



Kazakhstan

In 1999, the economy began to recover from a deep recession caused by the fall in world commodity prices and the Russian crisis. Nevertheless, to restore sustained economic growth along with macro-economic stabilization, the government needs to make greater efforts to accelerate enterprise restructuring and alleviate pervasive poverty.

RECENT TRENDS AND PROSPECTS

During 1999, the economy showed signs of recovery from the recession that had been caused by the weak world commodity markets and the Russian crisis that erupted in mid-August 1998. GDP grew by 1.7 percent in 1999, a moderate turnaround compared with a 1.9 percent contraction in 1998. After a continued decline in output during the first half of 1999, the recovery began in the second half. This resulted from a bumper harvest; a rebound in industrial production; an increase in capital investment; and rising world prices for major commodity exports such as oil, gas, and metals.

The agriculture sector grew substantially in 1999, as favorable weather resulted in a good grain harvest. The output of grain totaled 14.3 million tons, more than double the 1998 output. Kazakhstan planned to export at least 3 million tons of grain to neighboring countries such as Turkmenistan and Ukraine. The output of cotton also grew sharply by 54 percent, while production of livestock increased modestly.

Industrial output grew by 2.2 percent in 1999 mainly because of the rebound in production of natural gas and crude oil. In response to rising world prices, the output of gas and oil expanded by 51 percent and 12 percent, respectively. Processing industries, which account for more than half of the overall industrial output, also experienced growth, notably chemicals, metals, and textiles.

Capital investment expanded in 1999 to T277 billion as the government increased development expenditures to stimulate economic recovery. Because of the expansion, construction activities remained strong, while foreign investment continued to flow into the oil and gas subsectors.

Officially, the registered unemployment rate at the end of 1999 was 3.9 percent. However, actual unemployment was much higher because some still officially employed were on forced unpaid leave and many other unemployed persons were not officially registered. Due to mounting unemployment and the reduction in government social expenditures, poverty has risen rapidly.

In 1999, total government revenues accounted for 21.2 percent of GDP while total government expenditures were 24.7 percent, resulting in a budget deficit of 3.5 percent. This deficit was financed by receipts from privatization and by foreign sources. To improve the fiscal situation, the government took measures to strengthen tax collection and administration and rationalize public expenditures. However, the reduction in government expenditures resulted in arrears on payments of public sector wages, pensions, and benefits.

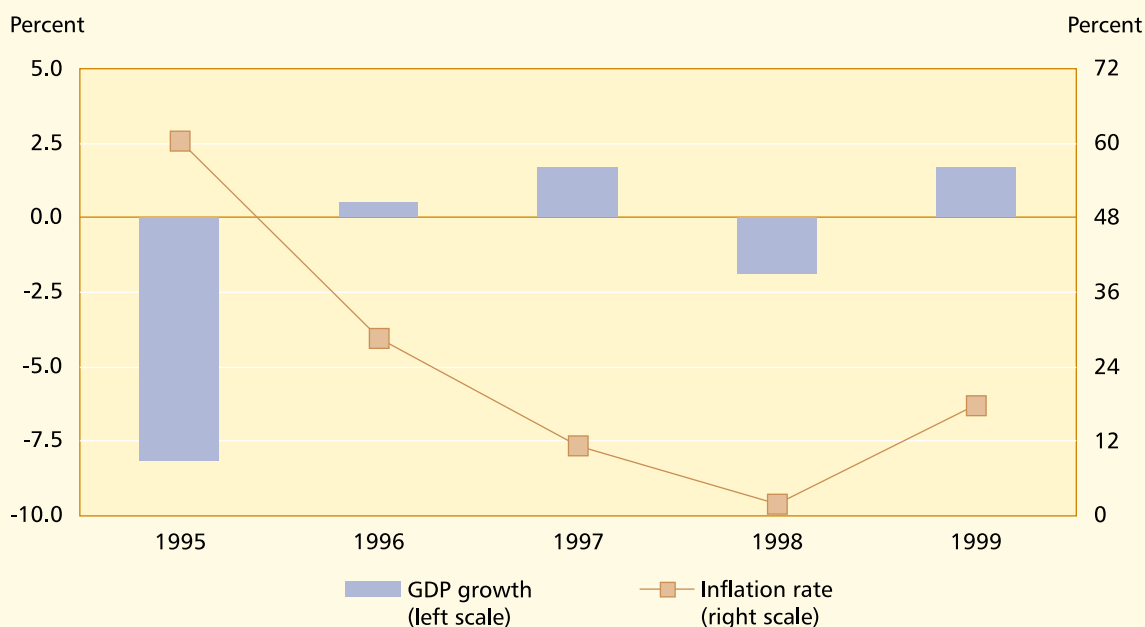
In 1999 monetary policy was designed and implemented to stimulate economic recovery while keeping inflation under control. The refinancing rate was reduced three times during the year, from 25 to 18 percent, and the requirement that exporters must sell 50 percent of their export earnings to the central bank was abolished in November. The rate of inflation was 17.8 percent, compared with 1.9 percent in 1998, largely because of currency devaluation. However,

while inflation increased in 1999, there has been substantial progress in reducing inflation since 1995, even though it has been difficult to sustain a pattern of growth in GDP (see figure 2.3). The national currency, the tenge, depreciated sharply against the dollar after the government floated the currency in April 1999, before stabilizing somewhat in the second half of the year.

The balance-of-payments situation improved, with a sharp reduction in the current account deficit from 5.5 percent of GDP in 1998 to 1.7 percent in 1999. This resulted mainly from the trade surplus of \$776 million in 1999—compared with a deficit of \$801 million the previous year—because imports declined more sharply than exports. Exports climbed in the second half of 1999 because of the rising world oil price and the effect of the currency devaluation. For the whole year, however, exports decreased by 4.8 percent while imports fell by 28.2 percent.

Foreign direct investment declined in 1999, as investors remained cautious after the Russian crisis.

Figure 2.3 GDP Growth and Inflation Rates, Kazakhstan, 1995-1999



However, as the first Commonwealth of Independent States country to return to the global capital markets after the Russian crisis, Kazakhstan issued new international bonds totaling \$300 million during the period from September to November 1999, the third offering since independence. By the end of 1999, gross international reserves totaled \$2 billion (four months of import equivalent). External debt increased in 1999 while the debt-service ratio declined slightly from 26 percent in 1998 to 25 percent in 1999.

The economic outlook for 2000 appears positive. GDP is projected to grow by about 3 percent, driven by a continuing upward trend in revenue from the major export commodities and by economic recovery in Russia. The budget deficit will likely shrink to about 3 percent of GDP, as the government is committed to achieve medium-term sustainability of public finance. The annual rate of inflation is projected to decline to about 13 percent, provided the central bank keeps tight control on credit growth and money supply. The balance-of-payments situation should continue to improve. Exports are expected to grow steadily and inflows of foreign capital should increase.

ISSUES IN ECONOMIC MANAGEMENT

The government has developed an economic program for 2000-2002 aimed at promoting economic growth and achieving macroeconomic stabilization. The program, supported by the International Monetary Fund under a three-year Extended Fund Facility approved in December 1999, focuses on adopting prudent fiscal policies that consolidate public finances, pursuing a tight monetary policy to reduce inflation while maintaining a free-floating exchange rate, and accelerating structural reforms. In the fiscal area, Parliament approved a more prudent government budget for 2000, which requires raising tax revenue, reforming the tax code, strengthening tax and customs administration, and improving public expenditure management.

The central bank will strengthen its supervisory activities to ensure that all banks comply with enhanced prudential requirements. Meanwhile, the central bank will continue to intervene on the currency market to prevent excessive short-term exchange rate fluctuations. The government will maintain efforts to

liberalize the trade system, removing the tariffs imposed on its major trading partners in early 1999 and further reducing trade barriers. As part of the structural reform programs, the government will restructure the financial and corporate sectors, accelerate privatization of medium-size and large state-owned enterprises, improve governance, strengthen transparency, develop legal and regulatory frameworks necessary for a market-based economy, and fight corruption. These steps will help improve the quality of public services and promote private sector development.

POLICY AND DEVELOPMENT ISSUES

Despite the positive short-term economic prospects, Kazakhstan needs to take concerted action on many fronts to accelerate economic recovery and realize equitable long-term development. The most important tasks are accelerating enterprise restructuring and strengthening poverty alleviation efforts.

Enterprise restructuring revives the corporate sector and enables private sector development, which are critical for economic growth. An effective and growing corporate sector would increase employment opportunities and thus benefit the poor. While the government has taken initial steps on enterprise restructuring, especially in privatizing state farms, agribusiness, and small and medium-size industrial enterprises, the corporate sector remains weak. Many enterprises have limited operational experience in a market-based economy. Old management remains in control of some privatized enterprises, while the government continues to intervene in operations of privatized or corporatized enterprises. In addition, many state-owned enterprises are experiencing difficulties caused by poor management, inefficient organizational structures, shortcomings in the incentive system, and internationally unacceptable accounting standards. This has resulted in extensive corporate losses and interenterprise arrears. About half of all enterprises were estimated to be unprofitable in 1999. By October 1999, total domestic corporate debts payable amounted to T1.8 trillion, a 25 percent increase over the same period of 1998.

Enterprise restructuring is imperative to develop an efficient corporate sector, and three major actions need to be taken. First, bankruptcy and merger pro-

ceedings should be enforced. Strong efforts should be made to formulate the necessary legal and regulatory frameworks for implementing bankruptcy and merger procedures. All nonviable enterprises should be liquidated through bankruptcy to reallocate resources to more efficient producers. Money-losing enterprises that can be salvaged should be merged with efficient ones, to render them profitable by changing their incentives and governance structures. Second, privatization should be accelerated. Whenever possible, the government should sell the remaining state-owned enterprises, especially large ones, in all the nonstrategic sectors. In particular, foreign participation in large companies—both capital and management—should be allowed during privatization. Third, corporate governance should be improved through effective management structures and internationally accepted accounting and auditing standards and manager training programs.

Poverty has climbed because of persistent economic difficulties after attaining independence in 1991, and is now a serious problem. The government indicates that 43 percent of the population lived below the poverty line in 1999. Poverty is also more pervasive in rural areas than in urban ones.

Fighting poverty in the medium term is essential to maintain social stability and public support for the government's macroeconomic stabilization efforts and structural reforms. From a long-term perspective, it is the key objective of development. Strong action needs to be taken to reduce and eventually eliminate poverty. The government planned to develop a national program on poverty reduction by April 2000. Greater efforts are needed in three areas.

First, the government needs to promote pro-poor, sustainable economic growth. Such growth will generate more income and government revenues needed to finance the social safety net. The government should pursue policies that encourage labor-intensive sectors, promote private sector development, and help small enterprises expand. Measures could include orienting public investment toward poor areas, promoting self-employment, providing incentives for job training and retraining, and supporting the poor through microfinance programs.

Second, the government needs to formulate and implement a comprehensive national poverty reduction strategy. An appropriate poverty line should be defined; a reliable database set up; and a comprehensive study undertaken to examine causes, constraints, and opportunities for poverty reduction. The government should also stipulate policies and programs designed for raising the incomes of the poor. Adequate budgetary resources for basic social services and social assistance to the poor should be allocated and the most vulnerable groups targeted. Particular attention should be paid to women, who usually suffer more from poverty, and have limited access to essential social services and assistance.

To formulate and implement the poverty reduction strategy, nongovernment organizations should be encouraged to identify and assist the targeted groups, and the private sector should be permitted to provide basic social services and social assistance to the poor. These efforts should be complemented by continued reforms in the education and health sectors to deliver these services more efficiently, and to strengthen the social security system that provides incentives for self-employment and job training.

Last, efforts should be made to improve governance. Aside from increasing the efficiency of the public sector, good governance also facilitates formulating and implementing pro-poor policies and the poverty reduction strategy. Public administration and expenditure management at both national and local levels must be strengthened to promote pro-poor growth and social development. In particular, strong institutional capacity is needed at the local level, because local governments and communities are primarily responsible for delivering basic public services and providing social assistance to the poor. Meanwhile, the central government must develop the mechanism to closely monitor budgeted social assistance programs. It should also establish effective regulations to ensure the accountability of public funds used for poverty reduction. Strong measures must be undertaken to fight corruption and waste of public resources. These efforts will contribute to effective and efficient delivery of basic public services and successful implementation of targeted antipoverty programs.