Chapter 8. Executive Summary and Conclusions

Before 1991, all external trade was centralized and FDI was practically nonexistent. Therefore the impact of trade and FDI on Kazakhstan was almost none. Right after the opening of the country, the immediate impact of trade on employment and poverty was negative. Low quality domestic goods had little value on international markets, and only local demand supported their production. High-quality low-priced imported goods flooded the country. The trade balance became negative. Rigid supply-side conditions in the absence of proper market institutions led to a fall in employment. Poverty headcount and depth quickly increased.

The fall in GDP, drastically reduced tax revenues, necessity to build market institutions, and lack of experience in poverty reduction did not allow the government to properly address the issues of poverty. The growth of local businesses and stabilization of production were slow because of bureaucratic controls, lack of access to credit, rent-seeking behavior and other obstacles. In this situation FDI was welcomed as a magic wand that could revive the economy. The first large investment by Chevron in 1993 was a message to the world that investment in Kazakhstan is a promising venture.

The country’s political stability played an important role in attracting FDI in a situation when the market has not been developed yet and the country’s legislation lacked proper guarantees for foreign investors.

The privatization process spanned several years. It started with privatization of small enterprises and gradually increased its scale and scope. Privatization of large enterprises is far from being complete, and, depending on the views of the government, may not be implemented soon. Privatization was an important source of government income. Together with the increased tax revenues, especially from natural resources extraction, it eventually allowed the government to increase transfers to the poor. The public external debt is quite manageable. The total external debt is less than one-year GDP and will be paid out of oil profits.

The social security system was restructured. The comprehensive system of benefits based mainly on the notion of categories of socially disadvantaged was replaced by means-tested benefits. The public pension system was almost completely replaced by a private system. Even though the public system needs to be strengthened in the future, the private system has already shown itself as a strong player on financial markets.

Another most successful of its reforms has been to first create and then stabilize the financial sector and to successfully regulate banks. The continuation of these reforms includes complete capital account liberalization.

Introduction of a national currency and wise (with a couple of exceptions) monetary policy helped the country to achieve macroeconomic stability. Inflation fell to one-digit numbers; GDP began to grow at highest rates in the CIS; exports of raw materials grow at even higher rates. Both the trade balance and government budget show signs of a healthy economy.

Most prices have been deregulated, and import tariffs are among the lowest in the CIS. The negotiations on accession to WTO show that the country is open enough to become its member. While WTO membership may not improve immediately access to international markets, it will certainly help the country to improve its production facilities to international standards. International agencies have warned the authorities that WTO accession may decrease output and increase unemployment in
the short run.

One of the obstacles to entering WTO is international obligations of Kazakhstan, first of all those aimed at creation of regional trade agreements. Russia is the strongest regional player, and it has a long way to go to reduce its tariffs to levels acceptable in WTO.

One of the results of the difficulties of transition was a huge emigration from the country. The country lost many highly qualified workers, mainly Europeans, while the recent immigration consists mainly of Asians. Because of better job opportunities and higher wages in Kazakhstan and the government’s plans to liberalize labor force movement, high immigration is expected in the future.

Despite the fall in population, labor force eventually stabilized at the pre-independence level, because of the higher participation rate. An unprecedented growth of self-employment was the main change within labor force. The initial fall in production strengthened the flow of labor from the real sector to services. The later revival of agriculture attracted labor mainly from services.

The public sector substantially shrank, and the ratio of employed in the public sector to those in the private sector changed from 3:1 to 1:3. The share of the private sector in employment became dominant in trade, agriculture, and industry.

Women are better educated and better represented in education, health care and public services and among businesspeople than men. Nevertheless, unemployment among women is higher in all age groups except for the youngest and oldest and unemployment duration is longer.

The level of unemployment among the youth is especially high. Unemployment declines with age and is higher in cities for all age groups. However, poverty is higher in rural areas.

Considerable wage disparity, up to six fold, exists across sectors and seems to be increasing. The growth rates reflect an increase in productivity (as in agriculture, hunting and forestry), in demand for labor (as in construction), and increased government expenditures (as in case of public administration). Growth fails to bring about fair distribution of income in the absence of anti-poverty programs.

The higher share of manufacturing played an important role in the recovery. The Karaganda and North-Kazakhstan Oblasts recovered faster than the others in the last years. The East-Kazakhstan Oblast scored much better than all others in all years. Small one-company towns, on the other hand, became local centers of massive unemployment. The economy’s capacity is underutilized, and hidden and partial unemployment persist.

Since 1996, total factor productivity and capital exhibit a growing trend, due to investment, macroeconomic stabilization and overall economic improvement. The magnitude of the effect on employment depends on whether the industry is labor- or capital-intensive.

The secondary and tertiary education systems increased. However, many institutions have registered in a higher category without an adequate improvement in curricula, staff, and facilities.

Poverty rate is the highest among unemployed and self-employed and it is lowest among pensioners and employees.

Poverty rate is the highest among Uzbeks, Kazakhs, and Uyghurs, and it is the lowest among Russians and Ukrainians. Differences in family sizes, education, and occupation (or place of residence) lead to those differences in poverty. There is a higher poverty among males, especially for Uyghurs.

In winter poverty increases, perhaps because of higher food prices, little
opportunities to preserve self-produced food and higher expenditures for heating and clothing. Self-production of food continues to be a significant source of food consumption in Kazakhstan, especially in the countryside and small cities.

Home ownership rate is high by international standards. High home ownership rate and low supply of apartments for rent may present problems for labor mobility when structural changes in the economy become more profound.

There is a sharp inter-regional inequality evidenced by both poverty rates and income inequality indicators. Regions that show higher poverty rates are the southern regions, oil-rich regions, and those adversely affected by particularly hard climatic and environmental conditions.

Poverty is significantly higher in rural areas where the population can fall back on self-production of food but is poorer in all other respects.

Family size and the number of children are positively correlated with poverty. The gender of the household head is not correlated with poverty. Disability (as measured by eligibility for a disability pension) was positively correlated.

Employment has increased in the recent years, due to an expansion of the economy and better social security network, in particular public works. However, the share of long-term, registered unemployed has increased and the share of unemployed youth is still high.

The quality of education varies substantially between rural and urban areas and between private and public institutions.

In comparison with the first years of transition, a significant decline in mortality and a slight decline in morbidity rates are visible, including the infant and maternal mortality rates. The gender gap in terms of life expectancy remains one of the largest in the world with almost 13 years. Some diseases associated with income poverty are on the rise.

The correlation between income poverty and various non-poverty indicators across regions (including unemployment, health and education) is always positive. Therefore, regions with high income poverty tend to manifest a worse situation also in non-income poverty indicators.

Coverage by basic public utilities is still low, especially in rural areas. There is a good coverage for gas and electricity, while public water supply and sewer systems reach only a marginal part of the population. Supply of clean water to households seems to be a particularly pronounced problem. Discontinuity in public utilities provision is also still very frequent, especially in supply of electricity.

Manufacturing and real estate activities rank second in GDP after the extraction industry. FDI in these areas significantly increased after the government announced tax and other incentives.

The effect of FDI is seen outside the extraction industry. Construction volumes are highly correlated with both local volumes of FDI and Gross Regional Product. However, the direct impact of FDI in extraction on employment and poverty reduction is invisible.

In addition to the policy of attracting FDI, import substitution policy has been used. It seems to gain more attention, especially in production of equipment for the oil industry, and it relies more on local investors than international.

Attraction of FDI by itself is not able to solve all the problems. Under reporting of exports by oil producers who manipulate invoices is believed to be quite large. Tax avoidance is the main explanation. In oil producing areas environmental pollution is of special concern. Environmental protection per se requires a comprehensive approach and special funding. Disputes with oil companies over
depreciation schemes and old contracts are inevitable as conditions change.

The shares of retail trade and services in GDP increased though not achieve levels normal for developed countries. The fall in agriculture, both absolute and relative, was not warranted by the normal course of events. It took a while for the government to understand the necessity to support agriculture, and the profits of public agricultural enterprises played an important role in changing the opinions of government officials.

Little of the growth since independence seemed due to the acquisition of skills, training, and experience. Kazakhstan has grown rapidly and successfully, but long-term growth will require a different kind of development. Current trends in the economy do not confirm that Kazakhstan has attained a fully market-oriented economy, but that it may soon do so.

GDP per capita has regained its 1990s levels; most, but not all, indicators show an improvement in living standards.

The country’s natural resource endowment put it among the top ten in the world in several areas, including oil and metals. Despite distance to the world markets, the country has comparative advantages in metal, petroleum products, and agriculture. The extraction industry, the driving force behind the today’s growth, has been modernized. Among the projects on the public agenda is construction of new pipelines.

The makeup of trade today reflects the structure and needs of the domestic economy. Export growth is due mainly to oil and metal, with agricultural and chemical products behind. A large share of imports is made up from mineral products and non-precious metals, but the importance of machinery, equipment, vehicles, and chemical products is increasing.

After independence, distribution of trade diversified over countries and continents. Importance of offshore zones and China increased. Export conditions will improve as transportation infrastructure and corporate governance develop further.

The desire to sterilize large inflows of dollars led to an increase in foreign exchange reserves, which are bound to grow further because of the persisting positive trade balance. In the long run, real appreciation of tenge seems inevitable. A proper combination of macro- and micro-economic policies plays a key role in accelerating productivity growth and export diversification.

Thus far, the economy has been resource-driven. The challenge for the government is to diversify the economy and its export structure. The current efforts of the government are concentrated around its Industrial-Innovative Program. Its goal is to restructure the economy and increase the share of products with high value-added. Indicators for science and technology suggest problems for Kazakhstan’s future, as their development have been neglected. Development of high-tech industries will require more time and different approaches than development of the oil and metal industries.

Savings in the country achieved the level characteristic of East-Asian countries during the period of their high growth. Because of the large accumulations in the National Fund, Kazakhstan’s official sector became a net creditor to the rest of the world. High savings are conducive to realization of government plans.

One of the main forces shaping the labor markets in Kazakhstan was the inflow of foreign capital, which at 30 bln. USD over the last thirteen years is by far the largest in CIS in relative terms. As a result of these developments, foreign-held or joint stock companies (JSFC) employ almost 10 percent of hired labor. The effects of foreign capital on jobs and wages have been growing as the stock of foreign capital
was increasing. These effects are analyzed in Chapter 6.

The panel data analysis of the effects of foreign direct investment on labor market was based on several quarters of data on JSFC activity for each of the sixteen administrative units of Kazakhstan. The effects vary from region to region, with territories hosting export-oriented activities claiming the bulk of the foreign direct investment. However, the rate of growth of foreign capital inflows has been roughly uniform in all regions with the notable exception of two wheat-growing oblasts in the North and one agricultural oblast in the South. The rapid increase in capital resulted in an increase in employment by foreign and joint stock companies.

In our analysis we distinguish the direct and indirect effects of foreign capital formation on employment. The direct effect includes the changes in employment at JSFC only. The indirect effects include job creation outside JSFC, which are in turn separated into secondary and tertiary effects. The secondary effects refer to the job creation in the enterprises that are part of the supply chain associated with the JSFC. Tertiary effects act through the increased wages and incomes of the population, which increase the aggregate demand. Unlike employment by JSFC, which mainly depends on FDI, wages at JSFC also depend on the degree of export and import intensity in production, and have fixed cross-section and trend effects.

These effects were observed in most oblasts and in all mining oblasts. The econometric analysis revealed that foreign capital investments have statistically discernible direct and indirect effects on the employment with different timing and magnitude. The direct effect registered almost immediately, that is in the same quarter the investment was made, but was relatively small in terms of employment and strong in terms of its effect on average wage. The indirect effects were greater in magnitude, more robust, had little impact on average wages, and were mainly observed several quarters after the investment.

The immediate effect of foreign capital formation was observed only in the JSFC (the direct effect) and had no effect on employment outside JSFC (the indirect effect). In the long-run the direct effect would roughly double its size while indirect accumulated effect on oblast employment was approximately 8-10 times greater than the immediate effect on JSFC employment. To put things in perspective, each 12,000 USD of FDI into any given oblast in the course of several quarters creates one additional job in the joint-stock and foreign-held companies and four more jobs in the other companies of the same oblast.

Unlike foreign capital, domestic investments in JSFC had negative effect on employment at JSFC itself. This paradoxical effect of capital increase on employment could be observed for a number of reasons. Among the most plausible explanations of the effect was the theory that JSFC have more chances to expand if the foreign partners own the controlling share of the company. Imports by JSFC have a negative but small effect on employment, both in the long run and in the short run. Exports by JSFC have no statistically discernible effect on employment either at JSFC or in the oblast.

The research in Chapter 7 investigated the effect of globalization on the gender and skill gap in wages. The data revealed substantial and increasing wage differentials, which worsened with further trade liberalization. The sectors with higher wages exhibited the most severe gender wage differentials. While increased trade and FDI into the oil economies of western oblasts created some high paying jobs, these were taken predominantly by men, contributing to the gender wage gap.

The nature of the gender gap was not explained by the differences in objective skill criteria, such as education. If anything, educational attainment of women is on
average marginally higher, especially in specialized technical education. While women receive essentially same pay for the same work in low paying jobs, the picture changes dramatically when wages go up. The higher is the average wage for a given occupation or a position, the greater gender gap is observed.

We found that indicators of globalization such as trade openness and FDI tend to increase the gender wage gap. However, when the average wage was controlled, the effects of globalization were much less pronounced. This suggests a particular mechanism through which the gender gap is associated with greater trade openness and FDI.

One of the reasons of the gender wage gap is lower mobility of women for the highly paid positions in the western oblasts and mining sector created by FDI.

In contrast to the gender inequality, where regression results for JSFC and the whole economy are consistent, for the skill wage gap the impacts of the foreign capital investments by JSFC are negative in the cross-oblast analysis and there is a positive impact of the FDI in the cross-sector analysis. The wages of the unskilled workers employed by JSFC of a given oblast increased with the foreign capital investments. Thus, FDI tended to reduce the skill gap in the recipient oblast.

On the other hand, analysis of the cross-sector panel indicated that FDI tended to increase the skill gap. This might be interpreted as the evidence in favor of the “skill-based technological change hypothesis” widely employed by the theoretical literature to explain growing skill gap around the world. This explanation is also supported by the evidence on unemployment rates among skilled and unskilled workers, with the unskilled having significantly lower labor force participation rate among those older than 30 and higher unemployment rate.

Coupled with practices of hiring of unskilled workers without working contracts and corresponding tax payments and increasing inflow of the unskilled workers from foreign countries, the skill gap could be expected to widen even more.

The methodological approach of the analysis in the monographic part has been quite different from that of the main body of the book. In this part we used computable general equilibrium model (CGE), which obtains the results consistent with the theoretical expectations by construction. The model is a useful tool for policy-making decisions. In this part we analyzed tax policy experiments, which had a negative impact on employment, real wages and production. The effect on the taxed sector was coupled with insignificant changes in other industries. The only exception in this regard was a public services sector, which seemed to absorb most of the labor lost by the taxed sector. In manufacturing, with relatively larger share of urban workers, a tax increase leads to a higher, compared to rural residents, decrease in welfare and real wages of urban residents. In the same way an increase in the agricultural taxes more adversely affect rural wages and welfare levels. The value added tax and tax on output have larger effect on economic indicators than labor and import taxes.

The sectoral protection, in the form of an import tariff increase, leads to a general decrease in the level of real wages. This exhibits higher impact of a price increase compared to a nominal wage increase for the industries. Agriculture is the only sector that uses mostly rural labor. In our model, protection of agriculture does not create any significant gains or losses in welfare, the real wage, or employment in agricultural production. This is because agriculture in Kazakhstan is mainly export-oriented. Our model demonstrates little effect of agricultural protection, at least in the medium term. We also found a significant difference between the effects of taxation on the rich and on the poor. A 5 percent tax increase causes an overall decline in
economic activity and welfare, but this effect was not significant for poor households.

Policy scenarios with foreign capital injections into agriculture, mining and manufacturing are consistent with the results of a vertical model of FDI. The magnitude of percentage increase in employment and production as a result of foreign capital depends on the share of capital and the size of the sector. Labor moves from other sectors to the foreign-capital-receiving sector. Increased foreign investment in rural sectors resulted in a higher, vis-à-vis urban, decrease in employment in rural non-agricultural sectors. The production changes by a smaller degree than employment. Foreign capital increases real welfare of poor households, whose incomes come mainly from labor. It is important to which sector foreign capital is injected. Foreign capital into agriculture, with relatively larger share of rural workers, will improve the welfare of the rural workers by a higher percent than that of the urban workers. In the same way, foreign capital injections into mining and manufacturing will mainly benefit urban residents.

Capital owners are net losers because the importation of foreign capital reduces the returns to capital. Foreign capital has almost no effect on households where there are two types of income, from both labor and capital. A possible exception may be the rural households that own not only capital, but also land. For these households, importation of foreign capital increases welfare unambiguously.