

## KAZAKHSTAN'S ECONOMY IN THE GRIPS OF THE WORLD FINANCIAL CRISIS

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During the past two years, the world economy has been functioning in the conditions of a global financial crisis that is having an impact on the economic development of almost every country in the world. The republic of Kazakhstan, which succeeded during the years of its independence to occupy a dignified place in the world economy, is no exception. It was the first CIS country (and one of the first in the world) to become caught in the grips of the financial crisis.

It should be emphasized that the current crisis has primarily affected highly developed countries. Beginning in the U.S., it quickly pulled Germany, France, Japan, Great Britain, and other countries into its orbit. Although in terms of its main economic indices, Kazakhstan lags far behind these countries, there were many reasons why it followed right behind the U.S. and fell victim to the crisis earlier than many others. The first signs of the crisis phenomena appeared in this country as early as the end of the summer of 2007.

It stands to reason that all the aspects of the global financial and economic crisis will become a target of comprehensive scientific study, from which the necessary practical conclusions will have to be drawn. Today it is too early to talk about the possible results of these studies, but some reasons for what is going on are already obvious. The main one seems to be that the theoretical concepts prevalent in world economic science over the past decades have proven untenable.

In the second half of the 20th century, particularly after the collapse of the world socialist

system, most countries took a so-called neo-liberal approach to economic development problems. This approach espouses the principle of liberalism (free market relations in the economy) and the concept of monetarism (amplification of the role of financial capital in economic development). In compliance with this, free market relations are viewed as the only possible regulator of the development of national economies and the world economy as a whole, while the state is allotted the role of passive observer. But when national banks and corporations found themselves on the brink of bankruptcy, it was the governments of the largest capitalist countries that had to fork out huge amounts of money from the treasury to help them avoid collapse of their financial and economic systems. So the theory of liberal monetarism as a universal mechanism of economic regulation has not justified itself.

At the beginning of April 2009, a meeting of the leaders of the twenty largest nations of the world was held in London to look for ways out of the crisis. Several decisions were adopted that essentially meant a rejection of the neo-liberal theory. However, President of Kazakhstan Nursultan Nazarbaev had been questioning its validity even earlier. At the beginning of March 2009, he realized that it was wrong for the republic's economy to be oriented solely toward market relations and said that the economy should be "hand-steered," which undoubtedly implied intensifying the government's role in the country's economic life.

## Economic Boom of the Beginning of the Century (the Kazakhstani Miracle)

The first years of this century were marked by high growth rates in Kazakhstan's national economy. For seven years (2000-2006), the annual real growth in the gross domestic product (GDP) did not drop below 9%. Sometimes it even exceeded 10% (in 2001, it reached 13.5% and in 2006, 10.7%). On the whole over the indicated period, the total GDP growth in constant prices, without taking account of the rise in hydrocarbon prices, amounted to 99.0%, that is, the GDP essentially doubled.<sup>1</sup>

In 2005, the republic's GDP amounted to \$56.8 billion, which was higher than the indices of all the Central Asian and Caucasian states (Uzbekistan, Turkmenistan, Kyrgyzstan, Tajikistan, Azerbaijan, Georgia, and Armenia) put together.<sup>2</sup>

In 2006, the country's GDP in current prices amounted to as much as \$81 billion, while in 2007 it topped \$100 billion (\$104.85 billion) for the first time.

And whereas in 2000, Kazakhstan's per capita GDP was only \$1,229, by 2007 this index had risen by more than five-fold, reaching \$6,772.<sup>3</sup>

Industry has been developing in leaps and bounds; in 2000, industrial production rose by 15.5% compared to the level of the previous year, in 2001 it increased by 13.8%, in 2002 by 10.5%, in 2003 by 9.1%, and in 2004 by 10.4%.

In subsequent years, the industrial production growth rates dropped slightly, but still amounted to 5-7% per annum.<sup>4</sup>

Such rapid growth in GDP, industrial production, and other macroeconomic indices at the beginning of this century prompted journalists and experts to call what was happening a "Kazakhstani miracle."

But the growing global financial crisis shed light on many secrets of this "miracle." It turned out that it was mainly based on "two whales": priority development of the oil-and-gas sector aimed at promoting a constant increase in the export of energy resources and the rapid increase in hydrocarbon prices in the world energy markets.

The vast oil and gas supplies on Kazakhstan's territory and the shelf of the Caspian Sea contiguous to it (along with their relatively low domestic consumption) also encouraged the government to concentrate on turning the oil-and-gas industry into a driving force behind the national economy.

In his annual message to the nation in February 2005 entitled *Kazakhstan on the Road to Accelerated Economic, Social, and Political Modernization*, President Nazarbaev openly admitted that "today the main source of economic growth is exploitation of the country's raw material potential."<sup>5</sup>

The favorable situation that developed in the world energy markets, as well as the extensive use of foreign direct investments for accelerating the development of the oil-and-gas sector yielded good results.

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<sup>1</sup> See: *Kazakhstan za gody nezavisimosti (1991-2007)*, Republic of Kazakhstan Statistics Agency, Astana, 2008, pp. 75-76.

<sup>2</sup> See: V. Babak, "The Oil and Gas Sector in Kazakhstan," in: *Central Asia and the Caucasus*, No. 4 (40), 2006, p. 47. Incidentally, data published later and evidently revised give a slightly higher figure. For example, the report of the Republic of Kazakhstan Statistics Agency *Kazakhstan za gody nezavisimosti (1991-2007)* (In the Period of Independence [1991-2007]) already cited gives a figure of \$57.1 billion.

<sup>3</sup> See: *Kazakhstan za gody nezavisimosti (1991-2007)*, p. 74.

<sup>4</sup> See: *Ibid.*, p. 10.

<sup>5</sup> *Kazhakhstanskaia pravda*, 11 March, 2005.

Since 1995, oil production in the country has been on the constant rise. For example, in 1995, 20.6 million tons of oil and gas condensate were produced in the country, while in 2000 this index reached 35.3 million tons, that is, over five years, liquid fuel production rose by more than 71%.

As a result, in 2000, the percentage of oil production in the total volume of the country's industrial production amounted to 39.9%, that is, almost 2/5.<sup>6</sup>

In the new century, oil and gas condensate production has continued to rise at a steady rate, while liquid fuel is still being exported to the world markets. In 2007, oil production had reached 67.5 million tons, while in 2008, it reached the 70-million-ton mark, which is 1.8% of world oil production.

In recent years, approximately 90% of all the oil produced in the country has been going to export. For example, in 2007, 60.8 million tons of the total 67.5 million tons of oil and gas condensate produced were exported. Compared with 1999, the physical volumes of oil export increased 2.57-fold.

There has also been rapid growth in natural gas production. Between 2000 and 2007, natural and casing-head gas production increased from 8.9 to 29.2 bcm a year, which is a by almost 3.3-fold increase.<sup>7</sup>

In 2006, the share of the oil-and-gas industry in the country's GDP amounted to 14.7%, and to 66.3% in export.

In other words, two dollars out of every three that Kazakhstan earned in the export markets came from the sale of oil and gas.<sup>8</sup>

The share of the gas sector has been relatively small compared to oil export.

In 2007, Kazakhstan exported 15.2 bcm of natural gas totaling \$648.2 million, while more than 60 million tons of oil totaling \$28.13 billion were exported. It is interesting to note that since 1999, the physical volumes of oil export have increased 2.57-fold, while export earnings from its sale have increased 13.59-fold, which shows the rapid rise in oil prices in recent years.<sup>9</sup>

The constant rise in the volumes of oil production and increase in oil prices in the world markets were the main reasons for the rapid increase in Kazakhstan's export. In 2003, it amounted to \$12.9 billion, in 2004 to \$20.1 billion, in 2007 to \$47.8 billion, and in 2008 to as much as \$71.2 billion.<sup>10</sup>

It goes without saying that import volumes also constantly rose, but to a much lesser extent. So in recent years the republic has had a high positive foreign trade balance (in 2005 it amounted to \$10.5 billion, in 2006 to \$14.6 billion, and in 2007 to \$15.0 billion).

The enormous earnings from hydrocarbon export made it possible for Kazakhstan to create a special National Fund in August 2000 to accumulate tax payments from raw material enterprises that obtained super profits from the export of raw materials and other receipts.

According to its founding documents, the purpose of creating this fund was to stabilize the socioeconomic situation, accumulate savings for the future generations, and reduce the economy's dependence on the negative influence of external factors.

The fund consists of two components: stabilization and savings (the Stabilization and Savings funds, respectively). It should be noted that Kazakhstan was the first CIS country to form such a financial structure called upon to ensure the creation of favorable conditions for further economic development.

Although the National Fund did not begin functioning until 2001, by the end of 2006 it had accumulated \$14,039.1 million. A year later this sum had reached \$21,045.5 million, and by the end

<sup>6</sup> See: *Kontinent*, 27 December, 2000-16 January, 2001, p. 19.

<sup>7</sup> [<http://www.rusoil.ru/opinions/o06-58.html>].

<sup>8</sup> *Ibidem*.

<sup>9</sup> Calculated according to: V. Babak, *op. cit.*, pp. 43, 45 and [<http://lider-invest.com.ua/news/2008-02-14-1961>].

<sup>10</sup> See: *Kazakhstan v 2008 godu*, RK Statistics Agency, Astana, 2009, p. 12.

of 2008 it was as much as \$27,334.2 million, which was almost 1.5-fold more than the international reserves of the National Bank at the end of 2008 (\$19,396.2 million).<sup>11</sup>

Significant positive changes have also occurred in the social sphere. Personal incomes have rapidly risen—wages, work pensions, various social benefits, and so on. For example, in 2004, per capita monetary income amounted to 12,817 tenge (a month), in 2005, it was 15,787 tenge, in 2006, 19,152 tenge, in 2007, 25,226 tenge, while in 2008, it had reached 30,509 tenge.<sup>12</sup> The nominal average monthly wage in 2004 amounted to 28,329 tenge, in 2006 to 40,790 tenge, and in 2008 to as much as 60,734 tenge (\$526).<sup>13</sup>

Between 2004 and 2008, state budget expenditures increased from 1,323.8 to 3,394.1 billion tenge, which is more than 2.5-fold.

During this time, the amount of residential space put into service increased from 2.6 to 6.8 million sq. m.<sup>14</sup>

In 2007, the republic's government promulgated a three-year socioeconomic development program for the country for 2008-2010. It stated that "the main goal of the country's socioeconomic policy in 2008-2010 was to create favorable institutional and economic conditions for raising Kazakhstan's international competitiveness and the standard of living of its citizens."<sup>15</sup>

The high indices of the republic's socioeconomic development inspired the president to put forward the ambitious goal of achieving Kazakhstan's entry into the club of the fifty most economically developed and competitive countries of the world.

## Development of the Financial Crisis

The first signs of the financial crisis in Kazakhstan, as already noted, appeared as early as the end of the summer of 2007. It was then, according to press reports, that some of the largest banks began to feel a liquidity shortage. At that time, due to the unfolding crisis, foreign creditors not only stopped lending money to customers abroad, they also demanded the return of previous debts. Kazakhstani banks were some of the first to fall victim to the crisis due to the enormous amounts of debt they had already accumulated to foreign creditors.

For example, on the eve of the crisis, by the end of 2006, more than half (52%) of their liabilities constituted foreign borrowing. It is interesting to note that in 2004 the share of foreign borrowing amounted to 38%, that is, in just two years, this index rose by more than 1/3.<sup>16</sup>

It should be stressed that it was precisely the enormous amounts of foreign financial borrowing and not the drop in hydrocarbon prices that was one of the main, if not the main, reason for the crisis in the country: it began when the oil and gas prices in the world markets reached record levels and continued to grow, with export earnings rising close on their heels.

The rapid growth rates of the national economy, the vast natural resources, and the national banking system that functioned in compliance with international standards augmented Kazakhstan's

<sup>11</sup> See: *Kapital kz*, No. 38, 16 October, 2008, available at [<http://news.finance.ua/ru/-/2/0/all/2009/02/05150897/printable>].

<sup>12</sup> See: *Sotsialno-ekonomicheskoe razvitie Kazakhstana v 2008 g. (predvaritelnye itogi)* (Kazakhstan's Socioeconomic Development in 2008 [preliminary results]), RK Statistics Agency, Astana, 2009, p. 7.

<sup>13</sup> *Ibidem*.

<sup>14</sup> *Ibid.*, p. 8.

<sup>15</sup> "Srednesrochniy plan sotsialno-ekonomicheskogo razvitiia Respubliki Kazakhstan na 2008-2010 gody," *RK Collected Acts of the President and the Government*, No. 32, 2007, p. 354.

<sup>16</sup> See: O. Skvortsov, "Finansovyy krizis: zarubezhnyy opyt (na primere Iaponii i Kazakhstana)," available at [<http://www.klerk.ru/columnists/skvortsov/?130694>].

role in the world financial system. Suffice it to say that it was given rather a high sovereign credit rating (in particular, BBB+ from Standard&Poor's, an international rating company).

In turn, the high rating the republic was given by prestigious world agencies helped to attract foreign investments and loans. The country's commercial banks had the green light to borrow large amounts of money from abroad and often on extremely preferential terms. This made it possible to lend out the money received under much higher interest rates in the domestic market—"reselling" money became an extremely profitable business.

By the beginning of the crisis, the loans received by commercial banks abroad amounted to the colossal sum of \$45 billion, that is, about half of the country's GDP in 2007. The commercial banks' use of borrowed foreign capital became a topic of discussion in the national parliament.

In April 2007, members of the Majilis (the lower house of parliament) finances and budget committee held a meeting with the heads of commercial banks at which they expressed their "concern about the rapid and accelerating increase in bank assets compared with their own capital." It was noted at the meeting that "in the past two years, the ratio of bank assets to Kazakhstan's GDP had more than doubled from 48.5 to 101.7%." In so doing, it was noted that the rapid growth in the banks' loan portfolio was a risk factor.<sup>17</sup>

The main recipients of loans from commercial banks were those branches of the national economy that guaranteed the highest profit (housing construction, commerce, and the non-production sphere). Unfortunately, only 1/10 of the funds received was used in industry.

As for the enormous inflow of foreign direct investments into the country, which amounted to \$166 billion between 1993 and 2008,<sup>18</sup> something the republic's leadership showed particular pride in, the large foreign investments were mainly used to develop the primary sector, which was supposed to ensure increased volumes of oil and gas production.

In this way, despite the generally positive influence of foreign capital on economic growth (in recent years up to 80% of its growth was ensured by means of foreign borrowing),<sup>19</sup> it also played a negative role, since it encouraged the national economy to focus predominantly on development of the oil-and-gas-producing industry. This branch of the national economy has been evolving at a rapid rate, while other branches (in particular, the processing industry) have been developing much more slowly; and this disproportion has been increasingly growing.

This situation could have been anticipated. As early as 2001 I wrote: "More or less easily earned petrodollars deprive other branches of attention. The strategy is perpetrating technological backwardness and will turn the country into a raw material appendage of the developed world. There is a real threat that oil will not take Kazakhstan into the future but slow down its economic advance."<sup>20</sup>

Unfortunately, the worries voiced eight years ago proved to be true. According to official statistics, in the first quarter of 2009, Kazakhstan imported not only machinery, equipment, metals, and items made from them, but also petroleum products that the country is still unable to fully provide itself with. Various commodities are still being imported that could quite easily be manufactured in the republic itself.

The newspaper *Delovaia nedelia* writes: "The production volumes of non-food consumer and investment commodities in the country are incredibly small, the production dynamics of many food-stuffs noticeably lags behind demand, which is making Kazakhstan extremely dependent on the import of these commodities."<sup>21</sup>

<sup>17</sup> See: K. Sagadiev, "Mirovaia ekonomika perezhivaet rubikonnoe vremia," *Delovoi Kazakhstan*, 6 March, 2009.

<sup>18</sup> See: *Kazakhstansko-britanskaia Torgovo-promyshlennaia palata. Perspektivy kazakhstanskoi ekonomiki* (Kazakh-British Chamber of Commerce. Prospects of the Kazakh Economy), available at [<http://kbcc.org.uk/ru/business-info/kazakhstan-economy-outlook/>].

<sup>19</sup> See: A. Kurtov, "Tsentralnaia Aziia—ispytanie krizisom," available at [<http://www.centrasia.ru/newsA.php?st=1234569780>].

<sup>20</sup> V. Babak, "Kazakh Oil: Economic Booster or Dead Weight?" *Central Asia and the Caucasus*, No. 3 (9), 2001, p. 45.

<sup>21</sup> N. Ramazanov, "Rost smenilsia padeniem," available at [<http://www.dn.kz/main/bank01.htm>].

Most of the funds Kazakh banks received were used, as mentioned above, for construction, as well as for issuing consumer and mortgage loans.

For example, five of Kazakhstan's largest commercial banks, which account for 70% of the assets of the national banking system, increased the volume of their loans to construction companies in just 2.5 years (from the end of 2004 to April 2007) from \$1.6 billion to \$10.4 billion.<sup>22</sup> The share of loans issued to construction companies (taking into account mortgage loans) amounted to 30%.<sup>23</sup>

It should be noted that the constantly growing earnings from oil and gas condensate export (due to the rapid increase in hydrocarbon prices in the world markets and increase in its production volumes in Kazakhstan) reached the colossal sum of \$28 billion in 2007. The above-mentioned foreign borrowing by Kazakh banks was another important source of foreign exchange receipts. A combination of these two factors caused "overheating" of the national economy.

The favorable external situation did not have a significant impact on the development of most production branches: the construction industry and the banking sector being the indisputable favorites.

The high earning power of the construction business and the shortage of housing, which has existed since as early as Soviet times, as well as the essentially unhindered opportunity to obtain mortgage loans stimulated a real building boom in the country which was accompanied by a speculative increase in housing prices. Between 2000 and 2007, housing prices increased by 1,780% in the secondary market and by 775% in the primary. While the amount of new housing put into service increased four-fold.<sup>24</sup>

The loan crisis of 2007 dealt a severe blow to the construction business in Kazakhstan—bankers were forced to tighten up loan-issuing conditions and many building projects were frozen; construction became an unprofitable business. An outflow of capital from the construction industry began. Many investors, unable to find use for their capital in the country, turned their sights abroad. The demand for foreign real estate dramatically rose.

The deterioration in the capital inflow and outflow balance that began several years previously continued with a vengeance. As early as 2005, the net capital outflow was expressed in quite a high negative value (–\$4.97 billion). In 2006–2007, this index continued to deteriorate (–\$8.49 and –\$10.95 billion, respectively).<sup>25</sup>

The loan crisis dealt a hard blow to small and medium business. Many small-scale and medium-sized enterprises, deprived of access to loans, began to close down. For example, according to the official data as of 1 January, 2008, approximately 1.4 million people were employed in small and medium business, but by the fall of the same year this figure had dropped by half.<sup>26</sup>

As a result, the ranks of the unemployed greatly swelled and revenue into the state budget correspondingly fell.

In recent years, wages have rapidly grown in the country, as well as pensions and other social benefits, which has promoted an increase in domestic consumer demand. Since this growth was much higher than the increase in labor productivity, it resulted in an increase in inflation. At first it was moderate, reaching 7.7% in 2005 and 8.4% in 2006, whereas in 2007 it had risen as high as 18.8%.

The growing financial crisis significantly worsened the country's macroeconomic indices. The GDP growth rates slowed: in 2006, they were 10.6%, in 2007, 8.7%,<sup>27</sup> and in 2008, only 3.2%. The

<sup>22</sup> See: *Program Statement of the Socialist Resistance of Kazakhstan about the crisis and measures for overcoming it...* available at [[http://www.kazakhstan.socializm.ru/ideology/program/antikrizis\\_econ\\_program\\_2009](http://www.kazakhstan.socializm.ru/ideology/program/antikrizis_econ_program_2009)].

<sup>23</sup> Ibidem.

<sup>24</sup> [[http://www.zakon.kz/our\\_news/news.asp?id=30176764](http://www.zakon.kz/our_news/news.asp?id=30176764)].

<sup>25</sup> See: P. Svoik, "Ekonomika Kazakhstana na fone mirovogo krizisa: chto my sozdali i s chem ostaemsia?" available at [<http://www.centrasia.ru/newsA.php?st=1225058400>].

<sup>26</sup> See: D. Satpaev, "V Kazakhstane zatiagivaiut poiasa," RIA Novosti (Moscow), 14 October, 2008.

<sup>27</sup> See: *Kazakhstan za gody nezavisimosti (1991-2007)*, p. 11.

industrial production growth rates also perceptibly dropped. In 2006, its growth amounted to 7.2%, in 2007 to 5.0%, and in 2008 to only 2.1%. Compared to the 2007 level, agricultural production dropped by 5.6%, although in previous years stable growth was seen in the agrarian sector: in 2005—4.6%, in 2006—4.5%, and in 2007—8.9%.<sup>28</sup>

As for the growth rates in the country's foreign trade turnover (export and import), they depend on the influence of two factors at once: the impact of the crisis on the demand for goods and services and the change in prices. The republic's high export growth rates were explained by the increase in price for the country's main export commodities (hydrocarbons, metals, and wheat) and the increase in their physical volume. For example, in 2006 export rose by 37.3% compared to the previous year, in 2007, by 24.8%, and in 2008, by 49.1%.

In 2008, the increase in oil prices continued, compensating for the negative effect of other factors. But at the end of the year, there was a landslide in the prices for Kazakhstan's export commodities, and in the first quarter of 2009, the picture dramatically changed. According to the data of the National Statistics Agency, during the first three months of 2009 export decreased by almost half (49.2%) compared with the first quarter of 2008 and amounted to only \$8.02 billion. At the same time, import decreased by only 15.8% and amounted to \$5.99 billion. In this way, the surplus in Kazakhstan's foreign trade balance in the first quarter of 2009 amounted to only \$2.03 billion, which is over four-fold less than during the first quarter of 2008, when the positive balance reached \$8.7 billion.<sup>29</sup>

If this trend continues, it will have a negative effect on settling of the external debt. The problem of paying off the country's growing external debt existed even before the onset of the world financial crisis. For example, in just two years (from 2004 to 2005), this debt almost doubled. By the end of 2005, it had reached the sum of \$43.4 billion, which was approximately 75% of the GDP.<sup>30</sup>

Kazakhstan came close to the critical mark when its gross external debt amounted to 80% of the GDP. But as early as 2006, the republic crossed even this boundary: in just a year the external debt rose to \$74 billion, which was more than 90% of the GDP (\$81 billion).

In 2007-2008, Kazakhstan's gross debt continued to rise: by the end of 2008 it was already as high as \$107.8 billion, although its share in GDP terms dropped to 81.5%.<sup>31</sup>

At present, the increase rate in the gross debt amount has dropped, but its relation to the GDP is still above the critical mark.

So-called second-tier banks have a particular role to play in this rapid increase in the country's gross external debt. By the end of 2007, their total external debt had reached almost \$46 billion, which amounted to 47.4% of the country's gross external debt. In 2008, these banks were supposed to pay off \$14.1 billion, in order to do which they had to resort to new loans (totaling \$7.4 billion). Nevertheless, they managed to reduce their debt to \$39.2 billion.

In 2008, the situation became much worse. Due to the inability of banks to independently pay off their debts, Kazakhstan lost several potential creditors. In addition, the worsened liquidity situation in the world markets dramatically limited the possibility of receiving foreign loans for settling the existing debt. Interest rates in the world credit markets noticeably increased.

In addition, the drop in prices for the country's main export commodities (oil, gas, metals, and grain) in 2008 significantly reduced state revenues.

The state still has the capacity to support the banking sector, but is unable to assist all private enterprises.

<sup>28</sup> Ibidem.

<sup>29</sup> See: *Brief Results of the Socioeconomic Development of the Republic of Kazakhstan for January-April 2009*, RK Statistics Agency, Astana, May 2009.

<sup>30</sup> See: N. Ramazanov, "Dolgovaia iama vse glubzhe," *Delovaia nedelia*, 10 April, 2009.

<sup>31</sup> Ibidem.

The external debt of Kazakhstan enterprises (without taking into account inter-company debts and bank debts) at the beginning of 2008 amounted to approximately \$35 billion, while the assets of the National Fund were evaluated at \$27.3 billion.<sup>32</sup>

Despite the fact that in 2008, there was limited access to foreign credit markets, the country's gross external debt continued to rise and by the end of the year had increased by another 11.2%, reaching a total amount of \$107.8 billion.

But it should be noted that in 2008, the national debt, as well as debts for which there are government-guaranteed obligations, increased by only \$68 million. At the same time, the external debts of the private sector increased over the year by more than \$10.8 billion.<sup>33</sup>

In 2008, Kazakhstan paid off the enormous sum of \$31.3 billion on its external obligations (including costs relating to paying off and servicing the national debt, as well as settling the external debts of the private sector). It was able to cope with this difficult task due to the enormous positive foreign trade balance that had developed because of the high hydrocarbon prices in the world markets and by means of new foreign borrowing. Despite this, as already mentioned above, the total amount of the Kazakhstan's gross external debt increased again, and by the end of 2008 each of the country's residents accounted for approximately \$6,800 of the external debt.

## Anticrisis Strategy

Despite the fact that the first symptoms of the crisis in Kazakhstan's banking system were noticed as early as the beginning of the second half of 2007, the country's leadership was long unable to define its anticrisis strategy. Naturally, it took several measures to remove the difficulties that arose in the country's fiscal system and to stabilize the situation in general. But this was more of a response to certain problems in the banking system than a well-thought-out anticrisis program.

For example, when capital began to stream out of Kazakhstan, and national commercial banks had limited access to the foreign capital markets, the country's leadership began to take steps to correct the situation that developed. But at that time it was unable to fully assess the dimensions of the crisis that had already begun. The authorities evidently viewed the situation that developed as merely a temporary liquidity shortage in second-tier banks and limited themselves to providing them with the necessary short-term liquidity.

According to Vice President of the country's National Bank Daniar Akishev, in the second half of 2007, the total amount of government assistance to commercial banks amounted to some \$40 billion. In addition, President Nazarbaev instructed that another \$4 billion be allotted to support the country's banking system.<sup>34</sup>

It was presumed that the measures adopted would be enough to remove the banks' temporary liquidity problems and that the situation would quickly recover. When speaking at a round table discussion in September 2008 in Moscow on the problems of the global financial crisis organized by the Russian Information Agency, Novosti, Daniar Akishev also said that the situation in Kazakhstan's banking system had dramatically improved by the end of 2007 and so the world financial crisis that developed in 2008 was not having any noticeable influence on the banking system of his country.<sup>35</sup>

Unfortunately, as often happens in countries with a high level of state corruption, the situation in the financial sphere developed contrary to the scenario designated by the government. After receiv-

<sup>32</sup> See: N. Ramazanov, "Dolgovaia iama vse glubzhe."

<sup>33</sup> Ibidem.

<sup>34</sup> See: RIA Novosti (Moscow), 24 September, 2008.

<sup>35</sup> Ibidem.



ing \$4 billion in 2007 to support small and medium business and construction, Kazakhstan banks were in no hurry to use it for its designated purpose. As a result, Prime Minister Karim Masimov was forced to recall some of the money the banks had still not used, hinting that this money was obviously being put on the float.<sup>36</sup>

As early as October 2008, less than a month after the victorious reports of National Bank Vice President Mr. Akishev in Moscow, the second wave of the financial crisis dealt Kazakhstan a severe blow. This time, the republic's leaders reacted quite promptly to the aggravated situation.

In October 2008, President Nazarbaev made a decision to create a National Prosperity Fund called Samruk-Kazyna, a kind of anticrisis headquarters. A total of \$10 billion was allotted to it from the stabilization part of the National Fund. Four billion of this sum was intended for four of the country's strategic banks (Alliance Bank, BTA Bank [Turam-Alem Bank], Narodny Bank, and Kazkommertsbank), as well as to support several other sectors of the national economy.

A total of \$3 billion was allotted to support the construction industry and mortgaging; \$1 billion was intended to support the agro-industrial complex, and the same amount was allotted to save small and medium business. In addition, \$1 billion was to be used to implement various production and infrastructure projects.

The government's anticrisis program adopted in November 2008 proposed, in particular, that the Samruk-Kazyna holding created by the government join the capital of the four above-mentioned strategic banks; it was presumed that it would become their co-owner.

In other words, Kazakhstan largely undertook the same measures to save its banking system that were undertaken in the U.S., Germany, and Great Britain.

In addition, in order to reduce the negative effects of the world financial crisis to a minimum, high export fees and a new tax on mineral production were introduced. With these measures the government showed its willingness to take active steps to settle the crisis situation in the economy and finances.

According to Dosym Satpaev, director of the Risk Assessment Group, governmentalization of the economy is going on in Kazakhstan, whereby not only in the financial sphere, but also in other important sectors, such as the energy industry, the mining industry, and others.<sup>37</sup>

At the end of November 2008, the president gathered local investors together at a special meeting. He expressed his concern that over the past year approximately \$52 billion had been exported from the country and asked the businessmen to share their opinions on the problem of loss minimization. But according to press reports, this idea was not supported and the talks failed. It is possible that the businessmen did not like some of the head of state's proposals. The president stated in particular that the state would allot \$3 billion to support the construction business, but believed that "the time had gone when a square meter of housing cost \$5-6,000 and construction companies enjoying state support should assume some of the losses themselves and sell housing at a lower price than previously. Those companies that objected would have to face bankruptcy."<sup>38</sup>

Nazarbaev also suggested that the money accumulated in the pension funds be used to recapitalize commercial banks; after stabilization of the financial situation this money should be returned.<sup>39</sup>

At the end of 2008, the republic's government, National Bank, and Financial Inspection Agency adopted a joint action plan for 2009-2010 aimed at stabilizing the economy and financial system, which envisages a whole series of measures for a quick exit from the crisis. According to this document, the state was to render financial support to banks by purchasing their shares and issuing them subordinated loans.

<sup>36</sup> Ibidem.

<sup>37</sup> See: RIA Novosti (Moscow), 14 October, 2008.

<sup>38</sup> V. Panfilova, "Nazarbaev meniaet ekonomicheskuiu strategiiu," *Nezavisimaa gazeta*, 25 November, 2008.

<sup>39</sup> Ibidem.

In order to receive this assistance, the banks are supposed to raise their own capital by means of their shareholders. It is presumed that as the global financial crisis abates and access is gained to the international capital markets, the state (in the form of the Samruk-Kazyna fund) will gradually cease its participation in the banks' capital.

There are also plans to create a distressed assets fund using revenue from the republican budget, the activity of which should be aimed at improving the quality of the banks' loan portfolios. In 2009, it was to have 122 billion tenge (approximately \$1 billion) at its disposal. The fund's main obligation will be to purchase doubtful bank assets and subsequently manage them.

In January 2009, the government rendered emergency assistance to Kazkommertsbank and Narodny Bank by depositing \$1 billion each in them. The following month, the same measures were also undertaken with respect to two other large banks, BTA and Alliance Bank; and a decision was made to purchase their shares.

The pumping of government resources into the banking system made it possible to maintain the banks' liquidity at a satisfactory level. The share of liquid assets compared to the total as of 1 March, 2009 amounted to 16.4%. But the quality of the loan portfolio was extremely unsatisfactory: almost 2/3 of the loans qualified either as doubtful (55.2%), or as unrecoverable (7.2%).<sup>40</sup>

In addition, \$5 billion was allotted to activate the real estate market in Astana and Almaty (by means of the Samruk-Kazyna fund). There are also plans to launch a special program of mortgage lending and housing development. Funds to implement it should come from resources borrowed from the National Fund and accumulative pension funds.

The plan also envisages rendering support to small and medium business. For this purpose, there were plans to allot \$1 billion in 2009. Second-tier banks are to be the operators of all the lending programs for small and medium business. The limit on financing of each project is being increased from \$3 to 5 million.<sup>41</sup>

The document also envisages several measures for developing the agro-industrial complex and implementing innovation, industrial, and infrastructure projects.

The International Monetary Fund (IMF) assessed the anticrisis measures adopted by the Kazakhstan government as positive. During a meeting with the republic's Prime Minister Karim Masimov, head of the IMF mission in Kazakhstan Tim Callen noted that "the policy of the Kazakh government shows that the country is doing the right thing to extricate itself from the current situation." In particular, the IMF representative very much approved the government's decision to recapitalize banks at the government's expense.<sup>42</sup>

At the beginning of February 2009, the country's leadership adopted a decision to greatly devalue the national currency, as a result of which the value of one dollar increased from 122.3 to 144.0 tenge (from 4 to 5 February). This measure was called upon not only to raise the competitiveness of domestic products in the world markets, it was also designed to put an end to the huge amounts the National Bank was spending to maintain the exchange rate of the national currency.

The National Bank made the sum it was spending to maintain the national currency public for the first time—between the fourth quarter 2008 and 4 February 2009, it spent \$6 billion. In January 2009 alone, maintenance of the previous tenge exchange rate cost \$2.7 billion.<sup>43</sup>

It should be noted that devaluation of the national currency was carried out in Kazakhstan much later than in many CIS countries, whereby its dimensions were much smaller than in other countries.

<sup>40</sup> See: N. Ramazanov, "Zhestkaia posadka," available at [<http://www.dn.kz/main/bank01.htm>].

<sup>41</sup> [<http://www.zakon.kz/our/news/news.asp?id=30369373>].

<sup>42</sup> See: *Kazakhstan segodnia*, 19 November, 2008.

<sup>43</sup> [<http://news.finance.ua/ru/-/2/0/all/2009/02/05/150897/printable>].

Devaluation of the tenge was a compulsory measure. The National Bank was faced with a dilemma: either to continue spending its own international reserves to maintain the exchange rate of the national currency, or to devalue it. The country's authorities understood that this would have ambiguous economic and social consequences for the country. But in the end the fact that devaluation could promote the expansion of export was evidently the clincher. And in the crisis conditions, this was extremely important for the country.

## Short-Term Prospects

Economic forecasting is usually a thankless task. Even during times of long economic stability it is accompanied by significant difficulties and depends on many factors of social life—psychological, legal, public, and so on, that do not have a quantitative expression and so can only be accounted for approximately.

In the conditions of an economic crisis, forecasting is complicated by the unusualness of the situation. So in this case it is not a matter of forecasts for the next 1-2 years as such, but rather prepositions based on already designated trends and expert opinions.

According to IMF experts who visited the country in mid-June 2009, the republic's GDP would decrease by more than 2%. But according to the forecasts of the republic's cabinet of ministers, economic growth in 2009 would continue, although its rates would slow down to 1%.<sup>44</sup>

Preliminary data of the RK Statistics Agency for the first quarter of 2009 show that the republic's GDP in January-March 2009 decreased to 2.2% compared to the same period for the previous year.<sup>45</sup>

In January-May 2009, industrial production dropped by 4.6% compared to the same period in 2008. Judging from the first intermediate data, the IMF's forecast might prove to be more precise than the forecast of the Kazakh cabinet of ministers.

Kazakhstan was one of the first countries to enter the financial crisis and, according to the available statistics, has a real chance of withdrawing from it before the rest, since the republic has managed to avoid a severe drop in GDP and volumes of industrial production.

Despite the fact that the government was slow on the uptake at the beginning of the crisis, the measures it subsequently implemented have yielded positive results. A total of \$19 billion have been allotted to carrying out anticrisis measures, which corresponds to 14% of the country's GDP.<sup>46</sup>

The funds invested in infrastructure, transportation, and social facilities have made it possible to create approximately 100,000 new jobs and, in so doing, partially resolve the employment problem.

According to the president, unemployment has come to rest at a level of 7.2%, and there is reason to believe that it will not go any higher than this mark.<sup>47</sup>

The government has succeeded in stabilizing the foreign exchange reserves (\$43 billion as of June 2009); the increase in oil prices that has begun gives rise to the hope that this trend will continue.

Despite the severe blow dealt to the banking system, it was able to withstand it thanks to government intervention.

In the first four months of 2009, the credit investments of second-tier banks in various branches of the economy decreased compared to the corresponding period in 2008 by only 9.3%,<sup>48</sup> showing

<sup>44</sup> See: *Press Dossier of the Kazakhstan National Economic Chamber "Soiuz Atameken,"* 16 June, 2009.

<sup>45</sup> See: *Brief Results of the Socioeconomic Development of the Republic of Kazakhstan for January-May 2009,* RK Statistics Agency, Astana, June 2009.

<sup>46</sup> [<http://www.centrasia.ru/news/A.php?st=1244816640>].

<sup>47</sup> See: RK Statistics Agency, available at [[http://www.stat.kz/news/Pages.n2\\_01\\_07\\_2009.aspx](http://www.stat.kz/news/Pages.n2_01_07_2009.aspx)].

<sup>48</sup> See: *Socioeconomic Development of the Republic of Kazakhstan in January-May 2009,* RK Statistics Agency, Astana, June 2009.

that the banking system in general has nevertheless retained its capacity to contract. In all likelihood, it can be assumed that in the near future it will be able to renew lending to the economy in the necessary amounts.

The state budget for 2009 formed taking account of the devaluation in the tenge forecasts an annual inflation of 11%. The cumulative inflation for January-June 2009 (3.9%)<sup>49</sup> is a positive sign that this task has been successfully dealt with. It is also possible that the annual inflation rate will be lower than the figure planned in the budget.

Regardless of how prices form in the world markets, oil will continue to be the country's main export commodity. In the first quarter of 2009, despite the increase in the physical volume of oil and gas condensate sales (by 63.3% compared to the same period for 2008), the earnings from their export decreased by 27.4% compared to the same period of the previous year.<sup>50</sup>

The increase in hydrocarbon prices makes it possible to count on a significant surplus in the republic's foreign trade balance in 2009 too, although it will undoubtedly be much lower than in 2008. The main reason for the decrease in surplus is that the average price of a barrel of oil in the world markets in 2009 will be much lower than the previous year.

The measures taken by the government to render assistance to small and medium business (allotting \$2 billion, introducing a new tax code, and so on) helped to revive it. According to state statistics, as of 1 June, 2009, 290,025 legal entities were registered in the country, which is 5.2% more than the previous year. The number of enterprises belonging to small business, that is, those with less than 50 employees, also rose by 5.5%.<sup>51</sup>

In 2009, corporate income tax was lowered by 1/3 and currently amounts to 20%. In 2011, the government plans to further lower this tax to 15%. The value added tax rate was lowered to 12%.<sup>52</sup> Many administrative barriers have been removed.

All of these measures are designed to revive and promote the successful development of small and medium business in the country in the near future. As mentioned above, the first positive shifts in this direction have already been designated.

Positive changes are also expected in the development of the agro-industrial complex. The state has allotted more than \$2 billion to the development of the agrarian sector. This made it possible to carry out spring sowing in full. In addition, in 2009 the amount of cultivated area was increased by 1.6 million hectares. Between January and May 2009, the volume of gross agricultural produce rose by 3.1% compared to the same period in 2008.

In May, Standard&Poor's raised its forecast of Kazakhstan's sovereign rating to "stable." This could stimulate the inflow of foreign investments, which essentially dwindled to nothing during the crisis.

During its years of independence, Kazakhstan has succeeded in attracting more than \$90 billion in foreign investments (in addition to \$140 billion in domestic assignments), which has promoted a 2.5-fold growth in the country's economy since 2000. Unfortunately, all of these funds mainly went to development of the oil and gas industry, the export of the production of which, as in other countries of the third world, is given primary significance.

But it should be noted that since approximately 2004-2005, most of the investments have been going to the construction and banking sectors, the share of which significantly rose in the country's GDP growth, although this could not change the raw material preponderance of export.

According to the republic's president, "the crisis has once again proven the need to diversify our economy. This is the only correct path of post-crisis development capable of ensuring the stable and

<sup>49</sup> See: *Socioeconomic Development of the Republic of Kazakhstan in January-May 2009*.

<sup>50</sup> See: N. Ramazanov, "Rost smenilsia padeniem."

<sup>51</sup> See: *Socioeconomic Development of the Republic of Kazakhstan in January-May 2009*.

<sup>52</sup> *Message of Kazakhstan President Nazarbaev to the Nation*, 6 March, 2009.

long-term prosperity for our citizens.”<sup>53</sup> In saying this, he essentially admitted the error of the previous investment policy.

In addition, in 2010, a ten-year plan will begin (consisting of two five-year plans) designed to accelerate the country’s industrial-innovation development.

Priority development of the following sectors of the national economy is envisaged:

- the agro-industrial complex,
- construction and construction materials,
- oil refining and services,
- metallurgy,
- chemicals and pharmaceuticals,
- the energy industry and infrastructure.<sup>54</sup>

It can be presumed that despite the president’s recent (June 2009) appeal to foreign investors and informing them of the impressive plans for developing the national economy, we cannot expect an inflow of monetary resources into the country in the previous amounts.

- First, although the banking sector has managed to withstand the crisis thanks to government support, its reputation has been greatly shaken.
- Second, the crisis forced foreign investors to choose the countries and facilities for their investments more carefully.
- Third, the drop in world energy resource prices is in no way helping to attract foreign investments into the oil and gas branch of the country’s economy.
- Fourth, the republic’s leadership is tightening up the legislative conditions for the operation of foreign companies in Kazakhstan and demanding a larger share of their profits, which will also hamper the inflow of funds into the country’s economy.

Despite the crisis, the country’s leadership is guaranteeing performance of its obligations to increase social payments and wages. In his message to the nation of 6 March, 2009, President Nazarbaev promised that, as planned, the salaries of budget employees and stipends would be raised, while at the same time the average amount of pensions would also be increased (in 2010 by 25% and in 2011 by another 30%).

The state plans to issue an additional 11,000 grants and 40,000 loans to help students who have been unable to pay their tuition because of the crisis. The data for January-April 2009 confirm the reality of the leadership’s promises. For example, according to the RK Statistics Agency, in April 2009, the average monthly salary in the country amounted to 64,730 tenge. Compared to April 2008, nominal wages rose by 11.8%. Real wages increased by 2.8% during this time.<sup>55</sup>

All of this shows that the Kazakhstan leadership is indeed striving to alleviate the negative impact of the global financial crisis and create favorable conditions for raising the nation’s standard of living.

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Specialists can still not agree on whether or not the economic crisis has reached its peak. But one thing is clear—sooner or later it will come to an end and become a topic of discussion and study throughout the world, including in Kazakhstan.

<sup>53</sup> N. Nazarbaev, “From a Speech to an Assembly of Investors,” 12 June, 2009.

<sup>54</sup> *Ibidem*.

<sup>55</sup> See: *Brief Results of the Socioeconomic Development of the Republic of Kazakhstan for January-May 2009*.

Both interior and exterior factors play a certain role in this kind of crisis, but most important is the correlation between them.

In the globalization era, it is essentially impossible to avoid the impact of external factors on a country's economic development. Kazakhstan, as other countries, must strive to alleviate the impact of internal factors of crisis phenomena. For example, the diversification program adopted is designed to eliminate the national economy's biased orientation toward priority development of the oil and gas industry.

This program will not be easy to implement. After the crisis, the world economy will begin to recover. The consumption of energy resources and their prices will grow throughout the world. This could give rise to the temptation to try and gain enormous profits from the sale of liquid fuel and "easy" oil money could again put the brakes on real diversification of the national economy.

World economic crises are inevitable. And the more successfully the diversification program is carried out, the better prepared the country will be for another disaster in the world economy.

Nor should we forget that reserves of energy resources, no matter how great they are, are nevertheless finite. And the economic life of society must go on even after the last barrel of oil is extracted from the subsurface.

So we need to learn some lessons from the current financial crisis and draw the appropriate conclusions.