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Summer 2021

TURNING THE TIDE ON THE COVID-19 CRISIS

KAZAKHSTAN ECONOMIC UPDATE



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Foreword

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, the National Bank of Kazakhstan (NBK), and additional information collected as part of the World Bank Group’s regular economic monitoring.

The team is grateful to the Ministry of the National Economy and the National Bank of Kazakhstan for their support and feedback.

The main authors of this KEU are Azamat Agaidarov (Economist) and Sjamsu Rahardja (Senior Economist), with contributions from Almaz Karassayev (IFC, Investment Officer), Baktybek Zhumadil (Senior Operations Officer), Katerina Levitanskaya (IFC, Operations Officer), Martin Melecky (Lead Economist), Salamat Kussainova (Public Sector Specialist), and Jane Olga Ebinger (Sector Lead). Asset Bizhan (Private Sector Specialist) and Mariana Iooty de Paiva Dias (Senior Economist) contributed to the special section on Productivity Growth.

The team received guidance from Ivailo Izvorski (Lead Economist), Lilia Burunciuc (Country Director for Central Asia), Sandeep Mahajan (Practice Manager), and Jean-François Marteau (Country Manager for Kazakhstan). The team thanks Gulmira Akshatyrova (Program Assistant in Nur-Sultan) and Sarah Nankya Babirye (Program Assistant in Washington, DC) for excellent administrative support, and Kubat Sydykov (Online Communications Associate) and Shynar Jetpissova (External Affairs Officer) for guidance on publication and outreach.

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I. Overview



Kazakhstan's economy started to recover in the second half of 2020, although real GDP is still lower than pre-COVID-19. After suffering the worst contraction in the past two decades, Kazakhstan's real GDP rebounded in the third quarter of 2020, and growth has extended to the first quarter of 2021. Real GDP in Q1 2021 grew moderately at 1.9 percent in seasonally adjusted terms relative to the Q4 last year. The external environment has generally improved and lifted the value of Kazakhstan's exports by about 5.8 percent in Q1 2021 compared with Q4 2020 in seasonally adjusted terms. In Q1 2021, China experienced a faster-than-expected economic rebound, while the euro area suffered another dip due to the COVID-19 resurgence. In addition, a relaxed OPEC Plus production quota and the incremental recovery of global demand lifted Kazakhstan's oil production by 6 percent in Q1 2021 compared with the lowest output in Q3 last year. The short-term economic indicators also suggest some improvement in domestic economic activities, including in the services sector. The contraction in retail trade and transport cargo has gradually eased. Construction activities have shown steady growth, supported by a policy allowing pensioners to partially withdraw their savings and a government program that promotes residential investments. Despite these improvements in economic activity, real GDP Q1 2021 remains 1.5 percent lower than in Q1 last year.

We expect the economy will expand by about 3.2 percent in 2021. We expect that growth will pick up in the rest of the quarters this year, supported by private consumption and more moderate inflation, which will help ease consumers' budget constraints. The government support measures on residential investments will partially offset weakness in non-residential investment and support growth this year. Nevertheless, we anticipate that the risks to growth will remain primarily on the downside. The resurgence of COVID-19 and associated restrictions, the specter of higher inflation that could lead to tightening of global financial conditions, and the possible deterioration of SMEs' balance sheet if the fiscal support is withdrawn, are the factors that could negatively affect the outlook.

The course of the COVID-19 pandemic is likely to affect the balance and pace of the economic recovery and have long-term effects on the economy. The recovery has been uneven, with manufacturing activities recovering faster than the services sector, which had employed a larger share of workers and was hit hardest by the pandemic. In April 2021, confirmed COVID-19 cases in Kazakhstan jumped again, reaching about 2,900 cases a day, and prompted the authorities to implement tighter restriction. The pandemic resurgence can create uncertainty for business expansion, which has already been depressed by the shrinking level of corporate credit and risks of higher nonperforming loans. Restrictions on face-to-face education prompted by COVID-19 are likely to cause learning losses, which can lower expected future earnings, particularly for students from lower socioeconomic backgrounds.¹ Moreover, contracting COVID-19 can cause long-term health effects for some workers, which can lower their productivity.²

The economic recovery's resilience and sustainability also depend on structural reforms and adapting policies to meet new development challenges. This year's budget was adjusted to accommodate an additional 1.7 percent of GDP for spending on health, education, infrastructure, small and medium enterprises (SME) support measures, and social assistance. To sustain aggregate demand and momentum for economic recovery, the government should consider avoiding a drastic reduction in

¹ "Kazakhstan Economic Update: Navigating the Crisis. World Bank, 2020.

² For example, long-term cases of COVID-19 in the UK are discussed in the following article: <https://www.bmj.com/content/373/bmj.n853>.

next year's budget deficit. To support the reopening of businesses and education, more efforts are needed to help people overcome their hesitation toward getting the COVID-19 vaccine. But progress in structural reforms will be essential to sustain growth in the medium term. The new National Development Plan 2020–2025 and the 2021 new Environmental Code are significant initiatives that enable Kazakhstan to promote more inclusive and greener development. Kazakhstan also made an important pledge as part of the global effort to address climate change: to reach carbon neutrality by 2060. Operationalizing these initiatives requires stronger policy coordination, better public administration, improved effectiveness and results in public budgeting, reduced market distortion, and a level playing field for the private sector—all of which are longstanding reform issues for Kazakhstan.

This update features findings on factors affecting the slow productivity growth among Kazakh firms, one of the critical development challenges. Productivity matters to sustain long-term growth and improve the standard of living. Findings from firm-level data analysis suggest a muted contribution of firms' upgrading capability (innovation, managerial), poor allocative efficiency, and limited contribution from entry/exit dynamics. The authorities should consider coordinating policies to improve productivity growth by ensuring competition in the product market, reducing barriers for firms to entry in sectors dominated by state-owned enterprises, improving the effectiveness of investment policy and promotion, and boosting firms' capability to innovate. Also, revisiting distortive support programs for firms should be reconsidered to avoid perpetuating inefficiencies in firms.





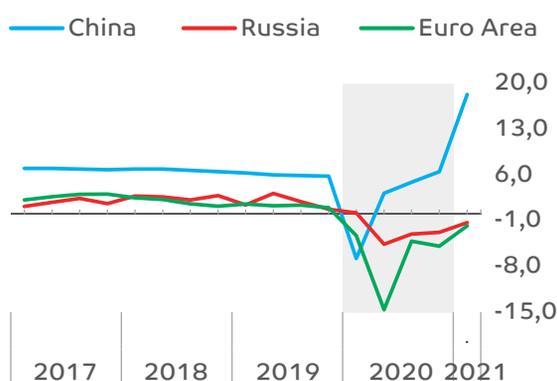
II. External Environment: Global Economic Recovery

The gradual improvement in the external environment helps increase demand for primary exports from Kazakhstan. Nevertheless, the pace of recovery varies among Kazakhstan's major trading partners. The US economy has picked up strongly while the euro area slipped into another recession in Q1 2021 because of the resurgence of COVID-19 and the resulting restriction measures.

The global economy is recovering from the recession, although the pace varies widely across Kazakhstan's main trading partners. US output, supported by a strong stimulus and the successful implementation of a nationwide vaccination program, is expected to grow rapidly by 6.5 percent in 2021 and help lift the global economy.³ China's economic activity also recovers sharply after dropping by 2.3 percent in 2020, and it is about to restore its pre-pandemic growth trajectory with a dramatic rebound of 18.3 percent year-on-year (y-o-y) in Q1, supported by industrial production and exports (Figure 1). On the other hand, weakness persists in the euro area economy, with a double-dip recession in Q1, driven mainly by the reinstallation of lockdowns in many member countries and slow rollout of vaccinations across the bloc. Nevertheless, acceleration of vaccinations and the easing of movement restrictions could support growth in the euro area in the second half of 2021. The Russian economy activity recovered slightly during Q4 2020, but the second wave of the pandemic has undermined the momentum.

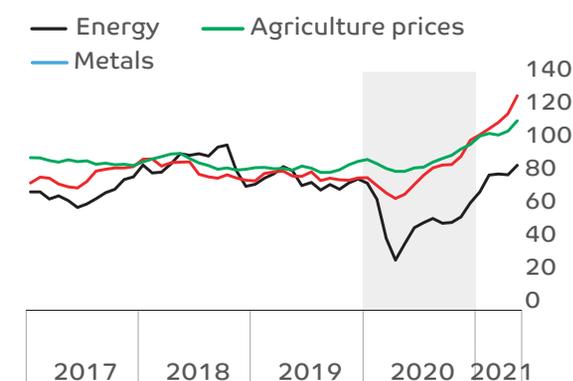
Global commodity prices—including prices of Kazakhstan's primary exports—rebounded over the second half of 2020 to close to pre-pandemic levels. Oil prices have been rising since the third quarter of 2020. In May 2021, crude prices stood at \$66.4 per barrel, well above the lows registered in the wake of global lockdown in May 2020.⁴ A sharp production cut by OPEC Plus producers in 2020 was supportive of oil prices as they started increasing steadily since November. Most recently, the rise in optimism about the effect of vaccinations on global demand and the swift recovery of the Chinese economy have also fueled commodity prices.⁵ Both metal and food commodity prices have risen well above their pre-pandemic levels (Figure 2)⁶. Metal prices increased by 26.2 percent in May, compared with December levels. Agricultural prices have also seen a significant rise, reaching their highest levels in almost seven years. Dry weather in South America, a rapid increase in demand from China to restore its reserves after the pandemic, and expectations in China of a rise in export tariffs on leading wheat-exporting countries all have been pushing up prices.

Figure 1. Growth momentum in key foreign markets (percentage change from same quarter of previous year)



Source: World Bank Group.

Figure 2. Trend in key global commodity prices (price index, 2010 = 100)



Source: World Bank Group.

³ Global Economic Prospects June 2021, World Bank, 2021.

⁴ World Bank, "Pink Sheet," April 2021.

⁵ ECB Economic Bulletin, Issue 2/2021, "Economic and Monetary Developments."

⁶ World Bank ECA Economic Update, spring 2020.

III. Uneven Recovery and COVID-19 Infection

There are signs that economic activity in Kazakhstan has started to pick up, although with uneven strength. A slightly lower inflation in Q1 provided some relief to consumers. Spikes in COVID-19 infection impose a challenge for a swift recovery as social distancing and other restriction measures weigh on business confidence. Ensuring progress in COVID-19 vaccination will help strengthen the resilience of the recovery.

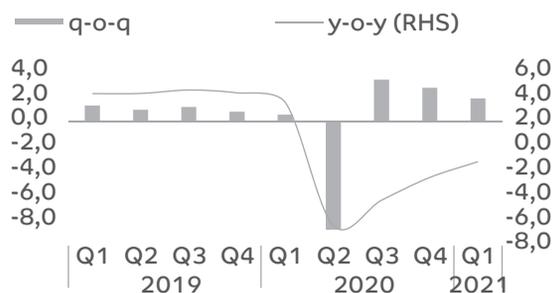


Kazakhstan's economy started to recover from the COVID-19 crisis in the second half of 2020. Real GDP in the first half of 2020 dropped by 3.4 percent in seasonally-adjusted terms compared to the second half of 2019.⁷ Real GDP inched up in the second half of 2020 compared to the first, with favorable quarterly growth rates in the last two quarters of the year (Figure 3). But as a whole, Kazakhstan's real GDP contracted by 2.6 percent in 2020.

The recovery has continued in the first quarter of 2021, although with uneven strength. Real GDP in the first quarter of 2021 grew moderately at 1.9 percent in seasonally adjusted terms relative to the fourth quarter last year (Figure 3), though it still registered a 1.5 contraction on year-on-year basis (Figure 4)⁸. Recent official data suggests that business activities from January to May 2021 grew by 1.6 percent. On the demand side, in the first quarter, the fall in private consumption has lessened to 1.2 percent y-o-y along with still weak performance in retail trade. Investment dropped by 9.6 percent over the same period, largely because of a sharp fall in foreign direct investment (FDI), despite the strong growth in housing investment in the first quarter of 2021.⁹ On the production side, after a severe contraction in April–June 2020, at the peak of restrictions, there was a rebound in trade and in transportation services through the first quarter of 2021, but growth still remained below the pre-pandemic level of output (Figure 5). In contrast, manufacturing and construction continued to expand on the back of solid government support measures.

Figure 3. GDP growth rates

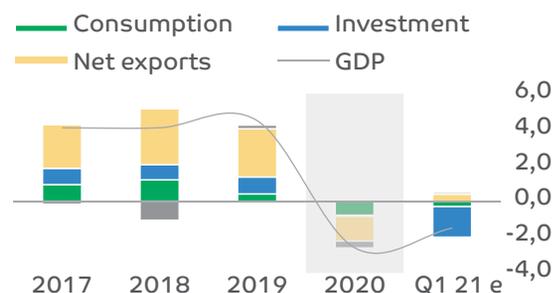
(percent, seasonally adjusted)



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

Figure 4. Year-on-year GDP growth

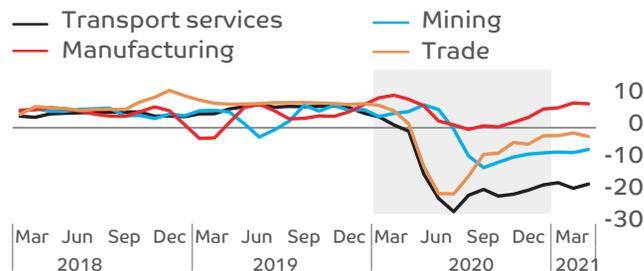
(contribution, percent)



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

Figure 5. Economic activities across sectors

(year-on-year three-month MA, percent)



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

⁷ Quarterly real GDP data by expenditure from Q1 1999 to Q1 2001 is seasonally adjusted using SEATS/TRAMO.

⁸ <https://primeminister.kz/ru/news/iv-kazahstane-na-fone-smyagcheniya-ogranicheniy-prodolzhaet-vosstanavlivatsya- indeks-delovoy-aktivnosti-1052510>

⁹ The government program to allow pensioners to use their savings to purchase a house or repay a mortgage has likely helped growth in residential investments.

Inflation in May edged down compared with the end of last year, but underlying price pressures persist. After increasing sharply during 2020 due to the impact of the pandemic, inflation slightly shifted down to a 7.2 percent y-o-y in May 2021 from a 7.5 percent in December 2020 (Figure 6). The downward trend in inflation reflects in large part the decrease in food price inflation, as food price pressure dominates the underlying inflation dynamics. Food price inflation weakened to 9.3 percent in May 2021 from 11.2 percent last December. But nonfood goods inflation increased to 6.7 percent y-o-y in May, up from 5.5 percent in December 2020, as import prices edged up by 7.9 percent y-o-y in April, compared with 5.4 percent in December. Import prices, a large contributor to inflation, have picked up since mid-2020, reflecting the earlier depreciation of the tenge exchange rate and the pandemic's impact on international supply chains (Figure 7). Prices of paid services saw a 5.1 percent increase in May, largely because of higher prices for transport and restaurant services as the effect of COVID-19 containment measures were likely weighing on consumer demand. .

The COVID-19 situation in Kazakhstan deteriorated significantly in April 2021 but has since begun improving. The number of officially recorded new cases surged to around 2,900 a day in April, up from 1,000 per day in March (Figure 8), before dropping to about 1,300 per day by end of May 2021.¹⁰ As the new wave spread, the authorities imposed selective restrictions across regions and major cities depending on the severity of confirmed cases, instituting less restrictive measures for cities and regions classified as green zones and more restrictive actions for those classified as yellow or red zones.¹¹ Large cities like Nur-Sultan and Almaty city have the highest number of cases relative to the national average. COVID-19 confirmed cases were also high and above the national average in Akmola, which is close to Nur-Sultan, and in North-Kazakhstan and West-Kazakhstan regions, close to Russia.

The COVID-19 vaccination program in Kazakhstan has gained pace, but more effort is needed to achieve the government's vaccination target. The government rolled out a nationwide vaccination campaign in February 2021, with a plan to vaccinate around 10 million people identified as the target group by September this year.¹² Currently, Kazakhstan mainly uses the Russian Sputnik V vaccine. The government also established local production of Sputnik V (Gam-COVID-Vac vaccine) and is negotiating the purchase of the Pfizer, AstraZeneca, Moderna, Sinovac, and Johnson & Johnson vaccines. The pace of the vaccination plan was slow initially, as by end of March, only about 1.3 percent of the target group had received at least one vaccination. The plan gained momentum and by early-June, around 21 percent of the target group had received at least one vaccine shot (Figure 9). To meet the September target, the authorities need to put more effort into increasing the vaccination pace with more vaccination centers and a more effective communication campaign to overcome vaccination hesitancy.

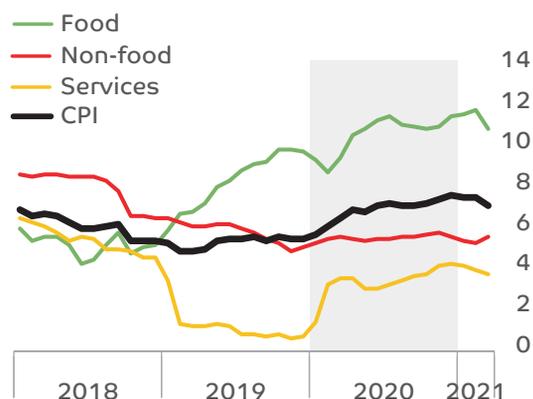
10 Our World in Data database.

11 The severity is defined by the infection reproduction number, R, and number of infections per 100,000 population.

12 <https://www.primeminister.kz/en/news/do-sentyabrya-tg-planiruetsya-obespechit-dostup-k-vakcinacii-poryadka-10-mln-naseleniya-kazahstana-minzdrav-1231844>.

Figure 6. Inflation trends

(year-on-year, percent)



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

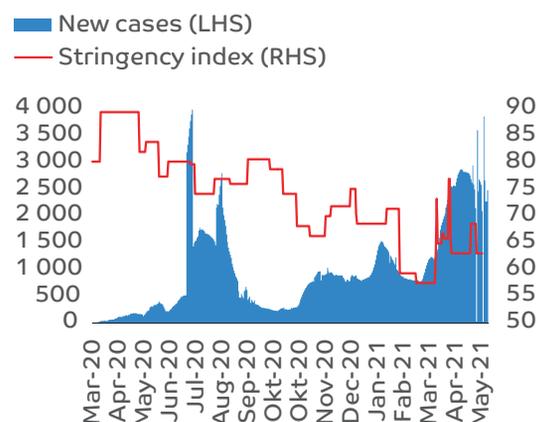
Figure 7. Growth in import price index

(percent)



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

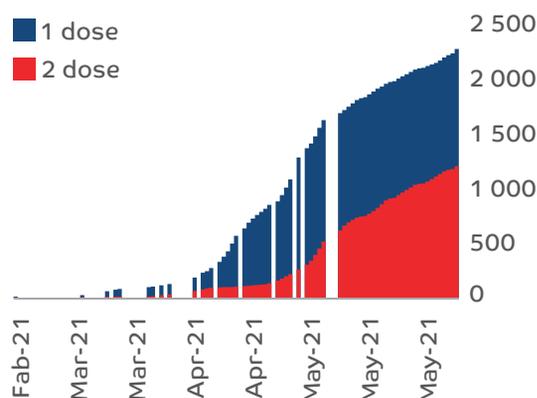
Figure 8. The number of COVID-19 cases and government response¹³



Source: Our World in Data database.

Figure 9. The number of people who received the COVID-19 vaccination

(contribution, percent)



Source: World Bank staff calculation based on Ministry of Health data

¹³ Stringency index is a composite measure from the Oxford COVID-19 Government Response Tracker based on nine response indicators including school closures, workplace closures, and travel bans, rescaled to a value from 0 to 100 (100 = strictest)

IV. Balance of Payments

Compared with last year, the current account in Q1 deteriorated on the back of a weaker trade balance surplus. However, commodity exports increased in March 2021 and the strong rebound of exports in extractive products reflect Kazakhstan's core comparative advantage. Weaker-than-usual net foreign direct investment could weigh down aggregate investment spending this year and underlines the need to improve the investment climate.



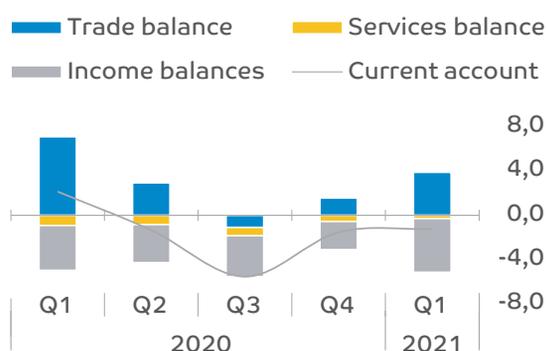
The shrinking surplus of the trade balance in Q1 2021 weighed on the current account deficit. The trade balance reached \$3.9 billion in the first quarter, well below \$7.1 billion last year (Figure 10). But Kazakhstan's export edged up slightly in Q1 on the back of a surge in commodity exports in March. The deficit in services trade narrowed as COVID-19 restrictions and weaker investment activities reduced import demand for travel and business services. The income account is expected to return to normal after a significant increase in Q4 2020 due to a settlement of the dispute between Kazakhstan and several

international oil companies over revenue sharing of Karachaganak oil field.¹⁴ In Q1 2021, profit repatriation increased by 20.5 percent y-o-y. This increase likely reflects the repatriated profits of international oil companies following an improved international oil price. In parallel, the average tenge exchange rate in Q1 depreciated by 7.7 percent y-o-y against the US dollar.

The dominant role of extractive products in sustaining export recovery reflects Kazakhstan's comparative advantage in commodities. The export value of crude oil grew by 77 percent y-o-y in March, supported by improved global demand, which saps crude reserves (Figure 11).¹⁵ Kazakhstan's oil production gradually picked up, reaching 17.9 million tons in Q1 2021 after dropping to 16.8 million tons in Q3 last year. Also, metal and mineral export benefit from pent-up global demand for manufactured goods, as consumer spending improved in China and the US amid global supply chain problems. The total export value of ferroalloys, flat ferrous metals, iron ore, refined copper, and unprocessed zinc and aluminum jumped to \$3.4 billion in Q1 2021 from \$1.6 billion in the same quarter of last year. On the other hand, the export value of agriculture and animal products has been stagnant, despite the higher international prices and sustained global demand for food. Kazakhstan can tap into the rising global demand for food. But it needs to raise the productive capacity in agriculture and animal product exports, including attracting FDI, improving quality and environmental sustainability standards, and improving the supply chain.

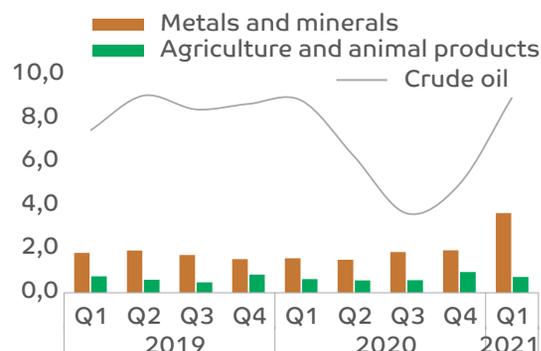
Net foreign direct investment in Q1 2021 was weaker than usual and could affect this year's aggregate investment spending. A preliminary estimate suggests that net foreign direct investment in Q1 2021 was only \$173 million, compared with \$1.8 billion in Q1 last year and \$3 billion in Q1 2019. The resurgence of COVID-19 cases in Europe, Kazakhstan, and Russia and restrictions in international travel might have delayed foreign investors' activities and could risk further dampening the decision to expand operations or enter the market. Given the global challenges to attract FDI flow to developing countries, the authorities should consider installing a comprehensive action plan for reforms to attract private investment, particularly FDI¹⁶.

Figure 10. Component of current account (\$ billion, seasonally adjusted)



Source: World Bank staff calculations based on NBK data.

Figure 11. Export value of crude, metal*, and animal and vegetable products (\$ billion)



Source: WB staff calculation based on data from NBK and Bureau of National Statistics.

* Iron ore, ferro alloys, flat ferrous metals, refined copper, and unprocessed aluminum and zinc.

14 <https://www.worldoil.com/news/2020/12/14/kazakhstan-nets-13b-from-shell-eni-in-revenue-sharing-settlement>.

15 Seasonally adjusted data.

16 The drop in the global FDI flow to developing countries is discussed in Evenett, Simon and Johannes Fritz. 2021 "Advancing Sustainable Development with FDI: Why Policy Must be Reset." The 27th Global Trade Alert Report.



V. Monetary Policy and the Financial Sector

The National Bank of Kazakhstan (NBK) has kept its accommodative monetary policy stance since the first half of 2020, leaving the policy rate unchanged in June 2021, and has continued to provide liquidity to help counter the crisis. Bank lending continued to be driven by domestic credit expansion on the back of policy support to mortgage lending, while corporate credit growth remained low, reflecting the lasting impact of the pandemic on businesses. Nevertheless, uncertainty and lacking structural reforms also depress demand for credit. So far, the banking system has weathered the COVID-19 crisis but remains vulnerable because of both legacy NPLs and new distress debt that has likely emerged.

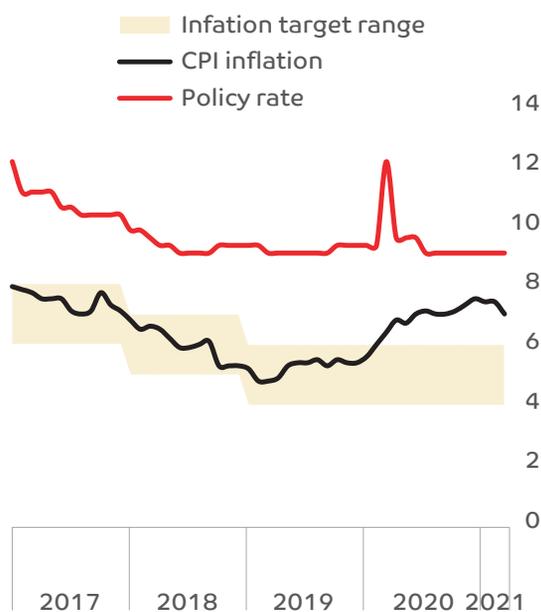
The NBK left the policy rate unchanged at a 9.0 percent since the beginning of 2021.

The NBK decided to hold its main policy rate steady in June for a fourth straight revision so far in this year to maintain favorable financing conditions, after cutting it to 9.0 percent in response to the pandemic-induced economic recession in the first half of 2020. The latest decision was made even though inflation was still running at 7.3 percent y-o-y in May, well above the central bank’s 4–6 percent target (Figure 12). Food price pressure, rising raw material cost coupled with increased fiscal spending through various state programs and NBK-backed liquidity provision plans, sustain pressure and complicate the task for the NBK to keep a lid on inflation. To counter inflationary pressure and effectively manage inflation expectations, the NBK has continued the practice of mopping up the excess liquidity from a banking system through its increased open market operations. The liquidity built up neared KZT 5 trillion (\$11.5 billion) in March 2021, 2.5 times higher than the level registered in 2016.

Rising excess reserves reflect a prevailing uncertainty and the limited appetite of banks for corporate and SME lending.

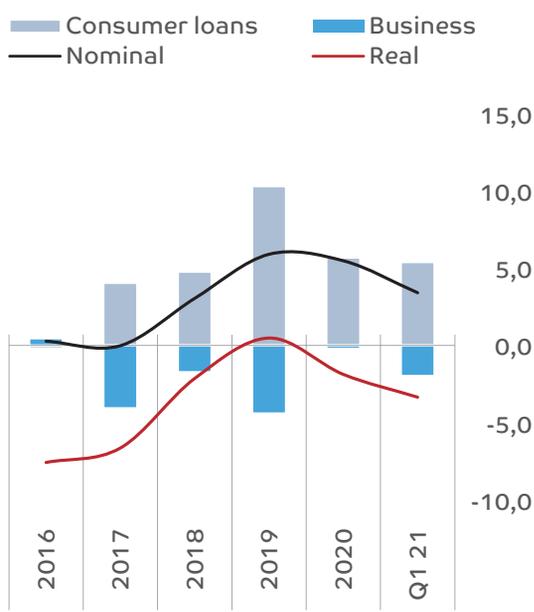
Commercial banks continue holding voluntary liquid assets with the NBK. Despite abundant liquidity, banks remain reluctant to expand lending to corporates and SMEs due in part to weak growth and possibly high risk of insolvency. Faced with uncertainty about the creditworthiness of corporate and SME borrowers, Kazakhstan banks keep growing their retail portfolios as the lending margins are higher. While retail credit remained robust in Q1 2021 — increasing by a third for mortgages and 5.6 percent for consumer loans—corporate credit continues to fall both in nominal and real terms (Figure 13). After scaling up subsidized credit programs in the wake of the pandemic, the NBK plans a gradual unwinding and complete exit from direct lending practices by 2025. From the monetary policy standpoint, the active involvement of the NBK in direct lending programs impedes the effectiveness of its interest rate policy tool and weakens monetary policy credibility.

Figure 12. Policy rate through the pandemic (percent, seasonally adjusted)



Source: World Bank staff calculations based on NBK data.

Figure 13. Nominal credit growth (contribution, percent)



Source: World Bank staff calculations based on NBK data.

The banking system has weathered the crisis, but pre-existing vulnerabilities and risks from the COVID-19 crisis call for vigilance. Despite reduced economic activity, banks managed to remain profitable through the crisis, due in part to continued lending on the back of consumer loans and various government support programs to businesses. In March 2021, the banking sector recorded a positive return to assets of 2.5 percent and has been able to retain capital reserves (with an average capital adequacy ratio of 21.2 percent). This positive development also reflects improved balance sheets after a series of bailouts in previous years and a cleanup following the 2019 Asset Quality Review (AQR) conducted by NBK and the Agency for Financial Market Regulation and Development (AFR). Since the AQR, AFR withdrew the licenses of three smaller banks with a high amount of problem loans lacking provisions and liquidity issues and resolved another larger bank through a combination of state support and market solution. Nevertheless, the potential effect of the COVID-19 crisis on the corporate and consumer solvency require monitoring.

Although the officially reported nonperforming loans (NPLs) have slightly increased, the real level of distressed assets in the system may be higher. The officially reported NPLs inched up to 7.1 percent of the loan portfolio in April 2021, from 6.9 percent in January 2021. The support measures, such as loan guarantees, moratoria, and subsidized loans, helped halt mass corporate insolvencies during the lockdown. However, the real size of NPLs could be higher than what is reported because of gaps in the regulatory framework for recognizing NPLs and provisioning of credit risk. The NPLs in the banking system can rise further once the regulatory forbearance measures are fully lifted.



VI. Fiscal Policy

The fiscal stance was expansionary in the first quarter, with a larger deficit and debt-to-GDP ratio, and is expected to remain supportive through 2021. The government presented the first supplementary budget proposal for 2021, with new measures to scale up fiscal support to economic recovery.



The authorities continued to maintain supportive fiscal policy stance with a higher budget deficit registered in the first quarter. The government budget deficit is estimated to have increased to 4.0 percent of GDP in Q1 2021, compared to a deficit of 0.2 percent reported for the same period of 2020. The budget deficit in the first quarter of 2021 is the reflection of lower revenues and to a greater degree of extended budgetary support measures to households and businesses facing hardship as a result of the COVID-19 outbreak. As the economy reopens, the authorities have moved spending priorities from rescue toward supporting recovery with larger budget deficits in Q1. Compared with the first quarter of 2020, budget revenues in Q1 have come weaker driven largely by lower oil revenue and VAT. The budget expenditure rose and stood at 24.1 percent of GDP in Q1, up from 21.4 percent a year earlier, with social assistance programs contributing the most of the allocation. The debt-to-GDP ratio moved up to 26.2 percent, reflecting the large deficit, the shortfall of GDP, and the higher nominal debt owing to the exchange rate depreciation. The increase is also attributable to the disbursement of external loans to finance the deficit.

Since the strong countercyclical fiscal response during the pandemic, the authorities have remain committed to a steady economic recovery. In April, the government adopted the supplementary budget for 2021 to increase spending on COVID-19-related measures and support economic recovery. The government plans to allocate an additional \$3.0 billion, or 1.7 percent of GDP, support package for 2021. The budget spending priorities will be: (1) to support frontline medical workers and the health system; (2) to support SMEs, which continue to be impacted by restrictions; (3) to finance transport and infrastructure projects; and (4) to increase funding to retraining programs for unemployed and economically inactive people, and to developing rural areas. Thus, budget expenditures would remain little changed, at 23.6 percent of GDP relative to the level spent in 2020 in the wake of the pandemic, while revenues are projected to increase to 21.2 percent of GDP (20.5 percent in 2020). The cost of new fiscal measures is to be funded through NFRK transfers, incoming revenue, and higher domestic borrowing. The government plans to withdraw an extra \$2.0 billion (equivalent to 1.1 percent of GDP) from the National Fund of the Republic of Kazakhstan (NFRK) on top of the \$8.7 billion (4.9 percent of GDP) planned for 2021, reflected in the revenues of the state budget. As a result of the adopted fiscal measures, the budget deficit is expected to reduce by 3.4 percent from 4.0 percent a year earlier, but the non-oil deficit would remain elevated in 2021, well above the sustainability targets.

Table 1. Government fiscal accounts, 2019–21 (percent of GDP)

	2019	2020	2021	1Q2020	1Q2021
Revenues	18.3	20.5	21.1	22.1	20.9
Oil revenue	6.1	7.6	7.7	9.2	8.0
Nonoil revenue	12.2	13.0	13.4	13.0	12.9
Expenditures	19.5	23.7	23.6	21.4	24.1
Wage bill	2.9	3.7	3.6	3.8	4.5
Goods and services	5.6	6.2	6.2	5.5	5.0
Interest payments	1.0	1.1	1.3	1.4	2.1
Social transfers	4.8	5.3	5.3	5.9	6.4
Producer subsidies	0.9	1.1	1.1	1.1	1.0
Capital spending	2.7	4.0	4.0	1.2	1.4
Others	1.7	2.3	2.1	2.5	3.8
Net lending and financial transactions	0.7	0.9	0.9	0.9	0.7
Overall balance	-1.8	-4.0	-3.4	-0.2	-4.0
Nonoil balance	-8.0	-11.5	-11.1	-9.4	-12.0
Financing of deficit/use of surplus	1.8	4.0	3.4	0.2	4.0
External borrowing (net)	0.3	-0.1	1.9	1.1	3.8
Domestic borrowing (net)	1.5	4.1	1.5	-0.9	0.2
Memorandum items					
Stock of FX assets in the Oil Fund	34.0	35.0	31.8	31.3	33.8
Total government debt	19.6	24.4	26.7	21.1	26.2
External debt and state guarantees	9.2	10.5	12.5	10.3	11.1

Source: World Bank staff calculations based on data published by the authorities.

Note: The government budget comprises the state and local budgets. FX: foreign exchange.



VII. Economic Outlook and Risks

After suffering from a sharp contraction, Kazakhstan’s economy is projected to grow this year, supported by a better external environment, increases in domestic consumption and residential investments, and continued fiscal support measures. Inflation is projected to moderate as food inflation calms and supply chains improve. The balance of short-term risks to growth is on the downside and mostly linked to the resurgence of COVID-19 and the resulting containment measures.

Economic growth is expected to rebound in 2021, driven by the resumption of domestic activity, recovery in the global demand for oil, continued fiscal support measures, and a successful national inoculation against COVID-19. Despite depressed economic activity at the start of the year, real GDP growth is expected to gain momentum in Q2 and continue in the second half of 2021. With the continued pace of recovery, the economy is expected to grow within the 3.0–3.5 percent range in 2021¹⁷. Private consumption spending, which had dropped in the period of lockdown last year, is expected to play a greater role in driving growth in 2021 and over the medium term. The release of pent-up demand, an income rebound, and the reopening of service sector businesses are likely to support household consumption. Stronger external demand for commodities is projected to improve exports. In 2021, following the OPEC Plus decision, the country will continue gradually increasing oil production and exports, which would help spur investments and growth.¹⁸ Higher demand for housing can also boost investment, as the government program allows pensioners to use some of their savings to purchase a house.¹⁹ Over the medium term, the recovery of the economy should be supported by favorable oil prices and global demand, fiscal support measures through several the central government and NBK-funded programs, as well as successful completion of the vaccination campaign.

Inflation is expected to moderate and re-enter its target range in 2021 as supply disruptions and precautionary food buying during the COVID-19 crisis wane. Food price inflation, which accelerated with the pandemic, is projected to come down as supply disruptions taper and fear-driven hoarding by consumers eases. Cuts by the authorities in 2021 in value-added tax rates on shipment and postal services will likely reduce the costs of those services and result in lower inflation. Nevertheless, underlying price pressures could persist. An expansionary fiscal stance with significant direct lending provisions,²⁰ recovery in consumer demand, and volatile exchange rates can push up inflation again.

The government is planning to withdraw its fiscal stimulus only gradually, therefore keeping an expansionary fiscal stance with an elevated budget deficit. The government will continue an expansionary fiscal stance in 2021 due to rising spending on social assistance, education, and infrastructure. As a result, the nonoil deficit is projected to stay at a double-digit level of 11.1 percent of GDP in 2021 and come down gradually to its 6.0 percent sustainability target in the medium term. Despite projected steady economic growth, government debt is projected to increase gradually through 2023 but remain at a sustainable level. Continued fiscal support measures, sustained budget deficit and disbursement of external loans to finance the deficit are projected to be the main factors behind an increase in the debt-to-GDP ratio. Risks for government external debt are largely mitigated by the sizable assets of the National Oil Fund, which is projected to remain little changed, at over 31.0 percent of GDP over the medium term.

The authorities should maintain a flexible fiscal policy to support recovery and to effectively manage fiscal risks in the medium term. Although fiscal support along with a fall in tax revenues raised deficits and debt during the pandemic, the country retains strong fiscal buffers to counter future shocks. Nevertheless, rebuilding fiscal buffers and broadening fiscal space are necessary to be able to invest in infrastructure,

17 Based on available data by end of March 2021

18 https://www.opec.org/opec_web/en/press_room/6375.htm.

19 https://www.enpf.kz/ru/about/press-center/news/index.php?ELEMENT_ID=11733.

20 <https://primeminister.kz/en/news/salymshylardyn-zeynetaky-zhinaktaryn-merziminen-buryn-alu-turaly-otinishteri-1-trln-tengeden-astamga-oryndaldy-e-dosaev-1234841>.

human capital, as well as the green agenda that the authorities have put forward. During the COVID-19 crisis recovery stage, fiscal policy should remain supportive of growth, and the government should avoid abrupt withdrawal of stimulus measures in order to put the economy on a strong footing. However, after the economy bounces back, the authorities could resort to fiscal discipline and spending consolidation. Better targeting and greater efficiency in the existing budget programs would also help promote healthy fiscal policy in the medium term.

The current account deficit is projected to narrow modestly, to 2.4 percent of GDP in 2021, supported by better-than-expected external environment. Export growth will continue to outpace import growth owing to improved terms of trade, leading to larger trade surpluses. Higher oil prices and a rebound in global demand for nonoil commodities, including metals, will result in stronger exports. Import demand will remain supported by a broad pickup in consumer spending, fiscal stimulus measures, and several subsidized credit provision programs. The primary income balance, which traditionally remains negative, is projected to widen slightly, reflecting larger repatriation profits from FDI-linked projects in the mining sector. The current account deficit is likely to be covered by FDI flows, mainly into the mining industry, possible Eurobond issuances, and loans from multilateral organizations.

Short-term risks to the growth outlook remain tilted to the downside. Three main downside risk factors for the baseline growth projection include the following: First, the pandemic is not yet over. The recent resurgence coupled with a slow pace of inoculation may require longer-lasting mobility restrictions. The renewed lockdowns could adversely impact business activity, employment, and the livelihood of low-skilled service sector workers. Second, a surge in inflation in major advanced economies could prompt central banks to start reducing liquidity support to markets, which could tighten global financing conditions. This development might slow recovery in advanced economies and limit demand for and prices of commodities, as output is still well below its pre-pandemic peak in Kazakhstan's major exporting markets. Third, as firms emerge from the crisis, business insolvencies and layoffs, which were put on hold thanks to support measures during the pandemic, could suddenly intensify once that support is withdrawn. In the downside scenario, this could trigger bankruptcies, hit incomes, and increase poverty. In addition, a sharp rise in real estate transactions and housing prices, fueled by mortgage lending in 2021, could overheat the property market and potentially undermine the balance sheet of the banking sector and further limit credit growth.

On the other hand, faster-than-forecast growth and strong pickup in demand in major advanced economies, thanks to stimulus measures and the vaccination program provide a scope for rapid growth in 2021 and thereafter.

Table 2. Baseline scenario: selected macro-fiscal indicators, 2018–23*(percent, unless otherwise indicated)*

	2018	2019	2020	2021	2022	2023
				Projections		
Real GDP growth	4.1	4.5	-2.6	3.2	3.7	4.8
Oil sector	8.6	5.0	-1.9	-0.4	1.2	9.5
Nonoil economy	3.0	4.4	-2.8	4.0	4.3	4.0
Consumer price inflation, end of period	5.3	5.4	7.5	6.1	5.0	5.3
(Percent of GDP, unless otherwise indicated)						
Current account balance	-0.1	-4.0	-3.7	-2.4	-1.2	-0.3
Foreign direct investment	2.6	3.1	3.4	3.4	3.3	3.3
Government budget balance	-1.3	-1.8	-4.0	-4.3	-1.7	0.0
Nonoil fiscal balance	-7.3	-8.0	-11.5	-11.1	-8.2	-6.4
Government debt	19.9	19.6	24.8	26.7	27.1	27.7

Source: World Bank staff calculations based on data published by the authorities.

Note: The government budget comprises the state and local budgets.

VIII. Policy Watch



The authorities continue to upgrade the overall strategic framework for development.

In the medium-term strategy the President laid out ten national priorities to focus on in following three key reform areas: citizens’ wellbeing, quality of institutions, and building a strong economy. These themes are embedded in the recently adopted National Development Plan 2025. These two high-level documents will be reflected in the medium-term plans, including the National Development Plan, National Security Strategy, Territorial Development Plan, national projects and concepts for sector/sphere development, and development plans of state agencies, regions, and the biggest entities of the quasi-public sector.

An effective implementation of these strategies also depends on improvements in the strategic and budgeting planning and public administration, as reflected in the new Public Administration Development Concept. Emerging fiscal, economic, and social needs call for a more results-oriented, integrated public sector performance management, which addresses different parts of the public sector value chain including planning, budgeting, public investment, performance management, and performance monitoring and evaluation (M&E). The new Public Administration Development Concept provides a good start for greater integration between strategic planning and performance M&E and better traction in implementation. Greater focus on capacity strengthening and change management for public and private stakeholders as well as society is needed to deepen technical expertise, enhance ownership and collaboration, and reduce resistance to change.

Kazakhstan’s pledge to reach carbon neutrality by 2060 marks an important milestone for the country in the global effort to address climate change. The President announced this pledge at the virtual 2020 Climate Ambition Summit. Kazakhstan subsequently adopted a new Environmental Code to strengthen and broaden the scope of environmental legislation from the protection of the environment to also include its preservation and restoration. The code introduces measures to facilitate climate change mitigation and adaptation and to address environmental impacts. This includes, for example, the “polluter pays” principle and initiatives to stimulate green investments and support the sustainable management of natural resources. Given Kazakhstan’s heavy reliance on hydrocarbons for revenue generation and power supply, achieving carbon neutrality will require a fundamental shift in policies and regulations toward a low-carbon economy that emphasizes energy efficiency, a greater share of renewable energy, a greener transportation system, and the restoration of environmental and forestry resources. The “green transition” will also require a substantial program to minimize a potential disruptive effect on jobs and energy consumption and promote inclusive growth through human capital and innovation.

IX. Productivity growth in Kazakhstan: Evidence from Firm-Level Data ²¹



The Kazakh government has put productivity growth at the forefront of its economic development strategy. The National Development Plan of Kazakhstan 2025 lists productivity growth as one of the critical drivers of economic transformation to lift Kazakhstan into the top 30 most developed countries by 2030.

Productivity is so important because it is the primary determinant of economic growth. Empirical evidence suggests that almost half of the differences in per capita income across countries worldwide are due to total factor productivity (TFP), a measure of the efficiency with which multiple factors of production are combined.²² In this context, it is vital to boost TFP to accelerate convergence to high-income levels. Increasing productivity will also allow climbing up the value-added ladder of products, create more and better jobs, diversify the economy, and boost integration with foreign markets.

COVID-19 adds momentum for the government to review its productivity strategy, as the short-term effects from the pandemic can impact the country's long-term trajectory of productivity growth. While the short-term effects of the pandemic on sales and employment are undoubtedly negative in Kazakhstan,²³ it is still unclear how the crisis will affect its long-term trajectory of productivity growth. For instance, the COVID-19 shock can negatively impact firm capabilities by bringing irreversible effects to intangible assets—like buyer-supplier trust, lender-borrower relationships, and employee-firm relations—that would require additional and newly sunk cost investments to replicate. Moreover, while the supply-and-demand side disruptions caused by the pandemic could indeed push inefficient firms to exit the market, it's unclear if those firms that manage to survive after the pandemic shock are necessarily more productive or survive because they have other features that are not necessarily linked with efficiency, like market power, rent-seeking ability, and so on. In addition, the pandemic triggered the reshaping of global value chains and put into the spotlight the climate change efforts, all of which will require rethinking Kazakhstan's economic policies.

Against this backdrop, the assessment conducted under the World Bank project on productivity²⁴ presented informative results about the underlying drivers of productivity dynamics and identified key policy areas to boost productivity in Kazakhstan. The analysis followed a two-prong approach. First, it used administrative-level data to go beyond aggregate trends, explored heterogeneity across firms, and identified the underlying micro drivers of productivity growth. Second, the analysis identified the pressing policies to boost productivity expansion in the future (see Annex 1 for a detailed description of data and methodology used in the analysis).

Conceptually, productivity growth can be split into three elements (see Box A2 in Annex 1 for a summary of the approach used): (1) the upgrading of firm capabilities through innovation, technology adoption, and better managerial practices (the within-firm element); (2) the reallocation of production factors (capital, labor, and land) toward more productive firms (the between-firms element); and (3) more productive firms entering and less productive firms exiting the market (the entry/exit element).

22 Productivity can be also measured by labor productivity (as revenue or value added per worker). Although useful, this measure does not correct for differences in capital intensity. On the other hand, the TFP proxy assesses how efficient capital and labor are used in the production process. Cross-country studies have shown that TFP growth accounts for a substantial portion of income differences across the world. See, for instance, Easterly and Levine (2001), Caselli (2005), and Hsieh and Klenow (2010).

23 A recent analysis conducted by the World Bank (2021a)—drawing on the follow-up survey to the standard World Bank Enterprise Survey—showed that sales from formal private firms in Kazakhstan have dropped substantially: the average monthly sales in 2021 fell by 21 percent; the pandemic's impact on the workforce was also substantial: on average, 28 percent of formal private firms decreased the total number of hours worked per week relative to before the outbreak.

24 The "Technical Assistance to Support Productivity Growth in Kazakhstan—Micro Dynamics of Aggregate Productivity Growth in Kazakhstan" task under the Joint Economic Research Program (JERP) for FY 2020-2021.

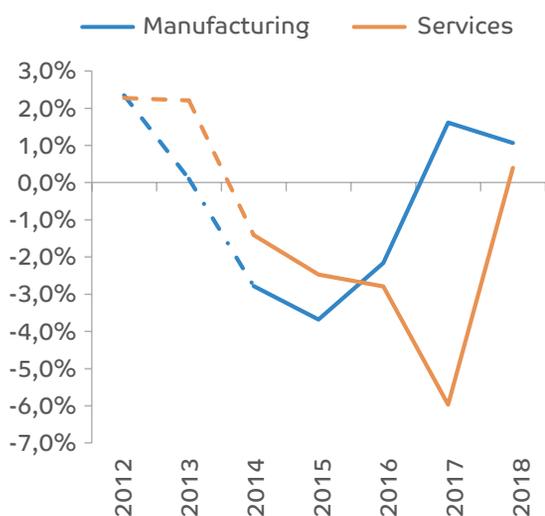
After negative results, Kazakhstan’s productivity performance started to resume with modest growth rates in recent years. After recovering from the aftermath of the global financial crisis in 2008–09, Kazakhstan’s productivity performance started to slow down in the early 2010s. The performance declined even more with the economic crisis of 2014 following the fall in oil prices and major devaluation, which have weakened domestic demand and contributed to a gradual deterioration of potential output (World Bank 2018). The firm-level data confirm a decline in TFP between 2010 and 2015 in both the manufacturing and services sectors. However, in more recent years, TFP growth has started to bounce back, possibly driven by the recovery in commodity prices, but still at a modest pace. Between 2015 and 2018, TFP grew by 1.1 percent in the manufacturing sector and 0.4 percent in the services sector. The regional disparities behind these recent numbers reflect the economy’s heavy dependency on the extractive sector: in Atyrau and Mangistau, the regions with the highest TFP growth in 2015–18 (17 percent and 10 percent, respectively), mining activities play a key role in value-added and employment.

Why has Kazakhstan seen low productivity growth so far? Results vary by sector, but on average, the modest productivity performance results from three main deficiencies: insufficient firm upgrading, poor allocative efficiency, and muted business dynamism. Decomposing the TFP growth of Kazakhstan firms over 2009–18 into these three elements reveals low results across all components, for both manufacturing and services. On average, there was muted contribution of firm upgrading (within), poor allocative efficiency (between), and limited contribution from entry/exit dynamics (Figure 15).

Looking forward, what are the policy priorities to boost productivity growth in Kazakhstan?

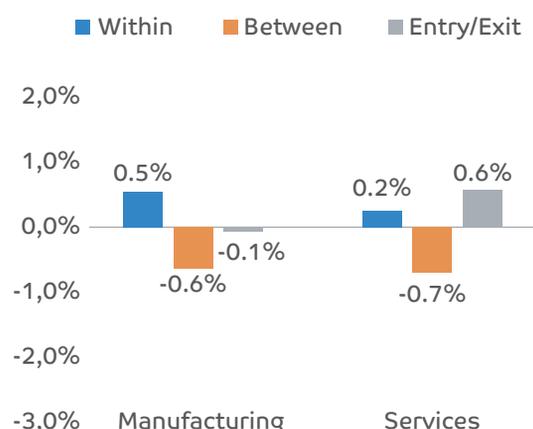
Figure 14. Growth in total factor productivity (TFP)

(three-year average)



Source: World Bank, 2020.

Figure 15. Decomposition of TFP growth in manufacturing and services (2011–18)



Source: World Bank, 2020.

The policy agenda for Kazakhstan in short to medium term should focus on streamlining the environment where firms operate and boosting firm upgrading.

The ability of firms to grow and become more productive stems from the combination of multiple policies.²⁵ In practice, a comprehensive productivity policy package needs to encompass all three dimensions of productivity growth (within, between, and entry/exit). The evidence provided by the decomposition exercise shows that Kazakhstan must improve all these components. In this context, a solid productivity policy mix should target the removal of distortions in the operating environment of firms simultaneously so that productive resources are allocated toward firms with higher productivity and growth potential, and the upgrade of firms' capabilities so that firms can identify new opportunities in the market, take the risk to develop and adopt new technologies, and expand their activities. Kazakhstan needs to improve cross-cutting issues affecting productivity, such as the functioning credit and land markets and improving skills. However, other pressing policies to boost productivity at the firm level include improving:

1. Boost competition in product markets by removing distortions to competition to allow more productive firms to grow faster.

The restrictiveness of product market regulation is a key driver of the efficient allocation of resources across firms. According to the 2018 Organisation for Economic Co-operation and Development (OECD) indicator of product market regulation, Kazakhstan's regulatory framework (as it appears "on the books") is considerably more restrictive to competition than Eastern European member countries and the OECD average.²⁶ Most of this restrictiveness stems from distortions induced by State involvement in the economy, especially through public ownership via the presence of SOEs in markets where private sector participation and competition are typically viable.²⁷ In addition, SOEs compete on uneven (non-neutral) terms with the private sector because of gaps in the current regulatory framework and its implementation.²⁸ Additional impediments to competition are associated with restrictive public procurement policies²⁹ and the continued use of price control mechanisms.³⁰ Several policy actions could be taken to reduce the restrictiveness of Kazakhstan's product market policies. Among the economy-wide measures, the most transformational would include: (1) fostering competitive neutrality principles in

25 See Cusolito and Maloney (2018) for an in-depth discussion on the elements of a "national productivity system," the set of policies and institutions necessary to improve the productivity of an economy.

26 The analysis presented in World Bank (2021b) relies on the OECD PMR indicator to identify and benchmark regulatory restrictiveness to competition in Kazakhstan. The 2018 aggregate economy-wide PMR indicator measures the incidence of regulatory barriers on competition via two main pillars: (1) distortions induced by state involvement; and (2) barriers that can hamper entry of domestic and foreign firms and products into the market. Each of these two broad pillars can be further decomposed into three medium-level indicators that comprise in total 18 low-level indicators.

27 Data suggest that of 29 broad sectors covered by the 2018 PMR database, the government controls SOEs in at least 20 of them (such as gas supply, retail e-communication services, air transport, manufacturing, accommodation, and banking services). This significantly exceeds the average number of sectors with at least one SOE in OECD economies (13) and non-OECD economies (14.5).

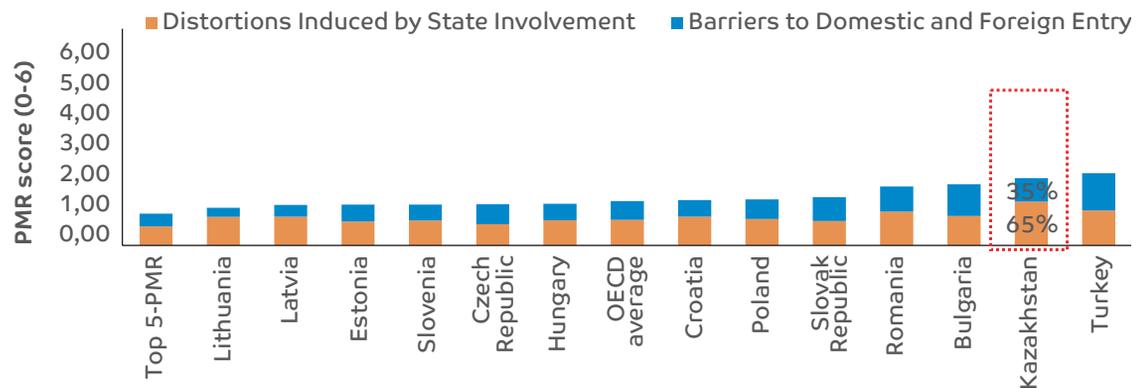
28 For instance, the State provides budget support and other financial advantages to SOEs—such as state guarantees and subsidized loans—which places SOEs in an advantageous position compared with private sector operators. Moreover, there is no legal requirement or systematic separation between commercial and noncommercial activities of the SOEs, which allows them to use the resources from noncommercial activities to cross-subsidize commercial activities where they face competition from private operators. Likewise, there is no express requirement for SOEs to achieve a commercial rate of return, which increases the risk of supporting inefficient firms.

29 The analysis presented in World Bank (2021b) shows that competition remains limited in public procurement and discriminates foreign firms in certain product markets. For example, tenders are not always the method for conducting public procurement in Kazakhstan. Direct award procurement is still widely used instead of public procurement tenders, especially for goods and services. The widespread use of direct awards and the concentration of these contracts within a few companies facilitate anti-competitive conduct.

30 Kazakhstan's government indirectly participates in the market through price controls, which may also create market distortions and affect strategic decisions in workably competitive markets. According to the 2018 PMR database, of the 46 economies covered, governments in seven economies, including Kazakhstan, still control retail prices in workably competitive markets. For instance, the government controls margins of 19 staple food products, as well as the price of gasoline, which is at odds with international experience. See World Bank (2021b) for further details.

Figure 16. Economy-wide Product Market Regulation score (2018)

Index scale (0 to 6, from least to most restrictive)



Source: World Bank, 2020.

markets;³¹ (2) reducing the use of noncompetitive methods for awarding procurement contracts while ensuring fairness and transparency; and (3) limiting the scope of price controls to market failure scenarios and for a limited period, while gradually removing undue price controls in industries without a clear market failure to be addressed.

As for sector-specific reforms, the government could prioritize removing competition distortions in key network sectors to bring trickle-down effects on productivity growth for the whole economy.³² Targeting the transport-logistics and telecom sectors is likely to bring substantial payoffs, as they are key enabling activities for the overall competitiveness of Kazakhstan's economy. Examples of pro-competition reforms in the telecom and transport sectors include, among others,³³ unbundling the vertically integrated incumbent SOEs, strengthening the regulatory authority and/or separating the sector regulator from the policymaking ministry, and removing legislative bottlenecks that prevent access by private companies to key input infrastructure.

2. Streamline the foreign investment promotion framework. FDI can bring many benefits to host countries and play a key role in global value chains (GVC) and enhanced productivity.³⁴ Having the right institutional framework for investment can lead to higher levels of FDI inflows. Kazakhstan has had limited success in attracting significant FDI inflows relative to the size of its economy. In addition, much of the investment that the

31 As per recommendations discussed in World Bank (2021b), this could be achieved by (1) requiring a clear separation between commercial and noncommercial activities of SOEs; (2) mandating that SOEs earn rates of return comparable to private-sector competitors; (3) limiting conflicting roles of the state as regulator and operator in certain sectors; and (4) ensuring full debt and regulatory liability of SOEs.

32 World Bank (2021c) shows that removing anti-competitive regulations in services sectors is expected to bring productivity dividends for the downstream economy (manufacturing sector), as final good producers would be able to get access to cheaper and higher quality services. Econometric analysis presented in World Bank (20201b) suggests that removing regulatory restrictions to competition in services sectors in Kazakhstan would bring positive payoffs to productivity performance in manufacturing industries. The highest payoffs would come from pro-competition reforms in the railroad sector. As for downstream beneficiaries, the largest productivity dividends from pro-competition reforms in services sectors would be experienced by the food products, chemicals, and basic metals industries. These are typically scale-intensive sectors that can lead to greater diversification of the economy.

33 See World Bank (2021c) for a detailed list of reform options to boost competition in the telecom and transport-logistics sectors in Kazakhstan.

34 In Kazakhstan, data from the 2019 WBES show that FDI firms bring increased productivity and technology to the economy, outperforming domestic firms, in particular, when it comes to technology innovation and product/service innovation. At the same time, these data also point to untapped potential in terms of further leveraging spillovers from FDI firms to domestic firms, as well as unlocking foreign firms' engagement in research and development activities linked to innovation. See World Bank (2021d) for further results.

country has attracted so far is concentrated in the extractives sector, which is vulnerable to commodity price swings and has limited spillovers into the domestic economy. To attract more and higher quality investments, Kazakhstan will need to strengthen the effectiveness of its institutional framework for FDI. An in-depth assessment of the country's current framework revealed significant potential for improvement to align with international best practices and reach OECD standards. A major area of concern is institutional coordination. There are many institutions involved in investment policy and promotion in Kazakhstan that have inefficiencies in coordination both at the national level and at the national-subnational level.³⁵

Therefore, pressing reforms to enhance the effectiveness of Kazakhstan's FDI institutions include: (1) revising the mandate of the investment promotion agency KazakhInvest to focus mostly on investment promotion, as well as on policy advocacy and matchmaking between FDI and the local private sector; (2) enhancing the governance arrangements for KazakhInvest, improving its service contract with the Investment Committee, and ensuring greater consistency of the agency's day-to-day operational management; (3) enhancing institutional coordination mechanisms between policymakers and implementing agencies of Kazakhstan's investment attraction and retention policies; and (4) establishing an effective national-subnational framework for coordinating the investment promotion activities.

3. Strengthen firm capabilities to innovate. Even if the market is undistorted, there will be no productivity growth if firms do not have the necessary capabilities to take advantage of it. Firms' ability to identify opportunities, manage the associated risks, formulate growth strategies, and introduce innovative products or processes depends on their capabilities.³⁶ Data from the 2019 World Bank Enterprise Survey (WBES) suggest that Kazakhstan's private firms underperform in several measures of the firm's capabilities. For instance, only 6 percent of formal private firms have internationally recognized quality certification, considerably below averages for ECA (around 18 percent). A similar pattern is observed for the share of firms using technology licensed from foreign companies. This subdued performance is translated into insufficient innovation efforts and outputs. Kazakhstan falls behind on measures of innovation: for a high middle-income country, Kazakhstan seems to be underinvesting in research and development (R&D), with gross expenditures in R&D systematically below what would have been expected given its development level.³⁷

In this context, examples of policies to help boost innovation and firm capabilities include (1) addressing the fragmentation of the policy delivery structure of science, technology, and innovation policies; (2) expanding managerial capabilities by improving management consulting services to SMEs; (3) spreading the adoption of productive technologies by scaling up existing pilots on supplier development programs; (4) promoting innovation by boosting the science-business collaboration and the capacity of technology commercialization offices; (5) closing the financing gaps for technology

35 The national lead agency for investment promotion KazakhInvest could benefit from a strengthened governance framework, a streamlined mandate, and improvements to enhance the effectiveness of its service delivery to investors. The mechanisms currently in place to address investor grievances also require upgrading to function more effectively.

36 Multiple capabilities are necessary: basic human capital, managerial capabilities, technological capabilities, and actuarial capabilities. See Cirera and Maloney (2017) for a general conceptualization of the necessary capabilities to innovate and grow.

37 As per the analysis presented in World Bank (2021e), the gross expenditure in R&D as a share of GDP is also much lower than in other natural resource-intensive countries, including Canada and Australia, and about 10 percent of Korea's investments level when the country had a similar level of development. At the micro level, this result is driven in part by the small number of firms investing in R&D in the country: according to 2019 WBES data, only 2.1 percent of formal private firms in Kazakhstan spend on R&D, around four times lower than the ECA average, and only 22.7 percent of formal private firms have introduced product service or process innovation. In addition, the number of firms reporting the use of technologies from foreign-licensed companies is lower than in peer economies.

startups and combining early-stage financing with nonfinancial support; and (6) easing access to soft infrastructure, such as support services.

4. Revisit the existing business support programs to create better conditions for the economy to rebuild back stronger. While the reform areas outlined above are addressed, it is equally important to revisit the innumerable set of business support programs the government has been deploying in the past 11 years. The Business Roadmap Program (2020 and 2025), Economy of Simple Things Program (2018–21), Productive Employment, and Mass Entrepreneurship Development Enbek Program are only a few examples among several initiatives. These programs encompass measures to improve access to finance (such as grants, subsidized lending, and partial credit guarantees), as well as nonfinancial support measures—including technical assistance tailored to micro, small, and medium enterprises (MSME), such as management training and consultancy, business advisory services, marketing, and business intelligence support of export activities. As of now, the impacts stemming from this wide set of programs are still unknown.³⁹

More recently, the government has adopted additional measures to ease the impact of the COVID-19 crisis on the corporate sector, focusing on tax and loan payment deferrals. As the economy moves to recovery, it is important to ensure that these support programs are carefully calibrated to tackle deeper structural challenges while helping to rebuild better so that a stronger, greener, and more inclusive economy flourishes.

In this context, a mere expansion of state support programs that have been in place since the global financial crisis will, at best, maintain the status quo in the short term. In other words, it will perpetuate the survival of inefficient firms and, in particular, the concentration of MSMEs in low value-added-low wage jobs sectors. Therefore, it is crucial to assess the effectiveness of available programs; this will allow identifying programs that need to be scaled and those that need to be redesigned or even discontinued. The key priority actions to guide the review of business support programs include:⁴⁰ (1) conducting a public expenditure review of existing MSME support programs; (2) revisiting the targeting criteria applied by current business support programs to prioritize firm growth rather than firm survival; (3) connecting business support programs with broader policies (in particular, policies supporting green growth and digitalization); (4) introducing a robust M&E framework that serves as the basis for the adoption of evidence-based policies; and (5) strengthening the institutional framework to deliver MSME policies.

Implementing such a comprehensive set of productivity reforms will require strong institutional coordination and political economy support. The proposed reforms span multiple policy areas and stakeholders. Implementation will require efficient coordination and will be accompanied by political processes of varying complexity and costs. In the end, the quality of government action and the government action will depend on four key drivers: overall rationale and design of policy, the efficacy of implementation, coherence of policies across various actors, and policy consistency and predictability over time. Underlying all these drivers is the need to build consensus, as some of these policies will challenge the incumbent interests. In this light, the reports developed under the World Bank Joint Economic Research Program (JERP) project on productivity provided strong analytical underpinning, connected the proposed reforms with a broader productivity agenda, and is expected to build stakeholder buy-in and consensus about the need for such reforms.

39 This is particularly true for MSMEs. Despite the large amount of resources deployed by the government, the MSME activities are still concentrated in industries with relatively low productivity (such as wholesale and retail, real estate sector, and transportation/storage), and their contributions to employment and value-added generation are still below the OECD average.

40 See World Bank (2021f) for a detailed list of priority actions to guide the review of business support programs, and MSME programs specifically, in Kazakhstan.

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Annex 1.

Box A.1 describes the firm-level administrative data used in the analysis developed in the context of the Joint Economic Research Program (JERP) for FY 2020-2021: “Technical Assistance to Support Productivity Growth in Kazakhstan—Micro Dynamics of Aggregate Productivity Growth in Kazakhstan.”

Box A.1. Description of Firm-Level Administrative Data

The analysis relied on administrative firm-level data covering 2009–18 that were collected for statistical purposes. These data cover business establishments across a range of sectors, including agriculture, mining, manufacturing, construction, commerce (wholesale and retail trade), transport, accommodation and food service activities, ICT, and other services (based on the ISIC two-digit industrial classification). The most prominent sector in terms of firm representation is “other services” (for example, personal services, recreation services), with 34 percent of firms representing 21 percent of employment. This is followed by the commerce sector, with 15 percent of firms representing 12 percent of employment. The manufacturing sector is represented by 9 percent of firms with 18 percent of employment.

Table A.1. Sectoral and regional coverage of the establishment-level administrative data
(number of business establishments with employment, 2018)

Region or city	Manufacturing	Services	Other/ Primary	Total
Almaty	785	7,057	293	8,135
Almaty Region	467	2,722	628	3,817
Aqmola Region	348	2,244	938	3,530
Aqtobe Region	197	1,660	320	2,177
Atyrau Region	108	2,483	131	2,722
East Kazakhstan	410	2,930	484	3,824
Karagandy Region	554	3,837	439	4,830
Kostanay Region	259	1,784	453	2,496
Kyzylorda Region	135	1,771	278	2,184
Mangistau Region	152	1,813	216	2,181
North Kazakhstan	193	1,286	679	2,158
Nur-Sultan	346	5,061	214	5,621
Pavlodar Region	318	2,064	247	2,629
Shymkent	165	1,105	142	1,412



Turkestan Region	237	1,693	1,075	3,005
West Kazakhstan	169	1,878	197	2,244
Zhambyl Region	217	1,577	254	2,048
All cities and regions	5,093	43,202	7,125	55,420

Source: World Bank, 2020.

Note: The figures include only establishments with at least one employee active in 2018. Others include agriculture, mining, and other primary activities. Services include construction and utilities. For 407 establishments, no region or city was reported.

The data are collected at the level of the business establishment (local production unit). The largest shares of establishments are in the main business cities of Almaty (15 percent) and Nur-Sultan (10 percent), representing 19 and 9 percent of employment, respectively. The share of establishments covered in the rest of the country varies from as high as 7 percent in East Kazakhstan and 6 percent in Aqmola to as low as 4 percent in Aqtobe, Kyzylorda, Mangistau, North and West Kazakhstan, and Zhambyl and 3 percent in the city of Shymkent.

Large establishments account for 2 percent of all firms in the dataset (2018) and 47 percent of total employment. SMEs represent one fourth of all establishments covered by the dataset, with 47 percent of total employment. The data do not contain information on informal (unregistered) establishments or informally employed workers.

The data provide information on employment, payroll, wages, material costs, volume of production and sales, capital stock, financial liabilities, as well as total current and fixed assets, among others. However, information on ownership status, imports, exports, and the founding date of the business is missing. For the purposes of the analysis, age has been proxied by the first appearance in the dataset.

The Dynamic Olley-Pakes Decomposition (DOPD), developed by Melitz & Polanec (2015), is used in this analysis to attribute productivity growth to three elements:

1. **Improvement of firm capabilities.** Firms can adopt new technologies and better managerial practices (within-firm productivity growth).
2. **Improvement in factor allocation.** Productivity can also improve if the factors of production, labor, and capital move from less to more efficient firms (between-firm growth). Failure of more productive firms to grow can be a sign that resources are being misallocated—and that there are barriers to the growth of more productive firms.
3. **Productive entry and exit.** Factor allocation improves when new firms that are more productive than the average enter the market and when less productive firms leave the market (dynamic productivity growth).

Box A.2 explains the methodology.

DOPD allows for disentangling productivity, based on the following equation:

$$\Delta\Phi = \Delta\bar{\phi}_s + \Delta cov_s + s_{E2}(\phi_{E2} - \phi_{S2}) + S_{X1}(\phi_{S1} - \phi_{X1}) \quad (1)$$

In the above, $\Delta\Phi$ is the (weighted) growth in revenue total factor productivity (TFPR), $\Delta\bar{\phi}_s$ is the unweighted growth in TFPR for surviving firms (the change in the simple average of TFPR; corresponding to the “within” component), $\Delta cov_s = \Delta [\sum_i (s_{it} - \bar{s}_i)(\phi_{it} - \bar{\phi}_t)]$ is the change in covariance of market share and productivity (corresponding to the “between” component), the third term represents the productivity difference between entrants and surviving firms (the “entry” component), and the fourth term represents the difference in productivity between surviving firms and exiting firms (the “exit” component).

The component of “between” firm growth can be further decomposed to separate the effect describing within-industry reallocations (inter-industry) and a term describing shifts between different industries within a sector (intra-industry).

In this analysis, market share is calculated by the value-added contributed by the firm, following the practice of Melitz & Polanec (2015).

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