

# ECONOMIC DIVERSIFICATION ISSUES IN OIL-EXPORTING COUNTRIES. CASE OF THE REPUBLIC OF KAZAKHSTAN

## GAZDASÁGI DIVERZIFIKÁCIÓS KÉRDÉSEK OLAJ-EXPORTÁLÓ ORSZÁGOKBAN. A KAZAH KÖZTÁRSASÁG

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### **Abstract**

This paper addresses diversification efforts of several major oil exporting countries including the Republic of Kazakhstan and attempts to analyse what are the reasons preventing economic diversification in oil-exporting countries in general and in Kazakhstan in particular. Nowadays, it is widely accepted that commodity-based economic models and policies make countries vulnerable to commodity price fluctuations and result in weaker growth in the longer term. However, practical implementation of economic diversification measures in different countries brought to light a lot of problems, which need to be addressed and solved properly. In fact most of government economic diversification problems in most of oil exporting counties failed. The author of this document does not share wide-spread optimism about economic diversification measures in the existing economic model of Kazakhstan. He is of the view that before undertaking any further step towards economic diversification, it is important to understand the reasons, which resulted in the failures of all previous economic diversification programs. Otherwise, new economic diversification measures can become just another dissipation of limited financial resources. This paper is an attempt to address this important topic.

The paper finishes with a set of measures, which can be recommended to the Kazakh government to make the Kazakh economy more sustainable to future impacts of resource price fluctuations.

**Keywords:** economic diversification, oil exporting countries, Kazakhstan

### **1. Introduction and research question**

The review of the current situation with diversification efforts in different resource-dependent countries shows their little success. In the periods of high oil prices, diversification does not seem urgent and important, so difficult structural reforms are often postponed. When oil prices go down it usually appears that time and financial resources required have been wasted. It is interesting that though the need to diversify economies away from dependence on natural resources is widely acknowledged, these countries keep making the same mistake for decades. This is especially true when their oil production horizon is still long.

So, diversification usually follows a difficult path. Examples given in this document serve good illustrations to this statement. The reasons for failures of economic diversification policies are deep-rooted and should be properly studied. To achieve this goal, this paper attempts to look at economic diversification efforts in oil-exporting countries in general and in Kazakhstan in particular.

The paper suggests that economic diversification should not be considered as the one and only solution. So, the research question is whether having so many examples of economic diversification failures there is a need to consider economic diversification as a single solution for overcoming consequences of oil price fluctuations and achieving long-term economic sustainability.

The paper finishes with a set of measures, which can be recommended to the Kazakh government to make the Kazakh economy more sustainable to future impacts of resource price fluctuations.

## 2. Literature review

Studying what have been done in this area by other authors, we see that there are plenty of examples giving additional confirmations to the fact that in spite of numerous appeals, economic diversification efforts in different countries usually fail.

For example, the famous writer and politician Pietri (1936) appealed for diversifying the Venezuelan economy using oil revenues in his famous article “To Sow the Oil” published back in 1936.

Hvidt (2013: 16. p.) notes that “over the last five decades, the GCC<sup>1</sup> states have taken a number of important steps on the route to diversifying their economies away from dependence on oil and gas... Data shows, however, that the countries remain in a position where the oil sector continues to dominate the economy, and that few of the industries and services established would survive in a post-oil era... Viewed in this manner, the diversification strategy has largely failed.”

This opinion is shared widely. Adelaja (2016) notes that “For more than a decade, Russia has been attempting to diversify, innovate and modernize its economy, but its efforts thus far have failed to come to fruition.”

“Nigeria’s over dependency on oil has contributed to the poor management of human capital/resources which has led to the migration of many talented citizens of the country to other countries in search of better life. Furthermore, the data show that the neglect of agriculture has, in addition, led to the constant depreciation in GDP of the country” points out Uzonwanne (Uzonwanne, 2015).

Bhaskaran (2007: 1. p.) admits that “Brunei Darussalam has explicitly stated economic diversification as a major policy objective at least since the Third National Development Plan (covering 1975-1979) although references to the need for economic diversification go back as far as the Second National Development Plan (1962-1966). As part of the planning and conceptualization process for the various efforts at diversification, many studies have been commissioned, all of which have been well formulated with specific projects and recommendations. Yet... these efforts do not seem to have produced the desired results...”

Tombe & Mansell (2016: 1.p.) also address this important topic “But does diversification even matter? Economists, for centuries, have found gains from specializing in areas where we have a comparative advantage. Subsidizing certain selected industries therefore risks causing economic damage by distorting activity and displacing workers and investment from more valuable uses. Policy-makers should therefore focus on neutral policies: create a favorable investment climate, facilitate adjustment and re-training, encourage savings (including by government), and so on.”

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<sup>1</sup> GCC - Gulf Cooperation Council. Its member states are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

### 3. Methods used

The research was conducted on the basis of a literature review, analysis of economic data and meetings with government employees and businessmen. Empirical and comparative approaches were employed in this document to analyze the reasons limiting success of diversification efforts in different countries and what lessons to be learned by the government of Kazakhstan in order to achieve real economic diversification. Data sources include: OPEC, World Bank, BP Statistical Review of World Energy, UNCTAD, UAE Embassy to the USA, Bruegel.org.

### 4. Experience of economic diversification efforts in selected oil-exporting countries

Diversification efforts in oil-exporting countries considered on the basis of the list of major oil producers.

**Table 1: 15 countries that exported the highest dollar value worth of crude oil in 2016**

No	Country	Oil Export, US\$ bn	% of total crude oil exports	Fuel exports (% of merchandise exports), 2015	Concentration Index*	Diversification Index**
1	2	3	4	5	6	7
1.	Saudi Arabia	133.3	17	78.4	0.529	0.757
2.	Russia	86.2	11	63	0.316	0.644
3.	Iraq	52.2	6.6	99.97	0.972	0.914
4.	United Arab Emirates	51.2	6.5	42.5 (2014)	0.243	0.485
5.	Canada	50.2	6.4	21.32	0.140	0.377
6.	Nigeria	38	4.8	91 (2014)	0.717	0.830
7.	Kuwait	34.1	4.3	89	0.598	0.787
8.	Angola	32.6	4.1	95	0.934	0.895
9.	Venezuela	27.8	3.5	97.69 (2013)	0.748	0.847
10.	Kazakhstan	26.2	3.3	68	0.658	0.793
11.	Norway	25.7	3.3	57.7	0.334	0.637
12.	Iran	20.5	2.6	70.48 (2011)	0.455	0.735
13.	Mexico	18.8	2.4	6.08	0.122	0.414
14.	Oman	17.4	2.2	62	0.447	0.716
15.	United Kingdom	16	2	7.66	0.112	0.342

\* Concentration index, also named Herfindahl-Hirschmann Index (Product HHI), is a measure of the degree of product concentration. An index value closer to 1 indicates a country's exports or imports are highly concentrated on a few products. On the contrary, values closer to 0 reflect exports or imports more homogeneously distributed among a series of products.

\*\* Diversification index is computed by measuring the absolute deviation of the trade structure of a country from world structure. The diversification index takes values between 0 and 1. A value closer to 1 indicates greater divergence from the world pattern. This index is a modified Finger-Kreinin measure of similarity in trade.

The countries listed above can be divided into the following main groups. Kazakhstan is considered separately further below. Examples are provided to illustrate each group's performance.

Sources: OPEC, World Bank, BP Statistical Review of World Energy, UNCTAD<sup>2</sup>

<sup>2</sup> <http://unctadstat.unctad.org/wds/TableViewer/tableView.aspx?ReportId=120>

*Group 1.: Countries heavily dependent on oil production with weakly diversified economies*

This group includes such countries as Saudi Arabia, Kuwait, Oman and Abu-Dhabi emirate of the United Arab Emirates.

Nota bene: At first glance it looks obvious not to consider Abu-Dhabi and Dubai separately as they are parts of the same country – the United Arab Emirates. However, the two emirates have very contrasting roles in the international system. As per the information of the UAE Trade and Commercial Office “Abu Dhabi holds 94% of the UAE's oil reserves, or about 92.2 billion barrels.”<sup>3</sup> So, as Davidson advises (2007: 38. p.) “the emirate (Abu-Dhabi) attempts to channel a large proportion of its surplus oil wealth into building a substantial buffer of overseas interest payments that can be called upon to stabilize the domestic economy should there be future oil price slumps or other such periods of austerity.” In contrast, as advised by the same author “By the mid-1990s Dubai’s non-oil sectors were already contributing 82 percent of the emirate’s GDP, but most remarkably (as the real estate and tourism strategies began to kick in) since then the non-oil share of GDP has increased to over 94 percent.”

Oil remains and in the foreseeable future will remain the basis of their economies, but these countries put some efforts into diversification. The results, however, are still very far from desired. Hvidt (2013) wrote that “Data shows, however, that the countries remain in a position where the oil sector continues to dominate the economy, and that few of the industries and services established would survive in a post-oil era. So the GCC<sup>4</sup> states continue to be in the situation where they sell their hydrocarbons on the world market and use the proceeds to import almost all of their living requirements and large parts of their labour force. Viewed in this manner, the diversification strategy has largely failed.” The same author also advised that “Kuwait has done little to diversify its economy over the years.” Albassam (2015: 116-117.p.) points out that “The Saudi government has issued 10 development plans since 1970, each covering five years, and economic diversification is a main objective of all these plans.” He then points out “that, after more than 40 years of development plans aiming to diversify the Saudi economy, oil is still the main engine driving the economy”. Describing economic diversification efforts in Oman Asra Mubeen et al (2017: 11.p.) also conclude that “In spite of all these efforts, diversification of the economy remains in its nascent stage and the economic dependence on oil has not come down amidst low oil prices. Diversification in Oman has not achieved its expected results”.

It is worth pointing out that “...Abu Dhabi alone commands nearly 7 per cent of the world’s proven oil resources. As such Abu Dhabi is by far the wealthiest emirate, and sponsors development in the other emirates through its contributions to the budget of the Federation and through large off-budget payments to the other rulers...” (Hvidt, 2013).

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<sup>3</sup> As per the information of the UAE Embassy to the USA “Abu Dhabi holds 94% of the UAE's oil reserves, or about 92.2 billion barrels.” <http://www.uaetrade-usa.org/index.php?page=economic-sectors-in-uae&cmsid=48>

<sup>4</sup> Gulf Cooperation Council (GCC) states include Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.

*Group 2.: Countries excluded from consideration*

This group includes two different sub-groups:

*Subgroup 2 A: Countries with already developed diversified economies.*

This group includes Canada, Norway, the United Kingdom and with certain reservations Mexico. Due to the obvious reason, the author excluded these countries from consideration. One can consider Norway as not fitting this group. However, it is included because of its overall economic performance.

*Subgroup 2 B: Countries excluded because of extremely difficult economic and political situation.*

The author intentionally omitted Iraq as its economy was severely affected by recent wars and internal clashes and riots. Venezuela was also excluded as the country "where oil still remains the country's main and almost only export product – is going through likely the worst economic crisis in its modern history, partly triggered by a sharp drop in world oil prices preceded by over a decade of market-unfriendly policies" (Bahar, 2016). Smaller oil-exporting countries have been omitted for the sake of brevity.

*Group 3.: Countries with very limited progress in economic diversification.*

This group includes Nigeria and Angola, which show quite similar performance in economic diversification.

Countries of this group perform poorly in terms of diversification. In spite of widely declared need to diversify the economy, the countries continue to depend heavily on petroleum revenues. Onodugo et al (2015) point out that in 2015 petroleum export was more than 92% of Nigeria's export revenue and created more than 80% of the government's budget. Angola performs similarly. Golub & Prasad (2016: 3.p.) note that "Angola's economy revolves around oil and to a lesser extent diamonds, making it the second most concentrated in the world. Until the recent decline, oil and gas accounted for about 45% of GDP, 96-98 % of exports and 75% of government revenue... Diamonds provide another 5% of GDP and 1-2% of exports. Manufacturing and agriculture account for only about 5%-7% of GDP each, despite the fact that some 70% of the population is employed in agriculture."

The need to diversify national economies of this Group with a view to widen the sources of revenue and decrease dependency on the crude-oil sector has been reiterated by international financial organizations several times. Urgent and well-designed measures are required to improve the situation.

*Group 4: Countries with relatively diversified economies implementing major diversification programs.*

This group combines very different countries (Russia, Dubai emirate of the UAE and Iran), which put a lot of efforts in diversifying their economies.

In spite of numerous failures, this group is of the most interest for the purpose of this article as these countries manage to achieve at least partial progress in economic diversification. Because of this reason the group is considered in more details.

It is worth pointing out that two countries of this group namely Russia and Iran have relatively diversified economies and are to great extent independent of imports. However, their exports are not very diversified and this shows the missing competitive power of their economies. Also these two countries possess quite sizeable populations with Russia having more than 144 million citizens and Iran more than 80 million forming sizeable internal markets.

Appeals to diversify the Russian economy have been heard since the 90ths, but the country continues to rely largely on a commodity-based growth model. Numerous efforts to diversify the Russian economy and government's heavy investments in the promotion of high-tech industries produced very limited results. As stated by EBRD (2012: 11. p.) "despite significant state-led efforts since the mid-2000s, the Russian economy has not diversified". Moreover, the share of fuel exports in merchandise exports was constantly growing from 1998 to 2013. The decline of this share after 2013 can be attributed to the sharp decline in oil prices as physical volumes of fuel exports have been growing.

In 2014 the Russian government introduced import-substitution schemes to counteract the effects of Western sanctions. It is not clear yet whether these measures will yield substantial results. However, one example is already visible - weaker ruble and low energy prices assisted in the country's move towards retaking leadership in the world wheat trade. The U.S. Department of Agriculture forecasts Russia to become the biggest wheat exporter in 2016-17. Though sounding impressively, this has not helped much in reducing the share of fuel exports because of the initial large difference in export revenues.

Since the UAE was formed in 1971, the diversification of the economy away from petroleum has been a clearly stated government policy. According to the World Bank data (column 5), in 2014 the share of fuel exports in merchandise exports was equal to 42.5%. This figure is more typical for countries with diversified economies and the UAE is praised as having the most diversified economy in the GCC. However, this is mostly true for Dubai. Other emirates continue depending on oil revenues. In this regard, it is worth pointing out that Dubai's economy was severely affected by the world economic crisis, which began in 2008. In 2009 Dubai, which is often considered as a model of successful diversification, was on the brink of default and was saved by Abu Dhabi, which provided a generous financial support. Davidson (2007: 43.p.) also informed that "Abu Dhabi seeks to bolster its very different neighbour. One such link is Abu Dhabi's daily donation of 100,000 barrels of oil to Dubai. At current prices, this 'gift' represents more than \$650 million a year. Similar generosity was shown in the winter of 2001 and through much of 2002 when Abu Dhabi purportedly bailed out the Jumeirah International Hotel chain when its Dubai-based hotels (including the landmark seven star Burj al-Arab) were suffering close to zero occupancy rates following the September 2001 attacks." This means that Dubai's economic model is less sustainable even in comparison with most of the other less diversified countries.

World Bank's data on the share of fuel exports for the UAE (column 5) are fragmentary. However, even though one can see that this share decreased from 65.345% in 2007 to 42.496% in 2014, WTO (2016: 67.p.) is of the view that "the UAE remains highly dependent on oil, which represents approximately 75% of total government revenues".

The performance of Dubai's economy in 2008-2009 gave a warning alert that economic diversification, whose ultimate goal is to make economies sustainable to oil price fluctuations does not necessarily provide the desired results. Because of the unsustainability of the Dubai model of economic diversification and the high dependence of other emirates on oil revenues, the author abstains from including the UAE to the group of well-developed diversified economies.

Sanctions imposed on Iran for its nuclear enrichment program decreased its oil exports substantially, but may have helped the country to cope with the commodities slump by forcing it to diversify its economy. Clawson (2013) notes that "For years, Iran's leaders called for reduced reliance on oil but did little to meet that goal. Western sanctions have seemingly spurred them to action..."

The World Bank states that “The slump in oil prices has hurt the Iranian economy but by less than other oil producers in the region. The reason is that compared to other oil producers, the Iranian economy is more diversified and therefore less dependent on oil revenues. Oil accounts for about 30 % of government revenues.”<sup>5</sup> This opinion is shared by Aasim Husain, Deputy Director of Middle East and Central Asia at the International Monetary Fund “Many of Iran’s neighbors are even more dependent on oil ... It is much more diversified than others in the region” (Barnato, 2016).

Another imposition of sanctions on Iran by the Trump administration in February 2017 can again negatively affect the country’s economic performance, but economic diversification remains to be a good mitigation measure.

Thus, keeping the political environment aside, Iran can be considered as a successful example of diversification.

Summarizing the above, it is possible to conclude that economic diversification efforts in most of oil exporting countries produced very limited (if any) results. Existing examples of successful diversification are either not sustainable like Dubai or fueled by mainly political reasons.

## **5. Economic diversification efforts in the Republic of Kazakhstan**

Non-extractive industries in Kazakhstan<sup>6</sup> are not only small, but have been shrinking over the last years. For instance, according to the information of the National Bank of Kazakhstan (2016: 24.p.) “the share of oil and gas industry in total GDP increased from 10.9% in 2001 to 25.2% in 2012, making the oil and gas industry one of the main drivers of GDP growth, and one that plays a vital role in Kazakhstan’s GDP structure.” The same source mentions that “soaring prices of oil, minerals, and other commodities have helped lifted GDP of Kazakhstan since 2000.” By the beginning of 2016 this share decreased again to about 20% of GDP, but this happened because of the decrease of world prices on these commodities.

Similarly, according to the World Bank’s data, the share of fuel exports in merchandise exports grew from 66.552% in 2007 to 76.627 in 2014 (except a small decline in 2012). In 2015 this share went down to 68.018%, but this again happened because of the decrease of world prices on these commodities.

Concentration and diversification indexes of Kazakhstan given in Table 1 above also typical of a non-diversified country: 0.658 and 0.793 respectively.

The situation is further complicated by the fact that price cycles of Kazakhstan’s main export commodities are very similar.

This means basically the following:

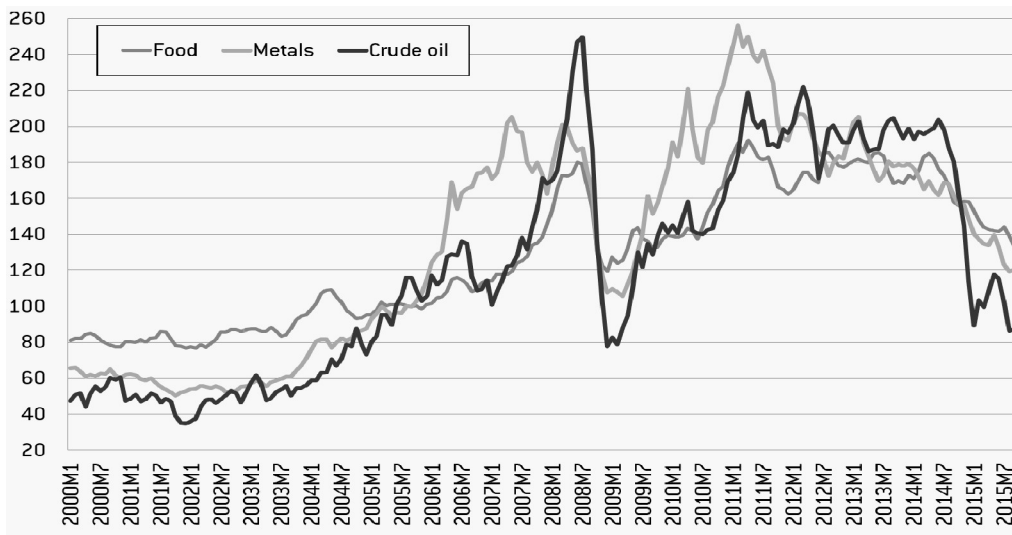
- Attempts to diversify away from oil into other major Kazakhstan’s export commodities like metals and grain cannot yield desired results;
- Kazakhstan should look for other areas for its diversification efforts. This is developed further below;
- In any case, over-reliance on extractive industries provokes macroeconomic cyclical economic instability.

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<sup>5</sup> World Bank’s publication on Iran’s Economic Outlook - July 2016 “How is Iran Reacting to Low Oil Prices?” <http://www.worldbank.org/en/country/iran/publication/economic-brief-july-2016>

<sup>6</sup> In addition to the oil and gas production, there is a well-developed mining industry in Kazakhstan.

**Figure 1: Commodity price indices, 2000-2015 (2005 = 100)**



Source: <http://bruegel.org/>

Practically all the previous efforts of the Kazakh government to diversify the economy failed. A summary of the Kazakh government diversification efforts is given below.

In Kazakhstan the government has developed and is implementing the following:

1) The state infrastructure development program “Nurly Zhol” for 2015–2019. The goal of this program is the development of infrastructure to ensure long-term economic growth in Kazakhstan as well as the implementation of anti-crisis measures to support specific sectors of the economy in a situation of deterioration in the external markets. The key objectives of the program are the development of transport and logistics, industrial, tourism, energy, housing and communal services and education infrastructure development, improving the competitiveness of SMEs and agribusiness entities, support to domestic mechanical engineering, export promotion, ensuring product quality through the development of laboratory bases, etc. In short, this program is aimed at the comprehensive economic recovery of the country.

2) The Nationwide Anti-Crisis Plan of Measures and Anti-Crisis Action Plan of the Government and the National (Central) Bank to Ensure Economic and Social Stability in 2016-2018 (this is one document). It consists of 2 main parts: economic reforms to create a new structure of the Kazakh economy and prompt actions to stimulate growth and lending to the economy. This is the rolling plan, which will be adjusted in subsequent years.

3) The State Program of Industrial-Innovative Development of the Republic of Kazakhstan for 2015-2019. The State Program of Industrial-Innovative Development of Kazakhstan for 2015-2019 was developed in accordance with the long-term priorities of the “Kazakhstan-2050” Strategy and in order to implement the key objectives of “Accelerating economic diversification” section of the Strategic Development Plan of the Republic of Kazakhstan till 2020. The program is a logical continuation of the State Program for Accelerated Industrial-Innovative Development of Kazakhstan for 2010 - 2014 and takes into account the experience of its implementation. The program is a part of the Industrial Policy of Kazakhstan and is focused on the development of the manufacturing industry with a concentration of efforts and resources on a limited number of sectors, regional specialization using the cluster approach, and effective sector regulation.



The number of anti-crisis documents adopted by the Government is not limited to the ones mentioned above. In fact, the Government has been declaring the diversification of national economy as its first priority for many years. It was adopting and implementing numerous economic diversification programs and plans. For instance, the national Strategy of Industrial-Innovative Development of Kazakhstan for 2003-2015 (not to mention other documents) was adopted back in 2003. It was said that this Strategy will pave a way for economic diversification.

However, the result from implementation of all these documents is far from desired. As mentioned earlier, the share of oil and gas industry in total Kazakh GDP increased from 10.9% in 2001 to 25.2% in 2012. Thus, during the period of high oil prices, Kazakhstan's raw material orientation of the economy did not decrease. *A contrario*, its dependence on extractive industries in general and the oil industry in particular intensified.

Another big question is the efficiency of investments in economic diversification. No data on return of such investments in Kazakhstan could be found.

The current oil crisis calls for a need to look at the situation from another angle and understand why all previous efforts to diversify the economy failed.

## **6. Possible reasons for economic diversification failures in Kazakhstan**

Having looked at what happened to diversification efforts in different countries, we can now try to understand what the reasons behind failures of so many diversification efforts are.

The main, but not the only reason for shrinking non-extractive industries is that they are usually less profitable. We should acknowledge that extractive and especially the oil industry will remain more profitable in the foreseeable future.

Diversification on the surface appears to be an appealing business strategy. Economic literature is full of explanations why economic diversification is so important. It is usually stated that diversification is required to mitigate the effects of resource price fluctuations and symptoms of Dutch disease. Numerous efforts have been made to communicate to the governments of resource-dependent countries the need to diversify their economies. However, the results of diversification efforts in most of these countries remain to be very limited and are often dictated by non-economic reasons.

Based on literature review and meetings with Kazakh government employees and businessmen, the following main reasons of economic diversification failures have been identified:

- Lower profitability of non-extractive industries in Kazakhstan. The reasons of lower profitability include strong competition from Chinese and Russian producers, insufficient size of the local market, insufficient number of qualified technical personnel and able professional managers, etc.

They are even more profitable in Kazakhstan where geological investigations, which usually constitute a lion's share of these companies' expenses, were mostly done during the Soviet period.

- Insufficient readiness for the change among government employees of different levels. This is caused by the fact that diversification is a very long term issue, which limits the readiness for change and for having economic and social disadvantages in the short time.
- Lack of enabling environment. There is no determination on the government's side to implement structural reforms, without which diversification is not possible. The

country needs to go away from the current model of state capitalism. However, this move is intentionally restrained. The government is trying to substitute reforms by financial injections.

- External economic shocks, namely the economic crisis in Russia (the economic crisis in Russia depreciated the Russian rouble over international currencies and made Russian goods much more competitive).
- Inappropriate government interventions into the banking sector, which resulted in the serious banking crisis.
- Economic diversification is impossible without political reforms and decentralization of power.
- Being a small country in terms of its population – just 17 million, Kazakhstan has a very small internal market. The market size is a serious obstacle for the development of non-extractive industries.
- Insufficient attractiveness of non-extractive industries for foreign investments, which have been so far mostly limited to communication, pharmaceutical and food sectors.
- Insufficient number of qualified technical personnel and able professional managers.
- Local producers face harsh competition from Chinese ones. It is obvious that in most cases Kazakh producers cannot compete.
- Political uncertainty both internal and external is another serious concern for local and foreign businessmen and banks forcing them to abstain from long-term investments and often prefer to withdraw funds abroad.
- Government investment programs are largely poorly prepared and unsuccessful.

As mentioned by Adillov (2016) “The ultimate goal of the first phase of the program (State Program for Accelerated Industrial-Innovative Development of Kazakhstan for 2010 – 2014) is to ensure diversification of the economy, the reduction of volumes, the increase in budget revenues, supplying the domestic market with quality domestic products,” – pointed out Kazakh parliament member Gulzhana Karagusova and stated: “Unfortunately, we must admit that for five years, none of these problems have been solved.” The amount spent on the program exceeded US\$28.5 billion.

Pavlova (2014) mentions that “in Norway every US\$10 spent on diversification provides just US\$5 of return”. Obviously in less developed countries the return would be even smaller. Employee of the Kazakh Ministry for Investments and Development pointed out that the Ministry has undertaken an internal assessment of diversification programs by a profitability index. Its results are confidential, but the employee suggested that the results of Norway’s economic diversification efforts were much better.

### **Measures recommended for the Government of Kazakhstan**

- A thorough audit of existing legislation, regulations, practices of government agencies and law enforcement that affect business activities with the aim to reduce legal and regulatory barriers to business.
- Based on this audit, structural reforms similar to those implemented in Georgia after the “Rose Revolution” of 2003 to be implemented. The ultimate goal of these reforms must become the creation of business enabling environment in the country. Reforms should include decreasing tax burden on small and medium businesses, eliminating most of licensing requirements, substantial decrease of different government inspections and obligatory reporting.

- Keeping in mind that since the 2008 financial crisis public finances deteriorated seriously, private businesses have to become a major driver of economic diversification. This is to be acknowledged and declared a national priority.
- Promotion of greater regional and international economic and trade integration. Further promotion of export of Kazakh goods through government-supported export credit guarantee schemes.
- Liberalization of the country's financial sector through lifting legal and regulatory barriers for foreign financial institutions with the aim to enhance access to credit, especially for small and medium enterprises.
- Serious efforts to attract foreign investors to be undertaken. However, it should be acknowledged that most likely these efforts will yield results in medium and long term.
- A thorough audit of projects implemented under different government economic diversification programs. Preparation of further diversification programs to be strictly based on the lessons learned from this audit.
- The government needs to be more careful in its spending limiting the number of possible areas for investments. Currently, the government is implementing several investment programs to support private sector projects in different sectors. Instead of dissipation of limited financial resources, it is suggested to select areas where Kazakh products and/or services can be competitive. At the moment, transportation services, agriculture, food and pharmaceutical industries look more attractive.
- Enhancing vertical diversification in existing sectors by focusing on moving into higher value-added products in extractive industries.
- If a number of attractive domestic projects is limited, the country can diversify into attractive foreign projects.
- Implementation of different workforce education and vocational training programs, orienting education and vocational training towards skills needed by the private sector.

Transferring the National Fund of Kazakhstan under the management of Norwegian Government Pension Fund Global.

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