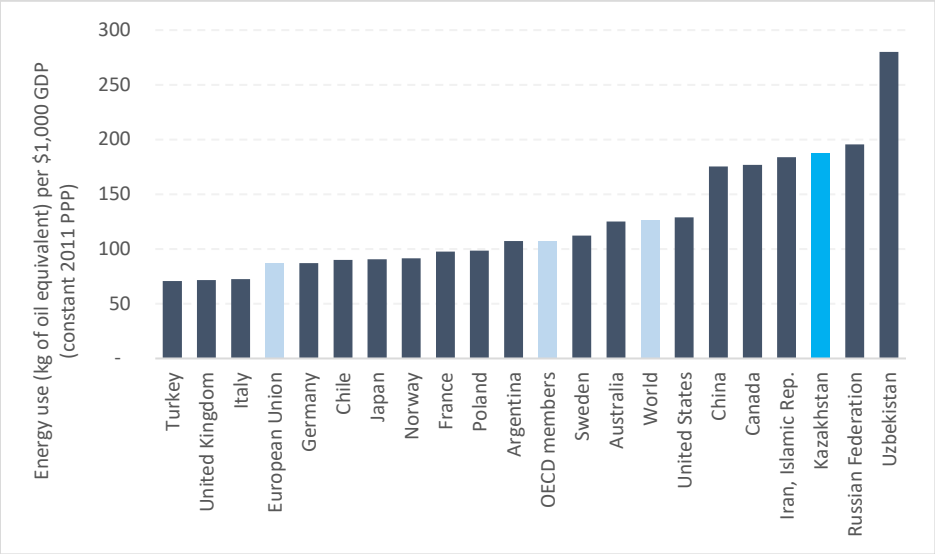
Diversifying the economy through clean energy and the green economy

The green economy concept adopted by Kazakhstan in 2013 aims to diversify the economy through efficient use of natural resources and includes targets for energy efficiency, renewable energy, and carbon-emission reductions. The Green Economy Law, approved in 2016, aims to increase energy efficiency and renewable energy use.

Energy efficiency

Kazakhstan is among the world's top-10 energy-intensive economies. It uses 1.7 times as much energy per unit of GDP (based on purchasing power parity) as the OECD average (figure 5.14). The high-energy intensity of GDP stems in part from high reliance on energy-intensive sectors and extreme climate conditions. But it is also due to low energy efficiency in key energy-consuming sectors, attributable to continuing subsidies for energy, which undermine incentives for efficiency.

Figure 5.14: Kazakhstan uses more energy per unit of GDP than many other countries, latest year available, 2013-15



Data source: World Bank Group, World Development Indicators.

The industrial sector is far more energy intensive in Kazakhstan than in most countries. This energy-intensity hurts Kazakhstan's competitiveness in international markets in semi-manufactured goods, especially in energy-intensive metal product categories. Inefficient use of electricity also contributes to power shortages, especially amid a tightening supply–demand balance, with adverse impacts on SMEs and on regional development.

The potential for energy savings is large in the energy and industry sectors. The economy is making strides on green energy and mitigation, as evidenced, for instance, by its ambitious energy efficiency[114] and emissions targets. One critical area for reform and investment is energy production. The transition to a low-carbon economy will require market incentives in the energy sector to attract private actors to grid strengthening, to efficiency and loss reduction projects in existing power and heat systems, and

[114] Reduce energy intensity of the national economy by 10 percent by 2015, 25 percent by 2020, and 50 percent by 2050. The economy seems on track for achieving the short- and long-term objectives: in 2012, energy intensity had fallen by 13.5 percent relative to 2008.

to new stand-alone or grid-connected clean energy generation projects. Apart from major efficiency opportunities, Kazakhstan has potential in wind and hydropower.

The country has a comprehensive legal, regulatory, and institutional framework for creating an environment that is more conducive to reducing the energy intensity of GDP. The Law on Energy Saving and Energy Efficiency, adopted in January 2012, provides a comprehensive legal, regulatory, and institutional framework and introduces the concept of energy services companies. A recent study identified cost-effective energy-efficiency measures with potential energy savings of more than 32,000 gigawatt hours, equivalent to 33 percent of electricity consumption in 2014.[115] However, multiple information, technical, financial, institutional, and policy and regulation barriers prevent these potential energy savings from being realized.

Building resilience has yet to gain the attention it needs. The country has embarked on initiatives such as the landmark Green Economy Concept and Action Plan and the State Program for development of the agro-industrial complex in the Republic of Kazakhstan for 2017-2021, with goals and targets supportive of climate resilience (especially in efficient water management and crop diversification). Yet Kazakhstan has yet to prepare a long-term, multisector adaptation policy document (including, for example, for such sectors as transport, urban development, oil production, and mining) that coordinates the country's response to climate challenges. For this purpose, it is necessary to develop the National Concept on Adaptation to Climate Change. Likewise, there is no mechanism yet for coordinating and managing resilience actions across government agencies, stakeholders, and development partners.

Renewable energy

The energy mix shows little diversification. Close to 50 percent of the economy's primary energy needs are supplied by domestic coal, two-thirds of it used in the power sector. Over 80 percent of electricity generation is coal-based. Such dependence on coal adds to environmental degradation and to health costs.

The country has adopted ambitious targets and policy measures on renewable energy development. These targets envisage the share of solar and wind in electricity production to be at least 3 percent by 2020, and the share of all alternative sources (solar, wind, hydro, and nuclear) to be 30 percent by 2030 and 50 percent by 2050. Policy measures have been adopted to support investment in renewable energy projects, such as feed-in-tariffs, guaranteed connection for renewable energy generation to the electricity grid, and establishment of a single buyer called the Financial Settlement Center.

An enabling environment still needs to be established, however, to attract investment in renewable energy projects. The following issues will need to be addressed: lack of implementing mechanisms for feed-in-tariff indexation to the foreign currency exchange rate, grid connection issues, lack of a comprehensive and "bankable" contractual framework, and insufficient capacity in and awareness of characteristics of renewable energy plants among key sector stakeholders. More work is needed in building institutional capacity and improving regulatory frameworks for project identification and assessment, financing, and implementation. Finally, so that variable renewable energy can be integrated into the coal-dominated power system, greater investment is needed in flexible power plants such as hydropower, gas-fired plants, and enhanced cross-border electricity trade with neighboring countries.

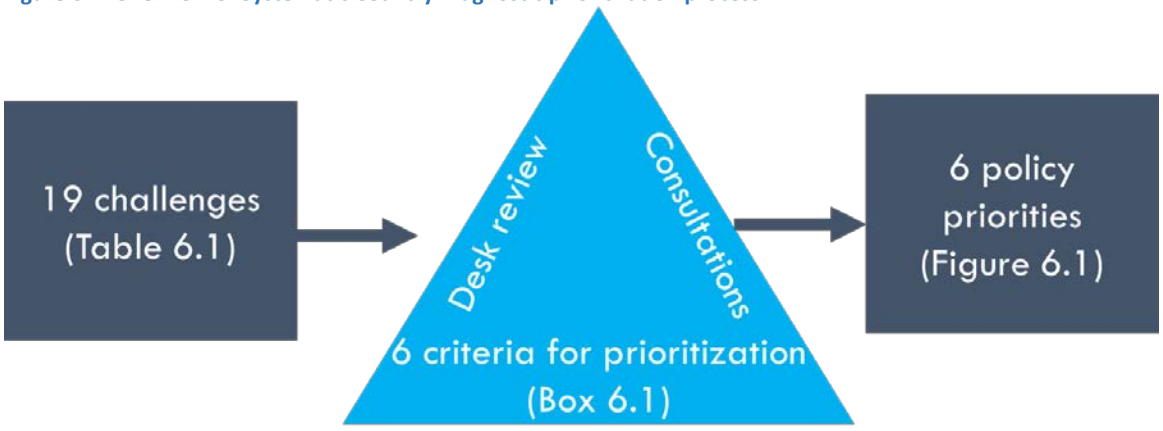
[115] USAID (2016).

6. Prioritizing the challenges

The analysis in this report shows that, despite substantial progress in poverty reduction over the past decade, Kazakhstan's lack of diversified sources of productive jobs has meant that the gains from growth were fragile, with lower skilled rural inhabitants especially vulnerable. The oil price collapse in 2014 exposed a growth and governance model that was not economically, fiscally, or socially sustainable. Getting back on track to achieve the country's long-term goals requires urgent attention to implementing widespread reforms to improve economic management, unleash the potential of the private sector, deepen domestic and international integration, and better leverage the potential of the country's human and natural capital. It will also require establishing a stronger system of social safety nets to support the transition to this new growth and governance model. Underpinning all of this is the imperative to build effective and inclusive institutions for improved governance.

This chapter sets out the priorities for Kazakhstan to transition to a new growth and governance model. It describes the challenges identified in the report and the process through which priority interventions were defined, as illustrated in figure 6.1.

Figure 6.1: Overview of Systematic Country Diagnostic prioritization process



6.1 Summary of the challenges

Kazakhstan faces a broad range of challenges to achieving the transition to a new growth model and thus to making continued, rapid progress toward eliminating poverty and delivering shared prosperity. Figure 6.2 later in this chapter summarizes 19 broad challenges identified in chapters 2-5 of this report. They are organized around four strategic pillars:

1. Economic and public sector management for diversification
2. Private sector–driven economic growth
3. Integration and connectivity
4. Productive and sustainable human and natural capital

Table 6.1: Priority challenges for Kazakhstan to address to eliminate poverty and build a large and secure middle class

Strategic pillar	Priority challenges identified	Growth	Inclusion	Sustainability	Description / specific constraints
Economic management for diversification	1. Fiscal adjustment to low oil prices	✓	✓	✓	A high non-oil deficit negatively impacts fiscal sustainability and immediate measures are required for fiscal consolidation.
	2. Public debt management			✓	Liabilities from the state enterprise and banking sectors have added greatly to the unsustainable non-oil deficit and claimed resources of the Oil Fund.
	3. Central Bank (NBK) independence	✓		✓	The central bank was slow in allowing the currency to respond to the changing oil price and to challenges in supervising and managing the banking sector, owing to the regulatory setup.
	4. Corruption and the rule of law	✓	✓	✓	Corruption and clientelism remain a major obstacle to effective government decision-making, program and project implementation, and public service delivery.
	5. Public sector management and responsiveness	✓	✓	✓	Planning is comprehensive, but weaknesses are evident in prioritizing and responding to citizens' needs. Implementation capacity is limited, resulting in weak management of projects, public investment, and public finance. While the state planning system provides for regular monitoring and assessment of state programs, the evaluation system requires significant strengthening.
Private sector–driven economic growth	6. State-owned enterprise (SME) development	✓	✓		Levels of Individual enterprises/entrepreneurs are high, but SMEs are still limited; they struggle to grow, caught between informality and competition from large SOEs.
	7. State role in the economy	✓	✓	✓	The government plays a direct role in many sectors and firms. Support programs tend to restrict competition and benefit individual enterprises through unsustainable subsidies.

	8. Contestable markets and regulation	✓	✓		Despite progress in improving the business environment, regulatory implementation remains problematic. Several sectors with high market concentration receive state support, including ownership and quantitative restrictions. Power in the private sector in the hands of a small set of connected actors. These conditions create a barrier to foreign direct investment (FDI) and to expansion of SMEs.
	9. Financial sector	✓		✓	The weak banking sector is a drain on the budget and is responsible for higher non-oil deficits. Saddled with high nonperforming loans portfolios, Banks have not expanded credit to the economy. The nonbank financial sector is underdeveloped.
	10. Financial inclusion	✓	✓		Access to finance in rural areas, particularly in agriculture, is very limited, especially for women. This situation restricts potential for the development and expansion of microenterprises and SMEs.
Integration and connectivity	11. Trade, transport, and energy infrastructure	✓		✓	Despite considerable investment, key national and regional road and rail corridors need to be completed. The economy's potential as a trade and transport hub is undermined by gaps in trade facilitation and by an underdeveloped logistics sector. Deteriorating energy infrastructure is an increasing risk.
	12. Agricultural value chain development	✓	✓	✓	Despite agriculture's critical importance to the rural economy, its competitiveness is weak, its productivity is low, and its integration with the value chain is limited.
	13. Urbanization and mobility	✓	✓	✓	Despite population sparsity and lack of economic opportunities in rural areas, migration and urbanization are much lower than expected, attributable mainly to infrastructure shortfalls and the deterioration or unsustainability of urban infrastructure, along with limited access to housing and social services.

	14. Voice and accountability		✓	✓	Political decision-making is highly centralized and opaque, with limited participation from citizens and communities. Risks to social cohesion are rising.
Productive human capital and sustainable natural capital	15. Education and skills development	✓	✓	✓	Despite widespread improvements, socioeconomic and geographical inequalities are considerable. The education system is not delivering the technical or soft skills to enable workers to meet changing market demand.
	16. Health	✓	✓	✓	Low male life expectancy and high levels of noncommunicable disease hurt productivity, the fiscal sustainability of the healthcare system, and the role of women in the household.
	17. Social protection	✓	✓		The social protection system fails to protect the poorest, incentivizes informality, and restricts labor market (including geographical) mobility. Public employment services are ineffective.
	18. Clean energy and energy efficiency	✓		✓	High levels of greenhouse gasses and pollution harm the environment and health. Lack of energy efficiency undermines the competitiveness of firms.
	19. Water resources management	✓	✓	✓	Declining water resources and high vulnerability to climate change will restrict the potential for agricultural development and may undermine the viability of some rural areas.

6.2 Prioritizing challenges and opportunities

Each of the challenges and opportunities in table 6.1 was assessed within a "theory of change" framework (see table A1.1 in annex 1). This framework identifies the desired results to be achieved by removing these constraints and the logical links between removing the constraints and ultimately achieving the twin goals of poverty elimination and shared prosperity, through their effects on growth, inclusion, and sustainability. This approach highlights key complementarities across challenges and reveals certain challenges that may need to be overcome to resolve others.

To identify priorities, each of these challenges was put through a desk assessment—where priorities were ranked based on the criteria in box 6.1—and consultations.

Box 6.1: Criteria for prioritizing challenges in Kazakhstan

The following criteria were used to prioritize the challenges:

- *Impact on the goal of eliminating extreme poverty*: To what degree would resolving the constraint have a direct impact on eliminating extreme poverty?
- *Impact on the goal of delivering sustainable welfare improvements to the less well-off and building a secure middle class*: To what degree would resolving the constraint have a direct impact on supporting sustainable incomes and livelihoods of the bottom 40 percent of the population income distribution? For Kazakhstan, the emphasis is on interventions that will back sustainable, job-creating growth that can support the emergence of a large and secure middle class.
- *Time horizon of impacts*: Over what timeframe will the impact be realized? While the focus of the Country Partnership Framework is five to seven years, some of the priority issues will necessarily have a longer-term framework. The assessment, therefore, attempts to balance short- and longer-term impacts.
- *Complementarities*: To what degree does the issue influence different domains (growth, inequality, sustainability) or magnify the positive impact of addressing other constraints? As with the assessment of preconditions, all issues have some complementarity. Here, the assessment rated more highly issues that had clear impacts across more than one strategic pillar.
- *Evidence base*: Based on the quality of the evidence, how confident are we in the identification of the issue as a priority? In many cases, the evidence base in Kazakhstan—given the availability of substantial statistics, strategies, and reports—is solid. That said, however, in some cases lack of access to statistics limits the strength of the assessment (e.g., on SMEs and more broadly on firm productivity and competitiveness). In other cases, analysis necessarily involves anecdotal or difficult to quantify evidence (for example, the state of public sector effectiveness and the factors contributing to it; the impact of clientelism and corruption). In these cases, issues were rated as having a lower evidence base to support the assessment.
- *Adequacy of existing interventions*: To what extent is the challenge being addressed by the Government of Kazakhstan? The intention of the SCD is not to identify issues that have somehow been completely passed over by policymakers. This is unrealistic, and indeed it would be concerning if such issues were identified. In fact, all the challenges identified here are being addressed in some form (with greater or lesser priority and effectiveness) by the government. This criterion aims to identify areas where significant additional public intervention is warranted.

To complement and enrich the desk assessment, consultations were held with key stakeholders. This included a workshop within the World Bank Group, soliciting input from across the global technical practices and from the International Finance Corporation and the Multilateral Investment Guarantee

Agency. In addition, consultations were carried out with stakeholders in Kazakhstan between January and June 2017. These consultations included several discussion fora as well as a Country Opinion Survey to capture views on priority issues (see figure A1.1 in annex 1).[116] A summary of the consultations during the SCD process is in annex 2.

The consultations, which underlined broad support for the analysis and priorities identified, affected the prioritization process in several ways:

- *Limitations of quantitative rankings*: As expected, individuals and organizations with vested interests in certain sectoral and technical areas that the desk analysis did not identify as priorities often argued for their inclusion among the priorities. With strong technical expertise in the area, these arguments were of course effective. This underlines the contestability of quantitative ratings and the importance of leaving scope for flexibility in the Country Partnership Framework process by grouping some identified priorities into broader categories.
- *Critical role of improving governance and government effectiveness*: Consultation sessions, both within the WBG and in Kazakhstan, put a much stronger emphasis on the priority of addressing issues related to government effectiveness and governance more broadly (accountability, corruption, the rule of law) than emerged originally from the desk analysis. Indeed, a broad range of stakeholders identified governance and government effectiveness as the number one priority.
- *Linkages and complementarities*: The consultation sessions were particularly helpful in identifying more closely the linkages and complementarities across challenges, which again supports the idea of grouping some identified priorities into broader categories.
- *Status of ongoing interventions*: The consultations provided additional details on the nature and status of existing interventions.

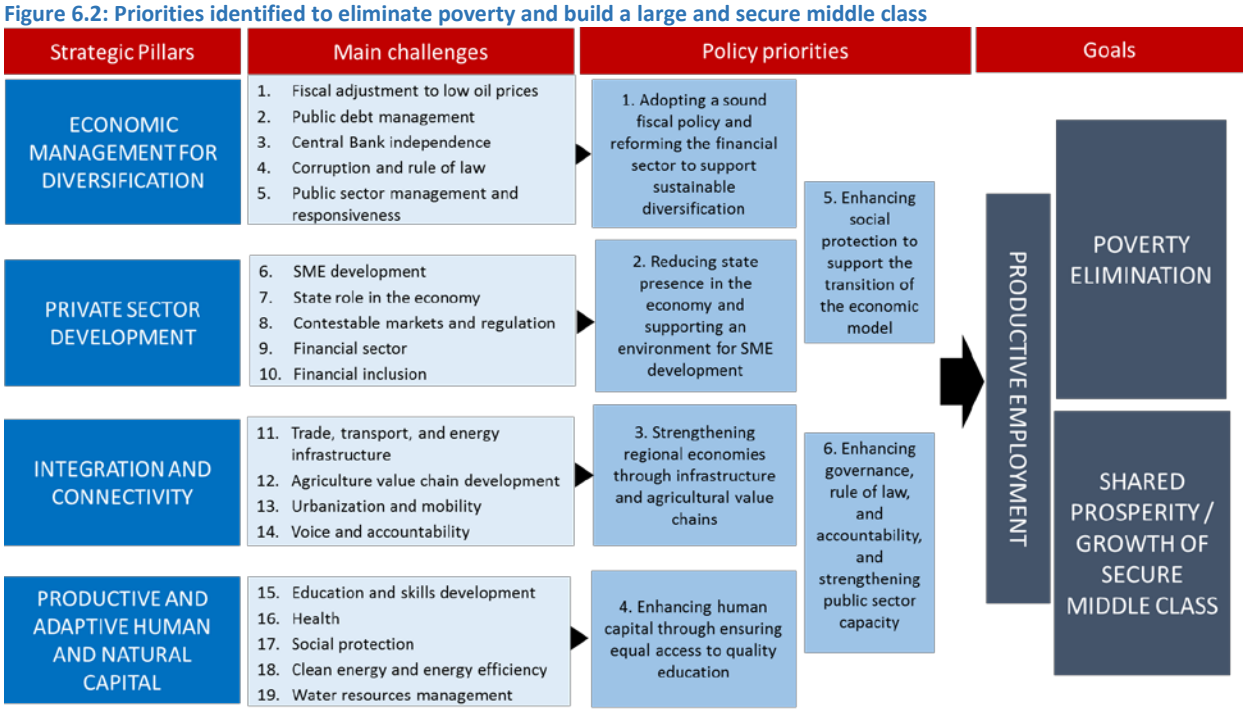
6.3 Final prioritization of challenges and policies

The policy prioritization described here is intended to identify the challenges likely to have the greatest bearing on eliminating poverty and building a large and secure middle class in Kazakhstan over the near to medium term. Figure 6.2 pulls together the results of the prioritization exercise. The challenges and policy priorities identified in that exercise are shown, together with their links to the four strategic pillars, to six broad policy priorities, and to the twin goals. It is important to note that prioritization of some challenges does not imply that others can be ignored. All the issues discussed in this report are important for achieving sustainable, inclusive growth in Kazakhstan. The government will need to put time and resources into all of them.

Of the six areas of proposed policy priorities identified, the first four are linked directly to the four strategic pillars identified as critical to transition Kazakhstan's growth and governance model; two additional priorities underpin and support the transition. The priorities are summarized in figure 6.2 and discussed below.

[116] Note that the Country Opinion Survey did not poll stakeholders on the "longlist" of priorities as defined through the SCD, as this survey was carried out through a parallel process and completed prior to SCD identification of the longlist. However, many of the same issues are covered on both lists.

Figure 6.2: Priorities identified to eliminate poverty and build a large and secure middle class



1. **Adopting sound fiscal policy and reforming the financial sector to support sustainable diversification**: Building a diversified economy, driven by the private sector and competitive tradable sectors, requires a predictable macro-fiscal environment that ensures a stable, appropriately valued exchange rate and a financial system that allocates and prices credit according to market signals. Achieving this will require ongoing management of the monetary framework, fiscal consolidation, and sustainable, non-oil sources of revenue. It will also require reassessment of the government's ownership and financial support of sectors and firms (see policy priority 2, below). Finally, delivering on and sustaining these reforms will require strengthening macro policymaking at the senior level of government (see policy priority 6, below).

2. **Reducing state presence in the economy and supporting an environment for SME development**: The need to develop a more competitive, diversified private sector is well understood in Kazakhstan, and strategies and programs are in place to support the needed policies. But these efforts have been undermined by a macroeconomic environment that weakens competitiveness, a financial sector that fails to price and allocate resources effectively, and a governance environment that has created an uneven playing field, with SOEs and connected firms crowding out SMEs and potential innovators. Building a competitive, diversified private sector will require reducing the presence of SOEs, including in key network sectors like electricity. But it will also require wider measures to support contestable markets, by facilitating foreign direct investment (FDI) and opening markets to import competition, among other means. Finally, it will require more effective support of SMEs by enhancing the business regulatory environment and facilitating the development of competitive value chains in place of credit subsidies.

3. **Strengthening regional economies through infrastructure and agricultural value chains**: This report highlights the widening disparities in economic outcomes and access to services between Astana and Almaty cities and the rest of the country. Greater attention to developing sustainable regional economies will need to accompany support for worker mobility and the continuing emergence of Astana and Almaty as regionally as well as nationally competitive cities. Strengthening regional economies means developing hard and soft infrastructure to help

Kazakhstan take advantage of regional and global opportunities like the Belt and Road Initiative, as well as completing critical corridor developments and addressing deteriorating urban infrastructure (including roads and electricity), particularly in secondary cities. Finally, and perhaps most important, it will require developing a more diversified and competitive agricultural sector that includes opportunities for smallholders by strengthening agricultural value chains.

4. **Enhancing human capital by ensuring equal access to high quality education**: Kazakhstan's success in diversifying its economy and improving its governance will depend in a large part on the ability of its people to make the considerable adaptations required to compete in the economy envisioned by the new growth model. Enhancing human capital will require addressing large regional disparities in education quality. It will also require modernizing the education and skills development system to emphasize the types of knowledge and skills that can adjust to changing technologies and work environments.

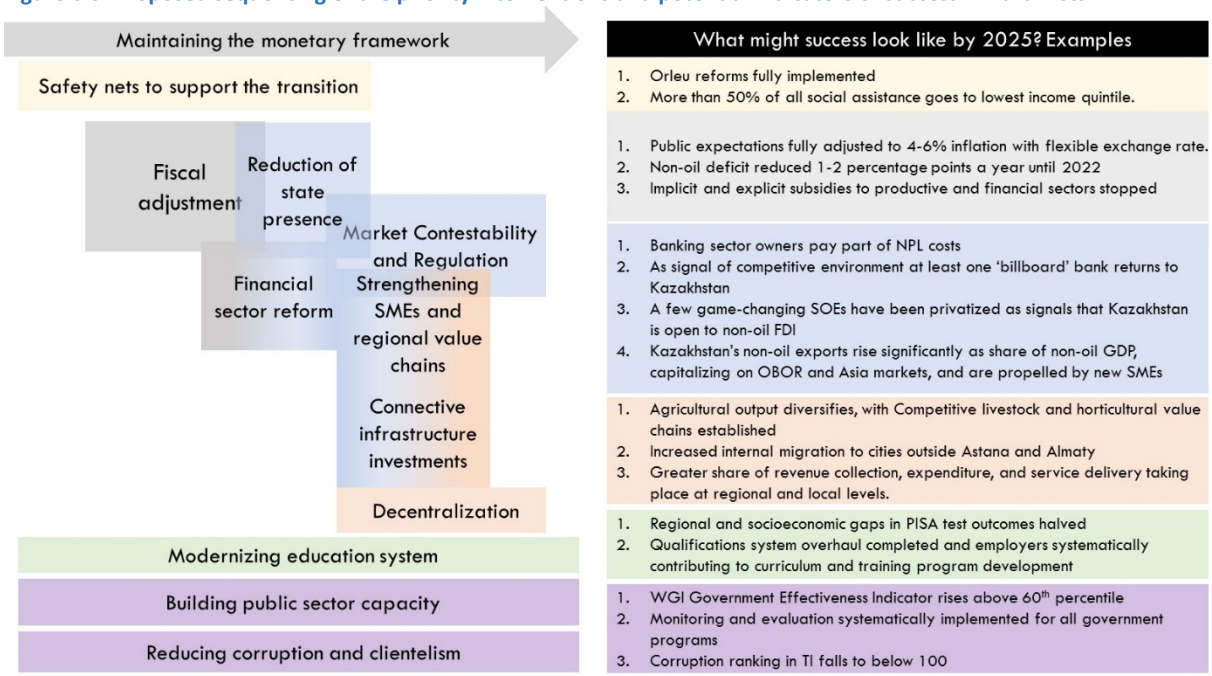
5. **Enhancing social protection to support the transition of the economic model:** The macroeconomic and structural reforms required to shift Kazakhstan's economic model will change the relative prices of tradables and nontradables, inducing large sectoral reallocations of labor. Similarly, SOE reform and privatization will likely result in shifts in the workforce. Transitional assistance for dislocated workers will be critical to mitigate risks of poverty and exclusion and to ensure the social sustainability of the reforms. Changes to the overall social protection system will also be needed, including targeting social assistance more closely to the poorest, reforming the pension system, and improving the reach and effectiveness of public employment services.

   Enhancing governance and strengthening public sector capacity*:* Delivering on all of these priorities will require modernizing and transforming Kazakhstan's institutions, so that they are more open, adaptable, and effective. Enhancing governance will require a wide-ranging set of actions to reduce corruption, strengthen justice institutions, and bolster the rule of law. Governance reforms can be supported by greater transparency and more attention to reinforcing citizen voice and government accountability, including through decentralization. Finally, delivery of these priorities will require strengthening the capacity of government to prioritize, implement, and monitor progress against clear objectives.

6.4 Implementing the priority interventions

Implementation of the policy priorities defined broadly above will require more comprehensive identification of policies and activities and close attention to sequencing. Some urgent reforms can be implemented fairly quickly. Others are best implemented after other reforms have established the right conditions. Still others require ongoing improvement. Figure 6.3 breaks out the policy priorities in more detail and outlines a proposed sequencing. It also includes examples of indicators of success that could be used to assess whether Kazakhstan has achieved the intended outcomes from these reforms.

Figure 6.3: Proposed sequencing of the priority interventions and potential indicators of success in Kazakhstan



Fiscal, financial sector, and safety net reforms, the foundation for developing a more diversified and competitive private sector, need to come first. The starting point is the monetary framework, continuing with the policies for maintaining a flexible exchange rate and an inflation targeting regime. In the short term, the emphasis should be on fiscal adjustment, keeping government spending sustainable in an environment of long-term low oil prices. A strategy to reduce public spending would depend largely on eliminating supports that reinforce the old structure of the economy, especially by imposing hard budget constraints on SOEs and the banking sector and sharply reducing or eliminating subsidies to traditionally protected sectors and companies. Complementing reduced spending must be a robust program to increase non-oil revenues over the next few years. Closely following and linked to these fiscal reforms are the substantial financial sector reforms needed to establish a more competitive environment for the private sector: overhauling and strengthening bank regulation, developing debt markets and credit markets, and strengthening non-bank financial institutions. The potential transitional impacts of these fiscal and financial sector reforms, along with the recent rise in poverty, makes strengthening social safety nets a parallel top priority. Doing so should include rolling out a nationwide program of conditional cash transfers to the poorest households (Orleu reforms), developing a more robust unemployment insurance program, and strengthening employment services and active labor market programs to support the transition of workers across jobs and sectors.

Building a diversified, competitive private sector, in an environment free of major macro-fiscal and financial sector distortions and with a level playing field and contestable markets, is the core of the reforms required to transition Kazakhstan's economic model. Key activities would be establishing a regulatory environment that enables SMEs to emerge, grow, and attract FDI, and substantially reducing the state presence in the economy. Privatization is part of the process, but a prerequisite is to clarify the regulatory environment, pricing policies, and government ownership goals in each sector. Bringing the competition and regulatory frameworks up to OECD standards will need to occur in parallel, to ensure that privatizations reduce concentrations of market power rather than simply transfer rents from the public sector to an entrenched elite. In addition, private sector support programs should shed or reduce subsidies (introducing sunset clauses, as needed) and include only programs that support

products in competitive markets. Support to SMEs should replace reliance on subsidized credit with measures to create an effective regulatory environment (which requires reforming inspections and enforcement), foster a domestic market for business development services, and encourage exports, including by strengthening value chains.

Measures to strengthen regional economies should be taken in parallel with efforts to transition the growth model, as many of the priority activities cross over both objectives. Value chain development should be linked to reforms in the agricultural sector. In addition, investments in connectivity—connecting internal urban agglomerations and connecting regional corridors—will be critical for capturing the medium-term opportunities of initiatives like Belt and Road and for supporting the growth of agglomerations outside Almaty and Astana. A related high priority in the short term is a program for financing the upgrading of urban infrastructure and public services. Finally, making real progress on decentralization, supported by capacity building of local officials, will be an important priority over the next five years.

Reforms to modernize and upgrade the education system need to be expanded and accelerated within the context of a long-term plan. Kazakhstan needs to speed up efforts to build a lifecycle approach to education and skills development, to better equip citizens to adapt to a changing labor market. Important steps over the next 5–7 years should include introducing programs that develop people's cognitive and socioemotional skills, starting with expanding access to early childhood education; overhauling the qualifications system; and deepening collaboration between knowledge and skills development institutions and employers to make skills training more relevant. Another top priority over the next five years is investment to close the gaps in education outcomes across socioeconomic and demographic groups and regions. Investments to improve the quality of healthcare services across the country will be an important complement to education to improve human capital.

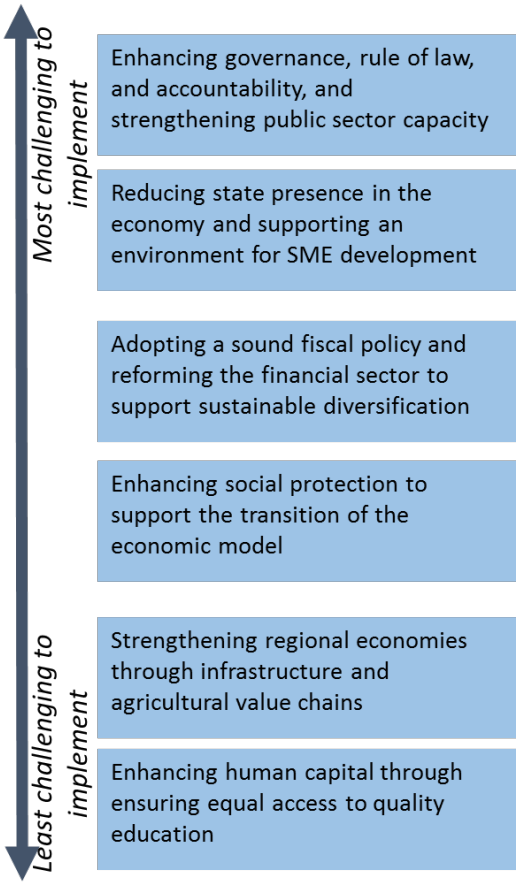
Delivering the reforms discussed above and achieving the objectives discussed in this report will require fundamental improvements in governance, perhaps the most urgent priority over the next few years. As with human capital, improving governance in Kazakhstan must be an ongoing effort, one that will bear fruit over a generation. Two areas of focus are reducing corruption and clientelism and enhancing public sector capacity. Reducing corruption will require continuation of programs to increase the transparency of government actions and decisions, including on procurement and support to sectors and firms. Enhancing public sector capacity will require taking apart the top-down approach to management, building stronger analytical and planning capacity in ministries, strengthening financial management skills and accountability, and establishing rigorous performance accountability processes, including systematic monitoring and evaluation of government programs and budgets. A number of additional priority governance reforms are vital to the delivery of the other priorities outlined in this report, including creating more space for citizen voice through decentralization and other actions that increase government transparency and accountability and establishing a more transparent competition and regulatory environment to level the playing field for firms.

The agenda outlined in this report does not differ significantly from the government's own agenda. Indeed, virtually all the priorities outlined above have already been identified in government policy and strategy documents, and interventions are under way on many of them. But the fact that strategies, policies, and programs have already been in place to address what are still being identified as priority challenges underscores the difficulties in implementation of this agenda.

A broad assessment of implementation challenges across priority areas needs to consider both capacity and political will (figure 6.4). Overall, the expectation is that addressing the issues of the education sector and strengthening regional economies—though by no means simple—have the best potential for effective implementation. This is in part because efforts are already underway in these

areas, but also, because there is relatively broad political will to address them. Perhaps most important, as compared to the greater complexity inherent in some of the other priorities, delivery on this agenda is largely a technical issue. Addressing aspects of the other priority issues runs into greater challenges of political economy and requires more fundamental changes in institutions.

Figure 6.4: Summary assessment of implementation challenges



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Annex 1: Detailed description and results of prioritization

To define priority interventions, each of 19 challenges identified in this report (table A1.1) was assessed against the six criteria shown in Box 6.1 of chapter 6. The analysis was carried out through two parallel assessments:

- **Desk assessment**: For each challenge, each criterion was scored on a 1–3 basis (low to high, in terms of importance of priority), based on its relative rating (small, medium, high; short, medium, long, etc.). Impact on the twin goals was separated to assess each independently: first, assessing the impact of eliminating extreme poverty; and second, assessing the impact on generating sustainable income and employment opportunities for the bottom 40 percent of the population, in order to build a large and secure middle class. The reason for separating the assessment of impact into these two issues is that Kazakhstan's levels of poverty are low and may be addressed effectively through a set of interventions that may well be different than those that are required to ensure sustainable improvements of livelihoods. Results are in table A1.2.
- **World Bank Group–wide consultations**: World Bank Group (WBG) units were asked to rank the five most important priorities from among the 19 challenges. In addition, discussions were held with WBG units in an August 2017 workshop. Inputs from in-country consultations, including from the Country Opinion Survey (figure A1.1), were also considered.

Table A1.3 summarizes the overall results of the desk prioritization assessment. Overall, around half (10) of the challenges emerged as having the highest priority (rated as among the top 5), while some others were identified as high priority in one of the two analyses.

Table A1.1: Summary of priority challenges, desired results, and links to achieving the twin goals

Strategic pillar	Priority challenges identified	Desired results	Links in the pillar to poverty reduction and shared prosperity
Economic management for diversification	Fiscal adjustment to low oil prices	Non-oil deficit reduced to sustainable level; forms anchor to guide fiscal policy	Supports sustainability of growth and makes country less susceptible to contagion and financial risk; restores credibility to fiscal policy, which supports investment and growth.
	Public debt management	Hard budget constraints imposed on SOEs and on supporting commercial banks. Overall, prudent government debt management in place, with sound policies for managing contingent liabilities.	As above; reducing support to SOEs and banking sector helps reduce Oil Fund and budget spending, contributing to a smaller, more sustainable non-oil deficit.
	Central bank independence	With legal and regulatory strengthening, Central Bank gains more independence in regulation and supervision of the banking sector, as well as in exchange rate management and monetary policy. Results in smoother adjustment to external environment and more level playing field in the financial sector.	Supports growth and sustainability of growth; supports competitiveness of the private sector and promotes exports through greater predictability in exchange rate. Levelling the playing field in the financial sector should lead to greater investment and credit availability.
	Corruption and the rule of law	Corruption lowered in four areas: procurement for SOEs, agencies that practice online inspection of enterprises, education services, and local government. Justice sector reforms introduced to ensure access to efficient, transparent, and objective rule of law.	A more level playing field for the private sector supports investment and job creation. Lower corruption in education should improve inclusion for disadvantaged and vulnerable households. Strengthened and accountable local government, along with strengthened justice system, supports a level playing field for the private sector while an enhanced voice for citizens helps bring equity and access to all women and men.
	Public sector management and responsiveness	Effective results-and client-oriented public administration that more effectively responds to citizens' needs, with strengthened strategic planning and implementation capacity, including improved public investment management, public finance management, project management, and monitoring and evaluation.	Improved government decision making, responsiveness, and delivery improves efficiency (reducing fiscal burden) and effectiveness (leading to better outcomes across all areas of government intervention); supports overall growth and inclusion, as well as social and economic sustainability.
Private sector–driver growth	SME development	SME contribution as share of GDP increases; SMEs expand into a broad range of sectors.	Support overalls growth; contributes to greater inclusiveness of growth.

Strategic pillar	Priority challenges identified	Desired results	Links in the pillar to poverty reduction and shared prosperity
	State role in the economy	Strategic privatizations completed with industry and subindustry visions known to the public and investors; role of state curtailed to regulation, where necessary, and strategic national interests (i.e. oil extraction, defense). Government support programs do not restrict competition and do not support individual enterprises, but provide industry know-how, conducive regulatory environment (e.g. permitting process), and infrastructure support to viable sectors.	Raises growth by supporting innovation, efficiency, competitiveness, and funding (domestic resources and FDI); supports sustainability through reduction in contingent liabilities. But can also lead to tariff adjustments, with an impact on inclusiveness (that needs to be offset by social programs) and redistribution of employment or layoffs. Reformed support to the private sector should result in a more competitive and sustainable industry sector, with jobs created based on market competitiveness not state support. Curtailing state support to SOEs and banking sectors signals a more privately-run economy, which also encourages investment and job creation.
	Contestable markets and regulation	Contested domestic markets with strong competition/regulation and opening of sectors to foreign provision (through FDI and trade), driving quality and cost effectiveness of key input and network sectors (e.g. energy sector)	Raises private sector investment and growth in employment-creating activities, by increasing returns to investment through lower costs and improved access to productivity enhancing spillovers; improves economic inclusion by ensuring fair access to economic opportunities by SMEs.
	Financial sector	A vibrant banking and nonbanking financial sector develops, with credit available and allocated in an efficient market.	Increased availability of credit to the economy raises investment and growth and supports inclusion through access to microentrenterprises and SMEs.
	Financial inclusion	Financial inclusion gaps closed, with broad access to credit for self-employed workers and SMEs, particularly those that are female-owned and rural.	Raises private sector investment in employment-creating activities and lowers vulnerabilities related to elimination of extreme poverty by increasing potential for investments in farm and nonfarm self-employment and SME sector.
Integration and connectivity	Trade, transport, and energy infrastructure	Connectivity gaps closed through improved transport infrastructure, trade facilitation, access to high quality and cost-effective ICT, and development of a competitive logistics sector. Better service and efficiency gained through integration and better connectivity of electricity	Improves access to markets and raises private sector investment in employment-creating activities by lowering input costs, improving connectivity and reliability, and increasing productivity; improves inclusion by opening access to all parts of the country.

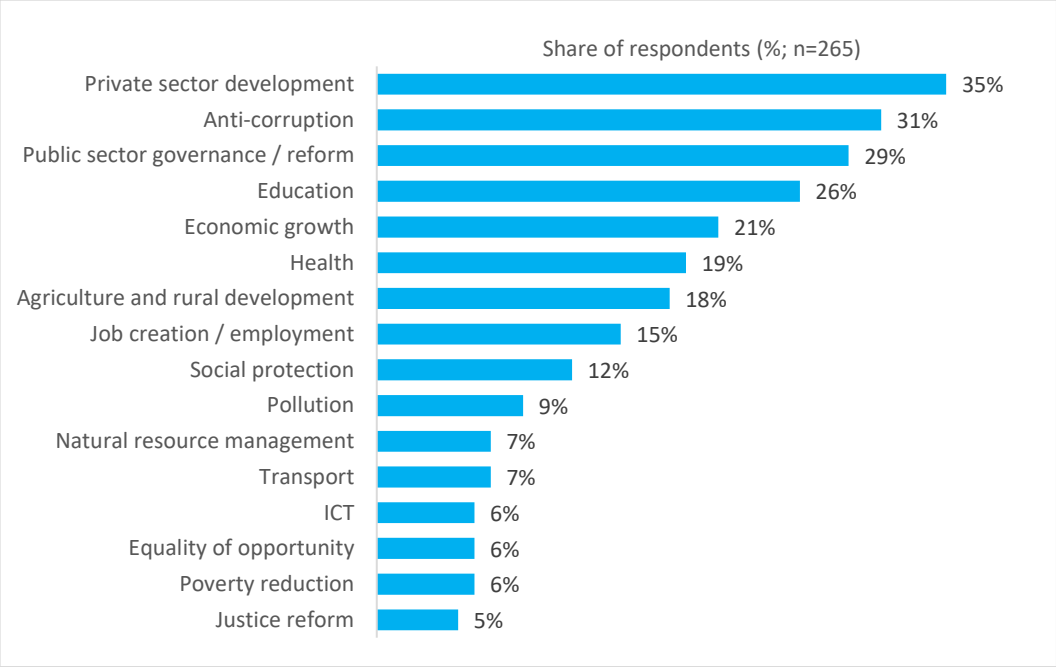
Strategic pillar	Priority challenges identified	Desired results	Links in the pillar to poverty reduction and shared prosperity
		systems in the country and in the region, as well as modernization of district heating systems in cities.	
	Agricultural value chain development	Competitive livestock and horticultural value chains developed that include extensive links with rural small producers and support sustainable regional economies.	Raises productivity and returns in the agricultural sector; supports inclusion by stimulating the nonfarm rural economy and creating earnings opportunities, including for women and youth, in areas where most of the poor are concentrated.
	Urbanization and mobility	Cities are strengthened as competitive locations for investment in diversified activities and provide high quality and cost-effective infrastructure and social services throughout the country.	Development of competitive agglomerations supports higher productivity (contributing to higher growth and higher quality jobs); greater opportunities for mobility directly supports earning opportunities for citizens outside of Astana and Almaty cities, ensuring greater inclusion.
	Voice and accountability	Greater regional and local autonomy, combined with fiscal and institutional capacity. Public transparency and accountability increased through open budget decision-making, integrated reporting and public feedback mechanisms. Overall, improved allocation of resources and delivery of services inclusively across rural and urban areas.	Decentralization supports inclusion as well as growth through improved capacity for bottom-up regional development, greater alignment between policy and public demand, greater responsiveness and flexibility to address local needs, and improved focus on communities and households that have been excluded from the country's growth.
Productive human capital and sustainable natural capital	Education and skills development	Kazakhstan's students substantially raise their performance in international tests; students from all locations and socioeconomic groups (boys and girls) given an equal opportunity to access high quality, relevant educational and vocational support, delivering a more productive and adaptive labor force.	Raises private sector investment in employment-creating activities by increasing productivity; improves inclusion by raising potential for labor market integration and more productive self-employment; promotes sustainability by focusing on youth (women and men) as a driver of change.
	Health	Life expectancy converging to OECD levels; geographically equitable health outcomes and reduced noncommunicable diseases; reduction in pollution causing adverse health outcomes; higher levels of patient satisfaction with care.	Contributes to growth by increasing productivity of employment and extending productive labor market participation of older workers and women; contributes to inclusion by reducing poverty among

Strategic pillar	Priority challenges identified	Desired results	Links in the pillar to poverty reduction and shared prosperity
			pension-age adults and reducing the care burden (mainly among women).
	Social protection	Full implementation of Orleu reforms, sustainable pensions, and broadened access to unemployment insurance and effective employment services.	Supports inclusion through reducing poverty and promoting labor market activation; increases mobility of workers across jobs, sectors, and locations. Critical to support the transition to the new economic and governance model.
	Clean energy and energy efficiency	Adoption of more efficient, sustainable practices of water and soil management in the agricultural sector	Greater efficiency of production and use of energy resources support lower energy expenditures and boosts the competitiveness of both public and private sectors; attention to clean energy supports the sustainability of energy resources and reduces climate, environmental, and public health burdens.
	Water resources management	More efficient production and use of energy, greater use of renewables, and much reduced production of greenhouse gases.	Supports sustainability of growth and the regional development priority by improving efficiency and sustainability of the agricultural sector, which is key to the livelihoods of poor households.

Table A1.2: Desk prioritization results

Challenge	Impact on eliminating extreme poverty (Small, Medium, High)	Impact on sustainable welfare improvements (Small, Medium, High)	Time horizon of impact (Short, Medium, Long)	Complementarities* (Weak, Medium, Strong)	Evidence base (Weak, Medium, Strong)	Adequacy of existing interventions (Weak, Medium, Strong)
Economic management for diversification						
Fiscal adjustment to low oil prices	Medium	Medium	Medium	Strong	Strong	Medium
Public debt management	Medium	Medium	Medium	Strong	Strong	Medium
Central Bank (NBK) independence	Small	Small	Medium	Medium	Medium	Weak
Corruption and the rule of law	Medium	Medium	Short	Strong	Weak	Weak
Public sector management and responsiveness	Medium	Medium	Short	Strong	Medium	Medium
Private sector development						
Financial sector	Small	Medium	Medium	Strong	Strong	Weak
Contestable markets and regulation	Small	Medium	Medium	Medium	Medium	Medium
State role in the economy	Small	Medium	Medium	Strong	Medium	Weak
SME development	High	High	Short	Strong	Medium	Medium
Financial inclusion	Medium	Medium	Medium	Medium	Weak	Medium
Integration and connectivity						
Trade, transport, and energy infrastructure	Medium	Medium	Medium	Medium	Medium	Medium
Agricultural value chain development	High	High	Medium	Weak	Weak	Weak
Urbanization and mobility	Medium	Medium	Medium	Medium	Medium	Medium
Voice and accountability	Medium	Medium	Medium	Medium	Strong	Weak
Productive and adaptive human and natural capital						
Education and skills development	High	High	Medium	Strong	Medium	Medium
Health	Small	Medium	Medium	Medium	Medium	Medium
Social protection	High	Medium	Short	Medium	Medium	Medium
Clean energy and energy efficiency	Small	Medium	Medium	Medium	Medium	Medium
Water resources management	Small	Medium	Short	Medium	Weak	Medium

Figure A1.1 Priorities identified in Country Opinion Survey



Note: Survey conducted in March, 2017 with individuals from Government of Kazakhstan, CSOs, think tanks, and media.

Table A1.3 Top-rated challenges identified through the desk prioritization and consultations

Rating	Strategic pillar	Priority challenges identified	
		Desk prioritization	WBG-wide consultations
Top-rated	Economic management for diversification	Fiscal adjustment Public debt management Corruption and the rule of law Public sector management and responsiveness	Corruption and the rule of law Public sector management and responsiveness
	Private sector–driven economic growth	SME development	Contestable markets and regulation State role in the economy
	Integration and connectivity	Voice and accountability	Agricultural value chain development
	Productive human capital and sustainable natural capital	Education and skills development	Education and skills development
Second-rated	Economic management for diversification	None	Fiscal Adjustment Public debt management
	Private sector–driven economic growth	Financial sector	None
	Integration and connectivity	Agricultural value chain development Trade, transport, and energy infrastructure Urbanization and mobility	Trade, transport, and energy infrastructure Voice and accountability
	Productive human capital and sustainable natural capital	Social protection	Health

Annex 2: Summary of consultations

World Bank Group (internal)	In Kazakhstan
February, 2017: SCD brainstorming / kick-off workshop *April, 2017*: Concept Note Review meeting *March-August, 2017*: one-on-one meetings with WBG technical experts and global practices *August, 2017*: SCD draft report review and prioritization workshop with country team and WBG practice / unit representatives *August-September, 2017*: Prioritization rankings	*January, 2017*: Initial consultations with think tanks *March, 2017*: Country Opinion Survey *June 15, 2017*: Presentation and discussion at Astana Economic Forum, including *Prime Minister, MPs, NGOs, and academia* *June 30, 2017*: SCD roundtable with Government and think tanks. Roundtable participants included: *MNE, MoF, MA, MID, MLSP, ERI, NAC, CMR, 'Talap'*

Annex 3: Assessment of key knowledge gaps

This annex identifies key knowledge gaps. These are topics that are critical to understanding the challenges facing Kazakhstan but for which there is limited quantitative and qualitative evidence for taking a clear position on what priority to assign to the issue or what interventions is required to address it. Table A3.1 summarizes these key knowledge gaps. It can be viewed as a set of research priorities for the government, development partners, academics, and research institutions over the next few years.

Table A3.1 Key knowledge gaps critical to understanding the challenges facing Kazakhstan

Knowledge gap	Description
Firms and productivity	Lack of access to firm-level microdata precludes a proper analysis of firm dynamics and productivity. This will be critical to understand better the role and performance of SMEs, performance and potential of diversified sectors, the factors that contribute to productivity at the firm level, and the allocative efficiency of the economy.
Regional economies	Given the high level of regional disparities and the importance placed on developing more competitive regional economies, it will be important to carry out more detailed assessments of the structure of regional economies, including firm performance and productivity (as per above). It will also be important to get a more qualitative understanding of local government structures and governance challenges at the regional and local level.
Planning, procurement, and public management: underlying factors of public sector effectiveness	While there is a sense that implementation of policies and programs has been ineffective, there remains relatively limited quantitative evidence (given the lack of rigorous monitoring and evaluation). There also remains limited understanding of the factors that contribute to weak implementation performance—e.g. the balance between capacity, institutional constraints, and political economy. Deepening understanding of these constraints will be important to identify the best approach to supporting improved public sector performance.

Annex 4: Statistical Performance of Kazakhstan

Kazakhstan has made significant progress in reforming and improving the national statistical system due in part to the World Bank–supported KAZSTAT project and the government's own initiative of e-*statistics* program. Based on the World Bank's recently developed Statistical Performance Index (SPI), Kazakhstan scored 73.6 out of 100 for 2016 (table A4.1).

The first dimension, Methodology, Standards, and Classifications (MSC), looks at whether countries follow internationally recommended methodology and standards in collecting and producing data. Kazakhstan gained a score of 80.0 in this dimension where Committee on Statistics (CS) has adopted more than 70 new and improved methodological guidelines in line with international standards during implementation of KAZSTAT project. The CS is still using SNA 1993, however preparation to move to the latest international standard (SNA 2008) is underway and will be completed soon. By updating the national accounts and CPI base year with annual chain linking, the country will be able to capture its national economy in advanced and accurate way. Also, the country could further improve its score by adopting noncash recording basis for consolidated central government accounting and following the latest government finance statistics manual.

The Censuses and Surveys (CS) section checks whether countries have conducted major censuses and surveys in internationally recommended form and frequency. Kazakhstan received a high score of 87.5 in this section. The Kazakh statistical system does a good job conducting timely population and housing census, agriculture census and regular Household Budget Surveys and Labor Force Surveys.

In terms of Dissemination Practices and Openness (DPO) that assesses the dissemination capacity of national statistical systems, Kazakhstan scored relatively high at 71.43. The CS does provide an advance release calendar, reusable and easy access to time series data and metadata, as well as a comprehensive, well-developed data portal. The user satisfaction survey results for CS was 94 percent and the website received over 3.5 million visits over the Internet in 2015. By listing of surveys, microdata, and featuring geospatial data, CS can further improve their score.

The fourth dimension, Availability of Key Indicators (AKI), checks the availability of selected core indicators in international organizations and databases. The country score was prepared using World Development Indicators database as of March 2017. Kazakhstan received sub-score of 50 with data from 2016. The score shows that Kazakhstan has the latest available data on poverty, child immunization, adult literacy rate and completion rate, water and sanitation, and national accounts. More recent data on social indicators such as stunting, maternal mortality rate, skilled health care workers particularly unemployment and up-to-date CRVS data are missing.

There is usually a two-year gap between the calendar year and the data that are incorporated to the WDI database. In other words, few advanced systems can produce the latest data within first quarter of the next calendar year. For Kazakhstan and other advanced economies, the relatively low AKI score is likely to improve as long as the process and channels of submitting and reporting of data to the primary international organizations configured since the latest survey and methodology is already in place.

The total score of 73.6 leaves a room for improvement of the statistical system particularly in areas of Sustainable Development Goals, External Trade, and National Accounts statistics to properly inform evidence-based decision-making process as well as monitoring and evaluating the development progress in coming years. CS has drafted the Statistical Master plan for 2017–25 to further integrate activities and improve the statistical system and added a proposal to create a research and training institute in Kazakhstan based on the best practices of the advanced economies to train the relevant staff and employees.

Detailed Scoring Matrix of the SPI for Kazakhstan

Methodology, Standards & Classifications						
#	**Indicator**	**Score 1**	**Score 0.5**	**Score 0**	**Weight**	**Weighted score**
1	System of National Accounts in use	SNA2008/ESA 2010	SNA1993/QNA Manual 2001/ ESA 1995	Otherwise	1	0.5
2	National Accounts base year	Annual chain linking	Within past 10 years	Otherwise	1	0.5
3	Classification of national industry	Latest version is adopted (ISIC Rev 4, NACE Rev 2 or a compatible classification)	Previous version is used (ISIC Rev 3, NACE Rev 1 or a compatible classification)	Otherwise	1	1
4	CPI base year	Annual chain linking	Within past 10 years	Otherwise	1	1
5	Classification of household consumption	Follow Classification of Individual Consumption by Purpose (COICOP)	N.A.	Otherwise	1	1
6	Classification of status of employment	Follow International Labor Organization, International Classification of Status in Employment (ICSE-93)	N.A.	Otherwise	1	1
7	Central government accounting status	Consolidated central government accounting follows noncash recording basis	Consolidated central government accounting follows cash recording basis	Otherwise	1	0.5
8	Compilation of government finance statistics	Follow the latest Government Finance Statistical Manual (2014)	Previous version is used (GFSM 2001)	Otherwise	1	0.5
9	Compilation of monetary and financial statistics	Follow the latest Monetary and Finance Statistics Manual (2000) or Monetary and Finance Statistics: Compilation Guide (2008)	N.A.	Otherwise	1	1
10	SDDS/e-GDDS subscription	Subscribing to IMF SDDS standards	Subscribing to IMF e-GDDS standards	Otherwise	1	1
	Maximum category score: 10				**10**	8
	MSC Country Score = Weighted Score / Maximum Category Score X 100					80
	Country Score					**80**

Censuses and Surveys

Censuses

#	Indicator	Score 1	Score 0.5	Score 0	Weight	Weighted score
1	Population & Housing census	Population census done within last 10 years	Population census done within last 20 years	Otherwise	1	1
2	Agriculture census	Agriculture census done within last 10 years	Agriculture census done within last 20 years	Otherwise	1	1
3	Business/establishment census	Business/establishment census done within last 10 years	Business/establishment census done within last 20 years	Otherwise	1	
					3	2

Surveys

#	Indicator	Score 1	Score 0.6	Score 0.3	Score 0	Weight	Weighted score
4	Household Survey on income/ consumption/expenditure/ budget/Integrated Survey	3 or more household surveys done within past 10 years;	2 household surveys done within past 10 years;	1 household survey done within past 10 years;	None within past 10 years	1	1
5	Agriculture survey	3 or more agriculture surveys done within past 10 years;	2 agriculture surveys done within past 10 years;	1 agriculture survey done within past 10 years;	None within past 10 years	1	1
6	Labor Force Survey	3 or more labor force surveys done within past 10 years;	2 labor force surveys done within past 10 years;	1 labor force survey done within past 10 years;	None within past 10 years	1	1
7	Health/Demographic survey	3 or more health surveys done within past 10 years;	2 health surveys done within past 10 years;	1 health survey done within past 10 years;	None within past 10 years	1	1
8	Business/establishment survey	3 or more business/establishment surveys done within past 10 years;	2 business/establishment surveys done within past 10 years;	1 business/ establishment survey done within past 10 years;	None within past 10 years	1	1
						5	5
	Maximum category score: 8					8	**7**
	CS Country Score = Weighted Score / Maximum Category Score X 100						87.5
	Country Score:						**87.5**

Dissemination Practices & Openness

1) Dissemination capacity of NSO

#	Indicator	Score 1	Score 0	Weight	Weighted score
1	NSO has an Advance Release Calendar and it is published	Yes	No	1	1
2	NSO has a listing of surveys and microdata sets (or NADA)	Yes	No	1	0
3	NSO has a data portal	Yes	No	1	1
4	Time series indicators are available for download in reusable format for free	Yes	No	1	1
5	Metadata is available providing definition, methodology, standards or classifications for existing data series	Yes	No	1	1
6	NSO has conducted a user satisfaction survey	Yes	No	1	1
7	Geospatial data available on NSO website	Yes	No	1	0
		Maximum score for sub-category: 7		**7**	**5**

2) Openness of data

#	Indicator	Score		Weight	Weighted score
8	Open Data Inventory	ODIN Score/100	Year: 2016; ODIN score: 46.8; Overall World Rank: 51	0	N.A.
	Maximum score for sub-category: 0				
	Maximum category score: 7			7	5
	DPO Country Score = Weighted Score/ Maximum Category Score X 100				71.43
	Country Score:				**71.43**

Availability of Key Indicators

#	Indicator	Score 1 - Data available for the latest year	Score 0	Weight	Weighted score
1	Proportion of population living below the national poverty line	Yes	No	1	1
2	Prevalence of stunting among children under 5 years of age	Yes	No	1	0
3	Maternal mortality ratio	Yes	No	1	0
4	Proportion of births attended by skilled health personnel	Yes	No	1	0
5	Child immunization (proportion of one-year-old children immunized against measles)	Yes	No	1	1
6	Primary completion rate, both sexes (%)	Yes	No	1	1
7	Adult literacy rate, population 15+ years, both sexes (%)	Yes	No	1	1
8	Proportion of population using safely managed drinking water services	Yes	No	1	1
9	Unemployment, total (% of total labor force)	Yes	No	1	0
10	Manufacturing value added as a proportion of GDP	Yes	No	1	1
11	Gross capital formation (% of GDP)	Yes	No	1	0
12	GDP implicit price deflator (annual % growth)	Yes	No	1	1
13	Net trade in goods and services (BoP, current US$)	Yes	No	1	1
14	Growth rates of household expenditure or income per capita among the bottom 40 per cent of the population	Yes	No	1	0
15	Proportion of children under 5 years of age whose births have been registered with a civil authority (completeness of birth registration)	Yes	No	1	0
16	Completeness of death registration with cause-of-death information	Yes	No	1	0
	Maximum category score: 16			**16**	**8**
	Availability of Key Indicators Country Score = Weighted Country Score/ Maximum Category Score X 100				50
	Country Score:				**50**

Total SCI score	***73.58***

No.	Indicator	Score 1 - Data available for the latest year	Score 0	Weight	Weighted score
Availability of Key Indicators					
1	Proportion of population living below the national poverty line	Yes	No	1	1
2	Prevalence of stunting among children under 5 years of age	Yes	No	1	0
3	Maternal mortality ratio	Yes	No	1	0
4	Proportion of births attended by skilled health personnel	Yes	No	1	0
5	Child immunization (proportion of one-year-old children immunized against measles)	Yes	No	1	1
6	Primary completion rate, both sexes (%)	Yes	No	1	1
7	Adult literacy rate, population 15+ years, both sexes (%)	Yes	No	1	1
8	Proportion of population using safely managed drinking water services	Yes	No	1	1
9	Unemployment, total (% of total labor force)	Yes	No	1	0
10	Manufacturing value added as a proportion of GDP	Yes	No	1	1
11	Gross capital formation (% of GDP)	Yes	No	1	0
12	GDP implicit price deflator (annual % growth)	Yes	No	1	1
13	Net trade in goods and services (balance of payments, current US$)	Yes	No	1	1
14	Growth rates of household expenditure or income per capita among the bottom 40 percent of the population	Yes	No	1	0
15	Proportion of children under 5 years of age whose births have been registered with a civil authority (completeness of birth registration)	Yes	No	1	0
16	Completeness of death registration with cause-of-death information	Yes	No	1	0
	Maximum category score: 16			**16**	**8**
	Availability of Key Indicators Country Score = Weighted Country Score/ Maximum Category Score X 100				50
	Country Score:				**50**

Total SCI score	***73.58***

Annex 5: Bibliography of studies and reports informing the Systematic Country Diagnostic

Table A5,1 provides an overview of key documents informing the SCD. It is organized according to WBG global practices. World Bank Group documents include Advisory Services and Analysis products, including under Reimbursable Advisory Services (RAS) and World Bank administrative Budget (BB). Some projects (P) are included in this list because documentation may be useful; all OECD documents are available at http://www.oecd.org/countries/kazakhstan/.

Table A5.1 List of studies and reports from World Bank, European Bank for Reconstruction and Development, Asian Development Bank, and Organisation for Economic Co-operation and Development

WBG global practice	Title
Macro & Fiscal	Growth/Development (RAS) Brainstorming on New Sources of Growth (FY17) (RAS) Development of the Strategic Plan for 2025 (FY16) (BB) Country Economic Memorandum (FY13) (OECD) Multi-dimensional Review of Kazakhstan - Volume 1. Initial Assessment (2017) (OECD) Multi-dimensional Review of Kazakhstan - Volume 2. In-depth Analysis and Recommendations (2017) (NU) Kazakhstan 2050 (2015) (P) Programmatic DPO (closed Dec 16, 2016) Fiscal work (BB) Public Finance Review (FY17-18) (RAS) Enhancement of Fiscal Sustainability (FY16) (RAS) Development of Medium-Term Counter-Cyclical Macro-Economic Policy (FY13-14) Informality (RAS) Impact of Systemic Measures to the Level of Shadow Economy (FY15)
Finance & Mkts	(RAS) Insolvency System Improvement (FY13-16) (RAS) Strengthening Stability of Financial Sector (FY15-16) (RAS) Govt Securities Yield Curve Formulation (FY13-14) (RAS) Transborder Money and Monetary Instruments Transfer (AML/CFT) (FY13-15) (BB) Financial Sector Monitoring (FY13-14) (P) Catastrophe Insurance System Development Project (GEF) (ADB) Enhancing Insurance Market Efficiency and Outreach

Trade & Comp	Overall assessment (EBRD) Kazakhstan Diagnostic Paper: Assessing Progress and Challenges in Developing a Sustainable Market Economy (2016) (OECD) OECD Investment Policy Reviews: Kazakhstan 2017 (2017) (OECD) OECD Reviews of Innovation Policy: Kazakhstan 2017 (2017) (ABD) Report to the Government of Kazakhstan: Policies for Industrial and Service Diversification in Asia in the 21st Century (2015) (ADB) Systematic Country Diagnostic with a Focus on Agriculture, Downstream Oil and Gas, Services-Logistics (Forthcoming June 2017) Regulation (RAS) Investment Attraction and Retainment (FY15-17) (RAS) Improving Conditions for Doing Business to Increase Competitiveness and Facilitate Econ. Diversification (FY13-14) (BB) GEMLOC Kazakhstan (FY115) (RAS) Improvement of Competitiveness through Reduction of Trade Barriers (FY13-14) (OECD) Responsible Business Conduct in Kazakhstan (2014) Competitiveness (BB) Dialogue and Next Steps in Competitiveness (FY17) (TF) Competitiveness and Economic Diversification (FY15-16) (RAS) Identification of Potential Barriers to New and Emerging Industries and Sectors with Fluctuating Growth Splashes on Domestic and Export Markets (FY14) (OECD) Kazakhstan-Sector Competitiveness Strategy (2012)–includes Agribusiness, Wheat, Beef, Dairy, Chemicals, Logistics for Agribusiness, IT for Business Services Competition policy (RAS) Improved Policy for Competition Protection (FY14)
Trade & Comp (cont.)	Investment support (RAS) Implementation Support for Establishment of Transparent System in Selection, Monitoring and Evaluation of Innovation Grants (FY15) (RAS) Enhancing Productivity and Competitiveness through Enterprise Modernization Support Mechanisms (FY13) (OECD) Boosting Kazakhstan's National Intellectual Property System for Innovation (2016) (P) Fostering Productive Innovation (P) SME Competitiveness Project (EBRD) Export oriented SMEs (RAS) Services Sector Gap Analysis (FY15) (EBRD) Selena FM company financing Sector support (RAS) Sectoral Assessment for Industry 4.0 (FY17)

	(RAS) Analysis of the effectiveness of current measures to support domestic industries and develop possible adaptation measures consistent with WTO Rules (FY15) (EuDB) Almaty Big Ring Road
Governance	Revenues (RAS) Revenue Code Development (FY16-17) (RAS) TA in Selected Tax Area (FY14-15) (RAS) TA on Integration of Fiscal Agencies (FY15) (OECD) Global Forum on Transparency and Exchange of Information for Tax Purposes Peer Reviews: Kazakhstan 2015 - Phase 1: Legal and Regulatory Framework (2015) (P) Tax Administration Reform Project Justice (P) Justice Sector Institutional Strengthening Project (EU) Support to judicial reform in Kazakhstan: enhancing criminal justice through support to reform of the penal process and of the procedure for enforcing judicial acts Budgeting (RAS) New Budget Code Development (FY16) (RAS) Results Based Budgeting (FY14-16) (RAS) Introduction of Basic Principles for Result-Oriented Budget (FY13-14) International Public Sector Accounting Standards (IPSAS) Gap Analysis Accounting and Auditing Report on the Observance of Standards and Codes (FY06) Voice (EU) Strengthening the capacity of Kazakhstani civil society and media to promote freedom of expression (EU) Empowering South Kazakhstan Civil Society Organizations to promote Human Rights Fiduciary (BB) Country Fiduciary Systems Review (FY14-15) (RAS) Strengthening Public Sector Internal Audit (FY13-17)
Governance (cont.)	Various (RAS) TA in Civil Service Reform Area (FY13-14) (OECD) Kazakhstan: Review of the Central Administration (2014) (OECD) Kazakhstan must sharpen its strategy and raise impact of its anti-corruption measures (2014) Private Sector related

	(RAS) Implementation of the Entrepreneurship Regulation Concept (RIA) (FY15-16) (RAS) Review of Intl Practices to Improve SOE Structure (FY16) (OECD) Regulatory Policy in Kazakhstan: Towards Improved Implementation (2014) (P) KAZSTAT Project
PPP	(RAS) Attracting Investment into Economy through Devt of Policy and Inst Mechanisms for PPP (FY15-16)
Education	(RAS) Education System Analysis and Improvement (FY13-16) (RAS) Expertise of E-Learning System (FY14) (BB) Education Efficiency Review (FY14-15) (BB) Higher Education Sector Briefing (FY16) (OECD) Higher Education in Kazakhstan 2017 (2017) (OECD) A Skills beyond School Review of Kazakhstan (Voc Train) (2014) OECD Reviews of School Resources: Kazakhstan 2015 (OECD) Enhancing Skills through Public-Private Partnerships in Kazakhstan's Information Technology Sector (2013) (P) Education Modernization project (P) Skills and Jobs Project (P) Youth Corps Program
Health	(RAS) Health Insurance System Improvement (FY15-16) (P) Social Health Insurance Project (P) Health Sector Technology Transfer Project
Social Protection and Jobs	(RAS) Improvement of Social Safety Net (FY13-17) (RAS) Social Policy for Growth: Modernization of the Social Sphere (FY13-14) (RAS) Review of Adequacy of Pension Income (FY13) (RAS) Migration Policy Advice (FY14) (RAS) Development of Options for Pension System Improvement (FY15) (RAS) Jobs - Sector Specific Analysis of Barriers and Opportunities (FY15) (RAS) Develop a Strategy to Support Functioning of Labor Market Institutions (FY15) (BB) Towards Development of a Jobs Strategy (FY16-17) (P) Skills and Jobs Project
Agriculture	(RAS) Preparation for the 2nd National Agro Census (FY15) (RAS) Analysis of the effectiveness of current measures to support agriculture (FY15-16) (RAS) Improvement of Approach to Agricultural Strategy, Policy and Budget Formulation (FY13-14) (RAS) Investment Promotion in High Value Food Supply Chains and Retailing (FY13-14)

	(RAS) Identifying Priorities for Sustainable Development of Animal Nutrition (FY14) (ADB and EBRD) RG Brands Agribusiness financing (OECD) Producer and Consumer Support Estimates database (incl Kazakhstan) (2016) (OECD) OECD Review of Agricultural Policies: Kazakhstan 2013 (OECD) Improving Access to Finance in Kazakhstan's Agribusiness Sector (2013) (EBRD) Savola Foods CIS company financing (EBRD) Soufflet company financing
Environment NR	
Energy Extract	(RAS) Supporting the Extractive Industries Transparency Initiative (FY13-15) (RAS) Analysis of International and Local Experience in Legislative Regulation in Mining Sector (FY13-14) (RAS) Comparative Study of Tax Regimes in Mining (FY14) (OECD) Energy Policies Beyond IEA Countries: Eastern Europe, Caucasus and Central Asia (2015) (P) Energy Efficiency Project (P) Ust-Kamenogorsk Environmental Remediation Project (cld Dec-16) (ADB) Akmola Electricity Distribution Network Modernization and Expansion Project (EBRD) Energy projects
SUR	(RAS) Further Improvement of the Legal Framework for Housing and Communal Utilities Sector (FY14) (RAS) Reforming of Housing and Communal Services Sector - Central Heating (FY15) (RAS) on Development of Urban Agglomerations (FY15-17) (RAS) Sub-National Doing Business (FY16-17) (OECD) OECD Urban Policy Reviews: Kazakhstan (2017)
Transport ICT	(TF) Building Safer Roads (FY17-18) (RAS) Improvement /Further Development of Logistical System (FY13) (BB) Transport Strategy 2020 (FY14) (TF) Railways Strategic Logistics (FY15-16) (RAS) Analytical Support to Digital KZ 2020 Program (FY16-17) (P) South-West Roads Project (P) East-West Roads Project (EDB) Automobile factory (IsDB) Reconstruction of Atyrau-Astrakhan Road (IsDB) Almaty Ring Road Project (ADB) Road Maintenance Sustainability Project (ADB) Kazakhstan: CAREC Corridors Connector Roads (EBRD) Urban Transportation

Water	(RAS) Implementation Support for Modernizing and Strengthening Efficiency of Irrigation (FY15-16) (RAS) Development of a Road Map for Strengthening Water Management for Improved Water Efficiency and Security (FY15) (OECD) Sustainable Business Models for Water Supply and Sanitation in Small Towns and Rural Settlements in Kazakhstan (2016) (OECD) National policy dialogue (NPD) in Kazakhstan (2014) (P) Irrigation and drainage Phase 2 (IsDB) Third Irrigation & Drainage Improvement
CC & Green Growth	(OECD) GREEN Action Programme: Greening the Economy in Eastern Europe, Caucasus and Central Asia (OECD) Green growth in countries and territories
SD VPU	(P) Kazakhstan: Joint Government of Kazakhstan and the Asian Development Bank Knowledge and Experience Exchange Program, Phase 2 (EU) Regional coordination and support for the EU-Central Asia enhanced regional cooperation on Environment, Climate Change and Water
DRM	(RAS) Probabilistic Disaster Risk Assessment and Risk Financing Strategy (FY14-15)