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Macroeconomics, Trade & Investment

ECONOMIC RECOVERY DURING CHALLENGING TIMES

KAZAKHSTAN ECONOMIC UPDATE • Spring 2023

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Foreword and Acknowledgement

The *Kazakhstan Economic Update* (KEU) is a semiannual report analyzing recent economic developments, prospects, and policy issues in Kazakhstan. The report draws on available data reported by the Government of Kazakhstan, the National Bank of Kazakhstan (NBK), and additional information collected as part of the World Bank Group's regular economic monitoring.

The main authors of this KEU are Azamat Agaidarov (Economist) and Sjamsu Rahardja (Senior Economist), with contributions from Ayesha Vawda, (Lead Education Specialist), Victor Aragones (Senior Transport Specialist), Nathan Hutson (Consultant), and Peter J. Milne (Consultant). The team thanks Hans Anand Beck (Lead Country Economist), Richard Record (Lead Country Economist) for valuable comments and suggestions.

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Overview

Kazakhstan's economy is set to experience a moderate growth acceleration, with real GDP forecast to rise by 3.5 percent in 2023 and 4 percent in 2024, propelled by the hydrocarbons sector, as oil production increases. The outlook for 2023 has been revised downward from pre-war projections due to weaker growth prospects in major trading partner economies and high domestic inflation that has resulted in a loss of purchasing power. Continued FDIs into mining and the government's housing program will likely sustain investment activity. Meanwhile, high inflation, rising borrowing costs, and increased household indebtedness may dampen growth in consumer spending.

Inflation is expected to remain high in 2023 due to elevated food prices and prices of imported intermediate goods. Inflation has surged to its highest level since the late 1990s due in part to wage increases across sectors and crisis-related fiscal measures. Prices rose broadly but food prices have been a major contributor to the surge. Inflation is projected to remain beyond the target range of 4-6 percent in 2023 and return to it in 2024. Although supply disruptions are likely to dissipate in 2023, tight monetary policy will need to be maintained to rein in inflation expectations.

The outlook for growth faces several downside risks. Any further disruptions to the operation of Caspian Pipeline Consortium could lead to losses in production volumes and fiscal revenues, posing downside risks to growth. The persistent high domestic inflation is a serious challenge, particularly for the most vulnerable households, and could potentially amplify the risk of social tensions. To mitigate this risk, continued monetary tightening and tighter control of fiscal spending, coupled with more effective targeting of social programs, may be necessary. Additional tightening of global financial conditions due to geopolitical tensions, energy crisis, and high inflation may pressure exchange rate, leading to potential capital flow volatility.

In the near-term, with rising geopolitical tensions, diversifying trade-logistics routes and developing alternative supply-chain links is crucial. Kazakhstan's significant economic ties and geographic proximity to Russia leave it heavily reliant on Russian economic infrastructure. Goods shipped from the EU must pass through Russian territory before reaching Kazakhstan, making it vulnerable to supply chain disruptions. The latest phase of Russia's invasion may further escalate sanctions imposed on Russia, causing problems in already distressed supply chains. Such disruptions can increase risk aversion and hinder business activity domestically, with western investors fearing that Kazakh businesses may be used to bypass sanctions. In this context, developing alternative trade-logistics routes is crucial to enhance supply chain resilience. **(see Section VII)**.

Kazakhstan needs to continue with structural reforms to address its medium-term development challenges. Economic growth has been significantly constrained by weak productivity over the past decade, hindering development prospects. Average real GDP growth has declined to less than 4 percent since the 2008 banking crisis and subsequent construction bubble burst, down from 10 percent annual expansion in 2000-07. One of the structural deficiencies of the resource-oriented economy is declining human capital, which has been worsened by the pandemic. The closure of schools and disruptions in teaching have likely erased previous gains made by investing in education. Moreover, the learning losses from the pandemic have disproportionately affected poorer households, exacerbating inequalities. The protests witnessed in January also call for further reforms to improve inclusivity in the development of human capital across the country. To address these issues, a comprehensive approach to improve access to quality education should be considered. **(see Section VIII)**.

I. The External Environment

Global growth slows due to policies aimed at controlling high inflation, deteriorating financial conditions, and ongoing disruptions from the Russian's invasion of Ukraine. Global growth, estimated at 2.8 percent in 2022, is projected to fall to 1.8 percent in 2023.[1] The euro area, China and Russia – Kazakhstan's key trading partners – are undergoing a period of pronounced weakness with the resulting spillovers to growth outlook and global commodity prices.

The euro area avoided a recession in 2022 despite natural gas supply cuts from Russia and surging energy prices, which fueled inflation and weighed on industrial output. The region's economy benefited from significant fiscal support to ease pressure on households and businesses and resilience of its energy intensive industries. A warm winter and diversification of supply sources helped to reduce energy prices. However, growth is expected to slow to zero percent in 2023 before rising to 1.6 percent in 2024. The

[1] World Bank Global Economic Prospects, January 2023

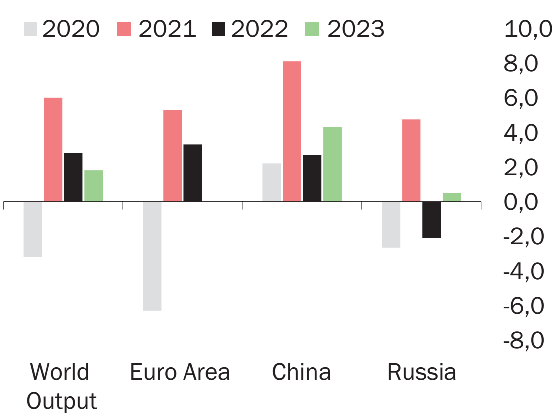
2023 projection reflects the uncertainty over energy supply disruptions and elevated inflation, which may require further monetary policy tightening that could restrain business sentiment and household consumption.

China's growth in 2022 slowed significantly due to a two-month lockdown in key manufacturing areas and other domestic issues, such as the property market crisis. Restrictions on housing speculation and defaults on property company debt payments resulted in decreased mortgage loans and investment in housing, which had previously driven growth. In 2023, the economy is expected to grow at a rate of 4.3 percent due to the easing of pandemic restrictions and subsequent release of pent-up consumer spending. Despite this positive outlook, continued stress in the real estate sector remains a significant downside risk that could impact confidence and impede the recovery.

The Russian economy contracted by 2.1 percent in 2022 amid international sanction as a result of its invasion of Ukraine. The economy faced a squeeze on both the supply and demand sides. Falling real wages led to reduced consumer spending, and investment was impacted by a significant number of sanctions. Industrial base was affected by western companied pulling out of the country and sectors such as car manufacturing were hit by importation restrictions on foreign parts. However, oil production continued to rise, and exports were redirected at discounted prices to non-European buyers, which resulted in a boost to the current-account surplus by over twice its level in the previous year. The central bank's aggressive tightening of monetary policy in the early days of the invasion helped to prevent a financial crisis and stabilize inflation. Unemployment remained unchanged due to the government's urging firms to keep workers on, even if on lower pay. A modest expansion in GDP is anticipated for Russia in 2023, but the effects of EU oil embargoes and a cap on oil prices could undermine economic activity, potentially leading to a recession.

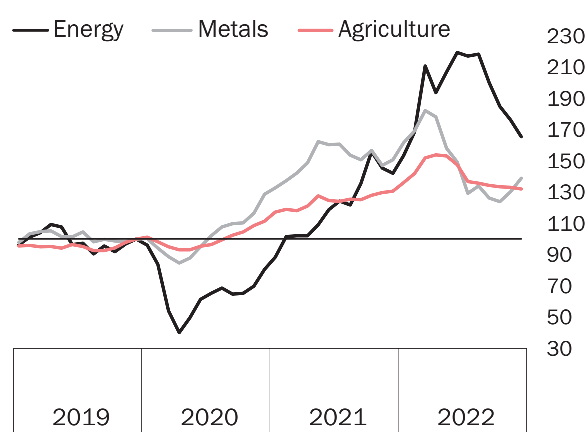
The prices of Kazakhstan's export commodities have eased due to weakening global demand, but are expected to remain high relative to the past five years. While oil prices have dropped since mid-2022, due to slower global growth and weaker demand, agricultural prices remain high, albeit with some decline due to higher yields and resumed exports from Ukraine. Metal prices have also declined due to slowing demand, particularly from China. In 2023, crude oil prices are expected to moderate further due to concerns about weaker global growth, while agricultural prices could stabilize with better global production prospects and easing input costs. Metal prices are expected to decline further as demand from China weakens, particularly as the property market cools. On the upside, oil prices could rise due to potential supply disruptions from Russia and minimal spare capacity among OPEC+ members.[2]

Figure 1. Growth momentum weakenes in key foreign markets *(percent, y-o-y)*



Source: World Bank Global Economic Prospects, January 2023

Figure 2. Global commodity prices ease
(price index, 12M2019 = 100)



Source: World Bank, Pink Sheet

[2] World Bank Commodity Markets Outlook: October 2023

II. Economic Growth and Inflation

The fallout from Russian invasion of Ukraine and soaring inflation has taken its toll on Kazakhstan's economy. Lower oil production and supply-chain issues stemming from the country's direct economic ties with Russia, as well as fast-rising inflation slowed economic growth in 2022. GDP increased by 3.2 percent, down from the 4.1 percent rise in 2021. On demand side, investment activity moderated, while consumer demand weakened as real incomes shrank due to double-digit inflation. As inflation soared after Russian invasion of Ukraine, real incomes contacted by 1.0 percent, contributing to subdued growth in retail trade. The sanctions imposed to Russia have dampened business activity due to longer delays and higher cost of sourcing the goods from Russia. This was evident from monthly business survey indicators that have underlined the difficulties facing businesses caused by higher input prices, logistics disruptions, and an increasing level of uncertainty.[3] Despite these facts, investment grew by 7.9 percent y-o-y supported to large extent by robust growth in housing, thanks to a government-run housing program, and a rebound in foreign

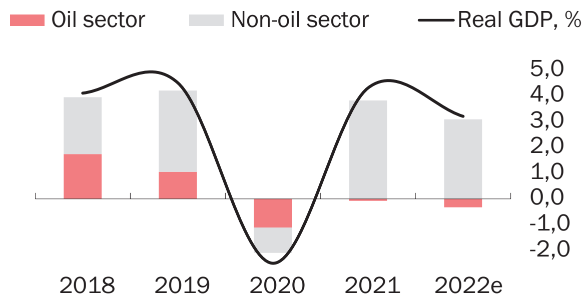
[3] Monthly Kazakhstan Business Activity Index (BAI) produced by the National Bank of Kazakhstan.

direct investment (FDI) in the mining sector after two consecutive years of decline **(Figures 3,4,5)**.

Manufacturing and services drove growth on the supply side, albeit at a slower rate than a year earlier. In 2022, the operation of the Caspian Pipeline Consortium (CPC) terminal on the Black Sea, through which Kazakhstan exports about 80 percent of its oil, has been suspended several times amid rising geopolitical tensions surrounding the invasion of Ukraine.[4] [5] The interruption to the pipeline has also global repercussions, as it transports about 1 percent of global oil. As a result of disruptions to the pipeline, oil production declined by 1.8 percent y-o-y and growth in the mining sector contracted in 2022. Meanwhile, manufacturing production continued to show a solid expansion of 3.4 percent y-o-y, driven by increased production in subsectors such as metal processing, products of chemical industry, and vehicles, representing roughly 60 percent of aggregate of the manufacturing production. The easing of COVID-related containment measures benefited activity in the contact-intensive services sector, in segments such as hospitality, telecommunications, and travel. While the aggregate services VA grew by 2.6 percent y-o-y in 2022, it lost momentum compared to previous periods.

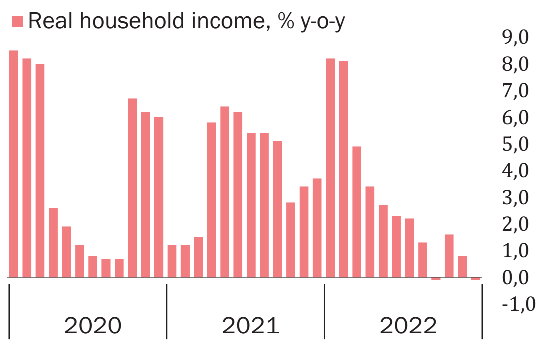
Inflation has soared to levels not seen since the late 1990s, largely driven by a sharp rise in food prices and wage increases across various sectors. As of January 2023, the inflation rate stood at 20.7 percent y-o-y a significant increase from the 8.7 percent reported in February 2022 when the Russia's invasion of Ukraine first began. The likely causes of a spike in inflation include sizeable minimum wage adjustments and riots induced nominal pay increases across sectors and the import prices increases exacerbated by tenge depreciation. While prices have risen broadly, food prices have been a major contributor to the surge. The cost of certain essential food items such as meat, sugar, and eggs, has skyrocketed. To ease the burden on low-income earners, the government has set price caps on staple foods, utility tariffs, and introduced export restrictions on certain goods, which were later relaxed.[6]

Figure 3. GDP growth slowes *(percent, y-o-y)*



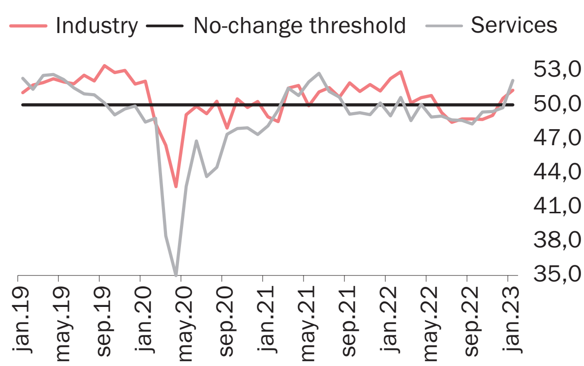
Source: World Bank staff calculations based on Bureau of National Statistics data.

Figure 4. Incomes squezee amid high inflation *(percent, y-o-y)*



Source: World Bank staff estimates based on Bureau of National Statistics data.

Figure 5. Business activity indexes decline



Source: The National Bank of Kazakhstan data

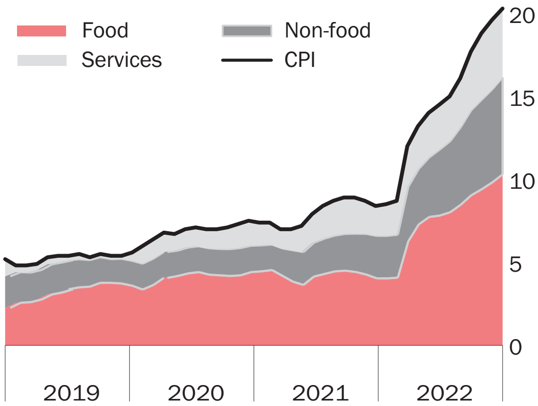
[4] In late March 2022, according to Russian officials, the pipeline was reportedly damaged by a storm; in late June, the Russian Government had to close two loading facilities at the marine terminal once again, due to the discovery of pieces of unexploded mines from WWII; in early July, a Russian court ordered a halt to pipeline activity on possible oil leakage concerns but later lifted the suspension.

[5] https://www.reuters.com/business/energy/oil-prices-resume-climb-after-us-stockpiles-drop-tight-market-2022-03-23/

[6] https://www.nasdaq.com/articles/kazakh-wheat-and-flour-export-restrictions-to-begin-on-april-15

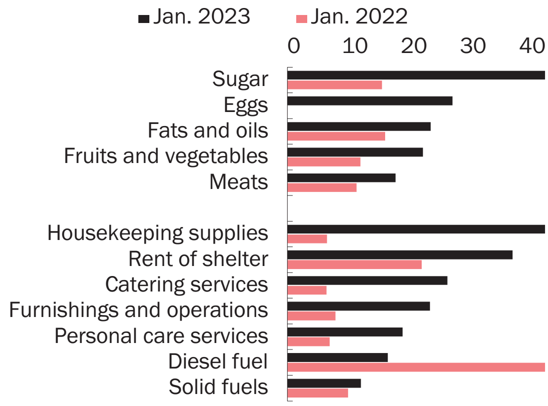
The partial mobilization in Russia has resulted in a surge of newcomers to Kazakhstan fleeing conscription, which has stoked demand for rentals and sharply increased housing costs.[7] Average rents saw an annual increase of 40.7 percent in January, contributing also to an overall rise in consumer prices. Additionally, continued labor strikes across various sectors and a 41 percent increase in the minimum wage drove up real wages by 2.8 percent y-o-y in Q4, potentially increasing costs for businesses. This has been compounded by the depreciation of the tenge exchange rate, which lost 8.1 percent of its value against the US dollar in 2022, driving up the cost of imported goods by 10.8 percent y-o-y. (Figure 6,7)

Figure 6. Inflation surges
(year-on-year, percentage point)



Source: World Bank staff calculations based on Bureau of National Statistics data.

Figure 7. Prices for staple food rise sharply
(year-on-year, percent)



Source: Bureau of National Statistics data.

In response to the accelerated inflation, the National Bank of Kazakhstan (NBK) has substantially tightened its monetary policy. In 2022, the NBK increased its policy rate by 6.5 percentage points to 16.75 percent in response to double-digit inflation, which was well above the target range of 4-6 percent. The policy rate has remained unchanged following another revision in January 2023 with the NBK warning that elevated inflationary pressures could stem from higher budget spending. The rate hike was the largest since the tenge devaluation in 2015, as the NBK typically increases its benchmark rate by increments of 0.5 of a percentage point **(Figure 8)**.

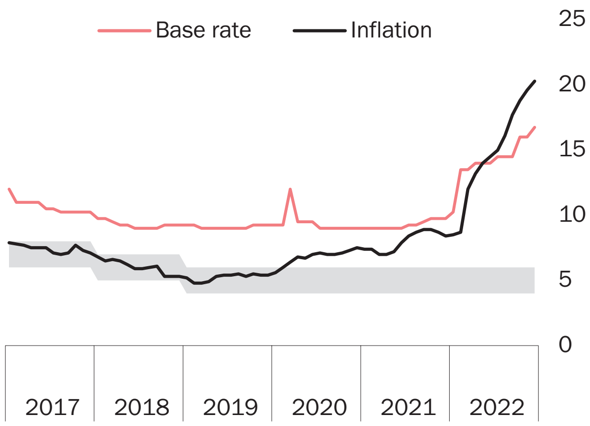
The increased tenge exchange rate volatility has created additional complications for the NBK in ensuring price stability, especially in the aftermath of the sanctions imposed on Russia. As pressure on tenge exchange increased in 2022, the NBK scaled up its presence in the market by selling foreign exchange (FX) from both its own reserves and the assets of the National Fund (NFRK).[8] The NBK has sold approximately US$1.5 billion in FX from its international reserves to mitigate short-term exchange rate volatility. Although the NBK sold reserves, its FX reserves increased by 2.0 percent y-o-y in December 2022, bolstered by a current account surplus, and they remain at a comfortable level of covering 7 months of imports. Additionally, the NBK imposed restrictions on FX transfers made by residents to accounts outside the country on amounts exceeding US$10,000, banned the transfer of refined gold bars, and introduced surrender requirements for commodity exporting SOEs, mandating them to convert a portion of their FX revenues into tenge.[9] **(Figure 9,10)**

[7] According to security officials, over 220 thousand Russian nationals have entered Kazakhstan since the announcement of partial mobilization on Sept. 21 in Russia and 147 thousand Russian citizens have left the country.

[8] NFRK assets in US dollars are converted into tenge before transferring to the government budget and are likely to support the tenge exchange rate in the process.

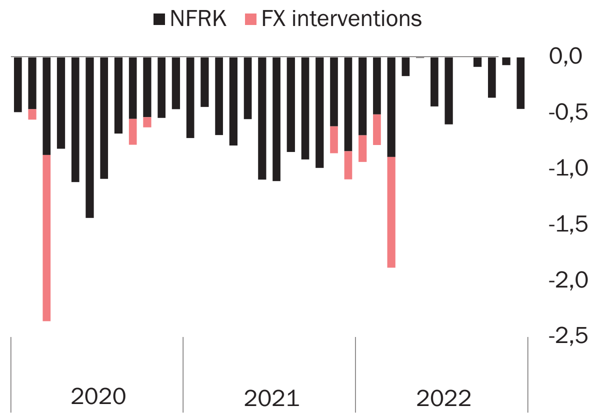
[9] In April, the NBK increased the share FX revenues to be sold in domestic market from previously set 50 percent to 75 percent

Figure 8. Monetary policy tightens to rein in inflationary pressure *(year-on-year, percent)*



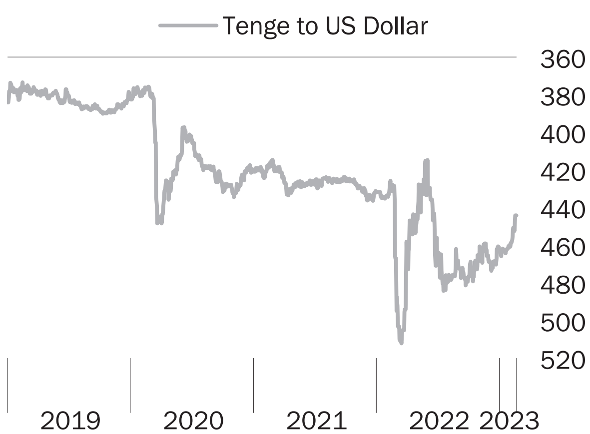
Source: Bureau of National Statistics data, the National Bank of Kazakhstan.

Figure 9. Central bank scales up FX interventions to backstop the currency *(US$ billion)*



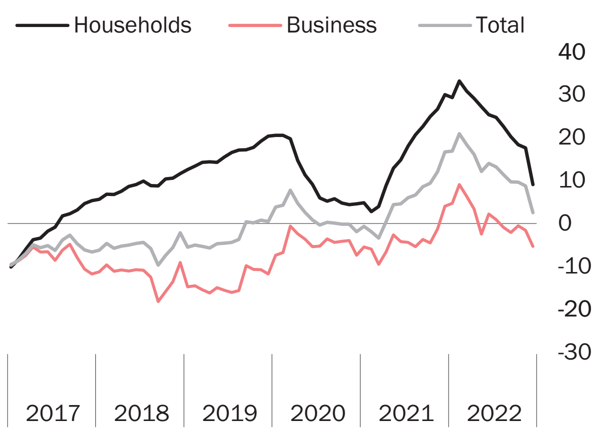
Source: Bureau of National Statistics data, the National Bank of Kazakhstan.

Figure 10. The tenge depreciates following the sanctions on Russia *(inverted scale)*



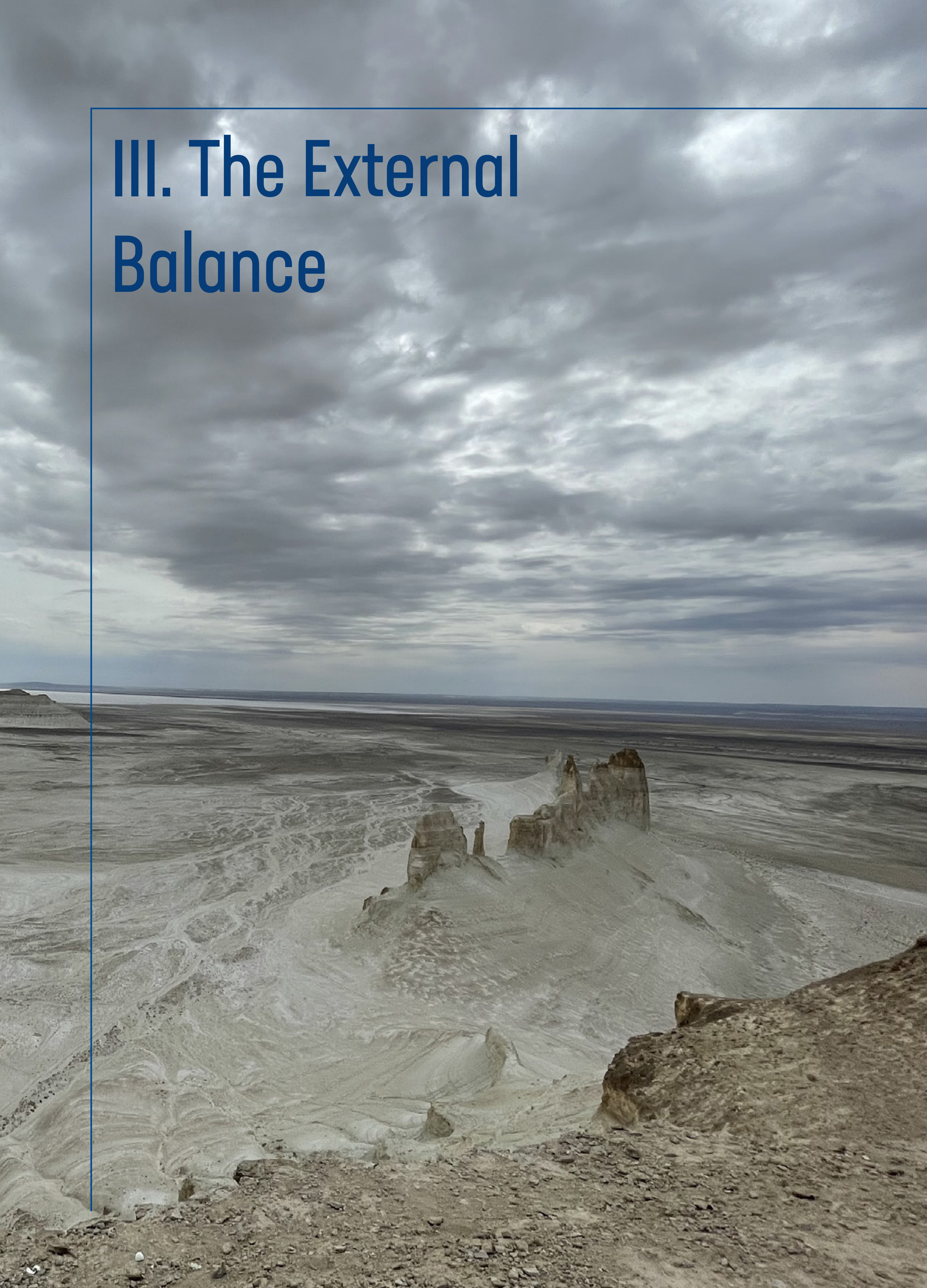
Source: The National Bank of Kazakhstan.

Figure 11. Bank lending growth slows *(year-on-year, percent)*



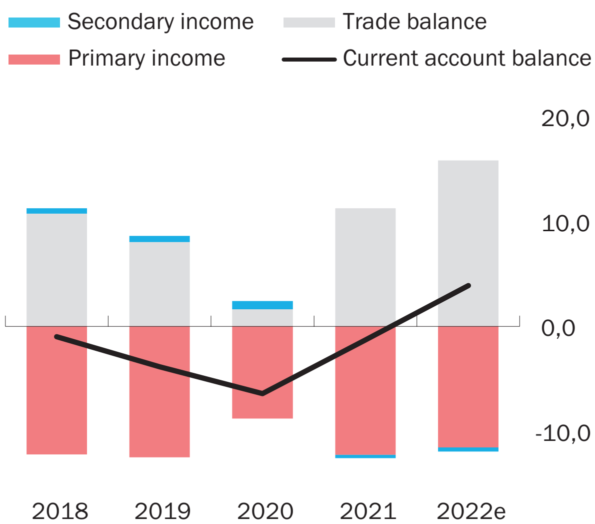
Source: World Bank staff calculations based on the National Bank data.

III. The External Balance



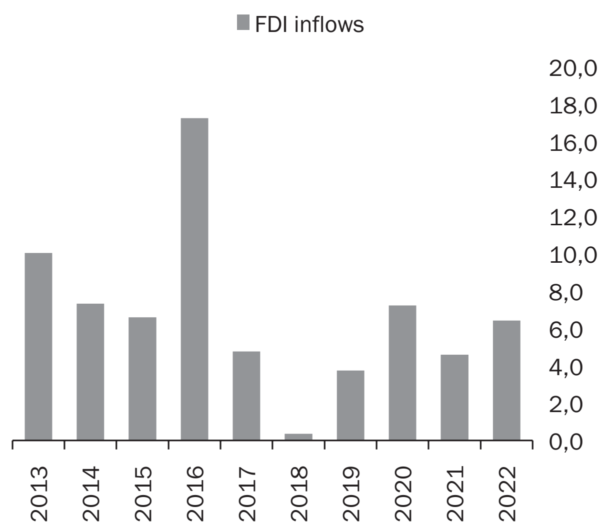
Boosted by a robust recovery in exports, the current account flipped into a surplus in 2022. The substantial increase in global oil prices has played a pivotal role in boosting merchandise export values and improving the trade balance. The export of goods rose by 30.9 percent, thanks largely to higher oil prices, while imports rose by just 19.7 percent y-o-y. The two largest goods exports, oil and gas, and metals, experienced a 51 percent and 13 percent annual increase, respectively, accounting for about 75 percent of total goods exports. Despite the deficit in primary income balance owing repatriation of earnings from mining sector, solid growth in the trade surplus led to a current account surplus of US$8.5 billion in 2022, compared with a deficit of US$2.6 billion in 2021. In 2022, foreign direct investment (FDI) [10] inflows increased by 7.9 percent compared to the same period last year. The increase in FDI inflows was primarily driven by a substantial surge in reinvested earnings from foreign companies invested in foreign-affiliated joint investment projects, which more than doubled compared to the previous year. The energy and mining sectors and manufacturing attracted a significant share of FDI flows, accounting for nearly 2/3rd of total inflows, followed by the trade and telecommunication sectors **(Figure 12,13)**.

Figure 12. **Figure 12. Current account turnes into suplus** *(percent of GDP)*



Source: World Bank staff calculations based on the National Bank data.

Figure 13. FDI flows sustaine *(US$ billion)*



[10] Net incurrence of liabilities from direct investment Balance of Payment statistics

IV. The Financial Sector

The banking system has so far been resilient to the stresses emanating from the challenging economic environment. Banks' aggregate capital ratio (CET1) decreased slightly to 18.5 percent in December 2022 from 19.3 percent a year ago (7.5 percent is the regulatory requirement), and the ratio of liquid reserves to assets stood at solid 30.2 percent, slightly less than 31.1 percent recorded in December 2021. While banks' capital and liquidity positions have remained strong, rising inflation and slowed growth have started to impact asset quality. The ratio of non-performing loans (NPLs) as a share of aggregate loan portfolio was only slightly up to 3.4 percent in December compared to 3.3 percent a year before.

The sanction on the Russian financial system have led Russian banks to exit Kazakhstan. Prior to the war and sanctions, Russian banks were active in both loan and deposit markets in Kazakhstan. Kazakh banks have limited direct exposure to Russia and Ukraine but prior to the war Russian banks held 15 percent of Kazakhstan's banking sector assets. In March and April 2022, the sanctions imposed on the Russian financial system limited the operations of these banks in Kazakhstan, owing to restrictions on FX transactions. Account withdrawals and moves to other local banks by corporate and individual clients intensified as risks of being unable to transfer funds in certain currencies to accounts at other banks had substantially increased. Over the rest of the year, that exposure was reduced to just 0.4 percent, as private and government-run financial institutions purchased subsidiary banks.

Corporate loan growth adjusted for inflation contracts, while reduced consumer demand moderates lending growth to households. Credit growth to the corporate sector was disrupted by the war and resultant policy shifts. Accelerated inflation and slowing economic activity led the annual growth rate (adjusted for inflation) of loans to businesses to contract by 5.3 percent y-o-y in December, from 9.1 percent growth seen in February 2022. In contrast, credit growth to households showed a 9.1 percent y-o-y expansion in real terms in December (33.2 percent in February 2022), though this growth is petering out now that the temporary pension fund withdrawal program that had spurred new mortgages has ended **(Figure 9)**.[11] In recent years, credit to households has been growing faster than the nominal income, raising households' debt burdens. By the end of 2021, the household credit-to-GDP ratio shifted up to the level last seen during the global financial crisis of 2008/09 **(Box 1)**.

Box 1. Developments related to household and corporate indebtedness *(percent of income and profits)*[12]

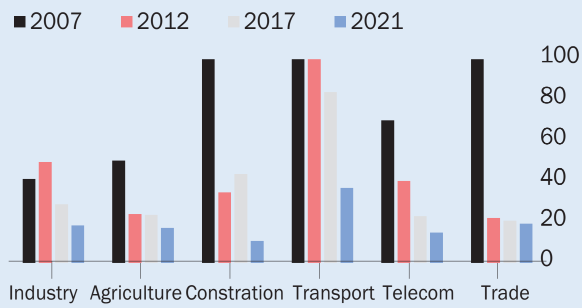
Household indebtedness grew rapidly in the run up to the 2008/09 global financial crisis, following by a steady downward path since then until before the COVID-19 crisis. Household debt had increased sharply before the global financial crisis. Consumer and mortgage credits were the main drivers of overall debt growth. Bank loans were extensively used to purchase real estate, which caused a housing market bubble. After the bursting of the housing market bubble, built up in early 2000s and the banking crisis in 2008/09, households' exposure to bank loans and leverage fell substantially relative to their incomes. Several instances of tenge devaluation reduced the US dollar value of housing and slowed mortgage-financed housing investment.

Household debt jumped in 2020 because of accelerated borrowing and the squeezing of incomes owing to the pandemic-induced recession. Government policy has played a crucial role in rising household debt leverage, as banks continued lending with support largely from government-funded subsidized lending programs. In 2021, the authorities rolled out a program to allow pensioners to use their savings to purchase a house or repay a mortgage. This boosted demand for mortgages, residential investments, and pushed up housing prices across the country. Going forward, spillover effects of the war and sanctions that tightened domestic financial conditions, economic slowdown, and intensified inflationary pressure are likely to hit employment prospects, households' purchasing power and their debt servicing capacity. Households at the lower end of the income distribution are likely to experience a relatively larger burden of increased debt exposure, as aggregate data conceal inequalities in household income and wealth, especially between the urban and rural dimensions in Kazakhstan.

Figure A. Debt-to-income ratio *(percent)*

Source: World Bank staff calculations based on Bureau of National Statistics and the National Bank data.

Figure B. Debt-to-profit ratio *(percent)*



Source: World Bank staff calculations based on Bureau of National Statistics and the National Bank data.

In contrast, leverage and exposure to bank loans in the corporate sector continue to be moderate. The COVID-19-induced crisis and economic recessions that Kazakhstan encountered before did not contribute to a build-up of corporate loans. This is due to the continued decline in lending to businesses that had persisted since the crisis of 2015–16, registering an annual contraction. Demand for loans from firms was not growing and financial intermediation stalled, despite various concessional lending programs and a series of bank bailouts. Despite abundant liquidity, banks remain reluctant to expand lending to large firms and SMEs due, in part, to weak growth and the possibly high risk of insolvency faced with uncertainty about the creditworthiness of borrowers. As a result, the debt-to-profit ratio across sectors has followed a downward trend, reducing firm's exposure to bank loans over time.

[11] The government incentive to use pension savings to purchase housing boosted residential investment and demand for mortgages in 2021. The program was effective until early April this year and helped retain growth momentum in Q1 2022

[12] As commercial bank loans are the main source of liquidity in the economy, analysis of household and nonfinancial corporation debt exposure includes only loans extended by banks.

V. Fiscal Policy

In 2022, the Government increased fiscal spending to implement measures aimed at alleviating the adverse effects of Russian invasion and the soaring cost of living. Before the events the government planned to cut budget spending and resume fiscal consolidation. But the economic fallout from the war and widespread social discontent after the January events pushed the Government to introduce fiscal support measures, amounting to an estimated 3.0 percent of GDP in 2022. Consolidated budget spending is estimated to have increased to 22.5 percent in 2022 from 21.2 percent of GDP in 2021. The government continued to prioritize budgetary support for vulnerable households and businesses facing hardship, scaled-up transfers to local governments, and the financing of food security-oriented projects and improving infrastructure. On revenue side, oil-related revenues increased from 5.6 percent of GDP in 2021 to 8.9 percent in 2022 thanks to high oil prices, while non-oil revenues were boosted by greater tax collection. Consequently, the consolidated fiscal balance turned into a moderate surplus of 0.4 percent of GDP from a deficit of 4.3 percent recorded in 2021. Government debt remained sustainable and stood at 23 percent of GDP in 2022, slightly lower than 23.7 percent in 2021 **(Table 1)**.

Following the January unrest, the government has prioritized improving tax administration efforts by closing loopholes and cracking down on evasion. This includes a significant investigation into the sources of undisclosed wealth and income of certain taxpayers, as well as other legal aspects related to concealing the proceeds of corruption and other financial crimes. These efforts align with President Tokayev's earlier commitments to strengthen the rule of law and anti-corruption measures in the country.[13] Other changes to the Tax Code include increased excise duties on gasoline and other oil products, and higher rates of customs duty for oil.[14] [15] Overall, these revenue-raising measures, along with a strong boost from higher oil prices helped to reduce the non-oil deficit to 8.5 percent of GDP in 2022 from 9.9 percent recorded in 2021.

Table 1. Government consolidated fiscal account, 2019–2024
(Percent of GDP)

	2019	2020	2021	2022	2023e	2024f
Revenues	**20.3**	**18.0**	**17.6**	**22.5**	**21.1**	**20.6**
Oil revenue	8.2	5.2	5.6	8.9	7.4	6.7
Non-oil revenue	12.1	12.8	12.0	13.6	13.8	13.9
Expenditures	**20.2**	**24.5**	**21.9**	**22.1**	**21.9**	**20.8**
Current spending	16.7	19.4	18.3	18.1	18.2	17.4
Wage bill	2.9	3.7	3.7	3.8	3.8	3.6
Goods and services	5.6	6.2	5.3	5.4	5.5	5.2
Interest payments	1.0	1.1	1.2	1.4	1.3	1.4
Subsidies, transfers, others	7.2	8.5	8.0	7.5	7.6	7.2
Capital spending and net lending	3.5	5.1	3.6	4.0	3.7	3.5
Consolidated budget balance*	**0.1**	**-6.5**	**-4.3**	**0.4**	**-0.7**	**-0.2**
Non-oil fiscal balance	-8.1	-11.7	-9.9	-8.5	-8.1	-6.9
Financing	**-0.1**	**6.5**	**4.3**	**-0.4**	**0.7**	**0.2**
A. External borrowing (net)	0.3	-0.1	1.1	-0.1	0.5	0.2
B. Domestic borrowing (net)	1.5	4.1	1.9	2.3	2.4	3.3
C. NFRK ***/	-2.0	2.5	1.3	-2.5	-2.2	-3.3
Gross financing needs **/	**1.0**	**7.6**	**5.8**	**1.4**	**1.4**	**1.0**

Sources: Government data, IMF, and WBG staff estimates and projections. f=forecast

*Notes: */ The consolidated budget comprises the state and local governments, and the NFRK*

**/ Gross financing needs is defined as the sum of budget deficits and amortization on external and domestic debt

[13] https://centralasia.news/13573-tokayev-announces-his-firm-intention-to-cleanse-kazakhstan-of-corruption.html

[14] https://home.kpmg/kz/en/home/insights/2022/04/nf-apr.html

[15] https://www.gov.kz/memleket/entities/kgd/press/news/details/358532?lang=ru

VI. Economic Outlook and Risks

The economy is expected to see a moderate acceleration in growth, with real GDP projected to rise to 3.5 percent in 2023 and 4 percent in 2024 led by the hydrocarbons sector as oil production increases. Several new projects, including the expansion of production capacity at the Tengiz field, are expected to further boost exports and contribute to growth in the petrochemical industry. The government expects the expansion project to be completed in 2023 with an increased crude output coming on stream in the following years. The authorities expect oil production to rise by 4–6 million tonnes in 2023, down from an earlier projected increase of 10–14 million tonnes.[16] Continued FDIs into mining and the government's affordable housing program will likely sustain investment activity. However, growth in household consumption is likely to be dampened by persistently high inflation, rising borrowing costs, and increased indebtedness after pension fund savings were used to take on

[16] https://www.reuters.com/world/middle-east/kazakhstan-sees-2023-oil-output-up-over-90-mln-tonnes-minister-2022-05-23/

mortgage loans. The baseline outlook is conditional on the assumption that crude oil shipments through the CPC will not be disrupted.

The outlook for 2023 has been revised downward from pre-war projections, primarily due to the uncertainty surrounding demand in major exporting markets and high inflation domestically that has resulted in a loss of purchasing power. Despite this, real GDP is expected to exceed its potential level, keeping up inflationary pressure that is likely to persist above the target level. In the medium term, the economy is projected to maintain its solid growth trajectory, albeit with a slight moderation to an annual average rate of 3-3.5 percent, in line with its estimated potential growth rate, after a temporary boost in 2024 driven by the launch of a new oil project. Exports are expected to continue to drive overall growth, supporting a robust economic performance over the medium term.

On the upside, if global demand and oil prices exceed expectations, especially with the reopening of the Chinese economy, it could provide a boost to growth particularly for Kazakhstan's export, restore the country's FX reserves and notably improve fiscal and external balances in the short term.

Inflation will persist at elevated levels in 2023 before moderating thereafter. The elevated food prices and prices for imported intermediate goods are likely to sustain price pressure. In 2023, the effects related to supply disruptions are likely to dissipate and tighter monetary policy can help to ease inflationary expectations. Nevertheless, in 2023, annual inflation is projected at 9-11 percent and still remain beyond the target range of 4-6 percent and return to it in 2024. Inflation may come in higher than expected if price pressures from food prices and input costs last longer. Strong global inflationary pressures and the pass-through of higher labor costs and other input supplies risk pushing up producer prices, which in turn can be passed on to consumers through higher prices.

In the medium term, the government intends to gradually reduce expenditures and resume fiscal consolidation. The 2023 budget outlines moderate spending growth, with a focus on social welfare support and regional infrastructure. The minimum wage will increase by 16.7 percent, and certain public sector salaries will rise by 25-30 percent, including those of teachers and doctors. The aging infrastructure demands continued maintenance and repair and will keep up the budgetary pressure. In line with a fiscal rule to replenish fiscal buffers and reduce the exposure of public finances to oil-related revenues, the government plans to cut annual withdrawals from NFRK. Non-oil revenue is expected to increase gradually over the forecast period as the government aims to ramp up tax collection efforts, combat corruption in the customs system, and introduce a new Tax Code with an emphasis on improving administration, digitalization, and introducing a simplified regime for small and medium-sized enterprises (SMEs). [17] [18]

The government debt is projected to increase gradually over the medium-term but remain relatively low and manageable. Total government debt, including public guarantees, is projected to rise from an estimated 23.6 percent of GDP in 2023 to 26.8 percent by 2026. The main driver of this trend is the anticipated deficit in primary income balance of the state budget, caused by steady growth in spending.[19]

High oil prices will help increase the trade surplus and improve the current account position. After a surplus in 2022, largely resulting from higher export earnings, the current account is forecasted to remain in surplus in 2023, but a deficit may follow in the subsequent years as oil prices subside and demand for imported capital and consumer goods strengthens. Exports will be supported by high prices for and planned production increase of crude oil maintaining the trade surplus. In contrast, sustained profit repatriation by companies operating in the oil and gas industry amid favorable commodity prices will keep primary income in deficit.

[17] https://lsm.kz/nalogovye-izmenenie-v-2022-godu

[18] https://eurasianet.org/kazakhstan-customs-feel-the-heat-as-anti-corruption-drive-steps-up-a-gear

[19] State budget comprises centra government and local government budgets and excludes NFRK

The outlook faces several downside risks. First, any further disruptions to the Caspian Pipeline Consortium, which handles the majority of Kazakhstan's oil exports, could lead to losses in production volumes and fiscal revenues, posing downside risks to growth. The pipeline activity was disrupted several times during 2022 for various reasons given that Kazakhstan has declined to publicly support Russia's invasion of Ukraine. Second, the persistent high domestic inflation poses a serious challenge, particularly for the most vulnerable households, and could amplify the risk of social tensions. Access to effective coping mechanisms will be important to protect the poverty reduction gains of the last decade. To mitigate this risk, continued monetary tightening and tighter control of fiscal spending, coupled with more effective targeting of social programs, may be necessary. This can help ensure fiscal policy does not work against tighter monetary policy. Third, additional tightening of global financial conditions, if geopolitical tensions exacerbate energy crisis and sustain high inflation, and subsequent potential capital flow volatility may pose risks to the exchange rate.

As a landlocked economy, Kazakhstan is heavily reliant on Russian economic infrastructure for the transportation of goods. In response, the Kazakh authorities are actively exploring the possibility of diversifying their trade and logistics routes to improve the country's long-term growth profile. Despite these efforts, given its close proximity and significant economic linkages to Russia, Kazakhstan must remain vigilant of the risk of secondary sanctions, a principal concern for domestic businesses. Such sanctions are designed to target countries and businesses that engage in extensive operations with sanctioned entities, which may include specific entities within Russia. Even if Kazakhstan is successful in avoiding explicit secondary sanctions, Western investors may still harbor concerns that Kazakh businesses could be used as instruments to bypass sanctions.

Table 2. Kazakhstan: selected macro-fiscal indicators, 2019–2024
(Percent of GDP)

	2019	2020	2021	2022	2023e	2024f
National income and prices						
Real GDP growth	4.5	-2.5	4.3	3.2	3.5	4.0
Oil sector growth	5.0	-5.8	-0.4	-1.8	8.3	7.1
Non-oil sector growth	4.4	-1.3	5.2	4.2	2.5	3.3
CPI inflation (end of period)	5.4	7.5	8.5	20.3	9.6	6.3
External accounts						
Current account balance	-3.9	-6.4	-1.3	3.9	1.0	-0.4
Exports of goods and services	37.0	28.8	36.4	42.7	39.2	37.8
Oil exports	18.5	13.9	15.8	21.3	19.8	19.1
Imports of goods and services	-29.0	-27.2	-25.1	-26.8	-27.9	-28.2
Foreign direct investment, net	3.3	3.4	1.0	3.6	3.0	3.2
NRFK assets, end-period	34.0	34.3	28.1	25.3	25.8	27.7
NBK reserves (bln. US$, end-period)	29.0	35.6	34.4	35.1	...	...
Total external debt	87.8	95.8	83.3	72.8	64.2	61.4
Monetary accounts						
Reserve money growth	3.6	41.8	12.1	8.4	9.5	11.5
Policy rate, year-end (in %)	9.25	9.00	14.00	14.50	14.75	
Consolidated fiscal accounts */						
Revenues	20.3	18.0	17.6	22.5	21.1	20.6
Expenditures	20.2	24.5	21.9	22.1	21.9	20.8
Consolidated budget balance	0.1	-6.5	-4.3	0.4	-0.7	-0.2
Public Debt **/						
Government debt	19.6	24.9	23.7	23.0	23.4	25.0
External	9.2	10.7	10.0	8.8	8.1	7.7
Domestic	10.4	14.1	13.8	14.2	15.3	17.2
Government debt service (% of state revenues)	11.4	10.8	14.7	16.2	10.6	12.1
Memoranda						
Nominal GDP (billions of US dollars)	182	171	197	220	238	256
Nominal GDP per capita (thousands of US dollars)	9.1	10.4	11.5	12.3	13.1	13.8
Oil price - Brent (US$ per barrel)	61.4	41.3	69.1	97.1	88.0	80.0

Sources: Government and NBK data and WBG staff estimates and projections. f=forecast.

Note: */ The consolidated budget comprises the state and local governments, and the NFRK

**/ Includes only the debt of the state and local government and government guarantees. Does not include SOE debt.

VII. Sanctions on Russia: Implications for Kazakhstan's trade logistics

The sanctions placed on Russia in retaliation for its invasion of Ukraine have impacted supply chains around the world, particularly in Kazakhstan. While the sanctions' objective is to impose severe consequences on Russia for fueling and escalating the war in Ukraine, they are also exacerbating Kazakhstan's pre-existing connectivity challenges. Kazakhstan remains highly dependent on Russian rail and maritime infrastructure to reach international markets. About 80 percent of Kazakhstan's crude exports were transported through the Caspian Pipeline Consortium (CPC), which is connected to the Russian Black Sea port of Novorossiysk. Kazakhstan also relies on Russian's rail infrastructure for trading with Europe as well as facilitating transit cargo between China and Europe.

A principal concern for Kazakhstan is to avoid secondary sanctions, which target countries that do extensive business with sanctioned entities.[20] These sanctions, for example, would apply to any dealings with sanctioned entities within Russia. However, even if Kazakhstan avoids explicit secondary sanctions, investors might pre-emptively withhold investment for fear that such cases might transpire in future. The U.S. Government has announced the product types most likely to be targeted by secondary sanctions. These are dual-use (civilian and military) products that can potentially be used for military activities **(Table 1)**. Kazakhstan, along with other Central Asian republics, was listed as a potential conduit for these goods. Although Kazakhstan has so far not been explicitly singled out, as the war in Ukraine evolves, so will the nature of the products that will be most scrutinized.

Table 3. Commodities of concern for secondary sanctions

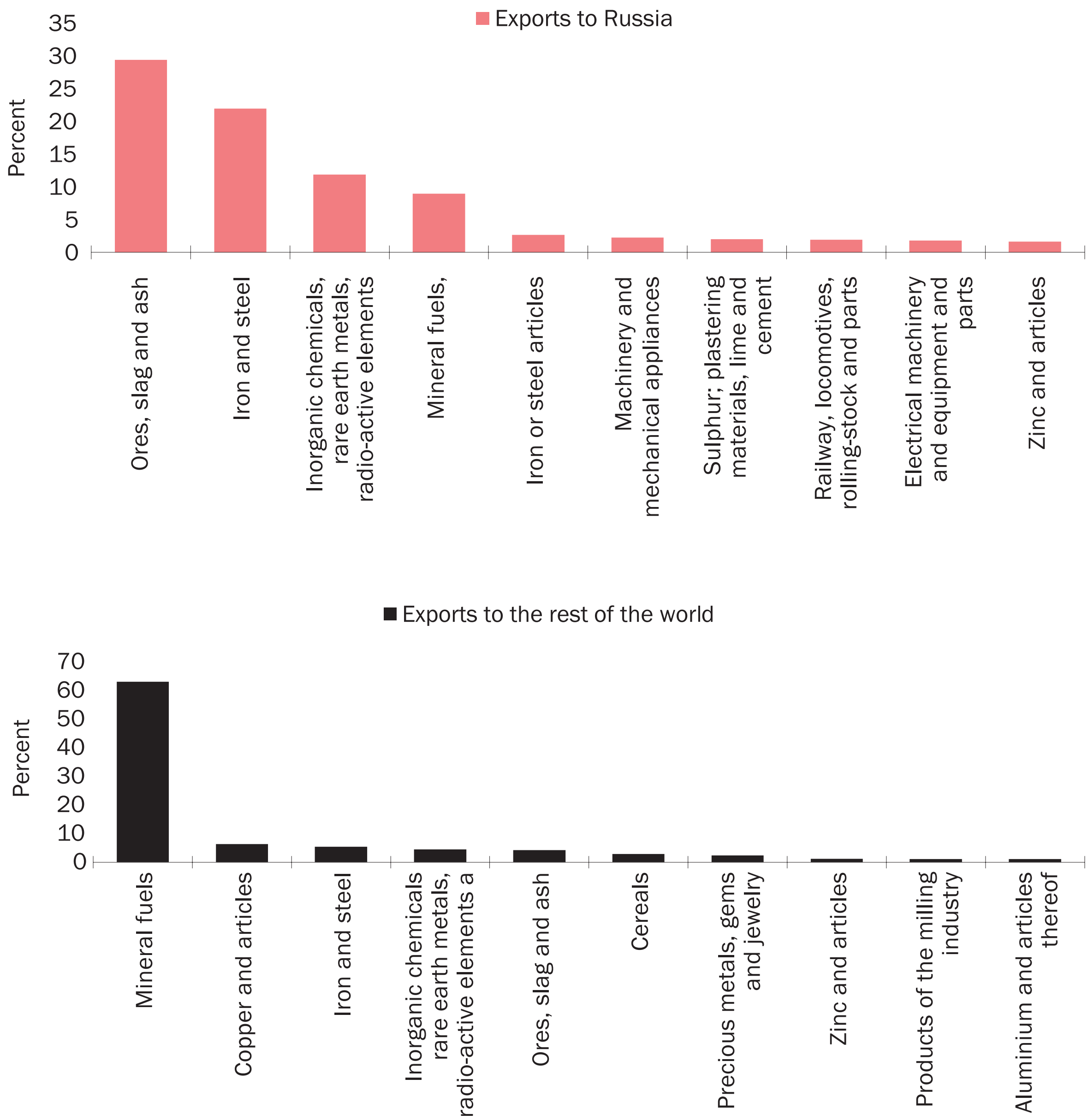
Item	Export Control Classification Number	Item	Export Control Classification Number
Aircraft Parts/ Equipment	9A991	Sonar Systems	6A991
Antennas	7A994	Spectrophotometers	3A999
Breathing Systems	8A992	Test Equipment	3B992
Cameras	6A993	Thrusters	8A992
CPS System	7A994	Underwater Communications	5A991
Incrtial Measurement Unite	7Λ994	Vacuum Pumps	2B999
Integrated Circuits	3A001,3A991, 5A991	Wafer Fabrication Equipment	3B001,3B991
Oil Field Equipment	EAR99	Wafer Substrates	3C00x

Source: FinCEN and Bis Joint Alert, June 28, 2022.

The sanctions on Russia and the projected decline in the Russian economy could have a negative impact on Kazakhstan's non-oil exports. While Kazakhstan's exports to the rest of the world are dominated by resource exports, its exports to Russia are more diversified and include a variety of manufactured goods. The Russian market represents about 10 percent of Kazakhstan's exports and **Figure 14.a** shows that the country's export basket to Russia is more diversified than to the rest of the world (Figure 20.b). For specific products, such as metal ores, slag, and ash (HS 526) and meat (HS 416), Russia represents about 44 and 83 percent of Kazakhstan's exports in 2022, respectively. In the context of sanctions, products that appear on the US list of commodities of concern that Kazakhstan is exporting to Russia may come under greater scrutiny.

[20] Jason Bartlett and Megan Ophel, "Sanctions by the Numbers: U.S. Secondary Sanctions," Center for New American Security, August 26, 2021, https://www.cnas.org/publications/reports/sanctions-by-the-numbers-u-s-secondary-sanctions.

Figure 14. Kazakhstan's export to Russia and the rest of the World in 2020,
percentage of total export value (2-digit HS category)

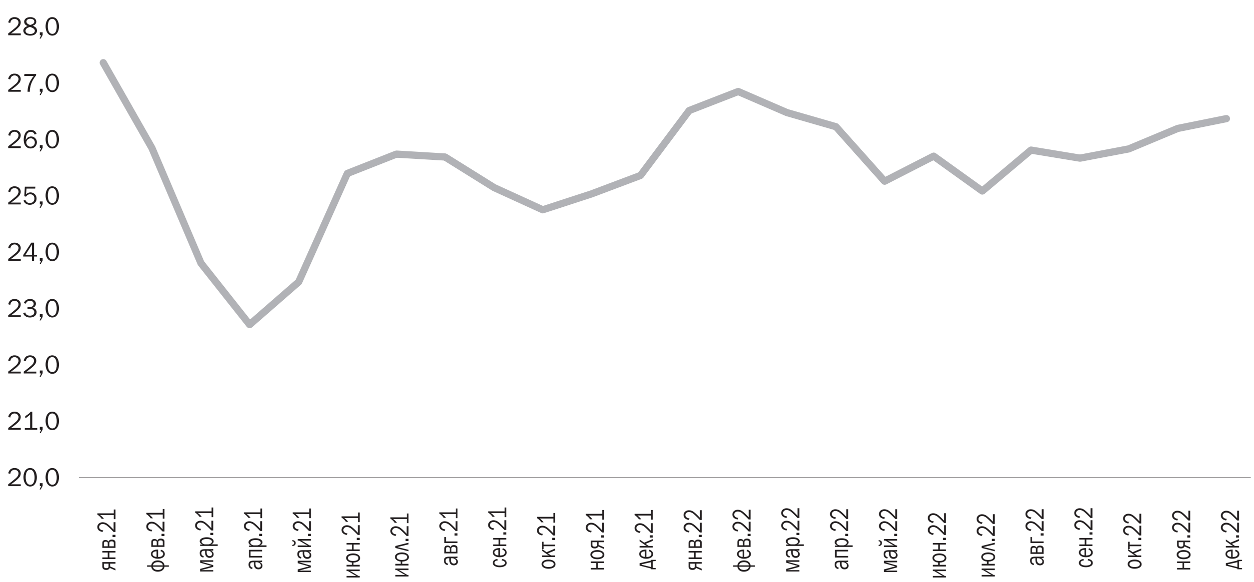


Source: Observatory of Economic Complexity, October 7, 2022.

Kazakhstan's imports from Russia across a number of key commodities could eventually be negatively affected by the sanctions. Of Kazakhstan's imports from Russia, the most likely to be impacted are manufactured goods, particularly machinery and vehicles, owing to the divestment of foreign partners and parts providers from Russia. In 2020, about 10 and 7 percent of Kazakhstan imports from Russia were machinery and parts (HS 1684) and vehicles (HS 1572), respectively. For each of these products, Russian suppliers represent 18 and 34 percent, respectively.

However, the net effect of the sanctions on Kazakhstan-Russian Federation bilateral trade remains uncertain. Kazakhstan has the potential to attract relocations of Russian firms seeking to avoid sanctions, in areas which Kazakhstan already has overlapping capabilities, such as in the production of foodstuffs, machinery, transport vehicles, and services.[21] A redirection exports previously sent to Russia may mean that Kazakhstan will have more potential to substitute for the shortfall in Russian exports of raw materials to Europe. Furthermore, Kazakhstan and Russia are also part of the Eurasian Economic Union (EAEU), with a customs union that provides favorable terms compared with trade with the rest of the world. As such, despite the sanctions, in 2022, Kazakhstan's exports to Russia expanded by 25.1 percent y-o-y, led by 3.5 times increase in machinery exports that compensated for a drop-off in exports foodstuffs, which partly owed to the wheat flour export restriction that Kazakhstan imposed in April 2022 and reversed in September[22], and mineral products and metals, which were likely caused by affected by weaker manufacturing activities in Russia. On the other hand, the longer delays in sourcing goods from western suppliers has likely encouraged Kazakhstan to source more products from neighboring countries, including from Russia. Despite the sanctions, Kazakhstan's trade with the Russian Federation in 2022 was generally higher with an increase in total exports driven by a sharp increase in chemicals and machinery which more than offset a falloff in mineral exports.[23] It is possible that this reflects a substitution effect from Europe. Imports from Russia were essentially unchanged with an increase in imports of agricultural goods offsetting a commensurate drop in imports of machinery. While it is possible that this falloff in machinery imports reflects the effect of sanctions, more disaggregated data would be needed to fully elucidate this effect.

Figure 15. Monthly railway freight volume in Kazakhstan,
(thousands ton/km, 12M 2021 – 12M 2022 (3 months moving average)



Source: WB staff estimates from National Bureau of Statistics data

Aggregate transport statistics for 2022 suggest a modest increase in railway cargo turnover in Kazakhstan compared with 2021. The statistics for 2022 show that Kazakhstan's national rail turnover in ton-km was 4.3 percent higher than for 2021. Cargo turnover by all modes was essentially identical to 2021. Only two regions, Atyrau and West Kazakhstan, experienced significant declines in cargo turnover at 85 and 78 percent of their

[21] Eurasianet, "Russian Companies Eye Relocation to Kazakhstan Amid Sanctions: Freight Companies Working with Russia Are Looking at Kazakhstan as a Transit Point for Goods," March 24, 2022, https://eurasianet.org/russian-companies-eye-relocation-to-kazakhstan-amid-sanctions.

[22] Wheat flour export restrictions were in place from April to September 2022., Source: Order of the Minister of Agriculture of the Republic of Kazakhstan, Sep 9. 2022 http://zan.gov.kz/client/#!/doc/171527/rus

[23] Статистика Внешней и Взаимной Торговли https://stat.gov.kz/official/industry/31/statistic/6

respective 2021 volumes. By contrast, the City of Astana and its surrounding province of Akmola saw a respective 9 and 15 percent growth compared to 2021.[24] An additional potential impact of the war is the increased level of coastal transport, part of which is connected to the Middle Corridor. Coastal and maritime transport tonnage was up 47 percent in 2022 compared with 2021. Maritime operators also reported a commensurate 33 percent increase in revenue.

The Russia's invasion of Ukraine has also severely called into question one of the brightest spots in Kazakhstan's recent economic development: growing China-Europe rail services that transited Kazakh, Russian and Belarussian territory. The opportunities for growth in this "Northern Corridor" for trans-Eurasian rail services had appeared bullish right up until the time of the Russian invasion of Ukraine and the route that ran through Kazakh and Russian territory was emerging as the dominant option. Before the invasion, the main question regarding the viability of the Northern Corridor was whether capacity could keep pace with demand. In particular, the Brest-Malzewicze border crossing was a recurrent bottleneck as it required a change of gauge from broad to standard but has seen a drop off in congestion since the Russian invasion.[25] At the end of 2021, total EAEU rail container transport market had reached unprecedented highs, with the equivalent of more than 6.5 million TEUs transported, a growth of 12.1 percent compared with 2020.[26]

Sanctions have not completely blocked the Northern Corridor, however its long-term growth prospects are dimming. The prospect of EU to fund planned capacity improvements at the Brest- Małaszewicze crossing is diminished.[27] In addition, while there was always a lack of balance between high Chinese exports to Europe and more limited European eastbound cargo, the development of European exports to Russia could have helped remedy the asymmetry. European exports to Russia are now forecast to remain severely depressed for the foreseeable future - raising the overall cost of transit and reducing the attractiveness of the route. For example, containerized shipments from China to Germany via the Northern Corridor declined by 55 percent in 2022 compared to same period in 2021.[28] Total China-Europe containerized shipments via trans-Eurasian corridors were 33 percent lower in 2022 compared with 2021.[29] The prospect of lower growth in China combined with normalization of maritime spot rates which had been severely elevated since COVID will also likely reduce the Europe-China transit volume through this route. While the growing trade between China and Russia may help minimize the fallout of the sanctions on the overall intermodal rail traffic in Kazakhstan, the outcome depends to a high degree on the state of the Chinese and Russian economies.

Developing the Middle Corridor will take time and should not be seen as a complete substitute for the Northern Corridor. The Middle Corridor runs from Central Asia, across the Caspian Sea to Azerbaijan, and continues either to the Port of Poti in Georgia or to Turkey through the Baku-Tbilisi-Kars (BTK) line – thereby avoiding Russian territory. Kazakhstan is actively pursuing the Middle Corridor in order to secure vital logistics routes in the face of an uncertain outlook for trans-Russian connectivity. Trans-Caspian lift-on lift off (LO/LO) vessel departures from Kazakhstan's Port of Aktau to Alat, Azerbaijan have risen significantly since March 2022 as have roll-on roll off (RO/RO) departures from Turkmenistan's Port of Turkmenbashi however port capacity and vessel infrastructure in still quite limited. For example, over the last year more than half of cargo deliveries between Aktau and Alat were made by only three vessels.[30]

[24] Основные показатели работы транспорта в Республике Казахстан, https://new.stat.gov.kz/ru/industries/business-statistics/stat-transport/spreadsheets/

[25] Greg Knowler, "Expansion Projects Choking China-Europe Rail Traffic," *Journal of Commerce*, August 25, 2021, https://www.joc.com/rail-intermodal/expansion-projects-choking-china%E2%80%93europe-rail-traffic_20210825.html.

[26] EATL, "ЕЭК констатирует рост контейнерных перевозок в ЕАЭС, в том числе благодаря интеграционном проекту ОТЛК ЕРА,", September 2, 2022, https://www.utlc.com/

[27] "Malaszewicze no longer an EU priority, focus on Ukraine", Railfreight, Sep 9, 2022 https://www.railfreight.com/corridors/2022/09/02/malaszewicze-no-longer-an-eu-priority-focus-on-ukraine/

[28] Eurasian Rail Alliance Index (ERAI) Data for March-September 2022, http://index1520.com/

[29] Eurasian Rail Alliance Index (ERAI) Data, http://index1520.com/

[30] Data source: Marinetraffic.com

Several recent changes have bolstered the competitiveness of this route. For example, some common pricing agreements have been established, and there are high-level discussions to establish a joint venture for the Middle Corridor following the United Transport and Logistics Company (UTLC) model used on the Northern Corridor. Nonetheless, the corridor still faces numerous coordination challenges betwixt different involved states and organizations, such as the Trans-Caspian International Transport Route (TITR) and the Transport Corridor Europe-Caucasus-Asia (TRACECA), which have sought to coordinate key players but have at times used contrasting data and definitions for the corridor and its traffic. Due to capacity constraints and a low rate of containerization among participant countries, the Middle Corridor should not be seen as a complete substitute for the Northern Corridor which principally served Chinese shipments to large consumer markets in Northern Europe. Rather, in the short run, the Middle Corridor has a key role in bolstering trade amongst Southeastern Europe, Turkey, the Caucasus and Central Asia.

VIII. Special section: Education in Kazakhstan - seizing the Opportunity at the Crossroads

As Central Asia's leading economy, Kazakhstan is entering the most significant and decisive decade since its independence. The development of the oil and gas sector has allowed the Kazakh economy to join the upper middle-income tier. However, a heavy reliance on fossil fuels has rendered the country vulnerable to commodity price shocks and reduced its scope for productivity-led growth. These risks cast an even longer shadow now, as the consequences of climate change become more and more evident, and a global shift toward renewable energy sources gains pace. The climate transition will lead to structural change in the economy, likely necessitating the contraction of certain industries and associated job losses. This context sets the challenge for Kazakhstan's economy to undergo major structural reform, relying more on high-skilled and green sectors for growth and ensuring support mechanisms for workers that stand to be adversely impacted by green transitions.

The COVID-19 pandemic has highlighted the benefits of shifting toward automation and digitalization, a transition that will require workers with better skills. With declining and increasingly unequal human capital, Kazakhstan is at a crossroads, and its success in designing and implementing people-centered reforms will determine the growth potential of the economy for future generations. Maximizing the potential of the people of Kazakhstan through better education, skills development, health and social protection, will be at the center of this transformation.

The contribution of human capital—the knowledge, skills, and health that people accumulate throughout their lives, enabling them to realize their potential as productive members of society—to the wealth of Kazakhstan, at 42 percent, mimics that of a low-income country, and is well below the average for high-income countries (70 percent). Prior to the COVID-19 pandemic, Kazakhstan's human capital was declining and undermining its ability to serve as an engine of sustained prosperity. Kazakhstan's Human Capital Index (HCI) was 0.63 prior to the pandemic, indicating a loss relative to full potential of 37 percent to the economy and society. When adjusted for access to, and the quality of, higher education, Kazakhstan's HCI drops to 0.45, comparable to low-income economies. The pandemic resulted in school closures, students acquiring lower educational content, and the depreciation of previously acquired learning. The COVID-19 pandemic is likely to: (i) wipe away a decade's worth of accumulated gains in human capital, reducing HCI to 0.59; (ii) generate an economic loss of up to US$4.1 billion per year (PPP 2011); and (iii) increase inequality among people, with the poorest 20 percent of the population likely to have fallen 1.5 years behind the richest in terms of human capital.

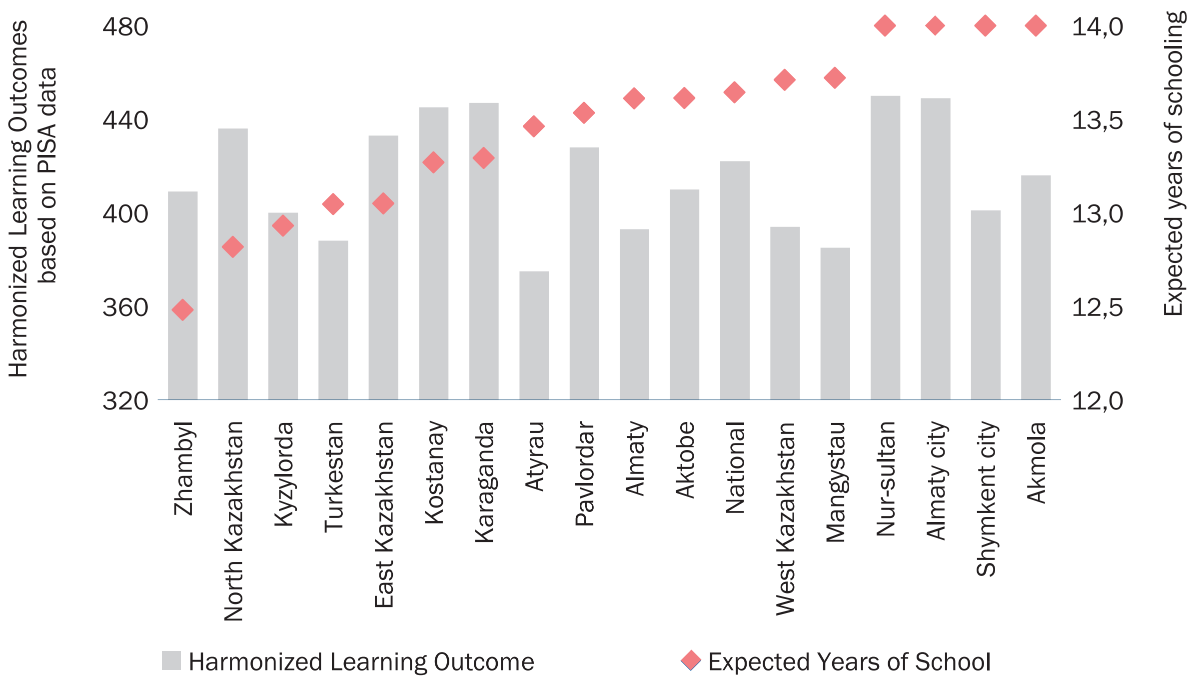
The January 2022 protests—a week-long period of violent unrest and crackdowns that resulted in 227 deaths and almost 10,000 arrests—underscore the need to address the rising economic inequality that threatens economic growth and social stability in Kazakhstan if left unaddressed. It requires a new social contract between the Government and the people that protects the poor and vulnerable, while ensuring that the foundation of growth is sound and sustainable. Ramping up investment in its citizens, especially the young, would equalize opportunities for building their knowledge, skills, job prospects, social protection and health throughout their lives. Affirmative and targeted interventions directed at those left behind, now in the bottom third of the population, would have long-lasting and sustainable impacts. Investment in building more equitable human capital—the driving force behind the sustained growth of many high-income economies worldwide—can facilitate Kazakhstan's transformation into a socially cohesive society and a sustainable economy with shared prosperity in the long term.

Key Challenges

While education holds much promise in contributing to national wealth, social development, and cohesion, in the case of Kazakhstan it is the weakest link in the chain contributing toward national prosperity. More than two-thirds of 15-year-olds are considered functionally illiterate, and as such unable to successfully operate in the modern world.

While education is the largest contributor to the HCI, it is learning, not years of schooling, that truly matters. In some regions, schooling fails to translate into learning (**Figure 16**). For instance, in Astana, the average number of years of education is close to 14, and the average learning score is around 440. In Shymkent City, the number of years of education is about the same as in Nur Sultan but the learning score is considerably lower at 401.

Figure 16. Regional differences in educational attainment and quality, Kazakhstan, 2018



Source: World Bank.

Good practices in education need to be expedited and supported by adequate resources. Educational opportunities are unequally distributed, and they are likely to result in higher gains for some regions and wealthier households. Kazakh-speaking students perform more than one year of schooling behind in PISA than Russian-speaking peers. The Nazarbayev Intellectual Schools (NIS), which accommodate 1 percent of students at a unit cost of more than three times the national average, produce learning outcomes equivalent to the levels of OECD countries. In 2018, NIS students performed three years ahead of the average student in the country. The resource levels and the practices of the NIS system need to be emulated in the rest of Kazakhstan's schools. The transfer of good practices is proceeding much too slowly and has not been underpinned by adequate resources. As a result, many students, especially those in the less well-resourced provinces, struggle to perform.

TVET reform is urgently needed to meet the needs of the industry. Technical and vocational education and training (TVET) students comprise a large part of the labor force: almost 4 out of 10 workers in Kazakhstan are TVET graduates and 46 percent of tertiary level students are in TVET. In addition, given that the Government aspires to provide TVET free for all, TVET can mitigate inequalities by becoming a social mobility tool for students from lower-income families. Therefore, good quality TVET is necessary to enhance productivity and competitiveness of the Kazakh economy through better alignment of skills with industry requirements and individual employment needs, and building a lifelong learning system. However, the quality of TVET is declining and is not aligned with the national goal of diversifying the economy to increase opportunities in the knowledge and service-based industries. Grade 9 entrants into the TVET track come mostly from low-income households and overwhelmingly represent low-performing students (27 PISA points in reading below peers in general secondary). They could be at a disadvantage due to being streamed after grade 9 into the TVET track, given that these students are the lowest performers of an already low performing system. TVET is not adding value to the foundational skills of students, and TVET graduates have significantly lower skills in all areas (literacy, numeracy and problem-solving) than youth with general upper-secondary education. These students require solid foundational skills to enable them to operate in a rapidly changing labor market.

Tertiary education quality needs to be boosted across the country. Enrolment in tertiary education has increased over time (50 percent of 25–34-year-old youth), but the quality of tertiary education has declined. Today, Kazakhstani youth with tertiary education have lower foundational skills (literacy, numeracy and problem-solving) than adults with tertiary education (PIAAC, 2017). Higher education quality and relevance to the labor market needs to be boosted across universities in the country. Only two universities in Kazakhstan qualify to be in international rankings.

Most adults in the labor market in Kazakhstan require significant skill enhancement. Currently, 12 million people (62 percent of the population) in Kazakhstan participate in the labor market and productivity gains depend on upskilling this group. However, 75 percent of adults perform at or below level 2 in reading (out of five levels) compared with 54 percent in the OECD (PIAAC, 2017). The skills development system does not provide sufficient incentives and opportunities to re-skill and upskill the workforce. In Kazakhstan, only 16 percent of adults (aged 25–64) participate in formal or non-formal learning (compared with 48 percent in OECD countries). Employers are not incentivized to invest in upgrading the skills of the workforce: in 2019, only 42 percent of large firms offered training (a decline from 50 percent in 2009). This situation needs a quick reversal to enable the Kazakh workforce to contribute to green growth, economic diversification, and automation.

Now is a critical time to entrench foundational skills for all labor market entrants and participants. As technological and global market trends evolve, and as Kazakhstan's 'baby boom' generation enters the educational system with the projected peak by 2030, the education and skills development system needs to provide the young and adults entering the labor force with sufficient foundational skills that are essential for labor market success. Jobs in the world of work will need a work force with the set of skills that enable them to adapt to changing labor market requirements. In this context, the basic foundational skills (literacy, numeracy, and problem-solving skills) are turning into survival skills. These skills are not only essential in navigating life but are a prerequisite for acquiring advanced skills. The European Skills and Jobs Survey also indicates that foundational skills are a minimum requirement for survival in the modern economy, with 80–90 percent jobs in the EU requiring at least a basic level of foundation skills.

Current reforms to address inequality and equal human development opportunities will shape Kazakhstan for decades to come. Kazakhstan has entered a decisive decade as the oil and gas economy faces threats, and as climate change, automation, and the pandemic necessitate economic diversification underpinned by significant improvements in skills and productivity. With the COVID-19 pandemic, incomes have declined, and poverty, learning, and skills deficits have deepened, while inequality has increased. Today's choice of reforms, and their successful implementation, will shape the fate of the people and the national economy for decades to come. Education reforms and human capital will likely be at the forefront of these reforms.

Proposed Framework for Reform

First, Kazakhstan needs to make human capital its top national priority going forward. No country has achieved high-income status with a low human capital base. Kazakhstan has begun to invest in education and training (the expenditure over the past decade was around 3.45 percent and was increased to 4.5 percent in 2020). However, too little has reached lower-income households, western and southern regions, and rural communities. The Government needs to continue to increase spending on education, focusing on cost-effective programs that increase quality and equity to ensure increased learning across the board, making sure that efficiency and effectiveness are the guiding principles for implementing education policies.

Second, choose equity for excellence as a principle of skills development by tackling regional disparities. This will require investing more in building human capital in lagging regions. Over time, this will show increasing returns on capital, leverage regional economic performance, and benefit the entire country. It also requires targeting the needy and vulnerable. Simple but significant reforms to resource distribution policies would have immediate benefits. These should include distributing state grants for higher education and TVET based on need, incorporating need-based weights into the formulae for per-capita funding, and subsidizing early childhood education for low-income families.

Third, Kazakhstan would benefit from focusing on implementation for results. The implementation of major education reforms is a complex social process, and good policies and initiatives have often been undermined by poor performance. Significant effort needs to go into planning for implementation, including capacity assessment and enhancement, adequate financing, and ongoing monitoring.

Specific reform areas. These include: (i) ramping up innovation in curriculum, teaching and learning and measurement to mitigate learning loss, especially for the most disadvantaged; (ii) raising teacher effectiveness through teacher development, not just through salary increases; (iii) orienting the education system toward improved quality and relevance through stronger implementation of new curricula, improved monitoring and analysis, regular assessments, increased school autonomy and increased accountability for results; (iv) providing innovative learning environments that are conducive to modern education; (v) initiating a long-term overhaul of the TVET system; and (vi) reinforcing a lifelong learning system.

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