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Kazakhstan:
On the Crest of the Oil Wave

Kazakhstan Economic Update | Spring 2013

THE WORLD BANK

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Government Fiscal Year:	January 1–December 31
Currency Equivalents:	(Exchange Rate Effective as of March 31, 2013)
	Currency Unit=Kazakhstan Tenge
	US$ 1.00=KZT 150.84
	KZT 1.00=US$ 0.0066
Weights and Measures:	Metric System

Abbreviations and Acronyms

BCC	Bank CenterCredit
BTA	BTA Bank
CEM	Country Economic Memorandum
CU	Customs Union between Belarus, Kazakhstan and Russia
DECPG	WB Development Prospects Group
DB	Doing Business report
EBRD	European Bank for Reconstruction and Development
ECCKZ	WB Country Office in Kazakhstan
ECSP1	WB Macroeconomics Cluster 1
ECU	Eurasian Customs Union
EU	European Union
FTA	Free Trade Agreement
FX	Foreign exchange
GDP	Gross domestic product
HR	Human resources
IMF	International Monetary Fund
IPO	Initial public offering
KKB	Kazkommertsbank
MEBP	Ministry of Economy and Budget Planning
MEP	Ministry of Environment Protection
MLSP	Ministry of Labor and Social Protection
MRD	Ministry for Regional Development
NAD	National Agency for Development
NBK	National Bank of Kazakhstan
NPLs	Non-performing loans
OECD	Organization for Economic Co-operation and Development
PISA	Program for International Student Assessment
PPP	Purchasing power parity
RER	Real exchange rate
SMEs	Small and medium size enterprises
SPVs	Special purpose vehicles
WB	World Bank
WEF	World Economic Forum
WTO	World Trade Organization

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Acknowledgements

This report was jointly prepared by the Kazakhstan country economists, Ilyas Sarsenov and Dorsati Madani (both ECSP1). The authors are grateful for a valuable support and guidance provided by the Bank management, Sebnem Akkaya (Country Manager, ECCKZ), Ivailo Izvorski (Sector Manager, ECSP1), and Francisco Carneiro (Country Sector Coordinator, ECSP1). The last section of the report (with a special focus on the issue of a skills mismatch in Kazakhstan) has benefited from inputs provided by the Human Development team as part of the work associated with the Kazakhstan Country Economic Memorandum. The formatting of the report was done by Budy Wirasmo. The cover images were taken by Maxim Zolotukhin, Kubat Sydykov and Christophe Bosch.

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Overview

Kazakhstan is on the crest of the oil wave and has had a wonderful ride so far, but what happens next will depend on how well the country advances initiatives in creating the favorable conditions for the diversification of its endowments—human, physical, and institutional capital—to continue prospering in the years ahead.

Following two years of strong economic recovery from the crisis of 2008-2009, the economy of Kazakhstan slowed down. Real GDP growth in Kazakhstan slowed from 7.5 percent year-on-year in 2011 to 5 percent in 2012 due to supply constraints in industry and agriculture. Against poor outcomes in industry and agriculture, economic activity was driven mainly by domestic consumption of goods and services, supported by higher revenue from commodity exports. In 2012, favorable terms of trade impacted positively on the external position of the country (current account surplus of 3.8 percent of GDP) and on fiscal accounts of the government (consolidated budget surplus of 4.5 percent of GDP). The economy is expected to grow by about 5 percent in 2013, supported by a normalization of production in industry and agriculture, while a possible worsening in terms of trade may slightly affect demand for the services sector, as well as the twin surpluses in the current account and fiscal balances. Real income gains, that have significantly improved poverty indicators, are expected to continue, contributing to poverty reduction in Kazakhstan over the medium term.

Macroeconomic policy remains largely prudent and responsible, while large stock of non-performing loans in the banking sector is gradually being addressed. The government continued following a conservative fiscal policy by controlling budget spending and accumulating oil revenue savings in the oil fund, which by the end of 2012 reached $65 billion or 32.5 percent of GDP, the biggest fiscal buffer ever. Monetary policy was more accommodating and led to higher bank lending to the economy last year. Nevertheless, although the fallout of the 2007 financial crisis has been managed through bank interventions, restructurings, and extensive liquidity provision, the banking sector has not fully recovered yet. While reported capital adequacy appears healthy and bank liquidity is ample, non-performing loans (NPLs) remain high—37 percent of total loans as of end-2012—and constrain the banks' ability to provide fresh credit to the non-oil sector. This is being addressed by improving the insolvency regime and implementing the government's strategy to finalize the resolution of the NPL crisis.

Looking forward, Kazakhstan's development objective of joining the rank of the top 30 most developed countries by 2050 will depend on its ability to sustain balanced and inclusive growth. In the near- to medium-term, economic prospects depend on a continuation of stability-oriented macroeconomic policies which hinge on continued adherence to the rules-driven framework for resource earnings and sustainable financial sector development. Enhancing medium- to long-term development prospects depends on the Kazakhstan success in diversifying its endowments—namely, creating highly skillful human capital, improving quality of physical capital, and, more importantly, strengthening institutional capital—all the necessary ingredients for development and expansion of the private sector in the country. Pursuing the recently launched 'green growth' vision is also essential to enable a more environmentally sustainable growth in the long run.

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A. Recent Political Developments

Kazakhstan has set a new long-term target to join the rank of the top 30 developed countries by 2050

President Nazarbayev presented a new 'Kazakhstan-2050' vision that lays out the long-term development goals for the country. In his annual address to the nation the president took stock of progress achieved under the 2030 Development Strategy, provided his view of key global challenges Kazakhstan faces, and outlined how the country would refine its long-term socio-economic strategy to join the top 30 developed countries by 2050 (Box 1). He noted the importance of economic pragmatism based on market economy principles, regional and global integration, improved business environment leading to private sector growth, and increased exports and diversified sources of economic growth. He highlighted the criticality of maintaining disciplined fiscal and monetary policies to ensure a solid management of the natural resources; investing in infrastructure, education, innovation to sustain a diversified and inclusive growth; and moving towards a 'green economy' to ensure environmentally sustainable growth. He also outlined specific visions for industrialization through public-private partnership, agriculture and the role of small- and medium-size enterprises (SMEs) and entrepreneurship.

Box 1. The Main Features of the New Strategy 'Kazakhstan-2050'

On December 14, 2012 the President in his address to the nation of Kazakhstan outlined the following seven main focus areas of the new long-term strategy 'Kazakhstan-2050':

1. **New economic policy,** covering the issues of managerial potential in the public and private sectors, favorable investment climate, new industrialization program, infrastructure development, natural resource management, and agriculture development and support.
2. **Entrepreneurship development policy,** covering the issues of SME development, public-private partnerships, and People's IPO.
3. **New social policy,** covering the issues of employment, migration, targeted social assistance, mother and child care, and health of the nation.
4. **Knowledge and skills development policy,** covering the issues of technical and vocational education, technology transfer, and youth initiative.
5. **Public service delivery and improved governance,** covering the issues of state strategic planning, professionalism of civil service, decentralization of power through local self-governance, anti-corruption legislation improvement, and reform of enforcement agencies.
6. **Balanced foreign policy,** promoting national economic interests and strengthening regional and global security.
7. **Multi-ethnic and multi-religious society approach,** covering the issues of multinational society with equal rights for all ethnicities, the role of Kazakh language, and multi-confessional tolerant approach in religion.

Source: Nazarbayev, Nursultan (2012), "Strategy 'Kazakhstan-2050'", The President's Address to the Nation of Kazakhstan, Astana.

To make all this happen, the president noted that the government and its role in the economy needed to be reformed. He sketched out a new role for the government, including privatization through initial public offerings to the population (People's IPO). Creation of a professional state apparatus is deemed critical to the success of the 'Kazakhstan-2050' strategy. This will be done through a number of reforms: a second phase reform of modernizing the civil service and an enhanced system of managing public assets to improve their management and governance. The president promoted decentralization of power, including immediate initiatives such as elections—for the first time—for more than 90 percent of local governor positions starting in 2013. He defined new principles for social policy that would provide minimal social protection and targeted social protection; address social imbalances amongst the regions; modernize labor policy as well health and education services; and encourage innovation.

Following the 'Kazakhstan-2050' vision announcement, the government structure has been realigned to match the additional priorities

The government structure has been revised to align with the additional long-term priorities identified by the president. In January 2013, a new Ministry for Regional Development (MRD) was established to oversee formulation and implementation of the regional development policy, including entrepreneurship support, housing and communal services, and land resource management. The authority of the Ministry of Labor and Social Protection (MLSP) was expanded to cover migration policy enforcement. The Ministry of Economy and Budget Planning (MEBP; reorganized from the Ministry of Economic Development and Trade), apart from its budgeting function, was also put in charge of formulating a 'green growth' strategy while the Ministry of Environmental Protection (MEP) will be in charge of implementing the strategy. All other ministries were tasked to adjust their existing functions accordingly. Furthermore, the government intends to create a new National Agency for Development (NAD) with a clear mandate to serve the new 'Kazakhstan-2050' vision. The NAD will consolidate all national development institutions[1] under its umbrella with the aim to improve their performance and refine their focus on supporting the private sector development in the country.

1 The history of state-owned development institutions started in 2001 when the Development Bank of Kazakhstan was established. There were a number of other development institutions established since then, including the Investment Fund of Kazakhstan, the National Innovation Fund, the Kazakhstan Export Insurance Corporation KazExportGarant, the Kazakhstan Center for Investment Promotion KazInvest and others. Currently, state-owned development institutions are split between the state-owned conglomerate Samruk-Kazyna and various ministries.

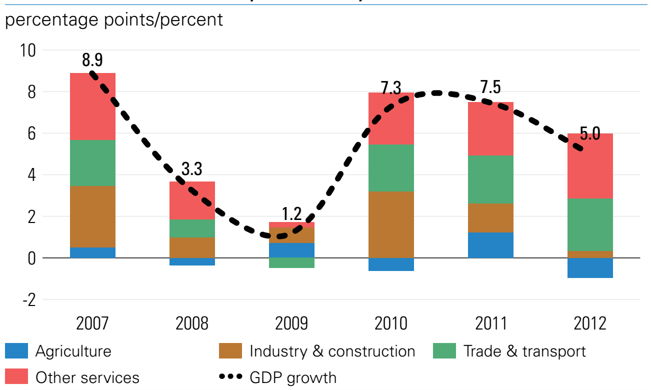
B. Recent Economic Developments

Production shortfalls in industry and agriculture led to slower economic growth

Economic growth slowed in 2012 due to capacity constraints in the oil sector, weaker global demand for metals, and unfavorable weather conditions affecting crop production. Real GDP growth slowed from 7.5 percent year-on-year (y/y) in 2011 to 5.0 percent in 2012 (Figure 1). The main contributors to the slowdown were the oil industry (-1.4 percent y/y, due to capacity constraints in on-shore oil production), metallurgy (-1.5 percent, due to weaker external demand for steel and metal products) and agriculture (-17.8 percent, due to a dry season and poor harvest of crops). Overall, industrial output expanded by 0.5 percent in 2012, with negligible contribution to GDP growth for the year. Against the decline of agriculture, and little change in industry overall, real GDP growth was supported by a 10 percent y/y growth of the services sector in 2012. Higher export revenues supported strong domestic demand for trade and transportation, as well as for other non-tradable services.

Figure 1. Services underpinned GDP growth, while goods production contribution was down

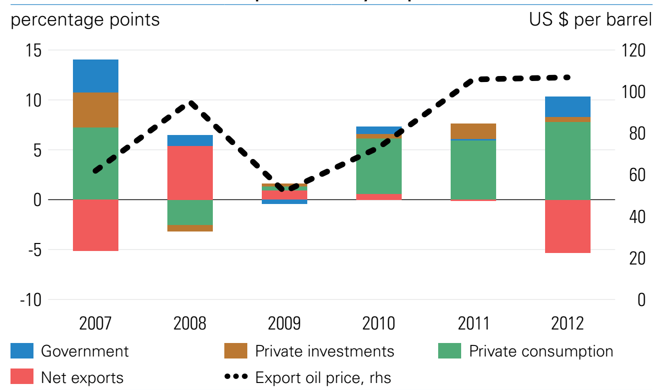
Real GDP Growth Composition by Sectors



Source: Statistical Agency of Kazakhstan.

Figure 2. Domestic consumption remains a key driver of the GDP expansion

Real GDP Growth Composition by Expenditure



Source: Statistical Agency of Kazakhstan.

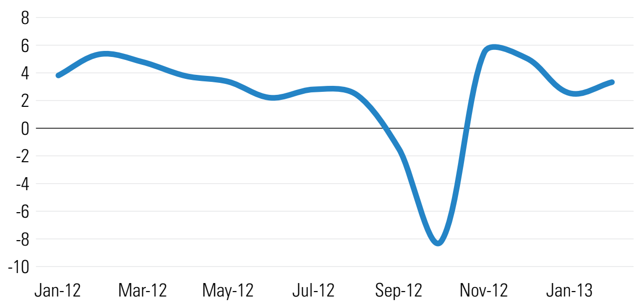
High oil prices continued spurring domestic consumption while fixed capital investments remained depressed. Private consumption remains the main contributor to GDP growth as it has been growing by 9–10 percent a year since 2010, supported by favorable commodity prices and high oil export revenue (Figure 2). Higher government spending also contributed positively to the economic expansion last year. Nevertheless, private investments remain stagnant (1–2 percent growth y/y a year since 2009) as profitability in the private sector is still depressed and, consequently, banks' lending to the economy is expanding slowly. Meanwhile, real imports jumped from 6.9 percent of GDP in 2011 to 19.5 percent of GDP in 2012, driven by the sustained domestic consumption and government spending. As a consequence net exports contributed negatively to GDP growth in 2012.

The first two months of 2013 indicate that GDP growth remains weak. The monthly GDP growth proxy indicator[2] went down from over 5 percent y/y during November-December 2012 to 2.9 percent during January–February 2013 (Figure 3). This outcome was also lower if compared to a correspondent period of the previous year when the indicator grew by 4.6 percent y/y during January–February 2012. The main contributor to this slowdown was the construction sector which contracted by 5.6 percent y/y during January–February 2013 due to an observed downward trend in residential housing construction (Figure 4). During the first two months of 2013, agriculture and industry remained stagnant while services continued expanding, including trade (12.8 percent growth), transportation (7 percent), and communications (9.5 percent).

Figure 3. Economic activity in Kazakhstan weakened during the first two months of 2013

GDP Proxy Indicator

percent change, year-on-year

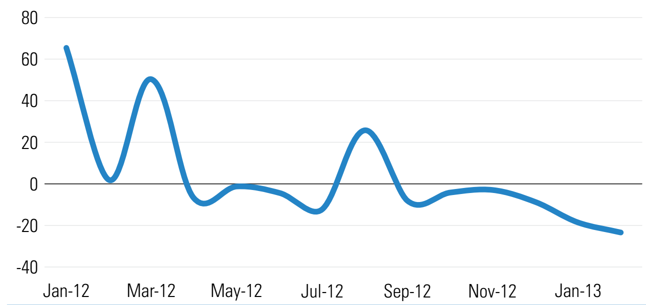


Source: Statistical Agency of Kazakhstan.

Figure 4. Residential housing construction is down and impacts GDP growth negatively

Volume of Constructed Residential Housing

percent change, year-on-year



Source: Statistical Agency of Kazakhstan.

Adjustments in regulated prices drove inflation higher

Inflation hit a four year low in early 2012 before picking up again due to upward adjustments in regulated prices. In early 2012 the authorities decided to postpone some adjustments in certain regulated prices,[3] leading headline inflation to dip to a low 4.6 percent y/y in March 2012 (Figure 5). However, headline inflation picked up during the year as the prices for other regulated prices for utility services, transport, communication, and education were adjusted upwards. On an annual basis, prices for utilities went up by 8.2 percent y/y, passenger transport tariffs and prices for communication services increased by 12 percent, and education costs were adjusted by 11 percent on average during the year. Nevertheless, moderate price increases in the rest of the consumer basket, as the pressure from international food prices eased, brought inflation to 6 percent y/y at the end of 2012. Although headline inflation rate went up to 7 percent y/y in February 2013, mainly due to further upward adjustments in railway tariffs and water supply charges, it is still well within the targeted policy band of 6–8 percent inflation. Meanwhile, money supply growth moderated from 15 percent y/y in 2011 to 8 percent in 2011, driven by withdrawals from demand deposits in tenge by the corporate sector (Figure 6).

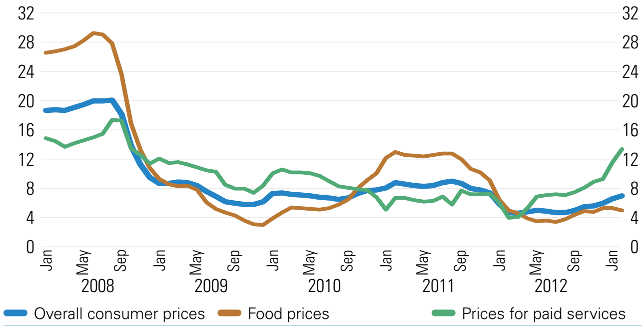
2 The GDP growth proxy indicator comprises the following six key sectors: agriculture, industry, construction, trade, transportation, and communication.

3 The Agency for Regulation on Natural Monopolies oversees and approves prices set by natural monopolies and dominant market participants in the utility sector (supply of water, heating, electricity and gas) and in licensed services (e.g. oil and gas pipelines, rail transportation, telecommunication services, and all types of education).

Figure 5. Regulated prices became the main contributors to inflation hike in recent months

Headline Inflation and its Key Ingredients

percentage change, year-on-year

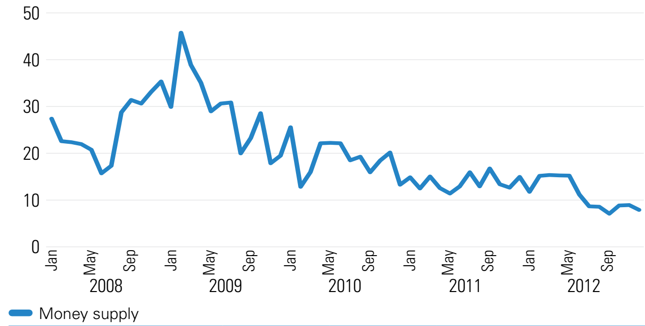


Source: National Bank of Kazakhstan.

Figure 6. Meanwhile, money supply growth is moderating

Money Supply Growth

percentage change, year-on-year



Source: National Bank of Kazakhstan.

Favorable terms of trade continue to impact the external position positively

The external position of Kazakhstan remained strong, supported by favorable international commodity prices and capital inflows. The current account surplus narrowed from $12.3 billion, or 6.5 percent of GDP, in 2011 to $7.7 billion, or 3.8 percent of GDP, in 2012 (Table 1), mainly due to a narrower trade surplus (down by $2 billion) as imports continued recovering. Nevertheless, the trade surplus remains strong at $45 billion in 2012 (compared to $15 billion in 2009 and $29 billion in 2010), supported by high commodity prices. Imports

Table 1. Kazakhstan—Balance of Payments (2008–2012)

in millions of US dollars

	2008	2009	2010	2011	2012
Current account	6,326	-4,114	1,393	12,281	7,716
Trade of goods	33,519	14,969	28,472	46,777	44,673
Exports f.o.b.	71,971	43,931	61,397	87,518	92,073
Imports f.o.b.	-38,452	-28,962	-32,925	-40,741	-47,400
Services	-6,694	-5,804	-7,082	-6,464	-7,761
Income, *of which:*	-19,515	-12,557	-19,515	-27,777	-28,191
Income of direct investors (net)	-16,956	-10,415	-17,316	-24,892	-24,589
Current transfers	-985	-722	-482	-256	-1,005
Capital and financial account	2,343	3,458	9,938	664	3,668
Direct investments	13,118	10,083	3,665	9,273	12,440
Direct investments abroad	-1,204	-3,159	-7,885	-4,630	-1,582
Direct investments in Kazakhstan	14,322	13,243	11,551	13,903	14,022
Portfolio investments /1	-2,898	-70	15,128	-322	-3,567
Medium and long-term investments	1,390	-3,310	-8,695	1,592	4,344
Other investments /2	-9,267	-3,245	-161	-9,879	-9,549
Overall balance/Change in monetary and fiscal reserves /3	**8,669**	**-656**	**11,331**	**12,945**	**11,384**
Memorandum items:					
Total official monetary and fiscal reserves (stock)	47,358	47,459	59,255	72,953	86,046
Gross international reserves	19,872	23,091	28,275	29,328	28,280
National Fund foreign assets	27,486	24,368	30,980	43,625	57,766

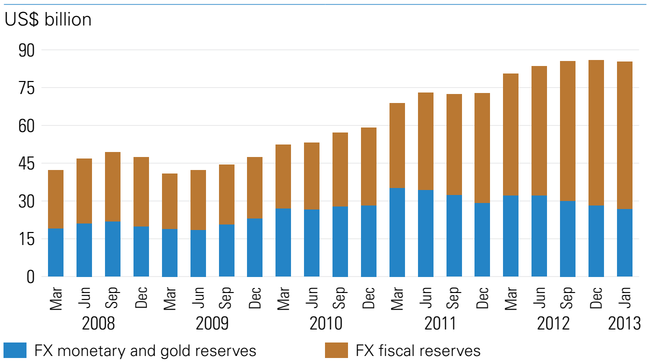
Sources: National Bank of Kazakhstan; World Bank staff calculations.
Note:
1/ Excluding investments of the National Fund.
2/ Including Errors and omissions.
3/ "+" = reserve accumulation.

of services, mainly of construction type in the oil sector, also outpaced exports of cargo transit services, bringing the net services balance down from -$6.5 billion in 2011 to -$7.8 billion in 2012. Higher net inflows of foreign direct investments and increased borrowings by the private sector contributed to the improvement of the capital and financial account which went up from $0.7 billion in 2011 to $3.7 billion in 2012 (excluding investments of the National Fund). The increase in net foreign direct investment happened mainly due to lower outflows of direct investments related to finalization of the government acquisition of a 10 percent stake in the Karachaganak oil project, while gross inflows of direct investments increased slightly.

The strong external position contributed to further build-up in official international reserves and helped the central bank to maintain stability of the exchange rate. Total official international reserves, comprising gross international reserves of the central bank and foreign exchange fiscal reserves saved in the oil fund, increased by $13 billion during 2012 and exceeded $86 billion, or 43 percent of GDP (Figure 7). While fiscal reserves expanded by $14 billion, gross international reserves of the central bank (excluding gold reserves) shrunk by $3 billion, indicating adherence of the central bank to the stable exchange rate policy and selected interventions to smooth the volatility of the exchange rate coming from the fluctuations in international oil prices. Despite the central bank interventions in the domestic foreign exchange market, the stock of its gross international reserves was still at a very comfortable level of 5.7 months of imports of goods and services at the end of 2012. Consequently, the real exchange rate of the tenge against the US dollar was maintained almost flat during 2012 (Figure 8), while in nominal terms the tenge depreciated by just 1.7 percent y/y.

Figure 7. Official reserves increased further, supported by the strong external position

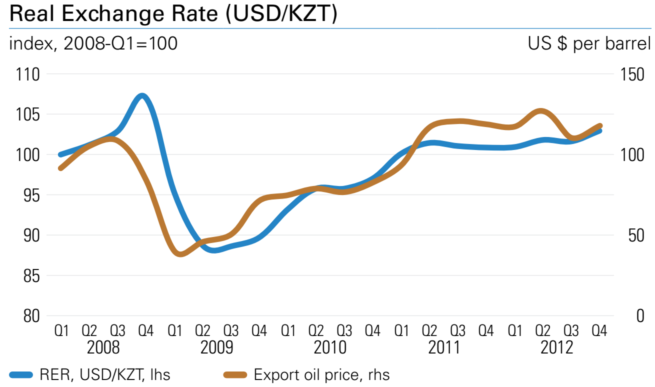
Total Official International Reserves



Source: National Bank of Kazakhstan.

Figure 8. The real exchange rate was kept almost flat, despite some fluctuations in oil prices

Real Exchange Rate (USD/KZT)

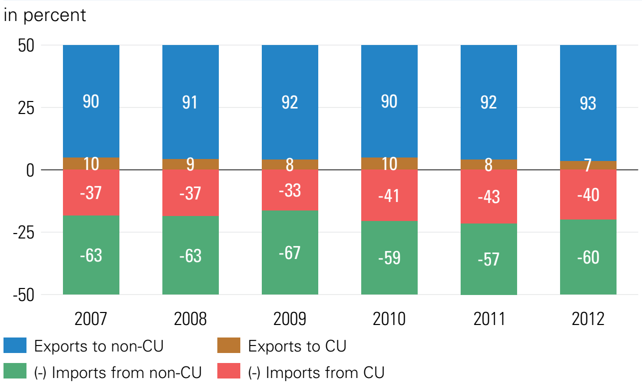


Source: National Bank of Kazakhstan.

Exports of oil largely influence the composition of Kazakhstan's trading partners, while membership in the customs union appears to be affecting composition of imports. The European Union (EU) maintains the first place among trading partners of Kazakhstan, mainly due to large imports of oil and other mineral resources from Kazakhstan. As the Kazakhstan-China oil pipeline went into operation in 2006, China gradually became the second largest export destination for Kazakh goods, as compared to the third place in 2007–2008 when Switzerland was the second largest single importer of Kazakh hydrocarbons. On the imports side, the establishment of a customs union (CU) between Russia, Belarus and Kazakhstan has led to more imports from Russia (Figure 9). The diversion of Kazakhstan imports toward Russia was largely an expected immediate negative outcome, which can be outweighed by potential benefits that the CU can bring in the long run. Despite the establishment of the customs union, the share of Chinese exports to Kazakhstan, comprising electronics, electrical and mechanical equipment, clothing and footwear, construction materials, and fruits and vegetables, has also expanded notably (Figure 10).

Figure 9. The customs union has changed the foreign trade landscape of Kazakhstan

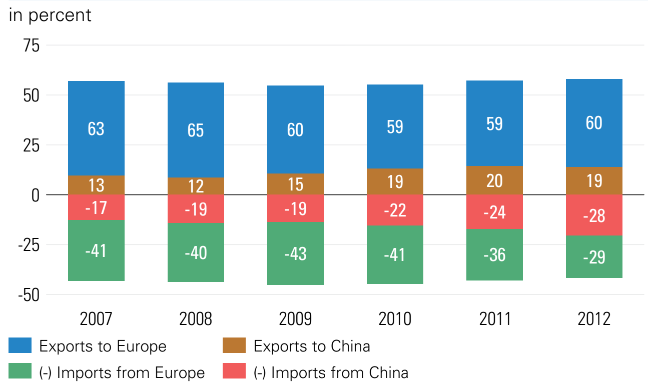
Trade Pattern pre- and post-Customs Union



Source: Statistical Agency of Kazakhstan.

Figure 10. Trade with China has expanded further, despite the customs union

Shares of Trade with Europe and China in Total Non-Customs-Union Trade



Source: Statistical Agency of Kazakhstan.

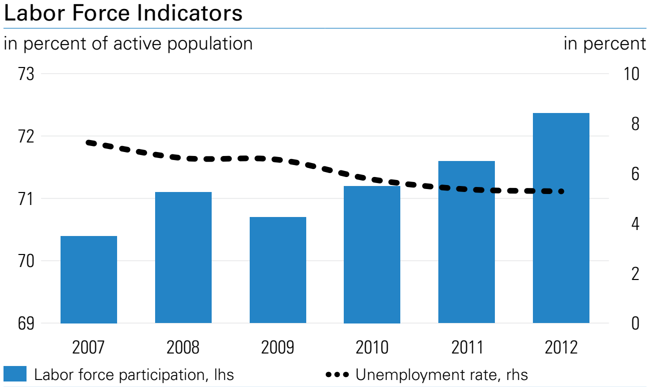
Economic recovery impacted positively on employment and poverty incidence

As economic activity has recovered from the crisis, employment rate has improved. Employment has steadily increased despite the crisis, with preliminary official data showing 8.5 million people employed as of end 2012, compared to 7.9 million people in 2008–2009. The unemployment rate rose from 6.6 percent of total labor force in 2008 to almost 7 percent in the first half of 2009, when the economic crisis hit the country the most. It has started improving since mid-2009, following the government anti-crisis measures aimed at boosting employment through provision of public works, and dipped to 5.3 percent or 474,000 persons in 2012 (Figure 11). Labor force participation has also increased from 71 percent of total active population in 2008–2010, to over 72 percent of total active population in 2012.

Overall, employment creation continues to be driven by the services sector. The latest data from 2012 shows that services (excluding central government administration) employ over 50 percent of the active population in its myriad sub-sector (Figure 12). Economic growth in oil and mining was almost jobless, while

Figure 11. The share of unemployed fell below 5.5 percent of total labor force in recent years

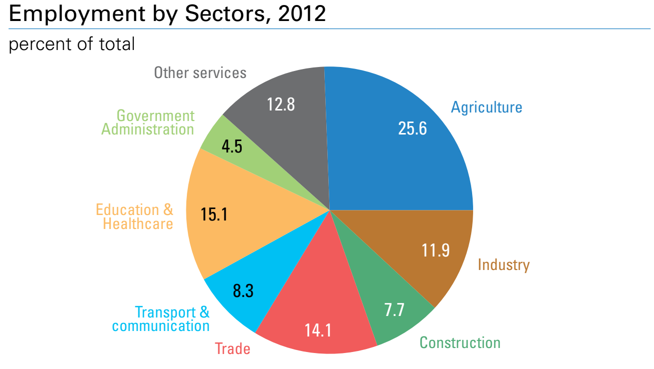
Labor Force Indicators



Source: Statistical Agency of Kazakhstan.

Figure 12. Agriculture employs a significant share of population

Employment by Sectors, 2012



Source: Statistical Agency of Kazakhstan.

the number of workers was either stable in manufacturing sector or steadily declining in agriculture. Agriculture still employed 26 percent of the active population, while industry and construction employed 12 percent and 8 percent respectively.

Kazakhstan growth has been pro-poor, driven by job creation and real income gains. Poverty reduction has been substantial; with the share of the population living in poverty (as measured by the PPP-corrected $2.5 per capita per day) fell from 41 percent to 4 percent during 2001–2009. In the same period, the share of the population living below $5 per day fell from 79 percent to 42 percent. Poverty reduction has been driven by the job creation discussed above. Analysis suggests that during 2000–2007, being employed increased the likelihood of moving out of poverty by 10 percent. More specifically, in Kazakhstan, shrinking self-employment in favor of wage employment appears to have contributed to poverty reduction: overall, employment shifted from self-employment (42 percent in 2001 to 32 percent in 2012) to wage employment (58 percent in 2001 to 68 percent in 2012). Furthermore, real income gains have further contributed to poverty reduction. Real wages grew by 11 percent per year over 2000–2010, with mean wages growing by 2.4 times in Kazakhstan over the same period. Real incomes (in constant 2012 prices) continued to improve post crisis, with an average monthly wage of $678 in 2012, compared with $559 in 2009.

However, income disparity, which had improved up to 2009, has worsened slightly due to the crisis. Inequality (as measured by the Gini coefficient) fell from 0.37 to 0.27 during 2001–2009, a level considered relatively moderate in the global context. The dynamics behind the decrease in inequality is best explained by the higher growth in consumption of the poor relative to the top quintile. But the Gini spiked up again to 0.29 by 2011, suggesting that the recent crisis negatively impacted incomes and consumption in the lower quintile more than in the top one.

C. Recent Economic Policies

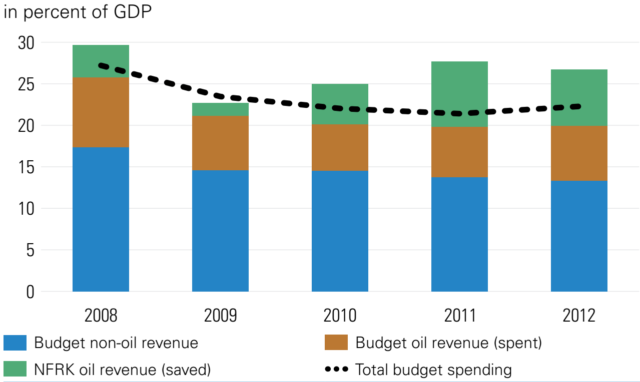
Conservative fiscal policy led to further build-up of fiscal buffer and to sovereign credit rating improvements

The government continues pursuing a conservative fiscal policy and building up fiscal reserves in the oil fund. The consolidated fiscal balance remained in surplus but narrowed from 6.2 percent of GDP in 2011 to 4.5 percent in 2012 due to lower proceeds from the oil and metal extracting sectors, while government spending level was maintained at about 22 percent of GDP (Figure 13). As total revenue from oil exports declined by 1.2 percent y/y in 2012, due to capacity constraints in on-shore oil production, the share of fiscal oil revenue decreased from 14 percent of GDP in 2011 to 13.4 percent in 2012 (Table 2). Half of this inflow was saved in the oil fund and by the end of 2012 its stock increased further to $64 billion or 32.5 percent of GDP, the biggest fiscal buffer ever (Figure 14). At the same time, the share of non-oil revenues also shrunk slightly from 13.8 percent of GDP in 2011 to 13.4 percent in 2012, mainly due to lower proceeds from the corporate income tax (75 percent of the initial plan) as lower international prices for ferrous and non-ferrous metals impacted the profitability of the metal-producing sector.

Figure 13. Government spending is under control, while oil revenues are still in excess

Government Budget Revenue and Spending

in percent of GDP

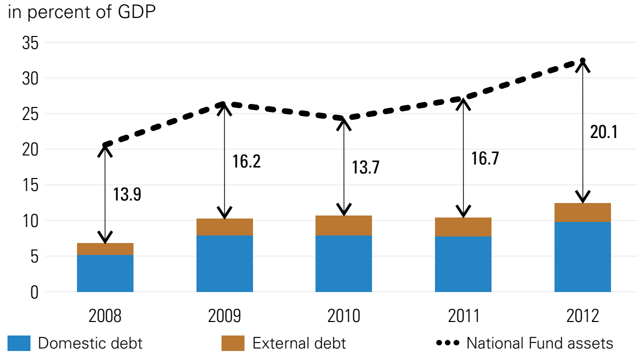


Source: Finance Ministry of Kazakhstan.

Figure 14. Oil revenue savings exceeded 32 percent of GDP, the biggest fiscal buffer ever

Government Debt and National Fund Assets

in percent of GDP



Source: Finance Ministry of Kazakhstan.

The composition of government spending shifted toward current expenditures, driven by higher spending on goods and services; while transfers to the state-owned enterprise sector were cut. The share of total government expenditures has been maintained stable at about 22 percent of GDP over the last three years (Table 2). Nevertheless, the share of government spending on goods and services increased from 6.7 percent of GDP in 2010-2011 to 7.8 percent in 2012, mainly due to higher spending on services. The size of the public sector wage bill stayed within 3.4 percent of GDP in 2012, despite sizable real adjustments in the salaries of civil and public servants over the last 3–4 years. These adjustments were the result of the government decision to narrow the gap in remuneration between the public and private sectors to retain professional cadre in the civil service. Nevertheless, the size of the wage bill was kept under control, as the government rationalized the number of civil servants from 97 thousand in 2009 to 87 thousand in 2010–2012. Meanwhile, interest payments (0.4 percent of GDP a year) and current subsidies and transfers (4.6 percent) are kept almost flat. The capital

budget of the government went down from 6.4 percent of GDP in 2011 to 6.0 percent in 2012, mainly reflecting lower capital transfers to the state-owned enterprise sector, while government investments were brought down to the pre-crisis levels of 4.6 percent of GDP in 2011–2012.

Table 2. Kazakhstan—Government Fiscal Accounts (2008–2012)

in percent of GDP

	2008	2009	2010	2011	2012
Consolidated government revenue	29.7	22.7	25.0	27.7	26.8
Oil revenue	12.3	8.1	10.4	14.0	13.4
Non-oil revenue	17.4	14.7	14.6	13.8	13.4
Total expenditures and net lending /1	27.2	27.9	22.5	21.8	22.3
Total budget expenditures	27.0	23.4	22.0	21.3	22.2
Current expenditures	14.2	16.1	15.0	14.9	16.2
Wage bill	3.2	3.7	3.4	3.2	3.4
Goods and services	6.2	7.0	6.6	6.7	7.8
Interest payments	0.4	0.4	0.4	0.4	0.4
Subsidies and current transfers	4.4	4.9	4.6	4.5	4.6
Capital expenditures	12.8	7.3	7.0	6.4	6.0
Government investments	5.8	5.5	5.1	4.6	4.6
Capital transfers	7.0	1.7	1.9	1.8	1.4
Net lending	0.3	0.2	0.1	0.3	0.1
Off-budget lending to Samruk-Kazyna	0.0	4.4	0.3	0.3	0.0
Consolidated budget surplus /2	**2.5**	**-0.8**	**2.9**	**6.2**	**4.5**

Source: Finance Ministry of Kazakhstan.
Note:
1/ Including off-budget lending to Samruk-Kazyna.
2/ Excluding off-budget lending to Samruk-Kazyna.

Following the expansion of Kazakhstan's sovereign net financial position, Fitch upgraded the country's rating to BBB+ and Standard & Poor's affirmed its rating at BBB+ in late 2012. Fitch highlighted that the upgrade reflects the continued strengthening of Kazakhstan's sovereign external balance sheet, low level of government debt and healthy growth prospects, as well as tentative steps towards cleaning up the banking system. The agency acknowledged that Kazakhstan is already the second-strongest sovereign net external creditor in the 'BBB' category. The agency expects the general government budget (including the oil fund) to remain in surplus even if the oil price falls to $80 per barrel. Both rating agencies see the country's economic outlook as stable, as they expect that Kazakhstan's economic growth will remain strong, and that high global commodity prices and public-sector spending will continue to sustain the economy and underpin the country's fiscal and external positions.

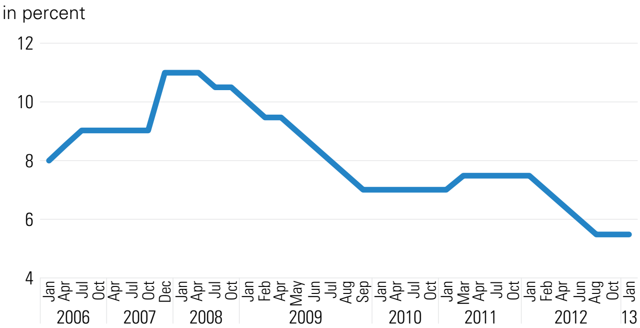
Accommodating monetary policy supported domestic credit but continued NPL problem constrains banks' ability to provide more cash to the economy

The GDP slowdown and low inflation led the central bank to cut its policy interest rate to stimulate the economy. As headline inflation remained almost flat and low at around 5 percent y/y in February through September 2012, the National Bank of Kazakhstan cut the official refinancing rate by 200 basis points from 7.5 of 5.5 percent during the year (Figure 15). Some monetary easing was considered to be a timely policy instrument to stimulate economic activity in the country. As a result, banks' lending to the economy has

continued expanding. As of end-2012, the outstanding credit provided by the banking sector to the economy was 13 percent higher than in 2011, with new lending 25 percent higher than in the previous year (Figure 16). Nevertheless, in real terms, growth of domestic credit to the economy moderated from 6.5 percent y/y in 2011 to 5.3 percent in 2012, partly signaling that the refinancing rate is still not an effective policy instrument and that the banking sector has not fully recovered from the financial crisis of 2007.

Figure 15. Refinance rate was cut by 200 basis points during 2012 to stimulate growth

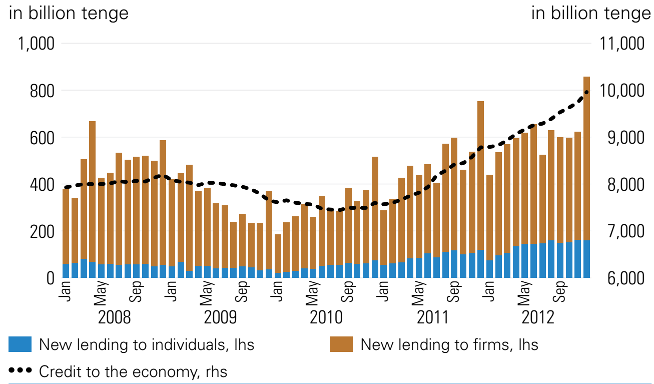
NBK Refinancing Rate Developments



Source: National Bank of Kazakhstan.

Figure 16. Domestic credit to the economy has expanded further but remain largely depressed

Banks' Lending Flows and Stock

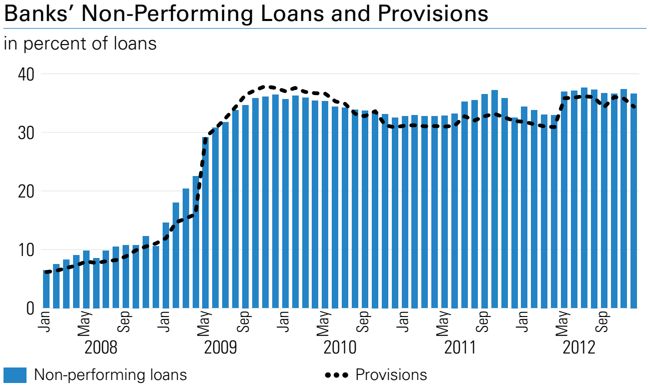


Source: National Bank of Kazakhstan.

Although the authorities have been providing support to the banking sector through interventions, restructurings, and extensive liquidity provision, it is yet to recover. While banks' reported capital adequacy appears healthy and liquidity is ample, the industry still has depressed profitability due to poor asset quality that leads to risk aversion. The non-performing loans (NPLs) remain high at 37 percent of total loans as of the end of 2012 compared to 35 percent at the end of 2011 (Figure 17). BTA Bank was the major contributor to this shift, with its NPLs going up from 61.5 percent of total loans in April 2012 to 87 percent in December 2012 (Figure 18). Although, NPLs in the banking sector are well provisioned (93 percent of total), they keep one-third of banks' loan portfolio idle and not working for the economy.

Figure 17. Problem loans are well provisioned but constrain banks' lending expansion

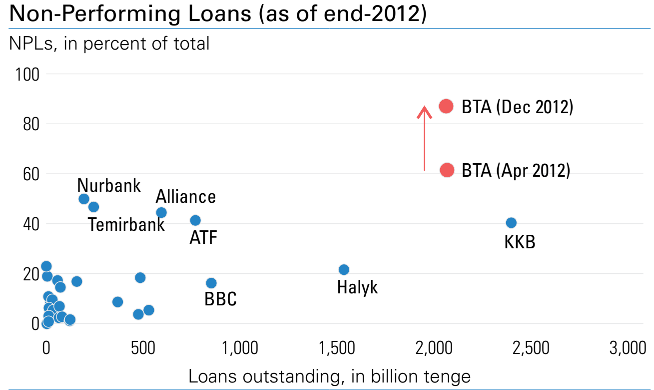
Banks' Non-Performing Loans and Provisions



Source: National Bank of Kazakhstan.

Figure 18. BTA remains the biggest outlier in terms of non-performing loans

Non-Performing Loans (as of end-2012)



Source: National Bank of Kazakhstan.

To address the NPL issue, the National Bank established a national and private asset management companies and provided additional incentives for NPL write-offs. The National Bank of Kazakhstan is

following its initial strategy of setting up (i) a national asset management company: the Problem Loans Fund was established in April 2012 and started buying problem loans (with a discount) from banks on a pilot basis; and (ii) private bank-specific asset management companies: four banks have already set up special purpose vehicles (SPVs) for this purpose and are expected to start transferring bad loans to their respective SPVs. As part of incentivizing NPL write-offs, the authorities came up with the following new initiatives: (a) extended tax exemptions for NPL write-offs until the end of 2013; and (b) imposed a ceiling for NPLs (over 90 days overdue) at 20 percent of a loan portfolio in 2013[4] and 15 percent in 2014.

With the finalization of the BTA Bank second debt restructuring program, the government intends to exit the nationalized banks by the end of 2013. BTA Bank has concluded its second debt restructuring program in late December 2012. As a result of the restructuring, the bank's financial indebtedness has been reduced from approximately $11.1 billion to approximately $3.3 billion and the maturity of the debt was extended to between 3 and 12 years. Following the second restructuring program, Samruk-Kazyna now owns over 97 percent of BTA equity, compared with approximately 81.5 percent prior to the restructuring. Nevertheless, the government intends to privatize BTA Bank, Alliance Bank and Temirbank, following President Nazarbayev's order to Samruk-Kazyna to withdraw from the capitals of these three banks by the end of this year.

4 There are six banks that do not meet this criterion so far: Kazkommertsbank (25 percent of NPLs over 90 days overdue), BTA Bank (78 percent), ATF Bank (43 percent), Alliance Bank (46 percent), Nurbank (28 percent), and Temirbank (44 percent).

D. Ongoing Structural Reforms

The Doing Business ranking of Kazakhstan is on a positive trend

Over the past few years the authorities in Kazakhstan have put a strong emphasis on reforming the investment climate as a foundation for private sector development and competitiveness of the economy. Regarding the enabling environment, the government has undertaken numerous reforms aimed at reducing regulatory obstacles for firms. This has translated into a significant improvement in the Doing Business (DB) rankings and other indicators. For instance, Kazakhstan's overall DB rank improved from 58th in 2010 to 49th in 2012, with major improvements registered in starting a business and getting credit (Table 3).

Table 3. Kazakhstan—Doing Business Indicators (2011–2013)

Topic Rankings	DB 2011	DB 2012	DB 2013	Change in Rank
Overall rank	58	56	49	↑ 7
Starting a Business	49	55	25	↑ 30
Dealing with Construction Permits	148	150	155	↓ -5
Getting Electricity	87	81	80	↑ 1
Registering Property	27	28	28	No change
Getting Credit	75	97	83	↑ 14
Protecting Investors	44	10	10	No change
Paying Taxes	26	16	17	↓ -1
Trading Across Borders	176	178	182	↓ -4
Enforcing Contracts	26	28	28	No change
Resolving Insolvency	49	55	55	No change

Source: World Bank.

However, beyond some targeted regulatory improvements, there are other areas that require more tailored policy interventions to enable private sector expansion. Access to finance (especially long-term financing for capital investment) remains limited and is therefore a major obstacle to firms' growth—especially for SMEs. Lack of financing to the private sector is directly linked to the challenges faced by the financial sector, including high levels of non-performing loans, limited capitalization, lack of active non-bank financial institutions (such as leasing, factoring and microfinance) and deficiencies in credit infrastructure. Furthermore, important challenges remain on key areas such as trade, trade facilitation and the judicial system.

Kazakhstan's trade environment remains dynamic and challenging, as the country seeks to integrate into the Eurasia Common Economic Space and join the WTO

Kazakhstan is transitioning through the first round effects of joining the Russia-Kazakhstan-Belarus Customs Union. Kazakhstan joined the CU in 2010 and as discussed above experienced a shift in its trade patterns and partners. While the potential benefits from increased regional economic integration are numerous (Box 2), the country has experienced trade diversion in the short run, due to the CU common external tariff structure. Kazakhstan's tariffs increased from an average of 6.7 percent to 11.1 percent on an unweighted basis (and 5.3 percent to 9.5 percent on trade-weighted basis), while those of Russia remained essentially the

Box 2. The Potential Economic Benefits and Risks of Greater Trade Integration

Regional economic integration of the Eurasian Customs Union (ECU) can have the following short and long-term benefits:

- lower tariffs and the removal of non-tariff trade barriers should increase trade and enhance consumer choice;
- producers within a regional integration grouping, including the ECU, can benefit from increased market size;
- exporting within a regional area may serve as a first step towards the expansion of exports worldwide;
- countries within a regional integration area can build cross-border production chains by leveraging each other's comparative advantages and subsequently exporting the finished product outside that area;
- deeper regional integration can help member countries to strengthen their economic and political institutions;
- integration can encourage the liberalization of service markets.

In spite of these potential benefits, there are some downside risks to joining a trade bloc such as the ECU. Two such concerns are:

- trade diversion whereby a relative change in tariff barriers can divert trade from more efficient external exporters to less efficient ones;
- if trade diversion affects the knowledge/technological content of imports, it can impact the long term diversification and growth potentials of domestic producers who use them.

Source: EBRD (2012), Transition Report 2012: Integration Across Borders.

same in the early stage of the CU.[5] Consequently, Tarr (2012) argues that Russia benefitted by expanding its exports even if they were not competitive while Kazakhstan and Belarus' imports from EU fell.[6] Of interest is that Chinese exports to Kazakhstan have continued to expand, most likely at the expense of the EU exports to Kazakhstan as well.

The tariff and trade structures of the country will continue to change as Kazakhstan's trade policy framework evolves. First, Russia's accession to the World Trade Organization (WTO) led to lower CU external common tariffs in over 1100 tariff lines. This was implemented in October 2012 by Kazakhstan and may impact trade patterns in 2013 and beyond. Second, the three countries are moving towards deeper integration into the Eurasia Common Economic Space, which will translate into changes to national economic incentives and productive structures, affecting trade. Third, the CU is engaging in Free Trade Agreements (FTAs) negotiations with third countries—such as Vietnam. This again may impact trade incentives and patterns beyond 2013. Finally, Kazakhstan's accession to the WTO, expected by end 2013, may lead to further tariff changes as well adjustments to WTO disciplines and rules, affecting productivity, production and trade flows in the medium term.

5 See World Bank (2012), "Assessment of Costs and Benefits of the Customs Union for Kazakhstan", Report No. 65977-KZ, Washington, D.C.

6 See Tarr, David (2012), "The Eurasian Customs Union among Russia, Belarus and Kazakhstan: Can it Succeed Where its Predecessor Failed?", New Economic School, Moscow.

The government is moving ahead with a multifaceted public sector management reform to improve its efficiency and service delivery

The government is reforming the civil service gradually. The authorities have based their reforms on new model of civil service to achieve five objectives: (i) strengthen the principles of meritocracy in selection and promotion of human resources (HR); (ii) create a managerial Corps (called Corps A); (iii) introduce elements of anti-corruption into the civil service framework including a code of conduct, standards of ethics, and other elements of reducing corruption in the system; (iv) improve mechanisms of HR management; and (v) increase the status of HR services. On the legislative front, the framework for the establishment of an impartial, independent and fairly managed civil service has been a priority reflected in number of strategic state documents (Kazakhstan-2030, Strategic Plan-2020). Key legislation includes the law on civil service, the law on fight again corruption and the law on conflict of interest.

Some important steps have been undertaken in recent years, but results have so far been very limited. Written tests for civil service appointments have been computerized to minimize manipulation, interview processes and procedures have been tightened up, and committees are used to assure that selection of candidates is objective. All of this has diminished the role of patronage, though it continues to exist. Civil servants with financial assets need to place these in trusts when taking office and a vetting of civil servants "with respect to the observance of anti-corruption legislation" for certain position is being proposed.

In late March 2013, new amendments to the legislation on the civil service came into effect. The amendments provide for financing of the Corps A, and include annual performance appraisal of administrative civil servants among other measures. The number of political civil servants is being reduced from 3,271 to 400, and clear guidelines have been set out for hiring the Corps A civil servants. This is to encourage transparent, merit-based selection and to reduce potential political influence peddling in the civil service. Finally, the annual performance appraisal is being introduced to the administrative civil servants.

The government is also considering reform of its budgetary processes to improve service delivery. It is considering adoption of results-based budgeting to improve its service delivery to the population. It is also working to improve management of targeted development funds through decentralization. Work is underway on a framework of subnational financial management and administrative systems to give more responsibility to the local government, and a draft law is in development. Furthermore, some steps have already been taken to increase the role of the private sector in the financing and provision of housing and urban utilities, but the public sector will still play a role in the provision of affordable housing.

The government intends to reform the pension system

The authorities have expressed a strong interest in addressing the problematic pension fund system. The mandatory Defined Contribution Pension system faces negative real rates of return and lacks domestic instruments for investment (Box 3). The government has already committed to the payment of a positive rate of returns to pensioners to assuage public concern. However, it seeks a viable solution and intends to reform the current pension system by revising its parametric components and the institutional set-up. One initiative

that the government has already launched is to consolidate these funds to improve their management. As a number of pension funds are held by some of the nationalized banks, the government considers merging the nationalized banks with local banks, as part of the pension system reform program.

Box 3. The Current Pension System in Kazakhstan

The current pension system has four main pension 'pillars' with different levels of maturity:

- A flat Basic Pension financed from the general government budget is a "zero pillar" pension in the World Bank terminology, which covers all residents of Kazakhstan who reach retirement age. The level of the Base Pension is currently set at 50 percent of the subsistence level—a government determined poverty level.
- A (closed) earnings-related Defined Benefit Pension funded by the general government budget is a "first pillar" pension under the World Bank terminology. The Defined Benefit Pension is the main source of current retirement income. Given that future pension right accrual was stopped in 1998, it will progressively disappear as a source of future retirement income. People with full length of service (20 years for women and 25 years for men) have a right to a full minimum pension guarantee.
- A mandatory Defined Contribution Pension funded by individuals is a "second pillar" in the World Bank terminology. The Defined Contribution Pension was introduced in 1998, with the aim of providing the bulk of the future pensions as own savings for the residents of Kazakhstan. Employees contribute 10 percent of their salary; with no additional contribution from the government or employer (the government only makes contributions of 20 percent of salaries for armed forces personnel). These contributions are invested in private pension funds. Approximately 41 percent of the Defined Contribution Pension money is invested in government securities in Kazakhstan, 28 percent in other domestic securities, and 15 percent in foreign securities. As a consequence of low returns and relatively short contribution histories since 1998, currently new retirees have only 4–6 months' worth of earnings accumulated in an average account. These small sums are normally paid out as a lump sum at the time of retirement.
- A voluntary Defined Contribution Pension funded by individuals is also a "third pillar". The Defined Contribution Pension can be funded by both employee and employer contributions.

Source: World Bank (2011), "Pension Reform in Kazakhstan: Options for Policy Reform", Report of the Joint Economic Research Program, Washington, D.C.

Given that there is still no foreign investor willing to buy the nationalized banks, the government is considering merging them with local banks. The government has already issued an order to Samruk-Kazyna allowing it to purchase the largest private pension fund owned by Halyk Bank in exchange for BTA shares owned by Samruk-Kazyna. Most likely, BTA will be split into a 'good bank' and a 'bad bank', with the former merged with Halyk Bank and the latter liquidated. The fifth largest private pension fund, owned by Kazkommertsbank, will be a subject to a swap for the government stake of 27 percent obtained by Samruk-Kazyna (on behalf of the government) as part of the liquidity support program during the financial crisis. These two pension funds, together with UlarUmit of BTA Bank, will be merged with the State Accumulative Pension Fund, managed by the National Bank of Kazakhstan, and jointly will represent 80 percent of the whole Defined Contribution Pension system (Table 4).

Table 4. Kazakhstan—Key Balance Sheet Items of Private Pension Funds (as of end 2012)

in millions of tenge

	Capital	Liabilities	Assets
Pension Fund of Halyk Bank of Kazakhstan	37,455	997	38,452
State Accumulative Pension Fund	24,418	874	25,292
UlarUmit Pension Fund (subsidiary of BTA Bank)	12,430	148	12,578
Astana Pension Fund	7,305	205	7,511
Grantum Pension Fund (subsidiary of Kazkommertsbank)	7,009	217	7,226
Capital Pension Fund (subsidiary of Bank CenterCredit)	4,383	30	4,412
Atameken Pension Fund (subsidiary of Nurbank)	3,371	269	3,640
NefteGaz-Dem Pension Fund	2,624	80	2,704
Respublika Pension Fund	2,243	79	2,322
Otan Pension Fund	33	3,168	3,201
TOTAL	101,271	6,066	107,337

Source: National Bank of Kazakhstan.

E. Outlook

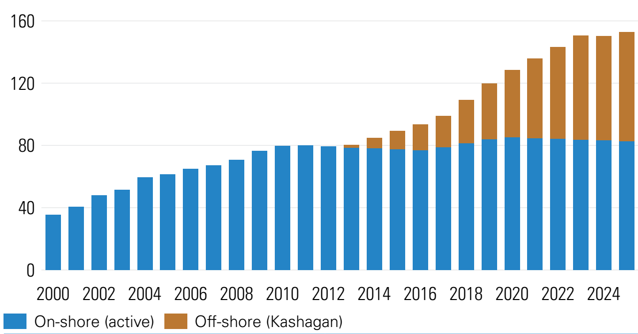
Off-shore oil production will be an additional driver for the economy but will not be creating significant macroeconomic imbalances in the medium term

The long-awaited Kashagan oil field will come on stream this year and will be driving the macroeconomic picture of the country in the years ahead. The Kashagan oil field in the northern Kazakhstan segment of the Caspian Sea was discovered in 2000 and its first oil was expected in 2005 but was delayed several times. Currently, the first commercial production at Kashagan is expected to start in June 2013. It is estimated that the Kashagan oil field has recoverable crude oil reserves of about 10 billion barrels (out of 38 billion barrels of oil discovered). Given the planned production profile (Figure 19), oil production at Kashagan may last for the next 25 years or more. If oil prices remain stable and high, off-shore oil production will be one of the key driving forces of economic activity in the medium- and the longer-run.

Figure 19. Off-shore Kashagan oil will double oil production in Kazakhstan in 15 years

Oil Production Prospects

in million of metric tons

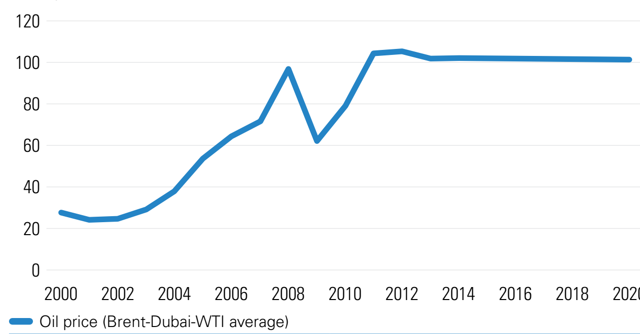


Source: World Bank staff estimates.

Figure 20. Oil price is expected to remain stable at the current high of about $102 per barrel

Oil Price Forecast (DECPG)

US $ per barrel



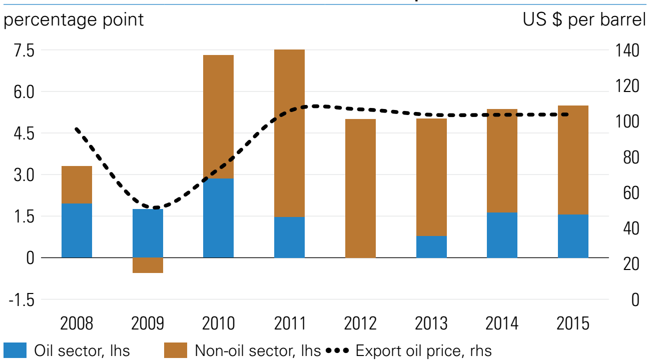
Source: World Bank staff estimates.

In the near- to medium-term, Kashagan oil will have a limited impact on the economic activity in Kazakhstan and will not be creating significant macroeconomic imbalances. At the initial stage of extraction, Kashagan is expected to produce 75 thousand barrels a day which would translate into an increase in total oil production of about 1.4 percent y/y in 2013. It is expected that oil production at Kashagan will gradually reach its full output capacity of 1.5 million barrels a day by 2025. Production in agriculture (i.e. crop production) and manufacturing (i.e. metallurgy) are expected to recover, subject to good weather conditions and stable external demand. A slightly lower petroleum prices over the medium term, as projected by the World Bank Development Prospects Group-DECPG (Figure 20) will slightly worsen the terms of trade in 2013 and will impact domestic demand for services on a downside. As a consequence, the overall real GDP is expected to grow by about 5 percent in 2013 (Figure 21). Real GDP growth may pick up to 5.5 percent in 2014–2015, if oil production at Kashagan expands as planned (to reach 370 thousand barrels a day by 2016) and real growth in the non-oil sector remains at about 5 percent y/y.

Following the baseline scenario with the stable and robust growth projections of 5–6 percent a year, the twin balances in the external and fiscal accounts will be sustained and headline inflation will stay within the targeted range. During the next three years, the current account and the consolidated government budget surpluses are projected to be about 3 percent of GDP a year each (Figure 22). The current account surplus will be supported by further expansion of the trade balance due to the expected sizable oil production and export increases of over 5 percent a year (starting from 2014) while import growth is assumed to moderate to below 5 percent a year, in line with non-oil economy growth. The fiscal picture, is expected to remain strong with stable inflow of revenues at 25½ percent of GDP a year (based on the assumption of stable oil prices) and stable government expenditures of about 22½ percent of GDP. Despite the fact that Kazakhstan will be hosting the next World's Fair EXPO-2017 in Astana, the government intends to finance construction of a new EXPO village out of the existing budget program 'Exporter-2020', as well as by using the government reserve fund allocated in the budget annually.[7] Therefore, our baseline scenario suggests that the fiscal surpluses will be maintained at about 3 percent of GDP over the medium-term. Without pressures coming from the government budget and from abroad, headline inflation will remain close to the floor of the targeted band of 6–8 percent.

Figure 21. Off-shore oil production will be supporting GDP growth over the medium term

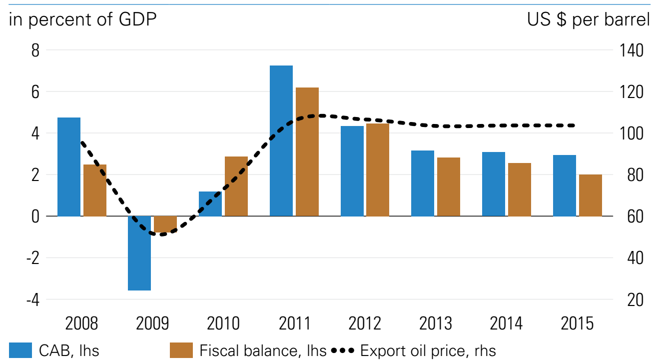
Real GDP Growth and Oil Price Developments



Source: World Bank staff estimates.

Figure 22. Twin fiscal and current account surpluses are expected to sustain

External and Fiscal Balances Outlook



Source: World Bank staff estimates.

However, in the long term, Kazakhstan's development prospects will depend on the country's success in diversifying its endowments

The ongoing Country Economic Memorandum (CEM) argues that diversifying the country's endowments—namely, creating highly skillful human capital, improving quality of physical capital, and strengthening institutional capital—are necessary ingredients for a more inclusive and sustainable development in the long run. The analysis finds that Kazakhstan's exports have a much larger gap in terms of their human capital content when matched with the imports from different comparator countries to Kazakhstan. There is concerted complaint by the private sector that the labor force lacks adequate skills (see special focus section below). Physical infrastructure requires more investments for upgrade and better connectivity. Kazakhstan also scores low on institutional quality indicators such as control of corruption and rule of law compared to comparator countries. The CEM highlights that (i) improving the quality of secondary and

7 See Government Resolution #10 of January 15, 2013 on "The National Plan for Organizing and Hosting the International Specialized Exhibition 'EXPO-2017' for the period of 2013-2018".

tertiary education as well as the marketability of the skills is critical for economic diversification and growth; (ii) improving quality of physical capital is also essential for enhancing productivity and competitiveness; and (iii) resource wealth will not be successfully used to promote shared prosperity if institutional quality is neglected. If done right, these policies will help Kazakhstan to diversify its economy, improve living standards and become one of the top 30 most developed nations by 2050.

F. Special Focus–The Effect of Inadequate Labor Skills in Kazakhstan

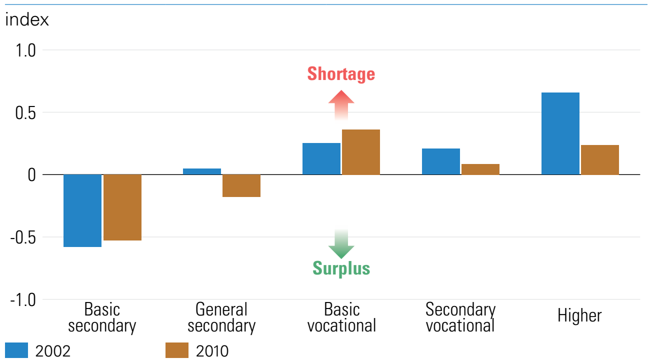
While employment creation has been significant, there is a clear skills mismatch in the economy

Economic growth has led to important and diverse employment creation. Employment has expanded from 6.2 million people in 2000 to 8.5 million people in 2012. As of 2012, agriculture still employed 26 percent of the active population, while industry and construction employed 12 percent and 8 percent respectively. Overall, services (excluding central government administration) employ over 50 percent of the active population in its myriad sub-sector.

But there is a shortage of workers with higher and vocational education and excess supply of workers with general secondary school education and below. Workers with higher and vocational education were avidly demanded in the labor market in 2010 based on comparing the structure of employment and unemployment by education level (Figure 23). Interestingly, workers with basic vocational skills are in higher shortage than workers with higher education. In fact, for men a basic vocational degree was highly valued in the labor market in 2010, while higher education degrees were in demand for both men and women. The highest surplus was observed among workers with basic secondary education and below.

Figure 23. There is a shortage of workers with higher and vocational education in the market

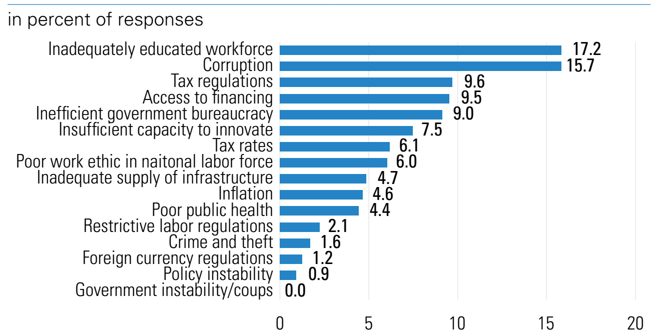
Index of Labor Shortages and Surpluses by Education Attainment



Source: World Bank staff estimates.

Figure 24. The quality of labor skills was identified as the major obstacle for doing business

The Most Problematic Factors for Doing Business



Source: World Economic Forum, 2012–2013.

This mismatch of skills is a major concern to entrepreneurs and may challenge the growth potential of technology-intensive manufacturing and business services. The 2012–2013 World Economic Forum (WEF) report indicates that inadequately educated workforce is the most problematic factor for doing business in Kazakhstan (Figure 24). More specifically, a recent survey by Ernst and Young notes that in general, the investors see the Kazakhstani population as talented and well educated. However, there is an insufficient number of potential employees with industry-specific knowledge and skills and practical skills and knowledge of modern technologies in Kazakhstan. Respondents mention the "generation gap" in technical specialties. Employees who received a sound Soviet-era education are retiring, and the new education system does not

yet offer the same fundamental quality and consistency. Furthermore, respondents note the comparatively low level of interest of the younger generation in pursuing engineering and technical careers.[8]

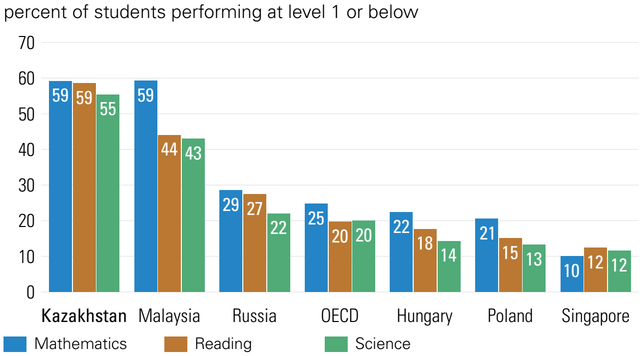
The skills mismatch highlights the need to improve the quality of education and its responsiveness to market demand

In international terms, Kazakhstan fares poorly when it comes to providing adequately trained workers to the labor market. The new entrants to the labor market often lack adequate levels of basic skills when entering the labor force despite having formal credentials from the country's education system. In 2009, Kazakhstan participated for the first time in the Program for International Student Assessment (PISA) that assesses functionality of students in mathematics, reading and science. The PISA results suggested that Kazakhstan students underperformed on these assessments compared to their peers in other income-comparator countries (Figure 25). In particular, students underperformed compared to other countries at similar levels of development, scoring an average of 40 exam points lower on the PISA reading scale—equivalent to about one year of schooling—than the level predicted by the country's GDP per capita (Figure 26).

Figure 25. Students in Kazakhstan underperformed in PISA tests compared to their peers

PISA Results in Selected Countries

percent of students performing at level 1 or below

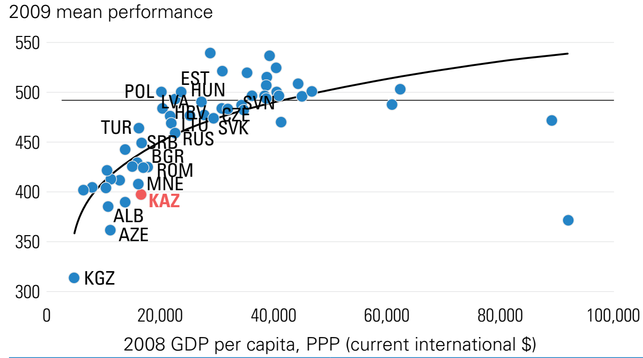


Source: Program for International Student Assessment (2009).

Figure 26. The average reading score is relatively poor in Kazakhstan

PISA Reading Results Worldwide

2009 mean performance



Source: Sondergaard and Murthi (2012).

The authorities are working to analyze and reform the system. The government, jointly with a World Bank team, recently undertook a study on students' assessment and school autonomy to be followed by teachers' assessment to help define further reforms. Some of the emerging recommendations, which are noted below, point to a need for improvement in the quality and relevance of education and training. The country is to participate in the 2013 PISA, providing newer insight into Kazakh students' performance. In the meantime, new education policies have been in place and have led to some improvements. Further efforts are needed and are being considered for improving the quality of the labor force, especially taking into consideration the level of country's economic development.

8 Ernst and Young (2012).

- The quality of secondary education will need to be improved and its content aligned with the development of key cognitive, behavioral, and technical skills to serve the economic need for diversification. This involves a two prong approach:
  - The quality of general secondary education needs to be improved to ensure all students learn and achieve above the basic literacy and numeracy which the PISA measure.
  - The secondary system needs to be reformed to better address cognitive/non-cognitive and technical skills. In this regard, the upcoming debate on switching to 12 year schooling with a tracking at 11–12 provides an excellent opportunity to look at the options for reform.

- Secondary education needs to be better aligned with market needs. This involves a two- pronged approach:
  - Information: More complete and more publically accessible labor market information is necessary to ensure matching of skills and needs. Building a knowledge base through skill measurement studies that can inform education and training policies is a critical step to aligning government policy with the country's development needs.
  - Private sector involvements: Higher quality education and training should be accompanied with much closer consultations with the private sector to assess their needs. It is important to assess what is the right balance between higher education and vocational education training places by consulting employers' representatives. Also, closer collaboration between educational/research institutions with private sector firms should be encouraged to foster sector specific research and human capacity building.

Appendix

Appendix 1. Kazakhstan—Economic and Social Indicators (2005–2015)

Selected Indicators	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Income and Economic Growth											
GDP growth (annual %)	9.7	10.7	8.9	3.3	1.2	7.3	7.5	5.0	5.0	5.4	5.5
GDP per capita growth (annual %)	8.7	9.5	7.7	2.0	-1.4	5.8	6.0	3.5	3.9	4.3	4.4
GDP per capita (US$)	3,771	5,292	6,771	8,514	7,165	9,070	11,357	12,009	12,869	13,893	15,007
Private Consumption growth (annual %)	9.7	11.9	10.5	4.4	1.6	10.7	9.7	9.3	6.5	4.4	4.4
Gross Fixed Investment (% of GDP)	31.0	33.9	35.5	27.5	29.4	25.4	22.2	21.6	21.3	21.1	21.0
Gross Fixed Investment - Public (% of GDP)	4.6	4.5	5.6	5.8	5.5	5.1	4.6	4.6	4.6	4.6	4.5
Gross Fixed Investment - Private (% of GDP)	26.4	29.4	29.9	21.7	23.9	20.3	17.6	17.0	16.7	16.5	16.4
Savings (% of GDP)	29.7	31.4	27.8	32.4	25.9	26.7	29.1	25.9	24.5	24.2	24.0
Savings – Public (% of GDP)	9.7	11.8	12.4	10.3	7.6	10.4	12.9	12.0	11.5	9.5	9.2
Savings – Private (% of GDP)	19.9	19.6	15.4	22.1	18.2	16.4	16.2	13.9	13.0	14.7	14.8
Money and Prices											
Inflation, consumer prices (annual %, end of year)	7.4	8.4	18.8	9.5	6.2	7.8	7.4	6.0	6.0	6.0	6.0
Inflation, consumer prices (annual %, period average)	7.6	8.6	10.8	17.2	7.3	7.1	8.3	5.1	6.4	5.8	5.8
Central Bank Refinancing Rate (%, weighted average)	7.8	8.6	9.2	10.8	8.4	7.0	7.4	6.2	..	..	..
Nominal Exchange Rate (end of period)	134	127	121	121	148	147	148	150	149	148	148
Real Exchange Rate index (1998=100)	100	90	81	71	81	76	72	71	69	66	64
Fiscal Accounts and External Debt/Assets											
Revenues (% of GDP)	28.0	28.3	29.2	29.7	22.7	25.0	27.7	26.8	25.5	25.5	25.1
Oil revenues (% of GDP)	9.4	10.0	8.1	12.3	8.1	10.4	14.0	13.4	12.0	12.1	11.7
Non-oil revenues (% of GDP)	18.6	18.3	21.1	17.4	14.7	14.6	13.8	13.4	13.5	13.5	13.4
Expenditures (% of GDP)	22.3	20.3	24.2	27.2	23.5	22.1	21.5	22.3	22.5	22.6	22.6
Current (% of GDP)	15.8	14.2	14.8	14.2	16.1	15.0	14.9	16.2	16.4	16.5	16.6
Capital and net lending (% of GDP)	6.5	6.1	9.4	13.1	7.4	7.1	6.7	6.1	6.1	6.1	6.1
Overall fiscal balance (% of GDP)	5.6	8.0	5.0	2.5	-0.8	2.9	6.2	4.5	3.0	2.9	2.5
Non-oil fiscal balance (% of GDP)	-3.7	-2.1	-3.0	-9.8	-8.8	-7.6	-7.8	-8.9	-9.0	-9.2	-9.2
Non-oil primary fiscal balance (% of GDP)	-3.3	-1.8	-2.8	-9.4	-8.4	-7.1	-7.3	-8.5	-8.5	-8.6	-8.6
External debt, total (current US$ billion)	43.4	74.0	96.9	107.9	112.9	118.2	125.2	137.1	148.9	161.0	172.5
External public debt (% of GDP)	3.8	3.9	2.0	1.6	3.2	3.5	2.9	2.9	3.1	3.0	2.8
Total public debt (% of GDP)	9.8	12.8	7.8	8.7	13.9	15.5	12.5	13.4	16.4	17.5	18.7
Total official international reserves (% of GDP)	26.5	41.0	36.8	35.5	41.2	40.0	38.8	42.7	43.7	44.3	44.5
External Accounts											
Export real growth (%, yoy)	1.1	6.5	9.0	0.9	-11.6	1.9	3.5	-0.4	1.3	4.9	4.9
Import real growth (%, yoy)	12.5	12.2	25.8	-11.3	-16.0	0.9	6.9	19.5	4.0	3.5	4.0
Merchandise exports (current US$ billions)	28.3	38.8	48.4	72.0	43.9	61.4	87.5	92.1	90.5	95.1	99.7
of which: oil & gas	19.5	26.3	31.5	48.9	30.0	42.5	65.3	64.5	63.7	67.8	71.8
Merchandise imports (current US$ billions)	-18.0	-24.1	-33.3	-38.5	-29.0	-32.9	-40.7	-47.4	-48.4	-50.2	-52.2
Services, net (current US$ billions)	-5.3	-5.9	-8.2	-6.7	-5.8	-7.1	-6.4	-7.7	-6.2	-6.6	-7.1

Selected Indicators	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Workers' remittances, net (BoP, current US$ billions)	-1.1	-1.9	-2.9	-1.9	-1.4	-1.4	-1.5	-1.7	-1.8	-1.9	-2.0
Current account balance (current US$ billions)	-1.1	-2.0	-8.3	6.3	-4.1	1.4	12.3	7.7	8.3	8.9	9.4
as percent of GDP	-1.8	-2.5	-7.9	4.7	-3.6	0.9	6.5	3.8	3.8	3.8	3.6
Foreign Direct Investment (current US$ billions)	2.1	6.7	8.0	13.1	10.1	3.7	9.3	12.4	12.7	12.1	10.2
Population, Employment and Poverty											
Population, total (millions)	15.1	15.3	15.5	15.7	16.1	16.3	16.6	16.8	17.0	17.1	17.3
Population growth (annual %)	0.9	1.1	1.2	1.2	2.7	1.4	1.4	1.4	1.0	1.0	1.0
Unemployment rate (% of labor force)	8.1	7.8	7.3	6.6	6.6	5.8	5.4	5.3	5.3	5.3	5.3
Poverty headcount ratio at national poverty line (% of population)	31.6	18.2	12.7	12.1	8.2	6.5	5.3	4.0	..	..	..
at US$ 1.25 a day (PPP)	..	0.4	0.2	0.1	0.1	..	..	..	..	..	..
at US$ 2 a day (PPP)	..	3.3	1.5	0.9	1.1	..	..	..	..	..	..
Inequality - Income Gini	0.304	0.312	0.309	0.288	0.267	0.278	0.289	..	..	..	..
Life expectancy (years)	66	66	67	67	68	68	69	..	..	..	..
Other											
GDP (current tenge billions)	7,591	10,214	12,850	16,053	17,008	21,816	27,572	30,073	32,496	35,377	38,533
GDP (current US$ billions)	57.1	81.0	104.8	133.4	115.3	148.1	188.0	201.7	218.4	238.2	260.0
Doing Business rank /1	..	..	..	..	74	58	56	49	..	..	..
Human Development Index ranking /2	..	..	..	..	..	69	68	..	..	..	..
CPIA overall rating	3.7	3.7	3.7	3.6	3.7	3.7	3.8	3.8	..	..	..
Economic Management	4.2	4.2	4.2	4.0	4.2	4.3	4.3	4.3	..	..	..
Structural Policies	3.7	3.7	3.7	3.5	3.5	3.5	3.7	3.7	..	..	..
Social Inclusion and Equity Policies	3.5	3.5	3.5	3.6	3.6	3.6	3.7	3.7	..	..	..
Public Sector Management and Institutions	3.4	3.4	3.4	3.4	3.4	3.4	3.5	3.5	..	..	..

1/ The Doing Business indicator is ranked out of 181 countries in 2009; 183 in 2010; and 185 in 2010-2011.
2/ The Human Development Index is ranked out of 169 countries in 2010 and 187 in 2011.

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