Executive summary

Kazakhstan's economy and society have undergone deep transformations since the country declared independence in 1991. The transition period was unstable and disruptive, with a 31% contraction of real gross domestic product (GDP) by 1995, hyperinflation, and the destruction of 1.6 million jobs during the 1990s. Kazakhstan's growth performance since recovering in 2000 has been impressive, averaging almost 8% per annum in real terms and leading to the creation of 2.3 million jobs. The period since independence was also marked by significant social transformation evidenced by massive migration flows during the 1990s and the evolution of social policy.

In 2012 Kazakhstan set the overarching objective of becoming one of the 30 most developed countries in the world by 2050. Under this overarching objective, the Kazakhstan 2050 Strategy sets priorities for economic, social and political development in the medium term.

This report is the first volume of the Multi-dimensional Country Review (MDCR) of Kazakhstan. It describes the driving forces of development in Kazakhstan and identifies the major constraints to equitable and sustainable progress in growth and well-being.

Main findings

After deteriorating during the early years after independence, living standards have improved, although outcomes remain below par in several non-monetary dimensions. The improvement has been notable in material conditions. Growth in incomes and the creation of salaried jobs have contributed to a dramatic fall in poverty, while inequality remained low. In dimensions of well-being where public services provision plays an important role, Kazakhstan performs well in measures that assess quantity but underperforms in measures of quality and effectiveness. For example, basic education is quasi-universal but average quality and learning outcomes are below par. Health outcomes also remain poor whether measured by life expectancy, mortality rates or the prevalence of major infectious diseases.

Extractive industries play an important role in the economy of Kazakhstan, as they generate 16% of GDP. The oil and gas sector contributed half of real GDP growth between 2000 and 2005. It still looms large in the economy. When related activities are included, the oil and gas sector generates as much as 30% of GDP, almost a third of budget revenues and close to two-thirds of exports.

Flows linked to oil and gas revenues are managed prudently, avoiding the main symptoms of Dutch disease. Most oil-related public revenues are channelled to a National Fund with limited transfers to and from the national budget. However, large oil-related

flows have challenged macroeconomic and financial stability in the past, mainly through large exchange rate devaluations and instability in the banking sector.

Kazakhstan is vulnerable to external shocks through its dependency on natural resources and its geographic position. Fluctuations in raw material prices, the economic performance of its main trade partners (in order of importance, the European Union, the People's Republic of China and the Russian Federation) and geopolitical tensions have important effects on economic performance. Kazakhstan is landlocked, which makes it dependent on its neighbours for the efficiency of logistics networks. Ties with the Russian Federation are strong and further sustained by the creation of the Eurasian Economic Union in January 2015.

Sources of growth beyond natural resource sectors remain underexploited. With labour force participation at almost 80% and unemployment at 4%, there is little scope for activating workers. However, there is scope for increasing productivity by shifting labour to more productive sectors, especially away from agriculture (which represents 24% of employment but 5% of GDP). There is also scope to increase investment which, at 23% of GDP, is lower than in comparable countries.

Diversification has progressed modestly but faces multiple obstacles. Manufacturing and knowledge-intensive services have experienced growth in employment and productivity since 2011 but remain small. The market structure limits competition and contestability, and there is ample room to lower regulatory burdens and improve the business climate.

Key constraints to development

Natural-resource dependency exposes the economy to external risks and can hamper growth in other sectors. Natural wealth offers great opportunities. However, the importance of extractive sectors has led to a configuration of the economy that is not conducive to the development of other sectors.

The concentration of economic clout in the hands of the state and of a small number of private actors constrains investment and dynamism. Public and state-owned entities still account for 30% to 40% of GDP. Strong price controls in a number of markets, discretionary intervention by state actors and limited competition distort price signals and limit opportunities for new entry and innovation. A privatisation programme is being implemented and legislation adopted in 2015 constrains the sectors of intervention of state-owned firms.

The financial sector remains fragile and underdeveloped. Non-performing loans accounted for 26% of the total loan portfolio in December 2014 before falling to 10% in June 2015. Banks are the main source of external funding for firms, yet lending to the private sector remains low. The financial sector operates in a difficult environment, characterised by weak rule of law, dollarisation and until recently a challenging exchange rate regime.

The effectiveness of environmental regulation is insufficient to overturn a legacy of overexploitation of natural capital and has consequences for environmental well-being. The energy intensity of the economy is high, as is the rate of greenhouse gas emissions. Adverse environmental outcomes are a major concern due to the inherent value of the environment but also because they challenge the sustainability of the current development model.

Widespread corruption hinders the business environment and undermines meritocracy and entrepreneurial spirit. It affects key state functions including the delivery of public service and public procurement. The government has identified control of corruption as one of its key priorities and has undertaken several anti-corruption measures as well as key institutional reforms.

There is limited implementation capacity for certain government functions. Outcomes in the quality of service provision are mediocre. Some constraints are sector-specific, such as the legacy of underinvestment in primary healthcare or the difficulties in human resource management in the education sector. Others are cross-cutting, including integrity issues, and difficulties in co-ordination across agencies and in managing efficiency differentials across administrations.

The skills system has so far failed to generate appropriately equipped labour in sufficient quantity in the labour market for a number of sectors, which limits their growth potential. Skills formation is focused on the education system. A more integrated approach to skills formation and acquisition and human resources management, going beyond formal education, would link skills formation with the importance of small and medium enterprises, the development of opportunities, and the attraction and retention of talent.

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