



FROM UPPER MIDDLE INCOME TO BUILDING A MORE SECURE MIDDLE CLASS: CRITICAL STEPS

WORLD BANK GROUP
Systematic Country Diagnostics
AEF June 15, 2017

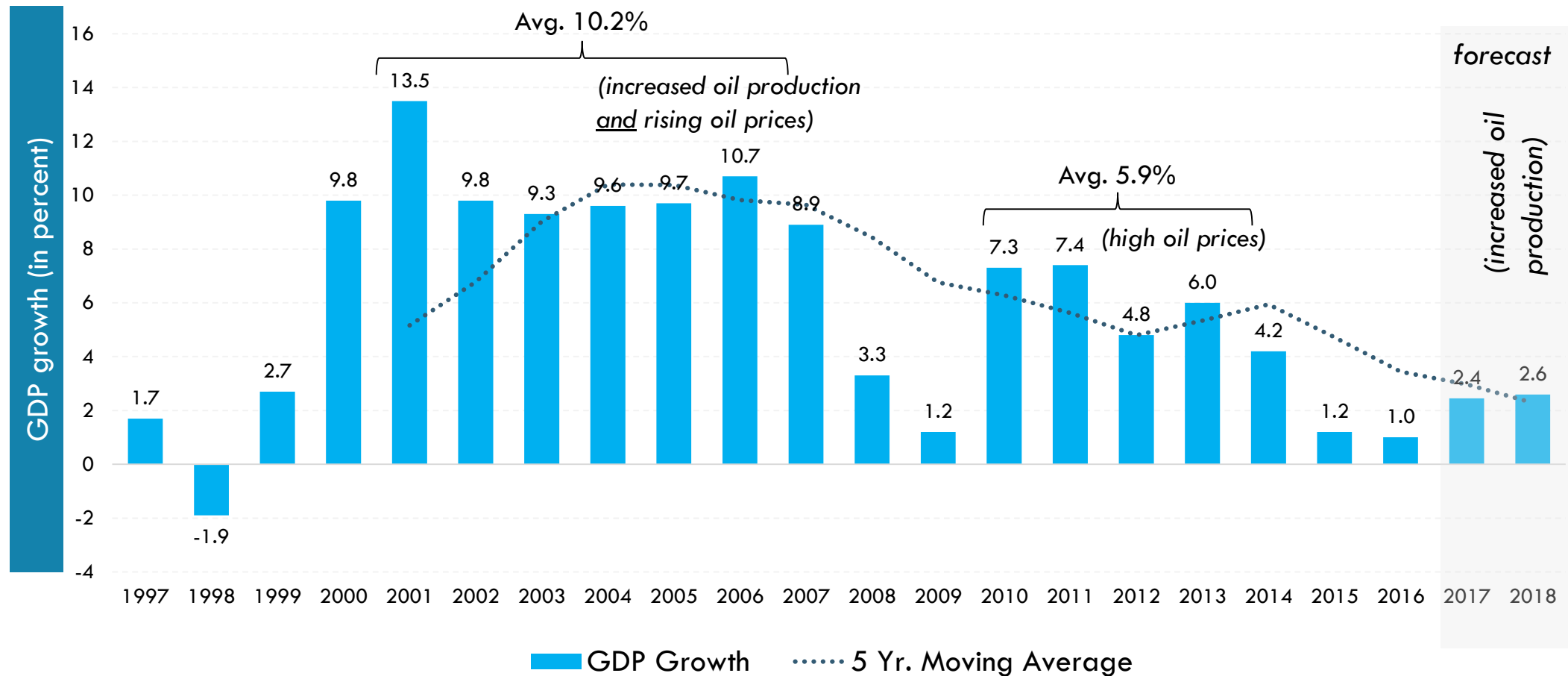
OUTLINE

- Setting the stage and identifying challenges..
 - ..to growth, jobs, and building a more secure middle class
- Getting back on course – 4 interconnected and interdependent paths:
 - ↳ Economic management for diversification
 - ↳ Private sector development
 - ↳ Integration and connectivity
 - ↳ Competitive and adaptive human capital
- Concluding thoughts: looking forward

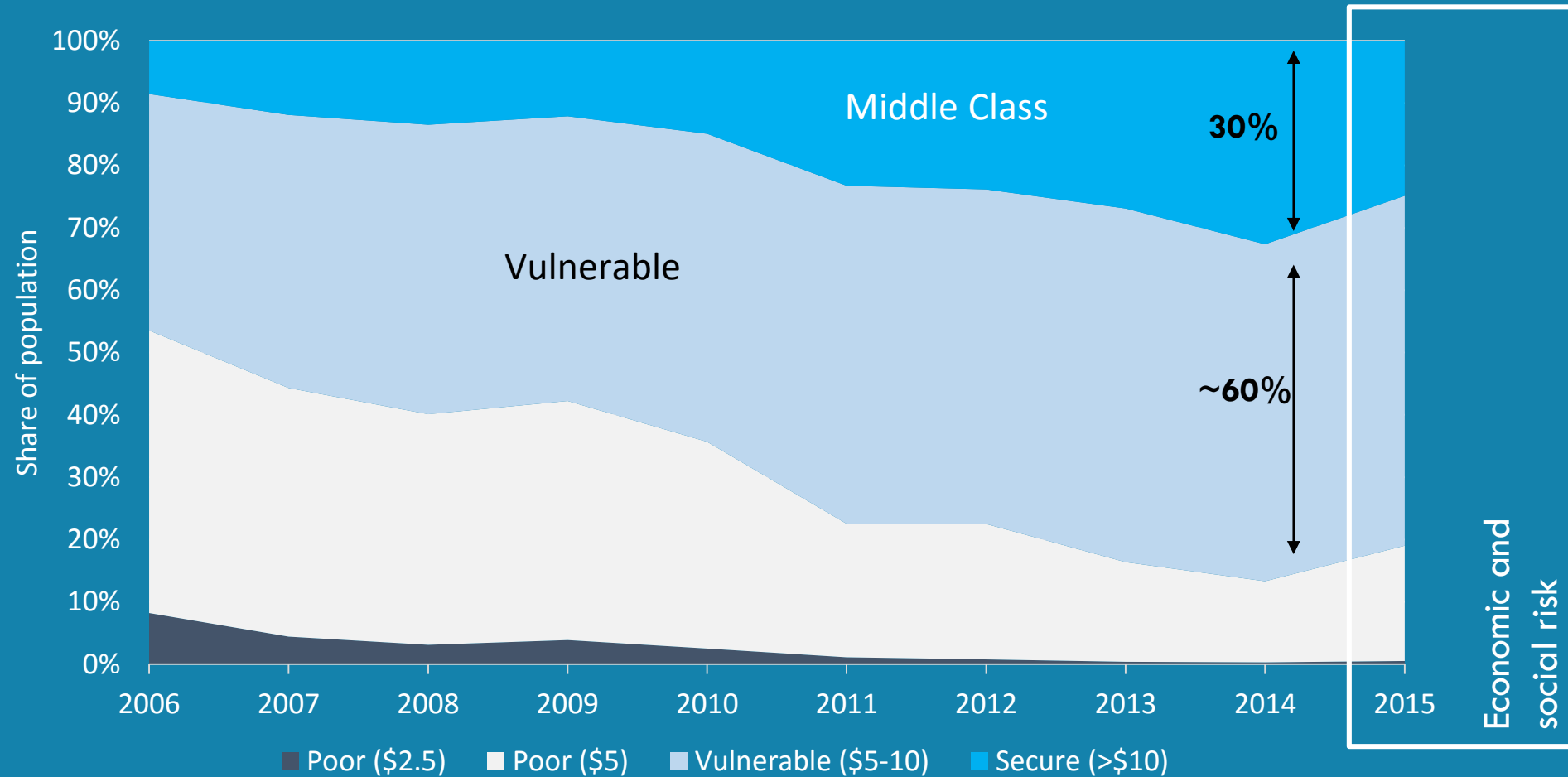


**SETTING THE STAGE: GROWTH, JOBS,
AND BUILDING A SECURE MIDDLE CLASS**

Has the current growth model reached its limit?



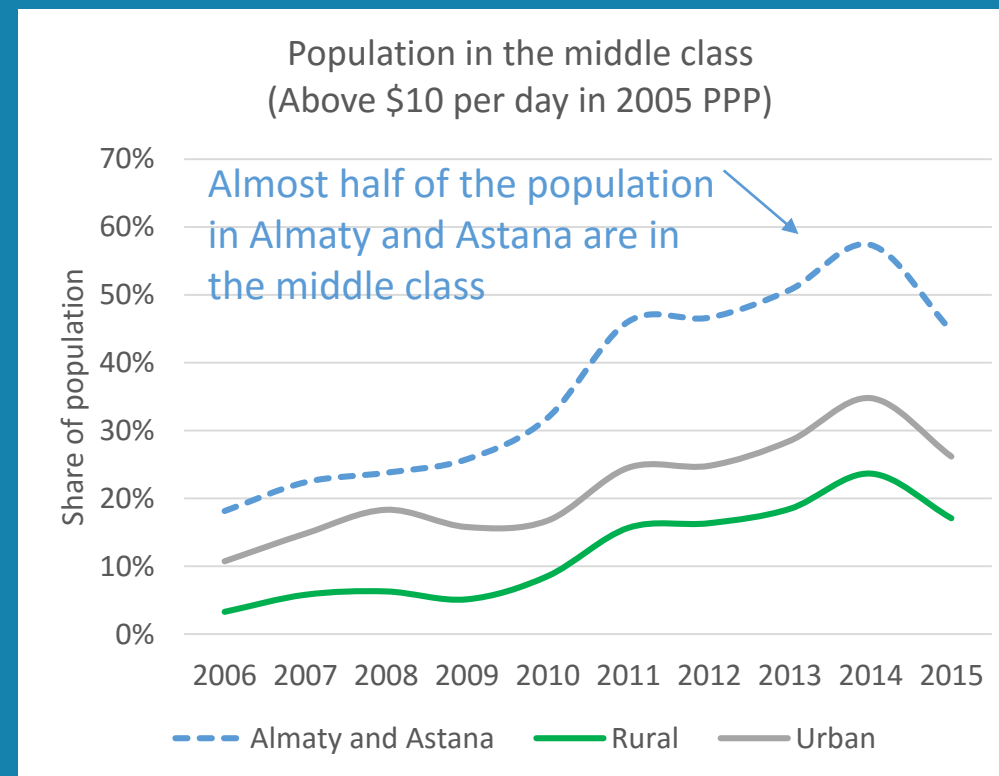
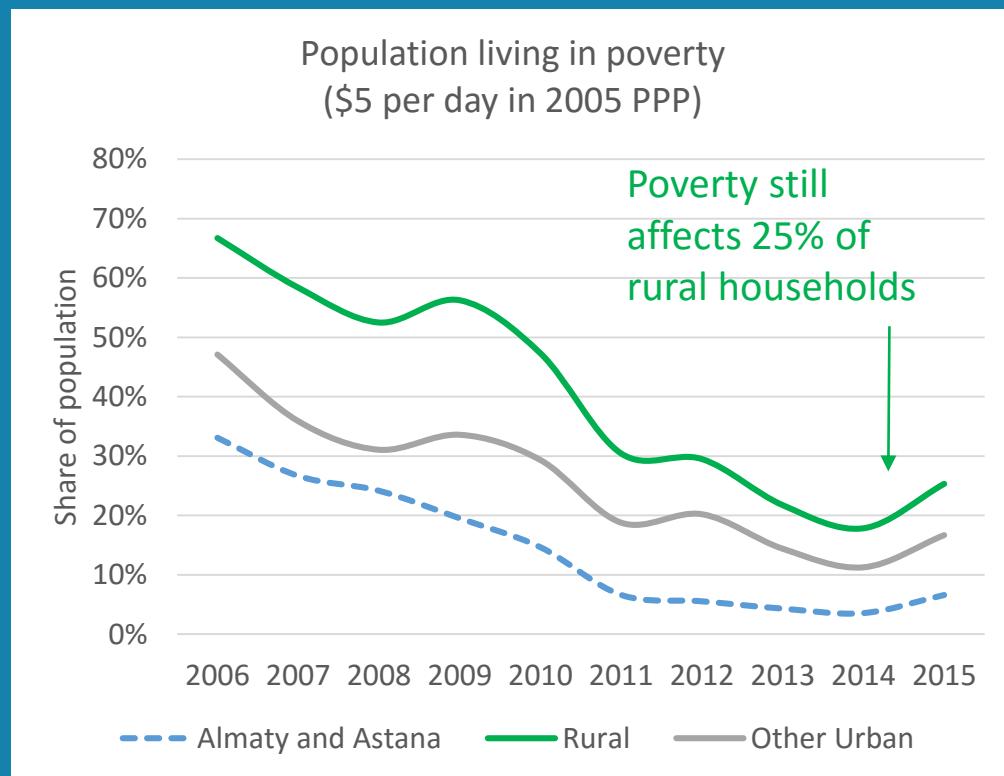
Is the rising middle class sustainable?



Source: Estimates based on official data.

Note: Thresholds are in PPP 2005. Middle class definition is for international comparison purposes.

The results were impressive but fragile



- Regional disparities in poverty have risen sharply over the past decade → the coefficient of variation in the poverty rate (\$5/day) across oblasts increased from 0.28 in 2006 to a high of 0.52 in 2013 and then fell slightly to 0.47 in 2015

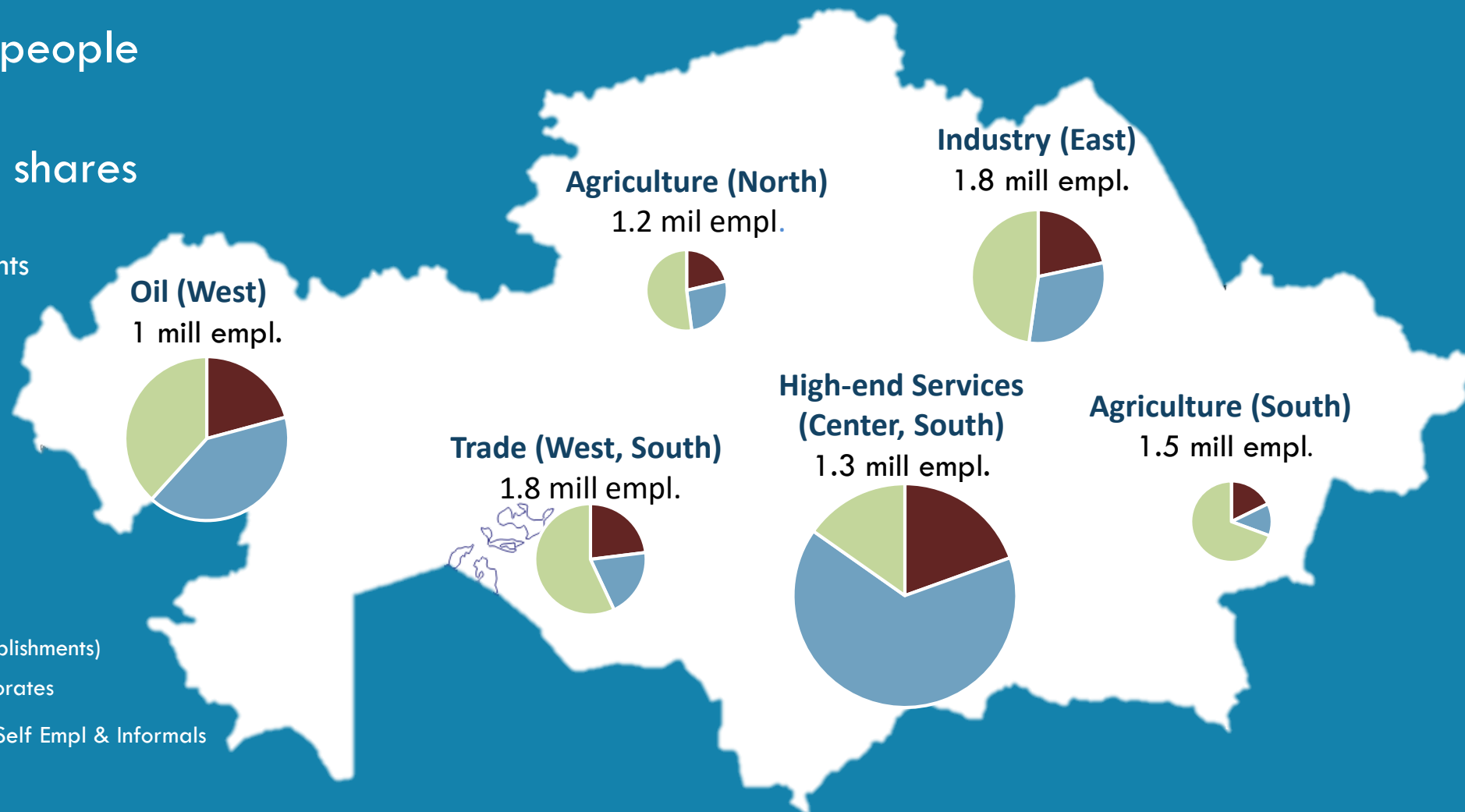
Many jobs were for people working “isolated” or informally

Where are people working?

Employment shares

2015

Circle size represents GDP share



Sector employment growth 2009-15

1.4

4.2

3.1

3.3

2.4

-5.4

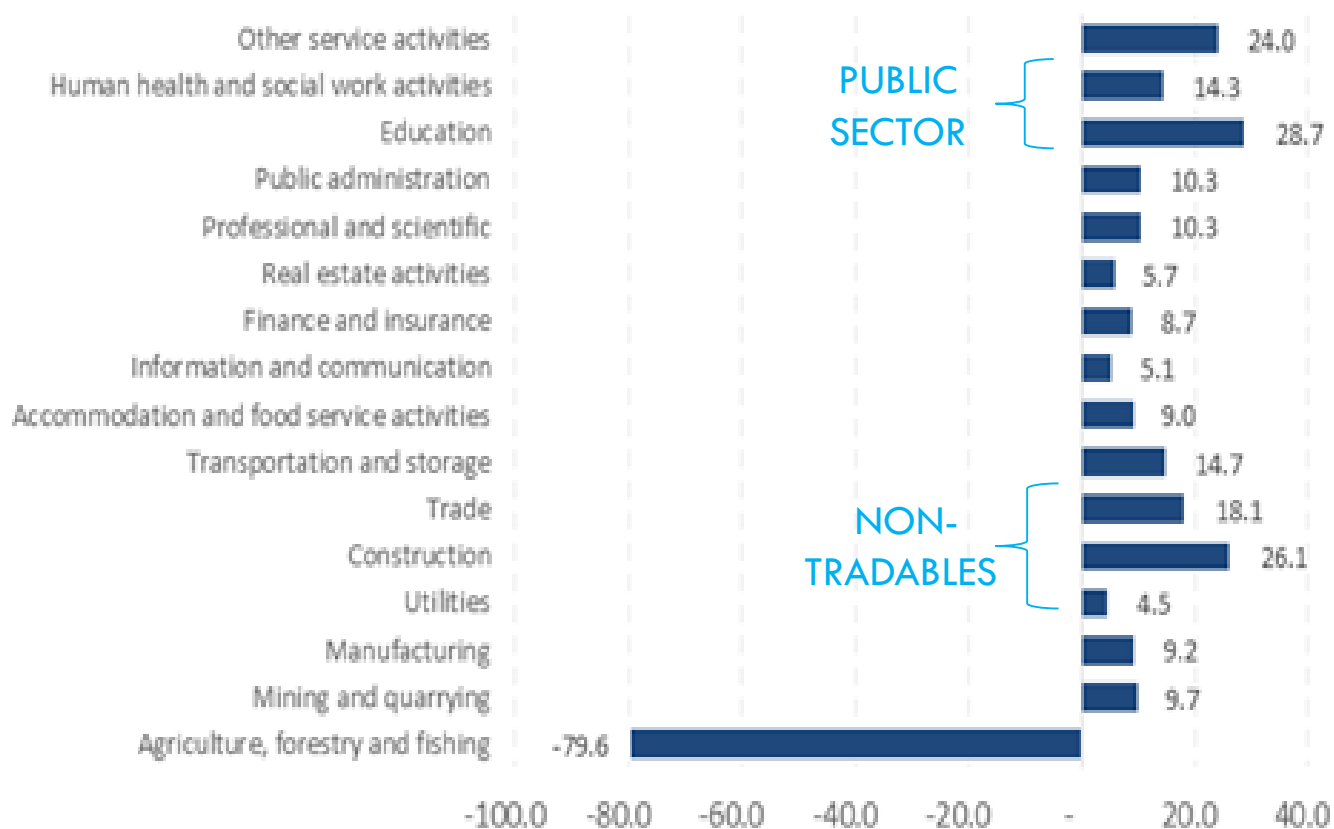
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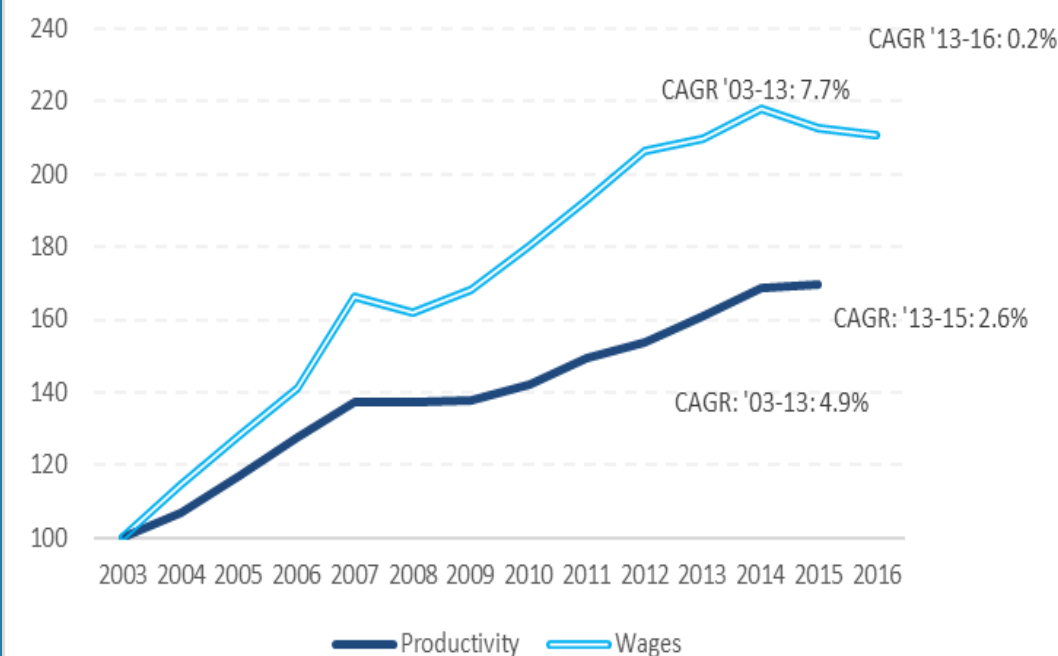
- Self employment accounts for close to half of all rural jobs; wide regional variation: from 5% in Astana to almost 50% in Zhambyl

Jobs were created — where and at what price?

Average annual job creation by sector ('000), 2003-16



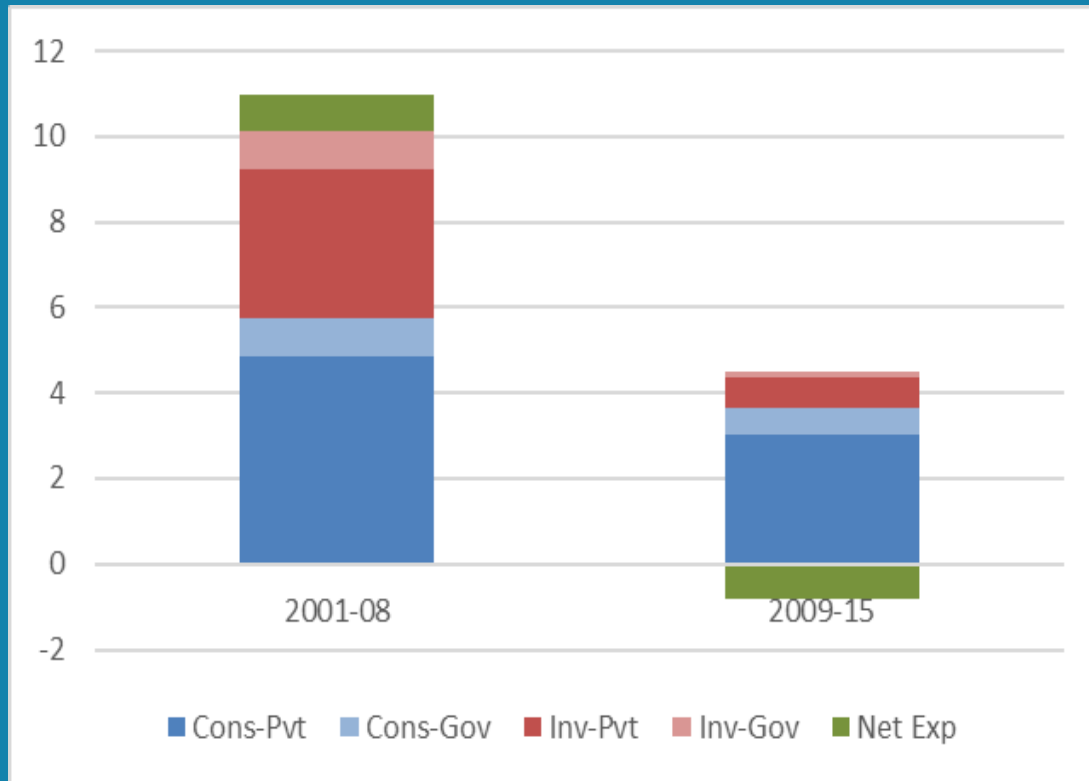
Evolution of productivity and wage growth



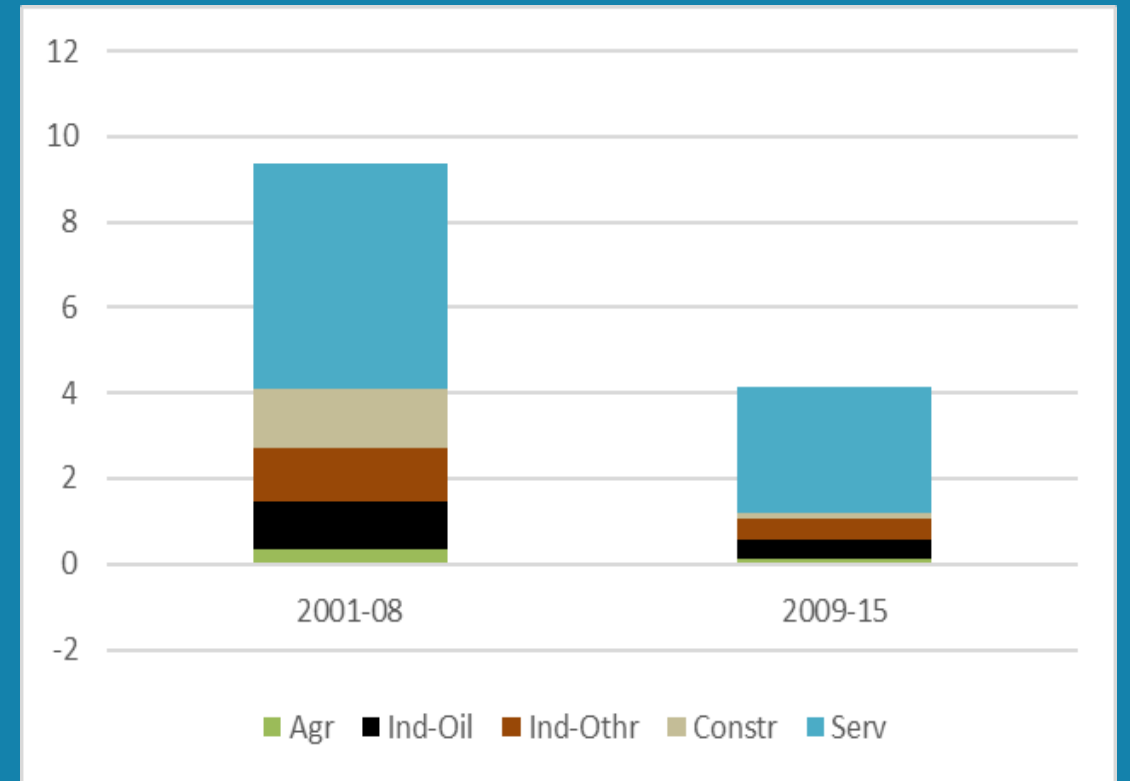
- **26% of all workers were self-employed in 2016** versus just 16% OECD average
- Wage growth far outstripped productivity growth until 2015

Economic management needs to enable the shift to tradables

GDP growth – Demand side



GDP growth – Supply side



PATHWAY #1

ECONOMIC MANAGEMENT FOR DIVERSIFICATION



Progress made since 2006

- ✓ Infrastructure
- ✓ Higher education and training
- ~ Institutions
- ✗ Macroeconomic policy
- ✗ Financial market development

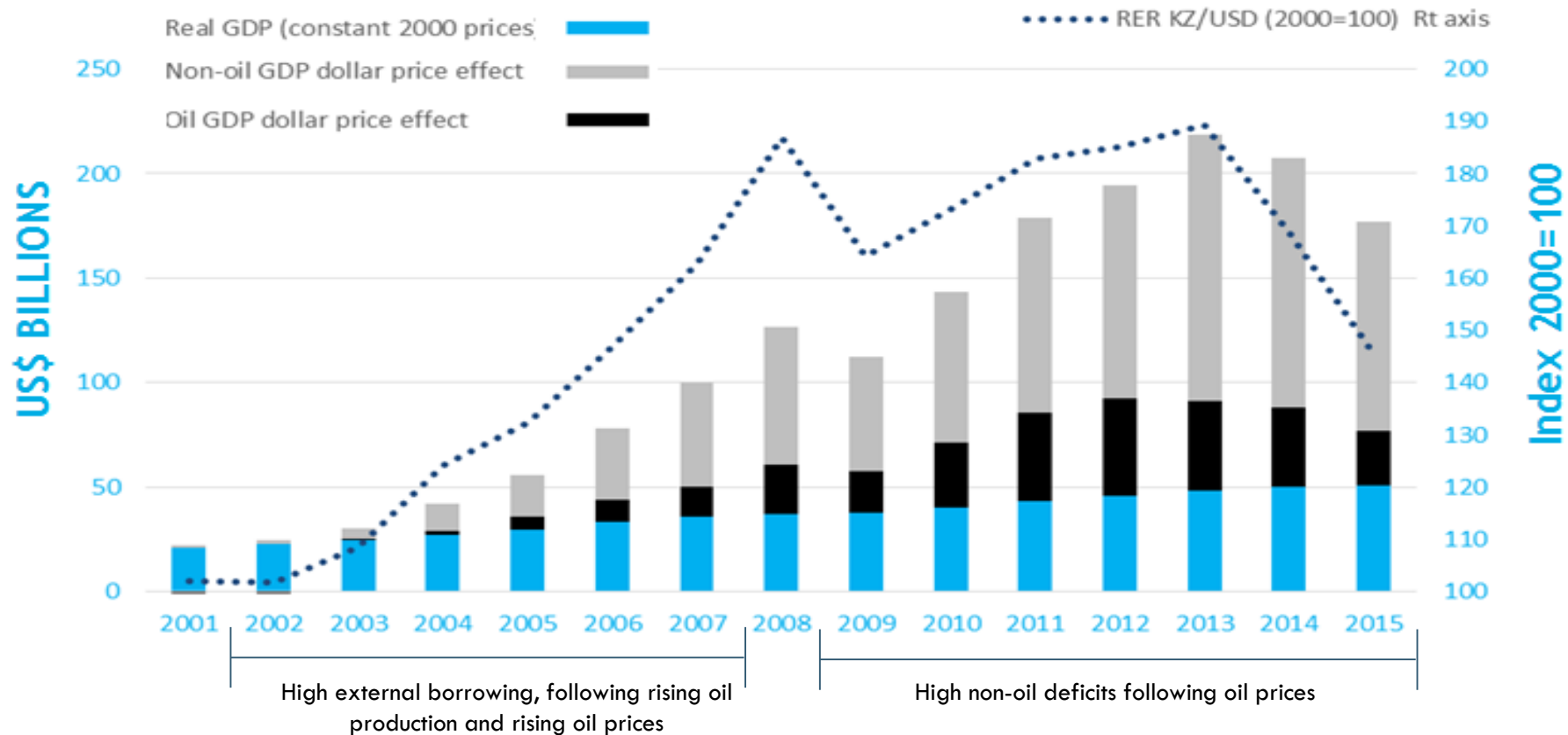
Are the gains enough for the next growth phase?

WEF Global Competitiveness Indicators



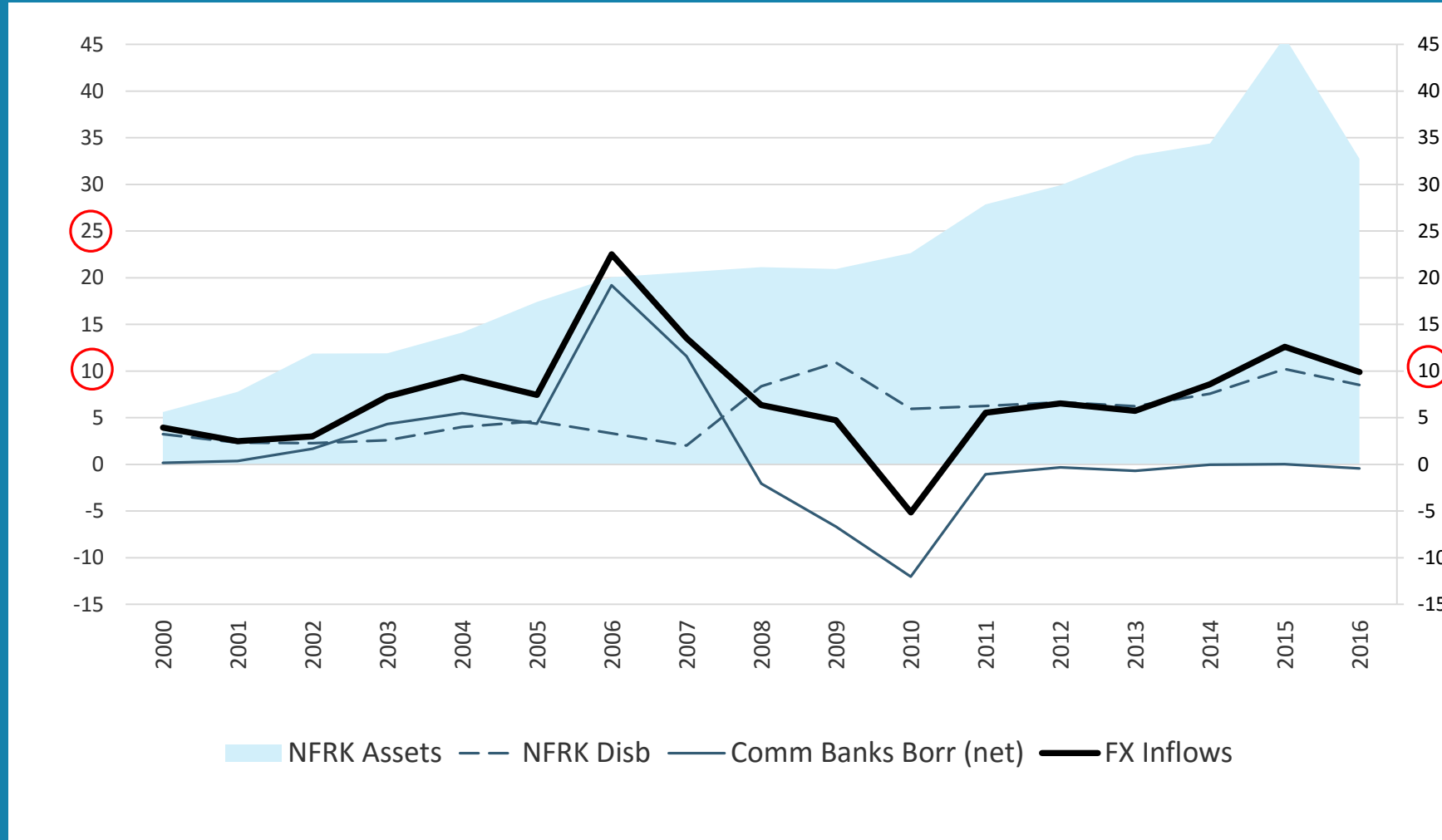
Kazakhstan's income was inflated

GDP in US\$ broken down by real increases in production and increases in prices



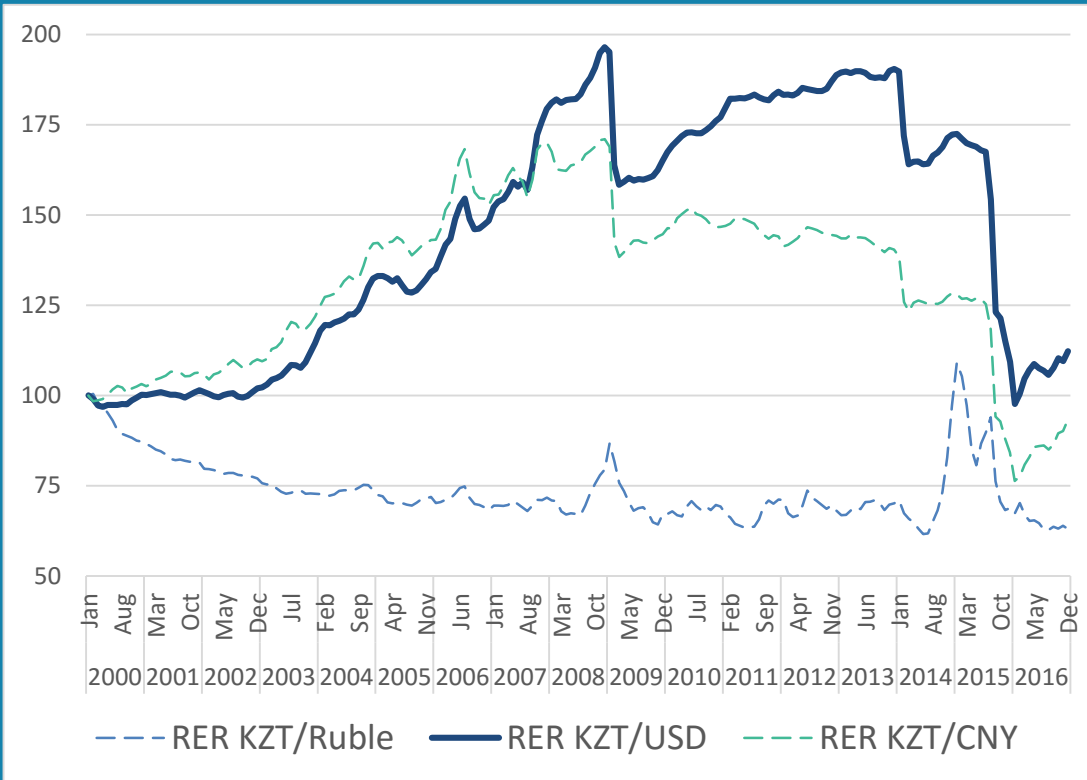
..in large part due to foreign currency inflows*

NFRK assets and net foreign exchange inflows

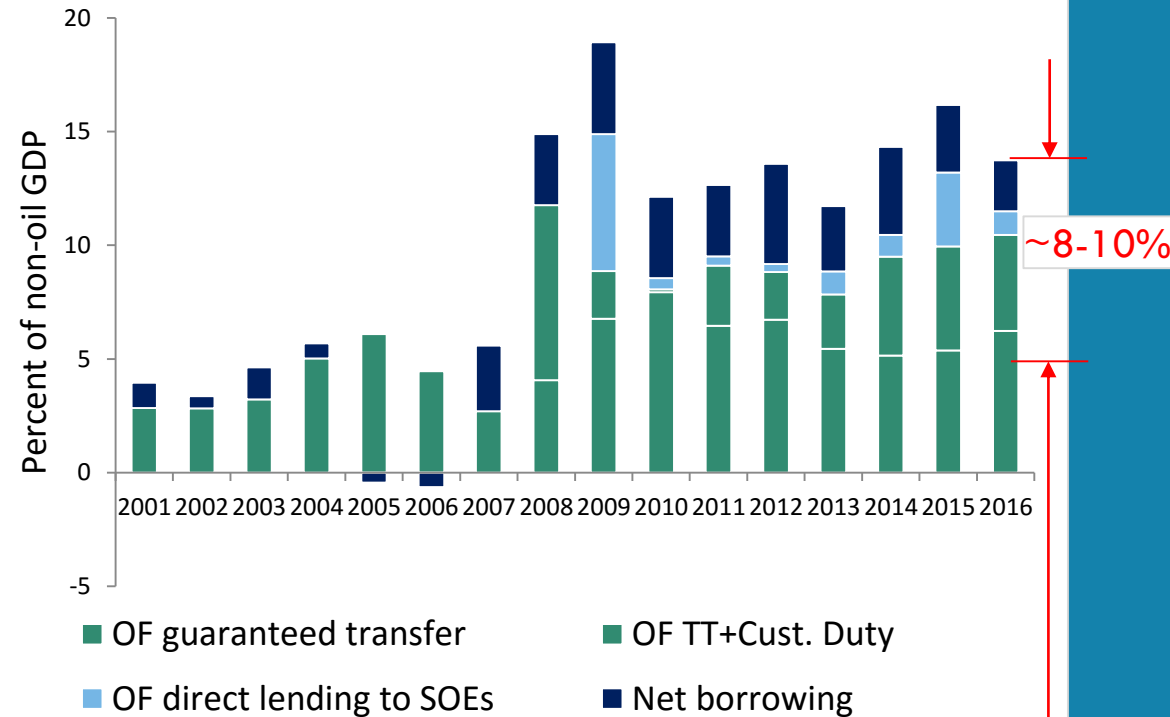


The non-oil deficit after 2008 was too large*

Real exchange rates 2001-2016



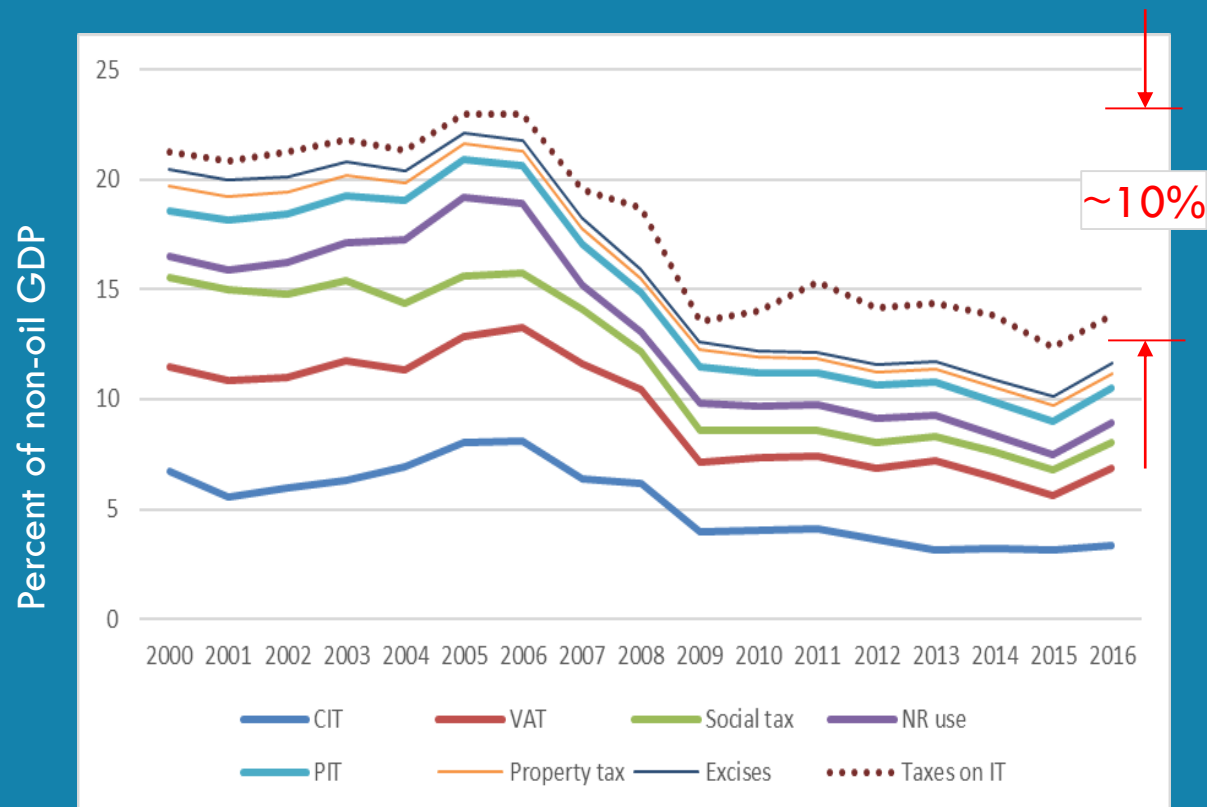
Non-oil deficit financing 2001-2016



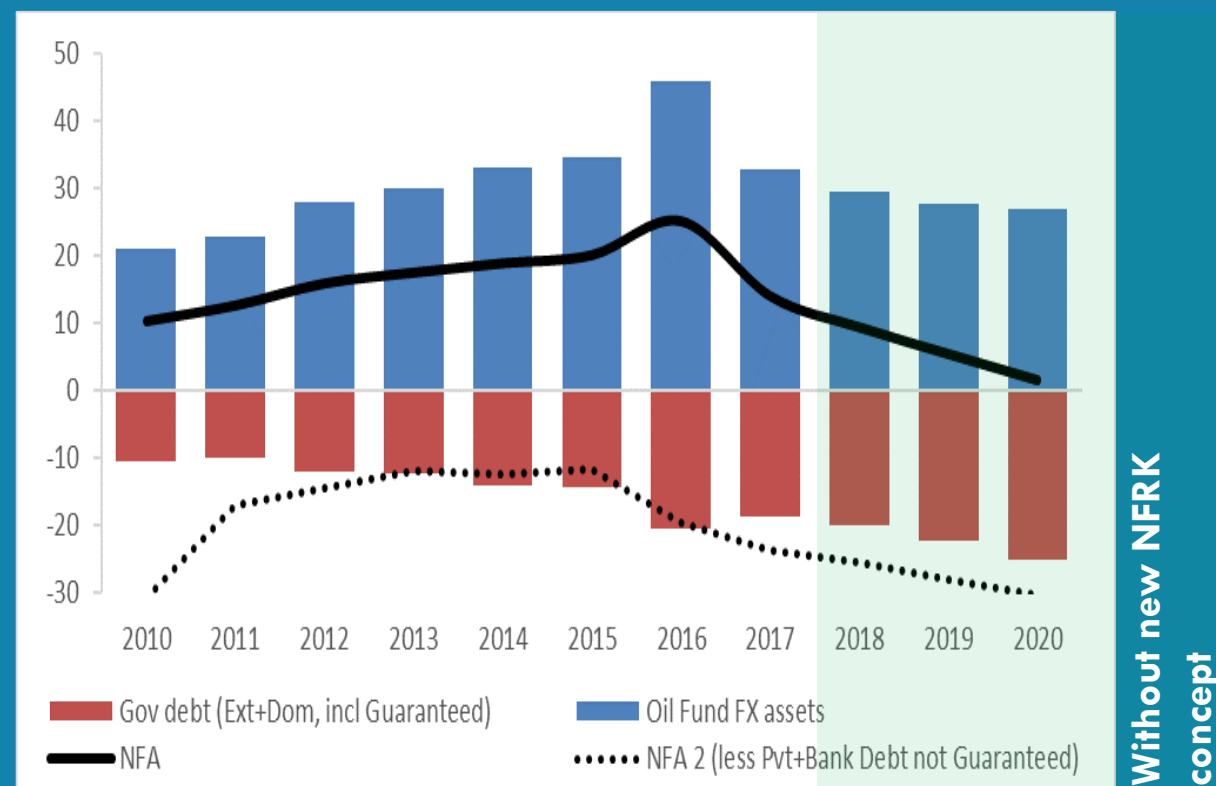
What's the implementation plan?

The oil fund is at risk

Non-oil revenues 2000-2016



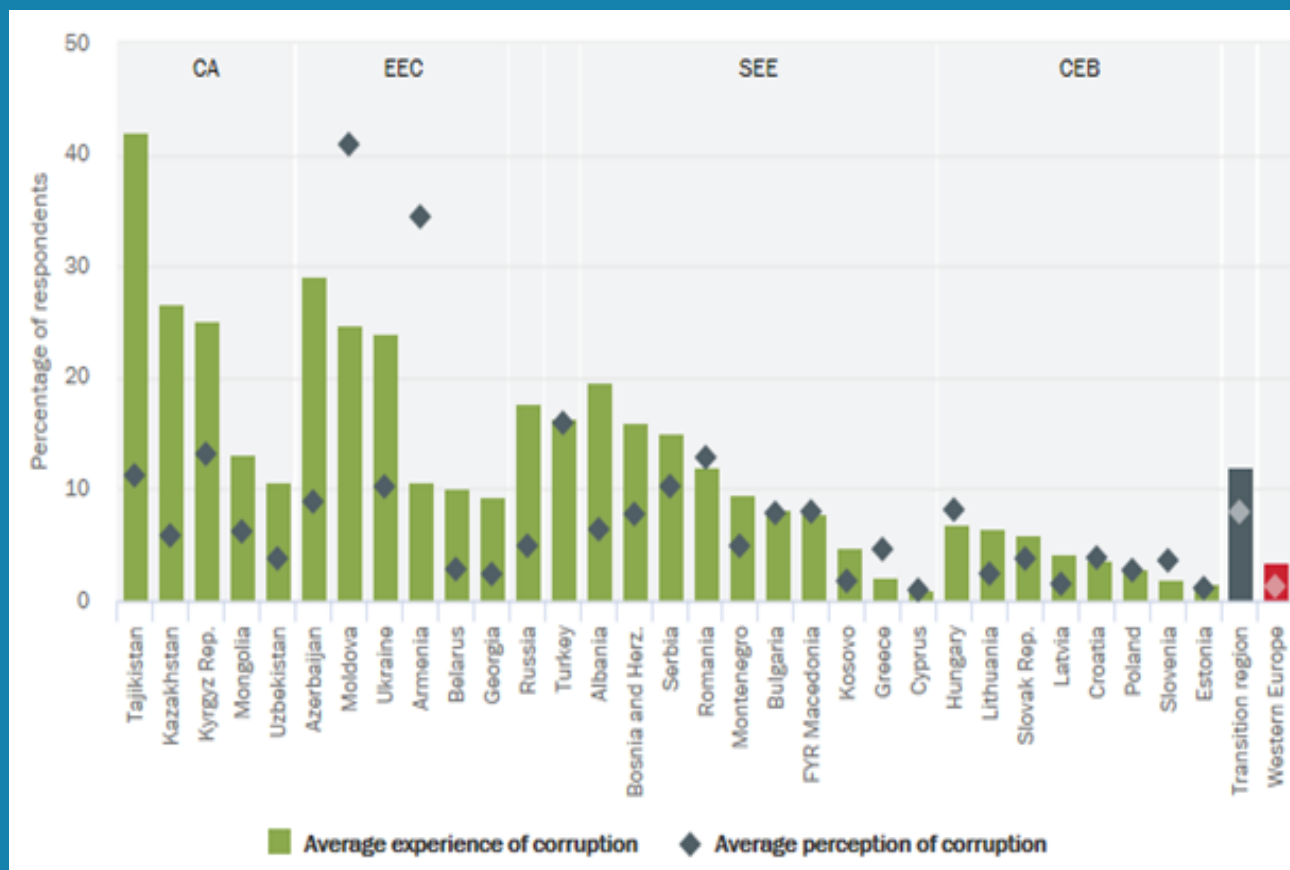
Net financial assets 2010-2020



What's the implementation plan?

Problems with corruption persist

Corruption experience in transition economies



Source: Life In Transition Survey III (2016)

Things to look at

Households

- Education quality
- Health access
- Health quality
- Utilities access

Businesses

- SOE procurement
- GOK procurement
- Licenses
- Inspections

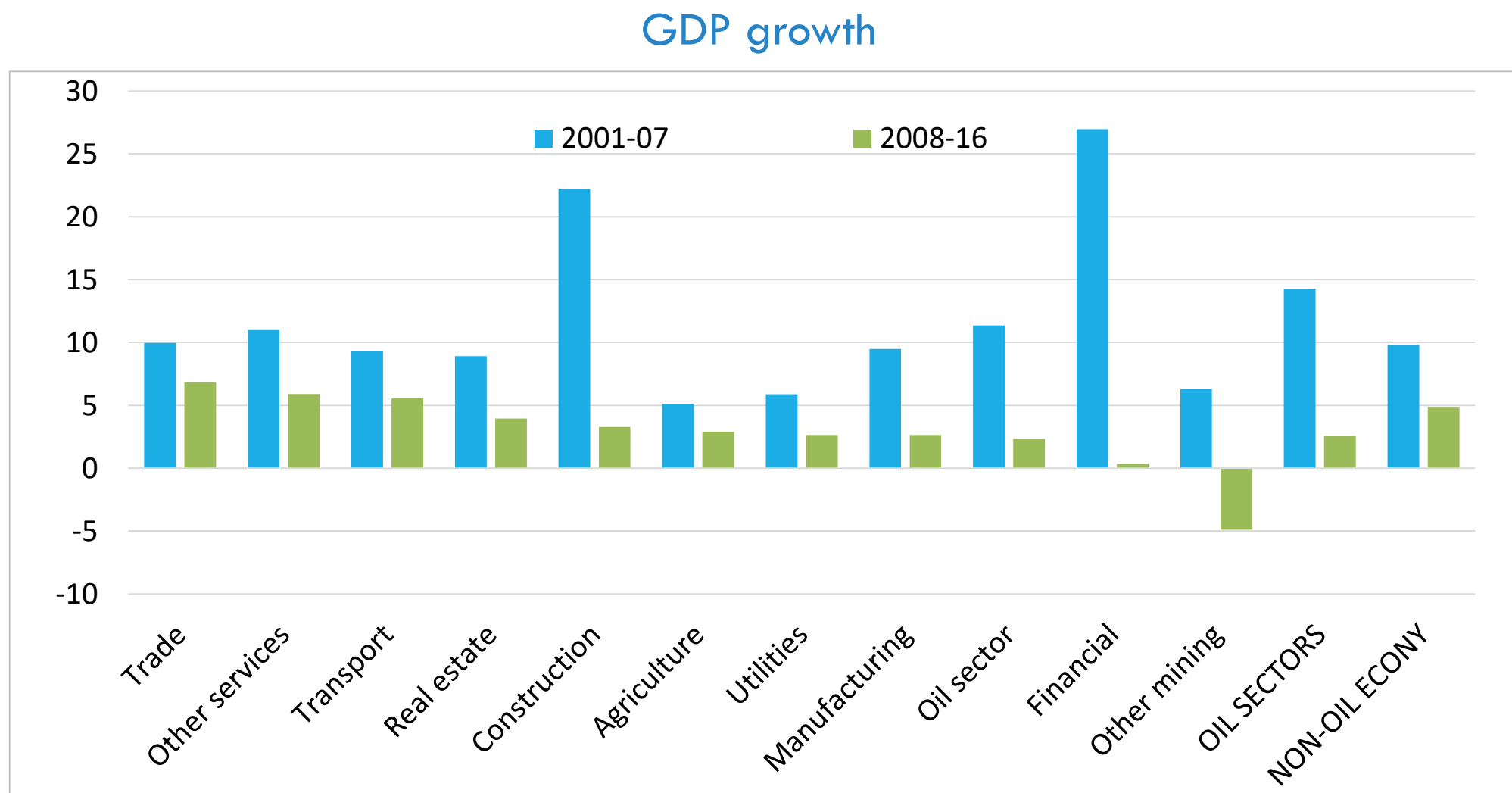
PATHWAY #2

PRIVATE SECTOR

DEVELOPMENT

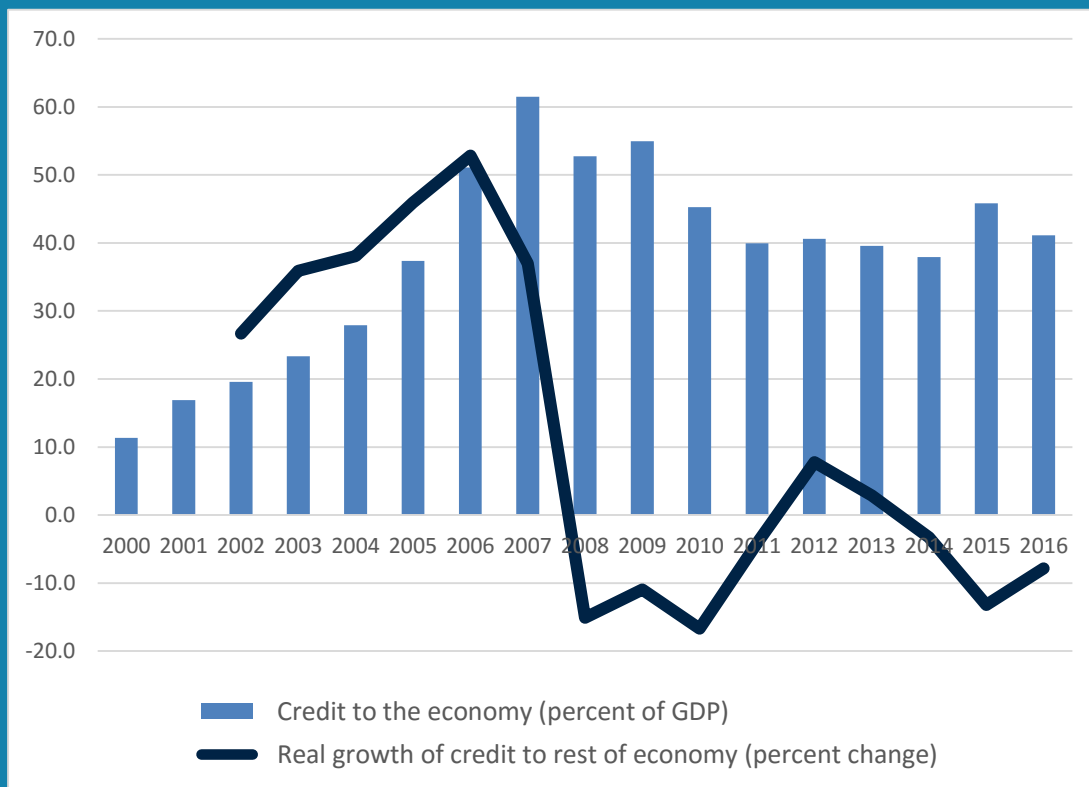


Non-tradable sector growth

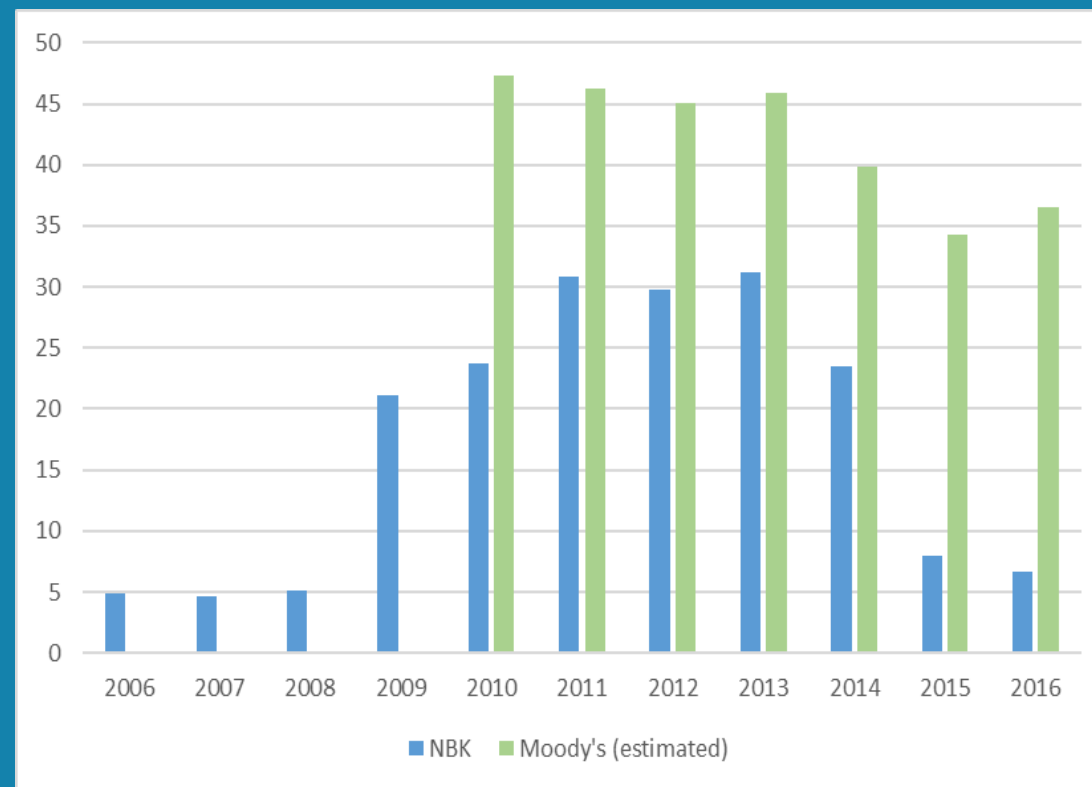


Banking sector not contributing enough to the economy

Credit to the economy (in percent)



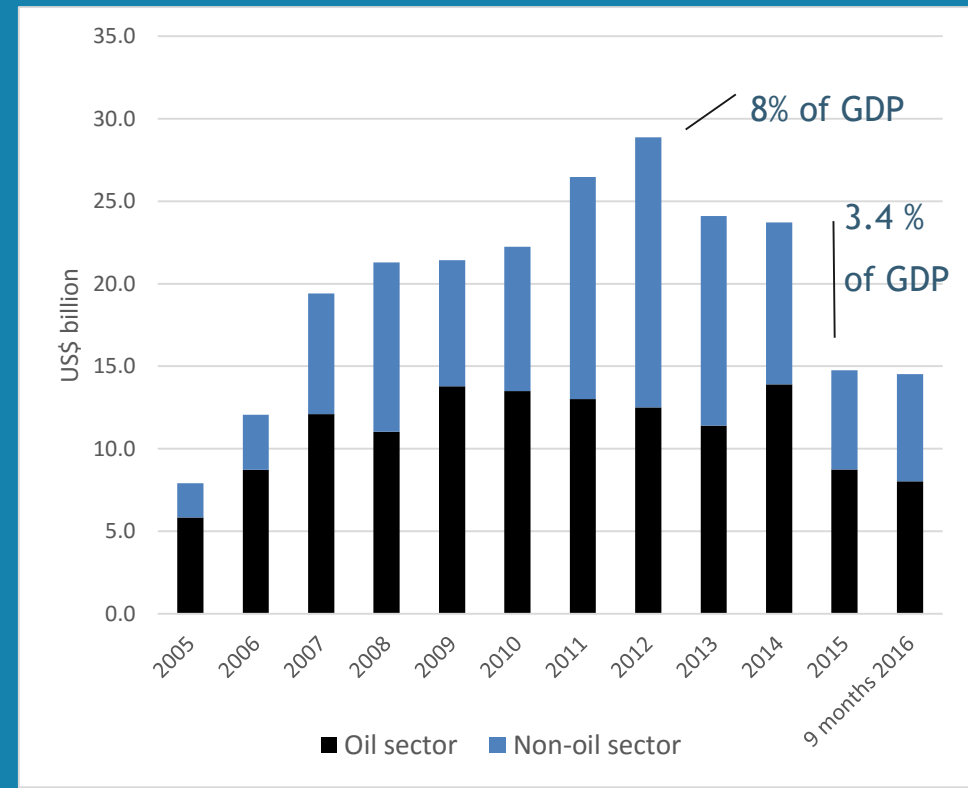
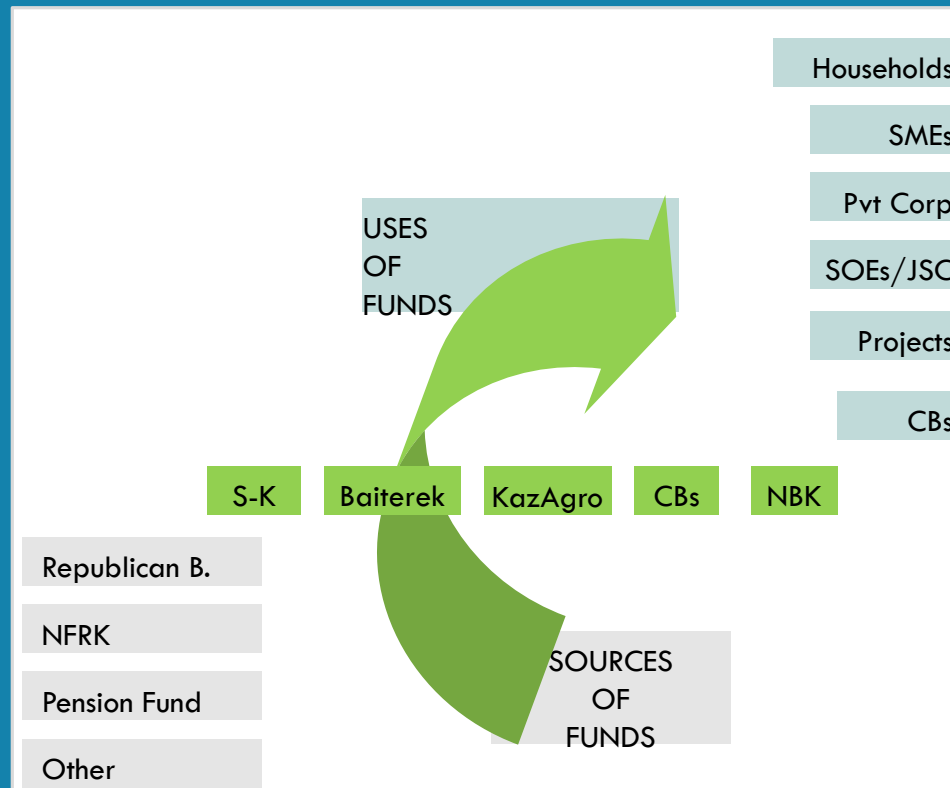
Non-performing loans (as percent of loans outstanding)



Note: NBK definition includes only loans 90 days overdue for banking system; Moody's definition captures retail and corporate loans, but based on survey of 9 banks which come to about 65 of commercial banks' portfolio.

Government tried to fill the funding gap, while non-oil FDI fled

Public funding of the private sector and households has sought to make up the shortfall domestic credit through quasi-fiscal activities

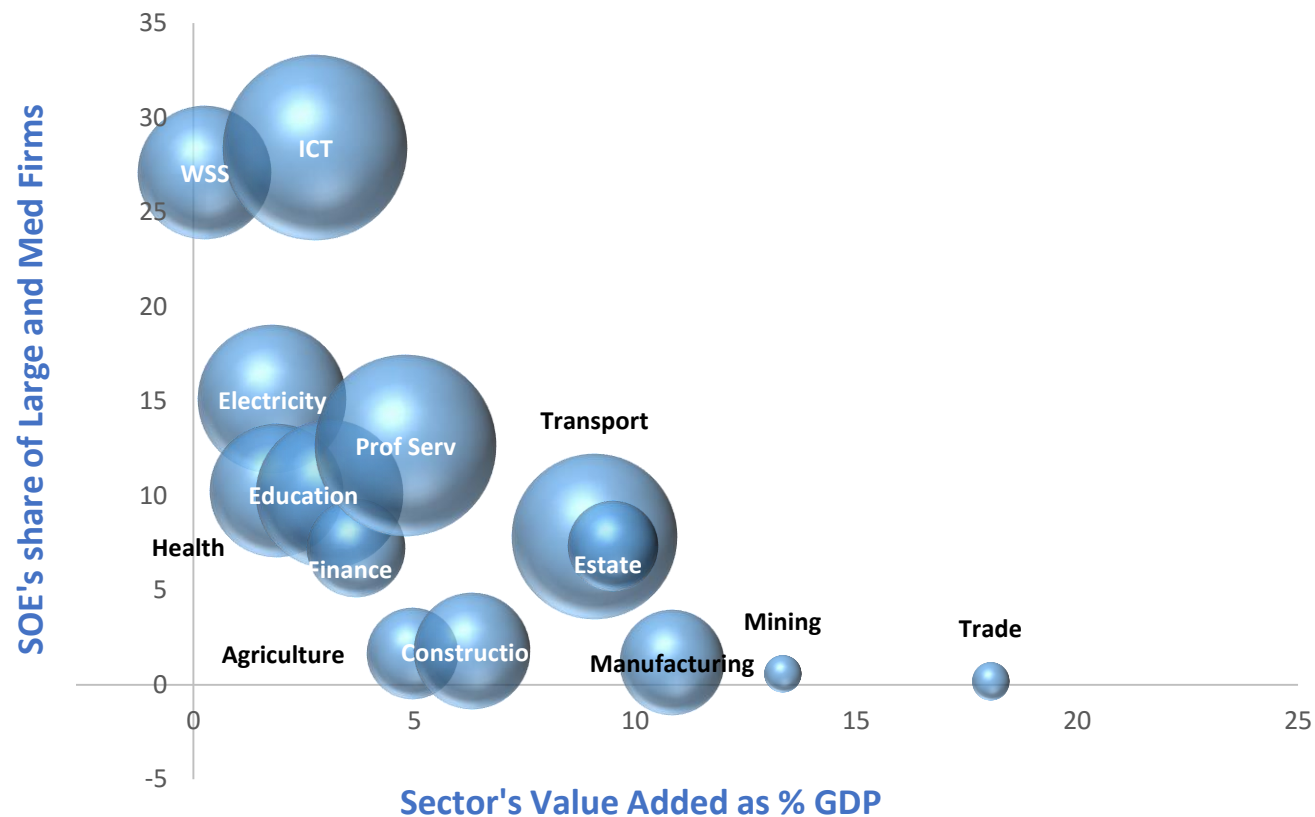


Gross inflow of FDI

SOEs are present in all critical sectors

Role of SOEs in Economy

(Size of balloons shows share of all SOEs in a sector)



Takeaways:

- More than 50% of SOEs are found in ICT, transport, professional services, electricity, WSS, education and health.
- SOEs are not likely to dominate the production of GDP (based on available evidence)
- SOEs are in a strong position to influence government policy in all sectors of the economy (though government participation in management boards, and other means).

OECD State Control Index

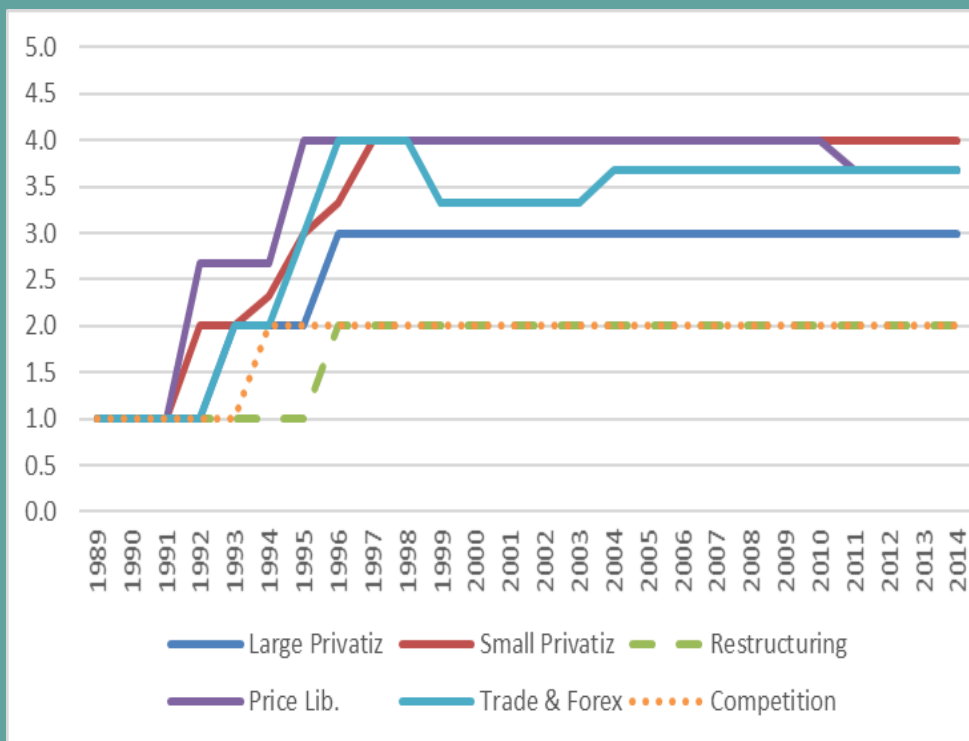
INDIA
3.8 KAZ

VENEZUELA
ARGENTINA
CHINA
TURKEY
RUSSIA

Most OECD
~1.5-2.5

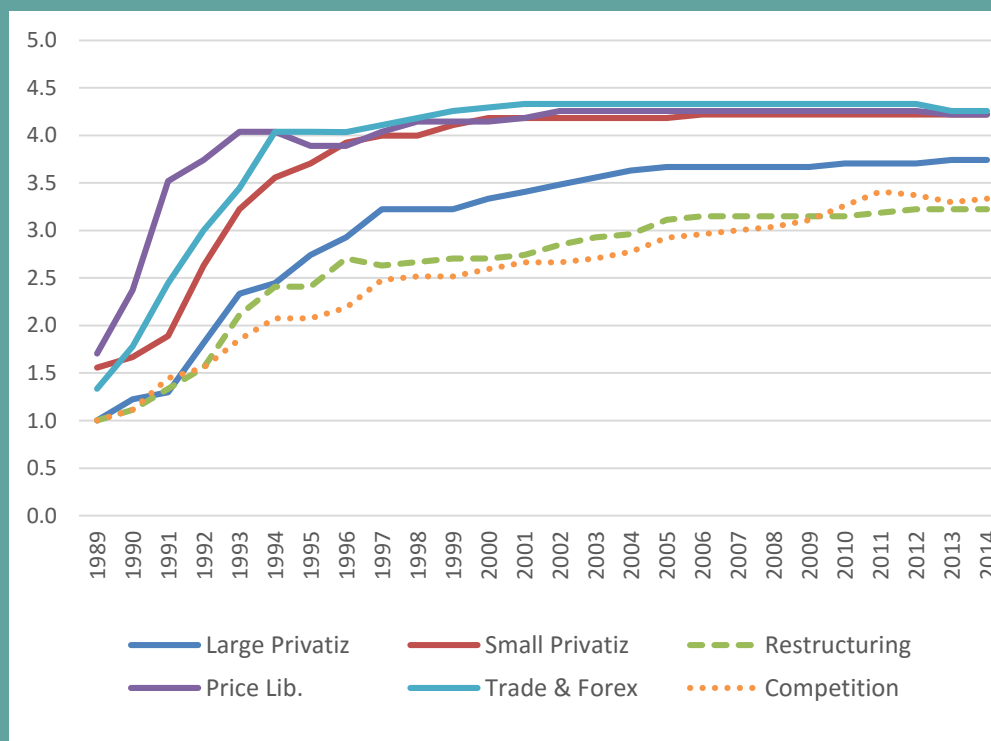
Enterprise reforms stalled in mid-1990s

EBRD Transition Index: Kazakhstan (1989-2014)



Source: EBRD

EBRD Transition Index: EU-9 (1989-2014)

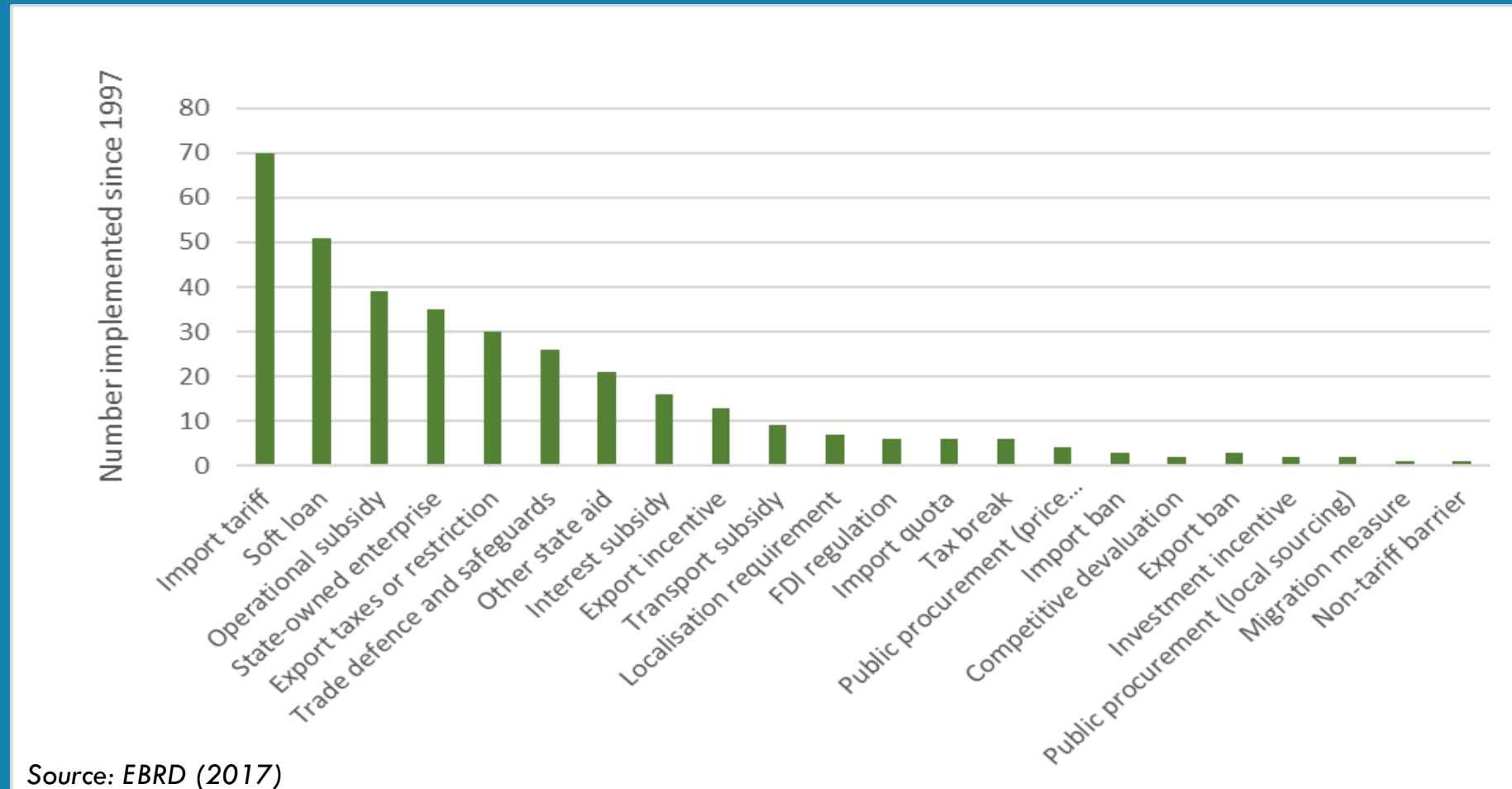


Note: EU-9 comprise Bulgaria, Croatia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, and Slovenia.

Source: EBRD

Industrial policies hinder competition

Industrial policy instruments and frequency of use since 1997

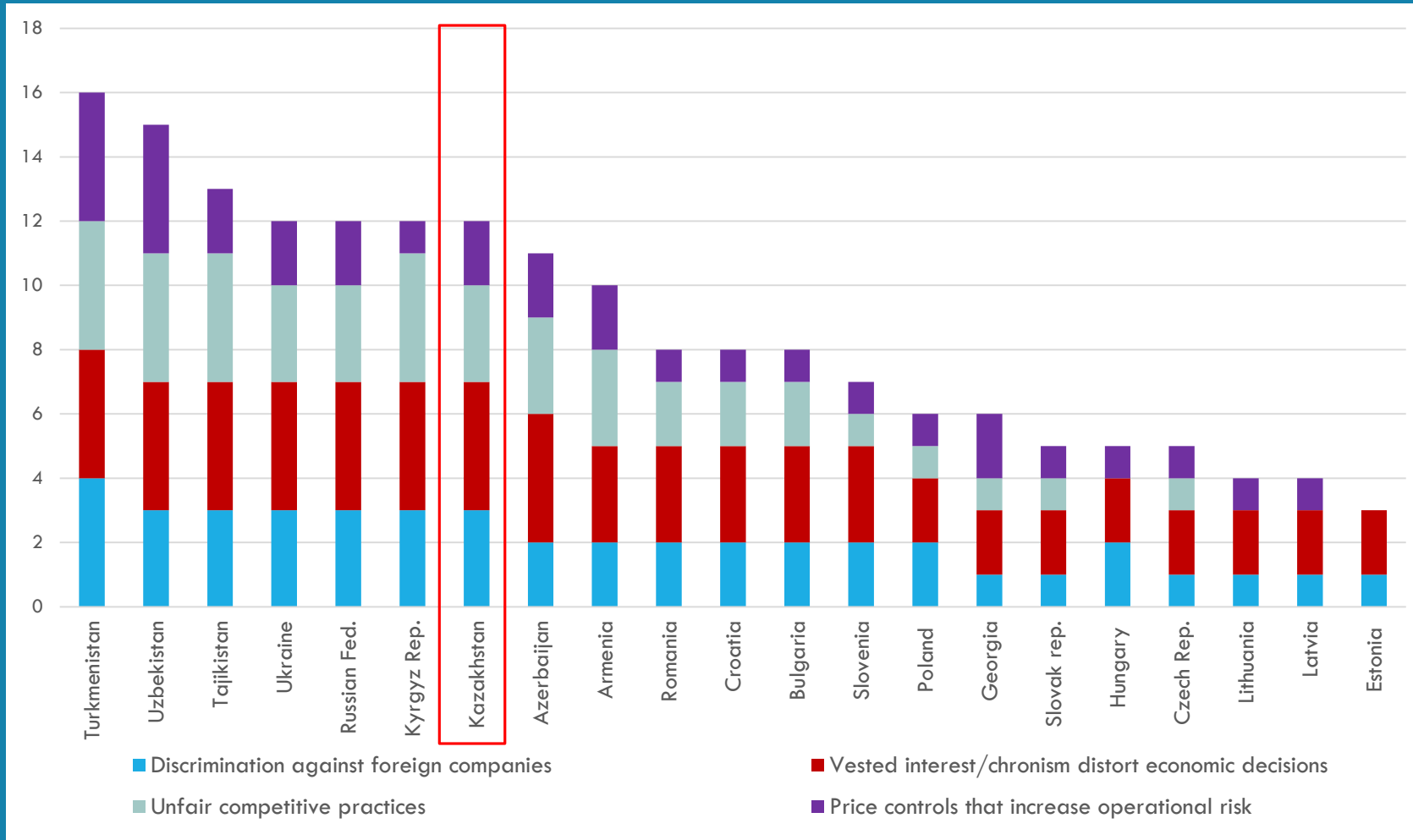


Note

Industrial policies are intended to support SMEs and larger firms

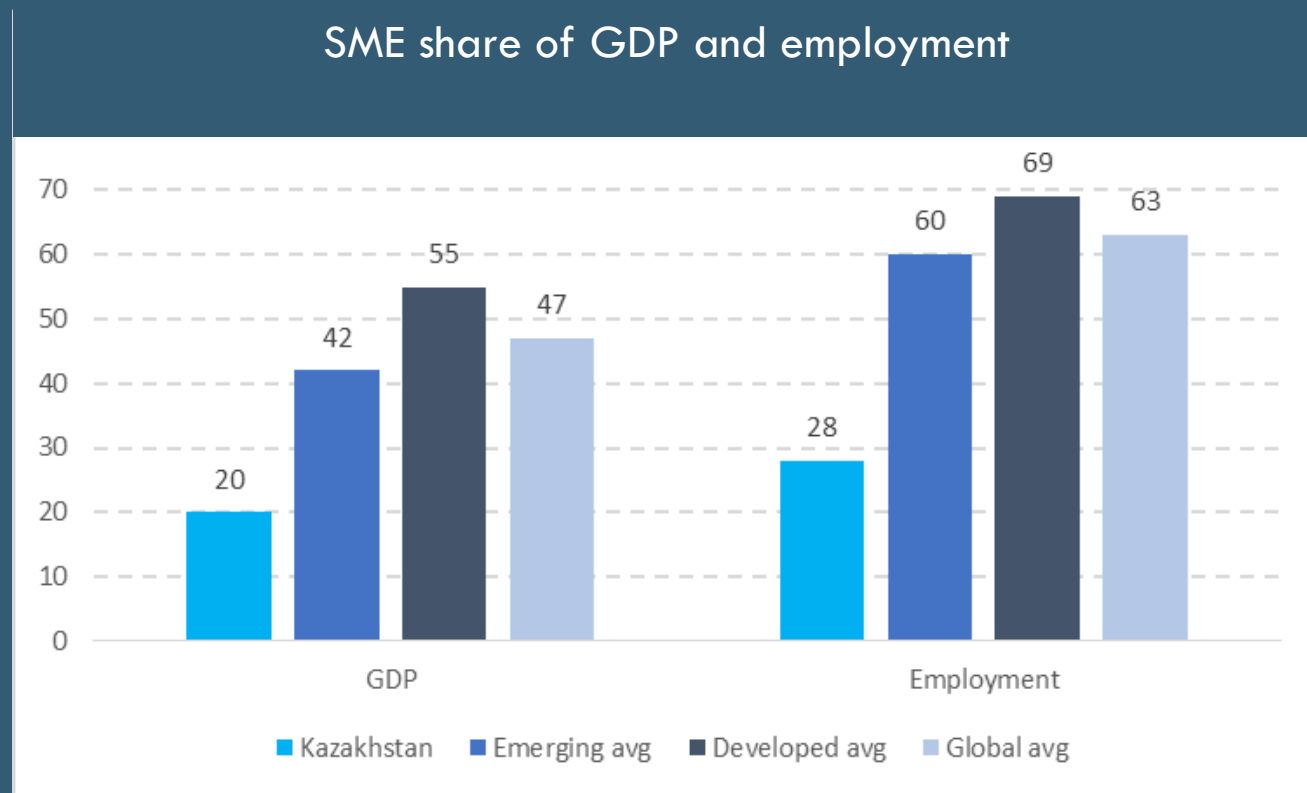
Competition environment remains restrained

Competition policies and FDI risks



Source: Economist
Intelligence Unit
(2016)

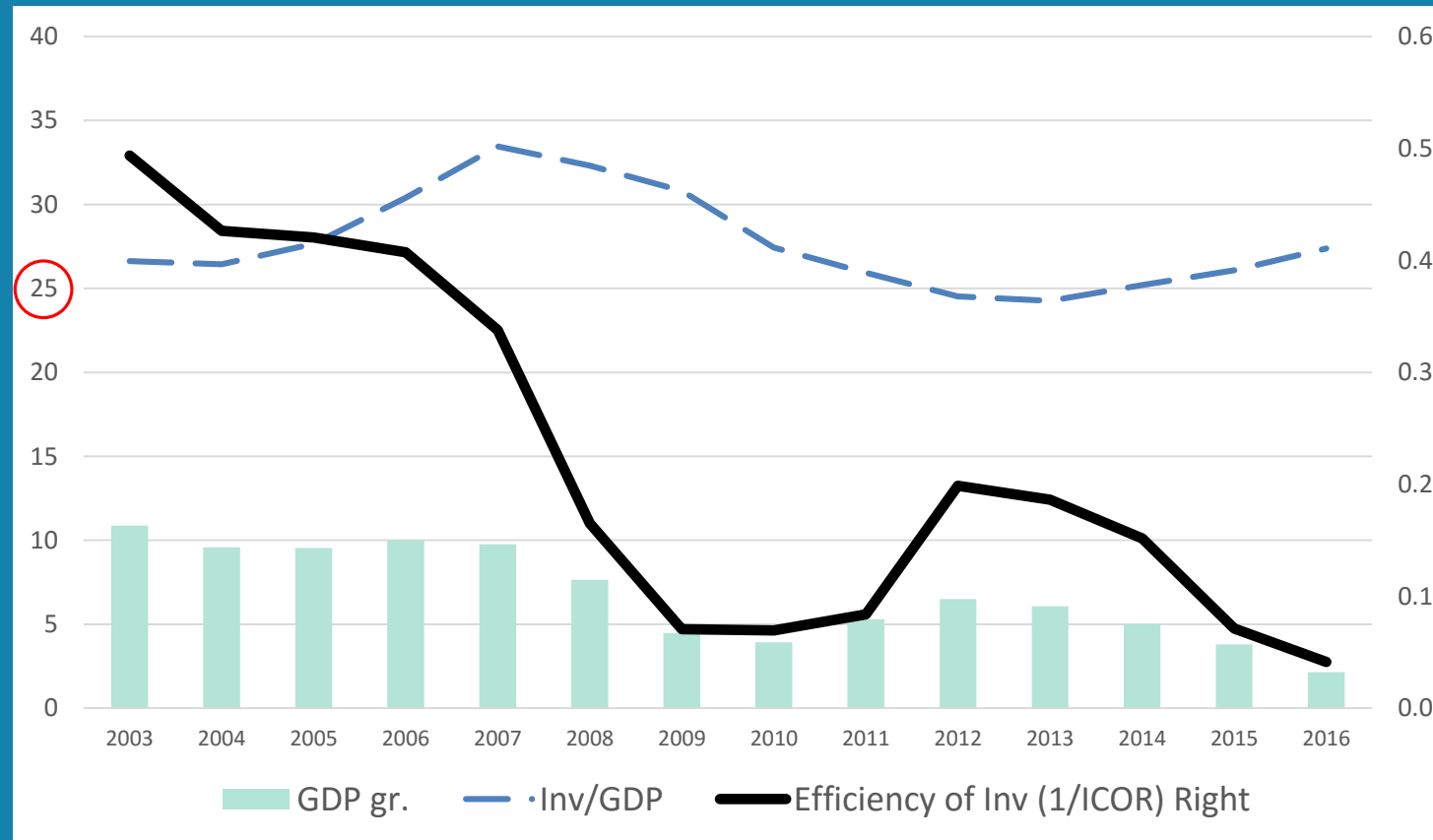
Contributing to low SME development



Source: World Bank SME Competitiveness Project (Project Appraisal Document)

Efficiency of investment is declining

GDP growth and investment rate



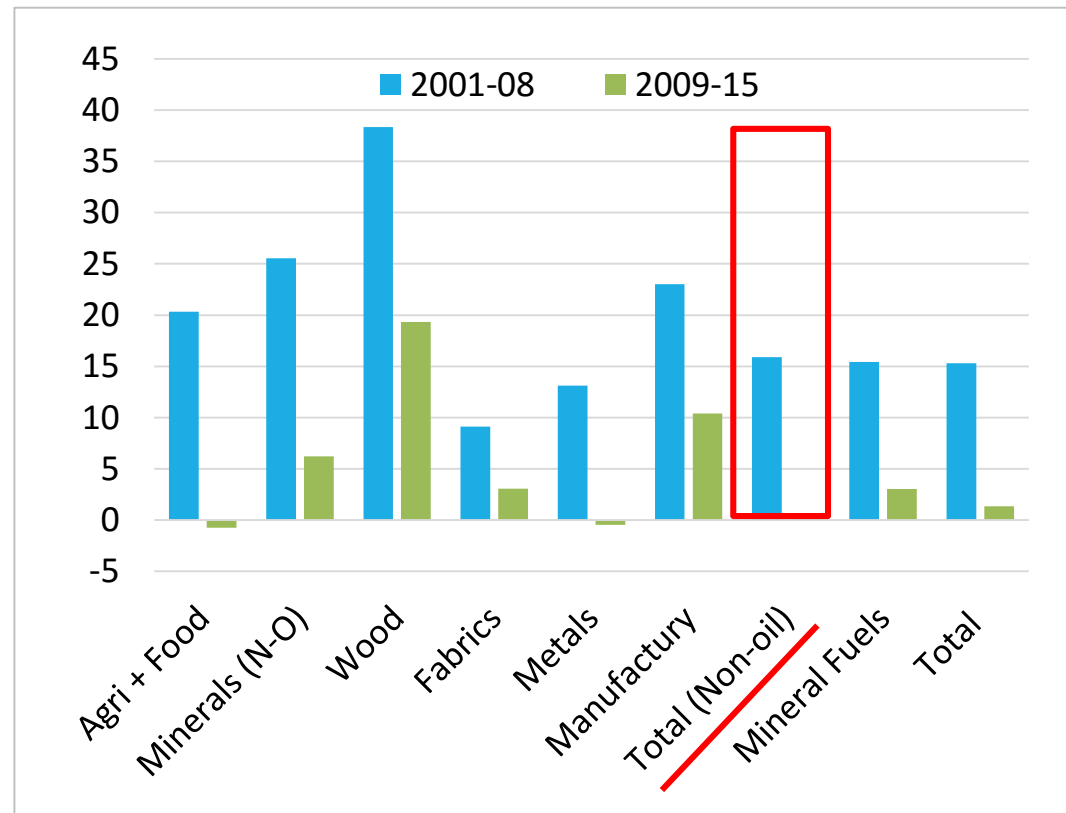
PATHWAY #3

TRADE,
CONNECTIVITY
AND
INTEGRATION



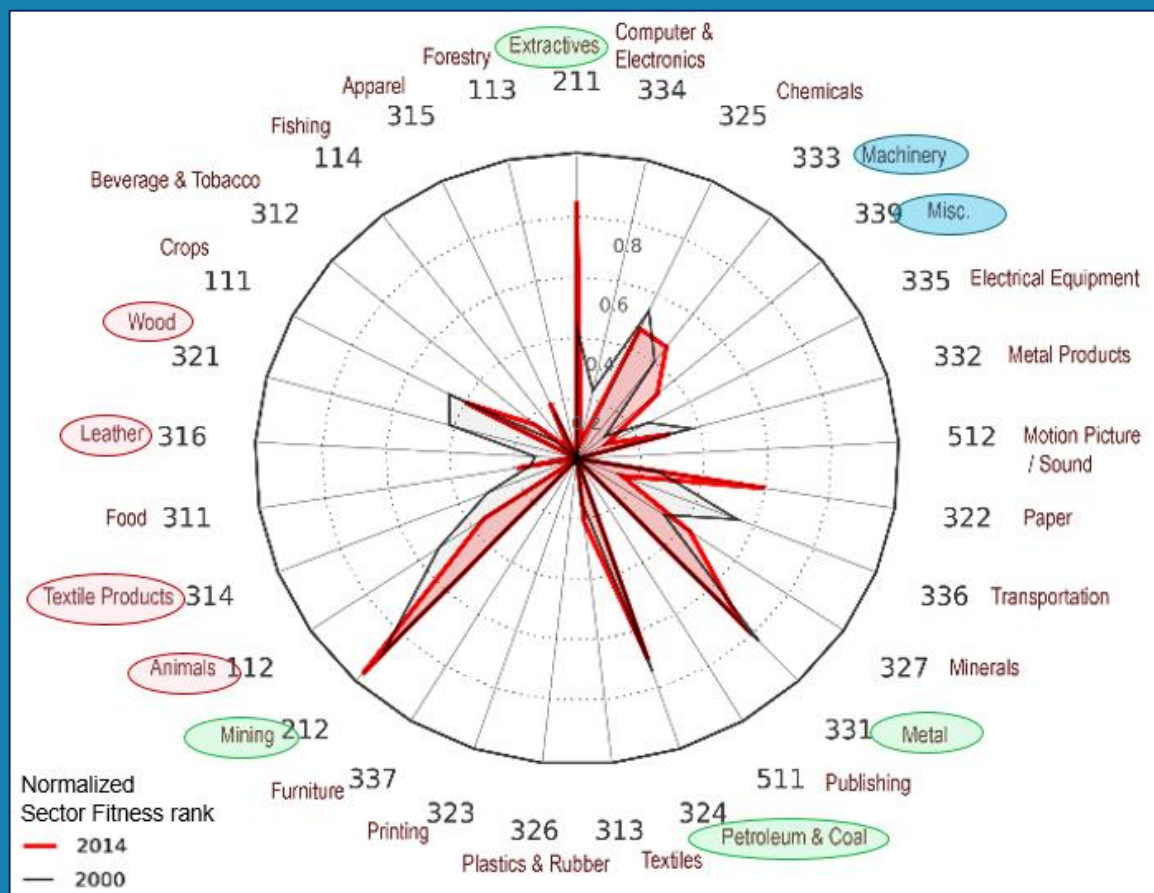
What's the big picture?

Merchandise export growth



There are many opportunities to be captured

Product
complexity
and sector
fitness:
2014
versus
2000



IFC diagnostic

- Wheat
- Livestock
- Trade and logistics

WB

- Agriculture and food processing

ADB diagnostic

- Agriculture and food processing
- Intermediate goods manufacturing and input to GVCs
- Oil field services

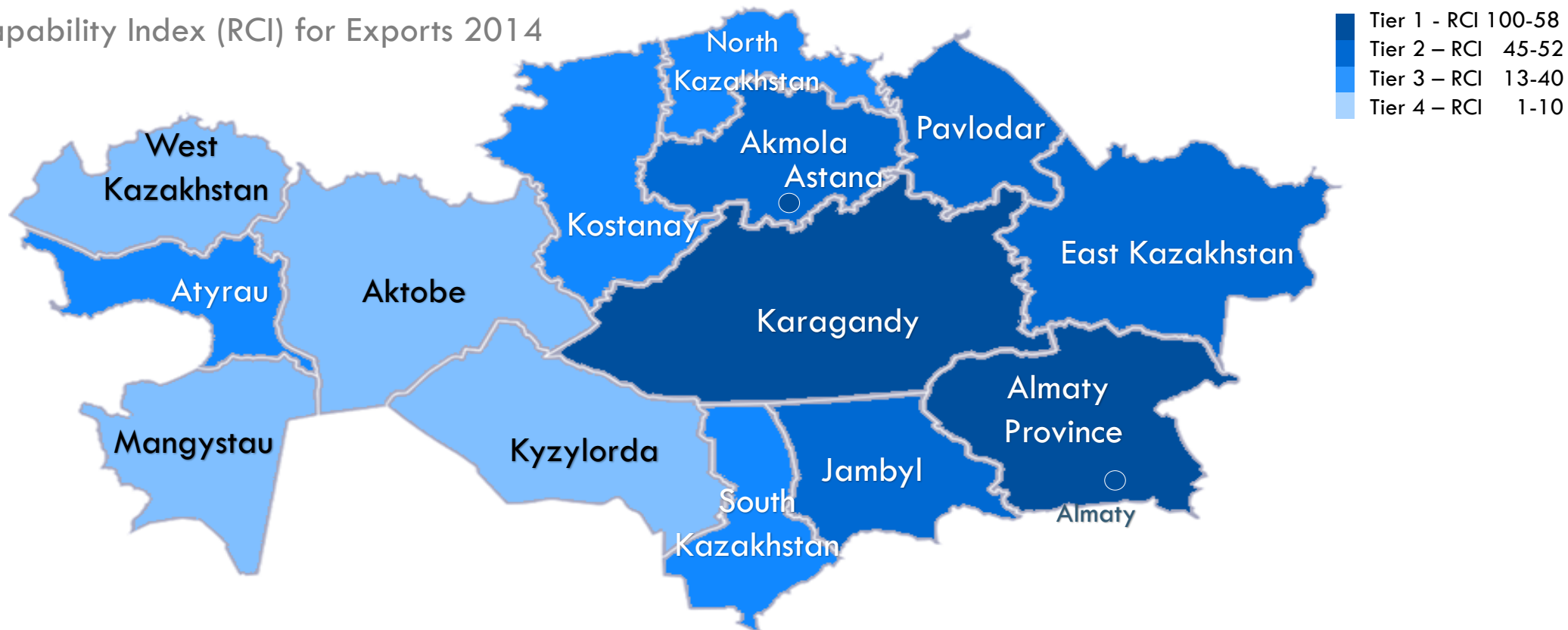
EBRD diagnostic

- Renewable energy

Some
opportunities
identified by
International
Financial
Institutions

Each region has its own capabilities

Regional Capability Index (RCI) for Exports 2014

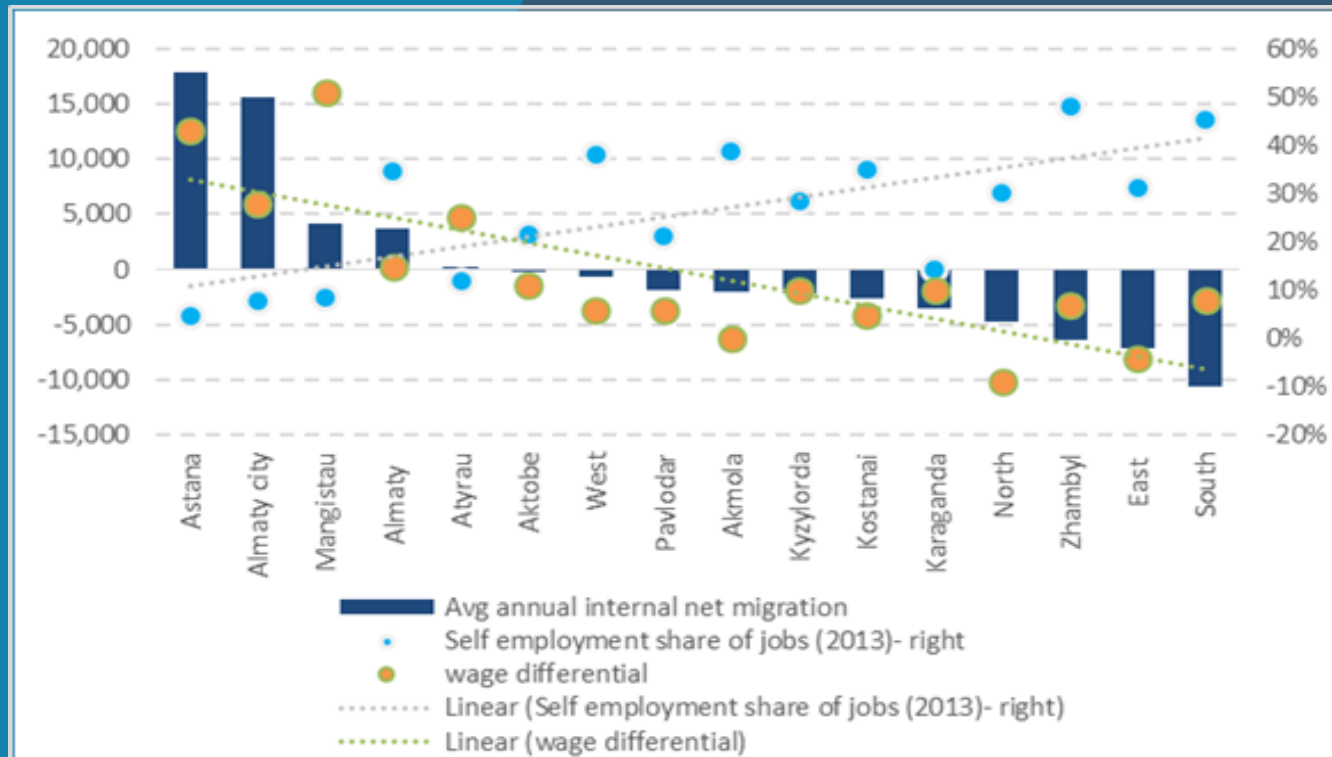


Note: RCI weighs equally the Regional Economic Complexity Index, Number of products with Revealed Comparative Advantage (RCA), RCA for Services of the region relative to the country, and RCA for Processing of the region relative to the country.

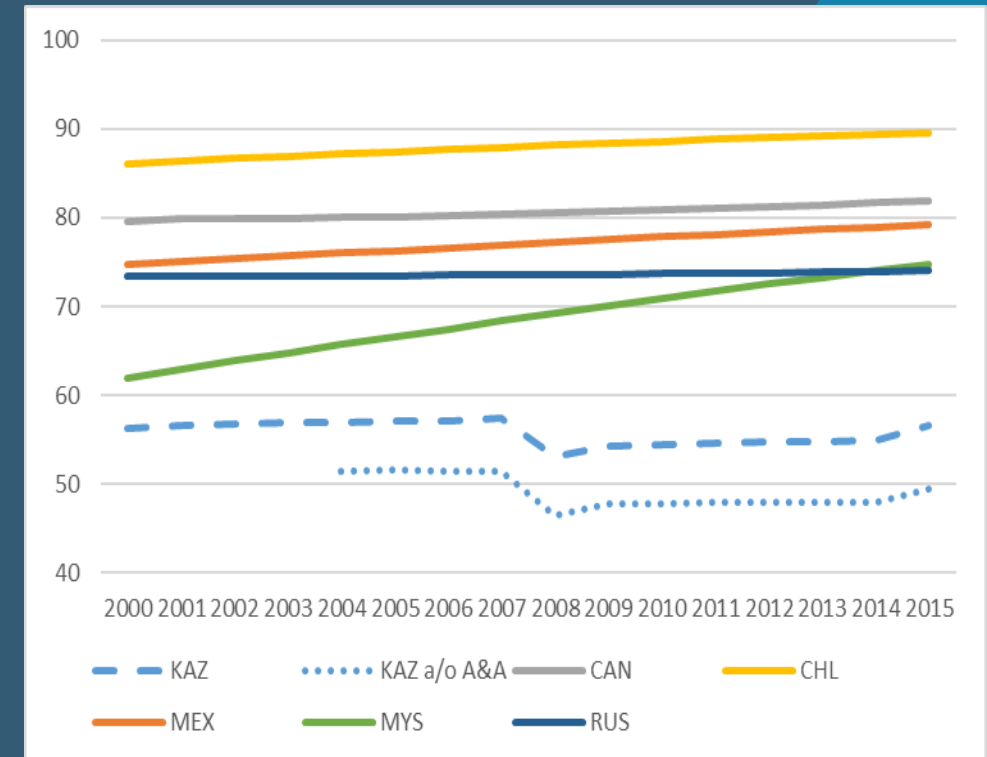
Source: Diversification of Kazakhstan's economy: A capability-based approach (Whitesheild Partners, EBRD 2015)

Kazakhstan may be losing out from low internal migration

Internal migration, self-employment rates, and wage differentials across



Urbanization rates

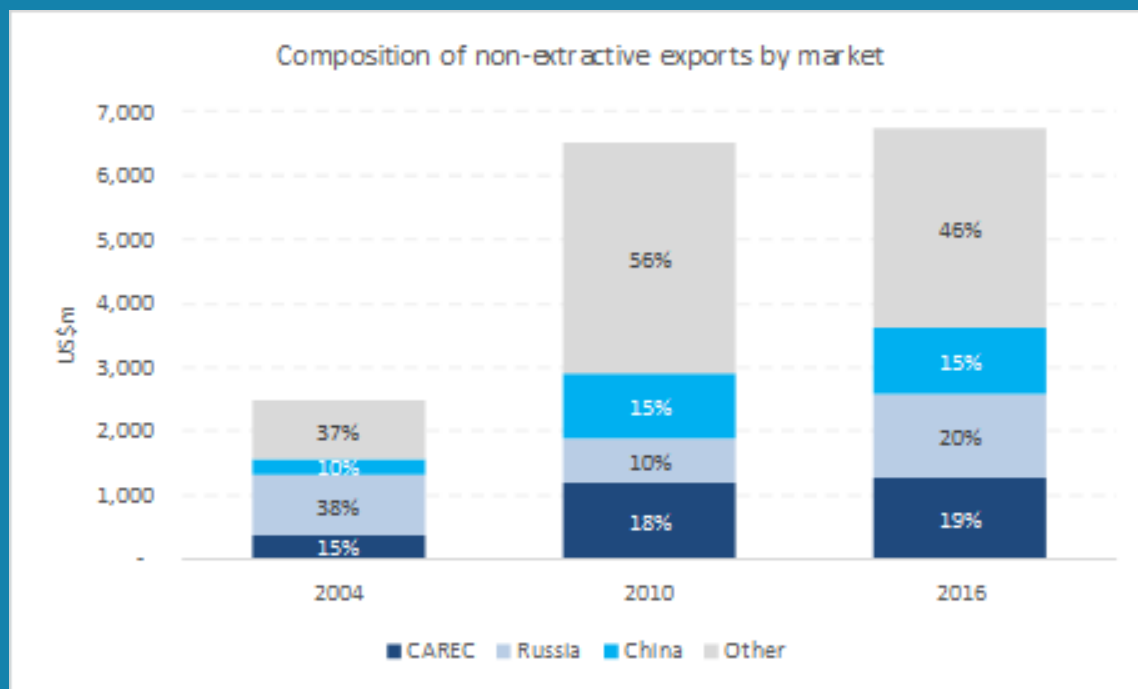


There is much to gain from regional integration

Central Asia still playing a limited role in non-extractives exports; Eurasian Economic Union becoming increasingly important

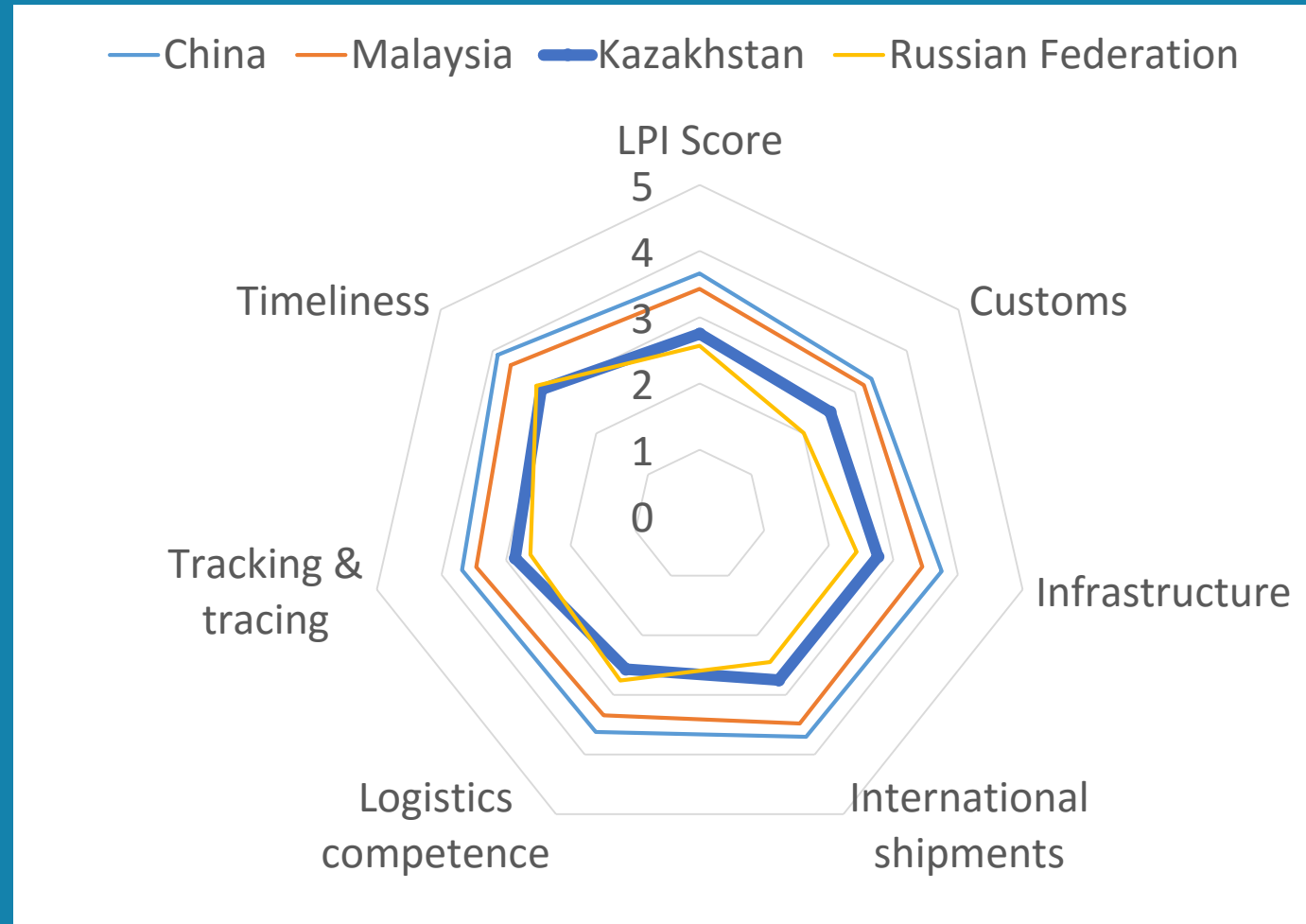
FUTURE

Can Kazakhstan take advantage of regional trade hub potential through One-Belt One Road? – will require:



- Infrastructure investment
- Streamlined and more transparent customs procedures
- Logistics sector development, including inter-modal facilities

But soft infrastructure will be critical



PATHWAY #3

COMPETITIVE AND ADAPTIVE HUMAN CAPITAL



Education

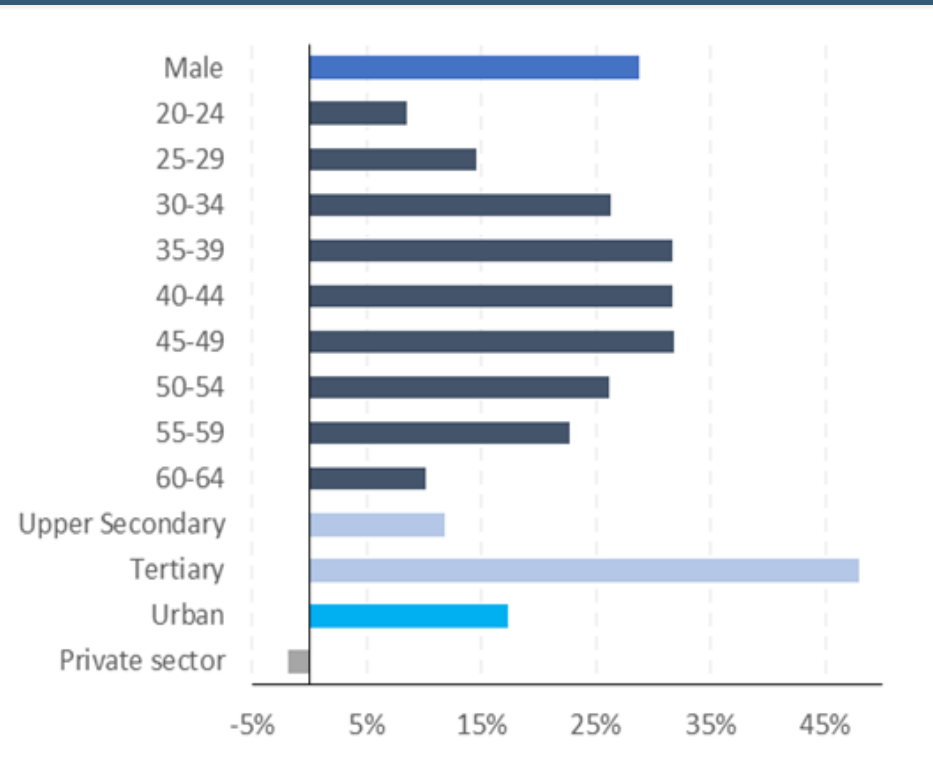
Job market
linkages

Health
outcomes

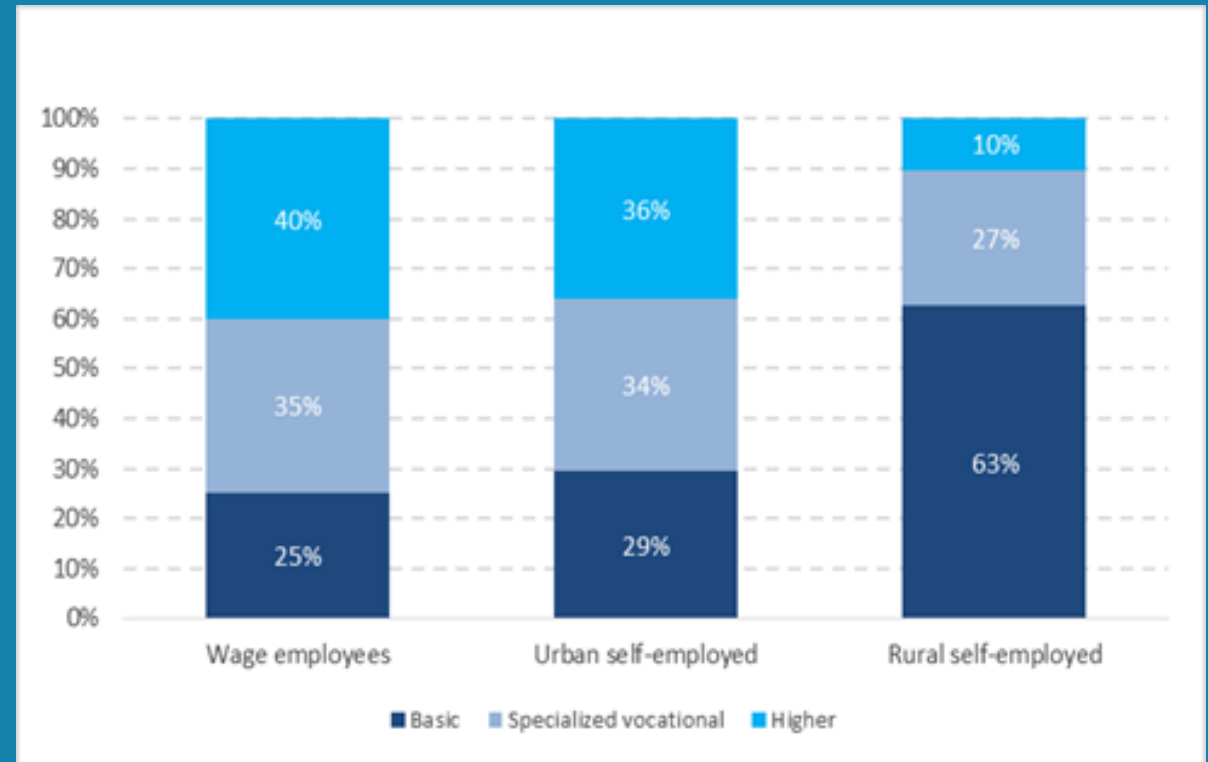
Social
protection
related to
job market

Low skills of rural self employed may inhibit access to better employment

Regression Results from Heckman Selection-Corrected Log Wage Regressions -2013

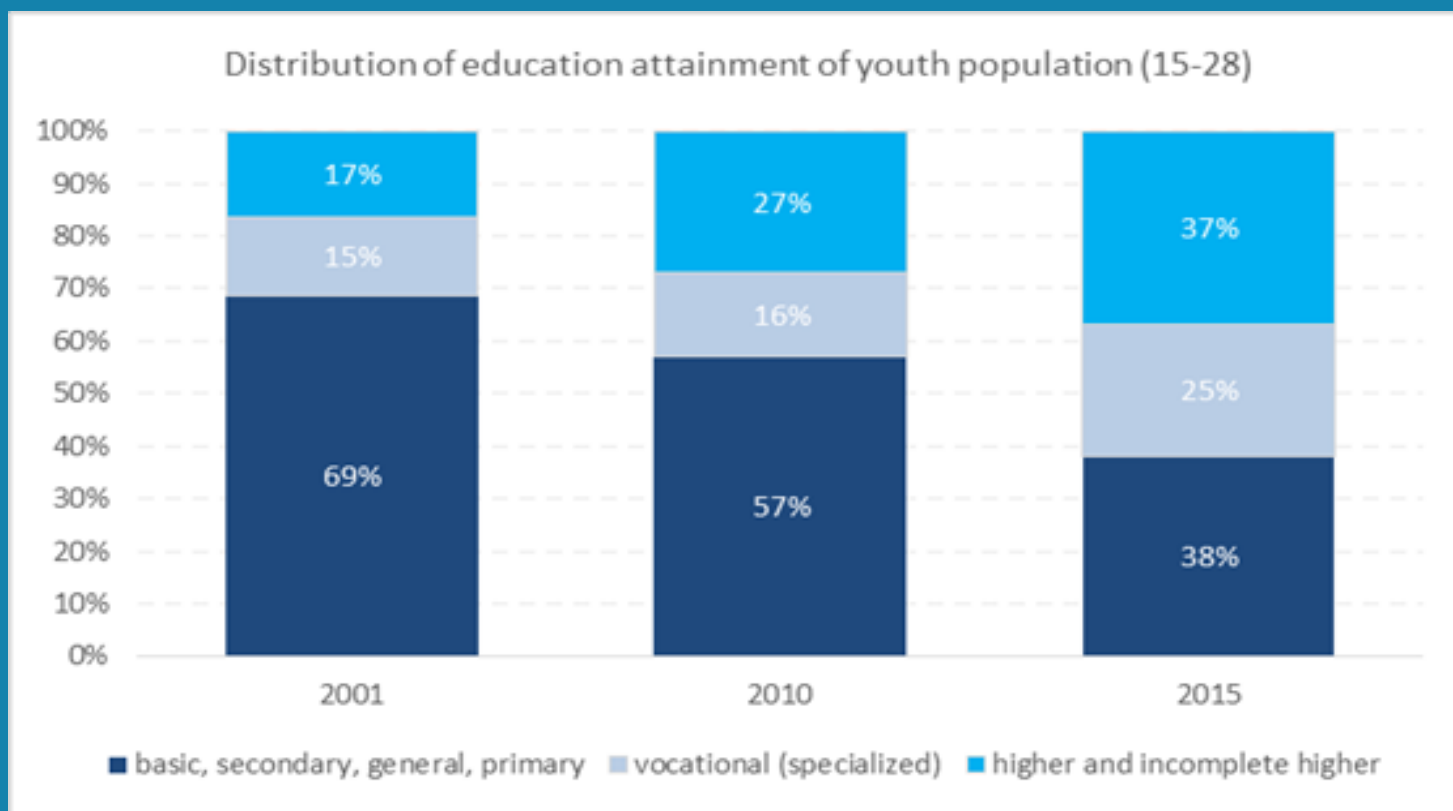


Self employed by level of educational attainment (2015)



Despite overall progress made on education

Distribution of educational attainment of youth population (15-28)

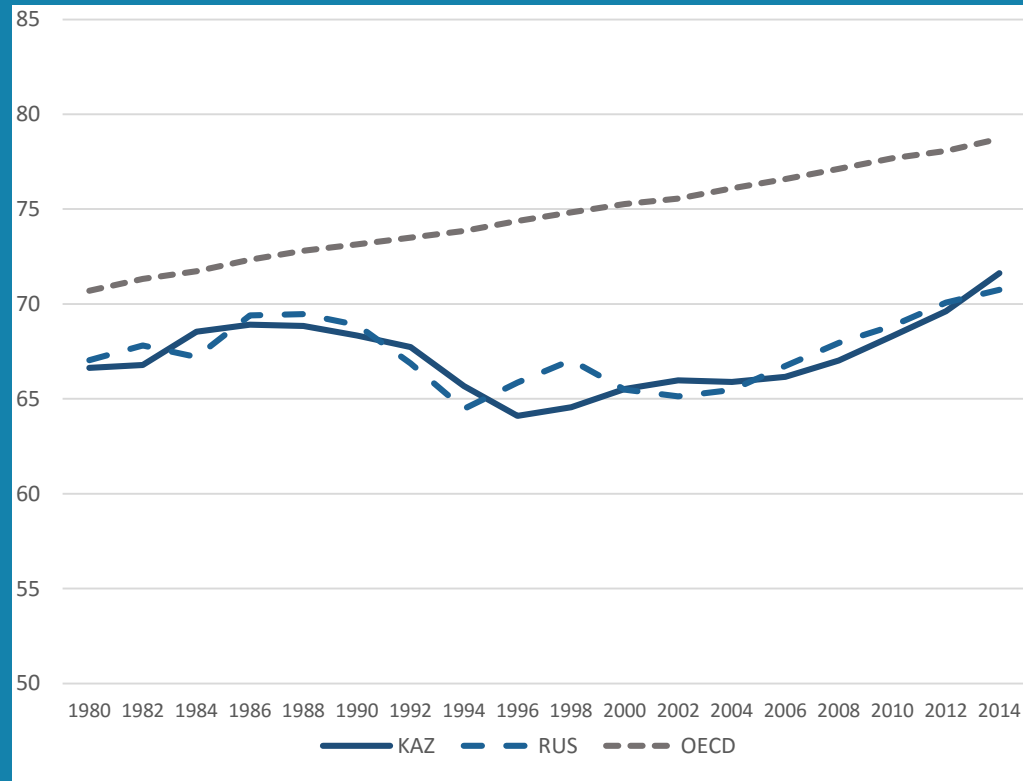


Evolution of Kazakhstan's PISA performance

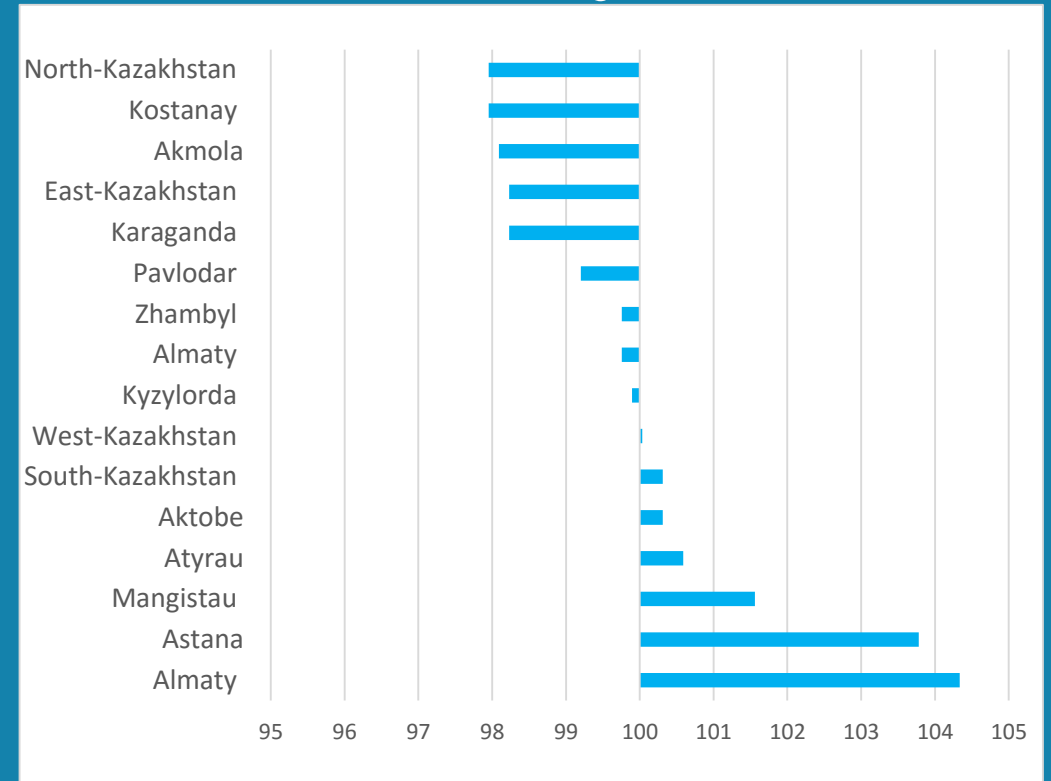


Health outcomes are lagging behind economic achievements

Life expectancy at birth 1980-2014

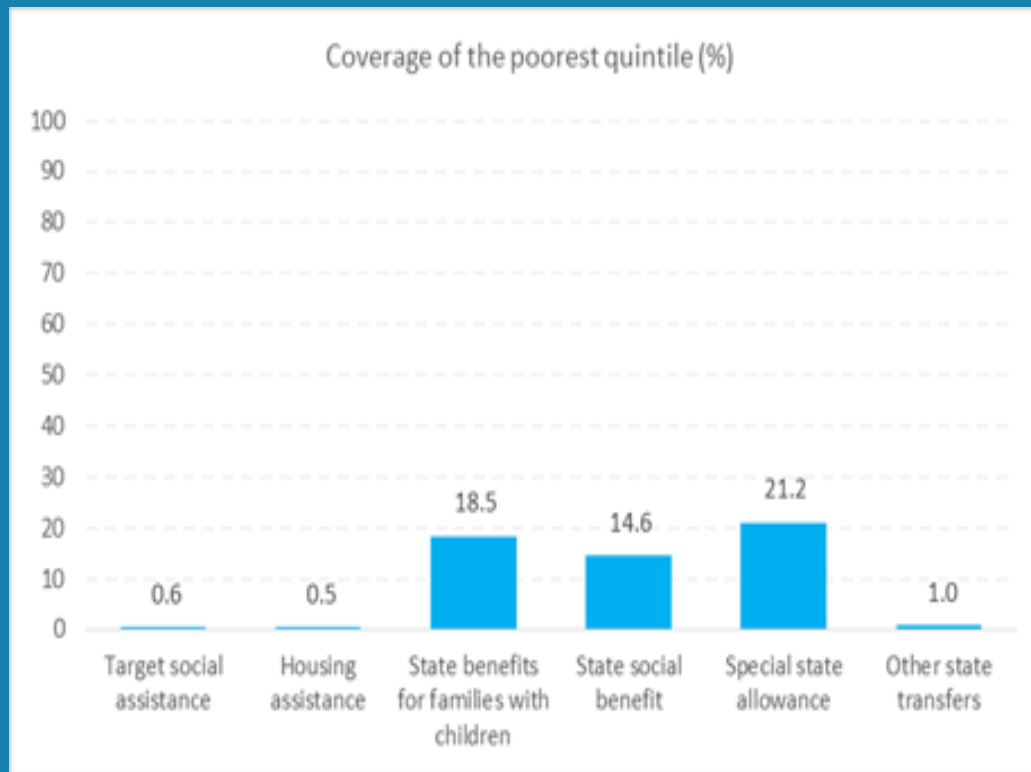


Life expectancy at birth – index to national average 2015



Current social protection systems do not promote labor market participation and mobility

Very limited support for the poor, and no conditionality



- Orleu reforms have potential for significant potential to improve outcomes for poor families while also promoting activation (CONDITIONAL CASH TRANSFER)
- Meager unemployment benefits (particularly for the self-employed) limits the potential for the self-employed to transition into formal employment and for existing workers to transition into new jobs, particularly when gaps in employment are required for re-training and relocation

Main challenges

ECONOMIC MANAGERMENTS FOR DIVERSIFICATION

- Credible non-oil deficit reduction strategy (incl non-oil revenue)
- Management of contingent liabilities (SOEs and banking)
- Service delivery
- NBK independence

PRIVATE SECTOR DEVELOPMENT

- Financial sector development
- Vibrant competition in economy
- Privatization of companies but with sector/industry vision
- Market approaches to supporting private sector
- Solve SME issues
- Procurement

TOP 30 GLOBAL
ECONOMY
WITH A LARGE,
SECURE MIDDLE
CLASS

*[Its about
strengthening
institutions]*

INTEGRATION AND CONNECTIVITY

- Reducing regional disparities in social service provision
- Supporting agglomeration and mobility
- Connecting to global economic powerhouses (including OBOR)
- Soft infrastructure

COMPETITIVE AND ADAPTIVE HUMAN CAPITAL

- Improving equity and quality of education and better linking education and training to employer needs
- Improving health outcomes
- Mobility-promoting social assistance programs

THANK YOU FOR YOUR ATTENTION