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

WORLD BANK GROUP
Systematic Country Diagnostics
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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?

The chart shows the GDP growth in percent from 1997 to 2018. Over the years, the GDP growth has fluctuated significantly. Notably, there was a period from 2000 to 2005 where the GDP growth was consistently above 10%, peaking at 13.5% in 2001. This period is labeled as "increased oil production and rising oil prices." Following this peak, the growth rate declined sharply, with a significant drop in 2008, reaching a low of -2% in 2009. Since then, the growth rate has been consistently lower than previous years, with an average of 5.9% from 2009 to 2018.

The forecast indicates a projected growth of 2.4% and 2.6% in 2017 and 2018, respectively. The chart also highlights the 5-year moving average, which shows the trend of GDP growth over the past five years, indicating a decline in growth rate.
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

- Public Services (Establishments)
- Private & SOE Corporates
- Indiv Entrepreneurs, Self Empl. & Informals

- Sector employment growth 2009-15
  - Total (TOT): 5.4
  - Industry (East): 4.2
  - Agriculture (South): 3.3
  - Agriculture (North): 3.1
  - Oil (West): 1.4
  - Trade (West, South): 2.4

- 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?

- 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 ✓
- Financial market development ❌
- Macroeconomic policy ❌
- Institutions ~

Are the gains enough for the next growth phase?
Kazakhstan’s income was inflated

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

Real GDP (constant 2000 prices)
Non-oil GDP dollar price effect
Oil GDP dollar price effect

High external borrowing, following rising oil production and rising oil prices
High non-oil deficits following oil prices
...in large part due to foreign currency 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

Without new NFRK concept

What's the implementation plan?

Percent of non-oil GDP
Problems with corruption persist

Corruption experience in transition economies

Things to look at

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

Businesses
- SOE procurement
- GOK procurement
- Licenses
- Inspections

Source: Life In Transition Survey III (2016)
PATHWAY #2
PRIVATE SECTOR
DEVELOPMENT
Non-tradable sector growth

GDP growth

- Trade
- Other services
- Transport
- Real estate
- Construction
- Agriculture
- Utilities
- Manufacturing
- Oil sector
- Financial
- Other mining
- OIL SECTORS
- NON-OIL ECONY
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.
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).

Note: Share of GDP from SOEs, in total and by sector is not available.
Source: Statcom and World Bank estimates.
Enterprise reforms stalled in mid-1990s

EBRD Transition Index: Kazakhstan (1989-2014)

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

Source: EBRD (2017)

Note
Industrial polices 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

SME share of GDP and employment

Source: World Bank SME Competitiveness Project (Project Appraisal Document)
Efficiency of investment is declining

GDP growth and investment rate

Graph showing trends in GDP growth and investment rate from 2003 to 2016.
PATHWAY #3

TRADE, CONNECTIVITY AND INTEGRATION
What’s the big picture?

Merchandise export growth
There are many opportunities to be captured

- Wheat
- Livestock
- Trade and logistics

**IFC diagnostic**
- Agriculture and food processing

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

<table>
<thead>
<tr>
<th>Level of Educational Attainment</th>
<th>Wage Employees</th>
<th>Urban Self-employed</th>
<th>Rural Self-employed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic</td>
<td>25%</td>
<td>29%</td>
<td>63%</td>
</tr>
<tr>
<td>Specialized Vocational</td>
<td>35%</td>
<td>34%</td>
<td>27%</td>
</tr>
<tr>
<td>Higher</td>
<td>40%</td>
<td>36%</td>
<td>10%</td>
</tr>
</tbody>
</table>

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

North-Kazakhstan
Kostanay
Akmola
East-Kazakhstan
Karaganda
Pavlodar
Zhambyl
Almaty
Kyzylorda
West-Kazakhstan
South-Kazakhstan
Aktobe
Atyrau
Mangistau
Astana
Almaty
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 MANAGEMENTS 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

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

TOP 30 GLOBAL ECONOMY WITH A LARGE, SECURE MIDDLE CLASS

[It's about strengthening institutions]
THANK YOU FOR YOUR ATTENTION