Focused economic diversification

A PROGRAMME OF ECONOMIC DIVERSIFICATION AIMS TO REDUCE DEPENDENCE ON OIL

Kazakhstan has a window of opportunity to diversify before oil prices shoot up again

Can anything good come out of a global economic crisis? Sometimes. Last year, as Kazakhstan – battered by a sudden stop in bank funding and a lower oil price – announced plans to speed up economic diversification and reduce the country's dependence on oil.

Since then, the government has pushed ahead with a full-scale economic diversification programme to create favourable economic and institutional conditions. Infrastructure modernisation and industrial revitalisation are at the heart of this policy, as are increased cooperation between the public and private sectors. The country's legal infrastructure has been further reinforced, and modifications made to the tax code, transferring a greater part of the tax burden to the oil and gas companies.

President Nazarbayev says that the government will be focusing on developing sectors that reflect Kazakhstan's current or potential comparative advantage, based on the country's existing capabilities and resource endowments. They include:

- Agriculture and agri-processing. Kazakhstan's vast land mass gives it a comparative advantage in agriculture, but substantial investments are needed to improve the productivity of primary agriculture and agri-processing. Better infrastructure (such as sufficient railway capacity to export grain) is needed as well.
- Construction industry and building materials. Although the construction sector and the manufacturing of building materials is currently hit hard by the bust in the real estate market, there is still a need to increase the quantity and quality of commercial and residential real estate.
- Metallurgy and manufacturing of finished metal products. Sensible given the large-scale mining industry (copper, iron ore).
- Development of the chemical, pharmaceutical and defence industries. The development of a (petro) chemical cluster makes sense given the abundant hydrocarbon and mineral wealth. The development of a viable pharmaceutical industry is less likely.
- Energy sector, including the development of clean power. Reducing the economy's energy intensity by 10 per cent by 2015. Important given the capacity constraints in the power sector and low energy-efficiency of the industrial and manufacturing sectors.

The European Bank for Reconstruction and Development (EBRD) is also backing diversification efforts through a three-year strategy that has seen the bank sign an agreement with Kazakhstan's state holding and investment company Samruk-Kazyna and the Industry and Trade Ministry to invest up to US$1 billion in projects to diversify the Kazakh economy.

A list of priority projects is being drawn up by Samruk-Kazyna and the Kazakh government. "In the past, there have been various diversification programmes that for one reason or another did not succeed," says Weinstein. "The newly announced programme is more promising. Momentum is building, and there is a window of opportunity to diversify post-crisis, but before oil prices go through the roof again." Weinstein considers the government's new plans to be more realistic than some of those outlined in the past. "The government has set its sights a bit lower this time," he says. "The priority sectors Nazabayev has selected are the right ones. Rather than looking at high-tech sectors, the government is targeting sectors such as pharmaceuticals, chemicals, petrochemicals, metals, construction materials and fertilisers – the things the country needs. At the same time, the strategy is to provide extra resources to develop the small and medium-sized businesses that have still to make a more meaningful contribution to the economy."

Another way that the Kazakh government is to help the development of medium-sized firms is to let them – and the wider Kazakh economy – profit more from the presence of large foreign-owned companies. Fostering backward linkages, by developing SMEs into partners that are 'fit-to-supply' foreign investors, will in many cases require technical and managerial upgrading. The EBRD (the biggest investor in Kazakhstan's non-oil sectors) says that, among a peer group of eleven transition countries, medium-sized companies in Kazakhstan score below average in terms of management quality (only overtaking Belarus, Uzbekistan, Russia and Romania). While the government has an important role to play by improving educational standards, foreign strategic investors also have a responsibility in upgrading local suppliers.

The next years will be crucial for Kazakhstan's diversification efforts. The window of opportunity to improve the business environment for SMEs is narrow: around 2013 the Kashagan oilfield will come on stream. By that time, pressures on SMEs will start to mount further in the form of an appreciating exchange rate and even tougher competition from the oil sector for human capital.