

# 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.

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# 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**

### Selected new agencies

- Centre for Marketing and Analytical Research (CMAR)
- Centre for Engineering and Technology Transfer
- Development Bank of Kazakhstan
- Export Insurance Corp
- National Innovation Fund
- Kazakhstan Investment Fund
- Kazakhstan Contract Agency

### Selected new projects and initiatives

- Industrial Innovation program 2015
- CMAR Cluster Project
- Almaty as a Regional Financial Center
- Kazakhstan Program at Harvard University
- World Bank Joint Economic Research Program

# 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

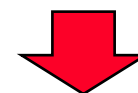
- Prosperity is derived from selling **inherited** natural resources or real estate
- Prosperity is constrained by the amount of resources available, and is ultimately **limited**



- **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

## Context for Firm Strategy and Rivalry

## 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

- A local context and rules that encourage **investment** and **sustained upgrading**
  - e.g., Intellectual property protection

- **Meritocratic incentive systems** across all major institutions
- Open and vigorous **local competition**

## Demand Conditions

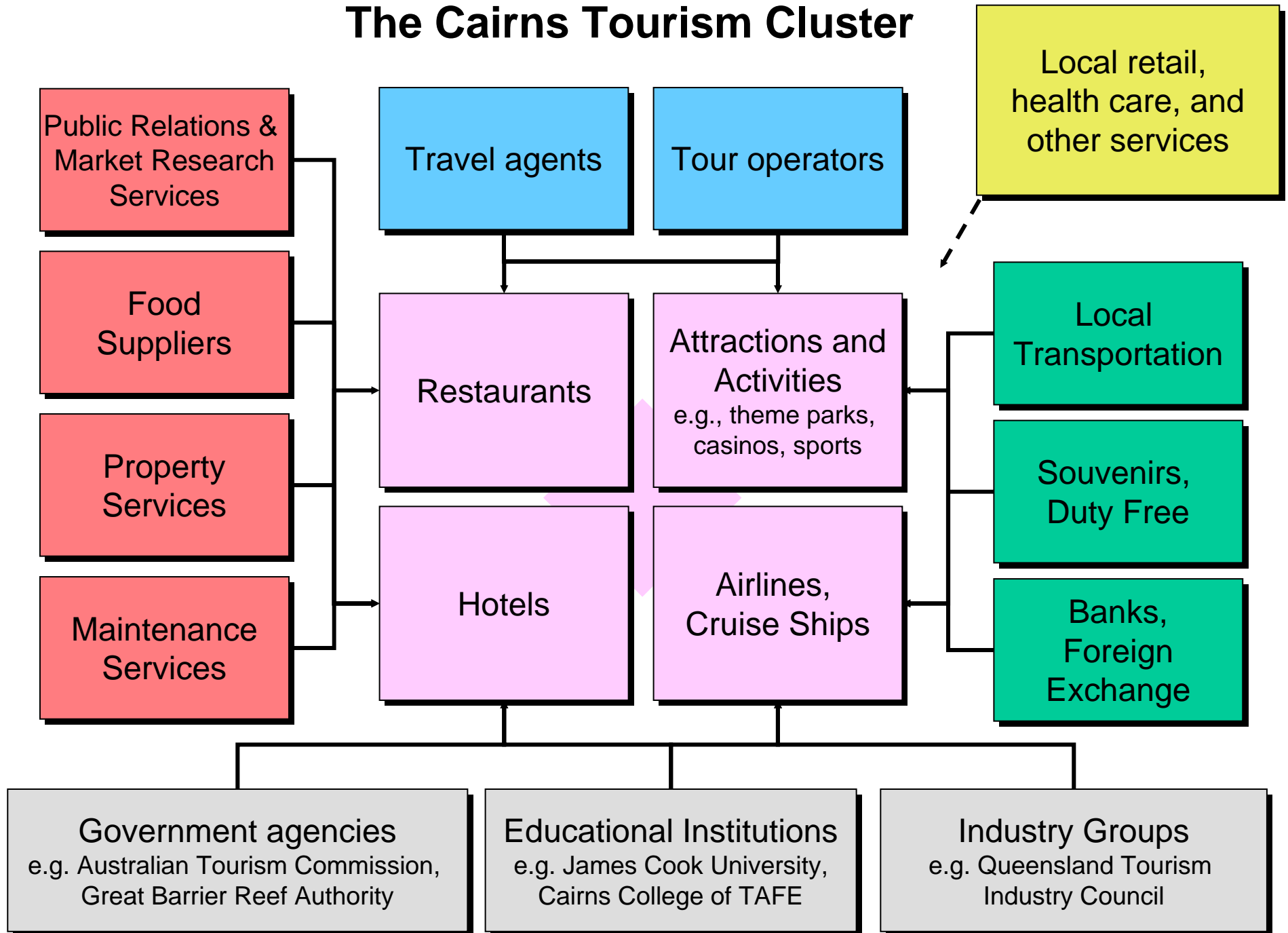
- **Sophisticated and demanding** local customer(s)
- Local customer needs that **anticipate** those elsewhere
- Unusual local demand in **specialized segments** that can be served nationally and globally

## Related and Supporting Industries

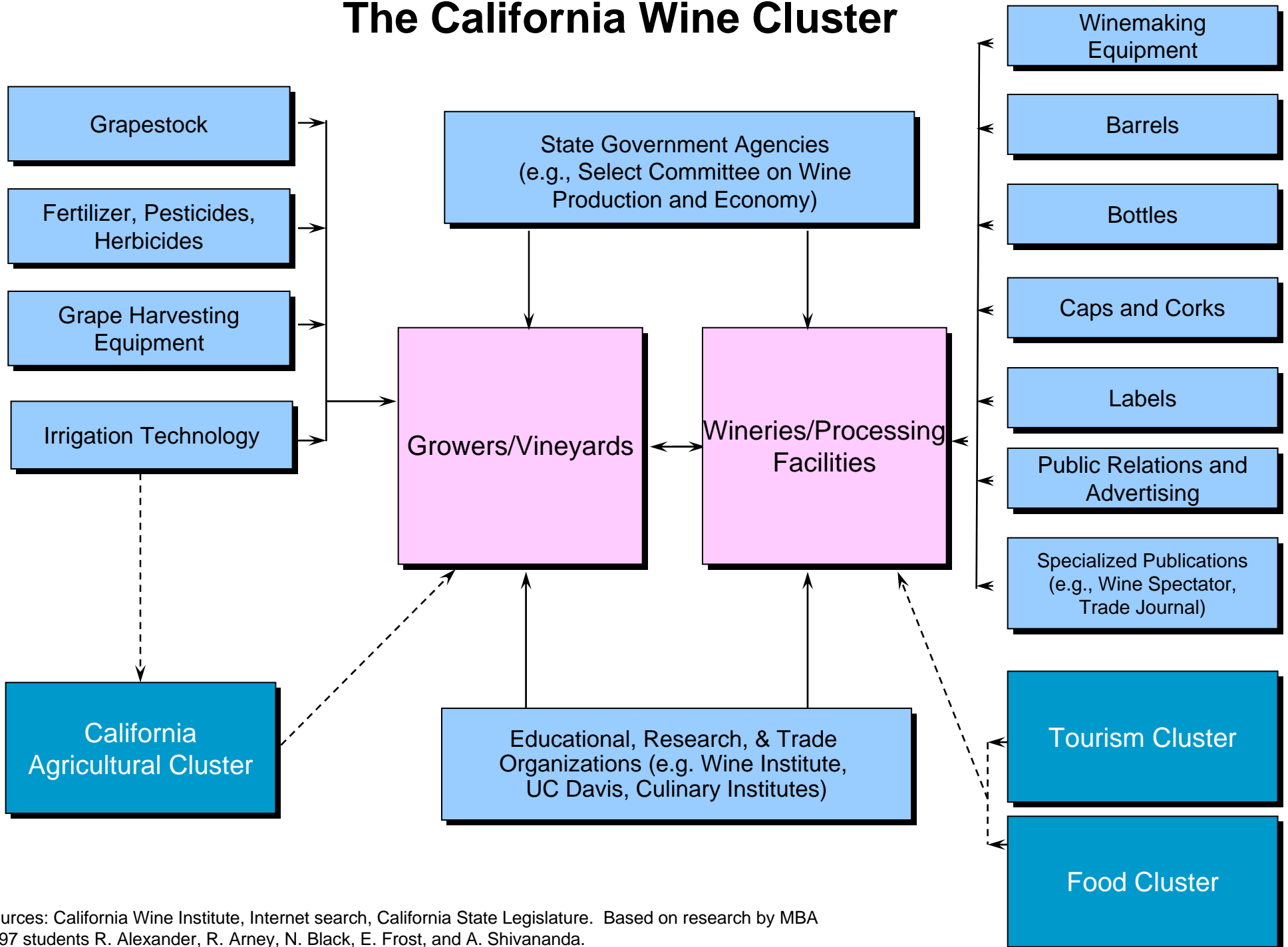
- Access to capable, locally based **suppliers** and firms in **related fields**
- Presence of **clusters** instead of isolated industries

- **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



# 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

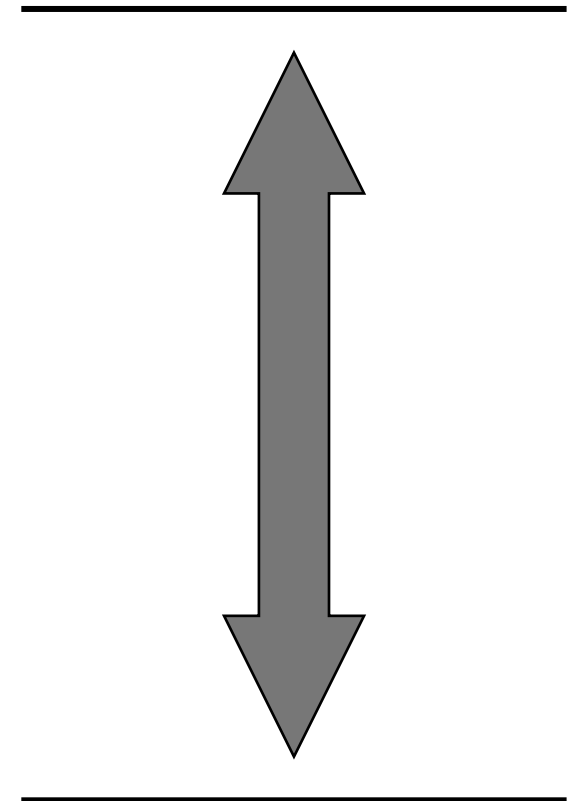
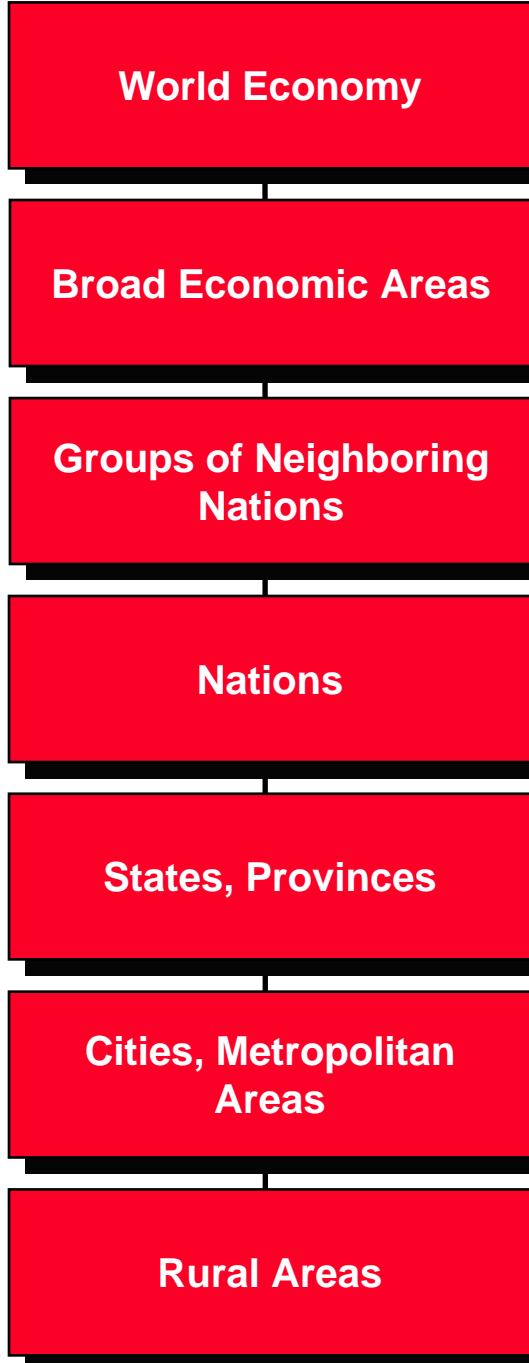
## *Cluster-specific*

- 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**

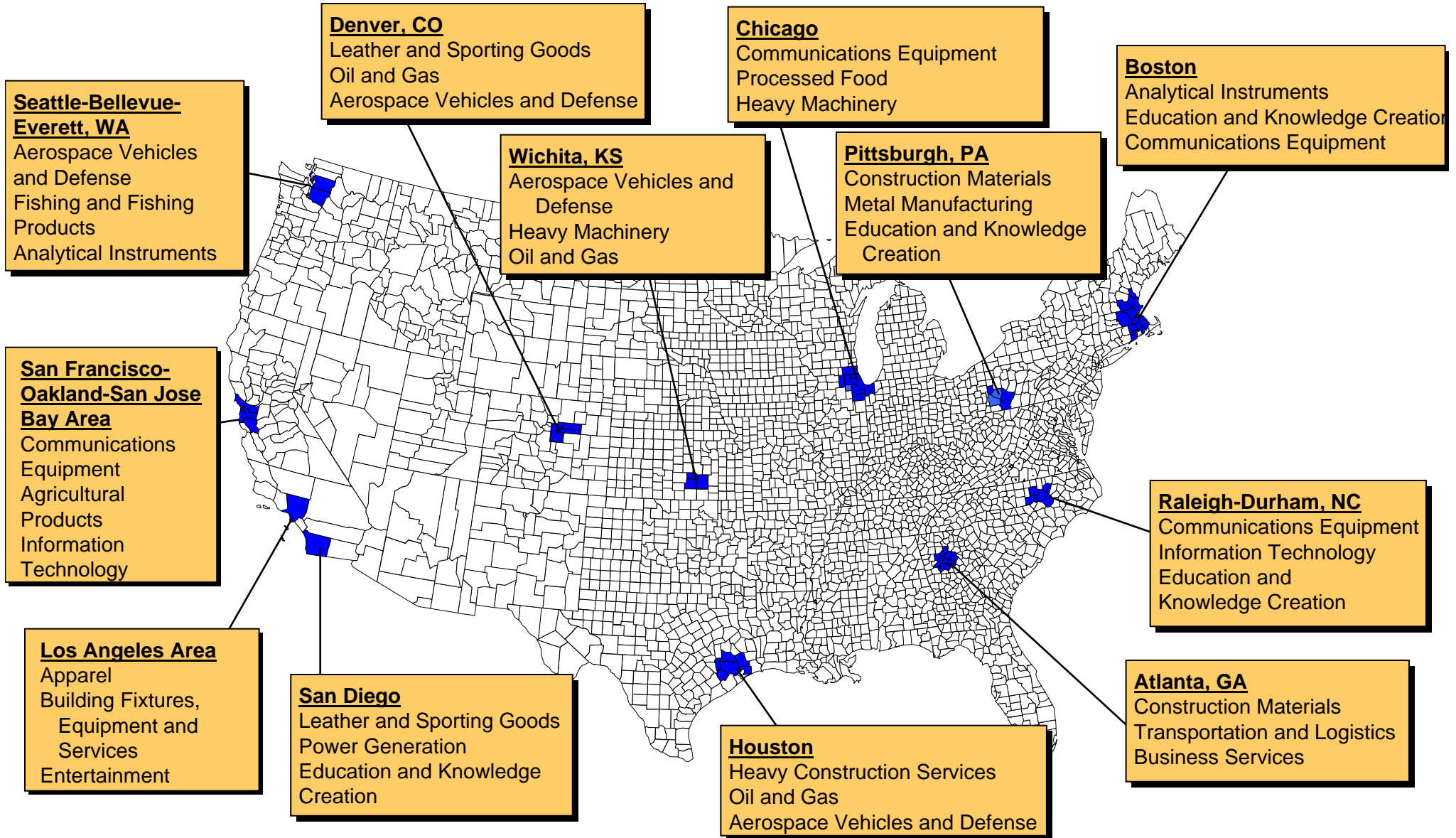
# Influences on Competitiveness

## Multiple Geographic Levels



# Sub-National Regions

## Selected U.S. Metropolitan Areas



Note: Clusters listed are the three highest ranking clusters in terms of share of national employment

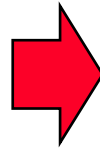
Source: Cluster Mapping Project, Institute for Strategy and Competitiveness, Harvard Business School



# 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

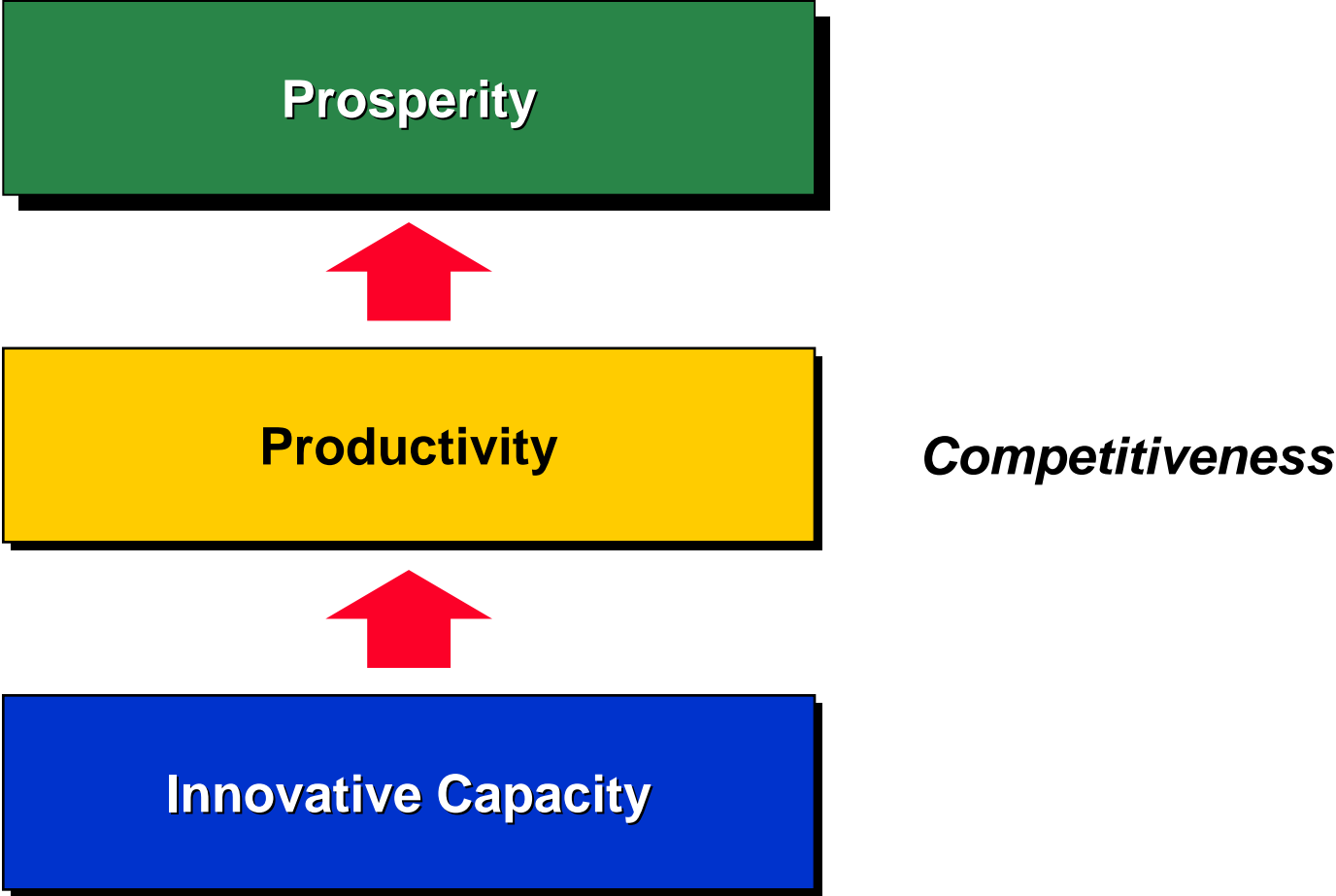
- A successful cluster policy builds on **sound overall economic policies**
- Government should support the development of **all clusters**, not pick winners among them
- Government policy should **reinforce established and emerging clusters** rather than attempt to create entirely new ones
- Government 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**

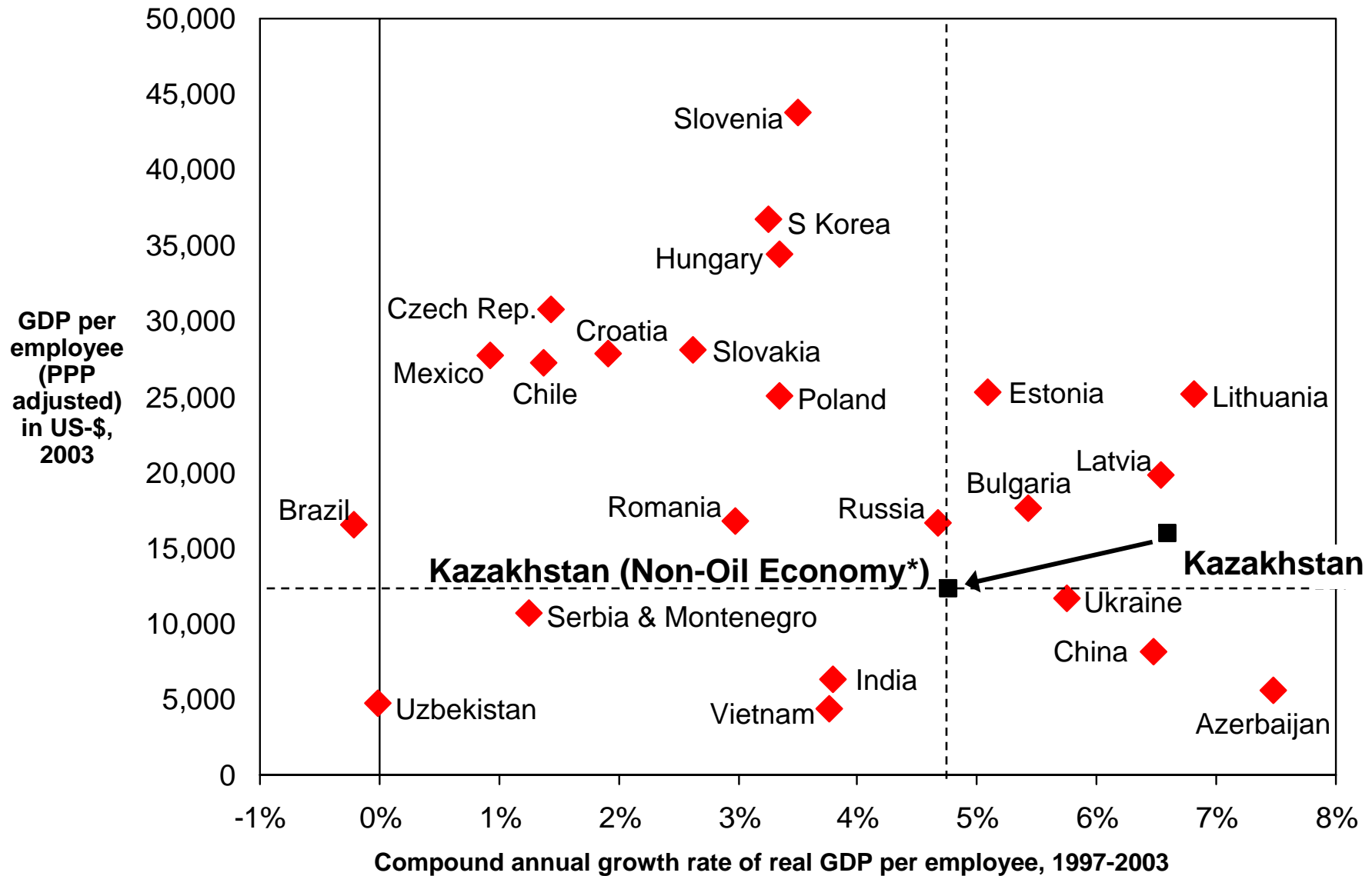
- Foundations of Competitiveness
- **Assessing Kazakhstan's Current Competitiveness**
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# Assessing the Drivers of Created Prosperity



# Comparative Labor Productivity

## Selected Countries



Note: CMAR estimate of the performance without the direct GDP contribution of oil & gas

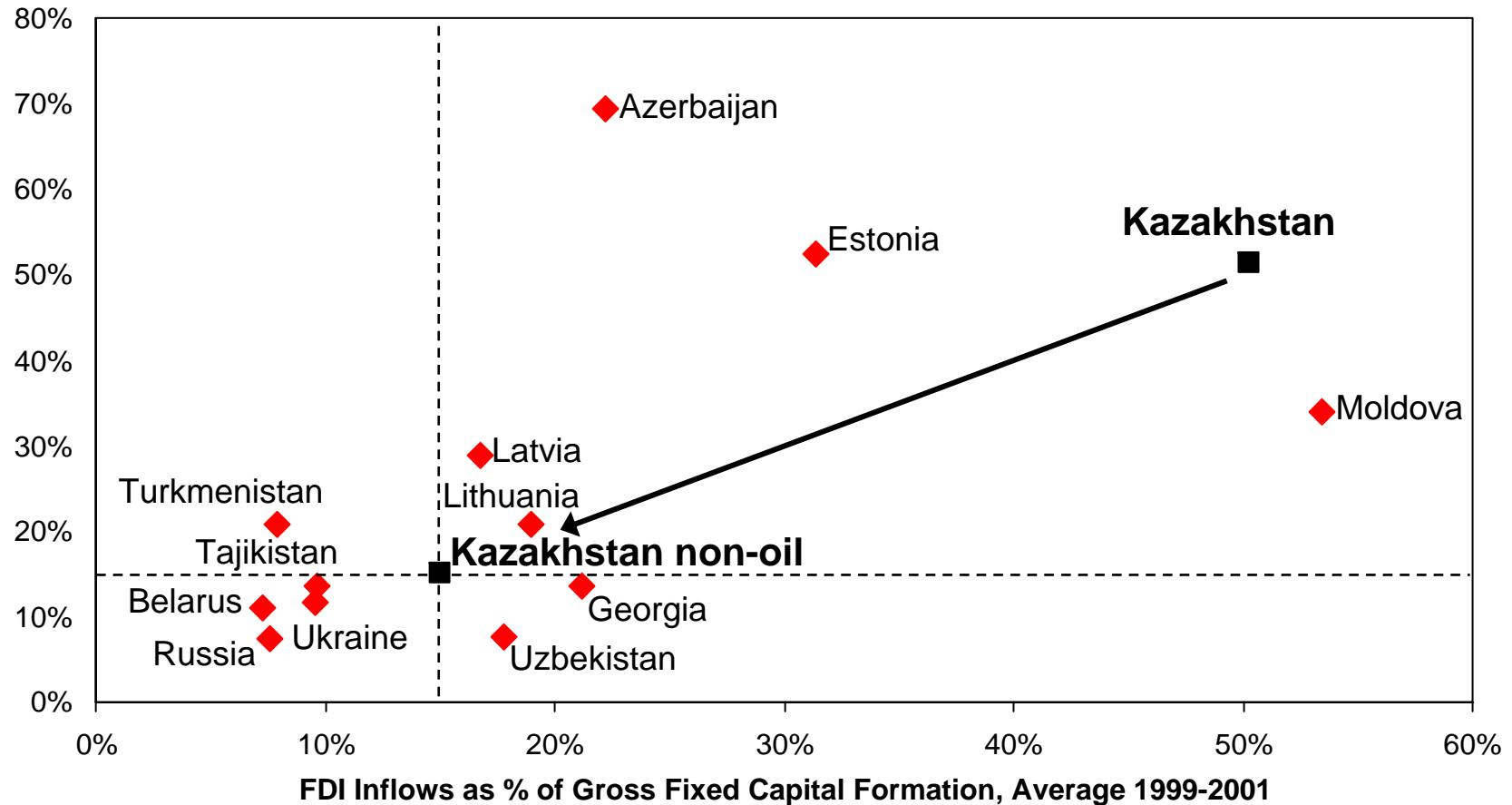
Source: EIU (2004)

Kazakhstan Competitiveness 01-06-05 CK

# Comparative Inward Foreign Investment

## Selected Transition Countries

FDI Stocks as % of GDP,  
Average 1999-2001



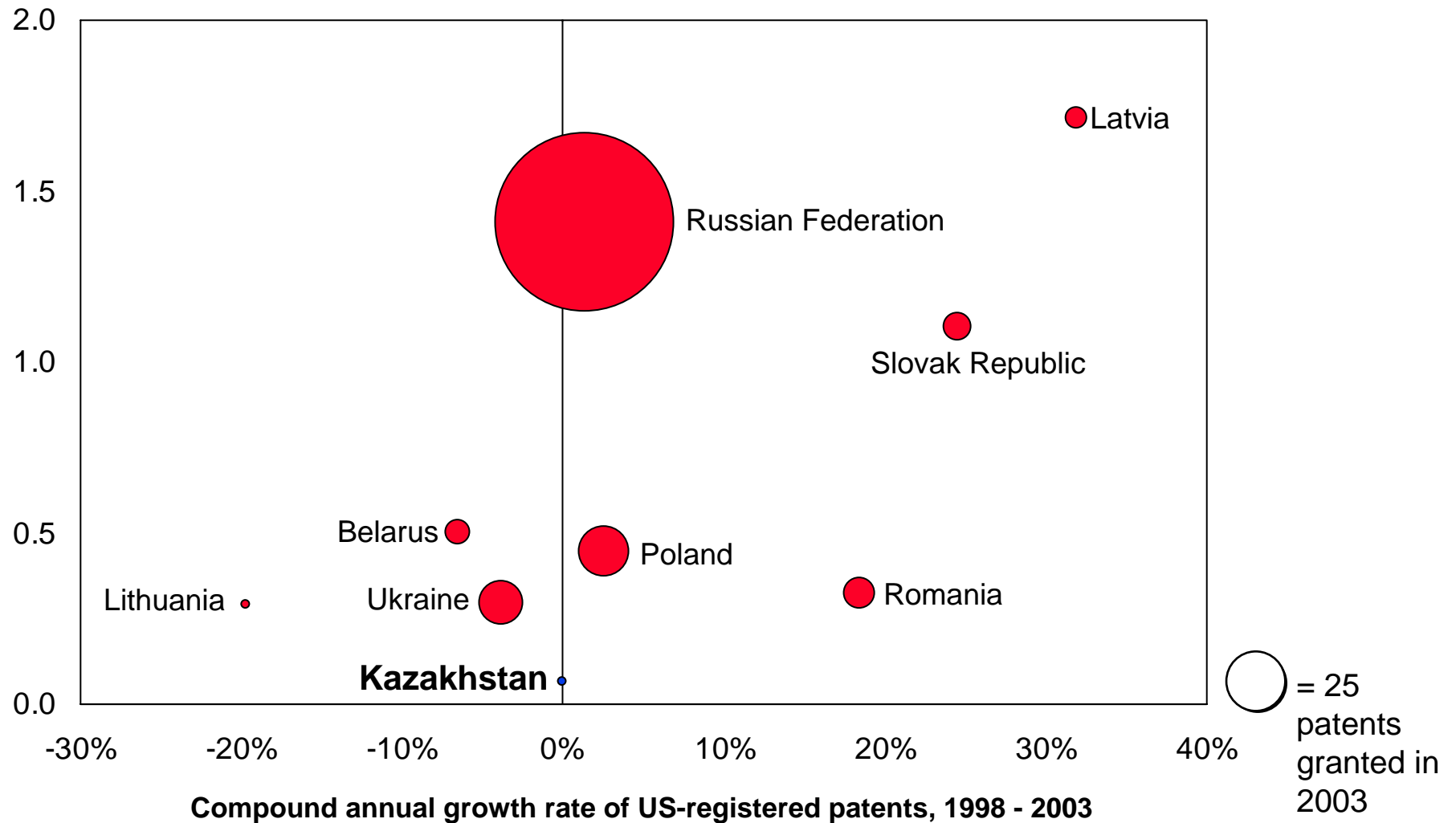
Note: 74% of Kazakhstan's FDI inflows are directly related to resource extraction

Source: UNCTAD (2004), CMAR (2005)

# 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

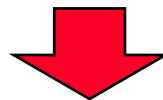
- The overall macroeconomic conditions in Kazakhstan are **favorable**
  - The fiscal position of government is sound, driven by strong revenues from the oil & gas sector and a growing economy
    - The creation of the National Fund to save revenues from natural resource exports has been an important 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

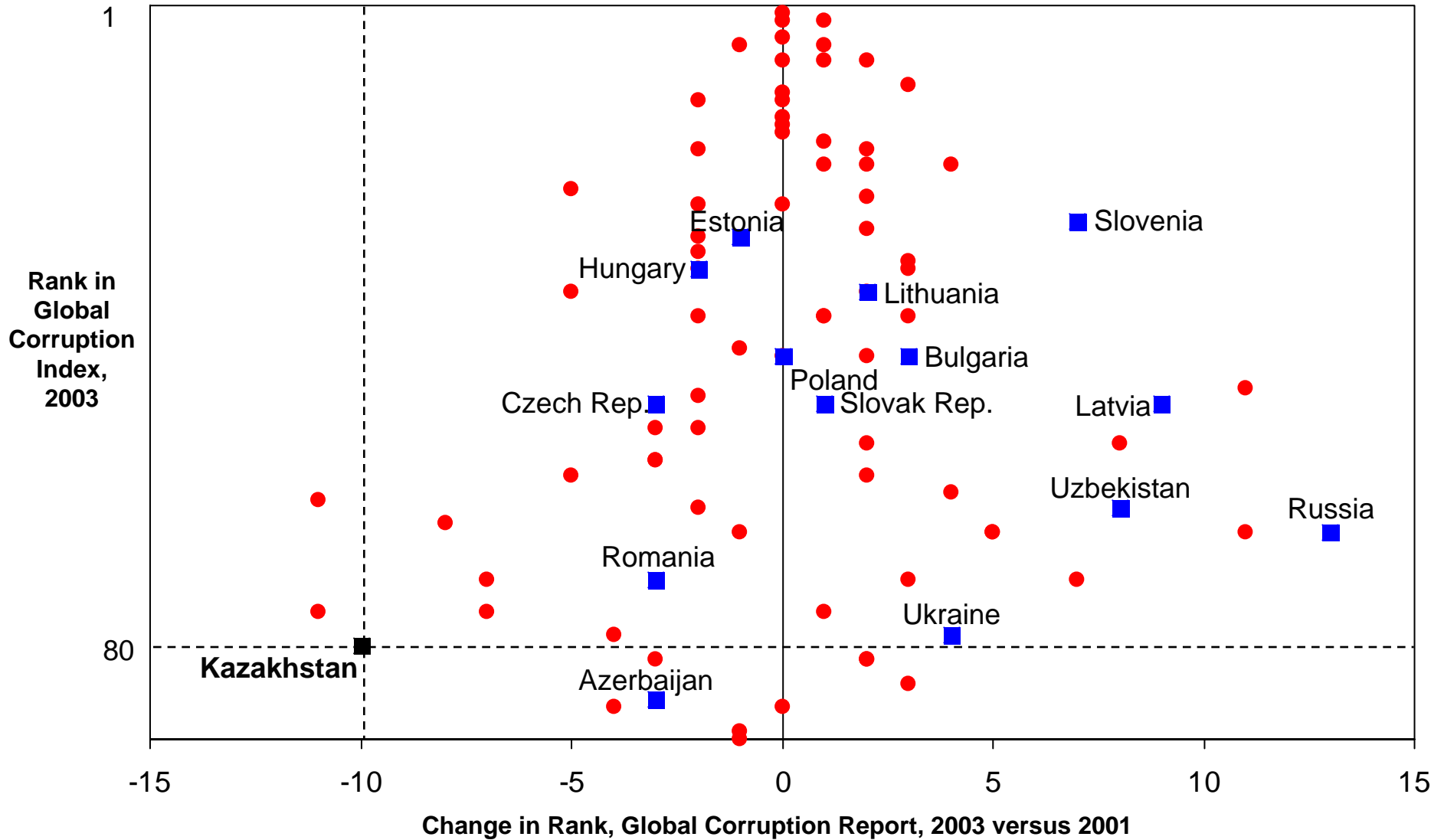
Political	Social	Legal
<ul style="list-style-type: none"><li>• Kazakhstan is rated as a country with relatively high <b>political stability</b></li><li>• International observers continue to be concerned about the <b>openness of the political process</b> in Kazakhstan</li><li>• Political power is highly <b>concentrated</b> with few checks and balances to ad-hoc decisions</li></ul>	<ul style="list-style-type: none"><li>• Kazakhstan, like many other CIS countries, scores <b>relatively better</b> on social indicators (health and education) than on GDP per capita</li><li>• Kazakhstan scores <b>weaker on some social indicators</b> than many other Central Asian countries, and inequality remains a significant problem</li></ul>	<ul style="list-style-type: none"><li>• Kazakhstan has low scores on important <b>governance</b> indicators, even compared to some of its peers in the CIS</li><li>• While the quality of laws is often considered to be good, challenges remain in <b>implementation</b> and <b>independent judicial review</b></li></ul>



- 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

# The Context for Competitiveness in Kazakhstan

## Legacies of a Planned Economy

### 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

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

# Microeconomic Foundations of Competitiveness

## Business Competitiveness Index Rankings

Rank	Country
51	Mauritius
52	Jamaica
53	Mexico
54	Romania
55	Poland
56	Colombia
57	Trinidad & Tobago
58	Panama
59	Russian Federation
60	Botswana
61	Kenya
62	Ghana
63	El Salvador
64	Sri Lanka
65	Ukraine
66	Philippines
67	Croatia
68	Pakistan
69	Argentina
70	Bulgaria
71	Peru
<b>72</b>	<b><i>Kazakhstan</i></b>
73	Uruguay
74	Vietnam
75	Dominican Republic

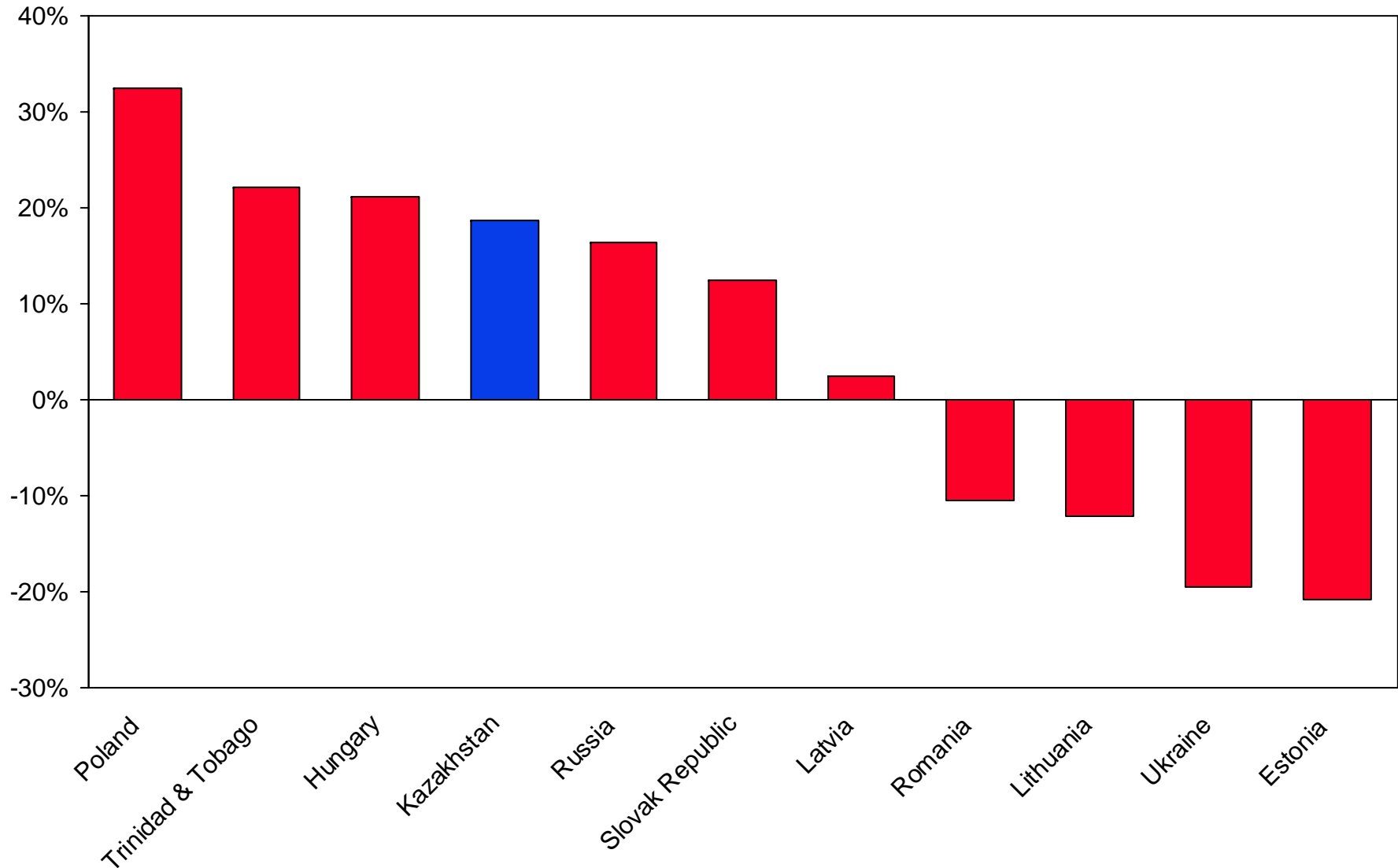
Rank	Country
76	Zimbabwe
77	Macedonia
78	Malawi
79	Serbia & Monten.
80	Guatemala
81	Madagascar
82	Venezuela
83	Algeria
84	Tanzania
85	Georgia
86	Bosnia & Herzeg.
87	Ecuador
88	Bangladesh
89	Mozambique
90	Honduras
91	Paraguay
92	Ethiopia
93	Nicaragua
94	Bolivia



# Current Prosperity and Underlying Competitiveness

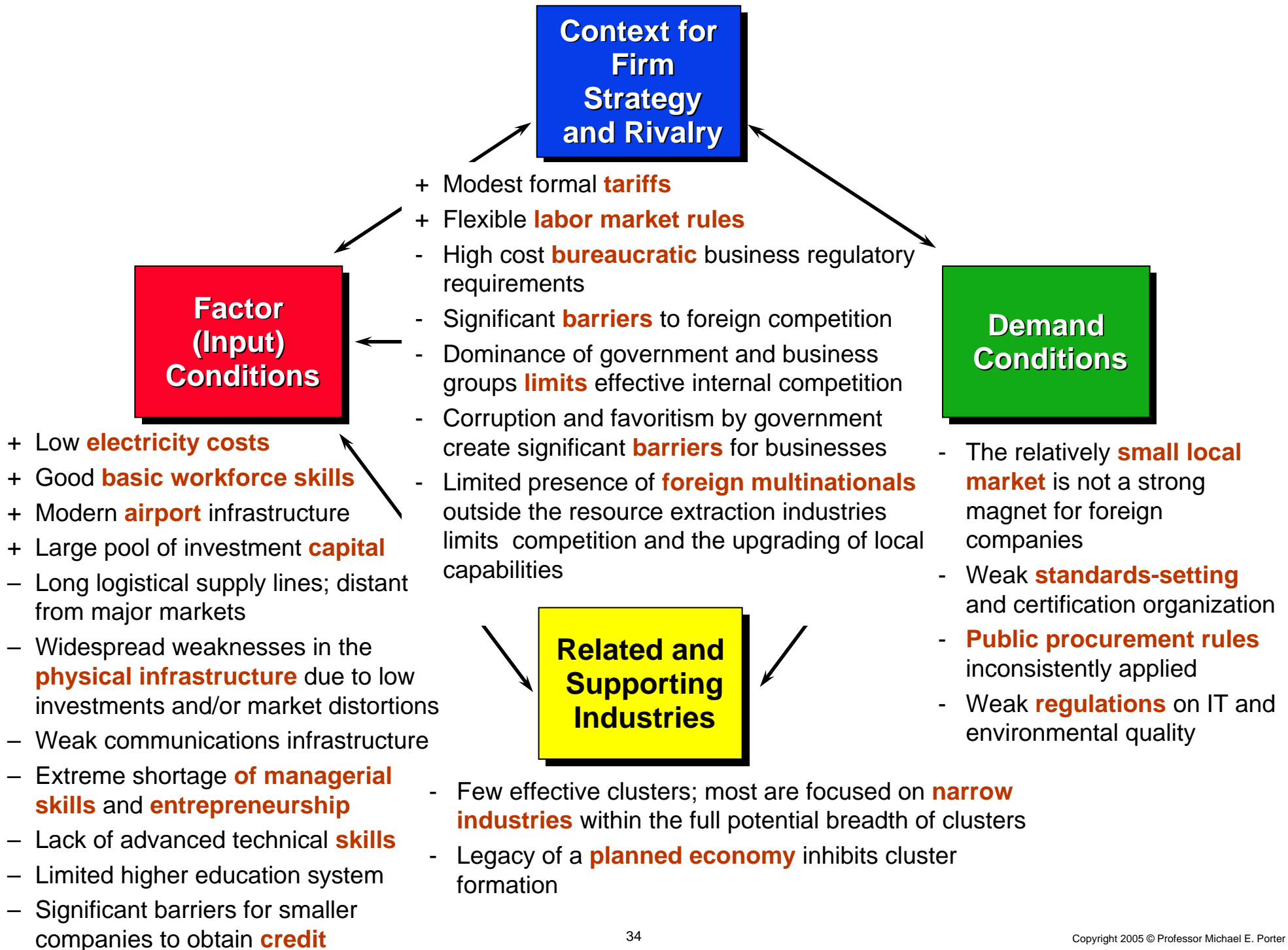
## Selected Middle Income Countries

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



## Skills and Knowledge Creation Kazakhstan's Relative Position

### Competitive Advantages Relative to GDP per Capita

Country Ranking

NONE

### Competitive Disadvantages Relative to GDP per Capita

Country Ranking

Quality of management schools	83
Availability of scientists and engineers	81
Intellectual property protection	75
Quality of educational system	69
Quality of math and science education	67
University/Industry research collaboration	66
Quality of public schools	65
Quality of scientific research institutions	64

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

	Country Ranking
Extent of locally based competitors	31
Prevalence of mergers and acquisitions	44

### Competitive Disadvantages Relative to GDP per Capita

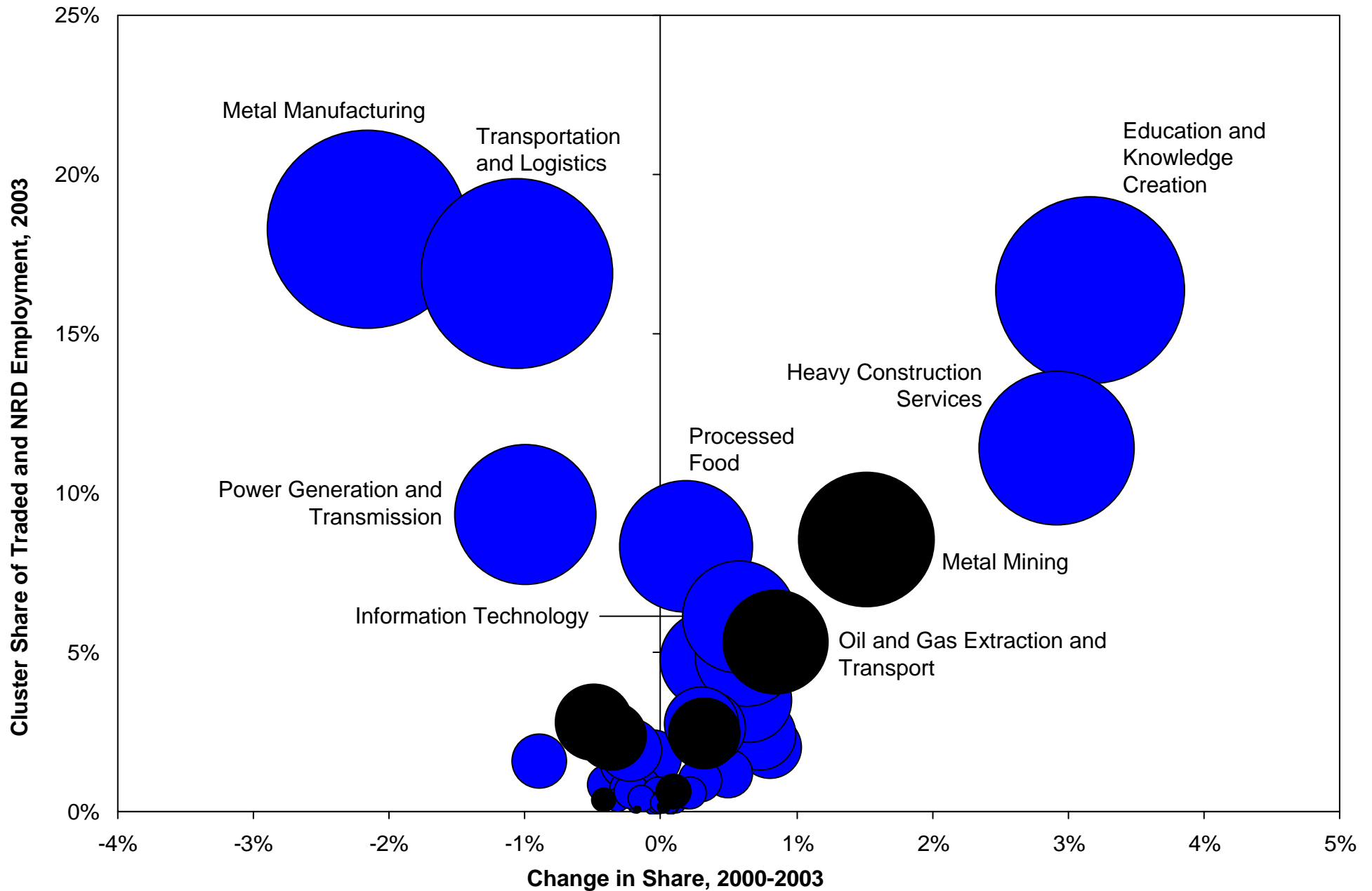
	Country Ranking
Extent of bureaucratic red tape	94
Business costs of corruption	91
Hidden trade barrier liberalization	86
Judicial independence	82
Foreign ownership restrictions	80
Reliability of police services	76
Decentralization of corporate activity	73
Intensity of local competition	72
Effectiveness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

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

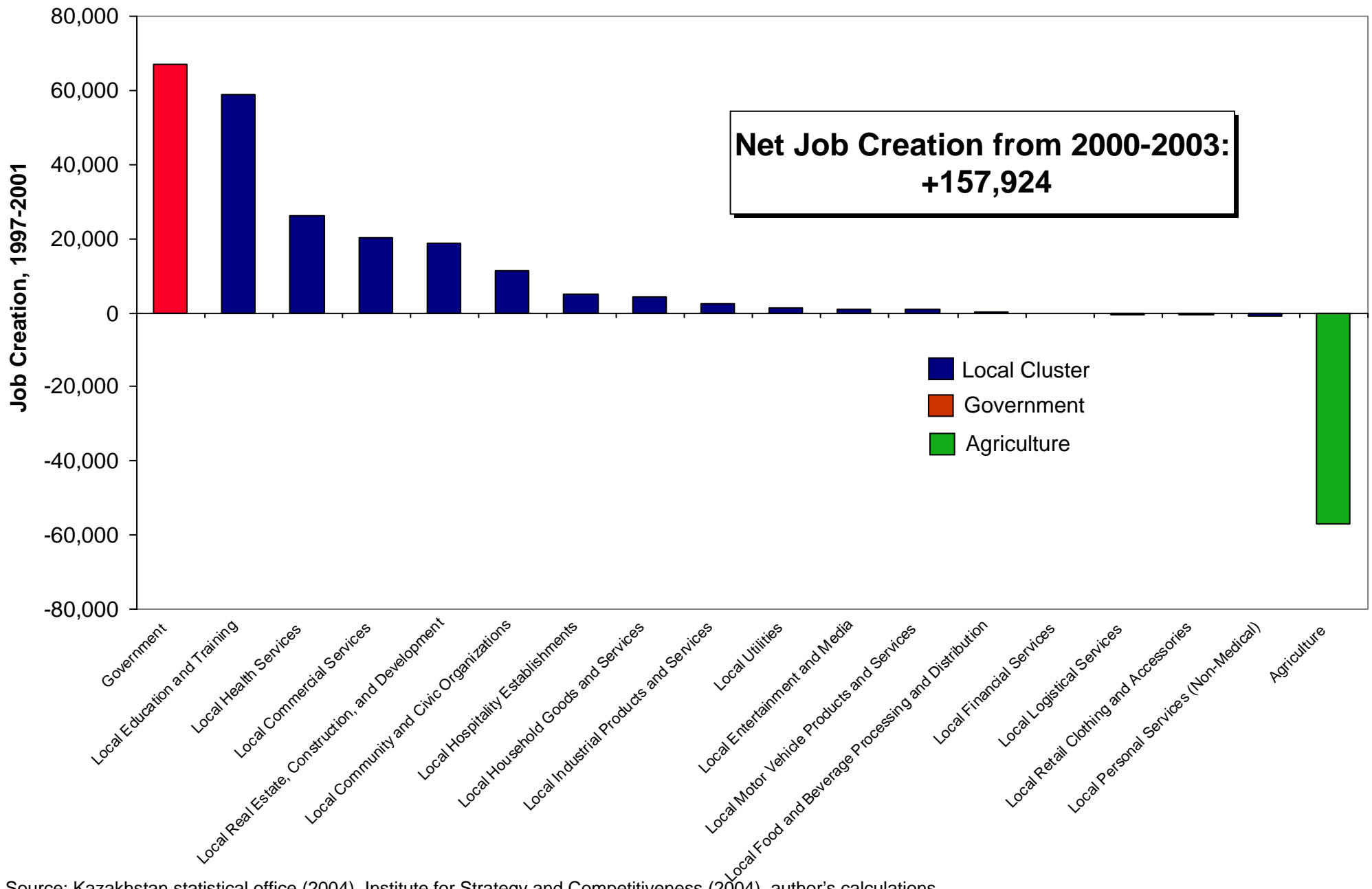
## Traded and Natural Resource-Driven Clusters



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



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

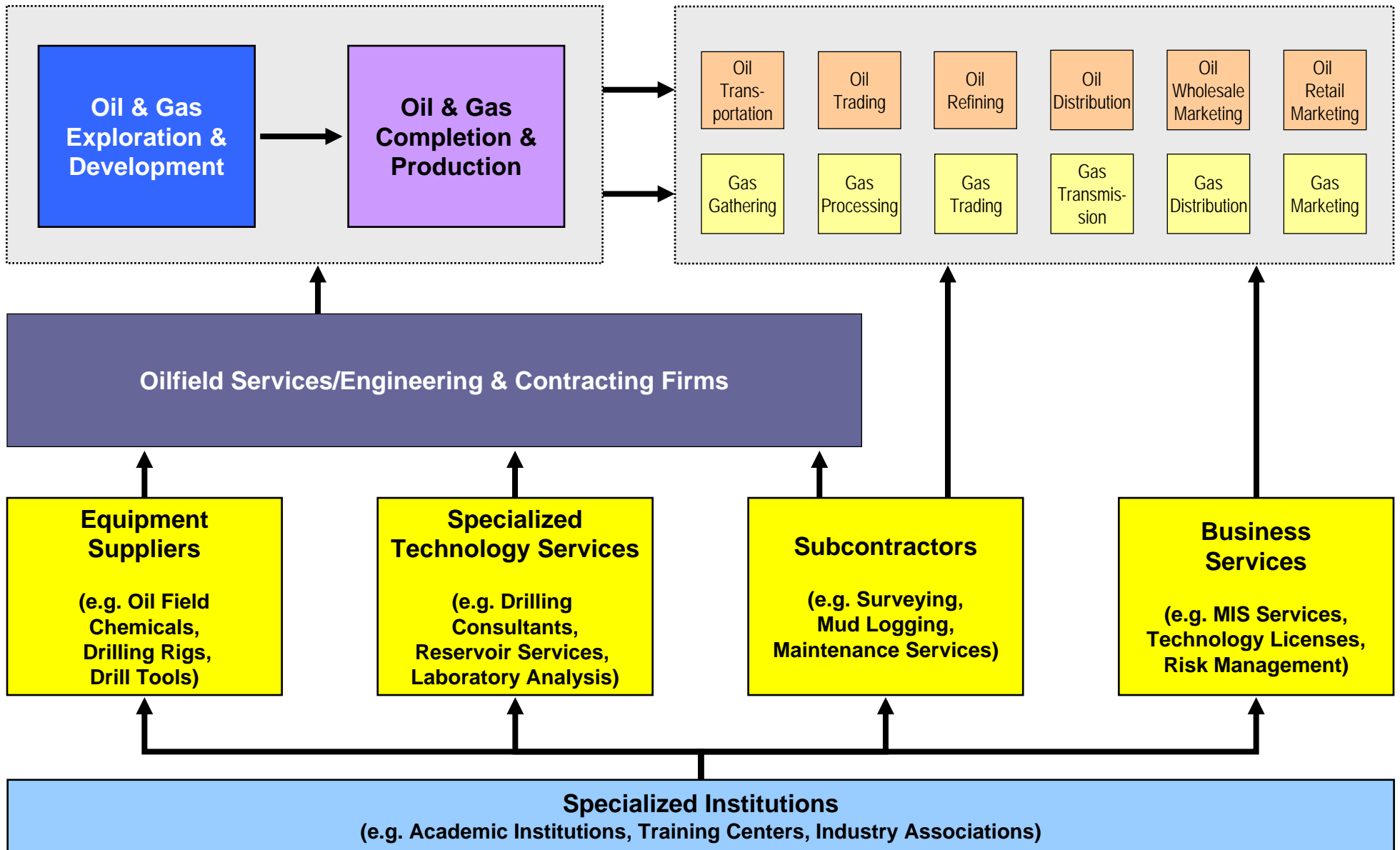
- Cluster building in **natural resources**
  - Oil and gas cluster
  - Minerals and ores cluster
  - Agriculture and processed foods cluster
  - Cotton-based textiles cluster
  - Tourism cluster
- **Business and logistical hub** for Central Asia
  - Transportation and logistics cluster
  - Business 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



- Houston exports technology and knowledge, not just resources

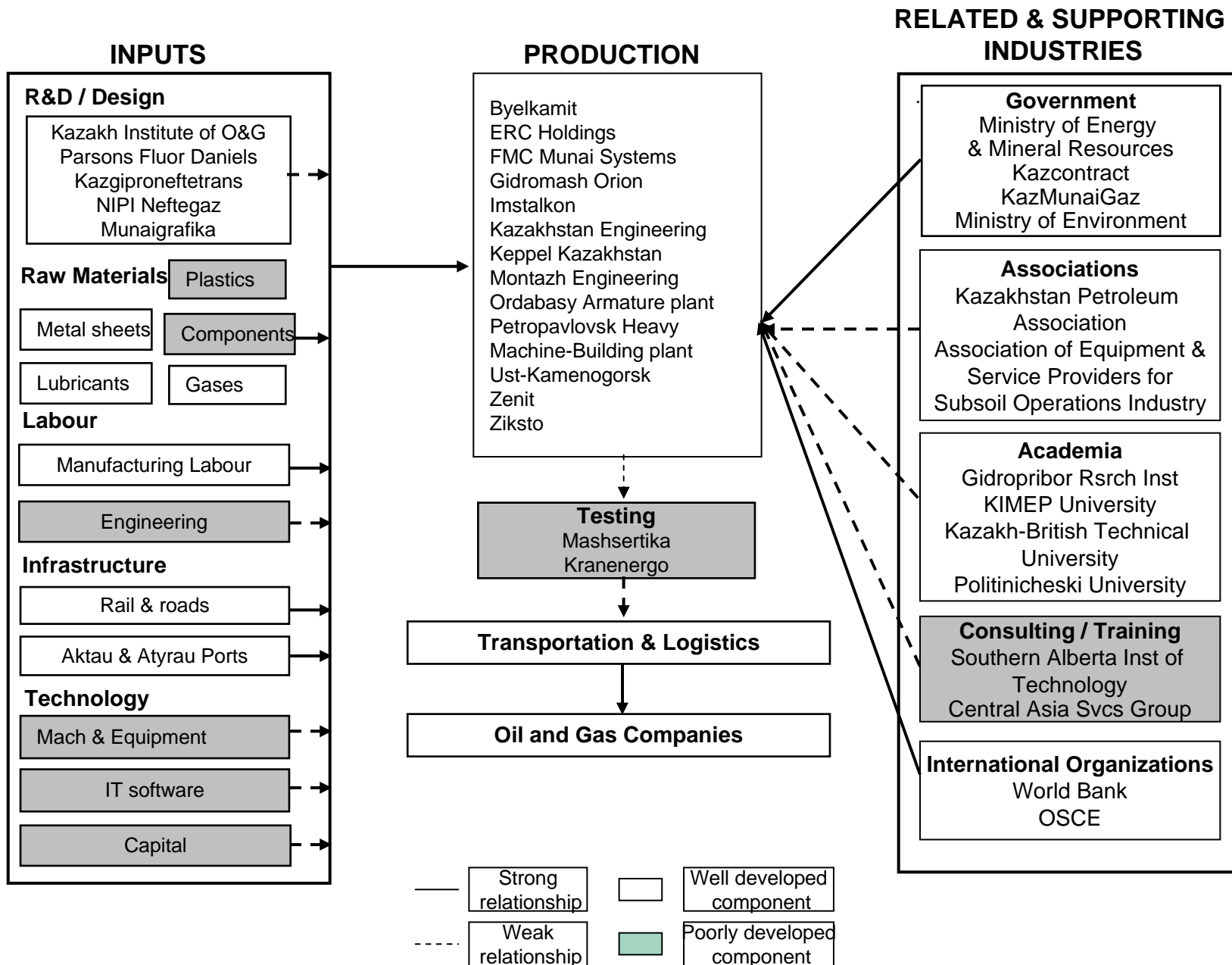
# Building Efficient Natural Resource Clusters

## Kazakhstan's Oil & Gas Equipment



# Natural Resource Clusters

## Kazakhstan Oil & Gas Equipment



Source: CMAR and JE Austin Interviews and Analysis

# 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**

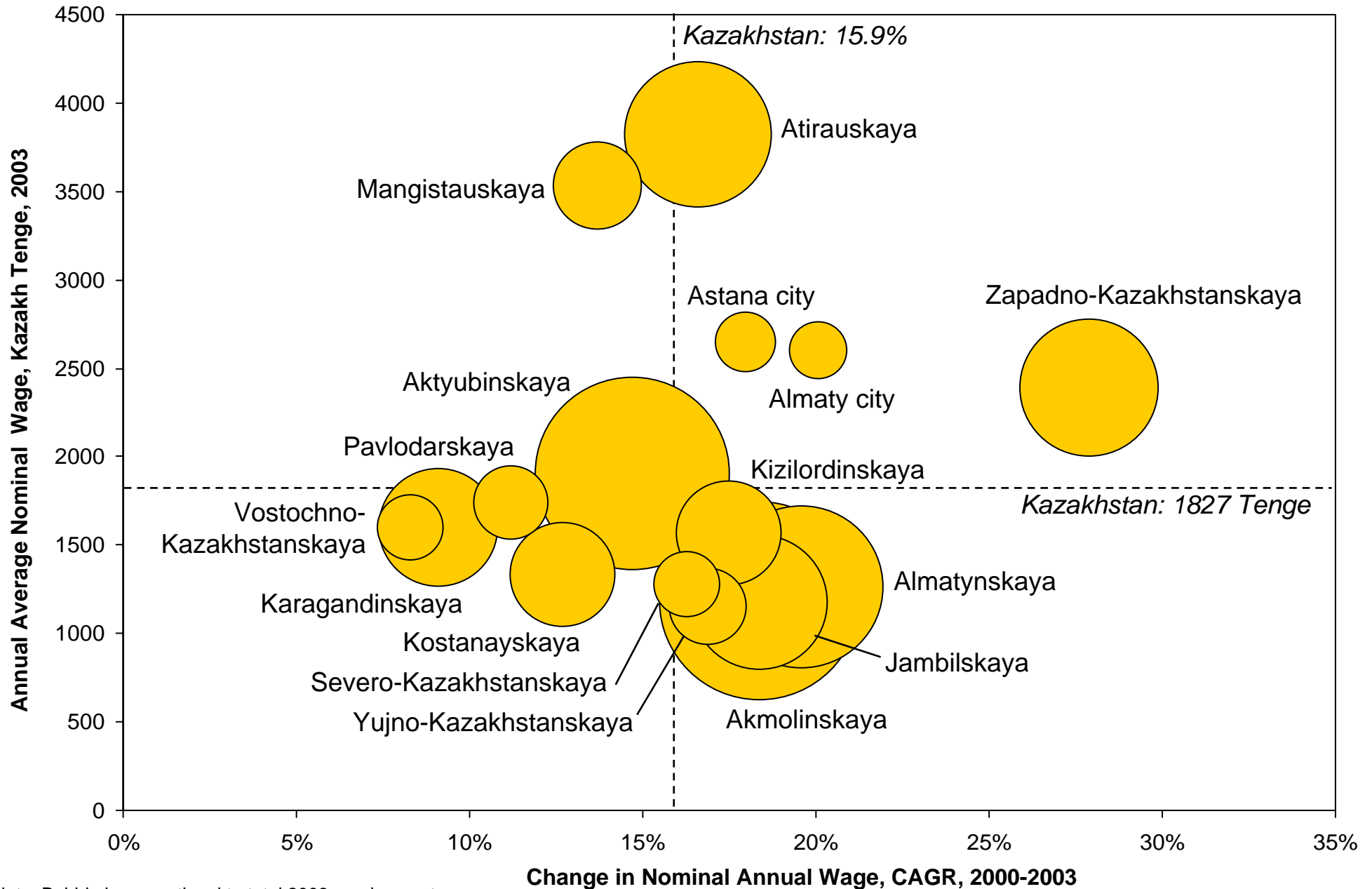
- Kazakhstan can also significantly **leverage** its competitiveness effort by extending the level of regional economic cooperation



- 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



# **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**

# 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

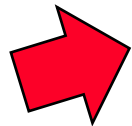
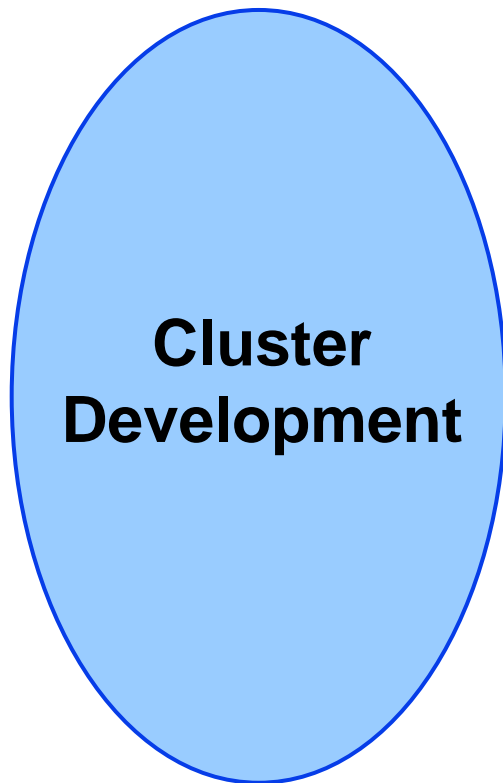


- Separation of regulation from economic activity
- Full transparency of licensing procedures and terms
- Regulations that encourage investments to upgrade and expand their activities in Kazakhstan

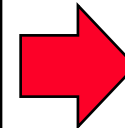
## Appropriate Roles of Government in Cluster Development

- 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



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



- 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 **servicing 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

Enable a  
Vibrant Private Sector

Area	Short-Term	Medium-Term
Physical Infrastructure	<ul style="list-style-type: none"> <li>• Aggressively <b>open the markets</b> for air transport and telecommunications</li> <li>• Begin to upgrade the <b>highway system</b></li> </ul>	<ul style="list-style-type: none"> <li>• Define a long-term <b>strategic plan</b> for investment in logistical infrastructure with a focus on linkages to neighbors</li> </ul>
Skills	<ul style="list-style-type: none"> <li>• Introduce educational <b>standards</b> in schools and colleges</li> <li>• Create <b>skills training council</b> to co-ordinate curricula with business needs</li> <li>• Make <b>IT</b> a universal component of education</li> </ul>	<ul style="list-style-type: none"> <li>• Strengthen <b>education</b> programs in accounting, management, and law</li> <li>• Expand <b>technical training</b> programs and upgrade the university system</li> </ul>
Competition	<ul style="list-style-type: none"> <li>• Accelerate a multi-faceted program to implement a <b>anti-corruption strategy</b></li> <li>• Swiftly conclude <b>WTO negotiations</b></li> </ul>	<ul style="list-style-type: none"> <li>• Strengthen the <b>competition authority</b></li> <li>• Implement the <b>privatization agenda</b></li> </ul>
Financial markets	<ul style="list-style-type: none"> <li>• Institute transparent <b>accounting standards</b></li> <li>• Ease restrictions for banks to take <b>equity stakes</b> in clients</li> <li>• Open market to <b>foreign</b> banks</li> </ul>	<ul style="list-style-type: none"> <li>• Create a <b>credit registry</b></li> <li>• Develop banks' <b>credit assessment</b> capabilities</li> </ul>
Regulatory simplification	<ul style="list-style-type: none"> <li>• Establish a simple <b>one-stop process</b> for business registration, licensing, and reporting</li> </ul>	

# Priorities in Upgrading Kazakh Institutions

Strengthen  
Kazakh Institutions

Area	Short-Term	Medium-Term
<p><b>Public sector – national</b></p>	<ul style="list-style-type: none"> <li>• Upgrade <b>professional training</b> for government officials; pursue plans for a training academy for the public sector</li> <li>• Reach out to experienced Kazakh professionals <b>abroad</b>, including native Germans and Russians with roots in Kazakhstan, as well as foreign nationals</li> <li>• Create separate <b>regulatory agencies</b></li> <li>• <b>Organize government</b> to support competitiveness and cluster development</li> </ul>	<ul style="list-style-type: none"> <li>• Create a <b>professional civil service</b> with standardized entry exams, transparent rules for professional advancement, and performance-based pay</li> <li>• Create a <b>formal coordinating structure</b> within government for economic policy</li> </ul>
<p><b>Public sector – sub-national</b></p>	<ul style="list-style-type: none"> <li>• Engage local government in <b>cluster development</b></li> </ul>	<ul style="list-style-type: none"> <li>• Create a designing making process that ensures <b>stability and transparency</b> in economic policy</li> <li>• Create <b>professional local government</b> with responsibilities for regional economic policy</li> </ul>

# Priorities in Upgrading Kazakh Institutions (continued)

Area	Short-Term	Medium-Term
<p><b>Private sector</b></p>	<ul style="list-style-type: none"> <li>• Use <b>cluster efforts</b> to select new private sector-driven institutions</li> <li>• Create defined <b>roles</b> for private sector institutions in the economic policy process</li> <li>• Actively involve <b>foreign multinationals</b> in Kazakh private sector institutions</li> </ul>	<ul style="list-style-type: none"> <li>• Launch <b>new public-private institutions</b> like workforce-skills development institutes and competitiveness councils</li> </ul>

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