Kazakhstan’s Competitiveness:
Roadmap Towards a Diversified Economy

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This presentation draws on ideas from Professor Porter’s books and articles, in particular, “Building the Microeconomic Foundations of Prosperity,” in The Global Competitiveness Report 2004-05 (World Economic Forum, 2004); “Clusters and the New Competitive Agenda for Companies and Governments,” in On Competition (Harvard Business School Press, 1998); and an ongoing project with CMAR and JE Austin on the Kazakh economy. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means—electronic, mechanical, photocopying, recording, or otherwise—without the permission of Michael E. Porter.

Additional information may be found at the website of the Institute for Strategy and Competitiveness, www.isc.hbs.edu
Kazakhstan’s Potential

- Abundant natural resources
- Capital
- Stability
- Outward-looking
- Determined leadership
- Role in its broader region
Kazakhstan’s Economy in 2005

- Impressive **GDP growth** since the Russian crisis in 1998, driving substantial increases in average prosperity
- Increasing dominance of the **oil & gas sector** in the economy with significant potential for further growth
- Pressure building up from real exchange rate appreciation
- **Overheating** of domestic real estate and asset prices
- Significant **government efforts** to overcome the challenges of a resource-driven economy and diversify the economic base

- Identifying the key elements of a long-term **competitiveness strategy** for Kazakhstan is a critical priority for the country
Recent Government Initiatives on Economic Policy

National Development Strategy (May 2004)

1. Preventing loss of competitiveness through appropriate **macro and fiscal management**
2. Enhancing competitiveness and private business by building a **supportive role of the state**
3. Building a foundation for competitiveness through **strengthening human resources and infrastructure**
4. Ensuring sustainable growth through a focus on the **environment**

<table>
<thead>
<tr>
<th>Selected new agencies</th>
<th>Selected new projects and initiatives</th>
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</thead>
<tbody>
<tr>
<td>• Centre for Marketing and Analytical Research (CMAR)</td>
<td>• Industrial Innovation program 2015</td>
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<td>• Centre for Engineering and Technology Transfer</td>
<td>• CMAR Cluster Project</td>
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<td>• Development Bank of Kazakhstan</td>
<td>• Almaty as a Regional Financial Center</td>
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<td>• Export Insurance Corp</td>
<td>• Kazakhstan Program at Harvard University</td>
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<td>• National Innovation Fund</td>
<td>• World Bank Joint Economic Research Program</td>
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<td>• Kazakhstan Investment Fund</td>
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<td>• Kazakhstan Contract Agency</td>
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Kazakhstan’s Competitiveness Challenge

- Kazakhstan suffers from a remote **geographic location**, the negative effects of its **legacy** as part of the Soviet Union, and many **weaknesses** in its business environment.

- There is sufficient **capital** and **willingness** to address many of these challenges.

- However, the country lacks the **human and institutional capacity** to tackle all of them effectively.

- Kazakhstan needs to set **clear policy priorities**, defining a sequenced action agenda in line with its capabilities to execute.

- The prioritization needs to be based on a sound **conceptual framework for competitiveness** and a **long-term vision** of where the country realistically wants to be twenty years from now.
Kazakhstan’s Competitiveness
Roadmap Towards a Diversified Economy

• Foundations of Competitiveness
  • Assessing Kazakhstan's Current Competitiveness
  • Defining the Vision: Kazakhstan in 2025
  • Kazakhstan’s Competitiveness Agenda
What is Competitiveness?

• Competitiveness is determined by the productivity (value per unit of input) with which a nation, region, or cluster uses its human, capital, and natural resources. Productivity sets a nation’s or region’s standard of living (wages, returns on capital, returns on natural resources)
  – Productivity depends both on the value of products and services (e.g. uniqueness, quality) as well as the efficiency with which they are produced.
  – It is not what industries a nation or region competes in that matters for prosperity, but how firms compete in those industries
  – Productivity in a nation or region is a reflection of what both domestic and foreign firms choose to do in that location. The location of ownership is secondary for national prosperity.
  – The productivity of “local” industries is of fundamental importance to competitiveness, not just that of traded industries
  – Devaluation and revaluation do not make a country more or less “competitive”

• Nations or regions compete in offering the most productive environment for business

• The public and private sectors should play different but interrelated roles in creating a productive economy
## Sources of Prosperity

### Inherited Prosperity

- Prosperity is derived from selling **inherited** natural resources or real estate
- Prosperity is constrained by the amount of resources available, and is ultimately **limited**
  - **Government** is the central actor in the economy as the owner and distributor of wealth
  - Focus gravitates towards the **distribution of wealth** as interest groups seek a bigger share of the pie
  - Resource revenues allow **unproductive policies and practices to persist**
  - Resource revenues support **distortive subsidies**

### Created Prosperity

- Prosperity is derived from **creating valuable products and services**
- Prosperity can only be created by **firms**
- Prosperity is **unlimited**, based only by the innovativeness and productivity of companies and subsidiaries operating in the economy
  - Creating the **conditions** for productivity and innovation is the central policy challenge
  - **Companies** are the central actors in the economy
  - **Government’s** role is to create the enabling conditions to foster private sector development
Determinants of Competitiveness

Macroeconomic, Political, Legal, and Social Context for Competitiveness

Microeconomic Foundations of Competitiveness

- The Sophistication of Company Operations and Strategy
- The Quality of the Microeconomic Business Environment

- Nations or regions compete in offering the **most productive environment** for business
- The public and private sectors play **different but interrelated roles** in creating a productive economy
- A sound macroeconomic, political, legal, and social context creates the potential for competitiveness, **but is not sufficient**
Productivity and the Business Environment

Factor (Input) Conditions
- Presence of high quality, specialized inputs available to firms
  - Human resources
  - Capital resources
  - Physical infrastructure
  - Administrative infrastructure (e.g. business registration, rules, licensing, property rights)
  - Information infrastructure
  - Scientific and technological infrastructure
  - Natural resources
- Access to capable, locally based suppliers and firms in related fields
- Presence of clusters instead of isolated industries

Demand Conditions
- Sophisticated and demanding local customer(s)
- Local customer needs that anticipate those elsewhere
- Unusual local demand in specialized segments that can be served nationally and globally

Related and Supporting Industries
- Meritocratic incentive systems across all major institutions
- Open and vigorous local competition

Context for Firm Strategy and Rivalry
- A local context and rules that encourage investment and sustained upgrading (e.g., Intellectual property protection)

Successful economic development is a process of successive economic upgrading, in which the business environment in a nation evolves to support and encourage increasingly sophisticated ways of competing.
The Cairns Tourism Cluster

- Travel agents
- Tour operators
- Restaurants
- Hotels
- Airlines, Cruise Ships
- Attractions and Activities (e.g., theme parks, casinos, sports)
- Local retail, health care, and other services
- Local Transportation
- Souvenirs, Duty Free
- Banks, Foreign Exchange
- Government agencies (e.g., Australian Tourism Commission, Great Barrier Reef Authority)
- Educational Institutions (e.g., James Cook University, Cairns College of TAFE)
- Industry Groups (e.g., Queensland Tourism Industry Council)

Source: Research by HBS Student Team, 2003
The California Wine Cluster

Sources: California Wine Institute, Internet search, California State Legislature. Based on research by MBA 1997 students R. Alexander, R. Arney, N. Black, E. Frost, and A. Shivananda.
The Role of Clusters in Competitiveness

• Clusters Increase Productivity / Efficiency
  – Efficient **access** to specialized inputs, services, employees, information, institutions, and “public goods” (e.g. training programs)
  – Ease of **coordination** and transactions across firms
  – Rapid **diffusion** of best practices
  – Ongoing, visible **performance comparisons** and strong incentives to improve vs. local rivals

• Clusters Stimulate and Enable Innovations
  – Enhanced ability to **perceive innovation opportunities**
  – Presence of multiple suppliers and institutions to assist in **knowledge creation**
  – Ease of **experimentation** given locally available resources

• Clusters Facilitate Commercialization
  – Opportunities for **new companies** and **new lines of established business** are more apparent
  – **Commercializing** new products and starting new companies is easier because of available skills, suppliers, etc.

Clusters reflect the fundamental influence of **externalities / linkages** across firms and associated institutions in competition
Institutions for Collaboration

**General**
- Chambers of Commerce
- Professional associations
- School alumni networks
- Military networks
- University partner groups
- Religious networks
- Joint private/public advisory councils
- Competitiveness councils

**Cluster-specific**
- Industry associations
- Specialized professional associations and societies
- Alumni groups of core cluster companies
- Incubators

- Institutions for collaboration (IFC) are **formal and informal organizations** that
  - facilitate the exchange of information and technology
  - conduct joint activities
  - foster coordination among firms

- IFC’s can improve the business environment by
  - creating **relationships** and level of trust that make them more effective
  - defining of **common standards**
  - conducting or facilitating the organization of **collective action** in areas such as procurement, information gathering, or international marketing
  - defining and communicating common **beliefs and attitudes**
  - providing mechanisms to develop a common economic or **cluster agenda**
Influences on Competitiveness

Multiple Geographic Levels

- World Economy
- Broad Economic Areas
- Groups of Neighboring Nations
- Nations
- States, Provinces
- Cities, Metropolitan Areas
- Rural Areas
Sub-National Regions
Selected U.S. Metropolitan Areas

Seattle-Bellevue-Everett, WA
Aerospace Vehicles and Defense
Fishing and Fishing Products
Analytical Instruments

San Francisco-Oakland-San Jose Bay Area
Communications Equipment
Agricultural Products
Information Technology

San Diego
Leather and Sporting Goods
Power Generation
Education and Knowledge Creation

Wichita, KS
Aerospace Vehicles and Defense
Heavy Machinery
Oil and Gas

Pittsburgh, PA
Construction Materials
Metal Manufacturing
Education and Knowledge Creation

Chicago
Communications Equipment
Processed Food
Heavy Machinery

Boston
Analytical Instruments
Knowledge Creation
Communications Equipment

Los Angeles Area
Apparel
Building Fixtures, Equipment and Services
Entertainment

Raleigh-Durham, NC
Communications Equipment
Information Technology
Education and Knowledge Creation

Atlanta, GA
Construction Materials
Transportation and Logistics
Business Services

Houston
Heavy Construction Services
Power Generation
Education and Knowledge Creation

Note: Clusters listed are the three highest ranking clusters in terms of share of national employment
Source: Cluster Mapping Project, Institute for Strategy and Competitiveness, Harvard Business School
Shifting Responsibilities for Economic Development

**Old Model**

- **Government** drives economic development through policy decisions and incentives

**New Model**

- Economic development is a collaborative process involving government at multiple levels, companies, teaching and research institutions, and institutions for collaboration
Roles of Government in Economic Development

- Improve the macroeconomic, political, legal, and social context
  - Establish a **stable and predictable** macroeconomic, legal, and political context
  - Improve the **social conditions** of citizens

- Upgrade the general business environment
  - Improve the availability, quality, and efficiency of **cross-cutting or general purpose inputs, infrastructure, and institutions**
  - Set **overall rules and incentives** governing competition that encourage productivity growth

- Provide a context in which companies continuously upgrade
  - Create support and incentives for companies to **compete in more sophisticated ways**
  - Support institutions that facilitate the transmission of **best practices**

- Facilitate cluster formation and enhancement
  - Identify **existing and emerging clusters**
  - Convene and participate in the identification of **cluster constraints and action plans** to address them

- Lead a collaborative process of economic change
  - Create institutions and **processes for upgrading competitiveness** that inform citizens and mobilize the private sector, government at all levels, educational and other institutions, and civil society to take action
Appropriate Roles of Government in Cluster Development

- A successful cluster policy builds on **sound overall economic policies**

- Government should support the development of **all clusters**, not pick winners among them

- Government policy should **reinforce established and emerging clusters** rather than attempt to create entirely new ones

- Government can **seed new clusters** through attracting foreign direct investment

- Government’s role in cluster initiatives is as **facilitator** and **participant**. The most successful cluster initiatives are public-private partnerships

- Government should **NOT provide subsidies**, set **preferential tariffs**, **exclude from competition laws**, **give preferential tax exemptions**, etc.
Kazakhstan’s Competitiveness
Roadmap Towards a Diversified Economy

- Foundations of Competitiveness
- **Assessing Kazakhstan's Current Competitiveness**
  - Defining the Vision: Kazakhstan in 2025
  - Kazakhstan’s Competitiveness Agenda
Assessing the Drivers of Created Prosperity

- **Prosperity**
- **Productivity**
- **Innovative Capacity**

*Competitiveness*
Comparative Labor Productivity
Selected Countries

GDP per employee (PPP adjusted) in US-$, 2003

Comparative Labor Productivity
Selected Countries

Compound annual growth rate of real GDP per employee, 1997-2003

Note: CMAR estimate of the performance without the direct GDP contribution of oil & gas
Comparative Inward Foreign Investment
Selected Transition Countries

FDI Stocks as % of GDP, Average 1999-2001

FDI Inflows as % of Gross Fixed Capital Formation, Average 1999-2001

Note: 74% of Kazakhstan’s FDI inflows are directly related to resource extraction
International Patenting Output
Selected Transition Countries

Annual U.S. patents per 1 million population, 2003


Kazakhstan’s Current Competitiveness

- Despite the strong recent improvements across the economy, labor productivity is still **modest**
  - Total factor productivity growth is encouraging but likely the result of **transitory effects** rather than true underlying competitiveness

- Exports are growing overall, but Kazakhstan’s export positions outside the natural resource-sector are **stagnating at a low level**

- Foreign direct investment inflows outperform other CIS countries but are still strongly **dominated by the natural resource-sector**

- Innovation performance is **almost non-existent**

- Kazakhstan needs to continue to upgrade its **natural resource-driven clusters**, which will remain the core of its economy for the foreseeable future

- However, Kazakhstan needs to significantly improve the **underlying competitiveness** of its economy to create prosperity outside the natural resource-sector
Macroeconomic Conditions in Kazakhstan

• The overall macroeconomic conditions in Kazakhstan are favorable
  – The fiscal position of government is sound, driven by strong revenues from the oil & gas sector and a growing economy
    • The creation of the National Fund to save revenues from natural resource exports has been an important positive step
  – Monetary conditions are stable, with inflation down to single digits
  – Interventions by the central bank have kept the appreciation of the exchange rate at a modest pace

• However, the consequences of being strongly exposed to capital inflows from oil export revenues create significant challenges
  – Upward pressure on the real exchange rate affects sectors exposed to international competition, making productivity growth crucial
  – Dependency on natural resource prices increases the volatility of the overall economy and government’s fiscal position

## Political, Social, and Legal Conditions in Kazakhstan

### Political
- Kazakhstan is rated as a country with relatively high *political stability*.
- International observers continue to be concerned about the *openness of the political process* in Kazakhstan.
- Political power is highly *concentrated* with few checks and balances to ad-hoc decisions.

### Social
- Kazakhstan, like many other CIS countries, scores *relatively better* on social indicators (health and education) than on GDP per capita.
- Kazakhstan scores *weaker on some social indicators* than many other Central Asian countries, and inequality remains a significant problem.

### Legal
- Kazakhstan has low scores on important *governance* indicators, even compared to some of its peers in the CIS.
- While the quality of laws is often considered to be good, challenges remain in *implementation* and *independent judicial review*.

- Kazakhstan has to address *significant challenges* in its broader context if it is to upgrade its economic performance.

Political, Social, and Legal Conditions in Kazakhstan

Corruption

Note: Eastern European and CIS countries in blue, constant country sample
Source: Global Corruption Report, 2003
The Context for Competitiveness in Kazakhstan

A Mixed Legacy

Factor

- Geography
- Culture

Kazakhstan’s situation

- Vast, sparsely populated country in a remote, landlocked location
  - Population centers on the Southern, Western, and Northern borders
  - 60% of population live in cities
- Potential to play an important role in Central Asia
- A meeting point for many cultures
  - 120 different ethnic groups from Asia and Europe living together peacefully
Legacies of a Planned Economy

- Economic policy is centrally directed
- Buyer/supplier linkages planned from a national perspective; many were broken after the end of the Soviet Union
- Relationships between suppliers and buyers are specified and focused on production of defined goods and services
- The geographic locations of related economic activities driven by political and security considerations
- Companies focused on narrow parts of the value chain, lacking marketing and other capabilities

Cluster-based Economy

- Economic policy involves significant autonomy and well developed institutions at the regional and local level
- Regions specialize in terms of the fields in which they compete
- Clusters leverage externalities across firms, universities, and other local organizations that drive productivity and dynamism
- Geographic choices are based on the economic attractiveness of locations; firms co-locate with others to reap cluster benefits
- Company scale and scope driven by economic efficiency, including the ability to access specialized skills available in the surrounding cluster
- Small and medium sized companies are an essential part of clusters
Competitive Assessment of Kazakhstan

Microeconomic Foundations of Competitiveness

The Sophistication of Company Operations and Strategy

The Quality of the Microeconomic Business Environment

Macroeconomic, Political, Legal, and Social Context for Competitiveness
### Microeconomic Foundations of Competitiveness

#### Business Competitiveness Index Rankings

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country</th>
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<th>Country</th>
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<tbody>
<tr>
<td>51</td>
<td>Mauritius</td>
<td>76</td>
<td>Zimbabwe</td>
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<td>52</td>
<td>Jamaica</td>
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<td>Macedonia</td>
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<td>53</td>
<td>Mexico</td>
<td>78</td>
<td>Malawi</td>
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<td>54</td>
<td>Romania</td>
<td>79</td>
<td>Serbia &amp; Monten.</td>
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<td>55</td>
<td>Poland</td>
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<td>Guatemala</td>
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<td>Colombia</td>
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<td>Madagascar</td>
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<td>Trinidad &amp; Tobago</td>
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<td>Venezuela</td>
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<td>58</td>
<td>Panama</td>
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<td>Algeria</td>
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<td>59</td>
<td>Russian Federation</td>
<td>84</td>
<td>Tanzania</td>
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<td>Botswana</td>
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<td>Georgia</td>
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<td>61</td>
<td>Kenya</td>
<td>86</td>
<td>Bosnia &amp; Herzeg.</td>
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<td>62</td>
<td>Ghana</td>
<td>87</td>
<td>Ecuador</td>
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<td>El Salvador</td>
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<td>Bangladesh</td>
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<td>Sri Lanka</td>
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<td>Mozambique</td>
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<td>Ukraine</td>
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<td>Honduras</td>
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<td>Croatia</td>
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<td>Ethiopia</td>
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<td>Nicaragua</td>
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<td>Argentina</td>
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<td>Bolivia</td>
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<td>Bulgaria</td>
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<td>71</td>
<td>Peru</td>
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<td><strong>72</strong></td>
<td><strong>Kazakhstan</strong></td>
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<td>73</td>
<td>Uruguay</td>
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<td>74</td>
<td>Vietnam</td>
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<tr>
<td>75</td>
<td>Dominican Republic</td>
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</tbody>
</table>

Source: Global Competitiveness Report 2004-05, CMAR survey 2004, author’s analysis
Current Prosperity and Underlying Competitiveness
Selected Middle Income Countries

Actual GDP versus GDP potential given underlying competitiveness

Source: Global Competitiveness Report 2004-05, CMAR survey 2004, author’s analysis
Assessment of the Kazakhstan Business Environment

Context for Firm Strategy and Rivalry

- Modest formal tariffs
- Flexible labor market rules
- High cost bureaucratic business regulatory requirements
- Significant barriers to foreign competition
- Dominance of government and business groups limits effective internal competition
- Corruption and favoritism by government create significant barriers for businesses
- Limited presence of foreign multinationals outside the resource extraction industries limits competition and the upgrading of local capabilities

Factor (Input) Conditions

+ Low electricity costs
+ Good basic workforce skills
+ Modern airport infrastructure
+ Large pool of investment capital
  - Long logistical supply lines; distant from major markets
  - Widespread weaknesses in the physical infrastructure due to low investments and/or market distortions
  - Weak communications infrastructure
  - Extreme shortage of managerial skills and entrepreneurship
  - Lack of advanced technical skills
  - Limited higher education system
  - Significant barriers for smaller companies to obtain credit

Demand Conditions

- The relatively small local market is not a strong magnet for foreign companies
- Weak standards-setting and certification organization
- Public procurement rules inconsistently applied
- Weak regulations on IT and environmental quality

Related and Supporting Industries

- Few effective clusters; most are focused on narrow industries within the full potential breadth of clusters
- Legacy of a planned economy inhibits cluster formation
### Skills and Knowledge Creation

#### Kazakhstan’s Relative Position

<table>
<thead>
<tr>
<th>Competitive Advantages Relative to GDP per Capita</th>
<th>Competitive Disadvantages Relative to GDP per Capita</th>
</tr>
</thead>
<tbody>
<tr>
<td>Country Ranking</td>
<td>Country Ranking</td>
</tr>
<tr>
<td>NONE</td>
<td>Quality of management schools 83</td>
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<tr>
<td></td>
<td>Availability of scientists and engineers 81</td>
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<td></td>
<td>Intellectual property protection 75</td>
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<td></td>
<td>Quality of educational system 69</td>
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<td></td>
<td>Quality of math and science education 67</td>
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<td>University/Industry research collaboration 66</td>
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<td>Quality of public schools 65</td>
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<td>Quality of scientific research institutions 64</td>
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</tbody>
</table>

**Note:** Rank versus 94 countries; Kazakhstan ranks 59th among the sample countries in 2003 PPP adjusted GDP per capita.

Source: Global Competitiveness Report 2004
## Context for Firm Strategy and Rivalry

**Kazakhstan’s Relative Position**

### Competitive Advantages Relative to GDP per Capita

<table>
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<th>Rank</th>
<th>Competitive Advantage</th>
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<tbody>
<tr>
<td>31</td>
<td>Extent of locally based competitors</td>
</tr>
<tr>
<td>44</td>
<td>Prevalence of mergers and acquisitions</td>
</tr>
</tbody>
</table>

### Competitive Disadvantages Relative to GDP per Capita

<table>
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<th>Rank</th>
<th>Competitive Disadvantage</th>
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<tr>
<td>94</td>
<td>Extent of bureaucratic red tape</td>
</tr>
<tr>
<td>91</td>
<td>Business costs of corruption</td>
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<td>86</td>
<td>Hidden trade barrier liberalization</td>
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<td>82</td>
<td>Judicial independence</td>
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<td>80</td>
<td>Foreign ownership restrictions</td>
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<td>76</td>
<td>Reliability of police services</td>
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<td>73</td>
<td>Decentralization of corporate activity</td>
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<td>72</td>
<td>Intensity of local competition</td>
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<td>71</td>
<td>Effectiveness of anti-trust policy</td>
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<td>71</td>
<td>Effectiveness of bankruptcy law</td>
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<tr>
<td>66</td>
<td>Administrative burden for start-ups</td>
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<td>63</td>
<td>Favoritism in decisions of govt. officials</td>
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</table>

*Note: Rank versus 94 countries; Kazakhstan ranks 59th among the sample countries in 2003 PPP adjusted GDP per capita*

*Source: Global Competitiveness Report 2004*
Composition of the Kazakh Economy
Traded and Natural Resource-Driven Clusters

Cluster Share of Traded and NRD Employment, 2003

Change in Share, 2000-2003

Source: Kazakhstan statistical office (2004), Institute for Strategy and Competitiveness (2004), author’s calculations
### Composition of the Kazakh Economy

**Job Creation in Local Clusters and Government, 2000-2003**

<table>
<thead>
<tr>
<th>Local Cluster</th>
<th>Government</th>
<th>Agriculture</th>
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<tbody>
<tr>
<td>Local Education and Training</td>
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<td>Local Health Services</td>
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<td>Local Real Estate, Construction, and Development</td>
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<td>Local Community and Civic Organizations</td>
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<td>Local Hospitality Establishments</td>
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<td>Local Household Goods and Services</td>
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<td>Local Industrial Products and Services</td>
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<td>Local Utilities</td>
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<td>Local Entertainment and Media</td>
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<td>Local Motor Vehicle Products and Services</td>
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<td>Local Food and Beverage Processing and Distribution</td>
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<td>Local Financial Services</td>
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<td></td>
</tr>
<tr>
<td>Local Logistic Services</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Local Retail Clothing and Accessories</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Local Personal Services (Non-Medical)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Net Job Creation from 2000-2003:**

\[+157,924\]

Source: Kazakhstan statistical office (2004), Institute for Strategy and Competitiveness (2004), author’s calculations
Competitive Assessment of Kazakhstan

Institutions

• Institutional capacity is weak to define, implement, and sustain a sound competitiveness strategy. This is one of the key challenges facing Kazakhstan

Public Sector

• The public sector suffers from the severe shortage of skilled personnel, especially outside the core policy making ministries in the capital
  – Recent economic growth has created lucrative opportunities in the private sector
  – New agencies have increased the demands on the small pool of skilled officials
• Operational effectiveness of agencies is limited
  – Power is vested in individuals, not institutions. Decision-making remains highly concentrated, which renders decision making ad-hoc and subject to frequent changes
  – Frequent moves of key personnel among agencies limits their effectiveness

Private Sector

• Although trade associations and chambers exist, they are still few and focused almost entirely on lobbying for government favors
• Institutions for Collaboration are largely missing
Overall Competitiveness Assessment

Kazakhstan

• While Kazakhstan enjoys considerable political stability, it has significant weaknesses in terms of social conditions, transparency and governance that create significant impediments to competitiveness

• Kazakhstan enjoys abundant natural resource-wealth but suffers from the legacy of the Soviet Union and a challenging geography

• Kazakhstan suffers from widespread weaknesses in the quality of its business environment and the sophistication of its companies, despite selected strengths and the examples of a few encouraging companies

• Kazakhstan’s leaders are aware of these strengths and weaknesses which are consistent with those reported by the EBRD, the World Bank, and others

• Current policies are attempting to respond to many individual weaknesses but lack strategic focus
  – Overambitious action agenda not in line with implementation capacity
  – Insufficient prioritization of weaknesses that are most critical at this stage in the economic development process
  – Little focus on modernizing the roles of government and the private sector in the competitiveness program. Without this, actual progress in implementation will be slow
Kazakhstan’s Competitiveness
Roadmap Towards a Diversified Economy

- Foundations of Competitiveness
- Assessing Kazakhstan's Current Competitiveness
- Defining the Vision: Kazakhstan in 2025
- Kazakhstan’s Competitiveness Agenda
Kazakhstan’s Economy in 2025

Elements of a Vision

Economic composition

• Cluster building in **natural resources**
  – Oil and gas cluster
  – Minerals and ores cluster
  – Agriculture and processed foods cluster
  – Cotton-based textiles cluster
  – Tourism cluster

• **Business and logistical hub** for Central Asia
  – Transportation and logistics cluster
  – Business services cluster
  – Financial services cluster

• An efficient **domestic economy**

Economic geography

• An economy in which each **region within the country** has a distinctive economy, its own strategy, and sound local government

• Kazakhstan plays a **leadership role** in economic coordination and integration with its neighbors
Efficient Natural Resource Clusters
The Houston Oil & Gas Cluster

- Oil & Gas Exploration & Development
- Oil & Gas Completion & Production

- Equipment Suppliers
  (e.g. Oil Field Chemicals, Drilling Rigs, Drill Tools)

- Specialized Technology Services
  (e.g. Drilling Consultants, Reservoir Services, Laboratory Analysis)

- Subcontractors
  (e.g. Surveying, Mud Logging, Maintenance Services)

- Business Services
  (e.g. MIS Services, Technology Licenses, Risk Management)

- Specialized Institutions
  (e.g. Academic Institutions, Training Centers, Industry Associations)

- Houston exports technology and knowledge, not just resources
Building Efficient Natural Resource Clusters
Kazakhstan’s Oil & Gas Equipment
Natural Resource Clusters
Kazakhstan Oil & Gas Equipment

INPUTS

R&D / Design
- Kazakh Institute of O&G
- Parsons Fluor Daniels
- Kazgiproneftetrans
- NIPI Neftegaz
- Munaigrafika

Raw Materials
- Plastics
- Metal sheets
- Components
- Lubricants
- Gases

Labour
- Manufacturing Labour
- Engineering

Infrastructure
- Rail & roads
- Aktau & Atyrau Ports

Technology
- Mach & Equipment
- IT software
- Capital

PRODUCTION

Byelkamit
ERC Holdings
FMC Munai Systems
Gidromash Orion
Imstalkon
Kazakhstan Engineering
Keppel Kazakhstan
Montazh Engineering
Ordabasy Armature plant
Petropavlovsk Heavy
Machine-Building plant
Ust-Kamenogorsk
Zenit
Ziksto

Testing
Mashsertika
Kranenergo

Transportation & Logistics

Oil and Gas Companies

RELATED & SUPPORTING INDUSTRIES

Government
- Ministry of Energy & Mineral Resources
- Kazcontract
- KazMunaiGaz
- Ministry of Environment

Associations
- Kazakhstan Petroleum Association
- Association of Equipment & Service Providers for Subsoil Operations Industry

Academia
- Gidropribor Rsrch Inst
- KIMEP University
- Kazakh-British Technical University
- Politinicheski University

Consulting / Training
- Southern Alberta Inst of Technology
- Central Asia Svcs Group

International Organizations
- World Bank
- OSCE

Source: CMAR and JE Austin Interviews and Analysis
Kazakhstan Competitiveness 01-06-05 CK

Capital

Law & Government
- Ministry of Energy & Mineral Resources
- Kazcontract
- KazMunaiGaz

Labour
- Manufacturing Labour
- Engineering

Infrastructure
- Rail & roads
- Aktau & Atyrau Ports

Technology
- Mach & Equipment
- IT software
- Capital

Strong relationship

Well developed component

Weak relationship

Poorly developed component

Source: CMAR and JE Austin Interviews and Analysis
Kazakhstan Competitiveness 01-06-05 CK
An Efficient Domestic Economy

• An efficient domestic economy is an **essential part** of any competitive national economy

• **The largest part** of Kazakh employment will be in the domestic economy, as is true in all economies

• An efficient domestic economy is critical so that export revenues translate into **domestic prosperity** by avoiding high prices for local products and services

• The efficiency of the domestic economy affects the competitiveness of **export clusters**
  – Japan nurtured competitive export clusters, but failed to upgrade the domestic economy at great costs to prosperity and competitiveness

• Improving the domestic economy is a tool for encouraging entrepreneurship and a useful preparation for economic diversification in the export sector

• Kazakhstan needs a **distinct strategy** on how to improve the performance of its local sectors
A Business Hub for Central Asia

- Because of its location, stability, and relatively better logistical systems, Kazakhstan has clear potential as a **regional hub**, serving neighboring countries and bordering regions of these countries as well as becoming an important bridge between Asia and Europe

AND

- Kazakhstan can also significantly **leverage** its competitiveness effort by extending the level of regional economic cooperation

- Easier access to regional markets creates opportunities for Kazakh exports and increase the level of **domestic competition**
- Economically healthy neighbors create positive spill-over effects in terms of demand and the **international profile** of the region
- Efforts to upgrade business environments and engage clusters are often **more effective** when coordinated across national borders
- The prospect of better access to the regional market and the more intense exposure to neighbors can be a powerful tool to **stimulate** faster domestic reforms for competitiveness
Sub-National Regions
Economic Performance of Kazakhstan’s Regions

Note: Bubble is proportional to total 2003 employment
Source: Kazakhstan statistical office (2004), Institute for Strategy and Competitiveness (2004), author’s calculations

Change in Nominal Annual Wage, CAGR, 2000-2003

Kazakhstan: 15.9%

Kazakhstan: 1827 Tenge

Annual Average Nominal Wage, Kazakh Tenge, 2003

Change in Nominal Annual Wage, CAGR, 2000-2003

0% 5% 10% 15% 20% 25% 30% 35%

0 500 1000 1500 2000 2500 3000 3500 4000 4500

Atiraskaya
Mangistauskaya
Almaty city
Astana city
Astana city
Zapadno-Kazakhstanskaya

Kostanayskaya
Karagandinskaya
Severo-Kazakhstanskaya
Yujno-Kazakhstanskaya

Vostochno-Kazakhstanskaya
Pavlodarskaya
Aktyubinskaya
Kizilordinskaya
Almatynskaya
Jambilskaya

Akmolinskaya

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Kazakhstan’s Competitiveness
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- Kazakhstan’s Competitiveness Agenda
Upgrading National Competitiveness: Key Tasks for Kazakhstan

• **Leverage the country’s natural resource base**
  – Improve the regulation of the natural resources
  – Develop clusters around natural resources

• **Enable the evolution of a vibrant private sector**
  – Activate clusters
  – Attract foreign direct investment
  – Upgrade the business environment

• **Strengthen management and institutional capacity**
  – Strengthen capabilities within government and private sector institutions
  – Broaden the array of institutions, especially in the private sector
Leverage Kazakhstan’s Natural Resources
The Regulation of Resource Extraction

• A crucial, immediate priority is the implementation of a world-class regulatory environment in which competition is the central principle

• Separation of regulation from economic activity
• Full transparency of licensing procedures and terms
• Regulations that encourage investments to upgrade and expand their activities in Kazakhstan
Appropriate Roles of Government in Cluster Development

- A successful cluster policy builds on **sound overall economic policies**

- Government should support the development of **all clusters**, not pick winners among them

- Government policy should **reinforce established and emerging clusters** rather than attempt to create entirely new ones

- Government can **seed new clusters** through attracting foreign direct investment

- Government’s role in cluster initiatives is as **facilitator** and **participant**. The most successful cluster initiatives are public-private partnerships

- Government should **NOT** provide subsidies, set preferential tariffs, exclude from competition laws, give preferential tax exemptions, etc.
The Role of Clusters in Economic Policy

Cluster Development

- Drive Improvements in the Business Environment
- Enhance the number and sophistication of Kazakh-based firms

Enable a Vibrant Private Sector

- Training and Education
- Applied Research
  - Link Schools and Universities to Business
- Standards and Certification
- Regulatory Streamlining
- Physical Infrastructure
- Industrial Parks/Free trade zones
- Quality Improvement (e.g. ISO)
- Export Promotion
- Attract FDI/Multinationals
  - End Products
  - Suppliers
  - Services
- Business-Government Cooperation
Cluster Activation

Key Activities

• Upgrading company operations
  – E.g., identifying operational best practices and providing market intelligence

• Strengthening of cooperation among companies
  – E.g., through joint activities in areas such as training, purchasing, quality standards, and export promotion

• Improvements in the cluster business environment
  – E.g., joint identification and improvement of barriers to productivity growth

• The appropriate mix of activities for a given cluster depends on the specific constraints that hinder further productivity growth
Roles of the Private Sector

• A company’s competitive advantage is partly the result of the **local environment**
• Company membership in a cluster offers **collective benefits**
• Private investment in “**public goods**” is justified

• Continuously upgrade individual company sophistication
• Take an **active role** in upgrading the local infrastructure
• Nurture **local suppliers** and attract new supplier investments
• Work closely with local **educational and research institutions** to upgrade quality and create specialized programs addressing cluster needs
• Provide government with **information** and **substantive input** on regulatory issues and constraints bearing on cluster development
• Focus **corporate philanthropy** on enhancing the local business environment

• An important role for **trade associations**
  – Greater influence
  – Cost sharing
Attracting Foreign Direct Investment

• Foreign multinational companies bring significant benefits to the economies in which they locate, especially in developing countries
  – Local employment and investment
  – Inflow of foreign human capital and skills
  – Training of citizens
  – Competition and exposure to world-class business practices
  – Access to world-class products and services and to global supply and distribution networks

• Kazakhstan has already attracted significant resource investment but needs to aggressively target companies serving the domestic/regional market
  – Consumer goods
  – Transportation and logistics
  – Financial services
  – Retailing

• Kazakhstan should tightly link its investment attraction and cluster development efforts
  – Investors are easier to attract to clusters
  – Clusters multiply the benefits of foreign investments for the local economy

• Current approaches to business attraction need to be significantly improved
  – Insufficient targeting of potential investors
  – Limited capabilities of the agencies involved in investor attraction and support
  – Business environment weaknesses, especially in skills and infrastructure
Attracting Foreign Direct Investment
Export Processing Zones / Industrial Parks

• Many oil-rich economies have made extensive use of “Free Zones” to attract foreign non-oil investments through tax incentives and dedicated infrastructure

• Export processing zones are more successful if they are targeted around the needs of specific clusters, where the country can offer a unique platform
  – Firms have common needs in terms of infrastructure and labor
  – Attracts additional companies as well as specialized suppliers and service providers

• Export processing zones (EPZ) can benefit country competitiveness if EPZ’s are not enclaves but lead economy-wide changes in the business environment
  – E.g., upgrading of rules and regulations
  – E.g., improving government services, such as customs

• It is essential to foster linkages between the EPZ and the rest of the economy, such as relationships with local supplier and service providers

## Priorities in Upgrading the Business Environment

<table>
<thead>
<tr>
<th>Area</th>
<th>Short-Term</th>
<th>Medium-Term</th>
</tr>
</thead>
<tbody>
<tr>
<td>Physical Infrastructure</td>
<td>• Aggressively <strong>open the markets</strong> for air transport and telecommunications</td>
<td>• Define a long-term <strong>strategic plan</strong> for investment in logistical infrastructure with a focus on linkages to neighbors</td>
</tr>
<tr>
<td></td>
<td>• Begin to upgrade the <strong>highway system</strong></td>
<td></td>
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<tr>
<td>Skills</td>
<td>• Introduce educational <strong>standards</strong> in schools and colleges</td>
<td>• Strengthen <strong>education</strong> programs in accounting, management, and law</td>
</tr>
<tr>
<td></td>
<td>• Create <strong>skills training council</strong> to co-ordinate curricula with business needs</td>
<td>• Expand <strong>technical training</strong> programs and upgrade the university system</td>
</tr>
<tr>
<td></td>
<td>• Make IT a universal component of education</td>
<td></td>
</tr>
<tr>
<td>Competition</td>
<td>• Accelerate a multi-faceted program to implement a <strong>anti-corruption strategy</strong></td>
<td>• Strengthen the <strong>competition authority</strong></td>
</tr>
<tr>
<td></td>
<td>• Swiftly conclude <strong>WTO negotiations</strong></td>
<td>• Implement the <strong>privatization agenda</strong></td>
</tr>
<tr>
<td>Financial markets</td>
<td>• Institute transparent <strong>accounting standards</strong></td>
<td>• Create a <strong>credit registry</strong></td>
</tr>
<tr>
<td></td>
<td>• Ease restrictions for banks to take <strong>equity stakes</strong> in clients</td>
<td>• Develop banks’ <strong>credit assessment</strong> capabilities</td>
</tr>
<tr>
<td></td>
<td>• Open market to <strong>foreign</strong> banks</td>
<td></td>
</tr>
<tr>
<td>Regulatory simplification</td>
<td>• Establish a simple <strong>one-stop process</strong> for business registration, licensing, and reporting</td>
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</tbody>
</table>
## Priorities in Upgrading Kazakh Institutions

<table>
<thead>
<tr>
<th>Area</th>
<th>Short-Term</th>
<th>Medium-Term</th>
</tr>
</thead>
</table>
| Public sector – national      | • Upgrade **professional training** for government officials; pursue plans for a training academy for the public sector  
• Reach out to experienced Kazakh professionals **abroad**, including native Germans and Russians with roots in Kazakhstan, as well as foreign nationals  
• Create separate **regulatory agencies**  
• **Organize government** to support competitiveness and cluster development | • Create a **professional civil service** with standardized entry exams, transparent rules for professional advancement, and performance-based pay  
• Create a **formal coordinating structure** within government for economic policy |
| Public sector – sub-national  | • Engage local government in **cluster development**  | • Create a designing making process that ensures **stability and transparency** in economic policy  
• Create **professional local government** with responsibilities for regional economic policy |
### Priorities in Upgrading Kazakh Institutions (continued)

<table>
<thead>
<tr>
<th>Area</th>
<th>Short-Term</th>
<th>Medium-Term</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private sector</td>
<td>• Use <strong>cluster efforts</strong> to select new private sector-driven institutions</td>
<td>• Launch <strong>new public-private institutions</strong> like workforce-skills development institutes and competitiveness councils</td>
</tr>
<tr>
<td></td>
<td>• Create defined <strong>roles</strong> for private sector institutions in the economic policy process</td>
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<tr>
<td></td>
<td>• Actively involve <strong>foreign multinationals</strong> in Kazakh private sector institutions</td>
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</tbody>
</table>
Upgrading National Competitiveness: Key Tasks for Kazakhstan

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- **Strengthen management and institutional capacity**
  - Strengthen capabilities within government and private sector institutions
  - Broaden the array of institutions, especially in the private sector

- **All parts of the economy, private and public, need to work together to move from agenda to action**