INCLUSIVE AND SUSTAINABLE GROWTH ASSESSMENT

1. Kazakhstan is an upper middle-income resource-rich country and one of the most developed economies among the members of the Central Asia Regional Economic Cooperation (CAREC) Program. After a difficult transition to a market economy in the 1990s, Kazakhstan developed well from 2000 to 2013, with a slowdown in 2008–2009 because of the global financial crisis (Figure 1). The latest period of development (2014–2022) has been challenging because of several external and internal shocks, which adversely affected the country’s economic and social development. These include (i) the decline and increased volatility of prices for crude oil, the main export product of Kazakhstan;¹ (ii) the coronavirus disease (COVID-19) pandemic;² (iii) the internal unrest in January 2022, which was the result of pent-up tensions and social inequality; and (iv) the economic spillover from the Russian invasion of Ukraine, which is a major source of uncertainty posing substantial downside risks to Kazakhstan’s economy.

A. Recent Growth, Poverty, Inequality, and Other Development Dynamics

2. Economic growth and productivity performance. Because of the decline and increased volatility of crude oil prices and the COVID-19 pandemic, the average gross domestic product (GDP) growth in Kazakhstan fell from 5.9% in 2010–2014 to 2.3% in 2015–2021 (Figure 1). This translates to a GDP per capita average growth rate of just 0.8% for 2015–2021 (compared with 4.4% in 2010–2014). This modest growth, coupled with the depreciation of Kazakhstan’s currency (tenge) against the United States (US) dollar, resulted in a decline of GDP per capita in current US dollars from $13,891 in 2013 to $7,715 in 2016. Since 2017, it has been $9,000–$10,400 ($24,800–$28,700 in current international US dollars at purchasing power parity).

3. Despite the oil price decline, the volumes of production in the oil and gas sector continued to grow in 2015–2019. The sector’s production volume index increased by 4.5% per year on average in 2015–2019, up from 2.2% in 2010–2014. The deceleration in GDP growth was caused by the non-oil sector, which experienced reduced export revenue, currency depreciation, and the associated stagnation of domestic demand for goods and services. According to the available data, the sector did not benefit from the currency depreciation as a potential driver of external competitiveness (para. 6). During 2015–2019, the non-oil sector grew at an average rate of 3.0% per year (compared with 7.1% in 2010–2014). The COVID-19 pandemic led to a decline in the production of both the oil and non-oil sectors in 2020. In 2021, the oil sector stagnated (near zero growth) while the non-oil sector recovered (5.1% growth) because of the gradual lifting of pandemic-related restrictions on economic activities.

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¹ International Monetary Fund (IMF). IMF Primary Commodity Prices (accessed 23 February 2022). The average crude oil price for October 2015–December 2021 fell by 38% from January 2010–September 2014. The price variation coefficient increased from 11% to 23% over the same period.

² Official sources recorded 18,000 COVID-19 deaths in Kazakhstan from March 2020 to December 2021 (Our World in Data. Kazakhstan: Coronavirus Pandemic Country Profile [accessed 23 February 2022]). The excess mortality in Kazakhstan associated with COVID-19 for 2020–2021 is estimated at 81,000 or 61% of the baseline mortality based on the 2015–2019 trend. This positions Kazakhstan among the countries with the highest values of excess mortality in the world (13th out of 117 countries for which data are available [A. Karlinski and D. Kobak. 2021. Tracking Excess Mortality across Countries during the COVID-19 Pandemic with the World Mortality Dataset, eLife. 10:e69336]). The economic damage was also large: the country’s gross domestic product (GDP) fell by 2.5% in 2020 (compared with average growth of 4.2% for 2017–2019). Here and below, unless otherwise stated, the data sources are Government of Kazakhstan, Agency for Strategic Planning and Reforms, Bureau of National Statistics (accessed 15 February 2023); National Bank of Kazakhstan (accessed 15 February 2023); and World Bank. World Development Indicators (accessed 15 February 2023).
4. Agriculture and manufacturing—sectors receiving significant government support—demonstrated only slightly better performance than the economy in general. The average annual growth rates were 2.7% for agriculture and 4.0% for manufacturing during 2015–2021, while their GDP shares remained virtually unchanged at about 5% for agriculture and 11%–12% for manufacturing. The only truly dynamic sector for this period was construction (average annual growth rate of 7.3%), which benefited from the government’s expanding investment and growing household demand. Because of the changes in growth rates and relative energy prices, the average share of non-tradable services in GDP increased from 52.0% in 2010–2014 to 56.4% in 2015–2021 at the expense of the export-oriented extractive industry, which shrank from 16.9% of GDP in 2010–2014 to 13.5% in 2015–2021. Comparing 2010–2014 and 2015–2020, the share of exports of goods and services in GDP fell by 9 percentage points while the share of households’ final consumption increased by 7 percentage points with no major changes in other GDP components.

5. Productivity growth requires agility and dynamism in reallocation of resources towards more productive firms and sectors through innovation, technology, or managerial practices. Macro- and enterprise-level studies conducted in 2019–2020 revealed near-zero growth in total factor productivity in Kazakhstan’s agriculture, manufacturing, and service sectors in 2011–2018.

6. Foreign trade, investment, and regional cooperation. The deterioration of Kazakhstan’s terms of trade associated with the fall in oil prices in 2014–2016 led to a major decline in all foreign trade indicators. Exports of energy products fell from $64 billion at their peak in 2012 to $22 billion in 2016. Oil prices fell again in 2020 as a response to the global demand contraction caused by the COVID-19 pandemic, leading to another decline in oil exports. As a result of the major decline in exports, the balance of payments’ current account turned from a surplus of 2.0% of GDP in 2010–2014 to a deficit of –3.1% of GDP in 2015–2021. To avoid the

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3 The government is implementing several programs aimed at agricultural, industrial, and innovation development through subsidized loans and insurance, consulting services, export promotion, Kazakh brand development, quality infrastructure upgrade, and enhanced legal protection of investors.

4 The average growth rates in 2010–2014 were 0.8% for agriculture and 5.6% for manufacturing.

5 Mostly low-productivity and low-quality jobs (see the discussion of labor market matters, paras. 24–25).

depletion of international reserves and to prevent domestic producers from experiencing a major loss of price competitiveness in relation to Russian goods after the sharp devaluation of the ruble in 2015, the National Bank of Kazakhstan (NBK) allowed the tenge to float in 2015, which weakened the average tenge–US dollar exchange rate from $1 = T152 in 2013 to $1 = T426 in 2021. This triggered a contraction in demand for imported goods. Imports of goods declined from a peak of $49 billion in 2013 to $25 billion in 2016, and partially recovered to $41 billion in 2021.

7. The export dynamics of other goods followed the same fluctuations as energy exports, although with smaller amplitude. Exports of manufactured goods (excluding metals) and agricultural goods were rather stagnant ($5.9 billion in 2021 compared with $6.3 billion in 2012) despite government policies aimed at diversification and favorable exchange rate dynamics. Exports of services showed modest growth of 10% in US dollar terms from 2014 to 2019. This growth was because of personal travel, i.e., tourism, and air transport. The gains from the growing transit of Chinese trains to Europe were leveled off by the declining exports of rail transport services on transit routes to/from the Central Asian economies going via Kazakhstan.

8. Foreign direct investment (FDI) inflows (mostly to extractive sectors) fell from an average value of $25.1 billion per year in 2010–2014 to $21.3 billion in 2015–2019. Because of the depreciation of the tenge, the ratio of FDI to GDP has not changed and remained at 12.5% of GDP. FDI declined by 30% in 2020 because of COVID-19 and almost recovered to the 2019 level in 2021. FDI in sectors other than extractive industries, pipeline transport, and geological explorations fell from an average of $10.9 billion per year in 2010–2014 to $8.9 billion per year in 2015–2019. Thus, the non-oil sector did not manage to increase its attractiveness for foreign investors despite the diversification efforts. This is particularly true for information technology and communications, finance, and professional and technical services (net of geological explorations).

9. Kazakhstan is increasingly focusing on developing economic relations with its neighbors, including through the CAREC Program. Compared with 2014, bilateral turnover of trade in goods with Uzbekistan grew by 86% (2021) and turnover of trade in services was up by 72% (2019). Trade with other CAREC partners is also growing steadily. Kazakhstan is working with neighboring countries to develop the Almaty–Bishkek and Shymkent–Tashkent–Khujand economic corridors, including assessing the potential of investments in a trade and logistical center at the border with Uzbekistan and joint investment projects in tourism, food industry, and other sectors. Kazakhstan is also seeking to harness emerging opportunities in the transportation route from the People’s Republic of China to Europe by gradually assuming the land bridge role through a key rail link.

<table>
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<tr>
<th>Impact of Russian Invasion of Ukraine on Kazakhstan’s Economy</th>
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<tr>
<td>The Russian invasion of Ukraine poses spillover risks to Kazakhstan’s economy because of the countries’ close economic links. In 2022, Russia was the main trade and economic partner of Kazakhstan, with bilateral trade turnover reaching 19.4% of total turnover. The Russian Federation is also a major investor in Kazakhstan, with an accumulated foreign direct investment stock of $6 billion as of the first quarter of 2022. Together with the Russian Federation and Belarus, Kazakhstan is a founding state of the Eurasian Economic Union, implying close cooperation and integration of the markets for goods, services, labor, and capital.</td>
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<tr>
<td>Kazakhstan’s economy is affected by sanctions imposed on the Russian Federation via several channels: (i) disruption of supply chains, as many of Kazakhstan’s exports and imports are traditionally shipped through the Russian Federation; (ii) macroeconomic shocks from the tenge exchange rate’s complex</td>
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7 Exports of services expectedly fell in 2020 because of the limitations on international travel and shipments of goods related to COVID-19.
dynamics in response to the highly volatile movements of the ruble and the associated rise in the inflation rate and tightening of monetary policy; (iii) the inflow of Russian migrants (political emigrants and people escaping military mobilization) and associated inflow of personal and business monetary transfers as well as the increase in rental prices in Kazakhstan; and (iv) consolidations in the banking sector, including mergers and acquisitions of local subsidiaries of Russian banks operating in Kazakhstan.

Supply chain disruptions were substantial. In mid-March 2022, the Russian Federation banned exports of wheat and sugar abroad, which led to staple food item shortages and spiraling prices in Kazakhstan. In 2022, the sugar price increased by 62.8% and the wheat flour price by 31.5%. In 2022, the Caspian Pipeline Consortium (the main crude oil export channel for Kazakhstan) postponed oil shipments or operated at reduced capacity on several occasions because of a variety of reasons: damage by storm, maintenance works, and suspension of operations for 30 days imposed by a Russian court. On 7 July 2022, President Tokayev instructed the government and the national oil company KazMunayGas to diversify oil export routes.

The geopolitical tensions led to a sharp depreciation of the tenge against the United States dollar by about 20% soon after the invasion, which triggered high inflation expectations, a temporary consumer panic, and a run on the banks. The tenge–United States dollar exchange rate subsequently bounced back to almost pre-invasion levels and stabilized. In 2022, the average annual inflation rate accelerated to 15.0%, with food prices rising by 19.0%, nonfood inflation by 14.0%, and services inflation by 10.3%. During the year, the National Bank of Kazakhstan had to increase the base rate by 650 basis points to 16.75% to cope with the inflation pressure. Out of three sanctioned Russian banks, two were sold to Kazakhstan partners.

In response to the shocks, the government adopted a new budget with countercyclical support measures. Expenditures increased by 16.7% (3.3% of gross domestic product) for employment programs, indexation of salaries and pensions, housing, infrastructure, agriculture, and manufacturing. The additional budget outlays were financed by transfers from the National Fund of the Republic of Kazakhstan, which increased to T4 trillion (close to $10 billion) in 2022.

Some positive spillovers included the windfall export revenues from higher commodity prices for oil, metal, and food items and the push for re-exports of consumer goods, machinery, and equipment to the Russian Federation; in 2022, total exports of goods increased by 40% compared with 2021. Some relocation of regional distribution and production facilities from the Russian Federation to Kazakhstan is occurring. An increase in transit traffic via Kazakhstan’s airspace to bypass the Russian territory has also been observed. There are expectations of increased surface transit via Kazakhstan through the Trans-Caspian multimodal transport and logistical route.

The Russian invasion of Ukraine will have long-term geopolitical implications that will primarily affect trade and investment flows. The magnitude of these impacts is difficult to predict, but these developments will weaken the role of the Russian Federation in the region. Kazakhstan is already adjusting to the situation by seeking to diversify export routes and economic linkages.

Source: ADB

10. Fiscal performance. As taxation of the oil sector provides a significant part of the general government revenue in Kazakhstan (35% in 2018), the fall in oil prices in 2014–2016 and subsequently in 2020 led to a contraction in revenue (Figure 2). The average share of general government revenue to GDP declined from 25.2% in 2010–2014 to 18.7% in 2015–2020. The government used the resources of the National Fund of the Republic of Kazakhstan (NFRK) to fill the gap and maintain the general government expenditure at 19%–25% of GDP.9 In 2015–2021,

9 The NFRK is a sovereign wealth fund established in 2000 that performs two functions: (i) a stabilization function to stabilize fiscal spending across economic cycles and reduce volatility from oil revenue inflows; and (ii) a savings function to address intergenerational equity from the oil windfall. The NFRK accumulates funds mainly from the tax
transfers from the NFRK to the central government budget totaled T2.5 trillion–T4.8 trillion per year. The sharp increase in the NFRK transfers in 2020–2021 was caused by the need to cope with the challenges of the COVID-19 pandemic. As a result of the rapid pace of NFRK resources spending, the NFRK assets fell from a peak of $77.2 billion in August 2014 to $55.3 billion or 29.0% of GDP at the end of 2021. This is below the level of 30% of GDP, which the government considers critical. Responding to this decline, the government planned to gradually decrease NFRK transfers from T4.5 trillion in 2021 to T2.0 trillion in 2024. However, the invasion-related shock resulted in an increased transfer of T4.0 trillion in 2022.

Figure 2: Revenue, Expenditure, and Deficit of the General Government Budget and Revenue of the State Budget (% of GDP)

GDP = gross domestic product, NFRK = National Fund of the Republic of Kazakhstan
Note: The state budget consolidates the central and local government budgets. It does not include operations of the NFRK and social security funds. The state budget revenue consists of two major components: (i) the budget’s own revenue (tax, non-tax, and income from sales of fixed assets); and (ii) the transfer from the NFRK to the central government budget. General government budget consolidates the state budget and operations of the NFRK.

11. The government budget indicators are relatively low compared with its peers. In 2015–2020, both the total general government revenue and expenditure in Kazakhstan were 4–11 GDP percentage points lower than the average values for the countries of Emerging and Developing Asia and 12–18 GDP percentage points below the average for Emerging and Developing Europe. The root causes of low government revenue include an uneven tax burden with a focus on large firms and light taxation of the non-oil sector in general, low rates of value-added and personal income tax, lack of taxation progressivity, the existence of many special tax regimes, and generous tax exemptions. There is also room for improving tax administration. This translates to modest (in % GDP terms) financing of key government functions. In 2019, public expenditures were 2.9% of GDP on education and 1.7% of revenues from the oil sector, privatization proceeds, proceeds from the sale of agriculture land by the government, and investment income from the management of NFRK assets.

10 Mostly middle-income countries of East, South, and Southeast Asia; and Türkiye and the post-socialist countries of Central, Eastern, and Southeastern Europe. IMF. World Economic Outlook Database. October 2021 Edition (accessed 6 March 2022).

GDP on health in Kazakhstan, compared with an average of 3.9% of GDP on education and 3.3% of GDP on health for upper middle-income countries (UMICs). Along with insufficient financing, public expenditure has significant efficiency gaps as Kazakhstan achieves less in terms of development outcomes compared with its peers at similar levels of expenditure per capita. This is confirmed by data on the quality of secondary education or life expectancy (para. 26).

12. While the Government of Kazakhstan continued borrowing in 2015–2021, its general government debt is not large. As of 1 January 2022, the total external and domestic debt of the general government was 27% of GDP. As of 1 January 2022, the external debt of the general government was $18.4 billion or 9.5% of GDP. Of this amount, the NBK’s debt was $2.5 billion and the central government’s debt was $15.9 billion. The International Monetary Fund (IMF) assesses the external government debt of Kazakhstan as sustainable because of the low level of debt and its high concessionality (with 50% of borrowing from international financial organizations).

13. Apart from the operations financed from the budget, government policies in Kazakhstan are implemented via multiple quasi-government entities and state-owned enterprises (SOEs). These include two national management holdings (the National Welfare Fund Samruk-Kazyna Joint Stock Company [JSC] and Baiterek JSC); four national holdings; and 19 national companies, which own many subsidiaries across key sectors of the economy (e.g., energy, natural resources, transport, telecommunications, finance, power, and product development). SOE assets are considerable, e.g., Samruk-Kazyna JSC alone reported assets worth 34% of GDP in 2019. These entities’ operations are not consolidated into the public finance system and their financing is shown in the government budget as acquisition of goods and services, so their revenues and expenditures are not shown in financial reports, which limits the transparency of their activities and finances. According to the IMF, the fiscal framework in the country is complex, lacks comprehensive institutional coverage, and is subject to frequent and unclear changes.

14. Monetary policy, inflation, and finance sector stability. The 2015 terms of trade shock forced the NBK to switch from the previous near-fixed exchange rate regime to a floating exchange rate regime and inflation targeting. This transition served the economy well during the pandemic. Despite strong tenge depreciation in 2020–2021 and external food and other price shocks, the inflation rate based on the consumer price index (CPI) has stayed at the one-digit level since 2010, except in 2016 (Figure 3). Because of the economy’s openness, however, the correlation between inflation and exchange rate depreciation remains positive and strong. Any additional rise in the tenge–US dollar rate provides a new impetus to inflation. The NBK is using its base interest rate flexibly to manage the monetary market rates. In 2017–2021, the base rate fluctuated from 9% to 12%. In 2020–2021, monetary policy was relaxed to supply the economy with the necessary liquidity; the monetary base grew by 59% while money supply (M3) increased by 41% for 2 years.

15. The January 2022 events and the Russian invasion of Ukraine created inflationary pressures, which forced the NBK to toughen its monetary policy by increasing its base rate (Box). Hence, in April 2022, the monetary base decreased by 9.0% while M3 fell by 3.7% compared with December 2021. As of the end of March 2022, the NBK’s international reserves were $33.1 billion (of which two-thirds were gold), equivalent to 179% of the IMF’s Assessing Reserve Adequacy metric (the range suggested by the IMF is 100%–150%).

16. Consumer inflation has direct social and political implications in Kazakhstan. The liberalization and sharp increase in prices for liquified petroleum gas, which is widely used as a fuel for passenger vehicles, served as a trigger for the domestic unrest in January 2022. Responding to this crisis, the government fixed gasoline prices for a 6-month period. Prices are controlled for other products as well, including electricity and 19 staple foods.18

17. Because of the somewhat relaxed regulation of the finance sector before the global financial crisis of 2008–2009, the quality of banking sector assets eroded, and a large amount of nonperforming loans (NPLs) accumulated.19 Finance sector stability remained a major policy challenge in 2015–2021. Several banks lost their licenses, and in 2017–2019 the government spent an amount equivalent to 7% of GDP from the budget, NFRK, and NBK resources to support the banking system (footnote 17). In 2019, the NBK conducted a bank asset quality review,20 and its results were published in 2020. The review provided an opportunity to address long-standing issues in the sector and boost confidence. The regulatory measures supported de-dollarization of the economy, and the proportion of deposits in foreign currency to the total amount of banking deposits fell from its peak of 80% in January 2016 to 36% in January 2022. To improve the supervision of the country’s finance sector, a new Agency for Regulation and Development of Financial Market (ARDFM) started operations on 1 January 2020 and is working on strengthening the bank resolution framework.

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19 By the end of 2013, NPLs were at 31.2% of the total loan amount (peak value) by official count. This indicator value fell to 3.3% by the end of 2021. Agency for Regulation and Development of Financial Market. 2022. Current State of the Banking Sector of the Republic of Kazakhstan as of 1 January 2022 (accessed 3 April 2022).
20 A diagnostic exercise to determine the banking sector capital needs, assess their loan portfolio quality, and analyze their lending practices. The review covered 14 major banks in Kazakhstan, concentrating 87% of the banking sector assets.
18. Overall, the banking sector is not an efficient and sustainable source of funding for non-resource sectors of the economy. Because of limited access to international capital markets, the depositor base (79% of the total banking sector liabilities) remains the largest source for funding. Meanwhile, the market has substantial demand for local currency funding (86% of banking sector lending provided in local currency), while sourcing of local currency funding remains a challenge for external investors because of inadequate development of the domestic capital market.\(^{(21)}\)

19. Financial inclusion in Kazakhstan has accelerated since mid-2010s, mainly because of the large share of mobile phone users and the expansion of internet coverage and digital financial services. However, access to financial services remains unevenly distributed among different groups of the population, depending on their location, employment status, and income levels. Financial inclusion beyond banks remains modest. Microfinance institutions are critical in expanding access to finance for micro, small, and medium-sized enterprises (MSMEs) in rural areas. In Kazakhstan, because of the vast territory and remoteness of the regions, microfinance organizations are key providers of financial services for MSMEs.

20. **Business environment, innovation, and digitalization.** The general business environment in Kazakhstan is considered challenging, as reflected in global and regional rankings.\(^{(22)}\) Insufficient domestic competition, the domination of SOEs in many sectors of the economy, and high market shares of large companies restrain the space available for SMEs and undermine incentives for private investments, innovations, and entrepreneurship. In 2019, Kazakhstan had more than 200 SOEs with total assets at 105% of GDP (up from more than 60% of GDP in 2015).\(^{(23)}\) About one-third of them operated at a loss, they received about 1.5% of GDP in transfers and direct lending from the government budget, and the stock of their debt was estimated at more than 10% of GDP.\(^{(24)}\) Even if not all this debt is formally government-guaranteed, there could be an expectation that the government would bail out these enterprises, if necessary, as it has done repeatedly in the past. SOE fiscal management and governance frameworks have gaps (footnote 15). Many SOEs receive significant government support through access to cheap credit, preferential tax treatment, protection from new market entrants, and bankruptcy protection. Regulatory gaps, corruption, and the size of the domestic market are among the most pressing issues hindering the development of the non-oil sector in Kazakhstan.\(^{(25)}\)

21. Following the implementation of the Comprehensive Privatization Plan, 2016–2020, which reduced the share of the state in the economy from 19% of GDP in 2015 to about 15% in 2021, the government developed a consecutive Comprehensive Privatization Plan for 2021–2025. It is also implementing several programs and strategies aimed at promoting entrepreneurship and innovation.\(^{(26)}\) The 2021 presidential state of the nation address included plans for extending the state manufacturing programs and the reform of the agricultural subsidy system. Other recent

\(^{(21)}\) ARDFM. 2022. *Kazakhstan Financial Sector Overview, as of 1 January 2022.* Almaty.

\(^{(22)}\) According to the Business Environment Rankings of the Economist Intelligence Unit, Kazakhstan ranked 64th out of 82 economies globally and 14th out of 16 post-socialist economies of Europe and Central Asia. Economist Intelligence Unit. 2021. *Kazakhstan, Business Environment Rankings Overview.* Similar assessments are provided by other international indexes (the Global Competitiveness Index and the Index of Economic Freedom).


\(^{(24)}\) Samruk-Kazyna, the government holding with a significant portfolio of nonfinancial SOEs, had debt equivalent to 12% of GDP in 2019.


\(^{(26)}\) These include the State Program for Industrial and Innovative Development of the Republic of Kazakhstan for 2020–2025; the State Program for Business Development and Support for the Business Roadmap 2025; and the Economy of Simple Things Program (since 2018).
government initiatives include the Competitiveness Leaders–National Champions 2.0 Program; the State Program of Productive Employment and Mass Entrepreneurship Development "Enbek" for 2017–2021; the National Export Strategy of the Republic of Kazakhstan for 2018–2022; and the National Project on Entrepreneurship development for 2021–2025. The government is now embarking on a systemic reform of SOEs, government development institutions, and other quasi-government entities to decouple enterprise operations from the vested interests of political elites, as stated by the President of Kazakhstan in his speech on 21 January 2022 and further developed in his recent address to the Parliament.

22. The country’s innovation capability is relatively weak as indicated in the Global Innovation Index 2021. Low levels of government and private spending on research and development are among the determinants of this performance.

23. While the adoption of information and communication technology (ICT) is at an advanced stage—the Global Competitiveness Index’s ICT pillar puts Kazakhstan in the top third of the global distribution, and the country is in the top quartile according to the Digital Adoption Index—the ICT utilization rates by businesses and population, as well as internet and mobile phone access in rural areas, are considered as having room for improvement. In 2021, the government adopted the National Project on Technological Breakthrough due to Digitalization, Science and Innovations for 2021–2025, which could be considered a continuation of the government’s digitalization and innovation agenda in the 2020s.

24. Labor market developments. The labor market situation in Kazakhstan has been largely stable since 2011. The labor force participation rate has remained at about 70%, and the official unemployment rate has declined gradually from 5.4% in 2011 to 4.9% in 2021. The average real wage in the economy grew at an average rate of 3.0% per year during 2015–2021, reaching T276,000/month ($639/month) at the end of 2021.

25. This relative stability hides persistent issues in the labor market. First, many jobs are not secure, safe, productive, and well paid. Of the total employment, 24% are self-employed. In 2020, the average monthly income of the self-employed was reported at 38% of the average wage. Moreover, 14% of the total employed people (26% of all self-employed and 10% of hired workers) function in the informal economy, usually without labor contracts or social and medical insurance. Second, according to Bureau of National Statistics (BNS), labor market inequality is remarkable across different dimensions (gender, age, regional, and sector). In 2021, the female labor force participation rate was 64% compared with 76% for males, while the unemployment rates were 5.6% for women and 4.1% for men. The regional variation is even more striking. For example, in 2020 the informal employment rate ranged from 2.6% in Mangystau oblast to 29.6% in

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27 This is one of several national projects adopted in 2021 aimed at different areas of economic and social development; the other projects address sustainable growth, regions, agri-food, technological breakthroughs, the green economy, education, health, and culture.

28 President Tokayev’s Address at the opening of the first session of the Parliament of VIII convocation (29 March 2023).

29 Spending on research and development was a mere 0.12% of GDP in 2018. Source: World Bank. Worldwide Governance Indicators (accessed 21 March 2022).


31 Although the COVID-19 pandemic did not change this trend, many people, especially those employed at SMEs in urban areas, were negatively affected by the lockdowns during the pandemic and were temporarily unemployed.

32 A typical self-employed person works in a microenterprise (mostly in agriculture, retail, and transport) with earnings below the average wage, effective working time well below the standard 40 hours per week, and unstable income. In practice, there is little difference between the self-employed (especially in rural areas) and underemployed or unemployed.
in Western Kazakhstan oblast. The self-employment rate in 2021 was 16.1% in urban areas compared with 32.2% in rural areas. The 2022 Labor Rights Index assigned Kazakhstan a score of 82 (out of 100), highlighting that the country is “approaching decent work.” While Kazakhstan was ranked relatively well in terms of decent working hours, employment security, maternity at work, and safe work, it received the lowest scores in fair treatment and trade union criteria. In June 2021, the Committee on the Application of Standards of the International Labour Organization recommended Kazakhstan to “bring all national legislation in line with the Convention to guarantee full enjoyment of freedom of association to workers’ and employers’ organizations”. Lastly, labor market dynamics across some vulnerable groups (e.g., young workers, internal and external migrants, working children, and adolescents), who have the least secure job environment and challenges in securing any job, especially the first one, might not be adequately observable and reflected in the existing data. Issues with youth (un)employment may worsen in the medium term, with an expected increase in the share of young people (15–29) in the total adult population (15–59) from 30% in 2020 to 33% in 2030.34

26. **Social development trends and the Sustainable Development Goals.** Kazakhstan is classified as a country with very high human development by the 2021/2022 Human Development Index.35 Since early 2000s, the country has demonstrated stable social development trends and achieved good progress in improving the population’s access to health care, education, and essential services. Life expectancy at birth increased from 71.4 years in 2014 to 73.2 years in 2019 (but in 2020-2021 fell back to the 2014 level because of increased mortality during the COVID-19 pandemic). The net secondary school enrolment rate is maintained at almost 100%, and the gross tertiary school enrolment rate grew from 50% in the early 2010s to 71% in 2020. The proportion of people using safely managed drinking water services increased from 75% in 2010 to 90% in 2017.36 At the same time, the quality of many services is not yet at adequate level, as evidenced by the country’s modest results in the Organisation for Economic Co-operation and Development’s Programme for International Student Assessment for schoolchildren37 and life expectancy at birth lower than the average for UMICs (in 2019, the gap was 2.8 years).

27. Urban development is critically important for Kazakhstan, considering the current domestic migration flows from rural to urban areas and the economic diversification agenda, which would presumably require the relocation of labor from rural-based agriculture to services and manufacturing concentrated in urban areas. According to the BNS, the share of the population living in urban areas increased from 54.6% of the population in 2011 to 59.2% in 2021, although this might not fully account for informal external and internal migration flows. Urban development challenges include the need for small towns to find a sustainable solution to replace the previous “monotown” (one-enterprise town) setup38; and, for big cities, to improve the quality of living.

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37 In the Programme for International Student Assessment 2018, most Kazakhstani students were assessed to be at level 1 (lowest) out of 4 for reading and science and at level 2 for mathematics—well below their peers in countries with the same or lower levels of per capita spending on education.
38 Before independence, many towns were established around large enterprises, which were major employers and providers of key infrastructure for everyone living in such towns. After the transition to a market economy, many such enterprises appeared noncompetitive and had to significantly reduce their activities. This led to mass unemployment and lack of support for urban services, which the government is addressing.
According to the City Quality of Life Index 2022, Astana and Almaty were ranked low, at 181 (Astana) and 241 (Almaty), out of 255 cities globally. The government is addressing urbanization through different policies, including the Predictive Scheme of the Territorial and Spatial Development of the Country until 2020 and the draft scheme until 2030. These policies aim at encouraging agglomeration and “managed urbanization.”

28. Kazakhstan is making good progress toward achieving many Sustainable Development Goal (SDG) indicators. In the 2021 Sustainable Development Report, Kazakhstan ranked 59th out of 165 countries globally. However, some global targets might not be fully relevant for Kazakhstan (e.g., economic benefits to small island developing states and least developed economies) or these targets were already achieved (e.g., 100% access to electricity). The national SDG targets have not yet been set for many goals. The integration of SDGs into the government policy and budget planning is still to be accomplished.

29. **Poverty and inequality.** According to the BNS, in 2011–2021 the absolute poverty rate was 2.5%–5.5% of the population based on the national poverty line. These poverty estimates are similar to the World Bank estimates for the $5.50 a day (2011 at purchasing power parity) poverty line, which is typically used for UMICS. In 2018 (the latest available World Bank data), the national poverty rate was 4.3% and the World Bank poverty rate was 4.6%. Following the BNS estimates, the COVID-19 pandemic increased absolute poverty from 4.3% in 2019 to 5.2%–5.3% in 2020–2021.

30. The official estimate of income inequality is also low. According to the World Bank’s World Development Indicators (WDI), the Gini coefficient for incomes was 0.278. However, this reportedly low level of inequality may not reflect the reality of the situation. In part, the low absolute and relative poverty rates are a result of the poverty line choice. However, there is a high concentration of households not far from the poverty line. Thus, any increase in this line may result in a hike of the poverty rate (e.g., the relative poverty rate would jump to 9.9% if 60% of median income is used as a poverty line instead of 50%).

31. These seemingly low country poverty and inequality estimates tend to hide existing pockets of poverty. According to official data, the regional variation in poverty is very significant. In 2021, the poverty rate was 9.8% in Turkestan oblast while it was just 2.2% in the country’s capital Astana. The large and growing regional inequality was revealed by an ADB study based on the newly developed Regional Competitiveness and Cohesion Index for Kazakhstan. The study identified polarization in terms of economic growth, employment, productivity, and competitiveness. The index also revealed diverging trends among different indicators within the regions. For instance, the region of Atyrau, home to a large part of the country’s oil industry, displayed high levels of wealth measured by gross regional product and market size, but fell behind on development dimensions such as health and standards of living, higher education and training, and innovation. This highlights that the wealth produced in the region does not necessarily generate spillover effects and improve access to basic needs. The analysis also indicates that some regions in the country may be at risk of falling into a development trap, i.e., stagnating at their current level of development.

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39 Numbeo. *Quality of Life Index by City 2022* (accessed 6 March 2022).
41 For example, this value of this coefficient is lower in Kazakhstan than in Sweden and only slightly higher than in Finland. This low-income inequality value reveals that many better-off households in Kazakhstan (and elsewhere) do not participate in household surveys, resulting in a strong downward bias of survey-based inequality measures.
32. The estimates of child poverty (the share of the population under 17 living below the absolute poverty line) provided by the BNS are 2–3 percentage points higher than the poverty estimates for the total population. Thus, multi-child households are at highest risk of poverty. Further, some vulnerable groups (e.g., internal migrants in urban areas) may not be adequately covered by statistical observations. While Kazakhstan provides near universal access to secondary education, a reasonable health care package, electricity, clean water, and other essential services and infrastructure, people with lower incomes and social status living outside major cities have limited access to quality education, advanced health care, and high-standard infrastructure. All these aspects of inequality affect the subjective perception of poverty and well-being of the population. Inequality perceptions and concerns were among the fundamental roots of the January 2022 unrest.

33. Other inequality dimensions are also important in Kazakhstan. For example, the Gini coefficient for wealth was 0.764 in 2020, indicating a high concentration of wealth in the hands of a small group of people. Another dimension of inequality is gender. In 2020, the average wage of women was just 75% of the average wage for men. Employment is unequally distributed by gender in certain sectors of the economy; women make up only 21.5% of workers in the transport sector, 23.7% in construction, and 31.1% in the industry sector. The share of women in political and leadership positions in the government, key national companies, and commercial banks was 9%–29% of the total.

34. Energy, climate change, and environment. Kazakhstan is exposed to climate change and disaster risks. About 75% of the country’s terrain is vulnerable to a high risk of multiple hazards, including floods, earthquakes, landslides and mudflows, droughts, heatwaves, snowstorms, avalanches, sand and dust storms, hurricanes, and wildfires. The projected rise in average temperature for 2080–2099 varies from 1.6°C (lowest emissions scenario) to 5.8°C (highest emissions scenario). The projected average annual precipitation varies from 225–500 millimeters (lowest emissions scenario) to 275–550 millimeters (highest emissions scenario). The frequency and severity of many hazards are expected to be increased by climate change. The economic losses from these hazards are estimated to be equivalent to 5% of GDP from events with a 1-in-200-year probability occurrence. Some areas of Kazakhstan are particularly vulnerable to climate change risks. The sea level in the Caspian Sea is projected to fall by 9–18 meters in the medium to high emissions scenarios until the end of this century. This could result in an ecocide as devastating as the one in the Aral Sea area.

35. The economy is one of the most energy- and emission-intensive in the world. In 2018, Kazakhstan was ranked in the top decile globally by energy consumption and carbon dioxide emissions per capita or per GDP unit. According to BNS data, the energy intensity does not reflect any trend toward a reduction of emissions. The main source of emissions is the energy sector (78%), followed by manufacturing and agriculture. Coal and other fossil fuels provide 87%–90% of the total electricity generation in the country, while renewable sources (mostly hydropower) contribute just slightly more than 10%.

36. The country also faces other environmental challenges including urban air quality, access to clean water, and waste management. Every year, 6,000–9,400 people in Kazakhstan die

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prematurely because of poor air quality. According to the BNS survey, in 2021 only 45% of respondents were fully satisfied with the quality of air and 44% with the quality of drinking water. In some parts of the country, these proportions fell as low as 13% for air and 11% for water (e.g., Aktobe oblast).

37. The government is addressing these issues through the Concept on Transition to Green Economy (2013) and several other government documents. The first intended nationally determined contribution of Kazakhstan, submitted in 2016, expressed a commitment to an economy-wide reduction of 15% of its greenhouse gas emissions by 2030 compared with the 1990 level. The updated nationally determined contribution is being prepared. Since 2013, the government has been pilot-testing its emissions trading scheme. It currently regulates about 40% of Kazakhstan’s domestic carbon dioxide emissions, mostly in energy production and district heating. On disaster risk management, the National Security Strategy, 2017–2020 took an all-hazards approach to disaster risk management, defined the roles and responsibilities of key stakeholders, and set goals and objectives throughout the risk management cycle.

38. Governance. Governance is one of the most challenging areas of the country’s development, as evidenced by Kazakhstan’s ranking on many international governance indexes. These indexes identify issues in control of corruption, rule of law, voice and accountability, and political stability as the governance aspects requiring much attention.

39. Governance issues adversely affect the economic and social development of Kazakhstan through different channels. Lack of intra-government coordination and slow decision-making reduce the effectiveness of development programs, which is key in the government’s economic diversification efforts. The government has room for improving its transparency and monitoring and evaluation mechanisms. A small set of connected actors in the private sector has large sway and influence over resource allocation and public procurement decisions. A preferential regime for certain private companies has been a cause for insufficient competition in the domestic market and a hindrance for strengthening Kazakhstan’s competitiveness abroad. Such an environment constrains the development of MSMEs and creates a barrier to FDI, especially in the non-resource sectors.

40. The government demonstrates a good understanding of the scale of the issues and is undertaking steps toward reforming the governance structure in the country. In February 2021, the government adopted the Public Administration Development Concept until 2030. It also introduced innovations such as the establishment of the Astana International Financial Centre to address concerns with the rule of law, investment climate, and attraction of foreign investors. The empowerment of the National Chamber of Entrepreneurs (Atameken) is another signal of the government trying to establish a better feedback mechanism with the country’s business community and society. In the aftermath of January 2022 events, the government is planning and has already started implementing a comprehensive program to reform the government development institutions (e.g., Kazakhstan Development Bank), Samruk-Kazyna, and other national companies, as well as law enforcement agencies.

48 The World Bank’s Worldwide Governance Indicators, the Corruption Perceptions Index, the BTI Transformation Index, the WJP Rule of Law Index, the Global Competitiveness Index, and the Index of Economic Freedom.
50 According to the Open Budget Index 2019, Kazakhstan is ranked 37th out of 117 countries on budget transparency with an assessment “limited information available.”
41. **Graduation criteria assessment.** Despite having a gross national income per capita level above the graduation discussion income threshold, Kazakhstan does not yet qualify for graduation from ADB regular assistance. Gross national income remains volatile and has not demonstrated a growing trend since 2014, access to commercial financial flows remains limited, and the development of key economic and social institutions is not yet adequate.

**B. Key Impediments to Inclusive and Sustainable Growth**

42. The national development strategy Kazakhstan 2050, adopted in 2012, still serves as a road map to inclusive and sustainable growth in the country. However, the January 2022 unrest urged the government to address the key development issues of the country. In the series of speeches after these events, the President of Kazakhstan set an ambitious agenda of economic, social, and political reforms covering such issues as reducing income and regional inequality; reforming the government’s economic development institutions; containing inflation; improving the efficiency of government expenditure; developing the agri-food, energy, and health sectors; changing the state security system and the administrative and territorial setup of the country; reforming the political party system; and fighting corruption.

43. Kazakhstan faces many impediments on its path to inclusive and sustainable growth and its long-term development goal of becoming one of the top 30 economies in the world. Key challenges can be grouped into three main categories: (i) socioeconomic challenges, (ii) sustainability challenges, and (iii) institutional challenges. The policies and actions required for addressing these challenges and their expected outcomes are all interconnected.

1. **Socioeconomic Challenges**

44. **Weathering shocks with continued diversification efforts and prudent macroeconomic policies.** The dependence of the economy and the government budget on oil and other natural resources is a permanent source of vulnerability. While this is well known and the government makes considerable efforts to reduce this dependence, there is still much room for improvement. Adjustment of the diversification strategy, coupled with governance reforms, particularly regarding SOEs and development institutions, is necessary to achieve faster growth of the non-resource sector of the economy. Moreover, macroeconomic stability in the country is at the center of the government’s policy agenda but needs strengthening. Monetary policy may need tightening, fiscal buffers need to be strengthened, and the finance sector stability needs to improve.

45. **Reducing multiple forms of inequality.** Inequality is one of the most critical challenges. Growing social, economic, and productivity discrepancies between regions endanger the development achievements attained since 2000. Some regions in the country are at risk of economic stagnation by falling into a development trap. The highly uneven distribution of wealth aggravates the gap between rural regions and big cities or extractive industry locations among social groups. Among other measures, transport infrastructure bottlenecks need to be addressed to reduce spatial inequalities across the country by developing inclusive infrastructure connecting

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51. The International Bank for Reconstruction and Development graduation discussion income per capita for 2021 was $7,455. Kazakhstan has exceeded the annual threshold since 2011, but with a highly volatile gross national income per capita.


urban and rural areas. Unequal access to finance is another source of inequality. While MSMEs are a driving force for Kazakhstan’s economic growth and diversification, many of these businesses, especially those owned or led by women, find it hard to access long-term finance as they face higher collateral requirements and loan rejection rates than male-led businesses. Women in Kazakhstan, particularly in rural and remote areas, are overrepresented in the self-employed and informal sectors, such as agriculture, trade, and services. As a result, they are disadvantaged in terms of access to finance including mortgages.

46. **Addressing the causes of gender inequality.** Gender inequality is persistent, especially in the labor market and in political, business, and social representation. The government’s gender equality policy is too formal, i.e., concentrating on having appropriate legislation rather than on measures promoting women’s participation in the labor force and society. Government awareness can be built in gender mainstreaming measures through the joint implementation of development projects and assistance.

47. **Increasing government revenue and efficiency of expenditure.** The budget’s non-oil revenues are too small, and the efficiency of the government budget expenditure needs to be improved. The government budget is too reliant on the transfers from the NFRK. The government’s investment projects are not consolidated and lack transparency and consistency. A public investment program needs to be instituted that combines all major public investment projects as part of the government budget to improve coordination and concentrate resources on identified development priorities.

48. **Increasing the efficiency of the government spending on human capital.** An increase in spending efficiency on human capital is needed to ease the pressure on the government budget. Access to services is good, but the quality of such services is unsatisfactory. This is especially relevant for education, health, and infrastructure services provided to people in rural and less developed areas and other underserved groups of the population. The education and training system also needs to be prepared to cope with the social impact of the structural shift to a low-carbon economy.

49. **Improving targeting of social protection programs.** Redistribution programs aiming at poorer segments of the population are insufficiently targeted. An underlying problem is the lack of accurate information about people’s income and assets. Until the government has implemented the rollout of the universal declaration of income and poverty, aimed to be completed by 2025, progress on better targeting is expected to remain limited.

50. **Fostering innovation and competition in the economy.** Kazakhstan’s business climate is not conducive for innovation, which is one of the key underlying reasons for productivity stagnation. The government spends too little on research and development. Insufficient domestic competition and a business environment skewed toward SOEs and large companies, at the expense of SMEs, do not provide incentives for firms to invest in technologies. Industrial policies explicitly and implicitly emphasize import substitution, which is a major source of inefficiency, and do not sufficiently promote non-oil exports.

51. **Developing and diversifying regional cooperation.** Regional cooperation is progressing, but much more needs to be done to achieve efficiency gains from cooperation with neighbors. Despite ongoing significant public investment in transport and other infrastructure.

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54 The government’s Nurly Zhol program supports improving the road infrastructure.
and some progress achieved.\textsuperscript{55} Low-quality infrastructure, insufficient economies of scale, and cumbersome border-crossing procedures deter the development of the transport and logistics sector.\textsuperscript{56} The Russian invasion of Ukraine accelerated the need to diversify economic and trade routes.

2. Sustainability Challenges

52. **Accelerating decarbonization.** The transition out of a carbon-intensive economy needs to accelerate. Consistent efforts in decarbonization, reforming the energy system of the country, scaling up the use of renewable energy sources, and improving energy efficiency are required. Investments of $610 billion would be needed to achieve the government target of carbon neutrality by 2060.\textsuperscript{57} Bridging the financing gap will require concerted efforts by the government, development partners, and the corporate sector.

53. **Addressing climate change impacts.** Average annual temperatures in Kazakhstan are projected to rise significantly by the end of the 21st century, with projected increases larger than the global average and most other Asian countries (footnote 45). This could lead to more frequent droughts and reduced water security, while accelerating the melting of Kazakhstan’s glaciers and leading to an increase in flood risk. Hence, resilience to climate and disaster impacts needs to be strengthened. In line with ADB’s commitment to fully align its new sovereign operations with the adaptation and mitigation goals of the Paris Agreement by 1 July 2023, innovative approaches will have to be deployed to integrate climate change in all planned operations.

3. Institutional Challenges

54. **Strengthening governance and public sector policy and institutions.** The governance system needs to be strengthened, as the implementation of many government-led programs faces issues in achieving the intended results. The quality of economic policy also needs to improve. Investment in SOEs and national development institutions, as the drivers of economic development, has not produced the targeted results. The government could improve the allocation of resources and the promotion of economic development by enhancing the quality of public services. An adequate evaluation and restructuring of their activities may be needed, building on the positive initial public offering experience of Kazatomprom.\textsuperscript{58} The rationale for the state ownership of many enterprises is not clear; SOEs lack transparency and oversight. The transparency of government activities also needs to be enhanced to provide a stronger voice for underrepresented economic and social groups. In the aftermath of the January 2022 events, the authorities recognized the need to strengthen the accountability system of the executive branches at the central and local levels.

55. **Increasing capacity of civil service.** Another key challenge is the need to strengthen the civil service. The internal machinery of the government is underperforming in areas such as interagency coordination, lack of process orientation to results, missing change management

\textsuperscript{55}According to World Bank. 2018. \textit{Logistical Performance Index} (accessed 6 April 2022), Kazakhstan fared better than all its neighbors except the People’s Republic of China and was just above the average UMIC level.


\textsuperscript{58}In 2018, the government sold 15% of Kazatomprom’s shares for $451 million, which were listed on the Astana International Exchange and the London Stock Exchange. The demand for shares exceeded supply by a factor of 1.7 as 49 foreign and 16 Kazakh institutional investors, as well as 2,700 Kazakh retail investors, bought the stock.
techniques, and insufficient capacity for undertaking reform measures inside the government. The penetration of appropriately trained young professionals in the civil service is also low, especially at the subnational level.

C. Implications for ADB Country Engagement

56. The unrest that took place in January 2022 and the impact on Kazakhstan’s economy of the ongoing Russian invasion of Ukraine present an opportunity for ADB to recalibrate its support to Kazakhstan. ADB will need to pay increased attention to promoting inclusive and resilient economic growth and undertaking structural reforms, while remaining focused on the underlying challenges of decarbonizing and diversifying the economy. In developing its assistance program for the next country partnership strategy, ADB also needs to consider its areas of expertise in the country, division of labor with other development partners, and government demand for ADB assistance.

57. To address inequality, ADB interventions must ensure that they contribute to making growth more inclusive. Given the unique geographical structure of Kazakhstan, continued investment in transport will play a crucial role by improving access to markets, education, and health services. As the Russian invasion of Ukraine is potentially reshaping the economic environment in the region, ADB—given its strong regional cooperation and integration mandate—will also need to support efforts to diversify economic and trade routes. Finance sector operations should focus on contributing to more inclusive finance. Greater investments in education and health, including for underserved groups, are needed to develop human capital and support inclusive growth, as well as a continued focus on eradicating gender inequality.

58. To accelerate decarbonization and promote green growth, ADB must focus on reforming the country’s energy system, scaling up the use of renewable energy sources, and improving energy efficiency. Recognizing the substantial investment gap, an integrated approach involving the corporate sector needs to be adopted. The decarbonization process entails a substantial structural shift for Kazakhstan, with potentially negative labor and social consequences. To mitigate the negative impacts and ensure a just transition, education and labor market policies will need to be amended. Adapting to and mitigating climate change are crucial for Kazakhstan. Given ADB’s commitment to align its operations with the adaptation and mitigation goals of the Paris Agreement, ADB will need to invest in greener transport and urban development options.

59. Building on the momentum to implement reforms triggered by the January 2022 events, ADB has an opportunity to build a stronger and strategic partnership with the government to address structural governance shortcomings. As the analysis in this document reveals, a wide range of reforms needs to be undertaken. ADB will need to be selective and strategic in the choice of reforms it aims to support. In line with its expertise in the country, priority areas for reform may include efforts to increase the efficiency of fiscal planning and management, especially public investment prioritization and planning, and to strengthen financial markets. Attention should also be paid to shifting the focus on SOEs and national development institutions as the development drivers for the economy toward a stronger role for the private sector. Building the capacity of the civil service, including through the provision of cutting-edge knowledge support, should equally be a priority.

60. ADB should ensure that its operations are designed in a coherent and mutually reenforcing manner to contribute to a more inclusive, sustainable, resilient, and diversified growth process.